The World Bank

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Report No: 37774 - RU

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF
US$200 MILLION

TO THE

RUSSIAN FEDERATION
FOR A

HOUSING AND COMMUNAL SERVICES PROJECT

January 28, 2008

Sustainable Development Department
Russia Country Unit
Europe and Central Asia Region

CURRENCY EQUIVALENTS
(Exchange Rate Effective December 22, 2007)

Currency Unit	=	Russian Ruble (RUR)
RUR 24.7235	=	US$1
US$0.0404	=	RUR 1

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
CS	Communal Services
EMP	Environmental Management Plan
EIA	Environmental Impact Assessment
FER	Foundation for Enterprise Restructuring and Financial Institutions Development
GDP	Gross Domestic Product
GOR	Government of Russia
GRP	Gross Regional Product
HCS	Housing and Communal Services
HOA	Home Owners' Association
IMF	International Monetary Fund
IWG	Inter-Agency Working Group
LDP	Letter of Development Policy
MRD	Ministry of Regional Development
MOEDT	Ministry of Economic Development and Trade
MOF	Ministry of Finance
MUE	Municipal Unitary Enterprise
NOBUS	National Survey of Households' Welfare and Social Programs Participation
PDO	Project Development Objectives
PER	Public Expenditure Review
PPL	Public Procurement Law
PSIA	Poverty and Social Impact Analysis
Rosstroi	Federal Agency for Construction and HCS
TA	Technical Assistance
WTO	World Trade Organization

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RUSSIAN FEDERATION
Housing and Communal Services Project

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HOUSING AND COMMUNAL SERVICES PROJECT
PROJECT APPRAISAL DOCUMENT
EUROPE AND CENTRAL ASIA

ECSSD

Date: January 28, 2008 Country Director: Klaus Rohland Sector Director: Peter D. Thomson Sector Manager: Wael Zakout Project ID: P079032 Lending Instrument: Specific Investment Loan	Team Leader: Gevorg Sargsyan Sectors: Sub-national government administration (100%) Themes: Other urban development (P) Environmental screening category: Partial Assessment

Project Financing Data

[X] Loan [ ] Credit [ ] Grant [ ] Guarantee [ ] Other:

For Loans/Credits/Others:
Total Bank financing (US$m.): 200.00
Proposed terms: Standard IBRD lending terms

Financing Plan (US$ m)

Source	Local	Foreign	Total
BORROWER	4.00	2.00	6.00
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT	165.50	34.50	200.00
Total:	169.50	36.50	206.00

Borrower: Russian Federation

Responsible Agency: Federal Agency for Construction and HCS of the Russian Federation (ROSSTROI)

Estimated disbursements (Bank FY/US$ m)

FY	9	10	11	12	13
Annual	3.00	20.00	62.00	76.00	39.00
Cumulative	3.00	23.00	85.00	161.00	200.00

Expected effectiveness date: July 31, 2008
Expected closing date: November 30, 2012

Does the project depart from the CAS in content or other significant respects? ***Ref. PAD A.3***	[ ]Yes [X] No
Does the project require any exceptions from Bank policies? ***Ref. PAD D.7***	[ ]Yes [X] No
Have these been approved by Bank management?	[ ]Yes [ ] No
Is approval for any policy exception sought from the Board?	[ ]Yes [ ] No
Does the project include any critical risks rated "substantial" or "high"?	[X]Yes [ ] No

Ref. PAD C.5	
Does the project meet the Regional criteria for readiness for implementation? ***Ref. PAD D.7***	[X]Yes [ ] No

Project development objective ***Ref. PAD B.2, Technical Annex 3***
The project development objective is to improve the quality and financial viability of HCS of participating municipalities.

Project description ***Ref. PAD B.3.a, Technical Annex 4***
The project will support the Government's HCS program in ten competitively selected medium-sized cities via a combination of technical assistance for reforms and investments for infrastructure through the following four components:

Component A: Support to HCS reform implementation at the federal level, including (i) developing the legal and regulatory framework at the federal level, (ii) setting up the national HCS monitoring system, and (iii) disseminating project results to non-participating municipalities and regions.

Component B: Support to implementation of HCS reforms at the sub-national level, including (i) assistance to cities on utility reform, social protection & housing; (ii) evaluation of implementation of municipal reform programs; (iii) knowledge exchange between municipalities; and (iv) public awareness campaign on HCS reforms in selected regions.

Component C: Preparation and implementation of HCS investment plans, including (i) preparation of municipal investment plans, feasibility studies and technical designs, (ii) implementation of municipal investment plans, and (iii) supervision of implementation of municipal investment plans

Component D: Project management and monitoring of results

Which safeguard policies are triggered, if any? ***Ref. PAD D.6, Technical Annex 10***
OP 4.01 Environmental Assessment

Significant, non-standard conditions, **if any**, for:
Ref. PAD C.7
Loan/credit effectiveness:
- The participating municipalities have been selected based on the Selection Methodology
- The Implementation Agreement among MOF, Rosstroi and the PIU has been signed
- The Project Operational Manual, satisfactory to the Bank, has been adopted by the Borrower.

A. STRATEGIC CONTEXT AND RATIONALE

1. Country and sector issues

1. The HCS sector is one of the most inefficient sectors in the Russian economy and one of the last sectors that requires serious reforms if Russia is to complete the transition to a market economy. Services in the HCS sector continue to be delivered by local governments in much the same way as they were during the Soviet era, with virtually no reliance on market-based mechanisms. During the unstable macroeconomic environment of the 1990s, the HCS sector acted as a shock absorber; the housing stock and utility networks were allowed to depreciate as maintenance and investment funds were diverted elsewhere by cash-strapped households and local governments. Usually, HCS reforms are difficult to implement in tough economic times. Numerous attempts to reform the sector have failed due to political circumstances and unforeseen economic shocks, the last one being the 1998 financial crisis.

2. However, the current sound economic conditions create a window of opportunity to improve HCS services through reforms and investments. Recent macroeconomic stabilization and rising household incomes have greatly improved the prospects for reforms in the HCS sector. Budget surpluses have increased the funds available for investments in upgrading infrastructure. It is therefore essential that the reform momentum is maintained as improved local fiscal accounts might lead to a degree of complacency in tackling reforms.

3. Housing and communal services are critical to the quality of life of Russian citizens and to Russia's economy. Shelter and water supply, sewerage, heating, and hot water services are basic services that citizens in all countries rate as important. However, the harsh climate of much of the Russian Federation makes the continuous and quality provision of these services even more critical not only for comfort but often for sheer survival.

4. The HCS sector in Russia constitutes about six percent of GDP, consumes 20 percent of the country's energy resources, and its fixed assets account for 24 percent of the total fixed assets of the Russian Federation. Also, housing has emerged as the most valuable asset of the majority of households.

5. The Russian Government places high importance on improving HCS service provision, and closely links service provision with improving the quality of life. The Russian Government has declared the reform of the HCS sector as one of its top priority areas. HCS reform is included in the Medium-Term Government Program for 2006-2008, which sets out the country's development priorities. In particular, the priorities include facilitating private sector participation in housing and communal services, developing targeted social assistance, and improving and measuring the quality of services provided.

The problems to be solved

6. The majority of the Russian population is dissatisfied with the quality of HCS. In a 2005 survey, 56 percent of surveyed respondents reported no change and 24 percent indicated a decline in services over the past few years. The following are the key problems that need to be solved:

(i) access to communal services still remains an issue, despite an existing perception that Russia has complete coverage of services, with only 87 percent of the urban population having access to water supply, 85 percent to sewerage, and 89 percent to heating; while figures for rural areas are much lower;

(ii) those who have access face declining quality of communal services combined with the challenge of receiving continuous and reliable supply, rising costs, emissions and pollution which is a result of over 55 percent of assets having deteriorated and 30 percent of assets being completely worn-out, a heat efficiency rate of as low as 30 percent, high level of heat and water losses, and the lack of metering;

(iii) about 3 percent of housing stock is dilapidated and uninhabitable (in some regions the number is over 25 percent) and annual backlog of housing requiring repair is about 100 million square meters;

(iv) the impact of targeted social assistance programs on poverty alleviation remains small as the shift from category-based privileges (*l'goti*) to means based housing allowances is still partial, and administration of subsidies is weak.

Underlying causes: lack of investment in infrastructure and weak institutions

7. The challenge now lies in improving HCS services at the local level where bold changes are necessary to implement the federal legislative framework. The Federal Government has enacted an impressive array of legal and regulatory acts in the past few years. Implementation of the Federal Government's HCS reform strategy at sub-national levels requires special focus on key interrelated policy areas, such as the management and maintenance of the existing housing stock, improved social protection for the poor and vulnerable, and the efficient operation of CS providers.

8. Institutional and policy reforms to improve services must be accompanied by increasing investment for infrastructure upgrading. Past HCS reforms have not been successful because they did not produce rapid and tangible improvements in service delivery. Ordinary people in Russia associate HCS reforms with tariff increases rather than with service improvements. A recent survey has indicated that 72 percent of Russians believe that the quality of HCS services will not improve after introducing cost recovery. Consumers will only be willing to pay the higher tariffs if they observe improvements in the quality of services delivered. In order to make reforms acceptable to the population and to politicians, it is important to combine them with investment that improves services. Investments should also be made to increase efficiency so that tariff increases needed to create a sustainable stream of financing are kept to a minimum.

Investment needs

9. The investment needs are huge. The federal government estimates that RUR 1,456 billion (US$49 billion) is required for full rehabilitation and modernization of the communal services infrastructure. This estimate does not include investment requirements to increase the coverage of communal services. The problems are compounded by lack of incentives for efficient use of services by consumers. The lack of thermostat controls and metering leads consumers to waste energy and water (by opening windows, running taps) as a means of controlling comfort levels. Most buildings are energy inefficient.

10. However, there is not sufficient funding to meet the needs. The cash flow of CS providers is inadequate due to low tariffs, subsidies which are not always reimbursed and poor management. According to Rosstroi, CS providers in 70 out of 88 regions had losses amounting to RUR 59.5 billion in 2005. Municipal and regional budgets also do not have sufficient funds to fully finance rehabilitation of infrastructure. Finally, private financing is in its infancy, and rapid increases in private investment in the sector are unlikely partially due to high investment risk, low profit potential, the lack of a solid legal and regulatory framework, and widespread political interference.

11. Investment needs to rehabilitate and renew the housing stock are also very large. The incremental dilapidated housing stock between 1996 and 2004 exceeded the capital repairs carried out in the same period. In some Russian regions, the share of dilapidated and uninhabitable housing stock reaches more than 25 percent.

Reform needs

12. Implementation of the Federal Government's HCS reform strategy at sub-national levels requires measures in three interconnected key policy areas. First, the financial viability of communal services providers has to be improved and their accountability increased. Second, the social protection of consumers has to be strengthened to ensure affordability of services to all. Third, market competition in housing management and maintenance has to be created to improve services and reduce prices. Below are the key issues that must be addressed as part of the reform program.

Improving financial viability of communal services providers

- Tariff regulation is inadequate and sets perverse incentives for inefficiencies;
- Tariff cross-subsidies result in distortions that further undermine financial sustainability of CS providers;
- Budgetary entities do not pay adequately for their consumption of communal services;
- Communal service providers are not autonomous and accountable;
- Corruption is one of the most persistent challenges in the HCS sector;
- Billing and collection of payments are not directly linked to services provided.

Strengthening social protection of HCS consumers

- The poor are not adequately protected against rising tariffs because of inadequate targeting and funding of social assistance programs;
- The subsidies are not always actually paid which victimizes consumers and also adversely affects the financial viability of CS providers who are not compensated for subsidizing household tariffs;
- The administration of targeted social assistance benefits is fragmented which limits effectiveness of housing allowances.

Creating market competition in housing management and maintenance

- Lack of building level collective management structures and inefficient housing management by municipal enterprises has strongly contributed to the physical deterioration of multi-family buildings;

- Privatized tenant-owners do not perceive they hold joint ownership of the common property and do not feel responsible for its management, maintenance and repair;
- The non-competitive nature of maintenance and repairs has contributed to the lack of availability, quality and inadequate pricing of these services;
- Lack of clear rights and obligations over common property land plots does not allow home owners to properly maintain and develop common property.

13. These reforms must be accompanied by capacity building at the local level. Municipal administrations do not have adequate human resources to regulate and oversee providers. Municipalities and CS providers are plagued by frequent rotation of personnel. The municipality's ability to get good information and its ability to set enforceable incentives for good performance by providers is crucial to successful reforms. Reform processes require new management and professional and technical skills to deal with the organizational changes that emerge from reform and the cultural issues that are involved. New concepts - like regulation, customer service, and private sector outsourcing - need to be understood.

2. Rationale for Bank involvement

14. The quality, accessibility, and affordability of housing and communal services is an essential element for improving the quality of life of ordinary people. In addition, more efficient housing and communal services can ease the large burdens on municipal and regional budgets and can reduce energy intensity.

15. The Bank has accumulated vast knowledge of this sector over the past decade as a result of implementing a number of investment and policy development projects, ESWs, and policy dialogue with the Government. More recently the Bank has conducted three pieces of analytical work related to housing and communal services (see Annex 12). In addition, there are four on-going projects which support reforms and investment in the HCS sector (see Annex 2).

16. The Government of Russia has requested the Bank's assistance for this project because of its comparative advantage to provide integrated support on the macro-economic, financial, technical, social and environmental dimensions. The Bank is considered a source of global knowledge and best practice, that has the convening power that can engage at all scales (country, regional, local), and has an ability to integrate across these. Several aspects of Bank engagement can benefit the complex process of HCS reform: (i) its packaging of capacity enhancement and policy advice in an integrated coherent and multi-sectoral package that supports quality decision making; (ii) its track record on infrastructure, housing and social policies; (iii) the Bank's sustained relationships that matches the long term nature of reforms.

17. In addition to the fact that the Russian Government continues to value highly its cooperation with the World Bank Group because of the Bank's experience, expertise and project management skills, the Bank continues to attract significant attention from the Government, mass media, and civil society as an independent, trusted, and critical voice that supports reform-oriented policies within the government and sub-national administrations.

3. Higher level objectives to which the project contributes

18. The proposed World Bank project will support the implementation of the Federal Government's reform effort as per the Federal Targeted Program Housing (Zhilishche) for 2002-2010 and its Sub-Program "Reforming and Upgrading of the Housing and Communal Services Sector of the Russian Federation." It will also support the national project on "accessible housing" that has been declared by the President of the Russian Federation and the Government as one of the four national priority projects. A key element of the "accessible housing" national priority project is to improve living conditions and quality of communal services. The implementation of the aforementioned federal programs and strategies at sub-national levels requires special focus on selected key policy areas, which will be supported through this project, i.e., the upgrading and efficient operation of utilities, namely water supply, wastewater treatment, heating, and hot water services, improving social protection for the poor and the vulnerable, and supporting the Program's emphasis on the management and maintenance of the existing housing stock.

19. In addition, one of the Government objectives is creation of an effective mechanism for channeling federal funds to regional infrastructure projects. The HCS would pilot such a mechanism which, if successful, could be replicated throughout the country to scale up reforms and channel funds to regions and municipalities in an efficient and effective way.

Link to Country Partnership Strategy (CPS)

20. The project is consistent with the three strategic pillars of the Country Partnership Strategy (CPS) for the period FY2007-2009: (i) improving the business environment as enterprises begin to operate in a sector driven by market-based relations and enhanced competition; (ii) strengthening the public sector by improving local governments' management of sector assets; and (iii) mitigating social risk through improved social protection mechanisms. The project is also consistent with the main goals of the new CPS which is being currently discussed. These goals are: (i) sustaining rapid growth; (ii) strengthening public sector management and performance; and (iii) improving the delivery of social and communal services. The CPS states that the Bank's support in the infrastructure sector will largely focus on improving the quality of utility services and housing. Also, the proposed project contributes to the Bank's increasing effort to promote development in the regions.

B. PROJECT DESCRIPTION

1. Lending instrument

21. The proposed loan in the amount of US$ 200 million is designed as a specific investment loan (SIL), combining investment and TA financing. The project uses an innovative approach whereby selected cities have to implement a reform program before gaining access to investment financing. This demand-based approach combines reforms and investment and will create a number of good practices as a basis for later scale-up.

22. The Loan will be a Variable Spread, denominated in US Dollars with repayment period of 15 years, including a 5 year grace, and level repayment of principal, with payments due on each June 15 and December 15.

2. [If Applicable] Program objective and Phases

N/A

3. Project development objective and key indicators

23. **The project development objective** is to improve the quality and financial viability of HCS of participating municipalities.

24. The following indicators will be used to monitor progress in achieving the project development objective:

- Improved financial viability of communal entities, including district heating, water supply, hot water supply and waste water disposal;
- Improved quality of delivery of communal services, including district heating, water supply, hot water supply and waste water disposal;
- Percentage of municipalities that have completed monetization of housing allowances and where cash payments are transferred to individual social accounts of citizens;
- Social payment arrears eliminated;
- Improved quality of delivery of communal services for the population (percentage of population rating services as satisfactory or better);
- Percentage of private investments in the total amount of investments to upgrade the communal infrastructure;
- Percentage of private companies managing communal sector facilities on the basis of concession agreements and other agreements in the total number of communal entities;
- Percentage of multi-family buildings managed by professional management companies

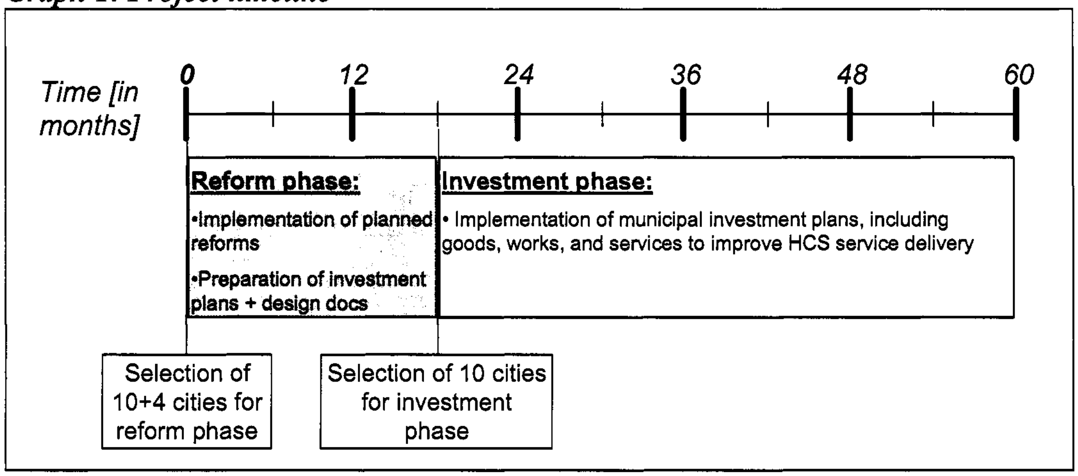
4. Project components

25. The proposed SIL will support the Government's HCS program in ten competitively selected medium-sized cities through a combination of technical assistance for reforms and investments for infrastructure.

26. The project will consist of two phases: (a) an 18-month reform phase and; (b) a 42-month investment phase (see graph 1). By project effectiveness, ten medium-sized cities (and four reserve cities) will have been competitively selected on the basis of their planned reforms for the reform phase. During the reform phase, these cities will implement the planned reforms. Cities will also prepare detailed investment plans to be financed by the project, plus design and tender documents. In order to be included in the investment phase of the project, municipalities will have to substantially implement their planned reforms and have completed relevant and quality investment plans. During the investment phase, targeted investments in HCS infrastructure will be made according to the investment plans. The size of the investments will depend on the population of the city (between 90,000 and 600,000). The participating municipalities will co-finance the project by financing implementation of the reform program, including audits,

preparation of production programs, settlements of arrears to residents and communal service providers, etc. and preparations of the investment plans, including feasibility studies and designs. Also, the participating cities will be given an opportunity to use up to 20% of the funds allocated for the investment phase to implement a set of high-priority investments in HCS for which the cities have well developed feasibility studies and designs within the first 18 months of the project implementation.

Graph 1: Project timeline



27. This project will finance investments yet to be defined in municipalities that are yet to be selected. Hence, it is important to understand the various components in the project as well as the process to select municipalities. The paragraphs below describe the project by outlining (a) the project components including key inputs and outputs and how they address sector issues, and (b) key steps to select cities, assess their investment plans, and evaluate their reform status. More details are provided in Annex 4.

Project components

28. Key issues highlighted in Section A.1. of the PAD will be addressed through four main project components:

29. **Component A: Support to HCS reform implementation at the federal level (US$2.99 million) -** The Federal Government has enacted an impressive array of legal and regulatory acts designed to improve HCS delivery. The project will provide targeted support to fill the gaps in the legal and regulatory framework, to improve progress monitoring, and to disseminate good practice across the country. The assistance at the federal level will include three subcomponents: (i) developing the legal and regulatory framework at the federal level, (ii) setting up the national HCS monitoring system, and (iii) disseminating project results to non-participating municipalities and regions.

30. **Component B: Support to Implementation of HCS Reforms at the Sub-national Level: (US$8.54 million) -** The component will finance technical assistance in ten selected and four reserve cities to implement reforms. It will also build capacity of these and other regional and municipal administrations, communal services providers, and consumers to improve HCS service provision. Technical assistance will focus on three reform areas:

a. **Improving financial viability of communal services providers** – Technical assistance will be provided to support breaking the vicious cycle of low tariffs, high operating costs, and low-quality services that communal service providers are trapped in. Technical assistance will also be provided to assist in increasing the autonomy and accountability of CS providers. Technical assistance will focus on: (i) improving cost recovery; (ii) reducing existing arrears of governments to service providers; (iii) linking collection of payments more directly to services provided; and (iv) reforming municipal departments - under direct control of local governments - into government owned joint stock companies and fostering private sector participation.
b. **Strengthening social protection of HCS consumers** – Technical assistance will support improving the targeting, coverage, and efficiency of HCS subsidies in order to enhance the impact of social assistance programs on poverty alleviation. In addition, the subcomponent will support the consolidation of program administration of various targeted social assistance benefits, including housing allowances. Technical assistance will focus on: (i) ensuring that payment of subsidies is done in cash and that payments are actually made, and (ii) consolidation of program administration of various targeted social assistance benefits, including housing allowances.
c. **Creating market competition in housing management and maintenance** – Technical assistance will support improving management, maintenance, and repair of multi-family buildings through clarifying and formalizing rights and responsibilities of owners in multi-family buildings. Technical assistance focuses on: (i) encouraging building-level collective management structures; (ii) creating market competition for building maintenance, current and capital repair; (iii) fostering greater tenant-owner awareness of their rights and responsibilities, and (iv) clarifying rights and obligations regarding land plots.

