

Document of
The World Bank

Report No: 18367-PH

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED LOAN
IN THE AMOUNT OF US\$23.3 MILLION
TO THE
DEVELOPMENT BANK OF THE PHILIPPINES (DBP)
FOR A
LGU URBAN WATER AND SANITATION PROJECT
NOVEMBER 1, 1998

Urban Development Sector Unit
East Asia and Pacific Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective)

Currency Unit = Peso

P.025= US\$ 1

US\$ 1.00 = P 40.00

FISCAL YEAR

January 1 to December 31

ABBREVIATIONS AND ACRONYMS

ADB	-	Asian Development Bank
APL	-	Adaptable Program Lending
BAP	-	Barangay Action Plan
CAS	-	Country Assistance Strategy
COA	-	Commission on Audit
DBP	-	Development Bank of the Philippines
DENR	-	Department of Environment and Natural Resources
DILG	-	Department of Interior and Local Government
DOF	-	Department of Finance
DPWH	-	Department of Public Works and Highways
EA	-	Environmental Assessment
EMP	-	Environmental Management Plan
EU	-	European Union
GFI	-	Government Financing Institution
GOP	-	Government of the Philippines
IDA	-	International Development Agency
IFC	-	International Finance Corporation
IRA	-	Internal Revenue Allocation
LGU	-	Local Government Unit
LWUA	-	Local Water Utilities Administration
MOA	-	Memorandum of Agreement
MWSS	-	Metropolitan Waterworks and Sewerage System
NEDA	-	National Economic Development Agency
NDF	-	Nordic Development Fund
OECF	-	Overseas Economic Cooperation Fund
PMO	-	Project Management Office (national level)
PMU	-	Project Management Unit (in each LGU)
SB	-	Sangguniang Bayan (Municipal Council)
SOE	-	Statement of Expenditures
USAID	-	United States Agency for Development
WUPSPF-	-	Water Utilities Private Sector Participation Facility

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PHILIPPINES
LGU URBAN WATER AND SANITATION PROJECT

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MAP(S)
IBRD 29796

PHILIPPINES

LGU Urban Water and Sanitation Project

Project Appraisal Document

East Asia and Pacific Region
East Asia Urban Sector Development Unit

Date: November 1, 1998	Team Leader: Vijay Jagannathan
Country Manager/Director: Vinay K. Bhargava	Sector Manager/Director: Keshav Varma
Project ID: 39022	Sector(s): WW - Water Supply & Sanitation Adjustment
Lending Instrument: Adaptable Program Loan (APL)	Theme(s):
	Poverty Targeted Intervention: No

Program Financing Data							
APL	Indicative Financing Plan			Estimated Implementation Period (Bank FY)		Borrower	
	IBRD US\$ m	%	Others US\$ m	Total US\$ m	Commitment Date		Closing Date
APL 1 Loan/ Credit	23.3	73.0	8.6	31.9	05/01/99	05/01/2002	Development Bank of the Philippines, with the Republic of the Philippines as guarantor
APL 2 Loan/ Credit	60.0	75.0	20.0	80.0	05/01/2001	05/01/2004	Development Bank of the Philippines and Land Bank of Philippines, with the Republic of the Philippines as guarantor
APL 3 Loan/ Credit	100.0	75.2	33.0	133.0	05/01/2003	05/01/2007	Development Bank of the Philippines and Land Bank of Philippines, with the Republic of the Philippines as guarantor
Total	183.3		61.6	244.9			

Project Financing Data

Loan
 Credit
 Grant
 Guarantee
 Other (Specify)

For Loans/Credits/Others:

Amount (US\$m) 23.3

Proposed Terms:
 To be defined
 Multicurrency
 Single currency
 Standard Variable
 Fixed
 LIBOR-based

Grace period (years): 5
Years to maturity: 20
Commitment fee: 0.75%
Front end fee on Bank loan: 1.00%

Financing Plan: <input type="checkbox"/> To be defined			
Source	Local	Foreign	Total
Government	2.6	0.0	2.6
IBRD	13.2	10.1	23.3
IDA	0.0	0.0	0.0
Total:	15.8	10.1	25.9

Borrower: Development Bank of the Philippines

Guarantor: Republic of the Philippines

Responsible agency:

Department of Interior and Local Government and Participating Local Government Units (LGUs)

Implementing agency(ies):

Estimated disbursements (Bank FY/US\$M):

FY	2000	2001	2002				
Annual	5.8	7.8	9.7				
Cumulative	5.8	13.6	23.3				

Project implementation period: 3

Expected effectiveness date: 05/01/99 **Expected closing date:** 05/01/2002

OCS APL PAD Form: October 9, 1998

A: Program Purpose and Project Development Objective

1. Program purpose and program phasing:

The Bank's assistance strategy for the Philippines is to strengthen infrastructure, facilitate private sector participation, and upgrade basic urban services in its towns, so that the Government's objective of ensuring that at least 90 per cent of the urban populations have access to safe and reliable water supply can be achieved within a reasonable period of time. This program aims to implement the strategy by assisting LGU-managed water utilities to operate on commercial principles, and thereby provide consumers with safe, reliable, sustainable water and sanitation services in about 250 secondary towns and cities in the Philippines. If the Program achieves its impact (stated as the Development Objectives indicators), this will contribute, along with other related programs, to improving the living standards of the urban population.

The development objective of the LGU Urban Water and Sanitation Program is to ensure that by year 2007, approximately a quarter of LGU-managed water utilities is able to provide residents with water and sanitation services on the basis of consumer demand, as enunciated in NEDA Board Resolutions Nos. 4 and 5 of 1994, and NEDA Board Resolution No. 6 of 1996. In order to achieve this objective the program will generate incentives for the private sector to participate in utility management, lower production costs and increase responsiveness to consumers.

2. Project development objective: (see Annex 1)

The development objective of this project will be achieved through a series of three Bank-supported investments, which will assist the Government of the Philippines implement its forward-looking water and sanitation sector policies. The current challenge is one of actually implementing those policies; particularly with regard to:

- a) Clarifying the role of local government units (LGUs) in the provision of water supply services and determine the types of assistance made available to them by national government agencies concerned;
- b) Providing guidance to the LGUs in the development and implementation of viable and sustainable water supply projects, supporting the principles of managing water as an economic good, promoting a demand-oriented approach in the provision of services and management to be made at the lowest appropriate level, greater private sector participation in service delivery, and
- c) Identifying institutional strengthening needs of LGUs that would develop their capacity to adequately perform their financing, planning and service provisioning functions.

The project objective is to test and fine-tune the set of institutional, technical, financial and economic rules through which the national policies can be translated to concrete measures that ensure better quality water supply and sanitation services in hundreds of small towns in the Philippines. The project development objective is, therefore, to provide practical demonstration, through a reasonably large sample of Local Government Units (LGUs), that with appropriate technical and financial designs, pricing rules and institutional incentives, water supply systems, irrespective of size, can be made both viable and sustainable. A litmus test on whether this demonstration exercise has succeeded is the extent to which the private sector is willing to invest its time, effort and finances in supporting the water utilities in these towns.

The experiences gathered with regard to the implementation of project rules, and whether or not the private sector shows interest in the proposed lease (affermage) contracts will be evaluated and utilized to calibrate the Operational Manual developed for the project. These lessons will serve to scale up the investment program to about 80 towns in the second project (APL2), due to start in late 1999. Annex 1 describes the project development objectives and key indicators.

3. Program Objectives

APL1 and APL2 aim at attracting the private sector in order to help LGUs operate water supply systems better than what is the current practice, and also at developing a sufficiently large LGU-based water utilities market, which can (under APL3 and beyond) attract much needed private sector financing into the sector. The program objectives, therefore, have both a short-term and a long-term aspect. In the short-term (APL1 and APL2), the objective is to finance investments in water supply infrastructure, and attract sufficient numbers of private sector operators to operate and maintain LGU-managed water supply systems efficiently, while being responsive to its customers. In the long term (APL3 and beyond), the objective is to create a sufficiently large market for LGU-based water utilities, so that private financing institutions supplement the meager public financing available at present.

The program objective will be accomplished if safe, reliable and sustainable water supply and sanitation services to at least 90 per cent of all urban residents in the Philippines is accomplished in participating towns by 2007, compared to the current estimate of 55 to 60 per cent. It may be noted that the three APLs proposed are the first significant intervention in a long-term program of sector assistance aimed at changing the structure and incentives of water utilities in the Philippines, and are entirely consistent with the Bank's sector assistance strategy. The three elements in the Bank's program of sector assistance are to:

- a) **Assist water utilities improve operational efficiency and accountability to consumers** : This will be in the form of developing rules and procedures that enable water utilities to provide services according to what consumers want and are willing to pay for.
- b) **Facilitate private sector participation in the sector:** In order to facilitate private sector participation provide technical assistance to the national government to develop a well-articulated framework of national policies that improves the overall business environment in water utilities.
- c) **Leverage private financial flows into the water and sanitation sector:** The biggest challenge in the urban areas is to attract adequate financing for basic urban services in LGUs, as public financing is limited because of competing claims on limited resources. Private financing will be attracted only when an adequate track record is established in the cities and municipalities, with tariffs raised to financially viable levels, and local administrations have built a record of honoring their commitments.

3. Key performance indicators: (see Annex 1)

B: Strategic Context

1. Sector-related Country Assistance Strategy (CAS) goal supported by the project: (see Annex 1)

Document number: Report No. 15362-PH

Date of latest CAS discussion:

02/15/96

A significant element of the Country Assistance Strategy is the offer of World Bank assistance to the Government to strengthen infrastructure/facilitate private sector participation. In the water sector Bank lending will support the rationalization of management of urban water utilities, promote private sector

participation, and help increase coverage of urban populations to safe and reliable water supply. The proposed project will advance these objectives in about thirty five of the approximately one thousand LGUs in which municipal offices manage town water supply systems under APL1.

2. Main sector issues and Government strategy:

i. General issues affecting the sector:

(a) **Lack of adequate coverage:** A substantial population in Metro Manila as well as in other urban areas of the town is without access to safe water and sanitation. In the 1000 small towns where municipal agencies are responsible for water supply and sanitation, approximately 37 per cent of the population do not have access to safe water and sanitation. These residents end up paying unit rates for water supply at ten to fifteen times higher than what residents with access to public sector services pay. The estimated financing requirements to meet existing deficits in services run into billions of dollars.

(b) **Unreliable services:** Even among those with piped water, services are often restricted to less than one hour a day. Residents often have to privately invest in wells, arrange for contracts with water vendors etc. to mitigate the risk of unreliable supply.

(c) **Inefficient management of water utilities :** The general standards of efficiency have been low throughout the country in LGU-managed water utilities. Tariffs have been often set based on political considerations, rather than on the basis of operational efficiency. Further, only a few have any metering in place, and the constructed water supply systems are managed by poorly trained staff.

ii. Specific issues to be addressed by the project:

(d) **Unsustainable service provisioning, especially in small towns:** Water supply services have been unable to meet demand because the past sectoral practice was one of undertaking investments based on programs and generic designs, rather than responding to what consumers wanted and were willing to pay for. There could be major welfare gains to communities if reliable and adequate water supply facilities are available on the basis of what consumers want and are willing to pay for. Such changes would also reduce the dependence of these water utilities on financial subventions from the LGUs concerned.

(e) **Low institutional and technical capacity in LGU-managed water utilities:** LGUs lack trained technical and financial management staff to run the water utilities as commercial enterprises. Additionally the small size of the respective customer bases make these utilities generally unattractive to qualified professionals and to infrastructure financing institutions.

iii. Government Strategy

Since 1994 the Government of Philippines, with donor support, has instituted a series of measures to develop a policy and financing framework aimed at (a) rationalizing the Philippine water sector, (b) promoting private sector participation, and (c) improving water and sanitation service delivery to low income communities in urban areas. NEDA Board Resolution Nos. 4 and 5, series of 1994, have laid out the national policies for extending sustainable service provisions in the country. A Water Management Cluster or Cabinet Cluster G was established with the mandate of implementing the policy recommendations. In June 1995 the National Water Crisis Act (RA 8041) was enacted, vesting the Executive with special powers in order to improve management of water resources in general, and addressing the specific water crisis faced by the Metro Manila area. In April 1996, the Joint Executive-Legislative Water Crisis Commission, set up under the National Water Crisis Act completed its recommendations to the President on strategies and approaches that could be adopted to rationalize and streamline the water sector in the Philippines. Further, NEDA Board Resolution No 6 in May 1996 devolved planning and implementation of water and sanitation services to LGUs, with the Department of Interior and Local Government (DILG) being made the national agency responsible for building capacity in LGUs. A Presidential Task Force for Water Resources Management presented to the Philippine Congress a

Bill to reorganize regulatory arrangements for the water sector. Finally, in August 1997, the Government successfully privatized MWSS by the award of two concession contracts.

3. Sector issues to be addressed by the project and strategic choices:

The challenge is to build into the design and operation of LGU systems practices which reflect the forward-looking principles already incorporated in the above resolutions. Chief among these are that water will be managed as an economic good, that the projects must be demand-oriented, and the systems managed at the lowest appropriate level. In the context of the small LGU-managed water utilities, which have been traditionally considered as being "non-viable" water supply systems, this requires a period of "doing and learning" before the changed approach can be operationalized across the entire sector. So far about 200 LGUs have signaled their interest in participating in the project, despite its conditionalities with regard to pricing of services, cost recovery and institutional re-organization. As the size of each individual subproject is likely to be quite small, the project team and national government have agreed to test out the methodology for an initial batch of about thirty five towns, before the project is launched on a large-scale through the subsequent loans using the Adaptable Program Loan instrument.

In this project the following strategy is being followed in order to validate the policy concepts before the successor project experiences enable the launch of a nation-wide program of improving basic water supply and sanitation services:

a. From Principles to Practice: Technically Feasible Options and User Choice:

The management of water as an economic good and demand-orientation require that municipal systems are constructed which provide local consumers the opportunity to make an informed choice among technically feasible options for the delivery of services. As technically feasible options for the delivery of service have significantly different capital and operating costs and provide somewhat different levels of service, choice has to be exercised by users. The key element in the procedure to select supply options, is the value which users attach to the improvement in service offered by the technical option. This information regarding user valuation is most accurately provided by the willingness of users to pay for the service. Consequently, project procedures have included not only the preparation of technically feasible options but user indications of the value (willingness to pay) which they attach to the different options. Selection of the preferred option was negotiated between LGU administrations and the users, with mutually shared information about the expected costs and the expected user payment for the improvement. The project promoted full cost recovery, with users from the household level to the barangay and town council levels exercising choice, and paying for the services. A Consultant team, funded under a Japan Government PHRD grant worked closely with LGU administrations to operationalize the above process.

b. From Principles to Practice: Lowest Appropriate Management Level:

In determining the lowest appropriate level for the management of water supply systems, the project design takes into account that the cost of a technical option is strongly influenced by the management mode and the scope of the service area. Economies of scale often result in lower costs for services to larger service areas. In practice, therefore, it is useful to investigate in which cases the establishment of a regional service delivery organization would result in lower costs and lower requirements for user payments for the same service level, compared to single LGU management. Such regional organizations are likely to have cost-saving advantages in several areas. It is intended to evaluate such options in this project, if mayors in the affected regions desire that it should be considered. A sub-regional system in Isabela province has been recommended in the first batch of projects of APL1. In the second batch of projects of APL1, the prospects of subregional systems appear to be promising.

c. From Principles to Practice: Identifying Feasible Financing Levels and Repayment Options: In the case of participating LGUs, the costs of agreed improvements are large relative to the initial revenue base of the LGU. Moreover, the expected benefits from the improvement for current and future users will be long lasting, if managed effectively. Financing the improvements from up-front revenues will not generally be possible for LGUs. LGUs, however, have little experience in financial management much beyond the range of current budgets. Practice in LGU assessment of the safe scope for borrowing is limited. Assistance to overcome this deficiency in the processing of the project has been provided by the development of a long-range financial management model to estimate LGU borrowing capacity to finance improvements safely. This estimate was discussed with each LGU during field visits, and has formed the basis of estimating the size of the IBRD loan.

