SPECIAL STUDY

Private sector participation in municipal and environmental infrastructure projects - review and evaluation

May 2014

EBRD EVALUATION DEPARTMENT

European Bank
for Reconstruction and Development

The Evaluation Department (EvD) at the EBRD evaluates the performance of the Bank's completed projects and programmes relative to objectives in order to perform two critical functions: reinforcing institutional accountability for the achievement of results; and, providing objective analysis and relevant findings to inform operational choices and to improve performance over time. EvD reports directly to the Board of Directors, and is independent from the Bank's Management. EvD Whilst EvD considers Management's views in preparing its evaluations, it makes the final decisions about the content of its reports.

This report has been prepared by EvD and is circulated under the authority of the Chief Evaluator. The views expressed herein do not necessarily reflect those of EBRD Management or its Board of Directors. Responsible members of the relevant Operations team were invited to comment on this report prior to internal publication. Any comments received will have been considered and incorporated at the discretion of EvD.

EvD's Special Studies review and evaluate Bank activities at a thematic or sectorial level. They seek to provide an objective assessment of performance, often over time and across multiple operations, and to extract insights from experience that can contribute to improved operational outcomes and institutional performance.

Report prepared by Tomasz Bartos, Senior Evaluation Manager, EBRD Evaluation department together with José Carbajo, a specialist consultant from Frontier Economics Ltd.

One Exchange Square

London EC2A 2JN

United Kingdom

Web site: www.ebrd.com

Contents

Abbreviations

ANE	Aqualia New Europe
EBITDA	Earnings Before Interest, Tax Depreciation and Amortisation
EIB	European Investment Bank
EPEC	European PPP Expertise Centre
EU	European Union
GDP	Gross Domestic Product
IFC	International Financial Corporation
IFI	International Financial Institution
ISPA	Instruments for Structural Policies for Pre Accession
MEI	Municipal and Environmental Infrastructure
MP4	Municipal Public-Private Partnership Project (TC)
OECD	Organisation for Economic Cooperation and Development
PHARE	Poland and Hungary: Assistance for Restructuring their Economies
PPP	public private partnership
PPIAF	Public Private Investment Advisory Facility
PSP	Private Sector Participation
TC	Technical Cooperation
TIMS	Transition Impact Monitoring System
WWTP	Wastewater Treatment Plant

Defined terms

additionality	The Bank complements rather than displaces private sector finance. It does not finance projects that can be funded on equivalent terms by the private sector.
“the EBRD” or “the Bank”	The European Bank for Reconstruction and Development
early transition countries	The Bank's countries which still face the most significant transition challenges: Armenia, Azerbaijan, Belarus, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Turkmenistan and Uzbekistan. More than 50 per cent of the people in these countries live below the national poverty line.
EvD	the EBRD Evaluation department
Evaluation Period	the Bank’s objectives and activities supporting private sector participation in municipal and environmental infrastructure and services sector between 2001 and 2012
Evaluation Team	EvD staff conducting the study, together with a specialist consultant
Legal Transition Programme	The Legal Transition Programme (LTP) is the EBRD’s initiative to contribute to the improvement of the investment climate in the Bank’s countries of operations by helping create an investor-friendly, transparent and predictable legal environment. LTP activities focus on the development of legal rules and the establishment of the legal institutions and culture on which a vibrant market-oriented economy depends.
MEI Team	The EBRD sector team responsible for the preparation and implementation of municipal and environmental infrastructure projects
PHARE	Poland and Hungary: Assistance for Restructuring their Economies (PHARE) expanded from Poland and Hungary to cover ten countries: eight of the ten 2004 accession Member States (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia), and the countries that acceded to the EU in 2007 (Bulgaria and Romania)
Transition	As stated in the Basic Documents of the EBRD Article 1 “In contributing to economic progress and reconstruction, the purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics.”
Transition impact	The likely effects of a project on a client, sector or economy, which contribute to their transformation from central planning to well-functioning market-based structures
Transition Impact Monitoring System (TIMS)	Transition objectives are translated into benchmarks to be monitored during project implementation (TIMS). The score assigned to a project is based on a combination of the Transition Impact Potential and the Transition Impact Risk of the project.

Executive summary

This report presents the European Bank for Reconstruction and Development (EBRD) Evaluation Department's (EvD's) review and assessment of the Bank's objectives and activities supporting private sector participation ("PSP") in municipal and environmental infrastructure and services sector ("MEI") between 2001 and 2012 (the "Evaluation Period"). It explores the various channels through which these efforts were made, how strategy and operations evolved over the period, and how experience and results compared with expectations.

The report's main focus is on the private sector support dimensions of sector policies and country strategies, MEI operations classified as private and those classified as public with private sector components, and Technical Cooperation (TC) activities related to these. The report is built upon analysis at three different levels: a close review of Bank's strategic priorities and operational activities over the Evaluation Period, during which two different sector operations policies were in effect, and broken into three discrete periods; a review of relevant MEI-specific evaluation work already available; and, supplemental lighter desk evaluations of selected additional MEI operations. The report identifies a number of findings and makes specific recommendations, which are presented in section 5, annexes 6-10 and summarised here.

Main findings – general and policy-related:

- Private sector participation in municipal infrastructure and services in the Bank's countries of operations is well below that observed in other regions, and overall has changed relatively little since transition began. For a variety of historical, policy and structural reasons the climate for PSP in MEI remains very difficult.
- The strategic importance given by the Bank to increase PSP at the level of MEI sector policies has declined over the past 15 years. After being one of several explicit priorities in the late 1990s, PSP is now of a lesser strategic importance to the Bank.
- In contrast, a higher level of stated emphasis on PSP in MEI is found in selected country strategies, suggesting disconnect among sectorial and country-specific policy objectives.
- Generally disappointing results from a few specific PSP promotion initiatives in the 1990s and 2000s appears to have sharply reduced the Bank's ambitions and expectations; operational work with a PSP dimension has become limited, cautious and highly selective.
- During the Evaluation Period the Bank signed 29 private operations for €942 million (25 percent of volume) and 52 public sector projects with private components, accounting for 28 per cent of total public sector project number. While absolute number and volume of MEI's public projects increased significantly over the period, comparable indicators for private sector projects remained low and largely constant in relation to public projects.
- Project design in the early 2000s saw increased integration of private components into public sector projects, which contributed to stronger transition potential ratings. However actual execution of these components was disappointing: fully achieved only in 13 per cent of cases, partly achieved in 35 per cent, and not implemented at all in 52 per cent of cases.
- Integration of private sector components into MEI's public sector operations subsequently dropped significantly and remained low, while their execution rates dropped further.
- A total of about €3 million of TC funds was committed to promote or support PSP projects over the period, accounting for only 2 per cent of the total TC funds committed in the MEI sector. Much was spent in the early years of the period on two large TCs which were largely viewed as unsuccessful. This early experience of using TC to "create a market" for PSP appears to have been decisive in the Bank's subsequent approach, which has largely been waiting for opportunities to emerge, rather than trying to pro-actively influence the market to create them.

- Notwithstanding all of this, the Bank has been a significant player in the limited regional market, providing financing to about half of all private MEI transactions which achieved financial closing during the Period.
- The Bank's approach to promoting PSP in MEI may be characterised as pragmatic, selective and reactive. Unlike in other sectors, countries do not have PSP/PPP strategies for the municipal sector, leaving it mainly to municipalities to decide whether they want to engage private operators or not. This makes it difficult for the Bank to develop a coherent strategy for promoting and financing PSPs, forcing it to rely mainly on opportunities as they arise.

Main findings - operations-related

- The private content of MEI operations has changed substantially over the period covered by this study. PSP operations in the first quadrennial (2001 – 2004) were focused on the water/waste water sub-sector and financed international operators, mainly in more advanced transition countries.
- The availability of European Union (EU) pre-accession and post-accession grants displaced a number of PSP initiatives in eentral and then southern Europe, and substantial challenges are evident looking forward due to confusion about eligibility of projects for EU grant co-financing.
- In the second quadrennial (2005 – 2008), opportunities to finance PSP projects deteriorated, due to the combined effect of the EU grants in more advanced countries, the lack of adequate PPP legislation in the less advanced countries, and the more cautious approach of international investors.
- To remain involved in private projects, the Bank increasingly turned towards local infrastructure operators, particularly in Russia, signing several transactions with them. Although all of them required derogation from the Bank's concession policies, some of these projects achieved good transition impact.
- In the last quadrennial (2009 - 2012), the number of PSP projects doubled (although one third were expansions of existing projects), while the average PSP project size shrank. The Bank expanded its geographical reach, signing its first MEI PSP projects in an Early Transition Country, Central Asia and Turkey, and also tapped into new sub-sectors such as parking and ferry services.
- There are noteworthy examples of policy dialogue with selected cities and several central governments, which contributed to better understanding of the PPP (PPP) concept at municipal level and the development or amendment of PPP-enabling legislation. However, these examples are relatively few, confirming difficulties with replicating such initiatives.
- Overall, the performance of the Bank's PSP-MEI projects has been evaluated as '*partly successful*', primarily on account of the '*satisfactory'* achievement of transition impact objectives, '*satisfactory'* efficiency, and the low success rate of achieving private components by MEI public projects.

Recommendations and measures to consider:

- Proposals for new public sector MEI projects should include a focussed section discussing the existing "gap" in PSP in MEI, the content/status of the Bank's efforts on the subject including its track record with the same client or others in the same country, and a summary of related PSP activities by other actors, if any. Such a section in the project's approval documents should explicitly describe what specific proposals for PSP the Bank pressed with the client and what the outcome of these discussions was.
- Any proposal that may result in reduced PSP (that is displacement of active private operators) should identify this clearly in the project approval documentation and summarise the factors weighed by the team.
- PSP components in public projects should be covenanted (where legally feasible) in order to be counted as contributing to the project's assessed transition impact potential.

- Financing for bus fleet renewals of public transport companies should ordinarily require explicit commitment by municipal authorities to allow or expand PSP in the sector.
- Consider identifying a dedicated PSP Enabling Specialist within MEI to promote PSPs at both the project and strategy levels.
- Examine ways to intensify efforts to reduce institutional and legal obstacles to PSP in MEI, through either an expanded Legal Transition Team programme of work or through a dedicated TC focused on policy dialogue rather than producing a pipeline).
- Consider providing longer-term assistance to cities to monitor/regulate PPP contracts during the first years of a PPP's operation (complementary to the support currently provided for PSP/PPP tender/contract preparation) to help mitigate implementation risks associated with institutional capacity.
- Consider working with the public procurement agencies of several key countries to develop standard PPP procurement documentation and concession contracts.
- Consider working with the Office of the Chief Economist (OCE) to produce a short analysis of the status of transition gaps in the MEI sector in respect of PSP and identify possible Bank initiatives to more effectively reduce those gaps.
- Develop a system of annual reports to the Board on the implementation of all PSP-supporting activities, including policy dialogue, private projects and status of public projects with private components.
- OCE should consider a special EBRD Transition Impact Monitoring System (TIMS) retrospective, the purpose of which would be to provide a broad snapshot of the MEI PSP projects (including public with PSP components) implemented in the past, as well as the status of those under implementation.

1. Introduction

1.1 Scope

The MEI projects financed by the Bank support the provision of essential services to individuals, urban households and businesses. MEI covers subsectors such as water supply, waste water collection and treatment, urban transport services, district heating, solid waste and facilities management (parking, street lighting, social housing).

1.2 Objectives

This report has two objectives:

i) to analyse and present the evolution of the Bank's efforts between 2001-2012 (**Evaluation Period**) to promote and support PSP in the MEI sector in the context of its overall municipal operations, those of other International Financial Institutions (IFIs) active in the region and the overall market conditions. It aims at exploring how private sector content has changed in MEI operations over time and what drove these changes. It also explores how the MEI operations policies in force at the time encouraged the active promotion of PSP in the sector;

ii) to evaluate the MEI private operations, that is, to establish to what extent these operations (and public operations with PSP components) have been successful and to present issues and ideas which may be useful in the preparation of future MEI operations involving the private sector.

1.3 Evaluation approach

The evaluation approach applied in this study was based on the combination of sample private projects evaluations (listed in annex 2); analysis of private project evaluations completed by EvD in the past; desk review of documents (mainly TIMS reports) related to public projects with private components; and interviews with selected clients and the Bank's staff. The rating applied here follows OECD evaluation criteria of relevance, effectiveness, efficiency and sustainability (or transition impact). The six-point rating scale is consistent with the scale normally used by the Bank for project evaluations: (1) Excellent; (2) Good; (3) Satisfactory; (4) Marginal; (5) Unsatisfactory; and (6) Highly Unsatisfactory.

Details of the evaluation approach and rating criteria applied in this study are presented in annex 13.

1.4 Structure of this study

This study has five sections and thirteen annexes. The sections are as follows:

Section 2 analyses the evolution of MEI's approach to promoting PSP during three quadrennials (four-year periods) over 12 years, in the context of the Bank's operating policies and the wider market conditions.

Section 3 presents the evaluation of MEI-PSP projects.

Section 4 provides summary answers to key evaluation questions (set out in the approach paper for this study).

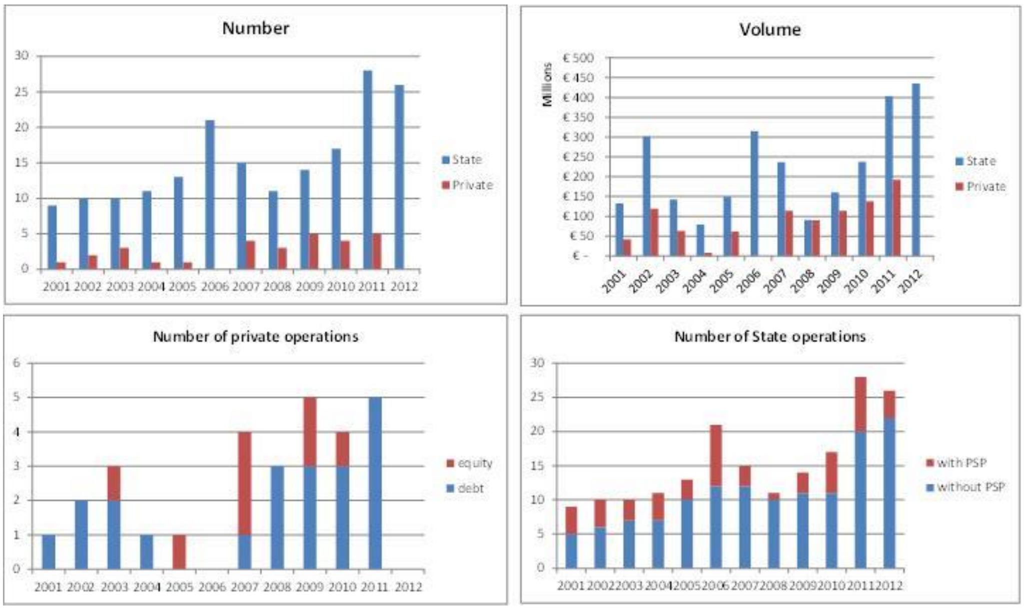
Section 5 identifies findings and recommendations. They stem from analysis performed in section 2 and the evaluations of the sample projects in annexes 6-10, where they are presented in more detail.

2. Evolution of the EBRD MEI group's approach to promoting PSP in the context of the sector operating policies and country strategies

2.1 Introduction

During the twelve years of the Evaluation Period the Bank signed a total of 214 MEI financing transactions (private and public) worth €3.7 billion. Of these transactions, 29 were private (13 per cent), amounting to €942 million (25 per cent). The remaining 185 financing transactions, worth €2.7 billion, were public sector (usually non-sovereign loans to municipalities or municipally-owned companies). 52 of public transactions (28 per cent) contained some PSP components (for example outsourcing of maintenance to private sector).

Figure 2.1: MEI financing transactions signed during 2001-2012 (by portfolio class)



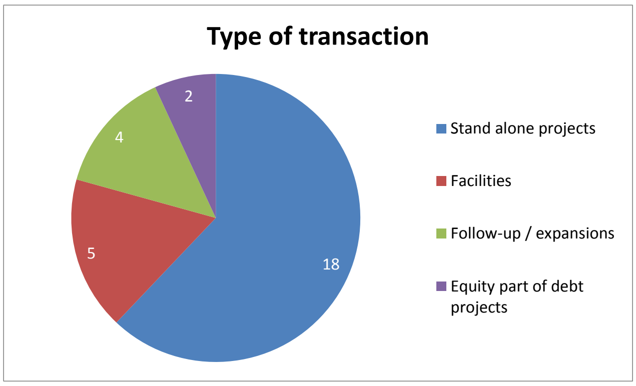
Box 2.1: Definitions of types of projects in respect of client's ownership, used by the Bank

State sector operations – are operations with clients that are national or local governments, their agencies, and enterprises owned or controlled by any of them. Such operations may either be "sovereign" (where the EBRD Member acts as borrower or guarantor and the Bank's Standard Terms and Conditions apply) or "non sovereign" (where the Member is not so involved and the STC do not apply).

Private sector operations - are all other operations.

However, the 29 private MEI project count becomes 27 when debt and equity transactions signed with the same client are counted as one project. The private projects count is further reduced to 23 if four expansions of existing projects (loan increases/capital increases for the same/similar investments extended to an existing client) are counted as one project. Using this approach, the number of MEI private projects signed during the Evaluation Period would have accounted for approximately 10 per cent of all MEI projects signed by the Bank.

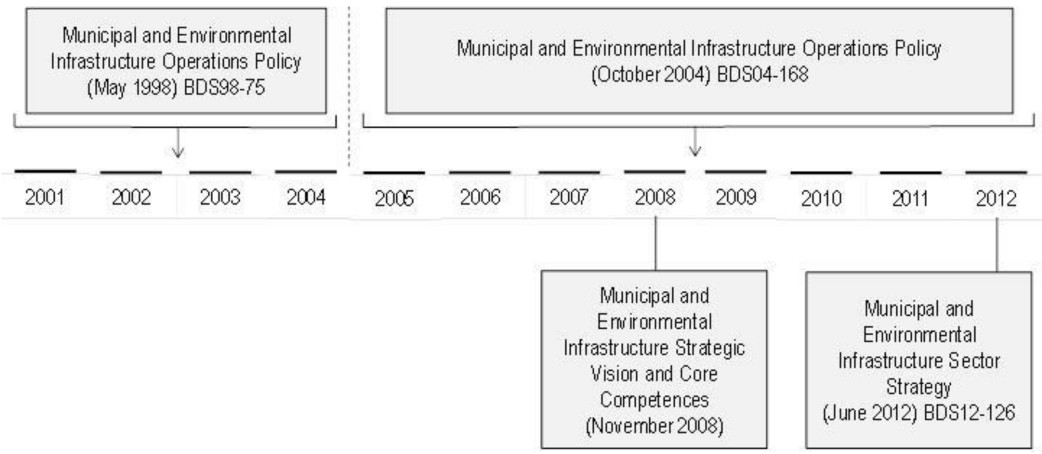
Figure 2.2: MEI private operations (2001-2012)



2.1.1 Sector policies

The 1998 MEI Operations Policy is the first reference point for this Study since it was the approved sector policy applicable during the first four years of the Evaluation Period. It identified the main operational objectives for the Bank in the MEI sector that have remained in place since (with some variations), namely, decentralisation, commercialisation, and environmental improvement. The 2004 Operations Policy, however, covers most of the Evaluation Period and applies to four of the five evaluation sample projects. It closes the Evaluation Period, as a new MEI Sector Strategy was approved in June 2012.

Figure 2.3: MEI Operational Policies and Sector Strategies relevant during 2001-2012



To analyse the evolution of the Bank's approach to PSP projects in the MEI sector, the 12 year Evaluation Period can be divided into three distinct quadrennials:

- **2001-2004** – first quadrennial, covered by the 1998 Operations Policy (applicable until a new MEI policy was approved on 20 October 2004),
- **2005-2008** – second quadrennial, covered by the 2004 Operations Policy, and
- **2009-2012** – third quadrennial, also covered by the 2004 Operations Policy (applicable until the new MEI Sector Strategy was approved on 26 June 2012)

Dividing the eight years covered by the same 2004 Operations Policy into two enabled the analysis of MEI activities during equal time periods. However there is also a clear qualitative and quantitative distinction between the private projects signed by MEI during these two periods, which warrants the division (see sections 2.3 and 2.4).

2.2 The 2001 to 2004 quadrennial

2.2.1 The 1998 MEI Operations Policy

The 1998 MEI Operations Policy (applicable until the end of 2004) set the "*promotion and optimisation of PSP*" in the MEI sector as the third priority among its five strategic objectives (see Box 2.2). The Policy made clear that the "*relative focus of MEI operations on the first three priorities will depend on the transition stage of a country, region or municipality where a project is considered*". The Policy stressed that in respect of PSP, the MEI "*will optimise such private involvement – making PSP not an end in itself but a critical element in the process of transition*".

Box 2.2: Priority objectives in 1998 MEI Operations Policy

- Decentralisation of municipal and environmental infrastructure provisions;
- Commercialisation and corporatisation of service provision;
- **Promotion and optimisation of private sector involvement;**
- Development of appropriate regulatory structure;
- Environmental improvement and energy efficiency.

This relatively cautious approach reflected MEI's early experiences with municipal private projects, when most countries of operations lacked a legal and regulatory basis for PSP in the municipal sector, and most cities lacked the institutional capacity to develop and effectively manage PSP projects. Affordability constraints for setting tariffs at a level which would provide the financial return required by private companies was one of the key limitations. Most importantly, many of these countries were not interested in remedying this situation (with or without the Bank's assistance), while their cities lacked the political will to undertake PSP projects.

Box 2.3: Bank's experience with PSP in MEI before 1998 MEI Operations Policy approval

In the mid-90s the Bank's approach to promoting PSP was mainly through close cooperation with the leading private municipal investors and operators, rather than particular cities, leaving it to those investors to find suitable projects, which could be financed by the Bank. To this end, the MEI signed a number of Multi Project Facilities (MPFs) with the leading private investors/operators such as General des Eaux (now Veolia), Suez Lyonnaise des Eaux (now Suez), FGG, or RWE. These MPFs were focused primarily on central Europe and were essentially lines of credit (or equity pools) ready for the clients to use if and when they found eligible sub-projects.

MPFs failed to meet expectations as the private investors/operators were unable to find viable projects. Some of the projects identified were too small, others did not comply with the Bank's procurement rules (for example, concessions were not obtained competitively). Nearly all of these MPFs were cancelled unused (except for the €3 million Heatco Project signed under FGG multi project facility in Slovakia).

When the 1998 Operation Policy was approved, just two of the MEI's 18 projects signed by that time were private (Heatco and an equity investment into the Environmental Investment Fund, for which suitable investments were also difficult to find). These private commitments accounted for just two per cent of MEI's volume signed by that time.

Despite identifying these limitations, the 1998 Policy clearly set the goal for the MEI to develop PSP projects, devoting seven out of the ten pages comprising the "*Sector objectives and investment priorities*" section to PSP development and the related subject of regulatory capacity development. It specifically promised to address legal, regulatory and capacity bottlenecks, that is,

> "The Bank will encourage national governments to go beyond the first and essential step establishing a sound legislative framework for concessions (and similar contract) and develop more comprehensive support services for municipalities – involving guidelines, model contract clauses, assistance in contracting…".

Finally, the 1998 Policy attempted to set a quantitative target for PSP: "*€140 million, or 55 per cent of the total portfolio by 2001*". Unfortunately, due to the project classification methodology (private/state) used by the Bank at the time, this target combined private and municipal (non-sovereign) projects.

2.2.2 PSP in the MEI sector in selected country strategies applicable from 2001 to 2004

The pursuit of PSP operations in municipal infrastructure projects was identified in the operational priorities of the country strategies relevant for this study related to evaluation sample projects, namely Croatia, Poland, Russian Federation and Turkey). References to PSP in MEI sector in country strategies applicable in the first quadrennial are summarised in Box 2.4.

Box 2.4: PSP in the MEI sector in the country strategies

Croatia country strategy of 2002:

Acknowledged that the PSP model à la Zagreb 'build operate transfer' was better for large municipalities, and that the Bank would have to use credit lines with local banks to promote PSP in small municipalities.

Poland country strategy of 2002:

The focus was on financing local governments to support their efforts to implement the environmental requirements associated with joining the EU and the *acquis communitaire*. This was to include support to off-budget financing and a limited number of private financing projects (for example water investments in Warsaw and Poznan). Overall, the Bank's stated priority was to try and support "selected" Polish municipalities in the development of PPPs and in privatising their utility companies.**Russian Federation country strategy of 2002:**

Acknowledged that the lack of adequate legal and regulatory framework for PSP and PPPs in the provision of public services was a key factor preventing such projects at the time. Thus, an important objective of the strategy was to improve the regional/local legal and regulatory framework, or the service agreements, between the city and its utilities with special regard to PSP in supplying municipal projects and operating municipal services. The strategy stated the Bank's intention to encourage greater PSP in municipal operations and financing, although it also admitted that greater private sector investment and risk-taking capacity would depend on a proven track record of reform implementation at the municipal level and in central/local fiscal relations.

2.2.3 Implementation of the 1998 MEI Operations Policy in respect of PSP from 2001 to 2004

The promotion of PSP was implemented by the MEI team on several levels. An experienced banker dedicated to PSP development was hired in 1998 and started preparing several stand-alone transactions in Poland, Slovenia and Bulgaria, and developed a large TC programme – Municipal Public-Private Partnership Programme (MP4), of which the main objective was to "create" a market for PSP transactions in the MEI sector (see Box 2.5).

Box 2.5: Municipal Public-Private Partnership Programme (MP4) TC

MP4 was a large, integrated PPP promotion programme implemented in two phases: 1998 - 2000 focused on Poland and 2004 - 2006 focused on Romania and Western Balkans. Funded with €1.3 million of EU-Phare and US Government grants, it had three objectives:

Dissemination of information on municipal PPP/PSP – education and information of municipal decision-makers about the different forms of PSP in the MEI sector and their benefits;

Legislative and regulatory improvement – identifying legal obstacles to PSP in the MEI sector and recommending legal and regulatory reforms;

Identification of bankable PPP demonstration projects – work with selected cities to produce sound project concepts, leading to the conclusions of deals.

To implement MP4, two multi-disciplinary consortia of consultants were selected. The "core activity" for the consultants was defined as the third goal listed above: development of bankable project concepts.

This approach seemed very efficient as it freed time for the regular MEI staff to work mainly on municipal finance projects (which were more likely to sign), while "outsourcing" time-consuming and uncertain PSP project generation and development to external consultants.

The result of these efforts was mixed. The MP4 consultants were indeed able to raise awareness of PSP in the MEI sector among the main municipalities in Poland, Romania and some other countries. They also identified legislative and regulatory gaps in these countries (working together with the Bank's Office of the General Counsel (OGC) and later with the Legal Transition Programme), contributing to the first PPP law being adopted in Poland in 2005. This law, although imperfect and later amended, paved the way for the first PPPs in Poland and can be treated as an important contribution by the Bank to the improvement of the PSP environment in the MEI sector.

However the result of the MP4 "core activity" – the identification of PSP projects leading to the conclusion of deals, was less successful. About 10-12 potential projects "leads" were identified in each country and two projects were developed conceptually. However, due to lack of commitment from the cities (possibly in part due to fear of negative political consequences related to PSP) none of the leads and only one of the concepts (Poznan Water Privatisation) was developed further, and failed in the end.

This negative experience hampered the use of TC funds by the MEI team to promote PSP in the following years. During 2001-2004, the MEI team managed seven TC assignments related to potential private projects for a total of €1.1 million (see Annex 4); however, only two of them (for a total of €469,000) have been linked to the projects ultimately financed by the Bank. The amount of TC managed by the MEI team allocated to private sector projects represented only four per cent of the total €26.7 million of TC funds used by the MEI team (excluding MP4) during this quadrennial.

Although the TC programme failed, as a result of the Bank's work with selected municipalities committed to the PSP, at the beginning of 2001 MEI already had a private portfolio of five projects in Hungary, the Czech Republic, Romania, Slovenia and Bulgaria – all in water/waste water sub-sector and all with major international operators.

However, during these early years, MEI also experienced some set-backs in its efforts to sign more PSP projects, notably in Poland, where the development of Poznan water privatisation and Warsaw WWTP 'build – operate – transfer' projects were ultimately abandoned due to these cities' decisions to finance them with EU grants rather than through PPPs.

More generally, the EU accession (even several years before it actually took place) spelled difficulties for PSP initiatives in MEI because large EU grants (€67 billion allocated for Poland alone) were to target mainly infrastructure development gaps. The most suitable for grant financing were projects expected to bring new members closer to compliance with EU environmental standards. Waste water treatment plants, sewer system developments, waste management or urban transport projects featured prominently as priorities to receive such grants. Ambiguity as to the eligibility of private projects to benefit from such grants co-financing convinced many cities to give up on plans involving private ownership or operations of their assets or services in favour of public options.

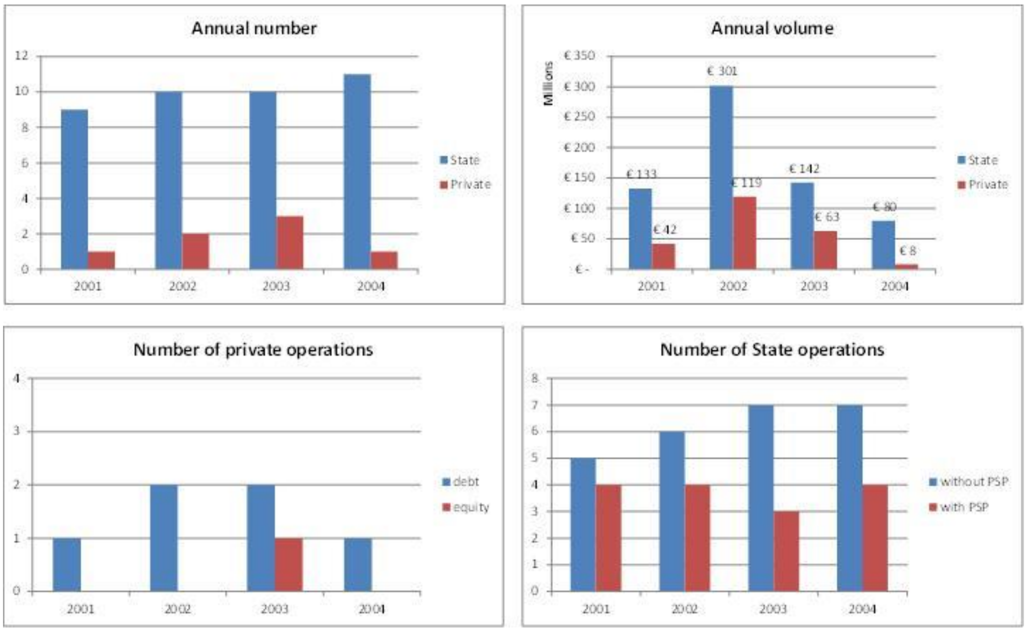
Nevertheless, encouraged by the completion of the first five PSP projects with selected, progressive cities, from 2001-2004 the MEI team focused on further cooperation with cities which expressed interest in PPPs, mainly in the water sector (Zagreb, Tallinn, St. Petersburg and Bucharest), as well as with several private investors. These efforts yielded seven PSP transactions signed during this quadrennial (summarised in table 2.1 below).

Table 2.1: Key features of MEI private projects (2001-2004)

Project name	Country	Year signed	Sub-sector	Amount (€ million)
Zagreb Waste Water Treatment Plant 'build operate transfer' project	Croatia	2001	Waste water	42.2 (debt)
Tallinn Water Privatisation Financing	Estonia	2002	Water and wastewater	55 (debt)
APA NOVA Water Treatment Plant	Romania	2002	Water	64 (debt)
St Petersburg South-West WWTP	Russia	2003	Wastewater	33.7 (debt)
MOL - Duna WWTP Outsourcing	Hungary	2003	Wastewater	12.3 (debt)
International Water United Utilities	Regional	2003	Water and wastewater	17.2 (equity)
EU/EBRD multi-finance facility (Risk sharing) - Dexia Slovensko	Slovak Republic	2004	Municipal services	8 (risk sharing guarantee)

The seven projects signed in 2001-2004 amounted to €235.5 million and accounted for 15 per cent of the total project number and 26 per cent of the total MEI project volume signed by the Bank during that period. Moreover the Bank signed 15 MEI public projects (37 per cent of total public projects concluded during this period) incorporating PSP components.

Figure 2.4: MEI Operations by portfolio class (2001 to 2004)



Most of these projects entailed the financing of PPPs through water or waste water concessions. Nearly all of them were innovative and ground-breaking, the "first" PPPs in the municipal sector in their respective countries and often the "first" of their type of financing provided by the Bank in the MEI sector.

Six of these projects have been evaluated previously, four rated as '*Successful*' overall and two as '*Highly Successful*'. However, from a longer perspective, not all of these projects went well. For instance, part of the Bank's investments under the International Water/United Utilities project (into Sofia Water company) did not perform well as the United Utilities and the city of Sofia embarked on a long and bitter legal dispute. This project itself was not ideal in terms of transition impact potential as the Bank essentially replaced one of the original private investors (International Water Ltd), which withdrew from the joint-venture with United Utilities. The selection of the private sponsor under the St Petersburg South-West WWTP project did not comply with the Bank's public procurement policy and required derogation (as it was awarded without a tender to a Swedish-Finnish consortium due to the provision of substantial capital grants from the Swedish and Finnish governments to co-finance the project). Moreover, its private component was limited to the construction and financing stages of the project (currently the WWTP is owned and operated by city-owned Vodokanal), so its "private" credentials could be seen as only temporary.

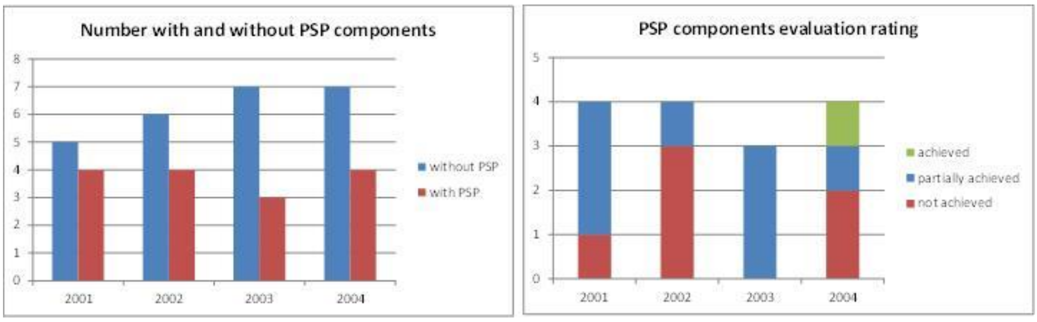
It should be also noted that although private content in MEI projects during the first three years of this quadrennial accounted for 30-40 percent of the team's total volume, it slipped to 10 percent in the last year, signalling an unfavourable trend. Nevertheless, the signing of seven new private projects, of which at least four can be seen as high profile and most of them as successful, was a notable MEI achievement. Critical to this success was relatively strong economic growth in central Europe but most importantly the progressive stance of selected cities, which understood the benefits of the PSP, and decided not to wait for EU grants to address their environmental issues. Another factor instrumental to this achievement was the role played by the experienced MEI banker, solely dedicated to the PSP projects.

2.2.4. Public projects with PSP components signed during the first quadrennial.

During this period the MEI started experimenting with "PSP components" in public sector projects, particularly in the urban transport sector, signing fifteen such projects (see table 2.2 in Annex 2). All of them were loans to cities or municipal companies, however they provided encouragement for the respective cities to engage (or consider engaging) private operators either to provide auxiliary services (including maintenance of buses, tram-stops, electronic ticketing) or to explore PSP in the operation of buses, tramway, and parking). Such encouragement was incorporated in the projects in a "soft" form, that is rarely covenanted as a firm obligation in the legal agreements with the city, and in those few cases where they were covenanted, they were expressed as a requirement to "explore" rather than "introduce" PSP. This ensured that such provisions remained uncontroversial and did not delay the signing of the financing agreements. However, the lack of a clear obligation resulted in a relatively poor rate of compliance.

Based on the analysis of TIMS reports for the public projects signed during that period, it can be concluded that out of 15 public sector projects containing PSP component targets, they were achieved in one project, partly achieved in eight, and not achieved in six (see table 2.2 in Annex 2).

Figure 2.5: MEI State projects with PSP components (2001 to 2004)



Two public projects with PSP components signed during this quadrennial were reviewed in more detail and the observations related to this review are summarised in the box 2.6 below.

Box 2.6: Analysis of sample public projects with PSP components

Belgrade Municipal Infrastructure Reconstruction Programme, signed in 2001 to finance Belgrade's urban transport, water and district heating companies. The project's transition impact benchmark under each sub-sector called for the "introduction of PSP" by the city. The PSP was not introduced in water and district heating, however 20 per cent of bus services are currently contracted out to the private sector. The city claims that it used to contract out about a quarter of its bus services (mainly in the suburbs) to private operators even before the project. Nevertheless, the project introduced more rigorous competition and contracting, and prompted tariff reform.

Gdansk Urban Transport Project, signed in 2001 to finance renewal of Gdansk's bus fleet and extend its tramway network. The transition impact benchmarks related to the "introduction of private bus operators" and "PSP in auxiliary services". The first objective was not fulfilled as the municipally-owned transport company is still the only provider of bus services in the city. However, the second objective was achieved as the municipal transport company outsourced ticket sales and enforcement, marketing, and the maintenance of vehicles, rolling stock, bus/tram-stop and tracks to private companies.

Although the success of both projects as vehicles to promote PSP can be seen as only partial, both projects supported a number of reforms which could enable PSP in the future. These included: creation of regulatory bodies, removeal of subsidies and rationalisation of ticket prices, introduction of coherent public service contracts and to some degree and introduction of competition for such contracts among operators.

2.2.4. Market context for MEI PSP from 2001 to 2004 and final conclusions

The proliferation of the private sector in the provision of water and waste water services (MEI's main sub-sector focus) was estimated in 2004 to be as follows:

Table 2.2: Percentage of privately owned or operated water/waste water services in 2004

Region	Percentage
North America	42
Western Europe	21
Latin America	16
Central and Eastern Europe	4

PSP in the global water supply and waste water sector increased during the 1990s, peaking in 1997, however the market for PSPs deteriorated during 2001-2004. There were various reasons for this slowdown, including several high-profile setbacks experienced globally by water/waste water PPPs (for example in Bangkok, Buenos Aires, Jakarta, Manila), which resulted in negative demonstration effect.

