1. Country and Sector Background

At the national level, the delivery of WSS services in Kenya is currently fragmented into various regimes under the direct responsibilities of the Ministry of Water Resources Management and Development (MWRMD), the corporatized National Water Conservation and Pipeline Corporation (NWCPC) and local authorities. The MWRMD operates 73 piped ‘urban’ water systems serving a total of about 52,000 connections and 1.4 million people. MWRMD also operates about 555 piped water systems in rural areas serving a total of 230,000 connections and 4.7 million people. NWCPC (a parastatal created in 1988 to take over operations from MWRMD in areas considered to be commercially viable) operates piped systems in 221 urban centers totaling 93,000 connections and a population of about 2.2 million. These include Mombasa and the Coastal Region. MWRMD and NWCPC do not operate wastewater facilities, leaving these (where they exist) to local authorities. Meanwhile, ten gazetted local authorities (including Nairobi) operate their own WSS systems. It is only in these ten urban centers that water supply and sewerage systems are operated by the same entity. Outside these areas, ‘self
help’ groups (registered with the Ministry of Gender, Sports, Culture and Social Services) operate about 355 piped water supply systems in urban and rural areas serving about 2.3 million people and about 10,000 water points serving about 2.6 million people. The deterioration of public piped water systems has also catalyzed the growth of a water vending industry of small scale independent providers.

**Water Supply and Sewerage Issues in Nairobi**

In Nairobi, the service is currently provided by the Water and Sewerage Department (WSD), a technical department within the Nairobi City Council (NCC). WSD’s lack of operational and financial autonomy has been determined to be a major factor causing poor and unsustainable operations. The service is caught in a cycle of declining investment, quality of service and financial returns characterized by: (i) low coverage and unreliable service; (ii) high levels of unaccounted for water (UfW) and of unpaid bills; (iii) very poor financial management; (iv) a tariff insufficient to cover operations and maintenance (O&M) costs; (v) inadequate commercial management. This has translated to inadequate service to the population, including to the informal settlements in Nairobi, where the vast majority of the urban poor reside.

**Government Response**

The Government of Kenya’s (GOK) National Water Policy (1999) and the Government Action Plan for the implementation of its Poverty Reduction Strategy envisage reaching full coverage of access to safe water to the country’s population. This is an ambitious target. The long term goal as reflected in the CAS the envisages the expansion of services from the current estimated 60% to 90% by 2024. In the medium term, the MDG target envisages about 70% coverage by 2015. The MDG also envisages access to improved sanitation reaching about 93% by 2015. Achieving these development goals represents a big challenge to the GOK.

The GOK recognizes the need for comprehensive institutional reform and investments in the WSS sector in order to remove the bottlenecks to achieving its set poverty reduction objectives. In recent years, GOK has engaged in a series of efforts aimed at formulating a clear policy and strategy to address the fragmented institutional framework for service delivery. The National Policy on Water Resources Management and Development and the Country Strategy Paper for the Water Sector were drafted. Efforts to formulate a comprehensive and integrated new water supply and sanitation and water resources management legislation to replace the various existing legislations under which water and sanitation services were governed were started.

In 2000, the World Bank in conjunction with other development partners (KfW, GTZ, AFD and the Water and Sanitation Program - WSP) carried out a comprehensive review of the WSS sector covering aspects such as demand assessment, pricing, decentralization, private sector participation, financing mechanisms and capacity building. The review represented development partners’ contribution to the dialogue and effort towards sector reform and was aimed in part to assist the GOK to finalize the new legislation. The GOK also secured financing from the Public Private Infrastructure Advisory Facility (PPIAF) to investigate the options for private sector participation (PSP) in water and sewerage services in Nairobi, Mombasa and Kisumu. These studies indicated that significant PSP is possible in Nairobi and Mombasa while lower forms of
PSP may be possible in Kisumu. However, they also indicated that significant institutional restructuring, revision of legislations, tariff revisions and considerations for a range of commercial improvement investment (e.g. improvements to commercial systems, improvements to technical and financial data and urgent rehabilitation of critical infrastructure) were needed prior to the introduction of PSP in operations.

