

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

Approved by the Board of Directors on 29 June 2021¹

MONTENEGRO

**MAIN ROADS RECONSTRUCTION PROJECT
(Commitment of Tranche C)**

[Redacted in line with the EBRD's Access to Information Policy]

[Information considered confidential has been removed from this document in accordance with the EBRD's Access to Information Policy (AIP). Such removed information is considered confidential because it falls under one of the provisions of Section III, paragraph 2 of the AIP]

¹ As per section 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose Board reports for State Sector Projects within 30 calendar days of approval of the relevant Project by the Board of Directors. Confidential information has been removed from the Board report.

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PRESIDENT’S RECOMMENDATION

This recommendation and the attached report concern the commitment of Tranche C of the Bank’s loan for the Main Roads Reconstruction Project in an amount of up to EUR 15 million.

The Project was approved by the Board on 1 November 2017 and involves a sovereign loan facility of up to EUR 40 million divided into three tranches for the benefit of Transport Administration of Montenegro (“TA”), a government agency responsible for the national road infrastructure. Tranche A of the loan was committed on signing and Tranche B on 13 December 2019.

Commitment of Tranche C will enable the reconstruction and upgrade of the road section between Tivat and Jaz. The Project’s expected transition impact is derived from the Integrated and Green qualities through (i) improved connectivity between Montenegro’s main cities and between Montenegro and neighbouring Serbia and (ii) enhanced resilience of the country’s road network to climate change by including climate resilience measures into the road design and adopting a climate change adaptation strategy for the road sector in Montenegro.

The Project is part of an overall investment programme that is co-financed with the European Investment Bank (“EIB”). [REDACTED]

I am satisfied that the operation is consistent with the Bank’s Country Strategy for Montenegro, the Transport Sector Strategy, Bank’s Green Economy Transition Approach 2021-2025, and with the Agreement Establishing the Bank.

Odile Renault-Basso

BOARD DECISION SHEET

MONTENEGRO: Main Roads Reconstruction Project - DTM 49075 Commitment of Tranche C	
Transaction / Board Decision	Board approval ² on a no objection basis is sought to commit Tranche C of the Bank's loan in the amount of up to EUR 15 million in favour of Montenegro (the " Borrower ").
Client	The Client is the Transport Administration. (" TA " or the " Client "), a government agency in charge of the national road infrastructure in Montenegro.
Main Elements of the Proposal	<p><u>Transition impact</u></p> <p><i>Primary Quality – Integrated</i></p> <p>The Project will support Montenegro's economic development and its cross-border integration by improving connectivity between its main cities and with neighbouring Serbia. The Project will improve the road infrastructure and services between important tourist destinations along Montenegro's Adriatic coast facilitating the flow of goods and people and reducing transportation costs.</p> <p><i>Secondary Quality – Green</i></p> <p>The Project will increase the road networks' resilience to climate change by introducing climate resilience measures into the road design and having TA adopt a climate change adaptation strategy for the road sector in Montenegro. These include measures to avoid erosion and landslides, increase drainage capacities, reinforce road embankments, altered bridge design, etc. The project is eligible for GET adaptation finance, with 20 per cent assessed for Tranche C.</p> <p><u>Additionality</u> – Long-term financing from commercial lenders is currently not available in Montenegro. The Borrower's financing needs cannot be met by a single financier, and the project is financed by EIB and EBRD. The Bank's financing is additional also by introducing climate change resilience measures into the design of the Project. By supporting the authorities in developing and adopting a climate adaptation strategy, the Bank "adds value" to ongoing reforms in the road sector.</p> <p><u>Sound banking</u> – The transaction is a sovereign loan.</p>
Key Risks	<p><u>Implementation risk</u>: One of the key risks identified is the Client's capacity to implement the Project within time and budget. In addition the Client lacks internal E&S capacity and management systems for effective E&S implementation of the ESAP commitments. This risk is being mitigated by TC-funded consultants to assist TA with project implementation and monitoring.</p> <p><u>COVID-19 Risk</u>: Fighting the impact of COVID-19 has led to a temporary spike in public debt to 105 per cent end 2020, and a sharp deepening of the budget deficit in 2020 (10.5 per cent of GDP in 2020 according to S&P). In 2020, Montenegro's GDP decreased by 15.2 per cent, primarily on the back of falling services exports (tourism). If the pandemic subsides in the near future, GDP is expected to partially rebound in 2021 [REDACTED].</p> <p><u>Political Risk</u>: The new majority coalition formed after 2020 elections supports this critical project [REDACTED].</p>
Strategic Fit Summary	The Project is fully consistent with the Transport Sector Strategy, and the Bank's Country Strategy for Montenegro which lists supporting connectivity and regional integration by expanding cross-border transport and energy links EIB, will support key projects in road infrastructure, especially those that serve to improve the country's connectivity with the rest of the region, including upgrading main internal roads that connect to cross-border links.

