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RESTRUCTURING PAPER

ON A

PROPOSED PROJECT RESTRUCTURING
OF
WATER AND SANITATION SECTOR MODERNIZATION PROJECT

CREDIT NO. 43350-HN

JUNE 21, 2007

IN THE INITIAL AMOUNT OF SDR19.8 MILLION
(US\$30 MILLION EQUIVALENT)

TO THE

REPUBLIC OF HONDURAS

November 9, 2010

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

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ABBREVIATIONS AND ACRONYMS

CONASA	<i>Consejo Nacional de Agua Potable y Saneamiento</i> ; (National Council for Water and Sanitation)
ERSAPS	<i>Ente Regulador de los Servicios de Agua Potable y Saneamiento</i> ; (Honduras Water and Sanitation Regulator)
GoH	Government of Honduras
IDA	International Development Association
IRP	Involuntary Resettlement Policy
ISR	Implementation Status Report
M&E	monitoring and evaluation
PDO	Project Development Objectives
SANAA	<i>Servicio Autónomo Nacional de Acueductos y Alcantarillados</i> ; (National Autonomous Water and Sewer Service)
SDR	Special Drawing Rights
SEFIN	Secretariat of Finance
UAP	<i>Unidad Administradora de Proyecto</i> ; (Project Administration Unit)
WSS	Water supply and sanitation

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Sector Manager / Director:	Guang Zhe Chen
Task Team Leader:	David Michaud

REPUBLIC OF HONDURAS

WATER AND SANITATION SECTOR MODERNIZATION PROJECT

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Restructuring	Status: Submitted to SECPO
Restructuring Type: Level one	
Last modified on date : 11/12/2010	

1. Basic Information	
Project ID & Name	P103881: HN WATER AND SANITATION PROGRAM
Country	Honduras
Task Team Leader	David Michaud
Sector Manager/Director	Guang Zhe Chen
Country Director	Laura Frigenti
Original Board Approval Date	06/21/2007
Original Closing Date:	12/31/2013
Current Closing Date	12/31/2013
Proposed Closing Date [if applicable]	
EA Category	B-Partial Assessment
Revised EA Category	B-Partial Assessment-Partial Assessment
EA Completion Date	09/03/2007
Revised EA Completion Date	

2. Revised Financing Plan (US\$m)		
Source	Original	Revised
BORR	5.00	5.00
IDA	30.00	30.00
Total	35.00	35.00

3. Borrower		
Organization	Department	Location
Government of Honduras		Honduras

4. Implementing Agency		
Organization	Department	Location
Finance Secretariat (SEFIN)		Honduras

5. Disbursement Estimates (US\$m)		
Actual amount disbursed as of 11/18/2010		6.59
Fiscal Year	Annual	Cumulative
2011	7.36	13.95
	Total	13.95

6. Policy Exceptions and Safeguard Policies	
Does the restructured project require any exceptions to Bank policies?	N
Does the restructured projects trigger any new safeguard policies? If yes, please select from the checklist below and update ISDS accordingly before submitting the package.	Y

Safeguard Policy	Last Rating	Proposed
Environmental Assessment (OD 4.01)	X	X
Natural Habitats (OP 4.04)	X	X
Forestry (OP 4.36)		
Pest Management (OP 4.09)		
Physical Cultural Resources (OP 4.11)	X	X
Indigenous Peoples (OD 4.20)	X	X
Involuntary Resettlement (OP 4.12)		X
Safety of Dams (OP 4.37)		
Projects in International Waters (OP 7.50)		
Projects in Disputed Areas (OP 7.60)		

7a. Project Development Objectives/Outcomes
Original/Current Project Development Objectives/Outcomes
The proposed project development objective is to improve the sustainability , efficiency and reliability of Honduras?s water supply and sanitation (WSS) services in the participating municipalities through implementing the Strategic Plan to Modernize the WSS Sector (PEMAPS). The specific objectives are to: o Establish and strengthen municipal service providers and support good governance in WSS services provision through increasing transparency and accountability; o Reinforce the national sector actors (ERSAPS, CONASA, SANAA) to fulfill their new roles?a necessity for successful decentralization of the services; o Reduce non-revenue water in selected areas of Tegucigalpa to provide immediate impact on the service quality.

