Summary of the Operation Performance Evaluation Review (October 2008)

The project

In December 2004 the European Bank for Reconstruction and Development (EBRD) approved a loan of 370 million roubles (then the equivalent of €10 million) to a municipal bus company. The loan was guaranteed by the city and supported by a project undertaken by the governing region. The operation built on connections and experiences with the city that have been established through previous investment operations.

The loan carried a maturity of 10 years, including a one-year grace period. The Bank's loan was complemented by 66 million roubles (€1.5 million) of local co-financing from the city. This amount covered the tax element involved (approximately 15 per cent of the total project cost).

Apart from helping the company to modernise its bus fleet through the purchase of approximately 100 city buses, the project aimed to restructure the municipal transport sector. This was the Bank's first urban transport transaction in Russia and the first transaction in which international financing, other than that provided by bus manufacturers, was made available to an urban transport company in Russia.

The operation was to introduce, for the first time, a public service contract in the Russian urban transport sector. The contract was intended to establish a transparent structure and standards for the provision of public transportation. In this regard, a number of ambitious non-financial covenants were included in the project design. The operation was expected to have a significant demonstration effect in Russia.

Four technical cooperation (TC) operations were attached to support the project.

Pre-signing:
- TC1: analysis of the company and public transport market in the area and environmental audit of the company (Bank funded €35,000; non-reimbursable)

Post-signing:
- TC2: public transport restructuring: (EIPF03-2006-07-30: €200,000)
- TC3: company management assistance: (JAP-2006-01-04: €220,000)
- TC4: creditworthiness enhancement programme (CEP) for the city (estimated cost was €300,000).

In the wake of the municipal administration crisis (see below) the last TC (TC4) never materialised.

Project implementation

Project implementation faced a number of difficulties. Towards the end of 2006 the project implementation started to suffer from, as some argue, politically driven disturbances at the top of the municipal administration. These disturbances resulted in the indictment and sentencing of the city's mayor in February 2008. In the wake of this protracted process the municipal management was becoming increasingly paralysed due to staff turnover and unclear reporting structures.

This management crisis had an adverse effect on the company as a municipal enterprise. A new mayor was elected in March 2008. He took office in May bringing in a fresh team of senior staff.

The municipal and environmental infrastructure (MEI) team was quick to establish a mutual trust base with the new city administration.

The loan was cancelled prematurely. After using the loan to purchase 92 low-floor city buses, at a cost saving of approximately 28 per cent, the borrower and the city administration informed the Bank, in December 2006, that they would not request an extension of the last availability date. This resulted in a cancellation of 33 per cent of the original loan (or 28 per cent of the original project cost) amounting to 124 million roubles (€2.8 million) only two years after the project was approved.

With this cancellation, the Bank's leverage to bring about the intended covenant-supported transition impact (TI) effects considerably decreased. In fact, TC2 and TC3 had just gained momentum when loan disbursements terminated. It is within this context that the previously mentioned re-engagement of the MEI team with the new city authority is important.

Project rationale

This operation represented the Bank's first urban transport project in Russia. As such, it was a pilot project with considerable expectations for demonstration effect. The prevailing country strategy at the time of appraisal did not explicitly cover urban transport.

However, the dilapidated state of this sub-sector in most urban communities was clearly visible and regarded as a hindrance to development and transition. By the same token, the MEI team saw the potential in pursuing private sector investment opportunities and, with their help, instigate positive effects for urban economies and beyond.

Achievement of objectives

The practical objective of the loan was to help the company finance the purchase of about 100 city buses, including spare parts and workshop equipment. In addition, the wider institutional objective was to assist the city and the company in restructuring and optimising its public transport services through:

- modernising the bus fleet
- upgrading workshops
- restructuring and commercialising the company with a view of improving its efficiency.

The TI objectives are discussed and rated in the section "Transition impact and additionality".

Linked to these wider institutional objectives were a number of non-financial covenants:

- transformation of the municipal enterprise company into a more independent and commercially oriented joint stock company (JSC)
- signing of a public service contract (PSC)
- realisation of full cost recovery principles, that is, operations without subsidies
- undertaking of a route tendering programme for private sector minibuses
- establishment of a framework transport strategy
- adoption of a business plan.

Conceptually, all these covenants are to some degree linked. Common to all these covenants is the idea that the company would be transformed into a bona fide JSC, with significant latitude to push the city into aggressive tariff increases while dramatically lowering costs to become competitive with the private sector. This would all be backed by a PSC similar to the ones that the Bank has promoted in eastern European cities.

