

**INTEGRATED SAFEGUARDS DATA SHEET  
CONCEPT STAGE**

Report No.: AC722

**Date ISDS Prepared/Updated: May 25, 2004**

**I. BASIC INFORMATION**

**A. Basic Project Data**

Country: Ukraine	Project ID: P087263
Project Name: MUNI CRDT MRKT DEVT (APL #1)	Task Team Leader: Lawrence M. Hannah
Estimated Appraisal Date: Jan/Feb. 2005	Estimated Board Date: May 10, 2005
Managing Unit: ECSPE	Lending Instrument: Adaptable Program Loan
Sector: Capital Market Development (30%); Municipal services and infrastructure (30%); sub-national government administration (30%); central government policy development (10%)	Theme: Decentralization (P); Municipal finance (S)
Safeguard Policies Specialists in the task team: Radhika Srinivasan,	
Loan/Credit amount (\$m.): IBRD: 150	
Other financing amounts by source: Borrower: 30	(\$m)

**B. Project Objectives**

The Program's development objective is to support the initiation and development of a market for municipal credit in Ukraine. If successful, such a market would be comprised of voluntary private lenders who understand and are prepared to manage the risks of this new line of business and an ever-growing number of creditworthy municipalities who can better serve their citizens through increased investment in services and infrastructure. There are at least four themes that describe how the Program will achieve its objective. First, the policy and regulatory framework for intergovernmental fiscal relations, in general, and sub-national borrowing in particular, will be strengthened and sustained. Second, municipalities and their utilities will be given the opportunity and the incentive to better manage their financial affairs so as to be viewed as creditworthy by potential lenders. Third, those same entities will be given assistance to develop, prioritize and select better investment projects so as to yield maximum returns and address the needs of their communities. Fourth, private financial institutions including commercial banks will be assisted and invited to consider these borrowers and these projects for investment where the risks of such lending can be minimized and managed effectively.

### **C. Project Description**

In the context of the reform of the system of intergovernmental fiscal relations, the Government has engaged the Bank in extensive discussions on how to make additional resources available to SNG without creating undue risk or liability for the central government. Initial discussions were to create a public fund as a semi-independent financial intermediary. The strategy was to have this entity mimic a commercially credible lender, only later inviting commercial banks into the system. While much of the preparatory work previously conducted remains relevant for the proposed operation, both the Government and the Bank concluded about a year ago that no design would adequately address the moral hazard of one level of government lending to another. On the other hand, in recent years economic growth in Ukraine, low inflation, deposit inflows into the banking sector, better financial regulatory policy and an improved legal framework have set the stage for dramatic increases in domestic financial intermediation and investment.<sup>1</sup> During this same period the commercial banks expressed an ever-growing interest in starting lending to SNGs.

In order for banks to lend to municipalities a number of risks they face must be addressed. In addition to the legal and regulatory reforms necessary to make this a safe business for lenders (and borrowers), the proposed Bank loan would be used to refinance bank lending to municipalities to help them manage the maturity mismatch between their short-term liabilities (largely demand deposits) and long-term assets (loans to municipalities). The concept underlying this Program, which involves commercial banks taking the full credit risk, was therefore agreed with the Government. The fundamental conception of the Program is that banks will choose the borrowers and the projects<sup>2</sup> to finance. Since commercial banks will be the lenders to municipalities under this concept, the UMDF will work as the PIU. In addition to housing those special skills uniquely required to implement and monitor the project, the UMDF will prepare reports for the Ministry of Finance and submit them for consideration. The main functions of the UMDF are to ratify the selection of participating banks, the eligibility of borrowers and to confirm that safeguard policies of the World Bank are being met. The UMDF will not consider whether a loan to a municipality should be granted. The lending decision, which includes a credit risk assessment and a subsequent responsibility for collection, rests solely with the commercial banks.

The process of selecting banks will be carried out jointly with the Rural Finance Project. Banks applying to participate will be evaluated on a number of criteria focusing on the safety and soundness of their banking practices. Qualified banks will be deemed eligible for one or both projects if they wish. This process is presently underway.

An important feature of the Program concept is that the foreign exchange risk should not be placed on the municipalities since they have neither the skill nor the financial capacity to manage it. It is thought that the commercial banks are in a better position to bear such a risk but in the absence of any real market for hedging such a risk, there is a danger they might overprice it. It is therefore suggested that this risk should be held by the Government (by MoF lending local currency to banks) and included in the price, i.e. the interest rate they charge the banks.

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<sup>1</sup> CAS 2003-2007.

<sup>2</sup> From a positive list set forth under the Project designed to meet the Development Objectives.

With regard to technical assistance (TA) to banks and municipalities, discussions with six municipalities visited during the preparation of this Program<sup>3</sup> revealed that municipalities will need some help in one or more of the following areas: improve municipal capacities in budget management, strategic planning, local economic development and/or project preparation and evaluation. A number of donor-supported projects are already tackling various aspects of this and the task team has been coordinating with all of them. TA to banks is more complicated but experience on how to do this has been tested in other countries with similar project (Bosnia-Herzegovina Local Development Project, active). The TA component will also involve further support to the Government on legislative and regulatory issues (policy development).

The proposed MCMD program comprises two, three-year phases and would be supported by US\$150 million APL, (of an estimated US\$180 million total program costs). The APL was selected because of the phased (Phase I Policy Development and Pilot Investment; Phase II Scaling-up) and longer-term goals of creating a credit market. The preference for the APL instrument is also because it easily permits adjustment of the loan amount of Phase II based on demand.

