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Report No.: **PAD1551**

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED LOAN

IN THE AMOUNT OF €25 MILLION

(US\$28.038 MILLION EQUIVALENT)

TO THE

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

FOR A

SECOND MUNICIPAL SERVICES IMPROVEMENT PROJECT

NOVEMBER 19, 2015

Social, Urban, Rural & Resilience Global Practice
Europe And Central Asia

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CURRENCY EQUIVALENTS
(Exchange Rate Effective as of September 30, 2015)
Currency Unit = Macedonian denar (MKD)
€1 = US\$1.12 = MKD54.92

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

CPS	Country Partnership Strategy
CSE	Communal Service Enterprise
DA	Designated Account
DWP	Danube Water Program
EA	Environmental Assessment
EAMF	Environmental Assessment Management Framework
EIA	Environmental Impact Assessment
EMP	Environmental Management Plan
EU	European Union
FM	Financial Management
FYR	Former Yugoslav Republic
GRS	Grievance Redress Service
IFR	Interim Un-audited Financial Report
IPA	Instrument Pre-accession
LARPF	Land Acquisition and Resettlement Policy Framework
M&E	Monitoring and Evaluation
MBDP	Macedonian Bank for Development Promotion
MOF	Ministry of Finance
MSIP	Municipal Services Improvement Project
MSIP2	Second Municipal Services Improvement Project
NBRM	National Bank of Republic of Macedonia
O&M	Operation and Maintenance
PAD	Project Appraisal Document
PCC	Project Coordination Committee
PDO	Project Development Objective
PMU	Project Management Unit
POM	Project Operational Manual
RPF	Resettlement Policy Framework
TA	Technical Assistance
UPP	Urban Partnership Program

Regional Vice President:	Cyril E. Muller
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PAD DATA SHEET

Macedonia, former Yugoslav Republic of

Second Municipal Services Improvement Project (P154464)

PROJECT APPRAISAL DOCUMENT

EUROPE AND CENTRAL ASIA

GSU09

Report No.: PAD1551

Basic Information			
Project ID P154464	EA Category B - Partial Assessment	Team Leader(s) Toshiaki Keicho	
Lending Instrument Investment Project Financing	Fragile and/or Capacity Constraints []		
	Financial Intermediaries []		
	Series of Projects []		
Project Implementation Start Date 01-Apr-2016	Project Implementation End Date 30-Sep-2020		
Expected Effectiveness Date 31-Mar-2016	Expected Closing Date 31-Mar-2021		
Joint IFC No			
Practice Manager/Manager David N. Sislen	Senior Global Practice Director Ede Jorge Ijjasz-Vasquez	Country Director Ellen A. Goldstein	Regional Vice President Cyril E Muller
Borrower: Former Yugoslav Republic of Macedonia			
Responsible Agency: Ministry of Finance			
Contact: Suzana Peneva		Title: State Advisor	
Telephone No.: 389 3 255 373		Email: suzana.stoimceva@finance.gov.mk	
Project Financing Data(in US\$, millions)			
[X] Loan	[] IDA Grant	[] Guarantee	
[] Credit	[] Grant	[] Other	
Total Project Cost:	28.04	Total Bank Financing:	28.04
Financing Gap:	0.00		
Financing Source		Amount	
Borrower		0.00	

International Bank for Reconstruction and Development	28.04
Total	28.04

Expected Disbursements (in US\$, millions)

Fiscal Year	2016	2017	2018	2019	2020	2021	0000	0000	0000	0000
Annual	0.30	2.50	6.00	8.00	7.67	3.57	0.00	0.00	0.00	0.00
Cumulative	0.30	2.80	8.80	16.80	24.47	28.04	0.00	0.00	0.00	0.00

Institutional Data

Practice Area (Lead)

Social, Urban, Rural & Resilience Global Practice

Contributing Practice Areas

Water

Cross Cutting Topics

- ☐ Climate Change
- ☐ Fragile, Conflict & Violence
- ☐ Gender
- ☐ Jobs
- ☐ Public Private Partnership

Sectors / Climate Change

Sector (Maximum 5 and total % must equal 100)

Major Sector	Sector	%	Adaptation Co-benefits %	Mitigation Co-benefits %
Transportation	Urban Transport	30		
Water, sanitation and flood protection	General water, sanitation and flood protection sector	20		
Water, sanitation and flood protection	Solid waste management	15		
Energy and mining	Energy efficiency in Heat and Power	15		
Public Administration, Law, and Justice	Sub-national government administration	20		
Total		100		

☒ I certify that there is no Adaptation and Mitigation Climate Change Co-benefits information applicable to this project.

Themes

Theme (Maximum 5 and total % must equal 100)

Major theme	Theme	%
Urban development	City-wide Infrastructure and Service Delivery	60
Urban development	Municipal finance	25
Urban development	Municipal governance and institution building	15
Total		100

Proposed Development Objective(s)		
The proposed development objective of the Second Municipal Services Improvement Project (MSIP2) is to improve transparency, financial sustainability, and inclusive delivery of targeted municipal services in the participating municipalities.		
Components		
Component Name	Cost (US\$, millions)	
Municipal Investment Subloans	20.76	
Poverty and Social Inclusion Investment Grants	5.53	
Project Management, Monitoring and Evaluation, and Capacity Building	1.68	
Systematic Operations Risk-Rating Tool (SORT)		
Risk Category	Rating	
1. Political and Governance	Moderate	
2. Macroeconomic	Moderate	
3. Sector Strategies and Policies	Low	
4. Technical Design of Project or Program	Low	
5. Institutional Capacity for Implementation and Sustainability	Moderate	
6. Fiduciary	Moderate	
7. Environment and Social	Low	
8. Stakeholders	Low	
9. Other		
OVERALL	Moderate	
Compliance		
Policy		
Does the project depart from the CAS in content or in other significant respects?	Yes []	No [X]
Does the project require any waivers of Bank policies?	Yes []	No [X]
Have these been approved by Bank management?	Yes []	No [X]
Is approval for any policy waiver sought from the Board?	Yes []	No [X]
Does the project meet the Regional criteria for readiness for implementation?	Yes [X]	No []
Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	X	
Natural Habitats OP/BP 4.04		X
Forests OP/BP 4.36		X
Pest Management OP 4.09		X
Physical Cultural Resources OP/BP 4.11		X
Indigenous Peoples OP/BP 4.10		X
Involuntary Resettlement OP/BP 4.12	X	
Safety of Dams OP/BP 4.37		X
Projects on International Waterways OP/BP 7.50	X	
Projects in Disputed Areas OP/BP 7.60		X
Legal Covenants		

Name	Recurrent	Due Date	Frequency
Project Management Unit (PMU) maintenance	X		CONTINUOUS
Description of Covenant			
Throughout the duration of the project, the borrower shall maintain the PMU with a composition, adequate staff and resources, and functions and responsibilities (including the responsibility to manage, coordinate, monitor, and evaluate the implementation of the project) satisfactory to the Bank.			
Name	Recurrent	Due Date	Frequency
Project carried out in accordance with the Project Operational Manual (POM)	X		CONTINUOUS
Description of Covenant			
The borrower shall carry out the project in accordance with the POM and shall not amend, suspend, abrogate, repeal, or waive any provision of said manual without the prior approval of the Bank.			
Name	Recurrent	Due Date	Frequency
Subprojects in line with POM, Procurement & Anti-Corruption Guidelines, Environmental Assessment Management Framework (EAMF), Resettlement Policy Framework (RPF)	X		CONTINUOUS
Description of Covenant			
Subprojects under Components A and B of the project shall be selected, appraised, implemented, and evaluated in accordance with the principles, procedures, and requirements set forth in the POM, the Procurement and Consultants Guidelines, the Anti-Corruption Guidelines, the EAMF, and the RPF.			
Name	Recurrent	Due Date	Frequency
Subloan and Grant Agreements on terms and conditions satisfactory to the Bank	X		CONTINUOUS
Description of Covenant			
Upon approval of any given subproject, the borrower shall provide each subloan or grant (as the case may be) to the selected participating municipality pursuant to an agreement (the Subloan Agreement of the Grant Agreement, as the case may be) to be entered into between the borrower and the said Participating Municipalities on terms and conditions satisfactory to the Bank.			
Name	Recurrent	Due Date	Frequency
Annual Audit Report	X		Yearly
Description of Covenant			
The borrower shall have its financial statements audited and each audit of the financial statements shall cover the period of one fiscal year of the borrower. The audited financial statements for each such period shall be furnished to the Bank not later than six months after the end of such period.			
Name	Recurrent	Due Date	Frequency
Interim unaudited financial reports (IFRs) prepared and furnished to the Bank	X		Quarterly
Description of Covenant			
The borrower shall prepare and furnish to the Bank not later than 45 days after the end of each calendar quarter, IFRs for the project covering the quarter, in form and substance satisfactory to the Bank.			

