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Report No: 75523-HN

PROJECT PAPER  
ON A  
PROPOSED ADDITIONAL CREDIT  
IN THE AMOUNT OF SDR 6.7 MILLION  
(US\$10 MILLION EQUIVALENT)  
TO THE  
REPUBLIC OF HONDURAS  
FOR THE  
HONDURAS WATER AND SANITATION SECTOR MODERNIZATION PROJECT  
May 14, 2013

Sustainable Development Department  
Central America Country Management Unit  
Latin America and the Caribbean Region

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## CURRENCY EQUIVALENTS

Exchange Rate Effective April 2, 2013

Currency Unit = Honduran Lempira (HNL)  
HNL19.6 = US\$1  
1US\$ = SDR 1.50125

FISCAL YEAR  
January 1 – December 31

## ABBREVIATIONS AND ACRONYMS

AMDC	<i>Alcaldia Municipal del Distrito Central</i> (Municipality of Tegucigalpa)
AF	Additional Financing
CONASA	<i>Consejo Nacional de Agua Potable y Saneamiento</i> (National Council for Water and Sanitation)
CPS	Country Partnership Strategy
CERC	<i>Componente de Respuesta a Emergencia Contingente</i> (Contingent Emergency Response Component)
COPECO	<i>Comisión Permanente de Contingencias</i> (Permanent Contingency Commission)
ERR	Economic Rate of Return
ERSAPS	<i>Ente Regulador de los Servicios de Agua Potable y Saneamiento</i> (Water and Sanitation Sector Regulator)
ESMF	Environmental and Social Management Framework
GIC	<i>Grupo Interinstitucional de Coordinación</i> (Interagency Coordination Committee)
GoH	Government of Honduras
IDA	International Development Association
IRM	Immediate Response Mechanism
OP/BP	Operational Policy/Bank Policy
PAD	Project Appraisal Document
PDO	Project Development Objective
PROMOSAS	<i>Proyecto de Modernización del sector de Agua y Saneamiento</i> (Water and Sanitation Sector Modernization Project)
SANAA	<i>Servicio Autónomo Nacional de Acueductos y Alcantarillados</i> (National Autonomous Water and Sewer Service)
SDR	Special Drawing Rights
SEFIN	Secretariat of Finance
TA	Technical Assistance
UAP	<i>Unidad Administradora de Proyecto</i> (Project Administration Unit)
USCL	<i>Unidad de Supervisión y Control Local</i> (Supervision and Control Local Unit)
WSS	Water Supply and Sanitation

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# HONDURAS

## WATER AND SANITATION SECTOR MODERNIZATION PROJECT ADDITIONAL FINANCING

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## HONDURAS

### WATER AND SANITATION SECTOR MODERNIZATION PROJECT

#### ADDITIONAL FINANCING DATA SHEET

Basic Information - Additional Financing (AF)	
Country Director: Carlos Felipe Jaramillo Sector Manager/Director: Wambui Gichuri/ Ede Ijjasz-Vasquez Team Leader: Lilian Pena P. Weiss Project ID: P144357 Expected Effectiveness Date: September 2013 Lending Instrument: Investment Project Financing Additional Financing Type: Scaling up/ financing gap	Sectors: Water supply (47%); Wastewater treatment and disposal (26%); Sub-national government administration (12%); Sanitation (8%); Central government administration (7%) Themes: Decentralization (29%); Municipal governance and institution building (29%); Administrative and civil service reform (14%); Improving labor markets (14%); City-wide Infrastructure and service delivery (14%) Environmental category: B -Partial Assessment Expected Closing Date: December 31, 2016 Joint IFC: N/A Joint Level: N/A
Basic Information - Original Project	
Project ID: P103881 Project Name: Water and Sanitation Sector Modernization Project Lending Instrument: SIL	Environmental category: B -Partial Assessment Expected Closing Date: December 31, 2016 Joint IFC: N/A Joint Level: N/A
AF Project Financing Data	
<input type="checkbox"/> Loan <input checked="" type="checkbox"/> Credit <input type="checkbox"/> Grant <input type="checkbox"/> Guarantee <input type="checkbox"/> Other:	
Proposed terms: The recipient is subject to IDA lending on blended terms (five years of grace period and a maturity of 25 years, with principal repayable at 1.65 percent per annum for years 6-15, and 3.35 percent years 16-25).	
AF Financing Plan (US\$m)	
Source	Total Amount (US \$m)
Total Project Cost:	<b>10.9</b>
Cofinancing:	<b>0.9</b>
Borrower:	
Total Bank Financing:	<b>10.0</b>
IBRD	
IDA	
New	<b>10.0</b>
Recommitted	
Client Information	
Recipient: Republic of Honduras Responsible Agency: Secretariat of Finance (SEFIN) Contact Person: Rosa Ayala Telephone No.: (504) 2220-1538	

Fax No.: (504) 2222-6120  
Email: [rayala@sefin.gob.hn](mailto:rayala@sefin.gob.hn)

**AF Estimated Disbursements (Bank FY/US\$m)**

FY	FY 14	FY 15	FY 16	FY 17		
Annual	1	3	4	2		
Cumulative	1	4	8	10		

**Project Development Objective and Description**

**Original project development objectives:** (a) to improve the sustainability, efficiency, and reliability of the Recipient's WSS services in eligible municipalities; and (b) to improve the performance of the Recipient's national WSS sector institutions in the exercise of their respective roles in accordance with the WSS Sector Framework Law.

**Revised project development objective:** to support the Recipient to improve: (a) the sustainability, efficiency, and reliability of its WSS services in Eligible Municipalities; (b) the performance of its national WSS sector institutions in the exercise of their respective roles in accordance with the WSS Sector Framework Law; and (c) its capacity to respond promptly and effectively to an Eligible Emergency.

**Project description:** The Project will support the following five components. Detailed description is provided in the Project's PAD. From the original description provided in the parent Promosas Credit, changes are proposed in the description of activities of components 1 and 3, and an inclusion of a fifth component - Immediate Response Mechanism (IRM), as follows:

**Component 1 (US\$7.9 million): Supporting Eligible Municipalities to Create Autonomous WSS Service Providers and to Invest in Efficiency, Rehabilitation, and Expansion of WSS Service Delivery.**

Revised description for Part 1.A.2.b of the Credit Agreement: "revise or prepare an action plan to improve efficiency, quality and coverage levels of the WSS service, including a financial and economic analysis."

Revised description for Part 1.A.3 of the Credit Agreement: "Design and supervise the investments conducted under Part 1.B.2 and Part 1.C of the Project.

**Component 2 (US\$0 million): Tegucigalpa Non-Revenue Water Reduction (no changes in component description)**

**Component 3 (US\$0.7 million): Institutional Strengthening of National and Regional WSS Sector Institutions**

Revised description for Part 3.A.1 of the Credit Agreement: "Support to CONASA and SANAA to strengthen their institutional capacity to comply with the WSS Sector Framework Law through, inter alia: (a) the development of a sector financing policy for CONASA aimed at guaranteeing the long-term sustainability of the WWS sector; and (b) the piloting of technical assistance activities by SANAA, including providing operational, commercial and managerial support to local WSS service providers."

Removal of Parts 3.A.3 and 3.B.2 of the Credit Agreement.

**Component 4 (US\$1.4 million): Project Management** (no changes in component description)

**Component 5 (US\$0 million): IRM Contingent Component** - Provision of support to respond to an Eligible Emergency (new component included).

