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PROJECT PERFORMANCE ASSESSMENT REPORT

REPUBLIC OF THE PHILIPPINES

**WATER DISTRICTS DEVELOPMENT PROJECT
(LOAN 4227-PH AND LOAN 4228-PH)**

June 30, 2009

*Sector Evaluation Division
Independent Evaluation Group (World Bank)*

Currency Equivalents (annual averages)

Currency Unit = Philippine Peso (PhP)

1997	US\$1.00	PhP 26.31	2002	US\$1.00	PhP 51.50
1998	US\$1.00	PhP 40.00	2003	US\$1.00	PhP 53.27
1999	US\$1.00	PhP 39.15	2004	US\$1.00	PhP 55.55
2000	US\$1.00	PhP 40.30	2005	US\$1.00	PhP 56.28
2001	US\$1.00	PhP 49.94	2006	US\$1.00	PhP 53.06

Abbreviations and Acronyms

BESP	Barangay Environmental Sanitation Plan
EIA	Environmental Impact Assessment
ESS	Environmental and Social Safeguards
GFI	Government Finance Institutions
IFC	International Finance Corporation
LBP	Land Bank of the Philippines
LGU	Local Government Unit
LWUA	Local Water Utilities Administration
NEDA	National Economic Development Authority
NGOs	Non-governmental Organizations
NWRB	National Water Regulatory Board
OM	Operational Manual
O&M	Operations and Maintenance
PAWS	Public Assessment of Water Services (new name of PPA)
PMO	Project Management Office (of LBP)
PPA	Project Performance Audit (project component)
SLA	Subsidiary Loan Agreements
SSD	Sewerage, Sanitation and Drainage Development (project component)
S2LDIP	Support for Sustainable Local Development and Investment Project
UP-NEC	University of the Philippines-National Engineering Center
WDDP	Water Districts Development Project
WSS	Water Supply and Sanitation

Fiscal Year

Government: January 1 to December 31

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IEGWB Mission: Enhancing development effectiveness through excellence and independence in evaluation.

About this Report

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEGWB annually assesses about 25 percent of the Bank's lending operations through field work. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons.

To prepare a Project Performance Assessment Report (PPAR), IEGWB staff examine project files and other documents, interview operational staff, visit the borrowing country to discuss the operation with the government, and other in-country stakeholders, and interview Bank staff and other donor agency staff both at headquarters and in local offices as appropriate.

Each PPAR is subject to internal IEGWB peer review, Panel review, and management approval. Once cleared internally, the PPAR is commented on by the responsible Bank department. IEGWB incorporates the comments as relevant. The completed PPAR is then sent to the borrower for review; the borrowers' comments are attached to the document that is sent to the Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

About the IEGWB Rating System

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Outcome: The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: relevance, efficacy, and efficiency. *Relevance* includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. *Efficacy* is the extent to which the project's objectives were achieved, or are expected to be achieved, taking into account their relative importance. *Efficiency* is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. The efficiency dimension generally is not applied to adjustment operations. *Possible ratings for Outcome:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Risk to Development Outcome: The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). *Possible ratings for Risk to Development Outcome:* High Significant, Moderate, Negligible to Low, Not Evaluable.

Bank Performance: The extent to which services provided by the Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan/credit closing, toward the achievement of development outcomes. The rating has two dimensions: quality at entry and quality of supervision. *Possible ratings for Bank Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

Borrower Performance: The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. *Possible ratings for Borrower Performance:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

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<p>This report was prepared by Fernando Manibog (Task Manager), who assessed the project in September 2007. Marie Charles provided administrative support.</p>
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Principal Ratings

	<i>ICR*</i>	<i>ICR Review*</i>	<i>PPAR</i>
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Risk to Development Outcome	Moderate	Moderate	Moderate
Bank Performance	Moderately Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Borrower Performance	Moderately Satisfactory	Moderately Satisfactory	Moderately Satisfactory

* The Implementation Completion Report (ICR) is a self-evaluation by the responsible Bank department. The ICR Review is an intermediate IEGWB product that seeks to independently verify the findings of the ICR.

Key Staff Responsible

<i>Project</i>	<i>Task Manager/Leader</i>	<i>Division Chief/ Sector Director</i>	<i>Country Director</i>
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Preface

This is the Project Performance Assessment Report (PPAR) prepared by IEG for the Philippines Water Districts Development Project, which was approved on September 9, 1997, at an estimated total cost of US\$80.7 million equivalent. The project consisted of two separate loans for the Public Performance Audit System for the Metro Manila Area (the PPA Loan No. 4227-PH) and the Sewerage, Sanitation and Drainage Services (SSD Loan No. 4228-PH). The total value of the loans was US\$57 million equivalent. The PPA loan was a pilot activity for US\$2.5 million. The SSD loan was originally for US\$54.5 million. This was scaled back to US\$36.3 million in 1999 due to the sharp depreciation of the Philippine peso during the East Asian Financial Crisis. This led to reduced demand for the SSD loan and the project's restructuring on May 15, 1999, at which time the two loans had a total value of US\$38.6 million equivalent (the PPA loan was also scaled back slightly to US\$2.3 million equivalent).

This PPAR is based on the revised Loan Agreements at restructuring. The PPA loan closed on the original date of June 30, 2003, at which time US\$1.97 million was disbursed and \$0.33 million was cancelled. The SSD loan closed on December 31, 2006, or two and a half years after the original closing date of June 30, 2004, to allow completion of pending activities. Actual disbursement of the SSD loan totaled US\$15.41 million at closing, after successive cancellations amounting to US\$20.29 million. Together with interest and other charges of US\$0.6 million equivalent, the total disbursement at project completion was US\$17.98 million equivalent.

The project was chosen for an IEG assessment as it tested the viability of lending through government financial intermediaries, which involved the challenges of institutional and capacity building, and adherence to safeguard policies under difficult conditions.

IEG prepared this report based on an examination of the relevant Staff Appraisal Report, Implementation Completion Report (ICR), legal agreements, project files and archives, as well as other relevant reports, memoranda, and working papers. Discussions were also held with a number of existing and former Bank staff in Washington DC, as well as in the Philippines. An IEG mission visited the Philippines in September 2007, conducted site visits, and discussed both the project and the effectiveness of Bank assistance with government officials and stakeholders. Their kind assistance is greatly appreciated.

Following standard IEG procedures, copies of the PPAR were sent to relevant government officials and agencies for their review and comments. Comments from the Borrower were taken into account and included in Annex C.

Summary

The Water Districts Development Project (WDDP) was approved by the World Bank in 1997. The project was identified during the early 1990s when both the Bank and the government recognized the serious constraints in the country's water supply and sanitation (WSS) sector including the lack of a sector policy and transparent financing criteria, inadequate incentives for commercial operations, a highly fragmented market, low tariffs, and political interference in tariff-setting. The Bank's global WSS portfolio itself was performing poorly throughout the 1980s, and the assessed project was in the new phase of projects that sought to adapt to the increasing global trend of private sector participation in public utility systems.

The adoption of the Local Government Code in 1991 triggered the decentralization of public services in the Philippines, leading the National Economic Development Authority to undertake a Water Supply and Sanitation Sector Review with the Bank's assistance. The study recommended greater private sector involvement, better cost recovery, decentralized management, graduation of commercially viable utilities from concessionary financing, and prioritization of investments in sewerage and sanitation that are cost-effective and financially sustainable. In line with the study's recommendations, the government enacted the National Water Crisis Act in 1995, calling for more efficient management of water resources, private sector participation, and selection of investments on the basis of local demand and willingness-to-pay. This was followed by the privatization of the Metropolitan Waterworks and Sewerage System (MWSS) assisted by the International Finance Corporation, with the concession agreements becoming effective in 1997.

The Bank played a crucial role in assisting government in developing a new policy framework for promoting private sector participation, supporting Local Government Units (LGUs) to deliver WSS services as mandated by the 1991 Code, and promoting Government Finance Institutions as channels of financing for investments at the local level. In September 1997, the Bank approved the WDDP, whose objectives were to assist the government in:

- (a) creating an institutional environment to encourage the participation of the private sector in water utilities; and
- (b) supporting the participating Local Government Units in improving water, sewerage, sanitation and drainage within the areas of their jurisdiction.

The project was supported by two loans that corresponded respectively to the these objectives: one loan was to support a Public Performance Audit System (the PPA component) in the Metro Manila Area to complement the privatization of MWSS, and the other loan for Sewerage, Sanitation and Drainage Development (the SSD component). The 1997 approval coincided with the onset of the East Asian financial crisis, which made the Government and the LGUs reluctant to commit to the project because of the steep fall of the Philippine peso. Thus, the loan agreements were unsigned for 19 months after approval, and the loans were restructured in May 1999 with no change in the project

objectives. The SSD loan shifted away from pre-identified projects toward a program approach responding to specific demands from various LGUs. The SSD loan became effective in September 1999, and the PPA loan in October 1999.

The **outcome** of the project is **moderately satisfactory**, based on substantial relevance, substantial efficacy and modest efficiency.