4. Program description and performance triggers for subsequent loan:

The program development objectives will be achieved with steady progress over an agreed seven year program including the following projects:

Project I (APL1): Testing and operationalizing the demand-based framework, as supported by GOP stated policy, in approximately 35 LGUs. In the first APL satisfactory water supply services will be extended to about 34,000 service connections in 12 municipalities at an investment cost of \$28 million. Many towns have opted to outsource operations and maintenance of the constructed facilities through affermage (i.e. lease) contracts between the municipal governments and private sector operators. Sanitation investments by households will be through specific arrangement between the LGU, the operator and the households.

Project II (APL2): Scaling up, on the basis of APL1, to a significant number of additional cities and municipalities (estimated at 80) that demonstrate sufficient demand to warrant inclusion and completion of contractual arrangements for private sector participation as developed in APL1 supported subprojects.

Project III (APL3): Changing the role of GFIs from retailers to wholesalers of loans, inducing private sector banks to invest in LGU-based water supply and sewerage systems. Improved financial management in LGUs and improved management of water systems through private sector participation are also expected.

Triggers for subsequent loans:

The Second LGU Urban Water and Sanitation Project (APL2; indicative amount of \$60 million) would be considered when there is:

- a) Devolution of operation, management, and revenue collection responsibilities under long-term commercial arrangements in 12 LGUs, and
- b) Fully operational project-funded water supply system improvements in 10 LGUs.

The Third LGU Urban Water and Sanitation Project (APL3; indicative amount of \$100 million) would be considered when there is:

- a) Devolution of operation, management and revenue collection responsibilities under long-term management contracts and leasing arrangements in 40 additional LGUs
- b) Achievement of a working ratio less than 0.50 in at least 80 LGU water utilities receiving financing from APLs 1 and 2

- c) Achievement of at least 16 hours of water per day to connected households in participating urban areas with completed systems through APLs 1 and 2 investments
- d) An average of 80% of consumers satisfied with service performance in LGUs participating
- e) At least 60% of households in any barangay of the LGUs participating in APL1 and APL2 connected to the water supply system

C. Program and Project Description Summary

1. Project components (see Annex 2 for a detailed description and Annex 3 for a detailed cost breakdown):

The major component of the project is to finance civil works and equipment in water supply infrastructure in participating municipalities. Preliminary feasibility studies and financial affordability analysis were conducted for a total of 21 municipalities. The findings were discussed with mayors, members of town councils and communities in order to select a technical option that matched the LGU and community willingness to pay. Of the 21 municipalities, twelve approved the project designs through the development and consolidation of project implementation plan (Barangay Action Plans or BAPs, inclusive of new tariff levels and how the constructed systems would be managed). For these municipalities, representing the Phase I of the project, feasibility studies have been completed by appraisal, and detailed engineering designs by negotiations. The sanitation and drainage components (derived from the BAPs and environmental assessments) will finance investments in communal toilets, on-site sanitation systems, and micro-drainage infrastructure respectively.

Based on the lessons learned from this phase, the project will finance approximately an additional 23 municipalities for Phase II of the project in the year 2000. The Water Utilities Private Sector Participation Facility will function as a pre-investment fund, designed to assist LGUs and water districts evaluate the available private sector participation (PSP) options, and select the ones best suited for the municipalities, cities or region. The institutional components (for which cofinancing arrangements are being finalized with the NDF) will support technical assistance to facilitate the formation of regional and subregional water utilities, training utility staff to plan and manage the water utilities and local environmental concerns in a sustainable manner, and undertake feasibility studies to prepare the next batches of water supply and sewerage projects. This component will also assist DBP monitor and evaluate project performance, in order to develop the succeeding phases of the Adaptable Program Loan (i.e. APLs 2 and 3 respectively).

Component	Sector	Indicative Costs (US\$M)	% of Total	Bank-financing (US\$M)	% of Bank-financing
Water Supply		23.3	73.5	21.0	90.1
Sanitation		1.6	5.0	1.4	87.5
Drainage		0.8	2.5	0.7	87.5
Water Utilities PSP Facility		1.5	4.7	0.0	0.0
Project Development for Water Supply and Sanitation		2.5	7.9	0.0	0.0
Institutional Capacity Building		2.0	6.3	0.0	0.0
Total Project Costs		31.7	99.4	23.1	72.9
Front-end fee		0.2	0.6	0.2	100.0
Total Financing Required		31.9	100.0	23.3	73.0

2. Key policy and institutional reforms supported by the project:

The project supports the key policy recommendations of the national government over the past five years. It also blueprints possible approaches by which private sector interest in the sector could be enhanced. At the consumer level, the project tests out methods by which consumers can actively participate in deciding levels of service, based on what they and the LGUs are willing to pay for. All of the above are related to implementation of key policy and institutional reforms that have already been established at the national government level.

3. Benefits and target population:

An estimated 155,000 residents, many of low income levels, and in the relatively small class V and VI municipalities) are expected to benefit from improved access to safe water and sanitation facilities from this project. The total beneficiaries from the program is estimated to be about 6 million persons.

4. Institutional and implementation arrangements:

The loan will be channeled through the Development Bank of the Philippines (DBP), a Government Financing Institution. Operational management of the project will be undertaken by a Project Management Office in DBP (DBP-PMO). Actual investments (first three components of the project) will be implemented by Project Management Units (PMUs) established by the participating LGUs. The national government has received an offer of cofinancing of SDRs 5 million from the Nordic Development Fund for the institutional capacity building component (of APL1 and APL2), which will be coursed through the Development Bank of the Philippines. The oversight role will be exercised by the Department of Interior and Local Government and Department of Finance through a Technical Working Committee comprising these two Departments and the DBP. This Committee will be responsible for overall coordination among the various components, with its working arrangements defined in a Memorandum of Agreement.

D: Project Rationale

1. Project alternatives considered and reasons for rejection:

The Philippine water sector has traditionally classified water utilities as being viable and non-viable. Financing and technical assistance has generally focused on viable water systems serving large cities and towns, where the full economies of scale could be realized. Non-viable systems, as in many of the smaller municipalities, have relied on sporadic grant financing (from bilateral donors or Congressional Development Fund grants from locally elected Congressmen and Congresswomen). A project alternative could have been to follow a traditional route of financing investments in larger, proven viable water districts in the country. This alternative was rejected because the project team questioned the distinction between viable and non-viable water utilities. At the heart of the distinction lies the political economy of tariff setting. If communities and LGU administrations could accept the idea that water supply and sanitation services should respond to what consumers want and are willing to pay for, most systems can, not only be made viable, but in fact even be attractive in terms of private sector participation.

The inclusion of three elements of the project discussed above--preparation of feasible technical options and their costs; agreement between service organizations and users regarding user valuation and user payment; plus assessment of feasible borrowing capacity of LGUs--have all been on the premise that any town can invest in viable systems, provided tariffs are set at a rate that reflects economic costs.

The project design, therefore, is focused on presenting options to users, and assisting them in deciding levels of service they want and are willing to pay for. In these small towns, consumers were willing to pay substantially higher prices for water than what was being traditionally charged by water utilities, provided services met their specific requirements in terms of service reliability, quality and access. These insights provide new institutional design options for the whole class of approximately 1000 LGU-managed water utilities that are traditionally described as "non-viable" water supply systems. The project design has built flexibility during planning and implementation, so that lessons learned are fed back in succeeding phases of the project to alter or modify project rules that are not working.

Providing the widest range of alternatives, on the technical, financial and institutional side thus forms the core of project design.

2. Major related projects financed by the Bank and/or other development agencies (completed, ongoing and planned).

Sector Issue	Project	Latest Supervision (PSR) Ratings (Bank-financed projects only)	
		Implementation Progress (IP)	Development Objective (DO)
Bank-financed Rural Water Supply and Sector Policy Framework Sewerage and sanitation development in secondary cities and introduction of public performance audit in Metro Manila Manila sewerage and sanitation development	First Water Supply, Sewerage and Sanitation Sector Project Water Districts Development Project (approved September 9, 1997)	S	S
	Manila Second Sewerage project (Effective in March 1998)	S	S
Other development agencies Asian Development Bank: Financing of water districts, MWSS investments OECD. Government of Japan: Financing of water districts investments Ausaid: Financing of water districts and LGU water supply systems KfW. Government of Germany French Protocol, Financing of MWSS investments	Small Towns Water Supply Project (1997-2002) Provincial Cities Water Supply Project (I through V) Baguio Water Supply Project, Northern Mindanao Water and Sanitation project Provincial Towns Water Supply and Sanitation Programs I and II Rizal Water Supply Project		

IP/DO Ratings: HS (Highly Satisfactory), S (Satisfactory), U (Unsatisfactory), HU (Highly Unsatisfactory)

3. Lessons learned and reflected in the project design:

The inclusion of the three elements of the project mentioned above--preparation of feasible technical options and their costs; agreement between service organizations and users regarding user valuation and

user payment; plus assessment of feasible borrowing capacity of LGUs--is expected to lead to the creation of viable systems. It is also expected to lead, in some cases, to the adoption of regional systems under the control of LGUs and the encouragement of private sector involvement in the sector, in both the management and operation of viable systems and in their financing. These features are based on the lessons learned from projects in the Philippines, and elsewhere in the world, with regard to service provisioning in low income communities, or where the community resource base is small.

The project design recommended follows substantial analytical work done by the Bank in the last decade. Willingness to pay studies showed, that consumers were willing to pay substantially higher prices for water than what was being traditionally charged by water utilities provided services met their specific requirements in terms of service reliability, quality and access. These insights have provided new institutional design options for what were earlier termed as "non-viable" water supply systems. The project design has built flexibility during planning and implementation, so that lessons learned are fed back in succeeding phases of the project to alter or modify project rules that are not working. Key economic, financial, organizational and technological rules will be defined during the appraisal process through the lessons learned from 12 subproject preparation activities. Project implementation will continue monitoring which of the rules worked and which did not work, and thus continually fine-tune the project design during the implementation of these subprojects.

4. Indications of borrower commitment and ownership:

Two of the primary platforms of government policy is to provide basic urban services to all city and town residents in the Philippines, and to build capacity in LGU administrations, so that decisions concerning services in a town are taken locally by the Mayor and Town Councils. The project development objectives, therefore, is fully consistent with the national government's interest in planning and management of local civic services through local institutions. The speed with which the national government departments, particularly DILG, has mobilized its staff and expedited project preparation attests the national government commitment to the project. The borrower, Development Bank of the Philippines, is also, as a part of its corporate mandate, interested in developing the LGU market for environmental-related investments.

5. Value added of Bank support in this project:

The World Bank is assisting the Government implement two such innovative demand-driven project in the Philippines through this project and the Water Districts Development Project. The value added by the Bank involvement is the global experience and multi-disciplinary support it brings at both the project design and implementation phases. There is also value added to the Bank's own learning experience of implementing a flexible project design.

E. Summary Project Analysis (Detailed assessments are in the project file, see Annex 8)

1. Economic (supported by Annex 4):

- Cost-Benefit Analysis : NPV=US\$ million; ERR = 21.26 %
- Cost Effectiveness Analysis
- Other

The major benefits of this project are improved water services to beneficiaries of LGU systems. These benefits are direct user benefits from water consumed and consumer surplus for users who now use less effective and more costly alternatives (such as buying water from vendors, relying on dugwells, rivers etc.).

The project offers improvements to LGUs who have expressed a willingness to participate and the improvements scaled to a level of service and a tariff which have been agreed with the beneficiaries. Thus, it is highly probable that user benefits calculated on the basis of expected revenues will be realized. In the initial batch of 12 towns in this phased project, the average economic internal rate of return based on conservative assumptions is 21.3 percent. The potential cost savings are also substantial and would raise the expected economic rate of return even higher. The results are robust since they link agreed user willingness to pay and cost of chosen technical solutions and as shown by sensitivity tests of possible reductions in revenue and increases in cost. Further information is provided in Annex 4.

2. Financial (see Annex 5): NPV=US\$ million; FRR = %

In the area of finance the project will aim to: (i) ensure financially viable systems through full recovery of both capital, and operating and maintenance costs; and (ii) strengthen prospects for commercial operations by broadening private sector participation in the financing and management of the water utilities. A methodology, utilizing a fully integrated long-term financial planning model, was developed for evaluating the borrowing capacities of the first 12 and subsequent generations of sub-projects. This involved three steps. First, a preliminary financial assessment was taken of each participating LGU to determine a total 5-year investment envelope for which a portion of which would be earmarked for water projects. Second, a total project budget ceiling was derived that would fit well within an affordability criteria of the finances of that LGU. Finally, tariff levels were derived based on a uniform formula which ensured full recovery of all capital and operating cost plus allow for a nominal return on the capital invested.

The tariff levels proposed are adequate to assure an adequate rate of return for a private operator interested in bidding for a long term affermage or lease contract. By the end of APL1, the project experience is expected to provide a more complete "road map" for private sector participants in water supply production and distribution. This should enable, by the end of APL2 for the program to more actively pursue the idea of attracting private financing into the sector.

At present many obstacles still exist for private banks to actively engage in extending credit to LGUs. On the one hand, domestic financing in long-term maturities are extremely scarce. Long term maturities in the private sector range between four to five years with a maximum of only seven years. However, recent developments for bridging the gap that currently exists in this market between the LGUs and private banks are extremely promising, as the banking community has begun to recognize the potential market in LGU lending. Whereas, just less than a year ago private banks often shunned the idea of lending to LGUs, now the focus is more on working out the mechanics by which this could be done. A private LGU credit guarantee facility has already been established to enable private banks to begin tapping this market. In order to complement this facility, an LGU credit rating system is being developed in the Philippines. Efforts are also under way to reform the accounting standards and reporting systems, so that the entire financial community can understand LGU financial management systems better.

The project will support these initiatives in the third APL project, when the DBP's financing facility will be converted to a wholesale operation involving private banks in lending to LGUs for the water infrastructure projects. Such an operation is essential for achieving the high volume target of facilitating the participation of 250 LGUs from the program by 2007.

Fiscal Impact:

The counterpart funding will be provided by LGUs from their internally generated revenues and Internal Revenue Allocations (IRAs). Hence there will be no fiscal impact at the national level. All participating LGUs have signaled their interest in encouraging the constructed facilities to be leased out to the private sector. In subprojects where the facilities are successfully bid out, the affermage fees are expected to fully amortize the loans. Annex 4 provides a summary of the fiscal impacts in the LGUs appraised for the project.

3. Technical:

The project will finance civil works and equipment for improved water supplies for about thirty five small towns in the Philippines. It will also finance the construction of on-site sanitation and micro-drainage system in participating towns to mitigate some minimum negative environment impacts that might result from the increase of wastewater. Detailed engineering designs have been completed for twelve towns selected for Phase I. These studies have been prepared with assistance of a reputed local consultant in collaboration with DILG, and have been reviewed by the Bank team. Based on this experience, a technical memorandum has been prepared, which includes technical design standards based on proven local and international experience. Innovative approaches that have been introduced for technical and practical reasons have been flagged for monitoring during implementation.

