

**URUGUAY**

**CONDITIONAL CREDIT LINE (CCLIP) AND INDIVIDUAL LOAN  
FOR THE MONTEVIDEO SANITATION PROGRAM (PSU IV)**

**(UR-L1005)**

**LOAN PROPOSAL**

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| Portfolio in execution                               | <a href="http://ops/approvals/pdfs/URen.pdf">http://ops/approvals/pdfs/URen.pdf</a>   |
| Tentative lending program                            | <a href="http://opsgs1/ABSPRJ/tentativelending.ASP?S=UR&amp;L=EN">http://opsgs1/ABSPRJ/tentativelending.ASP?S=UR&amp;L=EN</a>   |
| Information available in the RE1/EN1 technical files | <a href="http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=847767">http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=847767</a>   |
| Procurement table                                    | <a href="http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=847744">http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=847744</a>   |

| Maps  |   |
|---|---|
| Coastal water quality map at the beginning and end of loan 948/OC-UR            | <a href="http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=758435">http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=758435</a> |
| Map showing locations of investments financed with loans 76/OC-UR and 575/OC-UR | <a href="http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=758454">http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=758454</a> |
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## ABBREVIATIONS

|        |  |
|--------|--|
| ANCAP  | Administración Nacional de Combustibles, Alcohol y Portland [National Fuel, Alcohol, and Portland Cement Administration]         |
| AWP    | annual work plan   |
| CCLIP  | Línea de Crédito Condicional para Préstamos de Inversión [Conditional Credit Line for Investment Projects]                       |
| CESI   | Committee on Environment and Social Impact   |
| DDA    | Departamento de Desarrollo Ambiental [Environmental Development Department]  |
| DINAMA | Dirección Nacional de Medioambiente [National Environment Directorate]   |
| DINASA | Dirección Nacional de Agua y Saneamiento [National Water and Sanitation Directorate]   |
| EBTIDA | Earnings before taxes, interest, depreciation and amortization   |
| EIA    | environmental impact assessment  |
| ICAS   | Institutional Capacity Assessment System   |
| IGAS   | Informe de Gestión Ambiental y Social [environmental and social management report]   |
| IMM    | Intendencia Municipal de Montevideo [Municipal Government of Montevideo]   |
| INE    | Instituto Nacional de Estadísticas [National Statistics Institute]   |
| LTMC   | long-term marginal cost  |
| MEF    | Ministerio de Economía y Finanzas [Ministry of Economic Affairs and Finance]   |
| O&M    | operations and maintenance   |
| OC     | Ordinary Capital   |
| OSE    | Administración de Obras Sanitarias del Estado [State Sanitation Works Administration]  |
| PARR   | Plan de Reposición de Viviendas y Reinstalación de Actividades Económicas [housing replacement and business reinstallation plan] |
| PDSM   | Plan Director de Saneamiento de Montevideo [master sanitation plan for Montevideo]   |
| PEP    | Plan de Ejecución del Programa [program execution plan]  |
| PGAS   | Plan de Gestión Ambiental y Social [environmental and social management plan]  |
| PPMR   | Project Performance Monitoring Report  |
| PSP    | Plan de Supervisión de la Ejecución del Programa [program supervision plan]  |
| SEA    | strategic environmental assessment   |
| UES    | Unidad de Ejecución de Saneamiento [Sanitation Executing Unit]   |
| UPC    | Unidad de Planificación y Gestión Comercial [Commercial Planning and Management Unit]  |

URSEA      Unidad Reguladora de Servicios de Energía y Agua [Energy and Water  
Service Regulatory Unit]

## PROJECT SUMMARY

### URUGUAY

## CONDITIONAL CREDIT LINE (CCLIP) AND INDIVIDUAL LOAN FOR THE MONTEVIDEO SANITATION PROGRAM (PSU IV) (UR-L1005)

| Financial Terms and Conditions <sup>1</sup>  |  |         |     |                                  |  |
|--|--|---------|-----|----------------------------------|--|
| <b>Borrower:</b>   | The Eastern Republic of Uruguay  |         |     | Amortization period:             | 25 years                                     |
| <b>Guarantor:</b>  | The Eastern Republic of Uruguay  |         |     | Grace period:                    | 6 years                                      |
| <b>Executing agency:</b>   | Intendencia Municipal de Montevideo [Municipal government of Montevideo] (IMM) |         |     | Disbursement period:             | 6 years                                      |
| Source   | Amount (US\$ millions)   |         |     | Interest rate:                   | Adjustable                                   |
|  | CCLIP  | Program | %   | Inspection and supervision fee*: | 0%   |
| IDB (Ordinary Capital)   | 220  | 118.6   | 85  | Credit fee:                      | 0.25%  |
| Local  | 40   | 20.9    | 15  | Currency:                        | US dollars from the Single Currency Facility |
| Other/Cofinancing  | 0  | 0       | 0   |                                  |  |
| Total  | 260  | 139.5   | 100 |                                  |  |
| Project at a glance  |  |         |     |                                  |  |
| <b>Objective:</b> The purpose of the CCLIP is to support the IMM in its efforts to improve the standard of living of the population of Montevideo department. The goal of the first program is to reduce pollution in Montevideo Bay and adjacent beaches. The purpose of the program is to expand the coverage of sanitary sewer and storm drainage systems, increase the amount of sewage that is adequately disposed of, and improve the management of sanitation and storm drainage services.  |  |         |     |                                  |  |
| <b>Special contractual conditions:</b> (a) <i>Precedent to the first disbursement:</i> (i) signature of the subsidiary agreement to transfer funds from the borrower to the IMM (paragraph 3.1); (ii) incorporation of additional staff into the sanitation execution unit (UES) (paragraph 3.2); (iii) presentation of the program execution plan (paragraph 3.18); and (iv) a decision by the IMM approving the five-year management commitments 2007-2011 (paragraph 3.13). (b) <i>Prior to calling for bids for any work:</i> (i) evidence that the environmental specifications have been included in the bid documents (paragraph 3.16). (c) <i>Prior to the start of any works:</i> (i) evidence of legal ownership of the land (paragraph 3.17). (d) <i>Prior to the physical start at any work site:</i> (i) evidence that affected families and businesses have been relocated (paragraph 3.8). (e) <i>Six months after the contract becomes effective:</i> approval and allocation of financial resources to the residential connections fund (paragraph 3.11). (f) <i>Nine months after the contract becomes effective:</i> contracting of a certifier (paragraph 3.15). (g) <i>Twelve months after the contract becomes effective:</i> (i) contracting of consulting services to provide technical support for the UES (paragraph 3.4); (ii) contracting of consulting services to support execution of the resettlement plan (paragraph 3.8); and (iii) contracting of consulting services to strengthen the Sanitation Division commercially (paragraph 3.9). (h) <i>During execution:</i> (i) service sustainability target met (paragraph 3.14); (ii) presentation to the Unidad Reguladora de Servicios de Energía y Agua [Energy and Water Service Regulatory Unit] (URSEA) and the Bank of semiannual management commitment compliance reports (paragraph 3.15); and (iii) presentation of midterm and final reports (paragraph 3.29). |  |         |     |                                  |  |
| <b>Exceptions to Bank policies:</b> None   |  |         |     |                                  |  |
| <b>Project consistent with country strategy:</b> Yes [ X ]            No [ ]   |  |         |     |                                  |  |
| <b>Project qualifies as:</b> SEQ [ X ]            PTI [ ]            Sector [ ]            Geographic [ ]            Headcount [ ]   |  |         |     |                                  |  |
| <b>Procurement:</b> Procurement under the program will be done in accordance with the Bank’s policies (documents GN-2349-7 and GN-2350-7). See paragraph 3.22 for thresholds, paragraph 3.23 for the procurement plan, and paragraph 3.24 for cost recognition.  |  |         |     |                                  |  |
| <b>Verified by CESI on:</b> 13 October 2006 (meeting 40-06)  |  |         |     |                                  |  |

<sup>1</sup> The interest rate, credit fee, and inspection and supervision fee mentioned in this document are established pursuant to document FN-568-3 Rev. and may be changed by the Board of Executive Directors, taking into account the available background information, as well as the respective Finance Department recommendations. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed 1% of the loan amount.\*

\* With regard to the inspection and supervision fee, in no case will the charge exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

## I. FRAME OF REFERENCE

### A. The department of Montevideo

- 1.1 The department of Montevideo covers a total area of about 53,000 hectares and has a population of 1,326,000 (2004 census). Most of its population lives in the city of Montevideo, which is the country's capital and largest urban area, with 40% of the population. It lies on the left bank of the mouth of the River Plate. The department has a coastal strip 77.1 km long, including the internal perimeter of Montevideo Bay (11.6 km) where many beaches used by the department's population are located. The water quality at most of these beaches is considered safe for swimming and is monitored by the Montevideo municipal government (IMM).

### B. Water and sanitation sector

#### 1. Current institutional framework

- 1.2 Over the last decade, the country's government has gradually been implementing an institutional framework for the sector that distinguishes between the functions of policy formulation, regulation, and service delivery. The sector has a policy formulation body (the National Water and Sanitation Directorate—DINASA); a regulatory body (the Unidad Reguladora de Servicios de Energía y Agua [Energy and Water Service Regulatory Unit]—URSEA); two public service providers—the State Sanitation Works Administration (OSE) and the IMM, through its Sanitation Division. The services are the responsibility of the OSE, except for sanitation in Montevideo, which is the responsibility of the IMM. Work on implementing this institutional framework is in the early stages. Policy formulation is mainly carried out through the OSE and the IMM, when that role should be performed by DINASA. URSEA has directed its efforts to regulating the energy sector and is not yet active in regulating the water and sanitation sector.

#### 2. Service coverage

- 1.3 The department of Montevideo has 98% coverage of drinking water services (91% on the national level) and 84% for sanitation (55% on the national level). The sanitation service covers 1,110,000 people through approximately 2,400 km of sewers and 275,000 residential connections. About 55% of all sewage is pretreated and discharged through an underwater outfall located at Punta Carretas in the eastern part of the city.

| Table I-1<br>Service coverage |              |                    |                             |
|-------------------------------|--------------|--------------------|-----------------------------|
| Year                          | Coverage (%) | No. of connections | Adequate final disposal (%) |
| 1981                          | 44.3         | 140,000            | 0                           |
| 1990                          | 48.1         | 152,000            | 30                          |
| 1994                          | 80.0         | 253,000            | 40                          |
| 2006                          | 86.0         | 275,000            | 55                          |

### C. Sanitation in Montevideo

- 1.4 The responsibility for managing the physical and financial aspects of the sanitation service lies with the Sanitation Division, which reports to the Environmental Development Department.

## 1. The Sanitation Division

- 1.5 The Sanitation Division is responsible for sanitation and storm drainage services. It is functionally independent in its activities, mainly in technical matters and partly in administrative functions. The main operating and financial indicators are shown below:

| <b>Table I-2<br/>Sanitation Division indicators</b>                    |             |
|--|-------------|
| <b>Indicator</b>   | <b>2005</b> |
| Coverage (population served/total population)                          | 84%         |
| Clients billed   | 378,065     |
| m <sup>3</sup> sanitation billed x 1,000                               | 57,958      |
| Income/m <sup>3</sup> billed (rate + storm drainage surcharge) in US\$ | 0.40        |
| Complete cost of service billed m <sup>3</sup> in US\$                 | 0.56        |
| Overall collections ratio  | 88%         |
| Collections/O&M + investments + debt service                           | 68%         |
| Cash deficit (IMM subsidy) in millions of US\$                         | 11.5        |

- 1.6 The Sanitation Division provides the following services: (i) sanitation studies and projects; (ii) sanitation works; (iii) sanitation operations and maintenance; and (iv) sanitation administration. The Sanitation Division has a staff of 258 and has third-party operating and maintenance contracts covering approximately 25% of the system and 100% of final disposal. There is roughly one employee per 1,000 connections.
- 1.7 Since 2003, the division has had a business-type accounting subsystem within the municipal accounts and is implementing a cost accounting system. The financial statements produced by the Sanitation Division since 2003 are audited by the State Audit Office. The division administers the rate system for sanitation services. The financial flows, including income from rates, are managed centrally by the IMM.

