

**DOCUMENT ON THE POLICY OF ON-LENDING OF FUNDS TO THE
FINAL BENEFICIARIES FROM THE LOAN OF THE EUROPEAN
INVESTMENT BANK**

**Water and Sanitation Federation BiH
Project**

Sarajevo, September 2010

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1. Introduction

1.1. Basic Elements

The purpose of the On-lending Policy Document is to define guidelines (along with financial and technical aspects) fully establishing the method of implementation of the project "Water and Sanitation Federation BiH" (hereinafter called the Project) and all included schemes in line with terms and conditions of the Finance Contract signed with the European Investment Bank (EIB) (hereinafter also: the Contract) with a view to ensuring the following:

- Spending of funds for intended purpose;
- Implementation of the goals of the Borrower (BiH), Entity (Federation of BiH) and Final Beneficiaries (Municipalities) for which the Contract was concluded;
- Timely and successful implementation of the overall Project, including addition of other municipalities of the Federation subject to the availability of loan proceeds;
- Promoting sustainability of public utilities (PU) of the Final Beneficiaries and their financial ability to operate and maintain the existing and new infrastructure.

The Contract was initiated in March 2008 by the EIB representatives and BiH representatives - The Ministry of Finance and Treasury of BiH (MFT BiH), the Federal Ministry of Finance (FMF) and the Federal Ministry of Agriculture, Water Management and Forestry (MAWF) - and signed in two steps: by the Borrower (minister of MFT BiH) and Entity (Ministers of FMF and FMAWF) in Sarajevo on 15 July 2008 and the EIB representatives in Luxembourg on 18 August 2008. Pursuant to the Contract, the Federation of BiH (FBiH) undertakes to implement the Project consisting of investment schemes to be carried out by the municipalities included into the Project within the FBiH through the FMAWF and FMF using the loan funds in the amount of EUR 60 million and the equal amount of own contribution of the municipalities involved, which according to the Contract total 121.3 million EUR.

The financing of the Project under the Contract is secured by the Guarantee Agreement entered into on 29 August 2007 by and between the EU and the EIB pursuant to Article 8 of the Council Decision No. 2006/1016/EC dated 19 December 2006.

Under the Contract, this document is subject to adjustments upon prior consent by FMAWMF, FMF and EIB.

1.2. Goal and Purpose of the Project

Key goals of this loan arrangement are focused on providing support for the improvement of current living conditions of the population, securing adequate hygienic conditions in water supply and sanitation and the implementation of environmental protection measures in compliance with the obligations of the EU accession and harmonization with the EU legislation, in particular with the Water Framework Directive, Drinking Water Directive and the Urban Waste Water Directive.

The purpose of the Project is to use the resources (EIB loan, grants and own funds of the municipalities) to ensure the implementation of measures contributing to the improvement of infrastructure and provision of services aimed at adequate (both in terms of quality and quantity) water supply and waste water treatment in the municipalities included in the Project.

1.3. Support to the Project

Considering that the provision of own funds in the amount of 50% for investment schemes is a difficult requirement to meet by the municipalities, even under normal recession-free circumstances, the Delegation of the European Commission in BiH acknowledged the joint approach taken by the NIPAC of BiH, FMAWF, FMF and EIB that this Project should be supported by grants from pre-accession and other funding instruments (IPA, IPF, etc.).

Grant resources available to the Project shall be laid down in agreements to be signed between BiH and the EIB ("Grant Agreements"). The table below shows the structure of sources of support so far secured for the implementation of the Project:

SOURCE	EUR m	(%)
EIB loan	60.0	49.5
IPA 2009	12.0	9.9
IPF-MW	5.0	4.1
IPA 2010 I package	8.0	6.6
IPA 2010 II package	1.0	0.8
IPF-TA, EPPF	2.0	1.6
Local contribution and other IFIs	33.3	27.5
	121.3	100

With a view to facilitating the provision of own contribution by the municipalities, the EIB will also take into account past investments into municipal water infrastructure made over the period 2006-2009.

2. Purpose of Loan Proceeds

2.1. Project Scope

The Project includes priority investment schemes in the field of water supply and sanitation in the territory of the Federation of BiH with a view to improving public health and the environment. Individual schemes are implemented in the following municipalities:

- Zenica
- Zavidovići
- Visoko
- Olovo
- Usora
- Doboj Jug
- Doboj Istok
- Posušje
- Široki Brijeg
- Mostar
- Velika Kladuša
- Bosanski Petrovac
- Orašje
- Tomislavgrad
- Bosanska Krupa.

Other municipalities may be added to the Project if proven to the Bank that such schemes are closely connected to the schemes already included or will significantly impact public health and the environment as determined through an overall analysis and assessment of impact of such schemes on the water sector.

2.2. Eligibility of Municipalities

Municipalities listed under 2.1 or approved following the procedure of inclusion of new municipalities shall be eligible for loan funding provided that:

- they are creditworthy, with regard to limitations as laid down in Article 7. of Law on Debt, Indebtedness and Guarantees in Federation of Bosnia and Herzegovina, and their timely performance of all contractual obligations with regard to any previous projects has been confirmed by the FMF;
- Municipal Council has duly approved loan as a means to finance the Scheme concerned.

2.3. Inclusion of new Municipalities

When considering new municipalities for inclusion under this Project, apart from the conditions specified in paragraph 2.1., activities of the Bank and other partners with the municipalities/cantons regarding the loan preparations in relation to other projects in the Federation of BiH in this field should

not be disrupted. Municipalities having loan or similar arrangements with other financial institutions can be added provided that they meet the conditions of eligibility of municipalities and schemes. Loan and other resources used for investments in water supply and sanitation improvement, provided by other financial institutions, shall be considered as own contribution of the municipality in the Project.

All involved authorities shall undertake to ensure that this intervention contributes to even development of all areas in the Federation of BiH. Respecting the eligibility criteria, with regard to inclusion of new municipalities into the Project, priority shall be given to the municipalities:

- with no prior access to or participation in projects financed by the international financial institutions;
- with lower indebtedness rate as compared to indebtedness ceiling laid down by law;
- proposing projects that ensure better effects of water protection (higher level of treatment of waste waters).