The PPA—designed as a pilot activity—was successfully completed and is being scaled up for implementation in the Metro Manila Area. It encouraged private participation by introducing an audit system for utility performance. This initiated transparency, accountability and regular reporting on the cost structure, technical operations and beneficiary outcomes for the WSS sector, for which there was no established system prior to the project.

Risk aversion resulting from the East Asian financial crisis contributed to low LGU participation under the SSD component, although it in the end exceeded appraisal and restructuring targets. Of the 25 LGUs that were approved based on borrowing capacity, 10 signed Subsidiary Loan Agreements, of which 4 dropped out before project implementation. There were also some project-induced constraints. For example, while the LGUs had the responsibility for technical assistance, the innovative nature of the lending facility required that Land Bank establish consulting resources in order to bridge the LGUs' capacity gap as well as build their skills to operate under the new approach. Land Bank as the implementing agency, however, did not have a clear comparative advantage in providing technical assistance to borrowers for WSS projects.

The participatory processes associated with the Barangay Environmental Sanitation Plan investments caused delay and contributed to the drop in LGU interest and increased costs, in part due to the need to recruit private subproject design consultants. The Bank's WSS practice strongly advocates demand-responsive approaches as a necessary step to ensure sustainability of the water systems. However, project designs should correct for the longer time required to undertake participatory processes by ensuring that commitment charges would not be passed on to LGUs, e.g., by signing two sub-loan agreements—one for the design phase and one for implementation.

The **risks to development outcome** are *moderate*. Financing for the PPA component is expected to be sustainable, but this is less apparent for the SSD component unless contributions from taxes and tariffs are adequately increased. **Bank Performance** is **moderately satisfactory** in view of significant risks that were underestimated during the project's design and restructuring, and weaknesses in addressing technical assistance needs and other institutional capacity issues. **Borrower Performance** is also **moderately satisfactory**, due to its failure to sustain reforms that are needed to achieve sector integration, specifically the congressional bill to establish an independent regulatory authority for the WSS sector.

From a sectoral policy perspective, the WDDP has led to a better understanding of the potentials and limitations of WSS lending through government financial intermediaries, as well as the terms and conditions under which LGUs can benefit from on-lending facilities. The negative consequences of government's failure to establish a

regulatory authority and a lead agency for the WSS sector have become much clearer to government. This, in turn, has made the Bank's ongoing reform dialogue with government increasingly relevant and has facilitated the integration of the lessons learned from WDDP into successor operations, specifically the Support for Strategic Local Development and Investment Project.

The lessons derived from WDDP's implementation experience, especially for WSS operations that onlend through government financial intermediaries, include the following:

- A sudden change in a project's lending approach, when done under pressure of tight processing timetables and strong exogenous factors, works against effective project implementation.
- Issues stemming from the local political economy need to be addressed at project entry because they strongly influence local ownership and the ease of implementation.
- While well-intentioned and useful in building client ownership, participatory processes (usually associated with social and environmental safeguards) require substantial up-front time which needs to be built into implementation planning.
- Complex sub-projects such as private sector contracts for water supply or solid waste landfills require borrower expertise beyond procurement and financial management; thus, adequate provisions should be made for the significant technical assistance requirements of local borrowers, including monitoring and reporting on subproject outcomes.

Vinod Thomas
Director-General
Evaluation

1. Sector Background and Project Context

1.1 As a result of rapid population growth and urbanization, Water Supply and Sanitation (WSS) service levels in Philippines' urban centers had deteriorated considerably by the early-1990s, accompanied by serious negative environmental and health impacts. Both the government and the World Bank recognized that the sector's performance had been set back by six factors:

- the absence of a well-articulated policy framework for the sector;
- lack of transparent criteria for financing sector investments;
- inadequate incentives to manage the water utilities as commercial enterprises;
- a highly fragmented market;
- tariffs that are too low to recover costs; and
- political interference in tariff-setting.

1.2 In response, the Bank shifted its assistance from project lending to sector work. The review of sector policies was driven by three factors. First, the Bank-financed urban WSS global operations were performing poorly in the 1980s and a new strategic approach was required. Second, the growing global trend toward private sector participation and investment in public utility systems during the 1990s required a new Bank lending response. Third, in the Philippines, adoption of the Local Government Code (Code) in 1991 triggered a far-reaching decentralization of the public services. Under the Code, municipal governments received substantial block transfers each year through a formula-based Internal Revenue Allocation that supplemented their local resources.

1.3 Subsequently, the National Economic Development Authority undertook a Water Supply and Sanitation Sector Review with the assistance of the Bank. The main conclusion of the study was that the demand for WSS services was well beyond public financing capacity. Solutions recommended included: requiring greater private sector involvement, better cost recovery, decentralized management at the lowest appropriate level, graduation of commercially viable water utilities from concessionary financing, and, for public financing purposes, the prioritization of cost-effective and financially sustainable investments in sewerage and sanitation.

1.4 The National Economic Development Authority acted upon the study's recommendations by laying out specific national policies for the WSS sector in 1994¹. This was followed by the National Water Crisis Act in 1995, which vested the Executive Branch with special powers to act on the recommendations, and specifically to address the water and sanitation crisis in the Metro Manila area. The Bank played a critical role in assisting the government in developing these new policies, which reflected the widely accepted principles

1. Specifically, the National Economic Development Authority's Board adopted Resolutions Nos. 4 and 5. Resolution No. 4 called for more efficient management of water resources and encouraged private sector participation. Resolution No. 5 addressed the growing problem of human waste, stating that sewerage and sanitation investments should be made on the basis of demand, i.e., on the basis of local preferences and willingness to pay.

of providing services on the basis of demand and managing them at the lowest appropriate level.

1.5 Also in line with the new policy framework, the Bank began to focus on promoting new policies in three important ways by:

- (a) promoting private sector participation;
- (b) supporting Local Government Units (LGU) to deliver WSS services in accordance with their new mandate under the Code; and
- (c) promoting the role of Government Finance Institutions (GFIs) as channels of external and internal funding to finance investments at the local level.

1.6 Under this new policy framework, the government launched the privatization of the operations of Metro Manila's Metropolitan Waterworks and Sewerage System (MWSS) in 1996, with the assistance of the International Finance Corporation. Two concessionaires were selected for the Eastern and Western parts of the city, respectively the Manila Water Company Inc. and the Maynilad Water Services Inc. The concession agreements came into force in August 1997.

1.7 The Bank provided financing to MWSS to support the initiation of a Public Performance Audit System in Metro Manila. In addition, the Bank also provided financing to support investments by LGUs through Government Financial Institutions:

- (a) the Water Districts Development Project was approved in FY98 with two loans for implementation through the Land Bank of the Philippines (Land Bank) and the Regulatory Office of MWSS; and
- (b) the LGU Urban Water and Sanitation Project² was approved in FY99 for implementation through the Development Bank of the Philippines.

1.8 The underlying rationale of these operations was that the World Bank's financing of strategic investments in institutions and infrastructure for urban water supply and sanitation would lay the basis for future investments in secondary cities and towns. At the same time, it would enable the government to develop and test cost-effective and financially sustainable methods for improving urban sanitation as a public good because of negligible private sector interest in this area.

1.9 This report examines the project performance of the Water Districts Development Project.

2. APL 4422-PH. The Implementation Completion Report No. 25718-PH was issued on June 28, 2004.

2. The Project

OBJECTIVES, COMPONENTS AND RESTRUCTURING

2.1 The objectives of the Water Districts Development Project (WDDP) were to assist the Republic of the Philippines in:

- (a) creating an institutional environment to encourage the participation of the private sector in water utilities; and
- (b) supporting the participating Local Government Units in improving water, sewerage, sanitation and drainage within the areas of their jurisdiction.

This wording of objectives is based on the restructured Loan Agreements, since the original loan agreements corresponding to the Staff Appraisal Report were never signed (see paras 2.6 and 2.7).

2.2 The WDDP consists of two loans, which corresponded broadly to two project components described below:

Component 1: Public Performance Audit (PPA) – Loan 4227-PH

2.3 The PPA component—to be implemented by MWSS—would develop and pilot a public performance audit system to measure the performance of concessionaires for water and sewerage services, through the provision of technical assistance. At appraisal, the estimated cost was US\$2.5 million, which was adjusted to US\$2.3 million after project restructuring. The actual component cost was US\$2.0 million, or 11 percent of the actual total project cost. After the component's completion in 2001 under the project, the MWSS continued to expand the PPA and renamed it as the Public Assessment of Water Services (PAWS).

Component 2: Sewerage, Sanitation, and Drainage Development (SSD) – Loan 4228-PH

2.4 The SSD component—to be implemented by the Land Bank of the Philippines—would improve the water, sewerage, sanitation and drainage services in participating LGUs through the construction of:

- (a) water, sewerage and drainage systems in *barangays*;
- (b) on-site and communal sanitation facilities for residents of such LGUs;
- (c) a sewerage system consisting of house connections, feeder and trunk sewers;
- (d) a sewage treatment plant; and
- (e) drainage facilities.