## 2. Rates and cost coverage

- 1.8 A rate system based on metered water consumption came into effect in June 2001. The sanitation rate has one fixed charge and one variable charge. The fixed charge corresponds to administration and marketing costs and is 14.09 pesos a month (US\$0.6). The variable sanitation charge is 8.36 pesos/m<sup>3</sup> (US\$0.34/m<sup>3</sup>) on average and decreases by steps for large nonresidential users. The difference between the average rate and the long-term marginal cost (LTMC) is US\$0.07. The variable part of the bill is calculated based on the volume of drinking water consumed, as measured by the OSE. Under an agreement between the OSE and the IMM, the data on meter readings are sent monthly to the Sanitation Division. For low-income residential users a subsidy is applied to the variable charge for the first 10 m<sup>3</sup>

consumed which is equivalent to 37% of that charge. Thirty-two percent of the houses billed benefit from this subsidy, which represents a discount in that group's value billed of 8%.

- 1.9 Income from sanitation charges accounts for 75% of the Sanitation Division's total income. The remaining 25% comes from the property surtax collected for storm drainage and completely covers the costs of operating and maintaining those drains. Income from sewer service is, on average, US\$0.40/m<sup>3</sup> while the average cost of providing the service is US\$0.45/m<sup>3</sup> (including operation and maintenance costs, investments, and debt service). The incremental cost of the new works is an estimated US\$0.08/m<sup>3</sup>.

#### **D. Master sanitation plan for Montevideo**

- 1.10 In 1995 the IMM prepared a master sanitation plan for Montevideo (PDSM), which defined sanitation priorities for the department to 2035 and produced an investment schedule programmed in four phases, whose projected cost is US\$400 million. The works in phase 1 of the plan were partially financed by the Bank (paragraph 1.12). The PDSM investment schedule planned, in phase 2, to build new sanitation systems in the western part. In phase 3, it intends to rehabilitate the downtown sanitation system and to build an underwater outfall in the western part that would eliminate dumping sewage into the bay and reduce pollution levels. In phase 4, systems will be expanded, collector sewers built, and storm drains rehabilitated in the suburban areas of the department. The cost of these investments is approximately US\$260 million. Once the plan is completed, coverage in the department will be 100% (equivalent to approximately 60,000 new connections), the streams, the bay, and the coastal strip will be cleaned up, and 100% of the city's sewage will be adequately disposed of (with pretreatment) through two outfalls.
- 1.11 The process of cleaning up the bay, with different urban development plans and projects, expansion of the port of Montevideo, particularly the new port facilities for fishing vessels, and the planned expansion of the oil refinery by the Administración Nacional de Combustibles, Alcohol y Portland [National Fuel, Alcohol, and Portland Cement Administration] (ANCAP), coupled with the aspirations of the population of Montevideo to have a clean bay, demand construction of the western final disposal system, which will decontaminate the bay and make the beaches on the city's western coastline safe for swimming. Owing to its technical characteristics, the western final disposal system cannot be built in stages. The hydrodynamic mathematical model and the quality of the water used to simulate the different final disposal alternatives mean that in addition to the land outfall, it is necessary to build an underwater outfall at least 2,000 m long if the beaches in the western zone and some of the beaches in the eastern zone that have already been cleaned up are to remain safe for swimming.

#### **E. Sanitation programs in Montevideo**

- 1.12 Bank financing in the water and sanitation sector in Uruguay amounts to almost US\$300 million, with US\$244.4 million of that figure (82.5%) being financed

through three loans for sanitation and storm drainage works in Montevideo department, with the IMM acting as executing agency for them.

- 1.13 The operations financed by the Bank have permitted the IMM to: gradually improve service coverage, management and the environmental quality of the coastal strips and bodies of water, and industrial monitoring; make the quality of the beaches on the east coast safe for swimming again; and improve the management of the sanitation service. With the first loan, 76/OC-UR, an interceptor

| <b>Table I-3<br/>IDB financing</b>                                |                 |                                 |
|---|-----------------|---------------------------------|
| <b>Program</b>  | <b>Approval</b> | <b>Loan<br/>(US\$ millions)</b> |
| Water system expansion and improvement (432/SF-UR)                | 1975            | 7.0                             |
| Urban sanitation project for Montevideo (76/OC-UR)                | 1981            | 65.0                            |
| Sanitation project for Montevideo, stage II (575/OC-UR)           | 1990            | 26.1                            |
| National potable water and sewerage program (785/OC-UR)           | 1994            | 45.0                            |
| Metropolitan Montevideo sanitation program, stage III (948/OC-UR) | 1996            | 153.3                           |

sewer for the east coast, a pretreatment plant, and an underwater outfall in the eastern zone (Punta Carretas) were financed. The second loan, 575/OC-UR, financed extension of the systems and the construction of a coastal interceptor sewer to prevent sewage from being dumped into the river between Montevideo Bay and Punta Carretas, channeling the water to the underwater outfall. The third loan, 948/OC-UR partly financed phase one of the PDSM (paragraph 1.10), which included sewer systems and interceptors (in the watersheds of Pantanoso and Miguelete streams), and conveyance and interceptor pipes to eliminate spills on the beaches and carry the sewage to the pretreatment plant at Punta Carretas. The loan also financed institutional strengthening actions to boost the IMM's capacity for management and control of environmental quality and industrial effluents and for management of the sanitation service.

## **1. Results of the sanitation programs**

### **a. Execution**

- 1.14 The earlier operations were executed satisfactorily. Loan 948/OC-UR is 99.75% disbursed and is winding down. The loan experienced a delay in execution owing to the delay in implementing the rate for metered use, which conditioned the financial resources available.<sup>1</sup> Since then the operation has proceeded normally, as can be seen from the Project Performance Monitoring Reports (PPMRs), the progress reports, and the evaluations.

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<sup>1</sup> The utility rate established by the IMM in 1995 was repealed in 1996 by the Legislative Assembly, and finally came into effect in June 2001.

- 1.15 All the contractual clauses established in the loan contracts have been complied with, except for the cost-coverage clause, which was partially fulfilled. In this regard, significant measures adopted by the IMM during the previous operation should be noted: a rate for metered use was introduced in 2001; the Sanitation Administration Unit was established; and a business accounting system for the service was introduced (paragraph 1.17). With respect to covering costs out of income from utility rates, the clause in loan contract 948/OC-UR requires income from the service to cover O&M, depreciation, debt service, and 30% of the value of investments each year. In 2005, when debt service for the loan began, 20% of the goal was attained (79% if depreciation is excluded). As for efficiency in collections, in 2004 the figure was 84.7%, compared to 85% established in the contract. If government users are excluded, the collection rate is 88%.

**b. Environmental management on the coast and in bodies of water**

- 1.16 Environmental quality on the city's east coast, which runs for 27 km from Montevideo Bay to the Carrasco stream, has improved noticeably and the beaches can be used for swimming again, which attracts more people. The IMM's Industrial Effluents Unit, which monitors compliance with the rules on the treatment and disposal of liquid industrial waste, has been strengthened. Pollution has been reduced, despite the increase in the number of industries; the domestic and industrial organic load dumped into water courses has been reduced by 50% and heavy metal discharges by 96%. Today, industrial waste complies with the targets for organic load and heavy metals established in 948/OC-UR. Reports on water monitoring at beaches, the coastline, and the watersheds of Pantanoso, Migulete, and Carrasco streams, confirm an improvement in pollution control at different test points along the watercourses. Since 1995, fecal coliform counts at beaches on the east coast have systematically been below 500 UFC/100 ml (which is the maximum recommended for swimming). In February 2005, the IMM obtained ISO 14001 certification for its environmental management of Ramirez, Pocitos, Buceo, and Malvin beaches. In parallel, solid waste management has been improved in neighborhoods with access problems and illegal settlements in the Migulete and Pantanoso watersheds and a master solid waste management plan has been designed for metropolitan Montevideo.

**c. Service management and coverage**

- 1.17 By the end of 2006, the drained area had been expanded to 13,800 ha compared to 11,000 ha in 1996 and coverage had been increased from 80% to 86% (paragraph 1.3). Some suburban areas and settlements that have sprung up in the western part of the city and have grown faster than expected remain to be covered.
- 1.18 The administration and management of the sanitation service has improved. Under loan 948/OC-UR, reorganization of the Sanitation Division was financed, with major achievements such as: (i) establishment of the Sanitation Services Administration Unit; (ii) implementation of an accounting system of the kind used in businesses; (iii) reorganization of the operations area, separating the operating,

maintenance, and final sewage disposal units; and (iv) establishment of a systems management technical team for strategic analysis of the system and preventive maintenance planning.

1.19 As a result of these actions, the management and administrative goals established in loan 948/OC-UR have been attained, except for the goal for the real rate of sanitary sewer connections. Out

| Table I-4<br>Service management goals                               |                          |                                       |
|---|--------------------------|---------------------------------------|
| Indicator   | Program goal             | Current (2006)                        |
| Reduction in questions and complaints from 300/day to 100/day       | 100                      | 17                                    |
| Reduction in waiting time for service from 60 minutes to 5 minutes. | 5                        | 5-10 (estimated)                      |
| Computerized accounting system                                      | Implemented              | Implemented                           |
| Periodic updating of the rate in function of operating costs        | Covers 100% of O&M costs | Covers 100% of O&M costs              |
| Percentage of O&M outsourced  | 40%                      | 25% of systems<br>100% final disposal |

of a planned 22,000 connections, 19,000 have been built (October 2006) and the rest are connections for the Carrasco Norte zone, which will be built under the present program. Fifty-nine percent (11,200) of the connections built are in use. The main factor influencing this figure is the inability of families to pay for the cost of the connection inside the home.

## 2. Lessons learned

1.20 The design of the present program took account of the following lessons learned from the previous programs. (i) **The actual connection rate is generally lower than expected** because low-income families cannot pay for the connections. In the present operation, the IMM will use a mechanism to subsidize connections inside the home for poor families (paragraph 3.11). (ii) **The O&M contracted with the private sector for works financed by the Bank has given good results;** the companies have provided better service, solving problems more quickly, reducing the number of complaints, but at a cost that is much higher than the Sanitation Division anticipated (US\$28-US\$36/house/year vs. US\$13-US\$17/house/year) which means that it is not feasible to extend the comprehensive contract modality to a larger percentage of the system. (iii) **Introduction of a charge for sewer service when sanitation is separate from the water service makes the sanitation service supplier dependent on the efficiency of the water supplier.** The percentage of unmetered water reported by the OSE amounts to 56% in Montevideo. More than half is accounted for by business losses, and this inefficiency is transferred to the sanitation service, making sustainability of the service difficult in the short term. A rate increase in this context would, in turn, mean passing the inefficiency on to consumers. The present operation includes actions to strengthen the commercial area of the Sanitation Division (paragraph 2.6), which will be complemented with the actions carried out by the OSE (paragraph 1.24), including: a campaign to replace meters and reorganize its business management, including a census of users. An agreement exists between the two entities to exchange information to improve

their client records (paragraph 1.8). An agreement is also being negotiated by the central government to reduce the arrears in payments by government agencies (paragraph 4.15).

**F. The IMM's sanitation strategy**

- 1.21 The municipal government's strategy for sanitation in Montevideo is intended to: (i) expand the coverage of the sanitary sewer and storm drainage systems to zones where this is economically feasible; (ii) improve water quality in the receiving bodies, compatible with the desired uses; (iii) improve sanitary sewer and storm drainage services in the areas already served by rehabilitating collector sewers that have outlasted their useful life and reinforcing mains whose capacity has been overwhelmed; (iv) provide timely, efficient, and effective attention to client requirements and continue to develop education programs for better use of water and the adoption of environmentally sustainable behavior and practices; (v) improve operating and commercial efficiency and effectiveness in delivering the service; and (vi) generate sufficient income (rates and surcharges) to cover the costs of providing sanitary sewer and storm drainage services. The IMM has been implementing part of this strategy since 1996, through implementation of the PDSM.