Water Act (2002) is aimed at providing for a harmonized and streamlined management of water resources and water supply and sewerage services. With regards to the WSS services, the Water Act (2002) calls for a uniform service delivery institutional framework to be put in place country-wide. It also clarifies the new mechanisms and the role of the various actors within that framework. Responsibility for water and sewerage assets, their development and the provision of service will lie with new Water Services Boards (WSBs). These Boards would contract out water delivery services to Water Service Providers (WSPs). A Water Services Regulatory Board (WSRB) would regulate the service provisions and among others, would determine applications for licensing of WSBs, advise on tariffs and levies, and determine and monitor service delivery standards. A Water Services Trust Fund (WSTF) would be created to assist in financing the provision of water services to areas without adequate water services. These separate institutions effectively separate the functions of policy formulation, service delivery and regulation of the water and sanitation sector, and open the door for private investors and service providers.

Given the current state of the sector, the reform process will be complex. The large magnitude and range of activities in various areas that are necessary to carry out the sector reform in full to arrive at a uniform, efficient and sustainable service delivery entails implementation through a phased approach. Initial GOK efforts are aimed at institutional restructuring – the creation, operationalization and strengthening of the new institutions and the smooth transfer of responsibilities from existing asset owners and service providers to the new institutions. The WSRB and WSTF have been formed. With respect to WSBs, the GOK has focused on the Nairobi area, by forming the Nairobi Water Services Board (NWSB). The NCC has formed a WSP (Nairobi City Water And Sewerage Company – NWSC) as a separate company under the Companies Act, with the intention that it will be contracted by NWSB to provide service delivery. The GOK has requested the assistance of the World Bank to support these efforts in Nairobi.

A comprehensive communications program will be implemented in parallel with the institutional restructuring effort to inform and involve stakeholders in the reform process. Having brought about the structural changes, the next challenge would be to create long term efficient and sustainable operational and management systems within this structural framework. This would include the consideration for various options (including public and private sector participation options) acceptable to all stakeholders as a means to ensuring sustainability and increasing efficiency. The long term system/option will be developed with full stakeholder participation through the communications program to ensure strong support.

2. Objectives
The development objective of the proposed project is to build a strong governance, institutional and service delivery framework that will enable the efficient and sustainable delivery of water and sewerage services to the population of Nairobi. The project will support the creation and strengthening of new autonomous and ring-fenced service provision utilities – with clear roles, responsibilities and contractual arrangements. The key outcome will be an institutional framework that is capable of delivering safe, clean and affordable services to all strata of the Nairobi population in accordance with commercial and sustainable principles. Progress towards achieving the development objective will be monitored principally through the improvement in operating sustainability of the service delivery institutions throughout the project implementation period.

3. Rationale for Bank Involvement

WSS provision plays a critical role in the GOK’s economic recovery strategy. The Project will directly support the GOK’s policy and strategy in reforming its WSS sector. The Bank is uniquely positioned to assist the GOK to reform and improve the WSS service in Nairobi, having had direct and substantial experience in supporting WSS projects in the primary cities in Kenya (Nairobi and Mombasa). Since the end of its last operation in Nairobi in 1998, the Bank has kept an active dialogue with the GOK on issues and solutions to be addressed and implemented to ensure sustainability, reliability and affordability of the WSS service. In support of the GOK formulation of the Water Act, the Bank (in collaboration with KfW, GTZ and AFD) carried out a comprehensive review of the WSS sector covering aspects such as demand assessment, pricing, decentralization, private sector participation, financing mechanisms and capacity building. The Bank played a key role to assist GOK with the studies to investigate private sector participation options in Nairobi, Mombasa and the Coastal Region and Kisumu. The Bank is also leading a review of water resources management (WRM) issues jointly carried out with several financing agencies involved in the water sector.

Under the Water Act, for the first time the GOK has adopted its own sector wide framework and is committed to implement it. Given that this project represents one of the first implementation of the Water Act, the Bank would be supporting the GOK at a crucial point of sector reform. Success in implementing this Project is likely to lead to a scaling up of the institutional reforms in the sector especially with regard to the large urban cities. It is generally acknowledged among the GOK’s development partners community that the Bank has the comparative advantage in the large urban centers – Nairobi and Mombasa – and its leadership is most appropriate for supporting WSS in these areas. Discussion, cooperation and coordination among GOK’s development partners active in the WSS sector are provided through Water and Sanitation Technology Group (WSTG), comprising GOK’s development partners as well as the Bank. Outside Nairobi and Mombasa, other international agencies are active in secondary cities and small towns (AFD, KfW, ADB, Italy, Austria, JICA), and in rural areas (Finnida, Belgium, JICA, SIDA). Various NGOs are active in rural and informal settlements, including Kibera in Nairobi.

