Operation Performance Evaluation Review

The Surgut Municipal Services Development Programme (MSDP)

Russia

(A Technical Cooperation operation)

February 2008

Evaluation Department
(EvD)

European Bank
for Reconstruction and Development

OPERATION PERFORMANCE EVALUATION REVIEW

PREFACE

This evaluation report

This Operations Performance Evaluation Review (OPER) looks at the technical cooperation (TC) operations related to the Surgut Municipal Services Development Programme, ("the TC") in the amount of approximately €642,000 and funded through the Bank's Technical Cooperation Funds Programme (TCFP) from contributions by the European Commission. The related TC assignments were carried out from 2001 to 2005.

The operation leader (OL) of this TC was Eugene Ofrikhter who also prepared the available project completion report (PCR) for TCO2.

The evaluation was carried out by Amélie Gräfin zu Eulenburg, Evaluation Manager under the supervision of Dennis Long, Senior Environmental Evaluation Manager ("the OPER Team"). Information on the operation was obtained from relevant teams and departments of the Bank and its files as well as from external sector and industry sources. Fieldwork was carried out in September 2007. The evaluation department (EvD) would like to take this opportunity to thank those who contributed to the production of this report.

Post-evaluation selection process

Selection of an operation for post-evaluation by EvD uses the following criteria:

- relevance to the Bank's likely future operations
- lessons-learned potential
- size of the Bank's investment commitment/exposure
- balance among countries of operation
- balance among sectors and types of operations
- relative priority of investment operation OPERs within EvD's overall work programme priorities and resources.

The Bank's post-evaluation process is described in Chapter 8 of the Operations Manual. The responsible Operation Leader first writes a TC PCR. The PCR serves a self-evaluation function and establishes the basic facts and lessons from the operation's preparation, implementation, and outcome. EvD's independent evaluation follows, using the PCR as one of several inputs.

TABLE OF CONTENTS

ABBREVIATIONS

CDP	Corporate development plan
CSU	Consultant Service Unit (in the EBRD)
DH	District heating
ESD	Environment and Sustainability Department
EvD	Evaluation Department (in the EBRD)
FOPIP	Financial and Operational Performance Improvement Programme
GVK	Gorvodokanal **–** utility providing water and waste-water services in Surgut
GTS	Gorteploset – utility providing district heating services in Surgut
IFRS	International Financial Reporting Standards
MEI	Municipal and Environmental Infrastructure Department (in the EBRD)
MSDP	Municipal Services Development Programme
MUE	Municipal Unitary Enterprise
OAO	*Otkrytoe aktsionernoe obschestvo* equivalent to open joint-stock company
OCU	Official Co-Financing Unit (in the EBRD)
OL	Operation leader
OPER	Operation performance evaluation review
PIP	Priority investment programme
PIU	Project implementation unit
TC Com	Technical cooperation committee (in the EBRD)
PCR	Project completion report
PMC	Project management company
SNG	Surgutneftegaz
SMUE	Surgut Municipal Unitary Enterprise
TA	Technical assistance (synonymous with technical cooperation)
TOR	Terms of reference
TCO	Technical cooperation operation
TI	Transition impact
WD(s)	Consultant working day(s)

DEFINED TERMS

the Bank	European Bank for Reconstruction and Development (EBRD)
the Banking team	the staff in the Banking Department responsible for the TC design, planning, implementation, monitoring and reporting
the City/the Client	the municipality of Surgut
the District	the Surgutsky Rayon, region around the city of Surgut
the LFA	Logical Framework Approach is a project management tool with particular regard to planning and monitoring
the Okrug	the Khanty-Mansi Autonomous Okrug
the OPER team	staff of the Evaluation Department who jointly carried out the post-evaluation
the project companies	the municipal utilities (GVK and GTS)
the Projects	the TC projects related to the MSDP investment operation
the service contracts	service agreements in the spirit of public sector concessions for long-term operations of the municipal utility companies

1. The project

1.1 Background

At the end of the 1990s, municipal utility companies in Russia were in a poor state. Facilities were run down, resources for maintenance were not available and the reliability and quality of services was a major concern. At the same time, Russian municipalities and regions had only limited access to long-term financing for necessary capital investments.