31. This component consists of four subcomponents: (i) specialist assistance to cities on utility reform, social protection & housing and how-to-guidance on selected reform topics; (ii) evaluation of implementation of municipal reform programs; (iii) knowledge exchange between municipalities; and (iv) public awareness campaign on HCS reforms in selected regions.

32. **Component C: Preparation and implementation of HCS investment plans: (US$188.94 million)** - This component includes technical assistance to prepare investment plans and technical designs during the reform phase, and financing for investment subprojects to implement approved investment plans during the investment phase of the project.

33. Given the performance based selection of municipalities, specific investment subprojects will be determined during the project. The average investment per capita is US$50, based on the 10 cities of 90,000 – 600,000 population participating in the investment phase.

34. Most of the investment funds will be used for rehabilitating and modernizing existing infrastructure. System rehabilitation and modernization can reduce costs, improve service quality, and increase consumer-orientation through metering and consumer control of supply. Investment subprojects may include rehabilitation and construction of infrastructure for heating supply, water supply, sewerage, energy supply for CS facilities, and housing services. The investment plans may also include supply of goods and services that are required for infrastructure rehabilitation, goods and services required to improve social protection, and

consultancy services to support the implementation of investments. Based on investment needs and the demand expressed in seminars during project preparation, it is estimated that 60 percent of the expenditures on investment plans will be on heating supply, 35 percent will be on water supply and sewerage, 4 to 5 percent will be in the housing sector, and about 1 percent will be on social protection.

35. This component consists of three subcomponents: (i) preparation of municipal investment plans, feasibility studies and technical designs, (ii) implementation of municipal investment plans, and (iii) supervision of implementation of municipal investment plans.

36. **Component D: Project management and monitoring (US$5.53 million) -** This component will include technical assistance, equipment, and logistical support to implementing agencies for project implementation, monitoring, and supervision including consulting services for measuring results of the project. This component consists of two subcomponents: (a) results measurement, and (b) operating costs.

I. Key project steps

37. A methodology to select cities for the reform phase, to evaluate investment plans and to evaluate progress on reform status and select cities for the investment phase had been prepared by Rosstroi in consultation with other ministries, and agreed with the World Bank prior to the project negotiations. The methodology defines three key steps during the reform phase:

38. **Step 1: Competitive selection of cities for the reform phase -** Selection of participating cities will be through a nation-wide contest. The number of selected cities is ten to make the program manageable, and to ensure that participating cities receive adequate investments in a sector requiring substantial financial resources. In addition four reserve cities will be selected which will only receive investment funding if at least one of the ten selected cities does not implement its planned reforms. Only one municipality per region will be selected, and municipalities require a letter of support from the regional administration.

39. Selection of cities consists of two steps. First, cities will be evaluated against a set of absolute minimum criteria focused on the financial performance of the municipal administration and CS providers. The reform plans of the municipalities that pass this first step will be assessed using a formula that measures the planned reform status at the end of the reform stage relative to the reform status at the time of application. Municipalities that have submitted preliminary investment plans and design documents will receive a bonus. Cities will be ranked by their assessment score, and the top ten cities will be selected, with numbers 11 to 14 being picked as reserve cities. The criteria for assessing reform status during the selection process focus on three main areas:

a) Improving financial viability of communal services providers
b) Strengthening social protection of HCS consumers
c) Creating market competition in housing management and maintenance

40. **Step 2: Technical, economic, financial and environmental assessment of investment projects –** No later than six months into the reform phase, each selected and reserve municipality

will submit an investment plan outlining subprojects to be financed during the investment phase. The investment plan will be assessed to ensure that all investment subprojects are relevant and of high quality, using the following criteria:

- Eligibility of investments –Investment plans can only include subprojects with environmental classification "B", "C", or "D" as per World Bank Operational Policy 4.01 (see the chapter D5). Investments are limited to an agreed list of facilities; terms of implementation (see Annex 4 and EMP).
- Relevance of investments –Investment subprojects should be relevant to achieving broad improvements in HCS services. Municipal investment plans should include at least one investment subproject that primarily supports each of the indicators for the project development objective outlined in the results framework. Investment plans should encourage rehabilitation if this is the least cost option compared with new construction.
- Financial and economic outcomes - Each subproject should have an economic internal rate of return (EIRR) of minimum 15 percent and a financial internal rate of return (FIRR) of minimum 12 percent. A more detailed summary of the economic and financial screening process is included in Annex 9.

41. **Step 3: Reform status evaluation process and selection of cities for the investment phase** - Selected cities will participate in the investment phase of the program. The main requirement for a city to participate in the investment phase and receive grant funded investments is to complete at least 80 percent of its planned reforms. In addition, municipalities must have an approved investment plan and must have completed 80 percent of the technical designs by the end of the reform phase. In case a selected city does not meet these criteria, freed up funds will be distributed among reserve municipalities which implement at least 80 percent of their reform programs and prepare acceptable investment plans.

5. Lessons learned and reflected in the project design

42. Through its earlier engagement in operations and analytical work on transformation in the HCS sector in Russia, as well as in other countries, the Bank has gained meaningful lessons and experience on this subject. The main lessons are summarized below.

43. **The choice of the lending instrument**. As challenges facing the housing sector are often systemic and institutional in nature, traditional investment loans – primarily focusing on bricks and mortar – have not been successful in achieving results in sector-wide reforms. Conversely adjustment operations which focus solely on policy aspects often do not result in rapid rehabilitation of infrastructure or improvement of service quality which is essential for the financial viability of utilities and support of consumers. Therefore, both the Government and the Bank deemed that an investment lending operation with policy-orientation and with a defined scope, that supports the implementation of the Government's agenda on housing and communal services reform, would be more effective in achieving the desired development objectives.

44. **Flexibility in project design.** Flexibility to adjust to new information and changing circumstances during implementation is required to ensure the efficiency of the reform strategy. As the Housing Project and the Enterprise Housing Divestiture Project have shown, difficulties in implementing operations were complicated by the volatile political and economic context in Russia during the early and mid-1990s. The situation has stabilized over the past few years and

the Government has made substantial progress in its overall reform agenda. The current socio-economic environment provides a relatively stable policy environment in which the HCS reform agenda will be carried out. Still, mechanisms should be in place to allow restructuring of the project in accordance with evolving circumstances and client demands.

45. **Competitive mechanisms to accessing funds.** The design and implementation of the Fiscal Federalism and Fiscal Reform Project in Russia and other good practices have highlighted that performance-based criteria to determine the allocation of resources across sub-national governments can help to improve performance of sub-national governments. The proposed project has developed a methodology for a contest as the basis for the municipalities to participate in the project.

46. **Government ownership.** Past experience has shown that strong Government ownership is critical for effective operations. In the case of this particular loan, there have been ebbs and flows as well as substantial delays during project preparation due to a series of re-organizations of the government. Nevertheless, the formation of the Inter-Agency Working Group (IWG), a joint letter by the Ministries of Regional Development, Economic Development and Trade, and Finance which reconfirms strong interest of the government in the project and outlines its key design elements, and active preparatory work have signaled a stronger commitment on the part of the Russian Government.

47. **The need for broadening beneficiaries.** The recently completed Housing Project—the very first Bank investment loan in Russia—focused on delivery of new housing units and did not target middle to lower-income households. A focus on the well-to-do was taken in order to demonstrate the feasibility of market-based housing supply mechanisms. However, rapid service improvements for a broader constituency are required to create change and sustainable support for reforms in the sector. This Project includes a social protection component aimed at improving the targeting, coverage, adequacy, and equity of housing allowances and subsidies, and direct investments in rehabilitation and modernization of existing infrastructure.

48. **Project management**. In the past, the PIU often assumed the role of executing and policy making agencies which usually resulted in conflicts with the government agencies in charge of the respective sectors and lack of commitment and ownership by the latter. Also, there was often lack of appropriate supervision by and guidance from the Federal Government. In the HCS project the PIU's role would be limited to fiduciary functions and technical support to Rosstroi in the project management. Rosstroi will be in charge of project implementation. The project management team in the PIU will directly report to the Rosstroi management. In addition, the Interagency Working Group, which represents the key stakeholders, will provide regular oversight and guidance to the project management.

6. Alternatives considered and reasons for rejection

49. Four alternatives were considered as follows:

1. Development Policy Loan: The project was originally designed as a DPL. However, the DPL was ruled out mainly due to concerns that the grants allocated to the winning municipalities may not be invested in the HCS sector to improve the service delivery and

may not be used in a transparent, efficient and effective manner. The Government expressed the willingness to use the Bank's fiduciary and project management procedures to ensure better transparency and efficiency of money flows and mitigate potential risks of misuse of funds. The government made an informed decision to change the instrument based on the pros and cons analysis prepared by the team.

2. Program with a pure investment focus: The program with an investment-only focus was ruled out due to lack of reform processes that would allow for sustainability in investment spending (see lessons learned section).
3. On-lending in lieu of grants: On-lending option was ruled out due to lack of recipient buy-in, incentive, and motivation for municipalities and regions participating in the reforms which are often unpopular. Government loans would also have an impact on the debt ceiling limits of participating regions and municipalities thereby crowding out credit capacity to support ongoing investment programs. These debt ceilings could potentially have excluded certain reform-minded regions from participating in the reform process. Finally, the municipal heating and the municipal water and wastewater projects which are currently being implemented are already being financed through on-lending arrangements.
4. Sub-national lending: Sub-national lending as an alternative to sovereign lending was ruled out because it would not have allowed conducting a country-wide competitive selection of municipalities and would not have had sufficient leverage to facilitate comprehensive reforms in HCS. However, improving financial viability and capacity of CS providers will make them more creditworthy for accessing the sub-national funding. Also, regional administrations may use sub-national funding to replicate the HCS project locally.

C. IMPLEMENTATION

1. Partnership arrangements (if applicable)

N/A

2. Institutional and implementation arrangements

50. The Project will be implemented by Rosstroi. The day-to-day management of the project will be carried out by a small project management team within the project implementation unit (PIU). The project management team will report to Rosstroi for project related issues and to the PIU director for administrative issues. All procurement in this project will be carried out in a centralized manner by Rosstroi and the PIU.

51. The *Foundation for Enterprise Restructuring and Financial Institutions Development* (FER), a noncommercial legal entity, has been selected on a competitive basis to act as the PIU. FER has extensive experience gained through managing several World Bank supported projects in Russia. The PIU will be responsible for financial management and procurement functions. The assessment of the financial management and procurement capacity of FER has been carried out.

52. An Inter-Agency Working Group - composed of senior management of Rosstroi and representatives from the Ministry of Regional Development, Ministry of Finance, the Ministry of

Economic Development and Trade - is responsible for strategic issues and decisions during project preparation and implementation.

53. A number of actors at the local level – including municipal administrations, communal services providers, and building-level management structures – will have to cooperate to implement the reforms and investments under the project. Municipal administrations will apply to and participate in the project on behalf of all these local actors. Rosstroi will sign framework agreements with selected and reserve municipalities at the start of the reform phase that formalize the right and responsibilities of the municipalities under the project. Rosstroi and the MOF will sign investment program implementation agreements with those municipalities which will have successfully implemented the reform program and prepared satisfactory investment plans. The agreements will specify procedures for asset transfer and accounting, fiduciary responsibilities of parties, reporting and control requirements and remedies by the government and the Bank in case of poor performance or departure from the implemented reforms.

54. While the reforms and infrastructure upgrading will take place at the municipal level, the active involvement and support of regional administrations is crucial to create sustainable results. In order to ensure regional buy-in for participation in the project, regions need to sign off on municipal applications.

55. For a more complete description of implementation arrangements, see Annex 6. The detailed implementation arrangements will be described in the Operations Manual for the Project.

3. Monitoring and evaluation of outcomes/results

56. Rosstroi will be overall responsible for monitoring and evaluation of the project. The PIU will provide necessary assistance for timely and efficient monitoring. In order to conduct proper monitoring of the reform phase and verification of the results Rosstroi may need to engage auditors and other independent experts. Also, frequent visits to participating municipalities will be required. Rosstroi through the PIU will use an independent engineering firm(s) for routine supervision of quality of works during the investment phase. Also, Rosstroi and the PIU will conduct periodic spot checks. Monitoring and evaluation of the project indicators will largely rely on existing statistics and reports routinely produced by municipalities. In addition, formal reviews of project results and targeted household surveys to evaluate improvements of service quality will be conducted at least twice during project implementation. Finally, a technical audit to address the risk of inappropriate or ineffective use of project financed assets at the municipal level and to confirm that the assets are properly accounted will be undertaken around the mid-term review of the project. The necessity for follow-up audits would depend on the outcome of the first one. All monitoring efforts will require continuous support by local authorities. The obligation for providing such support will be stipulated in the implementation agreements between the Federal Government and participating municipalities.

57. In addition, during project implementation, the Bank team will carry out continuous supervision to help ensure good progress towards completion of the project deliverables. Supervision of the HCS project will focus on the impact outcomes of the program, stakeholder support, and feasible options for realizing the intended development goals. Supervision in the

reform phase will concentrate on monitoring reforms, while in the later stages of the project it will concentrate on the efficient implementation of the investment plans including all fiduciary and safeguards aspects. Moscow based staff will conduct the bulk of the supervision work. The monitoring and evaluation results framework presented in Annex 3 is the basis for monitoring for both project management and Bank supervision.

4. Sustainability

Sustainability of the implemented reforms and investments

58. The 18 month reform effort in the participating municipalities will build capacity within regional and local government agencies responsible for HCS reforms, and among CS providers. The transfer of best practices for housing and communal services infrastructure will establish a framework for long-term sustainable service provision, the implementation of cost recovery tariffs, capital investment planning, financial resource mobilization, introduction of operational efficiency, and related measures. In the housing sector, a clearer definition of property ownership and rights, the introduction of sound procurement practices, the duties and responsibilities that are commensurate with building ownership, the elimination of MUE monopoly on building maintenance services, and other initiatives will lead to a sustainable housing ownership and operation mechanism. The provision of grants instead of loans to implement the reform and investment program will promote greater regional buy-in and willingness to implement the above reforms. Once the reforms have been implemented and the HCS enterprises are efficiently run and financially viable, they will no longer be a drain on regional and local budgets.

Replicability of the implemented reforms and investments

59. The project aims to create good practice in the HCS sector in pilot municipalities as a basis for later replication. The project includes capacity enhancement of federal and regional governments to enable them to replicate these practices throughout the Russian Federation. Budgetary resources freed up in participating regions/municipalities can be directed towards potential program participants in other municipalities. The strong demonstration effect realized though the initial reform and investment initiative should motivate additional regions to join the effort.

5. Critical risks and possible controversial aspects

60. The overall risk rating for the project has been determined to be **Moderate**. The key project risks and their mitigation measures are provided in the following risk matrix:

Risks	Risk Mitigation Measures	Risk Rating With Mitigation
To project development objective		
If improvements in service quality do not accompany increases in tariffs or if poor households are not supported during tariff increases, social tensions may grow.	The project seeks to mitigate this risk by (a) improving service quality through extensive investments in upgrading infrastructure; (b) taking an integrated approach including improving social protection mechanisms, (c) making HCS enterprises more cost effective, and (d) financing public awareness campaigns to explain sector reforms and address issues of social	M

	opposition to cost recovery proposals. Social impacts will also be closely monitored over the life of the project.	
Implementation delays are common in Bank projects in Russia.	One agency has primary responsibility for implementation, thereby mitigating this risk. Furthermore the project supports implementation at the local level of reforms that have already been adopted at the federal level, minimizing uncertainties associated with new legislation. Lessons have been learned from the Municipal Heating and Municipal Water and Wastewater projects. The reform phase will be used to prepare designs, specifications, and tender documents so that procurement can start immediately following participant eligibility for access to financing.	S
There are obvious risks associated with transparency, including: (a) the capture of project benefits by politically influential stakeholders; (b) failure to apply consistent approach to selection of municipalities, assessment of investment plans and evaluation of reform results, as a result of the above, and (c) financing of technically and economically suboptimal investments, as a result of the above.	The project has identified a clear strategy to address transparency-related concerns. First, the Bank team jointly with government officials has worked intensively for over a year to develop an objective methodology for the competitive selection of participating municipalities and evaluation of reform results. Second, the project includes a rigorous process for the assessment of investment plans which focuses on quality and relevance of investments. Thirdly, a project implementation unit with 10 years' experience in implementation of Bank-financed projects will ensure that accounting, financial management and procurement procedures are consistent with the Bank's requirements. Bank fiduciary staff based in Moscow will also provide regular oversight.	M
To component results		
To component B: support for implementation of HCS reforms at the sub-national level: Lack of political will to implement reforms from local leaders who may find that they benefit more from the status quo, especially when it relates to control over resources and jobs in the HCS sector.	The competitive selection of participating municipalities will select the most reform minded municipalities to participate in the project. The presence of significant financial rewards in the form of investments should create sufficient incentives for reforms to take place.	M
To component B: support for implementation of HCS reforms at the sub-national level: The reported reforms are not sustainable and are reversed.	The most important assurance against such a setback will be the demonstration of tangible positive results to consumers and the emergence of an organized and informed consumer movement that locks in reforms by forming a counterweight to the monopolistic power of municipal politicians. Tangible positive results will be ensured by providing adequate investments for service improvements in participating cities.	M
To component C: preparation and implementation of HCS investment plans: There are risks of weak	A significant effort has been made to put in place the appropriate capacity and support structures (including extensive technical assistance to prepare investment plans,	M

implementation capacity at the local level which could directly affect the quality of investments financed under the operation.	feasibility studies, and technical designs) to mitigate such risks. Procurement has been centralized and an experienced PIU has been selected to assist in execution of the project. The quality of investment will be a key focus of Bank supervision efforts.	

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N (Negligible or Low Risk)

6. Loan/credit conditions and covenants

61. **Conditions for Effectiveness**

- The participating municipalities have been selected based on the Selection Methodology.
- The Implementation Agreement among MOF, Rosstroi and the PIU has been signed
- The Project Operational Manual, satisfactory to the Bank, has been adopted by the Borrower.

D. APPRAISAL SUMMARY

1. Economic and financial analyses

62. The project is expected to generate a variety of benefits. The benefits will include improved living conditions for households, improved quality of housing and communal services, reduction in emissions and pollution as a result of increased energy efficiency, reduced water losses, improved quality of potable water, increased value of housing, etc. Also, important economic and financial savings are expected to result from the efficiency gains derived from the market-based mechanisms for competitive service delivery in the HCS sector and improved targeting of social transfers.

63. Given the nature of the project, specific investments will be identified only during the implementation stage when the municipalities will develop their investment plans. Therefore, full economic and financial analyses of the specific investments can not be undertaken at this stage. Annex 9 describes the mechanism that will be used to conduct the economic and financial analyses and screening activities to be undertaken during project implementation to ensure that investments are economically justified. Specifically, it presents a detailed description and general guidelines for quantification of economic and financial benefits and costs.

64. Selected municipalities will be required to submit investment plans to improve HCS. The investment plans submitted by municipalities should demonstrate at least 12 percent FIRR and 15 percent EIRR and must clearly demonstrate consistency with the PDO of improving the quality and financial viability of HCS in participating municipalities. The attainment of the PDO will be measured as an achievement of at least one of the PDO monitoring indicators by each investment presented as part of the investment plan.

2. Technical

N/A.

3. Fiduciary

Financial Management:

65. FER has been chosen as the project PIU with the responsibility for the fiduciary arrangements. FER has implemented several Bank financed projects, including the Treasury Development project, Sustainable Forestry project, Northern Restructuring project, and others. The financial management (FM) arrangements of FER have been reviewed periodically as part of previous and existing project supervisions and have been found to be satisfactory. An assessment of FM arrangements for the project was undertaken in October 2006 and updated after the negotiations. The financial management arrangements of the project are acceptable to the Bank, subject to addressing weaknesses identified during the FM appraisal and described in the Annex 7. The overall FM risk for the project is substantial before mitigation measures, and with adequate mitigation measures agreed, the FM residual risk is rated moderate.

66. FER is in compliance with its audit covenants of existing Bank-financed projects. FER's previous and current project financial statements and auditing arrangements are satisfactory and will be replicated for HCS Project. The annual audited project financial statements will be provided to the Bank within six months of the end of each fiscal year and also at the closing of the project.

Procurement

67. The assessment of the FER's procurement capacity to implement the project was also conducted in October 2006. It revealed sufficient staffing, qualification of the procurement specialists and readiness to join the project preparation and implementation. Procurement arrangements under the considered project were found adequate and satisfactory to the Bank. Annex 8 addresses weaknesses identified during appraisal and recommends measures aimed at mitigating possible procurement risks. Overall assessment of procurement risk under the project is high.

4. Social

68. Substantial work related to poverty and social impacts of the policy program has been carried out as part of the overall HCS sector reform program in Russia, which has been going on for over a decade. Relevant PSIA activities include extensive analytical work, as well as regular consultations with local government, civil society, and donors, which have been involved in the dialogue since the early transition years. As part of project preparation, a summary of recent PSIA activities related to the three key reform areas was undertaken and is available in the project files. Recent and on-going analytical work forms an integral part of the broader poverty dialogue with the Government of Russia.

