

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: AB2599

Project Name	Housing and Communal Services Project
Region	EUROPE AND CENTRAL ASIA
Sector	Sub-national government administration (100%)
Project ID	P079032
Borrower(s)	Russian Federation
Implementing Agency	Federal Agency for Construction and HCS of the Russian Federation (ROSSTROI)
Environment Category	<input type="checkbox"/> A <input checked="" type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
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1. Country and Sector Background

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.

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.

Housing and communal services are critical to the quality of life of Russian citizens and to Russia's economy. The HCS sector in Russia constitutes about 5.9 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.

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 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 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 communal services providers. Building capacity at the local level is paramount for reforming the HCS sector.

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.

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. 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 it 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.

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. However, there is no 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 made losses amounting to RUR 59.5 bn 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.

2. Objectives

The project development objective is to improve quality and financial viability of HCS of participating municipalities. The project will support the implementation of the existing federal government reform program for the HCS sector at sub-national levels, by shifting from relying overly on government provision of services to market-based mechanisms for service delivery. The federal program focuses on reforming the institutional relationships within the whole HCS sector, from housing management and maintenance to utility enterprises. The proposed HCS project will combine the implementation of a comprehensive set of reforms in the HCS sector, with tangible investments to rehabilitate, upgrade and modernize infrastructure thereby placing it on a more sustainable path where there is less reliance on government finance and support.

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

- Number of municipalities with improved quality of delivery of communal services (including district heating, water supply, hot water supply and sewerage services) for the population, measured by (i) pipe breaks in water and heating distribution networks per km per year; (ii) reduced water losses as measured by a ratio of (produced water minus water delivered to consumers) to produced water; (iii) reduced blockages in sewerage per km per year; and (iv) improved energy efficiency of the heating system as measured by ratio of (primary energy used for producing heat minus heat supplied to consumers) to primary energy used for producing heat;
- Number of municipalities with improved quality of delivery of HCS services for the population, as measured by percentage of population rating service as satisfactory or better;
- Number of participating municipalities with improved financial viability of communal service providers (including district heating, water supply, hot water supply and sewerage services) as measured by ratio of collected annual operating revenues (excluding budget subsidies) to total annual operating cost.

3. Rationale for Bank Involvement

The quality, and accessibility of housing, and the affordability of housing and communal services is an essential element for improving the quality of life of ordinary people. In addition, inefficient housing and communal services remain one of the biggest burdens of municipal and regional budgets and are a major cause of energy intensity.

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, economic and sector works, and policy dialogue with the Government. More recently the Bank has conducted three pieces of analytical work related to housing and communal services. In addition, there are four on-going projects which support reforms and investment in the HCS sector.

The Government of Russia has requested the Bank's assistance for this project because the Bank is considered a source of global knowledge and best practice. These best practices could be applied in the Russian context to help to design an efficient management mechanism, transparent regulation, and an effective performance monitoring and evaluation system. This vast underpinning of sector reform and finance enables the Bank to apply national and international best practices to these projects. In addition, several unique aspects of Bank engagement will yield positive benefits for the HCS reform process as follows: (i) its unique focus on poverty alleviation as the end-result of all its activities; (ii) the bundling of its vast capabilities in capacity enhancement, knowledge expertise, research, and policy advice in an integrated and coherent package of assistance; (iii) a history of over 50 years of involvement in infrastructure; (iv) the ability to provide multi-sectoral, multi-country perspectives which enhance the quality of decision making during reform processes and the quality of risk mitigation; and (v) the longevity of the Bank's sustained relationships matching the long term nature of reform efforts.

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.

4. Description

The proposed loan in the amount of US\$ 200 million is designed as a specific investment loan (SIL), combining investment, and Technical Assistance (TA) financing. 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 (US\$ 2.75 million): 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 (US\$ 11.75 million): Support to implementation of HCS reforms at the sub-national level, including (i) specialist assistance to cities on utility reform, social protection & housing; (ii) evaluation of implementation of municipal reform programs; (iii) knowledge

exchange between municipalities; (iv) public awareness campaign on HCS reforms in selected regions; and (v) how-to-guidance on selected reform topics.

Component C (US\$ 179.75 million): Preparation and implementation of HCS investment plans, including (i) preparation of municipal investment plans and feasibility studies, (ii) preparation of technical designs, (iii) implementation of municipal investment plans, and (iv) supervision of implementation of municipal investment plans.

Component D (US\$ 5.75 million): Project management and results monitoring.

The project will consist of two phases: an 18-month reform phase, and a 42-month investment phase. 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. 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. 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 is being prepared by Rosstroi in consultation with other ministries, and will be agreed by World Bank.

During the reform phase, the selected 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 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) with the average investment per capita of US\$ 50.

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 communal services 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% of the expenditures on investment plans will be on heating supply, 35% will be on water supply and sewerage, 4 to 5% will be in the housing sector, and about 1 percent will be on social protection.

5. Financing

Source:	(\$m.)
BORROWER	0
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT	200
Total	200

6. Implementation

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

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.

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.

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 apply to and participate in the project on behalf of all these local actors. Rosstroi will sign implementation 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. The operations manual will specify 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 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.

7. Safeguard Policies (including public consultation)

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

* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas

The project is rated as Category "B" (partial assessment) project. Rosstroi has prepared Environmental Management Plan for the project with emphasis on ensuring mitigation of any potential environmental impacts associated with rehabilitation works and potential new construction. The EMP is available at Rosstroi's official web-site: http://www.gosstroy.gov.ru/m_deit11.htm. 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.

8. Contact point

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