

OFFICIAL DOCUMENTS

Supplemental Letter No. 2

REPUBLIC OF CROATIA

May 8, 2017

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Re: Loan No.8749-HR
(Modernization and Restructuring of the Road Sector)
Performance Monitoring Indicators

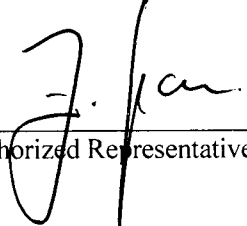
Dear Sirs and Mesdames:

This refers to paragraph A of Section II of Schedule 2 (Project Monitoring Reporting and Evaluation) to the Loan Agreement of this date between the Republic of Croatia (the Borrower) and the International Bank for Reconstruction and Development (the "Bank") for the above-captioned Project.

The Borrower hereby confirms to the Bank that the indicators set forth in the attachment to this letter (Results Framework and Monitoring) shall serve as a basis for the Borrower to monitor and evaluate the progress of the Project and the achievement of the objective thereof.

Very truly yours,

REPUBLIC OF CROATIA

By: 
Authorized Representative

Attachment to Supplemental Letter No. 2 (A)

Results Framework and Monitoring

CROATIA: Modernization and Restructuring of the Road Sector

Project Development Objectives

PDO Statement

The Project Development Objective (PDO) is to strengthen the institutional effectiveness, enhance the operational efficiency and increase the debt service capacity of Croatia's road sector.

For the purpose of measuring progress towards achieving the PDO, the following definitions are adopted:

- **Institutional Effectiveness:** Extent to which road sector companies have the legal and regulatory framework, organizational structure, incentives and technical capabilities needed to design, build, operate, maintain and finance the infrastructure under their management in an effective manner;
- **Operational Efficiency:** Ability to provide quality services in a cost-efficient manner;
- **Debt Service Capacity:** Ability of road sector agencies to cover principal and interest payment on new and existing debt from their own operating surpluses.

These results are at | Project Level

Project Development Objective Indicators

Indicator Name	Baseline End-CY 2016	Target Values				
		End-CY 2017	End-CY 2018	End-CY 2019	End-CY 2020	End Target End CY 2021
Institutional Effectiveness:						
Ability of MSTI to plan road sector investments	Inexistent sector-wide planning coordination	Creation of planning department under MSTI; transport strategy approved			Availability of inputs for rolling investment plan, in particular RAMS	Motorway and road networks managed under rolling investment plans

Ability of MSTI to monitor and enforce performance of motorway and road companies using Key Performance Indicators (KPIs) and standardized accounting measures under service agreements between Government and reorganized companies	Inadequate performance-monitoring system	Adoption of corporate governance plans	Completed new institutional setup of sector companies Service performance agreements in place			Integrated monitoring system in place
Operating Efficiency:						
Operating Expense Ratio (Total Operating Expenses / Total Operating Revenue)	HAC: 0.38 ARZ: 0.32 HC: 0.28					HAC+ARZ: <0.27 HC: <0.27
Operating Expenditures per kilometer of road network	HAC: 0.69 ARZ: 1.04 HC: 0.08					HAC+ARZ: <0.60 HC: <0.07
Debt Service Capacity:						
Annual Debt Service Coverage Ratio (DSCR)	HAC: 0.27x ARZ: 0.57x HC: 0.57x	1.0x	1.0x	1.0x	1.0x	HAC: 1.0x ARZ: 1.0x HC: 1.0x
Loan Life Coverage Ratio (LLCR) 10 Years	HAC: 0.7x ARZ: 0.7x HC: 1.0x	1.0x	1.0x	1.0x	1.0x	HAC: 1.0x ARZ: 1.0x HC: 1.0x
Debt to CFADS Ratio	HAC: 15.8x ARZ: 15.0x HC: 9.7x			12.5x 12.5x 9.0x		HAC: 10.0x ARZ: 10.0x HC: 7.3x
Intermediate Results Indicators- Track progress towards achieving outcomes						