**G. The Bank's country and sector strategy**

- 1.22 The Bank's country strategy with Uruguay (document GN-2398-2) defines three strategic areas for action: (i) improving public management and sustaining fiscal soundness; (ii) strengthening competitiveness and further integrating Uruguay into the global economy in order to sustain growth; and (iii) poverty reduction and social inclusion as a pillar of sustainable growth. The proposed operation is consistent with the first and third strategic areas, since it seeks to improve the standard of living of the population in Montevideo department by increasing the coverage of sanitation service, reducing pollution in the bay, and promoting activities to strengthen the IMM's Sanitation Division.
- 1.23 The Bank's strategy for the sector in Uruguay, aimed at supporting compliance with the Millennium Development Goals, is directed to: (i) increasing the levels of sanitary sewer coverage and appropriate sewage disposal; and (ii) improving the operating efficiency of utilities suppliers and strengthening service regulation. This operation is consistent with this strategy, since it supports the IMM in making the investments needed to increase service coverage and improve the management and operating efficiency of the Sanitation Division.

**H. Coordination with other agencies**

- 1.24 The Bank's support for the sanitation sector in Montevideo is complemented by actions to improve the commercial management of the potable water service being carried out by the OSE, which are financed by the World Bank. The actions include a campaign to replace residential meters and reorganize commercial management,

including a client census. These activities will have a positive impact on the Sanitation Division's commercial management.

## **I. CCLIP rationale and relevance**

- 1.25 As mentioned earlier, sanitary sewer coverage and sewage treatment in Montevideo department requires an investment in the order of US\$260 million to be made in the 2007-2022 period. The works are defined in the PDSM. Approving the CCLIP will permit the IMM to receive Bank support for the entire period covered by the PDSM, which will give it the flexibility of being able to count on the necessary resources in a timely fashion which can be processed more quickly, provided that execution takes place as planned.
- 1.26 The line will be for US\$220 million and the remainder (US\$40 million) will come from the local counterpart. The disbursement period for the CCLIP will be 16 years. Loans from the line will be made to the Eastern Republic of Uruguay, to be transferred under the same conditions to the IMM. The move to the second program under the CCLIP will take place when: (i) a minimum of 75% of the funds have been committed and at least 50% of the funds from the first program have been disbursed; and (ii) the Sanitation Division is complying with the agreed management commitments (paragraphs 3.13 to 3.15).
- 1.27 The CCLIP proposal rests on the fact that the IMM complies with the above requirements necessary to have access to the instrument: (i) The executing agency has carried out at least one similar project with the Bank and the first project has been fully executed. The IMM has carried out three similar projects with the Bank, two of which have been fully executed and the third is winding down (paragraphs 1.12 and 1.14). (ii) The previous programs have been satisfactorily executed and the projects financed have been adequately operated and maintained. The expected results were achieved and the works that were financed are being satisfactorily maintained (paragraphs 1.14 to 1.19). (iii) The proposed executing unit is the same and has a solid management history. The financial statements of the programs have been audited and the auditors had no reservations. The borrower and the executing agency have complied with the Bank's disbursement and procurement policies and with the loan contract, except for the clause on covering costs with income from rates for metered service, which has been partially complied with (paragraph 1.15). Also, the agency that executed the earlier programs will be the same agency that will execute the CCLIP (paragraphs 3.1 and 3.2). The institutional capacity of the executing agency has meant that the earlier programs have a solid record of good management and the institutional analysis indicates that satisfactory performance can be expected to continue on the fronts to be covered with the CCLIP (paragraphs 4.3 to 4.5). (iv) The areas to be financed under the line are among the priorities defined in the country's program of operations with the Bank. The first loan under the line forms part of the Bank's program of operations with the country agreed on when the country strategy with Uruguay for 2005-2009 was being prepared (paragraph 1.22). Given that the IMM meets the indicated requirements, it is

recommended that a CCLIP be granted, thereby continuing the support that the Bank has been providing for the IMM's sanitation program.

**J. Design and strategy of the first program under the CCLIP**

- 1.28 The IMM is seeking to improve the quality of the water in the bay to reach levels compatible with current and future uses and increase sanitary sewerage and storm drainage service coverage while improving the quality of services and generating enough revenue to cover the cost of delivering and expanding them. The first loan reflects this vision and is based on two complementary lines of action: (i) cleaning up the bay to achieve levels that are consistent with its future uses, preserving the environmental conditions on the coastal strip; and (ii) improving management of the sanitation service, increasing revenue, and achieving long-term sustainability.
- 1.29 To implement these lines of action, it is necessary to stop the effluents from the sanitary sewer system from being dumped into the bay and rehabilitate collector sewers in poor condition that have outlasted their useful life. In terms of management of the service, the short-term priority is to improve efficiency in billing and collections prior to making rate adjustments. Greater commercial efficiency increases the impact of such adjustments. To achieve long-term sustainability and ensure a gradual improvement in the Sanitation Division's service delivery and management, as part of this program an institutional mechanism of management commitments will be established with annual and five-year targets, between the Sanitation Division, the service operator, and the IMM, which is responsible for it. Fulfillment of the management commitments will be verified by an outside certifier and monitored by URSEA. In addition, fulfillment of the management commitments is a condition for processing subsequent operations under the CCLIP (paragraph 1.26). This mechanism is a medium-term option, by virtue of the fact that the sector's institutional and regulatory framework has not been fully implemented. The Bank's technical team and national authorities are simultaneously evaluating the possibility of a technical cooperation program to support sector development in the long term. This strategy is consistent with the objectives of the Bank's Public Utilities Policy (OP-708), and abides by the operational guidelines established for its application.
- 1.30 With the first loan, investments in sewer systems and final disposal in the western part of the city will be financed in the 2007-2012 period. To improve management of the service, the operation will finance measures to contribute to business efficiency related to ensuring that all service users are billed, improving the targeting of subsidies and the method for calculating rates, and boosting collections. The PDSM will be updated to tailor future investments to the needs of the department and its population.

## **II. THE CCLIP AND THE FIRST PROGRAM**

### **A. Purpose of the CCLIP and the first program**

- 2.1 The ultimate aim of the CCLIP is to support the IMM in its efforts to improve the standard of living of the population of Montevideo department. The goal of the first program is to reduce pollution in Montevideo Bay and adjacent beaches. The purpose of the first program is to improve sanitary sewerage and storm drainage services by broadening service coverage, increasing the amount of sewage that is adequately disposed of, and improving management of the sanitation and storm drainage services.

### **B. Description of the first program**

- 2.2 The first program has the components described below.

#### **1. Sanitation and storm drainage systems (US\$17.96 million)**

- 2.3 This component includes the construction of 65 kilometers sewer systems, 8 kilometers of microdrainage systems, and rehabilitation of 4 kilometers collector sewers that have outlasted their useful life in the center northwest, Pantanoso, Miguelete, Carrasco, and Cerro-Casabó areas, that form part of the department's sewer and drainage systems.

#### **2. Western final disposal system (US\$63.23 million)**

- 2.4 This component will finance the construction of a western final disposal system to replace the discharge system currently operating in the bay, thereby helping to improve its environmental quality. The system will include six pumping stations, three surge tanks, 15.5 kilometers of pressure pipes, a pretreatment plant, and two kilometers of underwater outfall.

#### **3. Family resettlement (US\$7.9 million)**

- 2.5 The resettlement of at least 516 families and three commercial activities needed for sanitation and drainage works are included. The construction of houses, purchase of housing on the local or regional market, or cash compensation will be financed, depending on the option chosen by each family. Consulting services to support implementation, monitoring, and evaluation of the plan for housing replacement and business reinstallation (PARR) will also be financed.

#### **4. Improvement in the management of the sanitation and drainage service (US\$2.25 million)**

- 2.6 The following will be financed: (i) updating of the register of sewer connections; (ii) implementation of procedures to keep the register permanently up to date; (iii) establishment in the Sanitation Division of a commercial planning and management unit (UPC), to take charge of updating costs and rates, and preparing annual proposals for adjustments in the rate structure; (iv) development of billing for clients with their own water sources who use the sewer system; (v) feasibility

study and design of a billing system based on the nature of effluents for industrial and commercial users; (vi) study on general implementation of users contracts; (vii) implementation of cost analysis methods (integrated with the cost accounting system) and rate setting at efficiency levels; (viii) preparation of a study reviewing the rate discount system, jointly with the UPC; (ix) campaign to promote the activities in the urban sanitation plan; and (x) updating of the PDSM. This component also includes the purchase of furniture, office equipment, computer equipment, survey and laboratory equipment, measurement tools, and vehicles necessary for execution of the works.

### C. Cost and financing

- 2.7 The cost of the first program in the line will be US\$139.5 million and the loan will be for US\$118.6 million from the Single Currency Facility of the Ordinary Capital. The IMM will provide the counterpart funds. Distribution by investment category and source of financing is presented below:

| <b>Table II-1</b><br><b>Program cost and financing</b><br><b>(US\$ thousands)</b> |            |              |              |          |
|---|------------|--------------|--------------|----------|
| <b>Category</b>   | <b>IDB</b> | <b>Local</b> | <b>Total</b> | <b>%</b> |
| <b>I Engineering and administration</b>   | 6,800      | 8,000        | 14,800       | 10.6     |
| 1.1 Executing unit  | 0          | 5,400        | 5,400        | 3.9      |
| 1.2 Support for the executing unit (supervision)                                  | 4,800      | 0            | 4,800        | 3.4      |
| 1.3 Studies and designs   | 2,000      | 2,600        | 4,600        | 3.3      |
| <b>II Direct costs</b>  | 85,240     | 6,084        | 91,324       | 65.5     |
| 2.1 Sanitation and storm drainage works   | 16,734     | 1,227        | 17,961       | 12.9     |
| 2.2 Final disposal, western zone  | 58,911     | 4,319        | 63,230       | 45.3     |
| 2.3 Institutional strengthening   | 2,250      | 0            | 2,250        | 1.6      |
| 2.4 Resettlement  | 7,345      | 538          | 7,883        | 5.7      |
| <b>III Concurrent costs</b>   | 4,102      | 4,800        | 8,902        | 6.4      |
| 3.1 External certifier, monitoring, and evaluation                                | 792        | 0            | 792          | 0.6      |
| 3.2 Land  | 1,310      | 0            | 1,310        | 0.9      |
| 3.3 Household connections fund  | 0          | 4,800        | 4,800        | 3.4      |
| 3.4 Projects in the second CCLIP program  | 1,800      | 0            | 1,800        | 1.3      |
| 3.5 Monitoring the environmental and social management plan                       | 200        | 0            | 200          | 0.1      |
| <b>IV Unallocated</b>   | 5,938      | 1,020        | 6,958        | 5.0      |
| 4.1 Contingencies   | 3,213      | 545          | 3,758        | 2.7      |
| 4.2 Cost escalation   | 2,725      | 475          | 3,200        | 2.3      |

| Category                         | IDB     | Local  | Total   | %     |
|----------------------------------|---------|--------|---------|-------|
| V Financial costs                | 16,520  | 996    | 17,516  | 12.6  |
| 5.1 Interest during construction | 16,520  | 0      | 16,520  | 11.8  |
| 5.2 Commitment fee               | 0       | 996    | 996     | 0.7   |
| 5.3 I&S fee                      | 0       | 0      | 0       | 0.0   |
| <i>Total</i>                     | 118,600 | 20,900 | 139,500 | 100.0 |
| Percentage                       | 85%     | 15%    | 100%    |       |

- 2.8 The costs of updating the PDSM, preparing the final EIA and the monitoring plan, and preparing the final designs for the western final disposal system are included under the “Studies and designs” item. The concurrent costs of the program include the estimated value of the land, the cost of certifying compliance with the management commitments, the program evaluation reports, monitoring the environmental and social management plan (PGAS), preparing the projects to be financed under the second CCLIP program, and financing the residential connections fund.