69. The primary stakeholders include federal, oblast and municipal governments, HCS providers, private companies, and residents/households. Reforms and investments are expected to positively affect all levels of government (by reducing the need for subsidies), HCS providers (by efficiency gains and improved financial condition), private companies (by improving access to new lines of business in housing management and maintenance) and households (by improving service quality). Poorly managed HCS providers may be affected negatively, however, if they cannot compete with more efficient (public and private) companies.

70. As tariffs for HCS are likely to increase over the life of the project, the project has been designed to include a series of policy actions to improve targeting, funding and delivery of housing allowances. Housing allowances are the primary mechanism for protecting the poor from tariff increases as they are designed to limit expenditures on HCS to a maximum share of household income. Selected indicators will allow regular monitoring of impact on households, for example, by monitoring adequacy of funding for housing allowances, adequacy of program administration, etc. The project also includes funding for additional impact assessment work.

5. Environment

71. Overall, the Project is considered to have generally positive environmental impacts by investing in energy efficiency improvements, rehabilitating wastewater treatment, solid waste management utilities and other urban infrastructure. However, during construction of new or repairing of old infrastructure (housing stock, boilers, pumping stations, wastewater treatment plants, water and heating supply network pipelines) and performing other project financed activities, some short-term, limited-scale environmental impacts and disturbances will occur. To mitigate these impacts, a framework Environmental Management Plan (EMP) was developed by the Borrower. The EMP contains all environmental requirements and procedures, suggests appropriate arrangements for evaluation of significant environmental impacts, and recommends appropriate remediation and mitigation measures. Recognizing the uncertainty associated with the lack of specific investment proposals at this stage of the project development, the EMP developed a "green" and "red" list of typical investments in the housing and communal sector. The "green" list includes those investments which are clearly compliant with Category B projects, while the "red" list shows those investments which would have higher environmental risks, would require full scale EA and should not therefore be supported by the project. The draft EMP presents procedures for compliance monitoring and delineates responsibilities of all parties participating in the environmental assessment process.

6. Safeguard policies

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP 4.01)	[X]	[]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OP/BP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP 7.60)	[ ]	[X]
Projects on International Waterways (OP/BP 7.50)	[ ]	[X]

72. The project is rated as Category "B" (partial assessment) project. An EMP has been prepared for the project with emphasis on ensuring mitigation of any potential environmental impacts associated with rehabilitation works and potential new construction. In addition to the overall Project EMP, the development of an investment specific EMP would be required in cases when new construction eligible for investment will be planned. Municipal authorities and project proponent/developer will be responsible for EMP preparation for the specific investments and its approval by relevant environmental authorities in line with existing regulations. The Project Implementation Unit (PIU) will provide overall guidance for EMP development and ensure compliance with the Project EMP.

7. Policy Exceptions and Readiness

73. This project complies with all applicable Bank policies, and requires no policy exceptions.

Annex 1: Country and Sector or Program Background

RUSSIAN FEDERATION: Housing and Communal Services Project

Recent Economic Developments in the Russian Federation

The performance of the Russian economy since the 1998 crisis has been impressive: macroeconomic fundamentals have improved considerably and the economy has grown robustly for seven years in a row. Between 1998 and 2005, Russian GDP expanded by about 50 percent, while real income of the population grew by 46 percent. In 2007, the GDP growth is expected to be about 8 percent. The growth is increasingly driven by domestic consumption. Poverty headcount rates were cut in half and regional disparities declined. Unprecedented macroeconomic stability was achieved through strong budgetary and current account surpluses. Russia has succeeded in reducing its public sector foreign-currency denominated debt from 56.6 percent of GDP in 1998 to 4.2 percent of GDP by end 2006. Russia has prepaid its debt to the IMF and paid off its debt to the Paris Club in 2006. Important reforms in taxation, budgetary institutions, and the removal of administrative barriers to business facilitated the rapid development of market institutions in many areas. While the pace of growth slowed in 2001 and 2002, a major strengthening of oil, gas, and other export commodity prices gave a new boost to economic growth from 2003 onwards. By the beginning of 2005 the ruble had appreciated in real terms to almost pre-crisis levels and the trend is continuing. Modernization and productivity growth outside the oil and gas sector have been important contributing factors to recent expansion. The continued implementation of the macroeconomic stabilization policy has supported economic growth. Surplus revenues were put in a Stabilization Fund. This prudent management of monetary reserves has kept inflation and real appreciation at sustainable levels, and has supported a record federal budget surplus estimated at 4.2 percent (cash basis) of GDP. In January 2005, Standard and Poors joined Fitch and Moodys in awarding Russia an investment grade rating.

Despite macroeconomic stability and sound economic growth since 1999, the pace of service improvements in the HCS sector has been slow. The HCS sector is one of the least reformed and most inefficient sectors in the Russian economy, and represents one of the last sectors to require serious reforms if Russia is to complete the transition to a market economy. Services in the HCS sector continue to be delivered by local governments in much the same way as they were during the Soviet era, with virtually no reliance on market-based mechanisms. During the unstable macroeconomic environment of the 1990s, the HCS sector acted as shock absorber. The housing stock and utility networks were allowed to depreciate as maintenance and investment funds were diverted elsewhere by cash-strapped households and local governments. Usually, HCS reforms are difficult to implement in tough economic times. Numerous attempts to reform the sector have failed due to political circumstances and unforeseen economic shocks, the last one being the 1998 financial crisis.

The sound economic situation creates a window of opportunity to improve HCS services through reforms and investments. Recent macroeconomic stabilization and rising household incomes have greatly improved the prospects for reforms in the HCS sector. Budget surpluses have increased the funds available for investments in upgrading infrastructure. It is essential that the reform momentum be maintained as improved local fiscal accounts might lead to a degree of complacency in tackling reforms.

The Importance of the Housing and Communal Services Sector

Housing and communal services are critical to the quality of life of Russian citizens. Shelter and water supply, sewerage, heating, and hot water services are basic services that citizens in all countries rate as being important. However, the harsh climate of much of the Russian Federation makes the continuous and quality provision of these services even more critical not only for comfort but often for sheer survival.

HCS plays an important role in Russia's economy. The HCS sector in Russia constitutes about 5.9 percent of GDP. The sector consumes 20 percent of the country's energy resources, and the HCS fixed assets account for 24 percent of the total fixed assets of the Russian Federation. With the majority of the population of the Russian Federation having become homeowners, housing has emerged as the most valuable asset of the majority of households.

The government places high importance on improving HCS service provision, and closely links service provision with improving the quality of life. The Russian Government has declared the reform of the HCS sector as being one of its top priority areas. HCS reform is included in the recently approved Medium-Term Government Program for 2006-2008, which sets out the country's development priorities. In particular, the priorities include facilitating private sector participation in housing and communal services, developing targeted social assistance, and improving and measuring the quality of services provided.

The problems to be solved: Low quality of HCS services and low consumer satisfaction

Access to communal services remains an issue in Russia. According to the Russian Statistics Committee (Rosstat), currently 87 percent of the urban population has access to water supply; 85 percent to sewerage; and 89 percent to heating, while figures for rural areas are much lower i.e. 42 percent, 33 percent and 44 percent respectively.

Quality of communal services has declined as assets are deteriorating. For those who have services, the quality varies. Shortages of heating supply in a number of regions in winter 2005 have shown the challenge of maintaining continuous and reliable supply of HCS services. Rosstroi estimates that 55 percent of HCS assets had deteriorated in 2005, up from 39 percent in 1995. Thirty percent of the assets are completely worn out. Network infrastructure is in the poorest condition, with deterioration of 60-65 percent of assets, while production infrastructure (such as boilers and treatment plants) has rates of asset deterioration in the 54-56 percent range. The poor condition of infrastructure assets has led to low quality and inefficient communal service delivery. For instance, heat loads have a low density of typically 40-45 percent of capacity. More than 48,000 small boilers have a heat generating capacity of less than three Gcal/hour. The fuel to heat efficiency is often 30 percent which results in higher cost, pollution, and CO_2 emission. In the water supply sector, unaccounted for water is high due to high technical losses in networks. Due to the lack of metering, leakage within buildings is also high.

The housing stock is dilapidated. According to Rosstroi, three percent of Russia's housing stock was dilapidated and untenable in 2005. The incremental dilapidated housing stock between 1996 and 2004 exceeded the capital repairs carried out in the same period. In some Russian regions, the share of dilapidated and uninhabitable housing stock is over 25 percent. Annual backlog of housing that needs repair is about 100 million square meters and this figure is expected to grow.

The majority of the Russian population is dissatisfied with the quality of housing and communal services. In a 2005 nationwide survey, only nine percent of respondents noted improvements in HCS services, 56 percent said that there had been no change, and 24 percent indicated a decline in services over the past few years. The large majority of the population (83 percent) pays their bills in full and on time despite their dissatisfaction with service provision. Only 12 percent of respondents reported outstanding bills. Low income households (less than 1500 rubles per family member) were more likely to have outstanding bills for housing and communal services (18 percent), than middle income (10 percent) or high income households (8 percent). The lack of professionalism and responsiveness to correcting service interruptions - rather than the cost of utility services was stated as the main reason for nonpayment.

The impact of targeted social assistance programs on poverty alleviation is small. In the Soviet system, certain population categories (pensioners, war veterans, etc) were rewarded with privileges (*l'goti*) or preferential discounts on key public services. The number of privileges expanded rapidly in the early years of transition: reaching 31 percent of the population in the case of communal services. As l'goti are not means-tested, the system did not provide adequate protection for the poor. In fact, households in quintiles four and five (the best off households) are more likely to receive l'goti than those in quintiles one or two (the worst off households). Since the mid 1990s, the government policy has been to phase out l'goti privileges and replace them with means-tested social payments. The 1994 housing allowance program was the country's first means-tested program. This program pays housing allowances to families who spend more than a set percentage of total family income on HCS payments. However, means testing is difficult in a country where many have informal incomes. The shift to cash means-based social payments has proven to be politically difficult as richer citizens would like to hold on to their perks while the remaining consumers fear that this is a first step towards abolishing social payments. The shift therefore is still partial.

Underlying causes: lack of investment in infrastructure and weak institutions

The challenge now lies in improving HCS services at the local level by implementing the federal legislative framework. The Federal Government has enacted an impressive array of legal and regulatory acts in the past few years. Implementation of the Federal Government's HCS reform strategy at sub-national levels requires special focus on key interrelated policy areas, such as the management and maintenance of the existing housing stock, improved social protection for the poor and vulnerable, and the efficient operation of CS providers. The challenge of implementing the HCS reforms is the existence of political will at the sub-national levels, where bold changes are necessary.

Institutional and policy reforms to improve services, however, must be accompanied by increasing investment for infrastructure upgrading. Past HCS reforms have not been very successful because they did not produce rapid and tangible improvements in service delivery. Ordinary people in Russia associate HCS reforms with increase in tariffs and not with improvement of service quality. A survey indicates that 72 percent of Russians believe quality of HCS services will not improve after introducing cost recovery. Twelve percent of respondents actually expect deterioration in service quality and only 6 percent expect the situation to improve. Consumers will only be willing to pay higher tariffs if they observe improvements in the quality of services delivered. In order to make reforms acceptable to the population and politicians, it is important to combine reforms with investments that improve services. Investments should also be made to increase efficiency so that tariff increases needed to create a sustainable flow of finance are kept to a minimum. Only by creating and locking in quick wins can meaningful and sustainable improvements in service delivery be made and can a coalition for change emerge.

Investment needs

<u>The federal government estimates that RUR 1,456 billion (US$49 billion) is required for full rehabilitation and modernization of communal services infrastructure</u>. HCS service provision is hampered by old infrastructure that was designed without regard for efficiency, that is often beyond its design life, and that has been poorly maintained. The investment requirement is spread evenly across the water supply, sewerage, and district heating services. Approximately 60 percent relates to distribution networks. This estimate does not include investment requirements to increase the coverage of communal services. If assets were to be restored through a one-time rehabilitation effort, CS providers would need to rehabilitate around three percent of their networks each year in order to maintain them. Current rehabilitation rates rarely exceed one percent.

<u>The problems are compounded by the lack of incentives for efficient use of services by consumers.</u> The lack of thermostat controls and metering leads consumers to waste energy and water (by opening windows, running taps) as a means of controlling comfort levels. Most buildings are energy inefficient. The creation of effective building-level management structures is critical to making buildings more energy efficient. One of the reasons for this attitude of neglecting maintenance to promote efficient use is the "historical" merger of the housing sector with infrastructure services. Citizens still view municipalities as the owners of buildings and property, and municipal enterprises as providers of maintenance and repair services.

<u>External funding for upgrading infrastructure is required.</u> The cash flow of CS providers is low. Municipal funding is scarce, at least in part because of inadequate tariffs. Private financing is in its infancy. Municipal and regional budgets have insufficient funds to fully finance rehabilitation of infrastructure. Municipalities generally spend 20-40 percent of their annual budgets on the HCS sector. Regional governments are only partially reimbursed for their housing allowance expenditures. According to 2003 data, the total amount of housing allowances was RUR 29.7 billion, but only RUR 24.6 billion (0.2 percent of GDP) was actually financed from the Federal budget.

<u>Communal service providers do not have sufficient resources to finance proper maintenance, rehabilitation, and development of assets</u>. The cash flow of CS providers is low, as tariffs do not properly account for depreciation, service providers are often not reimbursed for subsidies they provide to consumers, and government entities do not pay for consumed services. According to Rosstroi, CS providers in 70 out of 88 regions made losses in 2005 with losses from core operations amounting to RUR 59.5 billion. The accounts payable of CS providers increased from RUR 151 billion in 2000 to RUR 235 billion in 2005.

Private financing is in its infancy and rapid increases in private investment in the sector are unlikely. The HCS sector is unattractive to private financiers due to high investment risk, low profit potential, the lack of a solid legal and regulatory framework, and widespread political interference. These factors can only change over time. A surge in private sector participation in the water supply and sewerage sector in 2003 was reversed soon afterwards, as investors were not satisfied with the returns on investments. The surviving private sector transactions focus on outsourcing operations without major investments from the private operator.

Reform needs

Achieving results will require improving the efficiency of investment in the HCS sector. Despite significant budget resources that flow into the sector, the deterioration of the housing stock and the poor quality of the communal services continues. Public spending supports incompetent municipal unitary enterprises and does not provide incentives for efficiency. Much of the public spending is concentrated on expensive and unsustainable short term repairs to ensure that heating is provided during one upcoming winter.

Building capacity at the local level is paramount for reforming the HCS sector. Municipal administrations do not have adequate human resources to regulate and oversee providers, partially because at the local level, the sectoral knowledge has been traditionally concentrated with CS providers. Municipalities and CS providers are plagued by frequent rotation of personnel. The municipality's ability to get good information and its ability to set enforceable incentives for good performance by providers is crucial to successful reforms. Reform processes thus require a shift in skills. New management, professional and technical skills are required to deal with the organizational changes that emerge from reform and the cultural issues that are involved. New concepts - like regulation, customer service, and private sector outsourcing - need to be understood.

Implementation of the Federal Government's HCS reform strategy at sub-national levels requires measures in interconnected key policy areas. Firstly, the financial viability of communal services providers has to be improved and their accountability increased. Secondly, the social protection of consumers has to be strengthened to ensure affordability of services to all. Thirdly market competition in housing management and maintenance has to be created to improve services and reduce prices.

Improving financial viability of communal services providers

Tariff regulation is inadequate and sets perverse incentives for promoting inefficiencies. Most municipalities do not have formalized procedures for tariff regulation. They do not have: (a) formalized procedures for submitting applications for tariff adjustment, their review and approval; (b) formalized justification for tariff adjustment; (c) a fixed duration for new tariff application (e.g. tariffs are set for an indefinite term); and (d) consumer participation mechanisms that can reduce social tension (such as public hearings). Tariffs are generally set too low – CS providers do not receive adequate financial resources to operate efficiently. The existing regulatory framework creates perverse incentives against reducing costs and improving operational efficiency. The regulatory framework is based on "economically justified" tariffs, and is basically a cost-plus regulatory regime. Tariffs are based on a standard calculation of operating costs plus a standard margin to allow for capital investment and profit. The size of this margin is generally too low to even properly maintain infrastructure, let alone invest in expansion or service improvement. CS providers are 'punished' for efficiency gains by reduced tariffs in the next tariff review. Tariff regulation should be reviewed to take account of investment costs. It should be left to the individual enterprise to implement the most effective means to increase efficiency, such as decreasing non-revenue water and heat, improved business planning and management processes, introduction of outsourcing, etc.

Tariff cross-subsidies result in distortions that further undermine financial sustainability of CS providers. The tariffs for services are differentiated by type of consumer, including households, social sector (including budget-financed organizations) and commercial enterprises. Household tariffs are kept low; the gap is partially being compensated by the higher commercial tariffs (as well as through budget transfers). The level of cross-subsidies is the highest in water supply and sewerage sectors. Since CS providers make losses on services provided to households they lack incentives to improve service quality or expand service coverage.

The situation is aggravated by outstanding payments of budgetary entities for their consumption of communal services. The outstanding payments of various budgetary entities (such as hospitals, schools, military facilities and government buildings) remain one of the major detriments to improving the financial condition of the CS providers. For most providers, the debt of budgetary entities for communal services accounts for a large portion of accounts receivable. Total accounts receivable from all consumer classes increased from RUR 189 billion in 2000 to RUR 209 billion in 2005.

Communal service providers are not autonomous and accountable. The rights and responsibilities of CS providers are not clearly defined and their performance is not linked to rewards or penalties. Most communal service providers are municipal departments (municipal unitary enterprises) that fall under the direct control of local governments. Local politicians often prefer to extract the short term value of the utility through patronage. CS providers have been allowed to give priority to protecting the members of their organization or political masters over service improvement. One route to making municipal unitary enterprises more autonomous and accountable is through the creation of government-owned joint stock companies with clearly defined mandates and composition of the corporate oversight boards and management. Another route is by contracting a private operator to operate and manage service delivery through a properly designed management or lease contract.

Corruption is one of the most persistent challenges in the HCS sector. It ranges from petty corruption, collusion between contractors, and kickbacks in contracting. Ultimately, citizens pay for the high cost of corruption, either through higher tariffs or taxes. An important step in creating transparency within the HCS sector is to regularly publish tariffs, audited financial data, and core technical data of CS providers in the mass media and on the internet. This enables governments and consumers to benchmark the performance of sector enterprises against others and to watch trends within one sector enterprise over time. As part of greater financial transparency, all outstanding debts of Government (municipalities, regions and federal) to HCS service providers should be calculated, and accounts payable to HCS enterprise should be reduced over time. Thirdly, procurement processes should be made more competitive and transparent.

Billing and collection of payments are not directly linked to services provided. Payments for HCS services are traditionally collected by centralized billing and collection centers. These billing and collection centers are municipal departments and offer municipal administrations the possibilities to intervene in financial flows. The financial flows from the billing and collection centers to individual CS providers is not calculated by consumption but rather by formulas determined by the municipality. More effective collection channels for housing and CS payments are a vital part of more direct relationships between consumers, service providers and local governments. Introducing an effective, customer friendly and efficient system for billing and collection is critical for the credibility of the tariff regime and should accompany any plans to adjust tariffs.

Strengthening social protection of HCS consumers

The poor are not adequately protected against rising tariffs. As tariffs increase, social protection becomes more important. The government is in the midst of a shift in HCS subsidies to means-tested housing allowances while phasing out category based privileges (*l'goti*). The goal is to reduce the financial burden of social payments and to improve the targeting of subsidies to the genuinely needy. The policy has proved to be politically difficult to implement, as wealthy consumers are trying to hold on to their perks. In addition, means testing is difficult as many consumers have informal income, which makes under-stating of income to increase subsidies possible. The shift to means targeted subsidies has to be continued and completed to ensure that the poor are protected.

Ensuring that subsidies are actually paid - Housing allowances are mostly financed from regional and federal budgets. Since 2002, federal funds are allocated to the regions through the Social Expenditure Co-financing Fund. Regional governments are only partially reimbursed for their housing allowance expenditures. According to 2003 data, only 24.6 billion rubles (0.2 percent of GDP) was actually financed from the Federal budget, while the total amount of housing allowances was calculated at 29.7 billion rubles. The non-payment victimizes consumers who do not receive their subsidies. It also adversely affects the financial viability of CS providers who are not compensated for subsidizing household tariffs. According to official data, the deficiency of budget compensation to HCS enterprises amounted to RUR 5.7 billion in 2005. Additional budgetary resources will be required and procedures will need to be developed for: (i) estimating variation in future reform impact across particular types of housing and specific household groups, (ii) forecasting changes in demand for housing allowances, and (iii) making projections for trends in the total requirements for budget financing, including costs of both conventional budget subsidies and social assistance programs, such as housing allowances.

The administration of targeted social assistance benefits is fragmented which limits take-up of the housing allowances. In most municipalities, the Social Protection Department is in charge of child allowances and targeted social assistance benefits while a local unit of the Department of Housing and Subsidies or a division of the municipal administration is in charge of housing allowances. Thus different departments managed by different agencies take decisions on the eligibility of applicants for social assistance programs, determine entitlements, and verify the information provided by the applicant. According to the results of a September 2005 survey, 36 percent of the population believes that they are entitled to discounted CS tariffs. Among those with the lowest monthly income (less than 1500 rubles per family member), 47 percent believe they are entitled to discounts. At the same time, 42 percent of those who believe they are entitled to discounts have not applied for them. Reasons cited include long lines, the lack of availability of necessary documents, and red-tape. Transaction costs (both for the administration and the clients) could be reduced and cost-effectiveness of the benefit payment system improved with consolidation of the administration of social assistance programs, simplifying the menu of available benefits, and unifying eligibility rules. This includes the introduction of a unified database which will include data on the composition of households, housing conditions and other relevant information on living conditions, incomes, and benefits received.