The schemes proposed shall be eligible for inclusion into the Project if they meet the following requirements:

- the scheme concerns water and sanitation (waste water discharge and treatment);
- it improves the municipal infrastructure and service delivery;
- the scheme has a clear and complete investment and financing plan, including evidence that any proposed co-financing is or shall be secured in a timely manner;
- the scheme's investment and financial projections show that its implementation will increase public water supply and sanitation coverage (eventual reduction of restrictions) while reducing negative effects on drinking water sources or watercourses (or provide for a long-term implementation of these effects, upon completion of the overall project in a municipality).

As soon as the eligibility of Municipalities is confirmed by the competent institutions - FMF, FMAWMF, eligibility of schemes in terms of obtaining appropriate consents and permits required before the implementation shall be assessed. Subsidiary agreements with the municipalities shall only be signed when the criteria for eligibility of municipalities and schemes are met.

3. Project Implementation and Financial Sustainability

3.1. Intended Use of the Loan

Loan funds under the Contract shall be used for financing of various activities related to the implementation of schemes in municipalities/towns within the Federation of BiH, to be defined in Project description broken down by technical components in each individual subsidiary agreement, such as:

- development of studies (feasibility study, environmental impact assessment), preliminary designs and/or main designs;
- reconstruction and rehabilitation, upgrading of existing or construction of new facilities in:
 - water resource infrastructure
 - water supply systems
 - drinking water treatment facilities
 - waste water collection systems
 - waste water treatment plants
 - bulk or consumer water metering.
- measures to increase efficiency, reduction of losses, water and energy savings;
- supervision;
- technical assistance.

The following **shall not** be covered by loan proceeds:

- custom duties, taxes and fees

- settling of property matters

Prior to signing agreements with the municipalities, a detailed description of each scheme shall have to be approved by the Bank on the basis of a fiche filled in by PIT with PMU support on the basis of a template provided by the Bank and any other information required by the Bank. Project Fiche template is attached to this Document as Annex I. Taxes, fees (including VAT) will be paid from the Municipal funds according to the national regulations and Article 9 of the Contract.

3.2. Project Investment Plan

Investment costs and financing plan as estimated by the EIB:

Investment cost	EUR m	Financing plan	EUR m	%
Water Supply	39.5	Own funds of the Final Beneficiaries	33.3	27.5
Waste Water	54.1			
Efficiency measures	10.0	Other sources of funding from other international financial institutions and donors	28.0	23.0
		EIB loan	60.0	49.5
Technical contingencies	5.2			
Price contingencies	5.4			
Interest during construction	7.1			
TOTAL	121.3	TOTAL	121.3	100.0

Each municipality referred to in paragraph 2.1. shall have to provide auditable evidence of amounts invested in this area in the period from 2006-2009, which shall be treated as own participation. This shall also apply to new municipalities with regard to their previous investments, but they will be able to backdate two (2) years from their application. A detailed overview of the invested amounts shall be made and officially confirmed by the municipalities using the EIB's template. A document proving that water and sanitation investment projects were made in the mentioned period shall be submitted by the municipalities in the form of mayor's statement prior to signing of subsidiary agreements.

3.3. Project Implementation Period

According to the Contract, all schemes should have been/shall be implemented within the period from 2006-2012, including some ongoing schemes, while some stages like waste water treatment plant may be executed in phases (primary, secondary, tertiary treatment etc.). The availability period of the EIB loan may be extended in agreement with the EIB.

3.4. Operational and Financial Sustainability Requirements of Active Schemes

Aside from basic technical and eligibility elements, of particular importance is also the segment defining operational sustainability of public utilities as an integral part in the preparation of subsidiary agreements (Article 1.04.1 (vi) of the Contract).

In line with its obligations as defined in the Contract and with a view to supporting municipalities as Final Beneficiaries and their public utilities, the FMAWMF shall prepare proposals of operational sustainability policy of the schemes. Operational sustainability policy measures shall be defined for each individual scheme and be included in the Project Fiche. Operational sustainability policy measures will be proposed to the municipalities ahead of any project so that each one will have an idea of what will be expected of them in terms of demonstrating their operational sustainability.

In case of schemes creating significant additional operation and maintenance costs, including schemes providing for the waste water treatment plants, FMF shall include conditions aimed at ensuring operational sustainability and appropriate level of cost recovery into the subsidiary agreements based on financial models and affordability.

FMF provides guidance and support to Final Beneficiaries with a view to establishing financial models that will determine the appropriate level of cost recovery as well as calculate and justify specific tariffs.

For the purpose of complying with the obligations defined in Article 6.05.7 and Schedule A2 of the Contract, FMAWMF shall send to the EIB a regular update of cash flow projections for public utilities as municipal service providers along with a list of performance indicators as agreed, and at least once a year. This requirement with regard to the municipalities or public utilities shall be included into the subsidiary agreement.

Guidelines for the preparation of the „Operational Sustainability Policy” including: cost recovery model and tariff plans are attached as Annex III.

3.5. Scheme Description – Project Fiche

The Project Fiche provides a short description of the scheme subject of a subsidiary agreement and forms an integral part of the subsidiary agreement. The approval of the Project Fiche by the EIB is one of the preconditions for signing of subsidiary agreements. Project Fiches shall be prepared, on the basis of a template provided by EIB, by the municipal project implementation teams (PITs) with the assistance of the PMU.

The Project Fiche shall:

- define and describe the proposed scheme;
- demonstrate that the scheme meets the goals of the Project;
- show that the scheme is technically feasible;
- show that the scheme is financially feasible;
- contain realistic and acceptable operational sustainability plan;
- confirm that all pre-conditions for the implementation of scheme are in place, including property rights matters, issues pertaining to the issuing of relevant licenses and other documentation under the applicable legislation of FBiH and terms and conditions of the Contract;
- contain prepared implementation plan, including procurement plan.

Project Fiche template, attached to this Document (Annex 1), forms a starting point for the preparation of the Project Fiche, however the actual volume of required documentation and the analysis shall be determined for each individual scheme separately subject to its scope and complexity.

Particular attention shall be paid to defining the plan for the achievement of operational sustainability of the overall system, including new facilities.

In this segment of the Project Fiche the municipality concerned shall:

- demonstrate that the achievement of operational sustainability is possible and that it follows the implementation plan of the scheme;
- define measures and activities leading to the operational sustainability, such as:
 - increasing efficiency of the public utility operations in segments that are not covered by the scheme, such as: water loss reduction, power consumption, increasing collection rates in relation to parts of the system that are not subject of the proposed scheme etc;
 - increasing the number of service users;
 - increasing service prices;
 - increasing collection rate;
 - improving general performance efficiency.