In 2000 the city of Surgut ("the City") developed a priority investment programme (PIP). This was intended to upgrade e water, waste-water and district heating services to achieve sustainable financial viability of service provision. Surgut is located in the oil-rich region of Western Siberia, founded in the 1970s. With almost 300,000 inhabitants (as at 2007) it is the largest city in the Khanty-Mansi Autonomous Okrug, which is located in the Tyumen Oblast, one of 89 federal subjects of Russia.

The European Bank for Reconstruction and Development (EBRD) was approached to co-finance the PIP and has since then been involved in a number of investments and large TC operations, covering the City and the region of Surgut.

1.2 The Municipal Services Development Programme

The Bank's Board of Directors approved the Municipal Services Development Programme (MSDP) in December 2001. A legal advice TC project (referred to in this study as "TCO1") has reviewed the regulatory environment and prepared the necessary formal documents for the future loan agreement. The loan contract was signed in June 2002 between the Bank and the City, the borrower. Additional project agreements were signed between the Bank and the two municipal utilities ("the project companies").

In total, the investment loan provided in local currency amounted to 1.6 billion roubles (approximately €47.5 million) with the overall project costs estimated at 2.9 billion roubles (€78.9 million). Proceeds are used for

- project preparation and implementation (6 per cent)
- water supply and sewerage (38 per cent)
- district heating (56 per cent).

Commencing in April 2004, about €26 million (55 per cent of the loan),were disbursed and some €14 million in repayments had been received at the time of this evaluation (September 2007).

The Surgut MSDP was innovative as it was the first loan the EBRD extended to a *secondary* Russian municipality in roubles. The project location in Siberia was considered especially challenging as only a few donors and international financial institutions (IFIs) were active in the region.

1.3 Related actors on site

The City

According to Russian law, the municipality of Surgut has a statutory obligation to provide utility services, such as water, waste water and district heating. The utility companies and their infrastructure network are considered municipal properties. Hence, the City is responsible for maintenance and expansion of facilities. The City's responsibilities also pertain to subsidising private households for which the costs of municipal services are not bearable and to providing financial and technical support in cases of catastrophes, that is, natural disasters and emergency repairs.

The Okrug
This is the higher administrative tier. For this project, the Okrug entered, together with the City, into a partial guarantee and a Project Support Agreement with the Bank. In addition, an inter-budgetary agreement between the City and the Okrug has been made, which makes the Okrug responsible for taking any necessary action to enable the City to meet the loan agreement covenants.

The Project Implementation Unit (PIU) executes the general management of all PIP-related activities, including TC projects. The company assigned to act as PIU was appointed directly by the City ahead of the loan agreement and has benefited from a comprehensive training project, externally financed by European Funds.

The Project Companies are both carrying the legal status of 'Municipal Unitary Enterprises' (SMUE). They are the beneficiaries of the loan agreement and the attached TC work but also responsible for all debt service of the loan including interest, fees, and principal repayments.

The City's population, predominantly living in large residential blocks, is almost entirely (98%) connected to the water supply and sewerage system. The Water Project Company is responsible for providing potable water to commercial companies and to the municipal housing company, (which manages the housing blocks) and then for collection and treatment of sewage.

1.4 Scope of this Study

The operation's agreements included a number of covenants set for the City and the Project Companies. For facilitating those, TC activities were implemented between 2002 and 2005. The Bank carried out three TC operations with the help of funds originating from the EU-EBRD Cooperation Agreement, Bangkok Facility (TACIS programme), whilst additional projects were financed directly by other sources.

This OPER Report pertains to the three TC operations (TCO) listed above, by focusing on TCO2 and TCO3. This is due to their strategic role for the Project Companies, whilst TCO1 was employed to clarify the necessary formal conditions for the investment only. As far as it deemed necessary, additional information pertaining to the overall investment operation and other related TC projects have been taken into consideration.

2. PROJECT RATIONALE

The overall rationale (of the investment operation and TC projects), is to substantially improve the provision of municipal water and DH services in terms of increased operational safety, reliability and efficiency. Whilst the investment targets technical upgrades of facilities and equipment, the TC work focused on the performance of the Project Companies: firstly, aiming at improving their operational capacities and financial performance (FOPIP); secondly, supporting a more favourable operating environment by recommending substantial tariff increases, and thirdly, introducing *Service Contracts* in order to formalise the relationship between City administration and Project Companies and to establish this on commercial principles.

