

Special Study

Municipal and environmental infrastructure operations policy review

May 2010

Evaluation Department
(EvD)



European Bank
for Reconstruction and Development

Special Study
MEI operations policy review

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Preface

The subject of this Special Study is a sector review of implementation of the Bank's 2004 Municipal and Environmental Infrastructure Operations Policy ("MEI Policy"). Dr. Arthur Dennis Long (Senior Environmental Evaluation Manager), led this Special Study. To implement the study, the Evaluation Department (EvD) hired Michael Wenborn – a UK based consulting – to carry out the data collection, analyze the results and prepare background reports. This report represents a shared effort by the consultant and EvD staff.

The team wishes to express our thanks to the MEI Banking Department's Operation Leaders and Portfolio Managers who played a critical role in providing information, organizing portfolio and project data, arranging contacts, and facilitating field visits with clients. Various MEI Operation Leaders also participated in project site visits.

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Abbreviations

AER	Annual Environmental Report
BOT	Build Operate Transfer
CHP	Combined Heat and Power Plant
DBO	Design, Build and Operate
DLF	Direct Lending Facility (EBRD)
E&S	Environmental and Social
EBRD	European Bank for Reconstruction and Development
EIA	Environmental Impact Assessment
ENPI	European Neighbourhood and Partnership Instrument (EU)
ESAP	Environmental and Social Action Plan
ESD	Environmental and Social Department (EBRD)
ESIA	Environmental and Social Impact Assessment
ETCs	Early Transition Countries
ETCI	ETC Initiative (EBRD)
EU	European Union
EvD	Evaluation Department (EBRD)
FI	Financial Intermediary
FLAG	Fund for Local Authorities and Government (EBRD)
FOPIP	Financial and Operational Performance Improvement Programme
IFIs	International Financial Institutions
IFRS	International Financial Reporting Standards
IPA	Instrument for Pre-accession Assistance (EU)
ISPA	Instrument for Structural Policies for Pre-Accession (EU)
LAD	Last Availability Date (EBRD)
LLD	Lessons Learned Database (EBRD)
MEI	Municipal and Environmental Infrastructure (EBRD)
MELF	Municipal Environmental Loan Facility (EBRD)
MIRP	Municipal Infrastructure Reconstruction Programme (EBRD)
MSA	Municipal Support Agreement
MUDP	Municipal Utilities Development Programme (EBRD)
NEAP	National Environmental Action Plan
NIB	Nordic Investment Bank
NIF	Neighbourhood Investment Facility (EU)
NIS	Newly Independent States
OCE	Office of the Chief Economist (EBRD)
OGC	Office of the General Counsel (EBRD)
OL	Operation Leader (EBRD)
OPER	Operational Performance Evaluation Review
PIU	Project Implementation Unit
PPP	Public-Private Partnership
PSA	Public Service Agreement
PSC	Public Service Contract
PSD	Project Summary Document (EBRD)
PSP	Private Sector Participation
RO	Resident Office (EBRD)
SDC	Swiss Agency for Development and Cooperation
SECO	Swiss State Secretariat for Economic Affairs
SFF	Shareholders' Special Fund (EBRD)
SIDA	Swedish International Development Cooperation Agency
SEI	Sustainability Energy Initiative (EBRD)
SWM	Solid Waste Management
TACIS	Technical Aid to the Commonwealth of Independent States (EU)
TAMBAS	Turn around management and business advisory services (EBRD)
TC	Technical Co-operation
TI	Transition Impact
USAID	United States Agency for International Development
XMR	Expanded Monitoring Report
XMRA	XMR Assessment

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Executive summary

The EBRD's current Municipal and Environmental Infrastructure Operations Policy ("MEI Policy") was approved by the Board of Directors in October 2004. The EBRD is aiming to update its MEI Policy in 2010. This Special Study, carried out by the Evaluation Department (EvD), is designed to provide lessons from past experience as input to the development of the new policy. Overall, EvD rates the Bank's implementation of the 2004 Policy as *Successful*.

Based on the consultations with clients and other stakeholders in the countries of operations, on observations of the standards of municipal services through site visits to project facilities, and on detailed discussions with bankers and other EBRD staff, it is clear that the majority of the EBRD's operations in the MEI sector are having a major positive impact on the efficiency and quality of municipal services. This is backed up by the results of previous evaluations of MEI projects by the EBRD's Evaluation Department (EvD), from which 61 per cent of the evaluated projects in the MEI sector were given an overall performance rating of 'successful' or 'highly successful', which is slightly higher than the typical ratings across the Bank.

This Study has demonstrated that the EBRD is making successful progress in achieving the core objective of the MEI Policy, and also that there should be no major changes to the MEI Policy. The core directions in the policy of decentralisation, commercialisation and environmental improvement are very appropriate, and in line with the EBRD's overall mandate. There should be some changes of emphasis to the Policy, and to the framework for its implementation, which would further enhance the EBRD's positive impacts in this sector.

The key recommendations can be summarized as follows:

With respect to updating the MEI Policy, EvD recommends:

- Only a slight update is necessary, reflecting changes in the Bank's focus and achieving a better balance between various objectives and possibly to confirm or remove from the agenda the team's objective to work in the public building/housing sector (based on mandate limitations, if any).
- There are trade-offs between a broader – multi-subsector approach and a more focussed approach. The current policy takes a broad approach, but the implementation of which is actually focussed. Is there more advantage of doing one project in a subsector in only one country, or building an expertise and doing many similar projects in several countries to obtain a synergistic effect?
- As the Bank moves east, the strategy for early transition countries may reflect what it used to be for the more advanced countries. The strategy may need to be more nuanced by region.
- Historically, MEI has focused primarily on revenue generating projects and has limited non-revenue generating projects to local road rehabilitation. With the Bank's increased focus on energy efficiency, more clarity is needed on MEI's ability to expand its work into improving energy efficiency in housing and municipally-owned buildings. A more liberal interpretation of Article 11 of the Agreement Establishing the Bank would allow the MEI team to meet its stated policy objectives in this sector and respond to important energy efficiency investment needs in the public building and housing sectors.
- technical cooperation has proven to be a valuable component of MEI projects. It is generally recognized that more technical cooperation in support of basic municipal infrastructure would further enhance the work of the Bank in this sector, particularly to reach more difficult communities where affordability may be an issue, for example rural communities and early transition projects. This

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seems a constructive approach to balancing competing objectives. The use, role, and demand for technical cooperation should be clearly specified in the new MEI Strategy.

- The MEI Policy is defined by the MEI Team's client – municipalities – whereas most Bank Policies/Strategies are defined by a sector. Clarity on whether this is to be a Team Strategy or a Bank Strategy would be helpful. Is this client focus a constraint on the Team's capacity to be more private-sector focused? For example, as this team has the expertise shouldn't they also focus on industrial wastewater?

With respect to implementation of the MEI Policy, EvD found that the MEI Team was focused and that there is demand for MEI's products. EvD recommends:

- MEI should expand on the proposed LogFrame and develop a clearly articulated set of strategic objectives, expected outputs, and required inputs.
- The MEI Team should develop a clear Policy Dialogue/Menu document. EvD believes that the Policy Dialogue objectives are relatively obvious – for example commercialization, tariff increases, cost recovery, affordability, environmental compliance.– and that articulation of such positions will only enhance the Bank's impact.
- The new strategy should provide clarity on what is expected to achieve High Transition Impact would be helpful. A clearly articulated score sheet should be included in the updated Strategy.
- The Team should use project monitoring to develop case studies. Many projects show significant results positive results. Case studies can be used to promote "demonstration projects" to expand the Bank's message and therefore its ability to meet demand in the sector.
- Improving on the collection of key data enhances the capacity of the utility to improve performance. EBRD should build better data collection into the projects, both to improve project efficiency and to help the Bank tell its story. It is recognised that in some countries additional technical cooperation resources may need to be required to assist clients in developing the necessary tools for data collection.

1. Introduction

1.1 Background

The EBRD's operations in the Municipal and Environmental Infrastructure (MEI) sector aim to promote improved efficiency and higher standards of municipal services such as water supply and wastewater treatment, solid waste management, district heating, urban transport and other services.

The operations in the MEI sector are particularly relevant to the Bank's mandate as there is potential for high transition impact through investments in the sector. The MEI sector is fairly unique in that the sustainability of improvements depends on wider issues, such as tariff reform and proper enforcement of regulations. These wider issues can greatly affect the success of the investments. The EBRD's current Municipal and Environmental Infrastructure Operations Policy ("MEI Policy") was approved by the Board of Directors in October 2004. The EBRD is aiming to update its MEI Policy in 2010.

1.2 Objectives of the study

The aim of this special study is to carry out an independent evaluation of the implementation of the EBRD's MEI Policy, and to identify lessons and recommendations that will inform the EBRD in drafting an updated MEI Policy. The study focuses on the implementation of the transition and strategic objectives in the MEI Policy. A logical framework for the evaluation study is provided in Appendix 1.

1.3 Methodology

This special study on the MEI sector has been carried out by the Bank's independent Evaluation Department (EvD). The main activities during the study were:

- *Portfolio review* – Discussions with the MEI Operations Team and a desk-based review of the MEI portfolio of projects in order to identify trends related to the key policy objectives. A list of the MEI projects is provided in Appendix 2. The portfolio review included analysis of results of past evaluations of MEI projects, and an assessment of the Evaluation Department's Lessons Learned Database in order to identify common lessons from previous project evaluations.
- *Missions to selected countries of operations* – Visits to selected countries were carried out to evaluate MEI activities in Ukraine, Uzbekistan, Tajikistan, Croatia, Montenegro and Serbia. These countries were selected, in consultation with senior management in the MEI team, because it was important to learn lessons from activities in less advanced countries, for which the Bank has been aiming to expand its MEI portfolio, and to learn from activities in those countries that are preparing for EU accession. In total 18 projects¹ were visited, including six projects in the water and sewage sub-sector, four urban transport projects, four solid waste management projects, three district heating projects, and one project that includes investments in a mix of the above sub-sectors. Discussions were also carried out with other relevant

¹ Information on individual projects is not provided in this report, due to confidentiality agreements of the Bank, but such information has been shared with the MEI Team.

stakeholders, such as city administrations and other IFIs, on wider policy dialogue aspects, such as regulations, tariff reform and frameworks for private sector solutions.

- *Consultation with the MEI team and other relevant EBRD teams* - Consultation was carried out with the MEI team throughout the study, initially during the planning of missions, and later to discuss the main findings and recommendations.

2. Relevance - overview of EBRD policy in the MEI sector

The EBRD's Municipal and Environmental Infrastructure Operations Policy (2004)² sets out the general and specific operational roles of the Bank in the MEI sector and establishes the overall framework for the Bank's activities. The main directions in the Policy are covered by transition and strategic objectives. The 2004 Policy revised the previous MEI Policy of 1998. This section provides an overview of the key principles and objectives in the MEI Policy (2004). A comparison with previous MEI policies of the Bank is provided in Appendix 3. EvD rates overall relevance as 'fully verified'.

2.1 Overall objective of the MEI Policy

The core objective of the EBRD's MEI operations is:

- *"To promote greater efficiency and higher quality in the provision of local authority services through investment and the promotion of independent, well-managed and financially sustainable operations provided on commercial principles and in a market-oriented institutional and regulatory framework."*
- This Policy is distinct from other sector policies/strategies in that it is defined less by the sub-sector (for example water supply and sanitation) and more by the client (municipal), which puts an added constraint on the Banking team and potentially limits volume. The team is not encouraged to work on sovereign projects (for example raw water infrastructure) nor on the industrial wastewater with private clients.

2.2 Transition approaches in the MEI policy

The EBRD's overall approach towards transition in its countries of operations involves:

- Decentralisation of service responsibilities to local or regional levels.
- Commercialisation of the operating companies providing local services.
- Energy efficiency and environmental improvement through investments that conserve environmental resources and reduce pollution.
- Innovative approaches to addressing sector and client issues.

The MEI Policy recognises the different transitional and operational challenges in different countries of operations.

² In 2009 the Bank shifted from Sector Policies to Sector Strategies.

2.3 Strategic objectives and priorities of the MEI policy

The main strategic and operational objectives in the EBRD's MEI Policy are:

- To extend the use of standard products to Russia / intermediate / early transition countries.
- To build on experience in the water sector and expand the portfolio into other sectors (the policy gives examples of: urban transport, car parking, district heating, waste management, waste to energy, public housing, urban regeneration). It should be noted that a more liberal interpretation of Article 11 of the Agreement Establishing the Bank will be required to allow the MEI team to meet its stated policy objectives to expand in the public housing sector and respond to its important energy efficiency investment needs.
- To promote private sector solutions, where feasible.
- To extend the use of existing products to small municipalities (including multi-municipality projects).
- To carry out institutional strengthening through technical cooperation (technical cooperation).
- To address affordability constraints through grant co-finance.
- To increase access of municipal service companies to capital (for example commercial bank co-financing and expanding capacity to provide finance in local currency).
- To improve project implementation and improve disbursements.

2.4 Technical cooperation and policy dialogue aspects of the MEI policy

Technical Cooperation (technical cooperation) and policy dialogue are important activities to support the MEI investments and to achieve the objectives of the Policy. The MEI Policy states that, in particular in Russia, intermediate and early transition countries, the EBRD will support utility companies and local authorities in achieving institutional strengthening and financial and operational sustainability through mobilisation of donor-funded technical cooperation.

In relation to policy dialogue, the MEI Policy states that, where commercial discipline and cost recovery are underdeveloped, the Bank will selectively engage in policy dialogue to address constraints, linked to pilot transactions that illustrate the benefits of implementing the required reform. The Evaluation Team recommends that the MEI Banking Team prepare a clear and concise policy statement. Several of the policies objectives are obvious: full cost recovery, elimination of cross-subsidies and out-sourcing. If these cannot be clearly articulated, this constrains senior management's capacity to engage in effective and meaningful policy dialogue.

In addition, the Policy states that in the MEI sector, the EBRD maintains a constant dialogue with its counterparts in the World Bank, IMF, European Investment Bank (EIB), NIB and other bilateral donors/agencies with respect to policy conditionality in its countries of operations.

2.5 Other points in the MEI policy

Other important points in the MEI Policy include:

- A planned increase in the number of projects in Russia, intermediate and early transition countries (ETC) compared to advanced countries, while remaining active in advanced countries.

- A move into sectors that are not based on full cost recovery, but would benefit from commercialised approaches, such as urban transport.
- Similarly, a move into sectors that have strong energy efficiency and environmental benefits, such as district heating and solid waste management (including waste to energy).
- A move into new sectors such as urban regeneration and housing in more advanced countries (which is currently difficult, without a more liberal interpretation of Article 11 of the Agreement Establishing).
- An emphasis in the more advanced countries on new products (for example guarantees and revenue bonds).
- The use of opportunities in advanced countries for grant co-financing through EU Structural and Cohesion funds and other instruments.
- The promotion in early transition countries of the concepts in the MEI Policy (for example decentralisation, commercialisation) through demonstration projects.

- Of concern to the evaluation team is that some of these objectives conflict with others, for example, (1) expansion into ETC where the initial focus may best be on water supply, while trying to also move into new sub-sectors; or (2) increasing business volume while being asked to develop new products in traditional markets. Going forward, a more nuanced set of objectives may be useful by region and sub-sector.

2.6 Other relevant EBRD policies and strategies

The EBRD has a number of other policies and strategies, many of which are relevant to the MEI sector, including:

- EBRD Country strategies (for each country of operation).
- EBRD Procurement Policies and Rules (May 2007, updated May 2009).
- Environmental and Social Policy (ESP) – covers the objectives and standards for EBRD activities related to environmental and social aspects (the 2003 Policy was updated in 2008). The new Strategy should contain a section on application of the 2008 ESP to the sector strategy.
- EBRD's Sustainability Energy Initiative (SEI).
- EBRD's ETC Initiative.
- Gender Action Plan.

3. Effectiveness – EBRD portfolio in the MEI sector

This section provides a summary of the EBRD portfolio in the MEI sector as a measure of the Banks effectiveness in the sector. More details on the portfolio, in relation to the evaluation of specific policy objectives, are provided in Sections 4 and 5. Overall the Bank's effectiveness in implementing its 2004 MEI Policy is rated 'good', based on the performance in the core sectors of water and sewage, urban transport, and district heating, but 'marginal' with respect to solid waste and housing.

3.1 Overview of MEI portfolio

A total of 202 projects in the MEI sector have been signed from 1993 through 2009, with a total EBRD finance of €3,355 million. Table 3.1 provides an overview of the MEI portfolio in different sub-sectors. About 53 per cent of the projects in the portfolio are in the water and sewage sector. Urban transport (19 per cent) and district heating (17 per cent) are the other main sectors, and there are also nine SWM projects (2 per cent), but only one housing project. A list of the MEI projects is provided in Appendix 2.

Table 3.1 – Overview of the EBRD's portfolio in the MEI sector

	# projects	per cent of total	Volume of EBRD finance (€)	Volume as per cent of total
Water and Sewage	98	49	1767.4	53 per cent
Urban Transport	43	21	634.5	19 per cent
Solid Waste Management	10	5	69.9	2 per cent
District Heating	39	19	558.5	17 per cent
Housing	1	0.5	16.1	0.5 per cent
Other*	11	5	308.9	9 per cent
Total	202		3,355.4	

*Note – the "Other" category represents projects that cover more than one MEI sector.

3.2 Variation in MEI activity over time

Figures 3.1 and 3.2 illustrate the total number of MEI projects signed each year and the total EBRD finance of the projects. The number of projects signed each year has been steadily increasing.

Figure 3.1 – Variation in number of projects signed each year

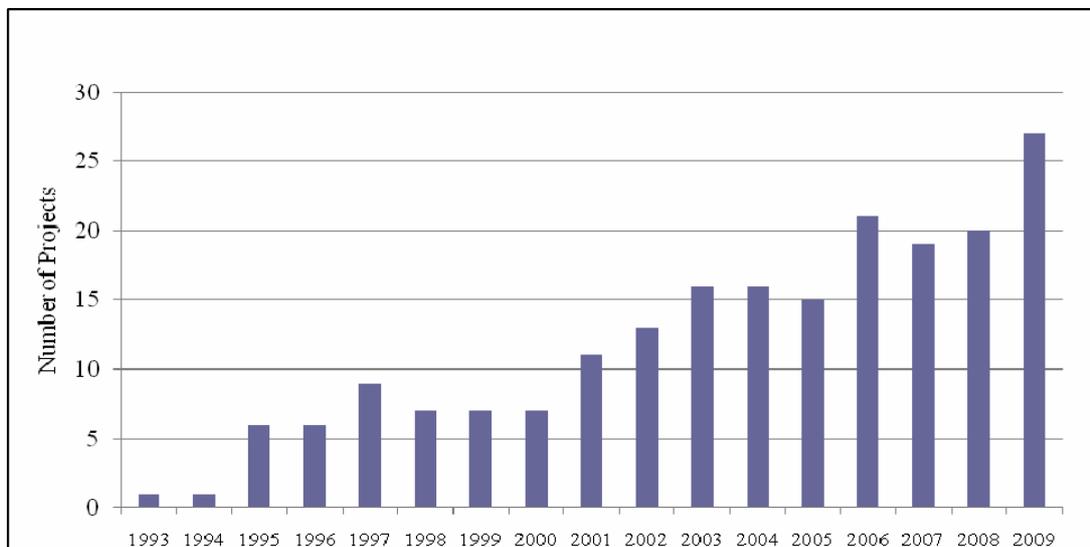
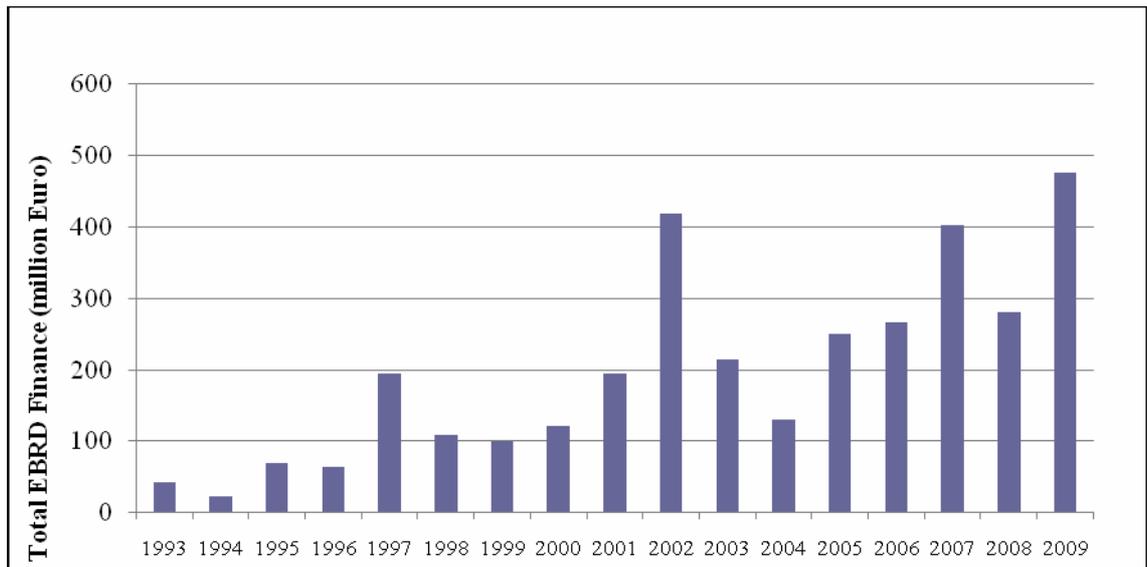


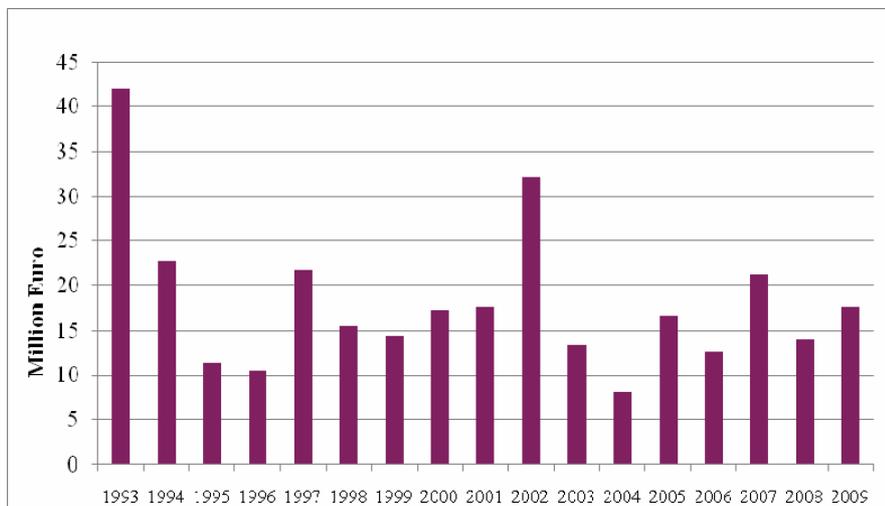
Figure 3.2 – Variation in total EBRD finance of projects signed each year



3.3 Size of MEI projects

The overall average size of MEI projects in terms of EBRD finance is €16.6 million. Out of the 202 projects signed, 89 are less than €10 million in size, and 7 projects are over €50 million in size. Two projects, one in Russia and one Regional project, have an EBRD finance of €177 million and €175 million respectively, and were signed in 2002 and 2007. The next largest MEI project in terms of EBRD finance is €80 million. The average size of MEI projects for each year is shown in Figure 3.3. This indicates no obvious major change in average size of projects overall. It should be noted that only one project was signed in 1993 and one in 1994. In addition, the value of the projects in the year 2002 was dominated by the very large project in Russia mentioned above, resulting in a peak in the graph for that year. Experience from evaluation indicates that actual disbursements are often less than approved amounts. Based on the Bank's profitability model, MEI projects under about €10 million do not provide an adequate return on investment to the Bank, thus the Bank has been willing to subsidize projects in the sector, given their strong Transition Impact.

Figure 3.3 – Average size of MEI projects



4. Efficiency – evaluation of MEI project performance

This section provides the analysis of the performance of individual projects in the MEI sector. Overall the Bank's efficiency in implementing its 2004 MEI Policy is rated 'Good'.

4.1 Project evaluation coverage of MEI sector project portfolio

The EBRD's independent Evaluation Department (EvD) carries out project evaluations in line with the Bank's Evaluation Policy. The most detailed evaluations involve Operational Performance Evaluation Reviews (OPERs), which include an evaluation visit to the project. A total of 23 OPERs of investment projects in the MEI sector have been undertaken by EvD since the start of the Bank's operations. In addition to OPERs, expanded monitoring report assessments (XMR/As) are carried out, which involve a detailed desk-based document review by the Evaluation Department to build on the monitoring reports from the Operation Leaders (OLs). There are 13 projects in the MEI sector for which XMR/As have been carried out.

Tables 4.1 and 4.2 provide a summary of the evaluations carried out by EvD on the EBRD's investment projects in the MEI sector. Out of a total of 202 MEI projects signed since the start of activities in the MEI sector (in 1993) to December 2009, 18 per cent have been previously evaluated by EvD, which is lower than the overall proportion of evaluated investment projects across all sectors at EBRD of 42 per cent. Two of the MEI evaluations have been carried out on projects signed since the EBRD's 2004 MEI Policy was adopted; many of the more recently approved projects, which are covered by the 2004 MEI Policy, have not yet reached a stage where evaluations can usefully be carried out.

Table 4.1 – Summary of investment project evaluations (by country type) in the MEI sector

MEI Sector	# projects signed	OPERs	XMRAs	Total evaluated	% evaluated
Regional	10	1	2	3	30
EU 2004	54	10	5	15	28
EU 2007	48	3	0	3	6
SEE	23	3	2	5	22
Russia	34	4	1	5	15
Other NIS	14	0	0	0	0
ETC	19	2	3	5	26
Total	202	23	13	36	18

Key to country categories:

- EU 2004 (Czech Rep, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia).
- EU 2007 (Romania, Bulgaria).
- SE Europe (Albania, Bosnia, Croatia, Macedonia, Montenegro, Serbia, Turkey).
- Other NIS (Belarus, Kazakhstan, Ukraine).
- Early transition countries - ETCs (Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Uzbekistan).

Based on these tables, the evaluations of investment projects in the MEI sector have been generally carried out across a range of representative sub-sectors and country categories. A higher focus in future on projects carried out in Russia and other NIS countries would provide an even better representation, particularly because these types of countries are the focus of a strategic objective of the 2004 MEI Policy in terms of expanding the portfolio to intermediate and early transition countries. It should be noted that, although the information in Table 4.2 indicates a low proportion of projects evaluated in EU 2007 countries (Bulgaria and Romania), the Evaluation Department did carry out a Special Study on the EBRD's contributions towards environmental quality improvements in the Danube River Basin, and this included a

detailed case study on Romania covering many of the MEI investments in the water and sewage sector in that country.

Table 4.2 – Summary of investment project evaluations (by sub-sector type) in the MEI sector

MEI Sector	# projects signed	OPERs	XMRA's	Total evaluated	per cent evaluated
Water and Sewage	98	16	6	22	22 per cent
Urban Transport	43	3	4	7	16 per cent
Solid Waste Management	10	1	2	3	30 per cent
District Heating	39	3	1	4	10 per cent
Housing	1	0	0	0	0 per cent
Other*	11	0	0	0	0 per cent
Total	202	23	13	36	18 per cent

*Note – the "Other" category represents projects that cover more than one MEI sector.

In addition to the evaluations of investment projects, 15 OPERs have been carried out on Technical Co-operation (technical cooperation) projects related to the MEI sector.

4.2 Overview of project evaluation results

This section provides a summary of the results of the previous evaluations of MEI projects by EvD.

4.2.1 Overall performance rating

Table 4.3 provides a summary of the results of the previous evaluations of the investment projects in the MEI sector in terms of overall performance rating. This is scored through a balance of factors covering transition impact, financial performance, additionality, bank handling and environmental performance. Sixty one per cent of the investment projects that have been evaluated were 'successful' or 'highly successful' (compared to 58 per cent of all projects evaluated for the EBRD).

Three of the evaluated projects were given an overall performance rating of 'unsuccessful' (representing 8 per cent of the MEI investment projects evaluated, compared to 14 per cent of all investment projects evaluated for the EBRD). The three unsuccessful projects, two of which were evaluated through XMRA's, were one each from the urban transport, solid waste management, and district heating sectors. No water and sewage projects have been scored as 'unsuccessful'. This perhaps reflects the stronger experience in the Bank with water and sewage projects compared to other MEI sectors. In addition, although only three solid waste management projects have been evaluated, this was the lowest performing sector overall, perhaps reflecting the challenges and long timescales needed for raising the standards of solid waste management in municipalities in the EBRD's countries of operations. As well as the three regional projects (each evaluated with an overall performance rating of successful), three other projects that cover several municipalities have been evaluated, and two of these had an overall performance rating of 'successful', and one 'partly successful'.

Table 4.3 – Overall performance rating of evaluated investment projects in the MEI sector

MEI Sector (OPERS and XMRAs)	Unsuccessful	Partly Successful	Successful	Highly Successful	Total evaluated	per cent of projects evaluated that were Successful or Highly Successful
Water and Sewage	0	8	12	2	22	64 per cent
Urban Transport	1	2	4	0	7	57 per cent
Solid Waste Management	1	1	0	1	3	33 per cent
District Heating	1	0	2	1	4	75 per cent
Housing	-	-	-	-	0	-
Other	-	-	-	-	0	-
Total	3	11	18	4	36	61 per cent

Table 4.4 provides the results of the evaluations of the investment projects in the MEI sector for different categories of country in terms of overall performance rating. The projects in EU countries, in Southeast Europe, and regional projects, were the highest performing projects. Projects in Russia and ETCs were evaluated as less successful overall. In Russia, two of the five projects evaluated were rated as unsuccessful, while in ETCs, none of the five projects evaluated were rated as successful or highly successful. These results are likely to reflect the experience of the Bank in working in EU countries and the challenges of MEI projects in Russia and ETCs.

Table 4.4 – Overall performance rating of evaluated investment projects in the MEI sector in different countries (OPERS and XMRAs)

Country categories	Unsuccessful	Partly Successful	Successful	Highly Successful	Total evaluated	per cent of projects evaluated that were Successful or Highly Successful
Regional	0	0	3	0	3	100 per cent
EU 2004	0	4	10	1	15	73 per cent
EU 2007	0	0	2	1	3	100 per cent
SE Europe	0	2	1	2	5	60 per cent
Russia	2	1	2	0	5	40 per cent
Other NIS	-	-	-	-	0	-
ETCs	1	4	0	0	5	0 per cent
Total	3	11	18	4	36	61 per cent

For key to country categories see Table 4.1

4.2.2 Transition impact

Tables 4.5 and 4.6 provide a summary of the transition impact ratings for the projects evaluated in the MEI sector. 78 per cent of the 36 projects evaluated were rated as having a transition impact of 'satisfactory', 'good' or 'excellent', compared to 79 per cent for all EBRD's investment projects that have been evaluated by EvD. One of the 36 MEI projects evaluated (three per cent) was 'unsatisfactory' in terms of transition impact, and no projects were evaluated as negative. By comparison, eight per cent of all EBRD investment projects that have been evaluated were rated with a transition impact of 'negative' or 'unsatisfactory'.

There are no obvious trends in the transition impact of MEI projects between sub-sectors or between countries, although transition impact has generally been rated as higher in EU and Southeast Europe than Russia and ETCs.

Table 4.5 – Transition impact rating of evaluated investment projects in the MEI sector (OPERs and XMRAs)

	Negative	Unsatisfactory	Marginal	Satisfactory	Good	Excellent	Total
Water and Sewage	0	0	3	7	10	2	22
Urban Transport	0	1	1	2	3	0	7
Solid Waste Management	0	0	2	0	0	1	3
District Heating	0	0	1	0	2	1	4
Housing	-	-	-	-	-	-	0
Other	-	-	-	-	-	-	0
Total	0	1	7	9	15	4	36

Table 4.6 – Transition impact rating of evaluated investment projects in the MEI sector in different countries (OPERs and XMRAs)

	Negative	Unsatisfactory	Marginal	Satisfactory	Good	Excellent	Total
Regional	0	0	0	0	3	0	3
EU 2004	0	0	2	5	7	1	15
EU 2007	0	0	0	0	2	1	3
SE Europe	0	0	0	2	1	2	5
Russia	0	1	1	2	1	0	5
Other NIS	-	-	-	-	-	-	0
ETCs	0	0	4	0	1	0	5
Total	0	1	7	9	15	4	36

4.2.3 Bank handling

One of the factors taken into account in the evaluation of the overall performance of investment projects is bank handling. This is important for MEI projects, where potentially long project timescales, and important wider activities (for example policy dialogue on aspects such as tariff reform), mean projects and client relationships need particularly careful management. Bank handling is scored within six categories: 'excellent', 'good', 'satisfactory', 'marginal', 'unsatisfactory' and 'highly unsatisfactory'.

Bank handling in MEI projects that were previously evaluated was rated to be slightly better than the average across all EBRD projects that have been evaluated. For 64 per cent of the 36 MEI projects evaluated, bank handling was scored as 'good' or 'excellent' (compared to 61 per cent for all projects evaluated at EBRD), and for a further 25 per cent of projects it was scored as satisfactory (compared to 22 per cent across all evaluated projects at the EBRD). Bank handling for three MEI projects was evaluated to be marginal, and for one project as unsatisfactory, and these projects were located in Russia / ETCs. For the three projects where the overall performance rating was 'unsuccessful', the bank handling was 'marginal' or 'unsatisfactory'.

4.2.4 Evaluation of technical cooperation projects

Out of the 15 evaluated technical cooperation projects that are associated with the MEI sector, nine were evaluated with an overall performance rating of 'successful'. Five were evaluated as partly successful and one was rated as 'unsuccessful' (in Russia).

4.3 Lessons database

The lessons from all project evaluations (OPERs and XMRAAs) are collated into the Evaluation Department's Lessons Database. As part of this Special Study, an analysis of the lessons learned from project evaluations in the MEI sector has been carried out. Several of the common lessons learned from the database were discussed in further detail during the visits to clients and other stakeholders, and also discussed with Operation Leaders (OLs) at EBRD, and have been taken into account in the conclusions and recommendations in this document. The results of this analysis, which particularly focused on identification of the common lessons, are provided in Appendix 3.

4.4 Policy implementation and bank handling

This section covers an assessment of the bank handling and implementation related to the MEI Policy. The section covers these aspects through comments on the Policy itself and the mechanisms for implementation, an assessment of the effects of the policy implementation on the volume of the MEI sector portfolio, the need to raise the profile of the successful MEI projects, and the need to increase the resources in the MEI sector team.

4.4.1 *MEI policy implementation*

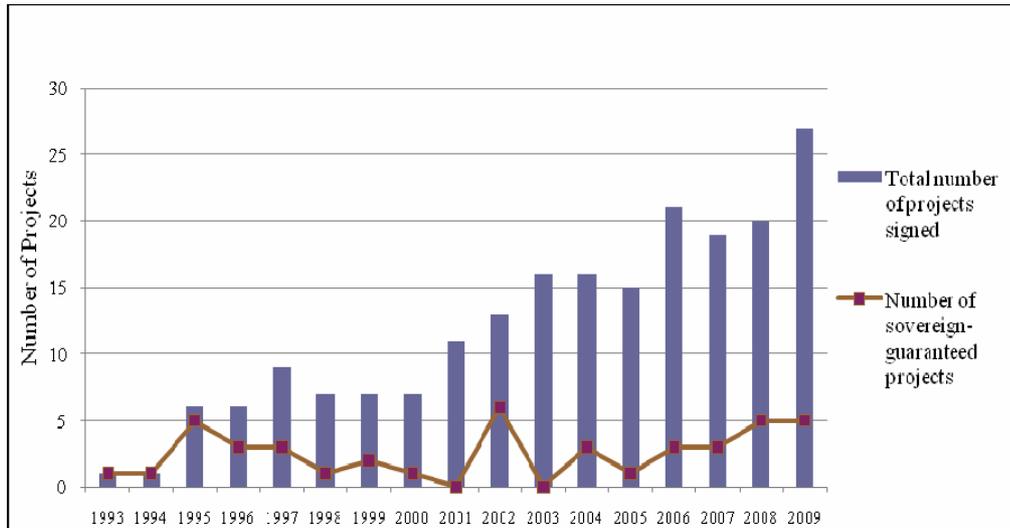
Comments on the objectives of the MEI Policy are provided in specific earlier sections of this document and in Section 7 on the overall conclusions and recommendations. The EBRD's MEI Policy has quite wide coverage, including a number of inter-linked transition and strategic objectives. It is still considered to be much longer than needed, and shortening the Policy might ensure wider readership. The section on the Bank's activities to date could, for example, be reduced to a summary and any detail moved to an annex. The policy dialogue action plans for each country could also link into the overall targets.

