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Attachments:

1. Project Design Matrix (including Plan of Operation)
2. Project Organization Chart
3. Tentative Selection Flow of the WDs subject to the Project
4. Result of Case Study on the Seven Less-creditworthy Small WDs
5. Awareness and Satisfaction Survey of Water Users

1. INTRODUCTION

The Japanese government received an official request for a technical cooperation project for Japan Fiscal Year 2004 from the Philippine government in March 2003 entitled "Water Supply Technology Training Center". The project was proposed to enhance training function of LWUA.

JICA understood that the strengthening of training function of LWUA would be one of the effective ways to improve water supply services of WDs. However, JICA suggested LWUA to extend support to WDs not only human resources development in various field but also capacity development so that water districts are able to provide water to local communities in a sustainable way.

After a series of discussions between JICA and LWUA, both parties reviewed the design of the project. Then both parties came up with the new approach, which support improvement of twenty (20) small and less financially viable water districts by improving their water supply facilities and strengthening their management capability with JICA technical assistance and necessary equipment and expense for the next five years project period.

JICA has been cooperating with LWUA for several years on the aspect of water supply development, providing assistance through a variety of technical and capacity building activities to water districts nationwide. The joint effort has already produced encouraging results and it is now the consensus of the two sides to take further steps to improve the performance of small water districts through this proposed JICA-LWUA Technical Cooperation Project scheduled from July 2005 to June 2010.

The forthcoming Technical Cooperation Project recognizes the need to refocus the priorities in order to keep up with the changing demand of the times. It is in line with Executive Order No. 279, which spells out the reorientation of LWUA's function and the changes in its organizational structure, sector coverage, financing policies, levels of assistance, etc. With the foregoing development, the bulk of assistance will now be focused on the improvement of services and management capacity of small-scale water districts, which are classified into non-creditworthy and pre-creditworthy categories.

2. BACKGROUND INFORMATION

2.1 Overview of the Philippine Water Supply Sector

In the Philippines, the development, operation and delivery of potable water in the country's three major island areas (Luzon, Visayas and Mindanao), is the responsibility of various government agencies and water utilities. Metro Manila is being served primarily by MWSS through its two private concessionaires, the Maynilad Water Services Inc. and the Manila Water Company, and by some private companies serving subdivisions. Water Districts, Local Government Units and some private companies, with government assistance from LWUA and DILG, are serving the provincial urban areas. The provincial rural areas meanwhile are being served primarily by the Local Government Units and Cooperative Water Associations, with government assistance from DILG and LWUA.

Based on the Medium-Term Philippine Development Plan 2001-2004, 79% of the 76.3 million Philippine populations were served with safe and reliable water. This figure is distributed as follows: 47% (6.2 million) in Metro Manila, 88% (18.3 million) in the provincial urban areas, and 85% (35.8 million) in the provincial rural areas.

In the same Plan, the Philippine government put forth its target of serving 90.5% of the total Philippine population with potable water by year 2004. The specific targets by 2004 on the three major areas are: 90% in Metro Manila, 89.6% in provincial urban areas, and 90.4% in provincial rural areas.

2.2 LWUA and Water District Concept

Thirty years ago, most of the municipal water supply systems all over the country were under the control of and were being operated, maintained and administered by Local Government Units. At that time, water supply systems were deteriorating faster than they could be replaced. Simultaneously, the ever-growing population and industry needs were imposing additional demands on these existing facilities. These led to major problems in the water supply sector such as shortages in water supply, inadequate funding for facilities improvement and expansion, inadequate skills in developing and maintaining water resources, inadequate physical infrastructure, institutional weaknesses as well as managerial and human resource inadequacies.

Due to the failure of these existing water utilities to meet the needs of the communities they were serving, the LWUA and Water District concept was conceived and operationalized in 1973 with the enactment of Presidential Decree No.198. The concept is a partnership arrangement - a partnership between LWUA as the government resource provider and the water districts as the local water service providers. The establishment of LWUA and the development of water districts provided a mechanism primarily for funding and managing the expansion and delivery of water supply services in the countryside.

LWUA, as a specialized lending institution, is to be the principal source of funding and will also provide technical and training assistance to the water districts. On the other hand, the water districts, operating as government owned or controlled corporations¹ are expected to become self-sufficient, to develop the necessary expertise and to be capable of maintaining financial viability.