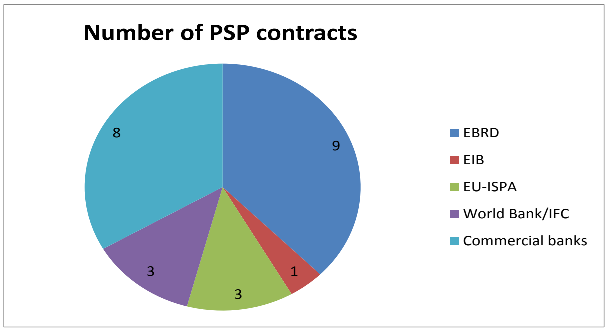
In the Bank's countries of operations, PSP in the water sector was embraced on a larger scale only in the Czech Republic, at the beginning of the 90s, when the Bank was not yet involved in this sector. In the rest of the region the market for municipal PSPs was difficult due to the impediments mentioned before (including legislative, regulatory, institutional capacity, affordability, historical and EU grants).

Moreover, during this period many of the leading private water and waste water private companies underwent consolidation and restructuring, which often entailed a reduction of their activities and assets in the emerging markets (including in central and eastern Europe).

According to available information, from 2001 to 2004 there were 23 bankable[1] PPPs completed in the water sector in the Bank's countries of operations. Of these, nine were co-financed by the EBRD (40 percent). Moreover, three of the PPPs where the EBRD was not involved were financed primarily by EU-ISPA grants (a type of financing the Bank cannot compete with). So, if these projects are also excluded, it can be concluded that the Bank participated in approximately half of all bankable water and waste water PPPs in its countries of operations which achieved financial closing from 2001 to 2004.

Regarding other IFIs, the World Bank/ International Finance Corporation (IFC) was present in three PPP water transactions (Yerevan, Armenia; Bielsko-Biala, Poland and Bucharest, Romania).

Figure 2.6: MEI PSP contracts in EBRD region by IFI (2004)



Another IFI involved in financing such projects was the European Investment Bank (EIB), which financed a water PPP in Prague. Moreover, EIB and the Nordic Investment Bank (NIB) co-financed the St Petersburg South-West Waste Water Treatment Plant with the EBRD. In addition, there were examples of other PSP contracts such as Build – Operate - Transfer and management and lease financed by sponsors or commercial banks, mainly in smaller municipalities. See figure 2.6.

In summary, during the first quadrennial the Bank doubled the number of private projects in its MEI portfolio from seven at the beginning of 2001 to 14 in 2004, increasing the value of the private projects category to 26 per cent of its total portfolio (December 2004).

The Bank participated in approximately half of all bankable PSP projects in the water and waste water sector, which achieved financial closing in the Bank's countries of operations during this period. It also cooperated with other IFIs, joining forces with them in respect of two projects.

PSP components have been introduced to 37 per cent of MEI's public projects, however the results of "soft promotion" of PSP (without covenanting the obligations to introduce PSP) were disappointing as only about half of such components were achieved or partly achieved.

Policy dialogue was conducted mainly on a municipal level and often included building awareness of opportunities related to PSP, however in one case (Poland) the Bank's involvement contributed to the preparation and enactment of the new PPP law.

[1] There were several other management and lease contracts in smaller municipalities across the region, however such contracts usually do not require substantial financing from external sources therefore are not counted here.

2.3 The 2005 to 2008 quadrennial

2.3.1 The 2004 MEI Operations Policy

The 2004 MEI Policy was approved in October 2004 and was designed to reflect the changing municipal services market in the Bank's countries of operations and to provide a better focus for the Bank to respond to these changes. Its priorities are summarised in Box 2.7.

Box 2.7: "Strategic trends for the Bank in the MEI sector " – 2004 MEI Operations Policy:

- Extend the use of standard products to early transition countries and Intermediate transition countries;
- Promote commercialisation and efficiency of municipal service companies (whether **private** or publicly owned;
- Develop and extend use of existing products to address the needs of smaller municipalities;
- Address the institutional development needs of clients through effective use of TC grants and address affordability constraints by use of grants to co-finance investments;
- Increase access of municipal companies to capital;
- Employ proven transaction structures to expand into selected new sectors where municipal services are provided at a local level;
- Improve levels of disbursement.

Areas of the Bank's focus in the MEI sector:

- Decentralisation;
- Commercialisation;
- Environmental Improvement.

The 2004 policy clearly de-emphasised the priority to be given to promoting PSP relative to the 1998 policy. However, it reflected the reality as the twilight of the previous period was characterised on the one hand, by the effect of several high profile water PPP failures in developing countries (often sponsored by IFIs), and on the other the consolidation and restructuring of private water companies. In effect, it was clear that already, the challenging market for the PSP projects in the MEI sector in the Bank's countries of operation would become even more difficult.

The 2004 Operations Policy also provided an analysis of each municipal sub-sector's outlook and set clear operational objectives for each of them. Although commercialisation and corporatisation of municipal companies featured prominently there, the goals for all sub-sectors also included "*support for PSP*". The analysis of the transition challenges also referred to the "*encouragement*" or "*introduction of PSP whenever possible*". To reconfirm the Bank's expertise in municipal PPP financing, the 2004 Policy contained an annex titled "Private Sector Participation", with detailed information about PPP market trends, principally in water and wastewater, and the Bank's experience with PSP.

Moreover, during that time the MEI team's prospects of diversifying its activities and expanding its PSP portfolio were boosted by a transfer of primary responsibility for district heating projects (sub-sector relatively susceptible to PSP) from the EBRD Energy Efficiency team to the MEI team. In this process ten private district heating projects amounting to €114 million (all of them with Dalkia) were transferred to the MEI team.

2.3.2 PSP in the MEI sector in selected country strategies applicable from 2005 to 2008

Although the 2004 MEI Operations Policy de-emphasised the Bank's role in promoting PSP, this was not reflected in the country strategies as many of them claimed that promotion of PSP options remained the Bank's operational priority in the MEI sector (see Box 2.8 below and Annex 11 for the analysis of a sample of nine country strategies – the largest country-clients of the Bank).

Box 2.8: PSP in the MEI sector in the country strategies

Croatia Country Strategy of 2005

Indicated the Bank's intention to seek PSP opportunities in municipal services where feasible, and showed where it contributed to greater operational efficiencies and financial sustainability through user pay principles, including through off-budget and off-balance sheet financing. Crucially, the strategy also indicated the need to consider financial structures that blended EU investment grants with PSP.

Croatia Country Strategy of 2007

While acknowledging the government's willingness to use PPP structures across a wide range of municipal services (including schools and hospitals), and the Bank's active policy dialogue engagement with the country's PPP agency, the Bank's stated intention was to concentrate on the preparation of projects with cities eligible for co-financing with EU ISPA funds, making the use of EU investment grants a key ingredient of potential PSP models.

Poland Country Strategy of 2004

The Bank identified its support to government efforts to develop PPPs in municipal sectors as a strategic objective, using policy dialogue and developing structures which blended private finance with EU grants. This was in the context of intensive policy dialogue discussions with the Ministry of Infrastructure, when the Bank initiated a programme of support for PPPs at central government level, contributing to the preparation of a new PPP law and the establishment of a PPP Task Force.

Box 2.8 continued: PSP in the MEI sector in the country strategies

Russian Federation Country Strategy of 2004

As did the previous country strategy, it acknowledged the lack of an adequate legal and regulatory framework for PSP and PPPs. However, it included participating in the privatisation of municipally-owned service companies through the active use of equity-based instruments and expanding the scope of projects from water and solid waste transactions to district heating, urban transport and housing. The facilitation of local currency financing was another strategic objective to facilitate PSP in municipal projects.

Russian Federation Country Strategy of 2006

Echoed priorities set in the previous strategy, stressing that the emergence of private Russian companies dedicated to infrastructure investment and operations, and a growing foreign investor interest, provided an opportunity for the Bank to support PPPs in municipal infrastructure in partnership with private operators.

2.3.3 Implementation of the 2004 Policy in respect of PSP from 2005 to 2008

At the beginning of this period the MEI team suffered the departure of an experienced banker dedicated to PSP development and filling this position took some time. In addition, the Bank did not fill the position of a departing Director for Strategy and Policy in the Infrastructure Department with responsibility to implement a Bank-wide PPP Action Plan, working with both the Transport and MEI teams.

From 2005 to 2008, the MEI team launched five technical cooperation assignments related to private projects for a total of €745,000 (see Annex 4); however, only three (for a total of €396,000) related to projects that were already signed or subsequently signed. The MEI team implemented the second phase of MP4 programme, funded with a €280,000 grant; however it did not yield any bankable projects, which was seen as its core objective.

The amount of technical cooperation grants managed by the MEI team allocated to private sector projects (excluding MP4) represented only two per cent of the €36.6 million in technical cooperation grants for MEI activities mobilised during this quadrennial and indicated a 36 per cent decrease in the use of technical assistance for PSP projects compared to the first quadrennial.

As in 2004 five advanced transition countries in central and eastern Europe joined the European Union and could now access substantial grant funds for MEI sector investments, both the team and the Bank redirected their activities towards Russia, other commonwealth independent states, and the western Balkans. This posed a serious challenge for the promotion of PSP in the MEI sector as Russia and most commonwealth independent states lacked at that time adequate legal framework for PPPs and had public procurement laws incompatible with the Bank's procurement policies, while affordability constraints in these countries made it impossible to introduce the steep tariff increases required to make private operations profitable. Moreover, the appetite of international infrastructure operators to make investments in Russia was limited to only Moscow and St. Petersburg.

The approach adopted by the Bank was to work closely with the Russian local private operators, primarily with Rosvodokanal and Russian Communal Systems (RKS), with the aim of improving their corporate governance, with selected Russian cities and with the government (see section 2.3.4) to improve the transparency of the tendering process for PPP contracts. In effect two projects, one with each of these companies, were signed during this period. In both cases the MEI team had to ask for derogation from the Bank's policy on Financing of Private Parties to Concessions to get them approved, although in the case of Rosvodokanal, the project ultimately achieved good transition impact.

The opening of the district heating market to the MEI team yielded four private projects with two local companies (one Russian and one Lithuanian). The Bank provided debt and equity to both clients (in effect recording four private financing transactions). Also in these cases, derogation from the policy on Financing Private Parties to Concessions was sought. Moreover, during the second quadrennial the MEI team signed two high profile equity investments into local special purpose vehicles sponsored by a leading international company, Veolia (Veolia Transport Central Europe, and Veolia Voda).

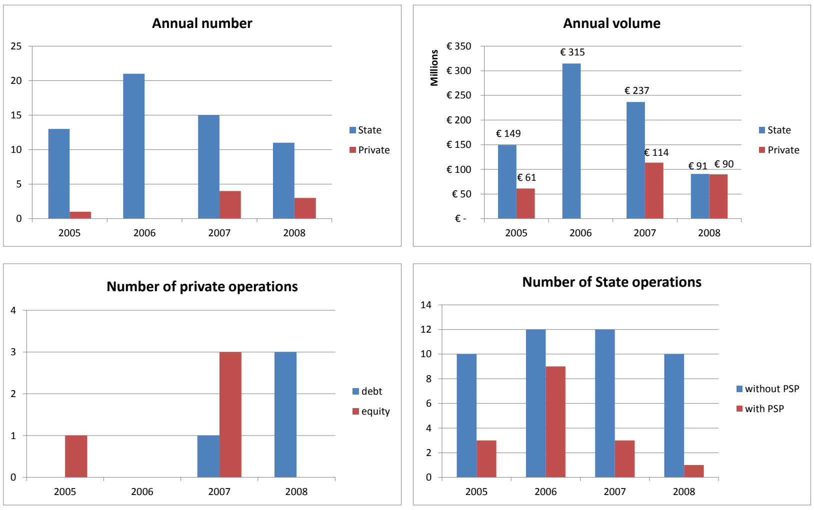
The eight PSP-MEI transactions signed during this period (if Taganrog and E Energija debt and equity parts are counted separately) are presented in table 2.3 below. [2]

Table 2.3: Key features of MEI private projects signed from 2005 to 2008

Project name	Country	Year signed	Sub-sector	Amount (€ million)
Veolia Transport Central Europe	Regional	2005	Urban transport	61.2 (equity)
E Energija District Heating	Regional	2007	District heating	5.0 (equity)
	Regional	2007	District heating	11.0 (debt)
Véolia Voda Equity Investment	Regional	2007	Water and wastewater	93.9 (equity)
Taganrog Teploenergo	Russia	2007	District heating	3.7 (equity)
	Russia	2008	District heating	5.5 (debt)
Rosvodokanal	Russia	2008	Water and wastewater	37.2 (debt)
Russian Communal Systems	Russia	2008	Municipal services	47.2 (debt)

The eight transactions amounted to €265 million and accounted for 12 per cent of the total MEI project number and 25 per cent of the total MEI business volume signed during the 2005 to 2008 quadrennial. This signalled a slight decrease from 15 and 26 percent respectively recorded in the previous quadrennial. Moreover the Bank signed 16 MEI state sector projects with PSP components (27 per cent of all state sector projects).

Figure 2.7: MEI Operations by portfolio class (2005-2008)



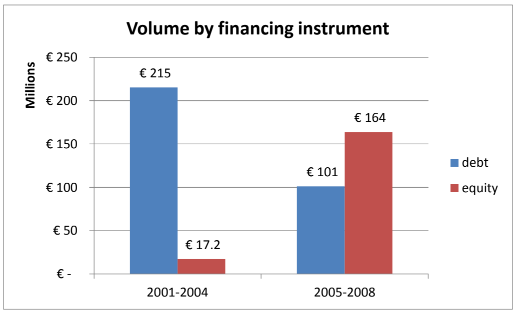
[2] In 2008 MEI also signed a refinancing project for Sofia Water System Concession (a project originally signed in 2000). However as the refinancing of an existing loan, this project has been omitted from the list of new projects.

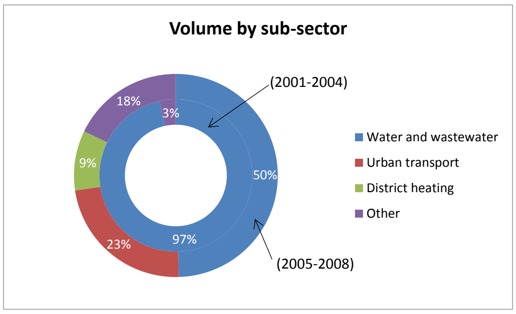
Although a similar number of projects were signed in the first and the second quadrennials, there are important differences between the types of projects signed in both periods, as characterised in Box 2.9.

Box 2.9: Key characteristics of MEI PSP projects signed from 2005 to 2008

- **A large relative share of equity financing** - half in number and 62 per cent in volume, equity investments constituting a tenfold increase (€171.2 million versus €17.2 million) on the amount signed in the previous quadrennial.
- **Diversification of sub-sectors** - out of six projects, two were in district heating, two in water, one in urban transport and one was multi-sector, while projects signed in the previous period were predominantly water or waste water sector projects;
- **Geographical re-orientation** – five of the six projects targeted Russia and in some cases also Ukraine. Only Veolia Transport was focused on western Balkans and central Europe, while in the previous period these proportions were exactly opposite (only one project was signed in Russia, while the rest focused on central Europe).
- **A substantial share of financing provided for local companies** – four of the projects (and six of the transactions) were with local companies (three Russian and one Lithuanian) and only two benefited an international operator (Veolia).
- **A wholesale approach** – five of the six projects signed during this period aimed to provide financing to several, sometimes undefined, sub-projects, usually in secondary and tertiary cities. This was in contrast with the previous quadrennial where in five out of seven cases the Bank financed a single, defined project in a large municipality.

Figure 2.8: MEI Private operations (2001 to 2004) versus (2005 to 2008)





Five of the six projects (debt and equity with the same client treated as one project) signed in this period were evaluated by EvD (the exception was E Energija). Two were rated as *successful*, two as *partly successful* and one was not rated. The projects rated *successful* were Veolia Transport Central Europe and Taganrog as both achieved their principal operational and transition objectives, although the performance of the Bank's equity investments at the time of evaluation in both companies was disappointing (rated *satisfactory* for Veolia Transport and *marginal* for Taganrog). Veolia Voda and Russian Communal Systems projects were rated as *partly successful.* The former achieved its stated objectives only marginally (and only after the Bank's follow up project Veolia Voda Capital Increase, signed in 2009). Under Russian Communal Systems the Bank failed to convert its loan into equity, thus limiting its impact on corporate governance and environmental practices. Both projects (as well as the equity performance of the projects rated *satisfactory*) were victims of the global financial crisis unfolding at the end of this period.

The Rosvodokanal project (including its follow up) is one of the Evaluation Sample projects under this study and is described in more detail in Annex 8. The original EvD evaluation in 2009 (OPER No PE09-437) was not subject to a rating as it was a "mid-term" evaluation, conducted at an early stage of the project given the novel features of the transaction.

The due diligence carried out in the follow up transaction (Rosvodokanal II) in 2011 concluded that the first operation had achieved its transition impact targets throughout the rebalancing of its portfolio of contracts. Moreover, the company's efforts to develop new business using competitive procurement following the Bank's recommendations, has had positive demonstration effects across Russia.

2.3.4. *Policy dialogue and capacity building*

An important initiative started by MEI together with the Bank's Legal Transition Team from 2005 to 2008 quadrennial (which still continues) was policy dialogue with the Russian government on the development of competitive procedures for tendering municipal concessions, particularly in relation to asset leases. Legal advisors (GLN, Freshfields and Clifford Chance) were contracted under several Legal Transition Programme TC projects to address the inadequacy of Russian tendering and contracting practices in this sector. Moreover, as part of the overall development of the PPP legislation in Russia, the Bank commissioned Atkins Consulting to provide a "*Report on Best International Practices in PPP with Regards to Regional Policy Issues*". Furthermore, in the context of the Bank's attempts to promote the competitive tendering of municipal leases in Russia (i.e. regarding the issues raised by the Rosvodokanal and similar transactions) the Bank --via its Moscow RO and the Legal Transition Team—worked as a member of FAS Expert Council, established in 2007 to foster the competitive award of rights to assets owned by municipalities.

The objective of these activities was to prepare an amendment to the Concession Law in order to introduce concessions in the municipal sector instead of the current quasi concession arrangements based on long-term leases. Through the Legal Transition Team and its consultants the Bank did intensive work with the Ministry of Economic Development and the Federal Antimonopoly Service and relevant Duma bodies.

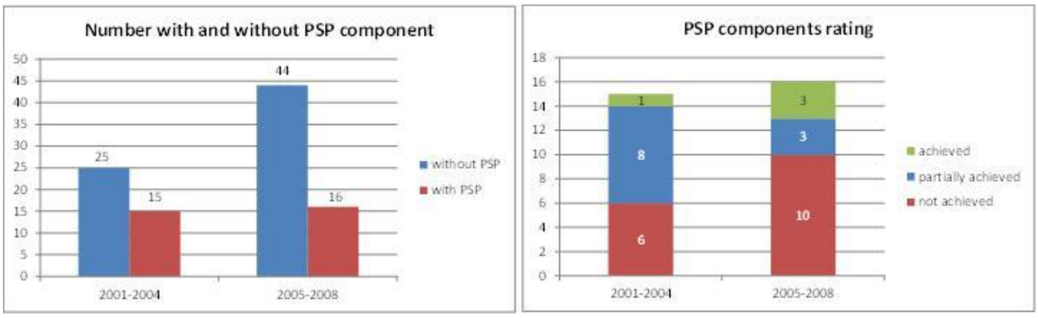
As a result of this work the amendments to the Concession Law were signed into law in May 2013 and are expected to be enacted on 1 January 2014. This is a clear success, although it took a very long time to achieve. Nevertheless work continues, with a new phase due to start at the end of 2013, as secondary legislation needs to be developed and enacted for the law to function well.

Moreover, the MEI team used its own staff to spread the knowledge of PPP practices and benefits at conferences in Moscow and St. Petersburg. This work was part of a concerted Bank effort which included several teams, namely, Russia, MEI, Transport, the Office of the Chief Economist, the Legal Transition Team (Office of the General Council) and Power and Energy, all of which held a stake in the promotion of PPPs and private sector involvement in infrastructure in Russia. In particular, the MEI team was involved in several institutional capacity building outputs intended to promote good practice in the procurement of public works involving the private sector. These outputs included, for example, the development of a template for holding tenders (with Clifford Chance); an analysis of the methods to set the initial regulatory asset value for the regulation of district heating system in Russia; and the review of the key principles for establishment of well-balanced long term contractual relations in the municipal sector (with the Urban Institute in Moscow).

2.3.5. *Public projects with PSP components signed from 2005 to 2008*

During this period the MEI team slightly increased the number of public projects with PSP components, signing 16 of them, out of a total of 60 public projects. This indicates that the number of projects signed decreased to 27 per cent from 37 per cent signed during the previous quadrennial. Based on TIMS review analysis, only 19 per cent of the PSP components could be treated as '*achieved'*, while another 19 per cent were '*partly achieved'* and 62 per cent are '*not achieved'* (see figure 2.8 and table 2.3 in Annex 2). This showed a deteriorating trend from a percentage of 40 per cent of PSP components '*not achieved'* in the first quadrennial.

Figure 2.9: MEI State projects with PSP components (2001 to 2004) versus (2005 to 2008)



2.3.6. Market context for MEI PSP from 2005 to 2008 and final conclusions

According to the World Bank's Private Participation in Infrastructure database[3] there were 12 new PPPs in eastern Europe and Central Asia region in the water and waste water sector signed during 2005 to 2008, which indicated approximately a quarter decrease from the first quadrennial. The reasons for this decrease have been discussed in previous sections and ranged from the accession of central European countries to the EU, inadequate PPP legal frameworks elsewhere, to the emerging global financial crisis and limited appetite of international investors to expand in the region.

Out of 12 PSPs signed in this quadrennial five were co-financed by the EBRD and the IFC (all of them Rosvodokanal's investments in Russia's secondary cities). The remaining transactions were mainly sponsored by local Russian operators and not financed by any IFIs.

In conclusion, from 2005 to 2008 the Bank managed to maintain the absolute number of MEI private projects at a level similar to that in the previous quadrennial. However the share of private projects deteriorated from 15 percent to 12 percent. Moreover, many of these operations did not perform as well as those signed in the previous period, while three quarters of them required derogation from the Bank's policies to be even approved. MEI continued to promote PSP in some public projects; however the result of this effort continued to be disappointing (62 per cent of projects with such components failed to achieve them). However, no change was introduced to increase compliance rate as PSP components have continued being embedded in some public projects in form of recommendations, rather than obligations covenanted in legally binding agreements. On positive side, during this period the Bank initiated a policy dialogue programme to amend the Russian concession law. This work only yielded tangible results in 2013 and it still continues.

2.4 The 2009 to 2012 quadrennial

During this period the 2004 Policy still applied (see section 2.3.1 above).

2.4.1 Country strategies

Five new country strategies relevant to the case studies adopted in this review were approved between 2009 to 2012 and contained references to MEI-PSP projects summarised in Box 2.10.

[3] This database omits eight higher income COO, such as Bulgaria, Croatia, Estonia, Latvia, Hungary, Poland, Slovakia and Slovenia. However it is the only database providing any information on PPPs in one of the MEI's key subsectors (global data on PPPs district heating or urban transport are non-existent). Given that the Bank has not actively targeted higher income countries during two last quadrennials, information from the PPI Database is considered adequate to analyse the Bank's PPP water sector activities in the context of the regional market.

Box 2.10: PSP in the MEI sector in the country strategies

Croatia country strategy of 2010

It did not mention PSP as a specific objective in MEI operations. Instead it set financing of municipal projects as a priority, particularly those with EU pre-accession grants, meeting the EU's *acquis communautaire*. However, the strategy acknowledged progress in the legislative and regulatory framework for PSP with the approval in 2008 of the PPPs and Concessions Act, which represented an important new step in promoting PPPs in Croatia (however, it appears, without the Bank).

Poland country strategy of 2009

Reiterated the same theme as previous strategies where a stated priority was to support the PSP in cooperation with EU Structural and Cohesion Funds, "in particular PPPs in transport and MEI projects". At the time of preparing the strategy, the Bank claimed to have supported MEI-PSP via two regional equity investments - Veolia Voda and Aqualia (which actually failed to find any projects). The strategy recognised the country's limited experience with MEI-PSP.

Poland country strategy of 2010

It defined more explicitly the support of PSP in public services in cooperation with the EIB and EU Structural and Cohesion Funds as a top priority of the Bank. In particular, the intention was to support privatisations and PPPs in transport and MEI projects to stimulate the development of revenue-backed financing.

Russia country strategy of 2009

Contained a generic definition of the strategic direction where the Bank would continue to provide investment in the MEI sectors using concession mechanisms and PPPs structures, and working with private companies. However, the strategy also acknowledged that financing PPPs s in municipal services presented a major challenge in the crisis environment, with innovative financing solutions required to channel know-how and finance to the sector. The strategy identified as a priority the development of the nascent PPPs market by supporting both granting authorities and private parties.

Turkey country strategy of 2009

Identified Bank support to the entry of private operators as a priority in the MEI sector, particularly into the water, wastewater sectors and solid waste sectors. However, it also acknowledged the difficult business environment for PSP, given the mixed success until then, and that few PSP projects were being implemented. It also highlighted considerable uncertainties as to terms, and strong and unilateral governmental termination rights as sub-optimal for PSP. Urban transport was singled out as a sector where it was necessary to enhance the efficiency of private sector operators.

2.4.2 Implementation of the 2004 Policy in respect of PSP from 2009 to2012

During this last quadrennial the approach to the allocation of MEI staff to work on PSP projects was different from that of previous periods. When the banker dedicated to PPPs departed in 2010, no replacement was hired but rather all MEI bankers were encouraged to identify and pursue private projects (in parallel to public projects). The opportunities for PPPs in the municipal sector were perceived to be at their lowest. The global financial crisis had dampened any appetite which might have still remained among international private operators for PPPs in the Bank's countries of operations, while the accession of Romania and Bulgaria to the EU in 2007 ensured that their cities joined the rest of those in central and eastern Europe concentrating their attention on the utilisation of EU grant funds available for infrastructure, rather than PPPs.

Between 2009 and 2012, the MEI team initiated four TC assignments related to private projects for a total of €870,000 committed. Three of these TCs (for a total of €670,000) were related to Shymkent Waste Water Treatment Plant project, which was ultimately signed, while one TC (related to Kotor Cable Car PPP project preparation) has not started yet. This low number of TCs allocated to private sector projects likely reflected a high degree of caution given the previous very limited success. Nevertheless, it represented the lowest number of PSP-related TCs of all three quadrennials and only four per cent of the €21.2 million of TCs mobilised by MEI between 2009 and 2012.

The Bank's PSP promotion strategy the last quadrennial was characterised by a combination of geographical and sector diversification, expansion of or follow-up on existing projects, and targeting of smaller PSP projects. During this quadrennial the Bank signed 14 MEI-PSP transactions for €444.6 million; however four were largely increments to existing projects. Therefore a more correct number of new PSP projects signed in this period would be ten. This still indicates the highest number of projects signed during all three quadrennials analysed, as well as the highest amount (nearly double the PSP project amount signed in each of the two previous quadrennials).

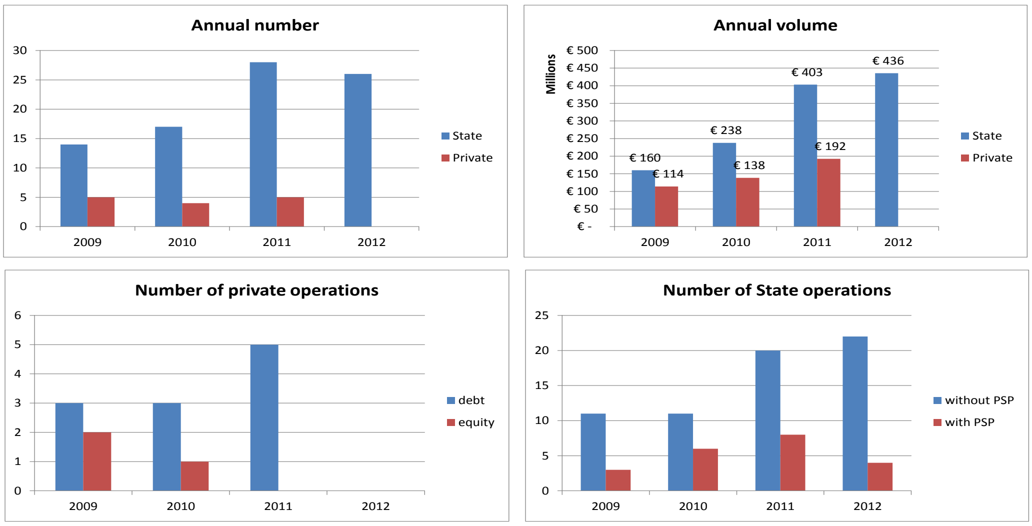
The share of private projects in MEI's total number of operations signed increased from 12 to 14 percent. However as average size of a private project shrank, while that of public projects increased, the share of private operations in the total volume of MEI portfolio remained virtually unchanged (26 percent compared to 25 percent in the previous quadrennial).

Table 2.4: Key features of MEI private projects (2009 to 2012)

(Projects which are expansions/follow ups on existing projects are highlighted in yellow)

Project name	Country	Year signed	Sub-sector	Amount (€ million)
Shymkent Vodokanal	Kazakhstan	2009	Water and wastewater	6.1 (debt)
Shymkent WWT Essential Modernisation	Kazakhstan	2010	Water and wastewater	13.6 (debt)
Aqualia Investment Venture	Regional	2009	Water and wastewater	30 (equity)
Hebros Bus Urban Transport	Bulgaria	2009	Urban transport	5.9 (debt)
DLF Sorbon Public Transport	Tajikistan	2009	Urban transport	1.9 (debt)
Veolia Voda Capital Increase	Regional	2009	Water and wastewater	70 (equity)
Taganrog Teploenergo II	Russia	2010	District heating	8.7 (debt)
TASK Water Venture – (Dilovasi + Gulluk Debt)	Turkey	2010	Water and wastewater	13.5 (debt)
	Turkey	2010	Water and wastewater	2.5 (debt)
Dalkia Baltica/Russia Equity Financing	Regional	2010	District heating	100 (equity)
CAEPCO District Heating – (Pavlodar + Petropavlovsk)	Kazakhstan	2011	District heating	15.1 (debt)
	Kazakhstan	2011	District heating	7.3 (debt)
Wroclaw Parking PPP	Poland	2011	Urban transport	7.7 (debt)
Energobit Esco	Romania	2011	Municipal services	10 (debt)
Istanbul Ferries Privatisation	Turkey	2011	Urban transport	115.1 (debt)
Rosvodokanal II	Russia	2011	Water and wastewater	37.3 (debt)

Figure 2.10: MEI Operations by portfolio class (2009 to 2012)



Box 2.11: Key characteristics of MEI-PSP portfolio signed between 2009 and 2012

Doubling of the absolute number of private projects and increased share of the number of private projects in the total MEI operations, with the volume remaining constant - the absolute number of private projects was double that from the two previous periods. However the increase in such projects relative to the MEI's total operations was not as dramatic, that is, it grew from 12 to 14 percent. The volume of private projects remained virtually unchanged (accounting for 26 percent as compared to 25 percent in the previous period).

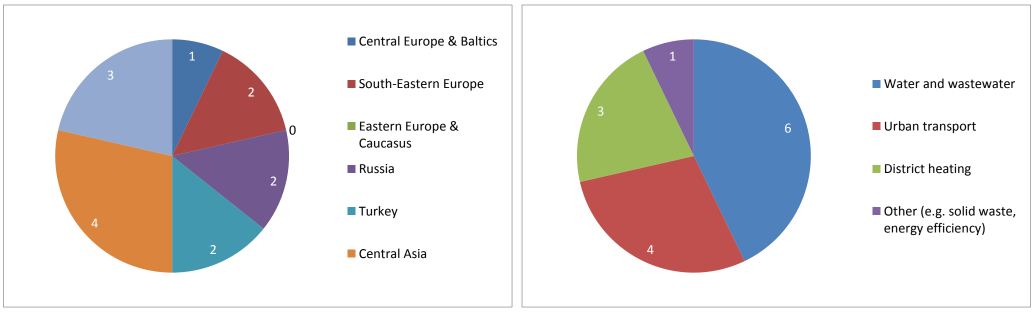
A lower average size of most projects – if three large projects are excluded (Veolia Capital Increase, Dalkia Baltica and Istanbul Ferries), the average size of the remaining 11 projects comes to €14.5 million, which is about half of the average size of private projects signed by MEI in the two previous quadrennials;

Reduced share of the number of public projects with private components in the total public operations – although the absolute number of public projects with private components increased substantially (from 16 to 21), due to the fast growth of MEI's public sector portfolio, the share of such projects actually decreased from 27 to 23 percent. This signalled a continued trend of a relative drop in the number of public projects with private components as compared to all public projects (from the high of 37 percent in the first quadrennial).

The expansion of existing projects – during this period MEI signed four follow-up projects with existing clients, in most cases expanding on the originally signed projects. This was an efficient approach as it boosted MEI's PSP portfolio, while the development of such projects required less effort and resources;

Geographical and sectorial diversification – MEI moved beyond Russia in this period, signing its first two private projects in Kazakhstan. The Bank also succeeded, for the first time, in signing a PSP project in an early transition country (Tajikistan) and in Turkey (two projects). After a long absence, more advanced countries featured again among PSP MEI projects (Poland, Bulgaria and Romania). In addition to district heating, urban transport and water/waste water projects, MEI's PSP projects covered new sub-sectors such as parking and ferry services.

Figure 2.11: MEI Private operations by country group and sub-sector (2009 to 2012)



Since 2009 to 2012 is the most recent quadrennial, only three transactions (21 per cent) from this period were evaluated – Shymkent Vodokanal, Veolia Voda Capital Increase (together with the original project) and CAEPCO – under an OPAV (covering both locations of this project). One was rated '*successful*' (Shymkent), while Veolia Voda and CAEPCO were rated '*partly successful*'. Under Veolia Voda the sponsor was only able to partly achieve the stated objectives (and only after a capital increase), while the mid-term review of the CAEPCO project indicates that the financial performance of the two district heating companies involved, gives the Bank (as a shareholder) cause for concern.

Four transactions signed during this period were evaluation sample projects. Their reviews are contained in Annexes 8 to 10. Overall, one of them (Aqualia) has been '*unsuccessful*' so far, one project (TASK) was rated as '*partly successful*', while two projects (Rosvodokanal II and Wroclaw Parking) were assessed as '*successful*'. Following a review of project documentation and interviews with the team it is also clear that some other projects signed during this period did not perform as planned. Taganrog Teploenergo II (2010) and Energobit Esco (2011) have not started disbursing yet.

2.4.3. Public projects with PSP components

During this period MEI increased the number of public projects with PSP components to 21 (from 16 in the second quadrennial) out of a total of 85 public projects signed in this period (or 24 per cent). This signals a somewhat steady decrease in the share of public projects with PSP components from 37 per cent in 2001-2004 and 27 per cent in 2005 to 2008. There is not enough evidence from the TIMS reviews to assess the performance of PSP components in MEI public projects for this recent period; however as for now most of these projects' PSP benchmarks remain unachieved.

2.4.4. *Market context for MEI PSP in 2009 to 2012 and final conclusions*

The overall PPP water and wastewater sub-sector (the only MEI sector for which global data is available) attracted only two projects amounting to a US$133 million investment in the Bank's lower income countries of operations between 2009 and 2012[4].The lack of data for the advanced transition countries is not material as there is clear evidence that these countries continued to be preoccupied during this period with the utilisation of EU grants for financing water and waste water infrastructure. The Bank participated in both water/waste water projects – Shymkent in Kazakhstan and Rosvodokanal II in Russia. In fact the Bank financed two more water/waste water projects in the countries covered by the World Bank's Private Participation in Infrastructure database – Aqualia and TASK, however the former was a framework which has not yielded any specific projects yet, while the latter refinanced earlier investments related to concessions granted before 2009 and was therefore excluded from the database.

According to European PPP Expertise Centre Market Update, 2012 the European PPP market recorded its lowest volume and number of transactions for decades. In particular, the number of large projects dropped significantly compared to earlier years. In the environmental sector there were only four transactions, all in waste management and all in the UK. According to the Public Private Investment Advisory Facility, in 2012 all infrastructure PSP investment in the Europe and Central Asia (ECA) region declined by 48 per cent to US$22.5 billion, the largest decrease of any region in the world. ECA comprised 12 per cent of global private infrastructure investment with 60 new projects but only two of them were water and waste water sector.

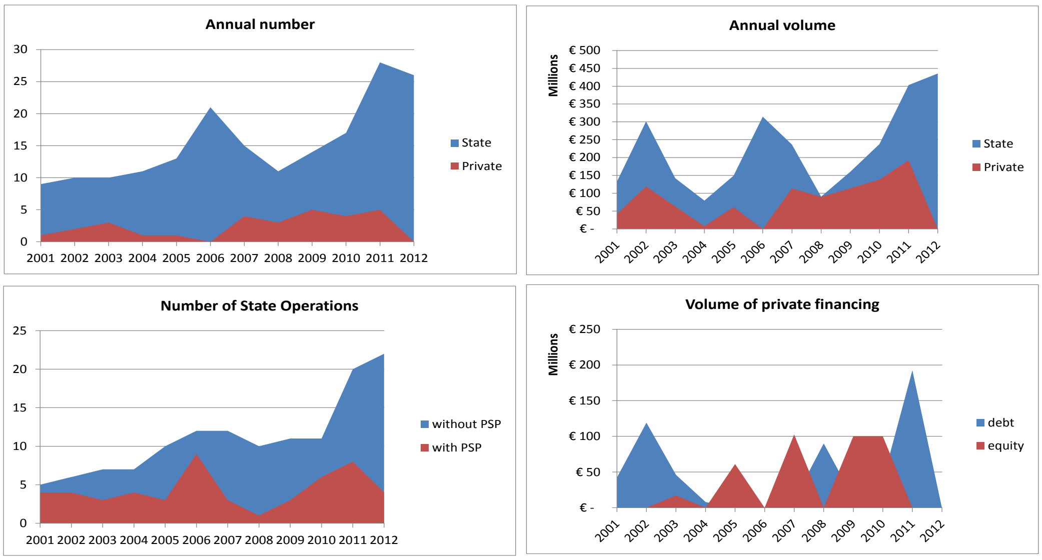
In conclusion, during the last quadrennial the Bank was able to sign a relatively high number of projects (double that of previous quadrennials), including some in new countries and in new sub-sectors. MEI continued to promote PSP components in its public projects; however the result of this effort remained disappointing (although most of the PSP benchmarks are not yet due). The quality of projects signed during this period was mixed as several have yet to start disbursement; one is in corporate recovery, while suitable investments have yet to be found for framework projects (TASK and Aqualia). Perhaps the most significant development in this period to which the Bank contributed was the signing into law of the amended Concession Law in Russia (concluded in early 2013), which contributed to an increase in Russia's position in the "PPP Readiness Index of 2013.