4.4.2 *The links between the policy implementation and the volume of the MEI portfolio*

The MEI sector represents a major opportunity for high transition impact, and the visits and consultations during this Study have confirmed that the focus of the MEI Policy on decentralisation, commercialisation and environmental impact is resulting in a positive transition in many cities. Also, municipal clients present a relatively lower risk of default on loans, although there is higher potential for delays in project implementation and therefore in disbursements. Although the MEI sector has a lower return than other sectors, the fact that many projects have a high transition impact, and the MEI sector generally has lower risk projects, means that the Bank should continue to perceive this as a particularly important sector.

During the process of setting up MEI projects, the EBRD is pushing the need for decentralisation to municipalities. In particular, the EBRD is setting up most projects with loans directly to municipalities, or municipal companies, without sovereign guarantee. Out of the 202 projects signed in the MEI sector up to June 2009, 43 have had a sovereign guarantee, and the proportion of loans signed with sovereign guarantee is broadly decreasing each year, as demonstrated in Figure 4.1. By volume the change is even more pronounced. This reflects a continuing shift away from sovereign projects, in line with the policy objective.

Figure 4.1 - Proportion of sovereign-guaranteed projects signed each year



There is clearly a high demand for MEI projects in the EBRD's countries of operations, but the planning and implementation of MEI projects is highly resource-intensive, and this is likely to be one of the main reasons for the relatively slow increase in volume. In addition, it should be noted that the average size of MEI projects is much lower than for most other Bank sectors. Since 2004, when there was a sharp increase in the total EBRD volume, the number of signed projects in the MEI sector has remained at about five per cent to seven per cent of the total number of EBRD projects each year. Also, as the Bank increases its number of MEI projects in ETCs, the average size of projects is likely to decrease further, because of the affordability constraints, meaning many more projects will need to be signed to increase the total volume.

4.4.3 Raising the profile of the EBRD MEI sector projects

One of the main gaps in activity of the MEI sector team is the lack of focus on the measurement and reporting of the positive impacts of the EBRD's MEI projects. This would have several benefits, including:

- Wider reporting on the high transition impact and positive environmental and social improvements of the Bank's activities in the MEI sector.
- Supporting external demonstration activities by reporting on the positive results of specific projects to municipalities, national governments and other stakeholders.
- Raising the profile of the MEI team within the bank, and therefore ensuring that the team receive the deserved credit for the successful projects. This is quite important to the motivation of the bankers and other staff in the MEI team, particularly as there is an increasing shift of bankers to be based in resident offices, and therefore the potential for them to feel more cut off from head office in London.
- The reporting of project results internally, including case studies on project implementation, would also raise awareness of the challenges of MEI projects to those personnel in the Bank who contribute to project planning and approval, but do not get much opportunity to travel to countries of operations and therefore might have a lower understanding of the practical challenges of projects.
- Raising the profile of the MEI portfolio internally might also encourage members of other sector teams to identify opportunities for MEI projects during their work.

- As part of this, the Bank should consider more detailed and specific measurement of environmental impacts of its project activity, for example:
 - When the data are available, measurement and reporting of effluent quality from wastewater treatment plants could be useful. The Bank's clients could measure water quality in rivers (before and after projects) into which the plants discharge. Examples would include a wastewater treatment project, which addressed the major environmental impacts of the previous situation that involved direct discharge of wastewater from the city into the river, and there is now a full treatment works in compliance with EU standards. This measurement activity would be particularly applicable where EBRD has had several wastewater treatment projects along one river system, such as the projects in Romania impacting the River Danube. Such data are readily available from external sources. Use of additional technical cooperation resources may be advantageous to assist clients to put appropriate reporting and monitoring mechanisms in place.
 - One particular area where measurement and reporting might be useful relates to energy savings. District heating projects in particular, but also many water projects, result in major savings in energy, and the EBRD should be commenting on energy reduction data and estimating the equivalent greenhouse gas reduction. This measurement and reporting would enhance the Bank's public relations, although it would be important to include a warning of the uncertainties in the data when reporting. It would be inappropriate for EBRD staff to have to spend considerable time calculating detailed results in energy savings, but the technical consultants under most projects would be able to make estimates to a sufficient level of reliability.
 - For public transport projects, customer satisfaction surveys are useful for clients to gain feedback and information from those using public transport, and EBRD should encourage this approach. The results of such surveys would also be useful for the Bank's own reporting.

4.4.4 *MEI team resources*

As indicated several times in this report related to the achievement of different objectives, the MEI sector is highly resource-intensive. As well as the project planning and implementation activities (Box 4.1), the sector also requires much time and focus on policy dialogue, and time to identify and plan grant co-finance, as well as the planning and management of technical cooperation components.

Box 4.1 - Example of the high resource requirements for multi-municipal projects in the MEI sector

For the multi-municipal projects, the setting up of the project uses a significant level of resources, but it is the monitoring of the project that is particularly resource intensive. A water rehabilitation project covering three cities and the future project for another seven cities in Central Asia will need much monitoring, and the EBRD Resident Office will need to employ a local person full-time for this. The employment and retention of someone for monitoring is not easy at EBRD because much of the performance focus and rewards are reportedly based on planning and signing projects. In addition, the set of skills required to properly monitor projects is may be different from the skills of planning projects.

At present the MEI team is expanding its approach to locate its bankers in resident offices in its countries of operations. This is very important considering the hands-on working with clients that is needed in project set-up, the large amount of meetings needed related to policy dialogue aspects, and the project monitoring requirements. There is a strong correlation between the number of MEI projects in a country and the presence of a full-time MEI banker in the resident office. For example, the EBRD has higher numbers of projects in Croatia, Romania, Russia, Georgia and Ukraine, where the team has (or has had)

MEI bankers located in the EBRD office. The EBRD needs to expand its resources in the MEI sector, and continue to base its MEI team in resident offices.

5. Impact and sustainability – evaluation of sector level performance

This section provides the results of the assessment of sector-level performance in relation to the implementation of the MEI Policy. The section covers the transition objectives, strategic objectives, policy dialogue and bank handling. Overall Transition and Project Impact and Sustainability of the MEI projects are rated as 'good'.

5.1 Achievement of transition objectives

The EBRD's overall approach towards transition in its countries of operations focuses on decentralisation of service responsibilities to local or regional levels, commercialisation of the operating companies providing municipal services, and environmental and social improvements. The assessment of the achievement of the main transition objectives is provided in this section.

Overall, the EBRD's operations are having very positive transition impacts in most of the cities in which the EBRD has been implementing MEI projects. The assessments during this Study have confirmed that the EBRD is correct in linking decentralisation, commercialisation and environmental improvements as the core transition objectives of the MEI Policy.

5.1.1 Decentralisation

The MEI Policy recognises that decentralisation is important to improving the standards and efficiency of local municipal infrastructure and services. Ensuring responsibility and accountability at municipal level, rather than national level (closer to the points of provision of the services), including the local responsibility for the payment of operational costs and investments, motivates the municipal utilities to improve the efficiency of services.

There is a large variation in decentralisation policies in the different countries-of-operation, and a variation in progress in implementation of decentralisation policies. For example:

- In the Balkans there is much decentralisation of responsibilities to municipalities, for example in allowing municipalities to directly receive loans and to set the tariffs for municipal services.
- In Central Asia, the government policy does not focus on decentralisation, and the government has control of the important decisions in municipalities, such as decisions on the main investments and on approval of the tariff levels. This is constraining the improvement of municipal services.
- In south-eastern and eastern Europe the government policy is shifting towards decentralisation to provide the cities with more decision-making powers and financial independence, but implementation of decentralisation policy is slow. For example in one country in eastern Europe, final approval on tariffs is uncertain, and not always in the hands of city administrations. Increases can be blocked by the national government, as has happened in Kyiv, which is affecting the financial performance of the Kyiv transport companies and constraining investments in improved services.
- There is also a variation in decentralisation policy related to allowing municipalities to receive loans. In one country in the Balkans, for example, there has been some decentralisation of decision-making, but municipalities still do not have much control over their budgets and, although there is now a law that allows municipalities to receive loans, the Ministry of Finance still maintains much central control.

- Specific project examples related to decentralisation include:
 - The EBRD has set up loans to the municipal district heating companies two Ukrainian cities. These are non-sovereign loans guaranteed by the respective city administrations. Since the initial planning of one, there have been major changes to the company in terms of commercialisation, accountability and taking responsibilities for decisions, and the fact that the loan is to the municipal company (without sovereign guarantee) is an important factor.
 - The EBRD water supply project in eastern Europe has had some success in changing the tariff structure and increasing tariffs, and the water supply services have significantly improved as a result of the more commercialised approach and the project investments. Although the solid waste project was designed to develop towards full cost recovery, this has been constrained by the slow progress in tariff increases, which are controlled by the central government. The municipal waste management company is not given responsibility for important decisions, and does not have control of budgets, and this project in particular demonstrates the need for decentralisation.
 - In one country of south-eastern Europe, although the implementation of decentralisation policy is slow, the EBRD activities are supporting decentralisation where possible. For example, the recent loan to a company for the development of the regional landfill site has been made without national or municipal guarantee, but on the basis of a Municipal Support Agreement (MSA) with the participating municipalities, despite several risks to project implementation in terms of inter-municipal co-operation.
 - The EBRD signed a loan with one municipal waste disposal operator for the rehabilitation of a landfill. The original loan was guaranteed by the municipality. The second project was mainly for re-financing the cost of the ongoing rehabilitation, and the EBRD carried out dialogue with the Ministry of Finance to gain approval that the deal could be signed without a city guarantee in order to give the company more autonomy. The Ministry agreed that the Municipal Support Agreement was acceptable instead, and approved this as an exception to the national law.
 - In numerous projects the EBRD has included the signing of a Public Service Contract (PSC), between the City and the municipal company, as a condition of disbursement. This has numerous advantages, including enhancing decentralisation as it sets a contractual framework that facilitates responsibilities for decision-making to municipal companies. More details are provided below in the section on commercialisation.

Although the EBRD is pushing decentralisation in project planning and policy dialogue where possible, the Bank is taking into account the reality of the situation in some countries with respect to the capacity of city administrations and municipal companies. In many small municipalities in ETCs, for example, the city administrations and municipal companies do not have the capacity and experience to make major decisions or to have absolute control of budgets, and decentralisation of responsibilities needs a step-by-step approach. Box 5.1 demonstrates this point in relation to a country in Central Asia.

Box 5.1 - The benefits of alignment of the decentralisation and commercialisation objectives of the key counterparts with the EBRD MEI Policy

In one country of Central Asia, there is a key counterpart organisation related to the MEI sector, responsible for the management of municipal services across the cities of the country. It has a strategy to commercialise the utility functions, and then transfer the ownership to the municipalities on a step-by-step basis as the municipal functions become self-sustainable. In eight cities, some of the municipal functions have transferred to the

relevant city administrations. For example, in one of the first projects in one country, the ownership of the company was transferred to the city in the 1990s. In another city, water and wastewater, and solid waste functions, have transferred to the city. For the municipal functions under the control of the organisation, government financing for investments comes through it. It is the main counterpart for international projects with most municipalities, many of which do not yet have the capacity to work with international institutions. The organisation appoints the Director, Chief Engineer and Chief Accountant of the municipal companies under its control. It has an official Charter, approved by the Government, defining these roles and its strategy for decentralisation and commercialisation of municipal functions. As more water companies become financially and operationally sustainable, and are transferred to the ownership of the cities, the role of the organisation will decrease and it will become a water sector regulator in the longer-term (for example in at least five to seven years). The EBRD projects in the MEI sector in Central Asia are being planned and implemented in line with this strategy on decentralisation, and include a focus on strengthening the municipal companies so that responsibility can be transferred from the organisation to the relevant city in future. In addition, EBRD are supporting the organisation with a technical cooperation component within a recently-signed project, on the institutional strengthening of the organisation and the development of a strategy for becoming the regulator.

5.1.2 Commercialisation

Linked to decentralisation, the commercialisation of municipal services is also a core transition objective in the MEI Policy. This approach drives municipalities to provide high standards of cost-effective services. Commercialisation covers improving the efficiency of the municipal companies as well as gaining the benefits of competitive private sector solutions, where feasible.

In order to provide a loan to a municipality, and to generate high transition impact, the municipality must be creditworthy and committed to commercialising municipal services to ensure improvements are sustainable. The current levels of commercialisation, and the commitment of city administrations to commercialisation, vary between cities in the EBRD's countries of operations.

The EBRD is particularly strong in setting up MEI projects to enhance the commercialisation of municipal services. Mechanisms that are used to enhance commercialisation include the signing of public service contracts as a condition to disbursement, development and agreement of tariff policies, and including technical cooperation components to strengthen the capacity of municipal companies to increase efficiencies as well as to develop business plans. The Financial and Operating Performance Improvement Programme and Corporate Development technical cooperation's have been particularly relevant in assisting clients to restructure and commercialise their operations. In addition, the MEI bankers carry out much policy dialogue with the city administrations to encourage this approach by highlighting and explaining the commercialisation benefits and approaches.

Cost recovery and tariff policy

Tariff policy is one of the most important aspects of commercialisation, and the EBRD projects in the MEI sector are structured to work towards full cost recovery. In most cases when the EBRD starts to work with a municipality, tariffs do not cover full operating costs. Therefore the city administration has to subsidise the shortfall in operating costs and also pay for any investments. Often municipal companies are operating with uncertainty about the level of subsidisation payments from city administrations, which is constraining operations.

Tariff policy is a highly political aspect of municipal services and it is often a major challenge for the EBRD to facilitate changes in policy. In most loans the Bank requires the development and agreement of a structured tariff policy, which sets the agreed increases in tariffs, and agreed levels of payments from the city administration, for future years. This has the important advantage that the municipal company can better forecast its revenues and can properly plan investments in services, and therefore the company tends to gain more independence for decision-making and accountability for performance. Including a

component in tariffs for investments is good practice that the EBRD is including in some projects, but which could be used in future tariff planning in other cities (Box 5.2). In many cases, in particular in urban transport projects, the city administrations are not stepping up tariffs to cover full operating and investment costs, for political reasons, and subsidy payments from the city are therefore continuing. This trend is not unique to EBRD's clientele and in fact the urban transport sector worldwide tends to be dependent on subsidy payments.

Box 5.2 – Example project with successful tariff reform

For example, in a highly successful solid waste disposal project in a city in south-eastern Europe signed the municipal support agreement (MSA) with the EBRD at the time of the re-financing project. The MSA committed the city to either approve increases in tariffs or to make payments to a landfill operator. The levels of tariff increases or payments were known by the company as they were set in the agreed tariff policy, and therefore this allowed the company to carry out reliable financial planning. As well as taking into account forecast operational costs of the landfill, the EBRD required the tariffs to include a development component, which has been ring-fenced and saved for future investments, in particular for treatment and disposal alternatives when the landfill is closed.

The affordability of tariffs is an important aspect in relation to tariff policy. In some of the EBRD's countries of operations, full cost recovery is not affordable at present to much of the population. In some countries there is a regulatory authority that has the role to give final approval on tariff increases taking into account affordability, but there is not an independent regulator in all countries. In the planning and feasibility studies for projects, and the development of tariff policies, the EBRD includes detailed assessments of affordability. In many countries of operations, energy costs are particularly high, which has an impact on the affordability of cost recovery for all municipal services. In most cases the EBRD is promoting the implementation of full cost recovery through tariff increases on a step-by-step basis (Box 5.3).

Box 5.3 - The target of full cost recovery in early transition countries

Full cost recovery might not be a realistic target in early transition countries within the lifetime of the project, where in most cities the affordability of tariffs is such a critical aspect because a high proportion of the population is in poverty. Full cost recovery (including future ongoing necessary investment costs) would be preferable so that the municipal company has much higher independence and autonomy, and does not rely on the city administration for subsidies, and so that the financial management is much more transparent. Some ongoing subsidisation by a city of the gap in cost recovery is a more appropriate in terms of affordability. The EBRD might sometimes consider that their projects should aim for step-by-step increases in cost recovery in ETCs, as indicated in the MEI Policy, or just target the recovery of operational costs, rather than full cost recovery that includes depreciation.

The introduction of metering systems is an important aspect of tariff policy for some types of municipal projects, which the EBRD has been including in projects, for example in a water supply project, and district heating project. The concept of payments of tariffs based on the amount of water or energy used is new to many city administrations and residents, and the EBRD has focused on dialogue and awareness raising to explain the benefits. Tariffs in most countries have typically been based on the number of people per household or the area of property. The introduction of metering has major environmental and cost advantages in that it encourages savings in energy and water.

Another relevant aspect of tariff policy is the fee collection rate, which greatly varies in the municipalities in which the EBRD has projects. Revenue forecasting during the project planning is taking into account predicted levels of fee collection, and in many cases the EBRD encourages and supports clients to focus

on improving fee collection as a priority. For example, in a city of Central Asia, fee collection for water supply has increased from about 40 per cent before the first EBRD project to about 85 per cent at present.

In most projects the improved services and environmental standards require increased operational costs, and the timing of tariff increases is important so that residents and other users of the services can see visible improvements to the services at that time. In addition, targeted awareness campaigns have been included by the EBRD in several projects to enhance fee collection at these times. These campaigns raise awareness on the benefits of improved environmental standards, highlight the planning and ongoing improvements to services, explain new initiatives, such as metering, explain the costs of the services, and encourage community participation. The benefit of awareness campaigns is one of the common themes in the EBRD Lessons Learned Database (Appendix 3). Fee collection is particularly challenging where practical aspects work against the municipal services. For example, in the cities of Central Asia the frequent power cuts impact water supply because the operation of water pumps is affected, and this therefore gives residents the perception of inadequate supply and reduces the willingness to pay the tariffs.

Both a wastewater project and a solid waste project in south-eastern Europe included extensive awareness campaigns and fee collection for both projects have been a success. Before the projects the operational costs of wastewater treatment and solid waste disposal were minimal as there was no wastewater treatment plant and only open disposal of waste with minimal environmental protection. Therefore, both projects had a step change in operational costs considering the new facilities are operated to EU environmental standards. The awareness campaigns were an important part of the good fee collection for these services.

Clear and agreed responsibilities

Linked to the concepts of decentralisation, it is important for the municipal companies to have clear and understandable responsibilities for decisions, which enhances their accountability and motivation for improving performance. The EBRD encourages agreements and contracts between a city and a municipal company, which specify the responsibilities. In addition, in some cases the EBRD encourages the unbundling of municipal services where this brings enhanced transparency and accountability, for example in a south-eastern Europe solid waste project, where the EBRD project design included the separation of the disposal and collection functions into two municipal companies.

Public service contracts

For investments to result in improvements that are sustainable, the commitment of the city administrations and municipal companies to commercialisation is essential. In many of its projects, the EBRD includes the requirement to set up a public service contract (PSC) between the city administration and the municipal company, and this is resulting in a major positive change in commercialisation. The PSC addresses many of the key issues identified in the paragraphs above, including the specification of clear responsibilities, and particularly the need for a clear and agreed tariff policy, including setting the levels of subsidy payments from the city to the municipal company when tariffs do not cover operational costs and investments.

The public service contract related to the urban transport project with the municipal bus company in one city, for example, has greatly helped the company to plan future investments in vehicles and garages. There is still a need for a good working relationship between the municipal company and the city administration, as demonstrated by the strong relationship in the city. In the development of PSCs, the EBRD spends much time explaining the advantages and benefits to the clients in order to encourage buy-in and agreement (Box 5.4). The benefits of PSCs are a common point in the EBRD's Lessons Learned Database (Appendix 3).

Box 5.4 - The challenges in gaining agreement to the concept of public service contracts to enhance commercialisation

A city transport project in eastern Europe will improve municipal services in the bus network and metro, at the same time reducing the use of the private minibuses, which have safety issues. The objectives of the project include improving the commercialisation of the municipal companies that operate the services. This includes the development and agreement of Public Service Contracts (PSC) between the City and the companies in order to set out the responsibilities and budget allocations for future years, establishing a more commercial relationship between the City and the companies. Although the PSC approach is ambitious for the city, it is in line with the transition objective in the MEI Policy of commercialisation, and has been successful for other EBRD public transport projects in other countries.

In one country of eastern Europe there are significant difficulties between the city and the company in coming to an agreement on the allocation of budgets from the city to the companies, and on other provisions in the Public Service Contract (PSC). The approach of PSC is a major step change for the city and the first such initiative in eastern Europe in relation to transport. One of the associated technical cooperation components involves the outputs of a Corporate Development Plan and the Public Service Contract, but a more detailed and longer-term corporate development technical cooperation project might have been beneficial, to focus on strengthening the company as an arms-length more autonomous organisation. In addition, the scope of work for such a technical cooperation project might also include more detailed working with the City to strengthen its role as the client and to build an understanding of the PSC provisions.

Strong management at the municipal company

One of the main themes noted during the visits to MEI projects as part of this Study was the link between successful project implementation and the strong and committed management at the client company. Examples of successful projects for which the client has a strong management team include a heating project in eastern Europe; wastewater, urban transport, and solid waste projects in south-eastern Europe; an urban transport project in south-eastern Europe; and a water supply project in Central Asia. In all these projects the client has a strong understanding of the concepts of commercialisation (for example full cost recovery and improved fee collection), and has a high level of management experience, which contributed to the successful project implementation and resulting transition.

Collection and use of reliable data

Another important theme noted during the project assessments as part of this Study, is that reliable data is very relevant to the commercialisation of municipal companies. Good data is essential for the basis of forecasting and planning, and ultimately in making investment decisions with confidence. In several cases an initiative to improve data has greatly contributed to the commercialisation of the municipal companies. Examples include:

- In the eastern Europe, the municipal transport companies have introduced electronic ticketing systems. The data from these systems have formed the basis for planning a more commercial approach, because this provided reliable information on the usage of the transport services and helped with forecasting revenues. In particular, the data have been useful to plan the details of public service contracts, especially in relation to payments from the national government or city administration to the company for the equivalent prices of the privileged categories of people (for example pensioners) for which travel is subsidised. In the past such payments have not always been made in full, and the lack of revenue for these users of the services has been a major constraint to the development of the transport systems in the past. Projects in south-eastern European cities (box 5.5) are good examples of where the data have helped the companies to commercialise, and in

eastern Europe the data is helping the negotiation of the PSC. With the crisis a number of PSCs may need to be renegotiated.

- Under the EBRD project, a municipal water company in central Asia has enhanced its commercialisation. Prior to the introduction of water meters, the water bills were estimated based on normative tariffs per person in each household. This was subject to inaccurate information, with many households reporting lower numbers of inhabitants than was really the case. The use of water meters to provide actual data on water use has greatly assisted the company's ability to plan the water supply services. Similar improvements in collection and use of actual data have been made in relation to the metering of district heating supply in the EBRD project in south-eastern Europe, and another weighing of solid waste arriving at the landfill.

Other examples of where the lack of reliable data has the potential to impact project implementation and/or company commercialisation include:

- The lack of measurement of current water production in municipalities in south-eastern Europe (even though metering is being installed at the users), means that water losses cannot be identified properly (the EBRD project is addressing this problem).
- Unreliable data on land ownership has been a problem for the EBRD projects in south-eastern Europe (wastewater, water supply and public transport).
- For some municipalities, there are many unregistered properties, which is impacting the payments of the main source of revenues for the municipalities (property tax).
- In many projects, the EBRD has included an improvement in data collection and use into the project plans. Reliable data can be a core basis for successful improvement in municipal services. In some cases the EBRD might consider wider initiatives to address some important shortfalls in data, for example policy dialogue initiatives at national level to encourage the collection of better data, or wider technical cooperation projects on data collection and management. Other aspects of the use of technical cooperation to support the commercialisation of municipal companies are covered above. It is recognised that additional technical cooperation funds may be necessary to support MEI in improving data collection and measurement.

Private sector solutions

Strongly linked to commercialisation of municipal services, one of the strategic objectives of the EBRD MEI Policy is to promote private sector solutions, where feasible. This is covered in below.

Box 5.5 - Steps in transition in major improvement of urban transport in south-eastern Europe

An urban transport project in south-eastern Europe has been very successful in commercialising the municipal company, and demonstrates the many concepts of commercialisation. There has been a major change in the performance and commercialisation of a municipal bus company in the last eight to nine years. The company was close to collapse nine years ago. The buses were in a very bad state-of-repair, and there was weak financial control at the company. The current management is very experienced and committed.

The Public Service Contract (PSC) introduced under the EBRD project has had a major impact on the positive transition in terms of the commercialisation and standards of the bus service. The key point is that the City has been very supportive of the PSC.

Note, the critical step in the company's commercialisation was before the PSC, when the data collection on journeys was improved through the introduction of an electronic ticketing system in 2004. The reliable data now forms the basis of all planning decisions. It also helps to monitor exact usage. In particular, the data has been used to identify exactly the number of journeys of subsidised passengers (for example pensioners) so that the

City can then transfer the actual equivalent revenues for these journeys to the company, as required by the PSC.

5.1.3 *Environmental improvement*

As stated in the MEI Policy, the EBRD projects in the MEI sector aim to have a direct positive environmental (and social) impact as a consequence of investments that conserve environmental resources and reduce pollution. In addition, the objective is to achieve environmental standards that are in line with best international practices and in compliance with EU directives. Given the shift in Bank environmental policy in recent years to include a strong focus on social issues, this transition objective could be changed in the updated MEI Policy to focus on environmental and social issues.

Examples of environmental and social improvements

EBRD projects in the MEI sector are generating major environmental and social improvements in many cities in the countries of operations, and therefore contributing to positive transition impacts. Examples of positive environmental impacts in some of EBRD's projects visited during this study include:

- The EBRD's water supply project in a city of eastern Europe has improved water supply in most areas of the city. The new pumping and monitoring systems have reduced energy use and cut maintenance requirements. Previously all pumps were switched on at all times, resulting in overload and burn-out of old pumps, and monitoring systems were inadequate so failures were not noticed for some time. The new system includes a computerised monitoring system so that pump use can be linked to demand, and therefore pumps can be switched off at off-peak times to save energy. In one part of the city the energy savings and system improvements were so effective that a planned new pumping station was no longer needed and these funds could be transferred to other investments. The water quality was not a major problem, but the water supply was the priority and most households no longer get breaks in supply, and therefore the project has positive environmental and social impacts. In addition, the introduction of meters in many areas has cut the estimated consumption of water in metered households by about 50 per cent.
- Before the EBRD project in south-eastern Europe, the wastewater from one district of the city was discharged directly into the Adriatic Sea. The project involved the design and construction of a collector drain and pumping stations, and the result is that the wastewater is now collected and passes through the sewerage network to the existing wastewater treatment plant. The environmental authority that monitors the pollutant levels in the coastal waters has reported major improvements in sea water quality.
- The environmental improvements resulting from a solid waste project in a south-eastern European city are very high. Before the project, the site was simply an open disposal site, presenting a significant risk to the groundwater in nearby aquifers, which provide water supply for much of the city. The site is also near a river, and there was potential for river pollution from run-off from the waste area, and the site is close to a village, from which there had been many complaints. The landfill is now constructed and operated to EU standards. The rehabilitation has included the lining of the previous disposal area.
- The district heating projects in cities in south-eastern Europe, and eastern Europe will generate major improvements in terms of energy efficiency, more efficient use of natural gas and other fuels and reduced water leakages, as well as leading to the associated cost savings.
- One south-eastern European city's wastewater treatment project has had particularly positive environmental impacts. Before the project there was no treatment of wastewater from the city and raw wastewater was discharged into the river, which had major potential for pollution and public health impacts. The effluent standards from the new plant, developed and operated under a PPP

contract, are now in compliance with EU standards. This has reportedly greatly improved the water quality in the Sava River.

- In the coastal towns of south-eastern Europe the current water supply is unreliable in terms of quality, but more importantly there are sometimes breaks in supply, which has impacts on residents and the tourism sector. The EBRD project to improve the supply will have a positive environmental and social impact in the coastal municipalities, affecting residents and the tourist sector.
- The EBRD water supply projects in Central Asia are resulting in major environmental and social improvements to the poor communities in this early transition country. In one city, the investments in the improvement of pumping stations and the supply network, installation of water meters, and development of additional boreholes, has been significantly improving the water supply reliability, reducing water losses, and reducing energy use. The environmental and social impact is therefore very positive. Before the EBRD involvement many households were receiving water supply for only a few hours per day, but the majority of households now receive a supply for most of each day.
- The loans for a Municipal Infrastructure Programme for a city in south-eastern Europe were rushed through approval steps in 2001 at a time when there was an urgent need for rapid reconstruction and municipal improvements in the city, following the long period of international sanctions and conflict. Although this meant that there was less detail to project plans than is the normal case for EBRD projects, the rapid signing of the loans at that time should be perceived as a positive approach by the EBRD for taking such risks and prioritising environmental and social improvements, when the projects could have been thought of as against sound banking.

Achievement of EU environmental standards

One of the main drivers for improving municipal services is improved environmental standards, working towards compliance with EU legislation. Through its MEI portfolio, the EBRD has helped many countries towards compliance. However, in some countries the achievement of EU standards within the lifetime of projects, as required under the EBRD's Environmental and Social Policy, is not currently realistic in terms of affordability. The EBRD MEI team recognise these difficulties, for example in (ETCs, and on several occasions derogation to the Environmental and Social (E&S) Policy is required for approval by the EBRD Board.

The application of derogations to the MEI projects has become more robust since 2007 when the approach to the use of derogations changed. Earlier projects that were unlikely to achieve EU standards did not include derogations, but would so under the current practice. The application of derogations remains quite inconsistent, particularly related to the perception of the boundary of the project with respect to compliance with EU standards. The question of whether derogation was needed for these projects is less important than the fact that there are inconsistencies in the interpretation of the E&S Policy.

The role of the Bank's Environmental and Social Department

Overall, the EBRD investments have had a highly positive environmental and social impact. It should be noted that the environmental investments for these projects have been planned by the EBRD Bankers, support teams of economists, environmentalists, social scientists, and consultants under the technical cooperation projects. The EBRD's Environmental and Social Department (ESD) carry out checks of the projects focusing on mitigation of potential negative impacts related to environmental, health and safety, and social aspects, and carry out monitoring in relation to any action plans on the mitigation. The EBRD might further enhance the role of the ESD to focus the team's considerable skills and experience more on supporting the identification and planning of the environmental investments, thereby contributing more to the positive environmental improvements, rather than just focussing on compliance. This means a greater focus on making the business case for environmental improvements.

The need for a prioritised programme of investments

For many cities, a programme of investments in the MEI sector in order to comply with EU standards is an affordable and applicable strategy only in the longer-term. For example, most cities cannot afford to upgrade all their water supply and wastewater infrastructure to achieve EU standards at the same time, and a programme of investments focusing first on water quality and supply, then on wastewater treatment and then sludge treatment, is a more realistic strategy. This step-by-step approach is also applicable for solid waste management improvements in many countries of operations (Box 5.6).

Box 5.6 - The need for a programme of investments in the solid waste sector

EBRD have signed a relatively small number of solid waste management projects (10 in total up to December 2009) and is less experienced in the implementation of these projects than in water and wastewater projects. Solid waste disposal projects, when designed and operated to EU standards, are likely to need a major step change in waste disposal tariffs, and there are risks that such high standards of operation cannot be sustained. These projects are also subject to significant delays if a landfill location has not been selected and agreed, and the EIA and consultation process can take much time. Although the solid waste projects that were visited as part of this study have been mostly successful so far in implementation, the EBRD might consider designing future solid waste projects within a programme of investments, focusing on waste collection, recycling and disposal as different projects at different times, just as water supply, wastewater treatment and sludge treatment are often planned as separate projects in the water and sewage sector. A solid waste management project in a city of Central Asia, for example, aims to address waste collection and disposal in the city, and raise performance to comply with EU environmental standards.

A south-eastern European city's solid waste management project involves a loan for the construction of a regional landfill, as well as recycling facility and transfer stations. The environmental protection at the existing disposal sites is minimal. The new regional site will be designed and operated to EU standards, and the plan is for the old municipal sites to be closed. Therefore the environmental improvements would be very significant. The city's regional landfill site will not accept industrial, medical and construction wastes and a plan for other waste types has not yet been developed. It is likely that some of the existing waste disposal sites will need to stay open to accept these wastes. The overall impact of the project will be very positive, but it does demonstrate the wider complexities of municipal improvements and the need for a step-by-step approach.

Measurement and reporting of environmental improvements

There would be benefits if the EBRD MEI team increased its measurement and reporting of the major environmental improvements in projects in order to enhance the EBRD's profile externally, strengthen the MEI team's profile inside the Bank, and particularly to increase the demonstration impacts of projects. For example, there have been many MEI projects to improve wastewater treatment plant along rivers in Romania that flow into the River Danube, and the EBRD might have monitored the resulting reduction in pollution in these rivers. For several projects, the environmental authorities are likely to be carrying out some monitoring, and these data might be accessible for the EBRD.

For public transport projects, involving the procurement of buses with improved safety standards, there is much focus on the need for environmentally sound diesel engines. For an urban transport project in south-eastern Europe, for example, the EBRD required Euro III engines and the company procured buses with Euro IV engines with higher standards of environmental protection. The improvement of the bus service and safety had a significant social impact, which could have been measured through customer satisfaction surveys.

Health and safety

The EBRD's Environmental and Social Policy requires high standards of health and safety practices, for example during construction. Based particularly on previous visits to EBRD MEI projects, it is clear that the EBRD has a challenge in influencing health and safety practices, and particularly in monitoring compliance with requirements during implementation.

A water project in the eastern Europe had been visited as part of an earlier monitoring study (Box 5.7). The project illustrates several of the above points.

Box 5.7 - Water Utility Development and Investment Programme

The EBRD project has included extensive upgrades of the water treatment works and wastewater treatment works. The project also included upgrading of pumps, installation of water meters, and improvements to water mains. Project benefits include improved quality of treated water for supply, improved quality standards of treated wastewater, improved reliability of water supply through new pump systems and reduced leakages, as well as improved energy efficiency.

Project implementation was subject to significant delays because of contractual issues during the upgrade works. In addition, it should be noted that the company still has regular non-compliances with national regulations in relation to the water and wastewater treatment plant that have not been upgraded and are outside the scope of the EBRD project. Also, the company has ongoing environmental problems related to the management of sewage sludge.

The client has had serious health and safety incidents in the past, including a fatal accident in 2004. The company's H&S Department are reportedly now very proactive in implementation and monitoring of the H&S procedures.

The works related to the EBRD project have been completed and the environmental and social impacts have been very positive. The company has had no problems with compliance with national regulations related to the upgraded facilities under the EBRD loan. These facilities are largely compliant with EU environmental standards. The upgraded water treatment and wastewater treatment plant are now very modern facilities, with computerised monitoring and control systems.

5.2 Achievement of strategic objectives

As well as the core transition objectives of decentralisation, commercialisation and environmental impact, the EBRD's MEI Policy has a number of strategic objectives. The assessment of the achievement of the following main strategic objectives is provided in this section:

- To extend the use of standard products to Russia / intermediate / early transition countries.
- To build on experience in the water sector and expand the portfolio into other sectors.
- To promote private sector solutions.
- To extend the use of existing products to small municipalities.
- To carry out institutional strengthening through technical cooperation (technical cooperation).
- To address affordability constraints through grant co-finance.
- To increase access of municipal service companies to capital.
- To improve project implementation and improve disbursements.