In general, the practical project objectives have been achieved. However, the transition impact associated with the sector/institutional objectives has not been achieved. Given that "improvement of workshops and maintenance equipment" was not realised, the evaluation team concurs with the expanded monitoring report (XMR) rating of *Marginal*. Although being a relatively small part of the project in terms of value (six per cent of the total project costs), it was very important in terms of function and relevance to the bus component of the project.

Overall assessment

In line with the Evaluation Policy the evaluation team has rated the project as *Unsuccessful* overall. The inherent project under-achievements are not solely attributable to the management crisis at the municipal level. They are also a consequence of overly ambitious and unrealistic expectations by the Bank.

All this calls for a realist rather than an optimistic appraisal. While the project design and documentation were deficient, Bank handling was rated *Marginal* due to the commendable implementation monitoring performance.

Transition impact leaves much to be desired since few, if any, intended impacts were achieved following, among other events:

- a serious management crisis at a crucial moment
- a premature loan cancellation, which eliminated any leverage for the TC-supported TI initiatives.

Thus, the TI was assigned an *Unsatisfactory* rating overall. The overall achievement of objectives is rated *Marginal* only, despite the successful procurement and utilisation of buses, because

- the failed TI effects constituted significant deliverables under the project
- the important institution-building component was cancelled together with the loan.

Environmental change is rated as *Some*: the new buses generated environmental benefits in terms of pollution, noise and transport safety. The environmental performance of the client, however, is rated *Unsatisfactory*. This rating is based on the failure to fully enact the environmental action plan (EAP) and the non-implementation of the workshop component, which gravely endangered the sustainability of the above-mentioned environmental benefits. The newly introduced environmental impact for future consideration is rated *Marginal*.

The Bank's investment performance was assigned a *Good* rating due to a number of factors, including the discounted project contribution after direct cost allocation, which was over 10 per cent higher than the level foreseen at the appraisal. The company financial performance is rated *Unsatisfactory* because the client is making losses, which leaves the guarantor to service the debt.

Transition impact and additionality

The TI assessment at the time of appraisal (November 2004) arrived at a rating of *Good* for TI potential with a risk rating of *High*. At the time of the chief executive officer's (CEO) reassessment in February 2007 under the transition impact monitoring system (TIMS), the TI potential rating remained unchanged, while the attached risk rating was downgraded to *Excessive*. This rating reflects:

- the effect of the management crisis
- the premature loan cancellation (and the lost leverage)
- the perceived possibility of the relationship breakdown between the Bank and its client (which fortunately did not happen).

Looking at the past TI performance of the project, the evaluation team arrives at an overall rating of *Unsatisfactory*. This is mainly attributable to the fact that most of the affirmative covenants recorded in the loan agreement were not met. This rating, however, is not regarded as implying a negative or a positive demonstration effect. The project is the first of its kind in Russia and was heralded as a pilot case that was supposed to stimulate replication.

Environmental performance

The project was assigned a "B/1" screening category on the basis that it involved existing workshop/depot facilities. Thus, the existing facilities had to undergo an environmental audit. As suggested by an independent environmental consultant, an EAP was developed to help improve environmental, health and safety conditions in workshops/depots.

However, its implementation and reporting were stalled. The investment component, which intended to address workshop/depot deficiencies, did not materialise. Therefore, the quality of maintenance and sustainability of the new bus fleet are called into question.

The EBRD's environmental performance is rated *Good*. The client's environmental performance is rated *Unsatisfactory*.

Additionality

The Bank's additionality is rated as *Verified in all respects*. This was the Bank's first urban transport transaction in Russia. It was also the first transaction in which international financing, other than that provided by bus manufacturers, was made available to an urban transport company in Russia.

The evaluation team does not think that displacing a potential supplier's credit challenges the Bank's "financial additionality" concept. Irrespective of this, the many 'design and functioning' additionality components, which were built into the project (TC2 and TC4) but did not properly materialise, constitute clear evidence for the assigned rating.

Bank handling

Bank performance is rated *Marginal*. The Bank's due diligence performance (including project design) was deficient. Procurement handling was good. Monitoring and, in particular, the care provided after the loan cancellation were commendable. This rating is less than satisfactory and emphasises that "quality at entry" is a decisive factor influencing a project's performance.

Key issues and lessons learned

Thorough institutional analysis

Prior to instigating reform processes the Bank needs to undertake more thorough and broader-based institutional analysis. Through comprehensive institutional analysis the Bank needs to identify:

- main constituent parties
- implementation capacity
- process ownership
- risk to the processes
- logical sequencing and related milestone events.

Related investments would need to be tailored and inter-linked with such reforms in order to serve as effective leverage tools.

Single working language

For the sake of practicality the Bank should define English as its sole working language and stipulate that all its key working files should be kept in this language. Similarly, some correspondence with the client and non-key documents may be maintained in another language but should always be accompanied by an English summary.