2.5 Evolution of MEI's approach to promoting PSP – summary analysis

During the 12 years of the Evaluation Period the Bank signed a total of 29 MEI private operations (13 per cent of the total portfolio), worth €942 million (25 per cent of the total volume). Although there were some differences in the approach and results during each of the three quadrennials, the share of PSP projects in the MEI team's total project volume remained relatively constant (accounting for 25-26 percent of total), while the relative number of private projects fluctuated, accounting for 15 percent of total in the first quadrennial, dropping to 12 in the second and increasing to 14 percent in the last period.

[4] Private Participation in Infrastructure Database, The World Bank Group (website) – higher income countries (Estonia, Latvia, Bulgaria, Poland, Hungary, Slovakia, Slovenia, Croatia) are excluded from this data.

Figure 2.12: PSP projects in the MEI portfolio (2001 to 2012)



The upper two graphs in figure 2.12 above illustrate the changing private content of the Bank's MEI portfolio over the Evaluation Period. They reflect the confident start, relative decline and subsequent revival of PSP business in the later years of the second quadrennial and a substantial increase of the number and volume of projects during the third quadrennial (with a slump in the last year). Eight private operations (27per cent) were equity projects amounting to €381 million (40 per cent of private volume).

The first quadrennial yielded seven high-profile stand-alone operations, primarily with international operators in the water and waste water sub-sector, mainly in more advanced countries. In the second quadrennial the Bank encountered a much more difficult market environment due to the EU accession of advanced countries, lack of an adequate PPP legal and institutional framework in the less advanced countries and the more cautious approach of international investors, further amplified by the financial crisis. During this period the MEI team moved firmly into Russia, signing four financial transactions there, although all of them required derogation from the Bank's policies on financing private parties to concessions. The MEI team also signed two important equity transactions with Veolia and established the district heating sub-sector as one of its main targets for PSP projects. In the last quadrennial the Bank doubled the number of projects (as compared with each of the previous periods), although four of them were expansions on existing projects. The Bank expanded its geographical reach, signing the first PSP projects in Turkey and the early transition country region, as well as tapped new sub-sectors such as parking and ferry services.

The MEI team also promoted PSP through the incorporation of private sector components into its public projects, primarily in the urban transport sub-sector. Of the 190 public operations, 52 of them (or 28 per cent) contained a PSP component. However as these components usually took the form of a recommendation rather than a covenanted requirement, about 52 per cent of them were not achieved, while 35 per cent were only partly achieved.

Approximately €3 million of TC funds have been utilised in relation to real or potential PSP projects in the MEI sector in the Evaluation Period. Only about half of TCs implemented during the Evaluation Period had links to private banking operations.

3. Evaluation of MEI PSP projects

3.1 Summary results of sample projects' evaluations

A detailed evaluation of the five MEI private projects in the Study sample can be found in Annexes 6 to 10. Table 3.1 provides an overall summary of the evaluation ratings assigned to each sample project.

Each project is rated on a three-point scale (either "+"; or "+/-"; or "-") against each of five indicators: (1) fit with Bank policies; (2) achievement of project objectives; (3) financial performance; (4) Bank handling; and (5) transition impact. The resulting ratings are justified and discussed in Annexes 6-10 for all of the Evaluation Sample projects.

The three-point scale used for rating individual project evaluation criteria corresponds to the six-point scale by identifying "+" with "Excellent" and "Good"; "+/-" with "Satisfactory" and "Marginal"; and "-" with "Unsatisfactory" and "Highly Unsatisfactory".

Please note that these ratings are time-specific, representing the judgement of the Evaluation Team at the time of carrying out the study, based on available evidence. Not all sample projects have had a full operation performance assessment done. The first evaluation in 2008 (of the Zagreb Waste Water Treatment Plant, for example, assigned a '*highly successful'* overall performance rating to this project based on the information available then. With new information and the evidence of five additional years of performance, the overall rating is now '*pPartly successful'*. Similarly, some active projects such as TASK Water Venture are today rated as '*partly successful'* but it can become overall a '*successful'* rated project if it overcomes the challenges it has encountered and reaches its objectives, including those related to transition impact.

Table 3.1: Summary sample project evaluation ratings

Name	Description	EBRD Indicators					Overall individual project assessment
		Fit with Bank policies	Fulfilment of project objectives	Financial perfor-mance	Bank handling	Transition impact	
Zagreb Waste Water Treatment Plant 'build operate transfer'	Construction of a wastewater treatment plant	+	+	+/-	+/-	+/-	*Partly successful*
Wroclaw Parking PPP	Creating underground parking facilities through PPP arrangement	+	+	not rated	+	+	*Successful*
Rosvodokanal - I	Upgrade water and waste water services in five Russian cities	+	+	+	+	+	*Successful*
Rosvodokanal - II	Second and third tranches to RVK of RUB 5 billion in total	+	+/-	+	+	+/-	*Successful*
TASK Water Venture	Financing of water and wastewater infrastructure investments	+	+/-	+/-	+/-	-	*Partly successful*
Aqualia Investment Venture	Investment vehicle to support Aqualia's expansion into EBRD's countries of operation	+	+/-	-	+/-	-	*Partly Successful*
Overall study sample assessment		*Excellent*	*Good*	*Satisfactory*	*Good*	*Satisfactory*	

Based on the assigned ratings, three of the six sample MEI private transactions are assessed as '*successful'* overall (Wroclaw Parking and Rosvodokanal I and II) and three as '*partly successfu'l* (Zagreb WWTP, TASK Water

Venture and Aqualia Investment Venture). However, the rating of the last project reflects its immediate potential (as according to recent information, Aqualia New Europe has just (early 2014) signed a purchase agreement for New Cairo Waste Water Treatment Plant), rather than any achievements to date. In aggregate, the Evaluation Sample projects are rated overall as '*partly successful'*. The following analysis provides a summary of the performance of the Study Sample projects along the key evaluation criteria.

3.2 Relevance

The relevance of Bank MEI operations with PSP is the extent to which they fit the policies and priorities of the Bank and the countries. In this evaluation it is taken to be the extent of the fit of MEI-PSP projects with Bank *stated* sector objectives in its operational policies and country strategies during the Evaluation Period.

The fit of MEI-PSP projects with Bank policy objectives is rated as *'excellent'* as all MEI-PSP Sample Projects had objectives well identified in the 1998 or 2004 MEI Operations Policies and relevant country strategies. Annex 11 provides a summary of the scope and key targets of the relevant MEI operational policies and strategies during the Study period, highlighting the specific treatment of private sector participation. As the summary in table 3.2 shows, all case study projects were highly consistent with the prevailing sector policies at the time (1998 or 2004) and relevant country strategies.

Table 3.2: Rating of case study projects for their fit with sector policies and country strategies objectives

Name	Summary	Evaluation rating
Zagreb Waste Water Treatment Plant 'build operate transfer' project	Project highly consistent with the Bank's prevailing 1998 MEI Operations Policy, which promoted facilitating and optimising PSP in the financing and provision of municipal services. Consistent with the 2000 strategy for Croatia, which promoted PSP in infrastructure	+
Wroclaw Parking PPP	Generic fit with the 2004 MEI Operations Policy, which encouraged PSP (where appropriate) in advanced transition countries. Specific fit with the same policy since it identified car parking as one of the areas to focus on. Consistent with the strategy for Poland 2010-13, supporting PSP in public services.	+
Rosvodokanal - I	Generic fit with 2004 MEI operations policy with its practical approach encouraging PSP in MEI sector in advanced transition countries and in Russia. RVK I identified well the possibility of supporting PSP and looked to fulfil conditions that would improve PSP potential in future. Broadly fitting with the 2006 strategy for Russia, which identified the emergence of private Russian companies dedicated to infrastructure operations as an opportunity for the Bank to support PPPs in MEI sector.	+
Rosvodokanal - II		+
TASK Water Venture	Project consistent with the Bank's MEI 2004 Operational Policy, which identifies working with private operators as a sector target. Consistent with 2009 strategy for Turkey, which states the Bank's intention to support a domestic private water operators to develop its business and expand PSP in the water and wastewater sector.	+
Aqualia Investment Venture	Project consistent with the Bank's MEI 2004 Operational Policy, which identifies working with private operators as a sector target.	+

3.3 Effectiveness

The effectiveness of Bank MEI-PSP operations is the extent to which they attain their stated objectives. The fulfilment of project objectives by MEI-PSP Case Study projects is rated as ***'good'***. Four of the projects have achieved or are expected to achieve their main objectives (Zagreb, Wroclaw, Rosvodokanal I and II). It is still uncertain whether the remaining two projects (TASK and Aqualia) will ultimately achieve their stated objectives.

The case study projects fulfilled their main project objectives to a varying degree. Table 3.3 provides a summary of the extent to which the project objectives have been achieved to date and the associated evaluation ratings based on that evidence.

Table 3.3: Rating of case study projects for the fulfilment of project objectives

Name	Summary of project objectives	Evaluation ratings
Zagreb Waste Water Treatment Plant 'build operate transfer' project	Construction of a wastewater treatment plant for the City of Zagreb on a 'build operate transfer' basis (with associated infrastructure) to enable compliance, in stages, with EU environmental standards. This objective has been largely achieved.	+
Wroclaw Parking PPP	Build and operate an underground parking facility through PPP arrangement. The underground parking opened for operations in July 2013. The project has fulfilled the objectives related to a PPP contract design and construction phase. It is too early to assess its operations, contract management and maintenance phases.	+
Rosvodokanal – I	Help RVK to (i) finance the modernisation of water and wastewater infrastructure in cities where the Company had obtained leasing contracts (e.g. Krasnodar, Kaluga, Tyumen, Orenburg, Barnaul, Tver, Omsk); and (ii) acquire water and wastewater operators in a number of cities in the Russia (including refinancing of investments under the investment programmes and acquisitions). *Largely achieved.*	+
Rosvodokanal - II	Continuation of the first facility: to support (i) the Company's long term investments for the rehabilitation and upgrade of the water and wastewater infrastructure in three cities (Tyumen, Orenburg and Tver) where RVK already operated under existing agreements; and (ii) the acquisition of new water companies in Russia subject to compliance with the EBRD policies and rules. The first objective *largely achieved*.	+/-
TASK Water Venture	Help TASK Group to finance investments in water and wastewater infrastructure in Turkey under various concession contracts and acquisitions. Gulluk concession refinanced and Dilovasi zone concession financed, however no additional acquisition targets found.	+/-
Aqualia Investment Venture	Support Aqualia New Europe's expansion into EBRD's countries of operation promoting PSP investments in the water and wastewater sector. No acquisition targets found so far.	+/-

3.4 Efficiency

The efficiency of Bank MEI-PSP operations is the extent to which they achieve their results (with a focus on their financial results) as cost-effectively as possible. In this evaluation it is considered in terms of: (i) the financial performance of MEI-PSP projects, and (ii) the Bank handling of MEI-PSP projects.

The financial performance of MEI-PSP Case Study projects is rated as ***'satisfactory'***, primarily due to relatively poor performance of the TASK framework and Aqualia framework, and excessive (and therefore undesirable) profits being achieved under Zagrab project.

The Bank handling of MEI-PSP projects is rated as '*good'*. The rating reflects the Bank's involvement in contract design and in engaging with the relevant authorities to effect sector reforms (for example in Russia on the Rosvodokanal project).

Table 3.4: Rating of case study projects for financial performance

Name	Summary	Evaluation rating
Zagreb Waste Water Treatment Plant 'build operate transfer' project	The profitability of the concessionaire is well above market average, although the EBITDA margin has been reduced in recent years (from 86 per cent to 79 per cent). This excessive profitability has been due to compensation formula, which is causing aggravation at the city and will be likely renegotiated. Negative "demonstration effect" caused by such windfall, results in the rating of this project's financial performance as "+/-", rather than "+" (although part of the profit might also be attributed to cost reductions and other efficiency improvements).	+/-
Wroclaw Parking PPP	The underground parking opened for operations last July 2013. There is not enough evidence to assess the financial performance of the project.	not rated
Rosvodokanal - I	RVK posted 6.3 per cent revenue growth in 2012 compared to 2011 results. Main contributor to this increase was an acquisition of the Voronezh concession for 30 years. EBITDA margin moderately decreased from 22 per cent to 19 per cent over the same period mainly due to the indexation of technical staff wages. Net profit margin correspondingly decreased from 10.4 per cent in 2011 to 7.4 per cent in 2012, however it remains largely in line with the financial projections made at approval.	+
Rosvodokanal - II		
TASK Water Venture	Akfen Water's (formerly TASK) financial results for 2011 and 2012 are the first full year results for both concessions financed by the Bank (Gulluk and a much bigger Dilovasi, opened in 2010). In 2012 revenues increased slightly to €3.9 million (up from €3.4 million a year earlier) and EBITDA was €2.8 million, which was approximately half of the base case forecast and slightly below the worst case forecast (€2.97 million) presented at approval.	+/-
Aqualia Investment Venture	There is no assessable evidence on financial performance related to projects since pipeline has not materialised. However, during the first three years of the Aqualia Investment Venture facility, before its restructuring in 2012, the Bank invested €1.32 million of the original €80 million commitment to fund developmental expenses in line with the original business plan. There are prospects for improvement however as Aqualia has recently signed a purchase agreement to invest in New Cairo Waste Water Treatment Plant.	-

Table 3.5: Rating of case study projects for Bank handling

Name	Summary	Evaluation rating
Zagreb Waste Water Treatment Plant 'build operate transfer' project	The Bank has been playing an "honest broker" role since the beginning of the concession, which is appreciated by the City and the concessionaire. The Bank worked intensively with both parties to amend the concession agreement to make it clearer and eliminate ambiguities, hoping that it would help to prevent disputes. The Bank could have been more pro-active in monitoring and could have encouraged both parties to address the current imbalance in contract implementation whereby the concessionaire is achieving well above market average financial returns.	+/-
Wroclaw Parking PPP	The Bank was approached by the private Sponsor late in the process with a framework for PPP parking projects with Wroclaw already in the pipeline, and at advanced stage of preparation. Still, the Bank had an important role in improving the arrangements, in particular by using the design of the Direct Agreement to regulate aspects that were not originally in the contract.	+
Rosvodokanal - I	Both RVK transactions represent a strong example of the Bank's additionality in Russia's municipal infrastructure sector. The Bank engaged well with the RVK group in the Russian municipal markets, and used its leverage –working together with the Russian authorities-- to improve the relevant legislation and contractual practices applicable to the entire sector.	+

Rosvodokanal - II		+
TASK Water Venture	While the selection of Akfen as client was good, given their solid PPP/concession experience, the choice of project has not been ideal as it consisted of refinancing local banks' and shareholders' loans already provided for two existing concessions. The expectations in respect of new concessions have turned out to be overoptimistic since Aifken has not obtained any.	+/-
Aqualia Investment Venture	The Bank was successful in teaming up with one of the industry leaders. The local knowledge of Bank staff across Resident Offices has also proved helpful to ANE in their business development efforts, although these efforts have not yielded any bankable projects yet. With the benefit of hindsight, the Bank's expectations have been overoptimistic, while its policies preventing the financing of single bidders to (even small) concessions, made it impossible to include such projects under the Bank's facility.	+/-

In summary, Bank handling of the case study projects has been mostly good in terms of client selection and interaction with the municipal authorities, for example playing the honest broker role between a city and concessionaire (such as Zagreb, Wroclaw), but also leading the policy dialogue for sector reforms (such as Rosvodokanal). However, with the benefit of hindsight, the Bank's projections and expectations related to framework facilities (TASK, Aqualia) turned out to be overoptimistic.

3.5 Transition impact and sustainability

The transition impact and sustainability of the MEI-PSP operations is the extent to which they foster transition from a centrally planned to a well-functioning market economy in a sustainable manner that invites replication.

The transition impact of the case study projects is rated as ***'satisfactory'***. The positive impact from more widespread private ownership (Wroclaw) and demonstration effect from the rebalancing of concession contracts (Rosvodokanal) is balanced out by the lesser impact of projects that have still to deliver (such as. TASK; Aqualia). There were two elements to the demonstration effect of the Zagrab Waste Water Treatment Plant 'build operate transfer' project – on one hand it proved that the private sector can efficiently complete and operate a WWTP but it also demonstrated that imperfect concession agreements can result in a concessionaire achieving excessive profits.

The sustainability of transition impact can be rated as *'satisfactory'*. This is based on the uncertainty related to the long run performance of projects, which are still to deliver on their objectives (such as Aqualia) or established projects that may encounter difficulties if they enter into a renegotiation phase (for example Zagreb Waste Water Treatment Plant, TASK).

The shaded cells in Table 3.6 illustrate the scope of the transition impact objectives in the case study projects according to the Bank's criteria. Figures inside the cells represent the number of transition impact indicators chosen to assess achievement.

Demonstration effects and *increased private ownership* (both in five projects) are the most pursued transition impact targets. They are followed by *Improved standards* (three projects) and *Skills transfer* (two projects). *Market expansion* and *Framework for markets* appear as objectives in one project each.

This distribution of transition impact objectives across projects is understandable since PSP in MEI projects expand the reach of the private sector *per se*, and they are still fairly new in the Bank's countries of operations, which means they have the potential to achieve both regional and countrywide demonstration effects. The improvement of standards is also an important objective since experienced investors and operators introduce new practices, including those related to corporate governance and transparency in the procurement and award of concessions. Only one case study project targets framework for markets (Rosvodokanal II). It is an interesting example since the project is a follow up transaction that builds on the Bank's extensive role in promoting sectoral reform and targets tariff reform for the entire sector. Traditionally, this type of transition objective is designed as part of MEI public projects rather than private sector transactions.

Table 3.6: Scope of transition impact objectives in case study projects (benchmarks)

Transition Impact criteria	Case Study Projects					
	Zagreb WWTP 'build operate transfer'	Wroclaw Parking PPP	Rosvodokanal I	Rosvodokanal II	TASK Water Venture	Aqualia Investment Venture
Market expansion					1 (100% user outreach)	
Increased *private ownership*	2 (concession award & project completion)	3 (successful project; new concession)		1 (new concessions)	4 (new concessions & operations)	5 (new investments)
Frameworks for markets (institutions, laws and policies)				1 (implementing RAB tariffs)		
Transfer and dispersion *of skills*						1 (competitive tenders)
Demonstration effects of new replicable behaviour and activities	2 (other PPPs in Croatia)	1 (other parking PPPs without EBRD)	4 (rebalanced contracts; operational improvements)	3 (operational improvements)	3 (improved performance; IFRS)	
Improved standards of corporate governance and business conduct		1 (concessions compliant with Bank policies)	2 (IFRS, corporate governance code)			1 (management practices)

The transition impact evaluation ratings contained in Table 3.7 are based on the extent to which the case study projects achieved the transition benchmarks agreed at project approval stage (summarised in in Table 3.6). More detailed information can be found in Annexes 6 to 10.

Table 3.7: Rating of case study projects for transition impact

Name	Description	Evaluation rating
Zagreb Waste Water Treatment Plant 'build operate transfer' project	The project has achieved more private sector participation in infrastructure in the sector based on it being the first privately owned concession for a water or wastewater utility in Croatia. Technically the project is very well run. It has had some demonstration effect for other PSP arrangements in the region but now qualified by the well above market average profit margins currently enjoyed by the concessionaire, which results in "negative" (or at most a "neutral") demonstration effect.	+/-
Wroclaw Parking PPP	The new parking facility has been implemented on a design-finance-build-operate-transfer basis by one of Europe's largest and most well established parking operators. Given that this is the first PPP carried out by the City of Wroclaw, and one of a handful of PPP projects implemented in Poland, the project could provide a platform for other PPP projects in the MEI sub-sectors, not only parking.	+
Rosvodokanal - I	The transition impact objectives of the first RVK transactions targeted demonstration effects from improved contractual structures and improved standards of corporate governance in the RVK group. RVK has rebalanced, to the satisfaction of the Bank, the contracts in six municipalities (Kaluga, Orenburg, Barnaul, Tver, Omsk, and Tyumen). The key changes introduced to the contracts provided for a more balanced tariff setting, performance targets and penalties for non-performance and termination provisions	+

Rosvodokanal - II	The second RVK facility continues to target (i) demonstration effects from successful restructuring across a number of Russian cities with PSP contracts run by RV; (ii) more widespread private ownership by targeting new cities (*the Company has recently added operation in the City of Voronezh*); and (iii) framework for markets with the intention to implement an improved tariff methodology based on the Regulatory Asset Base (RAB) approach (*not materialised yet*).	+/-
TASK Water Venture	Of eight transition impact benchmarks set at approval, only two have been achieved: (i) commencement of operations in Dilovasi; and (ii) reporting in IFRS. Thus a fair amount of transition impact remains to be achieved.	-
Aqualia Investment Venture	The Aqualia Investment Venture has not realised any projects yet and therefore it was not able to achieve any of its transition impact objectives. However there are good prospects for the future as the company has recently signed a purchase agreement for New Cairo Waste Water Treatment Plant.	-

3.6 Evaluation of other MEI-PSP projects

In addition to the five Evaluation Sample projects, evaluated in detail above, the Bank signed a further 24 MEI-PSP transactions (see Tables 2.1, 2.3 and 2.4 in Section 2 above) and 52 MEI public projects with PSP components during the Study Period. A complete and detailed evaluation of these projects is outside the scope of this study, although it is instructive to summarise their performance to date based on existing EVD evaluation reports and TIMS reviews to provide additional evidence.

3.6.1 Previously evaluated MEI-PSP projects

Table 3.8 provides a summary of the evaluation performance of an additional 11 MEI-PSP projects (covering 13 transactions, as two of them have debt and equity components) based on previous Evaluation reports, complementing the evaluation assessment from the Case Study projects.

Seven of the projects achieve overall individual project ratings of '*successful*', one is rated '*highly successful'* and the other three are rated as '*partly successful'*. On this basis, MEI private projects evaluated in the past are in aggregate rated overall as '*successful'.*

Table 3.8: Summary non-sample project evaluation ratings

Name	Country	Date of evaluation	Project summary and basis for overall project performance rating	Overall project performance
Tallinn Water Privatisation Financing	Estonia	April 2005	**Summary**: Debt refinancing for a newly privatised municipal water company to support network expansion, restructuring of the balance sheet and "optimising" the Special Purpose Contract. **Rating**: Based on '*good'* achievement of project objectives, transition impact, company's financial performance; and '*satisfactory'* Bank handling.	*Successful*
APA NOVA Water Treatment Plant	Romania	July 2009	**Summary**: Rehabilitation of a major water treatment plant, and the operation of water supply and waste water treatment for the city of Bucharest. **Rating**: based on '*excellent* ' environmental performance and transition impact (first PPP in MEI in the country, introducing full cost recovery tariffs); '*good'* achievement of operation objectives and Bank handling; and '*satisfactory'* financial performance.	*Highly successful*

St Petersburg South-West Waste Water Treatment Plant (SWWWTP)	Russia	April 2007	**Summary**: Completion of construction and full commissioning of the SWWWTP to reduce the discharge of untreated waste waters into the Gulf of Finland. **Rating**: Based on' *good'* achievement of (physical) objectives of the project and company's financial performance; and '*satisfactory* 'transition impact, Bank handling, and environmental performance.	*Successful*
MOL - Duna WWTP Outsourcing Project	Hungary	April 2007	**Summary**: Improvement of the wastewater treatment system of a refinery alongside the Danube to achieve (i) environmental improvements; and (ii) compliance with the EU environmental regulations. **Rating**: Based on '*excellent* 'environmental performance; '*good'* achievement of project objectives; '*satisfactory'* transition impact (only technology-driven impacts); and '*marginal'* Bank financial performance.	*Successful*
International Water United Utilities	Regional	February 2007	**Summary**: The project is to assist United Utilities in the acquisition of shares in the Project Companies that were held by International Water Ltd. and its affiliates. The owners of IWL, Bechtel and Edison, decided to divest their non-core assets. **Rating**: Based on '*excellent* ' Bank handling; and *good* achievement of project objectives, transition impact, and project financial performance.	*Successful*
Veolia Transport Central Europe (formerly Connex)	Regional	May 2010	**Summary**: The Bank's equity subscription in Connex Central GmbH intended for the expansion of passenger transport businesses in Central and Eastern Europe. **Rating**: Based on '*excellent'* transition impact; '*good'* achievement of project objectives and Bank handling; and '*satisfactory'* environmental impact and company's financial performance.	*Successful*
Taganrog Teploenergo (2 operations)	Russia	November 2010	**Summary**: Equity and debt financing for network rehabilitation and expansion of a local district heating system operator. **Rating**: Based on additoinality '*fullyl verified'*, *good* company performance and transition impact rating. However the project's operational objectives have been only '*partly achieved'.*	*Successful*
Veolia Voda Equity Investment	Regional	February 2011	**Summary**: Equity investment to allow Véolia Water to expand its operations east into new markets, building on existing operations in Central and Eastern Europe. **Rating**: Based on *good* company's financial performance; *satisfactory* Bank handling; '*marginal/satisfactory*' transition impact; and '*marginal'* achievement of overall project objectives.	*Partly successful*
Russian Communal Systems	Russia	November 2012	**Summary**: Pre-equity loan to a Russian utility sponsor. The funds were to be used by the sponsor to acquire the remaining 25 per cent plus one share of Russian Communal Utility Systems (RKS) via a public auction. **Rating**: Based on '*good'* project performance and Bank handling; '*satisfactory'* achievement of project objectives, realised transition impact, and company performance; but '*marginal'* environmental performance (partly due to the short tenor of the Bank's investment and lack of follow on project)	*Partly successful*
Shymkent Vodokanal	Kazakhstan	February 2013	**Summary**: Water supply project for TOO Vodnye Resursy Marketing, a privately-owned limited liability company mandated to provide municipal water and wastewater utility services to Shymkent, the fifth largest city in Kazakhstan. **Rating**: Based on *excellent* achievement of project objectives and Bank investment performance; *good* project financial performance, transition impact and Bank handling; and *substantial* environmental and social change.	*Successful*

CAEPCO (2 operations)	Kazakhstan	August 2013	**Summary**: Priority investment programmes in subsidiaries of CAEPCO, providing district heating services in the Northern cities of Pavlodar, expected to reduce heat losses, CO2 emissions and coal consumption, thus contributing to more efficient and sustainable energy use in the Kazakh district heating sector. **Rating**: Based on *good* Bank handling and Bank investment performance; *satisfactory* achievement of project objectives and transition impact, but an *unsatisfactory* project financial performance. However the programme has not yet been completed, so there is scope for improvement in the future.	*Partly successful*

3.6.2 MEI public projects with PSP components

PSP components in MEI public projects can take many forms. It may be a TC-funded study to assess the options for PSP in the future; or a requirement to explore the possibility of opening the market to private operators (for example. in the provision of urban transport services); or the outsourcing of an activity to the private sector (for example maintenance services, or electronic ticketing).

Tables 2.2 to 2.4 in Annex 2 contain a summary of the current performance status of the PSP components of 52 MEI public projects. The overall assessment is that for the 48 projects with available monitoring information, only 13 per cent of the PSP components are recorded as having been "achieved" while the rest are, or have been, "partly achieved" (35 per cent) or "not achieved" (52 per cent). On the basis of the evidence summarised in Annex 2, the achievement of PSP objectives in public projects is rated as '*unsuccessful'.*

3.6.3 Summary evaluation

Overall, the performance of the Bank's MEI-PSP projects (including both private projects and public projects with private components) is rated '*partly successful*', primarily on account of *'partly successful'* assessment of Evaluation Sample projects, '*successful'* performance of MEI-PSP projects evaluated in the past and '*unsuccessful'* performance of public projects with private components.

4. Responses to key evaluation questions

This review's Approach Paper set out a number of questions, to which the review was to provide answers. Sections 2 and 3 contain such answers, however for ease of reference summary responses to the key questions are presented below.

4.1 How did the Bank's stated approach to involving the private sector in its municipal projects evolve between 2001 and 2012?

The Bank's approach towards PSP in MEI operations, stated in sector policies and country strategies, evolved during the Evaluation Period in response to a combination of factors that influenced the view of the Bank over time on opportunities to finance such projects. These factors included, *inter alia* the business environment, political developments, and accumulated project experience. Overall, the pursuit of PSP options in MEI operations was steadily relegated from its status as a key operational priority at the beginning of the Evaluation Period to being one of many(less strategic) priorities..

The stated approach towards the support of PSP in MEI Operations Policy documents has steadily lost prominence becoming secondary to the long running strategic themes of decentralisation, commercialisation and environmental improvement. The Bank grew increasingly cautious about supporting full PSP solutions in MEI projects during the challenging experience of the mid-1990s. This experience influenced the 1998 MEI Operations Policy, where the Bank stated its willingness to pursue PSP in MEI, not as an end in itself, but as a means to facilitate transition in the sector and country, thus making a direct link between the scope for MEI PSP operations and the prevailing business environment in its countries of operations. Thus, the preferred MEI PSP option would be linked to a country's transition stage, meaning that the Bank would only pursue PSP projects in jurisdictions with a relatively well-developed legal and regulatory framework.

The 2004 MEI Operations Policy indicated the Bank's willingness to continue to promote the private sector in MEI operations, but only where feasible and economically attractive. PSP was mentioned as an option ("whether public or privately owned") in one of six strategic MEI trends identified in the 2004 Policy. Thus, the focus shifted towards the commercialisation and efficiency of municipal service provision irrespective of whether the provider was private or publicly owned and managed. This probably reflected the growing belief in the MEI team that the pursuit of PSP solutions in the sector was not necessarily critically important as long as it could promote one or more of the six transition attributes (as prescribed by the Office of the Chief Economist in addition to private sector participation), working with municipally-owned companies. This approach is illustrated with MEI public projects with PSP components, such as the outsourcing of maintenance activities to private providers. The change in emphasis was also reflected when the Bank started to increase PSP not directly through PPP contracts with long gestation periods, as in the beginning of the Evaluation Period, but via equity facilities in conjunction with international private operators (such as Veolia) or Russian private investors, although the latter required successive derogations from the Bank's concession policy.

The most recent MEI Sector Strategy, from 2012, confirms the loss of status of PSP as a strategic priority in the Bank's MEI policy. The Strategy mentions the promotion of (adequately structured) PPPs or performance-based outsourcing transactions, for example, as a solution to mobilise capital given the financial difficulties associated with the economic crisis. However, PSP in MEI is clearly no longer a key priority.

On the other hand, the stated intentions in many *country strategies* (nine analysed for the Bank's largest country-clients), have kept the objective of promoting PSP in municipal infrastructure as a priority in a context characterised by the need to invest in infrastructure, both at national and municipal levels. MEI-PSP in country strategies has nevertheless been subject to a changing emphasis depending on the country's political developments and business environment (see boxes in Section 2 and Annex 11).

4.2 What trends can be discerned in the specific form and content of private sector expansion efforts in the Bank's signed operations?

The number of private sector projects relative to the total projects signed by the MEI team fluctuated, decreasing in the second quadrennial and then increasing in the third one. However the volume of private projects relative to the total MEI operations remained relatively constant, accounting for 25 to 26 percent in each of the three quadrennials (see Table 4.1 below).

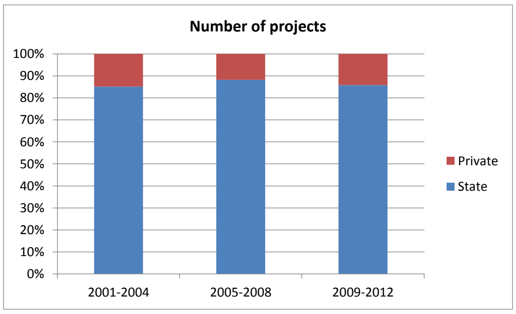
The content of the MEI-PSP portfolio shifted in various ways during this period but without a distinctive trend. The number of MEI private projects in the Bank's portfolio was relatively modest during the first two quadrennials of the Evaluation Period: seven projects between 2001 and 2004 (or 15 per cent) and eight projects between 2005 and 2008 (or 12 per cent). That number grew to 14 projects (or 14 per cent) in the 2009to 2012 quadrennial. In terms of business volume, the share of MEI private projects has been roughly constant throughout, accounting for approximately a quarter of the MEI portfolio in all three quadrennials.

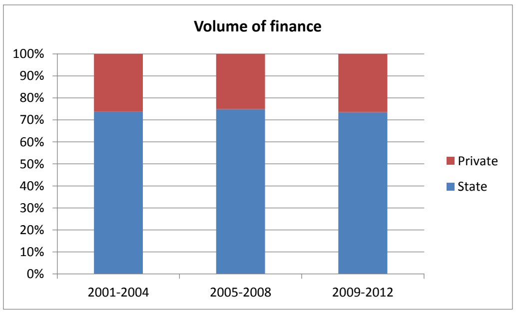
Table 4.1: Share of PSP projects in the Bank's total municipal projects

	Number of projects			Business volume		
	2001-2004	**2005-2008**	**2009-2012**	**2001-2004**	**2005-2008**	**2009-2012**
State	85%	88%	86%	74%	75%	74%
Private	15%	12%	14%	26%	25%	26%

During the Evaluation Period, the average value of the Bank's MEI private projects decreased for debt transactions and increased for equity transactions. The average size of MEI private debt projects was €36 million from 2001 to 2004; €25 million from 2005 to 2008 and €22 million from 2009 to 2012. The average size of equity transactions, in turn, was €17 million from 2001 2004; €41 million from 2005 to 2008; and €67 million from 2009 to 2012.

Figure 4.1: Percentage distribution of MEI portfolio (2001-2012)





Behind these average figures lie years of low or no activity (for example no MEI private project was signed in 2006 and 2012), compared to individual years, such as 2008, where the private project business volume accounted for 50 per cent of MEI's annual business volume. The volume of finance from MEI private projects experienced a steady positive trend between 2008 (€90 million) and 2011 (€190 million), only to finish with a sharp drop to zero in 2012. In some years the MEI private portfolio volume was heavily influenced by a single transaction such as the *Istanbul Ferries Privatisation* in 2011, which accounted for 60 per cent of the €192 million MEI private project signings that year.

Thus, there is no specific trend that is evident from the number or volume of MEI private transactions during the Evaluation Period. Some features of the portfolio, however, suggest some spurious regularity. For example, the Bank only signed MEI equity deals in five years during the 2001 to 2012 period but every other year between 2003 and 2009. However, this is just a curiosity, rather than a trend.

In terms of the subsectors and regional split of the MEI private portfolio, the operations in the first quadrennial (2001 to 2004) were mainly debt transactions in the water and wastewater sector, spread across central Europe, south-eastern Europe, Russia and the Baltics. Private operations in the 2005 to 2008 quadrennial were half debt and half equity with a slight concentration on district heating - but also covering water and wastewater and urban transport — either in Russia or with a regional scope. The key features of the portfolio changed the most in the 2009 to 2012 quadrennial with, for the first time, projects in Turkey, central Asia and early transition countries, combined with projects in new EU member states (Poland, Bulgaria, Romania) and Russia, as well as a return of water and wastewater (almost half of the projects), followed in equal numbers by urban transport and district heating.

In summary, the characteristics of the MEI private portfolio during the Evaluation Period changed from one quadrennial to the next. However there was no significant change in the share of private projects in relation to public projects in either the number or volume. There was no distinctive trend but rather a changing set of regions, countries and sub-sectors as MEI sought to respond to investor demand, rather than promote PSP pro-actively.

4.3 What can be concluded from the evidence as to the Bank's success in promoting PSP in MEI projects?

In its efforts to promote PSP-MEI projects the Bank operated within the constraints imposed by the need to adapt to a rapidly changing business environment and specific country circumstances. As an example, this led the MEI team, together with the Office of the General Counsel's Legal Transition Team, to launch technical assistance to Russia aimed at amending its PPP legislation, while in the interim requesting derogation from Bank policies to finance several projects in Russia before such amendments could be introduced.

During the 2001 to 2004 quadrennial (and before), the Bank relied on a large TC package (MP4) to create a market for PSP projects through education of local decision makers and addressing bottlenecks in legal framework. However, despite spending over €1.3 million on this TC (and another €1.1 million on other potential stand-alone PSP projects), these efforts were largely unsuccessful as they did not result in any bankable projects. Working closely with leading international investors, and dispatching a dedicated PSP banker to work with selected cities on the preparation of the PPP tenders, proved to be much more successful. As a result, the Bank developed a set of flagship PSP projects in the water and waste water sub-sector, which were evaluated ex post as '*successful'* or *'highly successful'*. These projects allowed the Bank to establish its credentials in central Europe (and to some extent in Russia) and build a reputation as the leading IFI for private sector investments in the water and waste water sector.

During the 2005 to 2008 quadrennial, the MEI team continued with its efforts to promote PSP but had to adapt to a rapidly changing market and political environment in advanced transition countries, notably those preparing to join the EU, such as Poland, and others such as Russia where the legal environment for PSP in MEI was inadequate. These challenges were amplified by MEI lacking a banker dedicated to PSP project deployment for a period of time. The result was a couple of transition years (2005 and 2006), where the Bank only managed to sign one private project (Veolia Urban Transport equity).

The MEI team's private portfolio really took off in 2007 and 2008 with projects that provided debt and equity to district heating companies, and was characterised by an equal split between projects in Russia and projects with a regional scope. The subsequent evaluation ratings for these projects were divided between '*successful'* or '*partly successful'.* Thus, the MEI team demonstrated that it was quick to change direction and look for alternative opportunities to promote PSP in the MEI sector. It is interesting to note that in 2006, for example, the year with no MEI private transactions, the Bank signed the largest number of MEI public projects with PSP components in one year. This can be interpreted as the MEI team trying to compensate for the lack of private transactions and keep alive the PSP flame via public projects. Unfortunately, the evaluation findings suggest that most of the PSP components in those projects were either '*not achieved'* or '*partly achieved'*.

Given the proximity of the 2009 to 2012 quadrennial, most projects from that period have not yet been evaluated (three of them were part of the Evaluation Sample projects under this review). However, some features of the PSP projects portfolio from this period confirm the Bank's commitment to promoting PSP in its countries of operations (*where feasible and economically attractive*).

First, there were transactions in Turkey, Central Asia and early transition countries reflecting the change in the strategic direction of the Bank as a whole. Second, while small in size, other projects explored new market segments (such as parking, energy efficiency in municipal services and ferry services), some in new EU Member States (such as Poland and Romania) with good demonstration effects (such as Wroclaw parking). Third, there were extensions of existing projects (for example Veolia, Rosvodokanal and Taganrog). Fourth, there have been a handful of large equity transactions which helped to explain the increase in business volume between 2009 and 2012 (Dalkia Baltica, Istanbul Ferries and Veolia Capital Increase). In sum, the increase in the total number and volume of MEI PSP projects in the last quadrennial demonstrates the adaptability and market opportunism of the MEI team and the Bank's continued commitment to such projects.

The design of public projects with PSP components (from outsourcing ticket sales to the maintenance of city roads; or allowing private bus operators to enter the market) also demonstrates a willingness to explore options to promote PSP through public projects. This approach can be effective if the municipalities are reluctant to opt for wholly private solutions or can be a way to prepare the ground for further PSP in the future. However, the evaluation evidence suggests that only a small share (13 per cent) of the PSP components can be considered as '*achieved'* (see Tables 2.2 and 2.3 in Annex 2).