A “*barangay*” is the smallest political unit into which cities and municipalities in the Philippines are divided. It is the basic unit of the Philippine political system, and consists of

inhabitants residing within the territorial limit of a city or municipality administered by a set of elective officials and headed by a *barangay* chairman³.

2.5 The SSD component would also strengthen the capability of the Land Bank's Project Management Office to support the participating LGUs in the design of their respective sub-projects and to manage the overall project implementation through the provision of consultants' services.

2.6 Key Milestones. The WDDP was approved by the World Bank in September 1997. The loan agreements were unsigned for 19 months due to onset of the East Asian financial crisis that coincided with the time of loan approval. The crisis made the government and the LGUs reluctant to commit to the project primarily because of the steep fall of the Philippine peso⁴. The cross-effectiveness condition requiring both the PPA and SSD loans to be signed together, and the delay in starting the PPA implementation, also contributed to the overall delay. As explained immediately below, the loans were restructured in May 1999, two years after the Board approval date, with no change in the project objectives. The SSD loan became effective in September 1999, and the PPA loan in October 1999. The PPA loan closed in accord with the restructured schedule of June 30, 2003. For the SSD loan, the restructured closing date of June 30, 2004 was extended twice—once to December 31, 2005 and then to December 31, 2006—in order to complete the implementation of physical investments in several LGUs.

2.7 Restructuring. The Board approved the restructuring of the two loans in May 1999. Instead of a new appraisal document, an Operational Manual and a new Loan Agreement were prepared. This option was chosen because the preparation of a new Staff Appraisal Report would not have allowed the May 15, 1999 deadline for loan signing that had been set by the Bank's regional management to be met. The Implementation Completion Report (ICR) justifies this manner of restructuring on the grounds that the development objectives remained the same.

2.8 The restructuring primarily affected the SSD Loan, while the PPA loan remained largely intact. The SSD Loan was shifted away from a project approach consisting of pre-identified projects toward a program approach where the design of each sub-project responded to specific demands from various LGUs. LGUs outside Metro Manila were made eligible to participate rather than only the four pre-identified ones (including Davao, Cotabato, Calamba, and Cagayan de Oro). The LGUs were also allowed to seek assistance for preparation of feasibility studies from the Project Management Office of the Land Bank. An original provision to obtain technical assistance from the Local Water Utilities Administration was dropped, after the focus was switched from the original four water districts to an open menu for local governments.

3. Source: National Statistical Coordination Board, Government of the Philippines.

4. It is important to note that the East Asian financial crisis affected the Bank's entire lending portfolio in the Philippines. All four loans approved between 1997 and 2000 were reduced in size by an aggregate 25 percent and their closing dates were all extended.

2.9 The restructured SSD consisted of trunk and feeder investments⁵ as follows:

- (a) capital-intensive trunk investments in sewerage, drainage and wastewater treatment infrastructure based on LGU priorities (Sewerage, US\$10.6 million and Drainage, US\$12 million); and
- (b) feeder investments in urgent environmental and sanitation investment programs in *barangays* identified by LGUs (US\$9 million).

2.10 SSD trunk investments were chosen through participation of stakeholders, local executives and the local legislature. To qualify for feeder investments, the *barangays* were required to prepare Barangay Environmental Sanitation Plans (BESPs) through a participatory process involving non-governmental organizations (NGOs) and partner organizations for sub-projects in water supply, sanitation, neighborhood drains and solid waste management. The LGU specified the budget ceiling to be financed by the Land Bank loan and/or city equity along with cost-sharing arrangements between LGU and communities. The SSD component's design and implementation were guided by beneficiary surveys, as follows: (i) Community Mapping to assess the type of environmental sanitation improvements that were required by households (piped WSS systems were identified as priorities); (ii) Willingness-to-Connect Surveys (60 percent of respondents were willing to connect to a piped water system and pay WSS tariffs computed to cover costs).

COST AND FINANCING

2.11 As shown in Table 1 below, the overall project cost at completion was US\$17.98 million, compared to US\$80.7 million at appraisal, and US\$38.6 million after restructuring. At appraisal, the estimated total cost of the SSD component was US\$78.2 million, but this was scaled down significantly to US\$36.3 million upon project restructuring, and the actual cost went down further to US\$15.41 million, or 42 percent of the estimated costs for that component at restructuring. The exchange rate fluctuations resulting from the Asian financial crisis had a significant impact on project disbursement, with the Philippine Peso value of the restructured project being 69 percent of the US Dollar value of the restructured project. Thus, the overall project costs at completion were 22 percent of the appraisal estimates, and 47 percent of costs estimated after restructuring. However, the Peso value of the final project cost was as much as 69 percent of the restructured loan, the remaining gap being due to three LGUs not availing of subsidiary loans. At project completion, the distribution of costs between trunk and feeder investments was 75 percent and 25 percent, respectively, and between water supply and sanitation investments, 79 percent and 21 percent, respectively. Details are presented in Annex A.

5. Trunk investments include central and often capital-intensive facilities for sewerage, drainage and wastewater treatment, while feeder investments include distribution systems and decentralized installations at the level of the local political unit, or the *barangay* in the case of this project.

Table 1 Changes in Project Costs (in US\$ million)

Component	At Appraisal	At Restructuring	At Completion
PPA	2.5	2.3	1.97
SSD *	78.2	36.3	15.41
Interest & Other Charges	-	-	0.60
Total	80.7	38.6	17.98

* For the SSD component, the World Bank Loan at appraisal of US\$54.5 million was reduced to US\$36.3 million at restructuring. Of this amount, successive cancellations were made totaling US\$20.29 million. Including the cancelled amount of US\$0.33 for the PPA component, the total cancellation from the two loans is US\$20.62 million equivalent.

IMPLEMENTATION EXPERIENCE

2.12 PPA component. The Regulatory Office of the MWSS took responsibility for implementing the overall PPA system. Initially, the PPA system was aimed at measuring the performance of two concessionaires in the Eastern and Western service areas of Metro Manila, by developing and piloting—under this WDDP component—a public performance audit system in 50 *barangays*. The National Engineering Center of the University of the Philippines designed and tested the audit methodology in order to ensure transfer of know-how, technology and expertise. The PPA pilot was completed successfully in July 2001. It demonstrated a clear value-added in a situation where no such monitoring was being done when operations were exclusively in the public sector.

2.13 SSD component. The Land Bank of the Philippines (Land Bank) took responsibility for implementing the SSD component. Initially, 50 LGUs expressed preliminary interest in borrowing from the Land Bank for a total investment of about Peso 1 billion, which would have fully utilized the restructured loan amount of US\$ 36.3 million. Subsequently, 25 of these LGUs were approved by the Land Bank based on borrowing capacity. Finally, ten LGUs signed a Subsidiary Loan Agreement with the Land Bank, but four of them dropped out before project implementation. Thus only six LGUs availed of subsidiary loans in the end. The four LGUs that dropped out at the last moment did so for various reasons including the inability of a municipal council to ratify the loan and the perceived complexity of World Bank procurement procedures.

KEY IMPLEMENTATION PROBLEMS

2.14 One of the reasons for selecting this project for an IEG assessment was to derive lessons from the WDDP's experience in testing directed lending for local infrastructure through government financial intermediaries. Several factors affected the SSD component negatively, as discussed below.

2.15 The Bank identified several risks during project appraisal and restructuring but underestimated them significantly. *First*, it recognized that the LGUs could back out before project implementation by failing to enter into a Subsidiary Loan Agreement. The 1999

restructuring aimed to mitigate this risk by widening the pool of LGUs, but the drop-out rate became a serious issue nonetheless.

2.16 *Second*, when the conversion was made from a project to a program approach during restructuring, the lack of LGU buy-in or fully tested technical and institutional rules were also recognized as a risk. However, according to the ICR, the program approach was considered unavoidable because little time remained to execute loan agreements, and government commitment was considered sufficient to counterbalance the institutional capacity issues. In reality, LGU commitment to environmental sanitation investments remained weak, and there was low interest in capital-intensive infrastructure especially following the 1997 financial crisis. The regional staff clarified subsequently that the program approach was in fact appropriate given the passing of the local government code. In line with the code, in 1996 the government issued a policy that required LGUs to access loans for additional infrastructure investments that they sought beyond their internal revenue allotment. This LGU Financing Framework was put in place just before the preparation of the PPA and SSD loans, which were the first two loans financed through official development assistance and passed on through Government Financial Institutions. It was further clarified that these loans have led to substantial improvement in access to finance for LGUs; for example, the Land Bank's LGU loan portfolio has risen to 40 billion pesos in 2008.

2.17 *Third*, in a few reported instances, the short election cycle influenced the selection of the *barangays* and led to changes in technically desirable but politically less popular sub-projects. For example, the IEG mission was informed during a field visit in Cabanatuan that a pre-election decision was made to postpone a planned sewerage treatment plant in favor of a bridge. The long processing lag times for demand-driven projects (see paras 2.19-2.20 below) were not well synchronized with the three-year mayoral term, which lessened the interest of incumbent mayors in undertaking WDDP subprojects. The added flexibility of the project was insufficient to counterbalance the weak response of LGUs to the project. The election cycle and short term of LGU executives are factors that influence LGU lending through financial intermediaries all over the world, and can be addressed by factoring in significant changes between interested and actual clients throughout project life.