² Article 27 of the AEB provides the basis for this decision.

1. Background

The Main Roads Reconstruction Project was approved by the Board on 1 November 2017 for a total amount of EUR 40 million. The Borrower is Montenegro and the Client is the Transport Administration (“TA”), formerly the Transport Directorate, the government agency responsible for national road infrastructure. The Project consists of three road sections (Rozaje-Spiljane, Danilovgrad-Podgorica and Tivat-Jaz) financed in tranches:

- (i) Tranche A in the amount of up to EUR 10 million to finance the reconstruction of the Rozaje – Spiljane road, 20 km in length near the border with Serbia (Part A);
- (ii) Tranche B in the amount of up to EUR 15 million to finance the reconstruction and upgrade of both road sections Danilovgrad – Podgorica (15.5 km, Part C) and
- (iii) Tranche C in the amount of up to EUR 15 million to finance Tivat – Jaz (16 km, Part B).

At the time of approval, it was decided to tranche to loan given Montenegro’s limited fiscal space and the need to complete the environmental and social due diligence for Tranche B and C, which were categorised as “A” projects under the Bank’s environment classifications. In 2019, the Board approved the commitment of Tranche B, following TA meeting the various conditions [REDACTED].

Having now met all the necessary conditions, the Client is currently asking the Bank to commit Tranche C to enable the rehabilitation and expansion of the main road from Tivat to Jaz (the M-2) roughly from the Tivat Airport to the end of the existing intersection at Jaz, north of Budva. Specifically the road will be expanded from a single two lane single carriageway to a four lane carriageways with roadside kerbs, paved footways and a grass planted central reservation. The road camber will also be improved and the road resurfaced. Given the extent of these works and the condition of the existing road, the road will be fully reconstructed. A more detailed description is available in Annex 1.

Given synergies, the works tender for the construction of the Tivat–Jaz road was combined with the works for the construction of the second water pipeline of the Regional Water Supply System. This project was launched in 2020 and is also financed by the Bank. Both scope of works were merged into a single contract to maximise synergy, implementation efficiency and economy between the two projects as water mains are to be placed along the same road section. [REDACTED]

2. Commitment of Tranche C

Montenegro has advised the Bank that it has met the following conditions, which are required for the Bank to consider effectiveness:

Condition	Status
Satisfactory environmental and social due diligence to assess whether the Tivat – Jaz road section has been structured to meet the Bank's policy requirements	The environmental and social impact assessment (“ESIA”) for the Tivat - Jaz road was prepared and disclosed on 7 August 2020 on both the Bank’s and the Client’s websites. The ESIA fully meets the requirements of the EBRD’s 2014 Environmental and Social Policy and Performance Requirements.
Allocation by Ministry of Finance to the annual budget the financing request for the Project.	Following the preparation of the detailed design for all three road sections, the Project’s cost