3. ACHIEVEMENT OF OBJECTIVES

3.1 The overall achievement of objectives

The overall achievement of objectives is rated ***Satisfactory***. Both Project Companies show good performance and fulfil the financial covenants as defined in the formal loan and project agreements. FOPIP and *Service Contracts* have been introduced and decisions on tariff increases – prepared by the TC work - have enhanced the utilities' revenues. It seems however that some problems in the timing of activities led to a couple of project objectives disappearing from the agenda. This is further explained in section 3.2.4.

3.2 The individual achievement of objectives

TCO1 – Surgut Legal Advice

Objective TCO1: To analyse the legal and financial conditions for the Bank's investment and draft all related contracts and legal documents as required and appropriate (in compliance with the Bank's rules and regulations as well as Russian legislation)

Although, a few activities originally included in the Terms of References (TOR) were dropped during project implementation - without written documentation - the Consultant has expanded on the legal and formal documents for the loan agreement based on an analysis of and in compliance with the local circumstances and conditions. Thus, the purpose of the assignment was met and the objectives considered ***Achieved.***

TCO2: Financial and Operational Performance Improvement Programme (FOPIP)

Objective TCO2: To provide a comprehensive range of support services, system development, expertise and training to the management and staff of the Project Companies, which is required for the enhancement of operational and financial performance and institutional transformation of the utilities into well managed companies

There were two main timely constraints (both calendar and work time) in the case of TCO2. Firstly, the procurement process for identifying a contractor led to a significant reduction of working days (WDs) available for this project. Only about 65 per cent of the workforce foreseen in the original budget had remained as WDs in the project's contract. The TOR did not change in accordance with the substantially lessened time so it is not surprising that some envisaged activities were not carried out. Secondly, the elaboration of *Service Contracts* described in the TOR as one sub-activity within FOPIP was apparently not expected to be demanding in terms of work time, however proved to absorb the majority of the Consultant's resources.

As a result, a number of activities have not been performed and the implementation phase of FOPIP and *Service Contracts* did not happen as envisaged during the lifetime of this project. Consequently, the objectives related to TCO2 are rated ***Partly Achieved***.

TCO3: Corporate Development Assistance

Objective TCO3: To assist the Project Companies during initial stages of implementation of *Service Contracts* and provide further Corporate Development Assistance

The FOPIP (with its different sub-components) and the *Service Contracts* have been successfully introduced into the Companies' daily management. In addition, the Consultant analysed some supplementing practices, e.g. public procurement procedures. With regard to the utilities' financial performance, it seems too early to conclude on a sustainable improvement. Nonetheless, the fact that both Project Companies show positive trends, meet their loan obligations and still yield a profit, suggests that TCO2 and TCO3 indeed have been useful. The objectives are thus, considered ***Achieved.***

Objectives not achieved or not envisaged

Although, the FOPIP defined in TCO2 included a sub-chapter on 'Organisation', the OPER Team had difficulties finding evidence on organisational restructuring in the two Project Companies. It seems that outputs in this regard are limited to the Consultant's proposal to merge both utilities together. The City and Project Companies, however, rejected this recommendation. The picture is also unclear with regard to cost savings and synergies achieved. With regard to staff development, both companies have seen growing numbers of employees during the last five years such as in the case of the Heat Project Company by 20 per cent (1,200 staff members in 2007 in comparison to 1,000 in 2002). This is surprising as it is against the advice and forecasts elaborated by the Consultant for TCO2 and probably happened before the *Service Contracts* were signed. The staff increase is of particular concern with regard to the general aims of cost reduction and efficiency improvements that are so important for regulated monopolies.

No consulting activity is reported in the field of environmental performance. This is despite the loan covenant: *"to meet at all times Russian and European Union environmental requirements"* and the TOR for TCO2 which foresee a number of activities in this regard. More specifically, sub-component FOPIP 8 'Environmental Performance' includes "*to review the current environmental management system, to deliver recommendations for a new system (possibly basing on ISO 1400 standards) and to address the issue of sludge disposal"*. Nonetheless, no activity or output is reported later on in this component. It is not clear whether these tasks have possibly been overtaken by the PMC (who were also responsible for the elaboration of the MSDP 'Environmental Action Plan') or whether they were found obsolete in the course of the project.