In order to enhance the prospects of efficiency and sustainability of investments, selection of participating towns has been demand-driven, entailing intensive and iterative consultations with households, communities and dialogue with legislative and administrative branches of the LGUs. For those towns where demand has been expressed at all the three levels, detailed engineering design was completed for the 12 towns by September 1, 1998. The drop-out rate during the consultation and dialogue process has been almost 30% of the towns. However, lessons learned in Phase I, particularly with regard to the high drop-out rate, are being used in planning feasibility studies in the remaining towns in Phase II of the project.

During implementation, engineering consultants will assist the local government in the supervision of construction. For the towns that have made the option for possible private operation, the prospective private operator will be in charge of the quality control during the construction phase.

4. Institutional:

a. Executing agencies: The borrower for the investment components of the project will be the Development Bank of the Philippines, which will on-lend the loan proceeds to participating LGUs. For the technical assistance components of the project, cofinanced by the Nordic Development Facility (NDF) the borrower will be the Development Bank of the Philippines, which will blend IBRD funds and other concessional loans/grants from bilateral assistance. The Development Bank of the Philippines will on-lend the technical assistance funds as either soft loans or a fee to participating LGUs and Water Districts under the overall supervision of the Technical Working Committee. A credit agreement has been signed between the DBP and NDF in this regard.

b. Project management: Project management will be the responsibility of the Development Bank of the Philippines, which has established a Project Management Office (DBP-PMO) to administer the project. As the project is the first APL of three IBRD-financed loans, the Water Supply and Sanitation Project Management Office of DILG (WSS-PMO) will continue functioning in its role of "advocacy, brokering and capacity building", by facilitating and managing the process of preparing new batches of subprojects according to the project rules. Consultants will provide technical assistance, as and when required. For overall coordination among the components, a Technical Working Committee comprising of the

DBP-PMO, DILG-WSSPMO and DOF has been established. A Memorandum of Agreement defining respective agency responsibilities has been entered into by these three agencies.

5. Social:

For the twelve LGUs under the first batch, no resettlement is expected. No major social issue has either been identified in the surveys conducted or raised during the consultation meetings with the LGU administrations and the barangays (communities). However, Guidelines on Resettlement and Compensation of Land and Other Assets consistent with Bank policies have been prepared to deal with land acquisition and other matters which may have a negative social impact in future batches of projects.

The guidelines provide principles and instructions on: (i) minimizing land acquisition and subsequent displacement; (ii) compensation to all project affected persons including non-title holders; (iii) replacement of productive assets and amenities; and (iv) provision of rehabilitation measures and transitional allowances.

More importantly, based on the lessons learned preparing the first phase projects, the guidelines simplify the process of consultation and the roles and responsibilities of the LGUs, so that while the project design principles are adhered to, all owners of assets and occupants of land likely to be affected by the proposed investments are properly consulted before final decisions are taken.

6. Environmental assessment : Environment Category A B C

The project is expected to have mainly positive environmental and public health impacts through the provision of affordable clean and more reliable individual water supply connections to residents of small towns in the project LGUs. There is potential for some negative impacts, mainly resulting from the wastewater which needs to be disposed off in these small urban areas without a piped sewerage system. However, these potential negative impacts can be mitigated and managed through actions by the public authorities and the individual households concerned.

Environmental assessments (EA) have been prepared by consultants for each of the first batch of LGUs, together with environmental management plans (EMP) which focus on individual sustainable on-site sanitation solutions plus mitigative actions by LGUs (available in project files for the EA and EMP for the first batch).

In order to guide the preparation of EAs and EMPs for subsequent batches of LGUs, an operational manual for EA has also been developed. The emphasis of the EA process for this project is less on the assessment of the obvious, generic impacts but more on their ongoing management, including the protection of the raw water sources (mainly groundwater). These EA procedures are in compliance with Philippines regulations for sanitation and environmental protection which are consistent with the Bank's OD 4.01 (Environmental Assessment).

Mitigative actions will be supported through capacity building, in particular training of local health officers and sanitation inspectors. The National Government will provide adequate funds for local capacity building, the project envisages that LGUs may on-lend a portion of their subloans to individual households for on-site sanitation improvements, based on full cost recovery. The NDF cofinancing is expected to build municipal capacity for sound environmental management. A part of the cofinancing will also prepare future batches of sewerage projects in LGUs facing the most severe problems of municipal pollution.

7. Participatory Approach (key stakeholders, how involved, and what they have influenced or may influence: if participatory approach not used, describe why not applicable):

a. Primary beneficiaries and other affected groups:

The participatory approach adopted by this project is expected to expose the potential negative environmental impacts and to raise awareness of the LGUs and the communities for the need for good environmental management.

During the project preparation stage, five significant activities demonstrated the characteristics of a demand-oriented participatory project. These were:

1. A letter of intent signed by the Municipal Mayor and in some municipalities, a Sangguniang Bayan (Municipal Council) Resolution were submitted to the Department of Interior and Local Government (DILG) signifying the interest of the municipal LGU in participating in the proposed project;
2. Results of the feasibility study and socio-economic surveys i.e. technical options, management options, financial assessment and cost recovery options were presented to the Municipal Mayors and Sangguniang Bayan for assessment of LGU's capacity and decision-making in assuming the responsibilities required by the Project. The agreements and decisions made among the members of the Municipal Council was embodied in a SB Resolution.
3. The content of the SB Resolution are: (i) the willingness of the municipal LGU to delegate the day-to-day management of the water utilities through supervision contracts to professional water management organizations; (ii) to adopt water tariff rates to levels that will ensure system sustainability; (iii) to undertake specific investments to ensure that there are no adverse environmental impacts from augmented water supply; (iv) to borrow from a recommended government financing institution (GFI) on terms and conditions specified by the national government; and (v) that 25% of the total project cost will be provided by the local government unit as their counterpart contribution.
4. The provisions of the SB Resolution were presented and discussed in a series of meetings with the barangays (village) that will be served by the project. The result of the barangay meetings is the signing of the Willingness-to-Connect (WTC) form by individual households. The WTC is a clear measure of demand at the household/community level. At least 60% of the target households to be served by the water supply project should sign and submit this document so that the project will proceed to implementation. If a number below 60% is reached, the project will not be implemented even if there is a demand at the LGU level. The Project believes that demand should be demonstrated at both LGUs and communities levels since the responsibilities of making the Project work also belong to both LGUs and communities. With the 12 municipalities for the first batch, a demand between 65-70% WTC has been generated.
5. The results of the barangay meetings, WTC and the detailed engineering design were presented to the Mayor and the Sangguniang Bayan. This led to the adoption of the final SB resolution designating authority to the Municipal Mayor to sign a subsidiary loan agreement in behalf of the municipality with the DBP after the loan is approved by the World Bank.

All of the 5 activities mentioned above underwent an iterative process of (i) information dissemination; (ii) discussions; (iii) decision-making; and (iv) commitment and responsibility, summarizes the participatory process adopted by the project team.

b. Other key stakeholders:

During the process of community participation, key stakeholders at the community level, including NGOs, religious organizations and cultural organizations are consulted. It is also expected that this involvement will be continued after project implementation, in order to ensure that: (i) the water supply services are sustained by the community maintaining oversight over the system operator, and (ii) adequate information dissemination takes place so that communities access the sanitation facility for household sanitation improvements.

F: Sustainability and Risks

1. Sustainability :

- The sustainability of project benefits depend on four key factors, as specified in the Operational Manual:
- (i) the full participation and ownership of stakeholders in the design, implementation and operation of the project;
 - (ii) clarity in fund channeling rules, particularly with regard to LGU commitments, contributions, and responsibilities of LGUs, communities and households;
 - (iii) flexibility in engineering design in order to meet specific service requirements of communities in a sustainable manner, and
 - (iv) outsourcing of operations and maintenance responsibilities to the private sector, as much as possible

2. Critical Risks (reflecting assumptions in the fourth column of Annex 1):

Risk	Risk Rating	Risk Minimization Measure
<p>From Outputs to Objective Newly elected LGU administrations will remain committed to agreements between the project and communities</p>	S	<p>1. Sign-off from at least 60 per cent of community was required as evidence of stakeholder commitment to the project 2. Repeated consultations with stakeholders will be ensured through the project cycle 3. The Subloan Agreements and lease contracts will address mitigation of political risks</p>
<p>Successor LGU administrations will remain committed to maintaining agreements with regard to tariffs and honoring long-term contracts with the private sector for operations and maintenance.</p>	H	<p>1. Contracts with operators will include substantial penalties to be recovered from an escrow account maintained by the DBP</p>
<p>Participating LGUs will agree to the provisions of the lease contract particularly the setting up of an escrow account at the DBP and will agree to allocate the needed resources. This was not earlier considered in the 12 pilot towns.</p>	H	<p>2. Contracts will have duration of at least fifteen years in order to insure the operator from political cycles.</p>
<p>Lessons learned from APL process generate support in national government and among other donors</p>	M	<p>Regular consultative meetings will be held to share experiences and work out consensus among sector agencies, government departments and donors</p>

From Components to Outputs		
DBP-PMO is established	N	A condition for Board Presentation
DBP-PMO and DILG work effectively in preparing second batch for implementation in 1999	M	Technical Working Committee to oversee the project work already established by the GOP
Cofinancing of technical assistance is available on time	M	Cofinancing arrangements with the NDF is a condition for Board Presentation
Overall Risk Rating	S	The Adaptable Program instrument allows the Bank and the national government test out methodologies and proto-type design before scaling up. The returns from successful implementation are very high

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

3. Possible Controversial Aspects

A potential area of controversy is that the Mayors and LGU residents might object to project beneficiaries paying much higher water tariffs compared to the more well-off residents of neighboring water districts, who benefit from existing policies of cross-subsidization by industrial/commercial consumers and local system economies of scale. The controversy will subside if the private sector is able to deliver services efficiently, so that consumers get value for the money they pay.

Another potential area of controversy is that affermage contracts may eventually lead to operators negotiating exclusive rights to develop other raw water sources in the LGU. Greater coordination and consistency between the water resource management aspect and water supply management aspect is urgently necessary, so that pricing of raw water reflects its opportunity costs. This is an issue for the national government agencies and the Bank project teams to monitor closely, as a part of the on-going policy dialogue.

G: Main Loan Conditions

1. Effectiveness Conditions

Conditions for Negotiations were:

1. A draft policy framework for land acquisition and resettlement has been prepared, and will be confirmed during negotiation. between the Bank and the Development Bank of the Philippines
2. LGUs will have to pass a Municipal Council Resolution signaling their desire to participate in the project before negotiations
3. The Resolution will confirm the LGU's acceptance of the condition that (a) the water utility will be separated from other municipal departments, and that it will begin functioning as an organization independent of municipal budgetary and accounting system, (b) tariffs will be charged on the basis of at the minimum covering operations and maintenance costs, and (c) outsourcing of operational functions would be undertaken as much as practicable.
4. The GOP will establish a Technical Working Committee at the national level to oversee project implementation before negotiations.
5. The Technical Working Committee will adopt the Project Operational Manual.
6. Finalization of a Letter of Sector Development Policy by the Government of the Philippines before negotiations.

Conditions for Board Presentation are:

1. The Government of the Philippines will approve the Credit Agreement with the Nordic Development Fund for cofinancing the technical assistance aspects.
2. The Government of the Philippines approves the offer of European Union Grant assistance for the proposed Water Utilities Private Sector Participation Facility.
3. The Development Bank of the Philippines will establish a fully functioning Project Management Office (DBP-PMO)

Condition for Effectiveness:

1. Subloan Agreements have been executed on behalf of the Development Bank of the Philippines and at least ten participating LGUs.
2. The Grant Agreement has been executed between the Republic of the Philippines and the European Union, in order to operationalize the Water Utilities Private Sector Participation Facility.
3. The Loan Agreement has been executed between the Nordic Development Fund and the Development Bank of the Philippines.

2. Other [classify according to covenant types used in the Legal Agreements.]


1. Subsidiary Loan Agreements are finalized between the DBP and each participating LGU
2. Each participating LGU establishes a Project Management Unit
3. DBP shall furnish to the Bank (i) semi-annual reports on or about April 30 and October 31 of each year commencing April 30, 1999, and (ii) a mid-term report on or about June 30, 2000.

H. Readiness for Implementation

1. a) The engineering design documents for the first year's activities are complete and ready for the start of project implementation.
1. b) Not applicable.
2. The procurement documents for the first year's activities are complete and ready for the start of project implementation.
3. The Project Implementation Plan has been appraised and found to be realistic and of satisfactory quality.
4. The following items are lacking and are discussed under loan conditions (Section G):

I. Compliance with Bank Policies

1. This project complies with all applicable Bank policies.
2. The following exceptions to Bank policies are recommended for approval. The project complies with all other applicable Bank policies.


Vijay Jagannathan
Team Leader


Keshav Varma
Sector Manager/Director


Vinay K. Bhargava
Country Manager/Director

Annex 1: Project Design Summary

LGU Urban Water and Sanitation Project

Hierarchy of Objectives	Key Performance Indicators	Monitoring & Evaluation	Critical Assumptions
<p>Sector-related CAS Goal: Living standards in Philippine towns and cities improved.</p>	<p>Sector Indicators: Improving trends in public health and urban environmental indicators by 2020: 1. 90% of LGU residents receive reliable water supply, at least 16 hours a day. 2. 90% of urban population has access to safe drinking water. 3. In the 20 largest cities outside Manila 80% of wastewater is collected and treated.</p>	<p>Sector/ country reports: 1. National Policy documents on urban service provisioning and living standards. 2. World Development Report and other internationally compiled documents on basic urban service provisioning. 3. Benchmark Philippines sector performance and compare to other developing countries.</p>	<p>(from Goal to Bank Mission) 1. Government adherence to its strategy, as stated in the NEDA Board Resolutions, remains committed</p>

Hierarchy of Objectives	Key Performance Indicators	Monitoring & Evaluation	Critical Assumptions
<p>Program Purpose: Reliable and sustainable water and sanitation services provided by commercially operated enterprises to secondary cities and towns of the Philippines.</p> <p>Phase I (APL1): Proto-typing and testing a demand-based framework, that provides participating LGUs with sustained water and sanitation services, and provides incentives for private sector participation.</p> <p>Phase II (APL2): Based on the lessons learned from APL1, adjusting and modifying the project design, and applying it to about 100 LGUs in order to create a sufficiently large market to attract a PSP-led water operators industry.</p> <p>Phase III (APL3): APL2 generates sufficient private sector operator interest to attract private financing of water supply infrastructure. This would enable a further scaling up in LGU coverage, with the role of DBP changing from a retailer to a wholesaler of financing to private sector banks interested in water supply and sanitation infrastructure investments.</p>	<p>End-of-Program Indicators: Program implementation strategy fully integrated into the national policy by 2007:</p> <ol style="list-style-type: none"> 1. The program design is replicated through a number of successor projects by the NG and ODA financing. At least one successor projects by OECF or ADB. 2. At least \$ 25 million of PFI investments by the end of APL3. 3. Subsidies from the national government to the water sector are reduced to zero for level III systems (i.e. systems with house connections). 4. PSP arrangements take place in at least 50% of the water utilities receiving investments. 5. Amalgamation of neighboring systems is accomplished wherever a cluster of small LGUs access project investments. 6. Performance indicators of water utilities in the program are significantly better than LWUA averages: (see standard performance indicators list below). 7. Participating towns provide at least 16 hours of water supply a day. 	<p>Program reports: NEDA and DILG monitor and evaluate policy lessons for the sector through:</p> <ol style="list-style-type: none"> 1. NEDA-sponsored national policy documents 2. Sector Reports from World Bank and other donors 3. Program Completion Report 	<p>(from Purpose to Goal) 1. Lessons learned from the APL process are going to generate support in the national government, and among other major donors.</p>