	estimates have increased from EUR 40 million to around EUR 75 million. Montenegro has elected to finance this increase in project costs [REDACTED]
Written agreement for the updated Environmental and Social Action Plan (“ESAP”) to include Part B and Part C of the Project.	The ESAPs for both Part B and Part C of the Project have been agreed for implementation with the Borrower [REDACTED]
Satisfactory implementation of the ESAP for the Project	The Client is on track with the implementation of the ESAPs for the previously approved and signed Part A (Rozaje – Spiljane) and Part C (Danilovgrad-Podgorica) with the support of an environmental and social (“E&S”) capacity building and implementation support consultant. The Bank has also agreed the ESAP for Part B (Tivat-Jaz), and the implementation will start upon approval of the financing for Tranche C.
Satisfactory evidence that the Project Execution Agency has completed the road safety audit and that the recommendations of the road safety audit consultant have been incorporated in the detailed design of Part B and Part C of the Project.	An independent road safety audit (“RSA”) was carried out for the Project and its recommendations have been addressed by the Client in preparation of the detailed design of Part B and Part C. In addition, a supplementary traffic and pedestrian safety report for Part B (Tivat-Jaz section) was prepared by an independent RSA consultant in December 2020, and specific provisions will be included in the detailed design to further enhance pedestrian safety. As agreed in the ESAP, the Client will require the contractor to update the Project’s design in full accordance with the traffic and pedestrian safety report recommendations. Moreover, the RSA consultant and the E&S implementation support consultant will review the contractor’s reports to ensure that the contractor and Supervision Engineer will implement the required road safety measures on site.

3. Implementation Progress

3.1. Background

[REDACTED] Implementation is now progressing according to plan with construction works in progress on both Part A and Part C. [REDACTED]

3.2. Progress by Road Sections and Works Supervision

- *Part A: Rozaje – Spiljane (border with Serbia) road reconstruction*

[REDACTED]TA signed a construction contract with Strabag AG for Rozaje – Spiljane road. The works are proceeding well despite an initial delay due to Covid-19 and poor weather conditions in the mountainous area. [REDACTED]

- *Part B: Tivat - Jaz road reconstruction*

The construction tender for the Tivat – Jaz road, which also includes scope of works for the regional water supply pipeline, was published on 22 July 2020. The evaluation of bids is ongoing. The tender evaluation report has been received [REDACTED].

- *Part C: Danilovgrad - Podgorica road reconstruction*

TA signed a construction contract with Bemax doo for Danilovgrad - Podgorica [REDACTED]. The works are proceeding well [REDACTED].

- *Works supervision*

The contract for the works supervision services for all three roads with IRD Engineering srl was signed [REDACTED].

3.3. Costs Increase

As detailed at the time of Part C commitment the Project's cost increase was documented. [REDACTED] There are two main reasons for the increase in project costs:

- a) The significant time lapse between the original cost estimates (in 2015) and the actual contract tendering which took place some three to five years later, and the impact this has had on main materials such as asphalt, cement and iron.
- b) A subsequent revision to the detailed design incorporate road safety and climate resilience measures, which were not considered during detailed design preparation.

[REDACTED]

4. Transition Impact / Risk to Transition Impact

The Bank has a long-standing relationship with the Client. The positive experience gained in similar projects in Montenegro has been the basis of incremental transition impact achieved by the Bank's follow-on projects in this sector.

The proposed Operation Change and the incremental transition objectives reflect the overall transition impact ("TI"). [REDACTED] Upon the second review in March 2021, progress on the *Green* quality has been made as the Climate Change Adaptation Strategy was adopted by the Government in October 2020. [REDACTED]

5. Integrity

In conjunction with OCCO, integrity due diligence was undertaken on TA and its senior management. [REDACTED] No conflicts of interest were identified or are foreseen.

The Project does not pose an unacceptable integrity or reputational risk to the Bank. The Transport Administration is an existing client of the Bank and the experience to date has been positive.

All actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the Project, and the Project files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the Project.

ANNEXES

Annex 1: Project Description and Map of Montenegro, with Roads to be reconstructed

The Project comprises the rehabilitation and expansion of the Tivat to Jaz main road (the M-2), situated at the coastal region of Montenegro, from approximately 100m before the entrance to Tivat Airport to the end of the existing intersection at Jaz, north of Budva.