Conditions					
Source Of Fund		Name		Type	
IBRD		POM adopted		Effectiveness	
Description of Condition					
Borrower adopts the POM satisfactory to the Bank					
Team Composition					
Bank Staff					
Name	Role	Title	Specialization	Unit	
Toshiaki Keicho	Team Leader (ADM Responsible)	Senior Urban Development Specialist	Urban Development	GSURR	
Antonia G. Viyachka	Procurement Specialist	Procurement Specialist	Procurement	GGODR	
Anneliese Viorela Voinea	Financial Management Specialist	Financial Management Analyst	Financial Management	GGODR	
Antonio Cristian D'Amelj	Team Member	Senior Counsel	Legal	LEGLE	
Bekim Imeri	Safeguards Specialist	Senior Social Development Specialist	Social Development	GSURR	
Cesar Niculescu	Safeguards Specialist	Environmental Specialist	Environment	GENDR	
Delphine Alberta Hamilton	Team Member	Senior Program Assistant	Senior Program Assistant	GSURR	
Jasna Mestnik	Team Member	Finance Officer	Finance	WFALA	
Kirsten Hommann	Team Member	Senior Economist	Economist	GSURR	
Luan Aliu	Team Member	Program Assistant	Program Assistant	ECCMK	
Noriko Oe	Team Member	Urban Specialist	Municipal Finance	GSURR	
Rama Krishnan Venkateswaran	Team Member	Lead Financial Management Specialist	Municipal Finance	GGODR	
Stjepan Gabric	Team Member	Senior Water Supply and Sanitation Specialist	Water Supply and Sanitation	GWADR	
Tatyana Shadrunkova	Team Member	Senior Operations Officer	Operations	GSURR	
Extended Team					
Name	Title	Office Phone		Location	
—	—	—		—	
Locations					
Country	First Administrative Division	Location	Planned	Actual	Comments
Macedonia,	—	Countrywide	—	—	—

FYR					
Consultants (Will be disclosed in the Monthly Operational Summary)					
Consultants Required? Consulting services to be determined					

I. STRATEGIC CONTEXT

A. Country Context

1. **The former Yugoslav Republic of Macedonia (FYR Macedonia) is a small, landlocked country in southeast Europe with a strong track record of macroeconomic stability.** The country has made impressive progress in steadily recovering from the economic, political, and social fallout from the 2001 ethnic conflict and obtained European Union (EU) candidate status in 2005. Economic growth has been above the regional average since 2009. The country has also been able to preserve macroeconomic stability during the global economic crisis. Between 2002 and 2009, the country grew at 3.7 percent annually, although after 2009, the average gross domestic product growth rate decreased to 2.3 percent per year. In 2014, the economy grew by 3.5 percent and the country reached the highest growth among the six southeast European countries. Since 1995, the Macedonian currency has been pegged to the euro and this has successfully supported price stability and maintained the inflation rate at 2.4 percent over the last decade. Macroeconomic policies have been geared toward keeping the external balance manageable, and monetary policy has responded quickly to any possible threats to the exchange rate.

2. **Economic growth in the country, however, has not yet translated into significant poverty reduction or improved welfare of the poorest 40 percent of the population.** While average consumption growth increased by 1.1 percent between 2003 and 2008, consumption growth of the bottom 40 percent of the population decreased by 1.5 percent annually during the same period. Although not comparable to the consumption-based data before 2008, most recent income-based data for 2010 and 2011 show a similar pattern: a slight decline in overall income, more pronounced for the bottom 40 percent of the population. Since the outbreak of the crisis, the country managed to decrease unemployment from 32.4 percent in 2009 to 28.6 percent in 2013, though unemployment remains high at around 27.6 percent of the labor force in 2014—that is significantly above the EU-28 average of 10.2 percent—and productivity and wages are low. High unemployment is a critical feature of the story, with poor labor market outcomes disproportionately affecting the bottom 40 percent of the population, many of whom are less educated. In addition, gender inequality remains, and female labor force participation (for women aged 15–64 years) is still low at 51 percent, well below the regional average of 62 percent. Sustaining the recent employment creation momentum and translating economic growth into jobs and income will help reduce poverty and improve the standard of living of all Macedonians.

3. **According to official statistics, poverty in the country decreased from 26.8 percent in 2011 to 24.2 percent in 2013, but the country still shows a high income inequality (with a Gini equal to 37) compared to its Western Balkan peers.**¹ Households among the bottom 40 percent of the population tend to have more children, live in more rural settings, and have lower access to public services. Although, for example, access to piped water and a sewer network is generally high with an average of 92 and 70 percent, respectively, the difference between the highest and lowest wealth quintiles is significant: 99 percent of the richer population has access

¹ State Statistical Office (2014), Standard of Living, http://www.stat.gov.mk/OblastOpsto_en.aspx?id=13, quoted in: World Bank (2015), FYR Macedonia: Measuring Welfare using the Survey of Income and Living Conditions.

to piped water versus 76 percent of the poorest quintile. This gap is even wider for access to public sewer systems, where 98 percent of the highest wealth quintile has access versus only 19 percent of the lowest wealth quintile.² Similar to other Western Balkan countries, the Roma population are among the poorest and least integrated with respect to formal public services. At the settlement level and compared to their non-Roma neighbors, Roma fair worse on various socioeconomic indicators, including access to water (87 versus 96 percent of non-Roma), toilets (61 versus 89 percent), and primary (74 versus 90 percent) and secondary education (27 versus 65 percent).³

B. Situations of Urgent Need of Assistance or Capacity Constraints (if applicable)

4. Not applicable.

C. Sectoral and Institutional Context

5. **Improving the living standards of the population requires more effective and efficient public service delivery.** Given the unfolding decentralization process that was launched in 2005 and brought delivery of many of the basic public services to the municipal level, better-performing municipalities are crucial to delivering this ambitious agenda. The number of municipalities was consolidated from 123 to 85 in 2005 and then further reduced to 81 in 2013 due to the changes in the Law on Territorial Organization. The changes led to the creation of larger municipalities with more rural areas included under their jurisdiction. In 2007, the municipalities that cleared their arrears entered into the second phase of the decentralization process—that is, fiscal decentralization to undertake new responsibilities such as managing primary and secondary education, some social services, and cultural institutions and firefighting. In parallel, municipalities started receiving block grants to implement these new functions and then progressively assumed responsibilities for maintenance and improvement of municipal infrastructure such as water supply and wastewater treatment systems, solid waste management, local roads, street lighting, preschool, primary and secondary schools, and local cultural institutions. Since 2011, municipalities also acquired responsibilities for managing state land. To date, municipalities provide key public services and infrastructure for their citizens and local businesses. Local authorities also influence, shape, and maintain stable interethnic relations at the level closest to citizens.

6. **Municipal governments control over 7 percent of public spending at the moment.** During the decentralization process, regulations for local borrowing were established, and municipalities may now borrow for capital investments. From 2009 to 2013, the share of own source of municipal revenues increased from 26 percent to 35 percent. Property tax collection increased by almost five times, though its share of overall revenues is yet modest. The biggest increase of own source of revenues comes from land development fees, lighting fees, and other charges for the use of public space. The long delayed process of transferring state-owned urban land to local governments has also begun to yield income from asset sales.

² United Nations Children's Fund. 2012. "Multiple Indicator Cluster Survey Macedonia."

³ United Nations Development Programme, World Bank, and European Commission. 2011. "Roma Settlement Survey."

7. **While municipal revenue has increased rapidly overall, this has not translated into higher levels of capital investments at the local level.** Average municipal capital investments in the country were 1.4 percent of gross domestic product between 2008 and 2012, which was lower than comparative statistics from the EU-27 and new EU member states. It is also lower than most other countries in the region, except Albania and Bosnia and Herzegovina. Furthermore, communal services have suffered from delayed maintenance, rigid price control, and poor financial management (FM). This leads to a vicious cycle of deteriorating assets and lack of funding for new investments.

8. **Most local public services such as water supply and sanitation, solid waste management, and urban transit are provided by Communal Services Enterprises (CSEs) owned by municipalities.** Although the CSEs are legally independent from their municipal owners, most of them do not work as independent, commercially oriented utilities in practice. The CSEs usually operate based on informal arrangements with municipalities, for example, using infrastructure owned by municipalities or the state to provide services, and proposing tariffs approved by the municipalities. In addition to the municipality being the owner, policymaker, and regulator, it is also a major user of CSE services through its own institutions, which lowers the CSEs' accountability to the average customer. To reduce the burden on municipal budgets and free up resources to increase investments, operational and FM performances of the CSEs need to be improved. Reforms in the water sector are currently being advanced, partly supported by the Danube Water Program (DWP), and include regulatory benchmarking of CSE performance and a review of the level and tariff-setting policies for water and wastewater.