2.3 New Financing Policies for the Sector

Previously, LWUA was allowed to finance water districts that were not commercially viable by supplying 50% of the funds required as a grant. However, this practice was stopped in 1998, when the NEDA ordered that LWUA finance only projects deemed financially viable².

¹ This implies that the hiring and firing of a WD personnel will be in accordance with the Civil Service rules; their salaries and wages will be in accordance with the civil service rules; their salaries and wages will be in accordance with the corresponding regulations for regular government employees; its financial operations will be subject to COA audit contrary to a specific provision of the enabling act (Sec. 20, PD 198); and for social insurance and pension purposes, they will be covered by GSIS instead of the SSS..

² Projects that are able to recover all cost and pay back their loans.

The Executive Order No. 279, series of 2004 ushers in a new form of financing for local water utilities development projects aimed not only at reducing the dependence of the water supply industry on government or public funds but also at rationalizing the allocation of scarce public funds through the pooling of resources of the LWUA, GFIs, water districts, local government units and private sector. The Executive Order stimulates the flow of both public and private funds into the water supply industry of the country.

To rationalize the application of funds for water supply sector, initially, the water districts will be classified into four (4) categories as described below:

- (1) Creditworthy: are financially self-sustaining water districts capable of accessing financing from government and/or private financing institutions.
- (2) Semi-Creditworthy: are water districts with the demonstrated ability to achieve creditworthiness in the short term based on relevant financial and operational indicators;
- (3) Pre-Creditworthy: are water districts which are not likely to become creditworthy in the medium-term due to performance issues but demonstrate potential for creditworthiness in the long-term, based on relevant financial and operational indicators; and
- (4) Non-Creditworthy: are water districts with potential to reach pre-creditworthy status in the medium-term based on relevant financial and operational indicators.

Creditworthy water districts have a wider option in sourcing their funds since they can source it from either private financial institutions as well as government financial institutions. Also, they have the freedom to choose the manner of implementing their projects, i.e., directly under their supervision or hire outside services if their in-house capabilities are lacking.

Less-Creditworthy (Semi & Pre) water districts are eligible to source grants and deep concessional and/or concessional funds from either LWUA, LGUs, GFIs, PFIs or international donors, whenever possible.

Non-Creditworthy water districts continue to be eligible for financing under LWUA, however; LGUs, DILG and MDFO are also encouraged to provide financial, technical and operational support to them.

2.4 Changes of LWUA's Role in the Sector

The World Bank Water Supply Sector Reform Study of 1993 and the USAID Water Supply Sector Privatization Study of 1996 both recommended the re-orientation of LWUA to its original corporate mission as a "specialized lending institution", financing only viable water supply projects with tariff levels formulated towards full cost recovery. This, in effect, will commercialize LWUA.

Very recently, Presidential Executive Order No. 279 was signed on February 2004, instituting reforms in the financing policies for the water supply sector as an off-shoot of the World Bank Financing Policy Reform Study of 2004. This, in effect, would actualize LWUA's commercialization. Under this Executive Order, LWUA, presently attached to the DPWH, will now be attached temporarily to the

Office of the President during the transition phase of its reorganization, then finally transferring to the DOF --- that means moving from the infrastructure sector to the financial sector. The re-orientation of LWUA's operations towards development banking principles implies the need to change its organizational culture to allow it to perform its reconstituted role with greater banking expertise.

Noteworthy is the fact that LWUA will broker arrangements (coordinate for pooling of resources) between Less and Non-Creditworthy water districts and the relevant LGUs in order to source financing from LWUA, GFIs and PFIs. Also noteworthy is the fact that LWUA will refocus its financial assistance to less creditworthy water districts and will no longer be limited to financially viable projects. Furthermore, LWUA's service coverage will no longer be limited to organized water districts but would also include other water service providers in accordance with their creditworthiness classification and eligibility.

2.5 Problems pertaining to small water districts

Most small water districts are facing multiple problems, including lack of financial resources, heavy indebtedness, lack of governance, weak technical and management capability, inadequate supply, poor water quality and high Non-Revenue Water etc. The following describes the current situation as well as the problems and issues that small water districts are facing.

