

POTABLE WATER AND SANITATION INVESTMENT PROGRAM

(HO0072)

EXECUTIVE SUMMARY

Borrower:	Republic of Honduras		
Implementation Agencies:	Municipalities for individual projects. Ministry of Finance through a private trust fund for channeling sub-loans to Municipalities.		
Amount and source:	IDB Loan (FSO):	US\$	26 million
	Counterpart and Municipalities:	US\$	3 million
	Total:	US\$	29 million
Terms and conditions:	Amortization Period:	40 Years	
	Disbursement Period:	4 years	
	Interest Rate:	1% for first ten years 2% thereafter	
	Inspection and supervision fee:	1% per year	
	Commitment fee:	0.5% of undisbursed commitment	
Objectives:	<p>The first objective of the Program is to contribute towards efficient and sustainable potable water and sanitation services by promoting and consolidating reform at a local level. It will invest in municipalities of intermediate size that have demonstrated the will to create operators with sufficient autonomy to provide services on a commercial basis within a clear regulatory framework.</p> <p>A second objective of the Program is to strengthen the capacity of the municipalities as the entities responsible for potable water and sanitation services. The Program will promote formal relationships with the other principal actors in the sector: the operators, the clients for the services and financial organizations.</p> <p>A final objective of the Program is to leave behind a set of tested procedures for preparing and financing potable water and sanitation projects. A financial mechanism, the Municipal Development Trust Fund, MDTF, is being established for projects for the municipalities of Tegucigalpa and San Pedro Sula, IDB projects HO-0135 and HO-0115 respectively. The same fund will be used to channel sub-loans to municipalities participating in this Program. The MDTF will include procedures to appraise infrastructure projects and ensure that they are within the financial capacity of the operator. In each case the loans will support potable water and sanitation services for</p>		

that municipality and will be directly linked to the capacity of the municipality to undertake the work and repay the loan.

Description:

The Program will finance technical assistance and civil works for municipalities that agree to modernize the way potable water and sanitation services are provided. Support to the municipalities will be carefully staged, beginning with technical assistance to develop and publicize a new water policy and support for the creation of the new institutional framework. Once the new institutional framework is in place, the Program will finance technical assistance to strengthen the operators. Finally, after the technical assistance has helped the municipalities and operators raise the performance of the services provided by existing facilities, the municipality will be able to borrow for civil works to improve and expand services further.

Twenty-one municipalities have submitted proposals, have formally committed themselves to make institutional changes to improve the services and have been pre-selected for the Program.

The Program is designed to be easily replicated, is modular in its implementation and can be changed in size without losing its design integrity. The size of the Program was originally set at US\$45 million, of which US\$40 million would have been loaned by the IDB, based on the project proposals from the twenty-one municipalities. There are not enough FSO resources in 1999 for this number of municipalities and the Program will begin with a reduced number. At the request of the Government of Honduras, the project team would process a second operation for more municipalities when FSO resources become available.

The Nordic Development Fund (NDF) is considering the cofinancing of the program with an additional US\$2 million which will increase the program value to US\$31 million (see Paragraph 3.30)

**Environmental and
Social Review:**

The environmental impact of the Program will be overwhelmingly positive: a) there will be better use of water resources, and therefore less waste, as water bills will be based on consumption, and b) there will be reduced pollution with better provision for the disposal of wastewater. Given the nature of the Program, the size of the cities and the finance available, there will be no major works that might have serious negative environmental effects.

The municipalities will establish an environmental function to carry out the studies and mitigation procedures mandated by IDB policy and by the Ministry of Natural Resources and Environment under the law of Honduras.

The Operating Regulations for the Program will set rules for assessing and mitigating any negative environmental and social impacts of the projects. Each project will have environmental and social impact studies and a management plan

Benefits:

Considerable welfare benefits accrue from improved potable water and sanitation services in Honduras. Those who are already connected to a potable water system will benefit from an improved level of service in several ways. There will be a general increase in the quality of life due the elimination of the uncertainty of the water supply. Potable water will be available when needed. Potable water will be treated to a higher standard and, by maintaining adequate pressure in the distribution system, will be less susceptible to contamination by ingress of contaminated groundwater. Those who are not already connected to a potable water system, predominantly the poor, will receive all of the above benefits to an even greater extent. In addition they will realize considerable direct savings since private vendors charge up to fifty times the unit cost of a piped water supply. The benefits of the Program to those presently without sewerage will be principally health related. There will be decreased gastrointestinal disease, a particular problem in Honduras where it is one of the main causes of a very high infant mortality rate. There will be less flooding with wastewater and less contamination of both groundwater and surface water sources.

The number of people benefiting is estimated as: 390,000 from improved potable water services, and 320,000 from improved sewerage services

Risks:

Political risk manifests itself in various ways. First, there is the risk that an inadequate legal and regulatory framework at the national level will undermine the new institutional arrangements for the provision of the potable water and sanitation services. To avoid this, an adequate potable water and sanitation law must be submitted to, and later approved by, the national legislature as conditions precedent to the approval of different stages of the Program.

Second, there may be delays in SANAA's devolution of the responsibility for the services to the municipalities. The Program has been designed in accordance with SANAA's policy of devolving this responsibility: "...in a gradual and orderly manner." Where SANAA is the present service provider, the organization will continue to provide the services under contract to the municipality during a transition period of three years. This will ensure SANAA's continued involvement in the short term and a smooth transition to municipal control.

Third, the Program is designed for municipalities throughout the country and has lacked a strong coordinating presence from the central government during preparation. Therefore the municipalities themselves, with the help of a private Program Manager, will implement the Program. The financial mechanism being developed for the municipal projects for Tegucigalpa and San Pedro Sula will be used to channel loan funds to the municipalities

Relationship of the Program to IDB Country and Sector Strategy:

The IDB has, in recent years, taken a two-prong approach to its support of the potable water and sanitation sector in Honduras. It has approached the problems from the top down by supporting the drafting of the new law, with its provision for new institutional and regulatory arrangements. This Program is designed to improve services at a local level based on the initiative of the municipalities themselves to make the necessary institutional changes

Poverty Impact:

Proxy measures for a series of unsatisfied basic needs for the municipalities that will benefit from the Program show that they are considerably poorer than the country overall. The Program qualifies as a geographically classified poverty targeted investment in terms of the Eighth Replenishment Agreement, Document AB1704, as modified in document GN-1964-3 of 3rd June 1997. (See Paragraph 5.18).

Special Contractual Conditions:

As a condition precedent to the first disbursement for the technical assistance stages of the Program the Borrower must submit evidence to the IDB that:

1. A potable water and sanitation law, with satisfactory provision for regulation, has been submitted to the legislature in Honduras. (See Paragraph 4.22)
2. The MDTF has been established and is operating. Credit Guidelines that apply to the account for the Program and the disbursement of funds to the municipalities must be in place and agreed with the IDB. (See Paragraph 4.23)
3. The Operating Regulations have been finalized and agreed with the IDB. (See Paragraph 4.24)
4. The Technical Unit and the Program Manager have been contracted under Terms of Reference approved by the IDB (See Paragraph 4.10 and 4.11)
5. The Ministry of Finance, the Central Bank and, if necessary, the trustee of the MDTF have entered into an agreement relating to the transfer of funds to the MDTF (See Paragraph 4.23)

The IDB may disburse up to US\$500,000 prior to compliance with the above conditions to enable the two consultants that will form the supervisory unit within the Ministry of Finance, the Technical Unit and the Program Manager to be contracted (See Paragraph 4.31)

As a condition precedent to the first disbursement for the civil works stage of the Program the Borrower must submit evidence to the IDB that a potable water and sanitation law, with satisfactory provision for regulation, has been approved by the legislature in Honduras (See Paragraph 4.22). Until the condition has been met there should be no calling for bids, or contracting, of work associated with the civil works.

In addition, a revolving fund of 10% instead of the usual 5%, of the total loan value will be established to respond to a high momentary demand for funds. Given the number of municipalities, and their parallel projects, a lower value may restrict their capacity to develop investment plans (Paragraph 4.32).

**Exceptions to IDB
Policy:**

See Procurement of Goods and Services.

**Procurement of Goods
and Services:**

Procurement of goods and services for the Program will be generally in accordance with IDB policies, with the exception that the Ministry of Finance be allowed to contract directly, as trustee to the MDTF, the same bank to be contracted for the municipal development project for Tegucigalpa and San Pedro Sula (1024/SF-HO). Competitive bids have already been called for the latter in accordance with IDB policy and it would be impossible to incorporate the present Program without substantial delay. The exception is justified on institutional grounds: the Ministry of Finance does not have the capacity to duplicate the complex bidding and selection process. The Ministry of Finance will also avoid the burden and the cost of supervising the two trustees undertaking essentially the function. (See Paragraph 4.30)

