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IDA/R2014-0204/1

June 3, 2014

**Closing Date: Friday, June 20, 2014
at 6 p.m.**

FROM: The Corporate Secretary

Lesotho - Water Sector Improvement Project - Phase 2

Additional Financing

Project Paper

Attached is the Project Paper regarding a proposed additional grant and credit to Lesotho for a Water Sector Improvement Project - Phase 2 (IDA/R2014-0204) which is being processed on an absence-of-objection basis.

Distribution:

Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC and MIGA

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The World Bank

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Report No: PAD1039

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT PAPER

ON A

PROPOSED ADDITIONAL GRANT

IN THE AMOUNT OF SDR 4.12 MILLION
(US\$6.38 MILLION EQUIVALENT)

AND A

PROPOSED ADDITIONAL CREDIT

IN THE AMOUNT OF SDR 5.84 MILLION
(US\$9.05 MILLION EQUIVALENT)

TO THE

KINGDOM OF LESOTHO

FOR A

WATER SECTOR IMPROVEMENT PROJECT, PHASE 2

MAY 28, 2014

Environment, Natural Resources, Water and Disaster Risk Management Unit (AFTN2)
Southern Africa Country Department 1 (AFCS1)
Africa Region

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CURRENCY EQUIVALENTS

(Exchange Rate Effective APRIL 30, 2014)

Currency Unit = Maloti

Maloti 10.758 = US\$1

US\$ 1.55 = SDR 1

FISCAL YEAR

April 01 – March 31

ABBREVIATIONS AND ACRONYMS

AGOA	Africa Growth and Opportunity Act
APL	Adaptable Program Loan
BADEA	Arab Bank for Economic Development in Africa
BP	Bank Procedure
CAS	Country Assistance Strategy
CoW	Commissioner of Water
EIB	European Investment Bank
EMWA	Ministry of Energy, Meteorology & Water Affairs
FM	Financial Management
FY	Financial Year
GDP	Gross Domestic Product
GoL	Government of Lesotho
IDA	International Development Association
IRP	Integrated Resource Plan
ISR	Implementation & Status Results
LHDA	Lesotho Highlands Development Authority
LHWC	Lesotho Highlands Water Commission
LHWP	Lesotho Highlands Water Project
LLWSP	Lesotho Lowlands Water Supply Program
MDWSP	Metolong Dam and Water Supply Program
MW	Mega Watt
NCS	Non-Consulting Services
OCGT	Open Cycle Gas Turbine
OFID	OPEC Fund for International Development
OP	Operational Policy
ORAF	Operational Risk Assessment Framework
PAPs	Project Affected Peoples
PDO	Project Development Objective
PMU	Project Management Unit
SDR	Special Drawing Right
WASCo	Water and Sewerage Company
WSIP	Water Sector Improvement Project

Vice President:	Makhtar Diop
Country Director:	Asad Alam
Sector Director:	Jamal Saghir
Sector Manager:	Jonathan Kamkwala
Task Team Leader:	Marcus Wishart

KINGDOM OF LESOTHO

Water Sector Improvement Project Phase 2 Additional Financing (P149467)

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Water Sector Improvement Project Phase 2 Additional Financing

ADDITIONAL FINANCING DATA SHEET

Basic Information – Parent									
Parent Project ID:	P108143			Original EA Category:	A - Full Assessment				
Current Closing Date:	30-Jun-2015								
Basic Information – Additional Financing (AF)									
Project ID:	P149467			Additional Financing Type (from AUS):	Scale Up				
Regional Vice President:	Makhtar Diop			Proposed EA Category:	A – Full Assessment				
Country Director:	Asad Alam			Expected Effectiveness Date:	31-Jul-2014				
Sector Director:	Jamal Saghir			Expected Closing Date:	30-Jun-2016				
Sector Manager:	Jonathan S. Kamkwala			Report No:	PAD1039				
Team Leader:	Marcus J. Wishart								
Borrower									
Organization Name	Contact	Title	Email						
Kingdom of Lesotho	Felix Malachamela	Commissioner of Water	commwater@ilesotho.com						
Lesotho Highlands Development Authority	Refiloe Tlali	Chief Executive	tlalir@lhda.org.ls						
Project Financing Data – Parent (Water Sector Improvement APL Phase II: Metolong Dam and Water Supply-P108143)									
Key Dates									
Project	Ln/Cr/TF	Status	Approval Date	Signing Date	Effectiveness Date	Original Closing Date	Revised Closing Date		
P108143	IDA-45740	Effective	26-May-2009	20-Jul-2009	18-Sep-2009	30-Jun-2015	30-Jun-2016		
P108143	IDA-H4750	Effective	26-May-2009	20-Jul-2009	18-Sep-2009	30-Jun-2015	30-Jun-2016		
P108143	IDA-H7380	Effective	10-Nov-2011	16-Nov-2011	22-Mar-2012	30-Jun-2015	30-Jun-2016		
Disbursements									
Project	Ln/Cr/TF	Status	Currency	Original	Revised	Cancelled	Disbursed	Undisbursed	% Disbursed
P108143	IDA-45740	Effective	XDR	11.10	11.10	0.00	0.00	11.10	
P108143	IDA-H4750	Effective	XDR	5.70	5.70	0.00	5.68	0.02	99.73
P108143	IDA-H7380	Effective	XDR	8.40	8.40	0.00	7.72	0.68	91.93

Project Financing Data – Additional Financing Lesotho WSIP2 AF: LHWP Ph2 Hydropower Component (P149467)			
[]	Loan	[]	Grant [X] IDA Grant
[X]	Credit	[]	Guarantee [] Other
Total Project Cost:		US\$15.435 million	Total Bank Financing: US\$15.435 million
Financing Gap:		0.00	
Financing Source – Additional Financing (AF)			Amount (\$USm)
BORROWER/RECIPIENT			0.00
IDA			15.435
Total			15.435
Policy Waivers			
Does the project depart from the CAS in content or in other significant respects?			No
Explanation			
Does the project require any policy waiver(s)?			No
Explanation			
Team Composition			
Bank Staff			
Name	Title	Specialization	Unit
Robert A. Robelus	Consultant		AFTA1
Elisabeth Sherwood	Consultant		AFTN2
Kristine Schwebach	Social Development Specialist		AFTCS
Satoru Ueda	Lead Dam Specialist		TWIWA
Lucson Pierre-Charles	Program Assistant		AFTN2
David Weston	Consultant		AFTN2
Edmund Motseki	Operations Officer		AFMLS
Sanjay Srivastava	Lead Environmental Specialist		AFTN3
Marcus J. Wishart	Sr Water Resources Spec.	Team Lead	AFTN2
Cecil Nundwe	E T Consultant	E T Consultant	AFTN2
Chitambala John Sikazwe	Procurement Specialist		AFTPE
Louise E. M. Croneborg	Water Resources Mgmt. Spec.		AFTN2
Tandile Msiwa	Financial Management Specialist		AFTME
Zoe Kolovou	Lead Counsel		LEGAM
Elizabeth Hassan	Associated Counsel		LEGAM
Christiaan Nieuwoudt	Finance Officer		CTRLA

Non Bank Staff					
Name	Title	Office Phone	City		
Locations					
Country	First Administrative Division	Location	Planned	Actual	Comments
Lesotho	Berea District	Teyateyaneng	X		
Lesotho	Berea	Teyateyaneng			
Lesotho		Metolong			
Lesotho	Berea	Berea District			
Lesotho	Berea	Berea District			
Institutional Data					
Parent (Water Sector Improvement APL Phase II: Metolong Dam and Water Supply-P108143)					
Sector Board					
Water					
Sectors / Climate Change					
Sector (Maximum 5 and total % must equal 100)					
Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %	
Water, sanitation and flood protection	Water supply	57			
Water, sanitation and flood protection	General water, sanitation and flood protection sector	21			
Public Administration, Law, and Justice	Public administration- Water, sanitation and flood protection	15			
Water, sanitation and flood protection	Sanitation	4			
Health and other social services	Health	3			
Total		100			
Themes					
Theme (Maximum 5 and total % must equal 100)					
Major theme	Theme	%			
Urban development	Urban services and housing for the poor	57			
Environment and natural resources	Water resource management	30			

management				
Rural development	Rural services and infrastructure	8		
Social dev/gender/inclusion	Social Inclusion	3		
Environment and natural resources management	Other environment and natural resources management	2		
Total		100		
Additional Financing Lesotho WSIP2 AF: LHWP Ph2 Pump Storage (P149467)				
Sector Board				
Water				
Sectors / Climate Change				
Sector (Maximum 5 and total % must equal 100)				
Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %
Energy and mining	Hydropower	70		
Water, sanitation and flood protection	General water, sanitation and flood protection sector	30		
Total		100		
<input checked="" type="checkbox"/> I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.				
Themes				
Theme (Maximum 5 and total % must equal 100)				
Major theme	Theme			%
Environment and natural resources management	Water resource management			100
Total				100
Conditions and Legal Covenants:				
Financing Agreement (FA) Reference	Description of Condition/Covenant	Due Date		
Article V. 5.01 (a)	The Subsidiary Agreement has been executed on behalf of the Recipient and the Project Implementing Entity.	Effectiveness		
Article V. 5.01 (b)	The Recipient has caused the Project Implementing Entity to prepare and adopt a Project Implementation Manual for Part D of the Project, in form and substance satisfactory to the Association.	Effectiveness		