(1) Inadequate financing

Even if new form of financing policy for the sector is provided by Executive Order No. 279, LWUA will not be able to allocate their financial resources to less and non-creditworthy water districts without concessionary loan/grant funds from the national government and other sources. Seemingly, it will take a greater time for less and non-creditworthy water districts to be able to access financial sources. And there is a high possibility that those water districts especially, the pre and non-creditworthy, will be left behind.

(2) Lack of governance resulting from non-existence of "owners"

Although water districts were established as an independent public entity (GOCC: Government Owned or Controlled Corporation) by PD 198, the PD is silent on who are the water districts' shareholders. Once LGUs provide capital to water districts either in cash or by handing over their water supply system, LGUs are no longer the owners of water districts, thus do not assume any direct responsibility. There are currently a considerable number of cases where non-existence of owners causes moral hazard in small water districts. For instance, once small water districts find it difficult to service the debt to LWUA due to a revenue shortfall, most of water districts simply delay repayment instead of cutting expenditures. As a result, the amount of debt quickly increases due to its high interest rate, which will eventually lead to a collapse of the WDs. In order to protect the interest of water users, a new monitoring system to ensure financial sustainability of WDs must be put in place.

(3) Lack of technical expertise and inadequate skills

This is a continuing concern of management among water districts and may be addressed by investing more attention to human resource selection, development and motivation.

(4) Water resource problems

More than 90% of all water districts derive their supply from groundwater (wells and springs). The rest utilize water from rivers and streams using treatment facilities and/or infiltration galleries.

Many water districts suffer from low quantity of supply due to low yields from their wells. Attempts to drill additional wells to meet demand are often hindered by the following:

- Lack of funds for exploratory/ production well drilling;
- The hydro-geological situation is complicated and past failures at ‘hit-and-miss’ drilling discourages further efforts of developing new sources; and
- There is lack or absence of study and/or investigation that would delineate potential sites for drilling, as well as ascertain the groundwater potential of study area;

Water districts using spring sources are few in number. Most springs exhibit wide fluctuation regimes, affected by seasonal climate changes, which bring about low discharge during periods of low rainfall. There are also situations when potential sources could not be tapped simply because of their far distance from demand areas, which entails high costs for transmission system.

(5) Water quality problems

LWUA database shows that there are many areas where water of poor quality (physical, chemical and biological) is supplied by the water districts. This may explain why people sometimes reject the supply from their utilities and instead buy their water from vendors at higher rates.

(6) Non-Revenue Water problems

The present average of Non-Revenue Water in various water districts has been recorded at 30%. The actual rate, however, is thought to be higher considering that small water districts mostly practice estimation rather than actual measurement in coming up with the figure.

In certain occasions, efforts to develop additional sources may be deferred for a considerable period once the high Non-Revenue Water is addressed. The control and/or reduction of water loss due to leaking pipes, reservoirs and fittings and through illegal connections can translate to savings in terms of time, manpower, and financial resources.

(7) Marketing problems

Limited service area, slow growth of service connections, or situations where households have easy access to ground water sources are some of the factors that reduce demands for the water district services.

3. PROJECT OBJECTIVE

The objective of the Project is to assist small-scale and less financially viable water districts in achieving sustainable growth and self-reliance to be able to provide better access to safe and sufficient drinking water to the people. The specific objectives include:

- (1) Improvement of water quality and service coverage of the selected water districts.
- (2) Improvement of financial sustainability of the selected water districts.
- (3) Enhancement of management and O/M capacity of target water districts

4. PROJECT DESIGN

4.1 Target Water Districts

The target of the Project is those small and less financially viable water districts that have a possibility to improve services and achieve financial viability through the Project. The Project has two pillars: (1) improvement of water supply service and financial viability of selected WDs and (2) enhancement of management and O/M capacity of target WDs. Approximately twenty (20) WDs will be selected for the pillar (1), while 50 to 70 WDs will be targeted for the pillar (2).

4.2 Project Purpose

The purpose of the project is to improve the services and financial viability of selected water districts (approx. 20) by the end of the Project in 2010, so that they will be able to renew or expand their facilities from their own sources in the longer term.