2.18 *Fourth*, significant delays resulted from the participatory processes for subprojects (comprising 25 percent of actual total project cost) that required the submission of Barangay Environmental Sanitation Plans. This was in addition to the time spent dealing with the bureaucratic obstacles to obtaining the required environmental clearances and water development permits. The long lag times between the LGU's initial expression of intent and project implementation start-up are shown in Table 2 below.

Table 2. Processing Lag Times for Demand-Driven Projects

Processing Step	Elapsed Time (in months)	
	Step	Cumulative
LGU submission of Letter of Intent	-	-
Signature of Subsidiary Loan Agreement	2	2
Participatory assessment of stakeholder demand:	6 to 12	8 to 14
(a) Signature of Willingness to Connect document *		
(b) Preparation of the Barangay Environmental and Sanitation Plan **		
Application for required clearances and approvals (e.g., Environmental Compliance Certificate)	3 to 6	11-20
Bank pre-approval of procurement documents	2 to 3	13-23
Bidding phase	3 to 6	16-29

* This formalizes the LGU's participation in the project and specifies that it will pay the tariff, and form an association or cooperative that will operate the project.

** This indicates how financing costs would be shared, the cost recovery mechanism, and the role of the project operator.

2.19 Thus, the process of moving from project identification to procurement took almost three years. Participatory demand assessment alone accounted for almost one-third of the elapsed period before actual on-site implementation could start. This resulted in substantially delayed loan disbursement, as well as higher commitment fees and increased project costs for the LGU. The time required for participatory planning should be built into the project so that sub-borrowers understand that this will require additional time and financial intermediaries factor the additional time required into their loan structure. Land Bank now offers two separate loans—one for technical assistance and one for the sub-project—to ensure that commitment costs are not factored in before the sub-project is ready for implementation.

MONITORING AND EVALUATION

2.20 Design. For the PPA component, the key monitoring indicators were all keyed to outputs, namely, the development of pilot reporting formats for the audit; the issuance of public audits in sample *barangays* of the MWSS; and positive feedback from stakeholders on the utility of the PPA (see also paras 4.5 to 4.7). These were appropriate indicators given the pilot nature of the component, and should not be confused with the larger set of indicators for measuring the performance of water utilities over the long term through the PAWS system (the successor to the PPA). For the latter, the MWSS developed a mix of primary and intermediate outputs covering network quality and water quality at both the provider and consumer levels (see Table 3 in the “Efficacy” section below). The need for outcome and impact indicators relating to health was recognized, but not included in this set of indicators. On the whole, this monitoring framework developed under the PPA component is considered well-designed and as having made a strong beginning towards eventually creating a comprehensive results framework.

2.21 In the case of the SSD component, after it was restructured and converted from a project to a program loan, the exact nature and quantities of investments and physical outputs were not defined or known in advance. The LGU proponents were required to provide

information on baselines in their applications, for which *barangays* conducted willingness-to-pay studies that provided a baseline and design year target population against which to monitor outputs at the end of the project. Using proceeds from the successor loan, the Land Bank has also established a monitoring and evaluation system to improve the tracking of its LGU portfolio based on implementation, budget use, environmental/social compliance (where applicable), and other milestones.

2.22 **Implementation.** For the PPA component, the Regulatory Office of MWSS and the National Engineering Center of the University of The Philippines used the results of the pilot phase to design the subsequent and ongoing phases of the audit program. The latest available monitoring results are presented in the PAWS website. The future implementation stages and the continuing expansion of the audit system's coverage are discussed under the "Efficacy" section of this report. For the SSD component, with the exception of one case, the indicators agreed between the Bank and the Land Bank in 1999 were defined only in general terms without any specific targets. Therefore, there was no benchmark against which to assess the achievements under this component. Beneficiary consultation was carried out after implementation, and results showed that most respondents perceived an improvement in their quality of life and environment. However, no details of the questionnaire, methodology and sampling were available to put these results in perspective.

2.23 **Utilization.** After the PPA pilot component's completion in 2001, the MWSS gradually expanded coverage to the whole MWSS service area and included sanitation. More importantly, the indicators were used by the eastern concessionaires, Manila Water Company Incorporated, to design its own monitoring program. This allowed them to monitor and improve performance in key areas being monitored by MWSS. However, the western concessionaire, Maynilad Water Services Incorporated (MWSI), did not utilize the monitoring system to a similar extent. This was partly because it was affected more severely by the Peso depreciation; it had to operate almost 100-year old facilities; and its client base came mainly from poorer social classes. Therefore, while it used some of the indicators, it considered the adoption of the whole audit system—calibrated to modern technology and operational practices—as inappropriate for its specific case and showed relatively less commitment at the time of project implementation in 2000/2001. In January 2007, however, the PPA reports on performance monitoring proved to be a useful tool in enabling MWSS to successfully re-negotiate the western concession contract with Maynilad Water Services Incorporated. It is important to note that the MWSI concession contract failed when the concessionaire went bankrupt and was only successfully re-awarded in early 2007. It is largely because of this that MWSS-RO has not been able to get MWSI to adopt the PPA as quickly as MWCI.

2.24 **The overall rating of the quality of monitoring and evaluation (M&E) is modest.** Although the initial design was satisfactory, the subsequent implementation and utilization were inadequate. The Land Bank does not yet have a system in place to continue monitoring sub-project performance after project completion. In line with decentralization, the responsibility for monitoring and reporting on sub-project outcomes rests with the LGUs. However, there are insufficient budgets at that level to build capacity adequately.

3. Project Evaluation

RELEVANCE OF OBJECTIVES AND DESIGN

3.1 **The project's objectives were and remain *highly relevant*.** The WDDP's objectives responded closely to sector needs by helping to address the following key issues in the WSS sector through the SSD component: (a) the deterioration of WSS levels due to population growth in urban areas and its attendant negative environmental impact; (b) the lack of a policy framework and financing criteria; (c) poor incentives for commercial operation of existing entities; and (d) political interference in setting tariffs. By specifically strengthening the MWSS through the PPA component, the project was also consistent with the government's Medium-Term Development Plan and the Bank Group's 2006-2008 Country Assistance Strategy, which sought to improve the enabling environment for private sector development by strengthening regulatory agencies and promoting private sector finance of infrastructure projects. The project also supported a participatory approach to encourage greater transparency and accountability in local government decision-making, and more reliance on government financial institutions for the channeling of funds, which the Bank also advocated.

3.2 **The overall relevance of project design is rated *substantial*.** Taking the two components separately, the design of the PPA pilot component was highly relevant, since it was developed as a complement to the MWSS privatization financed by the International Finance Corporation. Building on the foundation laid by this pilot component, the PPA was extended to other towns to increase the transparency of WSS investment performance and thereby promote private sector participation. IEG's review of the project documentation showed that the Bank made significant efforts through workshops and seminars to explain the PPA objectives and methodology to stakeholders.

3.3 However, there were shortcomings in the design of the SSD component. First, although the responsibility for technical assistance lies with the LGUs as prescribed by the local government code, there was a need to bridge the gap in LGU capacity as well as build skills and understanding for the innovative approach of the lending facility, for which the Land Bank established consulting resources. The Land Bank initially hired technical consultants and assigned Resident Engineers to field sites, but while this worked well for the LGUs, it proved quite costly for the Land Bank and did not serve to develop capacity at the LGU level. As a result the costs of the feasibility studies were passed on to the LGUs. Second, this resulted in less funds being available to the project itself, since LGUs had a ceiling on the amount they could borrow, and 12 to 14 percent of the loan funds could be used by the feasibility study alone. This amount could have funded more improved sanitation, water connections or longer drainage lines.

3.4 The restructuring of the SSD component from project- to program-based lending was seen as a much-needed design adjustment by the government and the Land Bank. It provided more flexibility for procurement, disbursement, and supervision compared to project lending. However, even after restructuring, the LGUs were still asked to finance any technical assistance on their own or seek assistance from the Land Bank, which itself had limited

technical capacity. Subsequently, the loan provisions were amended to allow use of sub-loans for sub-project preparation and feasibility studies.

EFFICACY

Objective 1: To create an institutional environment which would encourage the participation of the private sector in water utilities. Efficacy is rated substantial.

3.5 Overall Assessment of the PPA Component. The pilot PPA component, which pursued this first objective, encouraged private participation by introducing an audit system for utility performance, thus initiating transparency, accountability and regular reporting on the cost structure, technical operations and beneficiary outcomes for the WSS sector, for which there was no established system prior to the project. As a pilot, the PPA was administered to progressively larger numbers of units, after an initial series of testing and redesign. As evidence of its sustainability, the PPA system is being followed through in successive phases until 2011/12. The PPA was piloted in conjunction with the IFC-financed privatization of two public water companies in the Manila area. Thus, the Bank Group was achieving important strides in the WSS sector by privatizing water companies (IFC) while integrating pilot performance audit systems (Bank). There is some evidence that the PPA process has contributed to increased confidence on the part of other financiers—i.e., the Asian Development Bank as well as German and Japanese official aid—to approve successor projects. This helped lay the groundwork for renewed donor coordination through regular WSS financiers’ consultative meetings intended to develop a sector strategy after having been shut out of WSS lending by the government for about a decade.