The preparation of the operational sustainability plan shall take into account two types of investments:

1 Operational cost neutral or -reducing investments

Municipalities may sign subsidiary agreements for schemes (investment programs) that are cost neutral or cost reducing without specific additional conditionality or undertakings of financial nature in excess of those described above. As guidance, such components shall typically be:

- Gravity sewers
- Water mains in urban areas
- Mechanical waste water treatment
- Gravity fed and distributed drinking water production requiring minimal treatment
- Low-lift pumping arrangements
- Floating service reservoirs

- Efficiency generating investment such as more efficient pumping of water or waste water, pressure management or metering
- Energy generating measures
- Measures to reduce demand and metering

II Investment programs resulting in significant net increase in operational costs

As guidance, such components shall typically be

- Biological wastewater treatment
- High lift water or wastewater pumping facilities
- Drinking water production and distribution that is pumped or requires advanced treatment
- Major network extensions beyond urban areas into low population density areas

In case of investment programs with a significant net increase of operational costs, through their subsidiary agreements, the municipalities concerned shall undertake:

- to increase collection rate of the public utility as defined in the Project Fiche;
- to increase utility service tariffs in line with the Project Fiche.

Assumptions made for projections shall be clearly stated as well as the sources of data and the basis for the assumptions (e.g. "average population growth as determined by national statistics agency").

Whilst efficiency improvements as a result of the implementation of certain components of the scheme or other measures may mitigate the need for tariff increases, operational sustainability analysis shall determine the extent to which a service price increase is required in order to maintain or achieve operational sustainability. If the analyses show that the implementation of the scheme will not require tariff increase or such increase will not be significant on account of the achieved savings resulting from the implementation of the scheme, this should also be clearly stated and explained.

Phasing

The preparation of scheme fiches and subsidiary agreements may allow for phasing of investments, in line with the guidelines set out above and the specific provision of the Contract that significant extension of sewage networks may require commitment in the subsidiary agreement to the installation of wastewater treatment facilities in a later phase.

4. On-lending Conditions and Criteria

Loan terms and conditions are laid down in the Finance Contract signed between Bosnia and Herzegovina, Federation of Bosnia and Herzegovina and the EIB as follows:

Maturity	up to 25 years (grace period is included)
Grace period	up to 6 years
Interest rate	fixed or variable
Number of tranches	20
Repayment	semi-annual or annual

The above parameters will be chosen by the FMF for each individual tranche, and therefore apply independently to each tranche.

Loan proceeds under the same terms and conditions shall be transferred without any surcharge to the municipalities included in the Project which have signed subsidiary agreements with FMF. The FMF shall transfer all financial expenses related to the loan to the Municipalities, in proportion to their contribution to the expenses concerned.

4.1. Documentation required for subsidiary agreements

Signing of the subsidiary agreements with the Municipalities shall be subject to FMF having received by PMU the following documents:

- Municipal Council Decision on approving indebtedness for the scheme concerned,
- Decision on establishing of municipal PIT (municipal scheme implementation unit) or on appointing its members, in particular indicating the names of the PIT executives and the financial management officer for the scheme implementation in the municipality concerned;
- Statement of the Mayor regarding investments in water and sanitation infrastructure carried out by the municipality in the period from 2006-2009, and in case of new municipalities, this period shall cover two years preceding their application for inclusion into the Project;
- Statement of the Mayor regarding securing local contribution to Project investment in the amount stated in the Project Fiche,
- Statement of the Mayor regarding securing of sufficient funds for VAT with envisaged repayment of funds,
- Evidence that all required permits have been or will be obtained in time, including settling of property matters, if required for the scheme, in accordance with applicable law;
- Project Fiche- project description based on the EIB's template;
- Implementation and/or procurement plan.

An additional requirement for signing of subsidiary agreements with the municipalities is for the municipalities concerned to ensure timely performance of all obligations in respect of any prior loans, concerning loan repayment and well as obligations as laid down in the Law on Debt, Indebtedness and Guarantees in FBiH.

4.2. Conditions of Disbursement

Conditions of disbursement with regard to first tranche are defined in Article 1.04.1 of the Finance Contract, and MF&T BiH, Ministry of Justice of BiH, Federal Ministry of Justice, FMAWMF and FMF shall ensure their fulfillment.

With regard to all tranches and requirements set out in Article 1.04(2) of the Finance Contract, the fulfillment of conditions shall be secured by MF&T BiH, FMAWMF- Municipalities, FMF and MF&T BiH shall secure the fulfillment of requirements concerning the last tranche.

Coordination of the mentioned institutions and all activities ensuring the fulfillment of conditions and required documentation for tranche disbursement shall be carried out by the Project Management Unit (PMU) within FMAWMF.

In line with the abovementioned, the PMU, on the basis of the information provided by the Final Beneficiaries (municipalities and PITs), shall prepare the required documentation in timely manner before the disbursement request.

When documentation is provided and conditions for disbursement of each tranche are met, disbursement request is made by the FMF through the MF&T BiH, following the established procedure.

4.3. Procedures for the Preparation and Submission of Disbursement Request

Loan in the amount of 60 million EUR shall be disbursed to Bosnia and Herzegovina in tranches. MF&T BiH will on behalf of the Federation of Bosnia and Herzegovina open a special account for this Project for the withdrawal of loan funds in tranches. Submission of a request for disbursement or withdrawal of tranches shall include the following:

- 1) On the basis of the projected funding needs of the PITs, PMU will estimate funds needed for each tranche, and send the disbursement request accompanied by the documentation as required under the Contract to FMF.
- 2) Request for transfer of funds to the special account of the Project shall be submitted to the EIB by the MF&T BiH upon request by the FMF for withdrawal of the tranche concerned.

- 3) Funds from the special account will be withdrawn on the basis of an order to be signed by the competent representatives of the FMF and the FMAWMF.