**Safeguard and Exception to Policies**

Safeguard policies triggered:	
Environmental Assessment (OP/BP 4.01)	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Natural Habitats (OP/BP 4.04)	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Forests (OP/BP 4.36)	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Pest Management (OP 4.09)	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Physical Cultural Resources (OP/BP 4.11)	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Indigenous Peoples (OP/BP 4.10)	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Involuntary Resettlement (OP/BP 4.12)	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Safety of Dams (OP/BP 4.37)	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Projects on International Waterways (OP/BP 7.50)	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Projects in Disputed Areas (OP/BP 7.60)	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

Is approval of any policy waiver sought from the Board (or MD if RETF operation is RVP approved)?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Has this been endorsed by Bank Management? (Only applies to Board approved operations)	<input type="checkbox"/> Yes <input type="checkbox"/> No
Does the project require any exception to Bank policy?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Has this been approved by Bank Management?	<input type="checkbox"/> Yes <input type="checkbox"/> No

**Conditions and Legal Covenants**

Financing Agreement Reference	Description of Condition/Covenant	Date Due
Article V	Amendment to the Inter-Institutional Agreement	By effectiveness
Schedule II. Section I. A.1.	All the Recipient's obligations referred to in Section I of Schedule 2 to the Original Financing Agreement shall apply to the execution of the Project.	Throughout Project implementation
Schedule II. Section I. A.2.	Prior to carrying out of any Subproject to be financed with the proceeds of the Credit in a given Eligible Municipality that has already entered into a Municipality Agreement in accordance with the provisions of Section I.D.1 of the Original Financing Agreement, the Recipient, through SEFIN, shall amend the corresponding Municipality Agreement, in a manner satisfactory to the Association.	Throughout Project implementation

Schedule II. Section I. A.3.	The Recipient, through SEFIN, shall amend the Inter-Institutional Agreement, in a manner satisfactory to the Association.	Throughout Project implementation
Schedule II. Section I. B.	In order to ensure the proper implementation of Part 5 of the Project (“IRM Part”), the Recipient shall take the following measures: (a) prepare and furnish to the Association for its review and approval, an operational manual (“IRM Operations Manual”) which shall set forth detailed implementation arrangements for the IRM Part, including the designation of terms of reference for, and resources to be allocated to, the Coordinating Authority; (b) afford the Association a reasonable opportunity to review the proposed IRM Operational Manual; (c) promptly adopt the IRM Operational Manual for the IRM Part as shall have been approved by the Association; (d) ensure that the IRM Part is carried out in accordance with the IRM Operational Manual. The Recipient shall, throughout the implementation of the IRM Part, maintain the Coordinating Authority, with adequate staff and resources satisfactory to the Association.	Prior to implementation of Part 5 of the Project

## I. Introduction

1. This Project Paper seeks the approval of the Executive Directors to provide an additional credit in the amount of SDR 6.7 million (US\$10 million equivalent) to the Republic of Honduras for the Honduras Water and Sanitation Sector Modernization Project (PROMOSAS; P103881; Cr. 4335-HO). The proposed Additional Financing (AF) would finance the costs associated with: (i) the financing gap in Component 1 in order to complete activities for which indicators and beneficiary targets may not otherwise be achieved within the original Project amount and timeframe; and (ii) scaling up of the Project to incorporate new municipalities to enhance the Project's development effectiveness, as well as to include additional national and regional institutional strengthening activities under Component 3. This Paper also seeks approval for a restructuring of the parent Project to: (i) incorporate an Immediate Response Mechanism (IRM) Component; (ii) trigger OP/BP 7.50-Projects on International Waterways in the event that municipalities located in trans-boundary basins of Honduras are selected as additional beneficiaries of the Project; (iii) revise the description of Components 1 and 3; (iv) update the Project's results framework; and (v) reallocate Project funds. The original Credit will be extended to close together with the AF on December 31, 2016, three years after the original (and current) closing date to complete implementation.

## II. Background and Rationale for Additional Financing

2. **Country context.** Honduras remains a very poor and unequal country and recent progress towards poverty reduction has been disappointing. The situation of the poor has not changed significantly over the last decade and there has been no improvement in inequality. Remittances have played an important role in overall poverty reduction, especially in urban areas. The crises of 2008-09 (financial, food prices and political) slowed poverty reduction and, while economic growth is recovering, poverty has risen. Honduras is also facing weak labor demand in the more productive sectors such as manufacturing, while the agricultural sector, from where the poor derive a majority of their income, suffers from low and stagnant wages.

3. **Shared prosperity is also proving to be a challenging development goal.** From 2003 to 2011 the real incomes of the bottom 40 percent of the population grew at 4 percent per year. While this is higher than the Honduras average of 3 percent for the same period, it is still not fast enough to make significant progress in poverty reduction or shared prosperity. In addition, the reduction of poverty rates has been unequally distributed across the country. In the last ten years this has led to a rise in the share of the poor population living in rural areas and medium-sized cities: most poverty reduction occurred in the two largest cities.

4. Despite the above, there have been achievements in improving the efficiency of critical public services and Additional Financing for this Project will further expand access to services in Honduras' poorest municipalities.

5. **Sector and Project Background<sup>1</sup>.** Since the approval of the Water Supply and Sanitation (WSS) Framework Law (*Ley Marco*) in 2003, the WSS Sector in Honduras has made

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<sup>1</sup>The PROMOSAS' Project Appraisal Document (Report No. 39570-HN; May 18, 2007) provides a complete Sector Background, which has not changed.

relevant advances in the decentralization of the WSS provision to the municipal level<sup>2</sup>. The PROMOSAS Project, a SDR 19.8 million credit (US\$30 million equivalent), was approved in June 2007, became effective on February 22, 2008 and its closing date is December 31, 2013. The Project Development Objectives (PDO) are: (a) to improve the sustainability, efficiency, and reliability of the Recipient's WSS services in eligible municipalities; and (b) to improve the performance of the Recipient's national WSS sector institutions in the exercise of their respective roles in conformity with the WSS Sector Framework Law. The Projects finances four components and no changes to the PDOs or design have been made to date<sup>3</sup>.

6. **Project Performance.** The Project has achieved significant results, particularly on the institutional side, including: (i) creation of seven municipal autonomous service providers; (ii) preparation for the transfer of the WSS services to Tegucigalpa; (iii) significant work in tariff-setting review and regulation, as well as in utilities benchmarking activities; and (iv) development of a sector financing policy, to be issued by the National Council for Water and Sanitation (*Consejo Nacional de Agua Potable y Saneamiento-CONASA*) within the next year. However, the creation of new and fully operational WSS service providers was found to be more costly and time-consuming than expected at appraisal in 2007. Consequently, after the set-up phase of the new service providers, limited funds remained available to finance investments linked to quality of service (especially continuity of water provision) and efficiency (such as metering, non-revenue water and commercial efficiency). In addition, the mainstreaming and acceptance by municipalities of other aspects relevant to the sustainability of the service provision, such as cost-recovery tariffs and metering, proved to be a longer process than initially anticipated. As a result, key Project indicators are lagging behind, such as service continuity and cost recovery. Thus, PDO and Implementation Progress ratings have been moderately satisfactory for the past year. If no changes were made to the current situation, the Project would close with a partially achieved PDO and the results indicators related to service quality (cost recovery and continuity) would not be fully reached. In this context, the proposed AF and the extended implementation time will be strategic in reversing this trend and complementing the investments needed to ensure sustainability, efficiency and reliability of the service providers supported by the Project, thereby further supporting achievement of the PDO. Other ratings, including financial management and safeguards, are satisfactory, with the exception of procurement, which was recently downgraded to moderately satisfactory due to issues identified in the 2012 Procurement Post Review.

7. **Rationale for Additional Financing.** The Government of Honduras (GoH) officially requested the AF to support consolidating and expanding water sector reform and improve its impact on the population in terms of access to sustainable and efficient WSS services, given that the proposed AF is fully aligned with the Government priorities laid out in the Country Vision (2010-2038) and National Plan (2010-2022). The proposed activities are also consistent with the World Bank Group's Country Partnership Strategy (CPS) 2012–2014 (Report No.63370-HN, discussed by the Executive Directors on November 1, 2011). The components and core activities under the proposed AF are the same as in the parent Project and are consistent with the PDOs. The AF would allow the Project to meet its original targets and planned activities, focusing on

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<sup>2</sup>By transferring service provision from the National Autonomous Water and Sewer Service or SANAA to municipal autonomous service providers and/or by promoting the creation of autonomous service providers in those municipalities where the system was already operated directly by municipalities.