5.2.1 Expansion of MEI portfolio to Russia / intermediate / early transition countries.

The MEI Policy indicates that, based on the Bank’s experience of standard products (for example loans) for infrastructure projects in EU and advanced countries, the EBRD will expand its MEI portfolio into Russia, intermediate transition countries, and early transition countries.

Table 5.1 provides an overview of the proportion of projects signed in the different categories of country. It indicates that the number of projects in the portfolio in EU countries overall is high (51 per cent of projects). Figure 5.1 provides an illustration over time of the implementation of the strategic objective on ‘moving east,’ and confirms that the number of projects signed each year in EU (2004) countries has been decreasing since 2004, and the number of projects signed each year in EU (2007) countries was high from 2002 to 2007 and has been decreasing since. Figure 5.1 also illustrates the increase since 2001 of MEI projects in Russia, and in the categories of other NIS countries and ETCs, with a quicker increase in projects from 2006. The number of MEI projects signed in Russia, other NIS, and ETCs by the end of 2001 was only nine in total, but an additional 58 MEI projects have been signed in these countries since then.

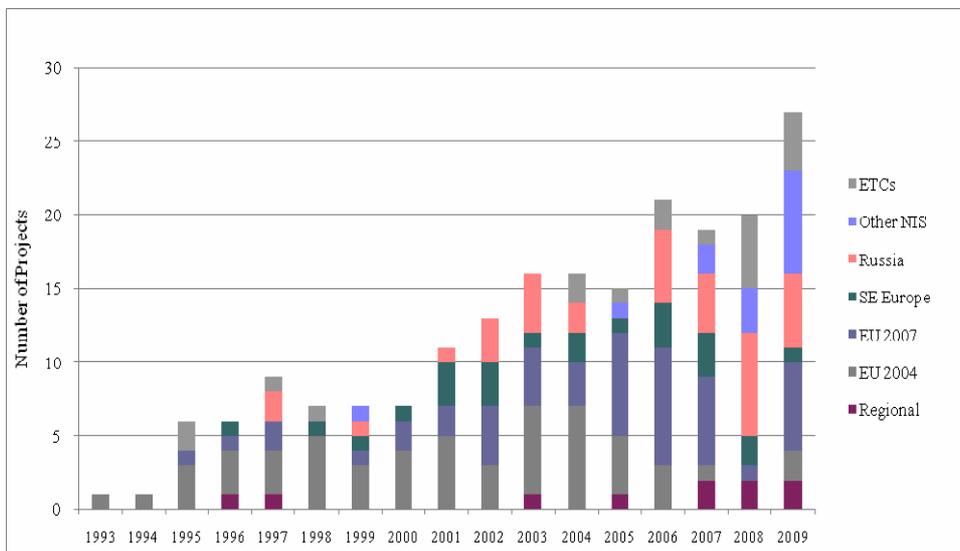
Table 5.1 - Total number of projects signed in each category of country (up to June 2009)

	Water and Sewage	Urban Transport	Solid Waste Mgt	District Heating	Housing	Other	Total	per cent of total
Regional	7	1	0	1	0	1	10	5
EU 2004	21	10	1	18	0	4	54	26.7
EU 2007	23	15	2	6	0	2	48	23.8
SE Europe	13	5	3	1	0	1	23	11.4
Russia	19	1	1	9	1	3	34	16.8
Other NIS	3	8	0	3	0	0	14	6.9
ETCs	12	3	3	1	0	0	19	9.4
Total	98	43	10	39	1	11	202	100

Key to country categories:

- EU 2004 (Czech Rep, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia).
- EU 2007 (Romania, Bulgaria).
- SE Europe (Albania, Bosnia, Croatia, Macedonia, Montenegro, Serbia, Turkey).
- Other NIS (Belarus, Kazakhstan, Ukraine).
- Early transition countries - ETCs (Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Uzbekistan).

Figure 5.1 - Number of MEI projects signed in each category of country



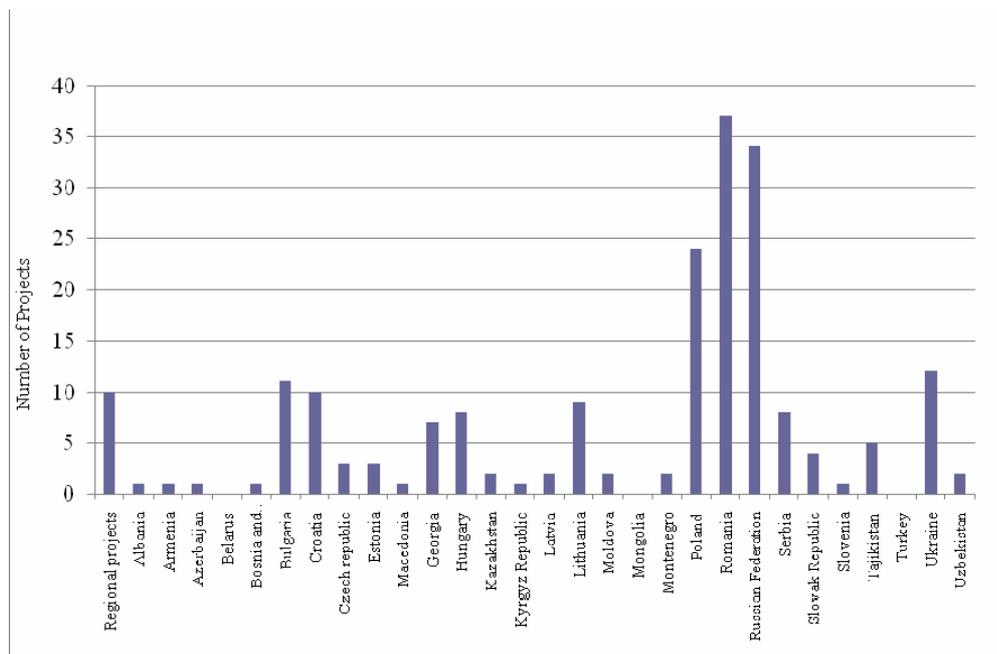
The number of projects greatly varies between countries. In some countries most municipalities are not creditworthy, or are not given responsibilities for investment decisions because of a lack of decentralisation policy, and in these countries the EBRD is carrying out fewer MEI projects. Figure 5.2 illustrates the spread of MEI projects signed in different countries. This shows that the number of projects in Romania is very high (20 per cent) relative to other countries. Also, Russia (18 per cent of projects) dominates the portfolio in non-EU countries, and the number of projects in eastern and south-eastern Europe is also relatively high.

There are a number of potential constraints and challenges to shifting the portfolio 'east.' For example, although there have been strong drivers for the implementation of MEI projects, especially water, wastewater and solid waste projects, in EU accession countries because of the need to develop compliance with EU legislation, regulatory drivers are much less applicable to municipalities in many of the intermediate and early transition countries.

Affordability is an important factor to shifting the portfolio to Russia, intermediate and early transition countries. Grant co-financing was available for many of the large MEI projects that have been implemented in EU accession countries. For most MEI projects in early transition countries, a larger proportion of the total project costs needs to come from grant co-financing because of the problems with affordability, but there are fewer formal mechanisms for co-financing and the process of setting up the co-financing can be time-consuming.

Another potential constraint to 'moving east' is the variation in commitment of city administrations to improving and commercialising municipal services, particularly in relation to the necessary tariff reform. Some of the typical approaches to commercialisation, such as service contracts between a city administration and the municipal company, represent a step change in approach in many places. In particular, the capacity of municipal companies and city administrations to implement MEI projects, including carrying out procurement in line with the EBRD requirements, is inadequate in many of the intermediate and early transition countries.

Figure 5.2 - Number of MEI projects signed in each country of operation



These factors and constraints to shifting the portfolio require a large amount of resources from the EBRD's MEI team and other staff in the resident offices, for planning and monitoring projects and carrying out the necessary wider policy dialogue. The bankers need to spend large amounts of time in these countries with clients explaining the EBRD requirements, the provisions of the loan agreement, and ensuring the clients understand the benefits of the project and are fully committed to its implementation. In general, larger technical cooperation components are needed in intermediate and early transition countries, which also require grant funding.

There is significant correlation between the number of EBRD projects in a country and the MEI resources in the resident offices. In Romania, Poland, Russia and Georgia, for example, the EBRD currently has, or has previously had, MEI bankers based permanently in the resident offices. This has had a clear impact on increasing the number of projects. This is the case also in a country of eastern Europe, where, despite the financial crisis, the EBRD has been able to grow its portfolio of MEI projects and the pipeline of future potential projects in the country. The EBRD MEI portfolio currently includes 12 projects, and 10 of these were signed since 2007. MEI bankers started to be based in one eastern European resident office from 2006, and the rapid expansion of the portfolio reflects these resources. There were only two other MEI projects signed before this, reflecting the difficulties in setting up MEI projects when there are no specialist MEI bankers based in the country of operation.

The volume of EBRD finance is also an important indicator related to the strategic objective of expanding the Bank's MEI portfolio into Russia, intermediate and early transition countries. Although the number of projects in ETCs has increased in recent years to over nine per cent of the signed projects in the MEI portfolio, the volume of EBRD finance in the projects in ETCs is only 2.7 per cent of the total MEI volume. Table 5.3 shows the average size of MEI projects in different countries of operations. The average size of MEI projects in ETCs is €4.7million, which is much lower than the average size of project for the overall MEI portfolio of €16.6 million. The key point is that, if the Bank is shifting its portfolio east, the projects will generally need to be smaller for a number of reasons (mainly affordability), and therefore to achieve the same total annual volume the Bank will need to sign more projects.

Table 5.2 - Total number and average size of projects in each country (up to June 2009)

Country	# projects	Average size of loan	Country	Number of projects	Average size of loan
Regional projects	10	46.4	Latvia	2	15.2
Albania	1	14.6	Lithuania	9	9.8
Armenia	1	7.0	Moldova	2	11.2
Azerbaijan	1	16.4	Mongolia	0	N/A
Belarus	0	N/A	Montenegro	2	10.5
Bosnia & Herzegovina	1	7.0	Poland	24	14.3
Bulgaria	11	18.5	Romania	37	12.1
Croatia	10	18.3	Russia	34	22.9
Czech republic	3	21.1	Serbia	8	16.9
Estonia	3	29.3	Slovak Republic	4	3.5
Macedonia	1	16.4	Slovenia	1	14.8
Georgia	7	2.2	Tajikistan	5	1.7
Hungary	8	12.4	Turkey	0	N/A
Kazakhstan	2	6.4	Ukraine	12	19.9
Kyrgyz Republic	1	5.5	Uzbekistan	2	7.1
			Total	202	16.6

The issues of lack of decentralisation and creditworthiness in some countries, as well as the high resource needs to carry out the policy dialogue in order to encourage reform, mean that there are some countries in which EBRD has no projects or only one project. Even in these countries, there are benefits to the implementation of small demonstration projects to encourage the reform through demonstrating the benefits of the core concepts of commercialisation, decentralisation of responsibility, and environmental

improvement. This has been the case in Central Asia, where the first project had a major demonstration impact (Box 5.8).

Box 5.8 - Demonstration benefits from successful pilot projects in water supply improvement in early transition countries

One of the first MEI projects of the EBRD in Central Asia was a water project. It was designed to be a test case as the first project under the EBRD's ETC Initiative. The successful approach is now being used as a model for other cities. Previously many households were receiving water for just a few hours per day, and the efficiency of water use was very poor. The project has improved the reliability of water supply throughout the city, and installation of meters has greatly improved the efficiency of water use in those areas. The technical cooperation related to the project focused on corporatisation of the company, signing of a Public Service Contract between the City and the company, development of the tariff setting policy, and a community participation programme, as well as the technical design and procurement support. A subsequent project to further improve the water supply in the city has been signed, and there could be potential for a third project in future on improving wastewater treatment. This successful model, with typically 50-70 per cent grant co-finance and structured technical cooperation support, and affordable improvements implemented on a step-by-step basis, is being used as the basis for the design of most of the EBRD's other MEI projects in Central Asia.

In Central Asia, the EBRD has signed another water project, is in an advanced stage of planning a second project covering seven cities, and is planning several similar water projects. The planning of all these projects will be based on the experience of the 2004 project. Relevant representatives of the cities and water companies in the water project have visited that city to learn lessons from the successful water supply project.

The demonstration effect of the successful 2004 project has been useful not just for EBRD projects. Stakeholders related to the World Bank water project have visited the city to learn lessons from the approach. In addition, the gas and electricity companies there are changing their approach, based on the lessons from the commercialisation aspects of the city's water projects.

The ongoing expansion of the MEI portfolio into Russia, intermediate and early transition countries will be a challenge to the EBRD as there are often higher potential risks to the implementation of projects in these countries. The MEI projects that have been evaluated in Russia and ETCs were less successful in terms of overall performance rating than in other countries. The expansion 'east' will require more resources to set up and monitor the projects, and to carry out the necessary policy dialogue.

Overall, despite the challenges outlined in this section, the EBRD is achieving this strategic objective of expanding its MEI portfolio into Russia, intermediate and early transition countries. It will be important for the EBRD to define its ongoing strategy towards projects in EU and advanced accession countries, in which there remain many potential opportunities. Although potential projects in these advanced countries are likely to have lower transition impact than in intermediate and early transition countries, there is a stronger potential for projects in MEI sectors outside the traditional sectors of water and urban transport, in the EU and other advanced countries. This objective of expansion of the portfolio into new sectors is covered in the following section.

5.2.2 Expansion of the MEI portfolio in other sectors

One of the core strategic objectives in the MEI Policy is to build on the EBRD's experience in the water sector to expand the portfolio into other sectors. The EBRD MEI Policy of 2004 gives examples of: urban transport, car parking, district heating, waste management, waste to energy, public housing³, and urban

³ A more liberal interpretation of Article 11 of the Agreement Establishing the Bank would allow the MEI team to meet its stated policy objectives in this sector and respond to important energy efficiency investment needs in the public building and housing sectors.

regeneration. Previous MEI policies (in 1992 and 1998) also mentioned industrial/business parks and natural gas⁴ distribution (Appendix 2).

Table 5.4 shows the number of MEI projects signed each year in the different MEI sectors in which EBRD has signed projects. The portfolio is dominated by water / sewerage projects (nearly 50 per cent of total number of projects). Urban transport (21 per cent) and district heating (19 per cent) are the other main sectors. There are also 10 solid waste projects but only one housing project. The EBRD has signed no MEI projects in other sectors such as car parking, waste to energy and urban regeneration. Energy efficiency and a focus on demand side management is an area where MEI's clients have asked the Bank for assistance in light of growing concerns about rising energy costs. Due to concerns about whether this area would be consistent with Article 11 of the Agreement Establishing the Bank, several of these projects have stalled.

Table 5.4 - Number of MEI projects signed in different sectors

	Water and	Urban	Solid	District	Housing	Other	Total
1993		1					1
1994	1						1
1995	4			2			6
1996	4	1		2			6
1997	4		1	3		1	9
1998	2		2	1		1	7
1999	6			1			7
2000	6			1			7
2001	5	2	1	2		1	11
2002	6	2		3		2	13
2003	9	2	1	3		1	16
2004	7	4		3		2	16
2005	6	7		2			15
2006	7	7	2	5			21
2007	12	3		3	1		19
2008	9	3	2	4		2	20
2009	10	11	1	4		1	27
Total	98	43	10	39	1	11	202
per cent	49	21	5	19	0.5	5	

Note – the “Other” category represents projects that cover more than one MEI sector.

An assessment of the types of projects over time shows that the domination of water and sewage in the portfolio has continued over the years of activity. Although urban transport and district heating projects have increased in number, there has been no obvious increase in projects outside the main three sectors (for example no major increase in waste management, housing or other projects).

One of the issues related to the objective of expanding the portfolio into other sectors, is that this could work against the strategic objective of expanding the portfolio ‘east.’ In most municipalities in ETCs the priority for improvements in municipal services is related to water supply. Therefore, if the EBRD is aiming to address the priorities in these countries it will need to continue also to implement water supply projects, for which the EBRD experience is useful.

The water and sewage projects have generally initially focused on water supply, and then municipalities tend to address wastewater treatment once the water supply has been improved. As well as several

⁴ Gas distribution projects are currently the responsibility of the Power and Energy Team

successful EBRD water supply projects, for example in Romania, there have been some major improvements as a result of wastewater projects, for example in eastern Europe.

Urban transport and district heating can also have had strong transition impact, particularly in terms of commercialisation, and there is potential to expand further the number of these projects. Only two urban transport projects had been signed before 2001, since when a further 41 have been signed. Many loans for urban transport projects are for the procurement of vehicles, and these have the potential for quicker disbursement than most capital projects in other sectors that involve works contracts for construction.

There has been no clear increase in solid waste management projects, but there are reportedly many of these projects in the pipeline. Solid waste projects can be particularly complex, and can take a long time to implement. The expansion of the MEI portfolio to more projects on urban transport, district heating, solid waste management, and other sectors, partly depends on the perception of transition impact by those in EBRD who are responsible for the approval of potential projects. The perception within the Bank on the EBRD mandate on transition impact varies between different EBRD staff. Reportedly, one of the aspects of planning projects is that the economists in OCE do not support deals in a sector once a few deals have been carried out, because their perception is that there would not be much extra transition impact and demonstration effect in the country. The opinion of some MEI bankers is that, although the first project might have the higher transition impact, the next planned investments might be the exact priorities for other municipalities, and access to capital from elsewhere for the investments might be difficult for the municipalities to obtain. It might be inappropriate for the MEI team to push for deals with these municipalities in other MEI sectors when the deals in the priority sectors cannot be signed because of EBRD's mandate on transition. It is important that the implications of the EBRD mandate on growing the MEI sector business are properly clarified and understood so that all staff are aware of the types of projects that can be approved in different countries, and that there is a consistent approach across the Bank. Otherwise this issue is likely to constrain the expansion of the EBRD portfolio in the MEI sector.

The development of a programme of investments for a municipality is particularly useful so that the city has a strategic plan of prioritised investments. There are several cases where the EBRD has encouraged this approach, for example through technical cooperation components that have included strategic programmes of investments as one of the outputs.

During this Study, there have been examples noted where EBRD bankers have been attempting to develop projects and increase dialogue with potential clients on municipal services outside the core sectors of water and sewage, urban transport, district heating, and solid waste management. For example, in south-eastern Europe, the EBRD has set up the development of strategic plans for two cities. In both cases the EBRD has had urban transport projects with the bus companies in these cities. The strategic plans have identified traffic congestion as a continuing priority and the need to invest in parking garages, and the EBRD has been in discussion with the city administrations about potential future projects. These would probably involve a PPP structure.

One particular sector that is mentioned in the MEI Policy is housing, and the EBRD has signed one housing project in total, in Russia. The MEI team in eastern Europe were planning the detail of a housing project (Box 6.9), but the financial crisis has meant that this project has not yet been progressed.

Box 6.9 - Example of EBRD activity to try to expand the MEI portfolio to other sectors

Improvement in the organisational framework and standards for housing remains a priority in most cities in eastern Europe. Although the majority of apartments are now in private ownership, the common areas (staircases, elevators, roof, and so on) remain in the ownership of the municipality, but there are uncertainties in responsibilities for

maintenance of these areas, and the city administrations are generally not carrying out maintenance works. In this city, EBRD were working with various stakeholders to try to set up a housing project with municipal housing associations as the clients, and working through local banks. The new systems of housing associations have the shortfall that it is optional for households to sign up to the association, and therefore there can be the situation in an apartment block where some residents are paying for maintenance of communal areas, and others not paying. This is clearly not workable and the housing association is ineffective in relation to maintenance. The EBRD has been in dialogue with the City in relation to a loan fund for housing associations, and the necessary policy changes to make it compulsory for residents to join the housing associations. The EBRD was in dialogue with the World Bank, USAID and some NGOs on this and had been setting up a technical cooperation project to establish and strengthen a housing association support centre. In this case, the local banks pulled out of the project because of the financial crisis, and, because of the need for financial intermediaries to manage the provision of many small loans, the EBRD was not able to complete the agreement. The concept for the housing project remains very applicable in eastern Europe and in some other countries.

The EBRD is already implementing a district heating project in the same city and has a good relationship with the municipality. As would have been the case if the housing project had been progressed, one potential strategy for expanding the portfolio into new sectors would be for the EBRD to test different types of projects with municipalities with which the Bank already has had a successful project and has a good relationship with the city. In addition, the city would already have a good understanding of EBRD's approach and requirements.

Potential projects in the MEI sector outside the core sectors of water and sewage, urban transport, district heating, and solid waste management, might therefore include:

- Public housing (including energy efficiency in buildings as well as municipal buildings).
- Urban regeneration.
- Car parking.
- Park and ride schemes.
- Waste to energy plant.
- Commercialising fee collection companies.
- Raw water management organisations (i.e. before "water supply").
- Irrigation and flood protection (where this is under municipal control).
- Industrial / business parks.
- Municipal park services (for example green parks and swimming pools).
- Road safety (for example speed cameras).
- Street lighting.
- Schools, hospitals and other emergency services.

Some of these are income generating, (for example car parking, waste to energy, industrial parks and road safety) while others may result in cost savings and contribute to transition impact, energy efficiency, and municipal development. It should be noted that a more liberal interpretation of Article 11 of the Agreement Establishing the Bank will need to be taken if the MEI team is to meet its stated policy objectives in relation to the public housing and urban regeneration and respond to important energy efficiency investment needs in the public building and housing sectors. Given the demand side management and high energy efficiency potential of such projects, these sectors would complement the MEI work in municipalities.

The EBRD MEI Policy also states that the Bank will include in its MEI portfolio projects in sectors that are not based on full cost recovery, but would benefit from commercialisation. The Bank has had some activity in the MEI sector in these types of projects, for example in urban transport projects. Currently, the EBRD has had no projects in sectors that generate no direct revenues, although one such project is being planned in a municipality of south-eastern Europe (Box 6.10).

Box 6.10 - Example project in a sector that would not generate revenues

The city is a very small municipality with 15,000 residents, and is one of the towns covered by the south-eastern European water supply project. The EBRD already has good dialogue with the client. The EBRD is planning a loan to the municipality for the widening and improvement of the main boulevard in the city, which links the airport with the city centre and other coastal areas. This project will be in a sector that is not directly revenue-generating. This area in south-eastern Europe is particularly important for tourism, and there are now many interested investors in tourism development. These potential investors are requiring the improvement of the main road from the airport, which can become particularly congested in the summer tourist season.

In practice, a balance might be needed between expanding the portfolio 'east' and increasing projects in other sectors. The Bank might need to continue to implement water and other core projects in Russia, intermediate and early transition countries, in line with the strategic objective. In parallel, in the EU countries and other advanced countries of operations the Bank should aim to expand the MEI portfolio into other sectors, such as parking, and housing, working with existing clients with which the EBRD already has a strong relationship. It is important to continue to address priorities in a particular municipality, rather than be steered by the MEI Policy objective towards other sectors, which might be a lower priority for some municipalities. One option, therefore, might be to amend this strategic objective when the MEI Policy is updated in 2010 to be more specific towards "building on experience in the water sector to expand the MEI portfolio in other sectors, initially in advanced countries."

5.2.3 *Promotion of private sector solutions*

Linked to the transition objective of commercialisation, the EBRD's MEI Policy states that the Bank will encourage the development of the role of the private sector as a means of achieving commercial efficiency in municipal services, where the possibility to structure private sector solutions exists.

Based on the projects assessed during this study, and the discussions with EBRD bankers and other staff, it can be confirmed that EBRD is promoting private sector solutions on a widespread basis. In many countries of operations the framework for private sector solutions is not yet strong enough to attract credible private sector interest on a large scale.

Feasibility of private sector solutions

There are several factors that affect the potential feasibility of private sector solutions, in particular:

- Some types of public-private-partnership (PPP) deals are particularly complex, and much depends on the capacity of a city administration to carry out its role as the client in a PPP deal, which will require planning, tendering, contract negotiations and contract monitoring. In many cases the capacity of the city administrations in the EBRD's countries of operations would need significant strengthening for such a role.
- A city administration must be committed to private sector solutions, which are often perceived as being more expensive because of the profit element for the private companies. Often the framework to set up PPP projects requires changes to certain policies, such as increases of tariffs to levels that attract the private sector, and these changes can be unpopular. Most city administrations are

generally committed to the concepts of commercialisation, but not necessarily to PPP, which can have political implications. In particular, many city administrations are elected for periods of four to five years, and PPP projects can take this long to be implemented and to start making visible improvements to municipal services.

- Where privatisation of an existing municipal company is being considered, then, amongst several factors, this depends on the standard of the existing service. If there is already a high standard then the perception of residents might be that there is no need for privatisation, but if the standard is very inefficient, then the private sector might perceive this as an indication that there are too many risks in the institutional or financial framework, or that there is not enough commitment of the city administration to improving municipal services.
- For many of the EBRD projects, the loans are structured alongside grant funding for the capital projects, much of which is from the EU, especially for projects in accession countries. There is a perception amongst the city administrations that private sector solutions are not allowed by the EU when grant funding is included. If the PPP contract is set up so that the city has ownership of the facility and there is a concession contract for the private sector to operate the facility, then this is reportedly acceptable to the EU. In these cases the EBRD's policy dialogue activities should encourage the cities to consider PPP as an option, although often the EBRD will be involved after the city has decided on the framework for the implementation.

In several projects the EBRD is encouraging private sector solutions involving international private companies, for example in the design, build and operation of wastewater treatment facilities, or in privatisation of existing municipal companies. Many international companies are concerned about the risks of their involvement in some of the EBRD's countries of operations. For example, international companies are concerned about an open and transparent tendering process, robust contracts with clear specifications on requirements and standards, confidence of payments from the clients (linked to tariff policy and fee collection), ensuring that contracts are for a long enough timescale to allow payback on investments, ensuring that contracts cover a large enough area to benefit from economies of scale (which is not the case in many of the secondary cities in the EBRD's countries of operations), guaranteeing against political risk. It is important that there are enough credible and interested private companies to ensure competition and that there are independent and transparent regulators with strong technical and monitoring capacity to enforce proper operations. Increasingly, the MEI Team is designing such projects to either share the demand risk, or have the city take on responsibility for the demand risk.

Planning of private sector solutions into projects

In some cases the EBRD appears to be over-ambitious in planning PPP solutions in difficult situations in some countries of operations. The MEI Team recognises that a period of full cost recovery under a commercialised regime is needed before PPP is feasible. In planning most MEI projects the EBRD is promoting private sector solutions, but with the realisation that it will take time to develop the framework and commitment of the municipality to such options. In several projects the technical cooperation components on strengthening the municipal company, often involving the development of a Financial and Operational Performance Improvement Programme (FOPIP), include a task on the development of options for PPP solutions in the longer-term. This is a sensible approach as it encourages the city to start to consider these options, and raises the profile of the types of changes that will be needed to the institutional framework and to tariff policies in order to successfully implement PPP. Although plans for potential longer-term PPP solutions are being included in some projects, the subsequent implementation of such plans is often not being progressed by the city administrations. For example, the technical cooperation preparation of the FOPIP in the wastewater project in a south-eastern European city included a plan for the introduction of the private sector into the water and sewage sector. However, no progress has been made in private sector participation, and there is limited commitment from the water company or

the City to this aspect. The EBRD must be realistic in its ambitions for private sector solutions and ensure ongoing dialogue with city administrations where these might be feasible in future.

In many projects the EBRD is enhancing local private companies through involvement of small scale private sector participation (PSP) in works or supply contracts during project implementation. The EBRD might consider expanding its focus on bottom-up private sector participation of local companies for some projects.

Some successful EBRD projects have focused on PPP solutions from the start. For example, a wastewater treatment plan in a south-eastern European city is a positive example of successful PPP, where the facility has been constructed and is being operated to EU standards. The international competitive tendering saved the City a significant amount of money compared to the forecast expenditure. The city had already decided to take the PPP option before EBRD was involved, but the EBRD carried out extensive policy dialogue during the tendering and provided particularly detailed support during the contract development and negotiations to ensure the city and the company had a clear understanding of the conditions and responsibilities. The lessons from this project are particularly that the tendering of PPP takes time, and it is a complex solution. This was for a major new facility with a total project cost of over €300 million, and the PPP solution might not necessarily be applicable to a much smaller facility given the resources and time taken in setting up the project.

There are few examples in the EBRD's MEI portfolio of loans to private sector companies involved in MEI services. In a city of Central Asia, the EBRD has had early discussions about a potential loan to an international operator that is interested in PPP in the water sector. In addition, the EBRD has recently signed a small loan through the Direct Lending Facility (DLF) to a private bus company in Central Asia. This particular project is forecast to strengthen competition amongst the operators in that city.

There are likely to be some opportunities for PPP solutions that are outside the EBRD's core sectors in MEI. For example, parking infrastructure is particularly needed in several cities (especially in south-eastern Europe (Box 5.11)) and, as properly operated parking systems can be highly cash-generating, PPP solutions where investments are needed for large parking garages might be feasible.

Box 5.11 - Example opportunities for PPP projects that are also related to the strategic objective of expansion of the EBRD's MEI portfolio to other sectors

As well as the strategic objective to promote private sector solutions, the EBRD's MEI Policy includes the strategic objective to expand the MEI portfolio away from the water supply sector, for which the EBRD has implemented many projects with successful transition impact, and into other municipal sectors that are priorities in the countries of operations.

In two south-eastern European cities, the EBRD has implemented successful urban transport projects for the municipal bus companies. Both projects included technical cooperation to develop a Sustainable Transport Strategy for the cities. Both cities have priority problems with traffic congestion and lack of parking, and the Sustainable Transport Strategies included a strong focus on addressing these problems through a mix of construction of parking garages in the cities, and also the potential development of park and ride schemes. Parking is a major provider of cash for the city administrations at present, and a more organised parking framework would address these priority problems and provide substantially more cash. For example, the sustainable transport strategy for one city included an option of PPP for the development of the parking garages (estimated project cost €5 million to €12.5 million). Parking presents an important opportunity for expanding the EBRD portfolio into new sectors in several cities, as well as promoting feasible private sector solutions.

5.2.4 Increase in projects with small municipalities

A strategic objective focusing on small municipalities was introduced to the MEI Policy in the 2004 revision. The objective is to extend the use of existing "products" to small municipalities. The Policy states

that this includes working with financial intermediaries and can also cover multi-municipal and regional projects.

Overall, the EBRD has been particularly successful in increasing its MEI projects with small municipalities. For example, the Bank has projects in seven different south-eastern European cities. These countries demonstrate the tendency for the Bank to have implemented initial projects in the capital city (the Bank signed four early MEI projects) and to later develop projects with smaller municipalities in the country. There have been minimal opportunities to work with financial intermediaries in smaller municipalities, although the EBRD was trying to set up a housing project in eastern Europe, and this would have included working with financial intermediaries.

The expansion of the portfolio to small municipalities has been helped by the set up of specific funds. The Municipal Utilities Development Programme (MUDP) and Municipal Environmental Loan Facility (MELF) have facilitated the successful implementation of many water supply and wastewater treatment projects in Romania. The Bank also lent to the Small and Medium-Sized Towns Investment Development Programme (SAMTID) in Romania which was a pilot project with the government on regionalising the water companies which provided the basis for its Operating Programme in the Environment. Through SAMTID, the Bank supported the regionalisation of a water company along river basin lines and provided financing support water improvements in seven smaller cities.

More recently, the Bank set up the Fund for Local Authorities and Government (FLAG) in Bulgaria in early 2009, and there has been initial dialogue and planning to set up similar funds in Romania and Serbia. One of the advantages of FLAG and other such facilities is that they can fund projects lower than the typical EBRD limit of €5 million, which can help some of the smaller municipalities in the country, and the project approval can be processed relatively quickly. A potential disadvantage is that these funds tend to be managed by the national government and therefore there might be less emphasis on the transition aspects of decentralisation and commercialisation.

The successful achievement of this strategic objective has been greatly helped by the planning and implementation of multi-municipal projects. For example, the water supply project in south-eastern Europe will lead to significant environmental and social improvements in an important tourist area in coastal municipalities.

The EBRD's approach of initially planning and implementing demonstration projects, and then expanding the portfolio in a country to smaller municipalities, has been successful in Central Asia. The first project was a demonstration project. The EBRD has since signed a multi-municipal project to improve water supply in three other cities. In addition, another multi-municipal water project is in an advanced stage of planning and this covers a further seven cities. These projects require significant technical cooperation resources. In smaller EU markets, working with smaller municipalities is constrained by the lack of technical cooperation funds.

As well as water supply and potentially wastewater projects, multi-municipal projects are also applicable to regional solutions in solid waste management, where economies of scale can be gained by combining municipal services to cover several smaller cities, although these projects are less applicable for some other sectors (for example district heating). For example, a solid waste project in south-eastern Europe covers nine small municipalities. Most of these municipalities are too small to develop their own sustainable waste management systems, and an inter-municipal regional solution is most appropriate.

One of the challenges of some types of inter-municipal projects is the need for strong inter-municipal co-operation. For example:

- The nine municipalities in the solid waste project in south-eastern Europe have signed a contract to ensure payments for the operation of the regional waste disposal facility to be developed under the project, but agreement on this contract took some time to secure.

- In one city of south-eastern Europe, the municipal bus company is majority owned by the City and the remainder is owned by several smaller nearby towns. The municipal bus company and the EBRD predicted that the surrounding towns would take time to sign up to the Public Service Contract (PSC), as they might have initially resisted making the payments required to the bus company. Nearby municipalities have observed the benefits of the PSC and have now signed up to the contract.

Multi-municipal projects clearly require more resources for planning and monitoring than a project that just covers one municipality (Box 5.12), and an increase in resources is particularly needed for these types of MEI projects in most resident offices. One aspect is that one of the performance targets for bankers relates to the number of projects signed, and therefore there might be less incentive for bankers to develop multi-municipal projects, which require more time to set up. The EBRD should take into account multi-municipal projects in the performance assessment of bankers, for example the Bank might consider a separate target for bankers for multi-municipal projects. Also, the Bank might treat some types of individual multi-municipal projects as equivalent to several projects in relation to performance targets. For example, water projects that cover several cities with separate water supply systems could be perceived as several individual projects, whereas a multi-municipal project involving a shared regional landfill would be treated as one project.

Box 5.12 - Resources for implementation and monitoring of EBRD MEI projects

The EBRD has signed a water rehabilitation project in Central Asia which covers three cities, and a further project covering seven other cities of Central Asia is in an advanced stage of planning, as well as planning several water projects. The planning of these projects will be based on past experience in the region. One of the lessons of that project was the complexity of implementation in terms of the mix of technical design, procurement, tariff policy, public service contracts, corporatisation and community participation programmes. In view of this, the EBRD needs to allocate more resources to a multi-municipal project than would be needed for most projects covering one municipality. A step change in resources in the Resident Office will be needed.

5.2.5 *Institutional strengthening through Technical Cooperation*

The MEI Policy recognises the need to strengthen municipalities and utilities to develop their capacity in management, operational, financial and commercial activities. For this purpose, the MEI Policy has a strategic objective for the Bank to include the use of technical cooperation funds in the structure of MEI projects.

The inclusion of the technical cooperation components in the majority of the EBRD's MEI projects is an important benefit of EBRD ahead of competition from commercial banks. Overall observations during this Study indicate that the MEI bankers have a strong focus on setting up technical cooperation components to address the priorities at the municipal company and in project implementation. The following points are noted:

- For a typical MEI project, there will be two technical cooperation components after signing. One focuses on the strengthening of municipal company with an emphasis on commercialisation, for example with the core output being a Financial and Operational Performance Improvement Programme (FOPIP). The other component typically focuses on the project implementation, including technical planning and design, as well as procurement in line with the Bank's procurement procedures. This component usually involves the set up of a PIU in the municipal company under the advice of international procurement and technical consultants.
- It is essential that the international consultants are encouraged to work with a hands-on approach, working alongside their counterparts to ensure capacity development, particularly aiming to strengthen the management skills at the municipal company. This important point is also identified

several times in the Evaluation Department's Lessons Learned Database (Appendix 3). Several of the tasks of the two sets of consultants overlap, and it is essential that the teams regularly communicate and ensure their work plans and advice are consistent. This communication has been happening in most, but not all, of the EBRD's projects that have been set up with more than one technical cooperation component.