### III. EXECUTION OF THE FIRST PROGRAM

#### A. Borrower, guarantor, and executing agency

- 3.1 The borrower and guarantor will be the Eastern Republic of Uruguay. The institution that will take responsibility for execution of the first program, the local counterpart contribution, and other contractual obligations will be the Montevideo municipal government (IMM). The loan will be in U.S. dollars from the Single Currency Facility of the Ordinary Capital, to be transferred to the IMM under the same conditions. A subsidiary agreement will be signed by the borrower and the IMM on the transfer of loan proceeds. *The subsidiary agreement is a condition precedent to the first disbursement.* The IMM will execute the program through the sanitation executing unit (UES) of the Environmental Development Department (DDA).

#### B. Program execution

##### 1. The executing unit

- 3.2 The UES administered the previous Bank operations with the IMM. As in those operations, the UES will receive support from an engineering firm that will assist it in technical aspects that arise during execution. The UES's technical team will be strengthened with the inclusion of a specialist in environmental management to supervise the program's environmental mitigation and management activities, and two social specialists for the PARR coordination group. *Bringing these specialists into the UES is a condition precedent to the first disbursement.*
- 3.3 The UES will have the following responsibilities: (i) planning program investments; (ii) preparation and monitoring the bid processes for works, goods, and consulting services; (iii) coordination and supervision of the PARR; (iv) control, monitoring, and works supervision; (v) coordination and supervision of the environmental and social management plan and verification that the environmental mitigation measures have been implemented; (vi) control of accounting and filing, presentation of disbursement requests, and rendering accounts; (vii) preparation of the program reports; (viii) presentation of evidence that the contractual clauses have been complied with; and (ix) monitoring and evaluation of the results.

##### 2. Execution mechanisms

###### a. Sanitation and storm drainage works

- 3.4 Execution of works for components 1 and 2 will be contracted through bid processes carried out in accordance with Bank policies. Works supervision will be performed with advisory support from the engineering firm contracted to assist the UES. *Contracting of the technical support consulting services within 12 months after the contract becomes effective is a contractual condition.*

- 3.5 The plans for the sanitation and storm drainage systems were prepared under the PDSM. All these plans have been completed and have final designs. Feasibility studies are available for investments in the western final disposal system and final designs will be financed during execution of the first loan.

**b. Resettlement**

- 3.6 The works require that 484 buildings be vacated (415 houses, 62 used as houses and workplaces, 3 commercial activities—depots operated by solid waste sorters—and 4 plots of land). A total of 516 low-income families will have to be resettled. The IMM has prepared a PARR based on the guidelines established in Bank policy OP-710. The compensation options include: (i) relocation to a new house built in a housing development, an option chosen by an estimated 175 families; (ii) replacement of the house with housing purchased on the local or regional real estate market, an option chosen by 325 families; and (iii) cash compensation to be applied in 16 cases.
- 3.7 For the first option, preliminary designs are available for the types of houses successfully used in the previous program. The second option consists of underwriting the purchase and assisting in the resettlement of families in existing housing in a location to be determined in accordance with the beneficiary, which comply with criteria for the quality of construction and legal tenure, within the limit established for the benefit (on the order of US\$13,000 for houses in Montevideo and US\$12,000 for houses elsewhere in the country). This option will allow for the immediate resettlement of families in an existing urban structure, promoting their rapid social reinsertion.
- 3.8 In function of the extent of resettlement requirements and the introduction of the new option of purchasing replacement housing, relocation will be supported with social actions and participation by the population affected, by installing a local office as a permanent place for consultations and the flow of information. The process will be supported by the UES' social team and a specialized firm, and includes permanent monitoring and evaluation to verify the results and impacts at the end of the program. *The firm to support the relocation process should be hired within twelve months after the contract becomes effective. Also, before the physical start at any work site, the affected families must have been resettled and land owners must have been paid compensation.*

**c. Improvement in the management of the sewer and drainage service**

- 3.9 The component to strengthen the commercial area will be executed by a consulting firm with international experience that will be contracted through competitive bidding following Bank policies and procedures. During the first year of execution, the following consulting services are expected to be contracted: (i) support for installation of the UPC in the Sanitation Division and the preparation of cost studies (integrated with the cost accounting system), updating the rates and the LTMC, and the subsidy policy; (ii) updating of the register of sewer connections,

implementation of procedures to keep it permanently current, and a study on the general introduction of user contracts; (iii) implementation of billing for users with their own water sources, and a feasibility study and design of a plan for billing based on the nature of effluents for industrial and commercial users; and (iv) design and conducting of a campaign to promote the urban sanitation plan. The UPC will prepare annual proposals for adjusting the rate structure, based on the cost and rate update studies, to be submitted to the mayor for approval, in accordance with the IMM's commitment to proceed with a general rate adjustment of 25% in real terms in the 2008-2011 period. The expected results of the activities described above will be translated into management goals for the Sanitation Division and form part of its management commitments (paragraphs 3.13 to 3.15). *The consulting services for commercial strengthening must be contracted within 12 months after the contract enters into force.*

- 3.10 Draft terms of reference (TOR) for the commercial strengthening studies are available. Monitoring of implementation of these studies will be included as part of the management commitments. The Sanitation Division has made headway in implementing the cost accounting system and the IMM's financial system module, which is needed to identify the Sanitation Division's cash flows.

#### **d. Residential connections fund**

- 3.11 The residential connections fund may subsidize in whole or in part or fully finance the cost of materials and labor for residential connections (up to about US\$500 for materials and US\$1,000 for materials and labor) for low-income families in the program areas and in areas with existing systems that have not yet been connected (paragraph 1.18). Seventy-five percent of the cost of the materials will be paid as a subsidy and the remaining 25% will be repaid by users over a period of up to 60 months. The subsidy will apply where justified based on the socioeconomic situation of the nuclear family, in accordance with the regulations of the fund agreed upon with the Bank. In certain cases (elderly persons, female heads of households, etc.) up to 100% of the cost can be subsidized (materials and construction). The amount to be repaid and the repayment period are based on the study of willingness to pay for the connection, adjusted by income level and the capacity to pay of the beneficiaries (established using information from the National Statistics Institute), estimated as 2% of family income (paragraph 4.10). The works to be financed or subsidized will be the minimum necessary for a proper connection to the public sewer and the elimination of cesspools. The agreement that the beneficiary will sign with the IMM and the bill for the sanitation service will be used to review the expense. *The IMM will present evidence that it has approved and allocated the necessary financial resources to cover the operation of the residential connections fund within six months after the contract enters into force.*

#### **C. Service performance strategy**

- 3.12 The financial projections indicate that to achieve a cash flow balance in 2006, the Sanitation Division would need to increase its income by 45%. In order for the

- increase not to be used to finance inefficiencies in the commercial area in both the water<sup>2</sup> and sanitation services, and avoid passing them on to the final consumer, the proposed strategy seeks to improve billing and collections efficiency before making rate adjustments. Improvements in Sanitation Division management include: (i) commercial efficiency measures (paragraph 2.6) to extend billing and improve collections; and (ii) rate adjustment measures (paragraph 3.9).
- 3.13 To implement this strategy, and in view of the fact that the sector's regulatory framework has not been fully implemented, management commitments will be established between the Sanitation Division and the IMM. The Sanitation Division will draw up the management commitments document with annual and five-year management indicators-targets it must reach in the following areas: (i) service coverage; (ii) financial sustainability; (iii) rate levels; (iv) efficiency; (v) commercial management; and (vi) service quality . The management commitments must be approved in a resolution issued by the mayor, who will send them to URSEA for its information and dissemination to the public. The annual work plan will include the management actions established in the management commitments. *Approval by the mayor of the Sanitation Division's management commitments for the 2007-2011 five-year period—and its transmittal to URSEA—will be a condition precedent to the first disbursement.*
- 3.14 Financial sustainability is defined in terms of covering the cost of the service<sup>3</sup> out of income from collections. Table III-1 below shows the Sanitation Division's financial sustainability target (average 82%, 2007-2012), included in the management commitments with an indicative timetable of annual changes therein. This average target of 82% is the expected outcome of measures to strengthen the commercial efficiency of the Sanitation Division, coupled with the rate adjustments planned by the IMM. *Achieving the average coverage ratio of 82% for the 2007-2012 period will be a contractual condition.* The annual values will be used as data for annual monitoring of contractual compliance. Clause 4.02(a) "Charges for the measured use of sanitation services" of loan contract 948/OC-UR, will be modified to adjust it as described above, based on coverage of service costs.

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<sup>2</sup> The level of unaccounted-for water in Montevideo is 56%, with more than half of the figure represented by commercial losses according to the OSE.

<sup>3</sup> These costs are: operation, maintenance, marketing, and administration of sanitation and storm drainage services, sanitation and storm drainage debt service; the local counterpart required for the program; and other necessary investments outside the program.

| <b>Table III-1</b><br><b>Financial sustainability goals of the Sanitation Division</b><br><b>Coverage ratio: Collections/ O&amp;M costs, marketing, and administration + debt service for sanitation and storm drainage + local counterpart required by the program + other nonprogram investments needed</b> |      |      |      |      |      |      |
|---|------|------|------|------|------|------|
|   | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| Indicative annual ratio   | 65%  | 75%  | 80%  | 85%  | 90%  | 95%  |
| Average for the period  | 82%  |      |      |      |      |      |

- 3.15 During execution, the Sanitation Division will conduct and annually update cost and rate studies that will serve as a basis for annually determining rate adjustments and the management measures required to achieve the sustainability target. It will also update the management commitments. To monitor the latter, the Sanitation Division will prepare a report on compliance therewith every six months. The quality of the information in the reports will be verified by an external certifier to be contracted by the IMM. *The certifier is to be hired nine months after the entry into force of the contract.* The certified reports will be sent to the mayor for approval with copies to the Bank and forwarded by the mayor to URSEA, for monitoring and public dissemination to sanitation service users. *Presentation of the certified semiannual management commitment compliance reports to URSEA and the Bank is a contractual condition.*

#### **D. Socioenvironmental management of the program**

- 3.16 The proposals for environmental mitigation, strengthening, and monitoring constitute the environmental and social management plan (PGAS), which incorporates the recommendations from the strategic environmental evaluation and the environmental and social evaluation of the first program. In the PGAS, the measures for mitigation, impact compensation, and compliance monitoring were grouped into programs whose compliance ensures the adequate construction and operation of the works included in the first program and establishes the necessary guidelines for subsequent operations under the line. The UES will be strengthened to adequately implement environmental management of the program (paragraph 3.2) and environmental supervision of construction is planned as part of the supervision and inspection process. The bid documents will include the obligation to comply with the environmental specifications deriving from the respective environmental management and control plans, as established in the program's PGAS. *Prior to calling for bids on any work, the UES will present evidence that the environmental specifications have been included in the bid documents.*

#### **E. Land and rights-of-way**

- 3.17 The proposed program will not pose any significant problems with purchasing land, since most of the works, such as the sanitation sewer and storm drainage systems

will be constructed on public streets. No difficulties or conflicts are anticipated in obtaining the land that is necessary for the program, since the law permits expropriation on the grounds of public utility. It should be noted that a sufficient number of properties have been identified in nearby areas to construct housing developments for the families to be resettled. *Prior to the start of any works, the UES will demonstrate that legal possession of the land necessary for construction of the works has been obtained.*

**F. Bank supervision and procurement**

- 3.18 The program will have a management system that will permit the operation to be monitored and will be based on the program execution plan (PEP), *which will be the initial report that the executing agency will present to the Bank prior to the first disbursement.* The PEP will include planning for all program activities based on the 'critical path' method and should be updated when deviations occur. Under this framework, the UES will prepare the annual work plans (AWPs) spelling out the activities and costs linked to the program's objectives, outcomes, and outputs and all other planning (financial, operational, or administrative) that stems from the PEP. Each 'critical' task for project execution should be associated with an expected outcome and with the inherent level of risk, to make it possible to identify the process or processes that will help to manage the risks effectively.
- 3.19 The operation will be supervised following the program supervision plan (PSP), which includes: (i) status control over the operation, which means verifying if the operation continues to be feasible and whether its outcomes and outputs are still attainable; (ii) support for the UES for project management; (iii) approval of the pertinence of expenditures made with loan proceeds, based on the AWP, with a description of activities linked to program outputs and outcomes; (iv) operations and environmental supervision through meetings with the executing agency and field inspection visits to program works; (v) opinion on procurement processes for international competitive bids and advisory services for the executing agency on all procurement processes when so requested; (vi) review of the assumptions and indicators in the logical framework and whether they continue to apply and identification of difficulties that could alter the critical path for execution; and (vii) analysis of proposals for program reformulation, if necessary.
- 3.20 The UES and the Bank will hold semiannual monitoring meetings at which the following aspects will be reviewed: (i) progress in the execution of each component and compliance with the goals established in the AWP; (ii) progress in compliance with the management commitments and, annually, the certified report on compliance with them; (iii) evidence of compliance with the contractual clauses; and (iv) an analysis of whether the assumptions and risks of the operation still apply and identification of any factors beyond the control of the executing agency that could affect the program's critical path. The aide-mémoires of these semiannual meetings will constitute the program's progress reports.