<sup>3</sup>A project restructuring was processed in 2010 to trigger OP 4.12, revise the results framework and reallocate proceeds.

service quality and sustainability within current municipalities (*covering the financing gap*) and would support the inclusion of new municipalities as part of the ongoing decentralization process (*scaling up*). The selection of the new municipalities and the implementation of the activities foreseen would benefit from the lessons learned from PROMOSAS, in terms of setting up and strengthening new WSS utilities and in terms of time and types of investments needed for service quality and sustainability.

8. **AF Alternatives considered.** Other sources of financing were considered, including increased counterpart funding, preparation of a new Project, or support from other donors. However, GoH does not have available resources; a new Project would take too long to prepare, thereby delaying completion of activities beyond an acceptable timeframe; and other donors active in the sector do not have enough funding to support the proposed activities. The AF is thus the most appropriate financing mechanism to enable completion and scaling up of the Project's activities.

### III. Proposed Changes

9. *PDO.* The GoH and the Bank have agreed that all IDA operations should include an IRM to allow the country to access uncommitted funds in the event of a national emergency. Therefore, the PDO has been revised to include a third part as follows: *(c) to improve the Recipient's capacity to respond promptly and effectively to an Eligible Emergency.*

10. *Components.* Changes have been made to Components 1 and 3 and a fifth Component has been added. Core activities under Component 1 remain unchanged. However, the criteria for allocation of funds among municipalities under the AF has been modified<sup>4</sup> as well as the municipality eligibility criteria to expand eligibility to small-size municipalities (10,000 to 40,000 population) and focus on municipalities classified as C or D in terms of poverty according to the Municipal Development Index. The requirement for all municipalities to develop Master Plans has been removed, as the activities to be financed will be defined with the support of an international consulting firm (already in place), in line with the Project's Operational Manual. The description of activities under Component 3 has been revised to reflect the support to the Sector Framework in a clearer and broader manner<sup>5</sup>. Finally, a fifth Component has been added to reflect the IRM (Annex 4).

11. *Safeguards.* The Project and its AF are rated as B for Bank's safeguards purposes, given the small scale of physical investments and that no significant environmental impacts are foreseen. The Project's Environmental Social Management Framework (ESMF) was updated and disclosed in-country and on the World Bank's website on March 11, 2013. An assessment of the scaling up of the Project concluded that some of the potential new municipalities could be

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<sup>4</sup>The Project Appraisal Document (PAD) established formulas to distribute funds among the participating municipalities, based on the number of connections of the municipalities and their accomplishments on efficiency indicators. This was useful for the first phase of the Project, however, for the AF, the focus will be to comply with specific indicators linked to service quality and sustainability in the most needed municipalities, therefore the funds will be distributed in a more tailored manner in order to comply with the indicators.

<sup>5</sup>The PAD focused a significant part of the institutional strengthening activities for the implementation of the Strategic Plan for Modernization of the WSS Sector. This document was intended to be a roadmap for the implementation of the Sector Framework. However, it was not prioritized by the Government and became outdated. The Project has since focused its institutional strengthening activities on the direct implementation of the principles of the *Ley Marco*.

located in trans-boundary basins. Given the type of interventions under Component 1 and the potential location of new beneficiary municipalities, OP 7.50-Projects on International Waterways is triggered (for PROMOSAS and the AF). The Bank team has assessed the Project activities in the context of OP 7.50 and concludes that while OP 7.50 applies to the Project, the Project meets the criteria for the exception to the riparian notification requirement laid out in paragraph 7(a) of said Policy, due to the expected nature of the planned interventions (consisting mainly of rehabilitations or minor additions to existing schemes)<sup>6</sup>. This exception was approved by the Bank on March 5, 2013. The exception to notification memo highlights, however, that in the event that the Project's works and activities in municipalities located in any trans-boundary basin should exceed the original scheme, change its nature, or so alter or expand its scope and extent as to make it appear a new or different scheme, a notification process will be carried out in accordance with OP/BP 7.50 procedures. The ESMF makes reference to this procedure as well as the specific steps to identify the need for carrying out the notification.

12. Results Framework. The results framework has been revised (Annex 1) to: (i) update targets for outcome and intermediate indicators to reflect the Project's current scope and the expected additional impact of the AF; (ii) include new indicators related to the new municipalities and to measure accountability activities as well as to reflect the new IRM Component and additional core sector and performance indicators; and (iii) modify intermediate results indicators of Component 2 to better reflect the outcomes from the Tegucigalpa non-revenue water contract.

13. Project Financing. The allocation of funds among disbursement categories of the parent Project has been revised in light of actual Project costs, taking into consideration that severance payments and consultant contracts have consumed more funds than expected. The Project's *pari-passu* in one disbursement category (3) has also been adjusted in order to increase Bank financing to 100%. The updated allocation of financing proceeds for the original PROMOSAS is presented in Annex 3. The co-financing from municipalities is maintained for both original PROMOSAS and AF<sup>7</sup>, following the criteria and amounts described in the Project's Operational Manual. Finally, no severances payments are expected under the AF<sup>8</sup>. Table 1 summarizes the costs of Components of the parent Project and the AF.

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<sup>6</sup>Activities and works under the parent Project involved minor additions and rehabilitation of ongoing schemes, such as rehabilitation of existing networks or plants, cleaning of wells or repair of tanks, which did not adversely change the quality or quantity of water flows. The same kinds of interventions are expected in the new municipalities.

<sup>7</sup>For the AF, there would be a co-financing from participating municipalities in the amount of US\$ 0.9 million.

<sup>8</sup>The AF will focus on new municipalities that are directly operated by municipalities (and not SANAA), therefore there is no need for severance payments.

**Table 1: Costs by Component**

<i>Component</i>	<i>Original cost (US\$)</i>	<i>Changes with AF (US\$)</i>	<i>Revised cost (US\$)</i>
1: Supporting eligible municipalities to create autonomous service providers	14.02	7.9	21.92
2: Tegucigalpa Non-Revenue Water Reduction	8.17	--	8.17
3: Institutional Strengthening of national and regional WSS institutions	7.01	0.7	7.71
4: Project Management	1.62	1.4	3.02
5: IRM Contingency	N/A	0	0
<b>Total (US\$)</b>	<b>30.82*</b>	<b>10</b>	<b>40.82</b>

\*This is equivalent to the SDR 19.8 million at the November 16, 2010, exchange rate (the date of the first restructuring of the project).

14. Extension of closing date. The original Credit will be extended to close together with the AF on December 31, 2016, three years after the current Credit closing date, in order to complete implementation of certain on-going activities, namely the Tegucigalpa non-revenue water contract.

15. Implementation. There are no changes in implementation arrangements of the Project. In addition, no exception or waiver of Bank policies have been sought<sup>9</sup>. The AF will continue to use the procurement and financial management arrangements of the parent Project and there are no outstanding financial management or audits issues or interim financial reports. A Procurement Capacity Assessment was conducted and a time-bound Action Plan was developed and agreed upon with the Borrower to address the weaknesses identified during the May 2012 Procurement Post Review and improve the overall procurement performance of the Project. Compliance with the Action Plan will be regularly monitored and a re-assessment of the rating will be carried out in the next Procurement Post Review, scheduled to take place next fiscal year. The Bank will also continue using prior review and support the Client in order to ensure smooth Project implementation. An acceptable Procurement Plan has been prepared and will be available through the Procurement Plans Execution System, including applicable thresholds. The Guidelines Procurement of Goods, Works and Non-Consulting Services and the Guidelines Selection and Employment of Consultants, both dated January 2011, and the procurement provisions stipulated in the Credit Agreement will apply to the AF. Finally, the Inter-institutional Agreement and the Agreements with the municipalities will be updated to reflect the AF.

#### **IV. Appraisal Summary**

16. **Economic Analysis.** The team carried out an economic analysis for the US\$10 million AF and the economic rate of return (ERR) is estimated at 9 percent. The current assessment was based on actual numbers from Project implementation and more realistic assumptions than the ones used in the parent Project preparation and reported in the 2007 Project Appraisal

<sup>9</sup>An exception to the notification requirement under OP7.50 (Projects on International Waterways) was sought and granted (as indicated in paragraph 9).