4. Description
The project has the following three major components, with a total project cost of US$16.3 million equivalent, of which IDA will finance about US$15.0 million in the form of an IDA Grant. The remaining will come from direct Government contribution and internal revenue of the water and sewerage operations.

**Component 1: Institutional Strengthening of New Service Delivery Framework (about US$5.6 million excluding contingencies).** This component will support the setting up and operationalization of (i) a new autonomous asset holding entity - Nairobi Water Services Board (NWSB); and (ii) a new autonomous and ring-fenced water and sewerage service provision company for Nairobi. The new institutions will be appropriately strengthened to ensure professional management and commercial operations.

**Component 2: Immediate Services Delivery Improvement Program (about US$6.2 million excluding contingencies).** This component will support selected activities aimed at strengthening the commercial, financial and technical operations of the service provision company – Nairobi City Water and Sewerage Company (NWSC). The focus will however be on strengthening the commercial operation of the six area/business centers. Some tangible service improvements to consumers are expected and specific service improvement targets will be set for the new institutions in the duration of the Project.

**Component 3: Project M&E, Consultations and Communications, and Preparation of Follow-on Program (about US$3.6 million excluding contingencies).** This component will support monitoring of project activities, implementation of a complementary communication program in support of the new institutional transformation in services provision as well as support the preparation of follow-on investment program in Nairobi and Mombasa.

5. Financing

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<th>Source</th>
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<td><strong>Total</strong></td>
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6. Implementation

The proposed Grant will primarily support the Nairobi Water Services Board (NWSB) and the Nairobi City Water and Sewerage Company (NWSC). NWSB and NWSC will be the project implementing agencies with responsibilities for the project’s procurement and financial management requirements for their respective project components. Project preparation activities for follow-on support in the Nairobi area will be carried out by NWSB. Activities outside NWSB’s area of jurisdiction will be carried out by MWRMD or the relevant services board. Under a special arrangement, NWSB will be responsible for the selection of consultants and sign contracts for these activities. IDA will have separate Project Agreements with NWSB and
NWSC. The proceeds of this institutional restructuring will be passed on to NWSB and NWSC as GOK grants.

NWSB will be issued with a Provisional License from WSRB to enable it to provide services. NWSB was gazetted by the Minister of Water Resources Management and Development on March 21, 2003. Subsidiary agreements will be signed between the Government and NWSB, and the Government and NWSC respectively effective for the duration of the project (including provision for extension if the project is extended). These agreements will specify the terms and conditions under which the components of the project will be financed by GOK (using proceeds from the IDA Grant) and implemented by NWSB and NWSC respectively.

NWSC will be NWSB’s Water Service Provider. NWSC and NWSB will sign a Service Provision Agreement (SPA) effective for the duration of the project (including provision for extension if the project is extended). The SPA specifies terms and conditions under which the water and sewerage services is to be provided to customers, consumption has to be metered and billed, and bills to be collected. The SPA also specifies how both NWSC and NWSB are to be remunerated from the collection of bills and other income, and the mechanics of funds collection and transfers (including provision for audits). NWSC will be entitled to a percentage of revenue collected (to cover all its operating and financial expenses and provide for some profit margin) and the rest should be remunerated to NWSB (to cover for its expenses and financial obligations). The SPA also specifies performance targets to be achieved by NWSC and should be designed to encourage NWSC to maximize its collections and profits by reducing commercial losses through improved billing and collection, and operating costs through limiting physical losses. Customers will enter into a ‘customer contract’ with NWSC (and not NWSB) that will stipulate the major terms of responsibility of NWSC to provide services to the customer as well as the responsibility of the customer to pay for services provided.