Indicator Name	Baseline End-CY 2016	Target Values				
		End-CY 2017	End-CY 2018	End-CY 2019	End-CY 2020	End Target End CY 2021
Component A – Institutional strengthening and Sector Reforms: The objective of this component is to establish an institutional framework for the road sector built upon: strong planning and oversight by the MSTI; clear division of responsibilities based on performance-based service agreements between the planning and oversight functions (MSTI) and the road asset management functions (road companies); and a coordinated financing plan.						
Status of implementation of new financing strategy for HAC, ARZ and HC under government coordination [A.1]	Contract with advisor signed	Financing strategy approved; execution of first debt restructuring transaction	Additional debt restructuring transaction is executed			Debt restructuring transactions contemplated in the Financing Strategy are executed
Operational status of Planning Department established within MSTI [A.2]	Inexistent planning and coordination functions within MSTI	Department created	Department produces first sector plan			Department is fully operational
Status of implementation of improved and harmonized accounting standards [A.2]	Non-harmonized accounting standards	TA completed	Improved accounting standards applied (implementation from Jan 1, 2019 if not feasible earlier)			
Component B –Operational Restructuring of Road Sector Companies: The objective of this component is to implement the management tools and carry out the revenue enhancement and cost rationalization actions required to increase income while reducing operating expenditures without sacrificing quality.						
Revenue Optimization						
Weighted Average toll revenue per Vehicle-Km travelled [B.4]	HAC: 0.59 ARZ: 0.63					HAC: >0.67 ARZ: >0.67
Status of implementation of new tolling revenue	Existing mixed toll system	New tolling strategy defined	Bidding documents for automated toll	New tolling systems contracts		New automated tolling system completely

enhancement measures [B.4]			system	awarded		implemented
Operating Expense Optimization						
Percent Reduction in Operating Cost of Motorways relative to baseline: HAC and ARZ [B.3]	HAC+ARZ: 830 mn HRK annual	7 percent	15 percent			30 percent
Reduction in Operating Cost for State Roads relative to baseline: HC [B.5]	HC: 543 mn HRK annual					515 mn HRK
Staff per Kilometer of road under operation (motorways) [B.3]	HAC: 2.7 ARZ: 3.3					HAC + ARZ: < 2.2
Management Tools						
Status of implementation of end-performance road maintenance standards [B.1]	Standards without end-performance requirements	Award consultancy	Update of regulations (pravilnici); end-performance standards in place			Service standards incorporated in rolling plan
Status of implementation of Road Asset Management System (RAMS) [B.2]	Road sector companies do not have integrated RAMS	RAMS TA contract awarded	RAMS implementation contract awarded		RAMS operational	RAMS inputs incorporated in rolling investment plan
Percent of HC network where county agencies (ZUC) participate in joint procurement committee	0 percent			50 percent		100 percent
Percentage of TEN-T road network for which road safety	0 percent		10 percent			100 percent

audit or inspection as per EU Directive 2008/96 has been carried out [B.6]						
Citizen engagement: Maintain full responsiveness rate to comments and grievances from citizens	100 percent	100 percent	100 percent	100 percent	100 percent	100 percent
Gender balancing: Ratio of women in the motorway sector after retrenchment	0.19		>0.20			>0.25
Component C –Debt Restructuring (Guarantees): The objective of this component is to increase the tenor and reduce the interest rate on road company debt, thereby enhancing debt service capacity and putting road companies on a sustainable debt path.						
Private Direct Mobilization (Debt Refinancing with support of IBRD Guarantee)	N.A.					Debt Refinanced: >EUR 750 million (all companies)
Private Indirect Mobilization (Debt Rescheduling)	N.A.					Rescheduled: >EUR 2,000 million
Weighted Average Maturity of Road Sector SOEs' Debt	3.5 years					7.8 years

Indicator Description

Indicators will be reported to the Bank as part of Project Reports to be produced with the frequency stated in the legal agreements.

Project Development Objective Indicators

Indicator Name	Description (indicator definition etc.)	Frequency of Calculations	Data Source / Methodology	Responsibility for Data Collection
Ability of MSTI to plan road sector investments	Availability of planning organization elements	Semi-annual	MSTI	MSTI

Ability of MSTI to monitor and enforce performance of motorway and road companies using Key Performance Indicators (KPIs) and standardized accounting measures under service agreements between Government and reorganized companies	Availability of KPI monitoring system that allows tracking of performance measures and standardized accounting standards to verify compliance with targets established in service agreements.	Semi-annual	MSTI	MSTI
Operating Expense Ratio	Calculated as ratio of operating expenditures (routine maintenance, tolling, administration – direct costs plus subcontracts) over operating revenue (toll and ancillary revenue for HAC/ARZ; and fuel tax plus ancillary revenue for HC)	Semi-annual	Calculated from the sector model to be maintained by the MSTI	Road companies
Operating Expenditures per kilometer	Calculated as ratio of operating expenditures (as defined above) over length of network in km	Semi-annual	Calculated from the sector model to be maintained by the MSTI	Road companies
Debt Service Coverage Ratio (DSCR)	<p>This indicator measures the capacity of the sector (road sector agencies-HAC, ARZ and HC) to meet its debt service obligations out of the cash flows generated by the sector. If the indicator is less than 1x [less than 100 percent if percentage representation is chosen], this means that the sector is unable to cover its debt service obligations out of its own cash flows.</p> <p>The indicator captures both the revenue and the debt service sides of the financial viability equation.</p> <p>The Indicator is defined as Cash Flow Available for Debt Service (CFADS) over Debt Service (DS) for</p>	Semi-annual	Calculated from the sector model to be maintained by the MSTI	Road companies