This, in turn, raises questions about the rationale behind the persistent inclusion of such PSP components in MEI public projects, as many of them had little impact beyond enhancing a project's *ex ante* transition impact rating before Board approval.

4.4 Do the Bank's strategies and operational work show evidence that it has incorporated and built upon experience accumulated?

The Bank's early experience with MEI-PSP projects in subsectors such as water has been useful for building up knowledge and expertise in other market segments (such as urban transport and district heating) or in dealing with similar types of clients (such as Russian private operators). Other experience has been less applicable as there have not been similar projects where it could be put to good use (see Zagreb 'build operate transfer' project). Some new PSP experience, gained in recent years (for example with parking projects) is expected to be useful as more such projects are currently being prepared. Finally, some PSP experience has been lost when MEI bankers who have been instrumental in developing the PSP portfolio left the Bank or moved to other departments.

The knowledge and experience accumulated during the 2001 to 04 quadrennial (and before) regarding failed PSP development TC projects (primarily MP4), and Multi-Project Facilities, guided the Bank in the following years, making it much more careful with the use of TC funds to support potential PSP projects in cases where there was no clear commitment to PSP from the public sponsor. This resulted in the reduction of TC spending on PSP projects from €1.1 million in the first quadrennial to €0.7 million in the second. In particular, no further "outsourcing" of PSP marketing and identification (similar to MP4) was undertaken. Also the Bank avoided multi-project facilities. No such new facilities were extended until 2009, and then only for one of the world's leading water infrastructure operators – Aqualia (a project whose current status unfortunately reconfirms the lessons stemming from early multi-project facility projects).

Experience drawn from the multi-project facilities and the relatively high development costs of stand-alone PSP projects completed in the first quadrennial, combined with a weak start to the 2005 to 2008 quadrennial (with a single private project in 2005 and no private transactions in 2006) prompted the MEI team to seek other "wholesale" vehicles to remain engaged in the private sector. It did so primarily by providing equity to Russian private operators and to international investors with a regional outreach. This is an example of the Bank's accumulated experience informing the MEI team of the need to change its strategy, given also the changes in the market in its countries of operations.

It is difficult to assess the extent to which the Bank learnt from the experience of other IFIs, given the strong local specificity of the market environment, institutions and political issues of the Bank's regions. However, most MEI bankers have been aware of developments related to high-profile PPPs projects worldwide, particularly in the water and waste water sector. However, due to the absence of large concessions/privatisation projects in the Bank's regions (and in turn due to the absence of such projects in the recent EBRD portfolio), no concrete examples of the application of such experience can be found.

4.5 To what extent has the Bank developed a comparative advantage in the sector and countries of operation?

As an IFI, the Bank has a particular attraction for private investors in public infrastructure, where risks are primarily associated with the political environment. However there are other institutions active in this sector and eager to promote PSP. During the 2001 to 2004 quadrennial (and before) the Bank developed a series of flagship projects which helped build its solid market reputation for MEI-PSP transactions, particularly in the water sector.

The Bank's comparative advantage lay primarily in the combination of its in-house expertise in respect of PSP conceptualisation, transaction development and regional knowledge (including access to grant TC funds to support multidisciplinary transaction teams), and its ability to finance projects through a spectrum of different financing tools (debt, equity, guarantees, frameworks, later also in local currency). Also, the Bank's long-standing relationships with and support of some public companies (such as the Tallinn Water Company or St. Petersburg Vodokanal) enabled the Bank to be at the forefront when these companies eventually decided to pursue PSP projects. Finally, the Bank's close relations with the world's leading private investors and operators, which can be dated to the early years (and the ill-fated multi-project facility projects), put the Bank at the top of their calling list, when they eventually acquired bankable concessions (for example in Brno, Zagreb, or Budapest) or decided to seek a passive equity partner for their regional ventures (Veolia Transport and Veolia Voda).

Afterwards, the Bank's role and its comparative advantage in promoting PSP in MEI operations evolved in line with changing market conditions (its association with the EU enabled the Bank to play a leading role in co-financing EU grant-funded projects, while advising on options for PSP in such projects). In relation to more challenging markets, (such as Russia) the Bank was able to utilise its unique attributes, such as the Legal Transition Team, to provide long-lasting and increasingly effective assistance for the preparation of legislative changes to enable PSP projects. The Bank was also the only IFI which had a local presence in the Russian regions. Proximity to its clients in such a vast country as Russia was a key advantage for the EBRD. This helped the Bank to conclude six PSP projects with local Russian companies.

During the financial crisis the Bank used its comparative advantage, stemming from flexible financing, to support PSP projects and respond to the changing circumstances in its countries of operations. While equity accounts for almost 40 per cent of the MEI's total private commitments, five transactions with three clients (Veolia, Aqualia, Dalkia) account for the lion's share (€355 million or 93 per cent). These equity projects were designed to allow the Bank to take a minority stake in equity vehicles to help international operators expand or enter in the Bank's countries of operations. The Bank did this either alone or with other IFIs, as is the case with the Dalkia Baltica/Russia transaction where the Bank co-invested with the IFC.

Another potential source of comparative advantage for the Bank is its ability to design public sector projects with soft or hard conditionality related to PSP options or features. The Bank chose to use a soft approach (that is, with no conditionality), which resulted in only a small share of those PSP components being achieved. This suggests that the Bank's comparative advantage in project design in this respect is not producing the expected results.

4.6 What factors appear to influence the Bank's ambition and specific form of engagement in expanding PSP?

Private participation is at the heart of transition and the Bank's mandate. Therefore the 1998 MEI Operations Policy put PSP as one of its strategic objectives. MEI embarked on active promotion of PSPs, through large TC initiatives, such as MP4, and stand-alone water and waste water projects. However the result of these efforts was mixed. The Bank appears to have concluded that its best chance of successfully financing PSP projects lay in cases where the cities have already decided on such projects and selected preferred bidders. Efforts to promote PPPs, through MP4 for example, largely failed relative to expectations, as did earlier efforts of private investors to embark on them using multi-project facilities. The cases where the Bank convinced the city to embark on PSP, conceptualised it and provided transaction advisors through TC, turned out to be very costly and lengthy processes with uncertain end results (Poznan Water Privatisation) or high reputational risk when the project eventually went sour (Sofijska Voda).

The experience accumulated with PSP projects by 2004, combined with the deterioration of prospects for PSP in the market and a shift in the Bank's direction (towards Russia and other Commonwealth of Independent States), influenced MEI's level of ambition. This was reflected in the 2004 MEI Operations Policy (and also in the 2012 Sector Strategy). Promotion of PSPs remained written into the 2004 MEI Operations Policy, however it was to play a secondary role to decentralisation and commercialisation of municipal enterprises and was to take place only "*whenever possible".*

The Bank's approach to promoting PSP in the MEI sector after 2004 can be characterised as selective, combined with good responsiveness to clear signals from the market (city/potential private sponsor) that there is a realistic chance of such a project coming to fruition.

Nevertheless, the Bank's ambition to continue to be involved in PSP projects in the MEI sector can be illustrated by the example of its operations in Russia. The MEI team did not hesitate to ask six times for derogations from the Bank's policies on concessions to finance private projects with relatively inexperienced local sponsors, as there were no other alternatives (no international sponsor and no PSP projects complying with the Bank's policies). Nor did the Bank shy away from embarking upon a challenging and costly initiative, which could be expected to take many years and whose result was highly unpredictable, such as policy dialogue to amend Russian concession law.

4.7 How relevant and effective have Bank policy dialogue initiatives been in promoting PSP?

Two examples of policy dialogue through project design and implementation are in Russia and Poland. In Russia, the Bank has been successful in supporting legal framework's reform to enable PSP in the MEI sector by engaging with the federal authorities though policy dialogue (and TC). Moreover the Bank has also been working with local authorities and private sponsors to achieve transition impact through the drive to rebalance the existing contractual arrangements, which were not considered good practice.

In the first quadrennial the Bank also played a supportive role in the preparation and enactment of the first PPP legislation in Poland. Policy dialogue can also take place in MEI public projects with PSP components when the project is being designed and during project implementation, especially if those components are covenanted in the loan agreement and require a closer follow up.

Moreover, the Bank worked at the municipal level with selected cities, contributing to the implementation of a number of policy measures, particularly those related to user tariff increases, in conjunction with the projects it financed. This resulted in water tariff rationalisation in such cities as Tallinn, St. Petersburg or Bucharest.

The Bank has also used training as a vehicle for policy dialogue on PSP options. In September 2007, the Infrastructure department of the Bank organised a public private partnerhsip training week for public sector officials from the Bank's countries of operation, including officials from central, regional and local governments (for example in St Petersburg). The training programme took place in the Joint Vienna Institute and was designed around the PPP project cycle and based on real life case studies, which included transport and MEI projects recently financed by the Bank. Evidence from the positive feedback received from the 20 participants suggested that specific project-focused training is a policy dialogue instrument with potential to be tapped.

5. Findings and recommendations

A number of issues and considerations were identified as part of this review, which might be useful when implementing the new sector strategy or preparing or executing MEI-PSP projects.

Findings and recommendations related to policy issues and those which might be applicable to most of MEI-PSP operations are presented in this section. They have been derived from analysis presented in the main body of this report. In addition, Annexes 6 to 10 present analysis of five evaluation sample projects with a summary of findings and recommendations stemming from each of them, which might be applicable to particular sub-sector or type of project. Most of these findings and recommendations are of technical nature and are geared towards remedy of practical problems encountered in MEI-PSP projects.

5.1 Findings

Findings - general/policy-related:

<u>Regional market for MEI PSP projects</u>

- private sector participation in municipal infrastructure and services in the Bank's countries of operations is well below that observed in other regions and overall it has changed relatively little since transition began. For a variety of historical, policy and structural reasons the climate for private participation in the municipal sector remains very difficult.

  <u>PSP in MEI operations policies</u>

- the strategic importance given by the Bank to increase PSP at the level of MEI sector policy has declined over the past 15 years. After being one of several explicit objectives in the late 1990s, PSP is now of lesser strategic importance to the Bank. .

  <u>PSP in MEI in country strategies</u>

- in contrast, a higher level of stated emphasis on PSP in MEI is found in selected country strategies, suggesting disconnect among sectorial and country-specific policy objectives.

  <u>Reduced ambition in respect of PSP</u>

- Generally disappointing results from a few specific PSP promotion initiatives in the 1990s and 2000s appears to have sharply reduced the Bank's ambitions and expectations; operational work with a PSP dimension has become limited, cautious and highly selective.

  <u>Relatively constant share of PSP projects in total MEI portfolio</u>

- during the Evaluation Period the Bank signed 29 private operations for €942 million (accounting for 13 and 25 percent of total number and volume of MEI's operations respectively). However, while the absolute number and volume of public sector projects increased significantly over the Period, comparable indicators for private sector projects remained low and largely constant in relation to public projects.

  <u>Public projects with private components</u>

- project design since the first half of the 2000 decade saw increased integration of private components into public sector projects, which contributed to stronger transition potential ratings. However actual execution of these components was disappointing. These components were embedded in 52 public projects (28 percent of total) but were fully achieved only in 13 per cent of such projects and partly achieved in 35 per cent of them, while they were not implemented at all in 52 per cent of such cases.

  <u>Decreasing share of public projects with private components</u>

- integration of private sector components into MEI's public sector operations subsequently dropped significantly and remained low, while their execution rates dropped further.

  <u>Use of TC for MEI PSP projects</u>

- a total of about €3 million of TC funds was committed to promote or support PSP projects over the period, accounting for only two per cent of the total TC funds committed in the MEI sector. Much was spent in the early years of the Period on two large TCs which were largely viewed as unsuccessful. This early experience of using TC to "create market" for PSP appears to has been decisive in the Bank's subsequent approach, which has largely been waiting for opportunities to emerge, rather than trying to pro-actively influence the market to create them.

  <u>Bank's position on the MEI PSP market</u>

- notwithstanding all of this, the Bank has been a significant player in the limited regional market, providing financing to about half of all private MEI transactions, which achieved financial closing in the region during the Period.

  <u>The Bank's approach to promoting PSP in MEI</u>

- such approach may be characterised as pragmatic, selective and reactive. Unlike in other sectors, countries do not have PSP/PPP strategies for the municipal sector, leaving it mainly to municipalities to decide whether they want to engage private operators or not. This makes it difficult for the Bank to develop a coherent strategy for promoting and financing PSPs, forcing it to rely mainly on opportunities as they arise.

5.1.1 *Findings - operations-related:*

Policy dialogue

- there are noteworthy examples of the Bank undertaking policy dialogue with selected cities and several central governments, which contributed to better understanding of the PPP concept at municipal level and the development or amendment of PPP-enabling legislation. However, these examples are relatively few, confirming difficulties with replicating such initiatives.

  Changing private content of the Bank's MEI operations

- such content has been changing substantially over the period of this study. PSP operations in the first quadrennial (2001 – 2004) were focused on the water/waste water sub-sector and financed international operators, mainly in more advanced transition countries.

  EU grants PSP disincentive

- the availability of EU pre-accession and post-accession grants displaced a number of PSP initiatives in Central and then Southern Europe and substantial challenges are evident looking forward due to confusion about eligibility of projects for EU grant co-financing.

  Deteriorating opportunities for MEI PSP projects

- in the second quadrennial (2005 – 2008), opportunities to finance PSP projects deteriorated, due to the combined effect of the EU grants in more advanced countries, the lack of adequate PPP legislation in the less advanced countries, and the more cautious approach of international investors.

  Growing share of local operators financing

- over time, faced with changing risk appetite of international investors and to remain involved in private projects, the Bank increasingly turned towards local infrastructure operators, particularly in Russia, signing several transactions with them (although all of them required derogation from the Bank's concession policies, some of these projects achieved good transition impact).

  Increased efforts and better results in recent years

- in the last quadrennial (2009 to 2012), the number of PSP projects doubled (although one third were expansions of existing projects), while the average PSP project size shrank. The Bank expanded its geographical reach, signing its first PSP projects in an early transition country, Central Asia and Turkey, and tapped into new sub-sectors such as parking and ferry services.

5.2 Recommendations and measures to consider

- Proposals for new public sector MEI projects should include a focussed section discussing the existing the "gap" in PSP in the MEI sector, the content and status of the Bank's efforts on the subject including its track record with the same client or others in the same country, and a summary of related PSP activities by other actors, if any. Such a section in the project's approval documents should explicitly describe what specific proposals for PSP the Bank pressed with the client and what the outcome of these discussions was.
- Any proposal that may result in reduced PSP (for example displacement of active private operators) should identify this clearly in the project approval documentation and summarise the factors weighed by the team.
- PSP components in public projects should be covenanted (where legally feasible) in order to be counted as contributing to the project's assessed transition impact potential.
- Financing for bus fleet renewals of public transport companies should ordinarily require explicit commitment by municipal authorities to allow or expand PSP in the sector.

- Consider identifying a dedicated PSP Enabling Specialist within MEI to promote PSPs at both the project and strategy levels.
- Examine ways to intensify efforts to reduce institutional and legal obstacles to PSP in MEI, through either an expanded Legal Transition team programme of work or through a dedicated TC focused on policy dialogue rather than producing a pipeline).
- Consider providing longer-term assistance to cities to monitor and regulate PPP contracts during the first years of a their operation (complementary to the support currently provided for PSP/PPP tender/contract preparation) to help mitigate implementation risks associated with institutional capacity.
- Consider working with the public procurement agencies of several key countries to develop standard PPP procurement documentation and concession contracts.
- Consider working with the EBRD's Office of the Chief Economist to produce a short analysis of the status of transition gaps in the MEI sector in respect of PSP and identify possible Bank initiatives to more effectively reduce those gaps.
- Develop a system of annual reports to the Board on the implementation of all PSP-supporting activities, including policy dialogue, private projects and status of public projects with private components.
- The EBRD's Office of the Chief Economist should consider a special transition impact monitoring system retrospective, the purpose of which would be to provide a broad snapshot of the MEI PSP projects (including public with PSP components) implemented in the past, as well as the status of those under implementation.

Please see additional findings and recommendations related to specific evaluation case study projects presented at the end of each of the Annexes 6 to 10.

6. Sources

Internal project documents: Board reports, Board minutes, Directors Advisors' Questions, Operations Committee minutes, Credit department notes, OCE comments, OGC comments Credit Review summaries, TIMS review, Portfolio Monitoring reports

EIB (2012) Project Bond Initiative

EPEC (2013) - PPPs financed by the European Investment Bank since 1990

EPEC (2013): Market Update -Review of the European PPP Market in 2012

EPEC (2013): Market Update -Review of the European PPP Market First half of 2013

FEMIP (2012) Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries (Volume 2 – Country Analysis)

IDB (2012): Evaluation of the IDB's Non-Sovereign Operations with Sub-National Entities: 2007-2010 -

IDB (2103): Mid-term Evaluation of IDB-9 Commitments -

IEG (2013): Evaluation of the World Bank group Support to Public-Private Partnerships – Approach Paper

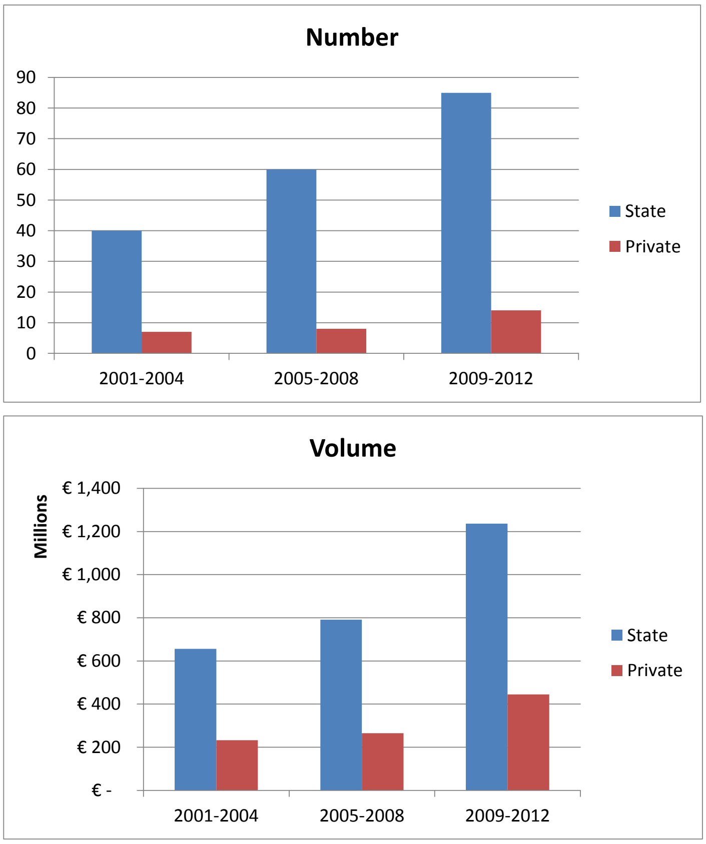
Infrastructure Journal Online -

PPIAF (2012): Private sector participation in water infrastructure- Review of the last 20 years and the way forward

PPIAF(2013) Infrastructure Policy Unit - 2012 Global PPI Data Update

Annex 1: Portfolio analysis

Figure 1: MEI operations by portfolio class



MEI portfolio

A total of 214 MEI operations, of which 185 (or 86 per cent) are state sector operations compared with 29 private operations (or 13 per cent).

(Note: Considering alternative financing instruments such as debt and equity in the same project, the 29 private operations relate to 27 projects)

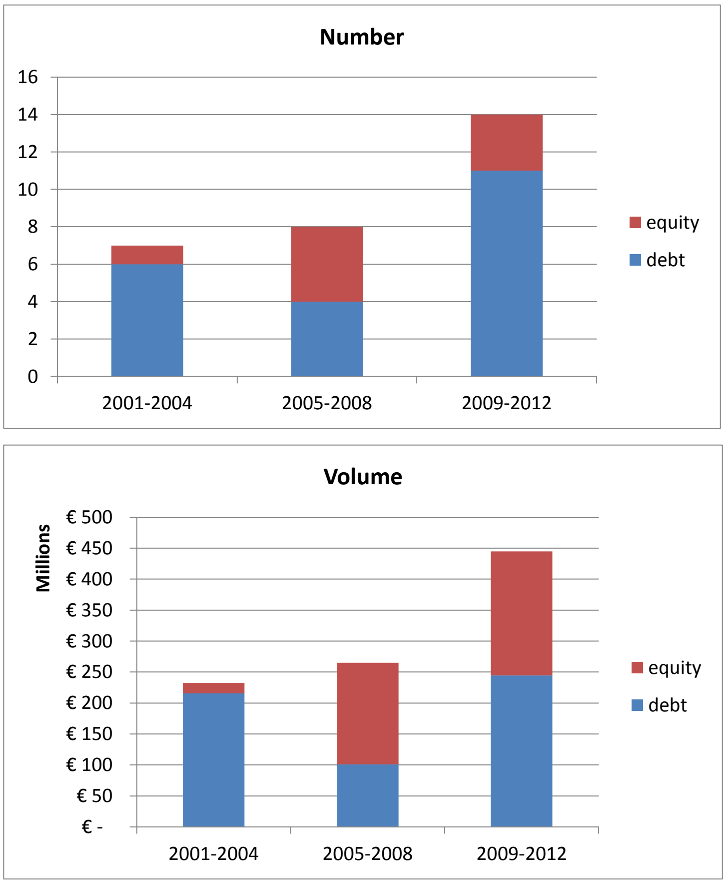
The number of state sector operations grew consistently from 40 in 2001 to 2004, to 60 in 2005 to 2008, to 85 in 2009 to 2012.

The number of private operations signed doubled from seven in 2001 2004 to 14 in 2009 to 2012, however their share in total MEI projects signed remained virtually the same (15 and 14 per cent respectively).

The total volume of MEI signed operations amounts to €3.7 billion, of which about €2.6 billion (or 72 per cent) relates to state sector operations, and €942 million (or 25 per cent) to private operations.

The volume of state sector operations has kept a fairly stable share of the total MEI portfolio in the 85 to 88 per cent range.

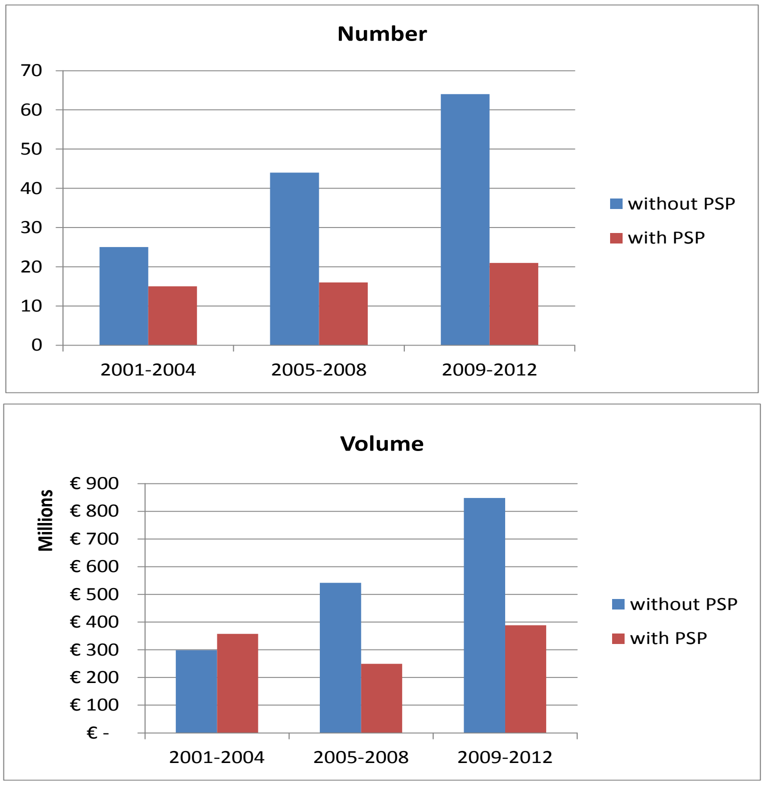
Figure 2: Number and volume of MEI private operations



Key features of MEI private operations

- About 73 per cent quarters of private operations are debt-financed while the remaining 27 per cent are equity-financed
- The number of projects with debt finance has tended to dominate private operations (a share of 85 per cent in 2001-04 and 79 per cent from 2009 to 2012) with the exception of the 2005 to 2008 period, which saw the share of equity finance increased to 50 per cent.
- The volume of debt finance in private operations amounts to almost €0.6 billion (or 61 per cent) compared with close to €0.4 billion (or 39 per cent) of equity financed operations.
- The average size of debt-financed private projects has decreased considerably from close to €36 million from 2001 to 2004 to €22 million from 2009 to 2012, while the average size of equity-financed private projects has increased substantially from €17 million from 2001 to 2004 to €67 million from 2009 to 2012 (as a consequence of just three equity transactions: Aqualia, Veolia, and Dalkia)

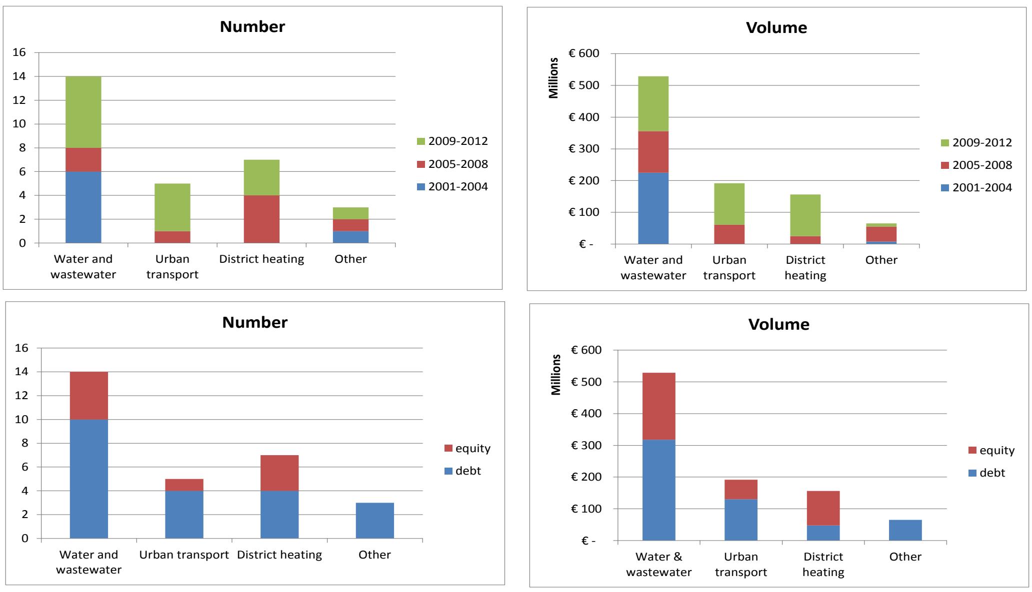
Figure 3: Number and volume of MEI State operations



MEI State operations with PSP components

- State sector operations with a PSP component represent 28 per cent of the total number of state sector operations during the study period.
- The share of state sector operations with a PSP component has decreased from 37 per cent from 2001 to 2004 to 23 per cent from 2009 to 2012. The average size of State operations has fallen slightly from €16 million between 2001 and 2004 to €14.5 million between 2009 to 2012.

Figure 4: MEI private operations by sub-sector 2001-2012



Private operations market segments

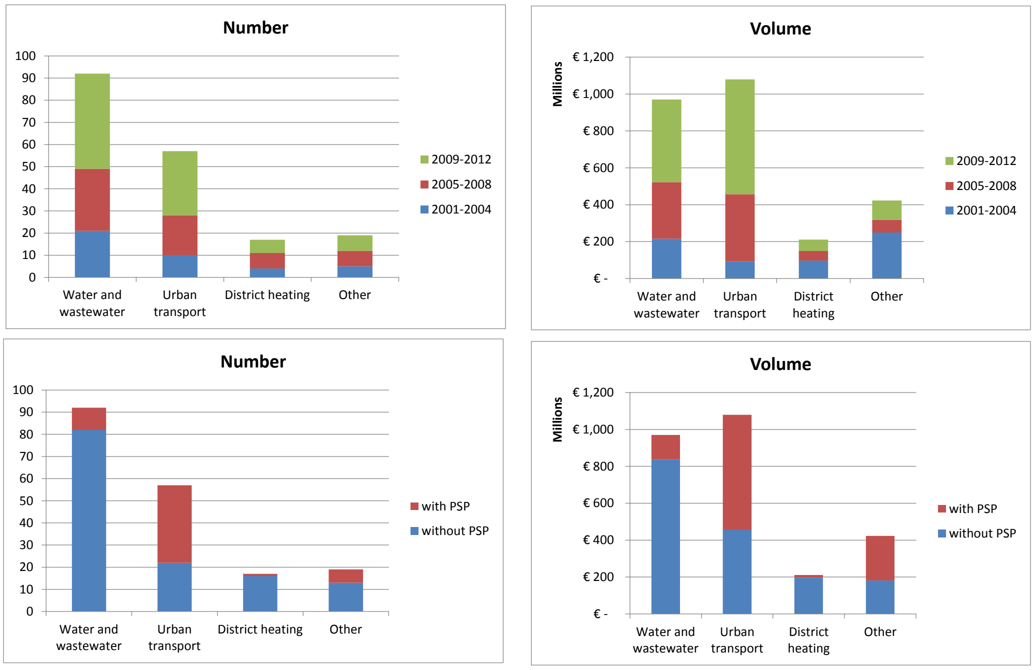
The water and wastewater sub-sector dominates the Bank's MEI private operations portfolio, with 16 operations (or 47 per cent) and €537 million (or 55 per cent) of the total.

In relative terms, private operations across all MEI sub-sectors took off from 2009 to 2012, which accounts for 14 of a total of 29 operations (or 48 per cent). In the first period (2001-04), however, the Bank's MEI private activity focused almost exclusively on water and wastewater (six out of seven transactions).

Equity operations focusing on water & wastewater and district heating account for seven of the eight equity transactions during the study period. The remaining equity operation is in urban transport.

In term of private operations volume, debt finance (€561 million) is larger than equity finance (€381 million) for all sub-sectors except for district heating where equity finance (€111 million) is more than twice the amount of debt finance (€45 million)

Figure 5: MEI State operations by sub-sector



State operations market segments

The water & wastewater and urban transport sub-sectors dominate the MEI State operations activity of the Bank with 92 and 57 operations, respectively, (a combined 81 per cent of the total).

The same two sub-sectors account for 76 per cent of Bank finance during the study period (€0.9 billion in water & wastewater finance; and €1 billion in urban transport finance).

In terms of project design, urban transport projects dominate the portfolio of MEI state operations with PSP components: 35 of the 57 urban transport transactions (or 61 per cent) had a PSP component.

Annex 2: Case study projects and PSP components in MEI state sector projects

Table 2.1: Details of MEI-PSP Case study projects

Name of Project	Country	Signing date	Project description	Financing value and instrument
Zagreb Waste Water Treatment Plant ‘build operate transfer’ project	Croatia	14/12/2001	Construction of a wastewater treatment plant	€42.2 million (debt)
Rosvodokanal	Russia	28/04/2008	Upgrade water and waste water services in 5 Russian cities	€37.3 million (debt)
Aqualia Investment Venture	Regional	15/05/2009	Investment vehicle to support Aqualia's expansion into EBRD's countries of operation	€30.0 million (equity)
TASK Water Venture	Turkey	15/10/2010	Water and wastewater infrastructure investments	€16.0 million (debt)
Wroclaw Parking PPP	Poland	23/06/2011	Creating underground parking facilities through PPP arrangement	€7.7 million (debt)
Rosvodokanal II	Russia	16/11/2011	Second and Third Tranches to RVK of RUB 5 billion in total	€37.3 million (debt)

Table 2.2: MEI-Public projects with PSP components (2001 to 2004)

	Country	Sub-sector	Description of PSP components (TIMS review comments in bold) and verification by Evaluation Team	TIMS review date	Financing value
2001					
Gdansk Urban Transport	Poland	urban transport	Introduction of private bus operators (**not achieved**); Private sector participation in auxiliary services (**achieved**)	31-Jul-11	€12 million
Kaunas Water and Environment Project - Phase II	Lithuania	water & wastewater	carry out the promotion programme; implementation of some PPP options (e.g. outsourcing)(**partially achieved**)	28-Feb-11	€19.7 million
Belgrade Municipal Infrastructure Reconstruction Programme	Serbia	urban transport, water & wastewater, district heating	Public transport: i) Commercialisation of the transport comany; ii) significant share of operating costs to be covered from fare revenues; iii) PSP in urban transport (**achieved**); Water/wastewater: i) Commercialisation of watercompany; ii) Full cost recovery tariffs and improved collection and metering; iii) PSP in the belgrade water sector (**N/A**); District Heating: i) Commercialisation of the DH company; ii) full cost recovery tariffs and improved collection rates; iii) PSP in DH operations (**N/A**)	01-Jul-11	€40 million
Rybnik Sewerage Network Development Programme	Poland	water & wastewater	Options for PPP: seminar on PPP option, implementation of suitable options (**not achieved**)	27-Mar-07	€19.7 million
2002					
Sofia Public Transport	Bulgaria	urban transport	privatisation of management workshops (**not achieved**); privatisation of bus operations (**N/A**)	18-Nov-09	€16.7 million
Sofia District Heating Rehabilitation	Bulgaria	district heating	Tender process: successful tender, Management Contract signed (**not achieved**)	15-Nov-12	€14.3 million
City of Lodz Road Improvement	Poland	urban transport	Outsourcing road maintenance to the private sector (**partially failed**); Evidence that other municipalities in the country have adopted 'best value' approach for road maintenance and management (**cancelled**)	25-Nov-08	€6.6 million
St Petersburg Flood Protection Barrier	Russia	water & wastewater	Private sector involvement in operating and maintenance of the Barrier (**partially achieved**)	15-Apr-11	€185.9 million
2003					
City of Vilnius Municipal Infrastructure Project	Lithuania	urban transport	Private sector participation in infrastructure projects (**partially achieved**)	18-Nov-09	€7 million
Bucharest Multi-Sector Project (Municipality)	Romania	urban transport	Mobilisation of private capital for redevelopment of the historic zone (**partially achieved**); Outsourcing of parking and street management in the historic zone (**not achieved**); Outsourcing of the maintenance of the Urban Traffic Management and Control and Public Transport Management systems (**achieved**)	30-Nov-11	€16.2 million
MELF Timisoara	Romania	water & wastewater	TC funded PPP Options Study (achieved); Follow up PPP work with ISPA support (**not achieved**)	30-Apr-13	€3.6 million
2004					
Dubrovnik Urban Transport Development	Croatia	urban transport	Completion of sustainable Transport Strategy including a PPP concept for on-street and off-street parking (**delayed**); Decision by the City Council regarding private sector participation in construction and management of parking spaces (modified)	31-Dec-12	€6.5 million
MELF Bacau	Romania	water & wastewater	Conclusion on PSP option study (not achieved); decision on PSP model (**not achieved**)	20-Dec-11	€13 million
Togliatti Urban Transport	Russia	urban transport	Improved quality of service provided by private operators (**partially achieved**); No decrease in market share of private operators below the current 20-25 percent (**on track**)	15-Dec-12	€6.1 million
Gdansk Urban Transport Project - Phase II	Poland	urban transport	Outsourcing of tram track maintenance to the private sector and transfer of ticket sales and fine enforcement (**achieved**); Successful operation of private contractors (without renegotiation) (**achieved**)	08-Jul-08	€6.6 million

Table 2.3: MEI-Public projects with PSP components (2005 to 2008)

	Country	Sub-sector	Description of PSP components (TIMS review comments in bold) and verification by Evaluation Team	TIMS review date	Financing value
2005					
Arad Urban Transport Project	Romania	urban transport	Issuing a tender for selection of a Strategic Partner (cancelled); signing a contract with a Strategic Partner (**cancelled**); signing a Share Option Agreement (**cancelled**); purchase of a stake in the municipal transport company by the Strategic Partner (**cancelled**)	30-Apr-13	€15 million
Tbilisi Public Transport Project	Georgia	urban transport	Establishment of an on-going route tendering system (**partially achieved**); Tender out all mini-bus routes (**partially failed**); City to review and make a decision on the Bank's recommendations for private sector participation in the operations of the Company (**not achieved**)	30-Aug-13	€3 million
Brasov Urban Transport Project - Company Loan	Romania	urban transport	Outsourcing of auxiliary RATB service (e.g. ticket sales, cleaning and some maintenance)(**not achieved**); Competitive tendering to the private sector of any new urban or suburban bus routes outside the service areas of the Company (**partially failed**)	01-Jul-11	€10 million
2006					
Bucharest WWTP - Glina	Romania	water & wastewater	Selection of consultants to assist in tendering for private sector contractors for collections and operations of landfill (**achieved**); Selection and contracting of collections operator (**delayed**);Selection and contracting of landfill operator (**delayed**)	30-Aug-13	€10 million
Brasov County Road	Romania	urban transport	Private contractors(s) for road rehabilitation and maintenance delivering quality services with no major disputes (**achieved**)	30-Nov-12	€10.1 million
Sava River Crossing	Serbia	urban transport	Consultants appointed to scope parking and other PPP opportunities in local transport (partially achieved);City decisions relating to parking PPP (**delayed**); Successful competitive award of contract(s) or concession(s) to private firm(s) for parking construction and/or operation (**delayed**); Successful competitive award of road and bridge maintenance contract and effective subsequent maintenance of the infrastructure (**delayed**)	30-Apr-13	€109.6 million
Kaunas Trolleybus Modernisation	Lithuania	urban transport	Outsourcing of ticket control and enforcement to a private company along with at least 90 employees (**achieved**)	31-May-13	€10 million
Bacau Solid Waste Management	Romania	solid waste	Selection of consultants to assist in tendering for private sector contractors for collections and operations of landfill (**achieved**);Selection and contracting of collections operator (**delayed**);Selection and contracting of landfill operator (**delayed**)	30-Apr-13	€4.9 million
Arges County Regional Solid Waste	Romania	solid waste	Private landfill management and at least 2 private operators in waste collection: 1) Contracting of a consultant (**achieved**); 2)Preparation and launch of the tender (**partially achieved**); 3)Successful operation (financial sustainability, collection oftariffs, no additional subsidies.)(**delayed**)	30-Nov-11	€6.1 million
Sibiu Public Transport (City Loan)	Romania	urban transport	Consultant to finalise strategic options study for TURSIB (**achieved**); EBRD and City to agree on milestones in line with recommended strategy. City council to review and consider strategy and steps to involve the private sector (**partially achieved**); Significant private sector participation in TURSIB or privatisation (**partialy achieved**)	30-Mar-11	€4.4 million
Sibiu Public Transport (Company Loan)	Romania	urban transport	Outsourcing cleaning (**not achieved**);Outsourcing security services (**achieved**); Outsourcing 50% of ticket sales (partially achieved)	21-May-10	€7 million
Pula Urban Transport	Croatia	urban transport	PPP Strategy for on-street and off-street parking in the sustainable Transport Strategy (**not achieved**); Private sector participation in construction and management of parking spaces (at least one project) (**not achieved**)	31-May-11	€5 million
2007					
Iasi Public Transport Infrastructure	Romania	urban transport	Transfer of the Company's minibus services to the private sector (**achieved**); Investigation of options to out-source non-core services (**achieved**); Effective out-sourcing of identified non-core service (**partialy achieved**)	31-Jul-11	€14.6 million
Armenia Lake Sevan Basin Environmental	Armenia	water & wastewater	Management contract to be extended or a new private sector participation contract acceptable to the Bank to be entered into (**achieved**)	01-Feb-11	€7 million
Zagreb Holding Water and Sewer Investment	Croatia	water & wastewater	Implementation of Consultants implementation plan, including privatisation of at least two business with units with total revenues at least equal to 10% of Holding Company revenues, comprising market services provided by the private sector, e.g., pharmacies (**delayed**); Operation outsourcing of one non-core function to private sector (**delayed**)	30-Apr-11	€30 million
2008					
Batumi Public Transport	Georgia	urban transport	Establishment of an on-going route tendering system (**delayed**)	30-Nov-11	€2.5 million