7b. Revised Project Development Objectives/Outcomes [if applicable]

REPUBLIC OF HONDURAS
WATER AND SANITATION SECTOR MODERNIZATION PROJECT
RESTRUCTURING PAPER

A. SUMMARY

1. The proposed project restructuring consists of three parts: 1) to trigger the Involuntary Resettlement Policy (OP4.12) and put in place appropriate mechanisms to manage involuntary resettlement issues that may arise during implementation; 2) to revise monitoring and evaluation (M&E) indicators for the result framework while project development objectives and outcomes remain unchanged; and 3) to modify the allocation of proceeds.

PROJECT STATUS

2. The Credit, in the amount of Special Drawing Rights (SDR) 19.8 million (equivalent to US\$ 30 million in 2007), was approved by the Board on June 21, 2007 and became effective on February 22, 2008. The Project Development Objectives (PDO) are: a) to improve the sustainability, efficiency and reliability of Honduras's water supply and sanitation (WSS) services in eligible municipalities; and b) to improve the performance of the Recipients national WSS sector institutions in the exercise of their respective roles in conformity with the WSS Sector Framework Law. The Project has the following four components: 1) support to municipalities with urban population between 40,000 and 300,000 to adopt autonomous service provider models by providing a combination of free technical assistance for creating the service providers, short-term efficiency improvement measures, and investment funding once services are transferred; 2) financing efficiency improvements in Tegucigalpa to provide immediate impact on the service quality, while the transfer from the national utility to the municipality is being discussed; 3) institutional strengthening actions that help fortify and establish the national sector actors; and 4) financing project management activities.

3. The Project's overall implementation has been satisfactory, most of its achievements being focused on supporting the decentralization of water and sanitation sectors. Up to date, the Project has supported transfer of water and sewerage services from the national utility, National Autonomous Water and Sewer Service (SANAA), to two municipalities, Siguatepeque and Comayagua. In parallel, it has been assisting seven additional municipalities interested in creating autonomous utilities (La Ceiba, La Lima, Villanueva, Potrerillos, San Manuel, Danli, and Pimienta) by mobilizing adequate technical assistance. The Project is also making good progress in non-revenue water reduction activities in Tegucigalpa. An innovative performance-based contract to reduce non-revenue water has been developed and will soon initiate bidding process. Technical

assistance activities to support institutional strengthening targeted to National Council for Water and Sanitation (CONASA) and Water and Sanitation Sector Regulator (ERSAPS) have been agreed. Implementation Status Report (ISR) in August 2010 rates Overall Implementation Progress as *Satisfactory*.

4. Such satisfactory progress in implementation is noteworthy considering rather a complex political context facing the Project. There was a setback in the pace of reform when the national parliament decided in 2008 to extend the deadline for the transfer of all water systems from the national utility (SANAA) to municipalities by five year, until October 2013. In addition, the Bank's Portfolio implementation was setback by the political crisis and the government transition. In line with OP7.30 the Bank stopped processing withdrawal applications during the process of assessing the prevailing situation. Without new resources from the Bank, most projects were unable to continue financing ongoing contracts. The Government also put a hold on entering into new contracts. Before resuming disbursements the Bank carried out individual project supervision in line with its fiduciary responsibilities. However, as resources from the Bank began to flow again in December 2009 project implementation slowed due to the political transition. As a result, considerable efforts were required to stabilize the portfolio, including the normalization of contracts implementation, reinforcement of project implementation arrangements including staffing, and ensuring that operational plans for 2010 are consistent with government fiscal constraints and emergency priorities.

5. Up to date, the Project disbursed about US\$ 6.59 million from International Development Association (IDA) funds, 20% of the total IDA funds. The Project so far focused its efforts on decentralization process and only a small share of the disbursement has been allocated for work. As the Project is now moving towards actual physical works, the team anticipates that the pace of disbursement will increase. In fact, in response to the recent Government of Honduras' (GoH's) request to accelerate disbursement for employment generation, the task team agreed with the Project Administration Unit – Secretariat of Finance (UAP-SEFIN) and the Ministry of Presidency on reallocation of funds in order to increase the amount of works and accelerate disbursement.

PROPOSED CHANGES

6. The proposed project restructuring consists of three parts: 1) to trigger the Involuntary Resettlement Policy (OP 4.12) and put in place appropriate mechanisms to manage involuntary resettlement issues that may arise during implementation; 2) to revise monitoring and evaluation (M&E) indicators for the result framework while project development objectives and outcomes remain unchanged; and 3) to modify the allocation of proceeds. These proposed changes will not affect the project's development objectives, overall design, scope or outcomes.