I. INTRODUCTION

A. The Potable Water and Sanitation Sector

- 1.1 Honduras has invested a higher percentage of its GDP in water and sanitation than any other country in Central America yet finds itself with deteriorating assets and poor quality services. Potable water and wastewater services exhibit all of the symptoms of spending on capital works without making the institutional arrangements necessary to ensure their sustainability. There is little maintenance provision, insufficient cost recovery and over-staffing. Coverage with potable water and sewerage services is inadequate and, in a sample of intermediate cities studied during the preparation of the Program, 37% of the population had no access to piped potable water and 76% had no sewerage facilities. This situation has worsened since Hurricane Mitch struck Honduras in October 1998. The poor in these societies suffer disproportionately from the lack of coverage for it is they that live on the outskirts of the cities which the water distribution and sewerage collection networks seldom reach. The same study showed that the true cost of potable water, per unit volume, for those without a connection to the distribution network, was fifteen times as high as for those with a metered connection.
- 1.2 Services are provided by the municipalities or by *Servicio Autónomo Nacional de Agua y Alcantarillado* (SANAA), the principal institution within the water and wastewater sector. SANAA thus combines operating, regulating and planning responsibilities. Standard performance indicators show the organization to be inefficient in both operational and commercial terms. SANAA provides potable water services to Tegucigalpa and eight of the largest twenty cities, accounting for approximately 23% of the country's potable water connections and serving 14% of the population. It provides sewerage services in Tegucigalpa only. In rural areas SANAA implements potable water and sanitation projects that are subsequently operated by *Juntas Administradoras de Agua*, private, community-based committees. SANAA arranges the original community participation and, for some schemes, provides ongoing technical support.
- 1.3 Municipalities provide all other urban potable water services. They also provide all sewage disposal services in urban areas outside Tegucigalpa. The Municipal Law of 1991 promotes strong local government and, in particular, assigns responsibility for potable water and sanitation services to the municipalities. USAID has played a leading role in strengthening the municipalities' ability to manage their own administration, public services and finances. Using technical assistance, grants and loans, USAID has directly supported municipalities' own efforts and the strengthening of an independent advisory institution for municipalities, FUNDEMUN. USAID works closely with the municipal association, *Asociación de Municipalidades de Honduras* (AMHON), which has been successful in improving local institutional capacity. The municipalities are just beginning to develop their capacity to provide potable water and sanitation services, but there is already considerable agreement on an appropriate institutional framework. There is evidence of peoples' willingness to pay for water and sanitation when the service is adequate and where the service provider is perceived as independent of government. Reforms in different stages of advance in three cities show that a program based on services that are both decentralized and commercial can be viable.
- 1.4 In 1997 the IDB approved a loan for a sewerage system for the city of Puerto Cortés which had already demonstrated its commitment to reform. The goal of the operation is to modernize potable water and sewerage service provision. The municipal water division will be converted into an autonomous operating company that will be incorporated as a *Sociedad Anónima* under commercial law. The private sector will be invited to invest in the new operating company that will sign a contract for the leasing of the potable water and sewerage infrastructure from the Municipality. The Puerto Cortés project is seen as a

model for the present Program, in that services are provided on an explicitly commercial basis and tariffs set at sustainable levels with the approval of the community.

- 1.5 San Pedro Sula has long enjoyed a good reputation for providing potable water and sanitation services and the municipal water division, DIMA, was seen as autonomous. Indeed DIMA operated well as long as the local politicians respected its autonomy. However, the corporate structure of DIMA does not ensure autonomy and a recent municipal administration blocked the tariff increases necessary to keep pace with cost increases. Expansion of employment and certain misguided investments further eroded DIMA's financial situation and threatened its ability to provide good services. The present administration intends to rectify this with a model similar to Puerto Cortés. However, given the size of the city, the administration believes it can attract private sector investment in new infrastructure. The municipal government proposes converting DIMA into a *Sociedad Anónima* with a shareholding sold to an international operator through public tender. The new operating company would be granted a long-term concession to provide the potable water and sanitation services, with responsibility for investing in new infrastructure.
- 1.6 The municipality of Tegucigalpa has considered involving the private sector in the potable water and sanitation services. Initially, a private firm would be contracted to manage the assets and provide the services for three years. During this time information and services would improve to the point where a long-term concession for the services, could be granted. The commitment of the new municipal administration still has to be tested but there is a general recognition that a similar solution is required.
- 1.7 These changes will not be effective without reforms to the national institutional and legal framework to guarantee financial and managerial autonomy for service providers. The present institutional and legal framework is filled with uncertainty since financial sustainability depends on ad hoc government subsidies. It is generally recognized that the sector requires reform which would include: a) assigning planning, regulatory and service provision to separate organizations; b) creating autonomous service providers, less susceptible to political interference; c) establishing tariff structures that would ensure financial sustainability; d) ensuring independent regulation of the services; and e) involving the community in decision-making. The Ministry of the Presidency is considering a draft potable water and sanitation law which includes the necessary provisions but no date has been established for sending it to the legislature. The submission of an acceptable potable water and sanitation law to the legislature and its approval will be conditions precedent to disbursement for different stages of the Program.

B. Financing Municipal Projects

- 1.8 Municipalities have limited access to reliable financing for their projects due to their underdeveloped ability to attract finance and the lack of institutional arrangements for municipal financing. There is no longer a financial mechanism to channel funds from the international lenders to the smaller municipalities since the central bank stopped lending to local governments several years ago, and a public municipal development bank, the *Banco Autónomo de Municipalidades* (BANMA), has ceased operations. BANMA was established in 1961 to make loans to municipalities, and was partially funded by an IDB loan. The organization had a poor record of project selection. Using political rather than technical criteria led to poor loan recovery and, eventually, bankruptcy. A social investment fund, *Fondo Hondureño de Inversión Social* (FHIS) also funded by loans from the IDB (among others) develops social projects, including potable water and sanitation projects in socially deprived areas such as peripheral neighborhoods and rural areas. FHIS support for social projects is in the form of grants to local communities.

- 1.9 There is limited lending to municipalities by commercial banks except for Tegucigalpa and San Pedro Sula, which borrow largely for working capital requirements against the general income of the city. Municipalities generally carry very little debt. However, several smaller municipalities borrow from the banking system for short-term needs such as working capital or equipment purchase, and a number of municipalities have agreements whereby banks handle tax payments and accounts. Banks' ability to provide financing for municipal infrastructure projects is hindered not only by their lack of knowledge of the needs, but also by the condition of the banking system in Honduras that attracts few long-term funds. Lack of investor confidence has prevented the development of a long-term capital market, which affects both the municipalities and the private sector.
- 1.10 The municipalities that are strongest financially have received loans directly from bilateral and multilateral international financial institutions. Tegucigalpa, San Pedro Sula and Puerto Cortés have raised loans for municipal projects from the IDB. San Pedro Sula raised a loan from the World Bank and the Commonwealth Development Corporation for potable water and sewerage.

C. Lessons Learned

- 1.11 In recent years the IDB has financed three important potable water and sanitation projects in Honduras. The major problems have been; a) the extreme weakness of the executing agencies, especially SANAA; b) lack of commitment to cost-recovery; and c) shortage of counterpart funds. On the positive side, the genuine community involvement that was a feature in the rural project appears to have been successful.
- 1.12 The IDB has a large portfolio of loans to support development of municipal governments throughout Latin America. Two important issues have been noted that are particularly relevant to Honduras. a) For multi-municipality projects, where the central government is the borrower, the design of the mechanism for channeling the funds to the municipalities is critical. In particular, the mechanism should impose the same discipline on a municipality, as would a direct loan. b) Utilities managed by municipalities have rarely been able to levy the tariffs necessary for loan repayment.
- 1.13 There is one example of a direct loan to a municipality in Honduras for a potable water and sanitation project, the Water Supply and Drainage Project for San Pedro Sula, World Bank Loan 2421-HO. This was the first loan made to the sector in Honduras by the World Bank who rated the overall outcome as "unsatisfactory". The physical aspects of the project, which comprised works to provide a reliable water supply to 96% of the population of San Pedro Sula, were considered satisfactory. However, the project failed in its objective of developing DIMA as a financially independent institution. DIMA also failed to cover the costs of the project from tariff revenues and the central government, as guarantor, had to intervene with debt payments. The report cites the need to reduce political interference, especially in setting of tariffs, as the most important lesson learned. It also notes the need for the implementing unit to be better integrated within the organization.
- 1.14 A more detailed analysis of the above projects is given in Program Technical File I

II. DEVELOPMENT OF AN INVESTMENT PROGRAM IN POTABLE WATER AND SANITATION

A. Program Development

- 2.1 The Government of Honduras has requested support for a program of investment in potable water and sanitation services that would be complementary to support of a new potable water and sanitation law. The Government used funds from the *Fondo Hondureño de Preinversión* (FOHPREI) to prepare the Program and established a *Comité Técnico Interinstitucional* (CTI) chaired by FOHPREI to liaise with the IDB. The CTI, assisted by two well-known local consultants, developed the concept of the Program as an operation to promote and consolidate water sector reform at a local level. The municipalities themselves have been involved in the Program starting with participation in a series of seminars for the mayors and other local government officers at venues outside Tegucigalpa in May 1997. At the seminars, international and local experts discussed the need for management autonomy and financial self-sufficiency and the implications of reform for the municipalities. The CTI explained the Program and its aims and invited interested authorities to submit projects for possible inclusion. Twenty-one municipalities expressed interest in the Program and have submitted investment projects with a total value of approximately US\$60million. Each municipality has signed a commitment to undertake the reform that is to be a precondition of the investment. The new mayors who took office in early 1998 have confirmed this commitment.
- 2.2 A Technical Cooperation, the Preparation TC, was used to prepare sixteen of the twenty-one municipalities for the Program. The Preparation TC funded international and local experts to help the municipalities understand the problems related to the potable water and sanitation services. A series of workshops was held to disseminate modern ideas for service provision emphasizing the institutional changes necessary to address the problems. The experts worked with the municipalities to identify the elements that each would need to make the institutional changes and to strengthen service provision to an acceptable level of efficiency. These elements have been incorporated in the design of the Program. As a consequence of the Preparation TC some of the municipalities are already making changes: the most important is the discussion of new water policy in the community and certain municipalities have established Water and Sanitation Committees to do this. Some municipalities are installing water meters for their consumers.
- 2.3 The CTI and the IDB's project team have worked closely with the USAID during the preparation of the Program. The USAID will fund a project for the reconstruction of municipal infrastructure following Hurricane Mitch which, among other things, will cover works for potable water and sewerage. The conditions relating to the USAID project are consistent with the reform required in the Program.

B. IDB Strategy and Rationale for Involvement

- 2.4 The IDB has, in recent years, taken a two-pronged approach to its support of the potable water and sanitation sector in Honduras. It has approached the problems from the top down by supporting the drafting of the new law, with its provision for new institutional and regulatory arrangements. This Program is designed to improve services at a local level based on the initiative of the municipalities themselves to make the necessary institutional changes.
- 2.5 The proposed reform of potable water and sanitation services in Tegucigalpa and San Pedro Sula (see below), as well as in Puerto Cortés, will be based on clearly-defined contracts which can be used as vehicles for regulation while a national framework is being established. This arrangement is not practical for municipalities with less institutional capacity and the framework proposed in the new law will be required. The IDB is discussing with the Government of Honduras a new project, which could be financed by

the MIF, for the establishment and putting into practice of the independent regulator for the sector.