Creating market competition in housing management and maintenance

Lack of building level collective management structures and inefficient housing management by municipal unitary enterprises has strongly contributed to the physical deterioration of multi-family buildings. Massive privatization of housing in the 1990s was based on virtually free transfer of apartment ownership to sitting tenants. However, common property in multi-family buildings and surrounding grounds was not explicitly privatized, and its management and maintenance typically remained with municipal unitary enterprises. There is a broad agreement that the reforms should introduce building-level management structures. As of the beginning of 2006, only 14 percent of all owners of residential premises in the multi-family buildings representing 5.9 percent of total housing stock made decisions regarding their form of building-level management (homeowner's association, condominiums, housing societies, or management companies). Further clarification and registration of ownership rights and obligations on common property is urgent, including the spelling out of statutory requirements for adequate building maintenance.

Fostering greater tenant-owner awareness of their rights and responsibilities is critical to ensuring successful implementation of the HCS reforms. Privatized tenant-owners do not perceive they hold joint ownership of the common property and do not feel responsible for its management, maintenance and repair. Only through greater awareness of the economic value of their housing assets, including common property, will tenant-owners become actively interested in maintaining the value of both their own apartments and common-property of their buildings and grounds. Information programs can potentially reduce the resistance of the population to the inevitable increases in housing related payments, while also promoting the housing reform program. Examples of awareness building measures are information and advisory services to households and homeowners' associations, and the education of a cadre of property managers capable of performing building-level management including asset management functions.

The non-competitive nature of maintenance and repairs has contributed to the lack of availability, quality and adequate pricing of these services. Competition for housing maintenance, current and capital repair services is still low. Private management companies represent less than one percent of the housing management and maintenance market. Homeowners' associations that are outsourcing maintenance and capital repairs to private companies are faced by the absence of competitive processes and standard contracts that ensure quality standards and foster cost reduction. However, new construction is contributing to higher housing standards, and households' expectations are rising with respect to higher quality and lower price of maintenance and repairs.

Clarifying rights and obligations regarding land plots requires delimitation and registration. According to the Housing Code, home owners in multi-apartment buildings are entitled to a share of common property and the associated plot of land. According to the legislation, titles of land plots which had been delimited and duly registered before the adoption of the Housing Code shall be transferred to the home owners free of charge. However, according to Rosstroi estimates, only one percent of the land plots have been so far properly delimited and transferred to home owners. This lack of clear rights and responsibilities over those land plots prevents home owners from properly maintaining and developing common property. Delimitation of the land plots is the responsibility of local authorities who have neither sufficient funds nor incentives to advance the work.

The Government's HCS Strategy

HCS continue to be one of the Government's top priorities. The main tenets of reform of the HCS sector were already formulated by the mid-1990s, but the 1998 financial crisis effectively stalled their implementation until the year 2000, when economic growth resumed. The reform of the HCS sector has been highlighted as a priority area in the Federal Government's successive Economic Reform Programs of 2000, 2002, and 2003, and by the presidential pronouncement of September 2005. The Government drafted new economic reform programs, including the Subprogram "Reform and Upgrading of the Housing and Communal Service Sector in the Russian Federation" adopted by the Government in late 2001 as a part of the Federal Targeted Program "Housing" (Zhilishche) for the years 2002-2010. After implementation of the first stage of HCS reform in 2002-2005, the Subprogram was updated to be more focused on modernization of the CS infrastructure. The total budget of the Subprogram is RUR 96.5 billion. The Subprogram sets out the goal to improve quality of communal services provided to the population and to create conditions necessary to attract private expertise and investments for management and upgrading of CS infrastructure. The main objectives of the updated Subprogram are:

- Modernization of the CS infrastructure. The Subprogram budget funds is intended for investment projects to upgrade CS infrastructure, including reconstruction of existing infrastructure and construction of new infrastructure to replace worn-out facilities;.
- Improvement of efficiency of communal infrastructure management. This task does not envisage direct budget financing, but its fulfillment will be supported through a contest that will allocate federal budget funds to the Russian Federation regions that meet certain conditions. One of the key reform areas is a tariff regulation system for communal services. Another important area is private sector participation on a competitive basis through lease and concession type contracts between local governments and operators;
- Attraction of off-budget resources to finance upgrading CS infrastructure. Off-budget resources include private investments and lending sources. It is planned to provide support to municipalities and CS providers to develop lending mechanisms for infrastructure projects.

In late 2004, the Federal Government passed an impressive package of 27 laws (including a new Housing Code) which became known as an "Affordable Housing" package. This package was designed to support modernization and reform of the HCS sector, and to redefine and stimulate the housing market in Russia. The provision of these laws was aimed at reducing price and increasing the supply of housing, making the HCS sector more transparent, stimulating demand for housing, and enhancing community involvement. The core of the new housing policy was laid out in the new Housing Code that regulates the basic principles of the housing sector: breaking the monopoly of municipal enterprises in housing services provision. Other laws, such as the new City Construction Code, were designed to stimulate housing market turnover by reducing transaction costs, lowering risks of property loss, and supporting competitive price-setting and price stability in the housing market. Certain aspects of the "Affordable Housing" package were aimed at the demand side of the housing market by providing conditions for mortgage system development, as well as by supporting other forms of the new housing demand stimulation. Finally, the package includes laws on utility tariff regulation, and a concession law that stimulate the supply side of the CS market.

RF President Putin and the Government of Russia have recently declared "Accessible Housing" as one of four national priority programs. A key element of the Accessible Housing project is to improve living conditions and the quality of communal services for the population. The "Accessible Housing" project has four main priorities:

- Increasing the volume of mortgage lending;
- Increasing housing affordability;
- Growing the volume of new housing construction and modernization of CS providers infrastructure; and
- Fulfilling the Government's duties for providing special categories of citizens with new housing.

A unifying theme of the various initiatives comprising the Federal Government's reform program is the clarification of the responsibilities and funding from different levels of government. The federal law "On the General Organizational Principles of Local Self-Government in the Russian Federation" (passed in 2003) established legal, territorial, organizational and economic principles for the organization of local self-government in the Russian Federation, and defined the state guarantees for exercising it. The aim of the law is to bring local governments closer to the people by making them more accountable. It provides a delineation of powers among federal, regional and local authorities and devolved more functions from the federal level to the regional and local levels. The regions have to implement the above delineation of power and reform measures by January 1, 2009 the latest. Many advanced regions and municipalities have voluntarily implemented the provisions envisaged in the law.

A critical factor for the success of HCS reforms is the political willingness and capacity of municipal authorities to implement reforms. Existing legislation grants municipalities the authority to determine the administrative structure for HCS service provision and to decide upon the timing of and form of reforms in the HCS sector. In addition, the administration of land is effectively in the hands of the municipal authorities as they establish land use, change the land-use category of land plots, set rates for land use, undertake inventories of land, supervise municipal land use, protect the property rights of landowners and settle disputes. HCS tariff setting is also a municipal responsibility, but the Federal Tariff Service fixes upper ceilings for all HCS tariffs up till January 1, 2009. The ceiling is perceived by regions and municipalities as political interference that adversely affects investment levels. A discussion within the government is taking place on how to establish a more flexible regulatory system and to allow regions to independently exceed limits for certain municipalities.

Annex 2: Major Related Projects Financed by the Bank and/or other Agencies

RUSSIAN FEDERATION: Housing and Communal Services Project

The multi-sector nature of the HCS Project means that the operation covers many sectors of the economy. The Bank's many ongoing and completed operations provide valuable insights into various aspects of HCS reforms and investments into HCS infrastructure. The project design has benefited from the following projects financed by the World Bank in the Russian Federation:

Sector Issue	**Project**	**Latest Supervision (PSR) Ratings Bank financed projects**	
		Implementation Progress (IP)	**Development Objective (DO)**
Alleviating the financial burden on municipal authorities related to their supply of district heating to local population through investments in the rehabilitation and partial replacement of municipal heating systems in 8 Participating cities	Municipal Heating Project, US$ 85.0 million approved 2001	S	S
Improving water and wastewater services in the project's participating cities through investments aimed primarily at rehabilitating and improving the efficiency of existing water and wastewater systems	Municipal Water and Wastewater Project, US$ 122.5 million approved 2001	S	S
Supporting Kazan City Government's reform program through reforms in several sectors to improve budget and financial management, the delivery of social services and the condition of the HCS sector	Kazan Municipal Development Project, US$ 125.0 million approved 2005	closed	
Supporting the St-Petersburg city's economic transformation through multi-sector reforms and investments in selected cultural sites that are critical to the city's future development as an international cultural destination	St. Petersburg Economic Development Loan, US$ 161.1 million approved 2003	S	S
Supporting the fiscal federation and regional fiscal reform in the competitively selected regions and rewarding them through grants for implementing	Fiscal Federation & Regional Fiscal Reform Project, US$ 120.0 million approved 2001	closed	
Transformation of municipal housing markets towards market-economy principles and stimulation of municipal land development, and commercially financed private housing infrastructure	Housing Project, US$ 400.0 million approved 1995	closed	
Accelerating the sustainable divestiture of enterprise housing throughout Russia by demonstrating within the Participating Cities a combination of housing reforms and investments designed to transfer housing to the private sector and lower its operating cost	Enterprise Housing Divestiture Project, US$ 300.0 million approved 1996	closed	

Annex 3: Results Framework and Monitoring

RUSSIAN FEDERATION: Housing and Communal Services Project

Results Framework

PDO	Project Outcome Indicators	Use of Project Outcome Information
To improve the quality of services and financial viability of HCS entities in participating municipalities	1. Financial viability of communal entities, including district heating, water supply, hot water supply and waste water disposal, improved 2. Quality of delivery of communal services, including district heating, water supply, hot water supply and waste water disposal, improved 3. Percentage of municipalities that have completed monetization of housing allowances and where cash payments are transferred to individual social accounts of citizens 4. Social payment arrears eliminated 5. Quality of delivery of communal services for the population improved (percentage of population rating services as satisfactory or better) 6. Percentage of private investments in the total amount of investments to upgrade the communal infrastructure 7. Percentage of private companies managing communal sector facilities on the basis of concession agreements and other agreements in the total number of communal entities 8. Percentage of multi-family buildings managed by professional management companies	The results will be used for designing and modifying federal targeted programs for HCS
Intermediate Outcomes	**Outcome Indicators by Components**	**Use of Outcome Monitoring**
Implementation of the reform programs by participating municipalities	Number of participating municipalities which implement at least 80 percent of their reform programs.	Undertaking quick actions by Project participants to implement the reform programs
Implementation of investment plans	1. Percentage of investment plans financed (against the budget) 2. The amount of payable arrears of HCS entities 3. Percentage of worn-out assets in the communal infrastructure	Undertaking quick actions to accelerate financing and to implement investment contracts
An internet portal which includes a system for monitoring HCS performance at the regional level and information about best practice in HCS (including regulations, methodologies, guidelines, etc) is operational	Percentage of regions connected to the portal	Overall monitoring of project outcome

Arrangements for results monitoring

Project Outcome Indicators*	Unit	Baseline	Target Values					Data Collection and Reporting		
			YR1	YR2	YR3	YR4	YR5	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
Financial viability of communal entities, including district heating, water supply, hot water supply and waste water disposal, improved	Percentage of entities that incur operational losses	60	50	40	30	20	10	Annually	Reports by municipalities combined in the Progress Report	Rosstroi, Project Team, Municipalities
Quality of delivery of communal services, including district heating, water supply, hot water supply and waste water disposal, improved: Reduced number of pipe breaks in distribution networks:								Annually	Reports by municipalities combined in the Progress Report	Rosstroi, Project Team, Municipalities
- in water supply systems	Number of pipe breaks per km of networks per year	30.4	27.4	21.23	15.2	9.12	6.08			
- in waste water systems		19.2	17.3	13.4	9.6	5.8	3.8			
- in heating systems		10.5	11.7	7.4	5.3	3.2	2.1			
Net output of: - water (ratio of amount of water supplied to consumers and amount of produced water)	Percent	94.8	95	95.5	96	96.5	97			
- heat (ratio of heat supplied to the	Percent	88.6	89	92	93	94	97			

Project Outcome Indicators*	Unit	Baseline	Target Values					Data Collection and Reporting		
			YR1	YR2	YR3	YR4	YR5	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
consumer and produced heat)										
Percentage of private investments in the total amount of investments to upgrade the communal infrastructure	Percent	26	40	50	60	65	70	Annually		Rosstroi, Project Team, Municipalities
Percentage of private companies managing communal sector facilities on the basis of concession agreements and other agreements in the total number of communal entities	Percent of private companies in the total number of communal entities	18	25	35	45	55	65	Annually	Reports by municipalities, forms of state statistical reporting	Rosstroi, Project Team, Municipalities
Percentage of multi-family buildings managed by professional management companies	Percent of multi-family buildings managed by professional management companies in the total number of multi-family buildings that have selected a method of management	15	35	60	83	85	90	Annually	Reports by municipalities	Rosstroi, Project Team, Municipalities
Percentage of municipalities that have completed monetization of housing allowances and where cash payments are transferred to individual social accounts of	Percent of municipalities that have completed monetization of housing allowances and where cash payments are transferred to	80	82	85	90	95	100	Annually	Reports by municipalities, forms of state statistical reporting	Rosstroi, Project Team, Municipalities

Project Outcome Indicators*	Unit	Baseline	Target Values					Data Collection and Reporting		
			YR1	YR2	YR3	YR4	YR5	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
citizens	individual social accounts of citizens									
Social payment arrears eliminated	Percent of social payment arrears (ratio of allowances and privileges assigned to allowances and privileges paid)	20	18	16	15	10	0	Annually	Forms of statistical reports 22 ZKH – allowances; copies of approved financial plans and reports on financing allowances and privileges, forms of statistical reports 22 ZKH – allowances and 26 ZKH – privileges	Rosstroi, Project Team, Municipalities
Quality of delivery of communal services for the population improved (percentage of population rating services as satisfactory or better)	Percentage population rating services as satisfactory or better in the total size of the city population based on data of sociological surveys	10	20	30	40	60	80	Annually	Surveys financed by the Project	Rosstroi, Project Team, Municipalities
Intermediate Outcome Indicators										
Number of participating municipalities which have implemented their reform programs by at least 80 percent.	Municipality	None	None	8	8	9	10	Twice during the 18 month reform stage	Progress report	Rosstroi, Project Team, Municipalities
Percentage of	Percent	No	Plans	Designs	20	50	80	Quarterly	Progress report,	Rosstroi,

Project Outcome Indicators*	Unit	Baseline	Target Values					Data Collection and Reporting		
			YR1	YR2	YR3	YR4	YR5	Frequency and Reports	Data Collection Instruments	Responsibility for Data Collection
investment plans already (financed against the budget)		investment plans	are prepared	and tender documents are prepared and implementation started					Financial Management Report	Project Team
Amount of payable arrears of HCS entities	Billion rubles	297.7	250.0	200.0	150.0	100.0	25.0		Reports by municipalities, a copy of the balance sheet of the communal service provider, attachments to the balance sheet "Description of accounts payable and accounts receivable of the communal service provider"	Rosstroi, Project Team, Municipalities
Percentage of worn-out assets in the communal infrastructure	Percent	56	55	50	49	47	45			Rosstroi, Project Team, Municipalities
Percentage of regions connected to the portal	Percent	No portal	Portal design is prepared	Portal is tested	10	20	30	Semi-annually	Progress report	Rosstroi, Ministry of Regional Development, Project Team

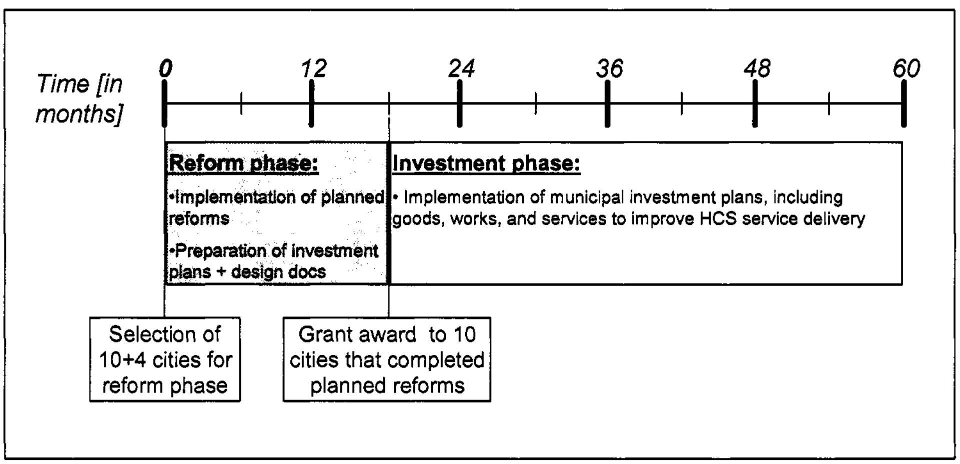
* The indicator will be considered to be fulfilled if planned results have been achieved in not less than 8 participating cities. The values will be updated after the selection of participating municipalities is completed.

Annex 4: Detailed Project Description

RUSSIAN FEDERATION: Housing and Communal Services Project

The proposed SIL will support the Government's HCS program in ten competitively selected medium-sized cities through a combination of technical assistance for reforms and investments for housing and communal services infrastructure.

The project will consist of two phases: (a) an 18-month reform phase and; (b) a 42-month investment phase (see graph 1). By project effectiveness, ten medium-sized cities (and four reserve cities) will have been competitively selected on the basis of their planned reforms for the reform phase. During the reform phase, these cities will implement the planned reforms. The cities will also prepare detailed investment plans for HCS infrastructure to be financed through the project, plus design and tender documents. In order to be included in the investment phase of the project, municipalities will have to substantially implement their planned reforms and have prepared relevant and quality investment plans. During the investment phase, targeted investments in HCS infrastructure will be made according to the investment plans prepared by the cities. The size of investments depends on the population size of the city (90,000 to 600,000 of population). The participating municipalities will co-finance the project by financing implementation of the reform program, including audits, preparation of production programs, settlements of arrears to residents and communal service providers, etc. and preparations of the investment plans, including feasibility studies and designs. A conservative estimate is that the average amount of co-financing will be around US$ 1 million to US$ 2 million per municipality.



Graph 1: Project timeline

This project will finance investments in municipalities that are yet to be selected competitively and investments that are yet to be defined in investment plans. Hence, it is important to understand the various components in the project as well as the process for selecting municipalities. This annex describes the project in two ways. First it describes the project components including their key inputs and outputs and how they address the sector issues highlighted in Annex 1. The investment subcomponent of the project is described in aggregate terms. Secondly, it describes the key steps during the reform phase to select cities for the reform phase, assess their investment plans, and award grants to cities that completed their planned reform.

II. Project components

Key issues highlighted in Annex 1 will be addressed through four main project components:

1. support to HCS reform implementation at the federal level
2. support to implementation of HCS reforms at the sub-national level
3. preparation and implementation of HCS investment plans
4. project management and monitoring

Table 1 provides the timing for these components and their subcomponents.

Table 1: project components by phases

component/subcomponent	reform phase	investment phase
component A: support to HCS reform implementation at the federal level		
1.1 development of federal regulatory acts and methodologies		
1.2 setting up national HCS monitoring system		
1.3 dissemination of project results to non-participating municipalities/regions		
component B: support to implementation of HCS reforms at the sub-national level		
2.1 specialist assistance to municipalities on utility reform, social protection & housing and how-to-guidance on selected reform topics		
2.2 evaluation of implementation of municipal reform programs		
2.3 knowledge exchange between participating municipalities		
2.4 awareness campaign on HCS reforms in selected regions		
component C: preparation and implementation of HCS investment plans		
3.1 preparation of municipal investment plans, feasibility studies and technical designs		
3.2. implementation of municipal investment plans		
3.3 supervision of implementation of municipal investment plans		
component D: project management and monitoring		
4.1 results measurement		
4.2 operating costs		

Component A: Support to HCS reform implementation at the federal level (US$2.99 million)

The Federal Government has enacted an impressive array of legal and regulatory acts designed to improve the financial viability of communal services providers, strengthen social protection of HCS consumers, and create market competition in housing management and maintenance with privatized tenant-owners assuming all rights and obligations that come with private property. The project will provide targeted support to fill the gaps in the legal and regulatory framework and to improve monitoring of the HCS situation in regions and municipalities. The project will also support dissemination of project results and good practice municipal reforms to regions and municipalities that do not participate in the project. The assistance will create capacity within key Federal ministries and agencies responsible for HCS reforms to enable implementation of the housing and communal services reforms in regions and municipalities.

The assistance at the Federal level will include three subcomponents:

- **Development of legal and regulatory framework at the federal level (US$0.25 million) -** This subcomponent will assist the federal government to develop government resolutions and normative acts to complete the existing legal and regulatory framework and make it operational.
- **Set up national HCS monitoring system (US$1.99 million)** – This subcomponent will support the set up of a monitoring system with which the federal government can monitor the status of the HCS sector in regions and municipalities, and aggregate data on the country-wide progress on reforms. This will include training of local and federal staff to use the system, to gather data, and to use indicators to improve performance. The proposed system scales up successful pilots implemented under the Municipal Heating Project financed by the World Bank.
- **Dissemination of project results to non-participating municipalities and regions (US$ 0.75 million)** - This subcomponent will support the federal government to spread the momentum of HCS reform and replicate reforms in other regions and municipalities by sharing lessons learned from participating cities. Activities will include seminars and the set-up of an internet portal aimed to provide information to government agencies and the population, including a library of best practice.