3.6 Output Indicators. The project documents were transparent in indicating that the PPA component would pursue only output indicators, which was justified given its pilot nature and the feasibility of measuring sector-level outcomes only when a much larger geographic coverage from the PAWS’ successive phases (beyond this project) has been achieved. The PPA pilot component focused mainly on developing, testing and calibrating the survey instruments, mapping out the logistics of achieving sufficient geographic coverage during the future roll-out phases, and helping the MWSS Regulatory Office internalize the audit methodology. The full coverage of the Metro Manila Area (or the National Capital Region) may take much longer than expected partly due to the elimination of LWUA’s technical assistance role when the project was restructured.

3.7 The original PPA pilot component’s indicators and its performance in terms of outputs are shown in Table 3 below.

Table 3. PPA Component Indicators and Outputs

Indicators	Outputs
1. Development of pilot reporting formats, including a Performance Measurement Framework (PMF), an Information Management System (IMS), and a Plan for Public Information Disclosure and Feedback (PIDF)	The PMF was completed by the project's closing date. The IMS is being scaled up under successor operations. The PIDF is being expanded as part of the ongoing phases of the PAWS system that was built around the PPA pilot.
2. Issuance of public audits in sample <i>barangays</i> of MWSS	Out of 1,697 <i>barangays</i> in the Philippines, 100 were surveyed through the pilot audit. This first phase was completed in 2001 under the project and renamed PAWS. The PPA loan closed in 2003, when 420 additional <i>barangays</i> were surveyed in a second phase. By 2006, a further 720 were surveyed in the third phase of the PAWS roll-out plan. All 1,697 are planned to be surveyed by 2011/2012.
3. Positive feedback on the utility of the PPA from MWSS and other stakeholders	Based on a survey of 95 out of 100 <i>barangays</i> that were surveyed under the pilot audit, consumers and concessionaires rated the overall audit quality as good. MWSS organizes <i>barangay</i> road shows to explain and discuss audit results with consumers.

Source: World Bank's Implementation Completion Report dated June 28, 2007 and the Land Bank of the Philippines' Implementation Completion Report (Undated; filed in the IRIS system on May 9, 2007)

3.8 The PAWS website includes the latest composite ratings for the surveyed *barangays* covering consumer-level and provider-level ratings, and combines them into an overall performance rating on a five-point scale ranging from Very Good to Very Poor. The detailed ratings are based on the parameters shown in Table 4 below. However, the website does not yet provide quantitative details of consumer-level and provider-level indicators, and does not include an explanation of the methodology used for arriving at the final overall rating.

Table 4. Consumer- and Provider-Level Elementary Indicators

Consumer-Level Indicators		
Network Quality	Water Quality	Service Quality
Continuity of Supply	Water Smell	Response to Water Interruptions
Interruption of Supply	Water Color	Response to Billing Complaints
Daytime Pressure Indicators	Sand and Foreign Bodies	Response to Customer Inquiry
Nighttime Pressure Indicator	Water Taste	Response to Service Complaints
Provider-Level Indicators		
Network Quality	Water Quality	Service Quality
Continuity of Supply (24 hours)	Total Coliform Content	Response to Service Complaints
Risk of Contamination due to Low Pressure	Residual Chlorine Concentration	Response to Billing Complaints
Daytime Pressure Indicator	Fecal Coliform (Screener Indicator)	Response to Requests for New Connections
Nighttime Pressure Indicator		Response to Main Failures

Source: Regulatory Office, MWSS, September 27, 2007 powerpoint presentation.

Objective 2: To support the participating LGUs in improving water, sewerage, sanitation and drainage within the areas of their jurisdiction. The SSD component's efficacy is rated substantial.

3.9 For the SSD component, the indicators and corresponding outputs after project restructuring are summarized in Table 5 below; the succeeding paragraphs provide more details; and the field data are presented in Annex B. Some consultations that were conducted at the beneficiary level pointed to positive results but there was no formal study to document the project's outcomes.

Table 5. SSD Component Indicators and Outputs

Indicators As Revised After Restructuring	Outputs
1. At least four LGUs outside the Metro Manila Area should have successfully implemented planned quality sanitation services in their communities.	<u>Trunk subcomponent</u> : four cities <u>BESP subcomponent</u> : two LGU loans supporting 15 <i>barangays</i>
2. Construction of sewerage and feeder water supply network outsourced to private sector or water district.	By project closing in December 2006, the management, operation and maintenance of the operational water systems in 13 <i>barangays</i> were outsourced to a local Water User Association or Cooperative in accordance with a Memorandum of Agreement between the LGU and the Association or Cooperative. The construction of sewerage and feeder supply networks was outsourced to the private sector.
3. A number of successor sanitation projects prepared and approved by the government.	Six successor projects are under implementation: three financed through Land Bank of the Philippines, one through the Development Bank of the Philippines, and two directly by the government. Four of these received financing from the World Bank, one from the Asian Development Bank, and one from the Japan Bank for International Cooperation.

Source: World Bank's Implementation Completion Report dated June 28, 2007 and the Land Bank of the Philippines' Implementation Completion Report (Undated; filed in the IRIS system on May 9, 2007)

Although the indicators at restructuring were met or exceeded, the project was affected by shortcomings that led to decreases in LGU interest. Of the 50 LGUs that originally expressed interest to participate, 25 were approved based on their borrowing capacity, and 10 actually signed Subsidiary Loan Agreements—of which 4 dropped out before project implementation. While being fully cognizant of the risk aversion resulting from the East Asian financial crisis, project-induced constraints also discouraged LGU participation. Significant problems were caused by selecting the Land Bank as the implementing agency despite the lack of a proven track record in managing and providing technical assistance to borrowers for WSS projects. The participatory processes associated with the environmental impact assessment of sanitation caused much delay and contributed to the drop in LGU interest and increased costs⁶, in part due to the need to recruit private subproject design consultants. While these may be plentiful in the National Capital Region, this is not the case in outlying provinces.

3.10 Trunk Investments. With respect to the first indicator, six LGUs (four of which are cities) had received loans by project completion. The project's achievement was higher than the target of financing four LGUs. In the four cities that made trunk investments

6. The Borrower commented that while this is true, it is important to consider that the WDDP-SSD cannot finance a stand-alone water supply system project. A sanitation component is required to qualify for WDDP-SSD financing.

(Cabanatuan, San Fernando, Candon, and Calbayog), an estimated 261,000 people benefited from improved drainage, which is reported by respondents as having reduced exposure to health hazards.

3.11 **Feeder Investments.** Two LGUs (Panabo City in Davao and the Province of Palawan) financed feeder infrastructure consisting of water supply, sanitation, micro-drain and solid waste management sub-projects in 15 *barangays*. Specific outputs included the following: sewage collectors (10,095 linear meters); communal septic tanks (40 units); toilet bowls (2,056 units); individual septic tanks (400 units); and combined storm/drainage collection pipeline (39,187 meters). Since households were not willing to connect to sewer systems if they already had septic tanks, lower-cost options for septic tanks and combined sewerage/drainage systems were constructed, along with purchase of maintenance equipment.

3.12 In the project's *barangays*, an additional 3,500 households (representing about 20,000 people) in poor communities now have access to safe water, over 400 have on-site sanitation, and over 1,650 more have access to communal sanitation facilities, all of which were expected to have a beneficial health impact. Sub-projects helped improve quality of life among low-income *barangays* where piped water supply and sanitation was almost non-existent. Beneficiary consultations carried out by Land Bank after implementation suggested that most respondents perceived an improvement in their quality of life and environment. Based on document reviews and field interviews, the IEG mission found that women respondents have identified several benefits, including less time spent on chores, and greater cleanliness. Beneficiaries show greater appreciation of the need to contribute toward operation and maintenance of the facilities.

3.13 The IEG document review and site visits to Davao and Cabanatuan also found the close and proactive involvement of LGU officials. For example, for the above feeder investments, Panabo City in Davao and the Province of Palawan identified low-income peri-urban and rural *barangays* in which WSS investments were a priority. Local commitment was verified through consultative methods at the provincial, city, municipality and *barangay* levels. Leadership training was provided for the Project Management Units of Panabo City and Palawan Province.

EFFICIENCY

3.14 **Overall project efficiency was modest.** The many delays experienced by the project resulted in long lapses of time before sub-project implementation could be started. On the positive side, the PPA component was finished in 2001, two years after the project's restructuring in May 1999, and two years ahead of the formal closing date of June 30, 2003. It was completed at a lower cost than the estimate done during the project's restructuring. For the SSD component, water supply tariffs were based on willingness-to-pay estimates. Initial investment costs were partly or fully covered by the LGUs and cost-sharing agreements were worked out with Water User Associations and co-operatives. No economic internal rate of return was calculated for the project after its restructuring to a program-based loan, for which investments were only known ex-post. Instead, a least-cost analysis was used, supported by an identification of project benefits based on the willingness-to-pay of LGUs and

beneficiaries, to ensure that investments were not beyond the capacity of the *barangay* or the local government.