Table 2.4: MEI-Public projects with PSP components (2009 to 2012) (data on 2012 projects has not yet been entered into TIMS)

	Country	Sub-sector	Description of PSP components (TIMS review comments in bold) and verification by Evaluation Team	TIMS review date	Financing value
2009					
Rustavi Solid Waste Management	Georgia	solid waste	Development of a plan and procedures to invite a public-private partnership of the landfill company (**no comment**)	30-Sep-11	€1.6 million
Lviv Public Transport Financing	Ukraine	urban transport	Competitive tendering of bus/minibus routes (**no comment**)	28-Sep-12	€12 million
Lviv Road Rehabilitation and Modernisation	Ukraine	urban transport	Competitive tendering of bus/minibus routes (**no comment**)	28-Sep-12	€26 million
2010					
Adjara Solid Waste	Georgia	solid waste	Development of a plan and procedures to invite a public-private partnership of of landfill company (**no comment**)	30-Oct-12	€3 million
Krakow Public Transport Project - Phase II	Poland	urban transport	Launch tender and contract-out a further 10 per cent of bus services (**no comment**)	30-Jun-12	€16.9 million
Warsaw Public Transport Programme - Warsaw Tramways	Poland	urban transport	Increase in outsourcing of track repairs (**no comment**)	31-Aug-12	€24.5 million
Almaty Bus Sector Reform	Kazakhstan	urban transport	Completion of the TC on e-ticketing system; Launch of the tender for integrated e-ticketing system; Sign a contract for integrated e-ticketing system;Tender and sign a management contract for the operation of CNG buses on the condition that the Ex-post Evaluation TC recommends that significant cost savings can be achieved **(no comments)**	30-Jun-13	€26.7 million
Sibiu Municipality Loan - Phase II	Romania	urban transport	Signing of PMMR contracting for maintenance of additional 30 km of urban road in Sibiu (beyond the covenanted 15 km) (**not yet applicable**); Reduction of the in-house road maintenance unit (currently consisting of more than 300 staff) to reflect the activities outsourced to private sector (**not yet applicable**); At least 3 of the Bank's client cities sign PMMR contracts for minimum of 15 km per contract (**delayed**); The team, with support from TC-funded expert consultants, will carry out a minimum of two seminars on PMMR contracting in Sibiu with the private sector contractor industry (**delayed**)	30-Jun-13	€11.5 million
Sfantu Gheorghe Street and Lighting Rehabilitation	Romania	urban transport	The Bank, with support from TC-funded expert consultants, will carry out a minimum of two seminars on PMMR contracting in the Transylvanian region with the private sector contractor industry and the national association of municipalities in promotion of PMMR (**partially achieved**); Signed-PMMR contracts awarded in at least two other Romanian cities, based on the Sfantu Gheorghe experience (**not yet applicable**)	30-Sep-13	€12 million
2011					
Armenian Small Municipalities Water	Armenia	water & waswater	Signed lease contract with the duration of at least 10 years signed for AWSC (**no comment**)	30-Apr-13	€6.5 million
Sofia Public Transport Sector Reforms - Sofia Municipality	Bulgaria	urban transport	A pilot for out-sourced ticketing control contract signed with the private sector; Successful implementation of the private sector ticketing control (**no comments**)	29-Mar-13	€6.9 million
Medias Urban Infrastructure Rehabilitation	Romania	urban transport	The Bank, with support from TC-funded expert, will carry out a minimum of one seminar on PMMR contracting with the private sector contractor industry (**delayed**); Extension of the pilot to other zones of the City for a minimum of 10 km (**no comment**); Replication of PMMR based contracting by two other Romanian municipalities (**delayed**); Signed PMMR based contract by at least one Romanian municipality - without EBRD financing (**no comment**)	30-Apr-13	€7.4 million
Sarajevo Urban Roads Development	Bosnia i Herzegovina	urban transport	Signed PMMR with private contractor(s) to include rehabilitation and maintenance services for a minimum of 50 km of urban roads (**on track**)	30-Nov-12	€16.5 million
Bodrum Water	Turkey	water & wastewater	Outsourcing contract for meter reading and maintenance (**no comment**)	31-Dec-12	€3.6 million
Gaziantep CNG Buses	Turkey	urban transport	Bus routes to be tendered to private sector operators in accordance with the new model PSC (**no comment**)	30-Nov-12	€10 million
Bishkek Public Transport	Kyrgyz Rep.	urban transport	Tendering out of an e-ticketing to a private sector partner on a build and operate basis (**delayed**); Implementation of an e-ticketing system (**delayed**); Allocation of funds on a transparent manner (PSC) (**achieved**)	30-Apr-13	€7.7 million
Chisinau Urban Road Sector	Moldova	urban transport	At least two multi-year maintenance contracts are signed (**not yet applicable**); On-street management of parking is contracted for with the private sector (**not yet applicable**); Road maintenance is outsourced to the private sector (**not yet applicable**)	31-Jan-13	€10.3 million
2012					
Burgas Integrated Urban Transport Project	Bulgaria	urban transport			€10 million
Mersin Wastewater Project	Turkey	water & wastewater			€20 million
Dnipropetrovsk Metro Construction Completion	Ukraine	urban transport			€152 million
Yerevan Metro Rehabilitation project Phase II	Armenia	urban transport			€5 million

Annex 3: Selected findings from past evaluations of Bank MEI-PSP operations

In this Annex we provide a brief commentary to the recommendations regarding PSP found in the 2010 Special Study: Municipal and Environmental Infrastructure Policy Review, which was a sector review of the implementation of the Bank's 2004 MEI Operations Policy. Our commentary relates the recommendations of the 2010 Study with the findings and recommendation of the sample case studies.

Regulation and institutional strengthening

Recommendation

"Successful 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."

Comment: This recommendation is still valid and dovetails with our findings and recommendations in the Rosvodokanal I and II, and Aqualia Investment Venture projects.

Recommendation

> "As well as providing TC for institutional strengthening and capacity development of the municipal client / utility, the EBRD could consider providing TC to regulators in relation to developing their capacity and strengthening their independence."

Comment: The recommendation remains valid but the evidence from this Study suggests a focus on fostering an enabling business environment for PSP and not only on improving regulations, as manifest in the evidence from Aqualia Investment Venture.

Recommendation

> "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."

Comment: This recommendation is still valid with a focus on contract standardisation with a view to reduce the transaction costs associated with preparation of PPPs, for example as in the case of the Wroclaw Parking PPP project.

Procurement and transaction costs

Recommendation

> "Larger, more complex projects involving PSP can be much more resource-intensive for the Bank. The EBRD needs to focus on strengthening and maintaining the relationship between the client and the private sector service provider in complex PSP projects."

Comment: We believe this recommendation is still valid and it is illustrated in particular in the role the Bank can play as an "honest broker", for example in Zagreb WWTP.

Recommendation

> "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

> 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."

Comment: The scope for this recommendation extends to contract management and not just contract design.

PSP approach and incentives

Recommendation

> "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."

Comment: This is correct and still valid. A finding of this Study which echoes the need for strongly planned and implemented design is that the state of asset monitoring in environmentally sensitive services –such as wastewater—can influence the cost and design of private sector solution/operations - e.g., Zagreb WWTP.

Recommendation

> "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."

Comment: this recommendation applies to operations where Sponsors are working with small and medium municipalities as is the case with the Aqualia Investment venture project.

Recommendation

> "Privatisation can assist commercialisation in that radical changes (for example staff reduction and environmental improvements) can be implemented much more easily by a private company."

Comment: This recommendation is central to the political economy of PSP in MEI where the risk associated with difficult decisions --such as redundancies or tariff increases— is sometimes transferred to the private sector. If this risk transfer does not take place, the municipality will tend to be reluctant to implement PSP that carries a loss of labour for fear of political conflict. The evidence form this Study suggests this may explain why some PSP components in MEI public projects do not materialise.

Recommendation

> "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."

Comment: The evidence from this Study suggests this is still the case.

Annex 4: TC activities

MEI TC projects (from 2001 to 2012) categorised as "private" or "private/state"

(Eight TCs related to Bank-financed private operations are in grey-shaded rows)

TC name	Country	Year signed	Sub-sector	Amount
2001-2004				
Brno Sewerage Network Rehabilitation -project implementation	Czech Republic	2001	Water and Sewage	€450,000
Romania District Heating Rehabilitation	Romania	2001	Steam and Air Conditioning Supply	€302,085
Zagreb Public Transport Project	Croatia	2001	Transit and Ground Passenger	€129,621
Sofia Parking Project: Parking Strategy and Action Plan	Bulgaria	2003	Transit and Ground Passenger	€189,654
Romania District Heating Rehabilitation - Municipal Services	Romania	2003	Steam and Air Conditioning Supply	€32,590
Constanta Water and Wastewater Project	Romania	2003	Water and Sewage	€23,625
District Heat Project Preparation & Implementation Advisors	Poland	2004	Steam and Air Conditioning Supply	€19,058
2005-2008				
Khanty-Mansi RMSDP. Megion. Teploenergo IFRS Audit	Russian Federation	2005	N/A	€49,380
Bucharest Parking Strategy and PPP Advisory Services	Romania	2006	N/A	€300,000
COWI - EU SMM Finance Facility: Slovakia - Dexia Slovensko: Assistance to TVK	Slovak Republic	2006	Municipal Services	€23,197
Kazakhstan: Shymkent Vodokanal - Feasibility Study	Kazakhstan	2008	Municipal Services	€188,546
Electronic Ticketing System Design for the City of Plovdiv	Bulgaria	2008	Transit and Ground Passenger	€184,625
2009-2012				
Shymkent Water Company	Kazakhstan	2009	Municipal Services	€193,400
Kazakhstan: Shymkent Waste Water Treatment Plant - Feasibility Study	Kazakhstan	2009	Water and Sewage	€266,870
Shymkent WWTP: Public Utility Sector Reform in Kazakhstan	Kazakhstan	2010	Municipal Services	€210,745
Kotor - Cetinje Cable Car - Technical Review and preparation	Montenegro	2012	Transit and Ground Passenger	€200,000

In addition to the above TCs, from 2004 to 2006 the Bank implemented also the second phase of Municipal Public-Private partnership programme (MP4), financed by a grant of US$ 354,633 from the US Government. This project's objective was to raise the awareness about PPPs in the western Balkans, Romania and Bulgaria, and to identify bankable PSP projects. However, similarly as the first phase (earlier implemented in Poland), it failed to identify any such projects. After negative experience with two phases of MP4 TC (which in total amounted to €1.3 million), the Bank used relatively rarely TC for the promotion of PSP-MEI projects. The TC projects listed above amount to €3 million, accounting for only two percent of total TC funds used by the MEI from 2001 to 2012. Even this number of PSP-related TC might be inflated as some of them are categorised as "private/state" because at the project development stage it was unclear whether they would be private or public. However many of them ultimately were financed as public projects (or failed to materialise altogether). Only eight TCs (highlighted above) were related to projects financed by the Bank.

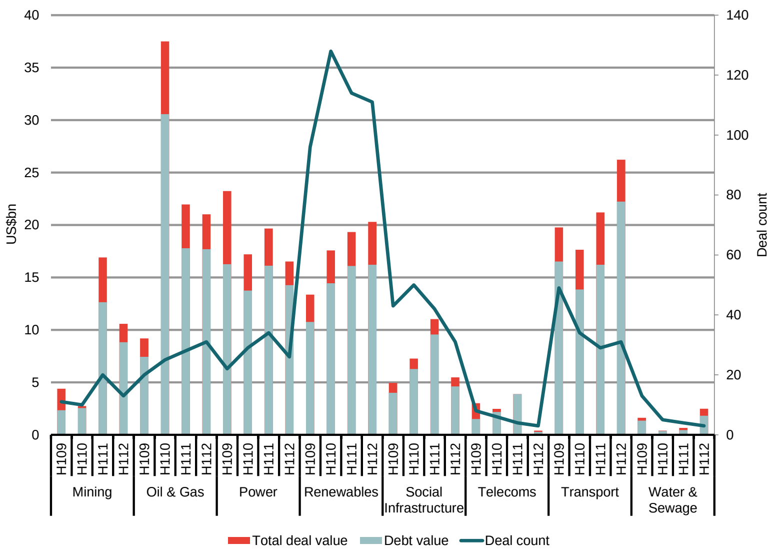
Annex 5: Recent IFI experience with PSP in infrastructure

This annex summarises recent IFI experience with infrastructure projects with PSP. We use a selection of IFIs including, for example, the EIB, World Bank Group and Inter-American Development Bank. The evolution of PSP in infrastructure in other IFIs, the challenges they face, their recent portfolio development, and the institutional and policy options they are considering to address those challenges, provide useful context and points of reference for the analysis and the findings of this study.

Global context

Global infrastructure investment activity slowed down as a consequence of the 2008 financial and economic crises, and has failed to gain sustained momentum since. In Europe, for example, the collapse of the inter-bank lending market drastically reduced liquidity after the start of the 2008 crisis. Most banks, particularly those with limited deposit bases, struggled to raise funds even on short maturities. In that post-crisis context, project finance and PPP lending competed for scarce regulatory capital allocations with more attractive corporate opportunities. Bank margins increased substantially and senior bank debt tenors were significantly reduced. As a result some banks partly or totally withdrew from the Project Finance market, and the viability of the traditional PPP model was put into question. The situation has been changing recently, but only slowly.

Figure 6: Global infrastructure project finance volumes by sector (2009 to 2012)

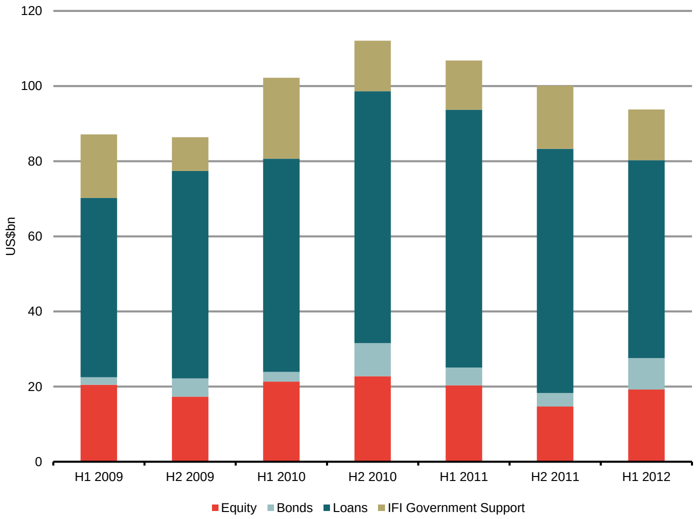


Source: Infrastructure Journal

Figure 6 shows the level of global activity (finance volume and number of projects) that has taken place since the 2008 financial crisis. It shows the relatively small share that the traditional municipal infrastructure sector (such as water and sewerage sector) represents compared with those of other infrastructure sectors (such as transport, energy or social infrastructure). An implication of their small relative size is that the municipal infrastructure sector faces strong competition for funds against other infrastructure sectors that demand large volumes of finance, (potential investors have a wide range of options available to them). Consequently, the municipal infrastructure sector needs to offer an attractive risk / return profile to continue to attract global investors to the industry.

The sources of funding up to the first half of 2012 were bank loans (60 per cent), sponsor equity (19 per cent); IFI loans and government support (12 per cent); and bonds (nine per cent) (see Figure 7). Europe experienced most of the drop in finance volumes, and for the first time since 2005 the European market was outperformed by the Americas and Asia.

Figure 7: Global infrastructure project finance by source (2009 to 2012)



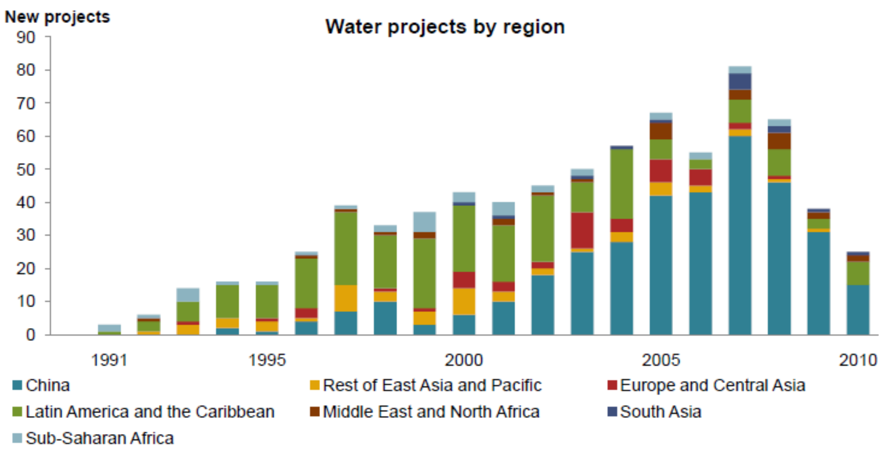
Source: Infrastructure Journal

The drop in PSP in municipal infrastructure since 2007 is illustrated by the evolution of global private activity in water infrastructure. While it more than doubled between 1991 and 2010 (523 new projects since 2001 compared with 232 projects from 1991 to 2000), since the beginning of the financial crisis in 2008, the global number of new water projects with PSP has constantly declined reaching a record low level of 25 projects in 2010[5]. The rapid increase in activity was led by China, which accounts for 61 per cent of new projects since 2001, and 71 per cent of new projects since 2005.

Despite the surge in activity by number of projects, private investment in water remained low: US$29 billion over the last decade compared to US$58 billion during the previous one.

In Europe and Central Asia , most private activity in the water sector concentrated in the first half of the 2000s and was almost entirely focused on the water utility sub-sector (29 of the 32 projects implemented over the last 10 years). Private activity has decreased since 2007, recording drops of between 15 to 25 per cent each year.

Figure 8: Regional distribution of private water projects (1991 to 2010)



Source: PPIAF (2012), Private sector participation in water infrastructure- Review of the last 20 years and the way forward

---

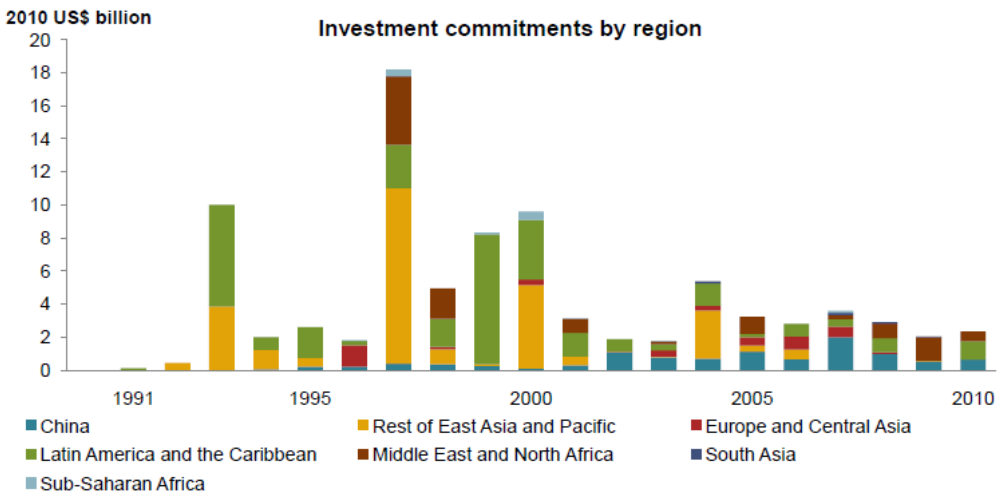
[5] PPIAF (2012): Private sector participation in water infrastructure- Review of the last 20 years and the way forward (http://ppi.worldbank.org/features/Feb-2012/Review-of-PSP-in-water-infrastructure-over-the-last-20-years.pdf)

Recent developments

In 2012, PSP infrastructure investment in Europe and Central Asia declined by 48 per cent to US$22.5 billion, the largest decrease of any region.[6] Europe and Central Asia comprised 12 per cent of global private infrastructure investment with 60 new projects of which 55 were energy, three transport, and two water and sewerage. While Turkey was quite active with 14 projects, Ukraine was the most active country with 16 energy projects amounting US$520 million. Twelve of these were divestitures of state owned natural gas companies.

Turkey had the largest share of PSP infrastructure investment finance in the region with US$9.7 billion, followed by Russia with US$6.3 billion. New projects were also implemented in Bulgaria and Romania with eight each, Albania (six), Russia (three), Serbia (three), Bosnia and Herzegovina (one) and Kosovo (one). Private infrastructure investment in 2012 comprised 1.2 per cent of regional GDP.

Figure 8: Regional distribution of private water project investments (1991to 2010)



Source: PPIAF (2012), Private sector participation in water infrastructure- Review of the last 20 years and the way forward

IFI portfolio developments

EIB

The PPP market in the European Union since the financial crisis of 2008 has been characterised by the sovereign crises which has led many countries to embark on significant structural reforms to try and restore growth and employment. It is widely accepted that Europe requires significant infrastructure investments across sectors (including energy, transport, telecommunications.) although it is less clear the extent in which the private sector is prepared to return to the levels of project finance seen in the years before the 2008 financial crisis.

According to the European PPP Expertise Centre (EPEC) at the EIB, the European PPP market in 2012 recorded its lowest volume and number of transaction in a decade. Only 66 transactions reached financial close for an aggregate value of €11.7 billion representing a 21 per cent drop in in the number of closed transactions and a 35 per cent decrease in value compared with 2011.[7]

In such context, the PPP model has been under review in several European countries (for example in the United Kingdom with the introduction of the PFI 2 model), and financing PPPs is proving increasingly challenging,

[6] PPIAF(2013) Infrastructure Policy Unit - 2012 Global PPI Data Update
[7] See EPEC (2013): Market Update -Review of the European PPP Market in 2012

especially in a context characterised by limited financial support from governments and other relevant public institutions given the scarcity of public funding.

More recently, the aggregate value of PPP transactions that reached financial close on the European market in the first half of 2013 amounted €9 billion. A recent MEI-PSP project is the Poznan solid waste project in Poland. It concerns the construction and operation of an energy-from-waste facility with a capacity of 210,000 tonnes per year. The project includes an availability-based contract for 25 years from completion and is expected to blend EU structural funds co-financing with private finance.[8]

Table 5.1 lists the PPPs co-financed by the EIB from 2001 to 2012 in the municipal sector: water and sewerage, waste and urban transport projects. The list excludes social infrastructure projects, such as schools and hospitals, although some of them may have local government obligors. The list includes 22 projects representing close to €5.9 billion of EIB financial commitments.

Table 5.1: EIB municipal infrastructure PPPs (2001 to 2012)

Project name	Country	Year	Sub-sector	Amount (€ million)
2001 to 2004				
Tramway in the Barcelona Metropolitan area	Spain	2001	Urban transport	136
London Underground	United Kingdom	2002	Urban transport	1,349
Wastewater Treatment, Delfland	Netherlands	2003	Water, sewerage	125
Tram System in Greater Barcelona	Spain	2003	Urban transport	125
London Underground - Bis	United Kingdom	2003	Urban transport	880
Water Infrastructures in Arezzo	Italy	2004	Water, sewerage	41
Light Metro Line in Greater Seville	Spain	2004	Urban transport	260
2005 to 2008				
Woolwich Arsenal Rail Extension	United Kingdom	2005	Urban transport	148
Brussels Wastewater Treatment	Belgium	2006	Water, sewerage	96
Thessaloniki Submerged Tunnel	Greece	2006	Urban transport	152
Northern Ireland Water	United Kingdom	2006	Water, sewerage	85
Cornwall Waste	United Kingdom	2006	Waste	120
Light Railway Network in Malaga	Spain	2006	Urban transport	325
Metro Train Sets for Madrid Region	Spain	2007	Urban transport	306
Tram network of Reims	France	2008	Urban transport	108
Turin Waste Incinerator	Italy	2008	Waste	273
2009 to 2012				
Manchester Solid Waste	United Kingdom	2009	Waste	195
Rolling Stock for Madrid Metro Network	Spain	2010	Urban transport	188
Barcelona – Metro Line 9	Spain	2010	Urban transport	400
Zaragoza Tramway	Spain	2010	Urban transport	175
Nottingham Express Transit	United Kingdom	2011	Urban transport	129
Metro de Granada PPP	Spain	2012	Urban transport	250

Source: EPEC (2013) - PPPs financed by the European Investment Bank since 1990

[8] See EPEC (2013): Market Update -Review of the European PPP Market First half of 2013

World Bank Group

The table below summarises both the main project and non-project activity of the World Bank Group (WBG) in relation to infrastructure PPPs during the period 2002 to 2012.

World Bank Group projects and services targetting PSP in infrastructure : 2002-2012										
PUBLIC					PRIVATE					
Project		Non-project			Project				Non-project	
Number of IBRD/IDA projects	Financial commitment	Number of WBI capacity building activities	Number of PPIAF operations	Total expenditures	Number of IFC investments	Financial commitment	Number of MIGA guarantees	Gross exposure	Number of IFC PPP Advisory Services	Total budget
203	$23 billion	120	788	$155 million	130	$3.7 billion	71	$5.2 billion	220	$228 million

Source: IEG (2013), Evaluation of the World Bank Group's support for Public-Private Partnerships - Approach Paper

A few other features characterise the WBG activity related to PSP infrastructure from 2002 to 2012[9]:

- During the last tenyears, World Bank Group support to PPPs has increased fourfold. Despite the 2008 global financial crisis, lending, investments and guarantees have risen both in absolute and in relative terms, from $1.6 billion to 4 billion and from 7 per cent in 2002 per cent to 15 per cent in 2012;
- IFC invested in 165 projects supporting PPPs and amounting to $6.1 billion original commitments from 2002 to 2012. IFC's investments in PPPs represent 41 per cent of its total infrastructure financing and nine per cent of total IFC investments;
- Most PPPs in 2002-12 can be found in energy, which represents over 55 per cent by volume and 50 per cent by number;
- More than half of IFC's PPP investments can be found in upper middle income countries and in non-IDA countries (with 52 per cent each), and more than a third occurred in Latin American and the Caribbean. Shares of volume and number of PPPs for Europe and Central Asia are 18 per cent and 13 per cent, respectively.
- Activities in the Bank's countries of operations: The IFC co-financed one transaction with the EBRD (Dalkia Baltica/Russia, regional) and was an advisor on another one (Apa-Nova in Romania). IFC also approved co-financing of Rosvodokanal I project, however did not agree on the gearing ratio with the sponsor and withdrew from this transaction. On its own, IFC financed two other water/waste water projects in the Bank's countries of operations during the Evaluation Period: A small municipalities project in Armenia, and Aqua Water in Bielsko-Biala, Poland.

IFI institutional and policy developments

Faced with business environment challenges in the private infrastructure markets, and equipped with the experience accumulated before and after the financial crisis of 2008, IFIs are reviewing or evaluating (or have recently reviewed or evaluated) their experience with PSP in infrastructure investments to identify new approaches and instruments, re-define their role in the market for private infrastructure; and draw lessons for the design and implementation of future investment projects.

Evaluations and strategy reviews

The Independent Evaluation Group of the World Bank Group, for example, is currently undertaking an evaluation of the Group's support for public private partnerships.[10] The scope of the evaluation will capture World Bank

[9] See IEG (2013), Evaluation of the World Bank Group's support for Public-Private Partnerships - Approach Paper (http://ieg.worldbankgroup.org/Data/reports/WBG_Support_PublicPrivatePartnerships_ApproachPaper.pdf)

Group efforts on market reform, regulatory frameworks and pricing in the infrastructure PPP space, and subsequent transactions—even if they do not result in PPPs per se. For example, much effort is dedicated to advising governments on sector reform issues, market structure and regulatory changes, but eventually those efforts may not result in traditional PPP arrangements. They may end up, for example, as a design build contract for a road, or a full privatization. The evaluation exercise intends to review such efforts with in-depth country case studies.

The background for the World Bank Group evaluation of its PPP experience reveals the shift in emphasis across Bank policies and strategies, including the internal incentives to pursue PPP s. After a phase of reliance on the private sector in the 1990s, the 'Infrastructure Action Plan 2003-2008' shifted World Bank Group's focus from transfer of infrastructure assets from the public to the private to a more flexible range of PPP s. The subsequent infrastructure strategy, the 'Sustainable Infrastructure Action Plan 2009-2011', focused on strengthening the enabling environment for PPP s and scaling them up, became a strategic objective, with assistance of trust funds, such as the GPOBA and the PPIAF. The most recent strategy update, 'Transformation through Infrastructure: Infrastructure Update FY2012-2015', reiterates a PPP scale-up. However it recognizes at the same time the lack of incentives for World Bank staff to pursue risky and time-intensive PPP projects rather than straight-forward public lending. It recognises the challenge posed by more than 20 different units contributing across the World Bank Group to the PPP agenda. Corporate strategies, for example, 'IFC's Strategic Directions and Road Maps 2002-2015', broadly reflect the PPP emphasis of the infrastructure strategy updates, expanding the PPP concept, however, to health, education, and the food supply chain. PPP s have not been the subject of a World Bank Group-wide stand-alone policy or strategy. Instead, they are considered in the context of sector, regional, or corporate strategies.

The Inter-American Development Bank is another IFI where recent evaluations have addressed the future of the private infrastructure projects in the context of both their experience with non-sovereign operations[11] and the institutional commitments related to the private sector adopted by the Bank as part of their ninth capital increase[12]. Both evaluations have been carried out by the Bank's Office of Evaluation and Oversight (OVE).

Non-sovereign lending

The IDB's 2006 non-sovereign loan expansion to sub-national entities was based on expectations of a large and growing market for non-sovereign sub-national loans. The overall expansion of non-sovereign lending to newly eligible sectors and borrowers was successful. The cumulative approvals of US$6.6 billion from 2007 to 2010 surpassed the expected US$4 billion specified in the Business Plan of 2007 to 2010.

By contrast delivery of loans to sub-nationals was very modest. Actual delivery was 1.8 per cent (three projects) to enterprises partly or wholly owned by a sub-national government, or 3.6 per cent (six projects) if PPP s, where the authorising counterpart is a public sub-national entity, are included.

Given that effective public service delivery is critical for poverty reduction, and decentralisation has increasingly placed investment decisions for infrastructure services at the sub-national level, the IDB's OVE suggest that the Bank could (i) understand better the potential market for sub-national lending, (ii) review the guidelines and practices of peer multilaterals, particularly the EBRD, to determine the desirability and feasibility of emulating them; and (iii) propose changes to existing policy and guidelines (institutional framework, costs to the borrower, and eligibility criteria) such that the Bank can better serve sub-national enterprises through non-sovereign lending.

---

[10] See http://ieg.worldbankgroup.org/Data/reports/WBG_Support_PublicPrivatePartnerships_ApproachPaper.pdf

[11] See IDB (2012): Evaluation of the IDB's Non-Sovereign Operations with Sub-National Entities: 2007-2010

[12] See IDB (2103): Mid-term Evaluation of IDB-9 Commitments

Private sector development strategy

The evaluation of the IDB-9 objectives of the IDB acknowledges the poor coordination of private sector activities of the Bank which rarely take advantage of potential synergies with the Bank's public sector work, and this is costly in terms of missed opportunities—whether in stimulating PPP s (which will be critical in attracting needed private infrastructure investment in LAC) or in strengthening financial systems or undertaking other reforms where both public and private actions are needed.

Some of the preliminary proposals that have been under discussion in the Bank include the creation of:

- A PPP network as an internal coordination mechanism, and virtual network formed by specialist assigned from the different departments, who will serve as the technical committee on PPPs and should have one department responsible for coordination to generate clear accountability, the PPP Network Coordinator;
- *A PPP advisory facility* to increase response to support a request in the short term for project implementation and PPP Program development, such as providing an expert advisor to resolve a technical issue during a negotiation; and to help bring PPP projects to market (i.e. to prepare tender documents to launch a bid);
- PPP knowledge management to systemize current knowledge and increase PPP capacity in the Bank.

Policy instruments

Other IFIs are reviewing the impact of policy instruments that were specifically designed to facilitate and promote PPP arrangements in certain sectors and policy contexts. Good examples are the evaluations that both the EIB and the European Commission are undertaking (independently of each other) of the 'Loan Guarantee instrument for the trans-European transport network' (LGTT). The LGTT instrument was established to mobilise private investment in large infrastructure projects with general rules for granting the Community financial aid for trans-European transport and energy network projects (the "TEN Regulation").

The LGTT is a debt instrument for project finance in transport infrastructure jointly established by the EU and the EIB, both partners sharing the financial risk, to accelerate and implement TEN-T infrastructure projects[13]. Progress with TEN-T projects using the LGTT instrument since it was approved in January 2008 has been limited to six projects (€475 million of EIB financial commitment). This may have been the result of factors related to the financial and economic crises started in 2008, which had a substantial impact on project finance markets. But it may also be the result of the design and functioning of the LGTT instrument itself. A main rationale for the on-going ex post evaluations is to assess these contributory factors and determine if the instrument is working or needs to be further re-designed.

In addition, to stimulate a revival in project financing, the European Commission and the EIB designed the 'Europe 2020 Project Bond Initiative' last year, which aims at attracting private finance for major infrastructure projects by enhancing the credit rating of the senior debt.[14]. It is too early to tell if the Initiative is working as planned.

Institutionalised PSP advisory platforms

Some IFIs play host to institutional platforms designed to advise the public sector on various dimensions of the PPP project cycle, infrastructure policy design and regulation, all intended to promote PSP. Two examples of such institutionalised advisory platforms are the 'Public-Private Investment Advisory Facility' (PPIAF) hosted by the World Bank Group, and the 'European PPP Expertise Centre' (EPEC) hosted by the EIB and supported financially by the European Commission.

---

[13] "LGTT facilities" benefit from a guarantee provided by the EIB to the private sector (project sponsors/ promoters), to enhance the credit rating of the senior debt by reducing traffic risk. The EIB provides a guarantee in the form of a contingent credit line, which may be drawn upon by the project promoter during the first 5 to 7 years of operation, if the revenues generated by a project are not sufficient to ensure repayment of the senior debt, in case the actual revenues from the project fall below the forecasted level.

[14] See http://www.eib.org/attachments/press-news-the-europe-2020-project-bond-initiative-07112012-en.pdf

PPIAF is a multi-donor technical assistance facility that consists of an advisory group of experts. It was created in 1999 to act as a catalyst to increase private sector participation in emerging markets. It provides technical assistance to governments to support the creation of a sound enabling environment for the provision of basic infrastructure services by the private sector. Through policy, legal, and regulatory support, PPIAF helps World Bank Group government clients explore ways to improve the delivery of infrastructure services involving the private sector. It also supports capacity building for governments to strengthen their ability to design, manage, and regulate infrastructure reform programs. Support comes in the form of grants to help governments explore PPPs in the financing, ownership, operation, rehabilitation, maintenance, or management of eligible infrastructure services. PPIAF-supported advisory and learning-related activities to support PSP in infrastructure through different types of activities, such as:

- Framing infrastructure development strategies;
- Designing and implementing policy, regulatory, and institutional reforms;
- Organizing stakeholder consultation workshops;
- Building government institutional capacity;
- Designing and implementing pioneering projects .

PPIAF also produces and disseminates knowledge and best practices on PSP in infrastructure. PPIAF activities are different from the PPP advisory functions related to transaction design provided by the IFC.

EPEC was established almost a decade after the PPIAF, in September 2008, as a joint initiative of the EIB, the European Commission and EU Candidate and Member States. It is located at the EIB headquarters and consists of an international team of 18 professionals with 39 full members (originally 20) with more than 120 participations annually in EPEC Working Groups. The scope of activities covered by EPEC include:

- PPP organisational capacity (for example understanding and strengthening PPP institutional structures and country capacity for delivering PPPs, including good practice guidance and PPP Investment Planning, Programme and Project Preparation)
- PPP *financing instruments* (that is, monitoring and analysis of developments regarding the financing of PPPs, to provide guidance to EPEC Members on how to foster the development of emerging financing solutions)
- Value for money (for example, advising EPEC Members on procurement issues, relevant European Community legislation; accounting and fiscal risk; ex-post evaluation)
- Bilateral advisory services (including stakeholder support activities --e.g. bespoke workshops; and bilateral "assignments" based on terms of reference agreed between EPEC and the requesting Member --e.g. re-launch of PPP programmes; blending of EU funds with PPPs)

PPP enabler / coordinator role

Several IFIs are hiring for positions of PPP enablers or coordinators to support their PPP advisory functions. For example, last July the African Development Bank was recruiting for a PPP -enabling environment specialist to focus on upstream activities, including the design of advisory programs to strengthen in particular North Africa's PPP -enabling legal and policy environment frameworks, the country institutional set up and capacity building. The role also included assisting public sector authorities in the procurement and monitoring of experts to conduct advisory programs and advice on industry best practices and methods.

Other IFIs, with more established PSP advisory capacity throughout, are announcing senior positions with a global coordinating role. This is the case of the World Bank group which has recently created a coss-cutting solution area director for PPP s with the objective of setting key strategic priorities and indicators on PPP s to guide World

Bank Group-wide work, establishing global goals to ensure alignment with the WBG Strategy, and supporting Regions in developing appropriate analysis and interventions in country partnership frameworks.

These positions are examples that reflect the human resource management options IFIs are currently considering to strengthen their PSP capabilities and improve their transaction and advisory offer.