Document<sup>10</sup>. Particularly, it is based on the progress on Project indicators to date, qualitative information on the Project context, and performance of similar projects elsewhere. The assessment was carried out using a comprehensive approach based on Project activities such that all costs and benefits are taken into account (whereas this was not previously the case). Moreover, the new estimates use more realistic assumptions as to the expected success of the reform and the average rate of return to physical investments in the sector<sup>11</sup>. Still, the ERR estimate is predicated upon a certain degree of success in achieving reform objectives, particularly with respect to cost recovery. Because these additional investments and their benefits depend upon the utility reform aspects, the Project has a risk rating of substantial as indicated in Annex 2.

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<sup>10</sup>Therefore, the former assessment cannot be compared to the current assessment. Originally, the ERRs ranged from 12 to 61 percent (with a weighted average of 33.5 percent). The analysis carried out in 2007 selected La Ceiba, Choluteca, El Progreso, and Siguatepeque as project's sample (indicative municipalities). However, only Siguatepeque ended up joining PROMOSAS.

<sup>11</sup>The ERR calculated here assumes that all physical investments in improving or extending the system have a standard return of 25 percent representing a slight downward adjustment to the original findings of 33.5 percent. This is similar to the returns calculated for additional urban water connections in the country.

**Annex 1: Results Framework and Monitoring**  
**HONDURAS: Water and Sanitation Sector Modernization Project**  
**Additional Financing**

<b>Revisions to the Results Framework</b>		<b>Comments/ Rationale for Change</b>
<b>PDO</b>		
<i>Current (PAD)</i>	<i>Proposed</i>	
(a) improve the sustainability, efficiency, and reliability of the Recipient's WSS services in eligible municipalities; and (b) improve the performance of the Recipient's national WSS sector institutions in the exercise of their respective roles in accordance with the WSS Sector Framework Law.	(a) improve the sustainability, efficiency, and reliability of the Recipient's WSS services in eligible municipalities; (b) improve the performance of the Recipient's national WSS sector institutions in the exercise of their respective roles in accordance with the WSS Sector Framework Law; and (c) improve the Recipient's capacity to respond promptly and effectively to an eligible emergency.	The specific Immediate Response Mechanism (IRM) objective of supporting Honduras "to improve its capacity to respond promptly and effectively to an eligible emergency" has been added to the PDO.
<b>PDO indicators</b>		
<i>Current (PAD)</i>	<i>Proposed change*</i>	
6 of the WSS utilities reach cost recovery (ratio total revenue / total operative cost equal to one).	<b>Continued with adjusted end of Project target value</b> (PAD target value:6; revised target: 7)	Definition and target value revised to include one new municipality.
At least 5 of the WSS utilities increase their service continuity rating by one category defined by ERSAP's performance indicators. <sup>12</sup>	<b>Continued</b>	No change
At least 50% of the SANAA systems financed under the Project are transferred to the municipalities.	<b>Continued</b>	No change
At least 50% of municipal service providers (non-SANAA WSS systems that are operated directly by municipalities) supported by the Project are converted into <i>autonomous</i> municipal service providers.	<b>New</b> (Target: 50%)	New indicator included to reflect focus of the Additional Financing in terms of scaling up to new municipalities.
CONASA issues the new financing policy of the sector.	<b>Continued</b>	No changes
Number of water service providers the Project is supporting	<b>New Core Indicator</b> (Target: 9)	Water Core indicators included.
Time taken to disburse funds	<b>New</b> (Target: 4 weeks)	Indicator included to reflect the

<sup>12</sup>Continuity categories defined by ERSAPS: Category A (from 18 to 24 hours of service per day); Category B (from 12 to less than 18 hours of service per day); Category C (from 6 to less than 12 hours of service per day); and category D (less than 6 hours of service per day).

Revisions to the Results Framework		Comments/ Rationale for Change
requested by Government for an eligible emergency		new IRM objective incorporated to the PDO.
<b>Intermediate Results indicators</b>		
<i>Current (PAD)</i>	<i>Proposed change*</i>	
<b>Component 1: Supporting eligible municipalities to create autonomous WSS service providers and invest in efficiency, rehabilitation, and expansion of WSS service delivery</b>		
Number of people in urban areas (covering semi-urban or small urban areas) provided with access to improved sanitation under the project.	<b>Continued with adjusted end of Project target value</b> (PAD target value:10,000; revised target: 3,700)	Target value revised to reflect a more realistic goal as sanitation has not been a priority for supported municipalities. In the majority of the municipalities, new sanitation connections would have involved the construction of waste water treatment plants, which would have used most of the funds available for investments.
Piped household water connections that are benefiting from rehabilitation works undertaken by the project.	<b>Continued</b>	No changes
At least 6 design proposals of autonomous service providers approved by ERSAPS.	<b>Continued with adjusted end of Project target value</b> (PAD target value:6; revised target: 9)	Target value revised to reflect the Additional Financing scaling up.
Five of the WSS utilities increase by 20% the ratio of revenues per volumetric unit of water produced.	<b>Continued with adjusted end of Project target value</b> (PAD target value:5; revised target: 6)	Target value revised to reflect the Additional Financing impact.
People trained to improve hygiene or sanitation practices under the Project	<b>New core indicator</b> (Target: 5000)	Sanitation Core indicator included.
Of which female	<b>New core indicator</b> (Target: 3000)	Sanitation Core indicator included.
Percentage of grievances satisfactorily redressed by service providers per year.	<b>New</b> (Target: 75%)	Indicator added in reference to the scaled up accountability activities.
At least 6 of the WSS utilities share indicators in the regional benchmarking database of IBNET according to their protocols.	<b>New</b> (Target: 6)	Indicator added to promote the sharing of utilities performance indicators internationally, through the World Bank-supported IBNET network ( <a href="http://www.IB-NET.org">www.IB-NET.org</a> ).
<b>Component 2: Tegucigalpa Non-Revenue Water Reduction</b>		
Number of active connections in service area.	<b>Dropped</b>	Indicator dropped as it does not reflect accurately the indicators and targets of the Tegucigalpa Non-Revenue Water Reduction Contract.
Urban areas covered by the contract increase service continuity by one category <sup>13</sup>	<b>New</b> (Target: B)	Indicator added for a better alignment with the indicators and targets of the Tegucigalpa Non-

<sup>13</sup>This indicator will follow the same ERSAPS categorization for continuity as in PDO indicator N. 2: Category A (from 18 to 24 hours of service per day); Category B (from 12 to less than 18 hours of service per day); Category C (from 6 to less than 12 hours of service per day); and category D (less than 6 hours of service per day).

<b>Revisions to the Results Framework</b>		<b>Comments/ Rationale for Change</b>
		Revenue Water Reduction Contract.
Percentage increase of collection per cubic meter of supplied water to the project area.	<b>Continued</b>	No changes.
<b>Component 3: Institutional strengthening of national and regional WSS sector institutions</b>		
SANAA has at least one regional unit operating under the new model.	<b>Continued</b>	No changes.
Indicators regarding utilities' performance are published by ERSAPS.	<b>Continued</b>	No changes.
At least 5 utilities have published their financial statements in a Website.	<b>Continued with adjusted end of Project target value</b> (PAD target value:5; revised target: 9)	Target value revised to reflect the Additional Financing impact.
SANAA / Tegucigalpa has complied with legal requirements for transfer to municipality.	<b>Continued</b>	No changes.
<b>Component 4: Project management</b>		
Cumulative percentage of disbursement targeted according to disbursement plan is met.	<b>Continued</b>	No changes.
<b>Component 5: Project management</b>		
IRM established and ready to provide access to financial resources to Honduras in case of an eligible emergency	<b>New</b> (target 1)	Indicator as per new IRM Contingent Component.