Hierarchy of Objectives	Key Performance Indicators	Monitoring & Evaluation	Critical Assumptions
<p>Project Development Objective:</p> <p>1. Provision of improved and sustainable access to water supply and sanitation in about 35 pilot project towns.</p>	<p>Outcome / Impact Indicators:</p> <p>1. 30% of the participating LGUs in the first and second batch of APL1 successfully complete project implementation (i.e. provide the planned quality water supply to communities).</p> <p>2. One third of those LGUs contract with the private sector to operate and maintain the newly constructed systems.</p> <p>Impact indicators of APL1 in participating LGUs in Year 2002:</p> <p>Water Supply component (see project documents per details)</p> <ul style="list-style-type: none"> - Increase in water supply in cu. meters (target vs. actual) Service coverage increase (target vs. actual) - Service reliability (target vs. actual) - Financial ratios of LGU water utilities - Unit price of vended water <p>Sanitation component</p> <ul style="list-style-type: none"> - On-site systems (target vs. actual) 	<p>Project reports:</p> <p>DILG monitors and evaluates success in implementing NEDA Board Resolution No. 4 and 6 with assistance from DBP-PMO through:</p> <ul style="list-style-type: none"> · Semi-annual progress reports · Supervision mission reports · Program mid-term Reviews · Consumer surveys and public performance audits 	<p>(from Objective to Purpose)</p> <p>1. Successor LGU administrations will remain committed to maintaining agreements with regard to tariffs and honoring long-term contracts with the private sector for operations and maintenance</p>

Hierarchy of Objectives	Key Performance Indicators	Monitoring & Evaluation	Critical Assumptions																
Output from each component: 1. Water supply systems in project towns constructed. 2. Project Operational Manuals designed and approved	Output Indicators: 1.1 Ten systems are completed and operational according to approved design specifications by negotiation. 2. Project Management Office in DBP operational by Board Presentation. 3. NDF Credit Agreement is signed by the DBP by Board Presentation	Project reports: DBP-PMO and DILG through: · Semi-annual progress reports · Supervision mission reports · Evaluation mission reports	(from Outputs to Objective) 1. Newly elected LGU administrations will remain committed to agreements between the project and communities; 2. IRA allocations to LGUs will continue																
Project Components / Sub-components: (Phase I) Completion of feasibility studies in Batch 1 towns Finalization of PSP contracts Completion of feasibility studies in Batch 2 towns Investments in water supply Sanitation Drainage Technical assistance for water supply, sanitation and drainage	Inputs: (budget for each component) <table border="1" data-bbox="479 829 779 1085"> <thead> <tr> <th>Target</th> <th>Actual</th> </tr> </thead> <tbody> <tr> <td>\$0.40</td> <td>\$0.40</td> </tr> <tr> <td>\$0.10</td> <td></td> </tr> <tr> <td>\$0.70</td> <td></td> </tr> <tr> <td>\$22.63</td> <td></td> </tr> <tr> <td>\$1.55</td> <td></td> </tr> <tr> <td>\$0.78</td> <td></td> </tr> <tr> <td>\$1.90</td> <td></td> </tr> </tbody> </table>	Target	Actual	\$0.40	\$0.40	\$0.10		\$0.70		\$22.63		\$1.55		\$0.78		\$1.90		Project reports: DBP-PMO and DILG through: · Semi-annual progress reports · Supervision mission reports · Project Implementation Plan	(from Components to Outputs) 1. DBP-PMO is established at by Board presentation 2. DBP-PMO and DILG work effectively in preparing second batch for implementation in 1999 3. Co-financing of technical assistance is available on time
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\$0.40	\$0.40																		
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\$1.55																			
\$0.78																			
\$1.90																			

Annex 2: Project Description

LGU Urban Water and Sanitation Project

By Component:

Project Component 1 - US\$23.3 million

Water Supply

This component will finance civil works, equipment and supervision for improved water supply systems for small towns that have traditionally been viewed as having “non-viable” and poorly functioning water utilities normally managed by municipal agencies themselves. Selection of project towns and technical options to be used in them have been demand driven, using consultations at household, community (Barangay), and local government levels, based on the project team's assessment of borrowing capacity using the GOP guidelines and a long-term financial planning model developed for this purpose. This component will finance the construction of new systems as well as the rehabilitation and expansion of existing systems. The constructed systems will be operated and managed, as far as practicable through leasing (affermage) and management contracts with private sector operators. Otherwise, the LGU concerned shall create an independent water utility duly registered under Philippine laws.

Project Component 2 - US\$1.6 million

Sanitation Program

This component will finance physical improvements in household toilets, on-site sanitation facilities, including soakaway pits for septic tank effluents or the disposal of wastewater flows arising from augmented water supplies hygiene education. Funds will be on-lent to the LGUs and would be administered by the water supply operators and recovered from the water bills on an installment basis over five years. Selection of beneficiaries will be demand driven and on the basis of first come first served.

Project Component 3 - US\$ 0.8 million

Urban Drainage Program

This component will finance investments and consultant services in micro-drainage infrastructure. Selection of towns for this component will be demand driven except where it would be encouraged to mitigate adverse impacts of the augmented water supplies.

Project Component 4 - US\$1.5 million

Water Utilities Private Sector Participation Facility: A number of LGUs and Water Districts have been receiving proposals from the private sector for participation in their operations, most frequently through unsolicited offers for BOT (build, operate and transfer). Experience from recent water utility privatization in the Philippines has shown that evaluation of such proposals is highly complex and procedures cumbersome enough to induce the spread of non-competitive alternatives in the market. This Facility, which will provide concessional TA from the EU (\$ 1.5 million to be recovered through a success fee), will be through the creation of a revolving pre-investment fund. The Facility will finance a technical assistance program to help LGUs and Water Districts prepare Information Memoranda as a basis of bidding by private operators, evaluate such proposals, and identify the most appropriate form of more competitive private sector involvement. EU cofinancing will finance preparatory work, such as feasibility studies, financial analysis and legal options studies leading up to the finalization of an Information Memorandum. The component cost will be recovered through success fees.

Project Component 5 - US\$2.5 million

Support for Preparation of Next Batches of Projects: This component, which will provide concessional TA from the Nordic Development Fund (NDF) and other bilateral donors will cofinance this component through the creation of a revolving fund from which LGUs can access resources for:

(a) Water Supply: Feasibility studies and detailed engineering designs for approximately another 80 towns, to be selected in a demand-driven way from towns that have confirmed commitment to participate on the basis of project rules. Several bilateral donors are currently examining these subprojects for possible funding through grant financing from their respective Consultant Trust Funds and bilateral assistance programs. Hence no separate cost estimate has been included.

(b) Sewerage development in secondary cities: Improvements in water supply and increasing concerns about the impact of pollution on availability of water and other environmental amenities are increasing the potential demand for sewerage systems. DENR has identified a list of 16 cities that need substantial investments in sewerage to mitigate the adverse impacts of municipal pollution.

Project Component 6 - US\$2.0 million

Institutional Capacity Building Program: This component, which will provide technical assistance at concessional rates will be co-financed by the NDF, and continued into APL2. The cost estimate for APL1 is US\$2 million. The Program is designed to strengthen managerial and technical capacities of organizations and staff that will be involved in (i) the implementation of the project, (ii) the regulation of private operators (if applicable), and (iii) assisting LGUs build institutional capacity and appropriate training programs.

I. Role of Capacity Building Program: The Capacity Building Program will respond to the need for assisting the LGUs to effectively and efficiently carry out their roles and responsibilities as outlined in the implementing Rules and Regulations (IRR) of NEDA Board Resolution No. 4 (Series of 1994):

Financing – The LGUs shall be responsible for mobilizing resources to finance water supply improvements through their own resources, through borrowing or by tapping private sector financing;

Management – LGUs shall adopt commercial principles in the operation and management of water utilities in order to provide cost-effective and reliable services to consumers whether management of the system is a direct responsibility of the LGU or is contracted out to the private sector;

Project Planning and Development – LGUs shall be required to prepare and update, on an annual basis, their sector plans consistent with the National Master Plan for the Sector;

Approval and Award of Contracts – The LGUs shall be required to conduct public bidding in accordance with the provisions of law and shall have the final authority to approve and award contracts for water supply and sanitation projects within their jurisdictions;

Application for Water Rights - LGUs or concerned water utility shall apply for water rights from the NWRB prior to implementing a project that would require extraction of water;

Public Performance Audit – The LGUs shall establish a system of public performance audit for public and private water utilities focusing on critical performance indicators; and

Formation and Capacity Building of BWSAs/RWSAs – The LGUs are responsible for organizing and training the BWSAs and RWSAs to operate and manage Level I and II water systems, respectively and for providing assistance in registering the same with the designated registering body.

II. Assistance in improving management of LGU water utilities: The Project envisages two management options:

- management by LGU through the setting up of a separate economic enterprise or a water utility registered as an SEC company, and
- delegation of system management responsibility to the specialized private sector entities through a suitably crafted contract that protects the interests of the LGU (which is the borrower of the loan), consumers (who desire value in terms of services for the money they pay), and the operator (who would require transparency in price setting and regulatory arrangements) or service contractors providers (such as, for billing and collection etc.). In situations where the LGUs decide to set up a separate economic enterprise, additional technical assistance will be necessary.

III. Training Programs: There will be training needs at the levels of the participating LGUs, as well as at the national level. The training for LGUs will be categorized into:

(a) General Training – This will involve the implementation of training program for all participating LGUs covering the following subjects:

- Water Utility - LGU Roles, Responsibilities, Performance Monitoring and Regulatory protocols
- Lease or Management Contract Supervision
- LGU Financial Planning and Investment Management
- Implementing the Environmental Monitoring and Management Plan
- Public Performance Audit
- Supervision of sanitation investments by households

(b) Specific Training: This will cover training to suit the public managed water utilities (i.e. under LGU Management)

- Water System Management - Operations and Maintenance Protocols for Water Supply production, transmission and distribution systems
- Development of procedures for managing water utilities on the basis of commercial principles - Billing, Collection protocols
- Efficient administration of contracts with service providers, including development of standard contracting forms
- Bookkeeping and Financial Management procedures

IV. Equipment and Other Resources: Capacity building will also include the provision of logistical support and equipment as well. The following equipment are proposed to be financed as a part of the capacity building component of the Project:

- Provision of computers and equipment for the Public Water Utilities under LGUs Management;
- Provision of computers and two cars for DILG - PMO monitoring and supervision;
- Printing, reproduction and dissemination of pertinent literature reference materials, documents, kits, handbooks; and
- Preparing of Newsletter and other information dissemination type of activities to sharing the best

practices.

In order to maintain consistency and focus with the APL Program objectives, an annual institutional capacity building program review will be conducted jointly between the national government, represented by the Technical Working Committee, the NDF and the World Bank.

Second LGU Urban Water and Sanitation Project (APL2)

Likely conditions to Proceed for APL2: To be met before commitment of APL2:

- Devolution of operation, management, and revenue collection responsibilities under long-term commercial arrangements in 12 LGUs;
- Project-funded system improvements fully operational in 10 LGUs

APL2 Development Objective : Devolve operation and management of water supply and sanitation services to qualifying commercial entities in 80 LGUs, together with continued improvement in the service delivery and financial sustainability in the participating LGUs (2001-2004)

The IBRD-Funded Project (US\$60 million) would likely finance : construction of water supply and sanitation facilities in 80 LGUs throughout the Philippines, focusing on the facilitation of subregional systems, wider involvement of different forms of private sector participation in those water utilities, and improved institutional capacity in participating LGUs

Other donors would likely finance technical assistance under Cofinancing arrangements (US\$ 7 Million): completion of feasibility studies using the LGUWSP design principles, continued expansion in the use of the Water Utilities Private Sector Participation Facility, institutional capacity building in LGUs, particularly with regard to local environmental management, financial management and staff training..

Financing by LGUs participating in the Project (US\$20 million): This would provide LGU equity for the project in the form of land acquisition and equity finance from internal resources.

Project Financing Data (Indicative)		Processing Time Table (Tentative)	
IBRD Loan:	\$60 million	Appraisal	December 1999
Bilateral Cofinancing	\$7 million	Negotiations	February 2000
LGU Equity	\$20 million	RVP Approval	March 2000
Total:	\$87 million	Effectiveness	May 2000

Estimated Disbursement (US\$ million)	FY01	FY02	FY03	FY04

Annual	10	15	15	20
Cumulative	10	25	40	60

Likely conditions to Proceed for APL3:

- Devolution of operation, management and revenue collection responsibilities under long-term management contracts and leasing arrangements in 40 additional LGUs
- Achievement of a working ratio less than 0.50 in at least 80 LGU water utilities receiving financing from APLs 1 and 2
- Achievement of at least 16 hours of water per day to connected households in participating urban areas with completed systems through APLs 1 and 2 investments
- Average of 80% of consumers satisfied with service performance in participating LGUs
- At least 60% of households in a barangay connected to the water supply system

Third LGU Urban Water and Sanitation Project (APL3)

APL3 Development Objective : Devolve operation and management of water supply and sanitation services to qualifying commercial entities in 130 LGUs, together with continued improvement in the service delivery and financial sustainability in the participating LGUs, and graduation of GFIs from retail financing to wholesale financing (2003-2007)

The IBRD-Funded Project (US\$100 million) would likely finance : construction of water supply and sanitation facilities in 130 LGUs throughout the Philippines, focusing on the facilitation of subregional systems, wider involvement of different forms of private sector participation in those water utilities, and improved institutional capacity in participating LGUs

Other Donors would likely finance technical assistance under Cofinancing arrangements (US\$ 3 Million): completion of feasibility studies using the LGUWSP design principles, continued expansion in the use of the Water Utilities Private Sector Participation Facility, institutional capacity building in LGUs, particularly with regard to local environmental management, financial management and staff training.

Private Financial Institutions (US\$20 million) would likely cofinance: construction of water supply and sanitation facilities in the subregional systems envisaged in the project.

Financing by LGUs participating in the Project (US\$13 million): This would provide LGU equity for the project in the form of land acquisition and equity finance from internal resources.