3.15 In the specific case of Palawan Province, the water supply investment cost was almost double compared to the ‘without-project’ cost in Panabo City in Davao. This was due to the use of a power generator and the costlier development and filtration of surface water resources in Palawan. In Panabo itself, full cost recovery was not achieved, since Panabo was able to remit only 40 percent of the levels agreed with the city government. In both cases, knowing that the *barangays* had few alternatives, the Provincial and City Governments were prepared to pay an initial subsidy for the investments with a view to eventually recovering the costs.

3.16 In some cases, loan commitment fees were passed on to LGUs, resulting in an increase in sub-project costs. (Although the passing-on of commitment fees to the sub-borrowers was a project flaw, it should be noted that the approach of building stakeholder buy-in through willingness-to-pay surveys was the right approach, although the time it took to complete the participatory processes could have been reduced.) In other cases, political considerations may have affected the choice of *barangays*. The *barangay* participatory model was untested at project start-up, and was based on a demand-driven and bottom-up approach to sub-project preparation that in itself took between six months and one year to complete, thus slowing disbursements and increasing costs to the participating LGUs in terms of commitment fees.

OUTCOME

3.17 **The Project Outcome rating is moderately satisfactory**, based on project sub-ratings of substantial for relevance, substantial for efficacy, and modest for efficiency (taking into account the much greater weight in project costs of the SSD component), as summarized in Table 6 below.

Table 6. Project Outcome Based on the Achievement of Project Objectives

Objectives	Relevance	Efficacy	Efficiency	OUTCOME
1. Create an institutional environment to encourage the participation of the private sector in water utilities	High	Substantial	Substantial	
2. Support the participating Local Government Units in improving water, sewerage, sanitation and drainage within the areas of their jurisdiction	Substantial	Substantial	Modest	
Overall Outcome Rating	Substantial	Substantial	Modest	Moderately Satisfactory

RISKS TO DEVELOPMENT OUTCOME

3.18 The future risks to development outcome are rated *moderate*. The PPA component is expected to be sustainable, including its financing. Although the PPA surveys were initially financed by MWSS, they were later cost-shared with the new private concessionaries in preparation for their inclusion in the new user rates. The extension of PAWS surveys outside the Metro Manila Area is also likely to be included in the Bank's proposed Local Government Support for Provincial and Regional Water Supply Project, while the GEF Manila Third Sewerage Project is assisting with the expansion of the PPA instrument to include sanitation and sewerage. These projects are expected to ensure a stable source of financing for the Regulatory Office of MWSS and the expansion of indicators to cover sanitation. The expansion of PPA to Water Districts is being considered under a proposed project with the Local Water Utilities Administration. However, the slow dissemination of PPA results needs to be improved as it has led to low levels of public transparency.

3.19 For drainage investments, LGUs are currently absorbing O&M costs without resorting to any increases in taxes. Operating costs of feeder investments are the responsibility of Water User Associations or Co-operatives, and are currently financed by tariffs agreed to by the community during the *barangay* process. However, these institutions face rising energy costs, which are the major expense, and some are being financed by grants from LGUs. Though beneficiaries are said to appreciate the need to contribute towards operation and maintenance costs, the seasonal nature of local incomes pose a challenge to revenue collectors.

3.20 **Achieving sustainability will require increased contributions from taxes and/or tariffs, which is hard to apply.** A key challenge for LGUs is the efficient collection of water fees that are sufficient to cover O&M expenses, service debt, meet other financial commitments such as accruing some return to the LGU. However, the results of water systems do vary considerably. Some schemes have been successful and are providing lessons to Provincial or City Governments on how to expand access to services. Moreover, business-as-usual would have probably yielded less sustainable arrangements, with LGUs subsidizing all maintenance and replacement costs, and *barangays* only collecting sufficient fees to cover their operations. With respect to institutional capacity, limitations are much higher outside cities, and the arrangements for providing technical assistance on a continuing basis are also not clear. In general, cities have the willingness, political interest and resources to operate and maintain the systems satisfactorily. For *barangay* investments, there is limited capacity among private sector entities (Water User Associations and Cooperatives) to collect revenues to sustain the systems, and only limited resources are available to sub-borrowers to provide necessary technical assistance. In the interim, LGUs are providing subsidies, guidance and technical assistance to *barangay* associations facing high operation costs.

SAFEGUARDS

(a) Fiduciary

3.21 The IEG mission interviews found that financial management arrangements were satisfactory at the Land Bank head office and at its lending and accounting centers. Early

during implementation, however, some LGUs did not maintain separate project accounts. This was resolved by requiring LGUs to keep dedicated accounts with the Land Bank where counterpart funds and sub-loan proceeds were deposited. However, the IEG mission field visits found that financial management capacity at the LGU level still varies considerably, and needs to be developed where it is lacking.

(b) Procurement

3.22 The participating LGUs were not familiar with Bank procurement guidelines and procedures, which caused delay and faulty documentation. Consequently, model bidding documents were prepared for all LGUs and the first contract for works and goods were reviewed for each LGU. All transactions were required to be reviewed and cleared by the Bank, including publication of bids. Consequently, all procurement documentation needed to be sent to the Bank's country office at the LGUs' cost. At times, the lack of technical competence, experience and availability of members of the LGUs' Bids and Award Committee—designed to evaluate technical proposals—proved to be an issue. The Land Bank informed the IEG mission that it has upgraded its LGU lending procedures to take these concerns into account. The Bank and the Land Bank staff conducted joint fiduciary reviews covering procurement and financial management. The Land Bank provided assistance through workshops and seminars on selection of consultants and bid evaluation. For successor projects, the Land Bank expects to be able to streamline its requirements and processes significantly given the agreement on harmonized procurement rules between the government, the Bank and other development partners.

(c) Social and Environmental

3.23 The project was classified as Category A for environmental safeguards. Under the WDDP, monthly and quarterly environment reports were required from the Land Bank and the LGUs. The Land Bank's PMO was responsible for oversight, and an environmental specialist and a social development specialist were recruited for that purpose. The IEG mission's document reviews and interviews with the Land Bank and the Bank's project team showed that the PMO satisfactorily coordinated compliance of all sub-projects with Bank guidelines as well as national environmental rules and regulations. With respect to social safeguards, a resettlement action plan was prepared for 13 project-affected persons as a result of the drainage improvements in Calbayog City. A relocation site was allocated and compensation paid by the City Government to the 13 persons. The IEG mission found that the action plan was implemented satisfactorily. No other subprojects required resettlement actions.

BANK PERFORMANCE

3.24 **Overall, the Bank's performance is rated moderately satisfactory**, based on moderately satisfactory quality at entry and supervision, as explained below.

3.25 **The quality of the Bank's performance at project entry is moderately satisfactory.** On the positive side, the Bank played a critical role in assisting government in developing its WSS sectoral policies over the years. The Bank did well in persuading the

government, the International Finance Corporation, and MWSS of the usefulness of launching a pilot PPA audit as a tool to promote private sector participation, and ensured sound methodology at entry for the component. It made special efforts to ensure a successful launch of the audit through workshops and seminars on the methodology and objectives of a PPA system. The Bank also acted appropriately in restructuring the SSD component to a program-based loan to provide flexibility in preparing sub-projects. However, given the Bank's management deadline of May 15, 1999 for signing the restructured loans after a reappraisal mission in March 1999, the Bank team left itself too little time to assess the uncertainties and practical implications of launching a program loan at short notice. Thus it could not be ensured that LGUs had sufficient capacity or provision for technical assistance for implementing the sub-projects. (The Region clarified, however, that even if the project team had had more time at restructuring, the program approach would not have changed the fact that only when an LGU has decided to take a loan from Land Bank could their capacity to undertake the technical design be assessed.)

3.26 The quality of Bank supervision is moderately satisfactory. Both the PPA and SSD components were supervised regularly and adequately. The SSD teams had the required diversity of skills to address the complexity of BESS projects. However, weaknesses in capacity of Water User Associations and Co-operatives were not well addressed. There were also three changes in the Task Team Leader for the project; however, the supervision remained steady as the second and main TTL was a team member from the start and also during ICR preparation. The last TL mainly oversaw the project closing and final stages of the ICR.

BORROWER PERFORMANCE

3.27 Overall, the Borrower's Performance is rated moderately satisfactory, based on a moderately satisfactory performance for both the government and the implementing agencies (MWSS and the Land Bank), as explained below.

3.28 The government's performance is moderately satisfactory. On the positive side, it articulated its needs in the sector effectively through the Water and Sanitation Sector Review and the National Water Crisis Act. Under this new policy framework, government launched the privatization of operations of MWSS with the help of International Finance Corporation, and selected two concessionaires for Manila.