- 2.6 The recently approved municipal development projects for Tegucigalpa and San Pedro Sula (IDB loan 1024/SF-HO) have several aspects in common with the Program. Each has a sizable component of investment in potable water and sewerage works to consolidate the institutional changes mentioned in paragraphs 1.5 and 1.6. It is proposed that the Program and the municipal development projects use the same mechanism to channel funds from IDB loans to the municipalities.

IDB support of the Potable Water and Sanitation Sector in Honduras				
-	Various TCs to support Program preparation, preparation of the new law, etc.	US\$ 1m	NR*	
997/SF-HO (Dec. 97)***	Puerto Cortés Sewerage.	US\$ 14m	FSO	Investment conditional on creation of autonomous commercial company with lease for service provision.
1024/SF-HO (Dec. 98)	Municipal Development, San Pedro Sula. Potable water and sewerage component.	US\$ 9m	FSO **	Investment conditional on creation of autonomous commercial company with long-term concession.
ATN/MT-6467-HO (Jan 99)		US\$ 0.7m	MIF	Management of transition.
1024/SF-HO (Dec. 98)	Municipal Development, Tegucigalpa. Potable water and sewerage component.	US\$ 15m	FSO **	Investment conditional on hand-over of services to the municipality and a private management contract.
****		US\$ 0.7m	MIF	Management of transition.
1028/SF-HO (Dec 98)	Social Investment Program, FHIS III.	US\$ 14m	FSO	Investment in potable water and sanitation systems in rural areas.
****	Creation of national regulatory framework	US\$ 1m	MIF	Still to be defined. Will be dependent on passing new potable water and sanitation law.
<p>*Source of funds: NR = Non-reimbursable FSO or trust funds; FSO = Fund for Special Operations which are concessional; MIF = Multilateral Investment Fund which is non-reimbursable or based on contingent recovery.</p> <p>**Lending to the Government of Honduras at FSO rates. Terms for on-lending to the municipalities are 25 years and the interest rate includes the cost to the Government of administering the funds.</p> <p>***Dates of approval (or anticipated approval) by the IDB.</p> <p>**** Pending discussion with relevant authorities.</p>				

- 2.7 Investment to renovate the existing infrastructure and to expand coverage is urgently required in parallel with institutional change to secure efficient and sustainable management of the potable water and sanitation systems in the intermediate cities in Honduras. The Program will begin to fill the need for investment in water and sanitation while promoting and consolidating the reform that is taking place at the local level. The Program will provide the technical and financial support that is required to ensure that local reform of potable water and sanitation services is properly designed and does not bring the process into disrepute.
- 2.8 The Program is included in the most recent Country Paper for Honduras and was included as a priority during recent discussions between IDB management and the central government. It is consistent with the IDB's longstanding goals of supporting local service

provision and promoting efficient potable water and sanitation services. The Program will:
a) give credibility to reform at local level; b) give it the basic design it needs to succeed;
and c) reward the pioneering of those local entities that have taken on the responsibility of
reform for the sake of improving the lot of their people.

III. THE PROGRAM

A. Objectives

- 3.1 The first objective of the Program is to contribute towards efficient and sustainable potable water and sanitation services by promoting and consolidating reform at a local level. It will invest in municipalities of intermediate size that have demonstrated the will to create operators with sufficient autonomy to provide services on a commercial basis within a clear regulatory framework.
- 3.2 A second objective of the Program is to strengthen the capacity of the municipalities as the entities responsible for potable water and sanitation services. The Program will promote formal relationships with the other principal actors in the sector: the operators, the clients for the services and financial organizations.
- 3.3 A final objective of the Program is to leave behind a set of tested procedures for preparing and financing potable water and sanitation projects. A financial mechanism, the Municipal Development Trust Fund (MDTF), is being established for projects for the municipalities of Tegucigalpa and San Pedro Sula, IDB projects HO-0135 and HO-0115 respectively. The same fund will be used to channel sub-loans to municipalities participating in this Program. The MDTF will include procedures to appraise infrastructure projects and ensure that they are within the financial capacity of the operator. In each case the loans will support potable water and sanitation services for that municipality and will be directly linked to the capacity of the municipality to undertake the work and repay the loan.

B. General Outline of the Program

- 3.4 Twenty-one municipalities have submitted proposals, have been pre-selected for the Program and have formally committed themselves to make institutional changes to improve the services. They will: a) accept responsibility for providing potable water and sanitation services and ownership of the infrastructure; b) establish an operator with management and financial autonomy; c) ensure financial, operational and environmental sustainability with adequate tariffs; d) accept regulation; and e) involve the community in decision making. Other municipalities could become eligible for financing under the Program by making the same commitment.
- 3.5 The Program will finance technical assistance and civil works for municipalities that agree to modernize the way potable water and sanitation services are provided. Support to the municipalities will be carefully staged, beginning with technical assistance to develop and publicize a new water policy and support for the creation of the new institutional framework. Once the new institutional framework is in place, the Program will finance technical assistance to strengthen the operators. Finally, after the technical assistance has helped the municipalities and operators raise the performance of the services provided by existing facilities, the municipality will be able to borrow for civil works to improve and expand services further. The rules of eligibility by which a municipality qualifies for each successive stage of the Program will be given in detail in the Operating Regulations (see Paragraph 4.24).
- 3.6 The Program is designed to be easily replicated, is modular in its implementation and can be changed in size without losing its design integrity. The size of the Program was based on the project proposals from the twenty-one municipalities. There are not enough FSO resources in 1999 for this number of municipalities and the Program will begin with a reduced number. At the request of the Government of Honduras, the project team would process a second operation for more municipalities when FSO resources become available.

C. Technical Assistance for Dissemination of Policy, Publicity and Education Campaigns
(IDB loan amount US\$0.5 million)

- 3.7 Public support is essential for sustainable potable water and sanitation services, and the Program will make funds available to involve the community in decisions related to the potable water and sanitation services. This will involve the initial step of establishing a water and sanitation policy in consultation with the public for which up to US\$30,000 will be made available, in the form of a grant, to each municipality. In addition to the grants, sub-loans will be provided for continuing education and publicity campaigns.
- 3.8 Each municipality must ensure that there is an explicit potable water and sanitation service policy that is properly publicized in, and agreed with, the community. The Program would support activities such as the creation of a Water and Sanitation Committee to establish and publicize the municipal water and sanitation policy. A model for such committees has already been established in some cities.
- 3.9 Each municipality will prepare a Water and Sanitation Policy which will outline the changes intended for the services. The policy will set objectives for levels of service and the coverage. It will also state the tariff policy. The policy will serve as a vehicle for disseminating the proposals and gaining consensus with the community through *cabildos abiertos*, or other events.
- 3.10 Activities that will be eligible for the grants or sub-loans will include the contracting of consultants to draft a Water and Sanitation Policy Document as well as the mounting of publicity and education campaigns. There are no pre-conditions for this stage of the Program except that the municipality state its intention of carrying out the reform in accordance with the principles stated in paragraph 3.4 and appoint a Coordinator (see Paragraph 4.5). The formal discussion of the water policy in a *cabildo abierto*, or other general forum, will be a rule of eligibility for further involvement in the Program.

D. Technical Assistance for Institutional Change (IDB loan amount US\$1.2 million)

- 3.11 Three basic models have been identified for the institutional change depending on the size of the municipality and whether or not SANAA presently operates the potable water services. Each model is based on an operator with a certain degree of autonomy from the municipality. In each model there is a contractual framework that: a) ensures an arms-length relationship with the municipality, b) mimics the relationship desired between the public (supervision) and private sector (service provision) in the provision of services, and c) defines operating indicators and is therefore a means of measuring performance. The publication of performance indicators for each operator to allow comparison with other operators will be an important requirement of each contract. The contractual framework also serves for regulations relating to the provision of potable water and sanitation services while a satisfactory national regulatory framework for the sector is being established.
- 3.12 The **FUNDEMUN Model** for municipalities with populations of less than approximately 30,000¹. FUNDEMUN has developed a model for the provision of public services that is appropriate for smaller municipalities where there is limited institutional and technical capacity. A separate water and sanitation division, the *Departamento de Agua y Saneamiento* (DAS), is created within each municipality to be responsible for the direct provision of potable water and sewerage services. The DAS is the operator and keeps accounts for the potable water and sanitation services separate from those of other municipal activities to ensure that income is utilized only for costs relating to the services.

¹ The population figure of 30,000 dividing the municipalities is arbitrary. It is possible that a municipality with a larger population would opt to use the FUNDEMUN model and vice versa. Such a change would have to be justified. Eight of the twenty-one pre-selected municipalities fall in this category.

It will be a requirement that the accounts are independently audited every year. The DAS will enter into an agreement with the municipality, similar to a formal contract, which will specify the guidelines for the services, including performance indicators. The FUNDEMUN model should be seen as the first step in an evolutionary process. Conversion to a model of private sector involvement would be relatively straightforward using the Puerto Cortés Model.