Project Financing Data (Indicative)		Processing Time Table (Tentative)	
IBRD Loan:	\$100 million	Appraisal	December 2001
Bilateral Cofinancing	\$3 million	Negotiations	February 2002

Private Financing \$20 million
 LGU Equity \$13 million
 Total: \$136 million

RVP Approval
 Effectiveness

March 2002
 May 2002

Estimated Disbursement (US\$ million)	FY03	FY04	FY05	FY06	FY07
Annual	10	20	20	30	20
Cumulative	10	30	50	80	100

**LOCAL GOVERNMENT UNIT URBAN WATER SUPPLY AND SANITATION PROJECT
 (LGU-UWSSP)
 As of October 15, 1998**

List of Municipalities with Letter of Intent

REGION	PROVINCE		MUNICIPALITIES	
CAR	Abra	1	Dolores	
		2	Pinukpok	
			3	Rizal
			4	Tabuk
I	Ilocos Norte	5	Laoag City	
		6	Pinili	
	Ilocos Sur	7	Sinait	
II	La Union	8	Rosario	
		Isabela	9	San Pablo
			10	Sto. Tomas
			11	Delfin Albano
			12	Sta. Maria
	13		San Mariano	
	Nueva Vizcaya	14	Naguillan	
		15	San Isidro	
		16	Ambaguio	
	Quirino	17	Bagabag	
18		Solano		
III	Pampanga	19	Aglipay	
		20	Nagtipunan	
		21	San Simon	

IV	Batangas	22	San Luis	
	Laguna	23	Pangil	
		24	Pila	
		25	Rizal	
	Quezon	26	Sariaya	
		27	Bordeos	
		28	Gen. Malvar	
		29	Mauban	
		30	Panukulan	
		31	Patnanungan	
		32	Pagbilao	
		33	Palilio	
		34	Sampaloc	
		Marinduque	35	Tayabas
			36	Infanta
			37	Jumalik
			38	Real
	39		Lucban	
	Marinduque	40	Boac	
		41	Gasan	
	Oriental Mindoro	42	San Teodoro	
		43	Baco	
		44	Calapan	
		45	Victoria	
		46	Bansud	
		47	Gloria	
		48	Bongabong	
		49	Mansalay	
		50	Calapan	
		51	Roxas	
	Palawan	52	Puerto Princesa City	
		53	Aborlan	
		54	Bataraya	
		55	Brook's Point	
		56	El Nido	
		57	Narra	
		58	Quezon	
		59	Rizal	
		60	Roxas	
		61	San Vicente	
		62	Taytay	
		63	Kalayaan	
		64	Sofronio Espanola	
		65	Agutaya	
		66	Araceli	
		67	Abordo (Linacapan)	
		68	Busuanga	

		69	Coron
		70	Cuyo
		71	Dumaran
		72	Cagayancillo
		73	Balabac
		74	Magsaysay
		75	Culion
V	Camarines Sur	76	Garchitorea
		77	Minalabac
		78	Gainza
		79	Tinambac
		80	Bula
	Sorsogon	81	Pilar
VI	Iloilo	82	Balasan
		83	Banate
		84	Miagao
		85	Batad
	Guimaras	86	Sibunag
	Negros Oriental	87	Bais City
		88	Ayungon
		89	Bindoy
		90	Valencia
		91	Guihulngan
		92	Vallehermoso
		93	Dauin
VII	Cebu	94	Badian
		95	Sogod
	Bohol	96	Antequerra
		97	Corella
		98	Loboc
		99	Dimiao
		100	Mabini
		101	Ubay
		102	Duero
VIII	Biliran	103	Cabugcayan
		104	Kawayan
	Eastern Samar	105	Calbayog City
	Leyte	106	Julita
	Southern Leyte	107	San Juan
	Western Leyte	108	Almagro
		109	daram
		110	Marabut

		111	Pagsanghan
		112	Paranas
		113	San Jorge
		114	Sta. Margarita
		115	Tagapul-an
		116	Talalora
		117	Zumarraga
		118	Basey
IX	Zamboanga del Sur	119	Ramon Magsaysay
		120	Midsalip
		121	Sominot
		122	Titay
		123	Tungawan
		124	Rosales
		125	Vincenzo Sagun
		126	Margosatubig
		127	San Miguel
		128	San Pablo
		129	Bayog
		130	Siay
		131	Tabina
		132	Labangan
		133	Malangan
		134	Guipos
		135	Pagadian City
		136	Ipil
		137	Molave
		138	Diplahan
X	Bukidnon	139	Kitaotao
		140	Cabanglasan
		141	Kadingilan
		142	Damulog
		143	Dangcaagan
		144	Pangantucan
		145	Manolo Fortich
	Misamis Oriental	146	Salay
		147	Talisayan
		148	Balingasag
	Misamis Occidental	149	Don Victoriano
	Camiguin	150	Sagay
		151	Mahinog
XI	Davao del Sur	152	Matanao
		153	Sulop
		154	Malalag
		155	Sta. Maria
		156	Padada
		157	Hagonoy
		158	Kiblawan

	Davao del Norte	159	Kapalong
		160	Sto. Tomas
	Lanao del Norte	161	Magsaysay
		162	Sapad
		163	Sultan naga Dimaporo
		164	Maigo
		165	Kapatagan
		166	Kolambogan
		167	Lala
		168	Salvador
XII	North Cotabato	169	Matalam
		170	Magpet
		171	Carmen
	Sultan Kudarat	172	Bagumbayan
CARAGA	Agusan del Sur	173	Trento
		174	Veruela
		175	Sta. Josefa
		176	Loreto
		177	Talacogon
	Surigao del Norte	178	Burgos
		179	Claver
		180	Dapa
		181	Sison
		182	Taganaan
		183	Placer
		184	Bakuag
		185	Gigaquaet
		186	Plaber
		187	Tubod
		188	Alegria
		189	Mainit
		190	San Francisco
		191	Malimuno
		192	
	Surigao del Sur	193	Carrascal
		194	Lanuza
		195	Dinagat
ARMM	Tawi-Tawi	196	Bongao

Annex 3: Estimated Project Costs

LGU Urban Water and Sanitation Project

Project Cost By Component	Local US \$million	Foreign US \$million	Total US \$million
Water Supply construction	10.8	8.6	19.4
Supervision during construction	0.9		0.9
Sanitation	1.2		1.2
Hygiene education for sanitation	0.2		0.2
Drainage	0.6		0.6
Consultant for drainage	0.1		0.1
Total Baseline Cost	13.3	8.6	22.4
Physical Contingencies	1.3	0.8	2.1
Price Contingencies	0.7	0.4	1.1
Total Project Costs	15.8	9.8	25.6
Front-end fee		0.2	0.2
Total Financing Required	15.8	10.1	25.9

Annex 4: Cost Effectiveness Analysis Summary

LGU Urban Water and Sanitation Project

Summary of benefits and costs:

The project aims to test a demand-based framework in the provision of water services in about 250 towns nationwide which are deemed non-viable systems under existing sector rules. The initial phase to be funded under APL1 covers about 35 towns, of which 12 towns have completed project preparation and involves a total of 31,000 connections. The objective of the project is to demonstrate that economically and financially viable systems can be built and operated in these towns by designing technical solutions whose cost can be recovered through tariffs that have been agreed upon with the beneficiaries prior to construction. Subject to sufficient progress in using the demand-based approach in APL1, the program would be scaled up in APL2 in terms of the number of towns to be covered. In APL2, the target is to cover an additional 80 towns and in APL3, another 130 towns. Also, in APL 3 it is expected that government financial institutions (GFIs) would be in a position to wholesale loans and induce private sector banks to invest in LGU systems, and for these systems to be increasingly managed and operated by the private sector primarily through lease and concession contracts. The assumption for proceeding to APL3 is that economic and financial viability is demonstrated in the earlier phases.

In this type of a program loan, it is not possible to have a prior estimation of the net present value or the economic internal rate of return for the whole project. This is because specific investments in the towns which would choose to participate are subject to negotiations between prospective beneficiaries and their respective LGU officials and their acceptance of the project rules regarding loan financing and cost recovery through user payments. However, the project design provides adequate assurance that technical solutions would be both economically and financially viable. In particular, the project rules require that tariffs should at least cover for the operation and maintenance costs and that users of the improved systems agree to the proposed tariff levels. Nonetheless, since this is a learning-by-doing project, economic performance would be continually monitored. The framework provides that the project may be modified as necessary in order to achieve its economic worth.

The LGU systems, which will be largely replaced in this project, perform poorly and usually for a very limited number of hours. The economic consequences are (1) that the current systems generate very low levels of direct-user benefits, and (2) people even for those already connected to the existing system are forced to seek alternative sources of water which are often expensive, time consuming and unsafe from a health perspective. With the improved system, many would be able to switch to more or exclusive use of the better and much more reliable services. They will therefore be able to avoid some of these costs, that is, money, time and health costs, while generating increased direct-user benefits. With the exception of health costs which are often difficult to quantify but are nonetheless real costs, the direct-user benefits, consumer surplus and cost savings would be estimated for the individual subprojects as these are prepared. In general, it is expected that direct-user benefits would be sufficient to

economically justify the projects. Considering consumer surplus and cost savings benefits would substantially increase the economic return of the sub-projects. However, from the perspective of society, the latter may only be a transfer if users opt to shift their spending from water to some other commodity or if the improved system results in a loss for the existing LGU-managed water utility or water vendors. In such a case, there would be no real savings to society, although a real gain from cost savings would have accrued to the consumers.

On the basis of the initial 12 towns, the required tariffs to fully cover the investment and operating costs are considerably lower than the costs that users at present incur to get water. This being the case, it is expected that the consumer surplus and cost savings would be significant for those who will be served under the improved system and are able to use more water at a lower price. While it is difficult to estimate the exact consumer surplus without more information on the shape and elasticity of demand, it is expected that this is positive and may be substantial.

For the initial 12 towns, the economic internal rate of return was estimated for each sub-project with the economic benefits comprising of direct user benefits, consumer surplus and cost savings. For the base case scenario, certain assumptions were adopted meant to approximate the most likely situation in these towns upon the operation of the improved systems. It is assumed that per capita water consumption levels would increase gradually towards full capacity, the reason being that it is possible for users to maintain their current water sources at least in the initial years of operation of the improved system. It is also assumed that a demonstration effect would be needed before the full target of served population is achieved. With these assumptions, the average EIRR for the 12 towns is 21.3 percent (using a discount rate of 15 percent) with direct-use and consumer surplus benefits only. Additional cost savings benefits would increase substantially the EIRR in all the initial 12 towns. Adopting more optimistic assumptions of full capacity in terms of per capita water consumption levels upon system operation and the target served population would provide a much higher average EIRR. Also, the EIRR estimates did not include possible consumption of institutional and commercial/industrial users. On the average, it is estimated that this would be an additional 15 percent in direct -use benefits. Table 1 presents a summary of the EIRR estimates for each of the 12 towns under the above assumptions.

From Table 1, a conservative scenario indicates that direct-use benefits, used as a proxy for revenues, may not be sufficient to reach a positive NPV. Thus, close monitoring is necessary especially while preparing the next batch of sub-projects. The aim is to ensure that these systems can be fully financed from the agreed levels of tariffs and that the level of services provided by the improved systems are both economically and financially viable. However, with the consideration of consumer surplus and cost savings, all 12 towns in the initial batch are economically viable. The 6 towns in the Isabela cluster were evaluated as a privately-managed amalgamated system; the rest of the towns were evaluated as individual publicly-managed systems.

On the whole, the sensitivity analyses show that even with much more conservative assumptions such as lower consumption levels, lower served population and a higher

investment cost, the 12 sub-projects are economically viable when direct-use benefits, consumer surplus and cost-savings are considered.

While there are variable results among the initial 12 towns, the innovations introduced by the project through rules and incentives in the provision of improved water services is worth testing. The APL mode under which the project would be funded provide sufficient safeguards and triggers to indicate the appropriateness of moving forward to the next APLs.

Table 1
Summary of Economic Analysis - LGUWSP

Base Case

Municipality	Economic Return @ 15% Discount Rate					
	W/ Direct-Use Benefits			W/ Dir. Benefits & Cons. Surplus		
	NPV (P '000)	EIRR (%)	BCR	NPV (P '000)	EIRR (%)	BCR
Isabela Province						
Aurora	(1,714)	12.18	1.00	(335)	14.49	1.12
Cabatuan	(133)	14.86	1.14	5,088	20.09	1.38
Luna	(1,542)	11.33	0.97	(378)	14.19	1.11
Mallig	(1,364)	11.64	0.99	(1,748)	10.78	0.94
Quezon	(2,042)	12.51	1.02	3,038	18.27	1.35
San Mateo	776	15.79	1.18	6,795	21.39	1.44
Laguna Province						
Magdalena	(8,160)	7.44	0.80	78,359	55.79	4.49
Camarines Sur Province						
Camaroan	(3,361)	8.70	0.81	17,342	34.95	2.89
Bukidnon Province						
Baungon	(2,298)	11.36	1.01	6,159	21.06	1.53
Kalilangan	(2,576)	11.93	1.02	8,820	21.48	1.59
Lantapan	4,600	18.56	1.28	25,138	25.60	1.88
Misamis Occidental Province						
Sapang Dalaga	(1,163)	11.59	0.98	1,684	18.26	1.39
Average		11.38			21.26	

LGUs are able to participate in this project if they are willing to borrow as opposed to receiving government grants. This has been done very little by LGUs in the past. It has only become a serious consideration for LGUs since the recent decentralization of task and revenues. Consequently, they have incentives to pay attention to costs and the means of repayment. Since user fees are a means of repayment, they have an incentive to learn more about the willingness-to-pay of users. The users, in turn, have incentives to make sure that a proposed improvement has value to them equal to or higher than what they

are willing to pay. Sector technicians in turn need to learn how to operate in an environment of relatively hard budget constraints, bounded by the LGU's willingness to borrow and the users' willingness to pay. In this regard, one piece of developmental learning has already occurred as participating LGUs in this first phase have all opted for professional management by private sector operators, who are familiar with working in this kind of environment.

There are, of course, risks in this demand-oriented approach, even though it should lead to substantial economic and service benefits. Learning is necessary for all parties and it is unrealistic to expect that it will occur at the same pace for everyone or with uniform depth everywhere. The phased approach to the project is desirable to mitigate the risks because it offers a means to capture on-going lessons and apply the lessons learned. In the end, collaborative assessment of benefits and costs by LGUs, city councils, and users will determine economically viable investments and improvements when given a voluntary opportunity to participate.

A summary of net fiscal impact is shown in Table 2 below:

Table 2
Summary of Net Fiscal Impact (NFI)
LGU-Urban Waster Supply and Sanitation Project (LGU-UWSP)
(P '000)

Items	Isabela Province						Quezon
	Total	Aurora	Cabatuan	Luna	Mallig	San Mateo	
Taxes							
Investment	5,842	502	740	343	337	848	524
O&M	11,875	421	1,280	417	407	1,309	621
Total	17,717	923	2,020	760	744	2,157	1,145
Tariffs							
Investment	32,532	2,146	3,625	1,489	1,388	3,790	3,323
O&M	2,520	141	354	129	126	389	201
Total	35,052	2,287	3,979	1,598	1,514	4,159	3,524
Forex premium							
Investment	(15,192)	(1,001)	(1,692)	(695)	(648)	(1,768)	(1,551)
O&M	(1,178)	(68)	(165)	(60)	(59)	(172)	(94)
Total	(16,368)	(1,067)	(1,857)	(755)	(707)	(1,940)	(1,645)
Net Fiscal Impact	36,401	2,143	4,142	1,603	1,551	4,376	3,024

Items	Laguna Prov	Camarines Su	Bukidnon Province			Misamis Occ.
	Magdalena	Caramoan	Baungon	Lantapan	Kallangan	Sapang Dalaga
Taxes						
Investment	850	80	432	84	503	499
O&M	1,436	429	1,155	2,746	1,307	347
Total	2,286	509	1,587	2,830	1,810	846
Tariffs						
Investment	3,329	2,091	2,283	5,659	2,981	448
O&M	294	138	238	293	160	77
Total	3,623	2,229	2,521	5,952	3,141	525
Forex premium						
Investment	(1,554)	(976)	(1,066)	(2,641)	(1,391)	(209)
O&M	(137)	(64)	(111)	(137)	(75)	(36)
Total	(1,691)	(1,040)	(1,177)	(2,778)	(1,466)	(245)
Net Fiscal Impact	4,875	1,698	2,931	6,004	3,585	1,126

Main Assumptions:

Economic Costs. Project investment and recurrent costs are based on 1997 prices. The financial price of the investment and operation and maintenance costs were converted to their economic prices using the following assumptions which are based on the NEDA-ICC project evaluation guidelines:

- Tariff rate on imported inputs - 30%;
- Tax on local inputs - 10%;
- Premium on foreign exchange - 20%; and
- Shadow rate for unskilled labor - 0.60.