- **Safeguards**

7. During the original appraisal, the Project was rated as Category B triggering the Environmental Assessment, Natural Habitats, and Physical Cultural Resources and Indigenous Peoples Safeguards Policies. Since subprojects and specific locations were not identified, a framework for environmental and social management was prepared. The Involuntary Resettlement Policy was not triggered at that time because foreseen water and sanitation works under the Project were relatively simple and conceived as complementary works to help the new service provider to enhance the efficiency of service provision. It was agreed and reflected in all project documents that no physical or economic involuntary resettlement shall take place as a consequence of project implementation.

8. Nevertheless, during the February 2010 supervision mission, the Project team noted that municipal authorities and service provider management were expressing the need to prioritize physical works that could potentially involve easements, construction on either privately-owned or leased land or land acquisition. None of the physical works identified so far in Choloma and Comayagua have had a case of involuntary resettlement. The Project team and the client subsequently agreed that the Involuntary Resettlement Policy would be triggered as an instrumental measure for future project activities and that, considering that project activities that may involve resettlement have not been determined yet, an Involuntary Resettlement Policy Framework (IRPF) would be prepared. An IRPF acceptable to the World Bank was approved on June 17, 2010 and disclosed on July 20, 2010. Resettlement Action Plans will be prepared by the Recipient and approved by the Bank prior to the implementation of any Project activity (including subproject activities) in which the IRPF applies. The approval will depend on the review and authorization given by the Bank. Where the IRPF applies to a specific subproject activity, the corresponding municipality, together with the implementing agency, will prepare and implement a Resettlement Action Plan, and will implement it in accordance with its terms once it is approved. It was agreed that compensation payments and land acquisition would be paid out of the proceeds of the Credit following the Bank policies and this has been accordingly reflected in the revised disbursement table (See below). Cash compensation and land acquisition will be paid with the proceeds of the Credit only after a resettlement action plan for each project activity involving resettlement has been developed by the recipient and approved by the Bank.

- **Results/indicators**

9. The proposed restructuring revises project indicators of the results framework as detailed in Annex 1, while the project development objectives and expected outcomes remain unchanged. During the project implementation, it was noted that some of the existing monitoring indicators are subject to different interpretations and others do not adequately reflect the actual activities financed under the Project. The Project team and the Recipient subsequently concurred on the need to revise the monitoring indicators in order to better align with the project activities and measure more effectively the overall impact and outcomes of the Project. In addition, the revised result framework support

and adopt benchmark indicators for overall water and sanitation sector developed by ERSAPS and it is also aligned with the Bank-wide efforts to utilize core sector indicators. Finally, the Project team and Recipient discussed and agreed on the detailed institutional arrangement to monitor, collect, and keep track of monitoring indicators, especially those indicators which need data sharing and coordination between the project implementation unit UAP and ERSAPS.

- **Reallocations**

10. The proposed restructuring revise reallocation of Credit proceeds as follows:

Category of Expenditure		Allocation (SDR)		% of Financing	
Current	Revised	Current	Revised	Current	Revised
(2) Consultant's services under Part 1.A. 2,3. A, 3.B.2, and 4 of the Project	(1) Consultant's services under Part 1.A. 2,3. A, 3.B.2, and 4 of the Project	5,400,000	4,170,000	100%	100%
(2) Consultant's Services under Part 3.C of the Project	(3) Consultant's Services and non-consulting services under Part 3.C of the Project	750,000	750,000	85%	85%
(3) Goods and works under Parts 2, 3.A and 4 of the Project	(3) Goods and works under Parts 2, 3.A and 4 of the Project	2,400,000	5,020,000	90%	90%
(4) Goods, works, consultants' services, non-consultant services and Training under Parts 1.B and 1.C of the Project	(4) Goods, works, consultants' services, non-consultant services, resettlement cash compensation and land acquisition, and Training under Parts 1.B and 1.C of the Project	8,900,000	6,940,000	100% except for those costs covered by the counterpart contribution by Eligible Municipalities cited in Section I.D.1 (a) (ii) (B) of Schedule 2 of this Agreement.	100% except for those costs covered by the counterpart contribution by Eligible Municipalities cited in Section I.D.1 (a) (ii) (B) of Schedule 2 of this Agreement.
(5) Severance Payments under Part 3.B.1 of the Project	(5) Severance Payments under Part 3.B.1 of the Project	1,800,000	2,370,000	90%	90%