9. **In its program for 2011 to 2015, the government underscored the importance of investments in urban infrastructure and municipal services to support economic growth and employment.** The government program lays increasing emphasis on balanced economic growth across municipalities and regions to help create equal opportunities and facilitate economic integration by improving their municipal infrastructure. The crisis in the euro area puts additional exigency on the government goal of improving infrastructure as the basis for accelerated economic growth and development. The ongoing Bank-financed Municipal Services Improvement Project (MSIP, P096481) is one of the government's instruments to provide access to investment funds to municipalities that cannot yet afford to borrow from other sources. The proposed Second Municipal Services Improvement Project (MSIP2) will actually present the second phase of the MSIP with an aim to respond to the continuing strong demand by the municipalities for local infrastructure finance.

D. Higher Level Objectives to which the Project Contributes

10. **MSIP2 is aligned with the World Bank's engagement in the country and builds on the Bank's continuing dialogue and partnership with the Macedonian government.** Enhanced access to basic and municipal services is one of the key outcomes of the Country Partnership Strategy (CPS) for the country for the period FY2015–2018. By facilitating improvements in transparency, financial sustainability, and delivery of targeted municipal services, MSIP2 will contribute to the two interrelated themes outlined in the CPS: (a) growth and competitiveness and (b) skills development and inclusion. MSIP2 will also benefit from the successful experience and lessons learned under the ongoing MSIP activities. Furthermore, the

CPS suggests that the Bank will apply a social filter to its entire pipeline to help task teams in the country address obstacles that limit poverty reduction and shared prosperity for specific groups (women, minorities, in particular Roma, and so on.) and to design activities and policy reforms that promote a more inclusive and cohesive society. Given the existing service access inequality, MSIP2 envisages improving municipal services in poorer and marginalized communities through its grant component and motivating more pro-poor public spending on infrastructure.

II. PROJECT DEVELOPMENT OBJECTIVES

A. PDO

11. The Project Development Objective (PDO) of MSIP2 is to improve transparency, financial sustainability, and inclusive delivery of targeted municipal services in the participating municipalities.

12. The project aims to achieve this objective by enabling investments in municipal services and infrastructure and in support of institutions responsible for delivering these services, such as municipalities and their CSEs.

Project Beneficiaries

13. **Since MSIP2 will improve delivery of municipal services in the participating municipalities, its primary beneficiaries will be local communities—that is, citizens of the participating municipalities.** Through its Poverty and Social Inclusion Investment Grant component, MSIP2 will support pro-poor investments in marginalized neighborhoods and will therefore directly benefit poorer households in need of better public services. Institutional beneficiaries include not only staff in the participating municipal administrations but also the CSEs and other service agents. Both private contractors and laborers will benefit indirectly from the construction and works contracts.

PDO Level Results Indicators

14. The MSIP2 PDO-level results will be measured through the following indicators:

- (a) Number of direct project beneficiaries, with breakdown on percentage of female beneficiaries and percentage of vulnerable/marginalized people who benefit from the project intervention (with marginalized measured as the number of unemployed, social assistance receiving, or in other ways vulnerable population)
- (b) Number of participating municipalities (that is, municipalities which signed subloan agreements) that regularly publish subproject progress information on their official websites or elsewhere—this indicator also is a citizen engagement indicator
- (c) Percentage of completed subprojects that generated improved financial performance, including through increased revenue earnings or cost savings
- (d) Number of completed subprojects that focus on social inclusion

15. Intermediate results indicators will be as follows:

- Number of subloans signed
- Number of poverty/social inclusion investment grants signed
- Number of subprojects, financed by subloans or grants, successfully completed
- Number of jobs generated, measured as the number of employees of contractors and engineering companies that perform works under the subprojects
- Number of visits to websites that publish subproject progress information
- Number of participants in consultation activities during subprojects preparation, with breakdown on number of female (citizens engagement indicator, gender informative)
- Number of piped household water connections that are benefiting from rehabilitation works undertaken under the project (core sector indicator)
- Kilometers of rural roads rehabilitated (core sector indicator)
- Kilometers of nonrural roads rehabilitated (core sector indicator)

16. **MSIP2 will also contribute to the selected Bank Group's core indicators related to specific sectors, citizen engagement, and social inclusion.** Gender-disaggregated statistics, where applicable, will be monitored. Selected core sector indicators will track progress of outputs generated under the municipal investments. Three core sector indicators—number of piped household water connections that are benefiting from rehabilitation works undertaken by the project, kilometers of rural and nonrural roads rehabilitated—are included in the list of intermediate results indicators. In addition, information on core sector indicators, such as number of people in urban areas with access to regular solid waste collection under the project, number of people in urban areas provided with access to all-season roads within a 500 m range, and so on, will be tracked. Number of consulted persons is set up ex-ante as an indicator to measure citizen engagement aspects of the project. This will be further enhanced during implementation as per nature of the project design. In a subproject level, once the subproject is defined by the local governments, indicators elaborating proposed feedback mechanisms will be established and later reported aggregately. Because the project finances demand-driven multi-sector local government investments, the feedback mechanism set at a subproject level will be appropriate both to size of local government and the sector of the investments and this will be set up ex-ante.

III. PROJECT DESCRIPTION

17. **MSIP2 represents the second phase of the MSIP (P096481)⁴ and a response to the continuing strong demand by municipalities for local infrastructure financing.** Given the persistent need for improving municipal infrastructure and based on the positive experience of MSIP implementation, the government requested the Bank for a new project or additional financing for the MSIP in the amount of €25 million, now that all funds under the MSIP have been committed. Since the MSIP had two additional financings already, including the recently

⁴ The original IBRD loan for the MSIP (approved on March 26, 2009) was in the amount of US\$25 million equivalent. It was followed by an additional financing loan of US\$50 million equivalent approved by the Board on May 10, 2012. More recently, a new component introducing the EU IPA-financed Rural Investment Window of €15.5 million, Recipient Executed Trust Fund, was added on December 22, 2014, to provide grants for priority rural infrastructure investments in eligible municipalities through the existing MSIP implementation mechanism.

approved Instrument Pre-accession (IPA) window, it was decided to proceed with the preparation of a new operation. The new project was also considered as a good opportunity to take stock of the implementation experience under the MSIP and bring in the needed adjustments, if any. As such, MSIP2 will be built upon the experience of the MSIP and its lessons learned to enhance the impact of a well-performing operation.

18. **MSIP2 will continue to focus on improving the transparency, financial performance, and delivery of services under the responsibility of participating municipalities and their CSEs, such as water supply, sewerage, solid waste management, energy efficiency improvements of municipal buildings, local roads, and other services delivered by municipalities.** As is the case with the MSIP, MSIP2 will continue to provide subloans to municipalities for infrastructure investments of high priority and clear impacts on welfare or efficiency. In addition, MSIP2 aims to enhance inclusive service delivery by targeting poorer and marginalized communities for infrastructure improvements through the newly introduced grant component.

19. **The project adopted implementation arrangements and mechanisms that proved to be effective under the MSIP, with some adjustments introduced based on the lessons learned during implementation.** In particular, MSIP2 will continue to support affordable finance to municipalities (subloans)—a demand-driven process with participating municipalities selecting priority investments—and technical assistance (TA) to municipalities throughout the subproject cycle, to help them become more transparent and accountable institutions.

20. **The project will benefit from the policy and analytical work carried out under the DWP and the capacity-building and knowledge activities provided by the Urban Partnership Program (UPP), both funded by Austria.** The DWP is a Bank-managed regional TA program to support water sector reforms and has been providing TA at the policy and utility levels throughout the region since 2013, including the Western Balkans. Among other things, the program has contributed to the improvement of utility benchmarking practices and the implementation of asset management and good practices in addressing nonrevenue water in several utility companies. The DWP has provided training to ministerial staff on topics ranging from utility regulation to EU accession and has ensured the participation of numerous Macedonian stakeholders in regional knowledge exchanges on water and sanitation service policies and practices. Similarly, the Bank is managing the UPP to improve local government capacity in Southeastern Europe, focusing on key areas such as municipal finance, urban planning and land management, and social accountability. Several municipalities in the country have already benefited from the UPP through innovative capacity-building tools like training in support of ‘municipal finance self-assessments’ and the carrying out of ‘urban audits’. As the DWP and UPP activities are expected to continue and intensify in the coming years, the project will benefit from ensuring close coordination with these programs.

A. Project Components

21. MSIP2 will consist of the following components:

22. **Component A: Municipal Investment Subloans (€18.5 million).** This component will provide subloans to municipalities for investments in municipal infrastructure, including

revenue-generating/cost-saving municipal infrastructure investments and other projects of high priority for the municipalities.

23. With a view to ensure a smooth start of MSIP2 implementation and to accelerate disbursement of the project funds, the Project Management Unit (PMU) has identified the initial pipeline of two potential subprojects to be financed under Component A of MSIP2 in the municipalities of Gazi Baba (water supply) and Kisela Voda (storm water drainage). Technical designs of these subprojects along with the respective safeguards documents such as site-specific Environmental Management Plans (EMPs) have been developed and reviewed by the Bank.

24. **Component B: Poverty and Social Inclusion Investment Grants (€4.9 million).** This component will provide investment grants to municipalities as an incentive for them to invest in infrastructure improvements in poorer and marginalized communities within their jurisdictions.