- Based on consultations with clients during this Study, the majority of clients provided good feedback on the technical cooperation components. Many clients, for example, have been implementing their business plans developed under the technical cooperation projects.
- There are numerous cases in EBRD projects where the commercialisation of the municipal company has improved. While technical cooperation components have played a vital role in educating and supporting the client, EBRD requirements in loan agreements and on-going EBRD policy dialogue which explains the mechanisms and benefits to commercialisation, are also main drivers.
- Technical cooperation is generally being targeted at the relevant stakeholders, although in many projects an increased emphasis on strengthening the city administration would be beneficial. For example, in parallel to the two major MEI projects, the EBRD implemented a separate technical cooperation project on the creditworthiness enhancement programme for the City Administration. The efficiency of a city administration itself, with respect to its client function, is important for the success of MEI projects, particularly for PPP projects. Even if there is an efficient utility service, this can still be constrained if the city administration is inefficient and reluctant to adopt reform. Institutional strengthening of city administrations through technical cooperation is also a common lesson in the EvD's Lessons Learned Database (Appendix 3).
- The EBRD has included the task of developing a programme into some technical cooperation projects, for example in the cities of south-eastern Europe, and there would be benefits in including this more often. Technical cooperation consultants must particularly focus on working with the key players in the City so that they have a strong understanding of the strategic programmes and agree to drive forward its implementation.
- In line with the EBRD's strategic objective in the MEI Policy of promoting private sector solutions, several technical cooperation components include tasks to plan the development of private sector participation (PSP) and public private partnerships (PPP). These plans are being included even for municipalities where private sector solutions will not be feasible for much time, but it is useful to start to raise the understanding of the city and the municipal company of the benefits and implications of private sector involvement. As this approach only captures existing clients, it would be good to have technical cooperation funds for new clients who are exploring PPP.
- A strong and independent regulator, with good capacity for monitoring and enforcement, is an important aspect of a robust institutional framework for improving municipal services and enhancing private sector solutions. In a few cases, such as in Central Asia and south-eastern Europe, the project has been set up to include technical cooperation to strengthen the relevant regulatory authority, or to plan a framework to introduce and develop the regulator function. The EBRD might consider more focus of technical cooperation on this aspect in other countries. (Note, these are sovereign loans, so it is easier to achieve. It is more difficult when there are separate stakeholders.)
- Even for technical cooperation projects, the commitment of the City and the municipal company is essential for the project to have an impact, as was shown in a Central Asian city's solid waste project, where it has not had the desired long-term impact, mainly because the commitment of the local stakeholders was inadequate.
- There are mixed opinions amongst the EBRD bankers that have been consulted on the best way to structure technical cooperation components. The benefits of including one large project, or two or more smaller components, are likely to depend on the exact situation in the municipality in which a project is being planned. The approach to plan one larger project should be easier in terms of

tendering and contract management, but it might be harder to get the required range of skills in one consultancy team. In some cases, there might be benefits in combining the technical and procurement component with the institutional strengthening and business planning component, both of which should have a focus on capacity development.

- The subject of the approach to structuring the PIU component is often discussed at EBRD and other IFIs. The inclusion of the costs of the PIU in a loan meets much resistance from clients, and can lead to a reduction in their commitment, because of the costs of relatively expensive international consultants. Increasing the salaries of the local PIU team members is often needed in order to select the most experienced staff into the team. This can have implications in terms of staff retention at the client after the project, but in many cases staff that have been trained during an international project will seek other employment afterwards, regardless of their salary when working with the PIU.
- It can be useful to include a twinning mechanism in technical cooperation components, where representatives of a city and municipal company can visit a city that has developed similar solutions. This has reportedly been useful in a south-eastern European city, where a city in Austria provided valuable advice and demonstration. Including wider study tours in technical cooperation components can also be useful, for example these have helped the client eastern Europe to plan the detail of the upgraded district heating system.
- As discussed above, more emphasis should be placed on the importance of reliable data for some types of MEI projects, particularly to enhance commercialisation, for example data on registration of properties, number of residents in houses, quantities of waste generated and electronic ticketing systems in transport. In some cases the EBRD might consider separate technical cooperation components to improve the reliability of priority data.
- At least one MEI project in the portfolio involves a loan to a private company working in the municipal services sector, and, as mentioned, for some technical cooperation projects there is a focus on wider planning to enhance the role of the private sector. The development of private sector solutions might apply more in future to roles of local private sector companies, and technical cooperation could be provided to these smaller private companies through TAM/BAS. This is the turn-around management and business advisory services, which targets strengthening the capacity of small private companies in the EBRD's countries of operations.
- The availability of technical cooperation funds varies by country. Whereas there are significant resources for ETC countries, fewer resources are available for Russia and EU countries. Mobilising scarce technical cooperation resources for these countries can delay project implantation of key transition covenants.

In summary, the majority of technical cooperation components are being set up by the EBRD to target the priority aspects of institutional strengthening for MEI projects. There might be benefits of wider emphasis in some cases on strengthening the capacity of the city administrations, the regulator function and the fee collection organisation. In addition, the EBRD should ensure strong communication between different technical cooperation components associated with the same project, and should continue to include tasks in the technical cooperation for working with the counterparts to develop programmes of priority investments and plans for private sector solutions, strengthening of data collection and use.

5.2.6 Address affordability through grant co-finance.

For the MEI projects in accession countries, the EBRD has co-ordinated with the EU to gain grant co-finance for projects, for example from EU Cohesion and Structural funds and other instruments. This has been important to address any problems with the affordability to municipalities of implementing major infrastructure projects to international / EU standards.

During the planning stages and feasibility studies, the EBRD has a focus on the affordability for a city administration to pay back the loan, both in terms of assessing its creditworthiness, and, in particular, assessing the affordability of tariff increases to the population. This latter aspect is particularly important in relation to the social benefits and constraints of a project, and during the planning the EBRD assess the likely tariff increases against specific indicators of affordability on the basis of the fraction of household income paid for municipal services.

Grant co-financing provides a major contribution to the success of projects. For many projects, the total finance needs to be quite large in order to make significant improvements. For many cities, the total project finance would not be affordable if it was taken as one loan, and the grant proportion makes it affordable. In some of the southern cities of Central Asia, for example, another IFI has implemented some improvements to the water supply, but the project funding was too small to improve the supply pipes, pumping stations and treatment works, and as a result, there have been minimal overall improvements for the consumer. In this case a larger project, made affordable by grant-financing, would have been preferred to generate wider and more visible improvements, which in turn help to encourage tariff payments and lead to sustainability. The EBRD is currently setting up projects with these cities that are large enough to have a considerable impact, and with a high proportion of grant co-finance.

In EU accession countries the grant co-finance through EU funds has made larger loans possible, and as a result there have been major improvements in municipal services, particularly for water and wastewater. Grant funding has been available through EU accession funds, and this will continue with opportunities for co-financing through the EU Instrument for Pre-accession Assistance (IPA).

In ETCs, grant co-financing is particularly important because of problems with affordability, even for small loans. There is no clear and common structure for grant co-financing as is available for EU accession countries. Some donor organisations (for example SECO, SIDA) do provide grant co-financing for ETCs, and there are some internal EBRD mechanisms, such as the ETC Fund and the Shareholders' Special Fund (SSF). It should be noted that the identification and agreement of grant co-financing takes up a significant proportion of the EBRD's resources during project planning in ETCs.

The grant proportion of most projects in ETCs currently needs to be high. For example, current water supply projects in municipalities in Central Asia have a grant component of about 65-70 per cent, and one solid waste project has a grant component of about 50 per cent. Although the loan component for many projects in ETCs is therefore relatively small, it is important to keep this component as it is driving changes in the approaches of municipal companies to become more commercial. The EBRD over time should be aiming for a gradual decrease in the proportion of grant co-financing as the municipalities develop. Grant finance works best when there are no procurement restrictions and the donor allows EBRD rules to be used. Otherwise it results in more complex packages, as EBRD may need a waiver for a lack of compliance when there are disbursements from the grant.

5.2.7 Increase access of municipal service companies to capital

The MEI Policy states that the EBRD will promote commercial bank co-financing and expand the access of the municipal sector in the countries of operations to long-term capital. In relation to this strategic objective, the Policy states that the Bank will increase activities related to:

- Applying new instruments such as partial guarantees of other lenders exposure to municipalities and revenue bonds.
- Providing equity finance to service providers, where appropriate.
- Provision of finance in local currency.

Activities related to this strategic objective are not always possible, particularly in the present financial crisis. For example, although there are some cases where the EBRD has arranged syndicated loans from

commercial banks (Box 6.13), many of these banks are less interested in the municipal sector, particularly at present. Moreover as many of these banks are not experts in the field of municipal finance, they are much less flexible to provide waivers which has resulted in significant delays for some projects.

Box 5.13 - Reacting to the Financial Crisis to Ensure Transition Impact

City Transport projects in a city of eastern Europe, to procure buses and metro wagons, were set up to include syndicated loans from commercial banks, covering a total of 40 per cent of the project cost. EBRD therefore structured the project in line with the strategic objective in the MEI Policy of increasing access of municipal companies to capital by promoting co-financing from commercial banks. The commercial banks that were going to provide additional co-finance through the syndicated loans have had difficulties during the financial crisis, and have had to pull out of the projects. EBRD has recently restructured the projects to provide additional loans and cover the shortfalls from commercial banks. This is a positive step from EBRD by ensuring the project will go ahead, despite the additional risks.

In addition, in some cases the Bank considers the provision of part of a loan in local currency, where this would be beneficial. For example, in an eastern European city district heating project the original project structure included a significant loan component (equivalent to €9.7million out of the total loan of €21.9 million) to be paid in local currency, in line with this strategic objective in the MEI Policy. This aspect has also been prevented by the financial crisis, and the total loan will now be paid in euros. The MEI Team has also promoted the use of a revenue bond on a project in eastern Europe, as an alternative and innovative funding mechanism.

There are also other mechanisms that the EBRD is using in relation to helping clients to manage currency exchange risks. For example, there have been two water supply projects signed in Central Asia. The first loan was given in US dollars, and the second in euros, to try to reduce potential risks with currency exchange rates.

The EBRD has not had much opportunity to work with local financial intermediaries in the MEI sector, mainly because these local banks are less interested in the sector. The EBRD did make progress in setting up a housing project through financial intermediaries in eastern Europe, but this project has been put on hold because of the financial crisis. Any future projects with financial intermediaries (FIs) would need a focus from the EBRD on shifting the approaches of FIs towards the transition objectives of the EBRD, which would require significant policy dialogue and possibly technical cooperation on strengthening the FIs in these aspects.

The EBRD has been shifting the approach to loan guarantees towards instruments such as municipal support agreements (MSA) rather than specific guarantees. This is helping to increase responsibility and accountability in municipal companies, and strengthening the transition impact in relation to decentralisation and commercialisation. There are a few cases of other instruments, such as revenue bonds, or equity finance to service providers, in the MEI portfolio. In many cases a client will have a better understanding of a simple loan, rather than other financial instruments, particularly in municipalities in intermediate and early transition countries. If the Bank is aiming for new instruments to municipalities, and equity finance, then it might be advisable to focus on advanced countries, and the MEI Policy could be updated to specify more clearly this approach, within this strategic objective.

5.2.8 Improving project implementation and disbursements

The MEI Policy states that the Bank will target resources and management attention to improved implementation through activities such as advance planning, acceleration of the procurement process, provision of adequate support to clients directly and through technical cooperation. The objective is to improve levels of disbursement and earning assets relative to levels of commitment.

The EBRD MEI team recognises that the level of disbursements is just as important as the performance indicator of volume of projects signed. The start of disbursements is a key point in project implementation. The performance targets of MEI bankers at EBRD now include targets on the timing of disbursements.

The timely implementation of MEI projects in many of the countries of operations is a major challenge. The EBRD often sets challenging and ambitious timescales for project implementation in the project plans, which is the correct approach as this encourages clients to focus on rapid actions. However, many projects are subject to at least some delays, and some projects have serious delays.

A particular problem in many projects is the initial delays between the time of signing of the MEI project and the time of first disbursement, often referred to as the 'effectiveness period.' If there are serious delays at this time, then this can lead to a drop in commitment of the counterparts. Initial delays can then lead to more problems as they create more time for prices to increase, exchange rates to move, changes in political administration, more approvals likely to be needed (for example project extensions). Therefore, there is a need for the EBRD MEI team to continue to focus on a fast start and making the early disbursements quickly.

In recent years in particular, the MEI team has been focusing on improving performance related to disbursements. Figure 6.3 illustrates the improvements in disbursements in the MEI portfolio. It shows that, despite the increase in finance in the portfolio, the un-drawn proportion has been decreasing. In addition, Figure 6.4 illustrates the un-drawn ratio for the MEI sector, indicating the quicker reduction in the proportion of un-disbursed funds in the MEI sector, compared to the EBRD portfolio overall; (note that the un-drawn ratio for MEI projects would be expected to be higher than for the EBRD portfolio overall, because other banking sectors at EBRD include equity deals, which disburse almost immediately, whereas the MEI portfolio is almost all loan projects, which are disbursed over time).

Based on the visits to projects, and consultations with MEI bankers, the following additional points are noted in relation to project implementation:

- The planning stages of projects can often take a long time, and this can have consequences when the delays mean that planning runs into the subsequent financial year of a city administration or donor providing grant co-finance, because they might have already agreed budgets for a particular financial year. For many projects pre-signing technical cooperation is used to contract consultants to carry out small planning studies and larger feasibility studies, and the tendering for planning and implementation consultants can take time. For the smaller projects in particular, there are advantages in approaches involving call-off contracts so that the consultants can quickly mobilise.
- As mentioned, although there is potential for delays at several stages in project implementation, there has been a particular problem during the effectiveness period before technical, PIU and corporatisation consultants start work. With the momentum and intense work during preparation and loan negotiations, the slow effectiveness period after signing therefore has the risk of reducing the commitment of the clients in the project, and lengthening the time to start disbursements. One of the tasks during this period is often the procurement of consultants for technical cooperation components, who then work on tasks such as detailed design before the first disbursements. The client is likely to need particular support related to the procurement of the consultants using the EBRD procurement procedures (there is not yet any international support to the PIU at this stage). More resources are therefore needed to support the client at this stage. This would ideally involve recruitment of more resources to EBRD in the Resident Offices, targeting skills in project management and monitoring. These employees should also be tasked with ongoing policy dialogue activities. Otherwise, the EBRD could consider a call-off contract with project management

consultants for short assignments working on the procurement of the main consultants in this initial period of the project.

Figure 5.3 - Operating asset stock growth of the MEI portfolio

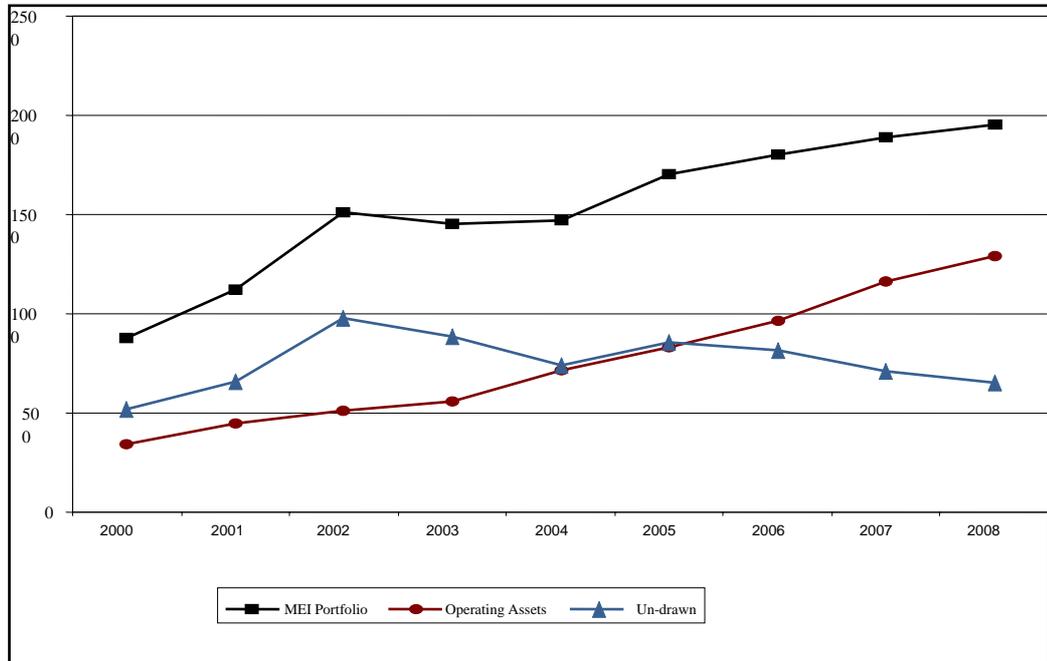
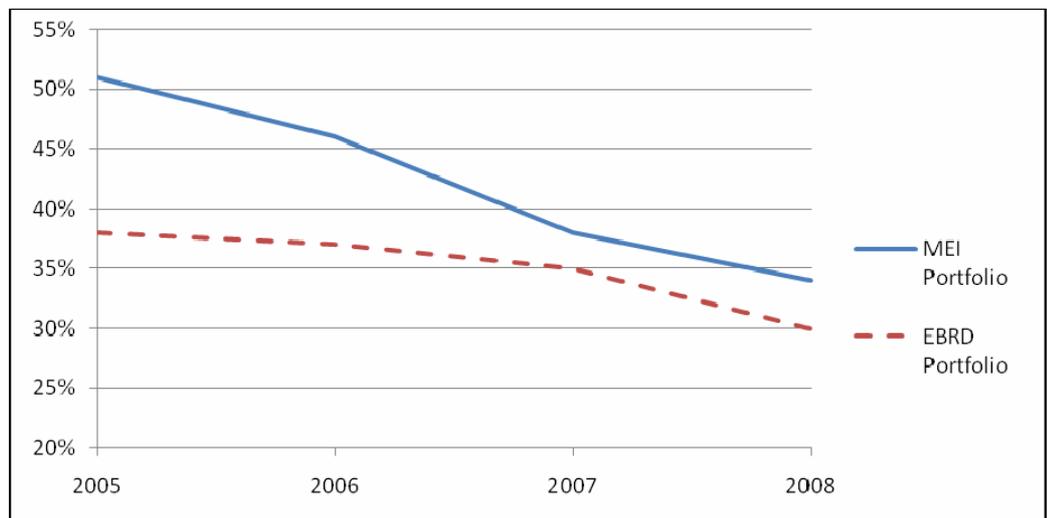


Figure 6.4 – Un-drawn ratio of the MEI portfolio and the EBRD overall portfolio



- As well as an essential increase in resources at EBRD, the problems with initial delays in projects could be addressed through a change in approach, where possible, to start the procurement of consultants for the post-signing technical cooperation before signing. They could then be appointed at the time of, or soon after, the loan agreement. Often the donor providing the grant for the technical cooperation would not want to commit until the loan is signed, but there could be a higher focus of persuading them of the benefits of an earlier start to tendering and including relevant

information to warn bidders in the tendering documents that the technical cooperation is subject to loan agreement. The procurement process could be started at the time of final review at EBRD, which would have the additional advantage of keeping the client engaged during the final stages in EBRD approval before loan agreement, which can sometimes be perceived by clients to take much time.

- In many cases the project delays are blamed on problems with understanding the required procurement procedures. Although, the feedback from clients on the EBRD's procurement procedures has been mainly positive. In many cases the procurement procedures of the Bank are a significant change from the procurement approach that has previously been used by clients, but, once the clients understand the procedures, then they tend to appreciate the value of the more transparent and competitive international bidding. For example a municipal water company stated that it took much time for them to understand the procurement procedures, but that they will use the main concepts of these procedures for future investments. In addition, a municipal waste disposal company saved a major amount of money by using the procedures compared to their initial forecasts of capital costs.
- In many cases the projects are set up so that the EBRD disburses money directly to contractors and suppliers. This can cause confusion with contractors, who frequently do not realise that EBRD can only disburse if the borrower is compliant with all covenants. Delay can occur while the Bank and client address the areas of non-compliance, which results in contractors assuming that EBRD is slow in making payments, which can be a source of frustration.
- Some specific project types are potentially at risk of project delays more than others. Public transport projects, for example, that involve just the supply of vehicles and parts, tend to disburse quicker. Projects that rely on information about land ownership, or decisions on locations of certain facilities (for example landfill locations), or inter-municipal agreements, can take much time. For example, one of the components of the urban transport project with a municipal bus company was on development of a new bus garage, and this was delayed because of land ownership problems. Eventually the project was restructured to replace this component with the supply of extra buses.
- The importance of strong management skills and experience at the client is emphasised, and this particularly helps in project implementation.
- The various aspects of project planning and implementation in the MEI sector, including policy dialogue, identifying and agreeing grant co-finance, negotiations, procurement of planning consultants under pre-signing technical cooperation and project monitoring, are resource intensive.

5.3 Policy dialogue

The MEI Policy has emphasis in different sections on policy dialogue. It states that policy dialogue has an important impact on establishing the appropriate legal and regulatory framework supporting decentralisation, and on increased responsibility and commercialisation at the local level.

In planning and implementing MEI projects, the EBRD have a strong focus on policy dialogue, in line with the directions in the MEI Policy. Most policy dialogue by EBRD is at city level, some activities are also carried out at national level, and with other IFIs as needed. During the Study, the EBRD bankers were observed to have particularly strong relationships with clients in municipal companies and most city administrations, demonstrated by the good feedback from the clients on the EBRD bankers. There are several positive examples of policy dialogue activity of the EBRD in most countries, and Box 6.15 illustrates the activities in one country of eastern Europe.

Box 6.15 - Examples of policy dialogue activities in one country of eastern Europe

The EBRD activities in the MEI sector one country of eastern Europe include policy dialogue related to various aspects of policy reform, at national level and municipal level. Example policy dialogue activities include:

- In 2006 the public procurement law was amended and required all publicly-owned companies receiving non-sovereign loans to exclusively use state procurement rules unless exempted by another treaty. EBRD carried out extensive policy dialogue with the relevant national stakeholders to address the issue so that EBRD procurement rules are applied for EBRD projects. The Bank signed a treaty on this aspect with the Government and this was ratified by Parliament.
- In a city of eastern Europe there was a delay of 17 months after the district heating project was signed for the time taken for the Ministry of Finance to approve the loan and the time taken for the national bank to register the loan. Delays for similar reasons are occurring on other projects, and the EBRD is carrying out regular policy dialogue with the Ministry of Finance on these issues, and is also trying to carry out dialogue with the national bank, although this is proving more difficult.
- In another city of eastern Europe, the Bank has worked closely with the Nordic Investment Bank (NIB), which is financing a loan for improvements in the district heating system in another part of the city. There has been good co-operation between EBRD and NIB, including during project planning and feasibility studies for the district heating investments.
- One example of the value of EBRD that is perceived by several institutions is that the Ministry of Housing is developing updated procedures for the calculation of water tariffs, and is consulting with EBRD on the draft procedures.

Policy dialogue activities are resource intensive, and take up much time of the EBRD bankers in resident offices.

Most policy dialogue activities focus on aspects of decentralisation and particularly commercialisation, for example on tariff policy and public service contracts. In addition, the EBRD is usually strong on the important aspect of explaining the various project implementation tasks required by the EBRD (for example procurement procedures and project monitoring and reporting). In some cases, policy dialogue is needed on specific aspects, for example for water projects to explain the benefits of metering. The EBRD continues policy dialogue during project implementation, and steps up dialogue at certain times, such as when political parties change after an election or when a project is delayed (the EBRD has stepped up policy dialogue for transport projects in eastern Europe, for example, in order to try to address the issues that are causing the delays).

In some cases, the EBRD has recognised an important specific reason to focus on policy dialogue at national level, for example related to procurement rules and loan approval mechanisms at national level in eastern Europe, and related to the strengthening regulation and the enforcement of contracts in the water project in south-eastern Europe. In other countries, the EBRD has been carrying out policy dialogue at a national level over a period of time, such as related to laws on concessions in Russia (Box 6.16).

Box 5.16 - Policy dialogue on the principles of PPP contracts at national level in Russia

Since 2007 the EBRD has been working closely with the Federal Anti-Monopoly Service in Russia to explain the benefits and support the reform related to developing a more competitive framework to concession contracts. The federal legislation in Russia did not require these contracts to be tendered competitively in the municipal sector, and most contracts with the private sector were negotiated directly by a municipality. The Federal Anti-Monopoly Service has prepared and distributed guidelines on tendering to municipalities, and the EBRD continued policy dialogue to try to encourage for these guidelines to become mandatory. In June 2008 the Russian Government did adopt a law on competition to require the competitive award of concession contracts in the municipal sector. As part of continuing policy dialogue on this issue, the EBRD has developed a set of

principles on PPP contracts for Russia (*Key principles for the establishment of well-balanced long-term contractual relations in the municipal sector, 2009*).

The EBRD also has strong co-operation with other IFIs through policy dialogue activities. For example, in Central Asia the EBRD has been working closely with the World Bank in a number of areas. In one part of the region, the World Bank Municipal Infrastructure Development Project (MIDP) has carried out some improvements to the water supply system in the 3 cities. The project did not have enough funds to make a serious and visible improvement to the water supply. The EBRD has been working with the World Bank to discuss the next priorities and plan more detailed investments in the 3 southern cities.

Dialogue with other IFIs is particularly important for joint projects, such as a regional water supply project in south-eastern Europe. There are many stakeholders involved in the project including the regional water company and the municipal water companies, the Government, World Bank, USAID and private sector investors. EBRD has been carrying out policy dialogue as necessary, particularly with the client, and with other IFIs.

The EBRD's policy dialogue activities in the MEI sector are often quite *ad-hoc*, and there would be strong advantages of a clearer definition of policy dialogue in the MEI Policy. Particularly considering the large amount of resources needed to carry out effective policy dialogue, a more structured policy action dialogue plan would be very beneficial. Such plans should include focused objectives, clear roles for the bankers in the resident offices, and specific actions and timescales. As well as face-to-face meetings with key stakeholders on specific issues, the policy dialogue plan might include the organisation of regional conferences, case study presentations and promotional material on projects and specific use of technical cooperation. The policy dialogue action plans should also be linked with the EBRD country strategies via an integrated approach. The action plans would also be a suitable mechanism to measure policy dialogue activities.

Many EBRD projects in the MEI sector have strong demonstration impacts, and the activities to demonstrate approaches to improvements are linked to policy dialogue. For many projects, the new or upgraded facilities and the more commercial municipal companies have had numerous visitors from other cities to learn from the EBRD projects. There appears to be minimal structured planning of demonstration activities, and there would be strong benefits to the development of action plans on demonstration projects in the EBRD's countries of operations, linked to action plans on policy dialogue.

6. Conclusions and recommendations

The aim of this Study was to carry out an independent evaluation of the implementation of the EBRD's MEI Policy, and to identify lessons and recommendations that will inform the EBRD in drafting an updated MEI Policy. The study focused on the implementation of the inter-linked transition and strategic objectives that form the basis of the MEI Policy. Table 6.1 provides a summary of the EvD Sector Ratings, using the OECD/DAC criteria. A summary of the main recommendations is provided in Box 6.1.

Table 6.1: Overall sector ratings

Criteria	Rating
Relevance	Fully verified
Effectiveness	Good
Efficiency	Good
Impact and Sustainability	Good
OVERALL	Successful

6.1 Achievement of transition objectives

Based on the consultations with clients and other stakeholders in the countries of operations, on observations of the standards of municipal services through site visits to project facilities, and on detailed discussions with bankers and other EBRD staff, it is clear that the majority of the EBRD's operations in the MEI sector are having a major positive impact on the efficiency and quality of municipal services. This is backed up by the results of previous evaluations of MEI projects by the EBRD's Evaluation Department (EvD), from which 61 per cent of the evaluated projects in the MEI sector were given an overall performance rating of successful or highly successful, which is slightly higher than the typical ratings across the Bank.

This Study has demonstrated that the EBRD is making successful progress in achieving the core objective of the MEI Policy; although, clarification is needed in the discussion around non-revenue generating projects and Article 11. The core directions in the policy of decentralisation, commercialisation and environmental improvement are very appropriate, and in line with the EBRD's overall mandate. There should be some changes of emphasis to the Policy, and to the framework for its implementation, which would further enhance the EBRD's positive impacts in this sector. These recommended changes in emphasis have been described in the sections of this report on the transition and strategic objectives in the MEI Policy, and are summarised below.

Decentralisation and commercialisation

As well as the positive environmental and social impacts, the Bank's operations are in particular resulting in the more commercialised and sustainable services. During their time working with the EBRD, several municipal companies, consulted during this Study, have changed from a weak state with no autonomy and poor services that rely on subsidies to be sustained, to a commercialised company with decision-making powers, high accountability, and providing high standards of services.

In the planning of projects, and associated policy dialogue activities, the EBRD has a major focus on the transition objectives of decentralisation and commercialisation, which are strongly inter-linked. For example, for a project to be successful, the EBRD recognises that a city administration must be creditworthy, have sufficient capacity and be fully committed to improving municipal services. Although in some cases there could be more focus on strengthening the capacity of a city administration, project structures are generally being planned by the EBRD to enhance these aspects. In particular, the EBRD is planning its projects and the associated technical cooperation to commercialise the municipal companies.

One of the core aspects of this is the development of tariff policies, agreed by city administrations, which work towards full cost recovery and have the major benefit that they allow the companies to properly forecast revenues and plan for future investments. The EBRD is correctly including the adoption of a more structured tariff policy as a condition to many loan disbursements, although the Bank recognises in some cases that municipal services will need to continue to be partly subsidised by city administrations. In several cases, the EBRD has encouraged a municipality to include a development component in the tariff structure, which generates revenue that is ring-fenced for future investments. This is particularly good practice.

In most projects, the EBRD requirements include the signing of a public service contract (PSC) between a city administration and a municipal company. These contracts in particular set out the agreed tariff and subsidisation structure, and clearly specify the roles and responsibilities. Although the EBRD often has had to use significant time and resources ensuring that there is a strong understanding of the benefits of these contracts at the city administrations, the high transition impact of the proper implementation of the contracts has been demonstrated for many projects, particularly in the urban transport sector.

One particular common aspect to those MEI projects that are particularly successful is that the management skills and experience in the municipal companies tend to be very strong. The EBRD should continue to focus technical cooperation on commercialising municipal companies through business planning and particularly strengthening the capacity of management teams.

There has been mixed feedback from clients on the EBRD procurement procedures, which many clients take time to understand, and this can be one a cause of project delays. This Study has shown that, once clients understand and have used the procedures, their awareness of the commercial benefits improves, and several clients indicated that they would continue to use the core concepts of the procurement procedures in future. In several cases, the competitive and transparent tendering process resulted in a saving in investment costs compared to the client's original cost estimates.

For many projects one of the core aspects of the more commercialised municipal services has been the improved reliability and use of data. For example, public transport companies have greatly benefited from electronic ticketing systems so that they can record and forecast usage of the transport system, and also know the exact amount of use by people who have subsidised travel (e.g. pensioners). Other important examples where data have helped with commercialisation include the metering of water supply and district heating, the weighing of solid waste deliveries to a landfill, and the registration of properties and the number of residents for the payment of tariffs. The EBRD should continue to focus on strengthening the reliability of data collection systems that are relevant to commercialisation, and in some cases focus technical cooperation and policy dialogue on wider aspects of data collection in a country where this would help the implementation of several projects.

The objective of promoting private sector solutions is strongly linked to commercialisation. In some projects the lessons have shown that credible international private companies will not be interested unless a city administration is fully committed to privatisation, there is already a tariff structure based on full cost recovery, and there are no serious political risks for the private sector. The EBRD has had some success in public-private partnerships (PPP) with large projects for new facilities (e.g. design, build and operate of a wastewater treatment plant), but the municipalities generally have less commitment to the introduction of PPP into an existing municipal service. Also, the Bank's Concessions Policy provides some constraint in countries which have a different approach under national law. The project visits have indicated that the EBRD in some cases might do better to focus on the bottom-up development of private sector participation through smaller local companies. The EBRD has the correct approach in most projects to encourage at least initial planning of private sector solutions, even where the municipalities are at a less advanced stage. In these cases the technical cooperation activities in the project simply include a task to develop a strategy for future options for private sector solutions, as well as policy dialogue on private

sector solutions. Overall, the EBRD should continue these approaches to decentralisation and commercialisation, including the promotion of private sector solutions, where feasible.

Environmental impact

There are numerous examples of major environmental improvements through the EBRD projects, many of which are described in this report. These include the more reliable supply of higher quality water in several cities, including reduction in water losses; upgrading wastewater treatment plant in compliance with EU standards in cities, some of which were directly discharging raw wastewater into rivers; and major energy efficiency improvements at district heating systems. In addition, the MEI projects are resulting in major social improvements related to improved public transport systems, improved water supply and more efficient district heating. Again, the Bank should continue to focus on activities that result in positive environmental impacts in relation to municipal services. Given the shift in Bank policy over the last few years to cover social aspects, as well as environmental, and given the fact that many of the MEI projects result in strong improvements to social aspects, the EBRD should consider changing this transition objective to focus on environmental and social improvements through its investments.

In addition, in view of the growing importance of energy efficiency, and the high potential for MEI projects to improve energy efficiency (for example district heating projects and water supply system improvements), the EBRD could consider a more specific transition objective on energy efficiency in the MEI Policy. The work to date in this area has been constrained as these projects tend to be cost saving as opposed to revenue generating.

6.2 Achievement of strategic objectives

One of the core strategic objectives in the MEI Policy is to expand the portfolio into Russia, intermediate and ETCs. Despite the challenges of working in these countries, the EBRD has been increasing its operations. Out of the total of 202 projects signed in the MEI sector up to December 2009, 67 are located in Russia, intermediate and early transition countries. By the end of 2001, the EBRD had signed only nine projects in these countries, and has signed 58 projects since then. Under the ETC Initiative, the Bank has been particularly successful in expanding MEI activities in countries such as Georgia and Tajikistan. The projects are subject to major constraints because of affordability, and a high proportion of grant co-financing is needed.

Another key strategic objective is to expand the portfolio into sectors other than the water sector. Nearly 50 per cent of the 202 projects in the MEI portfolio are in the water and sewage sector; the EBRD has increased the number of district heating projects (19 per cent of projects); and more recently the number of urban transport projects (21 per cent). The remainder of the portfolio is made up of solid waste management projects and one housing project. The EBRD has not expanded its portfolio into other sectors mentioned in the MEI Policy, such as public housing and urban regeneration and waste to energy, as well as into other municipal sectors, some of which generate lower revenues. In connection with the upcoming review of MEI strategy, the interpretation of Article 11 of the Agreement Establishing the Bank also needs to be reviewed and revisited to confirm or remove from the policy Team's objective to engage in the public building/housing sectors. In light of the important energy efficiency challenges of the sector and the Team's intimate relation with the actors of the sector, this exercise will have an important impact on the Team's strategy and development prospects.

It is recommended that the EBRD develops a more specific plan towards the above objectives, particularly related to different sectors. This will need to include a balanced approach to take into account the fact that the two objectives are not necessarily compatible. For example, it can be argued that the priority for most municipalities in ETCs is to improve water supply, and therefore the objective of expanding the

portfolio into other sectors in these countries is less applicable. More specific objectives might therefore focus on new MEI sectors in advanced countries, but in ETCs to focus initially on the core sectors such as water supply that are the typical priorities in the municipalities.