4.4. Technical Conditions for the Approval of On-lending of Funds

On-lending of funds (payment) for completed works shall be subject to PMU having received by the municipality concerned the contract signed between the municipality concerned and designer/contractor/consultant (subcontract) accompanied by the following documentation:

- 1) Statement of the Municipality concerned on taking the responsibility for the execution of all tender procedures in accordance with Law on Public Procurement of Bosnia and Herzegovina (Official Gazette BiH, number 49/04) and other relevant regulations, delivered to PMU accompanied by all required documentation relating to the procedure of procurement of services which are subject of the mentioned subcontract.
- 2) On-lending of funds for consultancy services shall be subject to submission of an order signed by authorized persons from FMAWMF and FMF accompanied by the consultant certificate and report made in line with payment conditions defined in the subcontract, verified by the Municipality (PIT) and confirmed by the PMU's supervisor of the scheme.
- 3) On-lending of funds for contractors shall be subject to submission of an order signed by authorized persons from FMAWMF and FMF and accompanied by:
 - the certificate of executed works verified by an independent supervision appointed by the Municipality and confirmed by the PMU's supervisor of the scheme.
 - in case of advance payment, the contractor agreement serving as the basis for payment order.
- 4) On-lending of funds for supervision shall be subject to submission of an order signed by authorized persons from FMAWMF and FMF and accompanied by the supervision certificate and report in appropriate worksheet in line with payment conditions defined in subcontract verified by the municipal PIT and confirmed by the PMU's supervisor of the scheme.

Responsible persons within the municipal PITs verify the received documentation - certificates and reports for completed tasks (designer/contractor/consultant) - and send it to the PMU, where they are signed by the PMU's supervisor of the scheme. The PMU prepares an order for payment from the special account and such order, signed by the authorized person in FMAWMF, submits to the authorized person in FMF for signing. The FMF then gives the payment instruction to the bank where the special account is open.

Payments from special account will be made directly to supplier's accounts (designer / contractor / consultant) for completed tasks. Municipalities are obliged to provide funds for VAT.

5. Instruments for securing loan repayment

In order to secure loan debt service (interest and repayment) any municipality – loan beneficiary shall by signing the subsidiary agreement agree to allow FMF to secure loan repayment directly from the public revenue account of the Federation of BiH, using the revenue funds earmarked for the Municipality concerned in case the Municipality concerned fails to perform loan obligations.

Municipalities shall submit 19 (nineteen) own blank bills of exchange with no-protest clause and the bill of exchange declaration signed and verified by the competent authority of the Municipality.

Suspension, Cancellation of Loan

If EIB cancels or suspends the loan, the right of Municipalities to the disbursement of loan will with immediate effect also be cancelled and suspended, as the case may be.

In case unforeseen circumstances delay the implementation of schemes in Municipalities, FMF can at any time cancel in whole or in part the loan approved to the Municipality concerned and propose to FMAWMF the re-allocation of funds to other beneficiaries.

6. Responsibility, reporting and monitoring

6.1. Responsibilities of PMU

- 1) **General management of the Project.** PMU will be responsible for managing the overall implementation of the Project.
- 2) **Subsidiary agreements with the municipalities.** PMU shall be responsible to coordinate the preparation and finalization of the documentation as defined in paragraph 4.1 of this document.
- 3) **Support to the implementation of schemes.** Schemes will be implemented by PITs in municipalities, with cooperation and monitoring provided by PMU. In line with the needs related to the implementation of schemes PITs can also provide for the necessary technical assistance as part of the schemes. Part of the technical assistance to be ensured for the Project through grant funds will be coordinated by PMU following the terms and conditions of the grant agreement and demands of the Project. PMU shall be responsible for monitoring the execution of procurement procedures under the terms and conditions of the Article 6. of the Contract. PMU will prepare *Guidance for Project Implementation* in order to ensure efficient coordination during implementation of Project activities.
- 4) **Financial management of the Project.** Upon PITs' request and documentation set out in paragraph 4.3, PMU prepares payment orders with all accompanying documents required and ensures their signing by the authorized persons of FMAWMF and FMF. Funds will be directly transferred from the special account to the accounts of the suppliers. PMU is responsible for timely initiation of the mentioned and other financial activities under the terms and conditions of the Contract.
- 5) **Review of implementation progress.** PMU will coordinate the review of the implementation progress of each scheme in municipalities included in the Project against the implementation plans defined in the Project Fiche in accordance with Article 6. of the Contract. The municipalities are obliged according to the Contract to deliver regularly or upon request reports on progress made in the implementation of schemes to PMU.
- 6) **Reporting.** Under the terms and conditions of the Contract, PMU is responsible for reporting to the EIB, as well as to the FMF upon request. Responsibilities include determining inception data, updating data base for monitoring, and verification of data delivered by municipalities to PMU, according to the reporting requirements set out in paragraph 6.3.
- 7) **Additional support.** If there is a need PMU can ask from FMoAWMF provision of additional technical and logistic support from Agencies in order to support implementation of individual sub-projects.

6.2 Responsibilities of Municipalities

- 1) **Preparation and implementation of schemes.** Municipalities as Final Beneficiaries will have a key responsibility for preparation and implementation of schemes and supervision over the implementation of all scheme aspects. Assisted by PMU, municipal PITs will be responsible for the preparation of schemes, including identification, technical documentation, tender documentation, tender implementation, and final execution of contractual obligations with contractors. Municipalities are also responsible for securing and delivering documented evidence to PMU on progress, impact of schemes and meeting operational sustainability conditions of water supply and sanitation system achieved during the implementation of schemes in accordance with subsidiary agreements (as defined in Project Fiche).
- 2) **Procurement.** Municipal PITs have general and overall responsibility for procurement, which shall be confirmed by necessary documentation and declaration on responsibility.
- 3) **Financial management of the scheme.** In line with the terms and conditions of the Contract, PITs shall, following the implementation of the scheme, prepare orders for

payment of contractors and deliver them to PMU for further processing. Upon execution of the contract, PITs shall submit reports to PMU on satisfactory execution of the contract.

- 4) **Monitoring and reporting on project implementation progress.** Municipalities will monitor project implementation progress and report to PMU on implementation progress against the initial indicators as defined in paragraph 6.3.

6.3 Reporting

BiH as the Borrower has contractual obligations to ensure that regular reports on the implementation of the Project are submitted to the EIB, as defined in the Contract. Moreover, procedures with regard to the use of loan funds of international financial institutions in Federation BiH provide for the submission of quarterly reports on the implementation of projects to FMF. PMU shall be responsible for the preparation and submission of the reports.