25. This component is specifically designed to target poorer and marginalized communities for municipal infrastructure improvements. Such communities will be identified by geographic targeting of neighborhoods within participating municipalities. Based on discussions with stakeholders at the municipal level, it has been concluded that the municipalities themselves are in the best position to identify such a target community in lieu of reliable official community-level statistics. Community-level service coverage data on paved roads, drainage, piped water, public sewers, and kindergartens could serve as a determinant of a neighborhood's poverty status. A more precise set of proxies and the guidelines for targeting procedures will be included in the Project Operational Manual (POM).

26. **Component C: Project Management, Monitoring and Evaluation, and Capacity Building (€1.5 million).** This component supports operational costs of the PMU, assists with project implementation and monitoring, and supports the relevant ministries and other agencies both at the national and municipal levels to strengthen institutional and financial systems and practices for sustainable municipal service delivery. Support provided under this component could include TA and capacity building for (a) capital investment planning, subproject preparation/implementation, and local capacity building for municipalities and the CSEs to improve service delivery; (b) strengthening municipal FM systems and practices; and (c) national-level institutional strengthening.

B. Project Financing

27. **MSIP2 will be a five-year investment operation with a total cost of €25.0 million, provided as an International Bank for Restructuring and Development (IBRD) loan.** The borrower will be represented by the Ministry of Finance (MOF). The MOF will on-lend the funds to participating municipalities through subloan agreements (under Component A) or in the form of investment grants through grant agreements (under Component B). The subloans will be provided on the same terms as the Bank loan, but the grace period shall be up to three years and the last repayment date of each subloan shall not exceed the last date of repayment of the Bank loan. The MOF will assume the currency risk since the subloans and grants will be in local currency.

Project Cost and Financing

Project Components	Project cost	IBRD Financing	% Financing
Component A: Municipal Investment Subloans	€18,500,000	€18,500,000	100
Component B: Poverty and Social Inclusion Investment Grants	€4,937,500	€4,937,500	100
Component C: Project Management, Monitoring and Evaluation, and Capacity Building	€1,500,000	€1,500,000	100
Total Costs	€24,937,500	–	–
Total Project Costs	€24,937,500	–	–
Front-end Fees	€62,500	–	–
Total Financing Required	–	–	–

C. Series of Project Objective and Phases

28. Not applicable.

D. Lessons Learned and Reflected in the Project Design

29. **The design of MSIP2 is based on the experience of MSIP and lessons learned to enhance the impact of a well-performing project.** MSIP2 will continue to focus on improving the transparency, financial sustainability, and delivery of services under the responsibility of participating municipalities and their CSEs, such as water supply, sanitation, solid waste management, local roads and streets reconstruction, energy efficiency improvements of municipal buildings, and other municipal services. It will adopt the implementation arrangements and mechanisms that proved to be effective under the MSIP operations, with some adjustments introduced based on the MSIP experience and lessons learned. Furthermore, MSIP2 aims to enhance inclusive service delivery by targeting poorer and marginalized communities for infrastructure improvements and includes a specific grant component to provide incentives for municipalities to improve service delivery to poorer and marginalized communities. The positive aspects of MSIP experience, which the new project will adopt, include the provision of affordable finance to municipalities (subloans), in a demand-driven process, and TA to municipalities throughout the subproject cycle to support them to become more effective and transparent institutions. The lessons learned include the need to improve construction supervision and quality of technical documentation prepared by the municipalities. There is also a need to improve the rigor in the financial and economic analysis to appraise subprojects, by adopting more standardized approaches in investment appraisals, as is outlined in the MSIP2 POM.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

30. **PMU.** The implementation arrangements of MSIP2 will follow the implementation mechanisms of the existing MSIP operation to capitalize on the already established and well-functioning PMU at the MOF.

31. In particular, the PMU will be responsible for project implementation, according to the requirements of the borrower and the Bank, and will have full responsibility for project FM, supervision of subproject implementation, and monitoring and evaluation (M&E). The PMU will promote the project among municipalities and will receive and appraise proposals for subprojects

according to criteria agreed with the Bank and recorded in the POM. The POM will specify project procedures for participating municipalities and the PMU and refer to the Bank project documents, including Procurement Guidelines and the Loan Agreement. The Bank will review all the subproject Project Appraisal Documents (PADs). The PMU will then be responsible for finalizing subloan and grant agreements between the MOF and the participating municipality. Due to the lack of capacity and knowledge of the Bank procurement procedures at the municipal level, the PMU will be responsible for quality assurance and supporting municipalities throughout the subproject procurement process. The PMU will liaise closely with the Bank on all fiduciary and safeguard issues and on adhering to the Legal Agreements. The PMU will also operate with a roster of consultants for specific expertise, whenever needed.

32. While the existing PMU has a proven track record of preparation and implementation of the MSIP, adding a new project will significantly increase the PMU's workload since the PMU is expected to play an important role in reviewing and assisting in improving technical designs prepared by the project participating municipalities. The PMU will also need to provide extensive implementation support for the municipalities during tendering processes and subproject implementation. To this end, PMU capacity was carefully assessed to ensure that it has sufficient manpower for executing its functions under MSIP2 with respective staffing plan developed and agreed with the Bank and the MOF.

33. As mentioned earlier, MSIP2 will also use the TA under Component C to support the establishment of a more sustainable and institutionalized financing mechanism for municipal infrastructure development, going beyond the current project-based PMU approach. One of the options currently being considered by the MOF is that the municipal infrastructure financing mechanism could be transferred to the government-owned Macedonian Bank for Development Promotion (MBDP) in the future. Through its TA component, MSIP2 is prepared to facilitate a transition to the MBDP if this option is chosen by the government, or the TA will provide support in identifying alternative options to ensure sustainability of the municipal finance instrument.

34. **Participating municipalities.** Municipalities, as the sub-borrowers from the MOF, will be responsible for preparing and supervising the subprojects with PMU support. Contracts will be signed by authorized municipal representatives and selected contractors. Details of procurement procedures and related responsibilities will be elaborated in the POM. Municipalities will prepare disbursement applications and forward them with the supporting documents to the PMU for final verification, recording in the project FM system, processing within the Treasury, and forwarding to the Bank. The PMU will ensure process quality control and will conduct periodic and random checks on participating municipalities. Training and support will be provided to participating local governments during subproject preparation and implementation.

35. **Project Coordination Committee (PCC).** The borrower will ensure that the inter-ministerial PCC that was set up for the ongoing MSIP will continue to function for MSIP2 in a composition and manner satisfactory to the Bank. The PCC will comprise representatives of central ministries and agencies involved, as needed, and will provide a forum for information sharing and providing advice to the PMU on project management. The committee's main responsibilities are to ensure good inter-agency communications about project objectives, rules,

and implementation progress; to advise the PMU on sectoral or inter-ministerial issues that may affect project-funded activities, such as those pertaining to water and sanitation policies and investments; and to reinforce transparency in the selection of municipalities and subprojects. The MOF will chair the committee.

B. Results Monitoring and Evaluation

36. **The PMU will be responsible for monitoring and evaluating project progress and outcomes and for reporting and discussing these with the Bank.** The PMU will collect and monitor key performance indicators agreed in the POM on the municipalities' technical, financial, and economic situation before and during project implementation, conduct analyses using selected data, and monitor progress in preparing and implementing subproject investment programs. The M&E of project progress against plans will be reflected in the semiannual progress reports prepared by the PMU and provided to the Bank. The progress report should include FM reports and updates of the procurement plans; narrate progress against plans, highlight issues, and propose solutions; and include a section on monitoring indicators and evaluation of outcomes and results that could be discerned at the time of the report and provide results of stakeholder workshops and surveys. The reports will also outline any corrective actions needed to sustain or improve project implementation progress. Details of performance indicators, target values, data collection, and reporting methods are presented in Annex 1: Results Framework and Monitoring. In addition, the PMU will track progress in each sector with respect to kilometers of urban roads rehabilitated or constructed, number of households newly connected to piped water or the sewage system, and others, as outlined in the POM.

37. **The Bank will provide close supervision and implementation support to the project to monitor and evaluate its results and achievement of PDO and recommend timely actions, whenever needed, to ensure successful completion of the project-supported activities.** The Bank will carry out regular implementation support missions throughout the implementation period and an in-depth midterm review after a few years of implementation. A detailed Implementation Support Plan is outlined in annex 4.

C. Sustainability

38. The project is designed to assist the government to continue strengthening municipal services operations to ensure sustainable service delivery to citizens. At the municipal level, the project promotes responsible local borrowing for investments, accountability to citizens and consumers by encouraging local voice and transparency, and creating more sustainable financial and supervisory relationships between local governments and the CSEs. The project builds on the strong disciplinary role imposed by the central government in its oversight of municipal borrowing. The project-funded infrastructure improvements are expected to be financially sustainable and are expected to enhance welfare or efficiency. In the present institutional circumstances of communal services, municipalities have the ultimate financial responsibility for the CSEs and will be responsible for loan repayment.

