

PROGRAM IN SUPPORT OF REFORM OF THE WATER SUPPLY AND SANITATION  
SECTOR

(AR-0175)

EXECUTIVE SUMMARY

BORROWER:	Republic of Argentina		
E X E C U T I N G AGENCY:	Ente Nacional de Obras Hídricas de Saneamiento [National Board of Water and Sanitation Works] (ENOHSA)		
AMOUNT SOURCE:	AND	IDB (OC):	US\$250.0 million
		Local counterpart funding:	US\$320.6 million
		Total:	US\$570.6 million
FINANCIAL TERMS AND CONDITIONS:		Amortization period:	25 years
		Disbursement period:	5 years
		Interest rate:	variable
		Inspection and supervision:	1%
		Credit fee:	0.75% annual of undisbursed balance.
		Currency:	US dollars, from the Single Currency Facility
OBJECTIVES:	<p>The main objective of the program is to support the process of sector reform and promote private sector participation in both service delivery and investment financing. The following specific objectives are proposed: (i) to improve the efficiency and quality of service; (ii) to ensure the long-term self-sustainability of the enterprises concerned; (iii) to strengthen regulatory capacity at the provincial level; and (iv) to improve access to service for broad segments of the population.</p> <p>To accomplish these objectives, the program will employ commercial public and private cofinancing mechanisms in support of: (i) measures to improve the administrative, financial, commercial, and operational management of the enterprises concerned; (ii) institutional reform and restructuring activities, including those required to increase private sector participation; (iii) emergency, rehabilitation and improvement works on existing systems; (iv) works to expand drinking water supply and sewage collection systems; (v) works for the control of water pollution caused by the service; and (vi) measures to strengthen the capacity of the regulatory agencies.</p>		

DESCRIPTION: The proposed operation will be executed as a global multiple-works program, with the participation of provincial or local service providers. Based on a preliminary estimate, between 80 and 100 localities will benefit from the program with services provided by cooperatives, municipal entities, provincial enterprises, semipublic corporations, or private concessions. The operation will consist of three complementary windows or lines of financing as explained below:

1. Service expansion projects

a. Trust administered by a private bank  
(US\$100 million)

In view of the particular risk/return characteristics of investment in the sanitation sector, and the reticence of private banks to participate individually, this mechanism is intended to encourage private bank involvement in the cofinancing of such projects. The trust, to be set up under the administration of a private bank, will provide a conduit for loan and cofinancing resources from commercial banks. For each lending operation, the IDB loan resources will constitute Loan A, which will be used to finance up to 40% of the investment. These resources will be supplemented by Loan B, consisting of the commercial bank resources, and by the counterpart funds to be contributed by the enterprises concerned. In most cases, the counterpart will cover about 30% of total project costs. The terms for the B loans will be determined on the basis of commercial bank risk analyses of each enterprise. The lending terms for trust resources (the A loans) will be uniform for all of the projects and will be determined on the basis of a detailed market analysis. Aside from introducing financial discipline and generating additional resources for investment in the sector, the proposed cofinancing mechanism is designed to: (i) reduce the perception of regulatory and political risk; (ii) encourage private banks to provide broader terms; and (iii) expand the range of projects that will have access to this financing.

b. Trust administered by the Banco de la Nación  
(US\$100 million)

A trust similar to the one described above will be set up and administered by the Banco de la Nación Argentina [National Bank of Argentina] (BNA). The resources allocated to this trust, together with cofinancing resources provided by BNA, will go to smaller projects, requiring less than US\$7.5 million. The resources from this trust (the A loans) will also be used to finance up to 40% of the required investment in each project and will be supplemented with the company counterpart funds

(30%) and the BNA cofinancing (the B loans). The terms for Loan B will be determined on the basis of a risk analysis of each participating company to be conducted by BNA. The terms for Loan A will be the same as for the private bank trust above.

2. Institutional restructuring and improvement projects  
(US\$47.5 million)

Companies, agencies, or cooperatives lacking access to commercial credit because of their precarious situation can go directly to ENOHSa to obtain financing for their institutional restructuring and/or operational improvements. A specific institutional and financial analysis will determine whether the enterprise: (i) requires action to improve its financial, commercial, and operating efficiency; or (ii) should be institutionally restructured to ensure a minimum level of self-sustainability. In the latter case, the possible approaches to be considered will include private sector participation through concessions, management contracts, outsourcing, etc. In principle, under the financing matrix for the operation, 50% of the project cost would be eligible for financing. However, this percentage could rise to the degree that the windows described above are able to attract additional resources and thus enable the IDB to reduce its participation in the commercially viable projects. This would free up resources which could then be transferred to this window and allow projects for commercial, financial, and operational improvement, or business restructuring, to receive up to 80% financing. The counterpart to be covered by the enterprises would be from 20% to 50%.