#### **D. Project location**

The project will be located in urban areas throughout the country. The aim of the project is to tackle needs of municipalities that are able to borrow from the UMDF. Depending of application process, municipal creditworthiness and capacity tests (as will be defined in the Operational Manual), it is not known at the outset of the project which municipalities will qualify.

#### **E. Borrower's Institutional Capacity for Safeguard Policies**

Ukraine has a reasonably good legal and regulatory framework related to environmental protection, including requirements for environmental assessments and mitigation. As noted elsewhere, the Operations Manual will provide the framework for designing the detailed environmental mitigation measures, as needed, to be undertaken by the sub-project municipal applicant. It will also establish the details of which civil works are to be considered "environmentally sensitive", and hence need to be kept out of the investment program.

## **II. SAFEGUARD POLICIES THAT MIGHT APPLY**

<b>Applicable</b>	<b>Safeguard Policy</b>
[ X ]	<a href="#">Environmental Assessment (OP/BP 4.01)</a>
	An environmental section will be integrated in the Operations Manual which will include a review of Ukrainian EA procedures relevant to the project, national and local capacity for implementing these, and institutional strengthening measures needed to assure application of safeguards in a manner consistent with Bank policy

<sup>3</sup> Cities visited and their potential projects for the UMDF's Year One pipeline financing are: Lutsk (Water rehabilitation project and Cogeneration system project); Khmelnytsky (Cogeneration system project); Kharkiv (District heating system); Shepetivka (Cogeneration system project); Starokostiantyniv (Cogeneration system project) and Komsomolsk (Water rehabilitation project). This is not an exclusive list as project proposals can be made in an ongoing basis by municipalities and their enterprises. More applications are expected once UMDF runs the information campaign for municipalities.

	as well as Ukrainian national environmental laws and regulations.
<input type="checkbox"/>	<a href="#">Natural Habitats (OP/BP 4.04)</a>
<input type="checkbox"/>	<a href="#">Pest Management (OP 4.09)</a>
<input checked="" type="checkbox"/>	<a href="#">Involuntary Resettlement (OP/BP 4.12)</a>
	Between pre-appraisal and appraisal, an approach will be developed to address any emerging land acquisition issues in the sub-projects. The Operational Manual will include a section on social safeguard screening and instructions for dealing with anticipated mitigation measures to ensure compliance with World Bank policies.
<input type="checkbox"/>	<a href="#">Indigenous Peoples (OD 4.20)</a>
<input type="checkbox"/>	<a href="#">Forests (OP/BP 4.36)</a>
<input type="checkbox"/>	<a href="#">Safety of Dams (OP/BP 4.37)</a>
<input checked="" type="checkbox"/>	<a href="#">Cultural Property (draft OP 4.11 - OPN 11.03)</a>
	The project documents will include some language to the effect that so long as actions are in accordance with the relevant Ukrainian legislation, they are acceptable to the Bank and, in the event that it becomes necessary, the operational manual and contracts with the entrepreneurs who will carry out works will include instructions for dealing with any chance finds that may occur.
<input type="checkbox"/>	<a href="#">Projects in Disputed Areas (OP/BP/GP 7.60)*</a>
<input checked="" type="checkbox"/>	<a href="#">Projects on International Waterways (OP/BP/GP 7.50)</a>
	Task team was advised to consult LEGEN on the compliance requirements.

**Environmental Assessment Category:**

A  B  C  FI

The investments to be financed under the Project are expected, among other things, to contribute to the improvement of municipal services and infrastructure; thus creating better living environment for the population of participating cities in the Project. An environmental section will be integrated in the Operations Manual which will include a review of Ukrainian EA procedures relevant to the project, national and local capacity for implementing these, and institutional strengthening measures needed to assure application of safeguards in a manner consistent with Bank policy as well as Ukrainian national environmental laws and regulations. The Operations Manual will provide the framework for designing detailed mitigation measures as needed by the municipal sub-project applicant. In addition, it will include information on social safeguard screening and instructions for dealing with anticipated mitigation measures to ensure compliance with World Bank policies. It is likely that subprojects in environmental category A may be financed. The environmental section of the operations manual and the policy framework will be submitted to ECSSD for review and disclosed in the country (in local language) and at the Bank's Infoshop (In English) prior to Appraisal.

**III. SAFEGUARD PREPARATION PLAN**

A. Target date for the Quality Enhancement Review (QER) meeting would be before appraisal, at which time the PAD-stage ISDS would be prepared.

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

B. For simple projects that will not require a QER, the target date for preparing the PAD-stage ISDS

C. Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing<sup>4</sup> should be specified in the PAD-stage ISDS.

#### IV. APPROVALS

<i>Signed and submitted by:</i>		
<b>Task Team Leader:</b>	<b>Lawrence M. Hannah</b>	<b>May 25, 2004</b>
<i>Approved by:</i>		
<b>Regional Safeguards Coordinator:</b>	<b>Ronald Hoffer</b>	<b>June 6, 2004</b>
<b>Comments</b>		
<b>Sector Manager:</b>	<b>Helga Muller</b>	<b>June 7, 2004</b>
<b>Comments</b>		

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<sup>4</sup> Reminder: The Bank's Disclosure Policy requires that safeguard-related documents be disclosed before appraisal (i) at the InfoShop and (ii) in-country, at publicly accessible locations and in a form and language that are accessible to potentially affected persons.