Cost of physical contingency was assumed to be 10 percent of basic construction cost and land, and the cost of construction supervision, at 4 percent of basic construction cost, land and physical contingency. For the operation and maintenance costs, it was assumed that 30 percent of the costs of energy, chemicals and maintenance would be imported inputs. The asset life for new/improved system was assumed to be 50 years for both civil works and equipment.

Economic Benefits. Project economic benefits consist of (a) direct-use benefits, (b) consumer surplus, and (c) cost savings. For a privately-managed system, collection efficiency of 97 percent was assumed and for a publicly-managed system, 90 percent. The estimates did not include possible consumption of institutional and commercial/industrial users. On the average, it is estimated that this would be an additional 15 percent of direct-use benefits.

In the estimation of consumer surplus and cost savings, for those consumers who go to nearby rivers and springs to do their laundry and other needs, the cost attributed to time spent was assumed to be 30 percent of the estimated per capita income foregone. This translates into the income of about 1.5 to 2 persons in a household, who are usually the economically active members of the household. Official data on average household size and minimum daily wage for each town were also used in the estimation of consumer surplus and cost savings.

Discount Rate. The rate used in discounting flows to their present value is 15 percent.

Sensitivity Analyses. Sensitivity of the net present value and economic internal rate of return were checked against the following scenarios:

Scenario 1: Lower consumption levels

- a. For slow urbanizing towns, consumption levels were assumed to be as follows:
- | | |
|------------|----------|
| 1999-2000 | 60 lpcd |
| 2001-2003 | 80 lpcd |
| 2004- 2010 | 100 lpcd |

- b. For fast urbanizing towns, consumption levels were assumed to be as follows:
- | | |
|-----------|----------|
| 1999-2000 | 80 lpcd |
| 2001-2010 | 100 lpcd |

Scenario 2: Lower served population

- a. For relatively high results of willingness-to-connect survey (above 80% of target population), served population was assumed to be as follows as percentage of target:

1999-2000	60%
2001-2010	80%

- b. For relatively low results of willingness-to-connect survey (below 80% of target population), served population was assumed to be as follows as percentage of target:

1999-2000	40%
2001-2003	60%
2004-2010	80%

Scenario 3: 20% increase in investment cost

Scenario 4: Combination of Scenarios 1, 2 and 3

Cost-effectiveness indicators:²

The average per capita investment cost was calculated for the 12 towns, about US\$ 58.17. The highest per capita cost calculated was for Caramoan, Camarines Sur, about US\$ 104.67 and the lowest calculated was for Lantapan, Bukidnon, about US\$ 34.47. The range of per capita costs calculated are comparable with other international projects for the same size of towns.

¹If the difference between the present value of financial and economic flows is large and cannot be explained by taxes and subsidies, a brief explanation of the difference is warranted, e.g. "The difference between financial and economic costs arises from price controls on the inputs."

²These indicators should compare the project with a suitable comparator, e.g. unit project costs of alternative project designs or international standards.

Annex 5: Financial Summary LGU Urban Water and Sanitation Project

Years Ending

Affordability Analysis for Participating LGUs

The financing rationale for the Water Supply Project suggests a two-phased development wherein, the LGUs carry the load of financing by assuming the project loans. The affordability analysis has verified whether the LGUs have adequate internally available funds in the loan amortization period to fully repay the loans. Thereafter, wherever possible, the water systems are contracted out through affermage/lease arrangements to prequalified PSP operators. In situations where PSP operators are available, the latter will assure the remittances of project revenues sufficient to reimburse the LGUs of their debt servicing needs arising from the project loans. This also includes the reimbursement of the LGUs' equity contributions. Recurrent costs will be the responsibility of the operators.

The cost-sharing nature of the financing scheme required an analytical approach which could assess the borrowing capacity of the LGUs and the financial feasibility of the water supply systems. This is accomplished by applying an innovative methodology through the use of the LGU Long-term Financial Planning Model, developed under an earlier project - the Water Districts Development Project. This methodology has involved a three-step process. First, a preliminary financial assessment was undertaken for each of the participating LGUs to determine their 5-year investment envelope (potential) for which a portion of which would be earmarked for water projects. Second, a total project budget ceiling was derived that would fit the borrowing capacity of the LGU. Finally, tariff levels were derived based on a uniform formula that ensures full recovery of capital and recurrent cost plus provision for a nominal return on the capital invested.

Details of current financial operations and the overall condition of the 12 LGUs are available in project files. It suggests that there are potentials to leverage infrastructure investments, although the current financial performances leave room for considerable improvements.

Based on these data, LGU projected performance was computed for each of the participating LGUs before the engineering feasibility studies. The projected performance took into account a number of important financial management parameters which clearly demonstrate the ability of each LGU to undertake the proposed water supply investments on financial grounds. These have formed the basis of estimating the budget envelopes available with each participating LGU. Discussions with Mayors, Municipal Councils and communities on affordability and tariffs were based on these estimates of affordability.

Financing Plan for LGUs Participating in Phase I:

LGU-UWSP
Project Financing Plan (1998 - 1999) in US\$ millions

	1998	1999	2000	2001	Total
Aurora, Isabela					
Financing Requirements					
Investment Program	-	0.400	-	-	0.400
Capitalized Interest	-	0.029	0.062	0.071	0.162
Total	-	0.429	0.062	0.071	0.562
Sources of Funds					
Development Bank of the Phil.	-	0.386	0.056	0.064	0.505
Internal Sources	-	0.043	0.006	0.007	0.056
Total	-	0.429	0.062	0.071	0.562
Cabatuan, Isabela					
Financing Requirements					
Investment Program	-	0.640	-	-	0.640
Capitalized Interest	-	0.046	0.099	0.114	0.259
Total	-	0.686	0.099	0.114	0.899
Sources of Funds					
Development Bank of the Phil.	-	0.618	0.089	0.102	0.809
Internal Sources	-	0.069	0.010	0.011	0.090
Total	-	0.686	0.099	0.114	0.899
Luna, Isabela					
Financing Requirements					
Investment Program	-	0.273	-	-	0.273
Capitalized Interest	-	0.020	0.042	0.049	0.111
Total	-	0.293	0.042	0.049	0.384
Sources of Funds					
Development Bank of the Phil.	-	0.264	0.038	0.044	0.346
Internal Sources	-	0.029	0.004	0.005	0.038
Total	-	0.293	0.042	0.049	0.384

Mallig, Isabela**Financing Requirements**

Investment Program	-	0.263	-	-	0.263
Capitalized Interest	-	0.019	0.041	0.047	0.106
Total	-	0.282	0.041	0.047	0.369

Sources of Funds

Development Bank of the Phil.	-	0.253	0.037	0.042	0.332
Internal Sources	-	0.028	0.004	0.005	0.037
Total	-	0.282	0.041	0.047	0.369

Quezon, Isabela**Financing Requirements**

Investment Program	-	0.535	-	-	0.535
Capitalized Interest	-	0.039	0.083	0.095	0.217
Total	-	0.574	0.083	0.095	0.752

Sources of Funds

Development Bank of the Phil.	-	0.516	0.075	0.086	0.677
Internal Sources	-	0.057	0.008	0.010	0.075
Total	-	0.574	0.083	0.095	0.752

San Mateo, Isabela**Financing Requirements**

Investment Program	-	0.694	-	-	0.694
Capitalized Interest	-	0.050	0.108	0.123	0.281
Total	-	0.744	0.108	0.123	0.976

Sources of Funds

Development Bank of the Phil.	-	0.670	0.097	0.111	0.878
Internal Sources	-	0.074	0.011	0.012	0.098
Total	-	0.744	0.108	0.123	0.976

Magdalena, Laguna**Financing Requirements**

Investment Program	-	0.642	-	-	0.642
Capitalized Interest	-	0.038	0.081	0.091	0.210
Total	-	0.680	0.081	0.091	0.852

Sources of Funds

Development Bank of the Phil.	-	0.510	0.061	0.068	0.639
Internal Sources	-	0.170	0.020	0.023	0.213
Total	-	0.680	0.081	0.091	0.852

Caramoan, Camarines Sur**Financing Requirements**

Investment Program	-	0.370	-	-	0.370
Capitalized Interest	-	0.027	0.057	0.066	0.150
Total	-	0.397	0.057	0.066	0.520

Sources of Funds

Development Bank of the Phil.	-	0.357	0.052	0.059	0.468
Internal Sources	-	0.040	0.006	0.007	0.052
Total	-	0.397	0.057	0.066	0.520

Baungon, Bukidnon**Financing Requirements**

Investment Program	-	0.390	-	-	0.390
Capitalized Interest	-	0.028	0.061	0.069	0.158
Total	-	0.419	0.061	0.069	0.549

Sources of Funds

Development Bank of the Phil.	-	0.377	0.055	0.062	0.494
Internal Sources	-	0.042	0.006	0.007	0.055
Total	-	0.419	0.061	0.069	0.549

Kalilangan, Bukidnon**Financing Requirements**

Investment Program	-	0.526	-	-	0.526
Capitalized Interest	-	0.038	0.082	0.094	0.214
Total	-	0.564	0.082	0.094	0.739

Sources of Funds

Development Bank of the Phil.	-	0.508	0.074	0.084	0.665
Internal Sources	-	0.056	0.008	0.009	0.074
Total	-	0.564	0.082	0.094	0.739

Lantapan, Bukidnon**Financing Requirements**

Investment Program	-	0.792	-	-	0.792
Capitalized Interest	-	0.057	0.117	0.123	0.298
Total	-	0.849	0.117	0.123	1.089

Sources of Funds

Development Bank of the Phil.	-	0.764	0.106	0.111	0.980
Internal Sources	-	0.085	0.012	0.012	0.109
Total	-	0.849	0.117	0.123	1.089

Sapang Dalaga, Misamis Occ.**Financing Requirements**

Investment Program	-	0.213	-	-	0.213
Capitalized Interest	-	0.015	0.033	0.038	0.086
Total	-	0.228	0.033	0.038	0.299

Sources of Funds

Development Bank of the Phil.	-	0.205	0.030	0.034	0.269
Internal Sources	-	0.023	0.003	0.004	0.030
Total	-	0.228	0.033	0.038	0.299

Total						
Financing Requirements						
Investment Program	-	5.737	-	-	5.737	72%
Capitalized Interest	-	0.407	0.867	0.979	2.252	28%
Total	-	6.144	0.867	0.979	7.990	100%
Sources of Funds						
Development Bank of the Phil.	-	5.428	0.768	0.867	7.063	88%
Internal Sources	-	0.716	0.099	0.112	0.927	12%
Total	-	6.144	0.867	0.979	7.990	100%

Annex 6: Procurement and Disbursement Arrangements

LGU Urban Water and Sanitation Project

Procurement

Procurement arrangements described below is for the Bank-funded parts of the project. Separate arrangements for cofinanced parts are being developed by the Government of Philippines and the Development Bank of the Philippines with the Nordic Development Fund and the European Union for the Institutional Capacity Building Program and the Water Utilities Private Sector Participation Facility respectively.

Procurement methods (Table A)

Procurement of works and consultant services funded wholly or partly by Bank Loan will be carried out in accordance with Bank procurement guidelines ("Guidelines for Procurement under IBRD Loans and IDA Credits" of January 1995 revised in January and August 1996 and September 1997 and the "Guidelines for Selection and Employment of Consultants by World Bank Borrowers" of January 1997 revised in September 1997). Project Management Office of the Development Bank of the Philippines (DBP-PMO) assisted by consultants will supervise procurements of works and consultant services for each LGU's sub-project. The Technical Working Committee (DBP, DILG and DOF) will implement or supervise procurements of private sector participation (PSP) operators to operate and maintain constructed water supply systems under an affermage contract arrangement. Project cost by procurement arrangement is presented in Table A.

Civil works would include construction and rehabilitation of water supply systems, sanitation and drainage infrastructure involving sub-project of LGUs. These are small infrastructure contracts to be constructed in participating LGUs with a wide geographically spread through out the Philippine islands. While foreign bidders would be allowed to bid, if interested, due to size and location, it is expected that these contracts would not attract them. Works for the construction of the water supply systems, which will include providing and installing equipment, one for each city, will be procured as follows:

a) individual civil works contracts estimated to exceed US \$ 50,000 equivalent, up to an aggregate amount not exceeding US \$22.2 million equivalent will be procured under National Competitive Bidding (NCB) procedures acceptable to the Bank. A procurement side letter will be issued by the Government detailing the procedures under local rules that are not acceptable to the Bank, and which will not be followed under this Loan. The project Operational Manual includes sample bidding documents and procedures (standard NCB procedures customized for the project in advertising, preparing tender documents, opening bids, evaluating bids and preparing evaluation report, and awarding contract) in compliance with Bank procurement guidelines and specifically designed for this type of infrastructure contract. DBP will include these procedures and the obligation of using the sample bidding documents as a conditionality in the Subloan Agreements to be signed with the LGUs; and

b) individual civil works contract estimated to cost less than US \$50,000 equivalent, up to an aggregate amount of US \$2.1 million equivalent will be procured through simplified procurement procedures similar to national shopping. The procedure will apply government procedures by

comparing at least three price quotations from qualified contractors. Participation of non-governmental organizations (NGOs) would be acceptable, if they are qualified. The project operational manual will include sample shopping documents in compliance with Bank procurement guidelines and specifically designed for this type of procurement.

Consultant services, estimated at US\$1.38 million will be needed to support project implementation. Of this, US\$1.0 million will be financed the construction supervision consultant who will assist the PMO in project implementation and the remaining, US\$0.40 million will be needed for individual specialists to support the LGUs staff in implementing the Hygiene Education for Sanitation and Drainage components. The terms of reference for evaluating proposals will be developed by DBP, with technical assistance from the Bank.

Procurement Management: All civil works procurement for the implementation of subprojects, financed by the loan/equity mix, will be undertaken by participating LGUs and supervised by DBP-PMO and DILG-PMO. Each LGU shall establish a bidding committee with, at least the third highest ranking official of the municipality as a Chairman. The procurement lead time as specified in Administrative Order No. 129 shall be observed. However, as most of the participating LGUs lacks the capacity to handle procurement under internationally funded project, DBP-PMO will provide technical assistance through consultants to guide them throughout the procurement process until contract award.

The project will involve the selection of private sector participating (PSP) operators to supervise, operate, and maintain constructed water supply systems. This selection will be handled by a selection committee established by the concerned LGU/s under procedures agreed with the borrower. Preparation of the tender document will be the responsibility of the DILG. The terms of reference for evaluating proposals are being developed with technical assistance from the Bank as a part of project preparation, while future technical assistance will be financed by the grant from the European Union. This process is being overseen by the Project's Technical Working Committee consisting of DOF, DBP and DILG.