The EBRD has also been successful related to the objective of increasing the number of projects with small municipalities, particularly through multi-municipal projects. One advantage of multi-municipal projects, for example in ETCs, is that additional municipalities can be included where investments are particularly critical for humanitarian reasons, and, despite the fact that the activity would be against sound banking, the EBRD would generate a particularly high transition. There is one such example in an EBRD project in Central Asia. It should be noted that multi-municipal projects are especially resource-intensive during planning and monitoring.

6.3 Policy dialogue

Policy dialogue is a particularly important component of the EBRD's activities in the MEI sector. The Bank pays much attention to policy dialogue, particularly at municipal level to create an understanding and commitment to the commercialisation and improvement of municipal services. In addition, the Bank has had some successes in policy dialogue at national level, for example in Ukraine and Russia. The policy dialogue activities use up much time and resources, and there would be benefits if the Bank developed more structured action plans on policy dialogue in the different countries of operations, linked to the country strategies. These action plans on policy dialogue could also include actions related to demonstration of projects. Although many of the EBRD's projects have potential demonstration effects, there would be better demonstration impacts if a more specific and targeted action plan on demonstration activities was developed in relevant countries.

6.4 Policy implementation

Several MEI projects have suffered from delays in implementation, for various reasons, and the EBRD has had some success in recent years in improving the rate of disbursements. There can be particular delays in the time period between the signing of a loan and the first disbursement, and there would be strong advantages, where feasible, in starting the tendering for technical cooperation components before the loan is signed, so that consultants start work as soon as possible after the signing of the loan.

The MEI sector is highly resource intensive, and the EBRD has been increasing the number of MEI bankers based in resident offices. There is a clear correlation between the number of MEI projects in a country, and the permanent presence of MEI bankers in the country. For example there are several MEI projects in countries such as Romania, Russia, Ukraine and Georgia, where MEI bankers are based. As well as project planning, the sector requires many resources for project monitoring and support during implementation, particularly for multi-municipal projects, and more resources in many countries are needed.

The high staffing resource requirement is one of the main reasons why the volume of MEI deals at EBRD has not been increasing as rapidly as the volume for other sectors. In addition, the expansion of the MEI portfolio partly depends on the perception of transition impact by those in EBRD who are responsible for the approval of potential projects. The perception within the Bank on the EBRD mandate on transition impact varies between different EBRD staff. One aspect of planning projects is that the economists in OCE do not approve deals in a sector once a few similar deals have been carried out in that country, because their perception is that there would not be much extra transition impact and demonstration effect in the country. The opinion of some MEI bankers is that, although the first project might have the higher transition impact, the next planned investments might be the exact priorities for municipalities. In addition, there are often few alternative options for access to capital for the municipalities. It is inappropriate for the MEI team to push for projects with these municipalities in lower priority MEI sectors when the projects in

the priority sectors cannot be signed because of the EBRD's mandate. It is important that the implications of the EBRD mandate to growing the MEI sector business are properly clarified and understood so that all staff are aware of the types of projects that can be approved in different countries, and therefore the bankers have a consistent approach to increasing the volume of the portfolio, taking into account the potential transition impact. The need for a consistent approach between the economists and bankers is also necessary in relation to sectors that generate lower revenues.

The development of a programme of investments for a municipality is particularly useful so that the city has a strategic plan of prioritised investments, and then EBRD can focus future operations on the agreed priorities. There are several cases where the EBRD has encouraged this approach, for example through technical cooperation components that have included the development of strategic programmes of investments.

The EBRD's activities in the MEI sector are having a positive impact on municipal services, and particularly improving environmental and social aspects, for example the number of houses newly connected to water supply, the improvements in water quality in rivers near upgraded wastewater treatment plant, and the energy savings from district heating projects. There would be major benefits to more focus on the measurement and reporting of the positive results. This would help with demonstration activities in the countries of operations, while also the raising of the profile of the MEI team's successes would have benefits internally at EBRD. It would increase the motivation of the MEI team, many of which are based in resident offices and could feel cut off from the London headquarters, it would demonstrate the challenges of MEI projects to the support teams, and it might encourage other banking teams to look out for MEI project opportunities in future. As well as reporting specific case studies on environmental and social improvements, estimation of the significant savings in greenhouse gas emissions from some MEI projects would assist the Bank with reporting on climate change.

Box 6.1 – Summary of recommendations for the MEI policy

Recommendations for updating the MEI Policy:

- In view of the positive performance and strong transition impact in the MEI sector, it is recommended that no major changes are needed to the MEI Policy, although there should be some changes to the emphasis of several objectives in the Policy.
- In particular, the main strategic objectives of moving the portfolio 'east', and expanding the portfolio in sectors other than water, are not fully compatible and should be made more specific.
- The strategic objective on moving the portfolio 'east' should emphasise the need to focus on the priorities for municipalities in intermediate and early transition countries, which are likely to be improvements to the water sector.
- technical cooperation is an invaluable component on the Bank's work in the MEI sector. It is generally recognized that more technical cooperation is needed and will enhance support to infrastructure projects, particularly for ETC countries, and/or rural communities where affordability may be an issue. The use, role, and demand for technical cooperation should be clearly articulated in the new MEI strategy.
- The strategic objective on expansion of the portfolio outside the water sector should be specific to the more advanced countries, where there have been widespread improvements in the water sector and expansion of the EBRD portfolio into other sectors is now more applicable.
- The development and application of an agreed programme of investments for municipalities is a useful approach for ensuring a focus on priorities and on the implementation of step-by-step improvements that take account of affordability.
- The EBRD are promoting private sector solutions in most MEI projects, even if it is simply to facilitate longer-term planning of privatisation. The strategic objective on private sector solutions in the MEI Policy is ambitious in terms of its emphasis on large PPP projects. For many cases in intermediate and early transition countries, it would be more applicable if the objective has a focus on the encouragement by the EBRD of solutions involving small-scale local private companies, and promoting private sector solutions through a

bottom-up approach. This approach; however, may not be compatible with the Bank's concession policy which has strict tendering requirements, which are not always easily met.

- Unless Article 11 of the Agreement Establishing the Bank is given a more liberal interpretation, the ambition of the Policy in relation to public building/housing could be toned down as appropriate.
- Although the EBRD is successfully shifting from sovereign to non-sovereign loans, the Policy implies that the EBRD will use different financial instruments for MEI projects, nevertheless the vast majority of these projects still involve loans. The ambition in the Policy could also be toned down on this aspect.
- As well as the positive environmental improvements, many of the EBRD's projects have a positive impact on social aspects, and there should be more emphasis in the MEI Policy on social aspects.
- Many projects in the MEI sector are contributing to major improvements in energy efficiency, and the associated reduction in greenhouse gas emissions. In view of the important focus on energy efficiency and climate change, the EBRD could consider a more specific transition objective on energy efficiency in the MEI Policy.

Recommendations for improving MEI policy implementation:

- The implementation of the MEI Policy would benefit from a higher profile separate implementation plan and targets associated with the objectives in the Policy.
- There remains a high demand in many municipalities in the EBRD's countries of operations for improvements to municipal services, and therefore there is a high potential for increasing the EBRD's volume in the MEI sector. It is noted that project sizes are relatively small and the planning and implementation of projects is highly resource-intensive. An increase in resources in the MEI sector at the Bank is recommended, particularly in relation to resources in Resident Offices for monitoring of projects and policy dialogue activities.
- Although there are many examples of successful policy dialogue by the EBRD at national and municipal (project) levels, the policy dialogue activities would benefit from more specific policy dialogue action plans for each country of operation.
- Likewise, there are many projects in the MEI sector with a high demonstration impact. The approach to demonstration activities could be better organised, and there would be benefits to the development and implementation of more specific action plans for each country on demonstration activities.
- The implementation of the Policy would be easier if a consistent approach was ensured between the banking team and OCE in relation to selection / approval of projects in terms of transition impact and institutional change, as well as in relation to opportunities for non-revenue generating projects.
- Given the successes of many MEI projects, it is recommended that the MEI banking team carries out more activities on monitoring and reporting of the environmental improvements that result from projects. This would greatly help with demonstration activities, and would also help to raise the profile of the successful MEI activities within the EBRD.

7. Reference documents

EBRD Municipal and Environmental Infrastructure (MEI) Operations Policy (October 2004)

Capital Resources Review 3 – Issues paper (October 2005)

Document on the Romanian Fund for Local Authorities and Government (FLAG)

Special Study (Volume 1) – Assessment of the Bank's Contributions towards Environmental Quality Improvements in the Danube River Basin (Evaluation Department) (November 2008) and Special Study (Volume 2) – Danube River Basin Assessment – Romania Country Case Study (Evaluation Department) (November 2008)

"Never mind the balance sheet – the dangers posed by public-private partnerships in Central and Eastern Europe" – Bankwatch (November 2008)

Review of key principles for the establishment of well-balanced long-term contractual relations in the municipal sector – Institute for Urban Economics Fund Moscow / EBRD (2008)

Evaluation Policy of the EBRD (October 2006)

EBRD Annual Evaluation Overview Report for 2009 (EvD)

A Revised Approach and Action Plan for Early Transition Countries (EBRD 2004) and The ETC Initiative – Going Forward (EBRD 2007)

For individual projects, the following reference documents were used where available:

- Project Summary Documents (PSDs)
- Board Project Documents
- Project Monitoring Reports
- Reports from technical cooperation components
- OPERS and XMRA

Special Study
MEI operations policy review
May 2010

Annexes

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Annex 1 – Logical framework for the evaluation

Sector Overall Objective	Key indicators	Means of verification	Critical assumptions
<ul style="list-style-type: none"> To promote greater efficiency and higher quality in the provision of local authority services through investment and the promotion of independent, well-managed and financially sustainable operations provided on commercial principles and in a market-oriented institutional and regulatory framework. 	<ul style="list-style-type: none"> Client perceptions / opinions. Monitoring reports. XMR data. 	<ul style="list-style-type: none"> Visits to clients / country case studies. Discussion with OLS. EvD project evaluation findings. MEI banking team project monitoring. 	<ul style="list-style-type: none"> Local political stability. Local and national support for tariff increases. Financial support from EU and other donors for municipal projects.
Transition Challenges / Objectives			
<ul style="list-style-type: none"> Decentralisation of service responsibilities to local or regional levels. Commercialisation of the operating companies providing local services. Environmental improvement as a consequence of investments that conserve environmental resources and reduce pollution. 	<ul style="list-style-type: none"> Portfolio / project data on various aspects, e.g. size of municipalities, PSP, TC, environmental objectives. Project documents. Client perceptions / opinions. Project monitoring reports. Environmental monitoring data. XMR data. 	<ul style="list-style-type: none"> Discussion with clients and OLS. Analysis of portfolio. Review of project documents and monitoring reports. Review of evaluation reports. Visits to clients / country case studies. Assessment of effectiveness of TC. 	<ul style="list-style-type: none"> Political stability and consistent national policy. Local and national support for tariff increases.
Strategic / Sector Objectives			
<ul style="list-style-type: none"> Extend the use of standard “products” to Russia / intermediate / early transition countries. 	<ul style="list-style-type: none"> MEI portfolio data. 	<ul style="list-style-type: none"> Analysis of portfolio. 	<ul style="list-style-type: none"> Political stability at national and local levels.

Sector Overall Objective	Key indicators	Means of verification	Critical assumptions
<ul style="list-style-type: none"> Build on experience in the water sector to expand the portfolio into other sectors (the policy gives examples of: urban transport, car parking, district heating, waste management, waste to energy, public housing, urban regeneration). 	<ul style="list-style-type: none"> MEI portfolio data. 	<ul style="list-style-type: none"> Analysis of portfolio. 	<ul style="list-style-type: none"> Potential for commercialisation including tariff increases. Approval from EBRD credit team for projects that are not clearly revenue generating.
<ul style="list-style-type: none"> Promote private sector solutions. 	<ul style="list-style-type: none"> Project documents. Client perceptions / opinions. Project monitoring reports. 	<ul style="list-style-type: none"> Review of project documents. Visits to clients / country case studies. Discussion with OLS. MEI team project monitoring. 	<ul style="list-style-type: none"> Institutional and legal frameworks for PSP are strong (including tariff system in which private sector will feel secure over the time of contracts).
<ul style="list-style-type: none"> Extend the use of existing “products” to small municipalities (includes multi-municipality projects). 	<ul style="list-style-type: none"> Project documents. Documents on wider financial instruments. Portfolio data. 	<ul style="list-style-type: none"> Review of documents. Visits to clients / country case studies. Discussion with MEI Banking Team Director / Portfolio manager. 	
<ul style="list-style-type: none"> Institutional strengthening through TC. 	<ul style="list-style-type: none"> Client perceptions / opinions. Project documents. Project monitoring reports. 	<ul style="list-style-type: none"> Review of project documents and monitoring reports. Visits to clients / country case studies. Discussion with OLS. Assessment of effectiveness of 	

Sector Overall Objective	Key indicators	Means of verification	Critical assumptions
<ul style="list-style-type: none"> • Address affordability through grant co-finance. • Increase access of municipal service companies to capital (e.g. commercial bank co-financing; expanding capacity to provide finance in local currency, etc). • Improve project implementation, improve disbursements, etc. 	<ul style="list-style-type: none"> • Project documents. • Portfolio data. • Project documents. • Portfolio data. • Client perceptions / opinions. • Project documents. • Project monitoring reports. 	<p style="text-align: center;">TC.</p> <ul style="list-style-type: none"> • Review of project documents. • Analysis of portfolio. • Discussion with OLS. • Discussion with OLS. • Review of project documents and monitoring reports. • Visits to clients / country case studies. • Discussion with OLS. • Assessment of effectiveness of TC. 	<ul style="list-style-type: none"> • Financial support from EU and other donors for municipal projects.
Inputs			

- MEI Policy and other EBRD policies.
- Projects
- Policy dialogue
- TC
- EBRD staff
- Co-operation with other donors.

Annex 2 - Comparison with previous MEI policies

This document summarises a comparison of the EBRD's policies over time on the MEI sector. The first policy was adopted in 1992, and updated in 1998 and 2004. A strategic paper was produced in 2008.

Overview of comparison

- Since the first policy in 1992, there has been a consistent emphasis on environmental improvements and transition impact, with objectives focusing on decentralisation, commercialisation and private sector participation (PSP).
- There has been an increasing emphasis in the policy on technical co-operation (TC) and policy dialogue, particularly related to frameworks for cost recovery, commercialisation of municipal services, and institutional strengthening of regulatory functions.
- The early operations of EBRD in the MEI sector were in EU accession countries and other advanced transition countries, and the policies from 1998 have included objectives to expand to intermediate and early transition countries.
- Sub-sectors in the policies have consistently focused on water and sewerage, urban transport, solid waste management and district heating. The inclusion of housing and other sub-sectors has varied.
- The current policy (2004) includes a focus on smaller municipalities, and the strategy paper (2008) recognises the benefits of a series of projects with long-term clients in the MEI sector.

EBRD Municipal Development Operations Policy Background Paper (1992)

The Policy (1992) focused on:

- Political, institutional and financial decentralisation.
- Improving the efficiency of municipal services management.
- The wider institutional framework (e.g. cost recovery, regulatory functions, PSP) and policy support.

Sub-sectors specified in the Policy (1992) were:

- Clean water supply.
- Wastewater treatment.
- Solid waste management.
- Urban transport.
- District heating.
- Housing.
- Infrastructure for economic development (e.g. industrial/business parks, roads, airports, etc).

The Policy (1992) had less emphasis on Technical Co-operation (TC) than subsequent policies.

EBRD Municipal and Environmental Infrastructure Operations Policy (1998)

The Policy (1998) has 5 core transition-related objectives:

- Decentralisation of municipal and environmental infrastructure provision.
- Commercialisation and corporatisation of service provision.
- Promotion and optimisation of private sector involvement.
- Development of appropriate regulatory structures and capacity.

- Environmental improvement and energy efficiency.

The Policy recognises that the majority of EBRD operations up to 1998 have been in advanced transition countries and EU accession countries. An objective in the 1998 Policy is to focus on non-sovereign projects in these countries in line with decentralisation.

The Policy also has an objective for selected transition-orientated projects in less advanced countries and might need to secure municipal loans through sovereign guarantees, or make sovereign loans.

The sub-sectors with investment needs that are included in the Policy are:

- Water supply and wastewater treatment.
- Solid waste management.
- District heating.
- Natural gas distribution.
- Local transport.
- (Municipal housing is not specifically included).

EBRD Municipal and Environmental Infrastructure Operations Policy (2004)

EBRD's overall approach towards transition in its countries of operation:

- Decentralisation
- Commercialisation
- Environmental improvement

The main strategic and operational objectives in the EBRD's MEI Policy (2004) are:

- Extend the use of standard "products" to Russia / intermediate / early transition countries.
- Build on experience in the water sector to expand the portfolio into other sectors.
- Promote private sector solutions.
- Promote commercialisation / improved efficiency of municipal services.
- Extend the use of existing "products" to small municipalities.
- Institutional strengthening through TC.
- Address affordability through grant co-finance.
- Increase access of municipal service companies to capital.
- Improve project implementation, improve disbursements, etc.

The Policy (2004) has much emphasis on Technical Co-operation (TC) and policy dialogue.

Other points in the MEI Policy include:

- A move into sectors that are not based on full cost recovery, but would benefit from commercialised approaches, such as urban transport.
- A move into sectors that have strong environmental benefits, such as district heating and solid waste management (including waste to energy).
- An emphasis in the more advanced countries on new products (e.g. guarantees, revenue bonds).
- A move into new sectors such as urban regeneration and housing in more advanced countries.
- The promotion in early transition countries of the concepts in the MEI Policy (e.g. decentralisation, commercialisation) through demonstration projects.

Municipal and Environmental Infrastructure – Strategic Vision and Core Competences**(Contribution to CRR4 Debate – November 2008)**

- This paper has a focus on commercialisation and decentralisation (e.g. direct lending to municipalities), including the promotion of private sector participation.
- The strategic vision includes movement of EBRD operations south and east, with selective use of existing products.
- The paper emphasises the need for policy dialogue to support governments to change fiscal and tax policies to ensure the creditworthiness of local municipal authorities.
- The focus is on non-sovereign financing approaches to mobilise finance at local levels in line with decentralisation.
- The vision includes the strategic objective of a series of projects with long-term clients in the MEI sector to reflect their progression from dependence on government to operational independence and financial autonomy.
- The paper recognises that a period of full cost recovery under a commercialised regime is needed before PPP is feasible.
- The paper also recognises that recent economic uncertainties mean greater credit discipline is needed.
- The strategy continues to focus on grant co-finance, TC, and co-finance with other IFIs.
- There is an increased focus in the strategy on supporting local private companies and strategic foreign investors through debt/equity under Bank conditions as a way of dealing with smaller municipalities.
- There is a sub-sector focus on water and sewage, solid waste management, district heating, urban transport and expanding into affordable housing and energy efficiency in buildings (with a selective approach because of market conditions).

Annex 3 - Analysis of lessons from MEI project evaluations

1. Introduction

This document contains the results of an assessment of the lessons learned from project evaluations in the MEI sector by the EBRD's Evaluation Department (EvD). The assessment has been carried out as part of a Special Study on the evaluation of the implementation of the MEI Sector Operation Policy.

The number of lessons in the lessons learned database from different types of project evaluations can be summarised as:

- A total of 23 Operational Performance Evaluation Reviews (OPERs) of investment projects in the MEI sector have been carried out, generating 134 lessons. OPERs include an evaluation visit to the project.
- In addition, 15 OPERs have been carried out of Technical Co-operation (TC) projects related to the MEI sector, and these generated 69 lessons in the database.
- As well as the lessons from OPERs, 48 lessons learned were highlighted in expanded monitoring report assessments (XMRAs) from 13 projects in the MEI sector on which XMRAs have been carried out. XMRAs involve a detailed desk-based document review by the Evaluation Department. Several of these lessons were common to those identified from OPERs.

Section 2 of this document provides the key points from the analysis of the lessons learned database.

Several common themes in lessons have been identified from the analysis of the lessons learned database. These common themes relate to:

- Programme of investments.
- Policy dialogue.
- Co-operation between IFIs / co-finance.
- Project planning.
- Technical Co-operation (TC).
- Local counterpart commitment and capacity.
- Tariffs / affordability.
- Private sector participation (PSP).
- Key performance indicators, project monitoring and reporting.
- Financial Intermediaries.
- Small municipalities / multi-municipal projects.
- Other lessons.

A summary of the common lessons under these themes has been developed in the table in Section 3 of this document. The numbers in the table correspond to the numbering of the original lessons learned, which are provided in Sections 4, 5 and 6 for Investment OPERs, TC OPERs and XMRAs respectively.

2. Key Points from Lessons

There are several lessons indicating the strong benefits of ensuring projects fit into an overall programme of investments for a municipality. Programmes of investments bring efficiencies to follow-on projects in planning and implementation, ongoing strengthening of relationships with clients, and are enhanced by the longer-term focus on wider aspects, such as tariff reforms and capacity development, which take time to implement and require ongoing policy dialogue. The main benefits of programmes of investments is that MEI clients usually cannot afford such a large project that would be required to bring a sector up to international standards, and smaller projects within an overall longer-term programme are more affordable. The obvious example would be an investment programme in the water and sewage sector involving projects over time in water treatment, supply networks, wastewater treatment and sewage treatment.

Policy dialogue at national and local municipal levels is essential for projects to be successful in the MEI sector. It must start at an early stage in project planning to encourage commitment from counterparts and other stakeholders to reforms in aspects such as tariffs, legislation and PSP, and to ensure the understanding of the client to the covenants in the agreement. Policy dialogue should be stepped up again during projects when there is a change in national or local government.

Where applicable, a co-ordinated approach with other IFIs to developing programmes of MEI investments, and to policy dialogue, has benefits.

There are several lessons in the database recommending earlier and more detailed institutional analysis and due diligence in project planning. At this early stage, it is important to identify stakeholder capacity, as well as client commitment to the project and to necessary associated reforms. Use of TC early in project preparation should lead to a more successful project. However, for larger projects with ongoing TC, the planning of some TC components should be linked to the timing of project components.

There were few lessons related to different financial instruments, although some indications that innovative instruments and pricing mechanisms are less applicable in countries where counterparts are less experienced. EBRD can still play an important role in municipalities in EU Member States by preparing complex projects, bringing high standards of governance and specialised skills.

There are many lessons highlighting the need to develop the capacity of clients, particularly management and leadership skills, and to strengthen their commitment and willingness to take a long-term approach, and to the necessary wider reforms. In many cases capacity in procurement and contract management needs to be improved in order to strengthen the counterpart's role as the client in private sector participation (PSP). Carefully planned TC projects, involving consultants that are experienced in the region providing hands-on support, are important for the development of capacity as well as proper project implementation.

Many of the lessons on tariff reform confirm the point that there is political reluctance to increase tariffs. There is a need to raise counterpart understanding and increase public awareness of the benefits of improving municipal services and the associated need to raise tariffs. There will be minimal credible private sector interest, and PSP will not be successful, without the necessary tariff reform.

Early setting of agreed tariff formula, with known increases over a number of years, helps long-term planning of investments. Linking increases to the timing of investments so that visible improvements in services are demonstrated at that time, helps to encourage tariff payments.

As well as a robust institutional framework, strong client capacity, and proper tariff policy, PSP requires a strong, independent and transparent regulatory function. In some cases there would be benefits for TC to focus on strengthening this regulatory function, as well as strengthening the municipality / utility.

Project monitoring in the MEI sector should include environmental and other performance data collection before and after the project. This is so that successes can be demonstrated (e.g. energy savings,

improvements in water quality, etc). Several lessons emphasised that project monitoring during major procurement is important, including technical inspections.

MEI projects in smaller municipalities can be resource-intensive in planning and monitoring, and often could be facilitated through local financial intermediaries.

There are opportunities for improving the planning of projects by more involvement of other EBRD teams (e.g. Power and Energy) in order to benefit from their experience. Enhancing the role of Resident Offices would strengthen planning, monitoring and policy dialogue activities.

3. Summary of common lessons

Theme Assigned lesson reference numbers	Summary of Common Lessons learned on Environment
Programme of investments	<p>When planning the first project with a municipality / utility, as well as defining the specific objectives of the project, the MEI team should work with the client (and other IFIs where applicable) to define a wider (and flexible) future programme of investments that could extend over several projects, each being planned in detail at an appropriate time in future. Examples include the water and sewage sector, where widespread improvements are not often affordable in one phase, and, for example, upgrade to water treatment and supply might be the first project, and improvements at the wastewater treatment plant the second project, and sewage sludge treatment the third project. Note that even emergency projects should be integrated into a wider development plan.</p> <p>The concept of programmes of investments is in line with the Bank's mandate on transition. Projects within such programmes benefit from the longer-term attention to wider aspects of municipal projects that can be addressed through policy dialogue on an ongoing basis over time, such as tariff reforms, client commitment, and strengthening capacity. Also, programmes of projects will strengthen relationships with municipal clients and bring efficiencies in due diligence and the implementation of each project.</p> <p>Although the first project generally has the most demonstration impact, follow-on investments do further enhance demonstration effects. It is important that follow-on investments are structured to maintain transition momentum.</p>
Policy dialogue	<p>Policy dialogue is essential in relation to addressing wider aspects, such as tariff policy, legal and institutional constraints, and commitment to the necessary reform. Policy dialogue is important at both national and local levels.</p> <p>The timing of policy dialogue is important. It must be carried out from an early stage in planning and certainly prior to agreement. As the project is implemented and the works on MEI projects start, EBRD's leverage on these issues reduces over time, although ongoing dialogue during implementation is useful.</p> <p>However, when political positions change at central and local government level, dialogue with new administrations is needed to raise the understanding and commitment to the project, as well as to wider reform.</p> <p>Policy dialogue is also important where Bank covenants might be perceived by the client as too ambitious, and it is important to discuss these aspects at an early stage with clients and to plan any necessary wider actions.</p> <p>Resident Offices have an important role to play in policy dialogue, particularly because of their knowledge of the local situation in the countries of operation.</p>
Co-operation	Co-operation between IFIs, to develop shared objectives and work jointly on policy

between IFIs / co-finance	dialogue activities, has generated positive results, for example in developing frameworks to mitigate risks for private sector participation. EBRD should closely co-ordinate with IFIs, EU and other donors to align objectives and optimise project implementation, including co-ordination of training at municipalities. In addition, co-operation with IFIs supports the approach of the municipality planning a wider programme of investments (see above).
Project planning	<p>Detailed institutional analysis is needed early in project planning. This will identify the main stakeholder organisations, assess the capacity of the client / utility for implementation, assess the levels of commitment of the client / utility and other stakeholders to the project and to the necessary associated reforms, including tariff restructuring. It will also identify the priorities for policy dialogue.</p> <p>Capacity development of the client / utility should be included at an early stage within the technical co-operation (TC) associated with the project. A TC contract on capacity development (e.g. on management and leadership, procurement, contract monitoring, etc) should be considered, and this could be a separate contract in cases where the main consulting firm(s) that are carrying out the core TC have only specific technical expertise. Use of TC early in project preparation will lead to a better project concept and plan, and clients should be engaged in the planning of TC to ensure they are fully committed to the TC component.</p> <p>Financial projections during planning should take into account the local situation, constraints, tariff levels and collection rates, politics, and wider risks, for example risks in countries that are experiencing rapid changes. Planning scenarios should include worst case examples.</p> <p>Detailed due diligence has the benefit that wider and more robust project management frameworks are likely to be planned, which in the longer-term should improve cost-effectiveness. The planning process should be wider than just financial and technical aspects, including management, environmental aspects, capacity development, land ownership, etc, during initial planning and during any restructuring. However, the potential transition impact should not be exaggerated, and transition targets should not be over-ambitious, in order to gain EBRD approval for projects. Where project proposals have the potential to be outside the Bank's mandate, this should be highlighted and addressed at an early stage.</p> <p>Flexibility and contingency in timescales should be included in project plans to allow adaptation in project implementation, for example because of rapidly changing conditions and demand, and to allow re-allocation of funds without time-consuming approvals.</p> <p>Innovative financial instruments and pricing mechanisms are less applicable where counterparts are less experienced (e.g. in early transition countries).</p> <p>Where a third agency has an involvement in a condition for disbursements, this could create delays, and in these cases there should be a focus on ensuring the co-operation of such agencies from an early stage in planning.</p> <p>Opportunities should be identified early in planning to utilise the expertise and experience of other EBRD teams, for example the Power and Energy Team for some district heating projects.</p>
Technical Co-	Technical Co-operation (TC) should be an early priority in MEI projects, particularly for the first project with a municipal client. Many clients need support during

<p>operation (TC)</p>	<p>planning and procurement at an early stage, and for larger projects the set up of a project implementation unit (PIU) has benefits. In some cases a bridge loan might facilitate some early TC whilst the main loan agreement is being finalised and approved.</p> <p>Activities to scope out potential donors for TC should be started before a project is presented to the Board. Engaging the client in the design of the TC at an early stage, as well as giving the client a joint role with EBRD in selection of consultants, will strengthen the client's commitment to the TC project, and its commitment to implementing the recommendations of the consultants.</p> <p>Where large inputs of TC are needed, results could be better if TC is divided into separate contracts according to the specialist skills needed, rather than contracting one consultancy firm for all TC activities. This can be especially the case for a client in early transition, which might have limited capacity to absorb a large TC project.</p> <p>The Terms of Reference (ToR) for TC projects should be carefully planned, and should include a logical framework. Planning of TC should be linked to the investment covenants and to the timing of project components as far as possible, for example setting up the TC activities in stages, parallel to steps in reform. Similarly, large infrastructure projects might need to be changed over time during planning and implementation because of uncertain future demand, and a staged approach to TC could be a lower risk (e.g. stage 1 – TC for concept design, stage 2 – TC for detailed design, etc). In cases where there might be necessary extensions to loan agreements, contingency options should be identified in advance for funding the necessary extensions to associated TC.</p> <p>At the start of TC projects, the Bank should be proactive in building the relationship between clients and consultants. The consultants should be encouraged to adopt a hands-on approach to working with counterparts. Larger TC projects can cover several years and consulting firms should also be encouraged to keep the core consultants in place for as long as possible in order to benefit from a strong client-consultant relationship and reduce any impacts on continuity and efficiency when consultant teams are changed. The transition impact of TC projects can be enhanced by follow-up actions after the end of the TC project.</p> <p>The role and experience of the project manager of TC projects is particularly important, especially when it involves a consortium of firms. A significant focus of the evaluation of bids for TC projects should be on the experience of the project manager, both in terms of project management skills and the achievement of results in previous projects. Similarly, the experience of the team of consultants in the region is often as important as its technical skills.</p> <p>Competent local consultants can enhance the effectiveness of TC. The Bank's Resident Offices can play a useful role in identifying credible local consultants.</p> <p>Wherever possible, TC contracts should be planned with payments related to achievement of performance indicators.</p>
<p>Local counterpart commitment and capacity</p>	<p>It is important for counterparts to have strong capacity, high commitment, and willingness to take a long-term approach. Lessons have demonstrated that for many MEI projects it is essential to develop the capacity of clients, particularly their</p>

	<p>management and leadership skills.</p> <p>Strengthening the capacity of the client to carry out proper procurement and contract management will improve the project implementation and support private sector participation. When an approach involves a PIU, the local PIU team should be selected from existing client personnel, in order to enhance capacity. Actions to encourage staff retention at the client should be planned so that those personnel that have been trained remain with the client after project completion.</p> <p>In some cases, limiting the consultant role in TC projects to providing advice and support to the PIU, thereby enhancing the ownership and responsibility of the PIU, can have benefits in terms of strengthening the PIU capacity and experience. In other cases, the role of the consultant will shift during the project from more emphasis on leadership early in tasks to more of a support/advisory role later on in the project.</p> <p>In addition, it is important for the client to have sufficient technical skills to develop and implement infrastructure plans. For example, municipality staff might need training in technical aspects as well as contract management in order to properly supervise infrastructure works.</p> <p>The involvement of senior and other key employees at clients in detailed project planning will strengthen commitment to successful project implementation.</p> <p>A project start-up workshop is advisable to gain the understanding and commitment of the counterparts and other stakeholders, in particular for complex projects.</p> <p>There is potential for the commitment of local counterparts to weaken as a result of changes to the political climate and the replacement of decision-makers. The Bank should take steps as far as possible to ensure continuity of commitment of all stakeholders, independent of political changes, for example through communication and policy dialogue, and through including loan covenants with critical dates in the agreements to enforce the project's progress regardless of political party motivations.</p>
<p>Tariffs / affordability</p>	<p>Financial analysis and planning of tariff increases need to take into account local affordability and the potential impact on the local economy, as well as potential cross-subsidisation approaches. Project planning also needs to consider foreign exchange risks.</p> <p>In most cases private sector participation (PSP) will not be successful without the necessary tariff increases and credible private companies will not be interested in participating in municipal services unless tariff levels are raised, so that the companies can make sustainable investments (and profits). Similarly, without the necessary tariff increases, utilities tend to remain loss-making, and therefore privatisation is not an attractive option.</p> <p>There is obvious political reluctance to increase tariffs and it is important to raise stakeholder understanding and public awareness of the need for investments in municipal services and on the associated necessary increases in tariffs. Stakeholder workshops and awareness programmes should emphasise these aspects from an early stage.</p> <p>Clients need to subscribe before the loan agreement to tariff increases, and where necessary they will need to adopt new regulations on tariffs and establish and</p>

	<p>strengthen regulatory entities. Disbursements could be linked to the agreed changes in tariff adjustments in order to ensure they are implemented. Early setting of tariff formula with known increases over a number of years will assist in long-term planning of investments.</p> <p>Tariff increases should be linked to the actual timing of investments so that improvements to municipal services can be demonstrated (therefore encouraging payments of tariffs).</p> <p>Financial planning should also reflect anticipated collection rates of tariffs, both from domestic customers and industrial customers of the utility. Industrial customers can often be the biggest debtors. Financial modelling should take into account predicted future conservation and the effect of the reduction in demand on total revenues.</p> <p>Parallel initiatives could be needed to expand the registration of customers where local regulations specify that tariffs can only be collected from registered customers.</p>
<p>Private sector participation (PSP)</p>	<p>Successful private sector participation (PSP) requires a strong institutional and legal framework, including tariff policy, and a focus on the mitigation of risks to private companies. PSP requires strong and transparent regulators and fair competition. When PSP is introduced, the benefits are often likely to take time to come through, often emerging in the medium to long term.</p> <p>As well as providing TC for institutional strengthening and capacity development of the municipal client / utility, consideration could be given by EBRD to providing TC to regulators in relation to developing their capacity and strengthening their independence.</p> <p>Client capacity is an important factor in PSP. Initially, simpler contracts are recommended where possible, with larger more complicated contracts preferably not being tendered until client capacity has been strengthened.</p> <p>Larger, more complex projects involving PSP can be much more resource-intensive for the Bank. EBRD need to focus on strengthening and maintaining the relationship between the client and the private sector service provider in complex PSP projects.</p> <p>The participation of international private companies is often a challenge, particularly when local operational working cultures take time to reform, and when tariff policy is uncertain. A strongly planned and implemented design, build and operate (DBO) scheme could facilitate the entrance of international private contractors, although the tariff and cost recovery framework must be suitable to sustain the project investments.</p> <p>There have been some uncertainties about the forms of PSP that are allowed in projects with EU ISPA or Cohesion grant co-financing. Letting the private sector operate and maintain facilities that are owned by the local government should not be a restriction on the use of EU grant funds.</p> <p>Independent assessments of privatisation proposals and other private sector participation are needed to ensure project implementation will be sustainable. In particular, EBRD monitoring should include reviews of the tender specifications for</p>