I. INTRODUCTION

1. This Project Paper seeks the approval of the Executive Directors to provide an additional IDA Credit in an amount of SDR 5.84 million (US\$9.050 million equivalent) and an additional IDA Grant in an amount of SDR 4.12 million (US\$6.385 million equivalent) to the Kingdom of Lesotho Water Sector Improvement Project, Phase 2 (P108143). Approval is also sought for an Extension of the Closing Date; this would be the first extension under the current project.
2. The additional financing will help finance the costs associated with new activities included as part of project restructuring in response to circumstances that arise during implementation and scaled-up activities to enhance the impact of a well-performing project. The activities will contribute directly to the Bank's twin goals of eradicating extreme poverty and promoting shared prosperity.
3. The Kingdom of Lesotho requested for the Additional Financing on January 3, 2014 under the provisions of OP/BP 10.00, Investment Project Financing, to enable a scale-up of activities and to introduce additional activities in order to enhance development impact. An additional request to re-allocate resources under IDA 16 was received on March 28, 2014, and has been incorporated into the original concept.
4. The additional financing will be allocated to a new component to be implemented by the Lesotho Highlands Development Authority (LHDA) to provide a predictable, transparent regime for advancing the hydropower component of Phase 2 of the LHWP. Funds will also be allocated to Component 3 of the existing Project to scale-up activities as part of a series of measures aimed at enhancing capacity within WASCo while also supporting longer-term strategic planning through the necessary studies for water supply infrastructure investments.
5. The Project Development Objective (PDO) has been amended to reflect the activities to be financed under this additional financing. The Results Framework has been updated to reflect the revised PDO and the new activities under the additional financing.
6. The disbursement categories under both the original Credit and the two IDA Grants have been consolidated to allow flexibility in the allocation and utilization of funds as the project enters into the final stages of implementation.
7. The original project is the second of a two-phase APL that supports the implementation of the Metolong Dam and Water Supply Program (MDWSP), a multi-donor-funded program aimed at improving the supply of water to Maseru and nearby towns in support of the GoL's efforts to sustain socio-economic growth and development. The MDWSP is comprised of five principal investment areas supported by nine partners, including IDA, the United States' Millennium Challenge Corporation, the Abu Dhabi Fund, the Kuwait Fund, the Saudi Fund, the Arab Bank for Economic Development in Africa (BADEA), the OPEC Fund for International Development (OFID), the European Investment Bank (EIB), and the Republic of South Africa.
8. The additional financing will further support the long-term sustainability of investments in the MDWSP, advance preparation of the hydropower component under the long-term cooperative investment program of the LHWP2 between South Africa and Lesotho, and build on the significant work over the past decade by the European Union in assisting the GoL in preparing a comprehensive investment program for the expansion of water service in the Lowlands of Lesotho. While the activities will not directly involve other development partners at

this time, some may provide funding to the investment projects to be prepared under the additional financing.

II. BACKGROUND AND RATIONALE FOR ADDITIONAL FINANCING

9. The project activities are consistent with the Country Assistance Strategy (CAS) for the Kingdom of Lesotho (FY2010–14; Report No: 51787-LS), which emphasizes water and water infrastructure as key areas of investment, as well as the importance of the Lesotho Highlands Water Project. The additional financing is similarly consistent with the CAS's focus on the leveraging of IDA resources to support other investment and donor financing. The project activities contribute to longer-term investments in improvements in service delivery and revenue generation.

10. Water is one of Lesotho's most important natural resources and the combined efforts to develop further phases of the LHWP and to increase the national coverage for water supply are central to Government's efforts to eradicate extreme poverty and promote shared prosperity. The Kingdom's high altitude, natural endowment and geographic proximity to major demand centers provide unique opportunities to capitalize on renewable water resources. Between 1994 and 2006, the development of the first phase of the LHWP amounted to approximately three times Lesotho's 2002 GDP of M4.175 billion. Currently the revenues from Phase 1 amount to between US\$20 and 30m annually (roughly 4.8 percent of GDP). With more than 40 percent of the estimated 1.8 million people without adequate access to water and sanitation services, these resources are an important contribution to supporting development of national water infrastructure and increasing water supply coverage.

11. The LHWP is a bi-national project between South Africa and Lesotho that transfers water from the water-rich highlands of Lesotho to the dry Gauteng region of South Africa through a series of dams, transfer tunnels and associated infrastructure, as well as to supply electricity to Lesotho. The Treaty governing the LHWP was signed in October 1986. Phase 1A, which included construction of the Katse Dam and water transfer tunnel and the 'Muela Dam and hydropower project, was implemented between 1991 and 1999 at a total cost of US\$2.4 billion. Phase 1B, which included the construction of the Mohale Dam and associated transfer tunnel, was implemented between 1998 and 2006 at a cost of roughly US\$885 million.

12. The Agreement for LHWP Phase 2 was signed August 11, 2011 and committed South Africa and Lesotho to the construction of the Polihali Dam and water transfer infrastructure and the Kobong Pump Storage Scheme. The Government of the Republic of South Africa is responsible for the costs of the water transfer activities. The Government of the Kingdom of Lesotho is responsible for the costs of the Hydropower and Ancillary Development activities. The additional financing will be used to support a transparent and predictable regime for preparation of the hydropower component under Phase 2 of the LHWP. The additional IDA financing would be implemented through the Lesotho Highlands Development Authority (LHDA) and be used to finance the next steps considered essential to advance preparation of the hydropower component of Phase 2 of the LHWP and prepare for an overall investment estimated at US\$1 billion.

13. The Lesotho Lowlands Water Supply Program has been identified as a series of parallel investments to improve water security and supplies for the populations in the lowland areas of Lesotho. A series of studies financed by the EU and completed in 2006 identified water supply options across eight zones. The MDWSP represented the first, and largest, of the investments

envisaged under the Lowlands Program. As the MDWSP approaches completion, the additional financing would assist the Ministry of Energy, Meteorology and Water Affairs to update these studies and advance the necessary preparations to crowd in financing from a range of partners around a prioritized series of investments.

14. The Lesotho Water and Sewerage Company (WASCo) is central to advancing the investment program and ensuring sustainability of existing investments under the MDWSP. However, the utility faces a number of operational and financial challenges. The additional financing would support WASCO to enhance capacity and support planning and design for new investments as part of a longer-term strategy to strengthen the utility.

Original Project: Water Sector Improvement Project, Phase 2 (P108143)

15. The original project (Phase 2 of the WSIP APL) was approved by IDA's Board of Directors on May 26, 2009 for an amount of SDR 16.8 million (US\$25 million equivalent at that time). This included a Grant of SDR 5.7 million (US\$8.5 million equivalent) and a Credit of SDR 11.1 million (US\$16.5 million equivalent). The agreement was signed on July 20, 2009, and the project became effective on September 18, 2009. The PDO was to support the Kingdom of Lesotho in: (i) developing and sustaining an environmentally sound, socially responsible, and financial viable framework for the Metolong Dam and Water Supply Program; (ii) increasing the quantity of safe, bulk water supplied to Teyateyaneng; and (iii) strengthening institutions and related instruments in the water sector.

16. The WSIP2 project has three components:

- i. **Component 1: Environmental and Social Management** (US\$10 million equivalent under the original financing and US\$6 million equivalent under the 2011 additional financing) supports activities addressing environmental, social, and cultural heritage protection under the MDWSP's Environmental and Social Management Program.
- ii. **Component 2: Engineering Support and Transmission Line to Teyateyaneng** (US\$13 million equivalent under the original financing and US\$3.5 million under the 2011 additional financing) supports the MDWSP water supply works program through (i) the construction of transmission mains to supply the town of Teyateyaneng with water from the Metolong reservoir and (iii) financing the position of engineering manager within the MDWSP implementing agency.
- iii. **Component 3: Institutional and Policy Support** (US\$2.0 million equivalent under the original project and US\$3.5 million equivalent under the 2011 additional financing) finances support through the office of the Commissioner of Water (CoW) to deepen institutional reforms, support further policy analysis, and enhance sector capacity, including support to the Lesotho Electricity and Water Authority (LEWA) in the regulation of water supply services.

17. Additional Financing in an amount of SDR 8.4 million (US\$13 million equivalent) was approved on November 10, 2011 in order to cover cost escalations in implementation of the MDWSP that arose during implementation. The agreement was signed on November 16, 2011, and became effective on March 22, 2012. There were no other changes to the project's objectives, design, or scope at that time.

18. Phase 1 of the WSIP APL was approved by the Board on October 26, 2004, in an amount of SDR 9.6 million (US\$14.1 million at that time) and closed on June 30, 2011. The Project Development Objective of the APL was to support the vision of the Government of Lesotho to secure adequate, sustainable, and clean water supply and to support adequate sanitation services for consumers living in the Lowland areas of Lesotho. The Implementation Completion Report for Phase 1 of the WSIP rated the Achievement of the Project's Development Objective as Satisfactory. The policy and legal frameworks for water were strengthened, with a Water and Sanitation Services Policy endorsed by Cabinet in February, 2007, and a Water Act passed by the National Assembly in December, 2008. These were supported by an amendment of the Lesotho Electricity Authority Act in March 2011 to include water regulation. The utility has increased the number of people with access to piped water from 34,275 to 54,742, and reduced the cost, distance travelled and time spent collecting water.