The Project involves widening the existing two-lane road to create a four-lane road with two-lanes in each direction (each lane being 3.25 m wide). The upgraded road will include a 2m wide central reservation as well as 2m wide sidewalks and a vegetated verge. In addition, seven road bridges, four culverts and one footbridge will be constructed, 11 new roundabout junctions will be constructed, and 2 existing roundabout junctions will be reconstructed.

The total width of the upgraded road corridor will be around 20 m (less at bridges). A number of additional works also form part of the Project including the provision of:

- a replacement underpass beneath the M-2 road for the Nikola Djurkovic Elementary school;
- bus stops in both directions at all local road junctions in the vicinity of settlements;
- pedestrian crossings principally at roundabouts and intersections;
- road lighting along the entire route; and
- an upgraded stormwater drainage system along/ the Budva-Tivat road section.

The road camber will also be improved and the road resurfaced. Given the extent of these works and the condition of the existing road, this will require the total reconstruction of the road. In the section between Tivat airport and Radanovici, a small section of the road will deviate from the existing road and will pass through government owned land.

Annex 2: Environmental and Social Update

The Tivat - Jaz road section includes the reconstruction and widening of the existing road from 2 to 4 lanes over 10km, hence this Project is categorised A under EBRD's Environmental and Social Policy (2014). The Bank's environmental and social due diligence (“**ESDD**”) was conducted accordingly with the support of several independent consultants and included documentation reviews and site visits.

The Project Environmental and Social Impact Assessment (“**ESIA**”) disclosure package includes the local EIA, a Supplementary ESIA, Non-Technical Summary, Stakeholder Engagement Plan (“**SEP**”), the Land Acquisition and Resettlement Framework (“**LARF**”), Framework Biodiversity Management Plan (“**F-BAP**”) and ESAP. These were disclosed on websites of TA and EBRD on 7 August 2020. Hard copies have been made available at TA’s offices locally, three local communities along the road and EBRD’s RO in Podgorica. A consultation report was published following completion of the public disclosure period.

The project has been subject to the national Environmental Impact Assessment (“**EIA**”) process, and the EIA was approved by the competent authority in April 2020. The Project is will improve traffic flows (thereby reducing journey times) and road safety (for both drivers and pedestrians), and promote climate resilience through reduced vulnerability to flooding and high temperatures.

The Client is in the process of developing and implementing an Environmental and Social Management System (“**ESMS**”) with the support of E&S consultant. A series of mitigation and management measures have been identified for all the project phases. A number of these measures require that the Contractor prepares Construction Environmental and Social Management Plans (“**CESMP**”) before the start of construction activities such as Construction Management Plan; Labour and Working Conditions Management Plan; Spoil Disposal Management Plan and a Biodiversity Management Plan.

There has been extensive engagement activity including one to one interviews, group discussions, socio-economic household surveys and community meetings carried out during the development of the Project, with 22 stakeholder engagement meetings, including also 4 EIA/ESIA consultation meetings. The necessary Covid-19 related measures have been adopted to make sure there is a continued stakeholder engagement. Concerns raised were related to access restrictions to properties and businesses, disruptions during construction, land acquisition and livelihood restoration, standard project nuisances (noise, traffic, impacts on local flora and fauna, flooding), overall road design (location of roundabouts and crossings for people and livestock), and pedestrian and school children safety impacts during construction.

The project involves an upgrade to an existing road, and its route alignment does not cross any known protected areas, hence the ecological sensitivities are considered to be generally low. An exception is local watercourses, which support a number of uncommon species (including the critically endangered, European Eel) and the Tivat Saline Ramsar site and Special Nature Reserve / protected area, which is designated as Critical Habitat, located some 300m from the road at its closest point. These will be protected through mitigation measures designed to avoid pollution of watercourses, including upgrade to the road drainage systems. The description of the existing biodiversity baseline and conservation status of the Project area has been developed through a combination of desk based studies, expert consultations, and site surveys. In particular, the work included a biodiversity assessment with targeted surveys conducted throughout 2019 and 2020. A Critical Habitat Assessment has also been carried out for the

