CONFERENCE ON IMPLEMENTING SUSTAINABLE URBAN TRAVEL POLICIES IN RUSSIA AND OTHER CIS COUNTRIES

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FINANCING PUBLIC TRANSPORT PROJECTS IN EASTERN EUROPE AND RUSSIA

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**Introduction**

Many cities in Eastern Europe and Russia face increasing difficulties in providing good quality public transport for their citizens. Ageing vehicle fleets and deteriorating public transport infrastructure are becoming more and more common. Car ownership is also growing fast, resulting in increasing congestion, pollution and parking problems. There is an urgent need for substantial investment in public transport. However, many cities and transport companies lack financial resources and management expertise, and do not work within a sound institutional and regulatory framework. The European Bank for Reconstruction and Development (EBRD) can offer financing for investments in public transport, in combination with sector restructuring.

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**The EBRD**

The European Bank for Reconstruction and Development (EBRD) was set up in 1991 to aid the transition from centrally planned to market economies in Central and Eastern Europe and the Commonwealth of Independent States. The EBRD is owned by 62 shareholders - 60 countries, the European Investment bank and the European Community - and operates with €20 billion in capital. The EBRD finances projects in both the private and public sectors. A strength of the EBRD is its in-depth knowledge of the region as well as specific sector expertise. The Bank is based in London and has regional offices in all countries of operation.

The EBRD operates in 27 countries from central Europe to central Asia:

- Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, FYR of Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia,

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**The current situation and the need for change**

Car ownership has massively increased in Eastern Europe and Russia over the past decade, whilst once efficient public transport systems have tended to fall into decline. Many systems are now characterised by ageing fleets and deteriorating infrastructure. Is the remedy simply a matter of money? Although the characteristics of individual cities vary considerably across the region, depending on size and wealth, they share some common areas of improvement that need to be addressed.

**Integrated and sustainable transport strategies need** to be developed as investments are often made on an ad-hoc basis. This has resulted in a greater emphasis on roads and bridges in response to growing congestion. On-street priority measures e.g. bus lanes, traffic signal pre-emption, are rare.
Moreover, without a **coherent multi-year investment programme**, companies are dependent on occasional grants from municipalities for fleet replacement. Therefore, they are not able to manage their own investment planning nor develop sound business plans.

Another issue is the **unclear financial relationships between municipalities and transport operators**. As there are no well-defined obligations for both parties, financial payments to the operator are “open-ended” as are the services to be delivered in return.

Due to a **weak regulatory and institutional framework**, a professional transport authority, which regulates and co-ordinates all public transport, has often not been established. In a number of cities, private minibuses operate without any restrictions, resulting in unfair competition and uncoordinated services.

Furthermore, **provisions have to be made for future capital investments**. Whilst cost recovery appears impressive in comparison with, for example, Western Europe, this is mainly because depreciation is not taken into account and funds are not set aside for replacement investments.

Next, **compensation needs to be received for privileged passengers**. Although many citizens are eligible for free or low price fares (such as students, civil servants, or pensioners), operators do not receive adequate compensation for this from the decreeing authority.

Moreover, **public transport is a heavy burden on a city’s budget**. Once the responsibility of central governments, public transport has been rapidly decentralised to municipalities but financial resources have not followed. Today, public transport is often the largest city budget item (up to 40%).

Nevertheless, **operators are not focused on customers**. Rather than being focussed on the needs of customers, many transport operators are still ‘production orientated’. Marketing and research, to attract more passengers, are rarely developed.

Finally, there is a **preference for capital-intensive projects**. Instead of upgrading existing, but dilapidated, systems with great potential (e.g segregated tram tracks), cities often prefer investments in unaffordable systems such as metros, dual-mode systems or monorails.

The picture, however, is not as clear cut as it is portrayed above. A number of cities and transport companies have managed to improve their services substantially whilst some are still managing to provide services with limited financial resources. This is in effect a starting point for restructuring public transport in Eastern Europe and Russia.

**EBRD financing of public transport**

The EBRD’s approach is based on **sound banking principles with a commitment towards supporting transition measures, for developing market economies in the region**.
The commercial criteria applied in financing investments for a city or a public transport company are similar to those applied to other projects:

- will the borrower be able to repay the loan (including all fees and interest)?
- have all risks been identified and acceptable mitigation measures put in place?
- in case of default by the borrower, how will the Bank get its money back (i.e. what form of “security” is available?)

The Bank is willing to assist municipalities in achieving important reforms that will support financial viability (see Table 1). The EBRD works with clients to define suitable financing structures in combination with an associated transition package. The preparation and/or implementation of these additional reform measurements may be arranged through grant-funded technical co-operation or from a loan.