Reporting to EIB

1. **Current reporting** includes commitment under which the Borrower shall deliver to the Bank regular semi-annual reports containing the following information:

- Short information on technical description, explaining reasons for significant changes, if any, as compared to the original framework of technical description;
- Notice on completion date of each of the main project components, explaining any delay if applicable;
- Notice on project expenditures, explaining reasons for any possible cost increase as compared to the originally budgeted costs;
- Description of any major issue impacting environment;
- Notice on procurement procedures (non-EU);
- Notice on planned demands for resources and their intended use;
- Any other major issue and risk that can have an impact on the operation of the Project;
- Any legal procedure related to the Project being initiated, if any;
- Specific issues related to individual schemes.

Semi-annual reports shall be delivered no later than 1 March and 1 September respectively.

2. **Mid-term review.** including, *inter alia*, the following: entire project flow; sector developments (reports delivered by FMAWMF), overview of effectiveness and efficacy of procedures, shall be delivered on disbursement, bringing total allocation in excess of 50% of the loan amount.

3. **Regular update on cash flow projections.** Public utilities shall annually deliver to PMU cash flow projections and performance indicators in line with subsidiary agreements (as defined in Project Fiche).

4. **Report on project completion** shall include the following:

- Short description of technical characteristics upon project completion, explaining reasons for any major change;
- Completion date of each of the main project components, explaining reasons for any delay, if any;
- Final project cost, explaining reasons for any cost increase as compared to the budgeted cost;
- Number of jobs created by the Project, including temporary positions during the project implementation and permanent new jobs;
- Description of any major issue with environmental impact;
- Information on procurement procedure (non-EU);
- Information on demand or utilization of the project and commentaries;
- Any major issue which has arisen or any significant risk which may influence the project operation;
- Any legal procedure related to the project, if applicable.

This report shall be delivered to the Bank within six (6) months after the last disbursement.

Reporting to FMAWMF and FMF

Apart from the abovementioned reports to EIB, PMU will make quarterly project reports and deliver it to FMAWMF and FMF, and to the Government of FBiH according to applicable regulations and instructions. PMU will draft the mentioned quarterly reports on the basis of three-month reports delivered to PMU by municipal PITs. PMU will also prepare IP tables as form to report to FMF. If requested, PMU will prepare reports and information for Minister of AWMF and Government of FBiH

Reporting of Municipal PITs to PMU

Three-month reports of PMU shall be produced on the basis of monthly reports of the PITs. The content of those monthly reports made by the PITs in municipalities shall be defined by PMU under the terms and conditions of the Contract. These reports shall be mandatory for the implementation of the schemes.

All subsidiary agreements shall specify the annual (and as required semiannual) reporting of a minimum level of cash flow projections. The projections should be presented on a spreadsheet (Microsoft Excel is recommended), and run from the year of the last available audited accounts and 4 years ahead. The figures can be presented in constant prices (i.e. no inflation). Also included shall be the corresponding actual realized figures for the years starting from 2006. Proposed framework of this template is given in Annex 2.

7. List of Annexes

1. Annex: Project Fiche
2. Annex: Performance Indicators of Municipal Public Utilities
3. Annex: Overview of the use of the Cost Recovery Tool
4. Annex: Loan Agreement between FMF and the Municipality - Template

Federal Ministry of Finance

Federal Ministry of Agriculture, Water
Management and Forestry

Minister: Vjekoslav Bevanda

Minister: mr. sci. Damir Ljubić

No: _____

No: _____

Date: _____

Date: _____

ANNEX 1.

Project Fiche for Water and Sanitation Federation of Bosnia and Herzegovina

PART ONE - Project Identification and Responsibilities

Name of Project
Name of Promoter
Location
Key contact people

Preamble and Background

Purpose of project
Request for assistance
Reference to key documents, including questionnaires, feasibility studies, master plans, municipal decisions etc.
Reference to connection with ongoing programs.
Reference to previous phases
Key Conclusions

Technical Description (phasing optional, put maps in annex and make reference)

PAST INVESTMENTS / UNDER EXECUTION

PHASE I

PHASE II

Financing Plan
(including eligible investments prior to signature of subsidiary agreements)
(show clearly financial and technical contingencies)

PHASE I	
Component 1	
Component 2	
Component 3	
Component 4	
....	
PHASE II	
....	
....	

Procurement, Implementation Operational Responsibilities

Who will be responsible for procurement, supervision of works and operating the infrastructure?

Planned implementation period (overall)

Phase I:
Phase II:

Procurement Plan (for new components)

Included design and tender phases
Type of procedure and source

Conditions and undertakings (optional)

Conditions for starting first phase
Collection rate
Municipal approval of tariff plan or cash flow projection
Land acquisition etc.

Conditions for starting second phase
Hard tariff conditions
Efficiency indicators

Undertaking and special reporting obligations
Preparation of strategies etc.
Specific reviews/studies

Technical Assistance (particularly that relevant to conditions and undertakings)

Financial and Operational Improvement
Review of technical options (say prior to Phase II)

PART TWO - Business Plan and Sustainability Issues (1-2 pages maximum)

Demonstration of positive operational trend and reversal of deterioration of assets / background for conditions and undertakings

Evolution of service area
Envisaged tariff policy and evolution
Projected evolution of demand
Recent and planned efforts wrt. to billing and collection (collection rate, % unbilled demand)
Recent and planned efforts wrt. stabilizing assets and service (annual maintenance and rehabilitation investments / leakage and burst trends
Any cooperation with other municipalities

Particular Risks and Mitigants

Mention anything that is external to the project, but which has some sort of bearing on it.
Particular interface issues/risks
Residual implementation risks