- 3.21 Since this operation has been classified as having a low level of fiduciary and operational risk (paragraphs 4.4 and 4.5), the eligibility of expenditures, excluding procurements and contracts subject to international competitive bidding, will be granted annually on the bases of the visits and other relevant supervisory activities carried out by Bank specialists, complemented by the audit reports on the procurement and disbursement processes and the review of the financial statements to be performed by the State Audit Office. The State Audit Office, together with its audit report on the project's financial statements, will present a report on the results of its review of procurements and payments. The report and the regular supervision exercises will permit the Bank to determine the eligibility of expenditures.
- 3.22 Procurements of works, goods, and consulting services will be subject to the Bank's procurement policies and procedures: Policies for the procurement of works and goods financed by the IDB (GN-2349-7) and Policies for the selection of consultants financed by the IDB (GN0-2350-7). When the estimated cost of the works is US\$3 million equivalent and over and the cost of goods and services is US\$250,000 equivalent and over, they will be subject to international competitive bidding. All consulting contracts for US\$200,000 equivalent and over will be subject to international competitive bidding. In the case of consulting contracts for less than US\$200,000, the short list can be composed exclusively of local consultants. All procurement will be reviewed ex ante. The Bank may decide, however, to perform these reviews ex post, on the basis of the results of the reviews it conducts, the external audit reports, and inspection visits, for contracts for works and goods procurement involving amounts below the thresholds for international competitive bidding and contracts for consulting firms and individual consultants involving amounts below US\$200,000 and US\$50,000, respectively.
- 3.23 Contracts for goods and works will follow the procurement plan presented by the UES for the first 18 months of execution, which has been reviewed by the Bank and is considered acceptable. The borrower will update the plan annually as necessary, or when substantial changes occur, always covering the next 18 months of execution. All proposals to revise the plan must be presented to the Bank for nonobjection.

**G. Recognition of costs from the local counterpart**

- 3.24 The borrower has asked the Bank to recognize costs or obligations contracted during program preparation for up to US\$1.5 million equivalent from the local counterpart. These costs can be recognized once the Bank has verified that they are eligible, were incurred in procurement procedures resembling those established in the loan contract, and made during the 18 months preceding the date on which the operation is approved by the Bank's Board of Executive Directors.

**H. Execution period, disbursement schedule, and revolving fund**

- 3.25 The disbursement period has been estimated as six years, based on the schedule presented in Table III-2. The execution schedule reflects the times required to carry

out the planned activities and takes the nature of the works and the bid processing periods.

| <b>Table III-2</b><br><b>Disbursement schedule (US\$ millions)</b> |        |        |        |        |        |        |       |
|--|--------|--------|--------|--------|--------|--------|-------|
| Source   | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Total |
| IDB  | 6.64   | 14.75  | 29.00  | 30.36  | 26.00  | 11.80  | 118.6 |
| Local  | 4.81   | 2.89   | 3.96   | 3.75   | 3.45   | 2.08   | 20.9  |
| Total  | 11.45  | 17.64  | 32.96  | 34.11  | 29.45  | 13.87  | 139.5 |
| %  | 8.21%  | 12.65% | 23.62% | 24.45% | 21.12% | 9.95%  | 100%  |

- 3.26 Given that execution of the sewer system works requires frequent payments of significant amounts and the contracting of numerous consulting assignments under the program, the establishment of a revolving fund equivalent to 10% of the financing is proposed to streamline program execution.

#### **I. Auditing**

- 3.27 The executing agency will present the audited financial statements of the program annually to the Bank, certified by the State Audit Office.

#### **J. Program evaluation and monitoring**

- 3.28 The UES has an information system to monitor and evaluate program goals. The system will compile, store, and maintain all the information on: (i) the performance indicators and impact of the CCLIP and the program, as defined in the logical framework; (ii) the indicators defined in the Sanitation Division's management commitments; (iii) the quality indicators of the bodies of water set out in the logical framework and the PGAS, which will serve to evaluate the impact of the components and activities financed on the quality; and (iv) the monitoring and ex post evaluation indicators for the families affected by expropriation and resettlement.

- 3.29 **Midterm and final evaluations.** The UES will prepare and send to the Bank a midterm report when 50% of the loan proceeds have been committed or 36 months after execution begins, whichever comes first. It will also prepare and send to the Bank a final report when 90% of the loan has been disbursed. These reports will include: (i) the results of financial execution by component; (ii) compliance with the goals for outputs and outcomes and progress in the expected impacts, in accordance with the indicators established in the logical framework; (iii) fulfillment of the environmental requirements and specifications for the works, as established in the PGAS; (iv) fulfillment of the tasks involved in operating and maintaining the completed works; (v) summary of the socioenvironmental impact, including reports on family resettlement; and (vi) compliance with the contractual commitments. The UES will compile, store, and maintain all indicator and parameter data—including

annual plans, midterm review, and final report—needed to help the Bank prepare the Project Completion Report. *Presenting the midterm and final reports will be contractual conditions.*

- 3.30 An external review of the program will be conducted half way through, based on an analysis of the midterm report and the semiannual progress reports prepared by the UES (paragraph 3.20). This review will verify progress in complying with the indicators in the logical framework, headway in the medium- and long-term institutional strategy depicted in the management commitments, and overall program execution progress. In the event that the review demonstrates the need to make adjustments in execution, the executing agency will present a plan to correct the shortcomings found. Until the plan is approved by the Bank, no new commitments will be authorized from the loan.

## **IV. FEASIBILITY AND RISKS**

### **A. Technical feasibility**

- 4.1 This program is considered feasible and justified from the technical standpoint since it responds to the need to solve sanitation and environmental pollution problems caused by the absence or insufficiency of sewage collection, treatment, and final disposal. The experience of the UES ensures the technical and administrative capacity necessary to execute and supervise the works and the execution and supervision schedules are suitable. The works to be financed do not present any special technical complexities in construction or in operation, since they involve widely-used technologies in storm drainage and in the collection, treatment, and final disposal of sewage. The housing solutions for the families to be resettled conform to best practices in housing for low-income groups and correspond to cost-efficient solutions.
- 4.2 The projects have been prepared up to generally-accepted engineering standards and principles and correspond to least-cost, technically feasible alternatives that have been widely tested under similar conditions in the country. The budgets have the appropriate detail and backing. The projects to be executed at the start of the program have final designs. The basic project for the western final disposal system is ready and resources have been included in the program to prepare the final designs during the first year of execution.

### **B. Institutional feasibility**

- 4.3 The institutional feasibility of the program was analyzed from the standpoint of capacity of the UES and the Sanitation Division, and a risk analysis of the preceding operation. Based on the conclusions of the risk analysis performed as part of the reformulation of the portfolio in Uruguay, it was recommended that the type of supervision described earlier (paragraphs 3.18 to 3.23) be used. Based on the ICAS analysis, it was recommended that the UES improve its activities programming, financial administration, and internal control areas.
- 4.4 In the risk evaluation exercise for the previous operation (948/OC-UR) the following risk areas were considered: fiduciary and operational performance, development effectiveness, and social, environmental, and quality safeguards. Each of these categories includes a series of risk factors that are viewed as representative of the inherent risks that could potentially affect the effectiveness of program execution. Based on the results of this analysis, the risk of the operation is classified as low.
- 4.5 The institutional capacity of the UES and the Sanitation Division was evaluated using the ICAS methodology, covering the areas of activities programming, administrative organization, personnel management, administration of goods and services, financial administration, internal control and external control. The results indicate that the UES and the Sanitation Division have a low weighted risk for

program execution and subsequent administration of the works. In the programming area, the analysis identified the need to formalize the process of preparing, amending, monitoring, and controlling the AWP; and in the financial administration area, the processes for financial management of the UES and the Sanitation Division and for accountability. The UES and the Sanitation Division have already made significant progress in formalizing these processes and have prepared an overall program dashboard. For the financial administration and activities programming areas, the UES will have the support of a short-term consultant financed by the program to complete the manuals of procedures. With regard to the internal control area, the UES has an action plan to strengthen this aspect of program execution. Loan proceeds will be used to finance a short-term consultant to revise the design of internal control activities, implement supervisory mechanisms, and develop a training plan to strengthen the Sanitation Division.

## **C. Socioeconomic feasibility**

### **1. Socioeconomic evaluation**

- 4.6 A socioeconomic evaluation was conducted for each of the investments in sanitation and drainage and for the western final disposal system, which affects the Pantanoso and Miguelete operating units. The evaluation was based on a comparison of the economic benefits and costs in situations with and without the program. The benefits were calculated using the results of surveys on contingent valuation performed in Uruguay, which provided estimates of willingness to pay for the services and for environmental improvements stemming from the reduction in water pollution and the increase in property values. The costs considered for the evaluation were the incremental costs of investment, operations and maintenance, equipment replacement costs, and the cost of relocating families and businesses, valued at efficiency prices at April 2006. The opportunity costs of the land used for housing and social works, although some of them belong to the municipality, were also considered.
- 4.7 A cost-benefit analysis was performed for each of the projects. The results of the analysis indicate that the program is economically feasible on the level of each functional unit, with internal rates of return of over 12%. The benefit-cost ratios were higher than 1.

| Table IV-1<br>Economic cost-benefit analysis |                                    |                          |                         |           |             |      |      |
|--|------------------------------------|--------------------------|-------------------------|-----------|-------------|------|------|
| Functional unit                              | Net present value (US\$ thousands) |                          |                         |           |             | IRER | B/C  |
|  | Benefits                           | Investment + replacement | Residential connections | O&M       | Net benefit |      |      |
| Casabó sanitation                            | 7,285.49                           | 5,283.36                 | 613.68                  | 218.18    | 1,170.27    | 14.2 | 1.21 |
| Casabó drainage                              | 5,669.75                           | 4,284.43                 | -                       | 239.82    | 1,145.50    | 15.1 | 1.25 |
| Cerro Norte sanitation                       | 2,033.10                           | 1,319.77                 | 357.00                  | 60.50     | 295.83      | 13.9 | 1.17 |
| Cerro Norte drainage                         | 2,648.67                           | 1,347.46                 | -                       | 67.14     | 1,234.09    | 17.3 | 1.81 |
| Carrasco Norte sanitation                    | 2,540.96                           | 1,775.92                 | 365.46                  | 81.39     | 318.19      | 13.6 | 1.14 |
| Carrasco Norte drainage                      | 1,868.56                           | 773.62                   | -                       | 38.55     | 1,056.40    | 21.8 | 2.32 |
| Western final disposal                       | 86,183.05                          | 63,669.60                | -                       | 16,379.84 | 6,133.61    | 14.9 | 1.07 |
| Resettlement                                 | 9,938.14                           | 7,422.28                 | -                       | -         | 2,515.86    | 13.4 | 1.34 |

## 2. Sensitivity analysis

- 4.8 A sensitivity analysis was performed of the estimated parameters that could have an influence on the results of the economic evaluation. The parameters are willingness to pay for sanitation and drainage, the percentage of actual connections to the systems, and the costs of the projects. According to the analysis performed, the results are robust, except for the investments in the Carrasco Norte sanitation project and the resettlement project, which can only accept an increase in costs of up to 15% or a reduction in benefits of up to 10%. The other projects accept increases in costs of up to 20% or reductions in benefits of up to 25%.