	<p>the preceding 12 months.</p> <p>For the purpose of this indicator:</p> <p>-CFADS is defined as total revenue net of opex and capex in the period</p> <p>-DS is defined as interest plus principal payable in the period</p>			
Loan Life Coverage Ratio –LLCR (HAC/ARZ and HC)	<p>Ratio of Present Value of Cash Flow Available for Debt Service (CFADS) over 10 years to Total Outstanding Debt in year of calculation. This indicator will be calculated over a 10-year period using forward looking projections.</p> <p>This measure is used to estimate the ability of the borrower to repay the outstanding loans over the medium term.</p>	Semi-annual	Calculated from the sector model to be maintained by the MSTI	Road companies
Debt to CFADS Ratio	<p>The measure indicates the capacity of road sector companies to meet their financial obligations from their own revenue. Where the ratio is falling, it indicates that the company's capacity to meet its financial obligations from its own CFADS is strengthening.</p> <p>The indicator is calculated as follows:</p> <p>Debt Outstanding for Period/CFADS</p>	Semi-annual	Calculated from the sector model to be maintained by the MSTI	Road companies

Intermediate Results Indicators- Track progress towards achieving outcomes

Status of implementation of new financing strategy for HAC, ARZ and HC under government coordination	Availability of financing strategy elements	Semi-annual	MSTI	MSTI
Operational status of Planning Department established within MSTI	Availability of policy elements	Semi-annual	MSTI	MSTI
Status of Implementation of harmonized accounting standards	Availability of policy elements	Semi-annual	MSTI	MSTI
Weighted Average toll revenue per Vehicle-Km travelled	Average toll rate (including VAT) per vehicle-kilometer for all vehicle categories, weighted by the percentage share of each category in the total vehicle-km	Semi-annual	MSTI	Motorway companies
Status of implementation of new tolling revenue enhancement measures	Availability of policy elements	Semi-annual	MSTI	MSTI
Percent Reduction in Operating Cost of Motorways relative to baseline: HAC and ARZ	Operating cost defined as including total amount of HAC-ONC contract plus HAC and ARZ staff and overhead costs	Semi-annual	Calculated from the sector model to be maintained by the MSTI	Motorway companies
Reduction in Operating Cost for State Roads relative to baseline: HC	Operating cost defined as including total amount of routine maintenance contracts plus HC staff and overhead costs	Semi-annual	Calculated from the sector model to be maintained by the MSTI	HC
Staff per Kilometer of road under operation (motorways)	Total staff (operator and road manager) per km	Semi-annual	MSTI	Motorway companies
Status of implementation of end-performance road maintenance standards	Availability of policy elements	Semi-annual	MSTI	MSTI

Status of implementation of Road Asset Management System (RAMS)	Availability of system for development and incorporation in planning	Semi-annual	MSTI	MSTI
Percent of HC network where county agencies (ZUC) participate in joint procurement committee	Total road length in respective HC business units over total HC length	Semi-annual	MSTI	HC
Percentage of TEN-T road network for which road safety audit or inspection as per EU Directive 2008/96 has been carried out	Total road length with documented completed audit or inspection	Semi-annual	MSTI	Road companies
Citizen engagement: Responsiveness rate to comments and grievances from citizens	Percentage of citizen inquiries (comments and grievances) that Road Companies address. This indicator will be measured using the internal reporting of the Road Companies regarding citizen engagement measures.	Semi-annual	Road companies	Road companies
Gender balance: Ratio of women in the motorway sector after retrenchment	Percentage of women in the motorway sector relative to total after retrenchment	Semi-annual	Road companies	Road companies
Private Direct Mobilization	Amount of debt that refinanced with support of the IBRD Guarantee It is worth pointing out that the terms and conditions of the envisaged refinancing may evolve in the future based on discussions with the creditors and evolution of the market conditions.	Annual	MSTI	MSTI
Private Indirect Mobilization	Amount of debt that is rescheduled in parallel to the refinancing exercise and the World Bank support to sector reforms It is worth pointing out that the terms and conditions of the envisaged rescheduling may	Annual	MSTI	MSTI

	evolve in the future based on discussions with the creditors and evolution of the market conditions.			
Weighted Average Maturity of Road Sector SOEs' Debt	<p>The average term to maturity of the road companies' outstanding loans weighted by the percentage of the total debt amount that each loan represents.</p> <p>The final weighted average term of maturity of debt will depend on market conditions at the time of implementation.</p>	Annual	Calculated from the sector model to be maintained by the MSTI	MSTI