

**PROJECT INFORMATION DOCUMENT (PID)
IDENTIFICATION STAGE**

Report No.: AB7446

Project Name	AZ Second National Water Supply and Sanitation Project (Additional Financing)
Region	EUROPE AND CENTRAL ASIA
Country	Azerbaijan
Sector	Water supply (60%);Wastewater Collection and Transportation (20%);Wastewater Treatment and Disposal (19%);Central government administration (1%)
Project ID	P147378
Parent Project ID	P109961
Borrower(s)	GOVERNMENT OF REPUBLIC OF AZERBAIJAN Ministry of Finance 83, S. Vurgun Street Azerbaijan, AZ 1022 Tel: +994-12-596-7184, Fax: +994-493-0546
Implementing Agency	Azerbaijan Amelioration and Water Management JSC 23 Niyazi Street Azerbaijan, AZ 1066 Tel: 994-12-493-80-11, Fax: 994-12-493-80-12
Environment Category	<input checked="" type="checkbox"/> A <input type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
Date PID Prepared	November 1, 2013
Date of Appraisal Authorization	
Date of Board Approval	May 22, 2014

Country and Sector Background

1. Since project effectiveness in July 2009, Azerbaijan has continued its path of economic growth driven by the oil-economy, although growth has slowed down from 5.0 percent in 2010 to only 2.2 percent of real GDP growth in 2012. However, growth is expected to increase again and stabilize at a moderate level with projections of annual growth of approximately 3.8 percent during 2013–16 (CPS Progress Report FY11-14). To sustain this growth, Azerbaijan will need to diversify its economy, introduce market-based policies, and strengthen public services. Particularly in rural areas, improving the coverage, quality, and sustainability of water supply and sanitation services remain a key Government priority.

2. Azerbaijan inherited a relatively extensive water supply system from the Former Soviet Union (FSU). About 95 percent of the population in Baku and about 83 percent of those living in secondary cities and small towns are connected to piped water, but the quality of infrastructure and services has deteriorated severely since independence, due to a lack of investment and deferred maintenance. In many secondary and small towns, water treatment facilities are largely dysfunctional or lacking completely, leaving the population in these towns without access to safe water. In addition, almost everywhere in the country, the piped water supply is unreliable and often available fewer than 12 hours per day. Centralized piped water supply systems are rare in

rural areas, where less than 33 percent of the population has access to a piped water supply. Azerbaijan has declared its commitment to using part of its new oil wealth to address infrastructure deficits in water supply and sanitation and to develop the sector to become financially sustainable. Important actions toward this goal include: i) implementation of a large countrywide water program composed of numerous projects financed by international development institutions and the state budget to rehabilitate/extend/construct the water and sanitation systems in all secondary cities across the country and the Greater Baku area; and ii) institutional development, including the consolidation of local subsidiaries, the introduction of International Financial Reporting Standards (IFRS), the application of European water supply and wastewater standards, a comprehensive capacity-building program for operational and managerial staff, a new billing and collection system, and the establishment of Geographic Information System (GIS)-based asset management system.

3. The original IBRD Loan in the amount of US\$230 million and IDA credit in the amount of US\$30 million were approved by the World Bank on May 27, 2008 and signed on September 5, 2008. The loan and credit became effective on July 13, 2009. The project has originally included 21 rayons where implementation of investments in mainland was assigned to Azersu OJSC while the Nakhchivan's State Amelioration and Water Management Agency (SAWMA) was responsible for investments in Nakhchivan Autonomous Republic. Due to initial implementation delays followed by price escalation and misprocurement against SAWMA under the first water project (NWSSP), the Government requested Bank to restructure the SNWSSP. As a result the SNWSSP has been restructured on January 27, 2012 and project's scope was downsized to 8 rayons in the mainland (i.e. Siyazan, Shabran, Aghsu, Ismayilli, Lerik, Yardimli, Masalli and Jalilabad) while implementation responsibility was transferred from Azersu to Azerbaijan Amelioration and Water Management JSC (AAWM).

Objectives

4. The Project Development Objective (PDO) is "to provide quality and reliable water supply and sanitation services in selected regional (rayon) centers in Azerbaijan".

5. The project development objective of the original project will remain unchanged.

Rationale for Bank Involvement

6. Investments under the AF include: (i) additional household connections; (ii) additional metering; (iii) increased water and wastewater treatment plant capacity; and (iv) the supply of maintenance equipment and other activities. The proposed investments do not go beyond the original objectives of the project, but would allow more people to benefit from project activities.

7. Implementation arrangements, with a well-performing Project Implementation Unit (PIU) in AAWM, will not be changed. No changes are required in either the Environmental Safeguards Category or in the arrangement for procurement and financial management. There is no change to the PDO. The Results Framework will be revised to reflect additional activities, clarify some intermediate outcome indicators, and incorporate core sector indicators. It is proposed that the

closing date be extended by three years to December 31, 2017, and that disbursement categories be unified in the legal agreement.

8. The proposed AF is fully aligned with the Government’s Water Sector Strategy for 2006–2015, which establishes the provision of reliable water and sanitation services as one of the top priorities for the country. This strategy was developed jointly by the Bank and the Government and is based on the Water Sector Issues and Options Report prepared and presented to the Government by Bank’s water team in 2006. The ongoing SNWSSP and the proposed AF are also consistent with, and form an integral part of, the government’s ambitious country-wide \$4 billion Azerbaijan Water Program, which is being supported by several development partners including the World Bank, ADB, KfW, IDB, and JICA. Finally, the proposed AF is also aligned with the Country Partnership Strategy (CPS) for the period 2011-2014 under its Strategic Objective 2: “Strengthening Social and Municipal Services.” The request for AF was received from the Deputy Prime Minister on June 19, 2013 (attached below).