The OPER Team has generally noted that related actors on site were solely referring to Russian environmental standards as binding. And even article 21, paragraph 2 of the *Service Contracts* confirms: *"The Operator must keep pollutions of all kinds to a reasonably achievable minimum, in particular those related to sludge disposal and gas emissions. In any case, those pollutions must be within the thresholds set out in applicable [domestic] law…."* Whether the application of European environmental standards is appropriate and realistic in such projects, is a separate debate. In this case, the EU standards are defined as a loan covenant. The Bank's Environmental Department (ED) stated that for instance, that the Water Project Company has been providing EHS reports since 2003 including information on the drinking water and effluent quality related to national and EU standards. Taking into account the unfamiliarity with this issue shown on site, however, EvD sees some more efforts needed to monitor the development more closely and to support the client to meet the environmental objectives.

There is an additional player in the field, that could have benefited from being included in the TC projects as well: the billing company. This company is responsible for fee collection in relation to all municipal services, delivered to residential blocks in Surgut, including DH, water, and wastewater. Thus, it is the billing company, maintaining direct contacts with regular service consumers, but not the Project Companies. As a consequence, FOPIP 6 with its foreseen work on 'Revenue Collection Procedures' as well as FOPIP 9 'Recommendations for Customer Relations Improvements' were addressed with a few remarks by the Consultant only, but proved to be obsolete during project implementation.

4. OVERALL ASSESSMENT

The Bank's TC operations overall, are rated as ***Successful.*** The projects have facilitated not only the design and approval of the loan agreement (TCO1), but also played a vital role in its effective implementation (TCO2 and TCO3). The Bank's 'Additionality' is ***Verified in All Respects*** as at the time of the loan approval, there was very limited possibility for a Russian Municipality to receive long-term financing. Transition Impact (TI) is rated ***Good*** with regard to the tariff increases for municipal services and the demonstration effect of the '*Service Contracts*'. Environmental Impact is not rated (see Section 5.3)**.** Fulfilment of TC Objectives is rated ***Satisfactory*** as described above. The Project's financial performance is not rated as this is an evaluation of TC only. Bank Handling is rated ***Satisfactory*** as it planned and implemented the TC operations with success overall; however, it showed a number of flaws in project design and administration. The project was and continues to be in compliance with the Municipal and Environmental Infrastructure (MEI) Department Policy, and the Country Strategies for the RF as approved in 2002 and 2004.

5. TRANSITION IMPACT AND ADDITIONALITY

The overall TI of the TC operations is rated ***Good.*** The TC work is likely to have demonstrated a new approach to the provision of public services in the City, Okrug and possibly beyond. Similar to the sister project in Yaroslavl, the endeavour in Surgut was ahead of its time. Particular challenges had to be met as there was yet no legal framework existing with regard to public or private participation in municipal services provision. The risk attached to TI has been mitigated through the adoption of tariff reforms and *Service Contracts* and is therefore rated ***Medium***.