Status of Implementation of Project (P108143)

19. The Project is performing well and therefore eligible for Additional Financing in line with OP 10.00. The ISR ratings for progress towards achieving the PDO have been consistently rated Satisfactory since effectiveness and those for the Implementation Progress rated Moderately Satisfactory or better over the past 12 months. Given progress to date, the Project is expected to achieve its development objectives.

20. The PDO-level project indicators are:

PDO-level Indicators	Status
Indicator One: Environmental Management Plan successfully implemented	On track to be achieved. Contractors implementing approved Environmental Protection Plan satisfactorily. Environmental Protection Plan for the Dam has been approved by the implementing agency and dam construction is ongoing and in compliance with procedures.
Indicator Two: Comprehensive Resettlement and Compensation Action Plan (CRCAP) successfully implemented	On track to be achieved. Payments totaling M39.5 million (US\$3.9 million) have been made to 2,057 PAPs, representing roughly 89% of all those PAPs identified. Consolidated CRCAP has been drafted with final submission pending completion of the MDWSP.
Indicator Three: WASCo's operational cost-coverage ratio maintained at equal to or more than 100%	WASCo's core operational cost coverage ratio (not including depreciation, as defined for the purposes of this indicator) for 2012/2013 was 107% - an improvement over the previous year's ratio of 103%.
Indicator Four: People in project area with access to improved water sources	94% of the Teyateyaneng pipeline has been laid. The WATSAN program has also improved access for an estimated 11,838 people.
Indicator Five: State of Water Resources Report prepared, consulted, and publicly available	The first State of Water Resources report was published with support from Technical Assistance; the second has been supported through training, while the third is being prepared using internal resources.

21. There are no outstanding fiduciary issues related to the project. All project audits have been received on time. The project is following World Bank procurement procedures, and no procurement issues have been identified.
22. All legal covenants related to project implementation have been completed as required. Ongoing covenants are in compliance.
23. Key risks are outlined in Annex 2: Operational Risk Assessment Framework (ORAF). The overall risk rating at this stage of implementation is Moderate.
24. The main contractor on the secondary water supply pipeline financed by IDA was debarred through a Notice of Uncontested Sanctions Proceedings issued on October 4, 2013. The original contract was awarded on December 13, 2011, prior to the temporary suspension and subsequent debarment. While the effects of the suspension or debarment do not extend to ongoing contracts, IDA issued no objection to a no-cost extension of time to the original contract completion on October 14, 2013. The no cost extension was determined not to constitute a material modification with no increase in the total contract value and all works to be completed within the original contract value. The debarred firm will not receive or benefit from any of the proceeds of the additional financing.

Rationale for Additional Financing

25. The Additional Financing was requested by the Government of Lesotho under the provisions of OP/BP 10.00, Investment Project Financing, to enable a scale-up of activities and to introduce additional activities in order to enhance development impact. The additional financing will be allocated to a new component to be implemented by the Lesotho Highlands Development Authority (LHDA) to provide a predictable, transparent regime for advancing the hydropower element of Phase 2 of the LHWP. Funds will also be allocated to Component 3 of the existing Project to scale-up activities as part of a series of measures aimed at enhancing capacity within WASCo while also supporting longer-term strategic planning through the necessary studies for water supply infrastructure investments.
26. The World Bank has a long involvement in the water sector in Lesotho and the additional financing builds on a history of support to development of the water sector, provision of infrastructure for urban water supply and the Lesotho Highlands Water Project. The Government considers IDA to be a key partner, not only as a source of affordable investment finance, but as an objective observer and analyst. All activities involve elements to advance on a pipeline of potential investments.
27. While not guaranteed, successful implementation of the additional activities may lead to further World Bank Group financing of Lesotho's investments in the Kobong Pump Storage scheme, which is part of the bi-national investment between Lesotho and South Africa in Phase 2 of the LHWP, and in the Lesotho Lowlands water supply program, which would expand safe, piped water supply to communities in the Lesotho Lowlands but beyond the existing number of towns currently served by WASCo.

III. PROPOSED CHANGES

28. **Project Development Objective.** The Project Development Objective has been revised to reflect the additional objectives.

29. The original PDO is to support the Kingdom of Lesotho in: (i) developing and sustaining an environmentally sound, socially responsible, and financially viable framework for the MDWSP, (ii) increasing the quantity of safe, bulk water supplied to Teyateyaneng; and (iii) strengthening institutions and related instruments in the water sector.

30. The revised PDO includes an additional part to the original project objective as follows: to support the Kingdom of Lesotho in: (i) developing and sustaining an environmentally sound, socially responsible, and financially viable framework for the MDWSP, (ii) increasing the quantity of safe, bulk water supplied to Teyateyaneng, (iii) strengthening institutions and related instruments in the water sector; and (iv) advancing strategic infrastructure investments.

31. Results Framework and Monitoring Arrangements. The PDO level indicators and the project intermediate indicators have been updated to reflect the revised PDO and additional activities under the additional financing.

32. Project Components and Activities. The additional financing will finance additional activities under Component 3, along with new activities to be implemented through an additional component consistent with the revised PDO. These are detailed below.

33. Component 3: Institutional and Policy Support (US\$9.050 million equivalent). The additional financing will support: (i) WASCo to strengthen operations in areas of financial management, regulatory reporting, network monitoring and control, unaccounted-for-water, investment and strategic planning, along with enhanced capacity to assist in operations and maintenance, including necessary equipment and expenses, such as telemetry, meters, pipes, pressure values, chemicals, energy etc.; (ii) studies to advance the Lesotho Lowlands Water Supply Program, including (a) the identification of priority investments under the program; (b) updates of feasibility studies and environmental and social assessments; (c) institutional support for ownership, operation and maintenance of investments; (d) the preparation of detailed design studies; and (e) the preparation of bidding documents for civil works and engineering supervision; and (iii) provision of operational support, including the financing of operating costs.

34. Component 4: Lesotho Highlands Water Project Phase 2 Hydropower Component (US\$6.385 million equivalent). The additional financing will support the Government of Lesotho to advance preparation of the hydropower component under Phase 2 of the Lesotho Highlands Water Project, through: (i) preparatory studies, such as a market study, feasibility and engineering studies, economic and financial models to determine necessary input and output requirements, and geotechnical investigations; (ii) transaction advisors, as required, and possible legal advisors to assist with contracting preliminaries, including bills of quantity, draft contract formats, power purchase agreements etc.; and (iii) technical assistance to the GoL, LHDA and LHWC to advise and support the preparation process.

35. Implementation Arrangements. Component 4 would be implemented through the Lesotho Highlands Development Authority (LHDA), which will be a new implementing agency under the project. The LHDA was established by the 1986 Order no. 23 as amended under the provisions of the LHWP Treaty; it is managed by a Board of Directors appointed and overseen by representatives of the two Governments through the Lesotho Highlands Water Commission. The LHDA will prepare and adopt a Project Implementation Manual prior to effectiveness.

36. Extension of the Closing Date. The project closing date is to be revised by 12 months, from the current (and original) closing date of June 30, 2015 to June 30, 2016. An extension is

required to accommodate delays in implementation of the MDWSP as well as to undertake the new activities. With respect to the activities under the existing project, an extension of the closing date will be required regardless of the additional financing, as the test on completion of the main works is currently scheduled for after the current closing date. Without the extension, a considerable portion of the IDA-financed safeguards work may not be completed.

37. The safeguard category of the project remains Category A (Full Assessment). However, the new activities will not include any support to additional civil works but will be limited to studies, technical assistance, equipment and training.

38. A Reallocation of the IDA financing is proposed. The additional financing will be added to the existing support, which includes two IDA grants and a single IDA credit. These resources are currently distributed among six expenditure categories: (i) Works; (ii) Goods and Non-Consulting Services; (iii) Consultant Services; (iv) Training; (v) Refinancing of the Project Preparation Advance; and (vi) Unallocated.

Financing Summary of Existing IDA Support (SDR)

		Credit 4574		Grant H4750		Grant H7380	
Category Description		Allocation	Disbursed	Allocation	Disbursed	Allocation	Disbursed
1	Civil Works	9 680 000	0	2 700 000	2,711,142.70	3 450 000	3,096,578.63
2	Goods & NCS	40 000	0	200 000	1,435.04	260 000	0
3A	Consultant Services Parts A & B	935 000	0	1 800 000	1,867,132.19	2 330 000	500,144.39
3B	Consultant Services Part C	445 000	0	774 095	773,804.11	2 240 000	782,038.22
4	Training	0		90 000	178,173.10	120 000	2,853.37
5	PPA Refinancing	0		135 905	135,904.37		
6	Unallocated	0		0	0		
Total Amount		11 100 000	0	5 700 000		8 400 000	

39. It is proposed that under this additional financing and restructuring, a single category would be established for each implementing agency to encompass all expenditures under the original and additional financing. This will allow flexibility in the allocation and utilization of funds as the project enters into the final stages of implementation. The reallocation of resources based on the current levels of disbursements and balance available under each category is included in the table below.