- 3.13 The **Puerto Cortés Model**² for municipalities with populations greater than 30,000. The model that is proposed for Puerto Cortés, and which is supported by the IDB loan for sewerage in that city, will be used for the larger cities. In this case, the operator will be a water and sanitation entity entirely independent of the municipality in management terms. The operator will be incorporated as a commercial company with either municipal, or mixed private and municipal, ownership. The municipality retains ownership of the infrastructure. There will be a formal contractual arrangement between the operator and the municipality that will take the form of a lease, concession or other contractual instrument. The contract will give the operator the obligation and right to use the infrastructure to provide services to the population. The operator will pay a fee to the municipality for the use of the infrastructure related to its value and for the cost of a small supervisory department. The contract will include performance indicators by which the operator will be monitored.
- 3.14 The **Transition Model** for municipalities whose services are presently provided by SANAA³. The potable water services in certain cities are presently the responsibility of SANAA and must be formally transferred, with ownership of the infrastructure, to the municipality. There must be a transition period during which the transfer takes place and the municipality learns its new role as supervisor. In addition, SANAA must be allowed some time to make adjustments. The municipality will assume legal responsibility for the provision of the potable water services⁴ at the earliest opportunity and will enter into a service contract with SANAA for a transition period of not more than three years. This service contract will provide for both potable water and sewerage services⁵ and will contain the same indicators of performance for SANAA as for the other operators. The service contract must also make provision for the repayment, during the term of the contract, to the municipality of an amount equivalent to any sub-loans taken out by the municipality for institutional strengthening which will benefit SANAA.
- 3.15 A tariff structure for the potable water and sanitation services must be developed to reflect the true economic cost of providing the services while maintaining the correct balance between the clients' right to protection from the monopoly operator and the operator's right to a reasonable return. An important condition of the Program is that the tariffs should be linked to inflation to prevent erosion of income or continual referral to contractual procedure. This implies charges based on consumption that, in turn, implies metering of individual connections. Installing meters will be a part of the Program, either as part of the institutional strengthening (see paragraph 3.22) or part of the civil works.
- 3.16 For each model the municipalities' role will change from direct service provision to contract supervision. A small unit within the municipality, possibly linked to the Municipal Engineer's Department or, if it exists, the Municipal Environmental Unit, will

² The three municipalities that could fall in this category are: 1) Tela, 2) Choluteca, where, at the moment the municipality and SANAA have responsibility for services in different parts of the city, and 3) Olanchito which has a population of 28,000 and is a borderline case.

³ SANAA at present provides potable water services in eleven of the twenty-one pre-selected municipalities.

⁴ The municipalities already have responsibility for the sewerage services.

⁵ At present, SANAA provides the potable water services only. The municipalities provide the sewerage services.

do the contracting and supervision. The department should be equipped to supervise contracts for solid waste collection and other municipal services, as well as the potable water and sewerage contracts. The municipality will have an environmental management function, either a Municipal Environmental Unit or, in the smaller municipalities, a single person attached to another department.

- 3.17 Technical assistance loans under the Program will cover the formation of the new operators, under one of the three models described above, including the legal precedents where the operator is incorporated under commercial law. The technical assistance will also cover writing the contracts between the municipality and the operator⁶, including writing the contracts under which SANAA will provide temporary services for a municipality. It will also include the establishment of a tariff structure and the calculation of tariffs for inclusion as part of the contracts. The Loans will also be available to train personnel for the supervision of the operating contracts. The establishment of a tariff structure and creation of the new operator functioning in terms of a contract with the municipality will be rules of eligibility for the following phases of the Program.
- 3.18 Establishing an environmental management function will also be a rule of eligibility for further phases of the Program. Technical assistance will be available for creating or strengthening the municipal environmental management function. Funds will be limited to those necessary for creating the function needed to manage the environmental and social impact of the Program.

E. Technical Assistance for Institutional Strengthening and for studies relating to the Civil Works (IDB loan amount US\$2.33 million)

- 3.19 The new operators will need strengthening so that they can provide services that are satisfactory to the public and generate sufficient income from existing facilities to finance its operations, as well as civil works to further improve and expand services. The technical assistance will be aimed at: a) bringing the services up to the levels stated in the Water and Sanitation Policy Document, b) meeting legal requirements in terms of potable water quality and environmental protection, and c) complying with performance indicators included in the operating contracts. For the Transition Model, where SANAA is to be contracted to operate the services for an interim period, there will be less need to strengthen the operator and the technical assistance will focus on the municipalities' ability to monitor the operating contract. Any institutional strengthening of SANAA necessary to support its operation in a particular municipality will be covered by the technical assistance but, in terms of the operating contract, SANAA will be required to repay the cost to the municipality (see Paragraph 3.14).

⁶ Draft outlines of the different contract forms will be written as part of the Program preparation and included as Technical File XI. These will give the scope of the contract, rights and obligations of the parties, remuneration, asset management, insurance provisions, dispute resolution procedures, penalties and bonuses.

Performance Indicators			
		As a condition for capital works	Ultimate aim.
Max. water unaccounted for:	(% of production)	50	30
Min. collection performance:	(% of invoiced)	80	98
Connections metered:*	(% of total)	20	80
Response to complaints:	(hours)	-	12
* Loans for the installation of meters may be raised as part of the Institutional Strengthening component where necessary to increase coverage to 20%.			

- 3.20 The aim of the institutional strengthening will be to enable the operators to comply with performance indicators included in the operating contracts. Achieving benchmarks will be a requirement of the contracts as well as a rule of eligibility for sub-loans for civil works. Performance relative to the benchmarks will be made public to enable a ready comparison between operators.
- 3.21 The types of activities that constitute institutional strengthening of the operator include: a) strengthening commercial performance and putting the services on a sound financial footing by updating asset and client registers as well as introducing appropriate invoicing and bill collection systems; b) introducing routine operating and maintenance procedures to ensure more efficiency; c) introducing inventory management for chemicals and spares; d) establishing a reserve fund for the replacement of equipment that has reached the end of its useful life (which will be a rule of eligibility financing for capital works); e) introducing water loss (physical and accounting) reduction programs which may considerably reduce the need for early investment in new works; f) establishing procedures for attending to the client, in particular complaint resolution; and g) training operator staff in the new administrative, operating and commercial procedures.
- 3.22 All of the activities mentioned above will be eligible for sub-loans for technical assistance under the Program. Investments for installing household meters may be included where they are required to bring coverage up to 20% of consumers. Investments for more household meters would be allowed under this component where it would have an immediate positive impact on the income of the operator.
- 3.23 Feasibility studies for the design and civil works, as well as environmental and social evaluations required by the law of Honduras and IDB policy, will also be eligible for sub-loans.
- F. Civil Works (IDB loan amount US\$18.0 million)
- 3.24 The municipalities will be able to borrow from the MDTF for civil works projects under terms set out in the Operating Regulations for the Program. Three key principles for the projects will be that: a) rehabilitating existing infrastructure will be preferred to the construction of new works, b) sanitation works will be promoted where they do not exist, and c) new works for the expansion of the potable water supply will not be permitted without complementary works for the safe disposal of wastewater. Potable water supply and wastewater disposal will be promoted as a single, indivisible service.
- 3.25 The cost of construction as well as the supervision of the construction of the civil works will be covered.
- G. Administration, Consultation, and Project Preparation (IDB loan amount US\$2.74 million)
- 3.26 This component will pay the costs of two consultants to man a supervising unit within the Finance Ministry, administering the account in the MDTF and the Technical Unit (see paragraph 4.13, *et seq.*) and of the Program Manager (see paragraph 4.7 *et seq.*). The

component will cover the cost of the preliminary consultation and agreement of the potable water and sanitation policy with the public in each municipality (see paragraph 3.7). This component also includes repayment of the Project Preparation Facility, PPF, of US\$135,000 used for the contracting of consultants for the preparation of Operating Regulations, the corporate design of the operators, the operating contracts, and the socioeconomic analysis of the Program.

H. Financing the Program

- 3.27 The demand for finance from the Program is potentially great. The size of the Program was set at US\$45million, US\$40million of which was to be loaned by the IDB. Due to the shortage of resources from the Fund for Special Operations (FSO) the Program has been reduced in size as explained in paragraph 3.6. The Program will now be set at US\$29 million, of which US\$26 million will be loaned by the IDB. The estimated distribution of costs between the different components of the Program has been based on the technical assistance and investment needs of the twenty-one municipalities that have submitted projects for inclusion in the Program, and is shown below.

Estimated Costs by Category (US\$ millions)				
Category	IDB	Local	Total	%
1 Administration, Consultation and Preparation	2.74	0.25	2.99	10
Management of MDTF account	0.50	0.00	0.50	
Technical Unit	0.15	0.05	0.20	
Ministry of Finance supervising unit	0.00	0.20	0.20	
Program Manager	1.25	0.00	1.25	
Consultation and agreement of policy with public	0.70	0.00	0.70	
Reimbursement of PPF	0.14	0.00	0.14	
2 Technical Assistance	4.03	0.50	4.53	16
Policy, Publicity and Education	0.50	0.00	0.50	
Institutional Change	1.20	0.00	1.20	
Institutional Strengthening	1.83	0.20	2.03	
Studies	0.50	0.30	0.80	
3 Civil Works	18.00	2.00	20.00	69
Construction contracts	17.15	1.20	18.35	
Supervision	0.85	0.80	1.65	
SUB-TOTAL	24.77	2.75	27.52	
Financial Costs	1.23	0.25	1.48	5
Interest	0.65	0.00	0.65	
Commitment fees	0.00	0.25	0.25	
Monitoring and inspection	0.36	0.00	0.26	
Auditing	0.32	0.00	0.32	
TOTAL	26.00	3.00	29.00	100

- 3.28 The IDB loan of US\$26 million will require counterpart financing of US\$3 million to be contributed by the municipalities based on their individual projects.

FSO Loan Conditions	
Amortization period:	40 years
Disbursement period:	4 years
Grace period:	10 years on capital repayments
Interest rate:	1% for first ten years, 2% thereafter
Inspection and supervision fee:	1% per year
Commitment fee:	0.5% of undisbursed commitment.

- 3.29 The IDB loan will be from the Fund for Special Operations (FSO) in accordance with the conditions given in the table above.

- 3.30 The Nordic Development Fund (NDF) is considering co-financing the Program with the sum of US\$2 million that would be allocated to Technical Assistance for Institutional Strengthening. This will increase the total Program value to US\$31 million. In the event that this co-financing is approved by the NDF, the funds from the IDB loan would be reallocated among the other components.

I. Retroactive Financing

- 3.31 Expenses incurred by the Ministry of Finance after 20th October 1999, for hiring consultants for the start up of the Program, of up to US\$50,000 will be recognized as part of the local counterpart of the loan. The contracting of the consultants will be in accordance with procurement policies of the IDB.