Prior review thresholds (Table B)

All civil works contracts procured according to NCB with a value of at least US\$ 300,000 equivalent each and the first five (5) civil works contracts per year regardless of amount, up to an aggregate of \$ 21 million equivalent, will be subject to the Bank's prior review. Prior review of civil works include bidding documents, evaluation reports and draft contracts accounting to about 73% of the total amount of works contracts. Prior Bank review would also be required for contracts of individual consultants estimated to cost at least US\$ 50,000 equivalent and contracts of firms estimated to cost at least US\$ 100,000 and estimated to total US\$ 1.20 million. Prior review procedures will apply regardless of the value of consultants' contracts with respect to draft letters of invitation and contracts, terms of reference, sole source selection, qualification criteria, evaluation reports, award proposals and final contracts when substantial differences to original draft are made. For other contracts of works and goods not subjected to prior review, the Bank will review them on a random sample basis, one out of five contracts, after they have been awarded.

Procurement Implementation Schedule: Phase I of the project will involve civil works for twelve LGUs with approved project designs through the development and consolidation of the project implementation plan (Barangay Action Plans). For these towns, feasibility studies and detailed engineering designs were completed by negotiations. Implementation of procurement activities will commence upon negotiations according to Bank's procurement guidelines (January 1995 revised September 1997). Phase II of the project is expected to involve an additional 27 towns, for which construction would start by 2000. To

expedite project implementation activities, DBP will create the project management office (DBP-PMO) by loan negotiations. The DBP-PMO will be guided by the Project Implementation Plan, which already has guidelines on how technical, financial, economic and institutional appraisal of subprojects will be carried out. This office should be adequately staffed by the end of bidding for civil works of Phase 1. The selection of consultants for construction supervision could start as a parallel activity with bidding for civil works. The General Procurement Notice has been published on Development Business of July 16, 1998.

Disbursement

Allocation of loan proceeds (Table C)

Disbursement of the proceeds of the loan would be made against expenditure categories as shown in Table C.

Use of statements of expenses (SOEs):

For Civil Works and goods contracts below US\$300,000 equivalent, consulting firms contracts below US\$100,000 equivalent, individual consultant contracts below US\$50,000 equivalent, sub-loans and grants and all administrative, operational and training expenditures, withdrawal applications will be supported by Statement of Expenditures (SOEs). For civil works and goods contracts over US\$300,000 equivalent, consulting firms contracts over US\$100,000 equivalent and individual contracts over US\$50,000 equivalent, withdrawal applications would be supported by full documentation and signed contracts.

Special account:

To facilitate loan disbursement, the Development Bank of the Philippines will open and maintain a separate special deposit account, in a commercial bank specifically authorized for this purpose by the Bangko Sentral ng Pilipinas, on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure and attachment. The Special Account, which would cover the Bank's share of eligible expenditures under all disbursement categories, would have an authorized allocation of US\$2.00 million with an initial withdrawal of US\$1.00 million and the balance to be withdrawn when the amounts disbursed and committed total US\$8.00 million. Applications to replenish the Special Account, supported by appropriate documentation, would be submitted regularly (preferably monthly, but not less than quarterly) or when the amounts withdrawn equal 50 per cent of the initial deposit. The Special Account shall be audited annually by the auditors acceptable to the Bank.

ACCOUNTING, FINANCIAL REPORTING AND AUDITING:

Project expenditures will be separately recorded and reported by each implementing agency under the Financial Information System for Foreign Assisted Projects (FISFAP) developed by the Commission on Audit (COA) funded by the Bank's Institutional Development Fund (IDF). By next year, the objective is to use it in all new projects. Its features are: (a) application of commercial methods of accounting; (b) use of a perpetual inventory method; (c) an improved chart of account and coding system; (d) a clear recording and reporting of accounting data from LGUs to the lead implementing agencies, and (e) generation of accurate and timely financial reports that are needed by agency management, oversight agencies and funding institutions. The system will run on a financial accounting software which has the capability of customization or programming modification to suit the needs of the project.

Project disbursements to LGUs are routed through subsidiary loan agreements signed between the Development Bank of the Philippines and LGUs. DBP has established policies and procedures by which these subsidiary loans are monitored. DBP will produce separate financial reports for each project, and accounting for subsidiary loan disbursements. The accounting, disbursement and record keeping functions

are segregated and independent of each other. DBP relies on statement of expenditures by LGUs to release funds. DBP does not have sufficient staff to review financial management arrangements in each LGU, but relies on COA verification and approval of SOEs.

In order to ensure sound financial management of subprojects, the PMO at DBP will be staffed with qualified and experienced financial analysts and financial management specialists who will be responsible for financial appraisal of subprojects, based on the long-term financial planning model developed by the project team, before feasibility studies commence. This staff will prepare action plans to implement FISFAP system. The staff will also review periodically the financial management arrangements of sub-projects and the effectiveness of internal control procedures.

All LGUs are required to prepare standard financial management reports quarterly and submit to the DBP-PMO. These reports will be in a format acceptable to the Bank, and will be used for monitoring of project progress by the DBP. DBP-PMO will be responsible for consolidation of the LGU financial management reports and the consolidated reports will be submitted to the Bank quarterly. In addition, the DBP-PMO will be responsible for preparing annual consolidated project financial statements based on the financial statements prepared by the LGUs. DBP-PMO will require that LGU financial statements are audited by COA and render an opinion thereon.

DBP-PMO will be responsible for submission of the consolidated project financial statements for the audit by COA. COA will perform an audit of the project financial statements and render an opinion. A separate audit of the operations of the Special Account and the withdrawal of expenditures through statement of expenditure will also be carried out by COA who will provide a separate opinion thereon.

Table A: Project Costs by Procurement Arrangements
(US\$ million equivalent)

Expenditure Category	Procurement Method ¹			N.B.F.	Total Cost
	ICB	NCB	Other ²		
1. Works	0.0 (0.0)	22.2 (19.9)	2.1 (1.8)	0.0 (0.0)	24.3 (21.7)
2. Goods	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)
3. Services	0.0 (0.0)	0.0 (0.0)	1.4 (1.4)	6.0 (0.0)	7.4 (1.4)
4. Miscellaneous	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)
5. Front-end fee	0.0 (0.0)	0.0 (0.0)	0.2 (0.2)	0.0 (0.0)	0.2 (0.2)
Total	0.0 (0.0)	22.2 (19.9)	3.7 (3.4)	6.0 (0.0)	31.9 (23.3)

¹ Figures in parenthesis are the amounts to be financed by the Bank Loan. All costs include contingencies

² Includes civil works and goods to be procured through national shopping, consulting services, services of contracted staff of the project management office, training, technical assistance services, and incremental operating costs related to (i) managing the project, and (ii) re-lending project funds to local government units.

Table A1: Consultant Selection Arrangements (optional)
(US\$ million equivalent)

Consultant Services Expenditure Category	Selection Method							Total Cost ¹
	QCBS	QBS	SFB	LCS	CQ	Other	N.B.F.	
A. Firms	0.0 (0.0)	1.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	4.5 (0.0)	5.5 (0.0)
B. Individuals	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.4 (0.0)	1.5 (0.0)	1.9 (0.0)
Total	0.0 (0.0)	1.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	0.4 (0.0)	6.0 (0.0)	7.4 (0.0)

1\ Including contingencies

Note: QCBS = Quality- and Cost-Based Selection
 QBS = Quality-based Selection
 SFB = Selection under a Fixed Budget
 LCS = Least-Cost Selection
 CQ = Selection Based on Consultants' Qualifications
 Other = Selection of individual consultants (per Section V of Consultants Guideleines), Commercial Practices, etc.

N.B.F. = Not Bank-financed

Figures in parenthesis are the amounts to be financed by the Bank loan.

Table B: Thresholds for Procurement Methods and Prior Review¹

Expenditure Category	Contract Value Threshold (US\$ thousands)	Procurement Method	Contracts Subject to Prior Review (US\$ millions)
1. Works	Less than \$50,000	Simplified procedure similar to national shopping	First five contracts each year \$1 million
	\$50,000 and above	NCB	\$300,000 \$20 million
2. Goods			
3. Services	Firms - regardless of value	QBS	More than \$100,000 \$1 million
	- Individual - Less than \$100,000	Individual Selection	More than \$50,000 \$1 million
4. Miscellaneous			

Total value of contracts subject to prior review: \$23.0 million

Overall Procurement Risk Assessment

Frequency of procurement supervision missions proposed: One every months (includes special procurement supervision for post-review/audits)

¹ Thresholds generally differ by country and project. Consult OD 11.04 "Review of Procurement Documentation" and contact the Regional Procurement Adviser for guidance.

Table C: Allocation of Loan Proceeds

Expenditure Category	Amount in US\$million	Financing Percentage
Works	21.7	89
Consultancy	1.4	100
	0.0	
	0.0	
	0.0	
	0.0	
	0.0	
	0.0	
	0.0	
	0.0	
	0.0	
Total Project Costs	23.1	
Front-end fee	0.2	100
Total	23.1	

Annex 7: Project Processing Schedule

LGU Urban Water and Sanitation Project

Project Schedule	Planned	Actual
Time taken to prepare the project (months)	26	28
First Bank mission (identification)	12/02/95	12/04/95
Appraisal mission departure	02/01/98	05/10/98
Negotiations	05/01/98	10/16/98
Planned Date of Effectiveness	10/10/98	05/01/99

Prepared by:

N. Vijay Jagannathan

Preparation assistance:

Martha Ochieng

Bank staff who worked on the project included:

Name	Speciality
Harvey Garn	Economist
Luiz Claudio Tavares	Engineer
Aldo Baietti	Financial Analyst
Heinrich Unger	Engineer-Environmental Specialist
Cecilia Vales	Procurement Specialist
Karen Jacob	Community Participation Specialist
Mariles Navarro	Economist
George Calderon	Financial Analyst
Albert Wright	Engineer
Hoi-Chan Nguyen	Legal Counsel

Annex 8: Documents in the Project File*

LGU Urban Water and Sanitation Project

A. Project Implementation Plan

Including Operational Guidelines for:

1. Preparing technical design
2. Financial Projections of LGU Borrowing Capacity using Long-term Financial Planning Model
3. Economic Appraisal of Subprojects
4. Resettlement and Compensation Guidelines
5. Environmental Assessment Guidelines

B. Bank Staff Assessments

1. Financial Projections for all participating LGUs
2. EDI-sponsored National Seminar on LGU Water Supply Proceedings (June 1997)
3. Back-to-Office Reports in October 1996, June 1997, October 1997, March 1998, September 1998

C. Other

1. Carl Bro Kampsax Kruger: LGUWS Project Feasibility Reports (3 Volumes) 1996
 2. Department of Interior and Local Government Implementing Rules and regulations for NEDA Board resolution No. 4
 3. NEDA Board Resolutions Nos. 4 and 5 of 1994 series, NEDA Board Resolution No. 6 of 1996 series
- *Including electronic files

Status of Bank Group Operations in Philippines Operations Portfolio

Project ID	Fiscal Year	Borrower	Purpose	Original Amount in US\$ Millions				Difference Between expected and actual disbursements a/	
				IBRD	IDA	Cancellations	Undisbursed	Orig	Frm Rev'd
Number of Closed Projects: 126									
Active Projects									
PH-PE-4566	1998	REP OF PHILS	EARLY CHILD DEV.	19.00	0.00	0.00	19.00	0.00	0.00
PH-PE-4576	1998	GOP	WATER DISTRICT DEV.	56.80	0.00	0.00	56.80	3.80	0.00
PH-PE-4595	1998	GOP	COMMUNITY BASED RESO	50.00	0.00	0.00	50.00	2.77	0.00
PH-PE-51386	1998	GOP	SZOPAD SOCIAL FUND	10.00	0.00	0.00	9.75	1.50	0.00
PH-PE-37079	1997	GOP	AGRARIAN REFORM COMM	50.00	0.00	0.00	46.72	3.12	0.00
PH-PE-40981	1997	SUBIC BAY METRO. AUTH.	SECOND SUBIC BAY	60.00	0.00	0.00	58.92	37.92	0.00
PH-PE-4602	1997	REP OF PHILS.	THIRD ELEM EDUCATION	113.40	0.00	0.00	110.40	35.56	0.00
PH-PE-4613	1997	GOP	WATER RESOURCES DEVE	58.00	0.00	0.00	56.01	18.52	0.00
PH-PE-4571	1996	GOP	TRANS GRID REINFORCE	250.00	0.00	0.00	153.24	-43.91	0.00
PH-PE-4611	1996	GOP	MNLA 2ND SEWERAGE PR	57.00	0.00	9.00	48.00	31.99	1.00
PH-PE-4614	1996	LBP	RURAL FINANCE II	150.00	0.00	0.00	34.58	-27.42	0.00
PH-PE-4567	1995	GOVT OF THE PHILS	WOMENS HEALTH & SAFE	18.00	0.00	0.00	15.77	3.72	0.00
PH-PE-4584	1994	NPC AND PNOC	LEYTE CEBU GEOTHERMA	211.00	0.00	0.00	31.86	31.85	0.00
PH-PE-4607	1994	GOV OF PHILIPPINES	LEYTE LUZON GEOTHERM	227.00	0.00	0.00	87.31	79.89	0.00
PH-PE-4609	1994	SBMA	SUBIC BAY FREEPORT	40.00	0.00	0.00	3.18	1.99	0.00
PH-PE-4568	1993	GOP	URB HEALTH & NUTRITI	0.00	70.00	0.00	51.36	31.59	0.00
PH-PE-4589	1993	GOP	IRRIG OPER SUPP II	51.30	0.00	0.00	20.08	17.30	0.00
PH-PE-4599	1993	GOVT. OF PHILIPPINES	TAX COMPUTERIZATION	63.00	0.00	0.00	23.98	24.01	0.00
PH-PE-4538	1992	GOP	SECOND VOCATIONAL TR	0.00	36.00	0.00	10.18	9.06	0.00
PH-PE-4592	1992	GOP	MUNICIPAL DEV III	68.00	0.00	0.00	30.83	26.88	7.84
PH-PE-4597	1992	GOP	HIGHWAY MANAGEMENT P	150.00	0.00	0.00	47.36	43.31	- .77
PH-PE-4558	1991	GOVT. OF PHILS.	ENV. & NAT. RES. MGT	158.00	66.00	0.00	17.00	13.71	0.00
PH-PE-4572	1991	ROP	COMMUNAL IRRIG. II	46.20	0.00	3.34	14.77	18.13	.93
PH-PE-4552	1990	R.P.	COCONUT FARMS DEVT.	121.80	0.00	.85	35.38	36.24	19.84
Total				2,028.50	172.00	13.19	1,032.48	401.53	28.84

	Active Projects	Closed Projects	Total
Total Disbursed (IBRD and IDA):	1,160.22	6,824.59	7,984.81
of which has been repaid:	42.17	3,652.48	3,694.65
Total now held by IBRD and IDA:	2,145.13	3,213.37	5,358.50
Amount sold :	0.00	31.35	31.35
Of which repaid :	0.00	31.35	31.35
Total Undisbursed :	1,032.48	41.23	1,073.71

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

Note:

Disbursement data is updated at the end of the first week of the month.