Allocation of Existing IDA Proceeds (SDR)

Category	Category Description	Credit 4574 Revised (2014)	Grant H4750 Revised (2014)	Grant H7380 Add Fin (2011)
1	Civil Works	0	2,712,000.00	3,450,000.00
2	Goods & Non-Consulting Services	0	2,095.00	260,000.00
3A	Consultant Services Parts A & B	0	1,870,000.00	2,330,000.00
3B	Consultant Services Part C	0	800,000.00	2,240,000.00
4	Training	0	180,000.00	120,000.00
5	PPA Refinancing	0	135,905.00	0
6	Unallocated	0	0	0
7	Parts A & B Works, Goods, NCS, Consultant Services and Training	10 655 000	0	0
8	Part C Consultant Services & Training	445 000	0	0
9	Part D Goods, NCS, Consultant Services and Training	0	0	
	Total Amount	11 100 000	5 700 000	8 400 000

Allocation of Additional IDA Proceeds (SDR)

Category	Category Description	Credit 5492 Add Fin (2014)	Grant H967 Add Fin (2014))
1	Civil Works	0	00
2	Goods & Non-Consulting Services	0	0
3A	Consultant Services Parts A & B	0	0
3B	Consultant Services Part C	0	0
4	Training	0	0
5	PPA Refinancing	0	0
6	Unallocated	0	0
7	Parts A & B Works, Goods, NCS, Consultant Services and Training	0	0
8	Part C Consultant Services & Training	5 840 000	0
9	Part D Goods, NCS, Consultant Services and Training	0	4 120 000
	Total Amount	5 840 000	4 120 000

Summary of Proposed Changes:

	Yes	No
Change in Implementing Agency	x	
Change in Project's Development Objectives	x	
Change in Results Framework	x	
Change in Safeguard Policies Triggered		x
Change of EA category		x
Other changes to Safeguards		x
Change in Legal Covenants		x
Change in Loan Closing Date	x	
Cancellations Proposed		x
Change in Disbursement Arrangements	x	
Reallocation between Disbursement Categories	x	
Change in Disbursement Estimates	x	
Change to Components and Cost	x	
Change in Institutional Arrangements	x	
Change in Financial Management		x
Change in Procurement		x
Change in Implementation Schedule	x	
Other Changes		x

IV. APPRAISAL SUMMARY

Economic and Financial Analysis

40. The additional financing will support strategic studies, technical assistance, equipment and training. As such, there are no direct economic or financial returns. This section therefore provides background information and context on the economic and financial contributions of the sector to the economy.

41. Water is one of Lesotho's most important renewable assets and is central to the country's long-term growth prospects. The sector contributes roughly eight percent to Lesotho's overall gross domestic product (GDP), a large portion of which is derived from revenues associated with the Lesotho Highlands Waters Project (LHWP). This will increase with the development of Phase 2 and construction of the Polihali Dam, associated water transfer infrastructure and the hydropower elements in Lesotho. The Lesotho Lowlands Water Supply Program, of which the MDWSP is the first of a series of investments, together with the second phase of the Lesotho Highlands Water Project, are critical elements in addressing the infrastructure gap in electricity and water provision and in supporting private sector activities in key export sectors. In addition, it is assumed that Lesotho will benefit from higher fiscal revenue and foreign exchange inflows generated by increased water supply to South Africa.

42. The Government has also invested significant resources into improving water supply coverage and levels of service, with a continuing focus on sector development. The urban water supply utility – WASCo – currently serves approximately 63,000 connections in Maseru and 16 other urban centers, estimated to serve approximately 315,000 people in urban areas. Based on estimates of Lesotho's urban population, the urban service coverage ratio is approximately 59 percent, however, other estimates of the ratio vary due to different definitions of service and urban areas. WASCo continues to undertake extensive supply extension programs as well as investments in new treatment capacity, which are largely financed by development partners, with a long-term objective of reaching 100 percent coverage in urban areas.

43. In addition to serving the water supply needs of the urban population, Lesotho's important garment manufacturing industry depends on reliable water supply from WASCo. Starting in the late 1980s and gaining momentum with the duty- and quota-free access to the U.S. market provided under the 2000 Africa Growth and Opportunity Act (AGOA), the garment industry has become the largest source of jobs and export earnings in Lesotho. In 2006, approximately 50 garment firms, mainly in the greater Maseru area, absorbed 95 percent of the workforce and contributed US\$567 million in foreign exchange earnings, equal to 38 percent of GDP. While growth in services and some other small industry has reduced that contribution somewhat, the industry remains the most important contributor to GDP and employment. Periodic water supply breakdowns in recent years, due both to drought conditions and infrastructure failures, have affected production in the short term and the commitment of the garment manufacturing industry to remaining in Lesotho for the long term, underscoring the vital importance of the seamless takeover and operations by WASCo of the assets developed under the MDWSP.

44. The LHWP also has a significant impact on the long-term structure and sustainability of the economy in Lesotho. The LHWP Treaty was signed in October 1986. Phase 1A, which included construction of the Katse Dam and water transfer tunnel and the 'Muela Dam and hydropower project, was implemented between 1991 and 1999 at a total cost of US\$2.4 billion. Phase 1B,

which included the construction of the Mohale Dam and associated transfer tunnel, was implemented between 1998 and 2006 at a cost of roughly US\$885 million.

45. Prior to the LHWP, electricity and water accounted for less than 1 percent, manufacturing for 10 percent and construction for 10 percent of GDP. The inception of the LHWP in 1987/88 infused significant changes to the supply and demand structures of the economy, raising the level of foreign capital inflows as well as imports. These have had significant implications for the productive sectors of the economy, as well as the balance of payments. During the peak period of implementation under the LHWP, growth in electricity and water escalated to 23 percent of GDP and in construction to 5 percent of GDP per annum. The project also increased access and improved infrastructure along with water supply and sanitation in the Highlands, in addition to significant short-term employment benefits for local communities. Under Phase 1B, over 9,000 jobs were created, generating nearly M400 million in earnings and national companies benefitted from over M623 million. In addition, the water supplied through the Vaal River system to Gauteng has continued to support service expansion to previously disadvantaged communities and economic growth in Gauteng, which contributes 10 percent of the GDP of the entire African continent.

46. The Phase 2 of the LHWP was officially launched on March 27, 2014 and has the potential to expand benefits to the national economy. The 2011 Agreement for LHWP Phase 2 commits South Africa and Lesotho to the construction of the Polihali Dam and water transfer infrastructure, along with the Kobong Pump Storage Scheme, provisionally identified as the preferred hydropower component. The Government of Lesotho is responsible for the costs of the hydropower and ancillary development activities. The Government of the Republic of South Africa is responsible for the costs of the water transfer activities. The additional financing will be used to support a transparent and predictable regime for finalizing preparation of the hydropower component of the LHWP2, estimated at over US\$1 billion. The fixed operating costs for the pump storage scheme are estimated to be around US\$20 million per year, with the cost of off-peak electricity for pumping around US\$130 million annually under the current tariff in South Africa. The project therefore depends on the price differential between the input tariff for power to pump during off-peak periods and the peak tariffs for power produced by the scheme. The additional financing will support the development of economic and financial models, with corresponding technical assistance, to integrate the model efforts into negotiations with potential power providers and off-takers.

Technical Analysis

47. The additional financing would continue to support the Government of Lesotho's efforts to extend basic water supply services to the people of Lesotho and to support strategic infrastructure developments that capitalize on the Kingdom's natural endowment of water, high altitude and geographic location close to major urban demand centers. Despite significant advances in the institutional and policy environment for the sector, and a concerted period of sustained investments in water supply infrastructure, more than 40 percent of Lesotho's population of approximately 1.8 million people do not have adequate access to water and sanitation services. This is due to various challenges related to uneven distribution of water resources, sector planning and management, and settlement patterns with roughly 75 percent of the population living in dispersed rural areas.

48. Component 3: Additional activities to support WASCo operations and service expansion: The Government has invested significant resources into developing national water resources, improving water supply coverage and levels of service, with a continuing focus on sector development. A sustained government commitment to water supply began in the late 1970s with support for the construction of piped water systems in seven small towns, serving about 50,000 inhabitants, which was complemented with measures to strengthen the government department responsible for urban water supply at the time – the Water and Sewerage Branch. The Lesotho Water and Sewerage Company (WASCo), the corporate successor to the department's successor (the Water and Sewerage Authority), is the national water services provider in urban areas in Lesotho. Capacity strengthening within the utility and policy reforms at the government level have, over time, resulted in WASCo's increasing financial and operational independence, culminating in its incorporation as a company (albeit state owned), and now regulated by the independent Lesotho Electricity and Water Authority.

49. Over the past decade, a series of investments supported by a range of development financiers, as well as local commercial banks, have financed repairs to treatment plants, large network expansions, and extensive connection campaigns, particularly in the capital, Maseru, and its peri-urban areas. Between 2004 and 2012, WASCo increased its water connections from 38,500 to 63,000 – growth of nearly 70 percent. Hours of service were above 18 hours per day on average. Collections from customers were generally at least 95 percent, and the utility's revenues have consistently covered its direct operational costs and its debt service requirements. In addition, it has improved its ratio of non-revenue water to less than 30 percent. However, the rapid expansion of domestic connections in recent years has been undertaken at the cost of the maintenance of older assets, whose age and weaknesses have begun to become evident.