39. Furthermore, during project preparation, financial analysis was undertaken for a sample of municipalities to assess the financial capacity of borrowing municipalities to service the subloan and to finance operation and maintenance (O&M) costs to run infrastructure assets

financed under the ongoing MSIP. For MSIP2 preparation, the analysis was limited to a sample of 10 municipalities out of the total 42 that borrowed from the MSIP and was based on their core budget data for 2011–2013 recorded in cash accounting. The core budget data were further supplemented by the accounts payable and receivable data for the same period. The findings of the analysis indicated the existence of residual risk for the MSIP subloans to become unsustainable particularly for financially weak municipalities, despite the controlled loan size in accordance with the Law on Self-Financing of Local Governments as well as responsible loan repayment budgeting practices that were observed during the data collection. To enhance the sustainability of the subloans, the MOF and PMU will adopt a more robust financial appraisal process by conducting a more comprehensive financial analysis than the operating revenue analysis and the basic compliance check of loan size to the Law on Self-Financing of Local Governments under the ongoing MSIP operations. Once any default risk is identified through the financial analysis, capacity-development activities to mitigate the risk will be conducted under Component C of MSIP2 for the municipalities at risk. See also Section A: Economic and Financial Analysis under VI. Appraisal Summary for more details.

40. The enhanced subloan sustainability assessment and capacity-development activities to improve the sustainability of municipal infrastructure financing under MSIP2 will also contribute to the medium-term vision of the MOF to establish a more sustainable and institutionalized financing mechanism for municipal infrastructure development. The MOF informed the Bank of its plans to transfer the municipal infrastructure financing mechanism to the government-owned MBDP in the future, while the MBDP's current role is to provide finances to small and medium enterprises and export-oriented companies. An option of creating a new institution such as a municipal development fund has been referred as too excessive for a relatively small country. Through Component C, MSIP2 will support a transition to the MBDP or identify alternative options to ensure sustainability of the municipal financing instrument.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

Table 1. SORT Summary Table

Risk Category	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Low
4. Technical Design of Project or Program	Low
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Moderate
7. Environment and Social	Low
8. Stakeholders	Low
9. Other	n.a.
OVERALL	Moderate

41. **The overall risk rating of MSIP2 is assessed as Moderate.** The main risks are associated with the limited institutional capacity of some participating municipalities. Given the volatile political situation in the country in 2015, political and governance risks cannot be overlooked.

42. **Institutional capacity risks.** The institutional capacity of participating municipalities to select and prepare subprojects and to ensure O&M of investments, with due care for adequate fiduciary arrangements, varies across municipalities and the CSEs. The risk of lower capacity in some of the participating municipalities will be mitigated by a well-performing and fully staffed PMU that has gained experience in providing support to municipalities during the ongoing MSIP operation and has been highly effective to date. The enhanced internal controls framework and reporting and monitoring mechanisms with respect to the higher risk subloans and grant components will follow the model implemented under the MSIP to be formalized in the MSIP2 POM, and their application in practice will continue to be regularly reviewed by the Bank and project auditors. However, it will be important to ensure that the PMU has sufficient capacity to keep the existing quality of implementation support for the ongoing MSIP, including its new EU IPA rural investment window, and the preparation of the MSIP2 operation. In this regard, while the process of strengthening the PMU (hiring two more engineers, one procurement assistant, and one FM assistant) to enable the smooth launch of activities under the EU IPA window has already been started, the borrower confirmed that the PMU capacity will be further strengthened by employing additional staff to work on MSIP2 activities in accordance with the agreed staffing plan. Moreover, the PMU will build a pool of consultants to provide institutional support to municipalities under the guidance of the PMU director. TA funds under Component C will also be available to support municipalities in subproject preparation and implementation.

43. **Political and governance risks.** While the proposed project is based on strong interest and ownership by the government and genuine demands by municipalities, it is possible that priorities may change during the five years of the project implementation, along with possible changes in leadership and management in the government, not to mention the leadership in municipalities. Nevertheless, irrespective of the possible future government changes, huge demand for investments in local infrastructure and services means that the shift in government priorities in this area will be highly unlikely. The Bank will monitor the current political situation closely and coordinate with key donors and partners and will adjust the project processing and project scope if deemed necessary. In addition, the project will adopt objective rules and criteria, which will be clearly documented in the POM to minimize political interference in decision making. Furthermore, the risk will be partly mitigated by ensuring citizens' participation and stakeholder involvement in identifying and planning subprojects, especially for the grant component.

VI. APPRAISAL SUMMARY

A. Economic and Financial (if applicable) Analysis

44. **Economic analysis.** Since the project is demand based, an ex ante economic rate of return could not be estimated during appraisal. However, a review of 10 subprojects completed under the ongoing MSIP was carried out to inform the current state of the assets rehabilitated or created, the maintenance of these assets, the economic benefits, and the satisfaction of beneficiaries, as applicable. Among these ten subprojects, four subprojects financed the rehabilitation or construction of local roads, including one bridge; three subprojects supported the rehabilitation or construction of water supply systems; and the remaining subprojects aimed at increasing the thermal insulation in primary kindergartens, improving street lighting, enabling solid waste collection, and preventing flooding through construction of storm water drainage

systems. These 10 subprojects are representative of the 37 subprojects so far completed under the ongoing MSIP and the details are documented in the corresponding report⁵ filed with the project documents.

45. The review indicates that the assets financed are in good state, relevant, and used. It has been more difficult to ascertain whether the assets are well maintained since newly constructed roads, pipes, and drainage systems may appear to require lesser maintenance in the first few years. The net present value and internal rate of return computed for each subproject have been exceeded mostly during this post review, although further refinement of the economic analysis approach conducted for subprojects is needed and outlined in the MSIP2 POM, with the intent to strengthen the economic appraisal capacity under the future pipeline. The post review also hints at a general lack of documentation on how subprojects have been identified or prioritized and whether marginalized groups were the intended or actual target. More explicit criteria will be adopted and outlined in the POM to provide better guidelines for prioritizing and targeting subproject investments under MSIP2.

46. **Financial analysis.** As mentioned earlier, financial analysis was undertaken for a sample of municipalities to assess the financial capacity of borrowing municipalities to service the subloan and to finance O&M costs. The 10 sample municipalities were selected based on the following considerations: (a) previous borrowing record under either the MSIP original loan or MSIP additional financing; (b) minimum one sample municipality per region; and (c) multiple samples from the Skopje region (due to its unique municipal service delivery and governance structure that is in place) as well as the Northeast region in the light of its economic disadvantage compared to other regions. The analysis defined the Core Budget Operating Surplus (Operating Revenue – Operating Expenditure) after deducting net accounts payable as the financing envelope for the MSIP loan repayment. Based on the original MSIP loan and MSIP additional financing borrowing size and interest rate, the annual repayment obligation was estimated. Subsequently, the existence of sufficient margin for the sample municipalities to meet the MSIP loan repayment obligation was assessed by deducting the obligation from the financing envelope (Operating Surplus – Net Accounts Payable).

47. Nine out of ten sample municipalities recorded average operating surplus, indicating that O&M of municipal services recorded in the municipal core budget (for example, roads) could be financed from their operating revenue. On the other hand, six out of ten sample municipalities demonstrated only limited capability to repay their MSIP subloan. Despite their positive average operating surplus, with the exception of one municipality, substantial net accounts payable limited the financial margin to fully meet their loan repayment obligation. Six municipalities recorded negative balance after deducting the MSIP loan repayment obligation and net accounts payable from the operating surplus. Conversely, four larger and economically stronger sample municipalities recorded sufficient operating surplus on average to contribute to their capital investment needs after meeting the MSIP loan repayment and net accounts payable financing obligation.

48. These findings indicate that some residual risk seems to exist for the MSIP loans to become unsustainable particularly for financially weak municipalities. This is despite the

⁵ Review of subprojects financed under the MSIP, unpublished.

controlled loan size in accordance with the Law on Self-Financing of Local Governments as well as responsible loan repayment budgeting practices observed.⁶ To enhance the sustainability of the MSIP subloans, a more robust financial appraisal process was recommended to be adopted by the PMU and the MOF. Such a process would include comprehensive financial analysis which goes beyond the operating revenue analysis and the compliance check of loan size to the Law on Self-Financing of Local Governments. The MSIP2 POM will incorporate the new financial appraisal procedures of the subprojects.

B. Technical

49. Like the MSIP, MSIP2 is a demand-driven project, financing subprojects proposed by municipalities on a rolling basis. Subprojects to be financed by subloans under Component A or by grants under Component B need to meet the Bank's technical and other standards outlined in the POM. Majority of the subprojects are expected to finance municipal infrastructure such as road rehabilitation/construction, water supply and sanitation, and solid waste management, but subprojects could also include rehabilitation or limited construction of education facilities and energy efficiency improvements of municipal buildings, among others. Such subprojects have been implemented satisfactorily under the ongoing MSIP, and it is unlikely that they will pose any technical challenges.