5.1 Framework for markets

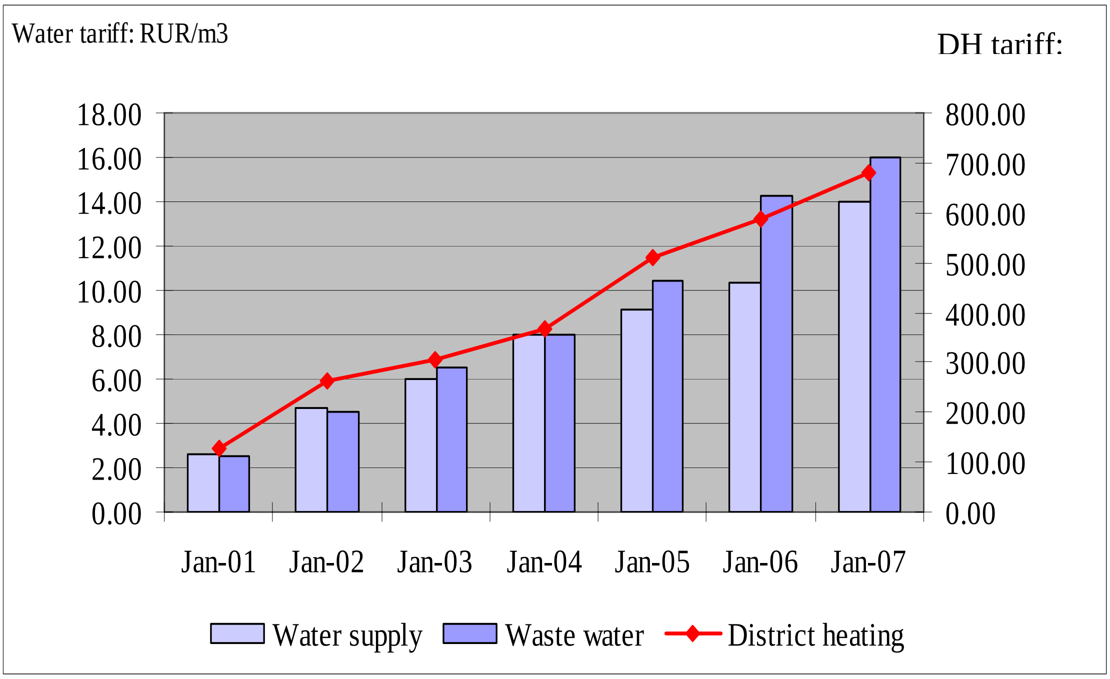
Service Contracts. The *Service Contracts* have helped to formalise the relationships between the City and the Project Companies. It should also be noted that they seem to grant the utilities' management a greater level of formality and autonomy in providing municipal services as well as the opportunity to introduce commercial principles to a greater degree. Distancing the two utilities from the municipality, is one step along the process of moving from 100 per cent owned "budget-based" municipal companies to fully privatised for-profit companies, even though the private sector is not yet involved.

On the other hand, it appears that a number of conditions laid down in the loan agreement and therefore of vital importance for the Project Companies, were not properly translated into the *Service Contracts*. 'Environmental protection is one topic (and is described below), the application of 'national' accounting standards another. Furthermore the '*Service Contracts*' were not subject to competitive tendering but have been granted quasi 'automatically' to the current management of the municipally-owned utilities for a period of 30 years. It is not clear what recourse the municipality would have if either of the two utilities failed to fully comply with the terms of the '*Service Contracts*'. Would the City be willing to cancel a contract with a company that it owns?

Tariff reform. With regard to TI, it is rather difficult to draw the line between what is a consequence of the investment operation and what attributes to the TC work only. The tariff reforms of Surgut municipal services present a good example, as they are named as loan covenants: "*approve and implement an adjustment in water, wastewater, district heating and hot water tariffs for all consumer groups, to reflect 100% of the incurred costs* *for provision of respective services"* as well as output of TCO2. Achievements in this regard are illustrated in Figure 5.1 overleaf.

Water tariffs are determined by the City administration directly and seem to fully recover the operating costs. In January 2001 – more than one year before the MSDP started – the average costs for a household (without VAT) for the supply and removal of m^3 water/ wastewater amounted to RUR 5.14 (equivalent to US$ 0.18). At this point, the City provided direct subsidies to households in the order of 30 per cent of tariff revenues. In January 2007, combined tariffs for one m^3 water supply/ wastewater amount to RUR 30.1 (equivalent to US$ 1.14). Thus over seven years, the inhabitants of Surgut saw a tariff increase that reached up to five times the original amount in RUR (including inflation).

Figure 5.1: Development of tariffs for DH and water/ wastewater services in the City of Surgut (2000 – 2007)



Tariffs for DH are determined in accordance with the RF legislation, which theoretically requires cost recovery tariffs by 2008. In practice however, the Federal Tariffs Agency has placed caps on tariff increases, thus limiting the moves towards cost recovery. In Surgut, the special committee on Okrug level has set tariffs to cover some 70-80 per cent of operating costs, leaving a gap between costs and tariff ratio of 20-30 per cent that is financed by the City. Still this is an achievement since in July 2001 subsidies were paid to an amount of 50 per cent. Average tariff levels for the customer group of private households (industrial customers who account for some 25% of clients have separate tariffs) were 128 RUR / one Giga Watt (Gcal), (equivalent to US$ 4.5) back in January 2001. Six years later this is up to 680 RUR/ Gcal, (US$ 25.75) which is an increase of 531 per cent (in RUR) or 572 per cent (in US$) respectively.