3. MIF technical cooperation (TC-98-06-32-6)

Given the importance of state regulation, and in view of the problem areas observed in the regulatory agencies concerned, a technical cooperation operation will be conducted as a complement to the program described here to help strengthen existing agencies, establish new ones where they do not exist, and encourage greater private sector participation in the delivery of these services.

ROLE OF THE  
PROJECT IN THE  
BANK'S COUNTRY  
AND  
SECTOR STRATEGY:

The Bank's operating strategy in Argentina places priority on the following areas: (i) continuation and consolidation of progress towards modernizing the state; (ii) reduction of poverty and improvement of living standards; and (iii) improvements in the productivity and competitive position of national producers. The proposed program is consistent with this strategy because it would: (i) promote more efficient and self-sustaining water supply and sanitation services; (ii) introduce mechanisms for attracting private sector participation; and (iii) finance

investments in the rehabilitation and expansion of sanitation services, improving the quality of life — particularly for low-income population segments. The Bank's participation in this program will not only help in developing a mechanism for private bank involvement, but will also ensure an emphasis on the institutional strengthening of service providers and regulatory agencies.

**ENVIRONMENTAL  
AND  
SOCIAL REVIEW:**

The rehabilitation and expansion works projects included in this program are intended to improve hygienic and health conditions for the beneficiary populations by ensuring better continuity of service, improved water quality, and greater access to the system. Special attention will be given to sewage treatment to prevent water pollution downstream. Given the nature of the program, the social and environmental impact of the construction works is expected to be minor, temporary, localized, and correctable using known methods.

During the analysis of this operation, the "Environmental procedures for ENOHSA-Financed Programs and Projects", published in October 1994, were revised. With a number of modifications, these procedures will be applied to this new program. The system is used to identify and propose measures to mitigate adverse environmental impact during project preparation.

**BENEFITS:**

The program is designed to produce the following benefits:

- a. approximately 280,000 new water supply and/or sewer connections, benefiting nearly 1.12 million persons;
- b. support for administrative, commercial, and operational improvements in 40 to 50 service enterprises;
- c. strengthening of approximately 10 regulatory agencies operating in the water resources sector; and
- d. establishment of a cofinancing mechanism providing incentives for private banks to participate in financing investments in this sector and instilling financial discipline in the management of these enterprises.

**RISKS:**

The main risks of the operation stem from the administrative and financial problems observed in most of the companies concerned. The viability of the proposed cofinancing mechanisms will depend on their credit-worthiness as revealed by the commercial bank analyses. Financing for institutional reform and operational improvements within the weakest companies is expected to mitigate these risks by contributing to their self-sustainability

in the near term. In addition, since the cofinancing mechanism will be new to the sector, close monitoring by the executing agency and the Bank will be required to contend with unforeseen developments.

SPECIAL  
CONTRACTUAL  
CONDITIONS:

As conditions precedent to the first disbursement of the operation, the borrower must produce evidence that: (i) the program operating regulations have been agreed upon with the Bank and put into effect (paragraph 3.22); (ii) the ENOHSA institutional and regulatory unit has been set up (paragraph 4.6); and (iii) two qualified professionals have been added to the ENOHSA internal audit unit (paragraph 4.10). As a condition precedent to the first disbursement from each trust, it must be demonstrated that the trust in question has been legally constituted and the necessary contractual formalities have been completed (paragraph 3.24). In addition, as a condition for the first disbursement from the trust administered by Banco de la Nación, the competitive process for selecting the private bank to administer the other trust must have been initiated (paragraph 3.24).

A review will be conducted 12 months after the start of the program with special emphasis on the trust operations (paragraph 3.52).

SOCIAL SECTOR/  
P O V E R T Y  
REDUCTION:

According to the guidelines established in paragraph 2.13 of document AB-1704, this program qualifies as a social sector operation. As indicated in paragraph 2.15, however, it is not a poverty targeted operation, since the portion of resources benefiting low-income groups is about 33%.

EXCEPTIONS TO  
BANK  
POLICY:

See the section on procurement below.

PROCUREMENT OF  
GOODS AND  
SERVICES:

For the procurement of equipment, materials, and other goods by the public sector companies, as well as works fully or partially financed with resources from the loan, international public bidding will be required for all procurement in amounts exceeding US\$350,000 equivalent in the case of goods, and US\$5 million equivalent in the case of construction services. For the procurement of consulting services, international public bidding will be required for all amounts in excess of US\$200,000. Procurement in smaller amounts will be conducted in accordance with national law (see paragraph 3.44 and 3.45).

The private sector companies will procure works and goods in accordance with market practices for the type of good or works

concerned. The Bank will ensure that these procurements are effected at market prices (see paragraph 3.49).

The contract for administration of the trust by a private bank will be awarded by means of private bidding, and all sufficiently qualified banks operating in Argentina will be invited to participate. The main qualification criteria include a rating of AA or higher; experience in project finance and corporate finance; experience in trust management; an active presence in the provinces; and a methodological proposal for managing the trust. The intermediation costs involved in administering the trust will be negotiated after selection of the best proposal (see paragraph 3.48).