project, which concluded that there may be species in the area that have the potential to trigger Critical Habitat. To address this and meet PR 6 requirements, an F-BAP has been prepared and disclosed as part of the ESIA package. The F-BAP will be used to enable the project to avoid, minimise and/or mitigate impacts to species and habitats of conservation importance. The F-BAP includes appropriate biodiversity offset mechanisms to achieve No Net Loss of Priority Biodiversity Features in line with EBRD requirements. Precautionary action plans have been prepared as part of F-BAP, and these are referenced in the ESAP and will need to be further updated and implemented upon further pre-construction surveys by the Client. Impacts during construction will be reduced through the use of GIP and contractors will be required to develop and implement a construction phase Biodiversity Management Plan. Operational impacts, such as habitat fragmentation, will be reduced by the provision of appropriate crossing points for fauna (e.g. culverts). Overall, residual impacts are not expected to be significant.

Relevant risk assessments in relation to climate change impacts have shown limited overall risks to the project. The design of the road takes into account the associated flood risks and includes relevant solutions such as, for example, improved surface water drainage systems, adjusted bridge design, reinforcement of the road embankments and surfaces, to make this road more climate resilient.

The Project will involve limited physical and economic displacement. To this end, the LARF was prepared and publicly disclosed, followed by a separate Land Acquisition and Resettlement Plan (“**LARP**”) that has also been prepared and disclosed and will be implemented by the TA prior to the start of the civil works. Land acquisition and livelihood restoration in compliance with EBRD PR5 will be financed by the Government of Montenegro. The Expropriation Study identified 661 land plots to be expropriated (424 private owners (36 per cent), 112 businesses (36 per cent) and 125 from government agencies and municipalities) of approx. 16.89 hectares in total. The formal decision that the Project is in the public interest, announcement of cut-off date and associated publication of data from the Expropriation Study has already taken place. Additionally, socio-economic surveys have been completed and identified 102 businesses and 106 households within 50 metres of the existing road that may be significantly affected by land-take. So far, only two (2) households will require physical resettlement to new housing, while loss of significant livelihood and business assets are expected to be limited with access to properties maintained. No main business buildings are within the expropriation corridor, and the most significant losses are expected to be parking areas and some gardens and agro-pastoral assets that are within the new road footprint. The implementation of LARP will be regularly monitored and verified by the external implementation support and monitoring consultant.

During the construction phase, the Contractor is expected to employ several hundred construction workers, and any temporary accommodation and welfare facilities (construction camps or private dwellings) for workers will be designed and constructed to meet requirements of IFC/EBRD Worker Accommodation Guidance Note 2009. To prevent any adverse impacts on the communities, the Contractor will also be guided by the respective WB and IFC guidance and good practice notes, including on gender based violence. The core requirements of the EBRD Performance Requirement 2 will also be cascaded down across all contracting chains, including subcontractors.

An independent Road Safety Audit (“**RSA**”) for the Project was conducted in 2018 during the design phase and its main recommendations have been addressed. A supplementary Traffic and Pedestrian Safety Report for Part B (Tivat-Jaz section) has been prepared by an independent RSA consultant in December 2020, and specific provisions such as additional pedestrian

crossings will be included in the detailed design to further enhance pedestrian safety. Through the ESAP provisions, the Client will require that the Contractor update the Project's design in full accordance with the Traffic and Pedestrian Safety report recommendations.

Noise modelling carried out as part of the ESIA work indicates that noise mitigation is required for the road. A Noise and Vibration Management Plan for construction will be provided by the contractor, and during the pre-construction phase the Owner's Engineer shall undertake further noise modelling to determine the specification and precise locations for any noise barriers and to reduce the number of affected properties along the route.

Assessment of air quality issues conducted as part of the ESIA indicated that no elevated sensitivity receptors in terms of air quality were identified along the route of the road. No cultural heritage impacts were identified in the Project affected area. However, as a precaution, the Contractor will adopt a Chance Find Procedure prior to the start of construction works.

The current SEP includes requirements for public engagement during the pre-construction and construction period, including a grievance mechanism and is addressing potential Gender Based Violence and Harassment issues.