## REVISED PROJECT RESULTS FRAMEWORK

<b>Project Development Objective (PDO):</b>												
The Project Development Objectives are:(a) to improve the sustainability, efficiency, and reliability of the Recipient's WSS services in eligible municipalities; (b) to improve the performance of the Recipient's national WSS sector institutions in the exercise of their respective roles in accordance with the WSS Sector Framework Law; and (c) to improve the Recipient's capacity to respond promptly and effectively to an eligible emergency.												
PDO Level Results Indicators	Core	UOM <sup>14</sup>	Baseline Original Project Start (2008)	Progress To Date (2012)	Cumulative Target Values				Frequency	Data Source/ Methodology	Responsibility for Data Collection	Comments
					2013	2014	2015	2016				
1. 7 of the WSS utilities reach cost recovery (ratio total revenue / total operative cost equal to one).	<input type="checkbox"/>	Number	4	3	4	5	6	7	Annually	Providers' annual report	USCL/ERSAP S	
2. At least 5 of the WSS utilities increase their service continuity rating by one category defined by ERSAP's performance indicators.	<input type="checkbox"/>	Number	0	0	0	3	4	5	Annually	Providers' annual report	USCL/ERSAP S	
3. At least 50% of the SANAA systems financed under the Project are transferred to the municipalities.	<input type="checkbox"/>	%	0	100	100	100	100	100	Annually	Transfer Act	SANAA/Municipality	
4. At least 50% of municipal service providers (non-SANAA WSS systems that are operated directly by municipalities) supported by the Project are converted into <i>autonomous</i> municipal service providers.	<input type="checkbox"/>	%	N/A	0	20	30	40	50	Annually	Mayor's Act	Municipality	
5. CONASA issues the new financial policy of the sector.	<input type="checkbox"/>	Yes/No	No	No	Yes	Yes	Yes	Yes	Annually	Financial Policy Document and other documents issued by CONASA	CONASA	

<sup>14</sup>UOM = Unit of Measurement

6. Number of water service providers the project is supporting.	<input checked="" type="checkbox"/>	Number	0	7	7	8	8	9	Annually		UAP	
7. Time taken to disburse funds requested by Government for an eligible emergency	<input type="checkbox"/>	Weeks	N/A	0	0	0	0	4	As needed	Bank client connection; Progress Reports	SEFIN, COPECO, World Bank	Measures effectiveness of the CERC / IRM in Honduras

### Intermediate Results and Indicators

Intermediate Results Indicators	Core	Unit of Measurement	Baseline Original Project Start (2008)	Progress To Date (2012)	Target Values				Frequency	Data Source/ Methodology	Responsibility for Data Collection	Comments
					2013	2014	2015	2016				
<b>Intermediate Result 1:</b> Supporting eligible municipalities to create autonomous WSS service providers and invest in efficiency, rehabilitation, and expansion of WSS service delivery												
1. Number of people in urban areas (covering semi-urban or small urban areas) provided with access to improved sanitation under the project.	<input checked="" type="checkbox"/>	Number	0	1536	1500	2300	3000	3700	Annually	Work implementation status and supervision report	ERSAPS/UAP	
2. Piped household water connections that are benefiting from rehabilitation works undertaken by the project.	<input checked="" type="checkbox"/>	Number	0	1508	1500	1500	1750	2000	Annually	Work implementation status and supervision report	ERSAPS/UAP	
3. At least 9 design proposals of autonomous service providers approved by ERSAPS.	<input type="checkbox"/>	Number	0	7	7	8	8	9	Annually	Municipality proposal and approval by ERSAPS	ERSAPS	
4. 6 of the WSS utilities increase by 20% the ratio of revenues per volumetric unit of water produced.	<input type="checkbox"/>	Number	0	2	3	4	5	6	Annually	Technical and financial report	USCL/ERSAPS	
5. People trained to improve hygiene behavior or sanitation practices under the project.	<input checked="" type="checkbox"/>	Number	N/A	0	1000	2000	3000	5000	Annually		UAP/municipalities	
6. Of which female	<input checked="" type="checkbox"/>	Number	N/A	0	500	1000	2000	3000	Annually		UAP/municipalities	

### Intermediate Results and Indicators

Intermediate Results Indicators	Core	Unit of Measurement	Baseline Original Project Start (2008)	Progress To Date (2012)	Target Values				Frequency	Data Source/ Methodology	Responsibility for Data Collection	Comments
					2013	2014	2015	2016				
7. Percentage of grievances redressed satisfactorily by utilities per year.	<input type="checkbox"/>	%	N/A	0	50	60	70	75	Annually	Annual publication	ERSAPS	
8. At least 6 of the WSS utilities share indicators in the regional benchmarking database of IBNET according to their protocols.	<input type="checkbox"/>	Number	N/A	0	1	2	4	6	Annually	IB-NET website	ERSAPS/UAP/ municipalities	
<b>Intermediate Result 2: Tegucigalpa Non-Revenue Water Reduction</b>												
9. Urban areas covered by the contract increase service continuity by one category	<input type="checkbox"/>	Category	N/A	C	C	B	B	B	Annually	Users database and volumes registry	UAP/Contract's supervision	
10. Percentage increase of collection per cubic meter of supplied water to the project area.	<input type="checkbox"/>	%	0% 2,52 Lps/m3	18% 2,98 Lps/m3	20% 3.024 Lps/m3	20% 3.024 Lps/m3	20% 3.024 Lps/m3	20% 3.024 Lps/m3	Annually	Users database and volumes registry	UAP/Contract's supervision	
<b>Intermediate Result 3: Institutional strengthening of national and regional WSS sector institutions</b>												
11. SANAA has at least one regional unit operating under the new model.	<input type="checkbox"/>	Number	0	0	0	1	1	1	Annually	SANAA/Municipality Agreement	SANAA/Municipality	
12. Indicators regarding utilities' performance are published by ERSAPS.	<input type="checkbox"/>	Yes/No	No	Yes	Yes	Yes	Yes	Yes	Annually	Annual publication	ERSAPS	
13. At least 9 utilities have published their financial statements in a Website.	<input type="checkbox"/>	Number	0	7	7	8	8	9	Annually	Annual publications in their Websites	Municipality/ERSAPS	
14. SANAA / Tegucigalpa has complied with legal requirements for transfer to municipality.	<input type="checkbox"/>	Yes/No	No	No	Yes	Yes	Yes	Yes	Annually	Technical Assistance approved	SANAA/AMD C/UAP	

### Intermediate Results and Indicators

Intermediate Results Indicators	Core	Unit of Measurement	Baseline Original Project Start (2008)	Progress To Date (2012)	Target Values				Frequency	Data Source/ Methodology	Responsibility for Data Collection	Comments
					2013	2014	2015	2016				
<b>Intermediate Result 4: Project management</b>												
15. Cumulative percentage of disbursement targeted according to disbursement plan is met.	<input type="checkbox"/>	%	0	0	10	50	90	100	Annually		UAP	
<b>Intermediate Result 5: IRM Contingent Component</b>												
16. IRM established and ready to provide access to financial resources to Honduras in case of an eligible emergency	<input type="checkbox"/>	Number	N/A	0	1	1	1	1	Annually	Progress Report, Operational Manual completed and approved	Ministry of Finance (SEFIN), COPECO	This component will Provide immediate response to an eligible emergency, if needed.