IV. IMPLEMENTATION

- 4.1 Implementation of potable water and sanitation projects has been weak in Honduras and merits special attention. There are four important aspects to Program implementation. a) The Government of Honduras is the Borrower and has ultimate responsibility for the loan through the Ministry of Finance. b) The municipalities themselves will be responsible for implementation and for counterpart financing. c) A private project manager, the Program Manager, will be contracted to ensure the overall implementation. d) A financial mechanism has been devised to ensure reliable repayment of the loans via reasonable on-lending procedures and conditions.
- 4.2 The Ministry of Finance will contract two consultants to form its own supervisory unit. This unit will be responsible for contracting and supervising the contracts with the Program Manager, the bank that manages the Municipal Development Trust Fund (MDTF) and the Technical Unit.

A. The Borrower

- 4.3 The Borrower is the Government of Honduras and will be responsible for repaying the loan to the IDB. The IDB will disburse funds into a special account of the Ministry of Finance in the Central Bank. From this account funds will be transferred to the Municipal Development Trust Fund, MDTF, for on-lending to the municipalities for their technical assistance and civil works projects.

B. The Municipalities as Implementing Agencies

- 4.4 Each municipality will appoint a Coordinator who will have general responsibility for preparing and implementing that municipality's projects. The Coordinator will draw up a plan for the municipal activities with the help of the Program Manager. The plan will be agreed between the municipality and the Program Manager and will form the basis for monitoring implementation.

Outline of a Typical Municipal Plan*	
Formulation of water and sanitation policy	2 months**
Appointment of Coordinator	3 months
Agreement of municipal plan	5 months
Eligible for loan for institutional strengthening	4 months
Eligible for loan for capital works	12 to 24 months
Capital works project complete	24 to 48 months
*A final Municipal Plan for each municipality will be agreed with the Program Manager before becoming part of Baseline Plan.	
**All dates are from the date of the signing of the Lump-Sum contract with the Program Manager.	

- 4.5 The Coordinator will be responsible for ensuring that activities at local level are properly coordinated and for carrying out the Program's procedures. The Coordinator will probably be a local consultant, with experience in project management, who will strengthen the capacity of the municipality to undertake the Program activities without adding to the municipal bureaucracy. Several municipalities, with the help of the Program Manager, may agree to contract a single Coordinator. Where the larger municipalities already have the capacity to implement projects, the Coordinator may be a municipal employee who will be required to work in close liaison with the Program Manager.

C. The Program Manager

- 4.6 The Program has been made as straightforward as possible, especially at the local level, but two aspects give it a degree of complexity: the multi-client nature of the operation and the fact that the operation focuses on mechanisms rather than physical projects. Due to this complexity, as well as the poor record of government agencies in implementing water projects, a professional project manager, the Program Manager, will be recruited to

implement the Program⁷. The Program Manager will be a firm that specializes in project management and will dedicate people with the necessary skills in sanitary and civil engineering, environmental management and financial analysis to the management of the Program.

- 4.7 The tasks of the Program Manager will be divided into three distinct, but overlapping, areas. First, the Program Manager will be responsible for ensuring that the municipalities play an active and full part in the Program as the implementing agencies for their own sub-projects. The Program Manager will assist the municipalities and their Coordinators in preparing technical assistance and in contracting all of the Program activities.
- 4.8 Second, the Program Manager will ensure that project proposals comply with all of the rules of eligibility when they are presented to the MDTF for appraisal.
- 4.9 Finally the Program Manager will play the classical role of the project manager: planning, coordinating, monitoring and controlling the activities of the Program to ensure completion as designed, on time and to budget. The Program Manager will be required to draw up a detailed plan, the Baseline Plan for the implementation of the Program, which will include the plans of individual Municipal Plans. The plan will include the Operating Regulations, a timetable and a budget. The Program Manager will coordinate all of the different actors to ensure full understanding of the tasks involved. The Program Manager will monitor advances in the Program against the Baseline Plan and take remedial action as necessary to control implementation. The Program Manager will make periodic progress reports to the Ministry of Finance and the IDB.
- 4.10 The Program Manager's contract will be designed to include appropriate incentives to ensure the timely completion of the Program. It will be a lump-sum contract for implementing the Program within a defined timeframe in accordance with pre-agreed Operating Regulations. The contract will give to the Program Manager the authority, as well as the responsibility, necessary to deliver the Program. The remuneration of the Program Manager will be linked to performance, possibly through a schedule of bonuses and penalties. The Program Manager will be contracted by the Ministry of Finance utilizing terms of reference previously agreed with the IDB⁸. The Program Manager's fees will be paid directly from the MDTF.

Preliminary Schedule for Program Implementation *	
Agreement on definitive Baseline Plan	3 months **.
Time for completion of 80% of technical assistance for Institutional Change	1 year.
Time for completion of 80% of technical assistance for Institutional Strengthening	2 years.
Overall implementation time, including construction and commissioning of all capital works.	4 years.
*Final or definitive baseline will be agreed between the Ministry of Finance and the Program Manager as a requirement of the contract between the two.	
**All dates are from the date of approval of the Regular Program.	

D. The Financial Mechanism

- 4.11 A financial mechanism has been designed to ensure that the loans are within the debt-carrying capacity of the water and sanitation services. It is also designed to ensure the

⁷ There is precedent for contracting a private project manager in Honduras. SANAA contracted a project manager to successfully complete a long overdue water project for Tegucigalpa in 1996. The Municipality of Puerto Cortés is contracting a private project manager to implement the sewerage project that is the subject of an IDB loan.

⁸ Drafting Terms of Reference for the Program Manager will be found in the Program Technical File XII.

timely repayment of the debt by the municipalities, thereby minimizing the risk of fiscal cost to the Government. The Municipal Development Trust Fund, MDTF, is being established as a temporary financing facility for this Program and the municipal development project for Tegucigalpa and San Pedro Sula approved by the IDB in 1998 (1024/SF-HO). The Trustee will be a local bank charged with managing the MDTF's flow of funds. A private firm will be contracted as a Technical Unit for the appraisal of projects submitted for sub-loans from the MDTF. The Program will have a distinct account within the MDTF that will make available funds for the Administration, Consultation and Project Preparation activities described in paragraph 3.25, as well as operate as a line of credit for the municipalities. The Technical Unit will be responsible for: a) applying pre-established Credit Guidelines to appraise projects and recommending approval to the IDB, and b) authorizing disbursements from the MDTF. The Trustee will be responsible for: a) performing portfolio surveillance against a set of relevant benchmarks, and b) keeping the Program's books.

- 4.12 The municipalities will present projects to the MDTF when they comply with the rules of eligibility for the Program. The Trustee will appraise the project to ensure that the Credit Guidelines are met, and submit it to the IDB Country Office in Honduras for final approval. When a project is approved, the relevant municipality will enter into a sub-loan contract with the Trustee. The disbursement schedule associated with the project will be part of the contract.

Responsibilities Related to Financial Mechanism	
Function	Responsible
Preparation of projects for submission to MDTF.	Municipality with assistance from Program Manager.
Project appraisal for compliance with credit conditions.	Trustee.
Approval of appraisal decision.	IDB Country Office in Honduras
Sub-loan contract.	Trustee and municipality.
Disbursements from IDB to Ministry of Finance account.	Authorized by IDB Country Office in Honduras
Disbursements from Ministry of Finance account to MDTF.	Automatic when MDTF disbursements to municipalities are due.
Disbursements from MDTF to municipalities.	Trustee.
Modified from Project Report for HO-0115 and HO-0135.	

- 4.13 The funds will be lent to the Government of Honduras at concessional terms, see paragraph 3.32. The benefits of these terms will be passed on to the municipalities for their water and sanitation projects. However, the terms will not be identical, since certain Program costs will be covered by a spread in the interest rate and shorter loan maturity. These costs include: a) the costs of the Program Manager, the Technical Unit and the management of the MDTF as well as the Ministry of Finance supervisory unit, b) the "grants" to the municipalities for consultation with the public, and c) the costs of project preparation that must be reimbursed (see paragraph 3.29). Also included in the interest rate spread is the cost of a reserve fund to cushion the effects of partial default on behalf of the municipalities.
- 4.14 The MDTF will lend in Honduran Lempiras at an interest rate of 4%, equivalent to a rate in US dollars. To achieve this, the Lempira-denominated principal outstanding at the end of each six monthly payment period will be indexed to the change in the rate of the Lempira to the US dollar during that period. The new amount will be used to calculate the amortization payment for the next period, which will also be denominated in Lempiras. This mechanism will ensure that costs are covered and at the same time gradually phase in any devaluation of the Lempira against the US dollar. The terms of the sub-loans will depend on the component they are financing. Terms of sub-loans for civil works will be 25

years to reflect the economic life of the works to be constructed. Terms of sub-loans for Technical Assistance for which funds will be disbursed earlier during implementation will be 40 years to avoid putting too great a financial burden on the municipalities. Likewise grace periods will be equivalent to the disbursement period plus 2 years for civil works and disbursement period plus 4 years for technical assistance.

On-Lending Conditions for Regular Program		
	Civil Works.	Technical Assistance.
Currency:	Lempiras.	
Interest rate:	4% on balance of capital indexed to Lempira/US\$ exchange rate.	
Maximum term:	25 years.	40 years
Grace period:	Disbursement period + two years.	Disbursement period + four years.