## 3. Beneficiary analysis

- 4.9 The analysis of beneficiaries was based on data from the INE on the average monthly income of the population of Montevideo between March 2005 and March 2006. The data indicate that 59.1% of the beneficiaries of the expanded sanitation and storm drainage systems are low-income families (earning less than three minimum wages). In the case of the western final disposal system, the low-income beneficiaries account for 29.7% of all beneficiaries.
- 4.10 **Capacity to pay.** The capacity to pay of users of the sanitation system was calculated. The average basic payment for sewer service according to the Sanitation Division and assuming an average residential consumption of 10 m<sup>3</sup> a month is US\$3.10. According to information on income distribution in the program's areas of influence and for the total population of Montevideo, this represents less than 2.3% of the average monthly income of low-income families. The IMM has a system of subsidies that apply to the variable charge for the first 10 m<sup>3</sup> used, depending on which of the department's zones the building is located in. At the

subsidized rate, the cost averages US\$2.2/month and represents less than 1.6% of the average income of low-income families. Even with the projected increases in rates, the monthly cost of the service would be 2.7% of monthly income without a subsidy and 1.9% with one.

- 4.11 **SEQ/PTI.** This operation qualifies as a project that enhances social equity as described in the key objectives of the Bank described in the report on the Eighth Replenishment of Resources (document AB-1704). This operation does not qualify as a poverty-targeted investment, since less than 50% of all beneficiaries belong to low-income groups.

#### **D. Financial feasibility**

- 4.12 The feasibility of the program is based on a series of commercial and rate measures to achieve the sustainability of the sanitation service in the medium term and strengthen the capacity of the IMM to meet its financial commitments. This set of measures represent the management commitments described above (paragraphs 3.13 to 3.15).

##### **1. Financial outlook and status of the Sanitation Division**

- 4.13 The Sanitation Division's income statement shows complete coverage of its operating and maintenance costs, depreciation, and part of the financial costs for the years 2003 to 2005. In terms of cash flow, collections permitted the Sanitation Division to generate a flow of funds close to the break-even point for 2004 (Table IV-2).

| <b>Table IV-2</b><br><b>Financial balance of the Sanitation Division</b><br><b>(millions of constant US\$)</b> |               |               |               |
|--|---------------|---------------|---------------|
|  | <b>2003</b>   | <b>2004</b>   | <b>2005</b>   |
| Income sanitation  | 15.89         | 17.69         | 18.61         |
| + Other income (storm drainage)  | 5.06          | 5.77          | 6.26          |
| <b>Total income billed</b>   | <b>20.95</b>  | <b>23.46</b>  | <b>24.87</b>  |
| - O&M costs  | 13.39         | 12.31         | 12.81         |
| - Depreciation   | 5.60          | 6.07          | 6.95          |
| <b>Result before interest</b>  | <b>1.96</b>   | <b>5.08</b>   | <b>5.11</b>   |
| - Financial costs  | 7.24          | 6.72          | 6.96          |
| <b>Net results</b>   | <b>(5.29)</b> | <b>(1.64)</b> | <b>(1.84)</b> |
| O&M coverage   | 156%          | 191%          | 194%          |
| % of total collections   | 82%           | 87%           | 88%           |
| - Variations in accounts owing   | 3.71          | 1.98          | 3.00          |
| + Variations in commercial debts   |               | 1.63          | (1.37)        |
| + Capitalized interest loan 948/OC-UR  | 5.46          | 4.91          |               |
| + Depreciation   | 5.60          | 6.07          | 6.95          |
| - Investments with own funds   |               | 4.60          | 3.92          |

|  | 2003 | 2004          | 2005           |
|--|------|---------------|----------------|
| - Amortizations 575/OC-UR and 948/OC-UR        | 0.58 | 0.59          | 8.35           |
| - Transfers to the IMM                         |      | 4.78          |                |
| <b>Net cash flow for the year</b>              |      | <b>(0.99)</b> | <b>(11.54)</b> |
| Coverage Collections/O&M+Invest.+ debt service |      | 89%           | 68%            |
| <b>Equilibrium subsidy from the IMM</b>        |      | <b>0.99</b>   | <b>11.54</b>   |

- 4.14 In 2005, when repayment of loan 948 OC-UR began (almost US\$8 million a year), coverage of funding requirements was 68% compared with 89% in 2004. This deficit in the Sanitation Division's cash flow was covered out of the IMM's general budget in the amount of US\$11.5 million in 2005, for 84% of the debt service on loan 948/OC-UR. It is estimated that for 2006, the ratio for covering the costs of delivering the service out of payments by clients will be 69%. In 2006, the amount of the subsidy will be approximately US\$10 million.
- 4.15 In 2005, the Sanitation Division achieved overall collection efficiency of 87%.<sup>4</sup> Implementation of the payment agreement by central government agencies currently being negotiated between the IMM and the Ministry of Economic Affairs and Finance (MEF) will reduce the arrears of government agencies and increase collections to 91%.
- 4.16 As a result of the measures to strengthen the Sanitation Division's commercial operations and the rate increases planned during the program, coverage of the costs of providing the service should reach 82% on average for the 2007-2012 period and rise to 100% on average in the 2018-2022 horizon. These measures will generate an 11% increase in billed volumes over the 2007-2012 period; a 25% increase in the rate in real terms; and a 3% increase in the collection ratio (from 88% to 91%). The implementation of these measures depends on the Sanitation Division and the expected impact of their implementation determines the level of financial sustainability established as the Sanitation Division's management target<sup>5</sup> (paragraphs 3.13 to 3.15).
- 4.17 The probability of achieving the goal for sustainability of the service established in the program is high, considering the positive impact of the measures planned by the OSE to improve its business efficiency with a possible increase in the volume billed of 12% by 2010. Table IV-3 shows the impact on the financial balance of the sanitation service of the measures to improve the Sanitation Division commercially and to boost the commercial efficiency of the OSE. The table indicates that the service will come close to achieving financial sustainability by 2017, with a cost

<sup>4</sup> Total collections in the year/total billing in the year.

<sup>5</sup> The financial projection considers the following parameters: internal inflation (annual mean): 4.9%; exchange rate (pesos per U.S. dollar): 25.8 in 2007, 26.6 in 2008, 27.5 in 2009, 28.4 in 2010, 29.4 in 2011, 30.4 in 2012; water billed by OSE: 76,036,000 m3/year.

coverage of 98% and a subsidy from the IMM of less than US\$1 million to achieve financial balance.

| <b>Table IV-3</b><br><b>Projections of the sanitation service's financial balance</b><br><b>(in US\$ millions, constant 2005)</b> |               |                |               |               |               |              |              |               |
|---|---------------|----------------|---------------|---------------|---------------|--------------|--------------|---------------|
|   | 2006          | 2007           | 2008          | 2009          | 2010          | 2011         | 2012         | 2017          |
| Sewer service billing   | 19.15         | 20.60          | 23.97         | 27.38         | 29.98         | 31.71        | 31.71        | 31.71         |
| Other income  | 6.26          | 6.26           | 6.26          | 6.26          | 6.26          | 6.26         | 6.26         | 6.26          |
| <b>Total income</b>   | <b>25.41</b>  | <b>26.86</b>   | <b>30.23</b>  | <b>33.64</b>  | <b>36.24</b>  | <b>37.96</b> | <b>37.96</b> | <b>37.96</b>  |
| O&M costs   | 12.81         | 12.83          | 12.88         | 12.93         | 12.96         | 12.98        | 12.98        | 12.98         |
| O&M incremental   |               |                |               |               | 0.22          | 0.67         | 1.09         | 1.30          |
| <b>EBTIDA</b>   | <b>12.60</b>  | <b>14.03</b>   | <b>17.35</b>  | <b>20.72</b>  | <b>23.05</b>  | <b>24.31</b> | <b>23.89</b> | <b>23.68</b>  |
| Depreciation  | 7.77          | 8.58           | 9.37          | 10.07         | 10.75         | 11.03        | 12.18        | 12.18         |
| <b>Result before interest</b>   | <b>4.83</b>   | <b>5.45</b>    | <b>7.98</b>   | <b>10.65</b>  | <b>12.31</b>  | <b>13.28</b> | <b>11.71</b> | <b>11.51</b>  |
| Financial costs   | 7.15          | 6.87           | 6.31          | 5.73          | 5.14          | 4.58         | 4.06         | 6.04          |
| <b>Net results</b>  | <b>(2.32)</b> | <b>(1.42)</b>  | <b>1.67</b>   | <b>4.92</b>   | <b>7.16</b>   | <b>8.70</b>  | <b>7.66</b>  | <b>5.47</b>   |
| % Collections   | 88%           | 89%            | 90%           | 91%           | 91%           | 91%          | 91%          | 91%           |
| Var. accounts payable   | 3.07          | 2.94           | 3.06          | 3.20          | 3.43          | 3.58         | 3.58         | 3.58          |
| + Depreciation  | 7.77          | 8.58           | 9.37          | 10.07         | 10.75         | 11.03        | 12.18        | 12.18         |
| - Investments, own resources  | 3.69          | 3.54           | 3.51          | 3.73          | 3.96          | 4.08         | 3.96         | 2.63          |
| - Counterpart   |               | 3.72           | 3.06          | 3.55          | 3.40          | 3.08         | 1.89         |               |
| - Amort. 575/OC-UR + 948/OC-UR  | 8.64          | 8.51           | 8.38          | 8.26          | 8.14          | 8.02         | 7.90         | 6.81          |
| - Amort. Program  |               |                |               |               |               |              |              | 5.24          |
| <b>Net cash flow</b>  | <b>(9.94)</b> | <b>(11.54)</b> | <b>(6.96)</b> | <b>(3.75)</b> | <b>(1.01)</b> | <b>0.98</b>  | <b>2.50</b>  | <b>(0.62)</b> |
| <b>Coverage collections/O&amp;M + investments + debt service</b>  | <b>69%</b>    | <b>67%</b>     | <b>80%</b>    | <b>89%</b>    | <b>97%</b>    | <b>103%</b>  | <b>108%</b>  | <b>98%</b>    |

- 4.18 With regard to the impact of the total investments that could be included under the CCLIP (i.e. US\$260 million), a simulation was performed with two additional programs of equal value (using the balance of the line and with a disbursement rate equal to the present program), executed in the 2013-2017 and 2018-2022 periods, respectively. The number of new connections under the two additional programs would be 55,000. The projection, with the impact of the increase on the OSE's billing, indicates that the sanitation service would become financial sustainable during the 2018-2022 period, i.e. during execution of the final program under the line.

## 2. Financial capacity of the IMM

- 4.19 In the 2000-2005 period, as a consequence of the sharp financial crisis, the IMM's real income fell by 10% between the years 2000 and 2002. In the same period, municipal management was able to hold operating costs below revenues. During the same period, the IMM's budget performance generated investment resources (after debt service) of close to US\$140 million (or an annual average of US\$23 million).