	<p>contracts to design, build and/or operate infrastructure facilities to ensure the benefits from competitive tendering are gained. Pre-delivery inspections of equipment are also important.</p> <p>Concession contracts can have the advantage that the private company will focus on investments in renovation and upgrade, rather than delaying these investments because of its major upfront investment in acquisition. In addition, these simpler contracts are more applicable initially than contracts involving private ownership of facilities until the legal and institutional framework has properly been strengthened.</p> <p>Privatisation can assist commercialisation in that radical changes (e.g. staff reduction, environmental improvements, etc) can be implemented much more easily by a private company.</p>
<p>Key performance indicators, project monitoring and reporting</p>	<p>The Bank needs a structured approach to monitoring MEI projects, with consistent reporting formats and contents, especially where there are multiple stakeholders involved. Monitoring should include wider aspects, such as progress in the implementation of tariff reform. Transition impact indicators must be measurable.</p> <p>Physical and financial, performance indicators are important for monitoring MEI projects. For example, on completion of environmental infrastructure projects, a representative of the Environment and Social Department (ESD) should assess and certify that the project meets the Bank's performance criteria.</p> <p>It is useful to monitor environmental performance and report successes to demonstrate positive environmental impacts, for example through emission reports before and after the project. In particular, district heating projects should include monitoring of energy savings, as well as financial savings.</p> <p>Clear requirements are needed for environmental data in AERs related to MEI projects, and environmental report formats would often be more useful if they were more tailored for specific projects.</p> <p>Monitoring is important during the procurement process, for example to ensure lower price bids meet the quality standards. Post-qualification verification, pre-delivery inspections and performance guarantees are essential.</p> <p>Although technical supervision and monitoring is outsourced by the Bank, basic technical monitoring could sometimes be usefully carried out by the Bank (for example checking basic plans for procurement to assess whether equipment is appropriate, common brands are being used, etc).</p> <p>Monitoring of smaller projects, or multi-municipality projects, can be resource-intensive, and there are benefits to outsourcing the project monitoring.</p> <p>For MEI projects and programmes in the MEI sector that involve financial intermediaries (FIs), the Bank should encourage the FIs to carry out monitoring. This should involve monitoring performance against domestic standards as well as those additional standards required by the EBRD.</p>
<p>Small municipalities / multi-municipality projects</p>	<p>For multi-municipality projects, it is important that the Bank not only assesses the affordability to individual municipalities, but also the aggregated affordability and the potential effect on the overall local economic base.</p> <p>A regional or basin-based approach could be applicable to water projects covering several municipalities, and the economies of scale are likely to assist</p>

	<p>commercialisation. Where the Bank is planning a project for a large city, it is worth exploring opportunities to include nearby small towns in the project.</p> <p>Some multi-municipality projects can be resource-intensive in terms of planning and monitoring. There is a balance needed between transition impact and risk return aspects of investments. Working through local financial intermediaries brings benefits.</p> <p>For larger multi-municipality projects EBRD could consider having one relationship manager per city.</p> <p>For multi-municipality projects, TC assignments should be tailored for different municipalities (e.g. according to size of municipality, stage in transition, etc).</p>
Financial Intermediaries	<p>Funding through local financial intermediaries, preferably competitively selected, can help MEI financing to several small municipalities to benefit from economies of scale, and TC support to strengthen relevant capacity at intermediaries can be justified. For example, it is useful for financial intermediaries to gain the capacity to carry out proper sub-project monitoring.</p> <p>However, financial intermediaries should not be selected unless they have a clear strategic objective towards the municipal market.</p> <p>The debt covenants with Financial Intermediaries should in turn be reflected in agreements with sub-borrowers to encourage financial discipline.</p>
Other lessons	
	<p>A comparison of relevant national standards with relevant EU standards is an important part of project planning.</p> <p>There are uncertainties related to the boundaries where the Bank requires the achievement of EU standards in projects in the MEI sector. Similarly, for several MEI projects, there are uncertainties whether EU standards are achievable within the lifetime of the EBRD project, particularly solid waste management projects.</p>
Advanced countries / EU Member States	EBRD can still play an important role in municipalities in EU Member States by preparing complex projects, bringing high standards of governance and specialised skills.
Technology	Investments in simpler technology, with parallel training of local counterparts in operation and maintenance of the technology, can initially have a greater transition impact than investments in state-of-the-art technologies that are challenging for the utilities to operate properly. Verification of suppliers and pre-delivery inspections are essential.
Social aspects	<p>MEI projects have the potential to help the development of local private construction firms in ETCs, and therefore contribute to employment in countries that are at risk of losing skills through migration.</p> <p>It is important that city administrations do not reduce expenditure in other budget lines, in particular social expenditures, in order to service the debt.</p>
Restructuring funds	Where cost savings are achieved on one procurement package, the Bank should

	<p>not necessarily simply reduce disbursements but look into whether the client would benefit from restructuring funds to expand other procurement packages.</p>
EBRD internal procedures	<p>There would be benefits in many cases to improved communication between the Bank and the client during project preparation, for example explaining in detail the procedures during preparation, and Resident Offices could play more or a role in maintaining good communication. In addition, the Bank should spend time with a client specifically ensuring the client understands the conditions in the loan agreement.</p> <p>Standardised templates for ToRs (e.g. for feasibility studies) would be useful for planning.</p> <p>Approval of changes to the project scope during implementation needs to involve all relevant parties within EBRD, including for TC components.</p> <p>When there is to be a change in OL, there should be joint participation (of the existing and new OLs) in monitoring missions and monitoring reports should include a wider historical perspective of the project.</p>
Evaluation	<p>Co-operation between IFIs in terms of joint evaluation can be difficult, for example with respect to timing. However, there might be interesting benefits in comparing evaluations carried out at different times by different IFIs.</p> <p>Where clusters of projects have effectively become programmes, then multi-project or programme evaluations would be a more applicable and useful approach.</p> <p>For some large MEI projects, two evaluations might be beneficial, for example the first evaluation could be about 2 years after signing to gain lessons from the planning and early implementation stages.</p>

4. Lessons on MEI Projects from Investment OPERs

The following table presents the 134 actual lessons in the database from the 23 investment OPERs. The left column indicates the common theme(s) to which a lesson is related in the table in Section 3 above. Although most lessons relate to a common theme, some lessons are very specific and have not been included in the table above. The lessons in italics are from an OPER that was in final draft stage at the time of the analysis.

Project planning	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 and 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.
Project planning	For practicality reasons the Bank would need to define English as its sole working language and stipulate that all its key working files should be kept in this language. Equally for practicality reasons, some correspondence with the client and non-key documents may be maintained in another language, but with an English summary attached.
Project planning	Bilateral grant finance, by nature, bears the significant political risks, which needs to be explained sufficiently to the recipient and beneficiary beforehand. The capacity of recipient and beneficiary entity must be adequately examined during due diligence if the donor finance is to be granted on a purely bilateral basis. Adequate support should be provided to realise the whole scope of the project presented at appraisal, which could formulate a contingency plan if the commitment seems hard to realise.
Project planning Technical Co-operation (TC)	Large and longer-term consulting services for implementation support run significant risks, which could seriously affect the efficacy and effectiveness of the investment project. For the first-time borrower and beneficiary of technical cooperation, capacity building support should be conducted with priority in the implementation schedule. In this project, procurement assistance and capacity building training were provided by the same consulting firm, which later turned as insolvent. It resulted in inadequate capacity building training. The consulting services could have been divided into separate contracts according to expertise and required specialisations, rather than hiring a consulting firm for multi-disciplinary services. A multi-layer multi-borrower implementation structure should ideally be avoided and a sufficient consultation prior to the implementation needs to be arranged. Each borrower should be benefited from respective consultants' services, so that the service period will not be prolonged unnecessarily.
Tariffs / affordability	Consequences of substantial upfront tariff increases have appeared negative in the small-sized local economy that has limited paths for economic growth. Tariff increases are often compulsive in the similar

municipal infrastructure sector facilities. However, the utility prices could impact on the local economy beyond the international affordability indicators. In this project, 50-100% real term increases of tariffs in one year hit the municipal economy and caused a spiral economic downturn. When launching the same type of programme for the same sector in a different country, the Bank needs to look into the potential impact on the economic cycle of the project local economy, which might turn as negative in a short-term.

Small municipalities / multi-municipality projects	<p>Optimal structure for the unbundled wastewater management could be sought in a smaller-sized economy based on the investment capacity and institutional capabilities regardless administrative boundaries. In this project, the IFI-led merger of two water companies resulted in conflict based on each municipality's interest. However, this inter-municipal enterprise structure indicates a future trend in the utility services. A regional or basin-based approach could be valid to reduce overall discharges or contamination in trans-boundary contexts. The scale of economies needs to be first created to advance corporatisation and commercialisation, which are worthwhile for the sector reforms. It has more advantages for potential investors. To achieve this, unnecessary municipal sectionalism should be avoided.</p>
EU Standards	<p>The Bank should require EU compliance across the full range of water resources management activities not just those covered under "use of proceeds". The Bank achieves its environmental mandate and promotes sustainability in the municipal water sector when EU standards are applied across the full range of corporate activities of a municipal water company, not just those covered under "use of proceeds".</p>
Private sector participation (PSP)	<p>The Bank should promote transition in the MEI sector particularly for the institutional framework whenever possible. The Bank's transition impact strategy calls for promotion of privatization. Thus, in the MEI sector, the Bank needs to work with Municipalities to help move beyond, municipally controlled/ownership structures. In this project, the municipal council endeavoured, over a decade with the assistance from the IFIs, to realise a concession approach in the water sector, which delivered a successful result and benefits to water users.</p>
Private sector participation (PSP)	<p>Recommendation: The Bank (MEI, the Country Team, and ESD) should work with the Ministry and EU authorities to see if it is possible to structure privatizations which would allow for continued access to the EU Cohesion Funds. This concession would appear to be an appropriate example. The Government continues to own the infrastructure, therefore there is, or should be, no restriction on use of the Cohesion Funds for infrastructure improvements, while letting the private sector operate and maintain the facilities. Management should prepare a report on this issue for the board presentation in which the Apa Nova case could be used as an example.</p>
Policy dialogue Co-operation	<p>The right project scope, good timing and cooperative efforts by international financial institutions helped realise the sector's take off to private sector involvement and resulted in benefits to users. For a</p>

between IFIs / co-finance	decade, the international financial institutions concertedly made efforts to assist the water sector in transition. The World Bank's investment largely mitigated risks for private sector operators but hinged its sustainability on the private concessionaire. The Bank assisted the private concessionaire in implementation of major investments. The cooperation for years to fulfil the shared objective resulted in positive outcome all round, which none of single investments alone could otherwise have achieved.
Private sector participation (PSP)	
Private sector participation (PSP)	Radical institutional change can be undertaken more readily by a private sector owner. In this project, on the occasion of the transformation from a public company to a private concessionaire, the private sector owner carried out the staff reduction to half in a few years through the voluntary retirement scheme without redundancy. Employees were receptive, perceiving the radical change as reasonable and reshuffling was undertaken smoothly. The staff reduction in early years helped the concessionaire improve better operational efficiency in later years.
Private sector participation (PSP)	Implementing a private sector participation project by aiming to maximise the advantages of the selected modality. The selection of private sector participation modality could be affected by various reasons such as political, institutional and legal frameworks. However, once selected, its implementation should always aim to maximise the benefits from the private sector involvement. In this project, the concession to a private sector company did not include the construction contract and the construction was separately and openly tendered. Notwithstanding the construction contract was awarded to a company in the concessionaire's group. In certain industries, it is difficult and impractical to separate the design and construction from the operation and maintenance contractors. However, if the project is designed to operate based on the separate contracts, the Bank should review the construction tender requirements and the terms and conditions of the contract to be awarded in order to ensure the benefits from the competitive tender.
Policy dialogue Local counterpart commitment and capacity	Large municipal infrastructure projects bear political risks that could weaken the original commitment of the municipality. When the decision makers at the municipal government are replaced, the rationale of the investment could weaken as a result of changes of the political climate. Priority infrastructure investments, however, should be implemented for the benefit of users regardless of political changes. Important investment projects should require a continuity of commitment independent from changes of key political figures. The Bank should seek to make sure early on that an adequate level of commitment exists from the local authorities and that is maintained.
Project planning Technical Co-operation (TC)	Timing of the technical cooperation is important in the country during the politically sensitive period. Ideally, the implementation of the technical cooperation should be undertaken promptly after the approval while the counterpart who was supportive of the project is still in the position to support the technical cooperation.
Project planning	Involving the third party agency in the condition precedent could

result in an unexpected delay in implementation. A discretion required from the third agency, if included as a condition for disbursements, could create risks of delay in project implementations, particularly in the situation where such an agency is new and unknown in cooperation with the international financial institutions. Ensuring the cooperation from such an agency prior to signing would avoid unexpected obstacles to timely implementations of the project.

Policy dialogue	<p>Limitation of legal framework could result in less effective technical cooperation and unrealised transition impact. The Bank was aware of the limitation of institutional set up imposed by the domestic legislation in this case. Nonetheless the sector study under the technical cooperation was engaged and carried out. Due to such legal impediment, the cooperation from the counterpart for the study was not sufficiently obtained. The study therefore delivered minimal results. Such a limitation should have been brought as an issue of policy dialogue at the beginning of the project.</p>
Policy dialogue Local counterpart commitment and capacity	<p>Resuming policy Dialogue during the project implementation period may be necessary after major political changes. The best timing for policy dialogue with the government is always prior to the investment. Once the physical works started in municipal infrastructure projects, the Bank's leverage reduces over time. When the politics change at the central and local government level, it would be very difficult to pursue the original objectives for sector reforms even though a technical cooperation is provided. Periodic follow-ups of sector reforms at proper level may be needed during project implementations.</p>
Programme of investments	<p>Demonstration effects can be multiplied by a successful first project in the municipal and environmental infrastructure sector when soon pursued by a follow-on investment. The first project in the sector has often a larger demonstration effect than any follow-on or similar projects. Its success is therefore highly visible and encouraging for the sector and could deliver a strong message to peer enterprises. In this case, when the subsequent project was launched soon after the first, the demonstration effect even intensified in the conventional municipal infrastructure sector.</p>
Programme of investments Co-operation between IFIs / co- finance	<p>Advantages of Integrated approach with a single project scope for Co-financing in infrastructure projects. The integrated approach, which considers all the components regardless of financiers in a single project scope, appears to be more sound and effective for implementation and monitoring. In addition, it helps to ensure the quality of the project. Discrepancy of defined project scope among co-financing parties' needs to be reconciled as it would make monitoring and evaluation rather difficult.</p>
Programme of investments	<p>Transition momentum needs to be maintained when designing a follow-on investment. In repeat financing when a different financing mode is applied, the project design and structure should build on the state of progress or, if not, the unfulfilled covenants and the Bank's mandate-related conditionality should be maintained.</p>

Tariffs / affordability	<p>Difficulty in reassuring tariff increases in a political context. Confronting voter's preference, even a well-thought through contractual framework could have a limited enforceability for increasing user charges. The municipality and a water company, when committing to the water infrastructure project, should be encouraged to promote and raise public awareness of the need for water investments to support the necessary tariff increases.</p>
Co-operation between IFIs / co-finance	<p>Importance of Grant-Based Finance for Environmental Infrastructure. Grant financing plays a vital role in financing the environmental infrastructure in economic and financial terms. The viability of the investment hinges on the grant funds; while the project is able to fully cover recurring O&M costs (i.e. cost recovery), the client could not have afforded the entire capital investment without the grant component. The facilities financed from grant funds, although they do not carry interest, need to be promptly implemented and completed in order to ensure the project benefits to flow as early as possible.</p>
Social aspects	<p>Need for Development of Construction related Services in early Accession Countries. In early accession countries, recognising the out-migration patterns, the Bank may wish to consider not only financing the project, but also helping the sector in development projects, which could foster local construction firms. It would assist the construction market in expanding, thereby meeting growing demands.</p>
Private sector participation (PSP)	<p>Recommendation: The Bank needs to address what forms of privatisation are allowed under ISPA and the EU Cohesion Funds with the EC and then present the case in a better way to its clients. However, when it is anticipated that the grant funding will restrict privatisation, this should be made more clear in Board documents. In this case, the Board document had set privatisation as an objective, yet this was hardly the company's objective.</p>
Project planning	<p>Appraisal realism needs more attention. Projects with high Development Impact but low Transition Impact (TI) credentials should not be 'over-sold' on TI grounds in order to attract EBRD approval. Projects with lower TI potential may well deserve appreciation through over-compensating elements, such as environmental benefits, delivery expediency in a critical situation, etc.</p>
Project planning	<p>Completion of partly built projects should be considered the same as Greenfield projects: Had the Bank carried out A-level environmental due diligence on this Project and thus covered additional aspects, the case could arguably be made that a better, more all-inclusive and larger-scale project management framework may have resulted, which in the long term may have lowered overall costs to the citizens of the City.</p>
Key performance indicators, project monitoring and reporting	<p>Performance criteria should be part of the required completion tests of any major environmental infrastructure project: When undertaking an environmental infrastructure project, completion should be based on both physical and performance criteria.</p>

Key performance indicators, project monitoring and reporting	Recommendation: For major environmental infrastructure projects, as part of the Bank's project completion procedures, the Environmental Department (ED), or a contracted lender's engineer on behalf of ED, should review and certify that the project meets the Bank's environmental performance criteria.
Programme of investments Project planning	Project restructuring must take a holistic, overall project perspective and not be confined mainly to financial and credit considerations. Projects normally have a variety of dimensions, including financial, technical, environmental and managerial aspects that all need to be properly (re-)considered during restructuring. Failing to do so can jeopardise the overall project's viability. By failing to go beyond financial matters, the Bank missed a key opportunity to further advance its environmental (e.g. sludge disposal and phosphorus reduction) and transition impact (private sector operation) objectives.
Tariffs / affordability	Restructuring public utilities will usually involve tough tariff decisions. To achieve its transition impact objectives, the Bank needs to ensure that the government is committed to making the necessary tariff adjustments. Without the necessary tariff adjustments, the utility will remain loss-making and therefore will not be an attractive privatisation target. Also, in this case, the municipal rules only allowed for collection from registered residents whereas the company collects from all residents. Allowing for full collection from all city residents would go a long way to achieving profitability, as demonstrated by the one local private operator.
Private sector participation (PSP)	In a difficult investment environment, local privatisation may be a good first step. A local entrepreneur, and previous district manager, established his own firm to provide solid waste services in the City's largest district. His secret of success was obvious – cut costs and increase revenue. His success provides a demonstration to others. As his company grows and is financially successful, it will be an obvious take-over target for potential international operators once the investment climate improves.
EU Standards	Project objectives should be achievable in the life of the project. EvD would argue for establishing clearly stated and realistic objectives. For example, both Management and the Board should have questioned the appropriateness of EU environmental standards for solid waste management in Central Asia, and the likelihood of international privatisation. Project Implementation Duration Needs to Be Realistic. EvD would argue that project implementation should reflect realistic time estimates for international procurement. Allowing for extra time will save on contract amendments, and projects that are able to respond quickly (2-3 years) will perform better than projects that take the same time but require multiple amendments.
Key performance indicators, project	Project monitoring of public sector projects requires a more structured approach. The Bank needs to take a more structured

monitoring and reporting	approach to project monitoring of public sector projects, particularly when there are multiple stakeholders.
Restructuring funds	Maintain flexibility in funding decisions. The Bank's response to cost savings was to reduce disbursements accordingly. As this was a sovereign guaranteed loan, an alternative approach could have been to expand other procurement packages and provide additional equipment. While the debt burden on the Company might have exceeded prudent limits, it could be argued that, as the municipality continues to support the company, this would have better met the specific needs of the client, while maintaining EBRD's profitability base. EBRD took one approach - to limit disbursements - while the World Bank took the other approach - to reprogram the funds.
Co-operation between IFIs / co-finance Evaluation	Joint evaluation may prove difficult to coordinate. Both EBRD and the World Bank worked in good faith to carry out a joint evaluation, but because of timing and procedures this proved difficult to achieve. EBRD would have had to delay the evaluation by a second year. What may prove equally interesting in certain circumstances to the donors may be to compare two separate and independent evaluations reflecting each organization's objectives and evaluation structures.
Local counterpart commitment and capacity	Demands on the client should be realistic. It is perfectly reasonable to ask for a contribution from the client in order to show his commitment, but if it is known that certain items are difficult in practice for the client to finance, it may be preferable to include them in the loan agreement or TC budget rather than spending much time and energy on convincing the client to live up to his obligations.
Technical Co-operation (TC)	Don't change a winning team. If the relationship between the client and the consultant is good, the consulting firm should be encouraged to keep the particular consultant in place for as long as possible.
Technical Co-operation (TC)	Have sufficient funds ready for possible extensions. If it can be expected that a loan agreement will have to be extended (for example due to procurement procedures), it may be prudent to already identify possible sources of funding for extending the associated TC so that these funds can be mobilised quickly in case the TC indeed needs to be extended as well.
Private sector participation (PSP)	Outsourcing activity of a former monopoly in the emerging market constitutes an important challenge. In the early stages of a private sector involvement framework, the contractual arrangements could be erratic when unanticipated events occur. The outsourcing to an international contractor has widened the exclusive market. However, the former monopoly, while receptive of transition, still maintains the rigid corporate culture operating according to its own norms. In unexpected events, a power gap between the former monopoly and the private sector service provider opts to emerge and hampers the fair risk allocation. The market expansion should be promoted through a fair risk allocation for the sake of transition. Although clear and thorough contract terms can mitigate this risk, the Bank must realise that it is difficult to exclude all

upfront ambiguity or anticipate all potential adverse events.

Private sector participation (PSP)	<p>Advantages and Limitation of Design-Build-Operate scheme. A well-implemented Design-Build-Operate scheme facilitates the entrance of international contractors in an exclusive market, thereby help achieving the market expansion. On the other hand, incorporating the cost recovery principle into the DBO scheme with the former monopoly can lead to tension, and therefore needs the Bank's extra attention. In this case, the Bank was instrumental in reaching agreement among parties.</p>
Private sector participation (PSP)	<p>Inducing Transition into the Cost Centre as a Challenge of Internalising Externalities. Earlier, the legislation for acqui communautaire forced the enterprises to raise the environmental standards. A command-and-control mechanism proves to be most effective to move the former monopoly toward sustainability. Beyond the legislated level, however, market forces, including regional competition, and the Bank, should work on the former monopoly to further improve its sustainable industry practices. However, the domestic market forces do not always provide incentives to the enterprises for internalising negative externalities, thereby limiting the positive thrust of the company in raising overall environmental standards.</p>
Project planning	<p>Monitoring of administrative costs for smaller MEI projects versus Bank profitability. The Bank should plan on the possibility of budget reductions from concept to final approval of MEI projects with municipal clients and should take this into account during concept review when estimating the Bank's potential profitability. (See related "Lesson Learned" in Gdansk Transport Project). Equally, the Bank may need to assess the country risk rating more often in countries experiencing rapid change, for example entry into the EU, such that risks are properly reflected in the Profitability Model.</p>
Key performance indicators, project monitoring and reporting	<p>The quality of environmental reporting could be enhanced through providing clearer guidance to clients. The Bank should provide greater guidance to project sponsors as to the type and frequency of environmental data it seeks. The pollution assumptions were well founded based on common engineering practice. It would have been helpful to quantify these gains, so as to demonstrate the importance of such projects (environmental externalities) and thereby provide a demonstrative effect that could lead to additional urban redevelopment activities.</p>
Project planning	<p>Successful urban redevelopment projects may lead to property sector opportunities. Senior Management should be on the look out for cross-team and cross-sector opportunities and encourage cross-team sharing. When there is a multi-sector approach the Bank's additionality is potentially enhanced.</p>
Project planning Technical Co-operation (TC)	<p>Fully engage clients in the design of TC to enhance client buy-in. Banking Teams should ensure that TC has the full backing of the prospective client and engage the client in the design of the TC. This will lead to greater acceptance by the client and, therefore, the sustainability</p>

of the resulting recommendations.

Private sector participation (PSP)	Strong regulators lead to less corruption: Strong and transparent regulators lead to less corruption and an even playing field that allows for fair competition under known rules, leading to the best outcome for the consumer and acceptable terms for the private sector.
Key performance indicators, project monitoring and reporting	Provide clarity in information needed in Annual Environmental Reports and only ask for what is needed: The Bank does not need annual environmental reporting from all clients. It is more useful to understand the project - "known your client" - and tailor environmental and other reporting to key project stages. Specifically, environmental reporting for this project would be most useful if the Bank received "before" and "after" emissions reports for each subproject which would allow the Bank to access the environmental footprint of the project.
Private sector participation (PSP)	The initial wave of privatisation is not EBRD's only chance to enter a market: Privatisation may occur in multiple phases – in this case, major cities, followed by secondary cities, followed by consolidation. Each phase is an important step in transition and each presents a different set of opportunities in which EBRD may participate. The Bank was able to participate in the second phase even though it missed the first phase.
Local counterpart commitment and capacity	Strong Sponsors are equally important in mature markets: The success of this project and EBRD's ability to enter into a maturing market (second phase transition) was built on the strength of a strong sponsor committed to the Czech Republic and willing to take a long-term view. The sponsor's excellent corporate governance standards and proven managerial skills ensured the success of this project.
Local counterpart commitment and capacity	Strong project management in selecting and implementing the right engineering design is key to success: The success of this project is partly based on the strong technical experience of the parent company/client and their ability to make the right technical decisions (plant conversions vs. rehabilitation) and to implement those decisions (re-engineering of existing plants and distribution systems) through effective engineering project management. This company's plants were all well designed, maintained and operated.
EBRD internal procedures	Bank-internal processing of post-approval changes of project scope and design require more rigour. The Bank-internal approval process of subsequent project scope and design changes (i.e. on the operational level and notwithstanding the required procedures involving the Board) should necessarily involve all erstwhile approval parties, if such change is considered material. In this regard changes have been made in the Bank's Operations Manual in 2003.
Project planning	Monitoring of administrative cost evolvement versus Bank profitability prospects needs more attention. The project clearance process, an important process element targeting avoidance of misallocation of scarce Bank resources, may need reconsideration and refinement. For investment areas where projects are known to enter the Bank's management cycle with high loan volume potential, but also with a

high risk that this volume may need to be scaled-down substantially in the course of project gestation, and also where gestation processes typically are protracted, the Bank should consider identifying alternative delivery mechanisms that are more cost-effective. Enhancing the project feasibility process and/or financing it through a loan (instead through Technical Cooperation grants, by way of which project ownership on the beneficiary side tends to increase) may be an alternative route to secure project profitability for the Bank.

<p>Programme of investments</p> <p>Policy dialogue</p> <p>Tariffs / affordability</p> <p>Private sector participation (PSP)</p>	<p>Preparing the ground for successful privatization: Through its early projects, the Bank worked with the Municipality to address facility engineering concerns, and legal and regulatory concerns, so as to ensure a successful privatization launch. The new company did not have to immediately address facility failures and breakdowns, and tariffs were already being adjusted to allow for a financially strong and viable company. The Bank had to be willing to take a long-term view and work with the Sponsor/Company over several projects to achieve desired outcomes.</p>
<p>Programme of investments</p>	<p>Recommendation: When entering into a relationship with a utility, the MEI team should not only define specific project objectives, but also define an investment program that could extend over several projects; the specifics of each would be defined when appropriate.</p>
<p>Evaluation</p>	<p>Recommendation: PED and the MEI Team should review the portfolio, define which clusters of projects have in effect, become programmes (e.g. Tallinn, St. Petersburg, and Rijeka) and undertake a multi-project, or programme evaluations.</p>
<p>EBRD internal procedures</p>	<p>Recommendation: Bank Management should update the Operations Manual so as to provide clear guidance to Banking Teams on appropriate Chinese Wall rules of engagement.</p>
<p>EBRD internal procedures</p>	<p>Recommendation: All Banking teams faced with Chinese Wall situations should receive a specialized half day training session.</p>
<p>Private sector participation (PSP)</p>	<p>The Need to Establish an Independent Regulatory Function: To further the Bank's privatization objectives and to ensure fair distribution of water and wastewater services throughout the Country, particularly in a small country such as Estonia, PED argues for the need for an independent regulator. Further, that the Bank should consider providing extended TC support to the regulator to ensure that they have the appropriate technical skills and to ensure their independence in the early years during the transition when such independence is fragile.</p>
<p>Private sector participation (PSP)</p>	<p>Announce Standard Term Sheets to All Bidders in a Privatization Deal: To ensure a fair, open and transparent process, the Bank should announce the terms of its post-privatization lending to all acceptable bidders, in advance, so that all bidders compete and operate on the same terms. This approach is standard industry practice on large municipal and state sector procurements.</p>

Project planning Technical Co-operation (TC)	Institutional development is key to success in municipal MEI projects. Early and judicious use of TC-funded technical assistance to support ID/HRD in working with municipal sponsors will lead to better understanding, planning and programming and thus better project outcomes.
Local counterpart commitment and capacity	The right leadership is key. St. Petersburg Vodokanal was fortunate to have a strong and capable leadership team willing to lead the “change process”.
Project planning	Assume conservative economic scenarios. Economic projections should always assume “worst case” scenarios, regardless of existing currency and/or market trends, or political expectations.
Programme of investments	Implement projects under long-term programs. The Banking Team should not incorporate too many discrete objectives into a single long-term loan. This is contrary to internal incentives and has proven difficult to implement, manage and monitor. Development of an investment program, which then leads to specific projects, may provide greater flexibility, better project management, and function more effectively in the context of the new business volume driven culture of the Bank.
Private sector participation (PSP)	<p>Concession may be a very effective legal system to privatise infrastructure. The primary advantage of such a system, when infrastructure exists but needs renovation, is that the private operator will concentrate its investments on such improvements instead of assuming upfront the acquisition cost of the assets. The success of the concession will however be dependent on the reliability of implementation of negotiated tariff and of their ongoing regulation. This element of, often significant, political risk may be better mitigated when the Bank is an equity owner in the operating company than a sheer lender.</p> <p>It is very important for the Bank to pre-agree a framework for the determination of a FMV when this is a basis for the exercise of a put option on its equity participation. This may be met with objections from the party granting the put option, particularly when it is a controlling shareholder who looks at the strategic value of its investment in non quantifiable terms. Furthermore a majority shareholder saddled with a known obligation to buy back shares at a higher price than the historical book value carried in its balance sheet may be required by its auditors to set a provision for future loss. A methodology may however be devised to overcome such problems by determining some parameters (such as the future discount rate) by reference to data which will only be available at the time the option is exercised. Thus the future option cost to the Sponsor may remain sufficiently random to not require provisioning.</p> <p>Special care must be used in the promotion of the Netherlands Carbon Fund for projects where the Bank is a shareholder. This rule must be even more strictly adhered to when the Bank holds a directorship in the project company. It should not deter representatives from the Fund</p>

from marketing their services which are in the interest of the project. It would generally be preferable though if the Bank would ascertain that other bids are also considered and would request documented evidence that whichever bid is retained was in the best interest of the company.

Financial Intermediaries	<p>Lending in countries of operation where withholding tax applies on EBRD London booked loans should be carefully considered. Where the Bank's additionality is warranted, it may be best to investigate alternative ways of channelling the Bank's funds, e.g. through a Bank with a presence in the country, which may not be a domestic bank, in order to avoid penalising the Bank's competitiveness or the project through higher borrowing cost. Alternatively, the Bank could guarantee loans made by a local Bank.</p>
Small municipalities / multi-municipality projects	<p>It is important for the Bank to weigh the significance of Transition Impact relative to the risk return aspect of investments. This may be even more important when a portfolio of individually relatively small operations result from business development under a framework agreement. Less quantifiable costs such as senior management time dedicated to directorships may make such investments apparently even less attractive to the Bank. When Transition impact is significant, the overall justification of the framework becomes clearer, even though such impact may not be delivered evenly across all operations.</p>
Local counterpart commitment and capacity Technology	<p>Reliance on sophisticated technological investments to achieve transition impact is often less effective than promotion of managerial skills. Better operating efficiency may be obtained from investments in standard equipment coupled with improved operating know-how which can be provided by an experienced foreign sponsor. This leads to broader transfer of skills and also greater opportunities for local content investments than foreign sourced state-of-the-art technologies.</p>
Project planning Technical Co-operation (TC)	<p>Early engagement leads to long-term success in MEI projects. Judicious use of TC-funded technical assistance to work with government counter-part agencies early on during project preparation will lead to a more fully developed project concept, and a more successful privatisation for utility services.</p>
Tariffs / affordability	<p>Need to brand the product also in the case of a natural monopolistic utility provider. For municipal projects emerging from privatisation, a project start-up workshop is critical for knowledge sharing. The new company needs to "brand" the product to meet changing public perceptions and promote its new services. Effective public outreach is critical to gain public acceptance, especially when faced with necessary tariff increases.</p>
Local counterpart commitment and capacity	<p>Project start-up workshops in complex MEI projects. For complex projects, such as this, where various parties have different defined roles and responsibilities, and prior knowledge, a <i>project start-up workshop</i> is advisable.</p>
Local counterpart	<p>The right leadership is critical to enhance the chance of success in</p>

commitment and capacity	large MEI projects. The deal should have been structured such that the Municipality had an opportunity to review staff recommendations for key management positions during the bid selection process. (Sofiyska Voda, Bulgaria, PE03-234)
Private sector participation (PSP)	Monopolistic utility service providers need strong independent regulators. Municipal utility projects require a strong independent regulator to act as an impartial independent body, with clear separation from political institutions and to ensure fair and equitable management of the sector.
Co-operation between IFIs / co-finance	Municipal appointed contract management staff may require additional training. While outside the scope of the EBRD project, Municipality staff responsible for contract supervision may require additional training to successfully carryout their defined job function. It is in the interest of the Concessionaire to have a well qualified contract administrator able to fully understand and administer the contract as intended. EBRD may wish to coordinate with other bi- and multi-lateral agencies to ensure that such training is provided, or build additional TC into the project after start-up.
Local counterpart commitment and capacity	
Private sector participation (PSP)	
Project planning	Appraising project mandate compliance needs more scrutiny and effectiveness. Concerns regarding a proposed project's compliance with Bank mandate dimensions need early flagging during the project preparatory process and dealt with more rigorously. Project proposals that do not hold adequate potential for mandate compliance, in spite of mitigating efforts, should be abandoned at the earliest possible preparatory stage.
Private sector participation (PSP)	Secondary purchase financing tends to limit scope for 'design and functioning' additionality. Where the Bank as a principal project financier seeks involvement in a municipal utility privatisation scheme, but is not actively involved in its design (as would be desirable), the Bank should employ a two-lane parallel approach. Whilst entering in an enhanced policy dialogue with the Municipality to stimulate certain design features (here: linking municipal waste water company share sale proceeds with a capex programme for the waste water system), it also should condition these elements as part of its principal expression of interest to tender participants regarding its readiness for financing.
Policy dialogue	
Co-operation between IFIs / co-finance	Need for closer coordination and collaboration with other donor or MDB parties. In cases where other Multilateral Development Banks (MDBs), the EU or other Donor facilities are already or will be involved in a project that the Bank is considering to support, the Bank should more closely coordinate with these other sources, both to harmonise expectations and to optimise project outcomes.
Evaluation	MEI projects may require two separate evaluations at different stages. Due to the nature of concession-type projects associated with longer maturities, evaluations are suggested at two stages. In order to generate and feedback lessons from the preparatory and early implementation stages a lead-time of about two years after Bank equity

investment is considered appropriate for a project evaluation. However, for gaining more insights and to capture the dynamics of maturing concessions it is recommended to bundle several such concession projects reflecting diverse maturity stages and to evaluate them under a special study evaluation framework.

Private sector participation (PSP)

Key performance indicators, project monitoring and reporting

Technology

Post-qualification verification and performance guarantee in the procurement process. Quality has its price, and tender design and evaluation clearly need to keep this functional relationship in mind. In the case at stake the offered equipment at comparatively lowest price did not meet quality expectations. This case is a classical example of how important post-qualification verification, pre-delivery inspections and the performance guarantee are. The cost of pre-delivery inspections may be small compared with the cost of rectifying faulty and inoperable equipment and therefore should be included as tender design element where warranted. This also tends to mitigate against implementation delays.