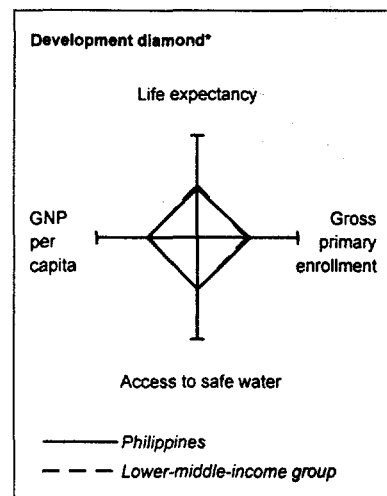
Philippines
STATEMENT OF IFC's
Committed and Disbursed Portfolio
As of 30-Sep-98
(In US Dollar Millions)

FY Approval	Company	Committed				Disbursed			
		IFC				IFC			
		Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1967/88	MERALCO	7.32	0.00	0.00	0.00	7.32	0.00	0.00	0.00
1970/86/88/89	PLDT	17.69	0.00	0.00	12.39	17.69	0.00	0.00	12.39
1974/79	Maria Cristina	0.00	.44	0.00	0.00	0.00	.44	0.00	0.00
1979/90	General Milling	0.00	1.73	0.00	0.00	0.00	1.73	0.00	0.00
1980/82/89/90/94/95	AACT	21.90	2.73	0.00	0.00	18.40	2.73	0.00	0.00
1989	H&QPV-I	0.00	.75	0.00	0.00	0.00	.75	0.00	0.00
1990	Avantex Mill	5.63	1.98	0.00	0.00	5.63	1.98	0.00	0.00
1992	Bacnotan	4.20	5.63	0.00	3.00	4.20	5.63	0.00	3.00
1992	Pilipinas Shell	0.00	0.00	11.63	0.00	0.00	0.00	11.63	0.00
1993	H&QPV-II	0.00	2.50	0.00	0.00	0.00	2.40	0.00	0.00
1993	Pagbilao	51.00	10.00	0.00	8.60	51.00	10.00	0.00	8.60
1993/94	Mindanao Power	0.00	4.50	0.00	0.00	0.00	4.26	0.00	0.00
1994	Walden Mgmt	0.00	.05	0.00	0.00	0.00	.05	0.00	0.00
1994	Walden Ventures	0.00	3.75	0.00	0.00	0.00	1.88	0.00	0.00
1995	Sual Power	30.00	0.00	0.00	196.00	17.60	0.00	0.00	131.80
1996	All Asia Growth	0.00	4.00	0.00	0.00	0.00	4.00	0.00	0.00
1996	All Asia Manager	0.00	.04	0.00	0.00	0.00	.04	.00	0.00
1996	All Asia Venture	0.00	.01	0.00	0.00	0.00	.01	0.00	0.00
1997/98	Far East Bank	25.00	15.00	0.00	50.00	25.00	10.00	0.00	50.00
Total Portfolio:		162.74	53.11	11.63	269.99	146.84	45.90	11.63	205.79
Approvals Pending Commitment									
		Loan	Equity	Quasi	Partic				
997	BATAAN P/E	30.00	0.00	10.00	163.00				
998	DRYSDALE	15.00	0.00	0.00	10.00				
998	H&Q PVIII	0.00	7.50	0.00	0.00				
997	MAGSAYSAY LINES	8.00	3.00	0.00	26.50				
967	MANILA ELECTRIC	0.00	0.00	0.00	.36				
998	PRYCE GASES	10.00	0.00	3.00	5.00				
997	PT&T	30.00	5.00	0.00	30.00				
995	SUAL THERMAL	0.00	17.50	0.00	0.00				
	PWR								
998	2/2/98	45.00	0.00	0.00	15.00				
Total Pending Commitment:		138.00	33.00	13.00	249.86				

Philippines at a glance

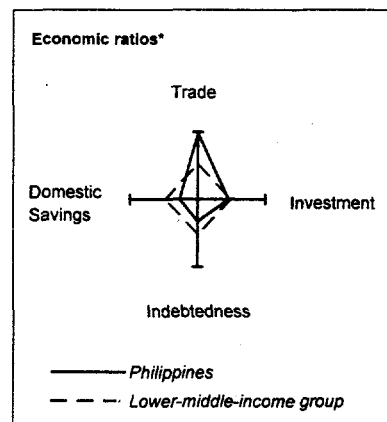
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POVERTY and SOCIAL	Philippines	East Asia & Pacific	Lower-middle-income
1997			
Population, mid-year (millions)	73.4	1,753	2,285
GNP per capita (Atlas method, US\$)	1,220	970	1,230
GNP (Atlas method, US\$ billions)	89.6	1,707	2,818
Average annual growth, 1991-97			
Population (%)	2.3	1.3	1.2
Labor force (%)	2.7	1.4	1.3
Most recent estimate (latest year available, 1991-97)			
Poverty (% of population below national poverty line)	54	..	..
Urban population (% of total population)	56	32	42
Life expectancy at birth (years)	66	69	69
Infant mortality (per 1,000 live births)	36	38	36
Child malnutrition (% of children under 5)	30	16	..
Access to safe water (% of population)	85	84	84
Illiteracy (% of population age 15+)	5	17	19
Gross primary enrollment (% of school-age population)	116	115	111
Male	..	118	116
Female	..	116	113



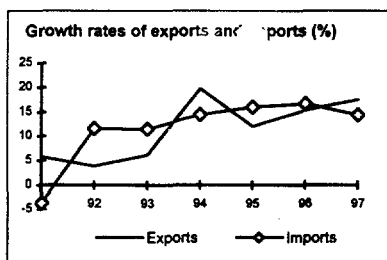
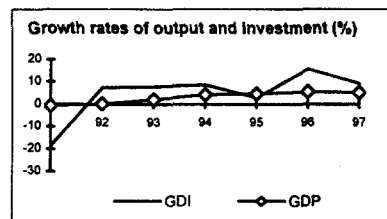
KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1976	1986	1996	1997
GDP (US\$ billions)	17.2	29.8	82.8	82.2
Gross domestic investment/GDP	32.9	16.0	24.0	24.8
Exports of goods and services/GDP	19.3	26.3	40.5	49.0
Gross domestic savings/GDP	26.9	19.9	15.2	14.5
Gross national savings/GDP	27.7	19.3	19.3	18.8
Current account balance/GDP	-6.4	3.2	-4.8	-5.2
Interest payments/GDP	1.0	3.8	2.1	2.3
Total debt/GDP	35.1	94.5	49.7	55.2
Total debt service/exports	16.9	33.7	14.4	..
Present value of debt/GDP	..	..	46.6	43.9
Present value of debt/exports	..	..	96.3	73.5
	1976-86	1987-97	1996	1997
<i>(average annual growth)</i>				
GDP	1.8	3.2	5.7	5.3
GNP per capita	-0.8	1.4	4.5	3.3
Exports of goods and services	6.0	9.5	15.4	17.5



STRUCTURE of the ECONOMY

	1976	1986	1996	1997
<i>(% of GDP)</i>				
Agriculture	29.3	23.9	20.6	18.7
Industry	35.7	34.6	32.1	32.2
Manufacturing	25.4	24.6	22.8	22.3
Services	35.1	41.5	47.3	49.2
Private consumption	62.3	72.1	72.8	72.5
General government consumption	10.8	8.0	11.9	13.0
Imports of goods and services	25.2	22.4	49.3	59.4
	1976-86	1987-97	1996	1997
<i>(average annual growth)</i>				
Agriculture	1.4	1.8	3.0	3.7
Industry	0.7	3.1	6.3	6.0
Manufacturing	0.5	3.0	5.6	4.2
Services	3.2	3.9	6.5	5.4
Private consumption	2.4	3.7	5.3	3.7
General government consumption	-0.3	3.9	5.2	0.6
Gross domestic investment	-3.2	6.3	15.6	9.2
Imports of goods and services	2.1	11.3	16.7	14.4
Gross national product	1.5	3.8	6.9	5.5

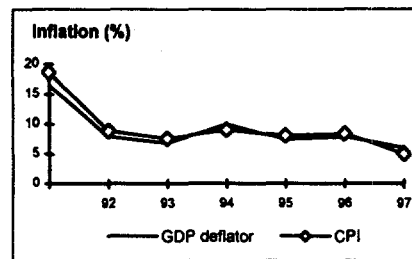


Note: 1997 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

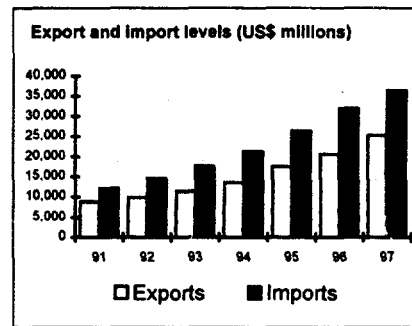
PRICES and GOVERNMENT FINANCE

	1976	1986	1996	1997
Domestic prices				
<i>(% change)</i>				
Consumer prices	9.2	0.8	8.4	5.1
Implicit GDP deflator	8.3	3.0	7.8	6.0
Government finance				
<i>(% of GDP, includes current grants)</i>				
Current revenue	..	13.0	18.9	..
Current budget balance	..	1.4	..	..
Overall surplus/deficit	..	-5.0	0.3	..



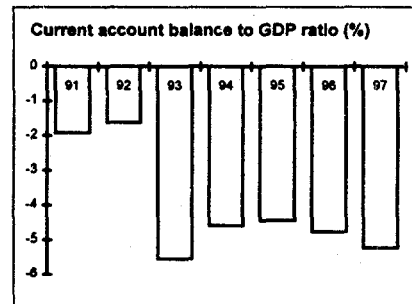
TRADE

	1976	1986	1996	1997
<i>(US\$ millions)</i>				
Total exports (fob)	..	4,842	20,543	25,228
Coconut oil	..	333	571	673
Sugar	..	103	136	83
Manufactures	..	2,672	17,106	21,488
Total imports (cif)	..	5,044	31,885	36,355
Food	..	193	1,578	1,435
Fuel and energy	..	869	3,008	3,074
Capital goods	..	639	10,472	14,369
Export price index (1995=100)	..	76	100	..
Import price index (1995=100)	..	61	101	..
Terms of trade (1995=100)	..	124	99	..



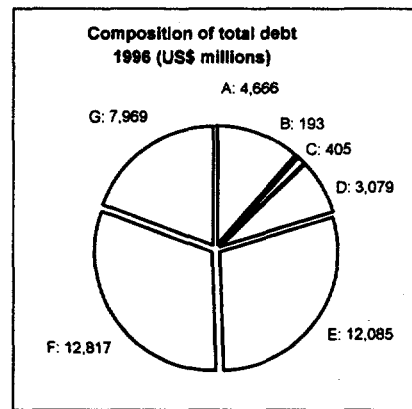
BALANCE of PAYMENTS

	1976	1986	1996	1997
<i>(US\$ millions)</i>				
Exports of goods and services	3,262	7,702	27,627	34,359
Imports of goods and services	4,381	5,868	41,371	50,477
Resource balance	-1,119	1,834	-13,744	-16,118
Net income	-253	-1,321	9,202	10,735
Net current transfers	268	441	589	1,080
Current account balance	-1,105	954	-3,953	-4,303
Financing items (net)	1,051	184	8,060	7,666
Changes in net reserves	54	-1,138	-4,107	-3,363
Memo:				
Reserves including gold (US\$ millions)	..	..	11,745	8,768
Conversion rate (DEC, local/US\$)	7.4	20.4	26.2	29.5



EXTERNAL DEBT and RESOURCE FLOWS

	1976	1986	1996	1997
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	6,039	28,204	41,214	45,433
IBRD	316	3,017	4,666	4,194
IDA	27	92	193	195
Total debt service	571	2,961	5,778	..
IBRD	35	406	766	636
IDA	0	1	3	3
Composition of net resource flows				
Official grants	61	401	246	..
Official creditors	212	198	-310	..
Private creditors	883	294	1,859	..
Foreign direct investment	132	127	1,408	..
Portfolio equity	0	0	1,333	..
World Bank program				
Commitments	226	151	528	60
Disbursements	102	197	457	305
Principal repayments	14	170	426	336
Net flows	88	27	31	-31
Interest payments	20	238	343	303
Net transfers	68	-210	-312	-335



A - IBRD
 B - IDA
 C - IMF
 D - Other multilateral
 E - Bilateral
 F - Private
 G - Short-term

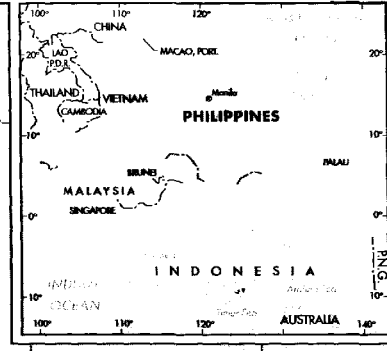
MAP SECTION

PHILIPPINES URBAN WATER AND SANITATION PROJECT

- PAN-PHILIPPINE HIGHWAY
- OTHER MAIN ROADS
- FERRIES
- ↑ INTERNATIONAL AIRPORTS
- MAJOR PORTS
- RIVERS
- PROVINCE CAPITALS
- ⊙ REGION CAPITALS
- PROVINCE BOUNDARIES
- REGION BOUNDARIES

Regions and Provinces:

- I Ilocandia**
 - 1. Ilocos Norte
 - 2. Ilocos Sur
 - 3. La Union
 - 4. Pangasinan
 - CAR Cordillera Administrative Region**
 - 5. Abra
 - 6. Apayao
 - 7. Benguet
 - 8. Ifugao
 - 9. Kalinga
 - 10. Mountain Province
 - II Cagayan Valley**
 - 11. Batanes
 - 12. Cagayan
 - 13. Isabela
 - 14. Nueva Vizcaya
 - 15. Quirino
 - III Central Luzon**
 - 16. Bataan
 - 17. Bulacan
 - 18. Nueva Ecija
 - 19. Pangasinan
 - 20. Tarlac
 - 21. Zambales
 - NCR National Capital Region**
 - IV Southern Tagalog**
 - 22. Batangas
 - 23. Bataan
 - 24. Cavite
 - 25. Laguna
 - 26. Marikina
 - 27. Mindoro Occidental
 - 28. Mindoro Oriental
 - 29. Quezon
 - 30. Rizal
 - 31. Tamarog
 - 32. Romblon
 - V Bicolandia**
 - 33. Albay
 - 34. Camarines Norte
 - 35. Camarines Sur
 - 36. Sorsogon
 - 37. Masawa
 - 38. Sorsogon
 - VI Western Visayas**
 - 39. Aklan
 - 40. Antique
 - 41. Cebu
 - 42. Iloilo
 - 43. Negros Occidental
 - VII Central Visayas**
 - 44. Bohol
 - 45. Cebu
 - 46. Negros Oriental
 - 47. Siquijor
 - VIII Eastern Visayas**
 - 48. Samar
 - 49. Eastern Samar
 - 50. Leyte
 - 51. Negros Oriental
 - 52. Western Samar
 - 53. Samar
 - 54. Sorsogon
 - IX Western Mindanao**
 - 55. Basilan
 - 56. Zamboanga del Norte
 - 57. Zamboanga del Sur
 - X Northern Mindanao**
 - 58. Bukidnon
 - 59. Compostela
 - 60. Misamis Occidental
 - 61. Misamis Oriental
 - XI Southern Mindanao**
 - 62. Davao del Norte
 - 63. Davao del Sur
 - 64. Davao Oriental
 - 65. Sarangani
 - 66. South Cotabato
 - 67. Sultan Kudarat
 - XII Central Mindanao***
 - 68. Lanao del Norte
 - 69. Lanao del Sur
 - 70. Agusan del Norte
 - 71. Agusan del Sur
 - 72. Sarangani del Norte
 - 73. Sarangani del Sur
 - XIII Caraga**
 - 74. Butuan
 - 75. Misamis Occidental
 - 76. Misamis Oriental
 - 77. Surigao del Norte
 - 78. Surigao del Sur
- *Includes Cotabato City.



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