50. Two subprojects for Component A have been identified and technical designs have been prepared by the municipalities of Kisela Voda and Gazi Baba. The PMU has pre-appraised these subprojects, and the Bank reviewed their designs and found them satisfactory. These are expected to be financed during the first year of project implementation.

C. Financial Management

51. **An assessment of the FM arrangements of the project has been carried out with regard to staffing, budgeting, accounting, internal controls, flow of funds, financial reporting, and external audit.** The assessment concluded that the FM arrangements are acceptable, subject that the FM section of the POM is completed with the procedures applicable to the new project before the loan effectiveness. The FM risk is assessed as Moderate after application of mitigation measures. The FM assessment has been updated during appraisal and then following negotiations to reflect the conclusions reached.

52. **The FM performance of the ongoing MSIP is Satisfactory.** As detailed in annex 3, there are no outstanding or unsatisfactory Interim Un-audited Financial Reports (IFRs) or audit reports under the current projects. **The new project will mirror the existing FM and disbursement arrangements under the MSIP.**

⁶ Law on Self-Financing of Local Governments enacted in 2012 limits the maximum amount of loan to be within 100 percent of current municipal operating revenue of the previous year. The maximum annual loan repayment is also not to exceed 30 percent of the current municipal operating revenue of the previous year. In the event of nonrepayment, the municipal share of value added tax will be intercepted by the MOF to offset the balance. Accordingly, the municipalities are required to present their operating revenue information in their borrowing request.

53. **The current FM project team, as recently extended for the implementation of the EU IPA-funded grant under the MSIP, is considered adequate and well familiarized with the Bank procedures.** Staffing capacity will be regularly assessed and may be supplemented during implementation in line with the project needs.

54. **The project will use the traditional disbursement mechanism, similar to the other two ongoing IBRD loans and recently effective EU IPA grant under the MSIP.** A new Designated Account (DA) in the loan currency (euro) in the National Bank, with a mirror Treasury account in local currency, will be opened for the new loan. Loan funds will be withdrawn to the respective DAs up to the account's ceiling (as defined in the Disbursement Letter of the project) by means of signed withdrawal applications and disbursed for eligible payments defined under the project.

55. **The accounting for the new project will be kept on a cash basis to an adequate level of detail in the existing project financial software.** The software will be upgraded to accommodate the records of the new source of financing by loan effectiveness.

56. **The internal controls framework instituted for the previous project is considered reliable and will continue to be used for MSIP2 as well.** The FM section of the POM will be completed as a condition for loan effectiveness with the arrangements applicable to the new project and with emphasis on the controls related to the subloans and grants components.

57. **Separate quarterly cash-based IFRs will be prepared for MSIP2 and submitted to the Bank within 45 days after the end of each quarter.** The format of the IFRs will be similar to the one used under the MSIP and will provide a breakdown of the use of funds under the subloans and grants for municipalities. The IFRs format has been agreed at negotiations and will be attached to the POM as an annex.

58. **The project financial statements will be audited by independent auditors acceptable to the Bank according to the terms of reference agreed with the Bank at negotiations.** The audit reports will be due for submission to the Bank within six months from the year end. The audit terms of reference will be similar to the ones agreed for the MSIP, with an extended scope regarding the use of subloans and grants as detailed in annex 3 and will be attached to the POM.

D. Procurement

59. The overall coordination, management, implementation, and oversight of procurement will be carried out by the PMU at the MOF, which is responsible for the implementation of the ongoing MSIP operation. The PMU is functioning well and experienced in managing procurement under Bank-financed investment lending. Given the nature of the project, selected municipalities that will benefit from the project will be involved in various stages of the procurement. Due to the lack of capacity and knowledge of the Bank procurement procedures at the municipal level, the PMU will take the lead for quality assurance and management of the subproject procurement process. Municipalities, with support from the PMU, will carry out procurement under the subprojects on behalf of the municipalities, with their participation in all stages of the procurement process. The PMU will be responsible for official correspondence with

the Bank on fiduciary issues and for adhering to the requirements in the project and legal documents.

60. A summary Procurement Plan for the proposed project, covering the first 18 months of the project, was prepared during the appraisal stage and its final version was agreed during project negotiations. It includes, at the minimum, (a) a brief description of the goods, works, and non-consulting and consulting services required for the project; (b) the proposed method of procurement; (c) the Bank's review requirements; and (d) the timeline for initiation of procurement, including contract commencement and completion.

61. Contracts not subject to prior review will be post reviewed once a year by the Bank's procurement specialist assigned to the project. At a minimum, one out of ten contracts will be randomly selected for post review.

62. To mitigate the risk for carrying out proper and timely procurement under the project, in summary, the following mitigating measures are recommended: (a) procurement under the project will be carried out in accordance with the relevant, most recent Procurement and Consultant Guidelines and standard bidding and proposal documents of the Bank; (b) if needed, an additional procurement specialist and/or a civil engineer will be hired in the PMU, given that for a certain period the PMU will be responsible for implementing the ongoing MSIP and the new MSIP2 in parallel; (c) the procurement staff, municipalities' representatives, members of evaluation committees, and other technical staff involved in the project procurement will be trained in Bank Procurement and Consultant guidelines and procedures on a regular basis during project implementation; (d) the POM will elaborate the procurement arrangements, roles and responsibilities with regard to project procurement in general, and procurement under the grants in particular; (e) the procurement and review thresholds for the project will be in accordance with the agreed Procurement Plan; (f) the particular prior and post review arrangements will be specified in the Procurement Plan agreed with the Bank; and (g) the initial summary procurement plan for the first 18 months of project implementation was agreed during negotiations and will be updated during project implementation annually or on an as-needed-basis.

63. More details with regard to procurement are outlined in annex 3 of the PAD.

E. Social (including Safeguards)

Table 2. Safeguard Policies Triggered by the Project

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]
Physical Cultural Resources (OP/BP 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) ⁷	[]	[x]

⁷ By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas.

64. MSIP2 represents the second phase of the ongoing MSIP project; it has the same programmatic nature of design and will finance subprojects proposed by the municipalities. Similar to the MSIP, MSIP2 triggered the Involuntary Resettlement safeguard policy (OP 4.12) and calls for the preparation of a Resettlement Policy Framework (RPF) since it will finance demand-driven municipal infrastructure available to any municipality and some subprojects may require temporary access to land and the possibility of land acquisition. The RPF will accommodate addressing of land expropriation or minor resettlement or demolition through precise procedures complying with OP/BP 4.12, though the experience of the MSIP shows that the subprojects are not likely to require resettlement but occasionally minor temporary or small-scale permanent land acquisition. The PMU will check the potential for this trigger in all investments and ensure (a) whether land acquisition or access to land is required; (b) if private land acquisition can be avoided; and (c) where land acquisition/resettlement is required and accordingly will support the local governments in preparing their respective and site-specific Land Acquisition Plan and implementing it. This will be done in accordance with agreed procedures in the RPF. The procedures will continue to be the same for MSIP2, given the same nature of the subprojects. Any land acquisition will be the responsibility of the participating municipalities and the Bank will not finance land acquisition.

65. Subprojects are appraised by social criteria in addition to economic, financial, and technical appraisal. Subproject appraisal contains a social section whereby the analysis is done through a common framework, which includes five entry points at the subproject level. These are social diversity and gender; institutions, rules, and behavior; stakeholders; participation; and social risks. The same subproject appraisal approach will be kept for MSIP2, whereby diversity and gender is one of the entry points of the social analysis at the subproject level. The project is gender informed and addresses all three of the Bank Group's gender tags, including the following:

- **Gender analysis and/or consultation on gender-related issues.** This is one of the five entry points of the subproject social appraisal. The project also benefits from a gender analysis which was completed in 2014 during the preparation of the Bank CPS for 2015–2018.
- **Mechanisms to facilitate monitoring and/or evaluation of gender impacts.** Gender-disaggregated statistics where applicable, such as for the number of beneficiaries, will be kept and monitored.

66. In addition, to ensure that the project neither continues nor exacerbates gender inequality and to make subprojects more inclusive to any other vulnerable groups, the beneficiary local government will assure that the proposed subprojects are in compliance with Local Government Equal Opportunity Action Plans. With the Law on Equal Opportunities adopted in 2006, every local government has established equal opportunity committees and is obliged to adopt Equal Opportunity Action Plans. With the amendments of 2014, local governments are obliged to appoint a coordinator/focal point for equal opportunity and this coordinator should support all local government operations to comply with the Equal Opportunity Action Plans, that is, make the local government operations more inclusive. MSIP2, while working with local governments,

will also incorporate equal opportunity coordinators into the project cycle and thus MSIP2 will contribute to the capacity building of beneficiary local governments with regard to social sustainability aspects.

67. Establishing citizen feedback mechanisms is one of the requirements for the eligibility of the local governments for the subloans. The feedback mechanism was part of the project design of the first project, the MSIP, and will continue to be part of MSIP2. MSIP2 will be upgraded in this aspect as it will have indicators to measure the feedback mechanism.