50. WASCo's revenues have been heavily dependent on water consumption from Lesotho's important textile industry which has in the past consumed approximately 40 percent of water sold while numbers only a few hundred connections. Tariffs paid by these industrial consumers have effectively subsidized domestic consumption. More recently, however, the rapid expansion of household connections (almost all among lower-income and lower-consuming households) and slowdowns within the local textile industry have exposed an underlying problem with the structure of water tariffs. This has also put additional pressure on WASCo's ability to adequately maintain its assets and meet the expectations of the expanding urban population in the Lesotho Lowlands, as well as take on the upcoming additional costs of running the Metolong Dam, water treatment works and associated conveyance system. These challenges have been compounded by a large, new activated-sludge wastewater treatment plant for Maseru which does not yet have a significant customer base connected to the sewerage system.

51. In addition to the above structural pressures on WASCo's customer and revenue bases, WASCo began to feel the effects of a series of small challenges beginning around 2010. These included extensive flood damage to key infrastructure, the loss of senior managers and staff, and the loss of institutional history and knowledge. Cumulatively, these began to have larger effects. Perhaps most significantly, WASCo's ability to track its financial position – which had always been a key strength – began to weaken, which has since caused follow-on impacts in operations, customer relations, planning, engineering, and investment. These problems have begun to surface at a key time in the implementation of the MDWSP. WASCo, while not implementing the MDWSP, will be responsible for the operations and maintenance of all of the MDWSP assets. A new management team has been in place at WASCo since early 2013, including a new

Chief Executive, Director of Finance, Director of Engineering, and Director of Operations. They are faced with new operational staff, accumulated maintenance and asset rehabilitation needs, the introduction of a formal regulatory reporting framework and tariff application process, and a backlog of basic financial management tasks.

52. The technical support and equipment would assist in strengthening WASCo's operations, including strengthening its financial management systems, developing reporting and other systems to ensure smooth regulatory reporting, assessing and supporting IT infrastructure and audit capabilities, strengthening planned preventive maintenance and asset management systems, undertaking a comprehensive customer review, reviewing tariff and revenue structures, and developing strategic investment and rehabilitation programs in both existing and proposed service areas. The goal of the assistance is to support WASCo's transition to a largely self-sustaining regulated utility, able to maintain its assets and meet the water supply needs of a growing urban population.

53. Assistance will also be required to enhance WASCo's capacity to take-over, operate and maintain the assets of the MDWSP, which are significantly larger and more complex than WASCo's current assets. Provision has been included in some individual construction contracts for the MDWSP to provide extended support to WASCo during the take-over of the operation of the assets. However, the water treatment works, financed under the MCC Compact, has the most complex operational implications and no guaranteed source of financing for continuing support. Similarly, the construction contract for the dam and raw water pump station does not include provisions for extended support. It is therefore proposed to finance transitional operational support in order to ensure sustainable operations for the water treatment works, raw water pump station and the dam. This will be extended to include support for the establishment of the requisite institutional arrangements and capacity building within WASCo.

54. To enhance the integration and operation of the MDWSP, there is a need for control center and telemetry equipment for monitoring and control of the supply of water from the MDWSP into the various supply zones. Additional GIS, leakage control, pipes and ancillary equipment will also be required to extend the current leakage control zones and provide additional security at particularly vulnerable locations in the distribution system. Computers and associated equipment will need to be enhanced to accommodate the need for improved management of new assets and build on existing financial and operational systems.

55. While focused on short-term measures to assist in strengthening the performance of the utility, the additional financing will also support longer-term strategic investment planning through the Lesotho Lowlands Water Supply Program. The preparation and initial designs for the Lesotho Lowlands Water Supply Program were completed in 2006 with financial support from the EU. These provide the overall framework for the expansion of piped, treated water supply to communities in the Lowlands of Lesotho, where the majority of Lesotho's population resides. Once fully implemented, it is expected that the LLWS will give more than half the population (an estimated 1.3 million people) access to clean water, in addition to improving industrial production capacity, promoting investment in the textile sector and enhancing employment opportunities. The MDWSP is the largest and the first in a series of key investments envisaged under the Lowlands Program. Following the completion of the MDWSP, the GoL intends to take on the next key investments in the LLWSP. The additional financing would deliver instruments that would help formulate an agreed, multi-donor partnership to expand water distribution networks and improve domestic access to safe water in the Lowlands of Lesotho. The sub-

component in support of the Lesotho Lowlands Water Supply Scheme would support: (i) the identification of priority investments under the program; (ii) updates of feasibility studies and environmental and social instruments; (iii) institutional planning for the operation of investments (building on current work under WSIP2); (iv) the preparation of detailed design studies; and, (v) the preparation of bidding documents for civil works and engineering supervision.

56. Component 4: Lesotho Highlands Water Project Phase 2 Hydropower Component. Part of the additional financing will be used to support a transparent and predictable regime for finalizing preparation of the hydropower component of the LHWP2. The preferred option has been provisionally identified as the Kobong Pump Storage Scheme. The proposed scheme could potentially cover the future domestic demand of peak and intermediate loads for Lesotho and therefore eliminate the need for the import of expensive peak and standard energy and for export of peak energy. The revenues from the export would be used for import of less expensive off-peak energy for the pumping mode and for socio-economic development of Lesotho. The Kobong Pump Storage Scheme would take advantage of the existing Katse reservoir constructed under Phase 1A of the LHWP. The upper reservoir could be as high as 111m with the preferred total installed capacity of 1,200 MW assumed in the Feasibility Study. This would allow a transfer capacity (export) of 1,000 MW of peak power, with a peak capacity of 200 MW available for domestic use in Lesotho. However, the optimum installed capacity, and the operation mode of the power station, will need to be determined in the generation system context by running the Kobong Pump Storage Scheme in any off-takers generation system models.

57. Initial studies concluded that the Kobong Pump Storage Scheme was viable from a technical perspective, with manageable environmental and social impacts, but required a series of additional studies and agreements. These included agreement with potential off-takers on the installed capacity and operation mode of the power station, the tariffs and tariff structure which would be regulated through future Power Purchase Agreements, along with additional supporting studies. The additional financing will support these studies and the development of appropriate economic and financial models to assist the GoL in negotiating these agreements. This support is intended to put in place credible governance and institutional arrangements, address revenue mechanisms, and other strategic issues considered essential for advance preparation of the pump storage scheme estimated at over US\$1 billion.

58. The Kobong Pump Storage Scheme is acknowledged in the Integrated Resource Plan for Electricity in South Africa (2010 and 2030) as a 1,200 MW scheme with pumped storage capacity from 2023. South Africa has the largest potential demand for peak power in the southern African region and is a potential supplier of off-peak electricity, making its inclusion central to the potential success of the proposed Kobong Pump Storage Scheme. The Integrated Resource Plan for Electricity in South Africa between 2010 and 2030, first published in 2010, identified the preferred generation technology (and assumed energy efficiency demand side management) required to meet expected demand growth up to 2030. The policy-adjusted IRP subsequently prepared in 2013 incorporated a number of government objectives, including affordable electricity, carbon mitigation, reduced water consumption, localization and, importantly for Lesotho, regional developments, producing a balanced strategy toward diversified electricity generation sources and gradual decarbonisation of the electricity sector in South Africa.

59. The IRP notes that there were no detailed costs to guide the technology choice in the case of the Kobong Pump Storage Scheme. Despite this, the scheme was included in the model but

utilization remained low for the full study period. As a result, the model suggests that it may not be the most cost effective use of capital to invest in another pump storage scheme. However, the IRP is based on a scenario based planning process in which the potential for different demand outcomes has an obvious impact on the capacity requirement. The Base Case and Derivative Scenarios for the demand trajectory were premised on an aspiration for the country and indicate a minimum requirement in order to meet developmental objectives. However, there are severe constraints on the realization of this base case. Electricity demand and economic growth forecasts results in declining electricity intensity expectations over the next forty years and flexibility has a premium to large-scale commitments under such circumstances due, for example, to higher open cycle gas turbine (OCGT) capacity. The proposal in the IRP is that the least regret approach is to accept higher fuel costs (in the higher demand outcome) offsetting the reduced capital costs, which would have been an increased (and possibly under-utilized) burden in the lower demand outcome.

60. The additional financing would support a series of technical preparatory studies through the Phase 2 LHWP Project Management Unit within the Lesotho Highlands Development Authority. The PMU was procured in 2013 by the Lesotho Highlands Development Authority (LHDA) to support implementation of the second phase of the LHWP. The PMU has multi-disciplinary expertise in the construction of large infrastructure projects involving the construction of dams and tunnels and the management of engineering, and the environmental and socio-economic effects of large construction projects on landscapes and the social lives of communities. South Africa is already financing the water transfer related activities within the PMU, and the additional financing would be used to finance the GoL obligations for scaling up the PMU to assist with the hydropower elements.

61. In addition to financing the hydropower component activities of the PMU, additional technical studies required to support further development of the hydropower component would be administered by LHDA with support from the PMU. Many of the required studies have been identified in the 2012 Technical Feasibility Study for the Kobong Pump Storage Scheme. These include a market study to define the installed capacity and operational mode, additional engineering and feasibility studies, a dedicated transmission study to determine the most appropriate and cost effective connection point into the Southern Africa Power Pool, along with development of economic and financial models. The output of these studies will be used by the GoL to identify and confirm the appropriate scheme, determine the necessary input and output requirements and its capacity, subject to which it will assist in the contracting preliminaries, including bills of quantity, draft contract formats, supported through transaction and legal advisors, as required.