4.3 Project Approach

In order to achieve the project purpose, the project will take the following approaches:

➤ **Demand-driven**

To make sure that the Project's technical and financial assistance takes maximum effect on the improvement of WDs' service and management condition and to ensure greater participation of water districts in the Project, the Project will consider willingness of the water districts to participate in the Project in the selection of target water districts.

➤ **Greater involvement of general manager and key personnel of water districts**

To secure ownership of water districts, the Project will involve the staff of the selected water districts (general manager and key personnel) in all the activities of the Project such as on-site survey activities to understand present service and operation condition, planning, engineering work, O&M of water supply system and financial management.

➤ **Assistance for improvement and rehabilitation of existing water supply systems**

To ensure that our assistance would benefit those who receive services from our target water districts, the Project will not only strengthen technical and management capacity of water districts through the development of improvement plans, but also actually improve or rehabilitate existing water supply systems identified in the improvement plan.

- **Generation of savings to ensure long-term sustainability of the WDs**
In order to secure long-term sustainability and future replacement or expansion of facilities after the investment by the Project, the selected WDs must improve the accountability of its financial management while making sure that the depreciation is properly accumulated. For this purpose, increased revenues resulting from the investment by the Project must be put aside in a separate account as savings based on an agreement between the WD and the Project, instead of increasing operation expenses.
- **Monitoring and follow -up assistance**
To make sure that water districts are moving toward self-sufficient and financially viable entities, the Project will regularly visit water districts and provide advice on operation and management.

4.4 Scope of Work

(A) The first pillar of the project, i.e. improvement of water supply service and financial viability of selected WDs, will be conducted in the following four stages. Selected WDs will be divided into two groups, and the implementation of activities of (3) and (4) will be conducted by group in two stages during the project period.

- (1) Selection of, and preparation of the profiles of, target water districts
 - 1) Selection of “target WDs” by applying the following criteria:
 - Those WDs that are classified as “small” by LWUA’s criteria;
 - Those WDs that have difficulties in repaying loans from LWUA;
 - Those WDs that have a possibility of achieving long-term financial viability, i.e. those WDs that are not too indebted; and
 - Those WDs that are not financed by either KfW or ADB
 The number of target WDs is expected to be approximately 60, **as shown in attached “Tentative Selection Flow of the WDs”**.
 - 2) Field survey on target WDs to identify their technical and financial needs and to roughly estimate the investment costs and future revenues. The results will be compiled as target WD profiles to enhance the knowledge of LWUA counterparts.
- (2) Selection of the water districts to be improved through the Project
 - 1) Based on the profiles prepared in (1), WDs (approximately 20 WDs) to be improved by the Project (“selected WDs”) will be selected by developing selection criteria including:
 - Communities’ needs of piped water
 - Possibility of improvement in financial viability after the investment
 - Possibility of future self-financing for the replacement and/or expansion of facilities
 - 2) Signing of Records of Agreement, between the selected WD and the Project, to undertake activities required.

(3) Preparation of an improvement plan for each selected WD.

- 1) Conduct of a workshop for orientation and guideline for selected WDs to prepare management and facility improvement plans. The general managers and key personnel of selected WDs will be invited to this workshop.
- 2) Assistance in the assessment of their current operation, among others:
 - Assessment of management, financial and technical condition of the WDs
 - Assessment of existing water supply system/facilities, operation & maintenance and services
 - Assessment of the needs of water supply of local communities, including their socio-economic, health and sanitation conditions
- 3) Assistance in the preparation of the improvement plan, among others:
 - Population and demand projection
 - Water source development plan
 - Long- and short-term facility/equipment rehabilitation/development plan
 - Cost estimation
 - Cash flow projection
 - Management and financial condition improvement plan
 - Operation & maintenance plan
- 4) Assistance in the preparation of a monitoring plan to ensure long-term financial viability. An agreement to put aside savings from increased revenues for the purpose of future replacement / extension of facilities between the WD and the Project will be drafted and discussed.