The concerns expressed in the OpsCom meeting at the Structural Review of the investment project about the City possibly: *"falling back on oil revenues, reducing the transition impact"* have not occurred. Subsidies have either been removed or substantially decreased. Generally, the City's financial contribution is limited to social subsidies targeting individual poorer households (approximately six per cent of private households), and adhoc support for emergency repairs. What is less clear however, is the operation side of the tariff setting. Are real operation costs per produced unit adequately mirrored by tariff setting? And is there further potential for cost savings in the Project Companies? It is appropriate to suggest that cost control should receive more attention from the project management in future FOPIP.

5.2 Demonstration effects: restructuring

Demonstration effect. The *Service Contracts* are considered to have substantial demonstration effect. This is well reflected on a local and regional level. It should be noted that the project is quoted as a good example for the successful restructuring of a relationship between municipalities and utilities in international studies dealing with economic transition/ development issues as well as energy efficiency.

Commercialisation. It appears that new standards in Business Conduct have been successfully introduced. Both companies regularly report to the City and to the Bank on their financial performance, and confirm that the application of International Financial Reporting Systems (IFRS) and related EDP-based management information systems has helped them to achieve transparency and control in financial planning and budgeting. Transfer of skills happened by majority via individual advisory and coaching activities, rather than wide-scale training measures (although these had originally been envisaged e.g. in the ToR for TCO2). As most senior and management staff within utilities mostly remained in the same position over time, the knowledge acquired is likely to be still present among the workforce.

The Project Companies are municipally-owned and there doesn't appear to be much appetite for a future privatisation at the local level. The *Service Contracts* have a considerably long duration period (30 years), granted without competitive tendering. This could be seen as limiting further TI change, on the other hand, the City can always decide to convert the MUEs in joint stock companies and terminate the *Service Contracts*.

The Bank and the City are now discussing regionalisation of Project Companies and the recently approved operation in the Surgutski Rayon would naturally provide a perfect opportunity for this. One of the problems in the sector is that as one moves out from larger cities to smaller communities, the costs per individual to provide services goes up, while the ability to pay goes down. Bundling across the region could – in the long run - provide an opportunity for cross subsidization between major urban and surrounding rural areas.

5.3 Environmental impact

Environmental impact (performance and change) is not rated as none of the TC projects directly relate to environmental issues. However, the OPER Team is concerned that at the local level, neither the Project Companies nor the City seem to have understood the implications of the covenants that relate to application of *EU Environmental Standards*. These standards are indeed very stringent and would appear to go beyond the intention of the Board Paper and scope of the Bank's use of proceeds. Nevertheless, having agreed to it, what are the implications and did the utilities have the resources and knowledge to *"meet at all times Russian and European Union environmental requirements"?* EvD would argue no, and therefore a detailed comparison of Russian and EU standards for water and wastewater ahead of the project design would have been recommended (see section 7.7 *Lessons Learned*).

Looking closer at the individual Project Companies, operates gas-fired plants therefore their emissions are assumed to be well in line with Russian and EU standards. In the water sector, EvD's observation was that the wastewater treatment plant is compliant with EU standards and utilises very up-to-date nitrogen removal and disinfection technology. Nonetheless, the Team observed construction related activities (replacement of existing distribution pipes) that did not meet EU health and safety standards (lacking fences around pipeline trenches, no helmets for the workers' protection, etc.). Support on occupational health and safety, thus could have been useful.

5.4 Compliance with country strategies and sector policies

Country Strategies. The Bank's Country Strategy for the RF 2002 analyses a range of obstacles for a systemic overhaul of public infrastructure. They also express an intention to support the Russian Government with its reform process to improve quality and efficiency in local and municipal service provision. This strategy also points to wide regional variations that exist, i.e. for cash collection ratios as well as tariff increases. The Country Strategy 2004 confirms the field of MEI as one of the priority areas, with a special focus on the DH sub-sector. The Project in question therefore continues to be fully compliant with the Bank's Country Strategies.

Sector Policy. In addition, the MEI Operations Policy is thoroughly met by this project. This is true especially for the specific challenge defined for the Bank's policy in the RF: *"[to] promote decentralised financing solutions through the use of […] loans to local public companies with local government guarantees to assist reform minded local administrations with the establishment of successful borrowing track records and utility commercialisation."*

Concession Policy. The OPER Team discussed whether the project in question - due to the *Service Contracts* - would be subject to the Bank's Concession Policy with several teams within EBRD. Although the term 'concession' is not used in Bank documents, and a 'public' operator is in charge, the agreements are definitely understood as such by the local Counterparts. On the other hand and given, that a Russian MUE is a specifically designed entity to undertake municipal services, the Service Contract should be understood as a contractual arrangement between the users (represented by the City) and the operator without a real 'concessionary nature'. Consequently, it does not require competitive tendering.