F. Environment (including Safeguards)

68. **MSIP2 will not finance any subproject with significant or irreversible environmental impacts and therefore has triggered OP 4.01 and been classified as Environmental Category B.** While the environmental impact of the proposed project will be largely positive, some adverse impacts may be generated. The identified positive environmental impacts of the project include (a) improved citizens' skills and awareness in planning and implementation of local investments, with particular attention to environment protection and (b) sustainable management of improved infrastructure by communities, which brings environmental and social benefits in relation to natural resources management.

69. The estimated limited environmental issues associated with the small- or medium-scale investments for local communities will be temporary nuisances resulting from construction activities. This may include (a) increased pollution due to construction waste; (b) generation of dust, noise, and vibration due to the movement of construction vehicles and machinery; (c) associated risks due to improper disposal of construction waste, asbestos, minor operational or accidental spills of fuel, and lubricants from the construction machinery; and (d) improper reinstatement of construction sites upon completion of works.

70. All these potential environmental impacts are readily identifiable, small in scale, and minimal in impact and can be effectively prevented, minimized, or mitigated by including specific measures to be taken by contractors into the work contracts under close supervision of compliance by the PMU. Use of construction materials that are hazardous to human health (for example, asbestos) will not be permitted.

71. MSIP2 follows the design of the ongoing MSIP operation except the grant component (Component B) since grants under this component will now go to the poorest neighborhoods without the condition of having achieved certain goals with loan support. Because the project is demand driven (Components A and B), the complete list of subprojects to be financed during the project life span is unknown ex ante. However, activities under Components A and B are not expected to generate significant adverse environmental effects. Physical works are expected to be small-scale rehabilitation (of water supply networks, schools, heating pumps, streets, and sewerage) for which an EMP checklist will likely be sufficient. The Environmental Assessment Management Framework (EAMF) that is already in place for the MSIP will be updated as needed. It will include screening criteria and processes for land acquisition and environmental aspects. The EAMF will present an overview of the legal framework of environmental and local self-government sectors in the country, procedures for environmental assessment for the project development required under national legislation, procedures for environmental assessment for

project development under the Bank procedures, and analysis of potential environmental impacts caused by subprojects during the implementation of different types of activities. The EAMF will list potential negative environmental impacts for each type of project activity and will provide a list of environmental mitigation and monitoring activities to mitigate and neutralize the relevant impacts. This will provide a framework outlining how the EMPs will be developed for each type of subproject and when site-specific Environmental Assessments (EAs)/Environmental Impact Assessments (EIAs) are needed. Furthermore, any subprojects expected to generate adverse, long-lasting, and irreversible environmental effects—that is, those subprojects which would qualify for Category A rating according to OP 4.01—will be ineligible for financing under the project. The project will prohibit those activities that can cause a significant loss or degradation of any significant natural habitat. The environmental screening process will check for the presence of physical cultural resources. In addition, chance find procedures will be included in all works contracts.

72. The borrower has the knowledge and capacity to comply with the Bank requirements for environmental and social safeguards gained during the course of the implementation of the MSIP operation. The EAMF and POM under the MSIP detail the implementation roles of the borrower and the Bank in preparation, approval, and execution of the EMPs for each subproject. As part of subproject identification, the PMU undertakes environmental screening for each of the proposed subprojects and develops the respective EMPs, which are subsequently included in the bidding documents. Environmentally related activities and procedures are carried out by the borrower as designed, with due diligence and sufficient attention to details. Compliance with measures prescribed in subproject-specific EMPs is reviewed by the PMU staff at regular intervals and written reports on findings are prepared and filed in the PMU. Contracts for civil works under the project are subject to screening for environmental impacts by the Ministry of Environment in the borrower country. All studies and bidding documents related to civil engineering works include measures to minimize and/or mitigate potential environmental damage. Separate EMPs or site-specific EAs/EIAs and EMPs are prepared for each subproject. Even if the EA/EIA studies are not required by the national legislation, the borrower observes requirements set in the EAMF Report and the respective EMPs prepared for this project. Those EMPs/EAs/EIAs are reviewed and endorsed by both the responsible environmental entity in the borrower country and the Bank. Monitoring compliance in accordance with the findings of the EA Report and requirements of the relevant EMPs, including progress monitoring on EMP implementation, is undertaken by the MOF and reported to the Bank twice per year in the semiannual progress reports.

G. Other Safeguards Policies Triggered

73. The project will support activities that could take place on trans-boundary waterways as defined in OP 7.50. The country is divided hydrographically into four river basins—Vardar, Strumica, Crni Drim, and Juzna Morava (a small part of the South Morava River Basin)—and all these river basins are shared with neighboring countries.

74. Project interventions are not expected to adversely affect water quality or quantity to downstream riparian states. It is anticipated that investments supported under MSIP2 will not (a) adversely change the quality or quantity of water flows to the other riparian and (b) be adversely affected by the other riparian possible water use. Infrastructure rehabilitation and modernization

and water supply management improvements should increase system efficiency, thereby generating water savings and providing users with reliable water supply. Further, the project aims to improve efficiency of water use and substantially reduce municipalities' high water consumption rates.

75. The project is exempt from notifying riparian governments because proposed activities do not attempt to modify waterways or significantly increase water abstraction volumes, leaving the water rights of other riparian countries unaffected.

76. Exception to the notification requirements of OP 7.50 has been granted because the project only supports investments for abstractions of water from (a) locally confined (non-transboundary) aquifers and (b) smaller, detached springs and small tributaries. Because water volumes and potential impacts are seen as negligible, a waiver to notification requirements was granted on October 6, 2015. However, the PMU will maintain dialogue with the Bank for additional guidance on any actions according to OP 7.50 that would apply to any investment that could potentially raise this issue.

H. World Bank Grievance Redress

77. Communities and individuals who believe that they are adversely affected by the Bank-supported project may submit complaints to existing project-level grievance redress mechanisms or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address project-related concerns. Project-affected communities and individuals may submit their complaint to the Bank's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of Bank's noncompliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the Bank's attention and Bank management has been given an opportunity to respond. Information on how to submit complaints to the Bank's corporate GRS are available at <http://www.worldbank.org/GRS>. Information on how to submit complaints to the Bank Inspection Panel are available at www.inspectionpanel.org.

Annex 1: Results Framework and Monitoring
Second Municipal Services Improvement Project (P154464)

Results Framework

Project Development Objectives

PDO Statement

The proposed development objective of MSIP2 is to improve transparency, financial sustainability, and inclusive delivery of targeted municipal services in the participating municipalities.

These results are at: Project Level

Project Development Objective Indicators

Indicator Name	Baseline	Cumulative Target Values					
		YR1	YR2	YR3	YR4	YR5	End Target
Direct project beneficiaries (Number) - (Core)	0.00	0	0	20,000	60,000	100,000	100,000
Female beneficiaries (Percentage - Subtype: Supplemental) - (Core)	0.00	0	0	50	50	50	50
Vulnerable/marginalized people with marginalized measured as the number of unemployed, social assistance receiving, or in other ways vulnerable population that benefits from the project intervention (Percentage - Subtype: Supplemental)	0.00	0	0	5	7	10	10
Number of participating municipalities (that is, the municipalities which signed subloan agreements) that regularly publish subproject progress information on their official websites or elsewhere (Number)	0.00	2	4	8	14	20	20
Percentage of completed subprojects that generated improved financial performance, including through increased revenue earnings or cost savings (Percentage)	0.00	0	0	30	50	90	90
Number of completed subprojects that focus on social inclusion (Number)	0.00	0	0	5	9	17	17

Intermediate Results Indicators

	Cumulative Target Values
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Number of subloans signed (Number)	0.00	3	5	10	15	20	20
Number of poverty/social inclusion investment grants signed (Number)	0.00	0	0	5	9	17	17
Number of subprojects, financed by subloans or grants, successfully completed (Number)	0.00	0	3	10	20	37	37
Number of jobs generated, measured as the number of employees of contractors and engineering companies that perform works under the subprojects (Number)	0.00	200	500	900	1,100	1,500	1,500
Number of visits to websites that publish subproject progress information (Number)	0.00	5,000	50,000	100,000	250,000	500,000	500,000
Participants in consultation activities during subprojects preparation (Number)	0.00	50	100	200	300	400	400
Participants in consultation activities during subprojects preparation - female (Number - Subtype: Breakdown)	0.00	15	30	60	90	120	120
Piped household water connections that are benefiting from rehabilitation works undertaken by the project (Number) - (Core)	0.00	100	200	300	400	600	600
Roads rehabilitated, Rural (Kilometers) - (Core)	0.00	0	0	10	20	30	30
Roads rehabilitated, nonrural (Kilometers) - (Core)	0.00	0	0	8	15	20	20

Note: Additional core sector indicators, as outlined in para 16, Section II PDOs of the PAD and elaborated in the POM, will be tracked.