Component B: Support to implementation of HCS reforms at the sub-national level: (US$ 8.54 million)

The component will finance technical assistance in ten selected and four reserve cities to implement reforms in line with the Federal Government's objectives. It will also build capacity of these and other regional and municipal administrations, communal services providers, and consumers to improve the HCS service provision. Technical assistance will focus on three reform areas:

a. **Improving financial viability of communal services providers** – Technical assistance will be provided to support breaking the vicious cycle of low tariffs, high operating costs, and low-quality services that communal service providers are trapped in. Technical assistance will also be provided to assist in increasing the autonomy and accountability of CS providers. Technical assistance will focus on: (i) improving cost recovery; (ii) reducing existing arrears of governments to service providers; (iii) linking collection of payments more directly to services provided; and (iv) reforming municipal departments - under direct control of local governments - into government owned joint stock companies and fostering private sector participation.

b. **Strengthening social protection of HCS consumers** – Technical assistance will support improving the targeting, coverage, and efficiency of HCS subsidies in order to enhance the impact of social assistance programs on poverty alleviation. In addition, the subcomponent will support the consolidation of program administration of various targeted social assistance benefits, including housing allowances. Technical assistance will focus on: (i) ensuring that payment of subsidies is done in cash and that payments are actually made, and (ii) consolidation of program administration of various targeted social assistance benefits, including housing allowances.

c. **Creating market competition in housing management and maintenance** – Technical assistance will support improving management, maintenance, and repair of multi-family buildings through clarifying and formalizing rights and responsibilities of owners in multi-family buildings. Technical assistance focuses on: (i) encouraging building-level collective management structures; (ii) creating market competition for building maintenance, current and capital repair; and (iii) fostering greater tenant-owner awareness of their rights and responsibilities, and (iv) clarifying rights and obligations regarding land plots.

This component consists of four subcomponents:

- **Specialist assistance and how-to-guidance to cities on utility reform, social protection & housing** and how-to guidance on selected reform topics **(US$ 4.31 million)** – The sub-component will finance work of teams consisting of specialists in utility financing, utility reform, social protection, and housing management and maintenance that will provide intensive coaching to selected and reserve cities to implement the planned reforms during the reform phase. It will also support preparation and dissemination of practical guidance on how to implement certain reforms that are not well understood by municipal and regional policy makers and implementers. Topics that have been identified include tariff setting, private sector participation in communal services, financing mechanisms for capital housing repairs, and bringing regional and municipal regulations on social assistance into compliance with the federal legislation.
- **Evaluation of implementation of municipal reform programs (US$ 0.54 million)** – This subcomponent will support evaluation of the municipal reform status of selected and reserve cities at the start and end of the reform phase. This assessment will determine whether cities are awarded grants for the investment phase of the project. The assessment will include visits to each of the participating cities.
- **Knowledge exchange between municipalities (US$ 0.5 million)** – This subcomponent will support the selected and reserve cities in the project's reform phase by providing them with knowledge through capacity building events and written knowledge products. The focus will be on spreading international and Russian best practice as well as on sharing the experience gained during the project among participating cities.
- **Public awareness campaign on HCS reforms in selected regions (US$ 3.19 million) -** This subcomponent consists of the implementation of regional public awareness and education campaigns to inform consumers about objectives and rationale of reforms, reasons for tariff increases, benefits and new approaches of collective management of multi-apartment buildings' common properties and commercial provision of HCS services. The aim is to establish a model for a national campaign to be rolled out in all regions of the Russian Federation.

Component C: Preparation and implementation of HCS investment plans: (US$ 188.94 million)

This component includes technical assistance to prepare investment plans and technical designs during the reform phase, and financing for investment subprojects to implement approved investment plans during the investment phase of the project.

Most of the investment funds will be used for rehabilitating and modernizing the existing infrastructure. This will help overcome the problems posed by old infrastructure that was designed without regard for efficiency, is often beyond its design life, and has been poorly maintained. System rehabilitation and the introduction of more modern technology can considerably reduce the cost of and improve the quality of service delivery. Rehabilitation and modernization also puts in place technical conditions for converting to a consumer-oriented policy by providing metering and mechanisms for consumer control of supply at the building level.

External funding for upgrading infrastructure is required. Cash flow is low, as tariffs do not properly account for depreciation, service providers are often not reimbursed for subsidies they provide to consumers, and government entities do not pay for consumed services. Municipal funding is scarce, at least in part because of inadequate tariffs. Private financing is in its infancy due to high investment risk, low profit potential, the lack of a solid legal and regulatory framework, and widespread political interference.

This component consists of three subcomponents:

- **Preparation of municipal investment plans, feasibility studies and technical designs (US$8.56 million) -** This subcomponent will consist of technical assistance to selected and reserve cities to identify the right mix of investments, prepare their investment plans, feasibility studies and technical designs for investment sub-components, and to conduct financial and economic analyses of the proposed investments. The ultimate responsibility for preparing the investment plans will stay with the municipalities. Preparation of design documents will also be the responsibility of the participating municipalities. It is expected that municipalities will allocate approximately US$ 200,000-300,000 for financing this work. Technical assistance will be focused on assisting municipalities to make the design documents compliant with the World Bank's technical requirements and preparing tender documents.
- **Implementation of municipal investment plans (US$175.00 million) -** This subcomponent is by far the largest in the project and will finance the investment subprojects in municipalities that participate in the investment phase of the project. Given the competitive selection of municipalities, specific investment subprojects will only be determined during the reform phase. Investment subprojects can include rehabilitation and construction of infrastructure for heating supply, water supply, sewerage, energy supply for CS facilities, and housing services. The investment plans can also include supply of goods and services that are required for infrastructure rehabilitation, goods and services required to improve social protection, and consultancy services to support the implementation of investments. All goods, works and services will be procured by Rosstroi. The resulting asset will be transferred to the appropriate institutions, in most cases communal service providers. Based on investment needs in the HCS sector in the Russian Federation and the demand expressed by regions and municipalities participating in seminars during project preparation, it is estimated that 60 percent of the expenditures for goods, works and services in this subcomponent will be spent on heating supply (including energy supply for heating supply facilities) 35 percent will be spent on water supply and sewerage facilities, 4 to 5 percent will be spent in the housing sector, and about 1 percent will be spent on social protection.
- **Supervision of implementation of municipal investment plans (US$5.38 million) -** This subcomponent will consist of a team of experts who will supervise the implementation of the municipal investment plans during the investment phase of the project.

Component D: Project management and monitoring (US$5.53 million)
This component will provide assistance to the implementing agency for project implementation, monitoring, and supervision, including consulting services for measuring results of the project.

This component consists of two subcomponents:

- **Results measurement (US$1.53 million)** - This subcomponent includes technical assistance and logistical support to implement the necessary monitoring and evaluation of the project, including impact assessment. At least two surveys to measure consumer satisfaction will be conducted during the project.
- **Operating costs (US$4.00 million)** – This subcomponent covers the operational cost of the PIU, including salaries, technical assistance, equipment, office rent, logistical support, and project audit costs.

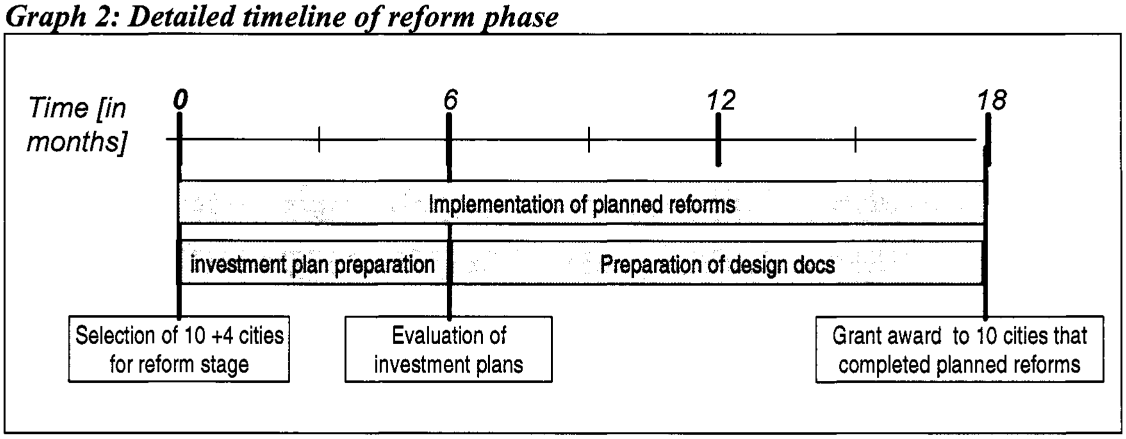
III. <u>Key project steps</u>

A methodology to select cities for the reform phase, to evaluate investment plans and to evaluate progress on reform status and to award grants to cities that completed their planned reform was prepared by Rosstroi in consultation with the Ministry of Finance, the Ministry of Economic Development and Trade, and other stakeholders. The methodology was agreed upon with the World Bank before negotiations. A series of seminars and round tables for interested municipalties to explain the methodology and to raise awareness is underway and the selection of participating municipalities will be completed before the project effectiveness.

This section describes three key steps during the reform phase (see timeline in graph 2):

- Competitive selection of cities for the reform phase;
- Technical, economic, financial and environmental assessment of municipal investment plans;
- Evaluation of reform status and award of grants to cities that substantially completed their planned reform.

Graph 2: Detailed timeline of reform phase



<u>Competitive selection of cities for the reform phase</u>

Selection of participating cities will be conducted through a nation-wide contest. The number of selected cities is ten to make the program manageable, and to ensure that participating cities receive adequate investments in a sector requiring substantial financial resources. In addition four reserve cities will be selected which will only receive investment funding if one of the ten selected cities does not implement its planned reforms by the end of the reform phase. Only cities having a population of between 90,000 and 600,000 can participate. Only one municipality per region of the Russian Federation will be selected, and municipalities require a letter of support from the regional administration to apply. In case two or more municipalities from one region participate, the one with the highest assessment score will be selected. All selected and reserve municipalities will sign an agreement with Rosstroi that will help define their rights and responsibilities within the project.

Selection of cities consists of two steps. First, cities will be evaluated against a set of absolute minimum criteria focused on the financial performance of the municipal adminstration and CS providers (see table 2). The reform plans of the municipalities that pass this first step will be assessed using a formula that measures the planned reform status at the end of the reform stage relative to the reform status at the time of application. Municipalities that have submitted preliminary investment plans and design documents receive a bonus. Cities will be ranked by their assessment score, and the top ten cities will be selected, with numbers 11 to 14 being picked as reserve cities.

Table 2: Minimum criteria for participation in contest

- Cost recovery level for housing and communal services > 90 percent
- Collection rate of HCS payments > 90 percent
- Ratio of local budget current expenditures to local budget revenues < 100%
- Ratio of local budget deficit to local budget revenues, without federal or regional financial assistance < 10 percent
- Ratio of municipal debt to local budget revenues, without financial assistance from other governments < 100 percent
- Ratio of the municipality's debt service to local budget expenditures < 15 percent
- Municipality and region have no overdue debt to the federal budget under IFI loans and guarantees
- Ratio of regional budget current expenditures to regional budget revenues < 100 percent
- Ratio of regional budget deficit to regional budget revenues, without federal financial assistance < 15 percent
- Ratio of regional public debt to regional budget revenues, without financial assistance from other governments < 100 percent
- Ratio of the region's public debt service to regional budget expenditures < 15 percent

The criteria (see Table 3 below) for assessing reform status during the selection process focus on three main areas:

a) **Improving financial viability of communal services providers** - Assessment criteria focus on breaking the vicious cycle of low revenues and bad services by: (i) improving cost recovery; (ii) reducing existing arrears of governments to service providers; (iii) linking collection of payments more directly to services provided; and (iv) making service providers more autonomous and accountable.
b) **Strengthening social protection of HCS consumers** - Assessment criteria focus on improving the targeting, coverage, and efficiency of HCS subsidies, by (i) ensuring that payment of subsidies is done in cash and that they are actually paid out, and (ii) consolidation of program administration of various targeted social assistance benefits, including housing allowances.
c) **Creating market competition in housing management and maintenance** - Assessment criteria focus on improving management, maintenance, and repair of multi-family buildings by: (i) encouraging building-level collective management structures; (ii) creating market competition for building maintenance, current and capital repair; and (iii) fostering greater tenant-owner awareness of their rights and responsibilities, and (iv) clarifying rights and obligations regarding land plots.

Table 3: Criteria to assess reform status

Improving financial viability of CS* providers	▪ Legal acts adopted by regulatory agencies that set tariffs for communal services for a minimum period of 3 years with a compulsory annual indexation for inflation and fuel cost. ▪ Approval by municipalities and regions of CS providers' production programs and investment programs (for a minimum period of 3 years with identification of sources of funding). ▪ Production costs per sold unit of communal services as a percentage of the tariff. ▪ Ratio between the tariffs for residents and the tariffs for other consumer groups. ▪ Amount of outstanding payments for communal services consumed by municipal or regional public institutions to CS providers. ▪ Financial statements and independent audits** of CS providers for the last 2 years published in the mass media. ▪ Percentage of payments by residents for communal services that is not channeled through billing and collection centers, but directly to the CS provider or via building-level collective management structures***. ▪ Percentage of consumers served by CS providers that are either government-owned joint stock companies or private operators.
Strengthening social protection of HCS consumers	▪ Adoption of regulatory act that determines that all subsidies for payments for housing and communal services to households are paid in cash. ▪ Availability and operation of a unified database on subsidy recipients under programs for provision of targeted social assistance. ▪ Ratio between formally granted allowances and benefits and actually paid allowances and benefits.
Creating market competition in housing management and maintenance	▪ Percentage of multi-family buildings, the owners of which have selected their building-level collective management structure*** and have signed the relevant agreements in accordance with the Housing Code of the Russian Federation. ▪ Percentage of multi-family buildings where maintenance and current and capital repair is carried out by private entities. ▪ Development, approval and implementation of a municipal public information program on HCS reform. ▪ Percentage of multi-family buildings, the owners of which have common equity ownership of the land plot where the building is located.

* Communal services (CS) include district heating, water supply, hot water supply and sewerage services
** According to the Russian accounting standards
*** Options for building-level collective management structures include home owners associations, condominiums, housing societies, or management companies

Technical, economic, financial and environmental assessment of investment plans

Not later than six months into the reform phase, each selected and reserve municipality will have to submit an investment plan outlining the investment subprojects to be financed in the investment phase plus feasibility studies for these subprojects. The project will provide technical assistance to support preparation of investment plans and feasibility studies. The estimated investment per capita is US$50, based on the number of cities that will participate in the investment phase, and their population sizes. The investment plan and its feasibility studies will be assessed to ensure that all investment subprojects are relevant and of high quality. After the approval of the investment plan, technical designs for each investment subproject will be prepared by the municipality.

The relevance and quality of investment subprojects in the investment plan will be assessed using the following criteria (the full assessment methodology is included in the Project Operations Manual):

- **Eligibility of investments** – Investment subprojects can include rehabilitation and construction of infrastructure for heating supply, water supply, sewerage, energy supply for communal services facilities, and housing services. The investment plans can also include supply of goods and services that are required for infrastructure rehabilitation, goods and services required to improve social protection, and consultancy services to support the implementation of investments. Investment plans can only include subprojects with environmental classification "B", "C", "D" per World Bank Operational Policy 4.01 (see the Environmental Management Plan prepared by the Rosstroi). Investments are limited to an agreed list of facilities and terms of implementation (see table 4).

- **Relevance of investments** –Investment subprojects should be relevant to achieving wide-ranging improvements in HCS services. Municipal investment plans should include at least one investment subproject that primarily supports each of the indicators for the project development objective outlined in the results framework (Annex 3). Investment plans should encourage rehabilitation if this is the least cost option in comparison with new construction.
- **Financial and economic outcomes -** Subprojects will be screened to ensure that they have positive economic and financial outcomes. Each subproject should have an economic internal rate of return (EIRR) of minimum 15 percent and a financial internal rate of return (FIRR) of minimum 12 percent. A more detailed summary of the economic and financial screening process is included in Annex 9.

Table 4: List of eligible investments

1. Heating supply
1.1. District heating station with up to 100 MW capacity with specific conditions as per art.2.2 of EMP.
1.2. Heating station (boiler houses) with up to 10 MW capacity for heat supply to separate housing complex (micro district), group of buildings and constructions.
1.3.Central heating stations
1.4.Heating points of separate building and constructions (individual heat substation)
1.5.Pumping stations
1.6. Main, distributing and district heating network
1.7. Space heating systems of residential buildings, facilities and constructions.
2. Power supply for HCS facilities
2.1. Transforming stations
2.2. Distributing substations and devices
2.3. Power transmission lines: overhead and cables
2.4. Renewable energy sources
2.5. Rayon diesel (gas & diesel) power stations with up to 100 MW capacities, excluding new constructions
2.6. Energy supply for buildings and constructions
3. Water supply
3.1. Surface water intake facilities with volume up to 2000 м3 per day
3.2. Subsurface water intake facilities
3.3. Waterworks pumping stations, holding and elevated tanks, water towers.
3.4. Water treatment plants, water hardness removal, deferrization for drinking and service needs
3.5. Distribution and circled water supply network
3.6. Water supply systems of buildings and constructions.
4. Sewage
4.1. Wastewater treatment facilities, excluding new construction
4.2. Buildings and installations to treat wastewater sediments
4.3. Sewer and pipes
4.4. Sewage pumping stations
5. Collection, treatment and rain water and melted snow water discharge
5.1. Facilities, buildings and systems for collecting, treating and discharging rain water and melted snow water
5.2. Pumping stations.
6. Housing, sanitary cleaning and urban amenities
6.1. Waster reloading and sorting stations
6.2. Facilities, building and drainage systems of separate buildings
6.3. Land reclamations
6.4. Territorial sanitation

Evaluation of reform status and award of grants to cities that substantially completed their planned reform

The main requirement for a city to participate in the investment phase and receive grant funded investments is to substantially complete its planned reforms. Municipalities are required to submit a report outlining their reform status before the end of the reform phase. The reports will be assessed using the criteria to rank cities during the selection of cities. The minimum requirement is to have completed 80 percent of the planned reforms outlined in their application. Assessment will include site visits, surveys and other data collection and verification methods.

In addition, municipalities will have to have an approved investment plan and must have completed 80% of the technical designs of the subprojects by the end of the reform phase in order to participate in the investment phase.

Ten cities will be awarded grants and participate in the investment phase of the program. In case a selected city does not meet the criteria (i.e., does not complete 80% of its planned reforms), this city will not be awarded a grant to implement its investment plans. Instead, reserve cities that meet the requirements for participation in the investment phase will receive a portion of the freed up funds. Funds will be distributed on a per capita basis.

Also, the participating cities will be given an opportunity to use up to 20% of the funds allocated for the investment phase to implement a set of high-priority investments in HCS for which the cities have well developed feasibility studies and designs within the first 18 months of project implementation.

Annex 5: Project Costs

RUSSIAN FEDERATION: Housing and Communal Services Project

Project Cost By Component	Local US$ million	Foreign US$ million	Total US$ million
A: Support to HCS reform implementation at the federal level	2.60	0.39	2.99
B: Support to implementation of HCS reforms at the sub-national level	7.20	1.34	8.54
C: Preparation and implementation of HCS investment plans	155.70	33.24	188.94
D: Project management and monitoring	4.00	1.53	5.53
Total Baseline Cost	169.50	36.50	206.00
Physical Contingencies	0.00	0.00	0.00
Price Contingencies	0.00	0.00	0.00
Total Project Costs	**169.50**	**36.50**	**206.00**
Total Financing Required	**169.50**	**36.50**	**206.00**

Financing Plan (US$m)			
Source	**Local**	**Foreign**	**Total**
BORROWER	4.00	2.00	6.00
IBRD	165.50	34.50	200.00
Total:	169.50	36.50	206.00

<u>Project implementation period</u>:
Expected effectiveness date: July 31, 2008
Expected closing date: November 30, 2012

The annual disbursement plan is presented in the table below:

Estimated disbursements (US$ million)	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**
Annual	3.00	20.00	62.00	76.00	39.00
Cumulative	3.00	23.00	85.00	161.00	200.00

Annex 6: Implementation Arrangements

RUSSIAN FEDERATION: Housing and Communal Services Project

The Russian Federation through its Ministry of Finance will be the recipient of the proposed IBRD Loan and will designate the Federal Agency for Construction and Housing and Communal Services (Rosstroi) as the executing entity for the operation. Loan proceeds will be used to fund technical assistance and investments for infrastructure in selected municipalities. Funds shall be disbursed against payment requests from the PIU which will be responsible for procuring consultants, engineering, procurement, and construction contractors, and for undertaking project investments. Procurement shall be undertaken using the Bank's procurement guidelines. Assets resulting from the project will be transferred to municipalities and local service providers on a grant basis.

Institutional and implementation arrangements at the federal level
Rosstroi will be responsible for the implementation of the project. Rosstroi will also serve as the primary agency for coordination and reporting to the Bank. The Ministry of Regional Development will oversee operations of Rosstroi for implementing the project. In particular, Rosstroi will be responsible[1]:

1. To review and approve the project Operations Manual.*
2. To execute investment and technical assistance activities including supervision of the procurement process for works and consultant contracts (as outlined in Annex 8), for:
   - activities aimed at helping selected municipalities to implement HCS reforms and infrastructure upgrading,
   - activities aimed at support to HCS reform implementation at the federal level including disseminating best municipal practices to non-participating regions and municipalities;
3. To prepare and implement the "Methodology for Competitive Selection of Participants of the Project and for Allocation of Funds for Implementing the Investment Plans of the Project Participants" including (a) issuing the invitation to participate in the project, (b) assessment and approval of technical designs and (c) recommendation for approval to the Interagency Working Group of
   - municipalities to be selected for the reform phase - based on assessment of applications*;
   - municipal investment plans - based on the technical, economic, financial and environmental assessment of investment plans;
   - municipalities to be awarded grant support for implementing their investment plans - based on the evaluation of regional reform status;
4. To prepare, negotiate and sign framework and implementation agreements with participating municipalities;
5. To conduct spot-checks of the technical quality of subprojects under implementation and completed.

The day-to-day management of the project will be carried out by a small project management team within the Project Implementation Unit. The project management team will report to

[1] Items marked * take place before project effectiveness.