**Annex 2: Operational Risk Assessment Framework (ORAF)  
HONDURAS: Water and Sanitation Sector Modernization Project  
Additional Financing**

**Stage: Board**

<b>1. Project Stakeholder Risks</b>	<b>Rating</b>	<b>Moderate</b>			
<p><b>Description:</b> <b>Vested interest groups delay implementation of reforms prescribed by law.</b> The implementation of Ley Marco implies sensitive actions such as the transfer of the water and sanitation sector (WSS) services from a traditional institution as SANAA and the creation of municipal service providers. These actions may receive opposition from different groups, starting from SANAA staff (please see risk related to Severances payments, below), different municipal political groups, and general civil society.</p> <p><b>SANAA's performance:</b> Despite the Project's efforts, the poor track record of SANAA on nonrevenue water may continue to prevail.</p>	<p><b>Risk Management:</b> The overall mitigation for the possible delay of reforms applied during the implementation of the PROMOSAS Project was to combine reforms with investment in order to create rapid service improvements and enhance the financial basis of the new service providers. To further mitigate this risk at the national level, the Bank has been working closely with SANAA, CONASA, and ERSAPS, and with the <i>Mesa Sectorial</i><sup>15</sup> to bring in various stakeholders who are more interested in increasing the efficiency of the sector. The Project relies on a coordination group (GIC - <i>Grupo Interinstitucional de Coordinación</i><sup>16</sup>), created during the preparation/initial implementation of the PROMOSAS Project. In addition, the severance payment included in Component 3 has proven to be a successful mitigation instrument for the risk of opposition from labor union and entrenched high-ranked officials in SANAA. This comprehensive approach worked well in the PROMOSAS Project and will continue to be applied in the implementation of the Additional Financing (AF).</p> <p>In the implementation of Component 2, a performance-based Non Revenue Water reduction program was included as an effective approach to overcome this issue in selected areas of the city of Tegucigalpa. The implementation of the contract is progressing satisfactorily, and preliminary results are expected by the end of 2013. However, due to the design of the contract, an additional implementation time would favor a stronger positive outcome, therefore, this contract/component will benefit directly from the three-year extension of PROMOSAS.</p>	<b>Resp:</b> Client	<b>Stage:</b> Implementation	<b>Due Date :</b> Recurrent	<b>Status:</b> on going
		<b>Resp:</b> Bank / client	<b>Stage:</b> prep / imp	<b>Due Date :</b> Recurrent	<b>Status:</b> on going
		<b>2. Implementing Agency Risks (including fiduciary)</b>			
<b>2.1. Capacity</b>	<b>Rating:</b>	<b>Moderate</b>			
<p><b>Description:</b> <b>Administrative changes / staff turnover (particularly after</b></p>	<p><b>Risk Management :</b> The PROMOSAS Project has traversed Government transitions in 2009/2010 and managed to</p>				

<sup>15</sup>The *Mesa Sectorial* is a group composed of government, civil society, and donor representatives that strategizes on how to implement necessary actions to meet sectoral goals and takes a lead role on coordinating, disseminating, and developing the sector by integrating the national, municipal, and local perspectives.

<sup>16</sup>The *GIC* is an ad hoc group comprising SEFIN, SANAA, CONASA, ERSAPS, and the Honduras Municipalities Association (*Asociación de los Municipios de Honduras*) that supports project implementation by monitoring project progress while ensuring institutional coordination.

<p><b>elections) hamper project implementation.</b> The current President and administration will be in place through the end of 2013, meaning the AF will be in full implementation by the time the Government changes. The risk of high staff turnover may affect project implementation.</p> <p>This risk applies not only at the central level (UAP), but also at municipal level, where the mayors could in theory change the whole teams of the municipal service providers.</p> <p><b>Municipal Implementation capacity:</b> Weak implementation capacity at the local level could directly affect the quality of investments financed under the operation.</p> <p><b>Procurement:</b> Low country procurement capacity affects the Project due to competition to hire scarce qualified procurement professionals. This is compounded by the fact that local procurement regulations are not completely consistent with Bank practices and by implementation at the subnational level. Also, the Procurement Regulatory Body has suffered considerable budget constraints that affected its operation, which are being partially addressed by Bank support through a technical assistance operation.</p> <p><b>Financial Management:</b> Staff turnover in financial management staff due to the upcoming change of Government could hinder project implementation.</p>	<p>avoid harmful disruptions in its implementation. The Financing Agreement of the Project has legal clauses preventing unnecessary project staff changes, and these will be maintained in the AF. Moreover, the UAP is a solid and experienced implementation unit that manages several international operations and is hosted within the Ministry of Finance, which traditionally has more professional staff. The AF is seen as an opportunity to ensure continuity of the reform agenda with the next administration.</p> <p>The Ley Marco establishes the creation of municipal structures to manage the WSS sector at municipal level in a participatory, transparent and efficient way, such as the creation of COMAS and USCLs. In parallel, during the creation of the municipal service providers, the CATS and all technical assistance provided reinforced the need of solid technical teams. This comprehensive arrangement, backed up the law, has contributed to minimize this risk during the implementation of PROMOSAS, and therefore, will be kept for the AF.</p> <p>A significant effort has been made to put in place the appropriate capacity and support structures (including ongoing support to municipalities and municipal service providers by the CATS) to mitigate such risks. Procurement has been centralized and an experienced implementation unit assists in execution of the Project.</p> <p>The Bank will continue exercising intense prior review work over project procurement decisions and post reviews will be conducted once a year. The Operational Manual will be revisited and updated to the 2011 version of the Procurement and Consultant Guidelines and to introduce Special Procurement Provisions aimed at making sure that there is no conflict between local regulations and Bank rules.</p> <p>The financial management team will monitor fiduciary staff composition throughout Project implementation and additional training to any new staff will be provided so as to mitigate the risk of slow implementation due to lack of capacity. This AF will be managed by the UAP-SEFIN, which is currently administering two Bank-funded projects (PROMOSAS-Cr. 4335-HO and COMRURAL-Cr. 4465-HO) and one trust fund (Strengthening Congressional Oversight – TF011581-HO), with satisfactory financial management performance up to date. In addition this unit administers several projects financed by other Donors with satisfactory financial management performance up to date.</p>			
<p><b>2.2. Governance</b></p>	<p><b>Resp:</b> client</p>	<p><b>Stage:</b> prep / imp</p>	<p><b>Due Date:</b> Recurrent</p>	<p><b>Status:</b> on going</p>
	<p><b>Rating:</b></p>	<p><b>Moderate</b></p>		

<p><b>Description:</b>  <b>Lack of transparency in project implementation</b>, including: (a) the capture of project benefits by politically influential stakeholders; (b) failure to apply a consistent approach to the selection of municipalities and investment projects; and, as a result of the above (c) financing of technically and economically suboptimal investments.</p>	<p><b>Risk Management:</b>  The Project has identified a clear strategy to address transparency-related concerns and will be continued in the AF. First, the Bank team, jointly with Government officials, has developed an objective methodology for a stepped approach with clear measurable benchmarks that must be met to move to the next step. Second, civil society organizations and consumer representatives are involved in the reforms, thus providing a counterweight to clientelistic interests. Third, mechanisms for improving communication and access to information were designed and implemented during the process to guarantee transparency and enable consumer and civil society participation in the decision-making process. Fourth, a project implementation unit with extensive experience in implementation of Bank-financed projects has been ensuring that accounting, financial management, and procurement procedures are consistent with the Bank’s requirements.</p>			
	<p><b>Resp:</b> Client</p>	<p><b>Stage:</b> Implementation</p>	<p><b>Due Date :</b> Recurrent</p>	<p><b>Status:</b> on going</p>
<p><b>3. Project Risks</b></p>				
<p><b>3.1. Design</b></p>		<p><b>Rating:</b> Moderate</p>		
<p><b>Description:</b>  <b>Project implementation Delays:</b> The complexity of implementation of reforms, particularly at municipal level, can generate delays in Project implementation.</p> <p><b>Lack of cooperation between the implementing agency (UAP) and the technical agencies (SANAA, CONASA, ERSAPS)</b> jeopardize Project implementation. The Project relies on several sector agencies to support the implementing agency (UAP) and their coordination is essential to guarantee that sector activities are implemented properly.</p> <p><b>Disinterest of the municipalities to participate in the stepped approach.</b> The Project was designed following an approach in</p>	<p><b>Risk Management :</b>  The PROMOSAS Project incorporates lessons learned from other Bank projects, including division of clear responsibilities among all key stakeholders; capacity building at all levels of project implementation; monitoring and evaluation to detect early warning signals; and a focus on improved coordination among national sector institutions and between the local and the national level. At the local level, delays have been minimized by first focusing on technical assistance for reforms, and by using the period up to the transfer of services to prepare, design and develop specifications. However, the process of consolidation of municipal service providers, and making them operating efficiently and independently revealed to take extra time and support. The AF is proposed with an additional three-year implementation period that will ensure enough time for the consolidation of the service providers.</p> <p>An inter-institutional agreement was signed in the beginning of PROMOSAS implementation, among those various agencies that defines the roles and duties of each of them and the processes for collaboration. A GIC group, formed by SEFIN, SANAA, CONASA, ERSAPS and the Honduras Municipalities Association, was also created and has been active. In addition, incentives have been provided since every one of these agencies is also a beneficiary of the Project (SANAA through Components 2 and 3B and C y ERSAPS and CONASA-including the PEMAPS unit-through Sub-Component 3A). The Project is supporting them in exercising their legal mandate, rather than adding responsibilities they would not otherwise have had. Finally, the UAP has also been strengthened with a few high-level sector specialists that act as back-up and oversight of the technical agencies. The same arrangement is kept for the AF.</p> <p>The stepped approach has been designed in order to provide incentives for a transfer process that is already mandated by the <i>Ley Marco</i>. Contrarily to other ongoing projects (Barrio-Ciudad, IDB),</p>			