Annex 6: Croatia

MEI sector challenges

The infrastructure sector in Croatia at the beginning of the 2001-04 quadrennial was characterised by the post-war rehabilitation and development efforts of previous governments. Croatia had relatively high levels of public expenditure on infrastructure as a percentage of GDP compared with neighbouring countries. However, many of those infrastructure projects were awarded in a non-transparent manner raising questions about their cost and economic viability, and lacked incentives for adequate commercialisation and efficiency in service provision. Thus, the key challenge at the time was to accelerate reform efforts in the commercialisation, liberalisation and privatisation of infrastructure services, and to create a sound regulatory framework and competitive environment.

The Croatian MEI sector was characterised by a few challenges. First, the weak institutional capacity of small municipalities to undertake necessary investments, particularly on the coastline linked to their tourism potential. Second, the increase in the number of municipalities over the years and the limited ability of fragmented municipalities to undertake necessary investments in water and waste water treatment, solid waste, district heating, rural roads and urban transport. Third, the limited borrowing capacity of municipalities, and the fiscal constraints of central government, to invest in municipal infrastructure, which attracted the idea of looking at private finance options.

PSP in the MEI sector was only considered a possibility in large municipalities. The Zagreb 'build operate transfer' project concession project for the construction of a wastewater treatment plant would soon become a national showcase to promote the involvement of the private sector in municipal infrastructure.

Box 1: Current PPP outlook in Croatia

Background: PPPs in Croatia are governed by the Public Private Partnership Act (2008, amended in 2011), the Concessions Act (2008), the Public Procurement Act (2012) and additional regulations. Regulation for public procurement is being aligned with EU legislation. The legal framework allows local authorities to carry out PPPs projects. Croatia has conducted two PPPss in the past decade which satisfy the criteria used in this study. Many more projects with private participation have been implemented in the past across sectors; however, most of these are for services indirectly related to the development or management of infrastructure and assets themselves, and as a result do not strictly classify as PPPss for benchmarking purposes.

Strengths: Croatia has an adequate institutional set-up for PPPss with a dedicated agency, established in 2008, in charge of project planning and oversight. Furthermore, laws establish clear and consistent rules for project selection and award. Line ministries, particularly the Ministry of Finance and Ministry of Transport, have good implementation capacity. Given that the experience with PPPss thus far has been relatively positive, the government is keen on further developing this type of project in multiple sectors.

Weaknesses: Despite the good legal framework, transparency and fairness of bid awards, in practice needs to be improved. Appeals post-contract award also need to be reduced, and on-going project management could be enhanced. The PPPs Agency is relatively new and although capacity is good, relative inexperience with PPP implementation issues remains. Although the country has historically met payment obligations to concessionaires, weak economic performance in recent years has resulted in the deterioration of its payment capacity. It is currently rated below investment grade according to the Economist Intelligence Unit, and capital markets for infrastructure finance are underdeveloped.

PPP

Source: The Economist Intelligence Unit (2013) Evaluating the environment for PPPs in Eastern Europe and the Commonwealth of Independent States - The 2012 EECIS Infrascope

Bank operations

Country strategy

The 2000 EBRD country strategy for Croatia is relevant to the Zagreb Wastewater Treatment Plant 'build operate transfer' project under evaluation. In that strategy, the Bank's stated objective was to promote the commercialisation and corporatisation of municipally-owned utilities and service organisations especially in water, waste water, solid waste and urban transport, and to explore private sector involvement in those sectors. Previously, the Bank had been active in the MEI sector in Croatia with three public projects covering seven municipalities (for example the Municipal Environmental Investment Programme; Zagreb Solid Waste Management Programme; and Rijeka Sewerage Services Improvement Programme).

The operational priorities of the Bank in the MEI sector at the time were (i) environmental protection in accordance with European Union requirements; (ii) urban transport; and (iii) energy efficiency (seeking to raise awareness of potential benefits associated with energy efficiency).

As part of the first operational priority related to environmental protection, the 2000 country strategy identified the wastewater treatment plant in Zagreb, involving private financing and operation on a build-operate-transfer basis, which also followed the model successfully established in Maribor, Slovenia.

Technical cooperation

Investments

Table 6.1 below lists the four relevant projects in the MEI portfolio in Croatia during the Study Period. In addition to the Zagreb Wastewater Treatment Plant ‘build operate transfer’ project, the project selected for evaluation, there are three other MEI State operations with PSP components, two urban transport projects in Dubrovnik and Pula, and a water and waste water project in Zagreb.

Table 6.1: Bank MEI-PSP projects in Croatia (2001-2012)

Project name	Portfolio class	Signing date	Project description	Financing value and instrument
Zagreb Wastewater Treatment Plant ‘build operate transfer’ project	Private	14/12/2001	Construction of a wastewater treatment plant	€42.2 million (debt)
Dubrovnik Urban Transport Development Project	State	18/10/2004	Dubrovnik Urban Transport Development Project	€6.5 million (debt)
Pula Urban Transport	State	24/08/2006	Upgrading of the bus fleet of Pula Promet d.o.o. and assistance to the city of Pula with development of sustainable transport strategy	€5 million (debt)
Zagreb Holding Water and Sewer Investment Project	State	24/12/2007	Investments in Zagreb’s water and sewer network	€30 million (debt)

Zagreb Wastewater Treatment Plant 'build operate transfer' project review

Summary

Faced with a pressing need to improve environmental standards, the City launched a process of international competitive bidding for the selection of a private partner who would be responsible for designing, financing, building and operating a plant capable of treating the City's wastewater. The Bank was not involved in mobilising advisors for the City, but the City based the PPP contract on tender documents that were developed by Bank-supported consultants in 1994 to 1998 for the Maribor 'build operate transfer' project in Slovenia.

The objective of the project was the construction of a wastewater treatment plant for the City of Zagreb on a 'build operate transfer' project basis (with associated infrastructure) to enable compliance, in stages, with EU environmental standards. The project was structured as a limited recourse financing with a standby facility available to finance variations and certain costs due to force majeure events.

The project company (a special purpose vehicle), Zagrebacke Otpadne Vode ("ZOV"), was established in September 1998. It is owned by the Sponsors, RWE Aqua (48.5 per cent), SHW Wassertechnik (48.5 per cent), and a City-owned company VZ (three per cent). The other major party in the project is the City of Zagreb, signatory of the Concession Agreement and responsible for payment of the service fee to ZOV.

Ratings

Table 6.2: Summary project evaluation

Name	Description	Indicators Fit with Bank policies	Fulfilment of project objectives	Financial perfor-mance	Bank handling	Transition impact	Overall view at this stage
Zagreb Waste Water Treatment Plant 'build operate transfer' project	Construction of a wastewater treatment plant	+	+	+/-	+/-	+/-	Partly successful

Fit with Bank policies

The project was highly consistent with the Bank's prevailing 1998 MEI Operations Policy, which promoted facilitating and optimising PSP in the financing and provision of municipal services, where appropriate. It was also consistent with the 2000 country strategy in that it promoted the commercialisation and corporatisation of municipally owned utilities in the water and wastewater sectors.

Financial performance

The financial performance of the concessionaire is well above market average. Although the EBITDA margin has been reduced in recent years (for example from 86 per cent to 79 per cent) the financial performance of the company is very strong. The most recent EBITDA margins are close to 80 per cent, which ZOV's senior management acknowledges is high. This outstanding financial performance is a result of a favourable concession payment formula whereby, if the operator meets all of the performance indicator standards he is fully compensated. Furthermore the operator has managed to keep its operational costs at a minimum. There have been two dividend payments to date: 2008 and 2011.

The City is "growing impatient" with high fees, which could lead to contractual disputes. The City alleges the tariff formula in the payment mechanisms is too complex and that it does not understand it. The Service Fee consists of a Capital Charge and a two-part Management & Operation Charge, both paid in kuna. The Capital Charge (about 85 per cent of the total) compensates ZOV for the design, construction and financing of the project. The fixed component of the Management & Operation Charge covers fixed operating and maintenance costs, overhead costs, working capital and provisions for replacement and renewal costs for the plant. The variable component of the Management & Operation Charge depends on flow, the quantity of pollutants removed, and the quantity of sludge treated.

Both the Capital Charge and the Management & Operation Charge will be indexed according to various official indices: Croatian retail prices, labour, energy, capital equipment, DEM (later EUR) inflation and HRK/DEM (later EUR) exchange rate. The entire Capital Charge is indexed to the nominal HRK/DEM (later EUR) exchange rate.

While the City has as adviser a civil engineering University professor, financial monitoring is done internally and not supported by external advisers or the Bank. Financial performance is rated here as "-/+" because of excessive profits being achieved by the operator, which create "negative demonstration effect" and are unsustainable.

Bank handling

Both the City and the concessionaire acknowledged the role of the Bank and, in particular, appreciate the "honest broker" and diligent role played by the banker in the Zagreb resident office in the dealings between both parties. The concessionaire is satisfied with both Banks (the EBRD and KfW). In the project design phase, the main risk was that of future major disputes between the City and ZOV. The Bank worked intensively with the two parties to amend the Concession Agreement to make it clearer and eliminate ambiguities, hoping that it would help to prevent disputes.

In projects like the Zagreb Wastewater 'build operate transfer' project, however, the Bank may consider the need to get involved in the contract management phase, especially if important dimensions of the transition impact of the project may be at risk. The apparent economic imbalance, which allows the PPP Company to enjoy 80 per cent EBITDA margins and is produced by the current payment mechanism (formula and arrangements), needs addressing and the Bank may have to intervene to mitigate the risk of conflict escalation.

Such Bank handling opportunity will be in line with a lesson from previous evaluations of MEI private projects, which acknowledges the importance of maintaining the balance between services and payments under a long-term PPP. It is good practice to review the main concession objectives and conditions every five years to secure the long term balance of a project and maintain good co-operation between the parties in a PPPs financed by the Bank.

Transition impact

The transition impact of the project was to achieve more private sector participation in infrastructure in the sector and country and to have demonstration effects based on it being the first privately owned concession for a water or wastewater utility in Croatia. The project was expected to have a demonstration effect for other PSP arrangements for utility services in Croatia.

<u>More widespread private ownership</u>

This transition objective of more private ownership/participation has been fully achieved. The transition benchmarks of this achievement are:

i) Concession awarded through an open competitive tender (*achieved);*

ii) Completion of works on cost and on time: Mechanical treatment: 1mn population capacity 1.25mn population capacity (*achieved)*

iii) Biological treatment from 1mn population capacity to 1.25mn population capacity (*achieved)*

<u>Demonstration effects</u>

While there have not been any follow-ups on the WWTP 'build operate transfer' project models, the project has created certain operational and efficiency benchmarks for the market which put additional pressure on the public sector operations in this sector

A key reason for success was the pre-existence of a monitoring programme that could assess the wastewater from the old city and the new city. The Company found this a robust basis on which to plan objectives and monitor performance

The monitoring benchmarks for demonstration effects are:

i) Good utility procedures financial, operational and regulatory success (*partly achieved)*
ii) Other PPPs in Croatia (*partly achieved)*

The assessment of partly achieved is due to the profit margins currently enjoyed by the Company which are considerably above market average and, if it not addressed, may trigger a contractual dispute with the City and cannot be considered good practice on which to build demonstration impacts.

<u>Sustainability of transition impact</u>

Regarding demonstration effects, the Croatian water and waste water sector is receiving grant funding from EU, which discourages similar PPP initiatives. This impact has been especially influential during the last three years, while the PSP has been further discouraged by the fallout from the economic crisis.

Regarding the transfer of skills, one source was the German engineers and supervisors employed in the construction phase. Civil engineers were hired from Croatia. Seven local staff were sent to Germany for training before returning to work in the plant. In terms of capital expenditures, 85 per cent was sourced locally and 15 per cent in Germany and Austria. Of the 65 staff currently working in ZOV, 60 are from Croatia, including the financial staff in ZOV who were hired from KPMG-Zagreb.

The overall sustainability of the PSP impact achieved by the project depends on how well potential or actual disputes can be resolved.

Findings and recommendations

PPP contract payment mechanism and the role of the Bank

Tariff formulas, which define compensation payable by cities to private partners for services provided (for example sewage treatment) or an increase of such compensation, are often so complex that they are not understood by the City officials and can result in a private partner achieving excessive profits (for example 85 per cent EBITDA). The Bank's role as an "honest broker" may be put into question if it is unable to explain the compensation formulas to its less experienced clients (the cities) and prevent private partners from achieving excessive profits.

Advisory services sought by municipal authorities

Instead of financial/economic specialists with knowledge of contract issues, cities tend to hire technical specialists (such as academics) to provide PPP contract monitoring services, who are of little help when discussing tariff/compensation formula adjustments (or formula renegotiation) with a private partner.

<u>Recommendation</u>

The Bank should reconsider the potential scope of its post-signing involvement in the monitoring of PPP contract implementation and management. The City of Zagreb may not have sufficient capacity to effectively monitor or regulate such contracts itself. To avoid or manage the risks that such problems can create, and the related "negative demonstration effect" of PPPs for other cities, the Bank should consider providing longer-term assistance to cities to monitor/regulate PPP contracts. This would need to be carefully structured to avoid any conflict of interest (as formally the Bank's clients are private investors). The creation of a Contract Monitoring and Oversight Office as part of the design of the PPP arrangement is an option with pros and cons which the Bank should consider.

Service quality monitoring pre-public private partnerhsip

Appropriate monitoring of key revenue and cost drivers (such as quality of waste water or urban transport demand) by the city or municipal company *before* undertaking PPPs can play a crucial role, considerably reducing the risk taken by the private partner and resulting in a PPP contract with better value-for-money (for example, lower compensation payments) for a municipality.

Recommendation

When undertaking project due diligence in the preparation of water or wastewater projects, the Bank needs to pay special attention to the extent and quality of the operations monitoring systems in place since they hold the key to business planning preparation and identification of key performance indicators that feed the PPP contract.

People consulted

Ms Nela Jurić (Deputy of Head of Office, City Office for Economy, Labour and Entrepreneurship, City of Zagreb)

Ms Slavka Megla-Relijć, Head of Monitoring Department, City Office for Economy, Labour and Entrepreneurship, City of Zagreb)

Dr Thomas Sichla (Managing Director, ZOV; Head of legal, Compliance and Regulatory Affairs, RWE)

René Matthies (Plant Manager, ZOV; Technical Plant Manager, WTE)

Summary performance of PSP components in public projects

The table below summarises the current status and extent of achieved objectives of the PSP components contained in MEI state projects in Croatia implemented during the study period. All of them have been either delayed, are not achieved, or at risk. In sum, based on the evidence of the three projects below, the Bank has not achieved any significant transition impact results supporting PSP in the MEI sector in Croatia through its state operations.

Table 6.3: MEI State projects in Croatia with PSP components (2001-2012)

Project name (signing year)	Sub-sector	TIMS review date	TIMS ratings: potential/risk	Description and status of PSP components (based on TIMS and verified by the Evaluation Team)
Dubrovnik Urban Transport Development Project (2004)	Urban transport	31/12/2012	Original: Good/High Current: Good/Medium	Completion of sustainable Transport Strategy including a PPP concept for on-street and odd-street parking (**delayed**); Decision by the City Council regarding private sector participation in construction and management of parking spaces (**not achieved**) The Sustainable Transport Strategy, which includes a PPP concept, has been completed, but it is pending Council approval. In 2012 the City carried out a new transport study, which included 16 goals related to parking locations, new bus terminal, petrol stations, re(construction) of main routes and a 3-phase implementation strategy starting in 2016. The likelihood of a corporate restructuring that would allow PSP is highly uncertain.
Pula Urban Transport (2006)	Urban transport	31/05/2011	Original: Good/High Current: Satisfactory /negligible	PPP Strategy for on-street and off-street parking in the sustainable Transport Strategy (**not achieved**); Private sector participation in construction and management of parking spaces (at least one project) (**not achieved**) PSP in parking has not been achieved due to economic crisis and insufficient funds and lack of political willingness.

Zagreb Holding Water and Sewer Investment Project (2007)	Water & wastewater	31/05/2013	Original: Satisfactory /High Current: Satisfactory /High - Excessive	Implementation of Consultants' plan, including privatisation of at least two business units with total revenues at least equal to 10% of Holding Company revenues, comprising market services provided by the private sector, e.g., pharmacies (**delayed**); Operation outsourcing of one non-core function to private sector (**delayed**) With the LA Amendment the client agreed to further evaluate the possibilities of the privatisation of some of its activities. The consultants for the assessment have been appointed in April 2013 and it is expected that the privatisation plan will prepared by them by the end of Q1 2014. Outsourcing of non-core function to the private sector has not been achieved so far. At this stage it is difficult to assess which non-core activities and when will be/could be outsourced.

Annex 7: Poland

MEI sector challenges

At the time the Wroclaw PPP parking project was being prepared, the MEI sector in Poland was characterised by limited PSP in municipal sub-sectors, in particular, water, sewage, wastewater and urban transport. In respect of energy efficiency, for example, the sector experienced significant operating costs due to heat losses from municipally-owned district heating networks and buildings placing Poland below EU energy efficiency average.

Regarding finance, the absorption of available EU structural and cohesion funds was a growing challenge, due partly to weak institutional capacity but also to the absence of long-term financing to support municipalities' investment plans and their opportunity to utilise EU funding. Smaller municipalities needed to complete reforms and commercialisation of municipal enterprises.

Other MEI sector challenges were the further development of PPP structures for municipal services and the development of a multi-year incentive-based tariff methodology for the utility companies and their managers.

In such a challenging context, the Bank's operational priorities were (i) the provision of long term finance outside municipal and regional budgets with a focus on PPPs, public service contracts and PSP; and (ii) general support for privatisation and PSP in municipal sectors.

Box 2: Current PPP outlook in Poland

Background: Poland has two main legislative acts that regulate PPPs in all sectors—the Law on Public- Private Partnership (2008) and the Law on Concession for Construction Works and Services (2009). The framework allows regional and municipal entities to conduct PPP transactions, and the greatest interest and activity in this area lies at the local level. National-level projects have been implemented in the transport and the water sector, with no record of cancellation or distress.

Strengths: The laws and regulations in place facilitate PPPs and aside from a few areas of improvement, such as the interpretation of step-in rights regulations and joint liability of consortium partners, they are generally fit for purpose. There is also sufficient political will to engage private partners in public-infrastructure provision at both national and local levels; moreover, the country has a relatively high income level and tariff setting for utilities usually follows a market-based approach. Poland also has a well-regulated, but developing, domestic capital market. More recently liquidity has tightened in tandem with heightened investor caution as a result of the deepening of the euro zone recession. Poland's high level of international reserves compared with other countries in east-central Europe also means that the government is in a good position to meet payment obligations. Furthermore, the new government in power since October 2011 has pledged to accelerate fiscal tightening to address the double burden of rising public debt and a high budget deficit.

Weaknesses: Neither the PPP law nor the concessions law include clear guidelines on how to select the correct form as an appropriate way to carry out infrastructure projects. The first PPP law of 2005 included a number of detailed analyses to be carried out by public partners before such projects were launched. However, the obligation to carry out those analyses was heavily criticised by the public sector and they were abandoned in the PPP law of 2008 and concessions law of 2009. Moreover, the institutional framework needs improvement. There are some PPP-specific roles assumed by state agencies, but these are uncoordinated and generally insufficient and ineffective. There is no dedicated national agency for PPP development or oversight, and the Ministry of Finance is insufficiently involved in accounting matters. Generally, agencies lack adequate expertise and knowledge in the area.

Source: The Economist Intelligence Unit (2013) Evaluating the environment for PPPs in Eastern Europe and the Commonwealth of Independent States - The 2012 EECIS Infrascope

Bank operations

Country strategy

The 2010 to 2013 EBRD country strategy for Poland is relevant for the Wroclaw Parking PPP project under evaluation. The Bank's stated objective in that strategy was to support the involvement of PSP in public services in cooperation with the EIB as well as EU Structural and Cohesion Funds, in particular privatisations and PPPs in transport and municipal and environmental infrastructure projects, in order to stimulate the development of revenue-backed financing and minimise reliance on sovereign guarantees while increasing the supply of long term finance.

Technical cooperation

Without considering the MP4 TC programme (see section 2.2.3), just a single TC operation related to an MEI-PSP district heating project was carried out in Poland during the study period for the amount of €19,058. By comparison, 27 other TC activities related to MEI State projects were carried out during the same period utilising a total of €6,271,450.

Investments

The table below lists the relevant projects in the MEI portfolio in Poland during the study period. In addition to Wroclaw Parking, the project selected for evaluation, there are six other MEI State operations with PSP components: five urban transport projects (Gdansk (2), Warsaw, Lodz, Krakow) and a water and sewer project in Rybnik.

Table 7.1: Bank MEI-PSP projects in Poland (2001 to 2012)

Project name	Portfolio class	Signing date	Project description	Financing value and instrument
Gdansk Urban Transport Project	State	16/07/2001	Investments to improve urban public transport and traffic	€12.0 million (debt)
Rybnik Sewerage Network Development Programme	State	30/11/2001	Co-financing for construction of new sewer network	€19.7 million (debt)
City of Lodz Road Improvement Project	State	16/10/2002	Upgrade of municipal roads and flyover	€6.6 million (debt)
Gdansk Urban Transport Project - Phase II	State	24/08/2006	Purchase of buses for the City of Gdansk.	€6.6 million (debt)
Mota-Engil Parking PPP Framework - Wroclaw Parking PPP	Private	23/06/2011	Creating underground parking facilities through PPP arrangement	€7.7 million (debt)
Warsaw Public Transport Programme - Warsaw Tramways	State	29/04/2010	Acquisition of low floor trams and modernise tracks and infrastructure	€24.5 million (debt)
Krakow Public Transport Project - Phase II	State	17/05/2010	Purchase new rolling stock and modernisation of infrastructure.	€16.9 million (debt)

Wroclaw Parking PPP project review

Summary

Wroclaw Parking was the first sub-project under the Mota-Engil Parking PPP framework. It involved financing Immo Park, a special purpose vehicle company in charge of the development and operation of the underground parking facility in the city of Wroclaw, Poland at the Nowy Targ Square. The Bank provided the company with a senior loan of up to PLN 31.3 million (€7.8 million equivalent) on a project finance basis.

The Bank's loan financing was signed in June 2011 and the underground parking opened for operations in July 2013. The evaluation of the project achievements therefore relates more to its contract design and construction phase than the operations, contract management and maintenance phase.

Ratings

Table 7.2: Summary project evaluation

Name	Description	Indicators Fit with Bank policies	Fulfilment of project objectives	Financial perfor-mance	Bank handling	Transition impact	Overall view at this stage
Wroclaw Parking PPP	Constructing and operating underground parking facilities through PPP arrangement	+	+	NR	+	+	Successful

NR- Not Rated, as it is too early to conclude (the parking was opened in July 2013).

Fit with Bank policies

Wroclaw Parking dovetails with both the Bank's Strategy for Poland 2010 to 2013 and the 2004 MEI Operations Policy. The country strategy states that the Bank will support private sector participation in public services, in particular privatisations and PPPs in transport and municipal and environmental infrastructure projects to stimulate the development of revenue backed financing to minimise reliance on sovereign guarantees and increase supply of long term finance.

The 2004 MEI Operations Policy states that one of the transition challenges in the advanced countries is to encourage private sector participation where appropriate and feasible and where it contributes to greater operational efficiency. It also states that the Bank would remain proactive in mobilising donor support to structure and prepare PSP operations with interested local governments of the region, and identified car parking as one of the areas to focus on.

Thus the fit of the Wroclaw project with Bank policies is very strong.

Financial performance

It is too early to conclude.

Bank handling

The role of the Bank in this project was to serve primarily as a source of finance. The private sponsor approached the Bank with a framework for PPP parking projects with Wroclaw already in the pipeline and at an advanced stage of preparation. Thus the Bank was invited late in the process of contract design. Still, the Bank had an important role in improving the arrangements, in particular by using the design of the Direct Agreement to regulate aspects that were not originally in the contract, for example the assignment of an insurance policy. From this point of view, even though the Bank added time and transaction costs to the process before financial closing, it did so with a strong rationale and improved the PPP arrangements.

Transition impact

The transition impact of Wroclaw Parking relates to that of the Mota Engil Parking PPP framework of which Wroclaw is the first sub-project. The transition impact of the framework targeted (i) successful private sector participation; (ii) demonstration effects of successful PPP development; and (iii) setting standards of corporate governance.

More widespread private ownership

The new parking facility has been implemented on a design-finance-build-operate-transfer basis by one of Europe's largest and most well established parking operator. Wroclaw's Nowy Targ Square parking is the first PPP in parking developed in the Bank's countries of operations. The framework is expected to provide further support to the sponsor (Mota-Engil) and its subsidiaries to expand further into regional parking markets.

Demonstration effects of new, replicable activities

Given that this is the first PPP carried out by the city of Wroclaw, and one of a handful of such projects implemented in Poland, the project could provide a platform for other similar projects in the MEI sub-sectors, not only parking. If its operation phase proves successful, the Wroclaw parking project could serve as an example or incentive to other parking projects contemplated by other cities in Poland and elsewhere. There is some evidence from other cities in Poland interviewed by the evaluation team (Warsaw, Gdansk) that they are considering similar projects and the Wroclaw project is closely monitored by them. However its demonstration effect still needs to be proved by new projects.

Transfer of skills and standards of corporate governance and business conduct

At approval stage the project was expected to transfer significant technological and management know-how through continuous technical and management support from the Sponsor (Mota-Engil) and training of the local middle management and workforce when necessary. The project was expected to create or maintain employment opportunities and promote high standards for corporate and employee behaviour.

Sustainability of transition impact

The sustainability of Wroclaw Parking demonstration effects will be tested if the contract remains in place without major disputes or even cancellation, and by the replication of similar PPP parking projects implemented in Poland without EBRD financing. It is too early to assess both aspects.

Findings and recommendations

<u>Need for PPP process and contract standardisation</u>

A recurring message from municipal decision-makers during this study was that PPPs take a lot of time to prepare and are complicated. Having models, standardised procedures and contract templates would greatly encourage cities to undertake such projects. The Bank should consider working with the public procurement agencies of several key countries to develop standard PPP procurement documentation and concession contracts (for example through dedicated technical cooperation or with the Legal Transition Team). This would greatly decrease the cost of PPPs and could create a market for the Bank.

<u>Improved communication in respect of the Bank's PPP financing offer</u>

To avoid the need to renegotiate concession contracts already concluded between the cities and private partners (for example, for parking services), the Bank should make its standard conditions of financing known to the city and all bidders, so they can be taken into account when negotiating a concession contract.

<u>Changing PSP project scope and format</u>

Large concessions and 'build operate transfer' PPPs in the water sector are becoming scarcer, while many cities in the Bank's countries of operation consider smaller, unconventional partnerships, which do not fall easily into the Bank's usual sphere of interest, for example, river transportation, bus/tram stop construction and management, street lighting, school building and management and sport facilities construction and management,. The Bank should consider providing assistance to the development of such "niche PPPs" with the view that financing them could build relationships with municipalities open to PSPs and may demonstrate the benefits of PSP. This could also gradually encourage cities to undertake PSPs in other sectors (which are better suited for conventional Bank financing, such as water and wastewater and urban transport).

People consulted

People interviewed and consulted for this Case Study project were:

Maciej Bluj, Deputy Mayor of Wroclaw (Municipality of Wroclaw)

Elżbieta Urbanek, Director, Infrastructure and Economy Department (Municipality of Wroclaw)

Pawel Rychel, President (Wroclaw Investments Ltd.)

Summary performance of PSP components in public projects

The table below summarises the current status of the PSP components contained in the six MEI State projects in Poland implemented during the Study period. One third of the nine PSP components have been achieved while the remaining two thirds have either not been achieved, have partly failed or been cancelled. Five of the six projects are urban transport projects. In sum, the Bank has achieved limited progress in supporting PSP in the MEI sector in Poland through its state operations.

Table 7.3: MEI State projects in Poland with PSP components (2001 to 2012)

Project name (signing year)	Sub-sector	TIMS review date	TIMS ratings: potential/risk	Description and status of PSP components (based on TIMS and verified by the Evaluation Team)
Gdansk Urban Transport Project (2001)	Urban transport	31/07/2011	Original: Good/High Current: Good/Negligible	Introduction of private bus operators (**not achieved**); Private sector participation in auxiliary services (**achieved**) The company has been corporatized, it is successfully operating under a good contractual arrangement, have outsourced auxiliary services and are now able to attract commercial financing on a non-recourse basis. Hence, full commercialisation of the company has been achieved and the risk to transition impact can be set as negligible. However city-owned company is the only one providing bus services in Gdansk.
Rybnik Sewerage Network Development Programme (2001)	Water & wastewater	27/03/2007	Original: Good/Medium Current: Satisfactory /Negligible	Options for PPP: seminar on PPP option, implementation of suitable options (**not achieved**) A seminar on PPP options was held, but the City is currently not interested in pursuing PSP projects. This is partly due to the abundance of the EU grant money and, hence, little need to tap into the private sector capital. The difficulty in accessing EU grants for privately managed municipal utilities is expected to delay privatisation for the foreseeable future.
City of Lodz Road Improvement Project (2002)	Urban transport	25/11/2008	Original: Good/High Current: Satisfactory /Negligible	Outsourcing road maintenance to the private sector (**partly failed**); Evidence that other municipalities in the country have adopted 'best value' approach for road maintenance and management (**cancelled)** The TC programme related to PSP has not been implemented. The Client had to allocate scarce staff resources to preparation of other projects related mostly to EU financing. Despite lack of formal programme, the Client implemented two recommendations of the Bank-financed scoping study (creation of Public Roads and Transport Authority and transformation of municipal road works unit into a company) and improved management of municipal roads with help of other consultants assisting the City in preparation of other project.
Gdansk Urban Transport Project - Phase II (2004)	Urban transport	08/07/2008	Original: Satisfactory /Medium Current: Satisfactory /Negligible	Outsourcing of tram track maintenance to the private sector and transfer of ticket sales and fine enforcement (**achieved**); Successful operation of private contractors (outside of the city and without renegotiation) (**achieved**). Public Transport Monitoring Unit has contracted private companies to sell and to check tickets. Repairs and maintenance of tram tracks was tendered. These services are provided by a consortium of ZKM and a private company. Private operators continue operating with a 5% share of inter-city market.
Warsaw Public Transport Programme - Warsaw Tramways (2010)	Urban transport	31/08/2012	Original: Good/High Current: Satisfactory /Medium	Increase in outsourcing of track repairs (**not achieved**) The tram companies has a large number of staff dedicated to maintenance (half of its staff are maintenance workers), and widespread redundancies are politically unacceptable. In-house maintenance is perceived to be cheaper and more flexible in terms of quick deployment or removal of works to avoid congestion in certain areas of Warsaw.

Krakow Public Transport Project - Phase II (2010)	Urban transport	30/06/2012	Original: Satisfactory /Medium Current: Satisfactory /Low	Launch tender and contract-out a further 10 per cent of bus services (**not achieved**) The City has organised and finalised the tender for the provision of additional 5% of bus services by a private operator, however the chosen bidder was not able to provide the said services due to technical problems associated with the buses. The City has not yet prepared or announced the new tender.

Findings and recommendations related to public projects in urban transport with PSP components[15]

PSP drivers

The excessive age of its bus fleet, combined with public transport company/city indebtedness constraints, is the main reason for a city to invite private bus operators to service part of its bus routes.

Unintended consequences of Bank finance

EBRD loans to public companies or cities to purchase new buses, effectively prevent (or delay) the introduction of private bus operations in such cities.

Non-complex PSP in urban transport

The gradual introduction of private bus services (taking over more routes from the public bus operator) is relatively uncontroversial and politically acceptable. MEI should consider developing more of such projects to demonstrate the benefits of PSP.

Acceptability of outsourcing maintenance activities in urban transport

PSP components of public transport projects calling for the contracting out of tram infrastructure maintenance failed mainly because the tram companies already had a large number of maintenance staff (in some cases half of all staff) and such widespread redundancies would be politically unacceptable. Moreover, in-house maintenance is seen as cheaper and more flexible (in terms of quick deployment or removal of works to avoid congestion in certain areas of a city).

Payment mechanism incentives

Compensation formulas for urban transport companies applicable under PSCs (developed with the Bank's support) often are "cost plus". They lack incentives to achieve cost efficiencies (savings would need to be paid back to the city). This economic model is not conducive to the introduction of PSPs.

Attitudes towards PSP in urban transport

Many cities in the Bank's countries of operation take the example of large cities in neighbouring Central European countries (such as Berlin and Vienna) where public transport companies are not only public but budgetary units of the city. This reaffirms their view that public services should be provided by public companies and not by private sector providers.

Service quality risks

Private bus operators are often perceived to provide a lower quality service, as some (often local) operators are reluctant to invest in modernising their bus fleets in the expectation that their contract will expire and they will face stiffer competition during the next tender. This creates a negative perception of PSPs in general (service users perceive public transport companies as providing a much better service with new buses, often financed by the EBRD).

[15] As part of this evaluation three urban transport projects with PSP components were analysed in more detail and their clients were interviewed. Two of these projects were in Poland (Warsaw Tramways and Gdansk Public Transport), therefore conclusions from these analyses are presented in this annex.

Annex 8: Russia

MEI sector challenges

When the Bank was preparing the first Rosvodokanal (RVK) transaction, which was then signed in August 2008, the economic environment in Russia was characterised by a combination of strong state presence in sectors considered to be strategic and liberalisation tendencies in the rest of the economy. The operational and reform environment remained complex with major uncertainty given that the state was assuming a much stronger role in the economy while the public institutions, both at federal and local levels, were at the early stages of their own reform.

In the infrastructure sector, the Bank selected projects where the promotion of PSP, environmental improvement, energy saving investments, and the priorities of the Russian government, such as the development of key transport arteries, were most prominent. Little had been achieved in district heating, for example, since main obstacles to energy efficiency investments remained. The Bank's launch of long-term RUR-denominated loans in the Russian municipal infrastructure market became pivotal as the Russian Budget Code did not allow municipalities and regions to raise additional borrowing in foreign currency.

The main transition challenges in the MEI sector at the time were (i) the upgrading and developing of Russia's municipal infrastructure with special regard to facilitating PSP and engaging in path-breaking PPP transactions; (ii) tariff reform and commercialisation of municipal utilities; (iii) a regulatory framework which did not provide appropriate incentives for efficiency; (iv) the need to improve corporate governance.

Some PSP has occurred in district heating, water services, and public transport (mostly minibus services). A few municipalities have commercialised their services and were able to borrow without a sovereign guarantee to finance infrastructure investment.

Many of the MEI sector challenges remained when the Bank signed the Rosvodokanal II (RVK II) transaction in November 2011. The water sector in Russia remained fragmented and dominated mainly by municipally owned entities controlling 84 per cent of the market. While the reforms in the sector kept pace, and there was a continued encouragement by the federal government for private businesses to enter the sector, actual PSP had not changed significantly between RVK and RVK II transactions.

The market involving PSP was small in size. It was represented by three major national players: RVK Group (operating in Barnaul, Kaluga, Krasnodar, Orenburg, Tver, Tyumen and Omsk) with a market share of five per cent; Russian Communal Systems (operating in Perm, Tambov, Togliatti, Ulan-Ude, Kirov and Petrozavodsk) with a three per cent market share; Evrazyisky (operating in Rostov-on-Don, Sochi and Krasnodar Region) with another three per cent market share each; and a number of smaller local players (for example Vodokanal Service in Tatarstan). In addition, between 2009 and 2011 the market experienced an increased activity by foreign operators: Remondis Aqua was the first foreign operator to obtain concession rights in the city of Arzamas (Volga region) and later Veolia Water won a water concession in the city of Tomsk (Siberia region).

Box 3: Current PPP outlook in Russia

Background: Concessions in Russia are governed by Federal Law No. 115 "On Concessions" and by elements of The Civil Code of Russia, the Budget Code and other federal, regional and investment laws. There is no definition of PPPs set by the law at the federal level; as a result, some non-concession types of projects are legislated and implemented at the sub-national level. According to data from the World Bank, between 2001 and 2011 Russia implemented PPPs in the energy, transport and water and sanitation sectors, with few instances of distress or failure. Russia has involved the private sector in infrastructure projects since 1992, though not always in the form of a PPP. In the past Russia has most commonly conducted divestitures, with the largest investment in projects going to the energy sector.

Local sources suggest that Russia has planned and implemented PPPs beyond those counted in the World Bank-PPIAF database, however, additional figures could not be confirmed.

Strengths: Multiple institutions are active in PPPs, including the Ministry of Economic Development which is in charge of policy-making at federal level; PPP councils at sector ministries involved in project selection; the Vnesheconombank (development bank); and dedicated PPP centres working in PPP promotion and capacity building. The Ministry of Finance oversees budget allocation.

Tendering is performed in accordance with pre-defined rules and procurement regulations. Regional and local governments are also active in PPP law making and project implementation. Country sovereign risk has been stable as public-sector external debt is low. Russia has partnered with the World Bank's Multilateral Investment Guarantee Agency in the past to guarantee infrastructure projects, and its investment climate ranks well thanks to political support in favour of PPPs, its large size and GDP per capita.

Weaknesses: Institutional actors involved in PPPs are not efficiently co-ordinated, which undermines the impact of their activity. Moreover, although formal bid procedures are fairly well outlined, project awards have suffered from low transparency and low competition in practice. Technical capacity is limited and procedures for planning and project design are not applied systematically. Risk-allocation practices have not been implemented so as to facilitate private participation. Tariff setting for public services does not usually follow a market-based approach, limiting the ability to generate stable cash flows. There is political support for PPPs, but it varies greatly across sectors and government levels.

PPP

Source: The Economist Intelligence Unit (2013) Evaluating the environment for PPPs in Eastern Europe and the Commonwealth of Independent States - The 2012 EECIS Infrascope

Bank operations

Country strategies

The 2006 EBRD country strategy for Russia, which was prevailing when the first RVK transaction was designed and agreed, acknowledged that the upgrading and development of municipal and transport infrastructure were among Russia's most complex, long-term and resource-intensive challenges.

In that context, the Bank's main objective in the sector was to significantly scale up municipal operations to achieve increased transition impact. The emergence of private Russian companies dedicated to infrastructure investment and operations, such as RVK, and a growing foreign investor interest in the sector, were seen as providing an opportunity for the Bank to support PPPs in MEI in partnership with operators, as in the case of Omsk (together with the Eurasian Water Partnership) and in Perm (together with Novogor), but also with other emerging private operators.

Additional efforts to rehabilitate existing MEI infrastructure (particularly in certain sectors or regions for example district heating and urban transport in most cities, water supply in smaller cities) remained a sector challenge in the 2009 to 2012 EBRD strategy, which prevailed when the RVK II transaction was signed.

The Bank's operational priorities at the time of the RVK II project included: (i) the development of new infrastructure; (ii) further development of the PPP market; and (iii) support to emergence of local corporate specialists in municipal services, while encouraging entry of strategic investors.