- 4.15 Sub-loans for technical assistance will be secured against the municipalities' general debt-carrying capacity. Sub-loans for investment in capital works will be based on the capacity to repay the sub-loans, and contribute the counterpart funds, from the income from the potable water and sanitation services. The debt-service-coverage-ratio will be used as an indicator to size the credit to be made available. Some of the municipalities have very low revenues from tariffs and the loans for which they would qualify would be inadequate. Therefore the maximum credit for which a municipality would qualify will be calculated after the operator has had an opportunity to improve income using the Program's technical assistance. A municipality will be entitled to a credit ceiling defined by a minimum debt-service-coverage-ratio of 1.0 on six months tariff performance after the technical assistance projects have been completed⁹. The Program Manager will check the financial projections for the operator to ensure that anticipated financial ratios are consistent with those expected of a potable water and sanitation operator as defined in the Operating Regulations.
- 4.16 Disbursement will be a two-level process. The Ministry of Finance's account will be replenished in accordance with IDB procedures for advancing funds to borrowers (document CC-5411). Transfers will be made from this account to the MDTF when disbursements to the municipalities are due. The Credit Guidelines will govern disbursements from the MDTF to the municipalities, and will include: a) approval of the specific project and signature of the sub-loan contract; b) opening of a project account by the Municipality with a commercial bank; and c) authorization of disbursement and transfer of funds by the Trustee to the Municipality's project account.
- 4.17 Repayment of the sub-loans will be through a mechanism that will promote prompt repayment as well as satisfactory operation of the potable water and sanitation facilities. Customers will pay service tariffs into dedicated accounts in local banks authorized to intercept a pre-agreed percentage of the monthly flow. This percentage will be transferred to a debt service account held in the MDTF. The percentage will be that required to repay the loan should the initial conditions remain unchanged: i.e., a debt-service-coverage-ratio of 1.0 and unchanged revenues and expenses. When a loan does not utilize the full credit capacity as defined above the intercept will be calculated in the same ratio as the actual

⁹ A debt-service-coverage-ratio is defined as the available net cash flow divided by the amount of principle and interest payments for a given period. A debt-service-coverage-ratio of >1.5 is usually recommended for water and sewerage utilities. However, given the low tariff performance of the municipalities, and the potential for increasing that performance substantially with the Program, it is appropriate that a lower figure is selected. The financial projections used in the Program justification show that the debt-service-coverage ratio will be >1.5 if conservative performance indicators are met.

credit to the full credit capacity. The funds remaining after the intercept will be made available to the operator.

- 4.18 Loan repayment will be secured, and the Government of Honduras protected as the ultimate guarantor, by a cascade of guarantees. As the first resort, if the intercept on revenues is insufficient to service the debt, the amount of the intercept will be increased to 20%. As a second resort, the Ministry of Finance will, at the request of the MDTF, intercept transfers from the Government of Honduras to the municipality. The MDTF will have the right to funds from the general budget of the municipality to cover the debt service. The MDTF will establish a loan reserve fund to cover any delays in debt service.
- 4.19 Establishing an adequate tariff structure linked to inflation will be a criterion of eligibility for each sub-loan . If the projects are successful, there will be a real improvement in tariff performance driven by better water services reaching a larger number of clients. As the original debt service calculation is based on the historic tariff (see Paragraph 4.17 above) and a term of 25 years, the sub-loan could be paid back quicker than anticipated. In addition, the imbalance between the terms of the loan from the IDB to the Government of Honduras and the sub-loans means that there will be a positive balance available for repayment to the IDB and held by the Ministry of Finance.
- 4.20 The MDTF has been designed to break even, not to generate profit. Funds transferred to the account for debt service in the MDTF will be channeled to the account of the Ministry of Finance. These repayments will go primarily to repay the IDB loan. The municipalities that originally qualified for sub-loans will have the right to further sub-loans for potable water and sanitation projects from any funds in excess of those needed for IDB debt repayment. After a period of five years, the IDB and the Government of Honduras may reassess the mechanism for paying back the individual sub-loans and allocation of excess funds.

E. Rules of Eligibility and Operating Regulations

- 4.21 Contracting the Program Manager and the Technical Unit will be a condition precedent to first the disbursement for the Program.
- 4.22 The presentation to the National Congress of a law governing potable water and sanitation services, which has adequate provision for independent regulation, will be a condition precedent to disbursements of funds for the technical assistance components of the Program. Approval of the law will be a condition precedent to disbursements of funds for the capital works component of the Program
- 4.23 Additional conditions precedent to disbursements of funds for the technical assistance components of the Program will be the establishment of the MDTF, agreement on the Operating Regulations and an agreement between the Ministry of Finance, the Central Bank and, if necessary, the trustee of the MDTF, on the conditions relating to the transfer of funds to the MDTF. . The Program will contain a series of criteria against which eligibility of the municipalities, their operators and the individual projects will be assessed. The other eligibility conditions will be those given against each component in Chapter 3. All eligibility conditions are given in detail in Annex I.
- 4.24 Detailed Operating Regulations are being written which will govern the implementation of the Program and will be the basic manual for the Program Manager. The Operating Regulations will define: the roles of the different parties involved in implementation; the activities eligible for financing and the conditions of eligibility; technical, financial, economic, social and environmental criteria for the civil works components; procedures for the selection and presentation of projects for financing; procedures for contracting and supervising the technical assistance and works; procedures for interception of the tariff for

repayment. The Operating Regulations will complement the Credit Regulations which apply to the MDTF¹⁰.

F. IDB Supervision

- 4.25 Careful IDB supervision is appropriate, especially during the early stages of implementation. The Project Team would travel to Honduras as soon as possible after loan approval to undertake a workshop with the Municipalities to initiate the Program. A key objective of this workshop would be to agree the Terms of Reference for the Program Manager and the Operating Regulations. A second mission would be held when the conditions precedent to first disbursements of funds for the technical assistance components.
- 4.26 Missions would visit Honduras to measure progress on the institutional changes in the municipalities and their impact on potable water and sanitation services six months and twelve months after the first disbursements of funds for the technical assistance components. The IDB Country Office would maintain a continual watch over the Program for the first two years to ensure its smooth implementation in addition to their responsibility for final authorization for individual sub-loans.
- 4.27 The Loan Committee of the IDB have requested that the Department of Regional Operations II prepare and present to the Committee a report on the implementation of the Program. This report will be prepared by the Environmental and Natural Resources Management Division of Region II and the IDB Country Office in Honduras within 2 ½ years after the disbursement of funds for the technical assistance components.

G. Procurement of goods and services

- 4.28 Contracting for the Program will follow IDB policies with the exception of contracting the trustee to the MDTF (See Paragraph 4.30). International public bidding will be used for procurement of works in excess of US\$1,000,000 and for acquisition of goods and services in excess of US\$350,000. National procurement regulations will apply for amounts below these thresholds.
- 4.29 Given the modest size of most of the civil works projects, just sufficient study should be undertaken to justify the selection of a given alternative and to determine its price. Final design should be left to the construction contractor who would then have undivided responsibility for the performance of the works. The contracts would be let as turnkey, lump sum arrangements, which would also leave the final price in the hands of the private contractor. The technical feasibility study would contain a design brief and specifications to prevent overdesign by contractors. Public bidding, national or international depending on the size, would ensure a fair price for the works. Supervision of works construction will be required whether or not turnkey contracting is used.
- 4.30 An exception to the IDB's procurement policies is requested to allow the Ministry of Finance to contract directly, as trustee to the MDTF, the same private bank to be contracted for the municipal development project for Tegucigalpa and San Pedro Sula (1024/SF-HO). This was always the intention and part of the design of the Program, but the contracting for the latter project is already advanced and competitive bids are being called for in accordance with IDB policy. It will not be possible to incorporate the Program in the competitive bidding process without delaying the other project substantially. The exception is justified on institutional grounds: The Ministry of Finance does not have the capacity to duplicate efficiently the lengthy and complex bidding process. The Ministry of Finance will also avoid the burden, and the associated costs, of supervising two trustees undertaking essentially the same function. Despite these

¹⁰

Draft Operating Regulations are given in the Program Technical File X.

advantages, it is important that the Ministry of Finance is not placed in an unfavorable negotiation position. In the event that the Ministry of Finance does not reach a satisfactory agreement with the private bank within 60 days after loan contract becomes effective, the Ministry of Finance will hire a bank as trustee using the IDB's normal procurement policies.

H. Special disbursement to initiate Program

- 4.31 Up to US\$500,000 will be disbursed prior to the satisfaction of the conditions precedent to first disbursement to permit the timely contracting of the Program Manager.

I. Revolving Fund

- 4.32 As the present loan is smaller than the loan originally envisaged, a revolving fund of 10%, instead of the usual 5%, of the total loan value will be established in the account of the Ministry of Finance, to respond to a possible high momentary demand for funds if disbursement for projects for two or three municipalities is required simultaneously. It is important that the municipalities are able to develop meaningful investment plans and this may not be possible if the amount in the revolving fund is limited to 5% of the loan value.

V. THE VIABILITY AND IMPACT OF THE PROGRAM

A. The overall viability of the Program

- 5.1 The basic viability of the Program depends on three factors, each of which is considered carefully in the design of the Program. a) The viability of the individual projects. Each project will be studied to determine its viability from a technical, socio-economic, financial and environmental point of view. b) The appropriateness and strength of the institutions. Technical assistance is provided not only to create and strengthen the institutions that provide potable water and sanitation services, but also to monitor the services for compliance with operating contracts and the country's environmental regulations. c) The willingness of the public to pay tariffs. The projects are sized according to historic tariff income.

B. Technical considerations

- 5.2 Most of the projects submitted by the municipalities are of modest proportion and commensurate with the needs of the community. However, some were clearly overdimensioned, being too big in terms of both the ability to pay and the actual needs of the community. As the technical assistance for institutional strengthening is undertaken, the operators will be increasingly sensitive to means of controlling costs and maximizing income. They will become particularly aware of the savings that can be made by reducing leakage from the potable water distribution system. Physical leakage is usually reported as less than 40% of potable water production but figures are unreliable and it is unlikely that the leakage is so low. Savings from leakage reduction programs will be high enough to allow for resizing projects or postponing them for a few years.
- 5.3 Wastewater disposal is an obvious priority, but there is the least willingness-to-pay for this service. Careful sizing and the use of appropriate technology can be used to ensure that the service is compatible with willingness-to-pay and the environmental requirements of Honduras.

C. Economic considerations

- 5.4 Based on an assessment of projects already identified in the municipalities, the beneficiaries of the Program will be as given in the Table.