Rosstroi for project related issues and to the PIU director for administrative issues. Specific responsibilities of the project management will include:

1. To coordinate investment and technical assistance activities including supervision of the procurement process for works and consultant contracts (as outlined in Annex 8);
2. To assist in implementing the "Methodology for Competitive Selection of Participants of the Project and for Allocation of Funds for Implementing the Investment Plans of the Project Participants" including assessment of applications and selection of municipalities*; technical, economic, financial and environmental assessment of investment plans; and evaluation of regional reform status, and assessment and approval of technical designs;
3. To assist in preparation and negotiation of agreements with participating municipalities;
4. To conduct Project implementation monitoring and evaluation, including working with municipalities to monitor the progress of project implementation by municipalities participating in the project, including verification and validation of data reported by municipalities, spot-checks of the technical quality of subprojects under implementation and completed.
5. To serve as the secretariat to the Interagency Working Group.

Rosstroi will establish an evaluation committee for procurement according to the legislation which will include representatives of the Ministry of Finance and the Ministry of Economic Development and Trade.

The *Foundation for Enterprise Restructuring and Financial Institutions Development* (FER), a noncommercial legal entity, has been selected on a competitive basis to act as the Project Implementation Unit. The FER was established in 1996, and has extensive experience gained through managing several World Bank supported projects in Russia. Within the framework of the HCS Project, the FER will report to Rosstroi. The functions of the FER to provide day to day coordination of the project will include:

1. To prepare the project Operations Manual;*
2. To prepare bidding documents and to submit them to Rosstroi for approval;
3. To ensure that procurement procedures and contracts implementation comply with World Bank guidelines and the Project's objectives and assist the Selection Committee with questions related to the procurement process;
4. To sign consultancy contracts resulting from competitive selection process and on the basis of Terms of Reference approved by Rosstroi and agreed upon with the Bank;
5. To carry out payments under the contracts within the project and to arrange for Project audits;
6. To open and manage the Special Account;
7. To collect relevant information and prepare needed financial reports for the IBRD, Rosstroi and the Ministry of Finance;
8. To handle other day-to-day activities in procurement, financial accounting and reporting.

An Interagency Working Group was established by order #102 of the Minister of Regional Development dated October 6, 2005. The Inter-Agency Working Group is composed of senior management of Rosstroi and representatives from the Ministry of Regional Development, Ministry of Finance, the Ministry of Economic Development and Trade. The Inter-Agency Working Group is responsible for strategic issues and decisions during project preparation and implementation. Specifically the Interagency Working Group will:

1. Review and approve the project's Operations Manual*;
2. Ensure coordination among the relevant government agencies in providing guidance on key implementation issues;
3. Approve - at the recommendation of Rosstroi - municipalities to be selected for the reform phase*, municipal investment plans, and municipalities to be selected for the investment phase and to be awarded grant support for implementing their investment plans.
4. Receive and review project reports and seek clarifications on various issues and instructions on needed actions;
5. Review proposals on extending the project implementation period and reducing or reallocating the Loan funds.

Relations with regions, municipalities and service providers

A number of actors at the local level – including municipal administrations, communal services providers, home owner associations and other building-level management structures – will have to cooperate to implement the reforms and investments under the project. Municipal administrations apply to and participate in the project on behalf of all these local actors. They are responsible for coordinating the implementation of reforms, preparation and implementation of investment plans, and reporting for all entities that are involved in the HCS sector at the local level. Municipal Steering Committees may be established where applicable to coordinate and provide guidance on project implementation and reporting.

All procurement in this project will be carried out in a centralized manner by Rosstroi and its PIU. The Operations Manual specifies the procedures for asset transfer to municipalities and service providers.

While the reforms and infrastructure upgrading will take place at the municipal level, the active involvement and support of regions of the Federation to their municipalities is crucial to create sustainable results. In order to ensure regional buy-in for participation in the project, regions need to sign off on municipal applications. Only one municipality per region will be selected to participate in the project

Rosstroi will sign framework agreements with selected and reserve municipalities at the start of the reform phase that formalize the rights and responsibilities of the municipalities under the project. Specifically, key municipal responsibilities will include:

- Implementing reforms as per the reform plan with TA from federal government;
- Preparing investment plans per guidelines;
- Preparing technical designs;
- Reporting to Rosstroi on the progress of the reform program.

Rosstroi and the MOF will subsequently sign investment program implementation agreements with those municipalities which will have successfully implemented the reform program and prepared satisfactory investment plans. The agreements will specify procedures for asset transfer and accounting, fiduciary responsibilities of parties, reporting and control requirements and remedies by the government and the Bank in case of poor performance or departure of municipalities from the implemented reforms. Key municipal responsibilities will include:

- Maintaining the progress achieved during the reform stage;
- Conducting day-to-day supervision of contractors;
- Certifying the completion of works to specified technical standards by municipal supervisors;
- Reporting on a periodic basis to Rosstroi based on monitoring formats to be included in the Project Operations Manual (including data gathering, quality control and coordination of financial and operational reporting from various entities at the local level, such as CS providers).

Operations Manual

The Project Operations Manual is currently being prepared and will be approved by the Interministerial Working Group and submitted to the Bank prior to effectiveness. The Operations Manual identifies in detail the distribution of responsibilities among federal entities (Rosstroi, PIU and Interagency Working Group) and between the federal level and regions and municipalities. The manual defines, *inter alia,* arrangements and procedures for:

- Supervision, monitoring, evaluation and reporting on subprojects with clear divisions of responsibilities at each level;
- Procurement and procurement supervision;
- Methodology for Competitive Selection of Participants of the HCS Project and for Allocation of Funds for Implementing the Investment Plans of the Project Participants;
- Arrangements for the in-house and independent technical audit of subprojects;
- Methodologies and guidelines for the application of and compliance with triggered safeguards in accordance with the EMP;
- Flow of funds and financial management arrangements, including asset transfer arrangements to municipalities.

Consistency with Bank Policy and Practice Related to the Use of PIUs

The Government has requested the use of a Project Implementation Unit at the national level under the proposed project to facilitate a smooth transition towards greater integration of project management functions into line agencies. Though Bank analytical work and practice have demonstrated the importance of mainstreaming technical implementation capacity within line agencies and the need to move away from parallel PIU structures, challenges remain in terms of human resources and procurement policies and practices. The Project advances from previous operations in a substantial way by providing for targeted institutional strengthening of municipal capacity during project implementation, and not including PIUs at the sub-national level. The proposed approach is consistent with that taken in other recently approved Bank operations in the Russian Federation and is consistent with Bank and regional practice.

Annex 7: Financial Management and Disbursement Arrangements

RUSSIAN FEDERATION: Housing and Communal Services Project

Country Issues

The last Country Financial Accountability Assessment (CFAA) in the Russian Federation was conducted in 2001. Overall, the CFAA concluded that gradual progress in public financial management had been made since the start of the transition. Pending the graduation of the Government's financial management and procurement capacity and infrastructure to a level of performance that would allow the World Bank to rely on those systems, the CFAA recommended that fiduciary functions (disbursement, procurement, accounting and reporting) continue to be outsourced to specialized agencies. Such agencies (PIUs) present the advantage of using skilled consultants and reliable, suitable, and stand-alone computerized information systems. Given that Rosstroi has limited capacity to implement the Bank-financed projects, the Russian side has decided to outsource the fiduciary functions (disbursement, procurement, accounting and reporting) to an external agency (PIU).

Based on the Bank's current audit policy, the CFAA recommends maintaining current arrangements for the annual audit of Bank-assisted projects, which involve audit by private sector audit firms competitively appointed among those pre-selected by the Bank, in consultation with the MOF.

Risk Analysis.

The overall financial management risk for the project is substantial before mitigation measures, and with adequate mitigation measures agreed, the financial management residual risk is rated moderate. Table below summarizes the financial management assessment and risk ratings of this project:

Risk	***Risk Rating***	*Risk Mitigation Measures*	*Risk Rating after mitigation Measures*
INHERENT RISK			
Country level. The country's financial management and procurement capacity and infrastructure may not reach a level of performance that would allow the World Bank to rely on those systems. Corruption is taking an upward turn after a period of significant reduction, and is considered a substantial risk.	S	To mitigate this risk, the CFAA recommended using the existing PIU and engaging private independent auditors. Accordingly, the project has selected the FER to act as a PIU. The PIU, on behalf of Rosstroi, shall deal with the necessary procurement activities, project accounting and financial management. Appropriate mitigation measures on corruption risk are incorporated in the section below.	M
Entity level. This project has complex implementation arrangements at the Federal and local levels. [See implementation arrangements below]	S	For financial management arrangements, a PIU has been contracted; it has extensive experience in implementing Bank financed projects; its organizational structure is adequate. The responsibilities of all parties (Ministry of Finance, Rosstroi, Regional Administrations and Municipalities) will be explicitly defined in the investment project implementation agreement.	M

Project level. The main complexity is the implementation of the HCS investment plans, involving many communal service providers.	S	The financing and procurement of HCS investment municipal subprojects will be done in a centralized way by an experienced PIU in Moscow with Rosstroi's supervision. In addition, it is envisaged that an independent firm of supervising engineers will be hired to monitor project implementation, verification of results and certification for payments	M
Overall Inherent Risk	**S**		M
CONTROL RISK			
1. *Budget*	M		M
2. *Accounting*	M	The PIU has a good accounting system	M
3. *Internal controls* for the project include measures to ensure that funds are disbursed for goods or services delivered to recipient in accordance with the agreed criteria.	S	Rigorous assessment and approval process of the investment plans prepared by municipalities; centralized procurement and funds transfers; independent supervising engineers to monitor the project implementation and results verification. A technical audit will be carried out, which will verify the assets acquired under the project. It will take place on or before mid-term review (approximately 2 years after the commencement of the investment phase).	M
4. *Funds flow*	S	Flow of funds has been agreed with Rosstroi; the key provisions of the legal framework for implementation of the investment projects were discussed at negotiations	M
5. *Financial reporting*	L	The PIU has a good reporting system	L
6. *Auditing.* Project audit and audit of FER will be done by auditors acceptable to the Bank. The key risk relates to the quality of the audits of HCS providers, as part of continuing monitoring of their compliance with eligibility criteria.	S	The scope of the regular project audits will be expanded to include the detailed review of internal controls. Such a review will take place on or before the mid-term review (approximately 2 years after the commencement of the investment phase). The audits of the financial statements prepared in accordance with local accounting standards of the HCS providers, will be carried out in accordance with local auditing standards by local firms that have demonstrated adequate capacity, quality and independence. The selection criteria of audit firms will be specified in the operations manual. The audit results of the HCS providers would be published.	M
Overall Control Risk	**S**		M
OVERALL FM RISK	**S**		M

According to recent BEEPS, corruption appears to have taken an upward turn after a period of decline during 1999-2002, and is increasingly cited by businesses as a major problem. If the number of businesses in the World Bank/EBRD BEEPS survey citing corruption as an obstacle to their business declined notably between 1999 to 2002 (from 51 percent to 29 percent), this number increased again to 39 percent in 2005. However, adequate mitigation measures are foreseen for the project, and Bank staff will closely monitor performance during implementation. The mitigating actions can be summarized as follows: (a) the size of procurement thresholds and the frequency of the Bank's prior review will be determined in a way that it allows an appropriate level of control after assessment of the procurement capacities and the risks of corruption and fraud in the country; (b) enhanced disclosure and transparency of project-related information; (c) a rigorous process for the assessment of investment plans which focuses on quality and relevance of investments; (d) the engagement of independent firm of supervising engineers to monitor project implementation, verify the results, and certify work for payments, (e) regular audits of the investment activities by Accounting Chamber of Russia (the supreme audit institution) and internal audit units of Ministry of Finance, (f) independent operational review of investment activities, the first one would be done around two years after the start of the implementation of the investment phase, and (g) finally there will be intensive Bank's supervision, which will visit a selected number of participating municipalities annually, including site visits to inspect the assets.

Strengths

The significant strengths that provide a basis of reliance on the project financial management system include: (i) the experience of PIU and its financial management staff of implementing Bank-financed projects and satisfying Bank financial management requirements; (ii) the unqualified audit reports issued on the PIU and projects' financial statements as well as the absence of any issues raised by the auditors in the management letters during the last three years; and (iii) sound internal control system within the PIU. Key comprehensive internal control procedures specific to the project are described in the internal control section below; the details will be described in the financial management part of the OM, satisfactory to the Bank, to be ready and approved by IMG before the Project effectiveness date.

Weaknesses and action plan

As noted earlier, the financial management arrangements of the project need to be strengthened. The FM assessment has identified some weaknesses, which should be corrected as follows:

Weakness	Action	Responsible person	Completion date
FM part of the OM	To prepare a detailed Project OM, including financial part for the Bank's review and comments	PIU (Finance Director)	By the Project Effectiveness date

Implementing Entity

The Federal Agency for Construction and HCS of the Russian Federation (Rosstroi) will be responsible for the implementation of the project, including progress reports and coordination with parties concerned. The Ministry of Regional Development will oversee the operations of Rosstroi for implementing the project.

The Inter-agency Working Group which is composed of senior management of the Rosstroi and representatives from the Ministry of Regional Development, Ministry of Finance, and the Ministry of Economic Development and Trade would be responsible for strategic issues and decisions during project implementation.

FER, a noncommercial legal entity, has been selected on a competitive basis to act as the PIU. The PIU on behalf of Rosstroi shall deal with the necessary procurement activities, project accounting and financial management in the course of implementing the HCS Project activities.

Considering the above controls and mitigation measures, the risk associated with the implementing entity is assessed as moderate.

Planning and Budgeting

Budgeting is done on the basis of the procurement plan approved by Rosstroi by finance staff in excel. Budget data is then entered in the project financial statements. Should the PIU desire to switch to the report based disbursement after the initial stage of project implementation; the budgeting system should be incorporated into the accounting system. The planning and budgeting system is acceptable to the Bank.

The risk associated with planning and budgeting is assessed as moderate.

Accounting

Accounting system

The PIU maintains its accounting books and records as well as accounting books and records for the Bank-financed Projects using a computerized accounting system. It prepares three sets of financial statements: entity financial statements on an accrual basis in accordance with IFRS and Russian statutory reporting requirements, and on cash basis (for Bank-financed projects). Cash accounting will be used for this project. The PIU uses "Era" (based on "Platina") management information system for projects and entity accounting and reporting. This integrated management system generates all the required reports automatically (including reports for MoF, FMRs for the World Bank). It also automatically produces SOE/Summary Sheets.

The package "Era" is a sophisticated information management system, which includes separate accounting and project modules. It is designed to support up to 10 projects. It is not used by other PIUs because it is expensive and it pays off only when a PIU manages several projects. The accounting system is acceptable to the Bank.

Accounting Staffing

At present, key financial positions are occupied (all people with a lot of experience in Bank-financed projects). Financial specialists regularly undergo various accounting seminars and trainings (organized by the Bank and external). All accounting staff have extensive accounting knowledge (including for WB financed projects) and are considered acceptable.

Accounting Policies and Procedures.

The PIU has a clear formal set of appropriate accounting procedures and internal controls including authorization and segregation of duties. Key internal controls for the project will include the following:

- Segregation of duties;
- Proper authorization and approval procedures;

- Restricted access to the accounting system

The FM manual for the project will describe all the details, including key internal controls on investment infrastructure, and will be reviewed by the Bank prior to the Project effectiveness.

Internal control and Internal Auditing

The PIU has adequate internal controls for project implementation, including adequate segregation of duties, defined internal control procedures (expenditure approval), reconciliation of disbursement summaries of the World Bank with project accounting records. Detailed procedures relating to internal controls and audits for this project, especially the investment components, will be specified in the financial management part of the OM.

Approximately 85 percent of the project cost relates to component C, Preparation and implementation of HCS investment plans. The majority of funds will be spent on financing of the subprojects of selected municipalities to implement investment plans. These plans are to be prepared by the municipality and approved by Rosstroi and the World Bank (No-Objection Letters). Based on these detailed investment plans, a procurement plan for this component will be prepared by the PIU, approved by Rosstroi and the Bank (No-Objection Letters). Please refer to Annex 4 for details on the process of the municipalities' selection and Annex 6 for details on the responsibilities of all parties in the project.

All procurement and funds transfers in this project will be carried out in a centralized manner by the PIU under Rosstroi's supervision. Please refer to Annex 8 for details on procurement arrangements.

The disbursement and payments of funds to finance the infrastructure investments of the selected municipalities (component C) will be done in a centralized manner from the single Designated Account operated by the PIU in the following way:

- Contractors submit invoices for payment to municipalities after goods have been delivered/services provided;
- Independent supervising engineers, responsible for the ongoing supervision of quality of works, will verify the work for payment;
- Municipalities independently check the quality of goods and services received, and also certify the work for payment;
- The PIU executes the payment to suppliers/contractors from the Designated account (the funds do not go through municipalities) after receiving the documents with the approval of both independent consultants and municipality.

A detailed protocol specifying the conflict resolution system between the municipalities, suppliers, independent supervising engineers and the PIU, acceptable to the Bank, will be developed.

Rosstroi and the PIU will conduct periodic spot checks. In addition, a technical audit will be conducted to cover the verification of assets acquired during the investment phase of the project. It will take place on or before mid-term review (approximately two years after the commencement of the investment phase), Consultants will be engaged on TOR satisfactory to the Bank. Besides, the scope of the regular project audit will be expanded to include the detailed review of internal control procedures (see the audit section).

There is no internal audit function in the PIU, which is acceptable given its size and structure. However, the project activities and funds are also expected to be audited periodically by the Accounting Chamber of Russia (SAI) and also internal audit units of the Ministry of Finance.

The internal control procedures for the Project will be further explicitly defined in the financial management section of the OM, which will be prepared by the PIU, approved by the IMG and to be reviewed by the Bank prior to the Project effectiveness.

Considering the above controls and mitigation measures, the risk associated with the internal control arrangements for the project is assessed as moderate.

Funds flow and disbursement arrangements

Funds flow arrangements for the project will be straightforward. Designated account will be opened in a commercial bank acceptable to the Bank. A project account in rubles will be opened, too. Co-financing will be provided through Rosstroi. Flow of funds for the whole project will be done in a centralized way. For details of the flow of funds under the component C, please refer to the internal control section above.

The traditional method of disbursement will be used at the initial stages of the project implementation with the opportunity to switch to report based disbursement during implementation provided that financial management capacity would be adequate and the Russian side would wish to do so.

All possible disbursement mechanisms (advances, direct payments, reimbursement and special commitments) will be used.

The ceiling for the Designated Account will be equivalent to US$3.0 million at the initial stage of the project to be subsequently increased to US$20.0 million. Payments made from the Designated Account are to cover eligible expenditures under the Project. Applications for replenishment will be supported by the necessary documentation.

The four party agreement between the Ministry of Finance, Rosstroi, Regional Administration and the Municipality will define the legal arrangements of the investment projects. The key responsibilities of the parties were explicitly discussed at the negotiations. The agreements (separate for each municipality) will be signed prior to beginning of the investment phase of the project. In summary:

- The municipality will act as the client under the investment contract, will be responsible for reporting on the investment projects to the Regional Administration (under the Russian legislation) and also for registration and safeguarding of the assets acquired under the project.
- The Regional Administration will be responsible to Rosstroi for reporting on investment project (under the Russian legislation).
- Rosstroi will act as the chief budget administrator.
- Ministry of Finance will set Russian reporting requirements and execute the overall control over disbursements.

Considering the above controls and mitigation measures, the risk of flow of funds for the project is assessed as moderate.

Financial reporting

The PIU will be responsible for producing all financial reports for the Bank. PIU has demonstrated in other projects that it is able to report on project expenditures accurately and on time.

Project Interim un-audited Financial Reports (IFRs) will be used for project monitoring and supervision. They will be prepared on a cash basis. Entity financial statements will be prepared in accordance with IFRS. The PIU will produce a full set of IFRs every quarter throughout the life of the project. Draft formats of these IFRs (including the physical progress report) have been prepared and discussed with the PIU.

The risk of financial reporting is assessed as moderate.

Auditing

There are no overdue audit reports or outstanding issues either for the PIU, or for projects it implements.

The audit of the Housing and Communal Services Project and the audit of PIU will be conducted by independent private auditors acceptable to the Bank, using International Standards on Auditing. Auditors will be engaged through standard terms of reference acceptable to the Bank and procured by the PIU in accordance with the Bank procurement guidelines. The cost of the audit will be financed from the proceeds of the loan.

The first and final project audits can cover up to 18 months. The contract for the audit will be awarded during the first year of project implementation and thereafter extended from year-to-year with the same auditor, subject to satisfactory performance.

The following chart identifies the audit reports that will be required to be submitted by the project implementation agency together with the due date for submission.

Audit Report	***Due Date***
Audit of Implementing Entity [PIU]	Within six months of the end of each fiscal year
Project financial statements (PFS), including SOEs and designated account. The PFSs include sources and uses of funds by category, by components and by financing source; SOE statements, Statement of designated account, notes to financial statements, and reconciliation statement. The scope of the regular project audit will be expanded to include an extensive review of internal control procedures mostly relating to investment infrastructures The scope of the standard audit TOR will be modified accordingly.	Within six months of the end of each reporting period; the first and the final audit can cover the period up to 18 months. The expanded audit will take place on or before mid-term review (approximately 2 years after the commencement of the investment phase).
A technical audit will be carried out, which will verify the assets acquired under the project.	The technical audit will take place on or before mid-term review (approximately 2 years after the commencement of the investment phase).

As part of the selection criteria and continuous monitoring of the participating HCS providers, the project (through implementation agreement between Rosstroi and municipalities) will require regular audits of the HCS providers. The audits of the financial statements in accordance with the local accounting standards of the HCS providers will be conducted in accordance with the local auditing standards by local firms that have demonstrated adequate capacity, quality and independence. The selection criteria of audit firms will be specified in the operations manual. The audit results of the HCS providers would be published.

Considering the above controls and mitigation measures, the risk associated with audit arrangements is assessed as moderate.