<p>which the access to investment funds inly come at a later step, after key non-structural actions have taken place. The later access to investment funds may be a disincentive for municipalities to join the Project.</p> <p><b>Effect of the 2013 budget cut on the national institutions (SANAA, CONASA, ERSAPS), as well as in the central government transfers to the municipalities.</b> These cuts could affect the operational capacity of these entities to support the sector reform and the activities under the AF.</p>	<p>this Project extended grants, not loans, to municipalities, hence providing more attractive financing rules. A municipal counterpart funding requirement has ensured that the municipalities commit to the entire process. A strategic communication campaign was also included in Component 3 and is helping to promote the Project, among others. The same arrangement is kept for the AF. Moreover, this risk is minimized because only 1-2 additional municipalities will be included in the AF, while additional support will be provided to the existing PROMOSAS municipalities, that are already engaged and following the stepped approach.</p> <p>The borrower has asked the Bank to include in the processing of the Additional Financing a restructuring of PROMOSAS in order to increase the Bank financing to 100% in selected categories, exactly to overcome the budgetary constraint.</p>								
<p><b>3.2. Social &amp; Environmental</b></p>	<table border="1"> <tr> <td><b>Resp:</b> Bank / Client</td> <td><b>Stage:</b> prep/impl</td> <td><b>Due Date:</b> Recurrent</td> <td><b>Status:</b> on going</td> </tr> <tr> <td colspan="2"><b>Rating:</b></td> <td colspan="2"><b>Low</b></td> </tr> </table>	<b>Resp:</b> Bank / Client	<b>Stage:</b> prep/impl	<b>Due Date:</b> Recurrent	<b>Status:</b> on going	<b>Rating:</b>		<b>Low</b>	
<b>Resp:</b> Bank / Client	<b>Stage:</b> prep/impl	<b>Due Date:</b> Recurrent	<b>Status:</b> on going						
<b>Rating:</b>		<b>Low</b>							
<p><b>Description:</b>  <b>Environmental:</b> If not properly managed, eligible civil works could have negative, yet anyway minor environmental impacts, e.g. improper disposal of waste materials or erosion.</p> <p><b>Social:</b> Despite the actions of the program's communication strategies, opposition to the proposed decentralization process and/or specific investments (such as metering) in the new municipalities is likely.</p>	<p><b>Risk Management:</b>  The UAP has a competent Environmental Specialist who supports and supervises adequate implementation of the Project's Environmental and Social Management Framework focused on the eligible construction works. Work contracts include pertinent environmental clauses and contractors and their supervisors are required to include environmental specialists in their teams.</p> <p>The UAP will continue to invest resources in the program's communication strategy which will now be strengthened by lessons learned during the parent Project.</p> <table border="1"> <tr> <td><b>Resp:</b> Client</td> <td><b>Stage:</b> Prep/impl</td> <td><b>Due Date:</b> Recurrent</td> <td><b>Status:</b> On going</td> </tr> <tr> <td colspan="2"><b>Rating:</b></td> <td colspan="2"><b>Low</b></td> </tr> </table>	<b>Resp:</b> Client	<b>Stage:</b> Prep/impl	<b>Due Date:</b> Recurrent	<b>Status:</b> On going	<b>Rating:</b>		<b>Low</b>	
<b>Resp:</b> Client	<b>Stage:</b> Prep/impl	<b>Due Date:</b> Recurrent	<b>Status:</b> On going						
<b>Rating:</b>		<b>Low</b>							
<p><b>3.3. Program &amp; Donor</b></p>	<table border="1"> <tr> <td colspan="2"><b>Rating:</b></td> <td colspan="2"><b>Low</b></td> </tr> </table>	<b>Rating:</b>		<b>Low</b>					
<b>Rating:</b>		<b>Low</b>							
<p><b>Description:</b>  <b>Overlap and/or weak coordination among donors supporting the sector.</b></p>	<p><b>Risk Management:</b>  PROMOSAS is largely considered as the premier sector modernization support program in the country and many other donors have sought to emulate some of its aspects. Donor coordination is on-going - every mission involves meetings with key donors in the sector - and has been rigorously pursued in specific areas of strengthening of CONASA throughout the project life. During the initial two years of the Project, the Bank insisted on the need for CONASA and ERSAPS to develop a single planning instrument / document that would detail all proposed activities, not just those financed through PROMOSAS. The local Bank presence also provides strong support to the donors coordination on key sector strategies and activities.</p> <table border="1"> <tr> <td><b>Resp:</b> Bank</td> <td><b>Stage:</b> prep/impl</td> <td><b>Due Date:</b> Recurrent</td> <td><b>Status:</b> on going</td> </tr> </table>	<b>Resp:</b> Bank	<b>Stage:</b> prep/impl	<b>Due Date:</b> Recurrent	<b>Status:</b> on going				
<b>Resp:</b> Bank	<b>Stage:</b> prep/impl	<b>Due Date:</b> Recurrent	<b>Status:</b> on going						
<p><b>3.4. Delivery Monitoring &amp; Sustainability</b></p>	<table border="1"> <tr> <td colspan="2"><b>Rating:</b></td> <td colspan="2"><b>Substantial</b></td> </tr> </table>	<b>Rating:</b>		<b>Substantial</b>					
<b>Rating:</b>		<b>Substantial</b>							
<p><b>Description:</b>  <b>Monitoring and Evaluation.</b> Lack of coordination among UAP,</p>	<p><b>Risk Management:</b>  The UAP is responsible for the overall management and implementation of the Project Monitoring</p>								

<p>CONASA, ERSAPS and SANNA jeopardize timely and accurate data of Project monitoring.</p> <p><b>Sustainability.</b> Newly created WSS service providers may not have the proper conditions (expertise, financial cash-flow, political support) to provide a good and sustainable service.</p>	<p>and Evaluation Framework. This includes maintaining the databases, managing the flow of information, and producing periodic monitoring reports. It is directly responsible for the Progress reports and the results-based M&amp;E. The consultants hired under the Project have a key role in providing timely monitoring reports with operational data. The social team in the UAP is responsible for carrying out focus group discussions and participatory exercises, contracting and supervising the midterm and final surveys, and conducting the evaluation reports. This approach has been satisfactorily implemented under the PROMOSAS Project and will be kept for the AF.</p> <p>The risk of poor sustainability of the investments at the local level has been gradually mitigated by the implementation of a series of technical assistance activities. In addition, the overall level of investments foreseen under Component 1 is fairly small, thus reducing the likelihood that operation and maintenance of the relatively small works would exceed the capacity of the utilities. However, some current PROMOSAS municipalities are struggling with financial cost recovery, and the Project actors have recognized that the provision of a good quality and sustainable service may require additional support and time. The AF of PROMOSAS was conceived exactly to consolidate the on-going sustainability and service quality efforts.</p>			
<p><b>3.5. Other</b></p>	<p><b>Resp:</b> Bank / Client</p>	<p><b>Stage:</b> prep/impl</p>	<p><b>Due Date:</b> Recurrent</p>	<p><b>Status:</b> on going</p>
<p><b>Description: Severance Payment related risks</b> (related to the parent Project only, since the AF will not finance severances)</p> <p><b>Noncompliance with Bank rules on payment of severance.</b> During the preparation of the Parent Project, one of the risks related to the compliance of severance payments with Bank rules was the fact that the SANAA regional offices that would participate in the Project were only identified during project implementation.</p> <p><b>Overpayment of severance.</b> Miscalculation or political interference may lead to overpayment of severance.</p> <p><b>Adverse selection of staff</b> to receive severance payments or to continue working in the WSS Utility</p>	<p><b>Rating:</b> Moderate</p> <p><b>Risk Management:</b></p> <p>In the Parent Project, an evaluation of the payment of severance to retrenched SANAA staff confirmed, prior to any disbursement, that such payment was in accordance with the principles detailed in OP 6.00 (Bank Financing) of productivity, sustainability and oversight requirements.</p> <p>In the Parent project, the Bank only financed payments that have been verified and certified by a credible, neutral entity. A limited national counterpart funding has been included under severance payments to ensure negotiations between the Government and the syndicates are conducted under the right incentives. The Ministry of Finance was required to maintain sufficient information on the number of employees retrenched and average severance payments to enable independent audit.</p> <p>Because all affected staff were/will be paid severance regardless of whether the new service provider chooses to hire them, there is no perverse incentive for staff when choosing to leave or not. In fact, under the Parent Project, very few staff remained within SANAA.</p> <p>In the implementation of the Parent Project, in most cases, only the most-effective staff of the</p>			