Regarding the second operational priority, the Bank intended to contribute to the development of the nascent PPP market by supporting both (a) granting authorities, lacking technical experience and resources, (notably through TC assistance to organise open, fair, transparent and efficient tendering processes on the basis of a balanced concession contract); and (b) private parties (by offering debt and/or equity financing to the winning bidder assuming the Bank could satisfy itself that the process followed good practice and the winning bidder had relevant qualifications). Such operational priority was expected to be underpinned by the legislation passed in June 2008 imposing a competitive selection process as standard for private sector operators to lease public assets to participate in public services and thereby enabling the Bank to support those operators who entered into the market as a result of proper competitive tendering.

Technical cooperation

The Bank carried out TC operations for a total of approximately €146,000 in relation to the RVK I and RVK II projects, which focused on policy dialogue mainly in connection with the RVK 1 project. These TC operations were the following:

"Legal Impediments to Non-Sovereign Financing of Infrastructure in Russia" prepared by GLN (funded by Legal Transition Team), € 40,000 (2004);

"International Practice on Tendering Municipal Leases", prepared by GLN, (funded by Legal Transition Team), €40,000 (2007);

"Development of a Template for Holding Tenders (taking into account the Concession Policy)" prepared by Clifford Chance (funded from MEI budget), €30,000 (2007);

"Review of key principles for the establishment of well-balanced long-term contractual relations in the municipal sector" prepared by Urban Institute (funded from MEI budget) €25,144 (2008);

"Review of Long-term Contractual Frameworks for Rosvodokanal and Kaluga Oblast", (funded by MEI budget), US$15,257 (2007).

Investments

The table below lists the relevant projects in the MEI portfolio in Russia during the study period. In addition to the two RVK transactions, which were selected for evaluation, there are four other private projects (for example in wastewater and district heating) and two state operations with PSP components (flood protection and urban transport).

Table 8.1: Bank MEI-PSP projects in Russia (2001 to 2012)

Name of Project	Portfolio class	Signing date	Project description	Financing value and instrument
St Petersburg Flood Protection Barrier	State	20/12/2002	Completion of St. Petersburg Flood Protection Barrier	€185.9 million (debt)
St Petersburg South-West Waste Water Treatment Plant	Private	20/03/2003	Completion of the South-West Waste Water Treatment Plant	€33.7 million (debt)
Togliatti Urban Transport Project	State	17/12/2004	Togliatti Urban Transport rehabilitation	€6.1 million (debt)
Taganrog Teploenergo	Private	18/12/2007	Equity investment in a district heating company	€3.7 million (equity)
Rosvodokanal	Private	28/04/2008	Upgrading of water and waste water services in 5 project cities	€37.3 million (debt)
Russian Communal Systems - Pre Equity Financing	Private	30/06/2008	A RUB 3.1 billion pre-equity Loan to an affiliate of IES.	€47.2 million (debt)
Taganrog District Heating Company Debt	Private	24/10/2008	Debt to a district heating company	€5.5 million (debt)
Rosvodokanal II	Private	16/11/2011	Second and Third Tranches to RVK of RUB 5 billion in total	€37.3 million (debt)

Rosvodokanal (I & II) project review

Summary

The first RVK facility signed in August 2008 was a senior loan provided jointly to the company, its various water company subsidiaries, and its holding company for RUB 1.5 billion (€42 million equivalent at the time). The IFC approved a loan of US$25 million in rouble equivalent in parallel to the EBRD, however did not agree with the sponsor on the gearing ratio and withdrew from this transaction.

The objective of the project was to help RVK (i) finance the modernisation of water and wastewater infrastructure in cities where the company had obtained leasing contracts and new others (for example Krasnodar, Kaluga, Tyumen, Orenburg, Barnaul, Tver, Omsk); and (ii) acquire water and wastewater operators in a number of cities in Russia (including refinancing of investments under the investment programmes and acquisitions).

However, the original contract award of those lease and investment contracts had not involved open and transparent competition, and therefore required derogation from the Bank's policy on Financing of Private Parties to Concessions. Moreover, given end user affordability constraints and limited financial resources of the cities involved, the type of investment components to be financed did not allow the achievement of full compliance with EU environmental standards, as required by the EBRD's Environmental Policy. Consequently, a further derogation from the Bank's Environmental Policy was also required.

In exchange for these derogations, but more importantly to try and achieve significant transition impact, the RVK transaction was designed to facilitate the set-up and implementation of a fair and balanced contract between the public sector and a private operator thereby providing the Russian operator market with guidelines for contractual arrangements in line with international best practice.

The proposed objective of the RVK II facility signed in November 2011 was a continuation of the first facility: to support (i) the company's long term investments for the rehabilitation and upgrade of the water and wastewater infrastructure in three cities (Tyumen, Orenburg and Tver) where RVK already operated under existing agreements; and (ii) the acquisition by RVK of new water companies in Russia subject to compliance with the EBRD policies and rules.

The Bank's RVK II facility also consist of a loan for RUB 1.5 billion (€37.5 million equivalent at the time) provided on a joint and several basis to eligible Russia-based borrowers within RVK Group, co-financed by a parallel loan from Vnesheconombank with the same amount and on terms substantially identical to the Bank's loan.

The RVK project signed in 2008 was one of the first Bank transactions with a large Russian private water operator to improve the provision of water and wastewater services. Fundamental to the Bank's engagement was the adjustment of existing long term lease arrangements between the private operator and municipality to achieve fair and balanced outcome in line with international good practice.

As part of the RVK transactions the Bank also pursued an active policy dialogue to promote competitive selection of private operators, and the improvement of the concession framework and tariff reform. A key element of the Bank's contribution was the preparation with sector experts of the Russian Urban Institute (RUI) of a set of key principles for the establishment of well-balanced long-term contractual relations in the municipal sector (see www.ebrd.com/country/sector/muninfra/ppp/index.htm).

Ratings

Table 8.2: Summary project evaluation

		Indicators					
Name	**Description**	**Fit with Bank policies**	**Fulfilment of project objectives**	**Financial perfor-mance**	**Bank handling**	**Transition impact**	**Overall assessment**
Rosvodokanal	Upgrade water and waste water services in 5 Russian cities	+	+	+	+	+	Successful
Rosvodokanal II	Second and Third Tranches to RVK of RUB 5 billion in total	+	+ / -	+	+	+ / -	Successful

Fit with Bank policies

Both RVK transactions fit well with the applicable Bank's policies, both the MEI operational policy and relevant country strategies for Russia. The 2004 MEI operations policy had a practical approach based on a general encouragement for PSP in MEI sectors in advanced transition countries and in Russia, suggesting the introduction of PSP whenever possible. From this point of view the RVK project signed in 2008 identified well the possibility of supporting PSP and looked to fulfil conditions that would improve PSP potential in future.

The 2006 to 2009 Bank strategy for Russia supported infrastructure investment in the MEI sector using concession mechanisms and PPP structures, and attracting private sector finance to construct or rehabilitate and develop waste processing, district heating, public transport, water treatment and housing. The country strategy also acknowledged that the emergence of private Russian companies dedicated to infrastructure investment and operations, such as RVK, provided an opportunity for the Bank to support PPPs (PPPs) in MEI.

Finally, the 2009 to 2012 country strategy stated that the Bank would continue to provide investment in the transport and municipal infrastructure sectors using concession mechanisms, such as with RVK II, and PPP structures.

Based on this the evaluation rating for relevance (fit with Bank policies) is *Good*.

Financial performance

RVK posted 6.3 per cent revenue growth in 2012 compared to 2011 results. Main contributor to the revenue growth was an acquisition of the Voronezh concession for 30 years. EBITDA margin moderately decreased from 22 per cent to 19 per cent over the same period mainly due to the indexation of operating (technical) personnel wages. Net profit margin correspondingly decreased from 10.4 per cent in 2011 to 7.4 per cent in 2012.

In the first half of 2013 RVK revenue increased by 24.1 per cent compared to the first half of 2012 due to higher revenue from water supply and wastewater services, which was boosted by acquisition of the Voronezh concession.

Total debt of RVK increased by 10 per cent to RUB 5,504 million mainly due to proceeds from new borrowings from the EBRD contracted in 2012. Despite the increased leverage all key financial ratios remain in compliance.

In March 2012 the Group sold its 100 per cent stake in Kaluzhsky oblastnoy Vodokanal LLC (KOV) at the nominal price of RUB 0.1 million back to the State body OJSC Corporation of development of Kaluga region.

Kaluga operations were different from the rest of the RVK utilities because Kaluga Vodokanal (KOV) covered both the city and the oblast, whereas other RVK utilities cover a city only. Tariff affordability constraints in Oblast are higher than in the city. This led to insufficient tariff revenue growth, which did not allow RVK to continue operating KOV and implement the agreed investment programme.

For RVK, disposal of Kaluga allowed to eliminate the loss generating entity (RUB 287 m loss in 2011, nearly zero EBITDA) and free up management resources to concentrate on the other parts of RVK's business.

Based on the above summary, the evaluation rating for efficiency (financial performance) is *Good*.

Bank handling

The role of the Bank in the RVK transactions is linked to the credit risk and transition impact pre-conditions and objectives of the engagement with the RVK group in the Russian municipal markets, and how the Bank used its leverageworking together with the Russian authorities, to improve the relevant legislation and contractual practices applicable to the entire sector. From that point of view, these RVK transactions represent a powerful example of the Bank's additionality in Russia's municipal infrastructure sector.

Based on this the evaluation rating for Bank handling is *Excellent*.

Transition impact

<u>Demonstration effects</u>

The transition impact objectives of the first RVK transactions targeted demonstration effects from improved contractual structures and improved standards of corporate governance in the RVK group. By the time RVK II was approved most transition impact targets of the first RVK transaction had been achieved.

Transition impact monitoring benchmarks in the first RVK project included the number of contracts to be rebalanced to the satisfaction of the Bank in several cities (for example Kaluga, Barnaul, Tver, Tyumen, Krasnodar, Orenburg, Omsk); the publication of the contract summary, investment programme and service targets (of all revised contracts); and the annual web publication of audited performance against targets.

RVK has rebalanced, to the satisfaction of the Bank, the contracts in six municipalities (Kaluga, Orenburg, Barnaul, Tver, Omsk, and Tyumen). The key changes introduced to the contracts (in a form of amendments) provided for a more balanced tariff setting, performance targets and penalties for non-performance and termination provisions. The company was not able however to achieve an agreement on contract rebalancing with Krasnodar though and therefore the EBRD loan was not used towards the investment programme in Krasnodar. An interview with a non-governmentconsumer group by EvD in Orenburg back in 2009 revealed that consumers enjoy service levels, which reportedly they never had before: uninterrupted sufficient water supply, water of good quality, wastewater treatment that works, and a complaint mechanism in place that seems to be responsive. Moreover, the Orenburg Municipality confirmed to EvD that the city administration had welcomed rebalancing with RVK and now requires other private operators in the municipal sector to rebalance the contracts in a similar manner.

Box 4: Bank's transition achievements with RVK

Bank's promotion of balanced PSP contracts - When considering its engagement with RVK in 2008, the Bank made it a condition that concession contracts be 're-balanced' to provide for clearer, fairer and more predictable rights and obligations for the private Company and the City. The rebalancing of RVK's contracts was successfully undertaken in 2008 and 2009 and the operating track record since then has improved, with three of Rosvodokanal's water companies – Omsk, Barnaul and Krasnodar – being awarded in April 2012 the gold, silver and bronze medals at the "Utility of the Year" event of the Ministry of Regional Development. Based on this experience, the Bank prepared and published 'Guidelines for Balanced Contracts' adapted to the Russian context, as a tool and reference document to further the demonstration effect for other MEI concession projects in Russia.

Bank's role in improving the Concession Law for the municipal sector - The Law on Concession Agreements had several serious impediments and was not used in the municipal sector since its adoption in 2005. As a member of the Ministry of Economic Development Working Group, the Bank's MEI team played a leading role in promoting amendments to the law covering: (i) the scope of property which can be subject to concession (now extended to municipal utility assets, for example water, heat, gas and energy supply, sewers and waste and water treatment); (ii) the possibility to give security over the rights of the concessionaire under a concession agreement through a Direct Agreement; and (iii) the possibility for the concession to stipulate long-term parameters to determine regulated tariffs applicable during the life of the concession, thus allowing improved predictability. The first large PPP structured under the new law is the water concession in Voronezh acquired by RVK, which remains the largest private water operator in Russia.

In addition, the following developments have taken place:

- RVK has improved its corporate ownership structure in accordance with the plan developed by KPMG to improve the manageability of the group's business. In line with the restructuring plan, water subsidiaries operating in Russia were consolidated under a Russia-based holding company RVK-Invest (Omsk Vodokanal was acquired the latest and only remains to be restructured). These operating companies are further supported by LLC "MC Rosvodokanal" (responsible for general management support, business planning, financial reporting, HR, IT, and procurement areas), LLC "RVK-Consulting" and LLC "VSK-Centre" (providing engineering/consulting and construction services respectively) that are also part of RVK;
- Since May 2009 RVK has had an independent director on its Board, as covenanted with the Bank under the first loan;
- RVK set up regular IFRS reporting, in line with the Bank's requirements under the first loan;
- In 2009 the RVK board approved a Corporate Governance Code as covenanted with the Bank. Furthermore, RVK management, of its own initiative, approached the Bank with a request for assistance to develop of a Code of Ethics, which was subsequently adopted by the RVK Board in June 2009;

Based on the above evidence, the evaluation rating for transition impact of RVK I is rated *Excellent.*

The second RVK facility continues to target demonstration effects from successful restructuring, intended to deliver operational improvements across a number of Russian cities with PSP contracts run by RVK and more widespread private ownership by targeting new cities. RVK II also targets framework for markets with the intention to implement an improved tariff methodology based on the Regulatory Asset Based (RAB) approach.

The following is a summary update of the transition impact monitoring benchmarks for RVK II:

Implementation of RAB in at least two cities – this has not materialized as the relevant methodologies are not yet approved on the federal level. Once these become available RVK plans to test its implementation.

Expansion in two new cities – the Company has recently added operation in the City of Voronezh. RVK management is actively seeking new opportunities at the moment. The team expects that a few new cities will be added in the near future due to (1) new active management and (2) federal authorities viewing concessions as a main way forward for the utility companies that has already materialized in the Presidential resolution from 31 May 2013 calling for transfer of inefficient utilities to concessions by 2016.

Implement a full-bodied concession contract in at least one RVK city – RVK has signed a concession contract with Voronezh which satisfied the EBRD core criteria.

On this bases transition impact of RVK II is rated *Satisfactory* with a reasonable chance to become *Good* if and when the outstanding transition impact benchmarks are achieved.

Sustainability of transition impact

The sustainability of the legal and contractual reforms introduced in Russia related to the Rosvodokanal projects depends to a large extent on the success of other contracts being designed and awarded in an open and transparent way and in achieving similar success with the reform of the tariff base. This has not yet taken place.

Both projects are rated in overall as *Successful.*

Findings and recommendations

Policy dialogue in private projects

The Bank can play a key role in effecting sector reform by supporting legal change through working with strong and committed private sector operators.

TC and private partner's commitment to a project

Committed private sector operator is a necessary pre-condition of embarking on a program of TC and policy dialogue which tries to effect transition impact beyond the scope of the project boundaries.

Follow up projects

A critical mass of projects may be necessary to maintain momentum and commitment to sector reforms by continuous engagement with the strong Sponsor and the relevant sector authorities.

Some flexibility with the application of the Bank's policies can help achieve Transition impact

The Bank can achieve transition impact by exercising discretion and flexibility in the application of its policies, as it did by accepting the derogation from such policies in respect of concession and environmental policies which paid off. Policies like contracts suffer from "incompleteness" (i.e. future uncertain developments cannot be fully captured) in that they can never foresee 100% of all possible scenarios on the ground with different circumstances.

Table 8.3: MEI State projects in Russia with PSP components (2001-2012)

Project name (signing year)	Sub-sector	TIMS review date	TIMS ratings: potential/risk	Description and status of PSP components (based on TIMS and verified by the evaluation team)
St Petersburg Flood Protection Barrier (2002)	Water & wastewater	15/04/2011	Original: Satisfactory/High Current: Not avaiable	Private sector involvement in operating and maintenance of the Barrier (**partly achieved**) In April 2010 the contract for monitoring the hydraulic structures and performing diving inspection of the chamber of C2 flat gate was awarded to OOO NPP Shelf on a competitive basis. The works commenced on 28 April 2010. In December 2011 OAO(JSC) "Metrostroy" won the tender for long term operating maintenance of the Barrier. The contract covers all main and auxiliary facilities and equipment, engineering infrastructure and automated control system. The contract was awarded for 3 years effective from 1 January 2012. OAO "Metrostroy" (46% owned by the City of St.-Petersburg and 26.7% by the head of Metrostroy Mr. Alexandrov and his son) is a company controlled by the city of St Petersburg and involved in a variety of infrastructure projects, most notably the construction of the metro in the city. Metrostroy was part of the consortium implementing 3 contracts for the Project.
Togliatti Urban Transport Project (2004)	Water & wastewater	15/12/2012	Original: Good/High Current: Satisfactory /Negligible	Improved quality of service provided by private operators (**partly achieved**); No decrease in market share of private operators below the current 20-25 per cent (**on track**) The improved standards for the services are set by the performance service contract framework (that covers private operators as well), which includes Service Quality Indicators (SQI), while imposes a bonus/malus regime for compliance/non-compliance with the SQIs. Currently private operators have a fair market share of transport services and the referenced above level of private operators on the market is sustained..

Annex 9: Turkey

MEI sector challenges

The MEI sector challenges in Turkey partly reflect the withdrawal of international commercial funding sources from the Turkish market during recent years due to the financial crisis. The role IFI-led financing in infrastructure is likely to continue given the difficult access to commercial co-financing. This allows the EBRD to play an important role.

Turkey faces a number of challenging environmental issues in its MEI sector, which are being addressed through changes in the regulatory framework, better governance, including capacity building and improved environmental compliance monitoring, increased funding and privatisation of municipal services. While municipalities are responsible for the delivery of local infrastructure services, there still remains a high degree of fiscal centralisation. Corporate governance of municipal companies, especially in smaller municipalities, falls short of international best practice. For water, wastewater, and solid waste services, medium-sized and large municipalities are able to cover the costs of services but poorer municipalities struggle to cover on-going asset maintenance and investment projects.

PSP in water services is limited and has had a mixed success to date. While the regulatory framework for PPPs has been evolving, very few projects are being implemented. Turkey's current approach to the granting of concessions, which involves considerable uncertainties as to terms, and strong and unilateral governmental termination rights, is not optimal for private sector financing and could be improved. In urban transport, it is necessary to enhance the efficiency of private sector operators and to ensure an appropriate level of municipal planning and regulation, while guaranteeing the funding of projects in the wake of the credit crisis.

Box 5: Current PPP outlook in Turkey

Background: Concessions are governed by Law No. 3996 on Build-Operate-Transfer (1994). Although the legal and regulatory framework allows several types of PPPs, the range of permitted models is limited and does not allow schemes such as Design, Build, Finance and Maintain/Operate. A new PPP law has been designed to solve the inconsistencies of the current framework, but its enactment has been delayed for several years. PPPs in Turkey are almost exclusively delivered by national authorities largely because of a lack of technical capacity at the sub-national level. According to data from the World Bank, between 2001 and 2011 Turkey implemented PPPs in the energy and transport sectors, with no instances of distress or failure. Turkey has involved the private sector in energy, transport and water and sanitation infrastructure projects since 1990, though not always in the form of a PPP. In the past Turkey has most commonly conducted greenfield projects, with the largest investment in projects going to the energy sector.

Strengths: Turkey has implemented large numbers of PPPs in both the energy and transport sectors. Its procurement rules are aligned with EU directives and follow the principles of transparency, fairness, competition and efficiency. Risk allocation has been performed adequately, with evidence of few large projects subject to renegotiation or bailout. The success of previous PPPs is seen as a reason for the strong, continued political support projects receive in Turkey. Public debt is low and credit and payment risk has not been an issue over the past decade; some projects have also been carried out with the World Bank's Multilateral Investment Guarantee Agency.

Weaknesses: Modest government capacity is regarded as a major impediment to an effective PPP programme. There is no specialised PPP unit and the roles of participating agencies are not clearly defined. Even though procedures follow good practice, deviations from pre-defined rules occur, and the planning and procurement process for PPPs can be lengthy, bureaucratic and fragmented. PPPs in Turkey are almost exclusively delivered by national ministries or agencies owing to both a lack of technical capacity as well as a lack of clear legislative power for municipalities to plan projects.

Source: The Economist Intelligence Unit (2013) Evaluating the environment for PPPs in Eastern Europe and the Commonwealth of Independent States - The 2012 EECIS Infrascope

Bank operations

Country strategy

The MEI priorities in the 2009 to 2012 EBRD country strategy for Turkey have a regional emphasis and focus on the private sector. The objective is to deliver a set of core utilities, infrastructure and services (for example water and waste water, urban transport, and other municipal services,) to the population and enterprises on a commercial basis, with particular attention to cities outside the large metropolitan areas.

The strategy identified PSP in municipal infrastructure as an essential area for further development despite its risks. After several unsuccessful recent cases (notably in the water sector), the credibility of PSP needs to be rebuilt, which gives the Bank an opportunity to implement its know-how, especially to contribute to a fair, transparent and balanced involvement of private sector operator in MEI sector, notably water, wastewater and solid waste.

The Bank's operational priorities are focussed on (i) working with municipalities on a non-sovereign basis to complete tariff reforms and institution building (cost recovery and removal of cross-subsidies) and improve organisation and accountability of delivery of municipal services; (ii) assist municipalities to face the credit crisis by contributing highly additional gap funding in cooperation with other IFIs to allow the completion of essential urban projects; and (iii) support entry of private operators, particularly into the water and wastewater treatment sectors and solid waste collection and management.

Technical cooperation

No TC activity has been carried out in Turkey related to a MEI-PSP transaction. A single TC activity has been carried out for a MEI state sector project (Bodrum Water - Corporate Development and City Support Programme) for the amount of €280,000.

Investments

The table below lists the relevant projects in the MEI portfolio in Turkey during the study period. In addition to the two TASK transactions, which belong to the same project framework and were selected for evaluation, there is one further private project (supporting the privatisation of Istanbul Ferries) and two State operations with PSP components (water and urban transport).

Table 9.1: Bank MEI-PSP projects in Turkey (2001 to 2012)

Name of Project	Portfolio class	Signing date	Project description	Financing value and instrument
TASK Water Venture - Dilovasi Debt	Private	15/10/2010	Financing of water and wastewater infrastructure investments	€13.5 million (debt)
TASK Water Venture - Gulluk Debt	Private	15/102010	Financing of water and wastewater infrastructure investments	€2.5 million (debt)
Bodrum Water	State	28/10/2011	Finance priority investments in the water sector in Bodrum	€3.6 million (debt)
Istanbul Ferries Privatisation	Private	22/09/2011	A senior loan to finance IDO privatization	€115.1 million (debt)
Gaziantep CNG Buses Project	State	17/11/2011	Finance up to 50 CNG buses, CNG fuelling stations and maintenance equipment	€10 million (debt)

TASK Water Venture project review

Summary

The project is a framework facility with TASK Group (a privately owned group with water and wastewater concessions in the Marmara, Bodrum and East Anatolia regions of Turkey) of €45 million to finance investments in water and wastewater infrastructure in Turkey. The Bank will support TASK with its investments under its various concession contracts and acquisitions.

The project required the approval of an exception to the policy for EBRD Financing of Private Parties because the open and competitive tender process for award of concessions in Turkey does not comply with all of the Bank policy although it meets its Core Criteria.

Ratings

Table 9.2: Summary project evaluation

Name	Description	Indicators Fit with Bank policies	Fulfilment of project objectives	Financial perfor-mance	Bank handling	Transition impact	Overall view at this stage
TASK Water Venture	Financing of water and wastewater infrastructure investments	+	+ / -	+ / -	+ / -	-	Partly successful

Fit with Bank policies

The project is consistent with the Bank's MEI 2004 Operational Policy which identifies working with private operators as a target in the MEI sector. It is also consistent with the Bank's 2009 country strategy for Turkey which states the Bank's intention to support a domestic private water operator to develop its business and expand PSP in the water and wastewater sector in Turkey, and also expand market interactions through the expansion of water and wastewater services to users that are currently under-served.

Financial performance

Akfen Water's (formerly TASK) financial results for 2011 and 2012 are the first full year results for both concessions financed by the Bank (Gulluk and a much bigger Dilovasi, opened in 2010). Akfen Water has no other concessions for the time being. In 2012 revenues increased slightly to €3.9 million (up from €3.4 million a year earlier) and EBITDA was €2.8 million, which was approximately half of the base case forecast and slightly below the worst case forecast (€2.97 million) presented at approval.

Gulluk was in breach of DSCR for 1H13 (0.93x vs 1.2x covenanted) and slightly below net debt/EBITDA covenanted ratio (however the team reports that the company was not in breach in the second half of 2013 and accumulated over €4 million in cash reserves). The lower revenues and EBITDA were caused by the Gulluk city council's decision to increase water tariffs by only half of the level agreed in the concession agreement with Akfen Water. Akfen has taken Gulluk to court and is expecting a favourable decision and compensation. Moreover, the rate of residential development around Gulluk (Bodrum region) has not been so intense as originally projected due to the financial and economic crisis. Hotels in the area usually have their own water wells.

Also Dilovasi concession run into problems as the industrial zone management requested a cancellation of the concession agreement and proposed to take-over of the Akfen-built waste water treatment plant for €11 million. The Akfen's lawyers maintain that the request is groundless. Dilovasi suffers from the existence of several water wells established by the zones' companies and widespread illegal discharges of waste water, which does not enter the system and is not treated by Akfen or any other facilities.

Bank handling

The client has been well-selected as Akfen has a solid PPP/concession experience from its airport and port operations in Turkey and abroad. The Board report provided thorough analysis of the sponsors and the Turkish water market.

However the choice of the project was not ideal as it consisted of refinancing of local banks' and shareholders' loans already provided for existing two concessions (€16 million). The Bank also provided additional €29 million facility for financing of future, yet undefined concessions, which Akfen Water was expected to obtain in Turkey. The expectations in respect of new concessions, and financial projections related to two existing concessions turned out to be overoptimistic as till now no new concessions have been obtained by Akfen, while key financial ratios remain at about half of the base case scenario. On positive side, the Banking team was successful in negotiating sponsor's guarantee until the financial closing (the achievement and maintenance of certain financial ratios), what decreases the Bank's risk.

Transition impact

Out of eight transition impact benchmarks set at approval, only two can be considered as achieved (commencement of operations in Dilovasi and reporting in IFRS).

More widespread private ownership

The key for the achievement of "widespread private sector participation" benchmark were the success of new concessions, particularly two already obtained by Akfen – one in Corlu and one in Kars. In the former case, integrity issues related to the city's mayor forced Akfen to withdraw from the concession talks, while in the latter case a long approval process by the central government authorities and a change of the mayor resulted in the cancellation of this concession by the city.

In respect of other new concessions, which were originally expected to come up on the Turkish market, none actually did. One likely reason could be a "negative demonstration effect" of the Izmit concession with Thames Water, which due to its structure gave advantage to the concessionaire and later caused political outcry at the city and high profile legal disputes.

Also Akfen was unable to avoid disputes with its both concession contracting parties - the city of Gulluk and Dilovasi Industrial Zone (such dispute-free operation was one of the transition impact benchmarks set at approval). This failure might be due to lack of full understanding of the concessions' provisions by the city and the zone, particularly those obliging them to tariff increases and the payment for the shortfall of water supplied for treatment.

Market expansion

The market expansion transition impact benchmark (supply of water to all users and treatment of waste water from all users) has also fall short of the target as Dilovasi industrial zone concession suffers from the existence of separate water wells operated by individual companies. Also large quantities of waste water are illegally disc arched. Environmental inspection at the zone is ineffective in preventing such practices. Akfen is protected against such practices through the provision in the concession agreement, which requires the zone to pay for any shortfall in estimated water quantity provided for treatment (effectively it is a "supply or pay" agreement). However it does not help Akfen (or the Bank) to achieve the project's fundamental operating objective (treatment of all water discharged by the industrial zone). It also causes aggravation on the part of the zone, which has to pay for the shortfall of water supplied. It resulted in the zone management's request to cancel the concession and transfer the treatment plant to it.

Demonstration effects of successful restructuring

Demonstration effect of the project was to be measured by two key benchmarks – commercial success of the project and the improvements in systems operations, including a reduction in network losses in Gulluk (from 60 to 30 per cent). So far, the project is barely breaking even, with EBITDA in positive territory, however at half of that projected at approval, while Gulluk has been in breach of its key financial covenants. Akfen has reportedly been meeting its annual investment obligations in Gulluk's network, however unaccounted for water has been decreased from 60 per cent to only 50 per cent. The company plans to introduce SCADA system in the coming years and expects to address this problem then.

Findings and recommendations

Impact of concession failure

Concession failures in the water sector have particularly widespread consequences as they are highly visible and impact decisions of other cities in respect of engagement of private companies in this sector. Potential of such "negative transition impact" presents particularly high risk to the Bank and requires very careful structuring, execution and monitoring of water sector concessions.

Populist management

New mayors or city councils may take populist decisions in breach of the PPP contract's provisions (particularly those requiring tariff increases) agreed by outgoing mayors. The Bank has a role to play in educating the public partners about consequences of taking such measures.

Enforcement and compliance

Effective enforcement of environmental regulations is key for the success of waste water treatment concessions in industrial zones. Faced with additional costs related to waste water treatment, some industrial companies may decide to illegally discharge effluent, rather than pay for treatment.

Project input assumptions

When projecting demand for water in touristic regions, the levels of residential and hotels developments projected by sponsors or consultants should be critically assessed by the Bank and stress-tested for economic downturns as such developments are the first to be put on hold in the time of crisis.

People consulted

People interviewed and consulted for this case study were:

Emre Sezgin, Assistant Manager (Business development)

Meral Altinok, Coordinator (Budget, Reporting and Risk Management)

Arzu Tufekcioglu, Operating Manager (Gulluk Water Company)

Burak Kutlug, Financial Manager (Gulluk Water Company)

Table 9.3: MEI State projects in Turkey with PSP components (2011-2012)

Project name (signing year)	Sub-sector	TIMS review date	TIMS ratings: potential/risk	Description and status of PSP components (based on TIMS and verified by the Evaluation Team)
Gaziantep CNG Buses Project (2011)	Urban transport	30/11/2012	Original and current: Good/High	Bus routes to be tendered to private sector operators in accordance with the new model performance service contract (**no comment**)
Bodrum Water (2011)	Water & wastewater	31/12/2012	Original and current: Good/High	Outsourcing contract for meter reading and maintenance (**no comment**)
Mersin Wastewater (2012)	Water & wastewater	N/A	N/A	N/A

Annex 10: Regional frameworks

During the study period the Bank's MEI team signed a total of eight regional frameworks with six different international groups: International Water-United Utilities; Veolia; E Energija; Aqualia; and Dalkia. All of these regional project frameworks were signed with private investors/operators, and all except one involved equity finance only. These regional projects amounted to a financial commitment by the Bank of €388 million covering practically all of the Bank MEI private projects involving equity, plus an additional €11 million of debt finance in a district heating framework.

The table below lists the regional framework projects in the MEI portfolio during the study period. The Evaluation team selected the Aqualia Investment Venture for detailed evaluation.

Table 10.1: Bank MEI-PSP Regional Framework projects (2001 to 2012)

Name of Project	Portfolio class	Signing date	Project description	Financing value and instrument
International Water United Utilities	Private	20/11/2003	Part funding of the acquisition of shares held by IWL.	€17.2 million (equity)
Veolia Transport Central Europe (f. Connex)	Private	2/12/2005	Equity funding to expand transport services.	€61.2 million (equity)
E Energija District Heating Project	Private	26/09/2007	Expand business in Latvia and Ukraine	€5 million (equity)
Véolia Voda Equity Investment	Private	17/10/2007	10% equity in a regional vehicle to enable Veolia Voda to expand its water and wastewater operations in CEE markets (e.g. Czech Republic, Hungary) and enter Russia and Ukraine.	€93.9 million (equity
E Energija District Heating Project	Private	18/12/2007	Expand business in Latvia and Ukraine	€11 million (debt)
Aqualia Investment Venture	Private	15/09/2009	Investment vehicle to support Aqualia's expansion into EBRD's countries of operation	€30 million (equity)
Veolia Voda Capital Increase	Private	8/12/2009	A follow up operation to Veolia Equity Investment Project.	€70 million (equity)
Dalkia Baltica/Russia Equity Financing	Private	9/12/2010	Minority equity interest in a Dalkia's Baltics/Russia Holding company along with IFC.	€100 million (equity)

Aqualia Investment Venture project review

Summary

In May 2009, the Bank signed an agreement to invest up to €80 million equity for a 49 per cent stake in Aqualia New Europe (ANE), a special purpose vehicle created to promote PSP investments in the water and wastewater sector in the EBRD's countries of operations. Aqualia, a leading Spanish water company serving over 27 million people in over 1,100 municipalities, is the project sponsor that owns the remaining 51 per cent of ANE.

By November 2012, three and a half years after signing, despite extensive business developments efforts by ANE, none of the 21 projects in the Investment Venture's original pipeline had materialised due to the slow pace of development of PSP projects in the water sector across the EBRD region. In that period ANE explored several acquisitions (for example in Russia, Georgia and Hungary) and concession tenders (for example in Hungary, Slovakia, Romania and Poland) but they could not proceed due to several factors, including integrity issues of local partners or cancellation of the concession tender by the local authorities.

In November 2012, the facility was restructured to reflect the difficult business environment and lack of achievement. The restructuring involved, *inter alia*, (i) a reduction of the Bank's equity commitment to ANE from €80 million to €30 million; (ii) an expansion of ANE's geographical focus to include the SEMED region; (iii) an extension of the investment period by an additional three years.

In 2008, before the Aqualia Investment venture was signed, the government of Egypt awarded Orasqualia a 20 year concession to build, own and operate the New Cairo Wastewater Treatment Plant (WWTP) with a 250,000 m3/day treatment capacity. Orasqualia is a 50/50 joint venture between Aqualia and Orascom, the leading Egyptian construction contractor active in the MENA region. ANE has recently sign a purchase agreement for New Cairo WWTP, substantially improving the prospects of the venture co-financed by the Bank.

Moreover, in 2011, ANE entered into a joint venture with SC Raja Management Solutions (Constanta Water company), to jointly explore investments in Romania and Bulgaria.

Ratings

Table 10.2: Summary project evaluation

Name	Description	Indicators Fit with Bank policies	Fulfilment of project objectives	Financial perfor-mance	Bank handling	Transition impact	Overall assessment
Aqualia Investment Venture	Investment vehicle to support Aqualia's expansion into the EBRD's countries of operation	+	+/-	-	+/-	-	Partly Successful

Fit with Bank policies

The Aqualia Investment Venture facility fits well with the 2004 MEI operations policy which had a practical approach based on a general encouragement for PSP in MEI sectors suggesting the introduction of PSP whenever possible. In line with the MEI operations policy, Bank country strategies in the countries where ANE has pursued acquisitions or concessions also identify in general terms the involvement of the private sector and the promotion of PSP options, including PPPs, as an operational objective in municipal infrastructure. On that basis, the project is rated as *Good* for its relevance.

Financial performance

During the first three years of the Aqualia Investment Venture facility before its restructuring in 2012, the Bank invested €1.32 million of the original €80 million commitment to fund developmental expenses in line with the original business plan. Following the facility restructuring last year, ANE's pipeline has shown signs of progress with the signing of a purchase agreement for New Cairo WWTP, opportunities in FYR Macedonia where ANE is in advanced negotiations for a potential concession in Orhid. ANE has also established a 60/40 joint venture (JV) with SC RAJA SA Constanta, the largest regional water company in Romania. The JV, Aqua Management Solutions, is exploring potential leads in Romania, Bulgaria and Moldova, building on RAJA Constanta's regional contacts and Aqualia's technical and financial expertise.

ANE reportedly has €600,000 accumulated cash. However at the time of writing this Evaluation Study, the venture produced loses, therefore it is rated "-". However, this could change in the near future with the investment in new Cairo WWTP and potentially other targets.

Bank handling

The Bank has proved instrumental in communicating to ANE the relevant Bank procedures and in providing indirect support to many of ANE's marketing efforts over the last three years. Such support has come from many levels including that of the MEI Team Director, especially in the relationship with RAJA Constanta project by introducing both ANE and the City to each other and acting as "honest broker". The local knowledge of Bank staff across Resident Offices (for example in Skopje) has also proved helpful to ANE in their business development efforts. Moreover, the Bank restructured the project, cutting its commitment and renegotiated its contribution to development costs (to be based on success fee), when it became clear that ANE may have serious problems making acquisitions. The Bank was clearly overoptimistic, however on the basis of the Bank's active participation in attempts to address impediments hampering this project, the rating for Bank handling is *Satisfactory*.

Transition impact

The Aqualia Investment Venture was expected to (i) contribute to increased private ownership through both new concessions and acquisitions; (ii) raise standards for business conduct, corporate governance, and employee behaviour, particularly in small and undercapitalised operators (through acquisitions) and in small and medium size towns (through concessions); and (iii) transfer skills via the high technical, management and consumer focus practices of Aqualia, in particular in operations management, energy efficiency, capital budgeting and financial management.

Since 2009 ANE has explored many projects that did not bear fruit for reasons that illustrate the difficult municipal business environment in the EBRD region. Such difficulties manifest themselves in tender cancellations, lack of institutional capacity in the City, tariff affordability, availability of EU funding, or unwillingness to approve Aqualia's purchase of existing private operator. Examples of those projects are:

- Komarno in Slovakia (the City Council cancelled the tender);
- Voluntari in Romania (the City Council lacked institutional capacity and decided not to tender);
- Feodosia in Ukraine (ANE did not pursue given imbalance between tariff affordability and tariff levels required to support the planned large capital investments);
- Pleven in Bulgaria (despite the IFC's advisory support and interest from private operators, the project was cancelled due to lack of political support and delays in the approval of key legislation);
- Arpad in Hungary (although the operator for the industrial wastewater treatment plant was willing to sell its contract to ANE, the final owner of the plant demanded additional investment commitments that ANE could not agree to);
- Neva in Russia (negotiations broke down after a local partner walked out of the initial consortium, ANE did not pursue the tender, which received only one bid and was cancelled by the municipal authority);
- Bedzin and Siemanowice in Poland (both tenders were cancelled after an in-house designed pre-qualification stage);
- Dabrowa Gornicza in Poland (talks to buy 33 per cent stake in the water operator failed when the City decided to buy the shares and re-take the service in-house)

Unfortunately, due mainly to the difficult business environment for PSP in municipal markets, the Aqualia Investment Venture has not produced any meaningful results to date with the exception of the New Cairo WWTP BOO where ANE is planning to enter the equity capital of the concession special purpose vehicle after the WWTP starts operations. Based on the record to date, the transition impact rating for this evaluation is *Unsatisfactory*.