- 4.20 Although the results in recent years present a budget deficit (except for 2001) the municipality's balance sheets for 2000 to 2005 show that the deficit did not seriously affect the IMM's debt, which remains low. Net current liabilities amounted to 27% of current income in 2005 (compared to 33% in 2004). The IMM's consolidated debt is US\$150 million (60% of current income). About 3% of current income is used to service the debt.

| <b>Table IV-4</b><br><b>IMM. Cash flow projection with the program</b><br><b>(in millions of constant 2005 U.S. dollars)</b> |               |               |               |               |               |               |               |               |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
|  | 2006          | 2007          | 2008          | 2009          | 2010          | 2011          | 2012          | 2017          |
| <b>Income</b>  | <b>276.95</b> | <b>276.52</b> | <b>282.81</b> | <b>289.15</b> | <b>294.63</b> | <b>299.36</b> | <b>302.57</b> | <b>319.27</b> |
| Income rest of IMM   | 229.80        | 232.50        | 235.23        | 238.00        | 240.80        | 243.65        | 246.54        | 261.56        |
| Income sanitation  | 22.35         | 23.93         | 27.18         | 30.45         | 32.81         | 34.38         | 34.38         | 34.38         |
| Central government transfer payments   | 24.80         | 20.10         | 20.40         | 20.71         | 21.02         | 21.33         | 21.65         | 23.33         |
| <b>Operating costs</b>   | <b>213.71</b> | <b>215.74</b> | <b>217.82</b> | <b>219.91</b> | <b>222.24</b> | <b>224.80</b> | <b>227.33</b> | <b>238.42</b> |
| Overhead and departmental council  | 200.90        | 202.91        | 204.94        | 206.99        | 209.06        | 211.15        | 213.26        | 224.14        |
| Sanitation costs   | 12.81         | 12.83         | 12.88         | 12.93         | 13.18         | 13.65         | 14.08         | 14.28         |
| <b>Savings before debt service</b>   | <b>63.23</b>  | <b>60.78</b>  | <b>64.99</b>  | <b>69.24</b>  | <b>72.39</b>  | <b>74.57</b>  | <b>75.23</b>  | <b>80.85</b>  |
| Rest of IMM  | 53.70         | 49.69         | 50.69         | 51.72         | 52.77         | 53.84         | 54.93         | 60.75         |
| Sanitation   | 9.53          | 11.09         | 14.30         | 17.52         | 19.63         | 20.73         | 20.30         | 20.10         |
| <b>Financial costs</b>   | <b>7.75</b>   | <b>7.17</b>   | <b>6.41</b>   | <b>5.73</b>   | <b>5.14</b>   | <b>4.58</b>   | <b>4.06</b>   | <b>6.04</b>   |
| Sanitation 575/OC-UR + 948/OC-UR   | 7.15          | 6.59          | 6.06          | 5.53          | 5.02          | 4.52          | 4.04          | 1.83          |
| Program loan (PSU IV)  | 0.00          | 0.28          | 0.25          | 0.19          | 0.12          | 0.06          | 0.01          | 4.21          |
| Other IMM  | 0.60          | 0.30          | 0.10          |               |               |               |               |               |
| <b>Debt amortization</b>   | <b>11.94</b>  | <b>11.21</b>  | <b>9.68</b>   | <b>8.36</b>   | <b>8.14</b>   | <b>8.02</b>   | <b>7.90</b>   | <b>12.05</b>  |
| Sanitation 575/OC-UR + 948/OC-UR   | 8.64          | 8.51          | 8.38          | 8.26          | 8.14          | 8.02          | 7.90          | 6.81          |
| Program loan (PSU IV)  |               |               |               |               |               |               |               | 5.24          |
| Other IMM  | 3.30          | 2.70          | 1.30          | 0.10          |               |               |               |               |
| <b>Net savings</b>   | <b>43.55</b>  | <b>42.40</b>  | <b>48.90</b>  | <b>55.15</b>  | <b>59.11</b>  | <b>61.97</b>  | <b>63.28</b>  | <b>62.77</b>  |
| <b>IDB loans</b>   | <b>7.49</b>   | <b>7.66</b>   | <b>14.25</b>  | <b>28.88</b>  | <b>30.31</b>  | <b>26.10</b>  | <b>11.88</b>  | <b>0.00</b>   |
| 948/OC-UR  | 7.49          |               |               |               |               |               |               |               |
| Program loan (PSU IV)  |               | 7.66          | 14.25         | 28.88         | 30.31         | 26.10         | 11.88         |               |
| <b>Investments</b>   | <b>38.59</b>  | <b>45.06</b>  | <b>51.33</b>  | <b>67.07</b>  | <b>69.28</b>  | <b>65.21</b>  | <b>49.92</b>  | <b>35.58</b>  |
| Other IMM  | 27.23         | 30.04         | 30.37         | 30.69         | 31.35         | 31.66         | 31.98         | 32.95         |
| Sanitation, own funds  | 11.36         | 3.54          | 3.51          | 3.73          | 3.96          | 4.08          | 3.96          | 2.63          |
| Program (PSU IV)   |               | 11.49         | 17.45         | 32.65         | 33.97         | 29.46         | 13.98         |               |
| <b>Surplus (deficit)/year</b>  | <b>12.44</b>  | <b>5.00</b>   | <b>11.82</b>  | <b>16.96</b>  | <b>20.15</b>  | <b>22.86</b>  | <b>25.25</b>  | <b>27.19</b>  |

- 4.21 The IMM's financial projection for the 2017 horizon presented in Table IV-4 includes the cash flow of the Sanitation Division and complete service for the sanitation debt, both for the existing loans (575/OC-UR and 948/OC-UR) and for the present program. With annual growth in municipal tax income of 1% in real terms and annual investments in works other than sanitation similar to those in the 2000-2005 period, the IMM's flow of funds will post a surplus over the entire period under consideration and therefore it will have enough money to balance the flow in the sanitation service. Starting this year, in application of Budget Act 17920 of 19 December 2005, the IMM will receive additional transfer payments from the government of a minimum of Ur\$465 million a year (approximately US\$20 million

in constant 2005 prices), subject to adjustments to reflect growth in government revenues.

**E. Environmental and social feasibility**

- 4.22 Because the operation is a CCLIP coupled with the first investment loan, the strategy for the program's environmental and social feasibility analysis is based on two-pronged evaluation: (i) a strategic environmental assessment (SEA), based on analyzing the scope of the overall PDSM and its socioenvironmental implications, as input for preparing the CCLIP; and (ii) the specific studies on the environmental and social impact of the interventions under the first package of investments to be financed under the CCLIP.

**1. Environmental feasibility**

**a. Strategic environmental assessment**

- 4.23 The strategic environmental assessment (SEA) provides an analysis of the performance of the IMM's sanitation sector in execution of the environmental and social aspects linked to projects financed by the Bank on previous occasions and reviewed the environmental management arrangement to be applied to the investment projects to be financed under the CCLIP. The results of the performance analysis are very positive, particularly the actions to control and prevent water pollution by both industrial and household effluents and control of water quality at the beaches. The main recommendations of the SEA are to strengthen the UES and update the environmental and social procedures and requirements in the manuals used in the IMM's sanitation sector, including criteria and basic terms of reference for the environmental studies required for the preparation and execution of future investment projects under the CCLIP.

**b. Evaluation and environmental authorization for the first package of investments**

- 4.24 The first investment program has a preliminary environmental impact assessment (EIA) for the western final disposal system based on the study of the system's feasibility and alternatives, and an environmental analysis for the urban drainage and sewer system works. The preliminary EIA includes an *environmental analysis of alternatives* for the western final disposal system. Based on the environmental and risk analysis of the five locations and the related infrastructure (pipes and the outfall) it was concluded that the location at Punta Yeguas is optimum from the environmental, technical, and economic standpoints. The preliminary analysis of the impact of the selected alternative suggests that the impacts and risks for air quality, transit, landscape, sightliness, and urban-territorial aspects will be low. The impact on the aquatic environment as a result of operation of the outfall will not be significant, given the dilution and absorption capacity of the River Plate in the discharge area.
- 4.25 Pursuant to current regulations, the EIA procedure applied to the western disposal system requires two levels of approval: (i) a Statement of Environmental Feasibility

of Location (VAL), that emphasizes the analysis of alternatives for the location of treatment and disposal structures; and (ii) prior environmental authorization. The IMM already has the VAL opinion issued by DINAMA, containing specific recommendations that the IMM will have to take into account in the final EIA for the western final disposal system, which will be prepared jointly with the final engineering designs to be financed by the program. The final EIA is a requisite for applying to DINAMA for the prior environmental authorization for construction.

### **c. Environmental and social management plan**

- 4.26 As a result of the environmental and social studies conducted when the program was being prepared, control measures for works, communications, oversight, and environmental education programs, as well as monitoring and evaluation programs, have been proposed. The measures and programs have been consolidated in a PGAS that is presented in the environmental and social management report (IGAS). The costs of PGAS have been incorporated into the different program components, including expansion of the program to monitor water quality that the IMM is already carrying out, to include more monitoring points in the River Plate in the areas of influence of the outfall and to expand the physical, chemical, and biological parameters recommended in the EIA.
- 4.27 To guarantee that the works will have a minimum environmental impact, in addition to the programs defined in the PGAS, a specialized firm will be hired to carry out environmental supervision of the works and be responsible for: (i) compliance with the environmental safeguards during construction; and (ii) advising the construction companies on the measures to be taken when unforeseen socioenvironmental situations arise. The environmental supervision of the works will be coordinated by the UES and will be performed in parallel with technical works supervision to ensure independence and pertinence. The frequency of the environmental reports will follow the provisions of the contract of the technical works supervision firm. The environmental mitigation and prevention measures to be adopted during works construction will be laid out in the PGAS. In addition, the UES and the Bank will conduct visits to evaluate the efficiency and effectiveness of the proposed environmental and social programs.

### **2. Social feasibility**

- 4.28 The social impact expected as a result of the planning, execution, and operation of the program works will be highly positive. The unfavorable impacts are associated with the need for involuntary relocation of families and commercial activities and some temporary disturbances in the circulation of vehicles and people during construction. The PARR has been prepared to guarantee alternatives for an effective improvement in the quality of life of the families (paragraphs 3.6 to 3.8). The affected businesses will be reestablished in premises adjoining the future housing, with the necessary size and architectural adaptations. Specifically, in the case of the families of trash sorters, once the land to be used for construction has been selected, architectural proposals will be made to the families, including the

establishment of green points close to their houses. The social actions planned in the PARR are complemented with specific actions for environmental and sanitary education directed to this population to enable them to incorporate hygiene and health care habits into their new circumstances.

### **3. Consultation with the affected and beneficiary communities**

- 4.29 Consultations were conducted during preparation of the program. The first consultation on the program took place on 2 August 2006, with a public hearing organized by the IMM in the western part of the city). It targeted the population in general and, in particular, the residents of the areas to be benefitted by the most significant program works related to the western final disposal system. Over 200 people attended the meeting, during which the IMM presented the various stages of the PDSM and its positive impacts, as well as the works to be executed under the first package and their overall impact. Most of the questions asked referred to the location of the areas affected by resettlement, the conditions of the resettlement dwellings, the timetable for the works, and job opportunities. The SEA, which was available at the consultation meeting, had been published earlier at the Public Information Center (PIC) on 5 July 2006 and, after the consultation, on the IMM's web page on 17 August 2006.
- 4.30 The second round of consultations took place in the context of preparing the PARR. The relocation proposals are the outcome of a process of interaction and consultation with the affected families, conducted through specific meetings with focus groups and interviews with each family during the socioeconomic survey. The public consultation with the affected families was held on 1 September 2006 in the most affected neighborhood (Barrio Casabó), as described in the PARR. During program execution, an ongoing process of community consultation and participation will be maintained through offices that the IMM will install in each intervention area. With respect to the environmental authorization process, DINAMA will hold one or more public hearings to discuss the final EIA (paragraph 4.25).
- 4.31 In addition, copies of the preliminary EIA of the western final disposal system are available to the public at various IMM offices and were posted on the IMM's website on 8 September 2006, and made available at the Bank's Public Information Center on 12 September 2006.

## **F. Benefits, beneficiaries, and results**

### **1. Benefits and beneficiaries**

- 4.32 The beneficiaries will be the inhabitants of Montevideo in general and, in particular, the 40,000 people living in the central northwest, Pantanoso, Miguelete, Carrasco, and Cerro-Casabó zones and in the areas around Montevideo Bay, which will be connected to the sanitation system. The main benefit of the CCLIP and the program is related to the improvement in the quality of the urban environment, particularly in aspects related to sanitary conditions and the health of citizens, and the

elimination or reduction of pollution from untreated sewage dumped into streams and the bay. The improvement in sanitary conditions will help to reduce the incidence of water-borne diseases, with the consequent improvement in family health. Other social benefits identified are the integration of the resettled population into the regular urban fabric of the city. With the component to improve management of the service, the intention is to assure the sustainability of the sanitation service as well as gradual improvements in the commercial management of the Sanitation Division so that it can undertake new projects in future.