Annexes
Maps showing location of investments
Tariff plans
Demand projections

ANNEX 2

Performance Indicators of Municipal Public Utilities

	Indicators	Unit
1.	Population projection of the scheme area	no.
2.	Coverage indicators	
2.1.	Access to water supply system (urban)	%
2.2.	Access to water supply system (rural)	%
2.3.	Access to sanitation system (urban)	%
2.4.	Access to sanitation system (rural)	%
3.	Water production	000/m ³
4.	Water sales	
4.1.	Households	000/m ³
4.2.	Commercial users	000/m ³
4.3.	Industrial users	000/m ³
5.	Unaccounted for water (water losses)	%
6.	Ratio: metered connections /total connections	
6.1.	Households	%
6.2.	Commercial users	%
6.3.	Industrial users	%
7.	Ratio: sales of metered water /sales in total	%
8.	Collection rate: ratio of collection /bills issued	%
9.	Service price / tariffs	
9.1.	Households	KM/m ³
9.2.	Commercial user (small enterprises)	KM/m ³
9.3.	Industrial users	KM/m ³
9.4.	Institutions	KM/m ³
10.	Revenue analysis	
10.1.	Water and waste water revenues	KM
10.2.	Other revenues	KM
11.	Cost Analysis	
11.1.	Operational costs	KM
11.2.	Maintenance costs	KM
11.3.	Other costs (e.g.. new investments)	KM
11.4.	Financial costs (e.g.. debts, loan repayment)	
12.	Budgeted municipal or other external support	KM
13.	Net cash flow	KM

ANNEX 3

Overview of the use of the Cost Recovery Tool

- The CoRe provides multi-year cash flow data on expenditure and finance for one or more water and waste water projects at the local/regional level.
- CoRe model uses fairly simple and clear methodology explained in the following diagram

Cost Recovery Tool – basic considerations

- Preparation of the Financing and Cost Recovery plans iterative process
- Usually at least several iterations will be needed to define realistic and viable cost recovery plans
- for each iteration step the user defines a new “SCENARIO” changing scenario parameters

Financial model consists of the following steps:

STEP 1 – Pre-model analysis/Input data analysis

STEP 2 – O&M Finance gap assessment

STEP 3 – Scenario building – definition of measures

STEP 4 – Scenario result assessment

STEP 5 – Input data adjustment (investment costs and related O&M costs reconsideration) /new scenario definition

Repeat process in sufficient number of iterations, if needed

Key parts of the cost recovery assessments are:

Pre-model analysis/Input data analysis

- Current supply of finance
 - Investment finance sources
 - Service revenues
 - Three types of consumers
- Households
- Industry and commercial enterprises
- Other consumers (Public institutions, government and state institutions and organizations and other)

Revenues defined by

- Service price
- Billed amount
- Collected amount
- Cost savings as a result of the project intervention and improved efficiency of the system and utility company

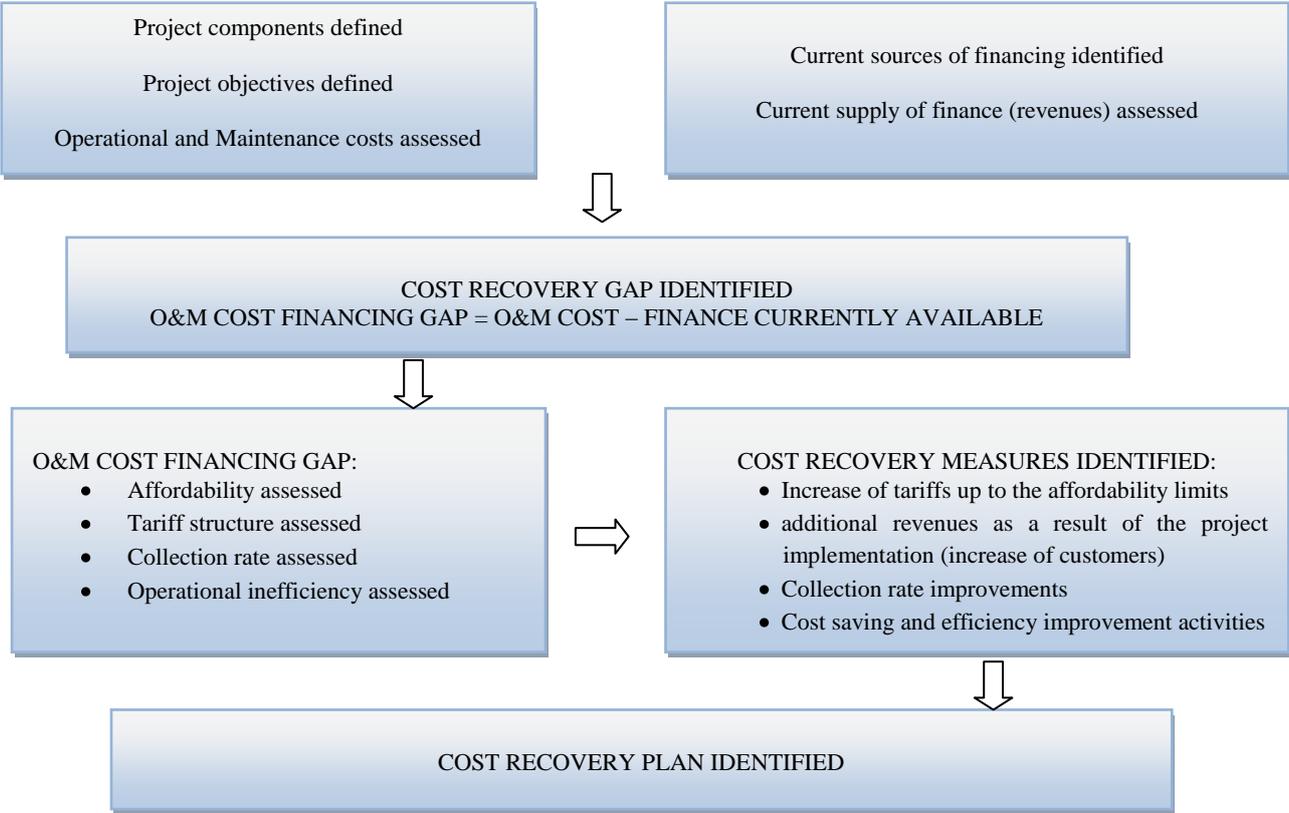
Household affordability analysis

- Annual average income per household member
- Percentage of the current costs for water and waste water services as percentage of the household member income
- Projected (targeted) percentage of income for water and waste water services
- Income growth projection follows real GDP growth (Real GDP growth = Nominal GDP growth – Inflation)

Scenario building

- New investment sources identified and assessed (budget transfers, loans, grants,...)
- New tariff policy built
 - Collection rate improved
 - Cross subsidies among different consumer group removed
 - Household tariffs increased up to affordability level
 - Other consumer group's tariffs reassessed

Based on the already explained analysis and steps, the user will finally be able to perform Cost Recovery assessment and scenario building using prepared excel sheets.