Private sector participation (PSP)

Key performance indicators, project monitoring and reporting

Appropriateness and due diligence of tender specification can ensure quality-at-entry. To an extent, the quality of offered services and equipment is a function of the appropriateness and due diligence of tender specifications. Outsourcing of the latter to specialist consultants is the widely accepted solution, since the Bank could not possibly cater for all sector expertise variants as represented in its investment portfolio. However, what should be feasible for the Bank are plausibility checks, particularly for since long existing and widely used technology. A quick survey among some major wastewater companies (as to what are the most common brands used, which are the most important design features to be looked for, and what is the experience record with certain suppliers) would greatly help to form a good basis for such plausibility checks, although also this won't prevent accidental deficiencies to happen.

Policy dialogue

Tariffs / affordability

Key performance indicators, project monitoring and reporting

Early intervention to secure continuous adequate tariff setting. In order to secure the Project's financial viability the Bank rightly stipulated a tariff formula to which the contracting parties had to subscribe before closure of the loan agreement. Although, after re-establishing a new regulatory entity and passing new laws affecting the tariff setting, the contracting counter-parties seem to continue to subscribe to the basic principles (i.e., notably cost recovery and tariff affordability) underlying this Project, the change of *modus operandi* (departure from a pre-set tariff formula to annually negotiated tariff adjustments), however, brings with it uncertainty that affects RW's ability for longer-term planning. As part of its monitoring obligation the Bank would need to step in at earliest convenience to help clarify/resolve this uncertainty in order to avoid more drastic steps at a later stage when cash-flow constraints and repayment problems might occur as a consequence of an otherwise too late intervention.

Technology

Mitigating vulnerability of public/municipal utilities. Project scope of public/municipal utilities would need to embrace security issues pertaining

to facility protection and alarm systems, independent internal communication devices, autonomous power supply installations etc. This is particularly so given this type of projects' vital service function vis-à-vis entire civil communities and industries.

Technical Co-operation (TC)

Technical Co-operations to realise objectives of a project. When the Bank decides to incorporate TCs as objectives of a project either to mitigate the risk or improve transition impact, these TCs should be implemented at the same pace as the other components of the project. Although it is difficult to link too closely TCs execution with conditions to disbursement because of uncertainty of donors' fund, OL should do his utmost to arrange the different components in parallel when required by the project. In particular, an advance resolution (pending the Board approval of the project) by the TC committee should be obtained and a search for donors should be launched before the project is presented to the Board.

EBRD internal procedures

Communication between the Bank and the client. To improve communication between the Bank and its client during preparation or implementation of a project, the Bank should provide detailed explanation (during workshop or seminar) regarding the methods and procedure that will be followed by the Bank during that time; further more it is recommended to associate the Resident Office more to the project so that it can easily maintain the dialogue with the client.

EBRD internal procedures

Loan agreement conditionalities. The Bank should be very careful that conditions introduced in the Loan Agreement could be met by the client and that the client understands what are the consequences of these conditions. The Bank should systematically review the Loan Agreement and its annexes with the client and make sure that the client fully understands all of the conditions for which they will be kept responsible.

Programme of investments

Even an emergency operation should be integrated in a global development plan. When preparing an emergency operation in the infrastructure sector, the medium and long-term justifications of the investments should be established through the development of a strategy for the future arrangements of the services in question. This should be done at the earliest possible time.

Programme of investments

Water supply and water waste management should be integrated. Even if the financial and time constraints limits the investments to the water supply sector the wastewater sector should be considered for future developments in connection with the preparation of the operation. This approach would limit the risks for public health hazards, excessive investments and would enable optimal use of scarce water resources.

Technical Co-operation (TC)

Corporate development and investment implementation tasks in a utility operation should be assigned to separate units. For optimal efficiency and to avoid unbalanced results, the recruitment of experts on organisational structures that need support should be handled separately whether for management of capital investment programmes or corporate development.

Local counterpart commitment and capacity	<p>The importance of creating future career opportunities. Companies, which cannot present future careers within the core organisation to the staff hired specially for the implementation of a project, lay open to loose part of their trained employees. The recruitment of local staff to a Corporate Development Unit should be made, when possible, from the core organisation. The local staff of the CDU should be presented with an individual prospect for their future career within the core organisation after the completion of the CDU assignment. This would prevent the loss of trained CDU staff to outside organisations to an unacceptable degree.</p>
Project planning Tariffs / affordability	<p>The financial projections supporting project proposals should be realistically based. In preparing the projections, due account should be taken of local conditions in the country of operation. In particular, the projections should reflect in anticipated collection rates such factors as the ability of the local population to discharge household financial obligations and the capacity of supply companies to enforce payment.</p>
Policy dialogue	<p>The importance of carefully chosen covenants to enhance transition impact. It is experienced that carefully chosen covenants can help the Bank fulfil its transition objective and facilitate significantly the transition process. However, if the covenants are viewed as virtually impossible to comply with from the start because of too optimistic assumptions about the willingness of the Government or client to adhere to the covenants, the Bank should reconsider its financial involvement in the project. In the decision making process an important consideration should be to which extend an intensive policy dialogue is expected to result over time in an adherence to the covenants by the Government.</p>
Programme of investments	<p>Non-project financing to municipalities and EBRD's mandate. Programme-type investment financing to municipalities with components for restructured finances and administration reform can be in line with the Bank's transition and sound-banking mandate. One of several requisites would be capacity building in the Bank concerning municipal financial administration in the region. There would be a need for applied financing techniques. The Bank's experience from MEI programs and the St. Petersburg Municipal Support Project can be taken as a basis for a review of operational policies for programme-type financing with or without financial restructuring elements. On country and client level, the conditions for this type of municipal financing would include: (a) No insurmountable domestic systemic constraints for municipal reform, such as in taxation, regulation or acute domestic economic and financial disruption on a wide scale; (b) Ascertained additionality in terms of financial facilities, catalysed financing and reform conditioning; (c) Due diligence confirming manifest reform-orientation of the political and administrative municipal leadership and therefore transition potential; (d) In-depth municipal credit-risk analysis, looking to past performance, budget discipline and transparency, confirming financial administration reform prospects as well as realistic means for risk mitigation; (e) Acceptable level of past and anticipated municipal political stability and professional independence of the financial administration; (f) Secured domestic and external funding of adjoining advice to the financial</p>

administration, meeting the assessed need for critical mass, concerned participation and duration to ensure real impact.

Tariffs / affordability

Municipal and sub-sovereign public loans and foreign exchange risk exposure. Prudent lending to and debt-management by municipal and sub-sovereign public borrowers should generally continue to avoid foreign debt exposure for non-income generating expenditure. This similarly applies to domestic debt re-financing, unless having a clear link to productive investments and revenue generation, e.g. by corporatised utilities. Transition economies can face repeated stress or setbacks, reducing or eliminating ways for municipalities to hedge against foreign exchange risk. Incomplete regulation of municipal borrowing and limited understanding in financial administrations of the full implications of foreign debt will add to the risks.

Deal preparation and additionality under unstable or volatile transition conditions. Perceived financial additionality can shift quickly with market sentiment for yet unstable transition economies and justify continued preparation or effectiveness of Bank facilities, despite signs of rising investor interest. The Bank's financing additionality can lie in catalysing market funds when there is a high transition impact potential or in supporting stability by keeping facilities on stand-by while watching developments. Conditions and other design elements to support transition can also constitute additionality.

Potentially conflicting EBRD interest at public issues of bonds or other securities. Market financing involves potential conflicts between lender-advisor and borrower interests and may make an inexperienced client vulnerable. Therefore independent financial advice is desirable, while there may be constraints, such as lacking insight by the client that this would be beneficial. The result could be undue information advantage of financiers or agents, such as managers of public flotation of securities. In such situations, the Bank should seek an "honest-broker" role. Its potentially conflicting interests as co-financier, co-underwriter or as parallel financier may justify to separate handling of the investment operation from the offering of financial advice to a client. This need may be met by ensuring that the client has access to independent external financial advisors. A sovereign or municipal borrower should have independent financial advice for a major international bond transaction.

Project planning

Loan pricing, benchmarking and risk-reward logic at volatile market conditions. The Bank should seek innovative pricing mechanisms where floating elements move with markets. Still, highly unstable conditions may limit the scope and justify the Bank to apply more proven pricing mechanisms that will help to predict their effects and risks. Innovative features should be introduced only in deals with adequately experienced counterparts capable of assessing the effects and risks. Benchmarking and floating rate mechanisms should be adaptive instead of over-reactive and avoid significant links to poorly functioning, volatile markets. The Bank's sound banking mandate requires it to apply sound risk-reward analysis in pricing, while observing the risk that unstable conditions in the region could result in risk margins so high that they could

jeopardise the client's capacity for repayment and therefore risk being speculative.

Technical Co-operation (TC)

Critical mass, transition impact and advice linked to non-project loan operations. Advice linked to non-project investments must adapt to each unique client's needs but can need critical mass to affect the client organisation. Sustainable impact may need enduring arrangements akin to project implementation units (PIUs) in project financing. Reliance on TC-components without direct links the investment operation or as embodied in the preparatory studies must assume highly reform-orientated clients.

Technical Co-operation (TC)

Local counterpart commitment and capacity

Client incentives, absorptive capacity and TC- financing of advisory services. Large client organisations at early transition may have limited capacity to absorb large TC- programs. A reform-orientated top management is a mitigating factor while programs will still encounter differing professional backgrounds, traditions and resulting communication constraints. Therefore, TC-programs that aim to support fundamental reform should be designed in a staged manner looking at critical mass needs as the programme progresses.

Policy dialogue

Co-operation between IFI's / co-finance

Municipal financing, IFI-co-ordination and policy dialogue. Municipal and public sector financing operations pursued concurrently with those of other IFI's should seek a co-ordinated approach to policy dialogue with the client. The Bank's endeavours to affect economic transition and the institutional development aims by the World Bank group in the region will generally coincide. Policy dialogue with regional or local government clients conducted jointly by the Bank and other IFIs can therefore add to its effectiveness.

Financial Intermediaries

Small municipalities / multi-municipality projects

MEI financing to several small municipalities can benefit from economies of scale, if supported by strong domestic intermediaries. Wholesale models for MEI financing to small municipalities via domestic intermediaries can benefit from returns to scale in project preparation and implementation management and enhance transition impact, if designed and structured towards these objectives. The SMEP programme for small municipalities in Estonia highlights the need for carefully tailored design and monitoring that can also adapt programmes to domestic contexts and changing conditions over time.

Key performance indicators, project monitoring and reporting

Financial Intermediaries

Small municipalities / multi-municipality projects

MEI financing programmes to several small municipalities present relatively high demand on monitoring by the Bank and can justify TC support. Returns to scale and delegation to domestic technical and financial intermediaries can reduce demands on monitoring at sub-borrower level, once actual capability and capacity of the intermediaries is proven. In the interim, TC-funded support to intermediaries can be justified to compensate their lacking experience and maturity. Experience from the SMEP operation in Estonia, a relatively advanced transition environment, suggests that MEI financing programmes on a wholesale basis for several small-medium end-users will remain monitoring intensive for the Bank in the early implementation stages.

Financial Intermediaries Small municipalities / multi-municipality projects	MEI-programmes and selection of intermediaries: MEI-programmes for multiple end user municipalities and utilities should select and contract intermediaries on a competitive basis to instil a market orientated culture from the start. Such competitive elements will not exclude careful screening of short-listed candidate intermediaries. Monolithic institutions with their roots in the past planned system should generally be avoided as intermediaries and realistic alternatives sought on the basis of invited proposals on a competitive basis.
Project planning Technical Co-operation (TC)	MEI-programmes and the need to avoid bundling of financing and consultancy services for implementation support. Bundling of sub-loan administration with project preparation and implementation management support will result in captive market elements, discourage competition in technical and project management consultancy and result in monolithic structures which could actually reinforce instead of break with legacies and traditions of the past. A competitive process for the assignment of partners for implementation management support should be applied even in environments in early stages of transition.
Financial Intermediaries	MEI-programmes and selection of domestic financial intermediaries in support of financial markets transition. Tendering or other forms of contracting with clear competitive elements should be used for selection of financial intermediaries. Selection criteria for domestic financial intermediaries should include that the selected bank or institution has a clear strategic orientation towards the municipal market. The selected domestic intermediary for MEI-financing should have a capacity and capability to serve municipalities and their utilities in a way that would be supportive of broadened and deepened domestic capital markets.
Key performance indicators, project monitoring and reporting	MEI programs should include competitive selection and contracting of twinning partners, whenever possible. Experience from the SMEP operation in Estonia supports the Bank's current policy to insist on competitive selection and contracting of twinning partners for domestic intermediaries and/or for municipal utilities. TC-funded twinning programs should be designed to ensure competitive selection and contracting of partners with performance related remuneration, whenever possible.
Technical Co-operation (TC)	MEI programs need PIU support from experienced consultants. MEI programs should seek institution development support to domestic project implementation entities from specialised consulting companies rather than from western utilities if these still lack a track record in international provision of services under competitive conditions. Western utilities with retained municipal ownership and captive markets for their core business will need to demonstrate a strong track record in other service assignments under competitive conditions to qualify as bidders for support contracts to MEI operations.
Technical Co-operation (TC)	MEI programmes for small municipal utilities and the need for tailored support. Wholesale programmes via domestic intermediaries should be designed for tailored institutional and know-how support to end-users. Municipalities and utilities of differing size and stages of

transformation will have varying requirements. Regional differences may add to the need for tailored approaches. TC-support programmes should be designed and dimensioned accordingly.

Project planning

Technical Co-operation (TC)

MEI projects need staged design and construction in situations of highly uncertain future demand. In environments in rapid transition demand forecasts have to be thoroughly scrutinised and continuously updated based on actual development of demand. Implementing a project based on what is in effect a pre-feasibility study at a time of rapidly changing conditions and parameters carries a risk that capacity of equipment and installations will prove to be wrong. Key components may require staged studies with increased degrees of detail. For larger investment components a pre-design phase is often essential.

Project planning

MEI programmes and adaptation to environments in rapid transition. Operation designs should include adequate implementation arrangements and procedures to permit significant adjustments to investment components from those presented in early feasibility studies or pre-designs. Schedules and resources should take into account that re-design of certain components may prove necessary to adapt to significant changes in demand. The length of preparation periods should be contained with programming and contingencies that allow adaptation and re-allocation without excessively demanding and time-consuming procedures.

Financial Intermediaries

MEI-financing programs via municipally owned intermediaries should ensure that suitable debt service covenants also reflect on the ultimate sub-borrowers. Debt service covenants applicable to a domestic intermediary owned by its sub-borrower clients may usefully extend these covenants to sub-borrowing municipal utilities and their guarantors from the outset to foster financial discipline at end user level. Such practise will support rates adjustment and collection in pursuit of self-sustainability.

Tariffs / affordability

Key performance indicators, project monitoring and reporting

Financial Intermediaries

MEI programmes should seek domestic integration of performance monitoring at sub-borrower level. MEI programmes should introduce performance monitoring of sub-borrowers in a way that will engage domestic intermediaries in follow up with use of criteria that reflect domestic standards as they evolve. Environmental performance by water and wastewater utilities should be monitored against relevant domestic standards as well as any additional standards imposed by the Bank. The degree of financial performance monitoring at sub-borrower level will depend on the strength of the financial intermediary and assignment of risk and guarantees. The Bank's transitional mandate may justify more interventionist approach at sub-borrower level than would be required from a credit point of view. Active monitoring of tariff adjustment plans and related affordability criteria at sub-borrower level can support improved financial discipline, tariff structures and effective collection.

ESCOs without equipment supply interests are preferable as pioneers in a new environment. ESCOs with the best prospects to pioneer demonstration and development of new EPC markets where

good models for such business so not exist are those sponsored by strong owners with energy conservation and services as their own core business rather than sale of equipment. A clear strategic market expansion motive of sponsors that have already entered internationalisation elsewhere is a good indication of enduring and competent back-up capacity, given that the gestation time from entry to break-even can be quite long for a pioneering ESCO.

ESCO operations need appraisal and design in an energy systems perspective. Appraisal and design of operations to support Energy Service Companies (ESCOs) must take into account energy systems and energy sector policies of the investee country. Remaining price regulation and taxation differentials for social, geo-political or other reasons may imply less than economically and environmentally optimal relative prices of power and energy. Such situations may also involve significant regulatory risk for future years. Assessment of segments where a new ESCO would expectedly focus its business must carefully review domestic energy regulation and taxation policy affecting relative prices. Actual taxation and/or price regulation that affects relative fuel and energy prices on the market resulting in price differentials that are deemed less than optimal from macro-economic and environmental perspectives motivates testing at appraisal if a market driven EPC would remain viable with border prices applied.

Project planning

ESCO operations will benefit from preparations with joint support from relevant teams in the Bank. Experience from the pioneering "Prometheus" operation in Hungary supports that early contribution from OCE, the Power and Energy Sector Team, the Country Team as well as from EAU can add important contextual and energy systems perspectives. Such broad analysis will help structuring and design of future ESCO operations, making use of past experience to enhance performance and transition impact.

Key performance indicators, project monitoring and reporting

ESCO operations and monitoring of savings. Negotiation and structuring of operations in support of pioneering ESCO businesses should aim at adequate monitoring of achieved energy and financial savings. Data should enable monitoring of energy and financial savings on a "with and without project" basis for important individual contracts and for categories of contracts. Reported financial savings should separate (i) financial savings as a result of fuel conversion; and (ii) financial savings from increased energy efficiency. The actual fuel consumption in a given year should be adjusted for (iii) climatic variations in comparison with a "normal year"; and (iv) any significant change in energy consumption patterns of a client. Finally, (v) financial "without project" data should be updated annually with regard to change in energy prices.

Technology

ESCOs can contribute to significant energy conservation in the long term. Experience from EBRD's first ESCO operation in Hungary is that promotion and penetration of new markets for EPCs will be a relatively slow process because of low awareness in energy efficiency and environmental fields. The "Prometheus" ESCO operation in Hungary supported by EBRD illustrates that pioneering ESCOs will need to

concentrate initially on relatively simple installations and services. These may be offered in market segments with the most obvious yields to clients since these will typically have low energy savings awareness. Strategy for pioneering ESCO's may justifiably concentrate initially on relatively simple types of installations and services and prefer gradual consolidation before entering more complex and demanding projects. This is illustrated by the CGC sponsored "Prometheus" ESCO in Hungary, supported by EBRD loans and equity financing. Only in its fourth year of commercial operations was "Prometheus" deemed adequately consolidated by its strong western sponsors to embark on any number of higher risk, complex projects with commensurate higher savings and environmental improvement potential.

ESCOs cannot generally be expected to lead significant early energy conservation. The rationale for support by the Bank to pioneering energy saving companies (ESCOs) lies more in their potential to demonstrate improved practise and techniques and promote conservation awareness among selected groups of clients, than in direct early contribution to large energy savings by the economy as a whole. An additional rationale for support to ESCOs is that Bank involvement can foster its own insight into selected segments of a country's energy sector. Past experience indicates that ESCOs may face long gestation and penetration periods in EBRD's countries of operations. Such long gestation periods will imply modest early conservation achievements in absolute terms and relative to the required investments to establish and consolidate an ESCO into a mature commercial operation.

ESCO's bundling of financing and other services in the Bank's countries of operation. ESCOs may bundle financing of equipment with operating and maintenance services only in initial stages preceding matured domestic financial markets. The reason, supported by industry experience in the west, is that alternative access by owners of energy plants to other sources of finance for equipment to save on energy consumption will generally make bundling of financing and conservation services less interesting for clients and ESCOs alike. Repeat contracts for operating and maintenance services upon completed amortisation of investments will generally have to be negotiated at reduced margins.

Transition impact from ESCO's in a dynamic perspective can justify ample initial safety and profit margins in pioneering EPC contracts. The unknown new concept and complexity of ESCO contracts in combination with low client awareness makes pioneering ESCO operations an uphill task. This factor deters early competition that would help bring about more market transparency. Therefore, good or ample margins in some of the early EPC contracts can be justifiable, since this will help consolidation of a pioneering ESCO business and be a positive demonstration to potential new market entrants. The Bank's present policy to encourage competition early on in ESCO markets is fully justified from a transition viewpoint, since term financing to one pioneering ESCO implies some monopolistic early advantage.

Key performance

ESCO operations should monitor environmental achievements with

indicators, project monitoring and reporting	<p>use of agreed reporting format and content. Environmental monitoring should firstly ascertain adherence to agreed norms. Monitoring cannot assume from domestic compliance waivers or practising of symbolic fines that such exceptions would automatically imply a waiver from compliance with EU standards. Equity participation by the Bank and the resulting responsibility should cause the Bank to consider contracted and monitored adherence to environmental EU standards, even if the investment comes under an MPF facility. Environmental monitoring of ESCOs should look to energy savings achievements and the associated environmental gains on a “with and without project” basis for individual large contracts and categories of contracts. “Before and after” project reporting only may not sufficiently capture environmental change brought about by all investments and EPC contracts.</p>
Project planning	<p>EPC contracts for large district heating systems need solid, competent providers. Large district heating systems require careful appraisal and risk assessment of performance in terms of energy efficiency and environmentally and will also generally need inclusion of end-user efficiency aspects.</p>
Tariffs / affordability	<p>ESCOs and EPCs must consider lock-in aspects of district heating systems. Situations with remaining cross-subsidisation between large scale users (like providers of district heating) and small scale users (principally households) call for analysis in financial and macro-economic term of centralisation vs. decentralisation. Contracts that lock the user to a district heating system, should oblige the central provider to offer prior discounts or some other form of compensation, if accession is not mandatory. Such practise will enable realisation of economic least cost solutions. ESCOs can offer services in such complex fields to district heating providers, user collectives and end users alike but must take into account potentially conflicting interests.</p>
Local counterpart commitment and capacity	<p>ESCO’s and their gradual advance to more complex and demanding contracts. Successful ESCOs may need a few initial years of concentration on less demanding contracts to consolidate, commercially, capacity-wise and financially. Initial contracts may need to see a dominance of installations and services for relatively less demanding clients before the ESCO can move on to more challenging contracts with complex designs, installations and operational undertakings.</p> <p>EPC contracts for large public clients should be procured under open tender. ESCO contracts for large public clients will have improved transition impact if procured under open public tender since a good tendering process will in itself improve client awareness and be conducive to transparency and competition.</p>
Tariffs / affordability	<p>Revenue forecasts in the modelling of cost-recovery water infrastructure should reflect true implications of desired conservation objectives. Municipal water projects in the Bank’s countries of operations can be expected to – and indeed are beginning to – lead to significant reduction in demand and sales. Most financial modelling is done on the basis that this is either a) a temporary</p>

adjustment or b) will be reflected in a similar reduction in costs. Water industry expertise suggests that these relationships are not always realised. The balance of design objectives, investment scope and affordability may require some refinement in the light of emerging trends.

Programme of investments	Long-term benefits of first stage infrastructure development are often dependent on securing follow-up investment. The physical benefits and financial success of MUDP I can only be secured if additional financing is arranged to fund further development of the network, and particularly in the waste water area. Internal cash generation will not meet further investment needs at current tariff levels and without seriously reducing the Bank's debt service coverage ratio requirements. While the Bank hopes that this extra investment might be raised by a foreign partner or other market financing mechanisms, this cannot be vouchsafed in countries with Romania's current economic situation and prospects. Involvement in public sector infrastructure in countries with a huge, and unquantifiable investment deficit built over many years, is difficult, and cannot be implemented through one single phase.
Tariffs / affordability	Additional criteria to be used in assessing tariff levels. The appropriateness of tariff increases is not only a question of affordability analysis, but should also be benchmarked against comparative levels in other countries and related to actual timing of investments.
Key performance indicators, project monitoring and reporting	Monitor physical and financial data and preserve time series. A mixture of financial and physical performance indicators are important in monitoring many infrastructure projects, but particularly in the water industry, at a time of high inflation and when original index ratios may be changing.
Private sector participation (PSP)	The Bank must insist on independent evaluations of all privatisation proposals. While the Bank may be sympathetic in policy to the introduction of foreign private capital and expertise into Romanian water companies, and see this development as instrumental to the achievement of long-term sustainability for MUDP I, it must ensure all parties have access to independent advice. The drafting of business plans and valuations by interested parties should be challenged.
Tariffs / affordability Small municipalities / multi-municipality projects	Multiple municipal projects should be analysed from a consolidated perspective on household and local economy affordability. The Bank must be wary of presenting a range of proposed projects that all meet individual affordability criteria but in aggregate clearly over-stretch the local economic base. If a project has economic benefits beyond the local economy, the Bank should encourage sponsors to receive appropriate support from other levels of government or enterprise. Consideration should be given to the idea of having one relationship manager per city. Projects should never be developed on the basis of keeping cities engaged in reform if underlying debt servicing conditions cannot be guaranteed.
Tariffs / affordability	Increase economic risk input and scope in municipal infrastructure

project design and monitoring. Despite the fact that this Project's financial viability is closely related to the question of the affordability of tariffs, the risks related to this issue were largely seen at appraisal as political and reform-linked rather than economic. In other words, it was felt that the tariff increases were fundamentally affordable if local authorities put sufficient backing behind the inevitably unpopular measure of raising them sharply. There should have been more attempts to monitor local economic developments during appraisal and implementation, even allowing for the fact that this type of local economic analysis remains very underdeveloped in Romania. It is dangerous to isolate totally the ability to pay or repay of a particular project in the municipal sector from the aggregated ability to pay of the sponsoring municipality (and ultimately country). The links between country strategy and municipal infrastructure projects and policy need to be very strong and consistent, if the Bank is to act as a responsive lender to countries like Romania.

Tariffs / affordability **Performance targets should distinguish between industrial and household bad debt.** Adequate evidence has been acquired from recent municipal financing projects in the Bank's Countries of Operation to indicate that bad debtor problems in the water utilities are likely to show a highly skewed distribution pattern between household and industrial consumers, with the latter bearing responsibility for around 90 per cent of all bad debt. Acquiescence in such an imbalance following the introduction of tariff increases is very detrimental to the transition impact potential of these Bank projects. MEI Teams should consider setting separate bad debt performance targets and covenants for industrial and household consumers to increase their ability to influence this payment aspect.

5. TC OPER Lessons from MEI Projects

The following table presents the 69 actual lessons in the database from the 15 OPERS that have been carried out on TC projects related to MEI investments. The left column indicates the common theme(s) to which a lesson is related in the summary table in Section 3 above.

	<p>Tap into existing professional networks to market the Bank and enhance demonstration effects. Business networks exist in many areas and may be particularly strong in sectors requiring a high level of technical or engineering expertise, such as water and wastewater management or the power or telecoms sectors. Tapping into such networks makes the Bank's job of marketing its business much easier. It is through such networks that demonstration effects are spread through to the decision-makers in a particular sector. The Bank should ensure that it involves its satisfied customers in its marketing efforts.</p>
Local counterpart commitment and capacity	<p>Limiting consultants to an advisory role enhances institutional development. The Consultant in this case was not contracted to run the PIU but instead to serve in an advisory role. The PIU was staffed by existing employees of the water company, who managed the project with the support and advice of the Consultant. As well as saving money on expensive consultancy fees, this approach enhanced the institutional development aspects of the project as the local staff obtained hands-on experience in project management.</p>
Project Planning	<p>Consultants should not make assumptions about the level of knowledge already existing in the client company. Consultants engaged in institutional development programmes may waste valuable time and resources if they do not first assess the business practices already followed by the Client at the start of the assignment. Such an assessment may indicate that the Client is competent in modern business practices and has already instigated many management reforms. In this case, the focus of the assignment can be changed from remedial work to a more forward-looking programme better suited to the existing level of expertise of the Client. Pushing ahead with basic training in such a situation not only wastes valuable TC resources, but is likely to alienate the Client and its staff.</p>
Project Planning	<p>The Client should always play a leading role in budget preparation and consultant selection. The Client knows its own project and local conditions better than EBRD. Involving the Client closely in the budget preparation and consultant selection is the best way to ensure that the assignment is appropriate to the Client's needs. EBRD should support the Client with guidance, either directly through its own experts or through consultants with expertise in western procurement practices. In the project under consideration, consultant selection was delegated to EBRD for logistical reasons. As the Bank moves further east, logistics will become increasingly challenging. This should not be allowed to create a barrier to the Client's close involvement at all stages of project preparation.</p>

Local counterpart commitment and capacity	<p>Staff the Project Implementation Unit with employees of the company, not with outside specialists. Contracting specialists to staff the PIU for the duration of the project does not assure skills transfer to the company as a whole, nor to other municipal companies in the area. Such specialists are likely to seek out further specific projects elsewhere. Creating a specialist and mobile group of highly skilled consultants in this way inhibits the uptake of new practices in the regular management of the industry. Similarly, existing staff seconded at a much higher salary than normal are unlikely to return to their regular positions and pass on their new skills to colleagues once the project is complete. A better result is obtained if clients allocate internal staff to the project for a limited period and then return them to positions within the company or at other municipal companies in the city.</p>
Technical Co-operation (TC)	<p>Fully align investment covenants with outcomes supported by the associated TC. When the risks associated with reform outcomes, investment and TC support, this signals that there is a potential deficit in the client capability to fulfil reform requirements. This can result from institutional constraints within the client company or from external policy constraints or both. Expected outcomes in TC, which are clearly specified and tightly linked to covenants in the related project, should help clarify the reform objectives, the steps to achieve them, and ensure that implementation follows.</p>
Technical Co-operation (TC)	<p>Tailor TC to project implementation timing constraints. When the design and purpose of a TC component is closely related to the execution of a timed institutional covenant, the timing and content of the component itself must carefully follow the implementation of the project and adapt to changes in order to avoid inefficiencies in the use of financial or human resources.</p>
Technical Co-operation (TC)	<p>The Bank should be in the front line to help maintain momentum in project implementation. When preparing a TC, the Bank staff (not the Consultant) should be the first one to be aware of the more difficult aspects of working and motivating a counterpart in the public sector, to buy into the benefits of this assignment. The Bank should be more proactive in preparing the ground for a successful collaboration between the Consultant and the Client.</p>
Technical Co-operation (TC)	<p>Make sure continuity is provided when a TC contract ends and more assistance is still needed. When a TC is so closely linked with the design and execution of procurement for the investment project, the needs must be as realistic as possible from the outset. This includes contingencies to avoid a rupture in the middle of the execution or renegotiating new contracts in order to continue work.</p>
Co-operation between IFIs / co-finance	<p>Be more proactive to ensure the success of TC implementation, especially when the process is new to those involved. While the Bank and the consultant have made genuine efforts in their contacts with the Romanian client to ensure that adequate mention be made of the Swiss commitment and contributions, they did not prevent a growing</p>

misunderstanding between RADET, the Romanian Ministry of Environment and SECO. The prevention work could have consisted in this case of helping detecting contradictions and obscurities in the statement of the original agreement between the Ministry of Environment and SECO.

EBRD internal procedures

In case of substantial changes to an approved TC project similar procedures should be applied as for investment operations. TC Com may wish to provide clear guidelines to staff when a change is substantial enough to require a second approval by the TC Com or other Authorities, as deemed appropriate. In addition, required documents and the documentation process should be defined.

EU Standards

Accurate comparisons between environmental standards of the EU and the ones in the beneficiary country should be made ahead of drafting the loan covenant. Substantial differences and their implications should be made clear to the potential borrower/client during the due diligence process. As to the knowledge of EvD, the Environmental and Sustainable Development (ESD) generally carry out such ex-ante analyses in cooperation with the European Environmental Agency.

Technical Co-operation (TC)

A substantial role of the Client in the Consultant procurement activities is desirable but should be supervised on site by the Bank. Local partners cannot be expected to be familiar with international procurement principles, especially not those as advanced as for EU and EBRD TC/ TA projects. The Operation Team should under all circumstances ensure that one of its members - or an independent Consultant on their behalf – is represented in the evaluation panels on site.

The delivery of a PCR should be made mandatory for the approval of any succeeding project. There is little use of PCRs that are delivered a year after project completion, especially when project extensions are due. The responsible units in the Bank are advised to ask for more substantial and written clarification on the pre-ceding project and its achievements in the TC approval process. If a PCR is not (yet) available, members of the TC Com should consider postponing the decision of the extension/ succeeding project until the PCR is delivered. Alternatively, the Committee Members could request an Executive Summary of the Consultants' Final Report at least.

OLs are advised to keep the core files of a TC project readily available as soft- and/ or hardcopy files, even after the electronic filing system TLink will be implemented. This pertains to Bank internal documents (ToR, contract, and others) as well as for Consultant reports.

Technical Co-operation (TC)

A Project Manager is key in the case of a consortium of consultancy firms. The role of the Project Manager is to manage the project without constant recourse to the EBRD's project staff. In a larger project, involving a consortium of consultancy firms or a number of complementary experts, there is a role for a Project Manager to pull

together the work of the individual parts. The selection of Project Manager should not be based on technical skills but on the ability to manage a project. The lead firm in a consortium is responsible to the Client and Bank for the timely delivery of the contributions of the other members and should have the personal skills and contractual power to be able to do so.

Technical Co-operation (TC)

Consultants' experience of the region is as important as their technical skills. In this case, the Consultant was faced with a difficult political situation, with a lack of cooperation between the City Council and the executive. This is not an unusual situation when dealing with a public sector client in a country of operation. While a political blockage or change of policy can be insoluble in some cases, a consultant with experience in the region can reasonably be expected to have the ability to push projects forward persistently and show initiative in the face of difficult clients. For example, a direct presentation to the City Council of the benefits of the project might have broken the deadlock or led to some movement. The Bank should look for evidence of success in bringing projects to completion in difficult environments, when advising clients on the selection of consultants.

Technical Co-operation (TC)

Differentiate between policy expertise and practical expertise. The lead Consultant in this project had significant experience and a good reputation for preparing policy papers and advice. This project demanded the rather different skills required to deliver practical results. In projects of this type, at least one of the consortium members, ideally the lead consultant or project manager, must have experience of delivering results in a difficult environment.

Consultancy time management. Too much of the Consultant's time was spent in the early stages of the project, particularly the Inception Report. When dealing with an inexperienced client, it is up to the Consultant and the Bank to indicate to the client a suitable breakdown of tasks, if this is not laid out in the contract. A good Consultant will not simply respond to the Client's requests but point out the possibly damaging effect on implementation of the later parts of the contract.

Technology

Keep design simple. It is easy for a client to be carried away by the potential of an exciting technical solution. The Consultant has a role in pointing out the benefits of a simpler system, implemented quickly and well. The initial selection and basic design of a system is the most important part of the process. A good selection from the start can increase the prospects of success of the entire project.

Key performance indicators, project monitoring and reporting

Ingenuity of monitoring tool can benefit not only the bank but also the borrowers. Monitoring of lending is the area which required most technology and intelligence in this MEI project. Primary benefits of systematic and standardised monitoring technology accrue to the Bank in terms of maintaining the quality of target portfolio. While good monitoring can also benefit the borrowers through enhanced approach in data collection and analysis. Monitoring exercises in this operation have greatly been enhanced when the borrower recognised the value and

benefits of such exercises.