Sustainability of transition impact

Until the Aqualia Investment Venture gets some traction and develops a meaningful pipeline one cannot assess the sustainability of the (potential) transition impact of its acquisitions and/or concessions. Meanwhile, ANE is contributing to educating the market, on behalf of Aqualia and EBRD, through its business development interaction with potential acquisition targets and municipal authorities considering concession tenders. ANE tries to make all potential projects in the pipeline compliant with EBRD policies and project eligibility criteria. Meeting such criteria has meant operational delays and commercial risks assumed in full by Aqualia.

Findings and recommendations

<u>Flexibility in applying Bank policy</u>

The Bank may want to draw lessons from Rosvodokanal and exercise discretion and flexibility when applying Bank policies. Some of the EBRD Concession Policy criteria from the EBRD (request for Pre-Qualification stage, more than one bid to be able to participate) has delayed or prevented ANE from participating in certain projects. While the criteria make sense for large projects, very few international water operators are interested in PPPs in small cities. The Bank may want to revisit the policy and allow for a modified approach for small projects, which would facilitate the building of initial relationship with the client and introduce reforms.

<u>Realism of pipeline</u>

The realism of pipeline projections needs to be accurately assessed at project approval stage, in particular for wholesale investment vehicles such as frameworks. This should be considered both from the perspective of potential deal flow and the risks associated with the potential concessions and acquisitions to manage expectations and work with a realistic set of business development assumptions. Requiring the first deal to be ready for financing at the time of the framework signing would test the ability of the private partner to acquire such concessions.

<u>Business environment risks</u>

The risks associated with the current and future business environment in the MEI sector cannot be overstated. The due diligence of regional investment vehicles needs to avoid optimism bias in deal flow by taking account of the many risks and uncertainties associated with the MEI sector in the Bank's countries of operations.

People consulted

People interviewed and consulted for this case study were:

Mark Muller, Director (Aqualia New Europe)

Francisco Atanasio, Chief Financial Officer (Aqualia New Europe)

Annex 11: Objectives and scope of MEI operation policies and selected country strategies related to PSP from 2001 to 2012

EBRD Municipal and Environmental Infrastructure Operations Policy (1998)

The 1998 Policy 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 1998 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.

EBRD Municipal and Environmental Infrastructure Operations Policy (2004)

The EBRD's overall approach towards transition in the MEI sector in its countries of operation revolves around:

- decentralisation;
- commercialisation;
- environmental improvement.

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

- 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 technical cooperation;
- address affordability through grant co-finance;
- increase access of municipal service companies to capital;
- improve project implementation and disbursements.

The 2004 Policy has much emphasis on TC and policy dialogue. Other features 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 (such as guarantees and 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 (for example decentralisation and commercialisation) through demonstration projects.

Strategy paper: 'MEI – strategic vision and core competences' (2008)

This is a strategy paper forming ,a contribution to the Capital Resources Review 4. It focuses on commercialisation, decentralisation (such as direct lending to municipalities) and the promotion of private sector participation.

The strategic vision includes a focus on:

- the movement of EBRD operations south and east, with selective use of existing products;
- the need for policy dialogue to support governments to change fiscal and tax policies to ensure the creditworthiness of local municipal authorities;
- non-sovereign financing approaches to mobilise finance at local levels in line with decentralisation;
- 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;
- grant co-finance, TC, and co-finance with other IFIs;
- a need for a period of full cost recovery under a commercialised regime before PPP is feasible (in recent economic uncertainties mean greater credit discipline is needed)
- supporting local private companies and strategic foreign investors through debt/equity under Bank conditions as a way of dealing with smaller municipalities.
- 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).

MEI – Sector Strategy (2012)

The most recent sector strategy reiterates the core themes of the Bank's MEI strategy since 1998, namely decentralization, commercialisation, and environmental improvement.

The "sector vision" relies on three pillars, which relate to the three core themes, namely:

- promotion of decision-making at local level to deliver quality, sustainable, market-based and demand-driven infrastructure;
- support for projects that focus on effective, affordable, customer-oriented services linked to regulatory and tariff reforms, restructuring and market-focused investments;
- placement of environmental, health and safety, social and low-carbon imperatives at the core of operations.

The strategy singles out the promotion of PSP through (i) PPPs as way to address the challenge of mobilising capital in times of economic crisis; and (ii) performance-based outsourcing in traditional MEI sub-sectors (see table in Figure 1.1) but also in infrastructure facilities management projects.

PSP objectives in the country strategies for Georgia, Kazakhstan, Ukraine, Romania and Serbia from 2001 to 2012

This study covers in detail the evolution of the Bank's PSP in MEI strategic orientations in the countries were the selected case study projects were implemented, namely, Croatia, Poland, Russian Federation and Turkey. This annex summarises the evolution of the Bank's objectives related to PSP in the MEI sector as evidenced by a set of 21 additional country strategies for five representative countries designed and/or implemented during the study period: Georgia (2002, 2004, 2006, and 2010); Kazakhstan (2000, 2002, 2004, 2006, and 2010); Ukraine (2000, 2002, 2005, 2007, and 2011); Romania (2001, 2003, 2005, 2008, and 2012); and Serbia (2004, and 2007).

Georgia

The 2002 Country Strategy for Georgia had no specific objective around PSP in municipal projects. However, the strategy aimed at supporting projects to promote the commercialisation of infrastructure as a catalyst to private sector development, paving the way for the specific commercialisation of utilities set out in the 2004 Country Strategy for Georgia.

The 2004 Country Strategy for Georgia emphasised the need for an effective regulatory environment and legal transition work to underpin municipal water utility development and to attract private sector management and investment. The Georgian government had requested particular Bank assistance with enabling private sector engagement in water utility management. In recognition that attracting private sector sponsorship for water supply and other municipal projects might not be immediately possible, the Bank planned to seek opportunities to blend lending under a sovereign structure with donor grant resources.

The 2006 Country Strategy for Georgia confirmed that the increased availability of grant co-financing had enabled substantial work to be initiated for municipal projects, but emphasised that lack of investments and mismanagement of municipal utilities had negatively affected their technical state, underlining the urgent need for private-sector involvement in the sector. Municipal and other infrastructure and state-owned enterprises was one of the Bank's priority areas for the 2006 strategy period, concentrating on priority municipal projects and regional transit infrastructure, in line with government's municipal development plans. Privatisation or PSP opportunities were to be pursued in (but not limited to) the fields of telecommunications and infrastructure services.

The 2010 Country Strategy for Georgia confirmed that the municipal and infrastructure sectors had begun yielding results, despite a slow pace of reform, but again emphasised the need for further investments, regulatory reforms and PSP in infrastructure and municipal utilities as essential for improving efficiency, quality of services, and long-term financial sustainability. The strategy prioritised strengthening the Bank's involvement in the municipal sector by capitalising on its expertise and strong portfolio of projects, such as municipal water supply, waste water and solid waste management, and the rehabilitation of urban transport. It also aimed at addressing the need to replace ageing infrastructure by promoting investment in MEI sub-sectors mainly using concession mechanisms and PPP structures, and attracting government and sub-sovereign co-financing and private sector finance.

Kazakhstan

The 2000 Country Strategy for Kazakhstan aimed at reducing reliance upon sovereign guarantees in municipal infrastructure, by developing lending operations to municipal borrowers and through projects supporting the commercialisation and privatisation of key utilities. The strategy set out to invest in and develop the infrastructure sector to assure its long-term financial viability, with specific emphasis on municipal services. The strategy emphasised that Kazakhstan was one of the main targets for expansion of the municipal sector Bank activities in the early transition countries. The Bank had already established a presence in the municipal sector through its involvement in two infrastructure projects in Almaty, of which one was developed as a non-sovereign municipal operation and the other on a private sector basis. The primary operational focus in the 2000 strategy for the MEI sector was to bring those two projects in the pipeline to fruition, and to consider new operations in other sub-national Governments with sound economic basis. Additionally, the Bank, in co-operation with the World Bank, aimed at participating in the policy dialogue with the central government about further reform of inter-governmental fiscal relations and development of municipal finance.

The 2002 Country Strategy for Kazakhstan saw the Bank continue its policy dialogue with the federal and regional government to explore the scope for more effective lending to the regions in support of environmental and municipal infrastructure, with emphasis on the need to attract private investment in municipal utilities as the best hope for Kazakhstan to realise the necessary investments without accruing a large foreign debt, and with a view to maximising efficiency. However, the strategy acknowledged that this would require the development of an appropriate regulatory framework, which had not been achieved yet in the majority of infrastructure sectors in Kazakhstan, and also needed improvements in long-term tariff methodologies and the financial transparency at the municipal level and within municipal enterprises. As such, the Bank aimed at continuing its work with the government to improve and implement long-term tariff methodologies and provide TC to promote transition elements essential for regional independence, and thus enhance municipal infrastructure investment conditions.

The 2004 Country Strategy for Kazakhstan acknowledged that the Bank had experienced serious difficulties with the implementation of its three signed MEI projects, which were all cancelled, largely due to significant tightening of fiscal control by the central government and weak institutional capacity at the municipal level. The strategy therefore emphasised the need to strengthen the implementation capacity of local governments to undertake investment programmes. The strategy noted that extent of PSP in water and waste water and district heating had been limited because of the uncertain regulatory environment, although there were already some local private sector operators in place. It also stated that tariff methodologies had been improved since the previous strategy period, which would not only spur more investment into rehabilitation and modernisation of facilities by municipal utility companies, but also facilitate more significant PSP. The strategy confirmed that the Bank would continue to actively seek commercial co-financing for the MEI sector and continue policy dialogue at the federal and regional government level to explore the scope for more effective lending to municipalities for infrastructure.

The 2006 Country Strategy for Kazakhstan stressed the importance of making further efforts to advance municipal infrastructure reforms, noting that legal restrictions on borrowing from and guaranteeing of loans from banks by local authorities were continuing, preventing the Bank's wider involvement in the sector. The strategy set out the Bank's aim to maintain its engagement with the government through the provision of technical assistance to promote budgetary independence on a municipal level. Financing of municipal projects was still structured as sovereign operations, giving sub-optimal transition impact. However, in order to maintain a policy dialogue with the government, the Bank had started to prepare the first project to be based on a sovereign structure, Astana New Transport System, to support the Astana city government for construction of light-rail based public transport system. The success or failure of that project was to determine the extent to which the Bank could be involved in other municipal projects in Kazakhstan in the future. The strategy set out that the Bank would also explore the viability of PPPs for the provision of municipal services. However, it also acknowledged that financing of municipal infrastructure based on PPP model would require (bar exceptional cases) financial undertakings from local or central governments.

The 2010 Country Strategy for Kazakhstan confirmed that in 2009, for the first time, the Bank engaged with the municipal sector in Kazakhstan through loans to a private water utility in Shymkent and an urban transport company in Almaty. Due to the limitations on the municipalities' ability to borrow and guarantee third-party debt, the Bank employed creative mechanisms, including greater use of transaction support agreements. One of the 2010 primary strategic priorities was to broaden the Bank's new involvement in the municipal sector. Within the MEI sector the Bank aimed at finding opportunities to engage with private operators to promote good governance and operational efficiency, and, having preliminarily identified a number of interested potential private operators, to support properly-structured PPPs where appropriate.

Romania

For the 2001 Country Strategy for Romania the Bank's focus included the generation of new projects in infrastructure and municipal services through concessions or PPP schemes, such as the Apa Nova Water Treatment Plant, and stated that the Bank anticipated growing demand for non-sovereign public finance (that is with local government guarantees) for infrastructure projects, particularly in municipal infrastructure and transport. The strategy acknowledged that promoting non-sovereign finance in municipal services remained a key transition impact challenge, and that increasing PSP in the financing and maintenance of infrastructure (in line with government objectives) would be successfully achieved only if appropriate legal reforms and cost recovery systems to support PPPs and private investment were put in place. The 2001 MEI operational objectives prioritised supporting projects with PSP in the provision and financing of municipal infrastructure.

The 2003 Country Strategy for Romania again emphasised the Bank's anticipation of increased demand for sub-sovereign public projects with sponsors such as municipalities/counties in municipal infrastructure and transport, with potential for a substantial transition impact by being instrumental in creating the conditions for PSP. The strategy stated that the Bank had seen an increased interest in the private sector in investing in water and waste water concessions. It also acknowledged that the Bank's focus in the MEI sector continued to be sub-sovereign, but that it would work closely with utilities to increase PSP, with an increased role to mobilise commercial banks for the municipal infrastructure sector and leverage its loans through syndication, where possible. The Bank would continue to work with those utilities involved in PPPs by providing long term debt and other products. The 2003 strategy noted that further local authorities were exploring PSP in the water sector and were participating in option studies, depending on the outcome of which, there could be further PSP projects in the municipal sector.

The 2005 Country Strategy for Romania acknowledged that PSP in the MEI sector was emerging, mostly in the form of concessions in the water and heating sectors, but remained sporadic and difficult to implement. The Bank's key priorities in the municipal sector would include continuing to support clients interested in using PPPs as a means to attract private sector know-how and increase efficiency. However, to ensure that tendering procedures would be undertaken on the most open and transparent basis, the Bank would also need to mobilise technical co-operation funds for its clients.

The 2008 Country Strategy for Romania saw a continuation of the Bank's objectives around activities in the municipal sector throughout, especially in view of the opportunities arising from the EU post-accession structural and cohesion funds, including a focus on smaller municipalities. In addition to the traditional areas of financing, the Bank also aimed at seeking to work with local authorities in developing PPPs and Design Build Finance Operate schemes for major municipal infrastructure investments, and also to explore new sectors including public housing, municipal revenue bonds and municipal parking concessions, and work with local capital markets to develop financing instruments in this sector.

The 2012 Country Strategy for Romania acknowledged that, although important progress had been made in the provision of local services, greater efforts were still needed to strengthen the municipal sector. As such, the 2012 strategy focused on enhancing commercialisation, competition and PSP in infrastructure, with the Bank aiming at expanding its activities in the municipal sector by supporting commercial structures for both urban transport and municipal water and wastewater projects backed by Public Service Contracts. Where appropriate, the Bank also aimed at working alongside the EU, and support and stimulate the private financing of municipal and national infrastructure.

Serbia

The 2004 Country Strategy for Serbia emphasised the Bank's continued role, together with the EIB, the EU and the World Bank, in developing municipal infrastructure in Serbia, and that the Bank would focus on developing an institutional framework to support the financing of smaller municipalities, and advancing commercial financing in the sector. Where appropriate, the Bank aimed at developing PPPs. The commercialisation and/or professional management support to utilities and PSP were cited as two of the main transition challenges in the infrastructure sector. The strategy acknowledged that the staged nature of some large projects in the MEI sector, combined with the high volumes of these projects signed during the Bank's previous strategy period, had led to a 67 per cent gap (as at end of August 2004) between commitments and disbursements, but the Bank expected the gap to gradually close by the end of 2005, when most of the existing large public sector projects would be fully implemented.

The 2007 Country Strategy for Serbia noted that significant progress in the MEI sector had been achieved. A landmark deal was the first infrastructure loan on a non-sovereign basis to the municipality of Belgrade, and that the commercialisation of the three utilities involved (water, district heating and urban transport) had advanced significantly. The strategy set out the Bank's expectation to continue its successful cooperation with the city of Belgrade and to work on successfully completing the signed projects. Key strategic objectives for the 2007 period included promoting competition, commercial orientation, and an enhanced role for the private sector in critical infrastructure sectors such municipal infrastructure. However, the Bank also acknowledged that, in general, local infrastructure reform had been slow in Serbia, reflecting the slow pace of decentralisation which would allow local government greater autonomy and fiscal resources. Continuing the objectives of the 2004 strategy, the Bank also aimed at playing a crucial role, together with the EIB, the EU and the World Bank, in developing the municipal infrastructure in the country. It also emphasised the need for policy dialogue to focus on the need for greater fiscal decentralisation to ensure adequate financial basis for lending to local governments without a sovereign guarantee, and a clear policy framework for improving the legal environment and promoting PSP in Serbia.

Ukraine

The 2002 Country Strategy for Ukraine built on the 2002 objectives, with the Bank committing to support projects which would advance the commercialisation and reform of key municipal utilities, and also improving services, efficiency, sustainability and environmental performance. The reform process would include tariff reform and the improvement of utility management through the introduction of performance-based service contracts and the involvement of the private sector through, for example, management contracts.

The 2005 Country Strategy for Ukraine set out MEI transition goals which included encouraging greater PSP in the provision of municipal services, where possible, although acknowledging that the Bank's focus would be sub-sovereign, it would work closely with utilities to develop private sector involvement where possible. The strategy also noted that improvements were needed in the legal provisions for PSP in infrastructure and utilities sectors to support private sector investment.

The 2007 Country Strategy for Ukraine set out further strategic objectives to increase PSP in the MEI sector. In the preparation of municipal projects, the Bank aimed at promoting institutional reforms and corporatisation of municipal utilities, financial and operational performance improvements and full cost recovery through tariffs, taking into account affordability constraints. The Bank would provide financing to municipalities and, where applicable, regional utilities without a sovereign guarantee, to support decentralisation of financing responsibilities and contribute to the enhancement of the creditworthiness of municipal borrowers; and work closely with utilities to support transparent PPP arrangements where possible.

The 2011 Country Strategy for Ukraine emphasised the Bank's continuing support for PSP in municipal utilities and enterprises through projects with large demonstration effects where evidence that sustainable and good quality services could be provided, in accordance with transparency and concession standards acceptable to the Bank.

Annex 12: Prospects for MEI PSP projects in the SEMED region

The current MEI Sector Strategy approved by the Bank in 2012 describes the overall approach the Bank will follow in the MEI sector in SEMED region, and identifies the Bank's operational priorities given the sector challenges and the Bank's comparative advantage in the region.

Overall approach

The SEMED countries are diverse and their demographics and culture are quite different to those found in other EBRD countries of operations. The Bank intends to tailor its approach and products to the specific regional needs.

Sector challenges

The key transition challenges in the MEI sectors of the SEMED region are a lack of decentralised fiscal control, decision-making and asset ownership. Tariff reform is also required since most tariffs are below cost-recovery levels, energy prices are subsidised, and direct subsidies to supplier and distribution companies are prevalent. The separation of regulatory and operational responsibilities has not yet taken place across most municipal services, and sector regulation is not independent yet. All these factors negatively impact efficiency. Also PSP in service provision started only recently in the region.

From a financing perspective, local banks have liquidity and long term financing is available from various agencies. In particular, numerous IFIs such as the African Development Bank ("AfDB"), the EIB, the Islamic Development Bank ("IsDB") and the World Bank, as well as bilateral organisations such as Agence Française de Développement ("AFD"), Kreditanstalt für Wiederaufbau ("KfW") and the United States Agency for International Development ("USAID") have been active in these countries for many years. Therefore, the EBRD will seek to learn from others' experience, act where the EBRD has a comparative advantage, and to coordinate its efforts with its peers.

Table 12.1 summarises the most recent assessment of the current transition gaps in the water & wastewater and urban transport MEI market segments in the countries of the SEMED region where the Bank plans to be increasingly active. Most transition gaps are assessed by the Office of the Chief Economist as being large which implies a sizeable reform agenda in the MEI sectors of these countries, including opportunities for PSP.

Table 12.1: Assessment of transition challenges in selected MEI market segments (2013)

	Water and wastewater		Urban transport	
	Market structure	Market supporting institutions	Market structure	Market supporting institutions
Egypt	Large	Large	Large	Large
Jordan	Large	Large	Medium	Large
Morocco	Medium	Large	Medium	Large
Tunisia	Large	Large	Large	Large

Operational priorities

In terms of priorities, the EBRD will focus on its comparative advantages of: engaging in policy dialogue to help de-link municipal infrastructure and services from the sovereign; promoting decentralisation, local ownership and inclusion; creating creditworthy entities at the local level; supporting regulatory independence and tariff reform; and establishing a pathway to sub-sovereign lending. The EBRD also has relevant expertise to contribute to successful and transparent PPPs, particularly in the water and urban transport sub-sectors.

The 2012 MEI Strategy advocates that the bank should start its activities with policy dialogue and TC support to encourage the decentralisation of responsibilities to the local level, the commercialisation of operating entities and capacity building in selected municipalities. The Bank will focus on enabling sub-sovereign financing of services and on PPP opportunities. However, based on experience on other EBRD countries of operations, an initial sovereign operation may sometimes be needed to demonstrate the Bank's commitment, opening the path to meaningful policy dialogue, and initiating essential changes to legal structures and administrative arrangements.

A summary of the planned activity of the Bank at the time of writing its 2012 Sector Strategy is the following:

- In Egypt there are large, short-term needs in the water and wastewater sub-sector and there could be PPP opportunities in due course in transport, solid waste and other infrastructure.
- In Jordan, the Bank will explore non-sovereign opportunities in all MEI sub-sectors (for example, with the city of Amman and public water utilities).
- Morocco is pursuing the regionalisation of municipal infrastructure and several PPP projects on a medium-term horizon, while immediate opportunities include working with the state-owned water and waste water company.
- In Tunisia, the Bank will investigate the scope to finance municipalities such as Tunis and will explore sovereign and non-sovereign financing of state companies.

PPP outlook in the SEMED region

The rest of this annex provides a brief descriptive summary of current market conditions and business environment issues related to infrastructure PSP in the four EBRDcountries of operations.

Box 6: PPP outlook in Egypt

Recent political turmoil in Egypt has impacted negatively the macroeconomic conditions placing the country in an unfavourable position to continue developing its PPP programme. Sustained economic growth, a controlled fiscal position and low aggregate and foreign debt outstanding (relative to Gross Domestic Product (GDP)) are all needed to give sponsors and investors confidence in the capacity of the Egyptian public sector authorities to commit to PPP concession payments for projects with a good business case. The political developments since early 2011 are likely to cause investors to be cautious due to increased uncertainty. This will need to be overcome when political stability returns and by a strong commitment to developing PPPs (for those projects where it is appropriate to do so) by the new government.

Successful experiences with PPP projects can be replicated by developing a sustainable pipeline of well-designed projects focusing on particular sectors. While Egypt has not implemented an official policy on project prioritisation, the successful financial close of the New Cairo Wastewater (NCWW) Project demonstrated the feasibility of wastewater projects, which are expected to continue to see procurement activity when stability returns. In addition, a small number of hospital and highway projects are currently in the pipeline for procurement as PPPs, as well as both conventional and renewable power projects. Building a credible pipeline of projects in particular sectors will serve to attract both local and international investors and lenders to the Egypt PPP market.

Building on the relatively successful implementation of the NCWW project, the focus may turn to medium size, less complex projects. Wastewater projects, potable water facilities or standard power and transport projects could be ideal projects to test the institutional capacity and local knowledge acquired through the implementation of successful pilot projects.

Difficulties in developing large-scale PPP projects should be overcome by strengthening institutional capacity. For example, particularly complex projects in the education sector, involving the procurement of 345 school buildings in various locations of the country, have been postponed or delayed. This has been partly due to the limited resources and means of the PPP Central Unit (PPPCU) to manage mega-projects, and lack of market appetite for projects of this sort. However, it is worth noting that the schools project has not been cancelled and that the government is likely to re-tender the project on the basis of fewer schools spread over 18 governorates. Through the effective use of advisers to successfully deliver 'pathfinder' projects, Egypt can improve the prospects of developing a good market reputation for their successful delivery. Such a reputation is important for long term investor participation in Egyptian PPPs.

Source: Based on FEMIP (2012) Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries (Volume 2 – Country Analysis)

Box 7: PPP outlook in Jordan

The World Bank classifies Jordan as a lower middle income country with an estimated. Jordan is heavily reliant on foreign transfers, specifically from Jordanians working abroad (19 per cent), tourism & transit fees for Iraq bound goods (23 per cent) and government grants (six per cent). Natural resources include potash, phosphate and relatively unexploited oil shale deposits. The population is 78 per cent urbanised (2008), and has been increasing rapidly: 6.5 million in 2010 compared to 3.2 million in 1990.

A number of large PPPs were successfully signed in Jordan over recent years. Examples include the AES Amman Jordan IPP (signed in March 2007), the Al Qatrana IPP (signed in October 2009), the new terminal for Amman Airport (November 2007) and the Disi Water PPP (June 2009). Total project funding for these four projects amounted to US$2.4 billion, with 30 per cent made available by sponsors in the form of project equity plus significant support from Islamic Development Bank, KEXIM, KfW, OPIC, JBIC, and EIB in the case of Disi Water.

Jordan has attempted a number of PPPs which were later withdrawn mainly due to limited project preparation. For instance, the Amman-Zarqa Light Railway System project, a transport demand-based 'build operate transfer' project, was tendered three times unsuccessfully. This project was first approved in 2004 but the preferred bidder failed to raise finance and procurement was suspended in March 2009. In September 2009 IFC was appointed as consultant to this project with the purpose to review, assess and update the economic, technical, legal and environmental studies that were conducted previously for the project. Following IFC's conclusion of this preparation stage, the project was put on hold for financing reasons. The Aqaba New Port Development, a US$540 million project, was terminated in November 2009 and procured conventionally after the selected consortium failed to agree terms with its public sector counterpart, reflecting limited project preparation. New projects are now subject to greater pre-procurement due diligence.

There is scope for PPP projects that are smaller in scale, and simpler to implement, than the country's current pipeline of large projects. A suitable PPP programme with certainty of deal flow would also serve to boost foreign interest in the Jordanian PPP market. This approach could demonstrate the advantages of successful PPP procurement, and stimulate domestic funding markets with projects of a scale that can be absorbed by the local bank market without significant dependence on IFI and ECA funding. The experience of the projects withdrawn highlights the need for more complete pre-procurement project scoping, and for appropriate project scaling to match investor appetite for projects in an economy the size of Jordan's.

Source: Based on FEMIP (2012) Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries (Volume 2 – Country Analysis)

Box 8: PPP outlook in Morocco

Morocco's sustained economic growth and progressive structural reforms have created favourable macroeconomic conditions for PPP investment. Morocco's fiscal deficit (4.4 per cent of GDP) and foreign debt levels (24.5 per cent of GDP) are moderate and sustainable despite a deterioration following the slowdown in the Euro area, which is Morocco's primary export market and main source of foreign direct investment. Nevertheless, the government has the capacity to maintain current spending levels and has a diversified range of funding sources offering long-term maturities. Morocco's investment-grade rating also implies reliable access to international capital markets at favourable rates.

There is a growing recognition in Morocco that PPPs provide an optimal procurement method for meeting infrastructure needs in a number of sectors. The National Development Plan has stated that the government can significantly benefit from a well-designed PPP initiative to help close Morocco's substantial infrastructure gap. Primary sectors include water, wastewater, irrigation, energy and transport. The government is pursuing policies that prioritise alternative sources of energy (for example wind and waste to energy) and PPP structures could be appropriate methods for realising these initiatives. Other sectors could also benefit from further PPP investment including non-commercial sectors, such as health, education and justice.

While the current legal framework supports concessions, broader PPP procurement options in Morocco, such as with projects where payments are directly related to performance, requires the implementation of comprehensive legal and regulatory reforms coupled with institutional capacity building. PPPs to date have been ad hoc in nature due to the absence of a single policy or procurement channel. Public bodies such as the National Office of Electricity and some state-owned entities have been active in entering into partnership contracts with the private sector in a number of sectors, including energy, water supply, and ports. These projects demonstrate that Morocco can attract high quality domestic and international bidders.

Source: FEMIP (2012) Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries (Volume 2 – Country Analysis)

Box 9: PPP outlook in Tunisia

Recent political turmoil and unstable macroeconomic conditions do not provide a solid platform for PPP investment in Tunisia. Tunisia's loss of investment grade status makes the government access to a diversified range of domestic and foreign funding sources rather unlikely. These macroeconomic conditions do not give the government enough capacity to maintain spending and to commit plausibly to PPP payments.

Tunisia's experience with concession contracts, however, offers a valuable foundation to develop PPP initiatives. The concessions in Tunisia that are procured under the Concession Law can be considered as PPPs for the purposes of the report, as they involve a partnership between the public and private sector pursuant to a long-term contractual agreement and are backed by project financing. The country has successfully implemented PPP concessions in different sectors such as water (desalination plants), electricity generation and airports.

By leveraging current experience, the development of a formal PPP policy and the establishment of a PPP centre of expertise could assure a coordinated and effective implementation of PPP programmes. A PPP framework including institutions has been established to manage digital economy-related PPP projects tasked with upgrading Tunisia's information and communication technology infrastructure (the "Digital Economy Initiative" or DEI). Following the success of many concession projects and of the DEI, Tunisia could bring consistency and efficiency in the implementation of PPP schemes by setting policy goals and priorities regarding the desired impact of PPP at the sector and local government level. In addition, identification of priority sectors and announcing a pipeline of projects would enhance the credibility of the PPP policy. The establishment of a centre of expertise could then assure the sharing of best practices, lessons, and monitoring and support for the implementation of the set PPP policies.

Source: Based on FEMIP (2012) Study on PPP Legal & Financial Frameworks in the Mediterranean Partner Countries (Volume 2 – Country Analysis)

Annex 13: Evaluation approach and rating criteria

During the Evaluation Period the MEI team signed a total of 214 operations (private and public), worth €3.7 billion. Of these, 29 operations (comprising 27 projects[16]) were private (13 per cent), accounting for €942 million (25 per cent of total). Additionally, over a quarter (or 52) of the 185 public sector transactions contained one or more PSP components in their design, usually as a transition impact objectives with specific monitoring benchmarks (although very rarely covenanted in the loan agreement). Thus, overall, over one third (38 per cent) of all MEI transactions signed during the Evaluation Period were either private or contained a PSP component (collectively private and public operations with PSP components are referred to as "PSP-MEI projects").

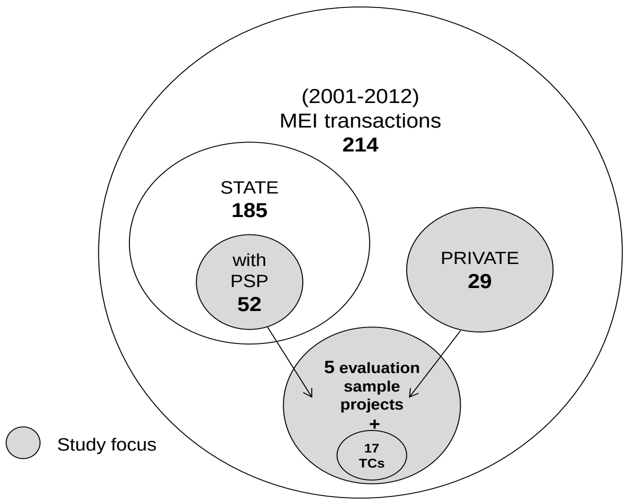
EvD used the following approach to evaluate the implementation of MEI private operations:

i) Sample project evaluation - in consultation with the MEI team, six operations (related to five MEI projects)[17] were selected as evaluation sample projects. These projects were implemented in various countries at different stages of transition, namely Croatia, Poland, Russia and Turkey, as well as one regional project (see figure 1.3 below and table 2.1 in Annex 2 for the list of the evaluation sample projects). These sample projects have been analysed in depth. In four cases the analysis included interviews with the private client and in two cases with the beneficiary cities, while one project was subject to rigorous desk-analysis. In addition, three public projects with PSP components were selected for closer review, including client interviews.

ii) Analysis of completed evaluations - of the 29 private transactions, 15 (51 per cent) have been evaluated by EvD through 13 reports. After adjustments[18], the evaluation team analysed the results of 11 evaluations covering 13 transactions, which results were considered in the assessment of the Bank's overall performance in respect of MEI private projects.

iii) Desk review - the remaining ten private transactions signed during the Evaluation Period, and 49 remaining public projects with PSP components, were subject to a less rigorous desk review (limited to the transition impact monitoring reports, in the latter case). Also, documentation (primarily project completion reports) from 17 technical cooperation projects related to MEI private projects, or intended private projects, was reviewed (see figures 1 and 2).

Figure 1 - MEI portfolio 2001 to 2012 and its relation to the evaluation of PSP content



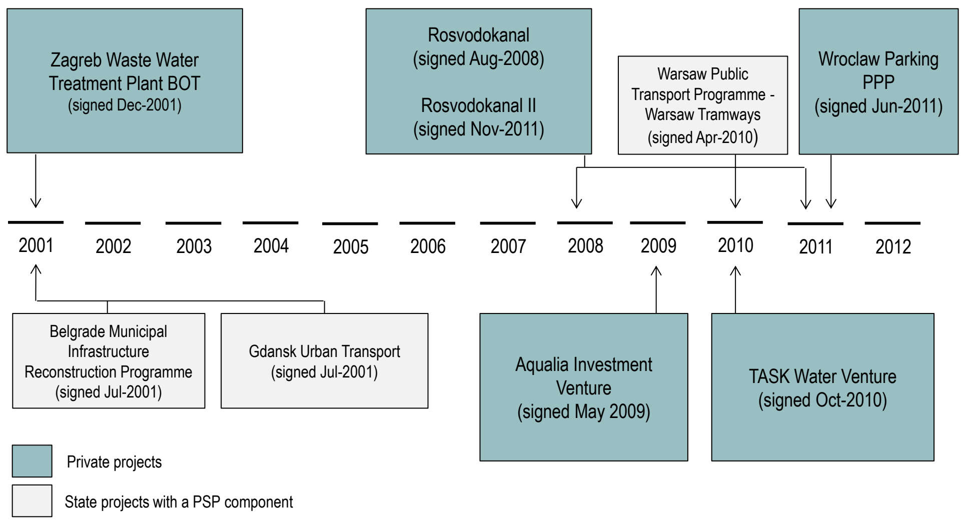
[16] Two projects consisted of debt and equity transactions.
[17] One transaction (Rosvodokanal) had a second follow-on operation (Rosvodokanal II).
[18] One evaluation was mid-term and did not provide ratings. Another was completed long ago, while the project's situation changed. Both projects covered by these two evaluations were selected as sample projects for detailed evaluation.

iv) Interviews with key Bank staff – the evaluation team conducted interviews with MEI management and key staff involved in PSP projects, and with EBRD Office of the Chief Economist staff responsible for MEI operations. Moreover, interviews were also conducted with three former MEI staff members who were critical to MEI private operations in the past.

v) Internet searches and publication reviews – searches of the World Bank's PPI Project Database in order to assess the market and degree of involvement and success of other IFIs in private water and waste water projects, were conducted. The web searches also provided an insight into the activities of key private companies involved in municipal infrastructure concessions. Publications reviewed included "Evaluating the Environment for PPPs in CEE and Commonwealth Independent States – the 2012 EECIS Infoscope" (a comprehensive study of the PPP environment in the Bank's countries of operations recently completed by The Economist Intelligence Unit), and numerous EPEC and IFC publications related to their PPP related activities.

vi) Communication with other IFIs – the evaluation team carried out telephone interviews with, and gathered report evidence from, IFI staff working on infrastructure PPP projects and policies (including those at sub-national government level), in particular with the IFC, PPIAF (World Bank), Asian Development Bank, European Investment Bank (including EPEC), and the Inter-American Development Bank.

Figure 2 - Evaluation Sample Projects[19]



Rating criteria

To evaluate the performance of MEI-PSP projects this study uses the four OECD criteria summarised in Box 10 adopted by IFIs to evaluate development assistance adjusted, however, to cover the EBRD's specific priorities (for example transition impact, rather than developmental impact and so forth).

Box 10: OECD evaluation criteria applied in this study

Relevance: the extent to which Bank's activities related to the promotion and selection of projects with PSP fit its stated policies, country strategies and country priorities.
Effectiveness: the extent to which MEI-PSP operations attained their stated operational objectives.
Efficiency: the extent to which the MEI-PSP operations achieved their financial objectives.
Sustainability (of transition impact): the extent to which the MEI-PSP operations helped (or hindered) sustainable transition to well-functioning market economies.

[19] Two projects selected as evaluation samples (Zagreb WWTP BOT and Rosvodokanal I) were evaluated in the past, however long time elapsed since the former was evaluated and its situation changed, while the latter was not rated as it was subject to only a mid-term evaluation (MTR).

Each of the evaluation sample projects was rated on a three-point scale (either "+"; or "+/-"; or "-") against each of five indicators: (1) fit with Bank policies; (2) achievement of project objectives; (3) financial performance; (4) Bank handling; and (5) transition impact. The resulting ratings are justified and discussed in Annexes 6-10 for all of the evaluation sample projects.

In evaluating the aggregate performance of PSP-MEI projects in respect of each criteria, the study uses a six-point rating scale consistent with the scale normally used by the Bank for project evaluations: (1) Excellent; (2) Good; (3) Satisfactory; (4) Marginal; (5) Unsatisfactory; and (6) Highly Unsatisfactory.

The indicators and ratings used to evaluate the Sample Projects can be related to the OECD criteria. In particular, "fit with Bank policies" corresponds to relevance, while "fulfilment of project objectives" corresponds to effectiveness; "financial performance" and "Bank handling" are aspects of efficiency.

The three-point scale used for Sample Project evaluation corresponds to the six-point scale by identifying "+" with "Excellent" and "Good", "+/-" with "Satisfactory" and "Marginal", and "-" with "Unsatisfactory" and "Highly Unsatisfactory".

Related Bank studies

This report takes into account a previous MEI sector evaluation carried out in 2010, Special Study: Municipal and Environmental Infrastructure Policy Review. This study was a sector review of the implementation of the Bank's 2004 MEI Operations Policy. Its specific recommendations regarding MEI operations with PSP are summarised in Box 11.

Box 11: The 2010 Sector MEI Policy Review – main recommendations related to PSP

Regulation and institutional strengthening

Successful 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 often take time to come through, emerging in the medium to long term.

As well as providing TC for institutional strengthening and capacity development of the municipal client/utility, the EBRD could consider providing TC to regulators to develop their capacity and strengthen their independence.

Municipal client capacity is a decisive factor in the success of a PSP project. Initially, simpler (e.g. management) contracts are recommended where possible, with larger more complicated contracts (concessions) preferably not being tendered until the client has sufficient capacity to regulate them effectively.

Procurement and transaction costs

Larger, more complex projects involving PSP can be much more resource-intensive for the Bank. The EBRD must focus on strengthening and maintaining the relationship between the client and the private sector service provider in complex PSP projects.

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 a review of the tender specifications for contracts to design, build and/or operate infrastructure facilities to ensure the benefits from competitive tendering are gained.

PSP approach and incentives

Concession contracts can have an advantage over acquisition (full privatisation) as they channel private funds for a more rapid achievement of required investments, rather than delaying them due to lack of funds which have been spent on acquisition by new owners. Also, until the legal and institutional framework has been strengthened, these simpler contracts are more appropriate than contracts involving private ownership of facilities.

Privatisation can assist commercialisation in that radical changes (e.g. staff reduction and other cost-cutting measures.) can be implemented much more easily by a private company.

There has been some confusion about the forms of PSP that are allowed in projects with EU ISPA or Cohesion grant co-financing. Clarifying this confusion should help to promote PSP.