Approximate Number of Beneficiaries	
People with reliable potable water services where supply was previously absent or inadequate.	390,000
People with safe disposal sewage where services were previously absent or inadequate.	320,000

- 5.5 Various studies have shown that considerable welfare benefits accrue from improved potable water and sanitation services in Honduras. Those who are already connected to a potable water system will benefit from an improved level of service in several ways. There will be a general increase in the quality of life due the elimination of the uncertainty of the water supply. Potable water will be available when needed. Potable water will be treated to a higher standard and, by maintaining adequate pressure in the distribution system, will be less susceptible to contamination by ingress of contaminated groundwater. Those who are not already connected to a potable water system, predominantly the poor, will receive all of the above benefits to an even greater extent. In addition they will realize considerable direct savings since private vendors charge up to fifty times the unit cost of a piped water supply. The benefits of the Program to those presently without sewerage will be principally health related. There will be decreased gastrointestinal disease, a particular problem in Honduras where it is one of the main causes of a very high infant mortality rate. There will be less flooding with wastewater and less contamination of both groundwater and surface water sources. An economic and financial analysis of the

Program has been undertaken using data gathered from previous studies. The full analysis is given in the Program Technical File VI.

- 5.6 There is evidence of willingness-to-pay for reliable potable water and sanitation services provided by an organization independent of political manipulation, a condition promoted by the Program. An analysis of consumption and price for potable water in Comayagua, where a considerable portion of water consumption is metered, has been used to generate a demand curve for potable water that can be used for intermediate cities in Honduras. An economic analysis of the potable water projects presented for consideration by fourteen of the twenty-one municipalities pre-selected for the Program gave an average Economic Internal Rate of Return, EIRR, of 18.6%. Five projects yielded an EIRR of less than 12% probably due to inappropriate sizing. The projects actually implemented will be designed to give an appropriate economic return.

Potable Water Demand Function				
Consumption (m3/month/ connection)	Tariff (L/m3)	Tariff (US\$/m3)	Income (L/month/ connection)	Income (US\$/month/ connection)
5	9.59	0.71	48	3.55
10	6.37	0.47	64	4.72
20	3.14	0.23	63	4.65
30	1.26	0.09	38	2.80

- 5.7 There is less data available for an economic analysis of sewerage services but a detailed study undertaken for a sewerage project in Puerto Cortés yielded an average willingness-to-pay of L84/month/connection (US\$6.21/month/connection). Informal surveys made during focal group interviews in low income neighborhoods of the municipalities pre-selected for the Program indicate that the willingness-to-pay varies between L30 and L10/month/connection. This indicates that the people with the lowest earning potential are conscious of the need for sewerage and are willing to pay for it.
- 5.8 The economic net benefit gained from rehabilitation of potable water and sanitation infrastructure is almost always positive given the low cost of the works compared with the benefits.
- 5.9 Rules for the economic analysis that will form part of the feasibility study for each project are being developed and will be included in the Operating Regulations for the Program.
- D. Financial considerations
- 5.10 The financial viability of the Program is assured by a debt service that is always less than or equal to net cash flow based on historic performance. For each project, a financial model will be constructed to ensure that the financial ratios normally utilized for the analysis of potable water and sewerage utilities are within the limits expected.

Financial Ratios to be utilized for Financial Projections.	
Financial ratios in the projections will be within the following limits.	
Current ratio: (Current assets/current liabilities)	1.5 to 2.0 minimum
Debt-equity ratio:	2.0 to 3.0 maximum
Operating ratio: (Total income/operating income)	Greater than 1.2
Debt-service-coverage ratio: (Available net cash flow/principal and interest payments)	Greater than 1.5
**See JORDAN, CARLSON and WILSON. "Financial Indicators Measure Fiscal Health", Jour. AWWA, 89, 8, 34 (August 1997)	

5.11 Nine municipalities that provide their own potable water services, and therefore have cost data available, have been analyzed to determine the size of loans for which they would qualify. The loan sizes vary between US\$150,000 and US\$2.2 million depending on the population and tariff assumptions made, but they are commensurate with the size of project envisaged. The loan sizes are certainly commensurate with investments required to provide better potable water and sanitation services.

5.12 The Program requires the municipalities to be responsible for sub-loan debt service in the event of there being insufficient revenue from the potable water and sanitation services to cover the repayments. The financial situation of the sixteen municipalities has been reviewed in order to assess their strength. Little information is available from the municipalities themselves and the analysis has been carried out using data provided by FOHPREI. These data indicate that the municipalities are in reasonable financial health. All but four of them have a positive net current income, indicating that current expenditure is under control. Of the four that do not have a positive net current income, after taking into account the capital balances (that include government transfers) only two showed a modest deficit. For the twenty-one municipalities as a whole, both current and total net incomes are positive. Data concerning debt are reassuring, average debt service being only 13% of current revenue and 52% of total savings, below the maximum levels normally recommended of 25% and 75% respectively. Even if the income from the potable water and sanitation services were insufficient to pay the first amortization of the IDB loan after the grace period, and the municipality had to make the payment, both these indicators would be at an acceptable level.

E. Environmental and social considerations

5.13 The environmental impact of the Program will be overwhelmingly positive. Given the nature of the Program, the size of the cities and the finance available, there will be no major works that might have serious negative environmental effects. On the other hand there will be considerable positive impact: a) there will be better use of water resources, and therefore less waste, as water bills will be based on consumption, and b) there will be reduced pollution with better provision for the disposal of wastewater. Small negative environmental effects such as noise, dust and other nuisances during construction will be small, temporary and easily manageable.

5.14 Certain rules relating to environmental and social issues are established for the selection of projects: a) rehabilitating existing infrastructure will be preferred to the construction of new works, b) sanitation works will be promoted where they do not exist, and c) new works for the expansion of the potable water supply will not be permitted without complementary works for the safe disposal of wastewater. Potable water supply and wastewater disposal will be promoted as a single, indivisible service.

- 5.15 An Environmental and Social Impact Report (ESIR) has been produced as part of the preparation of the Program. The ESIR gives: a) details of the rules for the environmental and social assessment that will form part of the feasibility study for each project and the mitigation measures that must be taken, and b) the environmental impact management required in terms of the law of Honduras. These rules will be in the Operating Regulations for the Program and will include quantifying impacts and developing a management plan for any negative impacts.
- 5.16 Each municipality included in the Program will be required to establish an environmental management function which may be a single functionary in a small municipality or may be a full Municipal Environmental Unit that is already found in a number of cases. The municipality will enter into an agreement with SERNA, the Ministry of Natural Resources and the Environment, which delegates to the municipality the responsibility of following the procedures established for environmental classification, environmental impact assessments and the application for an environmental license for a given project. SERNA itself will issue the license. The establishing of the environmental management function will be a rule of eligibility for technical assistance for institutional strengthening and the signing of the agreement between the municipality and SERNA will be a rule of eligibility for civil works projects.
- 5.17 To complement the Program, each municipality will be required to commit itself to a modest regime of environmental monitoring and control. A set of social and environmental indicators has been selected to a) monitor diseases caused by lack of sanitation, b) potable water quality, c) the quality of water in local watercourses, and d) the quality of the effluents of the wastewater treatment plant. The monitoring of these indicators will be included in each environmental management action plan, for each project approved.

Environmental and Social Indicators	
<u>Health</u> : Number of cases recorded in local clinics of: diarrhea and other intestinal illness associated with drinking water quality and poor sanitation.	<u>Baseline</u> : Cases recorded in 1999.
<u>Potable water</u> : pH, turbidity, coliform bacteria and residual chlorine.	<u>Baseline</u> : As established in the potable water quality guidelines issued by the Ministry of Health.
<u>Watercourse</u> : pH, turbidity, Biochemical Oxygen Demand, nitrogen and total solids.	<u>Baseline</u> : As established in regulations issued by the Ministry of Natural Resources and Environment.
<u>Effluents</u> : pH, turbidity, Biochemical Oxygen Demand, nitrogen and total solids.	<u>Baseline</u> : As established in regulations issued by the Ministry of Natural Resources and Environment.

F. Poverty Impact

- 5.18 Proxy measures for unsatisfied basic needs were studied for the sixteen Municipalities that received technical assistance during preparation of the Program to demonstrate that the Program qualifies as a Poverty Targeted Investment. These, when compared with the same measures for the urban areas of Honduras as a whole, demonstrate a significantly higher index of poverty for the communities that will benefit from the Program. The Program thus qualifies as a Poverty Targeted Investment under the Geographic Classification as set out in the Eighth Replenishment Agreement, Document AB1704, and modified in document GN1964-3 of 3rd June 1997.

Poverty Indices				
Municipality	Urban population	Nutrition deficit (% of population)	Potable water deficit (% of population)	Sewerage deficit (% of population)
Average for 16 Municipalities	414,357	44.7	37.5	75.9
Total for Honduras (Urban)	2,521,831	28.5	17.0	50.0

G. Risks

- 5.19 Political risk manifests itself in various ways. First, there is the risk that an inadequate legal and regulatory framework at the national level will undermine the new institutional arrangements for the provision of the potable water and sanitation services. To avoid this, an adequate potable water and sanitation law must be submitted to, and later approved by, the national legislature as conditions precedent to the approval of different stages of the Program.
- 5.20 Second, there may be delays in SANAA's devolution of the responsibility for the services to the municipalities. The Program has been designed in accordance with SANAA's policy of devolving this responsibility: "...in a gradual and orderly manner." Where SANAA is the present service provider, the organization will continue to provide the services under contract to the municipality during a transition period of three years. This will ensure SANAA's continued involvement in the short term and a smooth transition to municipal control.
- 5.21 Third, the Program is designed for municipalities throughout the country and has lacked a strong coordinating presence from the central government during preparation. Therefore the municipalities themselves, with the help of a private Program Manager, will implement the Program. The financial mechanism being developed for the municipal projects for Tegucigalpa and San Pedro Sula will be used to channel loan funds to the municipalities.