ANNEX 4

Loan Agreement between FMF and the Municipality - Template

LOAN AGREEMENT

between

Federation of Bosnia and Herzegovina

represented by

The Federal Ministry of Finance

and

Municipality _____

“Scheme _____”

_____ **2010**

Federation of Bosnia and Herzegovina

represented by

The Federal Ministry of Finance

Mehmeda Spahic 5, 71 000 Sarajevo,
(hereinafter: Ministry)

and

Municipality _____

Address _____

(hereinafter: Municipality),

date _____ 2010

have concluded the following

LOAN AGREEMENT

PREAMBLE

WHEREAS the European Investment Bank (hereinafter: EIB) on the basis of the Finance Contract no: FI no. 24.569 (BA), SERAPIS NO 2006-0272 signed between Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina and EIB (hereinafter: Finance Contract) made available loan proceeds in the amount of 60 million EUR to the Federation of Bosnia and Herzegovina for the Project Water and Sanitation Federation (hereinafter: the Project) concerning the financing of water and sanitation investment schemes. The aforementioned Loan and Finance Contract specifies the requirement that EIB loan proceeds shall finance 50% of the investment value of schemes of the Municipalities involved as Final Beneficiaries, while the remaining 50% shall be ensured by own contribution of municipalities and/or grant funds of the European Commission provided for the implementation of the Project.

WHEREAS Bosnia and Herzegovina and the Federation of Bosnia and Herzegovina signed Subcontract on Water and Sanitation Federation BiH Loan on December 10, 2008.

WHEREAS the Federal Ministry of Agriculture, Water Management and Forestry has established Project Management Unit (hereinafter: PMU) following the provisions of the Finance Contract signed with the EIB for the purpose of the implementation of the Project.

WHEREAS EIB approve "Document on the Policy of On-Lending of Funds to the Final Beneficiaries from the Loan of the EIB" (hereinafter: On-Lending Policy Document) and Project Fiche.

WHEREAS the Ministry and EIB agree to approve the loan proceeds in accordance with Finance Contract to the Municipality of _____ under the terms and conditions determined and specified in this Agreement and Annexes to this Agreement.

The parties hereto have agreed as follows:

Article 1

Subject of the Agreement

The Ministry and the Municipality agree that all terms and conditions and deadlines laid down in the Finance Contract shall apply *mutatis mutandis* to this Agreement, unless it provides otherwise, including Anti-Corruption Guidelines.

This Agreement shall specify terms and conditions under which the Ministry approves the loan to the Municipality in the total amount of principal of _____ EUR (hereinafter: Loan), and the Municipality undertakes to pay the Ministry the agreed interest and related fees, and repay the used amount of the Loan under terms and conditions and following the period and method as specified in this Agreement.

The loan is approved for the purpose of providing support for financing of the Scheme " _____ " (hereinafter: Scheme) described in **Annex 1** (Project Fiche) forming part of this Agreement.

Article 2

Use of Loan

The Municipality can use the loan proceeds solely for financing of projected costs of works, goods, and services needed for the execution of the Scheme. Contracts for works, goods and services shall be executed following the provisions of the Public Procurement Law of BiH and the adopted Project Fiche.

The deadline for use of the loan shall be 30 June 2012 or some other date as may be estimated by the Ministry upon receiving a prior written request by the Municipality and approval by EIB, and in that case the Ministry shall immediately notify the Municipality about such later date.

The Loan can be used provided that the requirements laid down in Article 10(1) concerning

entering into force of the Agreement are met and the following submissions are provided by the Municipality to the Ministry:

- Loan repayment insurance instruments as laid down in Article 6(1) of this Agreement;
- Municipal Council Decision on approving loan and proof that the said Decision has been published in the Official Gazette of the Municipality.

Article 3

Disbursement and Use of Loan Proceeds

Loan proceeds shall be used exclusively for paying contractors for works, goods and services delivered. The Municipality shall not demand any payments into its account.

The Municipality shall deliver disbursement request to the PMU accompanied by supporting documentation as well as other evidence that the amounts to be disbursed from the Loan shall be used exclusively for the purpose of implementation of the Scheme in accordance with the Finance Contract, Project Fiche (**Annex 1**) and the On-Lending Policy Document (**Annex 2**) as approved by EIB and forming part of this Agreement.

Loan proceeds shall be used in the initial phase of the Scheme, during which the parties to the Agreement shall have to agree on the plan of utilization of other proceeds set out in the Project Fiche (**Annex 1**) as they become available.

The Municipality responsibilities regarding disbursement and use of funds are defined in On-Lending Policy Document (**Annex 2**).

Article 4

Interest and Repayment

For any accumulated outstanding loan amount, starting from the date on which payment was executed, the Municipality undertakes to pay to the Ministry interest calculated on the basis of interest rate as defined in the Finance Contract and the On-Lending Policy Document.

The Municipality shall repay principle and interest in EUR following the instructions provided by the Ministry.

If repayment of principle and interest are due on the day on which banks are not open for business in the Federation of Bosnia and Herzegovina, the Municipality shall effect payment the following day which is a relevant business day. If the following business day falls in the next calendar month, payment shall be made on the day preceding due date.

The Municipality shall have the right to request, upon payment of all due interests and upon giving 30 days' prior notice to the Ministry, prepayment:

1. of the overall loan amount outstanding at the time or
2. overall amount of one or more tranches, provided that on the date of such prepayment no outstanding tranche of the Loan shall remain after payment of the prepaid tranche.

Article 5

Arrears

On any overdue sums payable under this Agreement, including accrued and unpaid interest, the Ministry shall for the overdue period calculate and charge statutory default interest. In this case the Ministry shall inform the Municipality of such adjustment in the calculation of interest.

Article 6

Loan repayment insurance instruments

For the purpose of ensuring payment of all receivables under this Agreement, the Municipality shall within 7 (seven) days from the date of signing of this Agreement submit to the Ministry 19 (nineteen) own blank bill of exchanges with no-protest clause and the bill of exchange declaration signed and verified by the authorized person. On the basis of this provision, the Municipality authorizes the Ministry to use the submitted blank bills of exchange for the purpose of paying receivables under this Agreement. In such case, the Ministry shall have the authority to insert in the submitted blank bill of exchange the amount of all receivables due on the day of filling in the bill and maturity date, to address it at its own discretion, to fill in all other missing items, and to submit it for payment, or to use the bill of exchange to carry out all other applicable actions required to pay bills receivable.