Table 1 Reform measures

<table>
<thead>
<tr>
<th>Areas</th>
<th>Situation today</th>
<th>Typical reform measure</th>
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<tbody>
<tr>
<td>Policy</td>
<td>Unclear vision regarding the development of public transport</td>
<td>Coherent and sustainable transport policy</td>
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<td>Organisational</td>
<td>Vertically integrated with city setting tariffs, specifying and delivering</td>
<td>Clarity of tasks and responsibilities, with a contractual relationship between</td>
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<tr>
<td>framework</td>
<td>services</td>
<td>authority and provider</td>
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<tr>
<td>Strategic planning</td>
<td>Focus on physical planning; emphasis on expanding the network</td>
<td>Co-ordination of public transport and roads development; optimisation of the</td>
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<tr>
<td></td>
<td></td>
<td>public transport network</td>
</tr>
<tr>
<td>Budgeting</td>
<td>Annual budget allocations: no direct reimbursement for concessionary fares</td>
<td>Sound business plans and long-term financial planning; compensation for privileged</td>
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<td></td>
<td></td>
<td>passengers</td>
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<tr>
<td>Expertise</td>
<td>With notable exceptions, low quality staff due to poor salaries and working</td>
<td>Management training; introduction of incentives; investment in management</td>
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<tr>
<td></td>
<td>conditions</td>
<td></td>
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<tr>
<td>Market forces</td>
<td>Generally limited</td>
<td>Commercialisation of transport enterprises; out-sourcing of activities; where</td>
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<td></td>
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<td>appropriate, the introduction of competition through a sound regulatory framework</td>
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A very important component is the introduction of a Public Service Contract (PSC), which is often a key condition for loan financing. The PSC defines rights and obligations between a city and a public transport company and, in particular, the formulae for the service payments to be provided to the transport company in return for the delivery of services. The PSC should also include provision for capital investments. The PSC will define the quantity and quality of services to be provided by the transport company in return for the service payments by the city involved. Incentives and penalties could be part of the PSC. A PSC could apply to a public operator or a private operator. (See Figure 1).
EBRD Financing structures

The main three financing structures the EBRD offers with regard to public transport projects are corporate loans, municipal loans and performance guarantees. In case of corporate loans, the borrower is a transport company, public or private (see also Figure 1). The Public Service Contract, including financial service payments from the municipality or Transport Authority to the transport company, is the foundation. The transport company should be able to repay the EBRD loan through the service payments it receives under the Public Service Contract. In principle, the loan is backed by a Municipal Guarantee but this is dependent on the credit risk. A corporate loan is preferred to a loan to a city as it makes the public transport company responsible for its own investments. Next, municipal loans are non-sovereign loans to a municipal client (without a guarantee from central government), which could be used to finance for example the rehabilitation of tram tracks, traffic management systems, ticketing systems, refurbishment of depots including workshop equipment, line extensions and occasionally fleet renewal etc. The EBRD can also support either out-sourcing of bus supply and maintenance (“contract-hire” or lease) or contracting out of bus services to private operators.

The final financing structure is an EBRD Performance Guarantee to the private contractor, guaranteeing contractual payment obligations of the client (e.g. a municipality). This encourages private companies (for example transport operators or lease companies) to enter into business as well as reducing prices because of risk reduction.
The maturity of an EBRD loan depends on the life of the asset being financed, and the finance market in the particular country. The grace period usually corresponds to the time needed for project implementation. Loan margins are based on client credit risk, market pricing and project risk.

**Technical Co-operation**

The Bank also assists with co-financing of investments under EU Structural Funds and mobilising Technical Cooperation grant funds for the development of public transport projects and sector restructuring. However, a condition for technical co-operation is that the project must be commercially viable and support transition. The EBRD does not finance general transport studies that are not directly linked to its own involvement in a project.

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Some examples of EBRD Public Transport

Belgrade
An EBRD loan of € 20 million was arranged for the City of Belgrade in 2001. The loan was used for the purchase of 109 buses, bus maintenance equipment and the refurbishment of bus workshops. Improvement of the tram infrastructure (tracks and power supply) was also part of the project. An additional € 15 million was granted by the Japanese and Swiss governments. Consultants, financed through EBRD donor funds, assisted the city with preparing a Priority Investment Programme and the procurement of goods to be purchased. They also provided advice on restructuring the municipal transport company “GSP Belgrade”. Furthermore, the city was provided with assistance to develop a regulatory and institutional framework for public transport. Since 1 January 2003, the City has established a Transport Authority that co-ordinates and regulates public and private operators in Belgrade. Finally, a Credit Enhancement Project for the City of Belgrade was set up.

Sofia
In 2002, the EBRD signed a loan agreement with the City of Sofia for the purchase of new buses and trolleybuses and the refurbishment of trams. The loan amount is € 35 million. In addition, a € 2.5 million grant was received from the Dutch government for a new ticketing system. Consultants provided the city with advice on the privatisation of the main workshop for tram and bus. An Environmental Action Plan was developed for all eight depots of the transport company in order to reduce pollution and improve health and safety. The City is currently preparing an open international tender, for a concession to operate around 100-150 buses in Sofia, with assistance from consultants financed through EBRD Technical Co-operation funds.

Gdansk
In Gdansk, the EBRD is financing new buses, tram track renewal and refurbishment of trams (loan amount € 12 million). An extra € 1.5 million was made available by the European Commission to contract consultants for the restructuring of public transport in Gdansk. An important step will be the transformation of the transport company from a municipal budget entity into a limited liability company, accompanied by a Public Service Contract. A business plan for the new company is under preparation.

Corporate loans
Currently the EBRD is looking into the financing of projects in Tallinn, Vilnius, Kaunas, Krakow and Dubrovnik on the basis of corporate loans to the transport companies. The development of a Public Service Contract will be a condition for the loan financing.