<p>Programme of Investments</p> <p>Policy dialogue</p>	<p>Large sequential sector facilities in MEI provide opportunities of successful policy dialogue by constantly improving the implementation process. Feedback from project implementation is the most useful input for sequential phases of long-term sector programmes. Therefore, lessons effectively incorporated into the MEI project cycle facilitate the projects in achieving successes, thereby gaining trust and good understanding of the Bank's long-signed endeavours in the sector. It might eventually lead to fruitful policy dialogue on major sector issues.</p>
<p>Tariffs / affordability</p>	<p>Actions and allocation of resources at the beginning of the project would increase the chance of success to achieve a difficult sector agenda. While requiring tariff increases as conditionality, the Bank allocated resources for this operation upfront to support the water company's proposal and action to increase tariffs and major conditions precedents. Gaining public and local government's support to tariff increases is easier when people still maintain a fresh impression of the commencement of large construction works.</p> <p>Emergency situations may not lead to the best design. The Bank responded to a crisis situation by budgeting funds without adequate due diligence, yet committing funds to specific line items. In such situations the Bank runs the risk of taking on what maybe "white-elephant" projects (pet projects of the existing municipal service companies) rather than focusing on projects which will maximise transitions while meeting the Bank's sound banking and additionality criteria. While such situations call for quick action, and the Banking Team is to be commended for responding quickly, in situations like this, the Banking Team would be advised to put greater emphasis on due diligence activities and continuing investigations even during the implementation stage after Board approval.</p>
<p>Policy dialogue</p>	<p>EBRD's Operation Leader (OL) can play an important coordinating role among project stakeholders. In this case, the OL contributed to the success of the project by acting as a "mentor" to other donor agencies and to City officials. He served as a point of "institutional memory" for the project and kept all players focused on the critical decisions. Although this was an exceptional situation, in that EBRD normally uses TC which is more directly related to the preparation or implementation of its projects, the role played by EBRD's OL was an important success factor in this case.</p>
<p>Local counterpart commitment and capacity</p>	<p>EBRD's loan documents need to address political risks at the municipal level. Political risk factors can seriously delay projects. These need to be anticipated in project design and addressed in the covenants so as to minimise their impacts on project completion. For instance, political risk can be mitigated if loan covenants with critical dates are introduced to force the project's progress regardless of party motivations.</p>
<p>Private sector participation (PSP)</p>	<p>Design of TC to support the commercialisation of public utilities. EBRD's project approach should support the commercialisation of public utilities, as a step towards privatisation. A TC could have been designed</p>

to improve the transfer of the buses from the municipality to the operating company. Where possible, EBRD should design TC operations which work directly with public utilities; this effectively happened in this operation though the formal structure interposed the City. Dealing directly with the utilities enhances instructional development and helps the companies move from being "budget-based" companies to fully commercialised operations.

Project Planning

TC allocations to due diligence should address land ownership. EBRD's due diligence of municipal projects should always ensure that the city has ownership rights over the land of proposed construction sites. Further, land ownership is an issue which should be addressed in the context of the EIA. Apart from the direct effect on EBRD's own investment and TC projects, EBRD has a more general duty to give guidance and help government officials where problematic issues of this kind are identified.

Local counterpart commitment and capacity

Politically 'charged' operations require Bank senior management's particular attention. As is well known, governmental elections, in general, whilst a natural and desirable phenomena in democracies, can jeopardise operation continuity. Conducive political framework conditions, and their stability, are important influential factors for the outcome and impact of operations. Therefore, operations of politically high visibility (such as major infrastructure investments in capitals) require special oversight by the Bank's most senior management who, in a sense, should "shadow", albeit not interfering with, normal monitoring activities at working levels. Such "shadowing" allows timely and decisive high level 'management-by-exception' interventions at crucial junctions, since staff of Bank Resident Offices occasionally can't muster sufficient leverage and weight.

EBRD internal procedures

Bank-internal optimisation of resource utilisation and delegation of work needs more focus. If, for practicality reasons, combining different tasks is considered (by nature of the activities and by motivation base for their execution), such tasks need to be assigned to multi-disciplinary teams, endowed with commensurate time and budgets. Any shifting priorities within the tasks would need to be reflected in adjusted team and budget compositions. In this case, the sector team in the Bank should have teamed-up with the Legal Transition Team much earlier.

Local counterpart commitment and capacity

The long-term benefits of the assistance will be enhanced by designing the consulting services with a capacity building element. A technical cooperation to assist in procurement for a long implementation period may need to incorporate a design, which aims at the recipient organisation to absorb the assistance and capitalise the skills and knowledge. The assistance design could incorporate a gradual move of emphasis from a support function towards an advisory function of the consultants based on the focused genuine needs of the recipient. The KIDSF has not yet disbursed € 0.5 million of its committed funds for procurement support and may need to consider modifying the terms of reference from the original one prepared for the EU-PHARE funded TC. It should be ensured that staff of the project implementation unit is

discharged from their original functions in the recipient organisation, thereby making themselves available on a full time basis for the Project.

Effective Combination of Financing for a Large Project. The recipient is generally willing to pay for the procurement support because the procurement can make a tangible difference to their infrastructure operations. To the contrary, the recipient tends to be unwilling to pay for the institutional development or sector reforms because the effects are often intangible and it might work against the existing regime. In an infrastructure project financed from multiple sources with reform endeavour, the level of commitment required from the recipient project stakeholders should be taken into account when determining the combination of financing. A good financing mix could maximise the effects of multiple assistances as a whole. For instance, procurement support could be financed from the loans to promote more project ownership and therefore skill transfer, while the preparation for a private sector participation and necessary institutional development could be financed from grant funds to alleviate the recipients' resistance to reforms.

Local counterpart
commitment and
capacity

Importance of Institutional Strengthening Component for MEI projects. Only a balanced combination of soft (institutional development, capacity building and sector reforms) and hard (design, construction and installation with associated procurement support, and construction supervision) components can together generate transition impact. These two components are inseparable. This project lacked an institutional development element in project design, which is now admitted with certain regret by the parties concerned.

Private sector
participation (PSP)

Capacity Building for Municipality and Utility Company. Neither the municipality nor the district heating company received capacity building training for the market-based utility operations and management. A comprehensive capacity building across the local stakeholders is necessary to ensure successful private sector involvement. The Sofia Water project is currently suggesting that the capacity of an independent monitoring body, which supervises the water concessionaire, needs to be much improved. The capacity of the independent body did not appear essential when the concession commenced. Identifying key local project stakeholders and designing the capacity building of such stakeholders in a balanced way should be undertaken in early stages of the project.

Co-operation
between IFIs / co-
finance

Preserve the Bank's mandates in multilateral parallel financing design. The Bank's leverage on policy agenda in multilateral financing should be ensured from the design stage. The project structure allowed the municipality and the WB to deal with the milestones for private sector participation, while the Bank took care of the procurement assistance. Though the Bank participated in a design and monitoring of the private sector participation study, the accountability did not lie with the Bank. It did not even pertain to the WB as it was sponsored by the USAID. This indirect study ownership has made the accountability ambiguous, particularly when the study turned out to be inadequate. It is important for the Bank to take a lead in such areas as the Bank's mandates,

particularly transition impact.

Policy dialogue	<p>Inadequate project design could significantly reduce the collective leverage of lenders on transition impact. Tuning a multi-party project in the midst of implementation is difficult when project objectives are not coherent. Under the Project, the project stakeholders are currently not in tune in respect of which path to follow towards privatisation of the district heating company. This is caused by inherent design inadequacies and weak policy dialogue. The key lesson is that a project with various stakeholders in the MEI sector should be designed from the outset to avoid inconsistencies among the interests of parties concerned and if possible synthesise these interest into an agreed action plan.</p>
Policy dialogue	<p>The importance of the Resident Office's input to a realistic policy dialogue in project design. A public sector project needs to adapt to frequent changes of political climate in the country or/and the municipality. The operating team, if located in the Bank's headquarters, may not be able to see the degree of the government's commitment when the project is formulated. Misjudging the counterpart's signal could cost an unrealisable commitment throughout the project implementation period. The Resident Office could provide the headquarter operation team early on with a more realistic and pragmatic view and practical advice on how to pave and maximise the Bank's policy dialogue with the counterparts. This could help the headquarter operation team avoid a "policy monologue", which might affect the project implementation later on.</p>
Policy dialogue	<p>Cooperation between the municipal government and the utility company in Municipality & Environmental Infrastructure Project. The Bank's visible presence and timely intervention can reduce tension between the municipal government and the respective utility company. The Bank's policy dialogue, if conducted wisely, could be valuable in a critical situation.</p>
Technical Co-operation (TC)	<p>Better Utilisation of study results during the preparation of Municipality & Environmental Infrastructure Projects derives from comprehensive and well defined terms of reference. In this project, the terms of reference under TC2 anticipated a multiple use of a generic agreement in various situations. As was experienced in this case, the Operation Team's knowledge of sector issues and experience in the reform agenda reflected in the flexible terms of reference for the consultants. It enabled the municipal support agreement to be applied in different sub-sectors and countries.</p>
Co-operation between IFIs / co-finance	<p>Cooperation between the Bank and donor agencies during the preparation of Municipality & Environmental Infrastructure Projects. Stronger upfront cooperation creates more efficiency and prevents disruption or fragmentation of studies. In this Project, The Bank and other agencies were committed to cooperating and delivering value-for-money studies for the Project despite each agency's own focus and agenda. This approach had a positive impact on the success of their assistance.</p>

Local counterpart commitment and capacity	<p>In utility companies, a good project implementation unit can maximise the achievement of technical cooperation. Ensuring the capacity of a project implementation unit is the key to success, particularly for the multi-donors' project in Municipality & Environmental Infrastructure sector. The Bank should make sure that the project implementation unit's capacity for the implementation of the technical cooperation is in place before the consultants' field mission to the site.</p>
Local counterpart commitment and capacity	<p>In Municipality & Environmental Infrastructure Projects, more tangible results can be achieved by involving the beneficiaries to their full extent in the implementation of technical cooperation operation. A participatory approach can have an advantage of gaining a stronger commitment to a corporate development plan from the municipal counterparty, who would actually implement this development plan. In this case, the corporate development plan jointly prepared by the consultants and the utility company had a good durability and is still used as a working document for taking a stock of corporate milestones.</p>
Tariffs / affordability Private sector participation (PSP)	<p>Payback periods of energy efficiency projects in both the municipal and the industrial sector need to be carefully analysed on the basis of today's sector framework and realistic near term tariff reform potential. The payback periods for DH projects before sector/tariff reform may be outside the Bank's target range in low and intermediate transition countries due to low tariffs. There is a need for grant funds for co-financing for quite some time in several countries of operations. Further constraints are linked to the institutional set up (regulatory framework) and the types of contracts (and their specific risks) which are used as a basis for the involvement of the private sector operator. The Bank may find CHP schemes within existing or new privately owned energy intensive manufacturing and processing facilities easier to implement within the existing guidelines. This may require a joint effort from the outset between the industry team and the energy efficiency team.</p>
Tariffs / affordability	<p>The structuring of energy efficiency projects requires an intricate network of policy, federal, oblast and municipality related elements. The structuring needs to create transparent systems which show energy savings. A targeted approach to subsidies for lower income segments from the outset is equally important in DH projects. The implementation and supervision units need to be carefully structured and include swift sanctions in case of significant deviations from basic agreements.</p>
Policy dialogue	<p>Demo projects in selected wealthy municipalities may not be easily repeated in other less creditworthy regions unless a policy dialogue leads to sector reform and tariff revisions. Policy/sector reform aspects cannot be neglected whilst targeting a bottom up approach from a demo project in a specific municipality. The budget allocation process works from the Federal Level and can have a significant impact on the credit rating of a municipality. At present fuel savings by a specific municipality do not necessarily lead to a reward in the form of continuous allocations in the next budget. Also some of the institutional aspects regarding the corporatisation and the specific contracts for the</p>

involvement of private sector operators lead to specific legal and accounting questions which need to be analysed in more detail in order to reduce the risk profile for the parties concerned. Since the Bank is adopting the case by case approach a careful sector risk assessment is crucial.

Project Planning

Importance of more realistic assumptions regarding key economic parameters and absorptive capacity. Realistic assumptions re economic growth, tariff increases, pay back periods as well as implementation periods are necessary in order to size the financing requirements properly and avoid large commitments, which cannot be disbursed within a reasonable timeframe. This may also lead to an early decision whether a project in this area is of interest to the Bank. Project preparation is intricate and time consuming since new concepts are being introduced at all levels (heat generation, distribution and consumption).

Emergency assistance and transition impact. Both deliverables, emergency assistance (the 'driver' of the TC operation) and CEP institution building measures, should not be linked through strong conditional relationships, although transition impact such as institution building improvements can well be initiated through emergency operations and even can receive a strong impetus. But, eventually, transition impact should be pursued following its appropriate own gestation pace. Otherwise, short-cuts and resulting conflicts on either side are likely and could lead to sub-optimal outcomes for the combined package.

Technical Co-operation (TC)

Enhancement of Transition Impact in TC operations. Transition impact initiatives resulting from TC operations often require follow-up actions to bring their effects to full fruition. Therefore, provisions need to be incorporated in the project design (and commensurate monitoring resources and budgetary allocations set aside) allowing the Bank to take a fuller commitment for fulfilment of respective TC objectives including intended transition impacts.

Swot analysis in cases of municipal creditworthiness reviews. The Bank should utilise the swot analysis both (i) as a scrutiny tool to capture the future risk of a city and (ii) as an educational instrument by which the city learns about itself and the way to modify its situation.

Technical Co-operation (TC)

Mixing infrastructure and institutional development. Linking the reorganisation of the city by a consultant to the improvement of infrastructure is a powerful instrument of change. It entails that the consultant works hands-on with the city administration so that both the elected officials and the professional managers accept the modifications of the new management oriented culture proposed by the consultant.

Technical Co-operation (TC)

Transfer of know-how to municipality early on during opening up to international capital market. Make sure that the Consultant not only prepares a finish product (Information Memorandum) but also transfers an expertise to enhance city financial systems through workshops and hands on assistance.

Local counterpart commitment and capacity

Direct contact with decisions making officials. In preparation of MEI projects (because of the still existing importance of the hierarchy in ex-socialist countries), EBRD should make sure that the staff involved in project preparation has direct contact with the decisions making officials in the city up to the level of mayor.

Technical Co-operation (TC)

Completion of the Work by the consultant. In public offerings, the Bank should inform the consultants about the difficulty they may face in completing their task due to local circumstances. If they maintain their offer, the Bank should link the full payment of the consultants' fees to the full completion of the work.

In municipal environmental infrastructure (MEI) project preparation, restrictions to free access to facilities and data are not compatible with the establishment of a realistic investment programme. An independent opinion about the state of the water producing facilities in a MEI project preparation is essential when identifying an investment programme because refurbishment or extension of water facilities represents one of the main budget items.

Hiring competent local experts is a necessary condition for success. When preparing a bidding process including the recourse to local experts, attention should be paid to the choice of these local experts hired by foreign consultants. Their selection should take place during the bidding period. A higher mark should be given to consultants who propose the name of local experts in their bid.

Technical Co-operation (TC)

Share project ownership with all local partners. When arranging an operation, a close relationship should be developed at all levels of the administration so that a real commitment and sense of ownership can be secured even if it means more delays in the first stage of the project due to culture differences. This includes for example, the local specialist's contribution to reviewing the terms of reference; the hiring of local or national consultants that would be accepted by the administration. Closely involving and informing the counterparts may have avoided logistical and the access permit problems from the outset of the DHV mission. National consultants know their technical and political surroundings well. But technical solutions proposed by national consultants have to be reviewed in the light of western standards to obtain a project not only based on Ukrainian standards but that complies also with the Bank's objectives.

Technical Co-operation (TC)

The importance of a multifaceted TOR. When designing a TOR for consultants, attention should be paid to both the technical and managerial objectives of the project.

Quality of the Project Completion Report (PCR). The PCR author provided an assessment of the TC operation, which by and large was adequate. The lessons learned and recommendations were excellent.

In MEI projects, The Bank should shorten the period as much as

possible between the beginning of the technical diagnosis and the commissioning of the work. If the period between a feasibility study and the start of detailed design are too long, it is necessary to review the feasibility study, which by definition costs time and money. Moreover, the feasibility study may become obsolete and a new project with different options may come out.

Technical Co-operation (TC)

Recommendation on Bridge Loan: A key issue in implementation is rapid mobilisation of the engineering consultant and the related funding problem. There is constantly a lengthy waiting period (6 months or more) between the signature of the loan and its effectiveness (especially due to the ratification by the Ukrainian Parliament as the guarantee of the country is needed). During this period, bidding process for design work can be envisaged and completed but no disbursement can take place leaving the project in an uncertain state. The Bank is committed to improve municipal and environmental services in Ukraine in line with its mandate to promote economic transition and environmental sound projects. The MEI team has developed a document called "Strategic Orientations and Medium Term Action Plan". An increasing volume of work is envisaged. The OPER team supports the idea expressed by the MEI team of a bridge guarantee allowing EBRD to disburse under a signed loan prior to effectiveness and the coming into force of the project-specific sovereign guarantee. This guarantee would be a revolving mechanism. It would apply mostly to early/intermediate transition countries where retroactive financing is hardly feasible.

Technical Co-operation (TC)

Recommendation: In order to preserve the integrity of purpose of PPTCs and the know-how transfer benefits of a project finance approach to infrastructure investment, the Bank must concentrate on shortening elapsed time between project preparation and project implementation. Experience has shown that financial due diligence and engineering design should be more closely coordinated at the various phases of detail, and that while the availability of finance does indeed usually prompt required design work, unacceptable time lags do still occur. Bank practice, discouraging the financing of detailed project engineering studies by the Borrower from Bank TC funds and often seeking to have such studies financed by Borrower's own funds, might be re-considered if other adequate means of securing commitment and 'ownership' can be substituted.

Technical Co-operation (TC)

Recommendation: In planning the use of TC at project identification and preparation stages, the Bank's operation teams should try to structure inputs in such a way that administrative considerations restricting continuity of consultant employment are minimised (e.g. through optimal use of available extension and contingency options on single contracts). In consultant selection, it should be remembered that good coordination between consortium members often has logistics and cost features that are more acceptable when transparently addressed in both the technical and financial components of consultants' proposals.

Co-operation between IFIs / co-

Recommendation: Parallel financing with the IBRD is clearly superior to pari passu financing on procedural grounds given that the project

finance

preparation timetables for the EBRD and IBRD are different, and generally the EBRD moves faster. In certain contexts, however, parallel financing by these two IFIs still poses clear risks to the EBRD because of the possibilities that the IBRD loan: (a) will not be approved, or will be approved so far behind the EBRD loan that project implementation is adversely affected; (b) will be approved at a later date with policy or other elements that conflict with the EBRD's approach. Bank policy is to support joint activities of the IFIs but this needs to be undertaken in a properly co-ordinated manner according to an agreed timetable from the time of identification and including all PPTCs.

Recommendation: In respect of this investment and others suffering similar delays, the Bank should consider creating a procedure for review of the investment project as actual full-scale implementation commences. In the case of the present PPTC, such a review could provide an opening to reinforce the know-how transfer possibilities as far as the various agencies are concerned.

Technical Co-operation (TC)

PPTC planning approach. A substantial improvement over existing practice can be achieved by applying the logical framework (LogFrame) method to PPTC project development and execution with close involvement of an operation's participants. More precisely, TOR formulation, supervision of bid invitation, and consultant selection should be mutually agreed upon through the forum of a steering group in which all parties to the follow-on investment operation's design should be represented. Final commitment of funding would be the last step in this preparatory process. The same steering group should also oversee the PPTC implementation, including commenting on draft reports and being available for consultation on key issues and design choices. This broad client involvement (beyond the executing agency, in this case, the TWWA) is especially critical in relation to the institutional issues, which are basic.

Consultant selection. Beyond the obvious consideration of achieving best value-for-(TC) money, the choice of shortlisted firms for a PPTC operation has a potentially critical impact not only on that operation's success prospects, but on the success prospects of the follow-on investment operation. The experience of this Operation suggests the need for the following measures.

(1) Compliance with existing consultant procurement guidelines should be carefully attended to by those parties designated in OM 10.4 as signatories to the consultant selection memo. Specifically, it is not in the best interest of the TC recipient -- and contrary to Bank procurement guidelines -- to allow designation of a single CFP funding source as a determinant of the short listing of consultants, since under most CFP funding agreements, this will serve to limit the pool of eligible consultants to one nationality only and proscribe the range of technology choices, given that consultants of different nationalities usually develop specific expertise from mainly domestic experience.

(2) OM 10.4 and 18.4 need to be revised to make it clear that the TC

financing decision must follow, rather than precede, the choice among nationalities to be included in the consultant shortlist.

(3) The Procurement and Technical Support Unit (PTSU) should carry out a survey of consultant contracts awarded under TC operations to determine the extent to which the pre-designation of single-source CFP funding is undermining compliance with the Bank's consultant procurement guidelines.

(4) On the basis of the survey findings, consideration should be given to adding the PTSU to the approval group for consultant contract awards, to ensure procurement guideline and OM procedural compliance.

Technical Co-operation (TC)

Local know-how resource development. Finding suitable local consultant counterparts and transferring know-how are important TC preparatory activities. The Bank's Resident Offices could play a key role in helping to identify local expertise. Know-how transfer should be included in an operation's objectives and made an integral part of PPTC design. As such, it needs explicit research and planning, and the TORs and solicitation of proposals should be designed accordingly.

Technical Co-operation (TC)

Monitoring and quality assurance. These were weak points during Operation implementation. Task report proformas or templates attached as appendices to the TOR could have helped the Consultants' team leader and the OL to monitor accomplishment of the TOR more effectively. Also, the contracting of a consulting firm, with its attendant relatively higher costs, instead of individual (self-employed) consultants, is sometimes justified by their home-office back-stopping capacity which should include performance monitoring and quality assurance. Specific attention should be paid to: (i) the need to explicitly include the back-stopping task in the TOR and contract, and (ii) the need to assess the short-listed consulting firms' related capacity and capability to deliver against this requirement.

OPER timing. With the concurrence of the OL and TWSME, the field visit for this OPER exercise took place during the period between the Board approval of the follow-on investment operation and the relevant loan documents' signing event which, with the benefit of hindsight, should have been avoided. Undertaking a post-evaluation of a PPTC feasibility study necessarily raises issues relevant to the follow-on investment operation and therefore to the loan agreement substance as a logical consequence. Any independent review with the client of PPTC efficacy at this follow-on interface stage could potentially disturb the loan conclusion process. Hence, if possible, field visits for PPTC post-evaluations should be scheduled to take place shortly after loan signing. This will mean that post-evaluation is restricted to an entirely backward looking accountability and lessons-learned role, and will be able to contribute only marginally if at all to follow-on investment operation quality management. The longer

the post-evaluation process is postponed, the greater is the loss of first-hand information sources due to the turnover of staff within the Bank's countries of operation and within the Bank.

6. XMRA Lessons on MEI Projects

The following table presents the 48 lessons in the database from the 13 XMRA's carried out on MEI projects. The left column indicates the common theme to which a lesson is related in the summary table in Section 3.

	<p>Maintaining the quality balance between services and payments under a long term PPP. It is good practice to re-address the main concession objectives and conditions every five years to secure the long term balance of a project.</p>
Private sector participation (PSP)	<p>Maintaining good co-operation with the parties in a PPP. In a complex project such as a BOT, with strong parties, one of the major roles of the Bank is to recognise the importance of maintaining a strong relationship with the parties.</p>
Private sector participation (PSP)	<p>The Benefits of PSP are likely to emerge in mid/long term. After Apa Nova in Romania, the second successful PSP in the MEI portfolio has delivered an even more comprehensive project structure in the water resource management sector. However, the benefits of private sector operator, which are mainly the quality of services and operational efficiency, are expected to be more evident in a mid/long term when comparing with the EU funds-financed water infrastructure project with the existing municipal-owned corporate set-up.</p>
Project planning	<p>Overambitious transition targets. This City transportation project appeared over ambitious in terms of setting transition targets. Many targets were slow to implement, given the often weak capacity of the Bus Company and the City's focus on the physical aspects of the project. It might have been more efficient to develop more detailed and realistic milestones to monitor progress, <i>inter alia</i> to better measure what has definitely been achieved.</p> <p>Weak Public Service Contracts. The initial Public Service Contract (PSC) between the City and the Bus Company, which had been developed without EBRD assistance, had a number of weaknesses. It had to be modified and renegotiated. A strong legislative framework for PSCs is necessary to avoid renegotiating the contracts and enable the Bank to better manage the credit risk.</p> <p>Environmental Standards for the Client. This is a Category B/1 project. During due diligence the Bank undertook an Environmental Audit, which included an extensive Environmental Action Plan (EAP). However, there have been delays in implementation. To further assist the client, the Bank has provided a consultant to help the client prepare its 2007 Annual Environmental Report (AER). The AER follows the structure of the EAP. However, the specified time frames and budgets have been dropped, reflecting the delays in implementation. Both reports (EAP and AER) are lacking in (1) specific requirements and (2) measurements against the requirements. The Bank's Policy is that the project should comply with host country <u>and</u> EU or World Bank (WB)</p>

standards. The client, with the assistance of the consultants, should report against relevant EU/WB standards.

The conditions of local economy for the mid/long -term have significant importance for project implementations of municipal and environmental infrastructure. The Project experienced a considerable amount of loan surplus due to the local construction market conditions and a pessimistic outlook for tariff increase from 2007 onward. The municipal and environmental infrastructure project is very susceptible and vulnerable to the local economic condition. The appraisal analysis usually emphasises an immediate to mid-term (2-3 years ahead) outlook. It could be worthwhile for the Bank to establish a mid or long -term view and outlook for a local economy at appraisal time as the Bank's loan is a long-term one.

Policy dialogue

Sector-wide common problems in Aquis Communautaire need to be resolved in stronger policy dialogue. Like other similar investments in the Polish water sector, the Project encountered sector-wide systematic problems. The years 2001- 2003 marked an optimistic period for the Bank's investments in the emerging market water sector. The thrust was driven by the EC through its massive grant finance. The Bank promoted the sector reforms roadmap particularly for tariff structure, corporatisation and commercialisation, institutional framework, market orientation and service improvement. These agendas were considered to be the basis for future privatisation. Following that period, the investments started manifesting certain drawbacks such as delays of the ISPA-based procurement, and impediments to private sector participation. The Bank's sector roadmap has therefore been on hold. It is difficult to induce transition into the natural monopoly through a series of individual investments. It is rather the legislation toward the EU norms, which would impact on the sector and industry at this stage of evolution. Taking stock of past investments and formulating future paths might be necessary to find a breakthrough in the roadmap for the water sector reforms.

Implementation readiness in procurement need to be closely examined during joint project formulation with other international financial institution. At appraisal, the board document enunciated that the Bank's involvement was eagerly sought by the ISPA fund because of the experience and expertise in procurement. In reality, there was not much contribution that the Bank could make because the ISPA imposed its own procurement procedures. The implementation of the ISPA components appeared very difficult, therefore slow, and created a significant gap of the completion timing. It also resulted in a very negative impact on the ISPA's economic and financial return calculations for the Project. The Bank could have clarified the expectations from the ISPA fund at appraisal and could have sought certain agreeable reconciliation of procurement procedures on the onset of the project.

Involving Bank's sector specialists from the inception of a project.

The earlier involvement of sector specialists into the preparation of a complex project adds value in terms of deal structuring.

Combining grant and loan in project financing. When a project implies grants, TC funding and a Bank's loan, it may be necessary to have a funds allocation scheme where grant funding is progressively disbursed for capital investments alongside with the Bank's loan.

Even in case of emergency project, appraisal has to be thorough.

In spite of its urgency, a complex project with a number of issues requiring special expertise should be subject to relevant studies covering all the specific issues prior to approval.

Financial Covenants may need to be reviewed during implementation: During the course of a project with a municipality, its financials may be changed (for the better or the worse). Covenants established to reflect one situation, may need to be adjusted as the City's conditions change.

Measurement of success should focus on results not activities:

This was an EU-Phare program driven investments and there was much talk about introduction of Best Value Concept. While desirable, the project proceed and was successfully completed without adoption of Best Value Concept approach. The failure of successful uptake of this approach is less a measure of the project's outcome and more a measure of the success for the TC program.

Tariffs / affordability

Project's may have unintended consequences: In order to meet the financial covenants, the City made cuts in social expenditures, which raises affordability questions which the Bank did not look at. During due diligence of MEI projects, in asking economic questions about the sponsors' ability to service the debt, the Bank's analysis should able consider how the City will meet its obligations. The Bank should not attempt social re-engineering via a road project, unless this is a clearly stated objective of the Sponsor and the Bank.

Social aspects

Key performance indicators, project monitoring and reporting

TI/TIMS benchmarks need to focus on measuring Outcomes rather than Inputs: So as to promote TI and achieve the expected demonstration affects of individual projects, EvD argues that the benchmarks under the objectives should be focus on measurable outcomes. In this case, a public roads projects, the outcomes relate to traffic congestion, use of public transport, etc.

Key performance indicators, project monitoring and reporting

Measures of Environmental Impacts should also focus on Outcomes: This project was designed to improve traffic patterns and reduce congestion. Arguably this would result in a reduction in noise and air pollution, both of which are measurable outcomes and are mostly likely measured by local authorities. In making the case for "environmental change" the Bank's position would be enhanced if the ESD encouraged sponsors to measure outcome variables.

Local counterpart

Client relationship management. Maintaining a close relationship with

commitment and capacity	clients secure efficient project implementation and create opportunities to detect new projects.
	Solid waste sector management. The solid waste sector can be very profitable if the solid waste collection is separated from the solid waste disposal.
Advanced countries/ EU Member States	EBRD's role in more sophisticated EU member states. The Bank can still play a valuable additional role there by preparing complex projects, bringing high standards of governance and specialised skills.
Technical Co-operation (TC)	Technical Assistance for project preparation. Technical co-operation with highly skilled consultants is crucial in the preparation and implementation of innovative projects in advanced transition countries.
Local counterpart commitment and capacity	Taking the long-term view. Strong committed sponsors are required to ensure effective, long-term sustainable delivery of public sector services. Banking staff also need to remain engaged throughout the life of the project.
Private sector participation (PSP)	Ensuring the independence of the regulator. Technically strong and politically independent regulators are key to the success of PPPs. The primary function of the regulator is to establish tariffs that are affordable while allowing for reasonable profits by the PPP operator.
Private sector participation (PSP)	PPPs are labour intensive for Bank staff. Banking teams need to budget accordingly when supporting PPPs as there are multiple stakeholders with competing objectives. The Bank often finds itself in the role of being a neutral objective voice bringing the stakeholders together to ensure the success of the project.
Small municipalities / multi-municipality projects	Materialising synergy effects through project bundling is worthwhile. When preparing projects in large cities, it is worth exploring opportunities in smaller neighbouring cities as well which could also benefit from the Bank's financing and these small projects can be processed together with those of their larger neighbours.
Small municipalities / multi-municipality projects	Bundling of separate projects still requires that each of the project constituents separately meets minimal Transition Impact, Additionality and Environmental Effect criteria. While the bundling of projects, where feasible, should be considered for materialising synergy potentials this, however, should not blur the requirement for each of the bundled projects to individually meet minimum requirements for transition impact, additionality, environmental concerns, and sound banking.
Tariffs / affordability	More rigour is required by the Bank monitoring compliance with loan covenants. Emerging non-compliance with loan covenants needs close monitoring and prompt response by the Bank. Although project downsizing and linkage of Bank's disbursements to full provision of local payments was used to mitigate the risks, the Bank should have developed a more firm approach to covenants compliance monitoring -
Key performance indicators, project monitoring and reporting	for example to link tranching of the loan to fulfilment of required tariff

adjustments and securing the local investment contributions.

Alertness for the need of currency risk hedging must be strengthened. Foreign exchange risk in an environment where the risk of local currency depreciation remains high and the Borrower's earnings are in local currency and are strongly dependable on the macro-economic situation should be addressed more thoroughly. No mechanism of foreign exchange risk hedging was introduced in the project and as a result the financial liabilities of the Borrower have significantly increased due to forex losses without adequate compensation of the local currency's depreciation through tariff mechanism.

Policy dialogue

For municipal infrastructure projects the continued policy dialogue with authorities at the national level is essential. Macro-level developments pertaining to regulatory and legal framework, tariff reform, and overall macro-economic situation have usually direct impact on municipal infrastructure projects, but can't be influenced or controlled at utility company level. Particularly in circumstances where regulatory frameworks are weak or absent the Bank should fill this gap through increased monitoring and policy dialoguing to protect its projects against undue influences.

Technical Co-operation (TC)

Institution building and strengthening is an important ingredient in municipal infrastructure projects. Technical cooperation (TC) supporting corporate development programmes is very important for acquiring needed know-how, skills and successful implementation of the project especially involving public utilities managed by local/central government. The Corporate Development Assistance (CDA) programme was one of the key factors that led to achievement of project objectives related to physical implementation of the project, improvement of management of the company and transfer of know-how.

Private sector participation (PSP)

Independence of the regulator. Ensure that the independence of the regulator is enshrined in law and also covenanted in the loan or guarantee agreement as appropriate.

Reality check for appraisal cost estimate. The Bank should do a "reality check" of work performed by consultants at appraisal in light of costs of other projects and using experienced engineers.

Prompt actions needed after early warning signals. The Bank should take a pro-active stance, in sovereign guaranteed transactions, when there are early warning signals of project failure. Close dialogue with the Borrower and the Government should take place in order to mitigate adverse developments, within practices generally accepted for the sector.

Tariffs / affordability

Risks to reform tariffs in volatile political environment. Throughout the project, the political environment in Moldova was volatile, with numerous changes in Government. This has hampered the effectiveness of the actions the Bank took, given that reforming DH and increasing tariff is always politically unpalatable. In this context, there is

no assurance that the situation would have been different had the Bank been more proactive.

Structuring TC and monitoring consultant. Structure TCs comprising financial and management strengthening components with an initial involvement of the consultant and follow up sessions. These should take place at three or six month intervals over a period of two or three years in order to make sure that the work performed is accepted and followed up on.

EBRD internal
procedures

Standardised feasibility study for DH projects. The Bank should develop template for standardised TOR for feasibility studies to be used for District Heating projects. Experience on World Bank feasibility study templates for District Heating projects could be utilised.

Analyse cash flow estimate with the Borrower in DH projects. If the Borrower stops requesting disbursement of the loan before the main part of investment is made, it risks bankruptcy and the planned energy savings and positive cash flow will not be obtained. The investment plan, cash flow, and loan payback schedule must be reliably analysed together with the municipality before loan agreement.

Structuring tariff reform. The tariff reform must be based on full cost recovery calculation of the supplying energy, comprising operation costs including maintenance, depreciation, and appropriate profit marginal. The subsidies to compensate increasing utility tariffs must be directed separately to the poorest part of the population.

Discussion on Public-private partnership. Lengthy discussions and official uncertainties of the Bank's position on delicate issues such as Private-public partnership prevent a continuous flow of project approvals.

The use of put options in framework agreement. Special Events that trigger a put in framework agreements need sometime to be renegotiated in order to mitigate additional political risks when going further East.

Transfer of ownership by municipalities. Relinquishing a majority ownership to a private company needs a lot of convincing to overcome a politically inspired reluctance.

EBRD internal
procedures

Monitoring and reporting on projects at transfer of operation leadership. Team leaders should oversee that monitoring reports apply wider historical perspective when a change of OL is imminent. The handover process will be enhanced by joint participation in a mission as part of regular field visits.

Sovereign projects' need to anticipate time for statutory approvals. Preparation and planning of sovereign guaranteed projects must take

into account realistic time requirements for statutory approvals.

Project Implementation units (PIUs) and their key role for implementation success: Municipal environment projects, such as the Tallinn Water and Environment Project, add to experience from numerous complex infrastructure projects that adequately manned PIUs are a key factor for success. PIUs provide on the job training in procurement, which cannot be learnt entirely by theoretical study.

Private sector participation (PSP)

Procurement documentation review and need for timely approvals. Operations like the Tallinn Water and Environment Project illustrate that the Bank should have access to adequate specialist competence for meaningful and timely review of procurement documentation, if ex ante Bank approval is required prior to award of contract for major components and lots.

Project implementation and suitable communication aids. Implementation of complex projects at early transition stages may suffer from insufficient access to effective means of communication. A client can be encouraged to make use of cellular phones, e-mail and PC programs since a new generation of local professionals will generally be familiar with such aids.

Private sector participation (PSP)

Municipal Environment Projects and the need for regulatory frameworks prior to privatisation. The Tallinn Water and Environmental Project and other public utilities projects which are natural monopolies illustrate that a good regulatory framework and adequate concession arrangements must be in place for a full privatisation to be beneficial. Prior to adequate such legislation and regulation, privatisation through outsourcing of operations under well-defined service contracts may be a more conducive route than privatisation involving ownership of facilities.

Tariffs / affordability

Municipal water and waste water projects and their need for monitoring of rates adjustment plans. Rates adjustment towards self-financing are a central feature of many municipal utilities projects (as illustrated by the Tallinn Water and Environmental Project). Structuring must therefore be conducive to effective monitoring of rates dynamics as defined in project plans and contracts.