7. Sustainability

The project undertakes to provide support directly to the GOK’s sector reform agenda that will lead to a harmonized service delivery framework underpinned by service delivery institutions that are efficient and sustainable over the long term. Given the fragmented state of the sector and the complexity of the reform process, the project is focused on the first step of the reform (i.e. institutional restructuring) in one Water Service Board area (i.e. Nairobi). This would enhance the probability of successful implementation yet can lead to a scaling up of the institutional reforms in the sector. Sustainable service delivery institutions are a pre-requisite for the creation of a conducive environment for sustainable long term capital investments or attracting private sector participation. The project also undertakes to ensure extensive stakeholder consultation and involvement in the reform process through the project’s communications program. The GOK is committed to the sector reform and MWRMD has taken an active role in spearheading the implementation of the Water Act. The WSRB, NWSB, WSTF have already been created. The Nairobi City Council (NCC) has formed the NWSC to provide for operational autonomy in service delivery.
8. Lessons Learned from Past Operations in the Country/Sector

The Project is consistent with lessons learned from past WSS projects in Nairobi, Mombasa and in the region:

- **Project should be compatible with and complimentary to overall Government activities:** Ownership and commitment is obtained by directly supporting the GOK’s implementation of (i) sector structural reforms outlined in the GOK’s PRSP document i.e. the *Economic Recovery Strategy for Wealth and Employment Creation* (ERSWEC), and (ii) the Water Act (2002).

- **Without a strong institutional development to create an autonomous and dedicated service delivery framework where investments and revenue are protected for use in maintaining and improving the services, major investments in the WSS sector are likely to be unsustainable:** The focus of the project on institution restructuring by creating dedicated and autonomous service delivery institutions. The size of the project is limited to an amount adequate to create, operationalize and strengthen the new service delivery framework. The risk of unsustainable capital investment is avoided by excluding them and reserving the consideration for them to a future period when the creation of a sustainable service delivery framework can be verified.

- **There should be an effective champion:** Leadership for sector reform has been earnestly taken on board by MWRMD, who is spearheading the implementation of the Water Act (2002). The project executing agency will be the NWSB, which has been formed by MWRMD. NWSB’s autonomy and legal authority to carry out its service provision mandate is embedded in the Water Act (2002).

- **WSS operational autonomy is critical for success:** The project design aims to ensure autonomous operations, protection of revenue and safeguarding investments in WSS through the formation of separate and ring-fenced service delivery institutions (NWSB and NWSC).

- **Stakeholder consultation:** The project will include a significant communications program aimed at building wide stakeholder support and consensus for the water sector reform. At the same time, the progress and interim results emanating from the project would be communicated to the public. These would be discussed, debated and feedback obtained. This will result in the development of an efficient and widely accepted long term management solution, including the consideration of the role the private sector can play, in the provision of water and sewerage services to Kenyans.

9. Safeguard Policies (including public consultation)

The project has been categorized as C/S3, meaning that no safeguard policies are triggered and as such no environmental requirements need to be met. This is meant to be a ‘short and quick’ institutional restructuring project (2-3 years) in preparation for larger future capital investment activities. The implementation of these investments will not be done under this project but
instead be considered for support under a separate follow-on project. Thus, the project is not likely to have any adverse environmental impact and none of the safeguard policies will be triggered.

<table>
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<tr>
<th>Safeguard Policies Triggered by the Project</th>
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<tbody>
<tr>
<td>Environmental Assessment (OP/BP/GP 4.01)</td>
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<td>Projects on International Waterways (OP/BP/GP 7.50)</td>
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10. List of Factual Technical Documents

A. Project Plans
- Draft Project Implementation Plan
- Draft Project Communication Plan

B. Bank Staff Assessments
- Project Preparation Back to Office Reports and Aide Memoires
- Project Information Document
- Integrated Safeguards Data Sheet

C. Other (Documents/Studies)
- Draft Customer Contract between NWSC and Customers
- Draft Provisional License from WSRB to NWSB
- Memorandum and Articles of Association of Nairobi City Water and Sewerage Company
- Draft Nairobi City Council Water and Sewerage Department Abstract of Accounts for year ended June 30, 2002
- Nairobi City Council Water and Sewerage Department Estimates for year ending June 30, 2004 and Projections for FY2004/05
- Water Act (2002)
- Kenya - Review of the Water Supply and Sanitation Sector (2001) – *ESW carries out by the Bank jointly with other development partners*

*By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties’ claims on the disputed areas*
• A Study of Options for Private Sector Participation in the Water and Sanitation Services of Nairobi (June 2002) – Study carried out by GOK under funding from PPIAF

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