Rules of Eligibility

Phase of Program	Rules of Eligibility
Conditions that Apply for Disbursements for the Rapid Reconstruction Component	
First disbursement.	That the Program Manager has been contracted, on a monthly fee basis, for a six-month period.
Conditions the Apply to Approval of the Regular Program	
First disbursement to the MDTF for sub-loans for technical assistance.	That a potable water and sanitation law, with satisfactory provision for regulation, has been formally submitted to the legislature in Honduras for approval. That the MDTF has been established and is functioning. That the Operating Regulations have been finalized and agreed with the IDB. That the contracts with the Program Manager and the Technical Unit are effective.
First disbursement to the MDTF for sub-loans for capital works.	That a potable water and sanitation law, with satisfactory provision for regulation, has been formally approved by the legislature in Honduras.
Conditions that Apply to the Inclusion of a Municipality in the Program	
Approval for the inclusion of a municipality in the Program.	That the municipality has made a formal written commitment to: a) accept responsibility for the provision of potable water and sanitation services and as owner of the infrastructure; b) establish an operator with management and financial autonomy; c) ensure financial, operational and environmental sustainability with adequate tariffs; d) accept regulation; and e) involve the community in decision making.
Conditions that Apply to Technical Assistance for Individual Municipalities	
Disbursement from the MDTF for technical assistance for dissemination of policy, publicity and education campaigns.	That the Coordinator for the municipality has been selected.
Disbursement from the MDTF for technical assistance for institutional change.	That the water policy of the municipality has been explained to the community at a cabildo abierto, or other open forum, and been accepted by a formal resolution of that forum.
Disbursement from the MDTF for technical assistance for institutional strengthening and for studies relating to the civil works.	The tariff structure has been determined and the tariffs calculated in accordance with the provisions of the potable water and sanitation law. An autonomous operator has been formed or selected and is operating in the terms of an operating contract with the municipality. A municipal environmental function has been established.

Conditions that Apply to Capital Works for Individual Municipalities	
Disbursement from the MDTF for construction of civil works.	<u>Rules relating to service provision</u>
	That the maximum amount of unaccounted for potable water is equivalent to no more than 50% of total production.
	That the amount collected in tariff revenue is equivalent to no less than 80% of the total amount invoiced.
	That no less than 20% of potable water connections is metered.
	That a reserve fund has been created to replace equipment that has reached the end of its useful life.
	<u>Rules relating to the individual projects</u>
	That the relevant project is technically, economically and financial justified by a study undertaken by a recognized expert in the field.
	That the relevant project has been assessed for its environmental and social impact and that it has a mitigation plan approved by the relevant authorities and that provisions of the plan are included in the construction contracts as relevant.
	That an Environmental License has been issued by the Ministry of Natural Resources and the Environment.

Performance Indicators

The indicators given below will be utilized for measuring performance of the different parties during Program implementation.

Global Performance Indicators.

The following indicators will be used to gauge overall performance with respect to potable water and sanitation service quality.

Operators' Performance Indicators: Global Indicators		
Indicator	Unit	
Max. water unaccounted for:	(% of production)	30
Min. collection performance:	(% of invoiced)	98
Connections metered:	(% of total)	80
Response to complaints:	(hours)	12

The following indicators will be used to assess the overall impact of the Program on health and the environment.

Environmental and Health Indicators	
<u>Health</u> : Number of cases recorded in local clinics of: diarrhea and other intestinal illness associated with drinking water quality and poor sanitation.	<u>Baseline</u> : Cases recorded in 1999.
<u>Potable water</u> : pH, turbidity, coliform bacteria and residual chlorine.	<u>Baseline</u> : As established in the potable water quality guidelines issued by the Ministry of Health.
<u>Watercourse</u> : pH, turbidity, Biochemical Oxygen Demand, nitrogen and total solids.	<u>Baseline</u> : As established in regulations issued by the Ministry of Natural Resources and Environment.
<u>Effluents</u> : pH, turbidity, Biochemical Oxygen Demand, nitrogen and total solids.	<u>Baseline</u> : As established in regulations issued by the Ministry of Natural Resources and Environment.

Implementation Performance Indicators.

The following indicators will be used to determine implementation performance and the performance of the Program Manager for determining remuneration in terms of the Program management contract.

Sign Lump-Sum Contract with Program Manager.	3 months from date on which conditions precedent to the first disbursement for the Program are satisfied.
Agreement on Baseline Plan.	3 months from the date of lump-sum contract with the Program Manager.
Time for completion of 80% of technical assistance for institutional change.	1 year from the date of lump-sum contract with the Program Manager.
Time for completion of 80% of technical assistance for institutional strengthening.	2 years from the date of lump-sum contract with the Program Manager.
Time for completion of 67% of capital works, including construction and commissioning.	3 years from the date of lump-sum contract with the Program Manager.
Program funds fully disbursed.	4 years from the date of lump-sum contract with the Program Manager.

Performance Indicators for the Rapid Rehabilitation Component. These indicators will be used to gauge performance related to the Rapid Rehabilitation Component.

Sign Fee Basis Contract with Program Manager.	1 month from date on which Loan Contract becomes effective *.
Time for approval of projects for inclusion in Rapid Rehabilitation Component.	12 months from date on which Loan Contract becomes effective.
Time for commitment of the Rapid Rehabilitation Component funds.	18 months from date on which Loan Contract becomes effective.
Rapid Rehabilitation Component funds fully disbursed.	24 months from date on which Loan Contract becomes effective.
*The procurement process will be initiated before the Loan Contract becomes effective.	

Performance Indicators for Individual Municipalities. These indicators will be used to gauge the performance of the individual municipalities and their Coordinators. Measurement of performance against these indicators will be used to determine whether remedial action should be taken to improve performance or, in extreme circumstances, the sub-loan should be rescinded.

Milestone	Target duration	Remedial Action	Sub-loan rescinded
Coordinator appointed.	2 months from acceptance into Program.	If monitoring of the Program shows that duration will be greater than 120% of that in the Municipal Plan.	If monitoring of the Program shows no significant progress with activity after 40% of the duration shown in the Municipal Plan has expired.
Municipal Plan agreed.	3 months from acceptance into Program.		
Eligible for sub-loan for institutional change.	2 months from agreement of Municipal Plan.*		
Eligible for sub-loan for institutional strengthening.	6 months from agreement of Municipal Plan.*		
Eligible for sub-loan for capital works studies.	1 to 2 years from agreement of Municipal Plan.*		
Eligible for sub-loan for capital works construction.	1 to 3 years from agreement of Municipal Plan.*		
All projects completed.	1 to 3 years and 9 months from agreement of Municipal Plan.*		
* The actual duration will be agreed between the municipality and the Program Manager and stated in the Municipal Plan.			

Performance Indicators for the Performance of the Potable Water and Sanitation Service Operators. These performance indicators are divided into two categories: a) those that are to be utilized as a rule of eligibility for loans for civil works under the Program, and b) those that are utilized to monitor the routine performance of the operator and which would form part of the operating contract.

Operators' Performance Indicators: Eligibility for Civil Works		
Indicator	Unit	
Max. water unaccounted for:	(% of production)	45
Min. collection performance:	(% of invoiced)	85
Connections metered:	(% of total)	20

Operators' Performance Indicators: Routine		
Indicator	Units	Standard
Service continuity and pressure.	-	To be included in water policy and operating contract.
Potable water quality	-	To the standards of the Ministry of Health.
Wastewater discharges to receiving waters.	-	To the standards of the Ministry of Health.
Staff numbers.	Employees/1,000 potable water connections.	Maximum 5.

Procurement of Goods and Services

The following is a schedule of expected procurement of construction and services for the Program.

Principle items of procurement	Financing		Method	Estimated date
	% IDB	% local		
SERVICES				
Trustee to manage MDTF account (US\$500,000)	100	-	Direct ⁽¹⁾	1 st quarter 2000
Technical Unit for MDTF (US\$200,000)	75	25	LPB	1 st quarter 2000
Min. of Fin. Supervising unit (US\$200,000)	-	100	LPB	1 st quarter 2000
Program Manager (US\$1,250,000)	100	-	IPB	2 nd quarter 2000
CONSULTANCY				
Publicity and education campaigns (typically US\$30,000 to 50,000) ⁽²⁾	100	-	C	2 nd quarter 2000 to 3 rd quarter 2001
Legal, contractual and corporate (typically US\$30,000 to US\$80,000) ⁽²⁾	100	-	C	2 nd quarter 2000 to 4 th quarter 2001
Advisors on water and sewerage utility operation (typically US\$30,000 to 150,000) ⁽²⁾	90	10	LPB and C ⁽³⁾	2 nd quarter 2000 to 2 nd quarter 2002
Engineering studies and designs (typically US\$10,000 to 150,000) ⁽²⁾	63	37	LPB and C ⁽³⁾	2 nd quarter 2000 to 4 th quarter 2002
CONSTRUCTION				
Construction contracts (typically US\$200,000 to 2,000,000) ⁽²⁾	93	7	IPB, LPB and C ⁽⁴⁾	3 rd quarter 2000 to 1 st quarter 2003
Supervision contracts (typically US\$10,000 to 80,000) ⁽²⁾	52	48	C	3 rd quarter 2000 to 1 st quarter 2003
IPB = International Public Bidding, LPB = Local Public Bidding, C = Local Bidding				

Notes:

- (1) An exception to IDB policy will allow the Ministry of Finance to contract the same private bank as that selected, using competitive bidding, for the MDTF to be used for the municipal development project for Tegucigalpa and San Pedro Sula, subject to IDB loan 1024/SF-HO.
- (2) The work will be split across the twenty-one municipalities that require financing. The requirements will be different for each municipality and the figures given are typical only.
- (3) For consultancy and service contracts C allowed only for contracts worth US\$100,000 or less.
- (4) For construction contracts LPB allowed only for contracts worth less than US\$1,000,000. C allowed only for contracts worth US\$1,000,000 or less. Public tender after advertisement in the national press is required for Local Public Bidding, LPB. No public bidding, but a minimum of three quotations are required for Local Bidding, C.

PROPOSED RESOLUTION

HONDURAS. LOAN ____/SF-HO TO THE REPUBLICA DE HONDURAS
Potable Water and Sanitation Investment Program

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de Honduras, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Potable Water and Sanitation Investment Programa. Such financing will be for the amount of up to twenty six million dollars of the United States of America (US\$26,000,000), or its equivalent in other currencies, except that of Honduras, which are part of the resources of the Bank's Fund for Special Operations, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.