3.29 However, while government demonstrated commitment initially for the PPA, it did not sustain the reforms necessary to achieve sector integration. An independent regulatory body for the sector was not established. The government did try to assign the task of economic regulation outside of Manila to the National Water Regulatory Board, which is yet to prove itself in this regard. Two other issues that needed to be addressed were the clear conflict of interest within the Local Water Utilities Administration (being both the financier and regulator of water districts); and the growing but unattended interest of LGUs in engaging in contractual arrangements with the private sector.

3.30 The performance of the implementing agencies is rated moderately satisfactory. MWSS showed strong commitment to the PPA, as evidenced by its efforts to integrate the audit results into its monitoring system. At project start-up, it assigned staff and recruited

consultants from the University promptly to assist with the audit. MWSS did not disseminate the PPA audit findings adequately under the project, although this has improved under the ongoing PAWS phases. MWSS received good cooperation from the Manila East concessionaire, but less so from the one in Manila West, which was uncommitted and considered the audit as unfair (see para 2.25). However, using the PPA reports on performance monitoring, MWSS was able to successfully re-negotiate the Western Concession contract with Maynilad Water Services Incorporated in January 2007.

3.31 With respect to the SSD component, the Land Bank expanded its cumulative lending to LGUs from Peso 11.9 billion to Peso 25 billion between 2000 to 2006. The Land Bank's performance with respect to fiduciary and financial aspects was satisfactory. However, the Land Bank could not provide sufficient support to the LGUs. Moreover, the PMO of the Land Bank performed inadequately in collecting and organizing information related to project implementation and monitoring of indicators. The Land Bank has learned from these early lessons under WDDP and has built in mitigating measures in the successor project, Support for Strategic Local Development and Investment Project.

4. Lessons Learned

4.1 As an operation intended to test lending through government financial intermediaries, the project laid the basis for increased on-lending for WSS investments; moreover, through the lessons learned during its implementation, the project led to improvements in the capacity of LGUs to provide WSS services within the framework of government's decentralization policy. More importantly, the WDDP introduced a demand-driven investment approach that incorporates willingness-to-pay assessments, cost recovery and tariff analyses, as well as prudent fiduciary management, procurement and environmental and social safeguards. Since the project's closing, the LGUs have financed new investments to sustain the benefits of the initial subprojects, strengthened the capacity of Water User Associations, and built-up O&M capacity.

4.2 The follow-on Support for Strategic Local Development and Investment Project approved in June 2006 would continue to provide access by LGUs to financing for strategic infrastructure investments that have been identified in development plans or multi-year, participatory planning exercises. Learning from WDDP's lessons, the follow-on project would also provide assistance to LGUs in the following areas: (i) the preparation of terms of reference for sub-project preparation work including feasibility studies and detailed engineering design; (ii) procurement; (iii) supervision and management including monitoring of outcomes during construction; and (iv) improvements in the management and operations of municipal enterprises and services.

4.3 The PPA component deserves special mention. Despite setbacks with a wider roll-out and dissemination weaknesses until 2001 when the pilot phase was completed, scale-up efforts are ongoing. The Public Assessment of Water Services (PAWS) system, which was built upon the PPA, is planned in several more phases up to 2011-12, with the objectives of: (a) assisting the Regulatory Office of MWSS in decision-making; (b) providing the private

concessionaires with operational and business planning information; and (c) increasing public participation in the assessment of water services. The Regulatory Office of MWSS has agreed to incorporate the PPA costs in the rate re-basing exercise, and to expand the audit indicators to cover sanitation and sewerage in addition to water supply. This signals a vote of confidence in the PPA approach. The WDDP resulted in buy-in from the eastern private concessionaire, and—through the PPA reports on performance monitoring—has enabled MWSS to successfully re-negotiate the western concession contract in January 2007. In its own ICR, the Borrower also indicated that the participation of concessionaires is essential for developing and calculating reliable performance indicators, and the PPA performance measurement system serves as a better baseline for privatization projects than traditional engineering assessments.

4.4 The lessons derived from WDDP's implementation experience, especially for WSS operations that onlend through government financial intermediaries include the following:

- A sudden change in a project's lending approach, when done under pressure of tight processing timetables and strong exogenous factors, works against effective project implementation.
- Issues stemming from the local political economy need to be addressed at project entry because they strongly influence local ownership and the ease of implementation.
- While well-intentioned and useful in building client ownership, participatory processes (usually associated with social and environmental safeguards) require substantial up-front time which needs to be built into implementation planning. Complex sub-projects such as private sector contracts for water supply or solid waste landfills require borrower expertise beyond procurement and financial management. Thus, adequate provisions should be made for the significant technical assistance requirements of local borrowers, including monitoring and reporting on subproject outcomes.

4.5 From a sectoral policy perspective, the WDDP has led to a better understanding of the potentials and limitations of WSS lending through government financial intermediaries, as well as the terms and conditions under which LGUs can benefit from on-lending facilities. Through the WDDP's experience, the negative consequences of its failure to establish a regulatory authority and a lead agency for the WSS sector have become much clearer to government. This, in turn, has enhanced the Bank's ongoing reform dialogue with government and facilitated the integration of the lessons learned from WDDP into successor operations.

Annex A. Basic Data Sheet

PHILIPPINES-WATER DISTRICTS DEVELOPMENT PROJECT (P004576)

Key Project Data (amounts in US\$ million) *

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Total project costs	80.7	38.6	48.0
Loan amount	57.0	38.6	68.0
Cofinancing	--	--	--
Cancellation	--	20.62**	--

*See Table 1 in the main text of this report. The loan less the cancelled amount equals the disbursed amount of US\$17.98 million equivalent.

** Cancelled amounts are in terms of loan amount at appraisal.

Cumulative Estimated and Actual Disbursements (amounts in US\$ million)

	<i>FY99</i>	<i>FY00</i>	<i>FY01</i>	<i>FY02</i>	<i>FY03</i>	<i>FY04</i>	<i>FY05</i>	<i>FY06</i>	<i>FY07</i>
Annual	0.00	2.04	2.82	4.58	5.22	0.87	0.0	0.59	1.86
Cumulative	0.00	2.04	4.86	9.44	14.66	15.53	15.53	16.12	17.98

Project Dates

	<i>Original</i>	<i>Actual</i>
Begin Appraisal	--	02/10/1997
Board approval	--	09/09/1997
Signing	--	05/15/1999
Effectiveness Loan, 4227-PH	09/10/1999	10/08/1999
Effectiveness Loan, 4228-PH	09/10/1999	09/10/1999
Closing for Loan, 4227-PH	06/30/2003	06/30/2003
Closing for Loan, 4228-PH	06/30/2004	12/31/2006

Staff Inputs (staff weeks)

Stage of Project Cycle	Staff Time and Cost (Bank Budget Only)	
	No. Staff Weeks	US\$ ('000)
Lending		
FY98		194.80
FY99		0.43
Total:		195.23
Supervision/ICR		
FY98		5.73
FY99		0.00
FY00	26	80.78
FY01	27	67.85
FY02	26	72.92
FY03	16	37.81
FY04	12	43.75
FY05	19	70.89
FY06	15	39.30
FY07	1	5.96
Total:	142	413.53

Mission Data

Ratings of Project Performance in ISRs

<i>No.</i>	<i>Date ISR Archived</i>	<i>Performance rating: Development Objective</i>	<i>Performance rating: Implementation Progress</i>
1	05/08/1998	Satisfactory	Satisfactory
2	12/116/1998	Unsatisfactory	Unsatisfactory
3	05/28/1999	Satisfactory	Satisfactory
4	12/15/1999	Satisfactory	Satisfactory
5	06/14/2000	Satisfactory	Satisfactory
6	12/26/2000	Satisfactory	Satisfactory
7	06/08/2001	Satisfactory	Satisfactory
8	12/20/2001	Satisfactory	Satisfactory
9	06/26/2002	Satisfactory	Satisfactory
10	12/12/2002	Satisfactory	Satisfactory
11	05/15/2003	Satisfactory	Satisfactory
12	11/17/2003	Satisfactory	Satisfactory
13	03/03/2004	Satisfactory	Satisfactory
14	08/20/2004	Satisfactory	Satisfactory
15	12/22/2004	Satisfactory	Satisfactory
16	06/22/2005	Satisfactory	Satisfactory
17	03/08/2006	Satisfactory	Satisfactory
18	06/25/2007	Satisfactory	Satisfactory

Other Project Data

Borrower/Executing Agency:

FOLLOW-ON OPERATIONS

<i>Operation</i>	<i>Loan no.</i>	<i>Amount (US\$ million)</i>	<i>Board date</i>
Support for Strategic Local Development and Investment Project (S2LDIP)	4833-PH	109	06/29/2006

Annex B. DETAILED OUTPUTS ON WATER SUPPLY, SANITATION, SEWERAGE, AND DRAINAGE SUBPROJECTS

Table 1 - Water supply sub-projects (BESP/feeder component)