(6) Operating Costs under Part 3.A and 4 of the Project	(6) Operating Costs under Part 3.A and 4 of the Project	350,000	350,000	90%	90%
(7) Training and non-consultant services under Part 3.A and 4 of the Project	(7) Training and non-consultant services under Part 3.A and 4 of the Project	200,000	200,000	100%	100%
Total Amount		19,800,000	19,800,000		

11. The proposed reallocation is necessary to respond to the GoH’s request to accelerate disbursement of the Bank-financed projects in order to create employment. The proposed reallocation would allow larger scope of physical works for non-revenue water reduction activities in Tegucigalpa which will soon commence its bidding process. Additionally, the client requested an increase in the category ‘Severance Payments under Part 3.B.1 of the Project’, given the larger number of municipalities that are participating in the decentralization process of water utilities than originally anticipated.
12. The proposed restructuring involves no other changes in terms of institutional arrangements, financing mechanisms, financing plans, financial management, disbursement arrangements, procurement, closing date, or implementation schedule.

APPRAISAL SUMMARY

13. Only minor changes to the appraisal summary have resulted due to the Project Restructuring.

- **Social**

14. At the time of appraisal, the Project was estimated to have positive social impacts on the beneficiaries in the project areas. The Project would contribute to improving quality of life and reducing a risk to public health by providing more reliable water and sanitation services. These impacts remain unchanged under the proposed restructuring.
15. The restructuring would make explicit that the Project could imply minor social impacts related to “involuntary resettlement” according to OP 4.12, associated with construction of water and sanitation infrastructure under the Project. The Involuntary Resettlement Policy Framework specifies that a resettlement action

plan will be prepared when direct economic and social impacts are identified as a result of Bank-assisted investment projects and caused by the involuntary taking of land which would result in (i) relocation or loss of shelter, (ii) loss of access or access to assets; or (iii) loss of income sources or means of livelihood, whether or not the affected persons must move to another location. It outlines the content of said action plan with the primordial objective of reestablishing social and economic conditions to or above pre-investment levels.

- **Risk**

16. A new risk related to resettlement safeguards management has been identified during the restructuring.

Risk	Risk Rating	Risk Mitigation Measures
Lack of sufficient institutional capacity to manage resettlement-related issues.	M	<p>The implementing agency's social specialist is being guided and trained by the Bank's social specialist.</p> <p>A project-wide workshop is being organized to expand awareness and capacity to identify possible cases at the municipal level.</p>

ANNEX 1: Results Framework and Monitoring

Water and Sanitation Sector Modernization Project 43350-HO

Project Outcome Indicators	Core	D=Dropped C=Continued N= New R=Revised	Baseline (Actual at the time of restructuring)		Cumulative Target Values*					
			UoM	Value	YR 1	YR2	YR 3	YR4	YR5	YR6
Indicator One 6 of the WSS utilities reach cost recovery (ratio total revenue / total operative cost equal to one).	<input type="checkbox"/>	R	Number	4	4	4	4	5	5	6
Indicator Two 5 of the WSS utilities reach a rate of revenues per volumetric unit of water produced of at least 80%.	<input type="checkbox"/>	D	Percentage	0	0	0	3	3	4	5
Indicator Three At least 5 of the WSS utilities increase their service continuity rating by one category defined by ERSAP's performance indicators (note: definition on the Category A, B, C, and D on service continuity to be included).	<input type="checkbox"/>	R	Number	0	0	0	3	3	4	5
Indicator Four At least 50% of the SANAA systems financed under the Project are transferred to the municipalities.	<input type="checkbox"/>	R	Porcentaje	0%	0%	20%	20%	40%	40%	50%
Indicator Five At least 6 design proposals of autonomous service providers approved by ERSAPS.	<input type="checkbox"/>	D	Number	2	2	2	3	4	5	6
Indicator Six CONASA issues the new	<input type="checkbox"/>	C	Yes-No	No	No	No	No	Yes	Yes	Yes