Supervision plan.

As part of its project supervision missions, the Bank will conduct risk-based financial management supervisions, at appropriate intervals. During project implementation, the Bank will supervise the project's financial management arrangements in the following main ways: (a) review on a quarterly basis the financial part of project's IFRs as well as the annual project's audited financial statements and auditor's management letter; and (b) during the Bank's on-site supervision missions, review the following key areas (i) project accounting and internal control systems; (ii) budgeting and financial planning arrangements; (iii) disbursement management and financial flows, including counterpart funds, as applicable; and (iv) any incidences of corrupt practices involving project resources. As required, a Bank-accredited Financial Management Specialist will assist in the supervision process.

Annex 8: Procurement Arrangements

RUSSIAN FEDERATION: Housing and Communal Services Project

A. General

Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, and the provisions stipulated in the Legal Agreement. The various items under different expenditure categories will be described in general below. For each contract to be financed by the Loan, the different procurement methods or consultant selection methods, the need for pre-qualification, estimated costs, prior review requirements, and time frame will be agreed between the Borrower and the Bank in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

Procurement of goods and works will be performed within the framework of municipal investment plans. Such investment plans will be implemented after municipalities have demonstrated certain reforms in the HCS sector which is expected to happen in 12-18 months after beginning of the project implementation. That is why it is not possible to identify procurement packages before municipalities present their investment plans and are selected for the participation in the project. Such procurement plans will include contracts for procurement of goods and works through appropriate methods (ICB, NCB or shopping/small works), using the Bank's Standard Bidding Documents for all ICB, and National Standard Bidding Documents agreed with or satisfactory to the Bank. Direct contracts may be concluded in cases envisaged in para. 3.6 of the Guidelines.

Selection of Consultants: The procurement plan will identify the consulting assignments and applicable methods of selection of consultants. QCBS, QBS, FBS, LCS, SBCQ or SSS will be used in appropriate circumstances. Short lists of consultants for services estimated to cost less than US$ 200,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Operating Costs: Traditional expenditures related to project administration will be financed through this category. The Bank will review and approve annual PIU budgets.

The procurement arrangements and procedures to be used for each procurement method will be described in the Operations Manual available at the time of the Project effectiveness.

B. Assessment of the agency's capacity to implement procurement

A Project Implementation Unit (PIU) called the **Foundation for Enterprise Restructuring and Financial Institutions Development (FER)** has been competitively selected to assist in the day-to-day implementation of the Project. The assessment of its procurement capacity to implement the project was conducted in October 2006. The FER has vast experience in implementing the World Bank projects. It implemented several projects in the past and is currently successfully implementing five projects. Procurement arrangements under those project were found adequate and satisfactory to the Bank. The assessment revealed sufficient staffing, adequate qualification of the procurement specialists and readiness to join the project preparation and implementation.

The following thresholds were established.

Procurement Methods Thresholds						
ICB		NCB		SH/SW	Consultants	
Goods	Works	Goods	Works		Firms	Individ.
>$1 Mil.	>$10 Mil.	<$1 Mil.	<$10 Mil.	<$100 k	-	-
Prior / Post Review Thresholds						
ICB		NCB		SH/SW	Consultants	
Goods	Works	Goods	Works	SH/SM	Firms	Individ.
All	All	First 2 & >$500 k	First 2 & >$5 Mil.	None	≥$350 k	≥$100 k

C. Procurement Plan

Procurement plan under sub-national component (which covers 87 percent of the project cost) cannot be elaborated until municipalities (beneficiaries of the funds) are selected. Such investment plans of each municipality will be reviewed separately, agreed by the Borrower and the Bank and included into the overall procurement plan of the project.

Procurement plan for the first 18 months of the project is under preparation and had been reviewed and approved by the Bank before the negotiations.

D. Frequency of Procurement Supervision

In addition to the prior review which will be carried out from Moscow Bank office, regular ex-post review exercises will be conducted twice a year.

E. Details of the Procurement Arrangements Involving International Competition

Not yet available.

F. Enabling Environment and Risk Mitigation

Given the wide difference of approach between the new public procurement law on the one hand, and the World Bank Procurement Guidelines on the other hand, insufficient practice under the new legal and institutional framework, and reportedly widespread corruption in the country, the procurement environment for the implementation of the World Bank's portfolio in the Russian Federation continues to be a complex and high risk one. As a consequence, intensive supervision of World Bank's financed projects remains a need.

There are other aspects, identified in CPAR update, that pose certain risks to procurement under World Bank-financed projects in Russia, among which are:

- Attempts to apply some features in line with national procurement legislation, fail because use of other procedures would not be understood by national controlling organs, such as the Chamber of Accounts. These arguments are used despite the provision of national legislation giving precedence to the procurement procedures set forth in the agreements with the International Financial Institutions.
- Tendency to "recover" implementation delays by putting last moment pressure on procurement procedures in the sense of reduction of the time necessary for them according to the guidelines.
- Formulation of overly restrictive qualification and evaluation criteria, as well as technical specifications, particularly in the procurement of IT, which leads to increasing complaints from bidders or from consultants, as it may apply, and to limited participation in bidding and selection processes.
- Attempts to disregard World Bank's comments on bidding documents with the excuse that it should be left as it is or otherwise it would take too long to amend due to the internal bureaucratic process.

In addition to those features applicable to the whole portfolio, the following project-related risks have been identified:

- municipalities have no experience in procurement under the Bank's rules and procedures, preparation of bidding documents, and evaluation of bids;
- municipalities might not exercise sufficient control over the civil work contracts;
- evaluation committees might be favoring certain bidders, especially regional.

The measures and arrangements for mitigating and managing the risks include:

- the procurement will be conducted only by the central PIU which has sufficient experience and qualification;
- training of relevant staff in procurement, in preparing technical sections of bidding documents and evaluating bids will be provided during the first phase of the project;
- an experienced firm will be competitively selected to assist municipalities in preparation of bidding documents;
- an independent firm with adequate experience and qualification will be selected for supervision of contracts;
- additional control and supervision of civil work and equipment supply and installation contracts will be performed by the municipalities, the Rosstroi, the PIU, and the Bank team
- a technical audit of internal aim to confirm whether internal control procedures on investment infrastructures are properly functioning and also to address the risk of inappropriate or ineffective use of project financed assets at the municipal level will be undertaken around the mid-term review of the project. The necessity for follow-up audits would depend on the outcome of the first one;
- bid evaluation committees will include representatives of different parties (municipalities, PIU, MoF, MoEDT) which should make the evaluation process more objective and transparent.

Annex 9: Economic and Financial Analysis

RUSSIAN FEDERATION: Housing and Communal Services Project

Given the nature of the project, specific investments will be identified only during the implementation stage after the municipalities have developed their investment plans. Therefore, full economic and financial analyses of the specific investments can not be undertaken at this stage. This Annex describes the mechanism that will be used for conducting the economic and financial analyses and screening activities to be undertaken during project implementation to ensure that the investments are economically justified. It presents the criteria that will be applied to different kinds of activities and also includes an example which can be expected in case of a typical participating municipality.

Investment options listed in the Requirements for the Preparation of Investment Plans in HCS include:

- Heating;
- Water supply;
- Sewerage;
- Collection, cleaning, and, averting of rain-water and melted-snow water drainage;
- Housing, including engineering protection and maintenance of housing stock, sanitary cleaning and improvement of territory.

The detailed list of eligible investments is provided in Annex 4 and the EMP.
Municipalities meeting pre-defined project eligibility criteria will be required to submit investment plans to improve HCS.

The investment plans submitted by municipalities should contain economic and financial analysis of proposed investments. The principles and guidelines for economic and financial analysis will also be included in the Methodology.

The investment plans submitted by municipalities should demonstrate at least 12 percent FIRR and 15 percent EIRR and must clearly demonstrate consistency with the PDO of improving the efficiency, financial viability, and quality of provision of housing and communal services for residents of the pilot municipalities. The attainment of the PDOs will be measured as an achievement of at least one of the following monitoring indicators by each investment presented as part of the investment plan:

- improved financial viability of communal entities, including district heating, water supply, hot water supply and waste water disposal as measured by percentage of entities that incur operational losses
- reduced number of pipe breaks per km of networks per year in (i) water supply systems, (ii) in waste water supply systems and (iii) in hearing systems
- increased percentage of private investments in the total amount of investments to upgrade the communal infrastructure
- increased percentage of private companies managing communal sector facilities on the basis of concession agreements and other agreements in the total number of communal entities

- Increased percentage of multi-family buildings managed by professional management companies as measured as percent of multi-family buildings managed by professional management companies in the total number of multi-family buildings that have selected a method of management
- Increased percentage of municipalities that have completed monetization of housing allowances and where cash payments are transferred to individual social accounts of citizens
- Reduced percent of social payment arrears as measured by ratio of allowances and privileges assigned to allowances and privileges paid
- Improved quality of delivery of communal services for the population as measured as percentage of population rating services as satisfactory or better in the total size of the city population based on data of sociological surveys

Economic Analysis
The economic analysis of investments in HCS, proposed by municipalities, should be undertaken from the perspective of a cost-benefit approach. The net benefit of each investment should equal the difference between the incremental benefits and the incremental costs of two scenarios, i.e.: "with" and "without" project scenarios. The "with" project scenario considers the proposed investment program and its associated targets. The "without" project scenario considers that nothing is done and the current situation will continue or deteriorate. The economic benefits and costs of investment plans should be calculated exclusive of taxes and subsidies.

Benefits:
General benefits of the investment plans can be classified into the following general categories:

- **Service Quality Improvement**. Municipalities which do not receive service or where the service is of poor quality may benefit from the availability of water supply, heating, wastewater and sewerage system, maintenance of housing stock, solid waste management and general territory improvements. The benefits that the municipality derives from service quality improvements can be estimated as cost savings from alternative avenues for filling the gap between the supplied service quality and adequate quality. For example, if the municipality's population does not receive treated water, and is therefore required to boil the water, purchase it from vendors, or buy bottled water, then the cost savings realized from improved service quality will be the existing cost of alternatives used to preserve the quality of water used. If the municipality residents experience inadequate quality of heating supply, then the low temperatures are most likely going to be compensated for by alternative sources such as electric heaters, gas stoves, etc. Therefore, the benefit derived from improved service quality is measured as the cost of alternatives used to ensure higher indoor temperatures.

- **Improved Service Continuity.** The investments may yield benefits in the form of increase in the hours of service availability at maintained or improved quality. Currently customers, in some cases, receive intermittent service that varies by location. For example, in order to avoid problems caused by intermittent heat supply, customers rely on alternative sources of heat generation, e.g. electricity. The economic benefit of improved service continuity should be calculated as the total economic costs required to ensure adequate service supply through alternative venues during service supply interruptions.

- **Increase in Coverage**. With increased service coverage, municipalities may benefit from the public system which has a lower cost than other alternative sources. The broader the service coverage, the lower the per capita fixed costs of the service, assuming availability of spare capacity at the utility. Therefore, economic benefit from increased coverage can be computed as the reduction of per capita fixed costs of HCS.

- **Improved Efficiency and Reduction of Operating and Maintenance Costs of HCS**. Heating, water supply, and wastewater service providers may increase their operational efficiency with investments in asset renovation and replacement, installation of automated management systems, and other cost-saving and efficiency-enhancing solutions. The resulting benefits can be measured as the reduction of the long-run marginal cost of supplying a unit of service (e.g. a cubic meter of water, 1 Joule of heat). For example, the long-run marginal cost of heat supply can be computed through the production costs of a boiler house. When physical losses are reduced a lower volume of heat needs to be produced to meet the same consumption requirement and therefore less operating costs are incurred. This saving is also an economic benefit.

- **Decrease in Disease Incidence Due to Poor HCS.** Within the framework of the above widely-accepted approach for conducting analysis, the following indicators may be utilized to gauge the impact of improved housing and communal services on health: reduction of morbidity (deriving from improvements in the quality of drinking water, sewerage, expansion of drainage, higher indoor temperatures, reduced indoor pollution, etc.). The economic benefits of decreased morbidity can be measured as the average economic value-added per employed individual (which can be found in the statistical publications of the National Statistical Service of the country) during a unit of time worked.

- **Environmental Benefits.** Improvements in HCS infrastructure may yield environmental benefits. With the increased fuel-efficiency of CS providers and reduction of physical losses due to improved infrastructure, additional benefits in the form of reduced CO_2 emissions may arise and can be quantified based on the market price of emission credit rights.

- **Increase in the Value of Housing.** The improvements in HCS may result in increase in housing prices, which is an economic benefit. The quantification of this benefit can be done through the hedonic price method. Within the framework of this approach, a marketed commodity such as housing is considered to have a range of attributes or services, with its implicit prices being reflected in the total commodity price paid. The method derives estimates of these implicit prices by observing how the price of the commodity varies with variations in its attributes. Using the hedonic price method, the implicit value of a particular HCS, such as 24-hour water supply, sewage connections, building insulation, is derived by observing how property values vary depending on whether the service exists or not.

The EIRR of the individual investment plans will most likely be underestimated due to difficulties in quantifying a number of benefits such as reduction of environmental damage, which may result from improvement in infrastructure and enhancement of the technical capacity of CS providers and increase in energy efficiency, employment gains, decrease in untargeted public subsidies, improvement of relations between municipality residents and local self-administration authorities.

Costs:

Investment costs. Investment costs should be calculated to include project preparation, physical contingencies, and supervision. There are some costs which are paid for by consumers and not by the CS providers, such as, connection charges in sanitation projects. These costs should be considered as economic costs.

Operating and Maintenance costs include the cost of labor, chemicals (applicable in water and sanitation, water-treatment), power, and all administrative costs. Operating and Maintenance costs for the "with" project scenario should include all the operating costs incurred by the project. Operating and Maintenance costs for the "without" project scenario should be based on current unit costs.

Financial Analysis

Financial analysis of projects should be based on cash flow analysis. For every period during the expected life of the project, the cash likely to be generated by the investment must be estimated and then cash outlays needed to sustain the project should be evaluated to derive the net cash flow figure. The financial analysis of investment plans should measure the cash inflows and outflows at market prices. The net financial benefit of each investment equals the difference between the incremental benefits and the incremental costs of two scenarios: "with" and "without" project. All financial figures included in the analysis should be in constant prices.

The financial benefits of the project can be classified into the following groups:

- **Reduction of Operating and Maintenance Costs of CS Providers**. Investments in infrastructure improve technical capacity of utilities, thus, resulting in lower technical and commercial losses. Savings derived from lower losses are a benefit for a utility and can be quantified by measuring the total financial costs of output a lower volume of service needs to be produced to serve the same consumption and therefore lower operating costs will occur. The benefit can be measured as the multiple of units of output saved and the average production cost of a unit of service.

- **Improved Efficiency of CS providers**. With investments in asset renovation and replacement, automated management system installation, better metering, and other cost-saving and efficiency-enhancing solutions, the cost-efficiency of utility companies may increase, which coupled with the increased service quality and appropriate changes in the legal framework may ensure a higher rate of revenue collection. Thus, the financial performance of utility companies, measured as the ratio of cash revenues/cash costs, may increase. The savings derived from the improved energy and water efficiency should be measured in market prices of water, heat, and electricity.

The financial costs of the project include the same items as in the "Economic Analysis" section and should include taxes.

Annex 10: Safeguard Policy Issues

RUSSIAN FEDERATION: Housing and Communal Services Project

The project triggers one safeguard policy, Operational Policy 4.01 – Environmental Assessment, and has been assigned environmental screening category B.

The project is specifically designed to support policy reforms in the HCS municipal sector. The project aims to support cost efficient investments into rehabilitation and expansion of HCS services: heating and water supply, energy supply, sanitation, renovation and maintenance of housing stock, waste water treatment facilities, solid waste management, sanitary cleaning, etc, as well as efficiency investments in the housing and communal infrastructure. The existing facilities consume excessive amounts of power, fuel and other resources per unit of production due to inefficient and outdated equipment, high losses of heat and water, poor design of facilities, etc. Overall, the housing and communal sector is one of the leading sources of pollution in the urban centers in Russia. Proposed investments will lead to sustainable medium and long-term environmental benefits due to increased energy efficiency, reduced emissions into atmosphere and water bodies, etc. The project is not expected to have any significant or irreversible long-term negative environmental impact.

However, during construction of new or repairing of existing infrastructure (housing, boilers, pumping stations, wastewater treatment plants, water and heating supply network pipelines) and performing other project financed activities, some short-term, limited-scale environmental impacts and disturbances will occur. Such impacts will include permanent or temporary withdrawal of additional land sites, cutting vegetation, air pollution, wastewater discharges, polluted storm water runoff particularly during construction period, generation of construction wastes, negative impacts of physical factors including increased noise levels, potential exposure of workers to asbestos containing materials. Therefore, during the planning and implementation phases of specific investments, proper preparatory work has to be done by municipal authorities, project developers and environmental authorities in order to identify, and, subsequently, to avoid or mitigate the potentially negative impacts. In this regard, a framework EMP has been developed and disclosed by the Borrower (see the official web-site of Rosstroi: http://www.gosstroy.gov.ru/m_deit11.htm)

The EMP contains all environmental requirements and procedures, suggests appropriate arrangements for evaluation of significant environmental impacts, and recommends appropriate remediation and mitigation measures. Recognizing the uncertainty associated with the lack of specific investment proposals at this stage of the project development, the EMP developed a "green" and "red" list of typical investments in the housing and communal sector. The "green" list includes those investments which are clearly compliant with the Category B projects, while the "red" list shows those investments which would have higher environmental risks, would require full scale environmental assessment and should not therefore supported by the project. The draft EMP presents procedures for compliance monitoring and delineates responsibilities of all parties participating in the environmental assessment process.

In order to be eligible for financing, the proposed investments would need to comply with the Russian Federation environmental legislation and with the World Bank safeguard policies.

Rosstroi has all necessary knowledge of the Russian Federation legislation and has become familiar with the World Bank safeguards policies during the implementation of Municipal Heating and Municipal Water and Wastewater Projects. At the same time, every effort will be made to ensure that the Rosstroi staff in charge of HCS Reform project implementation is knowledgeable on environmental and social issues. The PIU will be requested to hire a qualified environmental consultant. Training in the proper application of environmental and social safeguards will be provided to Rosstroi and the PIU staff as a part of the Component D activities.

The project does not trigger any of the social Operational Policies. Should there be a need to build new heating or water supply pipelines, they would be laid on public rights of way. In case the new pipelines or a new boiler house/pumping stations/wastewater treatment plants would be proposed for construction on privately owned land, the project proponent would need to agree on a legally valid deal with the land owner for purchase or leasing the land. The staff of Rosstroi and the PIU will be advised in such cases to approach the Bank for further guidance.

The Operations Manual, which is under the preparation, will contain an environmental chapter specifying all the steps, procedures and respective responsibilities of all parties in line with provisions of the EMP.

It is anticipated that most of the individual projects will be small in scale and scope and will have only limited short term impacts on the environment, which can be mitigated by adherence to the recommendations of the project EMP, good planning and construction practice. Therefore, it is anticipated that in the majority of investments, individual environmental management plans would not be needed. Rather, the requirements for meeting environmental safeguards will be described in the environmental chapter of each sub-project proposal and incorporated into bidding documents, if appropriate. When individual projects would include new construction eligible for investment (see Annex 1 of the EMP), the development of an investment specific environmental management plan would be required. Municipal authorities and project proponent/developer will be responsible for preparation of an environmental management plan for specific investments and its approval by relevant environmental authorities in line with existing regulations. The PIU will provide overall guidance for development of individual environmental management plans and will ensure compliance with the framework.

Rosstroi and the PIU staff will be required to regularly monitor compliance of contractors and clients in each project, and in case of noncompliance undertake the necessary actions to mitigate the situation. The project management team will continue to consult and share information with stakeholders on a regular basis during the process of project preparation.

Annex 11: Project Preparation and Supervision

RUSSIAN FEDERATION: Housing and Communal Services Project

	Planned	Actual
PCN review	December 19, 2003	September 9, 2003
Initial PID to PIC		October 2, 2003
Initial ISDS to PIC		October 2, 2003
Appraisal	October 29, 2006	October 29, 2006
Negotiations	May 24, 2007	May 24, 2007
Board/RVP approval	February 26, 2008	
Planned date of effectiveness	July 31, 2008	
Planned date of mid-term review	January 31, 2011	
Planned closing date	November 30, 2012	

Key institutions responsible for preparation of the project:
Federal Agency for Construction and HCS of the Russian Federation (Rosstroi) - implementing agency
Fund for Enterprise Restructuring and Financial Institutions Development (FER) – Project Implementation Unit.

Bank staff and consultants who worked on the project included:

Name	Title	Unit
Gevorg Sargsyan	Senior Infrastructure Specialist	ECSSD
Peter Ellis	Senior Urban Economist	SASEI
Ellen Hamilton	Senior Urban Planner	ECSSD
Jan Brzeski	Housing and Urban Specialist	ECSSD
Meike van Ginneken	Senior Water and Sanitation Specialist	EWDWS
Arvo Kuddo	Senior Labor Economist	ECSHD
Dhruva Sahai	Senior Financial Specialist, Consultant	ECSSD
Tatyana Shadrunova	Operations Analyst	ECSSD
Yan F. Zhang	Urban Economist	ECSSD
Vladimir Tsirkunov	Senior Environmental Engineer	ECSSD
Stepan Titov	Senior Economist	ECSPE
Maria Gavrilova	Program Assistant	ECCU1
Alexander Roukavichnikov	Procurement Specialist	ECSPS
Galina Kuznetsova	Senior Financial Management Specialist	ECSPS
Ani Balabanyan	Operations Officer	ECSSD

Bank funds expended to date on project preparation:
Bank resources: US$ 823,000.00

Estimated Approval and Supervision costs:
1. Estimated annual supervision cost: US$ 120,000.00

Annex 12: Documents in the Project File

RUSSIAN FEDERATION: Housing and Communal Services Project

1. Government of the Russian Federation (2006). Program for Social and Economic Development of the Russian Federation, Medium-Term Outlook for 2006-2008. Approved by the RF Government Resolution No. 38-p (January 19, 2006).