Coverage of Constructed Water Supply Systems

LGU/BESP site	Design Year Coverage (No. of Households)	Served Population at Design Year a/	2006 Coverage b/ in No. of Connections and Population	No. of Households recipients of toilet bowls
Palawan				
(a) Sibaltan	206	1,030	167 (835)	137
(b) Liminangcong	587	2,935	371 (1,855)	0
(c) New Guinlo	391	1,955	335 (2,010)	335
(d) Sta. Teresita	236	1,180	236 (1,080)	155
(e) Danleg	110	550	80 (400)	110
(f) Caramay	240	1,200	240 (1,200)	165
(g) Tumarbong	217	1,085	131 (786)	140
(h) Alfonso Bliss	349	1,745	349 (1,745)	182
(i) Port Barton	600	3,000	305 (1,625)	246
(j) Abaroan	230	1,150	173 (865)	186
Total	3,166	15,830	2,387 (12,401)	1,656
Panabo city				
(a) Mabunao	543	2,715	217 (1,875)	149
(b) Datu Abdul	687	3,435	226 (1,715)	64
(c) Manay	455	22,75	312 (1,560)	80
(d) Malativas	328	1,640	258 (1,290)	63
(e) Kauswagan	378	1,890	107 (535)	44
Total	2,200	11,000	1,120 (6,975)	400
Grand Total	5,366	26,830	3,507 (19,376)	2,056

a/ Household size is 5 persons to a household.

b/ As of October 2006

Table 2 - Sanitation, sewerage, and drainage sub-projects (Trunk and BESP components)

Length of sewerage collectors and sewage treatment added to their systems or no. of on-site sanitation facilities installed

	On site Sanitation		Sewerage		Drainage
	T (un)	ST (un)	SP (LM)	STP (un)	CSP (LM)
A. Palawan Province					
1. Port Barton, San Vicente	246		3,913	25	
2. Caramay Roxas	165		836	2	
3. Abaroan, Roxas	186		499	1	
4. Tumarbong, Roxas	140		465	1	
5. New Guinlo, Taytay	335		1,338	5	270
6. Liminangcong, Taytay	-				325
7. Danleg, Dumarán	110		168	2	
8. Sta. Teresita, Dumarán	155		565	1	
9. Sibaltan, El Nido	137		1,685	2	
10. Alfonso Bliss, Quezon	182		626	1	
<i>Sub-total A</i>	1,656		10,095	40	595
B. Panabo City					
1. Datu Abdul Dadia	64	64			
2. Manay	80	80			
3. Mabunao	149	149			
4. Kauswagan	44	44			
5. Malativas	63	63			
<i>Sub-total B</i>	400	400			
C. San Fernando City					995
<i>Sub-total C</i>					995
D. Cabanatuan City					23,822
<i>Sub-total D</i>					23,822
E. Candon City					6,340
<i>Sub-total E</i>					6,340
F. Calbayog City					525
<i>Sub-total F</i>					525
Total	2,056	400	10,095	40	39,187

Abbreviations:

T	- toilet facilities
ST	- septic tank
SP	- sewage collection pipeline
STP	- sewage treatment plant
CSP	- combined (storm & drainage) collection pipeline
un	-number of units
LM	-linear meters

Annex C. Borrower Comments



08 May 2009

MS. MONIKA HUPP

The World Bank
Manager, Sector Evaluation Division
Independent Evaluation Group
1818 H. Street, M.W., Washington D.C. 20433
USA

Attention : **Mr. Fernando Manibog**

Subject : **Comments on the WDDP Draft Performance Assessment Report**
Loan No.: 4228-PH

Dear Ms. Hupp:

We acknowledge the receipt of your letter as regards the draft performance assessment report for the Water Districts Development Project (WDDP).

Below are our comments on the said report:

1. On Page "yii" first paragraph

The WDDP-SSD Loan No is 4228-PH not 4229-PH.

2. On Page "x" second paragraph

"...Sanitation Plan investments caused much delay and contributed to the drop in LGU interest and increased costs, in part due to the need to recruit private subproject design consultants which Land Bank could neither provide nor finance."

Comment:

The statement "Land Bank could neither provide nor finance" should be deleted since it is inappropriate to associate the delays and drop in LGU interest to LBP inability to provide or finance the services. It is clearly defined in the operational manual of the WDDP program that the sub-borrower (or its consultant) is not tasked to provide the services for the preparation of BESP. However, the consultancy service for project preparation (which includes BESP) is part of the eligible components/expenditures that can be funded by WDDP. The role of Land Bank in extending assistance is exercised by the PMO of WDDP which has been clearly acknowledge in Section 2.8 of the PPAR – "The LGUs were also allowed to seek (technical) assistance for

preparation of feasibility studies from the Project Management Office of the Land Bank". Hence, the drop in LGU interest may be attributed to the increase in project cost as a result of (a) contracting consultancy services in order to satisfy the participatory process that the BESP requires and (b) stand alone water supply system project is not eligible for financing under WDDP-SSD *(to be eligible for financing under WDDP-SSD, a sanitation component must be included in the project)*.

3. On Page "xi" and Page "19"

Delete "Sustainable" in the following statement: Support for Sustainable Local Development and Investment Project and replace it with the word "Strategic".

4. On Page "4", Section 2.8

"... All LGUs were made eligible to participate rather than only the four pre-identified ones (including Davao, Cotabato, Calamba, and Cagayan de Oro.)"

Comment:

Only LGUs outside Metro Manila is eligible to participate in the WDDP-SSD.

5. On Page "5", Section 2.10

"...The SSD component's design and implementation were guided by beneficiary surveys, as follows: (i) Community Mapping to assess the type of environmental sanitation improvements that were required by households (piped WSS systems were identified as priorities); (ii) Willingness-to-Connect Surveys (60 percent of respondents were willing to connect to a piped water system and pay WSS tariffs computed to cover costs.)"

Comment:

Water Supply System project is not eligible for financing under the SSD trunk investments and therefore, the statement stated above is more appropriate to be included in paragraph 2.11.

6. On Page "7", Section 2.19

"*Fourth*, Land Bank was not fully equipped to fill the technical assistance requirements of LGU sub-projects, which proved more extensive than anticipated originally..... The weak or absent technical support led to the lack of reliable subproject cost estimates, which in turn resulted in the scaling back or phasing of sub-projects just to match net borrowing capacity limits."

Comment:

The statement made about LBP did not clarify the specific areas that needs to be substantiated or equipped that can satisfy the technical requirements of the LGU.

It may also be inappropriate to mention the LBP's lack of technical expertise because part of the WDDP program is the contracting of project implementation support consultant (C.LOTTI & ASSOCIATTI) that is fully staffed with the expertise in the areas of WSS. The involvement of such experts had even undergone World Bank's concurrence.

Contrary to the assessment in the PPAR, the organizational adjustments made by LBP did not reduce the bank's interaction with the sub-borrower because each project's has an assigned Account Officer aside from the regular supervision/monitoring by the WDDP-PMO. In addition, the engagement of resident engineer's by the LBP-PMO in the subproject areas has ensured the timely interventions of project related concerns.

It is very clear in the subsidiary loan agreement between the LGU and LBP that the necessary provisions to achieve the program objectives including the timely completion of the project shall be observed. Under normal conditions it is the contractual obligation of the LGU Contractor or LGU Consultant to ensure that the project is implemented according to industry accepted standards and the agreed engineering plans. The substance and form of the pre-implementation documents composed of the FS (including project cost estimates), DED, EIA, etc. have undergone PMO's intervention to ensure that the corresponding country standards and bank guidelines are met.

It is inappropriate to state and associate the lack of reliable subproject cost estimates which resulted to the scaling back (or phasing) of subproject with the net borrowing capacity limits because the subproject's basically underwent appraisal by the LBP lending centers. The appraisal includes the acceptability of the cost estimates of the materials and services according to the current market prices or indexes. As regards the issue of net borrowing capacity, the cost of the project to be funded shall be within the net debt service ceiling. In certain circumstances the scaling back of the project may be necessary in order to comply with the limitations on the net borrowing capacity of the LGU Code. As such, there is no linkage between the net borrowing capacity limits and the cost estimates.

7. On Page "7", Section 2.20

"Fifth, significant delays resulted from the participatory processes for subprojects (comprising 25 percent of actual total project cost) that required the submission of Barangay Environmental Sanitation Plans before feasibility studies can be prepared."

Comment:

There is no need to submit a feasibility study if a Barangay Environmental Sanitation Plan (BESP) had been submitted by the LGU. The technical as well as the financial viability of the project were discussed in the BESP.

8. On Page "13", Section 3.9

"The participatory processes associated with the environmental impact assessment of sanitation caused much delay and contributed to the drop in LGU interest and increased costs, in part due to the need to recruit private subproject design consultants. While these may be plentiful in the National Capital Region, this is not the case in outlying provinces."

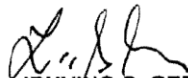
Comment:

It is true that participatory processes associated with the environmental impact assessment of sanitation caused much delay and contributed to the drop in LGU interest. We also have to consider that the WDDP-SSD can not finance a stand alone water supply system project. It must have a sanitation component to be able to qualify for financing under WDDP-SSD.

Hope that you find the above in order.

Thank you.

Very truly yours,



LIDUVINO S. GERON
FVP, PMG