## **2. Expected outcomes and outputs**

- 4.33 By making long-term funds available, which is a necessity for executing the PDSM, the CCLIP and the program promote: (i) an improvement in the environmental quality of the bay by providing for adequate final disposal of 100% of the sewage dumped into it; (ii) an improvement in the quality of the beaches in the western zone and preservation of the quality of the beaches that have already been improved in the eastern zone; (iii) through the increase in sanitation coverage to 90%, a direct improvement in the standard of living of the population (with the first program, 11,000 families will be connected to the system), benefiting some 40,000 people; and (iv) an improvement in the efficiency of the service and the modernization of the commercial management of the IMM's Sanitation Division.

### **G. Risks**

- 4.34 **Connections.** If the number of connections to the new sewer systems is lower than estimated, the expected benefits of the project would not be obtained and the IMM would be affected financially. This risk is minimized by the creation of the residential connections fund to finance part of the connection cost for low-income families. The cost is, in most cases, the main obstacle to making the connection.
- 4.35 **Compliance by the Sanitation Division with the indicators.** The possibility that the Sanitation Division will not comply with the performance indicators established in the management commitments is mitigated by: (i) the inclusion of annual progress indicators for the commitments in the AWP; and (ii) the proposed mechanism for an external certifier to sign, monitor, and evaluate the management commitments; and (iii) the authorizations of funds from the CCLIP for the investments envisaged in subsequent operations are subject to compliance with the management commitments.
- 4.36 **Compliance by the OSE.** One of the main means for attaining a financial balance in the Sanitation Division in the medium and long terms is the reduction by the OSE in the amount of water that is not commercially metered. The risk that the OSE will not comply with the plan is low, since bids are under way for the procurement of 100,000 residential meters and to contract consulting services to support the OSE in restructuring the company, with emphasis on commercial management. The World Bank is financing both these initiatives.

**CONDITIONAL CREDIT LINE (CCLIP) AND INDIVIDUAL LOAN FOR THE MONTEVIDEO SANITATION PROGRAM (PSU IV)  
(UR-L1005)**

**LOGICAL FRAMEWORK**

| <b>Objectives</b>   | <b>Indicators</b>   | <b>Means of verification</b>   | <b>Assumptions</b>  |
|---|---|--|---|
| <b>Goal of the first program</b>  |   |  |   |
| <b>To reduce contamination in Montevideo bay and adjacent beaches.</b>      | <p>One year after the investments of the first program:</p> <ol style="list-style-type: none"> <li>1. Reduction of pollution in Montevideo Bay measured as the organic load dumped in dry weather through the sanitation system. Falls from 47 t DBO/day in 2006 to 16 t DBO/day.</li> <li>2. Reduction of pollution at Cerro beach to comply with Decree 253/79 while maintaining the quality of water courses in accordance with the simplified water quality index (ISCA).<sup>1</sup></li> <li>3. The areas recovered in the project zone as a result of relocating families have not been reoccupied.</li> </ol> | <p>Tests by the Environmental Quality Laboratory and the Industrial Effluents Unit of the Environmental Development Department</p> <p>Tests by the Environmental Quality Laboratory of the Environmental Development Department</p> <p>Monitoring and evaluation system of the resettlement plan</p> |   |
| <b>Purpose of the first program</b>   |   |  |   |
| <b>To expand and improve sanitary sewerage and storm drainage services.</b> | <p>By the end of the first program:</p> <ol style="list-style-type: none"> <li>1. The average flow of sewage that is properly disposed of increases from 2.3 m3/s in 2006 to 3.9 m3/s during the dry season.</li> </ol>   | <p>Tests by the Sanitation Operation and Maintenance Service of the Environmental Development Department.</p>  | <p>Effective connection rates above 90% are achieved.</p> |

| Objectives   | Indicators   | Means of verification   | Assumptions  |
|--|--|---|--|
|  | <p>2. An increase in the units billed from 378,000 in 2005 to at least 428,400.</p> <p>3. The ratio for coverage of O&amp;M costs, investments with collected funds, and the Sanitation Division's debt service (69% in 2006) out of collections should reach 82% on average during execution of the first program (2007-2012), with the following tentative timetable for annual performance:</p> <p style="text-align: center;"> <b>2007:</b> 65%<br/> <b>2008:</b> 75%<br/> <b>2009:</b> 80%<br/> <b>2010:</b> 85%<br/> <b>2011:</b> 90%<br/> <b>2012:</b> 95%         </p> | <p>Reports from the Connections Unit</p> <p>Report on compliance with the management commitments issued by a certifier</p>  | <p>The users' register identifies at least 40,000 new billing units, in addition to the connections envisaged in the program.</p> <p>The IMM is able to adjust the rate in the period 2008-2011.</p> |
| <b>Components</b>  |  |   |  |
| <b>Component I: Physical investments in sanitation and storm drainage systems completed.</b> | <p>By the end of the first program (2012):</p> <p>1.1 Increase in sewer system coverage with at least 3,000 additional actual connections to new systems.</p> <p>1.2 7,000 additional actual connections to existing systems</p> <p>1.3 65 km of sewer mains built.</p> <p>1.4 8 km of storm collectors built.</p>   | <p>Sanitation executing unit reports. Works execution</p> <p>Sanitation executing unit reports. Works execution</p> <p>Sanitation executing unit reports. Works execution</p> <p>Sanitation executing unit reports. Works execution</p> | <p>Low-income users use the residential connections fund to connect to the system</p> <p>The contractors perform their work without problems.</p>  |

| Objectives  | Indicators  | Means of verification   | Assumptions   |
|---|---|---|---|
|   | 1.5 3 km of mains in Chacarita rehabilitated and extended.  | Sanitation executing unit reports. Works execution  |   |
| <b>Component II: Western final disposal system completed.</b> | <p>By the end of the first program, the western final disposal system is in operation, which includes:</p> <p>2.1 6 pumping stations built.</p> <p>2.2 15.5 km pressure pipes with diameters ranging from 250 mm to 1.5 m built.</p> <p>2.3 1 treatment plant built.</p> <p>2.4 2 km of underwater outfall at Punta Yeguas with a diameter of 1.5 m. built.</p>   | <p>Sanitation executing unit reports. Works execution</p> <p>Sanitation executing unit reports. Works execution</p> <p>Sanitation executing unit reports. Works execution</p> <p>Sanitation executing unit reports. Works execution</p>   | <p>The contractors perform their work without problems</p> <p>.</p>   |
| <b>Component III: Resettlement plan executed.</b>             | 3.1 By the end of the first program, 516 families have been resettled and 3 commercial activities reinstalled.  | Resettlement plan monitoring and evaluation system  | The resettlements and the improvements are successful and satisfy the beneficiary population.   |
| <b>Component IV: Sanitation service management improved.</b>  | <p>4.1 By the end of the first program , the users' register is updated.</p> <p>4.2 By the end of the first year of execution, the residential connections fund will be implemented.</p> <p>4.3 By the end of the first half of the second year of execution, the Commercial Planning and Management Unit (UPC) will have been set up.</p> <p>4.4 By the end of the first half of the second year of execution the study reviewing the rate discount policy will have been implemented.</p> | <p>Reports from the Sanitation Administration Service of the Sanitation Division</p> <p>Monitoring reports, Sanitation Executing Unit and Sanitation Studies and Projects Service</p> <p>Reports from the Sanitation Administration Service of the Sanitation Division</p> <p>Reports from the Sanitation Administration Service of the Sanitation Division</p> | <p>The consultants perform their tasks without problems.</p> <p>The institutional strengthening plan of the Sanitation Division is implemented and the division's performance has improved.</p> |

| Objectives | Indicators  | Means of verification   | Assumptions |
|------------|---|---|-------------|
|            | <p>4.5 By the end of the first half of the second year of execution, the studies of costs and sanitation and storm drainage rates will have been implemented, including the LTMC<sup>2</sup> of the sanitation and storm drainage service, and methodology will have been implemented in the UPC</p> <p>4.6 By the end of the first half of the third year of execution, the billing for users with their own sources will have been implemented.</p> <p>4.7 By the end of the third year of execution, the PDSM is updated.</p> <p>4.8 By the end of the third year of execution, the campaign to promote urban sanitation plan activities will have begun.</p> <p>4.9 By the end of the third year of execution, the billing system for industrial and commercial users based on the nature of effluents will have been designed.</p> <p>4.10 By the end of the third year of execution, the study on general implementation of users contracts will have been conducted.</p> <p>4.11 By the end of the first half of the fifth year of execution, detailed plans are available for the works included in the second loan under the CCLIP have been prepared.</p> | <p>Reports from the Sanitation Administration Service of the Sanitation Division</p> <p>Reports from the Sanitation Administration Service of the Sanitation Division</p> <p>Reports from the Sanitation Administration Service of the Sanitation Division</p> <p>Monitoring reports, Sanitation Executing Unit</p> <p>Reports from the Administration Service of the Sanitation Division</p> <p>Reports from the Sanitation Administration Service of the Sanitation Division</p> <p>Monitoring reports, Sanitation Executing Unit and the Sanitation Studies and Projects Service</p> |             |

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- <sup>1</sup> ISCA. Simplified water quality index that uses five general physical and chemical parameters: temperature, organic matter (permanganate oxidation), suspended matter, dissolved oxygen, and conductivity. The index can range from 0 (minimum quality) to 100 (maximum quality).

**ISCA = T (A+ B+ C+ D)**

| Parameter | Related to       | Minimum value | Maximum value |
|-----------|------------------|---------------|---------------|
| T         | Temperature      | 0.8           | 1             |
| A         | Organic matter   | 0             | 30            |
| B         | Suspended matter | 0             | 25            |
| C         | Dissolved oxygen | 0             | 25            |
| D         | Conductivity     | 0             | 20            |

- <sup>2</sup> Long-term marginal cost.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION

Uruguay. Conditional Line of Credit to Support the  
Montevideo Sanitation Program

The Board of Executive Directors

RESOLVES:

1. 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 agreement or agreements as may be necessary with the Eastern Republic of Uruguay, to establish a Conditional Line of Credit to support Montevideo sanitation programs, hereinafter referred to as the "Credit Line", of up to the sum of US\$220,000,000, chargeable to the resources of the Single Currency Facility of the Ordinary Capital of the Bank.
2. That the establishment and utilization of the Credit Line shall be carried out in accordance with: (a) the objectives and regulations of the Conditional Credit Line for Investment Projects Lending Instrument established by Resolution DE-58/03 of July 16, 2003; and (b) the specific provisions set forth in document GN-2246-1.
3. That the approval of individual operations, chargeable to the Credit Line, shall be subject to, with the exception of the first of such operations, to the satisfactory performance of the previous program or programs financed under the Credit Line.
4. That the amounts authorized to finance individual operations chargeable to the Credit Line shall be granted as individual loans subject to the usual financial terms and conditions applicable to financing from the resources of the Single Currency Facility of the Bank's Ordinary Capital, in force at the time that the individual operation is approved, which shall be specified in the executive summary of the corresponding loan proposal.
5. That the Bank may only sign an agreement or agreements with the Eastern Republic of Uruguay to grant financing for the first individual operation after the Credit Line agreement or agreements between the Eastern Republic of Uruguay and the Bank enter into force.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION

Uruguay. Individual Loan /OC-UR to the Eastern Republic of Uruguay  
Utilization of the resources of the Conditional Line of Credit for  
Investment Projects established by Resolution DE- /-  
Montevideo Sanitation 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 utilize the resources of the Conditional Line of Credit for Investment Projects approved pursuant to Resolution DE--/06, by entering into such contract or contracts as may be necessary with the Eastern Republic of Uruguay, as Borrower, for the purpose of granting financing for an individual operation for cooperating in the execution of a Montevideo sanitation program. Such financing will be in the amount of up to US\$118,600,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Executive Summary of the Loan Proposal.