62. Additional Technical Assistance to the GoL would be financed under the Credit as part of the activities intended to advance the preparation of the LHWP2. This would be additional to the support for undertaking the studies through the LHDA and the PMU. The technical assistance would include individual advisors to the Ministry of Energy, Meteorology and Water Affairs, the Ministry of Finance, the Lesotho Delegation to the LHWC, and others as may be appropriate during implementation. Areas of expertise include engineering, economic and financial, and hydrology, along with legal and institutional as required, to help inform Phase 2 of LHWP.

Procurement

63. A procurement risk assessment of the LHDA was carried out on 30 January 2014. Using the Procurement Risk Assessment Management System (PRAMS), an implementing agency risk rating of moderate was determined. LHDA's procurement and consultant selection are governed by the LHDA Contract Procedures which forms part of the Governance Manual. LHDA has competitively hired an international firm to provide technical, procurement and contract management support. Provided the staff assigned from the firm are suitably qualified and experienced this arrangement is deemed adequate.

Financial Management Analysis

64. The financial management aspects of the additional Component 4 will be handled by Finance Department of LHDA. The LHDA has been assessed to have mature financial management system to manage a project of this magnitude. The Finance Manager will take ultimate responsibility for financial management. Based on the assessment the financial management risk is assessed as Low.

65. The LHDA will open a designated account to receive and report on the proceeds of the loan. Disbursements into the designated account will be based on unaudited interim financial reports. The computerized accounting system (SAGE) will be used to account and report on the use of funds. Unaudited IFRs will be submitted quarterly to the Bank for reporting and disbursement purposes.

66. Entity audited annual financial statements will be submitted to the Bank six months after the end of the fiscal year. Project specific activities will be disclosed by the notes to the audited financial statements.

Social Analysis

67. The additional financing is intended to support strategic studies, technical assistance, equipment and training with no anticipated social impacts associated with the envisaged activities. The additional financing will not finance any civil works but will support studies that could result in substantial investments in the hydropower elements of the LHWP, such as the Kobong Pump Storage Scheme. The studies in support of the Lowlands Water Supply Program are also likely to lead to a series of investments in further water supply infrastructure. The additional financing includes support for social assessments and associated resettlement instruments to provide bankable solutions that can guide any future investments.

Environmental Analysis

68. There are no anticipated environmental impacts associated with the activities envisaged under the additional financing. However, the original project is classified Category A due to its support to the MDWSP. The additional financing will not finance any civil works but will support studies that could result in substantial investments in the hydropower elements of the LHWP, such as the Kobong Pump Storage Scheme. The studies in support of the Lowlands Water Supply Program are also likely to lead to a series of investments in further water supply infrastructure. The additional financing includes support for environmental assessments and associated environmental instruments to provide bankable solutions that can guide any future investments.

ANNEX 1: REVISED RESULTS FRAMEWORK AND MONITORING INDICATORS
Lesotho: Water Sector Improvement Project, Phase 2 Additional Financing (P149467)

Revisions to the Results Framework

Revisions to the Results Framework		Comments/ Rationale for Change
PDO		
<i>Current</i>	<i>Proposed</i>	
To support the Kingdom of Lesotho in: (i) developing and sustaining an environmentally sound, socially responsible, and financially viable framework for the Metolong Dam and Water Supply Program (MDWSP), (ii) increasing the quantity of safe, bulk water supplied to Teyateyaneng, and (iii) strengthening institutions and related instruments in the water sector.	To support the Kingdom of Lesotho in: (i) developing and sustaining an environmentally sound, socially responsible, and financially viable framework for the Metolong Dam and Water Supply Program (MDWSP), (ii) increasing the quantity of safe, bulk water supplied to Teyateyaneng, (iii) strengthening institutions and related instruments in the water sector, and (iv) advancing strategic infrastructure investments.	Inclusion of additional element reflects new activities included under the additional financing.
PDO indicators		
<i>Current</i>	<i>Proposed change</i>	
EMP successfully implemented	None	Retained
CRCAP* successfully implemented	None	Retained
WASCo's operational cost ratio maintained at equal or more than 100%	None	Retained
People in project areas with access to 'Improved Water Sources'	None	Retained
State of Water Resources Report prepared, consulted and publically available	None	Retained
	Strategic investments advance	Reflects new activities under AF
Intermediate Results indicators		
Component 3: Institutional Support and Capacity Building		

Revisions to the Results Framework		Comments/ Rationale for Change
<i>Current</i>	<i>Proposed change</i>	
Number of water utilities that the project is supporting	None	Retained
Regulatory instruments governing the urban water sector updated	None	Retained
WASCo Hydraulic Model Prepared	None	Retained
	Lowlands Water Supply Scheme Advanced	Reflects new activities under AF
Component 4: Lesotho Highlands Water Project Phase 2 Hydropower Component		
	LHWP2 Hydropower Component Confirmed	Reflects new activities under AF

Project Name: Lesotho WSIP2 AF: LHWP Ph2 Pump Storage (P149467)		Project Stage: Additional Financing	Status: DRAFT
Team Leader: Marcus J. Wishart	Requesting Unit: AFCS1	Created by: Marcus J. Wishart on 09-Apr-2014	
Product Line: IBRD/IDA	Responsible Unit: AFTN2	Modified by: Marcus J. Wishart on 19-May-2014	
Country: Lesotho	Approval FY: 2014		
Region: AFRICA	Lending Instrument: Investment Project Financing		
Parent Project ID: P108143	Parent Project Name: Water Sector Improvement APL Phase II: Metolong Dam and Water Supply (P108143)		

Project Development Objectives

Original Project Development Objective - Parent:

The Project Development Objectives is to support the GoL in: (i) developing and sustaining an environmentally sound, socially responsible, and financially viable framework for the MDWSP; (ii) an increase in the quantity of safe, bulk water supplied to Teyateyaneng; and, (iii) strengthening institutions and related instruments in the water sector.

Key project indicators include:

- Cultural heritage plan in the catchment area is successfully implemented;
- Environment Flow Requirements (EFRs) established and monitored;
- Livelihood restoration program successfully implemented;
- Water supply to Teyateyaneng increased; and
- Independent urban water regulation implemented.

Proposed Project Development Objective - Additional Financing (AF):

To support the Kingdom of Lesotho in: (i) developing and sustaining an environmentally sound, socially responsible, and financially viable framework for the MDWSP, (ii) increasing the quantity of safe, bulk water supplied to Teyateyaneng, (iii) strengthening institutions and related instruments in the water sector; and (iv) advancing strategic infrastructure investments.

Results

Core sector indicators are considered: Yes

Results reporting level: Project Level

Project Development Objective Indicators							
Status	Indicator Name	Core	Unit of Measure		Baseline	Actual(Current)	End Target
No Change	Environmental Management Plan successfully implemented	<input type="checkbox"/>	Text	Value	No		YES
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment	Successful implementation of the Environmental and Social Action Plan is an aggregate of the lower levels of the results chain. Successful implementation implies the objectives of the ESAP are achieved and individual components met such that the natural environment is sustained. This will be determined through annual environmental and social audits of the ESAP.	On track. Contractors implementing MA-approved-EPP satisfactorily. EPP ¹ for the Dam still to be approved by MA (minor revisions, expected done). Dam construction is ongoing and in compliance with EPP procedures	Successful implementation of the Environmental and Social Action Plan

¹EPP-Environmental Protection Plan.

No Change	Comprehensive Resettlement and Compensation Action Plan successfully implemented	<input type="checkbox"/>	Text
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Value	No		Yes
Date	30-Jun-2009	07-April-2014	30-Jun-2016
Comment	Successful implementation of the RAP is an aggregate of the lower levels of the results chain. Successfully implementation implies the objectives of the RAP are achieved and individual components met and that the project-affected people benefit. This will be determined through annual environmental and social audits of the ESAP supported by the socio-economic monitoring during and after implementation.	On track. Total payments M39.5 million (US\$3.9m) made to 2,057 PAPs, 89% of all those ID'd Consolidated CRCAP drafted, submission pending MDWSP completion	Successful implementation of the RAP

No Change	WASCo's operational cost ratio maintained at equal or more than 100%	<input type="checkbox"/>	Percentage	Value	100.00		100.00
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment		WASCo's 2012/2013 operational cost coverage ratio (incl. depreciation & uncollected revenues) =120% - a significant improvement over the 103% last year.	WASCo's operational cost ratio maintained at equal or more than 100%
No Change	OLD Version of Indicator: People in project areas with access to Improved Water Sources	<input checked="" type="checkbox"/>	Number	Value	20000.00	20000.00	25000.00
				Date	30-Jun-2004	07-April-2014	30-Jun-2016
				Comment	The estimated number of people in TY in 2004 was 20,000 (Based on the Lowlands Feasibility study of 2004)	On track - TY pipeline 86% complete.	Number of people in TY with access to Improved Water Sources
No Change	State of Water Re-sources Report pre-pared, consulted and publically available	<input type="checkbox"/>	Yes/No	Value	No	No	Yes
				Date	10-Nov-2011	07-April-2014	30-Jun-2016
				Comment	PDO outcome indicator added with Add Financing to reflect expected results in institutional strengthening.	2 nd SoWR draft with training support and 3 rd under preparation	State of Water Re-sources Report pre-pared, consulted and publically available

No Change	Direct project beneficiaries	<input checked="" type="checkbox"/>	Number	Value	0.00	0.00	30000.00
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment	Baseline not available - total number estimated based on TY beneficiaries and those from WATSAN improvement.	First delivery of MDWSP water expected Nov, 2014. ID'd WATSAN 2 beneficiaries = 14,737	Total number estimated based on TY beneficiaries and those from WATSAN improvement.
No Change	Female beneficiaries	<input checked="" type="checkbox"/>	Percentage Sub Type Supplemental	Value	0.00	0.00	18000.00
New	Strategic infrastructure investments advanced	<input type="checkbox"/>	Amount(USD)	Value	1300000000.00		1300000000.00
				Date	31-Oct-2012		30-Jun-2016
				Comment	Lowlands Bulk Water Supply Scheme in 2006 estimated investment at US\$300m and Kobong pump storage feasibility study completed in 2012 at US\$1 billion		Financing secured for implementation of the Lowlands Bulk Water Supply Program and negotiations concluded for the hydropower component of LHWP2.