5.5 Additionality

In light of the situation in the RF at the beginning of the new Millennium, the Project's Additionality ***is verified in all respects***. On one side, there was the urgent need for capital investment in municipal infrastructure and related public service. On the other, local administrations only had limited access to long-term financing, as the Federal Government was endeavouring to impose budgetary discipline on regional and local governments, prohibiting them from incurring foreign currency liabilities including guarantees. Thus, municipalities and regions were only allowed to borrow and guarantee local currency debt. This in turn is reported not to have been available by local commercial banks at the time. The EBRD was the only MDB able to offer long-term financing needed for capital intensive projects in local currency.

6. BANK HANDLING

Bank Handling is rated ***Satisfactory*** for the reason that the TC projects have achieved their overall objectives and shown a successful outcome. Looking into the details of the project management however, reveals a number of flaws with regard to project design, planning, procurement activities, monitoring and reporting, as well as record keeping which would deserve a *Marginal* rating. Section 7 below includes a number of *Lessons Learned* in this regard.

With regard to the TC work's design, the Operation Team did not use the Logical Framework (Log Frame) approach – even though the feasibility study has recommended so. As a result, the TOR (with the exception of TCO1) lack clarity in their structure, sometimes confusing the (primary) loan covenants with the (secondary) TC objectives, and suffer from imprecise definition of a number of activities.

More severe problems appeared with timing, as TCO2 and TCO3 both had problems in accomplishing their defined tasks in time. TCO2 started almost 10 months later than planned and was not able to carry out its 'Implementation Phase' (Phase II). TCO3 in turn suffered from a decreased lifespan – five instead of nine months. In both cases, problems in handling the procurement process seem to be responsible for the delays.

Finally, record keeping and availability of Consultant's and Bank internal reports have shown significant weaknesses.

7. LESSONS LEARNED AND RECOMMENDTIONS

Project design

Re-approving procedures for projects in case of substantial changes.

Lesson learned:

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.

Adequacy of information on the different technical standards (EU and Host Country) to be complied with by Bank projects.

Lesson Learned:

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.

Public procurement activities

Effective and efficient implementation of competitive selection procedures. In the case of TCO2, a competitive tender procedure was carried out, whilst the Consultant for TCO3 was selected from a short-list. Both selections were done on site by an Evaluation Committee. This was composed of Members of the Project Steering Committee and the PIU, involving the directors of both Project Companies, but without participation of the OL or other EBRD staff members. A number of misunderstandings occurred between related parties revealing that neither the Client nor the PIU were fully familiar with the procurement rules required. CSU came close to cancelling the tender process for TCO2 entirely because of concerns on the accuracy of a bidders' clarification meeting in Surgut.

Lesson Learned:
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.

Project reporting and record keeping
Severly delayed reporting endangers its monitoring function.
Lesson Learned:
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.

Record keeping.
Lesson Learned:
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 *TClink* will be implemented. This pertains to Bank internal documents (ToR, contract, and others) as well as for Consultant reports.

OPERATION PERFORMANCE RATINGS
SURGUT MUNICIPAL SERVICES DEVELOPMENT PROGRAMME (TC)