Description

9. The original project finances activities under three components to achieve this objective. The cost per component and funds allocated under the original loan are summarized in Table 1. The original components include:

Component A: Rayon Investment Component

This component finances the rehabilitation and extension of water supply and sewerage systems, as well as facilities for water, wastewater and sludge treatment in selected regional (rayon) centers in Azerbaijan (i.e. Siyazan, Shabran, Aghsu, Ismayilli, Masalli, Jalilabad, Yardimli, and Lerik rayons). The project covers the rayon centers and the villages located in close proximity of the urban centers or along the transmission mains supplying the centers.

Component B: Institutional Modernization Component

This component supports capacity building and modernization of the utility, through: (a) the provision of training for management, financial management, customer service, procurement, preventive maintenance and other subjects pertinent to effective and efficient management of the utilities; (b) development of performance monitoring, preventive maintenance and leak detection and repair; and (c) design and technical support for construction management, including procurement support and contract supervision for the investments.

Component C: Project Implementation and Management

This component supports project implementation by financing project management activities including incremental operating costs and project audits.

Table 1: Original cost and fund allocation by component (USD million)

Component	Original cost
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	Total estimate (incl. VAT)	IBRD + IDA¹
A: Rayon Investment Component	392.0	246.8
B: Institutional Modernization Component	15.8	11.4
C: Project Implementation and Management	1.6	1.2
Front-end Fee	0.6	0.6
TOTAL	410.0	260.0

Project performance

10. Project implementation is progressing well and, overall, the Project is on track to achieve its objective which is “to provide quality and reliable water supply and sanitation services in selected regional (rayon) centers in Azerbaijan,” whereby quality and reliable water supply and sanitation services is defined as 24-hour continuous service that complies with water supply quality standards, including treatment in conformity with the EU Wastewater Treatment Directive for secondary treatment. The Project Implementation Status Report (ISR) ratings for implementation progress (IP) and development objectives (DO) were rated ‘Moderately Satisfactory’ (MS) over the last 12 months. Currently all project funds are committed and more than 60 percent of the loan and credit funds are disbursed. Procurement has been completed and construction is progressing in all rayons covered under the project’s restructured scope. Most of civil work contracts are expected to be completed within the current closing date of December 31, 2014. As such Government has recently inaugurated the new water supply and sanitation networks in Siyazan, Shabran, Aghsu, Ismayilli and Lerik and design and construction is progressing in other sites. Fully meeting key PDO indicators will require completion of rehabilitation works, including construction of scaled up water supply and sanitation systems included under this AF.

Financing

Source	(USD million)
Republic of Azerbaijan	50.0
International Bank for Reconstruction and Development	140.0
Total	190.0

11. The majority of AF funds would be allocated to Component A to finance the rehabilitation and extension of water supply and sewerage systems, as well as facilities for water, wastewater and sludge treatment in selected regional (rayon) centers in Azerbaijan (i.e. Siyazan, Shabran, Aghsu, Ismayilli, Masalli, Jalilabad, Yardimli, and Lerik rayons). Additional funds would also be made available to Component C for project management and to cover additional

¹ IBRD +IDA financing excludes VAT which is financed under the Government contribution

expenses required by the PMT, and to Component B to finance activities related to institutional development and supervision of works.

Implementation

12. The AF and project restructuring does not require any changes to the implementation arrangements in place. The Azerbaijan Amelioration and Water Management JSC (AAWM) has the overall responsibility for project implementation. A Project Implementation Unit (PIU) has been established within the AAWM to manage day-to-day project management responsibilities. The PIU has been staffed adequately and functions well. The existing structures have proven to be very effective and the PIU at AAWM will remain the implementation unit in charge. The activities financed by this AF do not require additional capacity at the PIU.

Sustainability

13. The AF will support additional activities to scale-up on-going civil works in selected rayons. These activities are expected to increase the overall impact and benefits of investments, cover a larger number of utility customers, and strengthen the financial sustainability of capital investments. An additional 30 suburban villages will be supplied with gravity water and connected to a sanitation network providing an additional 100,000 people with piped water supply and sanitation services. The AF will also fund larger sanitation networks accompanied by larger capacity wastewater treatment plants. This would enable water utilities to collect and treat larger volumes of effluents, thus reducing the negative environmental impact from the use of septic tanks by households. A cost-effectiveness analysis will be conducted prior to decision meeting and will be included in the Project Paper. The AF will also contribute to regional development by providing sustained and improved services, and a greater positive impact on the health and quality of life of low-income households in select rural centers.

Lessons Learned from Past Operations in the Country/Sector

14. The proposed AF incorporates lessons learned from the original project and the National Water Supply and Sanitation Project. It also builds on the ongoing original project and will utilize its implementation structure and mechanisms which have proved successful.

Safeguard Policies (including public consultation)

The project falls under Category A for Environmental Assessment (EA) since it may provide financing for one or more wastewater treatment plants of considerable size and potential impact. Most sub-project investments in water supply, rehabilitation of infrastructure, and smaller wastewater treatment plants pose less risk. Prior to appraisal of the original project the client prepared an Environmental Assessment document which set out an environmental framework for screening, due diligence, mitigation and monitoring. The specific utility and sites locales have been determined during the implementation of the original project, and site-specific EIAs prepared and approved for each selected site, which provide for the assessment of the associated environmental risks and put in place mitigation and monitoring mechanisms. Likewise, the

possibility of small scale land acquisition was reflected in the existing Resettlement Policy Framework, and site-specific RAPs are being prepared for relevant sites. In addition all existing EIAs for works to be financed under the AF are being updated by the Borrower to reflect the scale up of works. This was discussed and agreed to as part of the ISDS review meeting, which was approved by the RSC. Details are provided in the ISDS available at infoshop.

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