(4) Implementation of facility improvement construction works

- 1) Assistance in the organization of a public hearing in order for the WDs to explain to the local community on the project outline and to ensure the signing of sufficient number of connection contracts
- 2) Designing of a small-scaled pilot water treatment plant. Construction of a cost-efficient water treatment plant will be proposed in order to demonstrate its effectiveness in improving the operation of WDs that have poor raw water quality.
- 3) Preparation of detailed design and procurement plans in consultation with WDs
- 4) Implementation of bidding
- 5) Construction of water supply facilities in collaboration with WDs. Construction is considered as completed when the construction completion reports are submitted and the facilities are inspected by the WDs and the Project.
- 6) Signing of Records of Agreement, between the selected WD and the Project, to ensure long-term financial viability of the WD, i.e. saving money for future replacement / extension of facilities

* The local consultants to be employed by the Project will prepare detailed design, procurement plans and tender documents, and supervise the construction works.

* Local contractor(s) will carry out construction works under the contract with the Project.

* The Project will procure materials such as pipes, valves and meters based on the procurement plans.

(B) As the second pillar of the Project, management and O/M capacity of the “target WDs” as well as the “selected WDs” will be enhanced. More specifically, the following activities will be conducted:

- (1) Training of personnel and chairpersons of the boards of directors of target WDs on management and O/M skills
 - 1) Training courses on small districts’ common problems, namely “general management”, “water supply system” and “water quality monitoring”
 - 2) Case studies on the improvement of services and management of water districts by using the cases of selected WDs
- (2) On-the-job training of selected WDs personnel on planning, design, construction supervision, management and O/M
 - 1) Training through actual improvement of general and financial management, including proper depreciation, reduction in operation expenses, financing, increase in collection, and review of tariff structure.
 - 2) Hands-on training of operation skills, including pump operation, water pressure control, maintenance technology.
 - 3) Training for water quality control

In addition to (A) and (B) described above, the Project is also aimed at enhancing LWUA staffs’ capacity to support small WDs. Throughout the project period, Japanese experts will conduct field surveys together with LWUA counterparts, where LWUA counterparts will learn how to assess and improve WDs’ financial and technical condition. Upon completion of each of the WDs’ construction activities, inspection will be conducted jointly by JICA experts, LWUA counterparts and WD personnel, through which LWUA counterparts will learn the importance and proper methodology of inspection. Upon necessity, JICA experts will provide advice on LWUA’s Water District Graduation Policy so that the policy will be able to effectively achieve its intended objectives.

4.5 Implementation Schedule

The project will be implemented in accordance with the timeframe specified below. For detailed schedule, see "PDM" attached.

Time Frame	Major Activities
2005.7 2006.1	Preparation of the profiles of target WDs, i.e. small and less financially viable WDs.
2006.1 2006.2	Selection of the water districts to be improved through the Project.
2006.5 2007.3 2008.5 2009.3	Preparation of an improvement plan for each selected WD.
2007.4 2008.3 2009.4 2010.3	Implementation of facility construction works.
2006.8 2009.10	Training of target WDs personnel on management and O/M skills.
2006.5 2010.6	On-the-job training of selected WDs personnel on planning, design, construction supervision, management and O/M.

4.6 Inputs

The following inputs will be provided by JICA:

- (1) JICA Experts namely, Chief Advisor (Specialist for Water Supply System) , Coordinator, Specialist for Management & Finance, Specialist for Water Supply Facilities Design, Specialist for Hydro Geological and Groundwater Development, Specialist for O/M of Water Treatment Plant.
- (2) Provision of equipment to selected water districts, such as water quality test kit / equipment and P/Cs for tariff collection & management and photocopy machines.
- (3) Necessary expenses for the implementation of improvement plans of selected water districts and for the training program/seminars/workshops of water districts personnel.

The Philippine side will provide the following inputs:

- (1) Philippine counterpart namely, Project Director, Project Deputy Director, Project Manager, Project Staff (Specialist for Management & Finance, Specialist for Water Supply Facilities Design, Specialist for Hydro Geological and Groundwater Development, Specialist for O/M of Water Treatment Plant, Specialist for Water Quality Monitoring, and Specialist for Training).
- (2) Office space and necessary facilities in LWUA for the project activities
- (3) Land, buildings and necessary facilities in the water districts for the project activities.

5. PROJECT ORGANIZATION

For the effective and efficient implementation of the Project, attached “the Project Organization” is established.

END