Performance Indicator	Rating
OVERALL TRANSITION IMPACT (Analysis in Appendix 3): **(Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Negative)** *With especially positive effects noted such as tariff increases for municipal services and the demonstration effect of the 'Service Contracts'*	**Good**
ENVIRONMENTAL PERFORMANCE OF THE PROJECT AND SPONSOR: **(Ratings: Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Highly Unsatisfactory)**	**N/A**
EXTENT OF ENVIRONMENTAL CHANGE: **(Ratings: Outstanding, Substantial, Some, None/Negative)**	**N/A**
ADDITIONALITY: **(Ratings: Verified in all respects, Verified at large, Verified only in part, Not verified)** *At the time of the loan approval there was very limited possibility for a Russian Municipality to receive long-term financing*	**Verified in all aspects**
PROJECT FINANCIAL PERFORMANCE: **(Ratings: Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Highly Unsatisfactory)**	**N/A**
COMPANY FINANCIAL PERFORMANCE: **(Ratings: Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Highly Unsatisfactory)**	**N/A**
FULFILMENT OF PROJECT OBJECTIVES: **(Ratings: Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Highly Unsatisfactory)** *Both Project Companies show good performance and fulfil the financial covenants as defined in the formal loan and project agreements, problems in timing of activities however, prevented from a better rating*	**Satisfactory**
BANK HANDLING: **(Ratings: Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Highly Unsatisfactory)** *Banking Team planned and implemented the TC operations with success overall; however, showed a number of flaws in project design and administration*	**Satisfactory**
BANK's INVESTMENT PERFORMANCE: **(Ratings: Excellent, Good, Satisfactory, Marginal, Unsatisfactory, Highly Unsatisfactory)**	**N/A**
OVERALL PERFORMANCE: **(Ratings: Highly Successful, Successful, Partly Successful, Unsuccessful)** *The projects have facilitated the design and approval of the loan agreement and played a vital role in its effective implementation through institution building in related Project Companies*	**Successful**

TRANSITION IMPACT ANALYSIS
Surgut Municipal Services Development Programme (TC)

TI checklist categories	STEPS OF RATING TRANSITION IMPACT *EX POST*	Short-term verified impact	Longer-Term transition impact potential	Risk to potential TI
	STEP I: CHANGE BY THE PROJECT AT CORPORATE LEVEL	Rating[1]	Rating[2]	Rating[3]
3	**Private ownership** – GTS and GVK are municipal unitary enterprises and their was no intention to privatise the utility companies within this operation	N/A	N/A	N/A
5	**Skill transfers** – Albeit no intensive training programmes were executed, transfer of skills took place via coaching and training-on-the-job, employees stable and likely to apply new knowledge even in the longer run	Satisfactory	Good	Low
6	**Demonstration effects** – Substantial information spread i.e. of Service Contracts within the region and beyond, until the innovativeness of this approach will be overtaken by (private) Concession Contracts	Excellent	Good	Medium
7	**New standards for business conduct** – in the fields of MIS, IFRS and tariff calculation methods introduced in professional manner and with expected sustainability	Good	Satisfactory	Low
	STEP II: TRANSITION IMPACT AT THE LEVEL OF THE INDUSTRY AND THE ECONOMY AS A WHOLE	Rating	Rating	Rating
1	**Competition** –In water and wastewater, a natural monopoly exists; in DH, competition could have been fostered i.e. by awarding procedure of Service Contracts	Satisfactory	Satisfactory	Medium
2	**Market expansion** – through the new project in the Surgutsky District, a regional expansion of water, wastewater and DH activities is guaranteed	Good	Good	Low
3	**Private ownership** – both Project Companies are municipally-owned	N/A	N/A	N/A

[1] This range is: Excellent/Good/Satisfactory/Marginal/Unsatisfactory/Negative.
[2] This range is: Excellent/Good/Satisfactory/Marginal/Unsatisfactory/Negative.
[3] This range is: Low/Medium/High/Excessive.

TI checklist categories	STEP II: TI AT THE LEVEL OF INDUSTRY AND THE ECONOMY AS A WHOLE	Short-term verified impact	Longer-Term transition impact potential	Risk to potential TI
4	**Frameworks for markets** – was essentially improved through the tariff increases in the last seven years (to cost-recovery level in water/ wastewater and some 80-90 per cent of cost recovery level in district heating	Good	Good	Low
5	**Skills transfers** – was limited to utilities staff not involving government officials from City and Okrug administrations	N/A	N/A	N/A
6	**Demonstration effects** – improvements to overall companies' performance and services delivered and formalisation of relationship with the City administration expected to unfold demonstration effects over the region	Good	Good	Low
7	**New standards for business conduct** – consisting in application of IAS and audited financial reporting and tariff adjustments	Satisfactory	Good	Medium
	SUMMARY OF VERIFIED, POTENTIAL AND RISK RATINGS	Good	Good	Low
	OVERALL TRANSITION IMPACT RATING:[4]	Good		

[4] This range is: Excellent/Good/Satisfactory/Marginal/Unsatisfactory/Negative.