financial policy of the sector.										
Intermediate Results										
Intermediate Result (Component one): Support to medium-sized municipalities to create autonomous service providers and invest in efficiency, rehabilitation, and expansion of service delivery										
Revised Intermediate Result (Component one): Support to medium-sized municipalities to create autonomous service providers and invest in efficiency, rehabilitation, and expansion of service delivery										
Intermediate Result Indicator One At least 7 municipalities have signaled their intention to create an autonomous service provider in the spirit of the Ley Marco by a letter to the implementing agency in order to enter this component.	<input type="checkbox"/>	D	Number	2	2	5	7	7	7	7
Intermediate Result Indicator Two At least 10,000 additional people in urban areas (covering semi-urban or small urban areas) provided with access to improved sanitation under the project	<input checked="" type="checkbox"/>	R	Number	0	0	0	0	5,000	7,500	10,000
Intermediate Result Indicator Three Improved customer rating of water supply and sanitation as expressed in increase by TBD(*) percent in population rating service as satisfactory in participating towns.	<input type="checkbox"/>	D	Percentage	TBD	-	-	-	-	-	-
Intermediate Result Indicator Four At least 4 utilities in participating municipalities reach levels of Non-Revenue Water (including apparent losses, real losses and unbilled	<input type="checkbox"/>	D	Number	TBD	0	0	0	1	2	4

authorized consumption) by 10 percentage points.										
Intermediate Result Indicator Five At least 2000 additional piped household water connections affected by rehabilitation works undertaken under the Project.	<input checked="" type="checkbox"/>	N	Number	0	0	0	0	500	1,500	2,000
Intermediate Result Indicator Six At least 6 design proposals of autonomous service providers approved by ERSAPS.	<input type="checkbox"/>	N	Number	0	0	2	3	4	5	6
Intermediate Result Indicator Seven 5 of the WSS utilities increase by 20% the ratio of revenues per volumetric unit of water produced.	<input type="checkbox"/>	N	Number	0	0	0	2	3	4	5
Intermediate Result (Component Two): Tegucigalpa Non-Revenue Water Reduction Program										
Revised Intermediate Result (Component Two): Tegucigalpa Non-Revenue Water Reduction Program										
Intermediate Result Indicator One Non-Revenue Water (including apparent losses, real losses and unbilled authorized consumption) reduced by 15% points in service area.	<input type="checkbox"/>	D	Percentage	40%	40%	40%	40%	35%	30%	25%
Intermediate Result Indicator Two Ratio total income/m3 produced in targeted area increases by 20%.	<input type="checkbox"/>	D	Percentage	0%	0%	0%	0%	10%	15%	20%
Intermediate Result Indicator Three Number of active connections in service area.	<input type="checkbox"/>	N	Number	28,328	28,328	28,328	28,328	28,328	30,000	37,750

Intermediate Result Indicator Four Percentage increase of collection per cubic meter of supplied water to the project area.	<input type="checkbox"/>	N	Percentage	0% 2,52 Lps/m3	0% 2,52 Lps/m3	0% 2,52 Lps/m3	0% 2,52 Lps/m3	10% 2.77Lps/ m3	15% 2.898Lps/ m3	20% 3.024Lps/ m3
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	Intermediate Result (Component Three): National and Regional Institutional Strengthening									
	Revised Intermediate Result (Component Three): National and Regional Institutional Strengthening									
Intermediate Result Indicator One The 3 sector agencies (SANAA, CONASA, ERSAPS) have substantially complied in applying the Ley de Transparencia y Acceso a la Información.	<input type="checkbox"/>	D	Yes-No	No	No	Yes	Yes	Yes	Yes	Yes
Intermediate Result Indicator Two SANAA / Tegucigalpa has complied with legal requirements for transfer to municipality.	<input type="checkbox"/>	C	Yes-No	No	No	No	No	Yes	Yes	Yes
Intermediate Result Indicator Three SANAA has at least one regional unit operating under the new model.	<input type="checkbox"/>	N	Yes-No	No	No	No	No	Yes	Yes	Yes
Intermediate Result Indicator Four Indicators regarding utilities' performance are published by ERSPAS.	<input type="checkbox"/>	N	Yes-No	No	No	No	No	Yes	Yes	Yes
Intermediate Result Indicator Five At least 5 utilities have published their financial statements in a Website.	<input type="checkbox"/>	N	Number	0	0	0	2	3	4	5

Intermediate Result (Component Four): Project Management										
Revised Intermediate Result (Component Four): Project Management										
Intermediate Result Indicator One Cumulative percentage of disbursement targeted according to disbursement plan is met.	<input type="checkbox"/>	C	Percentage	0%	10%	20%	40%	60%	80%	100%