Intermediate Results Indicators

Status	Indicator Name	Core	Unit of Measure		Baseline	Actual(Current)	End Target
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No Change	Environmental Flow Requirements determined, incorporated into design, and applied	<input type="checkbox"/>	Text	Value	no EFR determined		Monitored
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment	IFR set at 11% of MAR.	Monthly monitoring still ongoing at 4 sites including training	IFR implemented and monitored.
No Change	Cultural Heritage sites identified and recorded	<input type="checkbox"/>	Number	Value	0.00	30.00	30.00
				Date	23-Apr-2009	07-April-2014	30-Jun-2016
				Comment	Cultural Heritage Sites "preserved" means those sites inundated by the reservoir are documented and that this documentation is available.	Nine Rock Art panels removed and in temporary storage in Roma prior to transition to Thaba Bosiu. Long-term mgmt. under discussion. Ph4 completed and final report satisfactory.	Cultural heritage plan successfully completed
No Change	% PAPs with assets directly impacted receiving compensation as agreed in CRCAP	<input type="checkbox"/>	Text	Value	none		100%
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment	Livelihood restoration will feed into the higher levels of the results chain and will be determined through annual environmental and social audits of the	89% of all Project Affected People identified have been paid and 90% of total compensation paid.	CRCAP successfully implemented and compensation paid.

					ESAP supported by the socio-economic monitoring during and after implementation.		
No Change	Improved community water points constructed or rehabilitated under the project	<input checked="" type="checkbox"/>	Number	Value	0.00	0.00	473.00
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment	No water & sanitation in catchment communities.	Design of WATSAN in 35 villages ongoing.	WATSAN program successfully implemented in 35 catchment communities
No Change	# kms of pipeline laid & operational	<input type="checkbox"/>	Kilometers	Value	0.00	2.20	28.00
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment		96% of TY pipe laid; with 86% overall completion	TY pipeline and associated infrastructure successfully completed.
No Change	Number of water utilities that the project is supporting	<input checked="" type="checkbox"/>	Number	Value	1.00	1.00	1.00
				Date	30-Jun-2009	07-April-2014	30-Jun-2016
				Comment	Indirect support to WASCo through the provision of water supply	WASCo's 2012/2013 operational cost coverage ratio (incl. depreciation & uncollected revenues) =120% -	WASCo financially sustainable and technically competent.

					infrastructure under the MDWSP and independent regulation through support to LEWA.	a significant improvement over the 103% last year.	
No Change	Regulatory instruments governing the urban water sector updated	<input type="checkbox"/>	Yes/No	Value	No	No	Yes
				Date	30-Jun-2011	07-April-2014	30-Jun-2016
				Comment	Added to measure results of support to LEWA	First water license issued and tariff application under review.	Successful regulation under implementation.
No Change	WASCo Hydraulic Model Prepared	<input type="checkbox"/>	Yes/No	Value	No	No	Yes
				Date	30-Jun-2011	07-April-2014	30-Jun-2016
				Comment	No model for integration of the MDWSP assets.	Model applied to scenario planning for integration of MDWSP	Model successfully informing operational decisions.
New	Lowlands Water Supply Scheme Advanced	<input type="checkbox"/>	Yes/No	Value	No		Yes
				Date	01-May-2014		30-Jun-2016
				Comment	No financing available due to status of preparations.		Financing secured for implementation of the Lowlands Scheme
New	LHWP2 Hydropower Component Advanced	<input type="checkbox"/>	Yes/No	Value	No		Yes
				Date	01-May-2014		30-Jun-2016

				Comment	No agreement between Lesotho and South Africa on implementation of the LHWP2 hydropower component		Agreement between Lesotho and South Africa on implementation of the LHWP2 hydropower component
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ANNEX 2: OPERATIONAL RISK ASSESSMENT FRAMEWORK (ORAF)
Lesotho: Water Sector Improvement Project, Phase 2 Additional Financing (P149467)

Project Stakeholder Risks						
Stakeholder Risk	Rating	Moderate				
<p>Risk Description:</p> <p>There is a complex array of internal and external stakeholders, reflecting the bi-national and multi-sectoral nature of the LHWP. This complexity could pose challenges in reaching consensus positions on the approach to development of hydropower component and its position within LHWP Phase 2.</p> <p>Different interests among the various stakeholders, with a focus in South Africa on the water delivery and in Lesotho on the pump storage, could create competing demands that detract from achieving the desired development outcomes.</p> <p>The LHWP is internationally recognized and the focus of considerable attention. There is a high risk that the supporting preparation will result in increased scrutiny of the WBG involvement in the LHWP and domestic criticisms for supporting the “export” of water.</p> <p>International NGOs may criticize the project.</p>	<p>Risk Management:</p> <p>The Phase 2 agreement on the LHWP signed on August 11, 2011 and has been ratified, with the Government of Lesotho holding a series of discussions to ensure a consensus position within Government. This is now clearly articulated in the request for WBG support.</p> <p>Frequent engagement with various stakeholders based on transparent principles and building on the history of WBG engagement in the LHWP has helped to position the WBG as an honest broker. This is re-enforced through a focus on analytical work to help position the support appropriately and dual implementation through the LHDA and the MEMWA.</p> <p>Government’s efforts to advance on the parallel process of developing national water resources infrastructure through the Lowlands Water Supply Scheme will help balance the export opportunities with national expectations.</p>					
	Resp:	Status:	Stage:	Recurrent:	Due Date:	Frequency:
	Both	Implementation				Not Yet Due
Implementing Agency (IA) Risks (including Fiduciary Risks)						
Capacity	Rating	Low				
<p>Risk Description:</p> <p>There is a risk that institutional capacity within the new implementing agency is not sufficient to oversee implementation of a highly complex project within a bi-national, multi-stakeholder context.</p> <p>There is a risk that institutional capacity within the Lowlands Water Supply Unit is not sufficient to oversee implementation of the</p>	<p>Risk Management:</p> <p>The LHDA has well established systems and has previously executed WBG financed projects under the LHWP. A dedicated Divisional Manager has been appointed for Phase 2 and is supported by a Project Management Unit. Additional Technical Assistance will be supported to provide guidance to the Government in advancing negotiations and aligning within the context of the broader Phase 2 LHWP.</p> <p>The Lowlands Unit has new management and TA support from the EU to strengthen capacity.</p>					

updates to the 2006 feasibility studies and this may delay the implementation of key elements to advance on the updates ad reaching financial closure within the two years available.	Resp: Both	Status: Preparation	Stage:	Recurrent:	Due Date:	Frequency: In Progress
Governance	Rating	Low				
Risk Description: A poor governance and weak fiduciary environment would undermine the quality of the outputs, limit the value for money and undermine the ability of the GoL and the LHWC to advance with development of the hydropower component. The bi-lateral nature of the project increases the complexity of the governance arrangements and has the potential to delay implementation, undermine the outcome of the studies and delay on the necessary negotiations required to reach closure.	Risk Management: The LHWC and LHDA have instituted a robust governance framework drawing on lessons from Phase 1A. This is embedded in the Treaty, the Protocol VI and the Phase 2 Agreement. Specific policy provisions include independent auditing and comprehensive oversight mechanisms. The project will also support an institutional assessment to outline a roadmap for addressing any issues around institutional arrangements and governance concerns.					
	Resp: Both	Status: Preparation	Stage:	Recurrent:	Due Date:	Frequency: Not Yet Due
Project Risks						
Design	Rating	Substantial				
Risk Description: The LHWP is a large and complex program with demanding technical and engineering expertise. The inclusion of two components at different stages of development introduces a risk of the hydropower component being left behind in implementation and limiting the ability of the GoL to advance with development of the hydropower component. The financial viability of the proposed hydropower scheme is dependent upon securing the necessary Power Purchase Agreements. These take time and require complex negotiations within the context of the LHWP2 that could jeopardies the timeline for conclusion of the financing.	Risk Management: The additional financing is intended to specifically address the risks by assisting the GoL to provide a predictable, transparent schedule for advancing the studies, taking advantage of the existing project to expedite their implementation. The LHWP2 Agreement includes specific commitments between the two countries and provides for support to the hydropower component. The studies under the AF will inform the negotiations to conclude the provision of these agreements with additional support from specialized TA to assist in guiding the process.					
	Resp: Both	Status: Preparation	Stage: Both	Recurrent:	Due Date:	Frequency: In Progress
Social and Environmental	Rating	Moderate				
Risk Description:	Risk Management:					