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Annex 13: Statement of Loans and Credits

RUSSIAN FEDERATION: Housing and Communal Services Project

			Original Amount in US$ Millions						Difference between expected and actual disbursements	
Project ID	FY	Purpose	IBRD	IDA	SF	GEF	Cancel.	Undisb.	Orig.	Frm. Rev'd
P089733	2007	JUDICIAL REFORM SUPPORT	50.00	0.00	0.00	0.00	0.00	48.00	-1.88	0.00
P092429	2007	STATE STATS SYST 2	10.00	0.00	0.00	0.00	0.00	10.00	0.00	0.00
P078420	2006	CADASTRE DEVT	100.00	0.00	0.00	0.00	0.00	26.32	-38.68	0.00
P093050	2006	REGISTRATION	50.00	0.00	0.00	0.00	0.00	50.00	7.30	0.00
P082239	2005	HYDROMETEO SYST MOD	80.00	0.00	0.00	0.00	0.00	71.72	25.24	0.00
P075387	2004	E-LRN SUPRT (APL #1)	100.00	0.00	0.00	0.00	0.00	20.57	8.47	15.37
P046497	2003	HEALTH REF IMP	30.00	0.00	0.00	0.00	0.00	13.21	11.94	4.67
P072960	2003	CUSTOMS DEVT	140.00	0.00	0.00	0.00	0.00	85.69	74.29	64.16
P064237	2003	TB/AIDS CONTROL	150.00	0.00	0.00	0.00	0.00	80.23	72.93	29.56
P069063	2003	ST. PETERSBURG ECON DEVT	161.10	0.00	0.00	0.00	0.00	130.09	110.46	0.00
P066155	2003	TAX ADM 2	100.00	0.00	0.00	0.00	0.38	29.12	21.50	23.50
P064508	2002	TREASURY DEVT	231.00	0.00	0.00	0.00	0.00	216.43	156.43	31.54
P064238	2001	N RESTRUCT	80.00	0.00	0.00	0.00	0.00	45.78	45.78	1.42
P038551	2001	MUN HEATING	85.00	0.00	0.00	0.00	0.00	8.92	8.92	8.92
P046061	2001	MOSC URB TRANS	60.00	0.00	0.00	0.00	0.00	6.93	6.93	0.00
P008832	2001	MUN WATER & WW	122.50	0.00	0.00	0.00	43.39	17.75	61.14	23.42
P058587	2000	REG FISC TA	30.00	0.00	0.00	0.00	0.00	5.93	5.93	3.55
P053830	2000	SUST FORESTRY PILOT	60.00	0.00	0.00	0.00	0.00	20.49	20.49	20.49
P042622	1996	CAP MRKT DEV	89.00	0.00	0.00	0.00	34.09	8.78	42.87	9.12
P008821	1995	ENV MGMT	110.00	0.00	0.00	0.00	0.00	27.20	27.20	21.92
		Total:	1,838.60	0.00	0.00	0.00	77.86	923.16	667.26	257.64

RUSSIAN FEDERATION
STATEMENT OF IFC's
Held and Disbursed Portfolio
In Millions of US Dollars

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic.	Loan	Equity	Quasi	Partic.
2006	Absolut Bank	15.00	8.76	0.00	0.00	8.00	8.76	0.00	0.00
2006	Absolut Bank	15.00	8.76	0.00	0.00	8.00	8.76	0.00	0.00
2002	AgroIndFinC	5.00	0.30	0.00	10.00	3.83	0.30	0.00	7.67
2006	Alliance Oil Co.	25.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2003	BCEN Eurobank	50.00	0.00	0.00	0.00	50.00	0.00	0.00	0.00
2004	BSGV	25.00	0.00	0.00	0.00	25.00	0.00	0.00	0.00
2004	BSGV Leasing	71.28	0.00	0.00	0.00	56.69	0.00	0.00	0.00
2001	BVF	0.00	2.13	0.00	0.00	0.00	0.19	0.00	0.00
2005	BVPEF III	0.00	12.50	0.00	0.00	0.00	5.92	0.00	0.00
2004	Bauxite Timana	15.00	0.00	0.00	10.00	0.00	0.00	0.00	0.00
2006	Brunswick Cptl	37.50	7.50	0.00	0.00	6.14	7.50	0.00	0.00

	Center-Invest	4.03	0.00	0.00	0.00	4.03	0.00	0.00	0.00
2005	Center-Invest	5.21	0.00	5.00	0.00	5.21	0.00	5.00	0.00
2006	Chuvash Republic	8.57	0.00	0.00	0.00	8.57	0.00	0.00	0.00
2006	Cinema Park	20.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2002	Delta Credit	14.12	0.00	0.00	0.00	14.12	0.00	0.00	0.00
2003	Delta Credit	54.04	0.00	0.00	0.00	45.04	0.00	0.00	0.00
2004	Delta Leasing	2.50	0.00	0.00	0.00	2.50	0.00	0.00	0.00
2006	Delta Leasing	6.26	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2002	Egar Technology	0.00	0.76	0.00	0.00	0.00	0.26	0.00	0.00
2005	Esanna	14.30	0.00	0.00	47.05	12.58	0.00	0.00	41.28
2005	Eurosibtrans	30.00	0.00	0.00	0.00	30.00	0.00	0.00	0.00
2006	Eurosibtrans	33.00	0.00	15.00	71.50	0.00	0.00	15.00	0.00
2006	Fora Bank	6.71	0.00	0.00	0.00	4.03	0.00	0.00	0.00
	GTFP Absolut Bk	10.00	0.00	0.00	0.00	10.00	0.00	0.00	0.00
	GTFP CBM	1.66	0.00	0.00	0.00	1.46	0.00	0.00	0.00
	GTFP LOCKO Bank	0.64	0.00	0.00	0.00	0.64	0.00	0.00	0.00
2002	IBS	0.00	8.00	0.00	0.00	0.00	8.00	0.00	0.00
2004	INTH	0.00	3.50	6.13	0.00	0.00	0.00	6.13	0.00
2006	INTH	10.00	0.00	0.00	0.00	10.00	0.00	0.00	0.00
2002	KMB Bank	3.86	0.00	0.00	0.00	3.86	0.00	0.00	0.00
2005	Kronospan Russia	89.24	0.00	0.00	0.00	89.24	0.00	0.00	0.00
2004	Kronostar	46.67	0.00	0.00	38.37	46.67	0.00	0.00	38.37
2005	Kronostar	45.00	0.00	0.00	0.00	45.00	0.00	0.00	0.00
2005	KuAz	13.50	0.00	0.00	0.00	13.50	0.00	0.00	0.00
	Kupol	14.00	0.00	25.00	0.00	7.70	0.00	19.82	0.00
2004	Lebedyansky	35.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2006	Locko	11.16	16.37	0.00	0.00	3.71	16.37	0.00	0.00
	Moscow Credit Bk	5.00	0.00	0.00	0.00	2.00	0.00	0.00	0.00
2005									
2005	Moscow Credit Bk	5.00	0.00	0.00	0.00	2.00	0.00	0.00	0.00
1998	Mosenergo	6.75	0.00	0.00	0.00	6.75	0.00	0.00	0.00
2003	NBD	2.50	0.00	2.00	0.00	2.50	0.00	2.00	0.00
2006	NBD	5.12	0.00	0.00	0.00	5.12	0.00	0.00	0.00
2001	NMC	1.73	0.00	0.00	0.00	1.73	0.00	0.00	0.00
2004	NWSC	23.00	0.00	0.00	23.48	3.33	0.00	0.00	3.40
2005	Novatek	0.00	11.53	0.00	0.00	0.00	11.53	0.00	0.00
2005	Peter Hambro	0.00	11.25	0.00	0.00	0.00	11.24	0.00	0.00
2006	Peter Hambro	0.00	17.53	0.00	0.00	0.00	17.46	0.00	0.00
2004	Pilkington Rus	54.18	0.00	0.00	0.00	54.18	0.00	0.00	0.00
2007	Primsots	0.00	0.00	5.59	0.00	0.00	0.00	0.00	0.00
2001	Probusiness Bank	0.00	0.00	5.00	0.00	0.00	0.00	5.00	0.00
	Promek	159.72	0.00	0.00	0.00	133.72	0.00	0.00	0.00
2006	Prominvestors	0.00	0.00	15.00	0.00	0.00	0.00	0.00	0.00
2003	Quadriga Capital	0.00	17.70	0.00	0.00	0.00	7.11	0.00	0.00
2005	RWMN	1.07	0.00	0.00	0.00	1.07	0.00	0.00	0.00
2004	RZB Leasing Russ	18.36	0.00	0.00	0.00	9.86	0.00	0.00	0.00
	RZB Russia	70.00	0.00	0.00	0.00	70.00	0.00	0.00	0.00
2003	RZB Russia	24.44	0.00	0.00	35.56	24.44	0.00	0.00	35.56
2004	RZB Russia	9.41	0.00	0.00	0.00	9.41	0.00	0.00	0.00
1998	Ramstore	6.30	0.00	0.00	0.00	6.30	0.00	0.00	0.00
2001	Ramstore	12.84	0.00	0.00	0.00	12.84	0.00	0.00	0.00

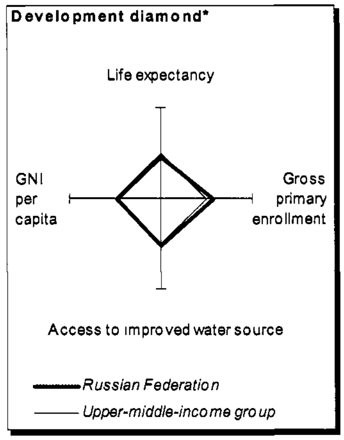
2002	Ramstore	21.42	0.00	10.00	15.00	21.42	0.00	10.00	15.00
2005	Ramstore	40.00	0.00	0.00	0.00	30.00	0.00	0.00	0.00
2003	Ru-Net	0.00	5.00	1.00	0.00	0.00	5.00	0.00	0.00
2006	Rus MBS 2006-1	8.77	0.00	10.60	0.00	0.00	0.00	10.60	0.00
2001	Ruscam	3.50	0.00	3.50	0.00	3.50	0.00	3.50	0.00
2003	Ruscam	8.00	0.00	0.00	0.00	8.00	0.00	0.00	0.00
2004	Ruscam	15.91	0.00	0.00	0.00	15.91	0.00	0.00	0.00
2004	Russ Stndard Bnk	63.08	0.00	0.00	0.00	63.08	0.00	0.00	0.00
2006	Russ Stndard Bnk	42.80	0.00	25.50	60.00	42.80	0.00	25.50	60.00
1995	Russ Tech Fnd	0.00	0.23	0.00	0.00	0.00	0.23	0.00	0.00
2005	RussiaPartnersII	0.00	9.80	0.00	0.00	0.00	2.00	0.00	0.00
	Russkiy Mir	23.41	0.00	0.00	28.37	11.22	0.00	0.00	13.48
2004	Russkiy Mir	10.71	0.00	0.00	0.00	10.71	0.00	0.00	0.00
2005	Russkiy Mir	19.57	0.00	0.00	23.72	9.25	0.00	0.00	11.11
2004	Severstaltrans	21.43	0.00	12.86	0.00	21.43	0.00	12.86	0.00
2004	Sibakadembank	3.00	0.00	6.00	0.00	3.00	0.00	6.00	0.00
2006	Sibakadembank	10.00	0.00	0.00	0.00	10.00	0.00	0.00	0.00
2003	Stav. Broiler	13.50	0.00	0.00	0.00	11.00	0.00	0.00	0.00
2002	Swedwood Tichvin	4.83	0.00	0.00	0.00	4.83	0.00	0.00	0.00
2005	ToAz	30.00	0.00	0.00	45.00	0.00	0.00	0.00	0.00
2006	Trio	20.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2006	UralSib Bank	30.00	0.00	0.00	0.00	30.00	0.00	0.00	0.00
2003	UralTransBank	5.83	0.00	0.00	0.00	5.83	0.00	0.00	0.00
	Vladpivo	0.00	5.31	0.00	0.00	0.00	5.31	0.00	0.00
2006	Vladpivo	9.66	0.00	0.00	0.00	9.66	0.00	0.00	0.00
2004	Volga Shipping	24.15	0.00	0.00	16.72	14.03	0.00	0.00	9.79
2001	Volga-Dnepr	9.84	0.00	5.89	12.02	9.84	0.00	5.89	12.02
2006	Vyksa	60.00	0.00	0.00	0.00	60.00	0.00	0.00	0.00
2002	ZAO Europlan	2.86	0.00	0.00	0.00	2.86	0.00	0.00	0.00
2002	ZAO Storaenso	3.50	0.00	0.00	0.00	3.50	0.00	0.00	0.00
	Total portfolio:	1,649.44	146.93	154.07	436.79	1,262.64	115.94	127.30	247.68

		Approvals Pending Commitment			
FY Approval	Company	Loan	Equity	Quasi	Partic.
2006	UVTB	0.01	0.00	0.01	0.00
2002	RSB II	0.00	0.00	0.00	0.00
2006	OMK-Vyksa	0.01	0.00	0.00	0.00
2006	Europlan II	0.02	0.00	0.00	0.00
2005	KMB Bank II	0.03	0.00	0.01	0.00
2005	Novatek Gas	0.05	0.00	0.00	0.07
2006	CityMortgage	0.03	0.00	0.00	0.00
2006	PIP-Vladpivo	0.01	0.00	0.00	0.00
2007	Primsotsbank	0.01	0.00	0.01	0.00
2003	DeltaCredit Bank	0.02	0.00	0.00	0.00
2007	Rusfinance Bank	0.05	0.00	0.00	0.00
	Total pending commitment:	0.24	0.00	0.03	0.07

Annex 14: Country at a Glance

RUSSIAN FEDERATION: Housing and Communal Services Project

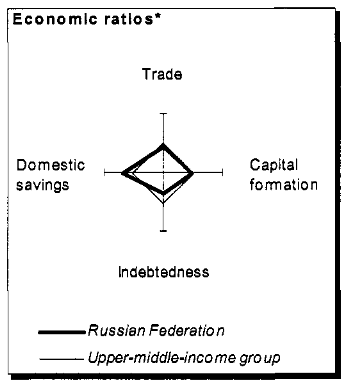
POVERTY and SOCIAL	Russian Federation	Europe & Central Asia	Upper-middle-income
2006			
Population, mid-year *(millions)*	142.4	460	810
GNI per capita *(Atlas method, US$)*	5,780	4,796	5,913
GNI *(Atlas method, US$ billions)*	822.9	2,206	4,790
Average annual growth, 2000-06			
Population *(%)*	-0.5	0.0	0.8
Labor force *(%)*	0.5	0.5	1.3
Most recent estimate (latest year available, 2000-06)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	73	64	75
Life expectancy at birth *(years)*	65	69	70
Infant mortality *(per 1,000 live births)*	14	28	26
Child malnutrition *(% of children under 5)*	6	5	..
Access to an improved water source *(% of population)*	97	92	93
Literacy *(% of population age 15+)*	99	97	93
Gross primary enrollment *(% of school-age population)*	129	102	112
Male	129	103	106
Female	128	100	104



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

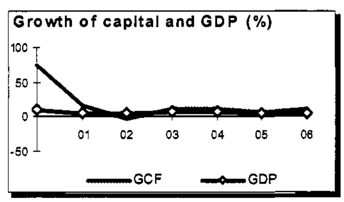
	1986	1996	2005	2006
GDP *(US$ billions)*	..	391.7	764.5	986.9
Gross capital formation/GDP	..	23.7	20.1	20.2
Exports of goods and services/GDP	..	26.1	35.1	33.9
Gross domestic savings/GDP	..	27.9	33.7	32.9
Gross national savings/GDP	..	26.5	31.1	29.8
Current account balance/GDP	..	2.8	11.0	9.7
Interest payments/GDP	..	0.9	1.0	..
Total debt/GDP	..	32.3	30.0	..
Total debt service/exports	..	6.8	14.4	..
Present value of debt/GDP	..	..	30.1	..
Present value of debt/exports	..	..	80.3	..

	1986-96	1996-06	2005	2006	2006-10
(average annual growth)					
GDP	-8.5	5.4	6.4	6.7	6.3
GDP per capita	-8.4	5.8	6.9	7.3	7.0
Exports of goods and services	-4.4	8.2	6.4	7.2	5.7

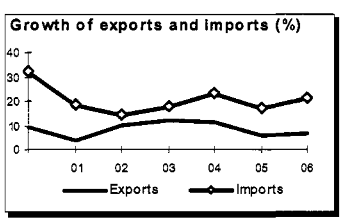


STRUCTURE of the ECONOMY

	1986	1996	2005	2006
(% of GDP)				
Agriculture	..	7.2	5.5	4.9
Industry	..	38.7	39.7	39.4
Manufacturing	..	..	19.3	19.4
Services	..	54.1	54.8	55.8
Household final consumption expenditure	..	52.6	49.7	49.6
General gov't final consumption expenditure	..	19.5	16.6	17.5
Imports of goods and services	..	21.8	21.6	21.2



	1986-96	1996-06	2005	2006
(average annual growth)				
Agriculture	-7.5	4.8	1.0	1.7
Industry	-13.4	5.9	4.7	5.3
Manufacturing	..	..	..	..
Services	-3.8	4.9	7.0	7.5
Household final consumption expenditure	-1.6	7.3	14.5	15.5
General gov't final consumption expenditure	-5.3	1.6	2.2	2.2
Gross capital formation	-24.1	7.3	7.2	13.4
Imports of goods and services	-11.1	11.3	17.0	21.7



Note: 2006 data are preliminary estimates.

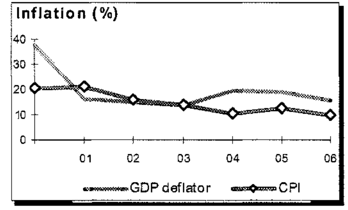
This table was produced from the Development Economics LDB database.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

PRICES and GOVERNMENT FINANCE

	1986	1996	2005	2006
Domestic prices				
(% change)				
Consumer prices	..	47.7	12.7	9.7
Implicit GDP deflator	..	45.8	19.2	16.1
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	35.5	39.6	39.4
Current budget balance	..	-1.2	10.6	10.8
Overall surplus/deficit	..	-9.5	8.1	8.4

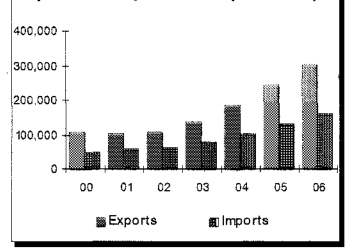
Inflation (%)



TRADE

	1986	1996	2005	2006
(US$ millions)				
Total exports (fob)	..	89,685	243,798	303,926
Crude oil	..	15,578	83,439	102,283
Natural gas	..	14,683	31,671	43,806
Manufactures	..	9,441	14,300	18,412
Total imports (cif)	..	70,684	129,578	159,838
Food	..	11,557	17,400	21,600
Fuel and energy	..	1,848	1,600	1,900
Capital goods	..	14,894	43,400	65,600
Export price index *(2000=100)*	..	87	185	228
Import price index *(2000=100)*	..	115	110	112
Terms of trade *(2000=100)*	..	76	168	204

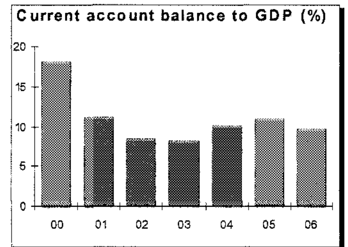
Export and import levels (US$ mill.)



BALANCE of PAYMENTS

	1986	1996	2005	2006
(US$ millions)				
Exports of goods and services	..	102,966	268,768	334,853
Imports of goods and services	..	86,757	164,299	209,431
Resource balance	..	16,209	104,469	125,422
Net income	..	-5,433	-18,989	-28,563
Net current transfers	..	72	-1,038	-1,538
Current account balance	..	10,848	84,442	95,321
Financing items (net)	..	-15,862	-23,236	26,171
Changes in net reserves	..	5,014	-61,206	-121,492
Memo:				
Reserves including gold *(US$ millions)*	..	15,318	182,240	303,732
Conversion rate *(DEC, local/US$)*	..	5.1	28.3	27.1

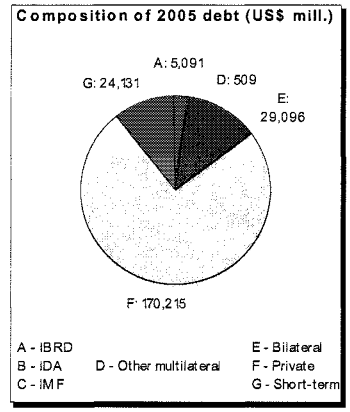
Current account balance to GDP (%)



EXTERNAL DEBT and RESOURCE FLOWS

	1986	1996	2005	2006
(US$ millions)				
Total debt outstanding and disbursed	..	126,374	229,042	..
IBRD	..	2,509	5,091	4,759
IDA	..	0	0	0
Total debt service	..	7,315	41,380	..
IBRD	..	121	963	936
IDA	..	0	0	0
Composition of net resource flows				
Official grants	..	460	..	..
Official creditors	..	3,570	-18,287	..
Private creditors	..	245	43,323	..
Foreign direct investment (net inflows)	..	2,579	15,151	..
Portfolio equity (net inflows)	..	2,154	-215	..
World Bank program				
Commitments	..	1,923	305	0
Disbursements	..	1,097	251	324
Principal repayments	..	0	780	693
Net flows	..	1,097	-528	-370
Interest payments	..	121	184	243
Net transfers	..	976	-712	-612

Composition of 2005 debt (US$ mill.)



Note: This table was produced from the Development Economics LDB database. 9/28/07

MAP SECTION

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