<p><b>Moral Hazard.</b>The largest moral hazard is that the newly formed municipal service providers will be free to select their entire staff based on actual needs.</p> <p><b>Negative financial impact on SANAA central.</b> In the short term, overstaffing in SANAA will increase as it transfers systems: a large central department will depend on income from fewer connections. Staffing issues are critical to further improvements in the sector, at both the national and the local level.</p>	<p>existing SANAA was hired by the new service provider. The Parent Project financed through the CATS, the preparation of business plans that helped the service provider in choosing suitable staffing levels and profiles; the business plans were backed by cash-flow analysis.</p> <p>The PROMOSAS Project financed a study on rationalization staffing of SANAA during and after decentralization. The SFLAC technical assistance <i>Sustainable Water for a Sustainable City: Promoting Integrated Urban Water Management in the Greater Tegucigalpa Area</i> (P125903) is also supporting additional studies to tackle this issue.</p>			
	<b>Resp:</b> Bank / Client	<b>Stage:</b> prep/impl	<b>Due Date:</b> project approval	<b>Status:</b> completed
<b>4. Overall Implementation Risk</b>		<b>Rating: Substantial</b>		
<p><b>Comments:</b> Overall Risk Rating for the PROMOSAS Project was determined to be Substantial during its preparation in 2007. This was based on the assessment that while the innovative nature of the Project offered significant rewards in terms of developing a more efficient water supply and sanitation sector, it also carried a substantial level of risk, especially given the overall country risks prevailing in Honduras at that moment. Based on the combined risks identified regarding the sustainability of the municipal WSS management model, the uncertainty surrounding the upcoming elections and implementing agency staff turnover, the risk for the AF is also proposed to be rated as Substantial.</p>				

**Annex 3: Immediate Response Mechanism (IRM) Contingent Component**  
**HONDURAS: Water and Sanitation Sector Modernization Project**  
**Additional Financing**

1. The proposed Project will support Honduras to improve its capacity to respond promptly and effectively to emergencies through an Immediate Response Mechanism (IRM) Contingent Component with zero allocation of under the Project (Component 5) as part of the IRM established for Honduras. This approach allows for the use of simplified procedures and for rapid restructuring of project portfolios to meet crises and emergency needs. Accordingly, implementation arrangements and fiduciary and safeguard policies, which will be detailed in an IRM Operational Manual, will seek to ensure smooth implementation based on rapid and effective disbursement of available funds.
2. The IRM for Honduras, including the contingent component under this Project, will provide financing for a positive list of goods including public and private expenditures, both domestic and imported and/or for specific works, goods, services (including audit costs) and emergency operation costs, required for emergency response and recovery. These expenditures will be appraised, reviewed and found to be acceptable to the Bank before any disbursement is made.
3. The eligible expenditures will be defined in the IRM Operational Manual, but may include in the positive list, *inter alia*, (i) construction materials and industrial machinery; (ii) water, land and air transport equipment, including supplies and spare parts; (iii) school supplies and equipment; (iv) medical supplies and equipment; (v) petroleum and fuel products; and (vi) communications equipment.
4. Other eligible expenditures to be defined in the IRM Operational Manual (a) for specific works may include urgent infrastructure works (repairs, rehabilitation, construction, etc.) to mitigate the risks associated with the disaster for affected populations; (b) for goods may include construction materials and equipment, agricultural inputs (excluding pesticides), and telecommunication equipment among others; (c) for services may include studies (technical, social, environmental, etc.) necessary as a result of the effects of the disaster for identification of priority works, feasibility assessments, or delivery of related analyses; and (d) for emergency operation costs may include incremental expenses such as additional transport costs, increased electricity bills for the public sector, staff overtime, and rental of light and heavy machinery. In the case of works, a sequenced approach to safeguard policies Fwill be followed.
5. The IRM will be made operational at the country-level by:
  - (a) Adding to the PDO of new operations or restructured ones the specific IRM objective of supporting Honduras “to improve its capacity to respond promptly and effectively to an eligible emergency;”

(b) Including an IRM Component with zero funds through which an agreed amount of Credit funds from the respective project would be reallocated to finance post-emergency needs.

(c) Adding to the Project Results Matrix a PDO outcome indicator and an intermediate indicator related to the IRM Component. These would be: (i) at PDO level, “Time taken to disburse funds requested by Government for an eligible emergency (target of four weeks); and (ii) at component level, “IRM established and ready to provide access to financial resources to Honduras in case of an eligible emergency.”

(d) Finalizing the IRM Operational Manual, reflecting agreements on implementation arrangements, fiduciary and safeguard requirements. The IRM Operational Manual will also define what an eligible emergency is and describe the actions to be taken by the Government when a crisis or emergency occurs. The Manual will also describe the country’s Coordinating Authority, as well as roles and responsibilities of implementing and oversight bodies in the context of emergency response; arrangements on procurement, financial management, safeguard policies, and disbursements; eligible expenditures; and the monitoring and evaluation, and reporting arrangements. The Bank’s corporate policies on financial management, procurement, safeguard policies and disbursement will apply, with the added flexibility.

(e) The IRM Operational Manual will be referred to in all the Financing Agreements of the Operations including an IRM Contingency Component and will be reviewed and cleared by legal, procurement, financial management, disbursement and safeguard policies staff before it is approved by the Country Director. The Manual may be updated periodically to reflect evolving country conditions.

(f) The initial Disbursement Letter for all the Projects with an IRM Contingency Component should identify the disbursement methods and corresponding supporting documentation requirements for disbursement under the component, if known. Alternatively, a revised Disbursement Letter may be issued once the arrangements become clearer or the circumstances change.

6. As part of country dialogue and Country Performance Portfolio Reviews, the Government and the Bank will periodically identify the amount of funding that may be reallocated from the list of projects with an IRM window, and the list and indicative amounts reflected in the IRM Operational Manual.

7. Following an eligible emergency or crisis, as defined in the IRM Operational Manual, Honduras will be able to access funds, depending on financing needs, through this operation (and eventually through new IRM windows under other projects in the country portfolio.) The GoH may request the Bank to re-allocate project funds to this component to support response and reconstruction. This component would draw resources from other Project components to cover emergency response and recovery costs. Additional funds could also be made available through this window to cover emergency response, recovery and reconstruction needs.

8. To access funds under the Project's IRM Contingency Component, based on the process described in the IRM Operational Manual, the relevant Government authority should have declared the state of emergency and the Bank agreed and notified the Government. Any required safeguard policies instruments should have been finalized and disclosed. Goods purchased up to 12 months from the date that eligible emergency is declared will be eligible for financing, while retroactive financing will also be made available under the Project's IRM Contingency Component.<sup>17</sup>

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<sup>17</sup>Under an IRM Component, the 12-month retroactive period is from the date when the implementation of the contingent component is triggered.