The ESAP agreed with the Transport Administration includes, among others, the requirements: to further improve its internal environmental and health and safety management systems in line with ISO 14001 and OHSAS 18001/ISO 45001 requirements; to develop HR policy in line with PR2; to implement a Contractor oversight plan including appropriate monitoring and enforcement of EHSS and Labour requirements; to prepare a Traffic Management Plan ("TMP") for the construction phase; for the contractor to develop and implement a CESMP, as well as to implement requirements contained in F-BAP, LARP and SEP. In addition, mitigation measures require that the Contractor and the Owner's Engineer employ a number of professionals such as an Ecological Clerk of Works and Biodiversity Specialists. The TA is also required to ensure the Contractor (and subcontractors) transpose relevant elements of the SEP into their own plans of work, as reflected in contractual agreements as well as review and improve the Grievance Management Process.

The independent implementation support consultants will undertake regular audits of the Project to assess EHSS performance during construction in accordance with the Bank Performance Requirements. The Bank will also monitor the Project through quarterly reporting during construction phase, annual E&S reports and carry out site visits, if and when required.

Annex 3: Economic and Public Debt Analysis of Montenegro

The economy experienced a strong recession in 2020. GDP growth already slowed in 2019 (to 3.6 per cent), primarily due to large investment projects approaching completion (the Bar-Boljare highway) or being completed (power link to Italy), although the tourist season was the strongest on record. In 2020, GDP contracted by 15.2 per cent, primarily on the back of falling services exports (tourism). Foreign tourist arrivals declined by 85 per cent. Covid-19 had a strong effect on Montenegrin economy since around one-fifth of GDP comes from tourism. In addition, most tourists visit the country in the summer months and majority of them come from three countries – Serbia, Bosnia and Herzegovina and Russia. Since borders were closed for travellers from Western Balkans countries for most of the summer, the fall of number of tourists, and hence GDP, was much more pronounced in Montenegro than in neighbouring Croatia and Albania, which are also heavily reliant on tourism. The economy also entered deflation in the second quarter, with year-on-year inflation averaging -0.3 per cent for the year as a whole.

Public debt reached a record high level in 2020. As in other countries, economic support measures aimed at mitigating the negative effects of the coronavirus pandemic, combined with falling revenues, led to an increased budget deficit in 2020. According to the government estimate, the deficit in 2020 was around 10 per cent of GDP. Besides coronavirus-related measures, the previous government also announced a pension hike (raising minimum pensions by around 13 per cent retroactively from 1 January 2020) ahead of the parliamentary elections at the end of August. At the end of 2020, public debt reached 105 per cent of GDP, almost 30 percentage points higher than at end-2019. In March 2021, the government officially requested EU to help repay Chinese Exim Bank loan for the Bar-Boljare highway.

The current account deficit increased strongly in 2020. Montenegro has run high current account deficits for many years, reaching 15 per cent of GDP in 2019. In 2020, the deficit increased to 26 per cent of GDP, because of the strong decline in export of services (tourism). In March 2021, S&P downgraded Montenegro's long-term sovereign credit ratings by one notch, to B from B+, on the back of the deteriorating fiscal and external positions.

A partial GDP rebound [REDACTED] is expected in 2021 (EBRD September 2020 forecast). However, the forecast is subject to high uncertainty over the further development of the pandemic. While the worsening of epidemiological situation in the first quarter of 2021 and a slow vaccination progress might slow down the recovery, the strong contraction last year and the consequent positive base effect, as well as the expected change in the border policy this year, will act in the opposite direction.

MONTENEGRO'S SOVEREIGN DEBT EXPOSURE WITH EBRD

Total EBRD's portfolio in Montenegro as of 31 March 2021 amounts EUR 440 million within 45 operations [REDACTED]. Sovereign exposure in terms of portfolio accounts 48 per cent or EUR 211 [REDACTED]:

The 2021 Budget proposal published on 31 March 2021 by the Government projected a EUR 140 million reduction of public expenditures. The Government plans to sign seven sovereign loans worth EUR 123.6 million and four guarantees worth EUR 68.25 million for state owned enterprises.

[REDACTED]