Without prejudice to the provisions of the paragraph above, the Municipality agrees and gives irrevocable binding authorization to the Ministry to use the revenue funds earmarked for the Municipality concerned in the public revenue account of the Federation of BiH to pay any arrears under this Agreement.

Article 7

Technical obligations

The Municipality shall implement the Scheme through the Municipal Team for the implementation of the Scheme (PIT – Project Implementation Team) (hereinafter: PIT), appointed by the Municipal Mayor Decision ref. no: _____. The Municipality through the PIT shall ensure the complete compliance with the purpose of the Project.

PIT shall fully cooperate with PMU in accordance with the provisions of the Finance Contract, this Agreement and its Annexes.

PIT shall use its rights under this Agreement in such a way as to protect the interests of the Ministry, PMU and the Municipality, and achieve the purpose of the Loan; it shall not ascribe, add or waive any of the provisions of this Agreement, unless agreed otherwise among the Ministry, PMU and the Municipality.

PIT shall in a timely manner inform the Ministry, PMU and the Municipality of any circumstances impeding or likely to impede progress of the implementation of the Scheme.

Starting from the date of the first Loan disbursement, the Municipality shall, on request by the Ministry and at least quarterly, submit to the Ministry reports on disbursement and expenditure of loan proceeds and the reports on the implementation of the Scheme. The Municipality shall submit such reports to PMU as well. Upon completion of the Scheme, the Municipality shall submit to the Ministry the final report on all components of the Scheme and its implementation.

The Municipality through PIT shall keep or ensure keeping of books and records providing unambiguous evidence that the Loan has been used for the purpose of the Scheme implementation. The Municipality and PIT shall allow the representatives of the Ministry, PMU and EIB to carry out at any time checks of books and records or any other documentation relevant to the implementation of the Scheme and the expenditure of loan proceeds.

The Municipality and PIT shall take or cause each measure to be taken as they deem necessary for the implementation of the Scheme and shall not take or allow to be taken any measure preventing or impeding the implementation or work on the Scheme or any provision of this Agreement.

For investment programs generating significant net increases of operational costs, the Municipality shall undertake to increase the collection rate, utility service tariffs and all other measures that shall ensure operational sustainability and an appropriate level of cost recovery in accordance with the cost recovery models and affordability considerations in second part of Annex 1 of this Agreement. The Municipality shall submit to PMU on annual basis the regular update of cash flow projections for municipal service providers along with a list of performance indicators.

The Municipality and PIT are responsible for the overall implementation of the Scheme in the Municipality, including: preparation of project documentation, obtaining all required permits for the implementation of the Scheme including resolving all property rights issues, the preparation and implementation of procurement procedures, obtaining and maintaining all permits and authorizations from the authorities responsible for the environment, ensuring that the Scheme does not produce

negative impact on protected areas, taking care that materials or substances likely to have negative impact during construction, operation and maintenance of the Scheme are not used or disposed of and carrying out all the activities within the Scheme as requested by the authorities responsible for the environment.

The Municipality shall notify the Ministry and PMU of all relevant municipal planning documents (e.g. spatial plans, capital investment budgets), in particular those relating to the utility infrastructure (organization, strengthening of institutions, investment planning and financing etc). The obligation of the Municipality is to ensure timely adoption and enforcement of all planning documents.

Article 8

Notices

Unless otherwise specified in this Agreement, all notices, requests and other correspondence related to this Agreement shall be made in written form by the contracting parties. The following addresses are specified for this purpose:

For the Ministry:

Federalno ministarstvo finansija-financija
Mehmeda Spahe 5
71000 Sarajevo
Attn: Minister
Fax: 033/203-152

For the Municipality:

Municipality of _____
Address

Attn: Mayor
Fax:

Article 9

Representation

Federal Minister of Finance or any other person or persons in possession of a full written authorization by Federal Minister of Finance may on behalf of the Ministry undertake any action or produce any documents as required or allowed in accordance with this Agreement.

Municipal Mayor or any other person or persons in possession of a full written authorization by the Municipal Mayor may on behalf of the Municipality undertake any action required of such person/s or allowed in accordance with this Agreement.

Manager of PMU or any other person or persons in possession of a full written authorization by the PMU manager may on behalf of PMU undertake any action required of such person/s or allowed in accordance with this Agreement.

Manager of the Municipal PIT or any other person or persons in possession of a full written authorization by the Municipal PIT manager may on behalf of PIT undertake any action required of such person/s or allowed in accordance with this Agreement.

Article 10

Validity of the Agreement

This Agreement shall enter into force on the date when the Ministry sends to the Municipality a notification on EIB's approval of this Agreement.

Invalidity of any of the provisions of this Agreement shall not affect the validity of other provisions. Any gap as a result of this shall be filled in by a provision which is in accordance with the purpose of

this Agreement.

This Agreement and all obligations of the parties herein shall cease to be valid if and when the total amount of Loan principle and all interests on Loan have been paid.

If the Municipality fails to meet the conditions laid down in Article 2 (3) required for utilization of the Loan within the period of 90 days from the entry into force of this Agreement, the Ministry may at any time after this period at its discretion terminate this Agreement by sending notification to the Municipality. Upon submitting this notification, this Agreement and all obligations of parties of the Agreement shall cease to apply accordingly.

Article 11

Dispute resolution

Unless regulated by this Agreement, all other matters shall be governed by Obligatory Relations Law as well as the provisions of other applicable laws in the Federation of Bosnia and Herzegovina.

All disputes arising out of this Agreement or related hereto, and failing the mutual agreement between the parties, shall be finally resolved before the competent court in Sarajevo.

Article 12

Copies of Agreement

This Agreement shall be executed in 6 (six) identical copies, of which 2 (two) for each party to the Agreement, 1 (one) for PMU and 1 (one) for EIB.

Article 13

Annexes

The following Annexes shall form integral part of this Agreement:

Annex 1: Project Fiche

Annex 2: On-Lending Policy Document.

Federal Ministry of Finance

Municipality

Minister

Mayor