Studies supported under the AF will lead to significant infrastructure development and so the quality of the studies under the AF will inform the risk profile associated with subsequent development phases for both the hydropower component of LHWP2 and the Lowlands Water Supply Scheme.	The GoL has requested the WBG to support preparation to provide the international benchmarks and best practice that will provide a transparent, predictable regime for subsequent development of the hydropower component and the Lowlands Water Supply Scheme.					
	Resp: Both	Status: Implementation	Stage:	Recurrent:	Due Date:	Frequency: Not Yet Due
Program and Donor	Rating	Moderate				
Risk Description: The AF to the WSIP2 introduces two additional sets of activities, a new implementing agency, and a required higher level of coordination between an existing implementing agency and WASCo, all of which could slow implementation. There is risk that the level of financial commitment required to ensure implementation of the recommended studies for both the hydropower component and the Lowlands Water Supply Scheme might not be achievable in relatively short duration (2yrs).	Risk Management: Ring fencing the hydropower component and the lowlands studies isolates any risks to the ongoing MDWSP, and helps to direct the discussions and negotiations to securing appropriate financing for both projects.					
	Resp: Bank	Status: Preparation	Stage: Both	Recurrent:	Due Date:	Frequency: In Progress
Delivery Monitoring and Sustainability	Rating	Substantial				
Risk Description: The outcome is measured in the successful contribution of the studies to the development of hydropower component under Phase 2 of the LHWP and to the readiness for investment of Lowlands water supply. With respect to the hydropower component, there is a risk that the outputs from the AF will not secure the power purchase agreements require to ensure financing for development. With respect to Lowlands water supply expansion, there is a risk that other investment needs within the country may take priority, leading to a further postponement of these investments.	Risk Management: The LHWP has a strong governance framework for facilitating implementation, with the commitment of Lesotho and South Africa to implementation articulated through the Treaty and Agreement on Phase 2 of the LHWP. Specific transaction advisors, TA and modeling will help strengthen the position to close the necessary negotiations. Preparation of the AF has facilitated discussion with GoL and a range of potential partners to identify potential sources of financing. Positive indications supported by continual engagement and timely studies should help mitigate the risk and assist the GoL to secure the financing required for implementation.					
	Resp: Both	Status: Preparation	Stage:	Recurrent:	Due Date:	Frequency: Not Yet Due
Overall Risk						

Overall Implementation Risk:	Rating	Moderate
<p>Risk Description:</p> <p>The overall risk rating is Moderate. The activities intended to be supported by the Additional Financing are clearly defined and the client has articulated a clear road-map for ensuring timely implementation. However, the bi-lateral nature of some of the activities and the complex process of negotiations introduces risk elements beyond the control of the project. Activities have been included that are intended to mitigate these risks.</p>		

ANNEX 3: REVISED IMPLEMENTATION ARRANGEMENTS AND SUPPORT

Lesotho: Water Sector Improvement Project, Phase 2 Additional Financing (P149467)

1. The additional financing will introduce a new Component 4 to be implemented through a new implementing agency, the Lesotho Highlands Development Authority (LHDA). The LHDA was established under Article 7 of the LHWP Treaty with responsibility for the implementation, operation and maintenance of that part of the LHWP situated in the Kingdom of Lesotho, in accordance with the provisions of the Treaty which vests it with all the powers necessary for the discharge of such responsibilities.
2. The LHDA is managed by a Board of Directors appointed and overseen by representatives of the two Governments through the Lesotho Highlands Water Commission. Under the Treaty this Board was appointed by Lesotho in order to establish the policy of the LHDA in accordance with the provisions of the Treaty, giving priority to its duties arising from the delivery of water to South Africa and the generation of hydro-electric power in the Kingdom of Lesotho as its primary functions. Protocol VI amended this provision to empower the LHWC with responsibility for appointment of the Board. Non-executive members are nominated by Lesotho and the executive members from nominations submitted by the Chairperson.
3. The provisions of the Treaty require the Lesotho Highlands Development Authority to apportion all costs incurred by the Authority to one or more of the following activities: i) the delivery of water to South Africa; ii) the generation of hydroelectric power in the Kingdom of Lesotho; or, iii) Ancillary developments in the Kingdom of Lesotho envisaged under the provisions of paragraph (2) of Article 4. These are to be done on the basis of the accounting and costing systems and procedures referred to in paragraph (19) of the Treaty. The Government of the Kingdom of Lesotho is, by way of Cost Related Payments, responsible for the costs of the Hydropower and Ancillary Development activities. The Government of the Republic of South Africa is, by way of Cost Related Payments, responsible for the costs of the water transfer activities.
4. The LHDA maintains separate banking accounts for: (a) all amounts received from South Africa as cost related payments as provided for in Article 10 as well as amounts drawn down on loans or other borrowings procured for the implementation, operation and maintenance of that part of the Project relating to the delivery of water to South Africa; and; (b) all amounts received from Lesotho as cost related payments as provided for in Article 10 as well as all amounts drawn down on loans and other borrowings procured for the implementation, operation and maintenance of that part of the Project relating to the generation of hydro-electric power in the Kingdom of Lesotho or for the developments envisaged by the provisions of paragraph (2) of Article 4.
5. The costs incurred in the implementation and construction of the LHWP, including costs incurred prior to the establishment of the Authority, but excluding the costs of operations, are capitalized and shown as fixed assets work-in-progress. Hydropower and water transfer components are transferred to completed works when the work is completed, whilst ancillary development costs are transferred to the capital fund. After completion such costs capitalized to work-in-progress are transferred to the capital funds. The costs comprise all attributable costs of bringing the asset or group of assets to working condition for their intended use, and include inter alia:

- a) All costs of investigations, surveys, feasibility studies, engineering studies, preparation of designs, constructions, construction supervision, procurement and commissioning;
- b) The establishment and net administration costs of the Authority, other than those assigned to operations;
- c) The costs of any land or interest in land, and any improvements in such land;
- d) The costs of measures taken in order to ensure that members of local communities in Lesotho are not adversely affected by Project related activities, including the cost of providing compensation, and a provision for estimated future compensation;
- e) All finance charges and income (including interest payments, financing and foreign exchange cover charges, gains and losses on foreign exchange and other charges) relating to finance raised to fund capital expenditure, up to the date of commencement of operations.

6. Apportionment of the capital costs is subject to ratification by the Parties to the Treaty. The ratification of costs between Hydropower, Ancillary Development and Water Transfer is subject to agreement by the Parties to the Treaty. Such agreements are reflected as prior year reallocations within work-in-progress and transferred to completed works for the hydropower and water transfer components or capital funds for the ancillary development component, unless capitalization had already ceased in which case such reallocation are transferred to the respective capital funds.

7. The costs of operating and maintaining the completed works including depreciation and financing costs are divided between hydropower and water transfer activities on the basis of an agreement between Lesotho and South Africa dated February 2002. Such cost allocations are transferred to the hydropower reserves or to the Government of South Africa Capital Fund. Likewise revenues arising as a result of operations or cost related payments in support of operations are credited to the respective hydropower or water transfer activities.

8. Completed works are stated at cost as transferred from capital work-in-progress upon completion, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Such cost includes the cost of replacing part of such plant and equipment when that cost is incurred if the recognition criteria are met. Depreciation is calculated on a straight line basis over the useful life of the assets. The carrying values of plan and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal.

9. The total annual expenditure for LHDA in 2012 was ZAR/LSL 486,457,000 (~US\$60m) including ZAR/LSL 306,340,000 (~US\$38m) in depreciation expenses. Based on this, the annual operating budget is estimated around ZAR 180,000,000 (US\$22m). The authority had 267 employees at the end of financial year March 2012.

Procurement

10. A procurement risk assessment of the LHDA was carried out on 30 January 2014. Using the Procurement Risk Assessment Management System (PRAMS), an implementing agency risk rating of moderate was arrived at. LHDA's procurement and consultant selection are governed by the LHDA Contract Procedures which forms part of the Governance Manual. LHDA has competitively hired an international firm to provide technical, procurement and contract

management support. Provided the staff assigned from the firm are qualified and experienced this arrangement is deemed adequate.

Financial Management Analysis

11. The financial management aspects of the projects will be handled by Finance department of LHDA which has been assessed to have matured financial management system to manage the project of this magnitude. The Finance Manager will take ultimate responsibility for financial management.

12. The entity will open a designated account to receive and report on the proceeds of the loan. Disbursements into the designated account will be based on unaudited interim financial reports.

13. Computerized accounting system called SAGE will be used to account and report on the use of funds. Unaudited IFRs will be submitted quarterly to the Bank for reporting and disbursement purposes.

14. Entity audited annual financial statements will be submitted to the Bank six months after the end of the fiscal year. Project specific activities will be disclosed by the notes to the audited financial statements.

15. Based on the assessment the financial management risk is assessed as Low.

ANNEX 4: MAP OF LESOTHO

Lesotho: Water Sector Improvement Project, Phase 2 Additional Financing (P149467)