Indicator Description

Indicator Name	Description (indicator definition and so on)	Frequency	Data Source/Methodology	Responsibility for Data Collection
Direct project beneficiaries	Total number of people who directly derive benefits from the project intervention—that is, citizens of the participating municipalities that receive improved municipal services as a result of the project interventions.	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Female beneficiaries	Percentage of female beneficiaries in the total number of direct project beneficiaries	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E,	PMU

Indicator Name	Description (indicator definition and so on)	Frequency	Data Source/Methodology	Responsibility for Data Collection
			and progress report	
Vulnerable/marginalized people	Percentage of vulnerable/marginalized people, with marginalized measured as the number of unemployed, social assistance receiving, or in other ways vulnerable population that benefit from the project intervention	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Number of participating municipalities (that is, the municipalities which signed subloan agreements) that regularly publish subproject progress information on their official websites or elsewhere	Number of participating municipalities (that is, the municipalities which signed subloan agreements) that regularly publish subproject progress information on their official websites or elsewhere	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Percentage of completed subprojects that generated improved financial performance, including through increased revenue earnings or cost savings	Percentage of completed subprojects that generated improved financial performance, including through increased revenue earnings or cost savings	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Number of completed subprojects that focus on social inclusion	Number of completed subprojects that focus on social inclusion	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU

Intermediate Results Indicators

Indicator Name	Description (indicator definition and so on.)	Frequency	Data Source/Methodology	Responsibility for Data Collection
Number of subloans signed	Number of subloans that have been signed	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E,	PMU

Indicator Name	Description (indicator definition and so on)	Frequency	Data Source/Methodology	Responsibility for Data Collection
			and progress report	
Number of poverty/social inclusion investment grants signed	Number of poverty/social inclusion investment grants that have been signed	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Number of subprojects, financed by subloans or grants, successfully completed	Number of subprojects financed by subloans or grants that have been successfully completed	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Number of jobs generated, measured as the number of employees of contractors and engineering companies that perform works under the subprojects	Number of jobs generated which is measured as the number of employees of contractors and engineering companies that perform works under the subprojects	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Number of visits to websites that publish subproject progress information	Number of visits to websites that publish subproject progress information	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Participants in consultation activities during subprojects preparation	This indicator measures the level of community engagement in subprojects preparation and is calculated as a number of participants in consultation activities during subprojects preparation	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Participants in consultation activities during subprojects preparation - female	Number of female participants in consultation activities during subprojects preparation	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Piped household water connections that are benefiting from rehabilitation works undertaken by the project	This is a core sector indicator which measures as the number of piped household water connections benefiting from rehabilitation works undertaken by the project.	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU
Roads rehabilitated, rural	Kilometers of all rural roads reopened to motorized traffic, rehabilitated, or upgraded under the project. This is a core	Semiannual	PMU M&E, data from participating municipalities, supervision	PMU

Indicator Name	Description (indicator definition and so on)	Frequency	Data Source/Methodology	Responsibility for Data Collection
	sector indicator.		missions/PMU semiannual M&E, and progress report	
Roads rehabilitated, nonrural	Kilometers of all nonrural roads reopened to motorized traffic, rehabilitated, or upgraded under the project. This is a core sector indicator.	Semiannual	PMU M&E, data from participating municipalities, supervision missions/PMU semiannual M&E, and progress report	PMU

Annex 2: Detailed Project Description

1. The PDO of MSIP2 is to improve transparency, financial sustainability, and inclusive delivery of targeted municipal services in the participating municipalities. MSIP2 presents the second phase of the successfully ongoing MSIP (P096481) with an aim to respond to the continuing strong demand and growing interest of the municipalities for local infrastructure financing. It will be built on the experience of the MSIP and its lessons learned to enhance the impact of a well-performing project.
2. The ongoing MSIP is aimed at improving the transparency, financial sustainability, and delivery of targeted municipal services. Its implementation is progressing well, and the subproject results so far demonstrate good progress toward achieving its PDO. To date, a total of 59 subloan agreements have been signed with eligible municipalities under the MSIP component of Municipal Investments (loan component), out of which 35 subprojects were completed and 15 are under implementation while others are either at the tendering stage or about to start the tendering process. Furthermore, 15 subprojects are currently under preparation by the respective municipalities with support from the PMU. In addition, 23 municipalities submitted applications to access funds under the MSIP component of Performance-based Investment Grants, with 15 performance grant agreements signed and 6 grant activities already successfully completed. Some of the MSIP accomplishments to date include more than 11,000 households with new water connections, about 240,000 people with access to regular solid waste collection, and all participating municipalities/utilities publish their budget information on their websites.
3. The original IBRD loan for the MSIP (approved on March 26, 2009) was in the amount of US\$25 million equivalent. It was followed by an additional financing loan of US\$50 million equivalent approved by the Board on May 10, 2012. More recently, a new component introducing the EU IPA-financed Rural Investment Window of €15.5 million, Recipient Executed Trust Fund, was added on December 22, 2014, to provide grants for priority rural infrastructure investments in eligible municipalities through the existing MSIP implementation mechanism.
4. To date, more than 40 percent of the total MSIP loan amount (including both original loan and additional financing funds) has been disbursed. In addition, about €47.2 million has already been committed for municipal investments under the existing subprojects pipeline. This represents 98 percent of all available MSIP investment funds excluding the IPA-financed window. Thus, the MSIP funds are now fully committed and the project cannot respond to new applications from the municipalities. At the same time, municipalities continue to express growing interest and demand in using MSIP financing.
5. Given the persistent need for improving municipal infrastructure and based on the positive experience of MSIP implementation, the government requested the Bank for a new project or additional financing to the MSIP in the amount of €25 million, now that all funds under the MSIP have been committed. Since the MSIP already has two additional financings, including the recently approved IPA window, it was decided to proceed with the preparation of a new operation. The new project was also considered as a good opportunity to take stock of implementation expertise under the MSIP and bring in the required adjustments, if any. As such,

MSIP2 will be built upon the experience of the MSIP and the lessons learned, to enhance the impact of a well-performing operation.

6. MSIP2 will continue to focus on improving the transparency, financial performance, and delivery of targeted services under the responsibility of participating municipalities and their CSEs, such as water supply, sewerage, solid waste management, energy efficiency improvements of municipal buildings, local roads, and other services delivered by municipalities. As is the case with the MSIP, MSIP2 will continue to provide subloans provided to municipalities for infrastructure investments of high priority and clear impacts on welfare or efficiency. In addition, MSIP2 aims to enhance inclusive service delivery by targeting poorer and marginalized communities for infrastructure improvements through the newly introduced grant component.

7. The project adopted the implementation arrangements and mechanisms that proved to be effective under the MSIP, with some adjustments introduced based on the MSIP experience and lessons learned. In particular, the positive aspects of MSIP experience, which MSIP2 will adopt, include the access to affordable loans to municipalities (subloans), demand-driven process with participating municipalities selecting priority investments out of the wide variety of municipal investments, support for municipalities throughout the subproject cycle contributing to capacity building, and increased transparency and disclosure of information by participating municipalities as an eligibility condition.

8. The lessons learned include the need to improve construction supervision and quality of technical documentation prepared by the municipalities. Also, since bigger municipalities have tended to receive bigger amounts of grants through the performance grant component of the MSIP, MSIP2 will use revisited criteria/grant financing rules for its social inclusion grant component. In this regard, the grant component of MSIP2 will be used to provide incentives for municipalities to improve infrastructure services in poorer and marginalized communities (if they meet certain criteria). Accordingly, the new criteria will be linked more with proper identification of target communities such as collection of settlement-level data.

9. While MSIP2 will largely employ the institutional arrangements and implementation mechanism developed under the ongoing MSIP operation, its design includes an opportunity to support the establishment of a more sustainable and institutionalized financing mechanism for municipal infrastructure development, going beyond the current project-based PMU approach. The MOF informed the Bank of its plans to transfer the municipal infrastructure financing mechanism to the government-owned MBDP in the future, while the MBDP's current role is to provide finances to small and medium enterprises and export-oriented companies. An option of creating a new institution such as a municipal development fund has been referred as too excessive for a relatively small country. Through its TA component, MSIP2 will support a transition to the MBDP or identify alternative options to ensure sustainability of the municipal financing instrument.

10. Since MSIP2 will contribute to the improvement of delivery of targeted municipal services in the participating municipalities, its primary beneficiary will be local communities—that is, citizens of the participating municipalities. Also, at the regional and local levels, the beneficiaries will include administrations of the participating municipalities, CSEs, and providers

of municipal services, and at the central level, the beneficiary will be the MOF. In addition, the primary beneficiaries of the MSIP2 Poverty/Social Inclusion Investment Grant component, which is aimed at providing grants to the municipalities as an incentive for them to invest in infrastructure improvement in the poorer and marginalized communities within their jurisdiction, will be the population of these vulnerable communities. Indirect beneficiaries and stakeholders may also include private sector businesses and nongovernmental (civil society) organizations.

11. MSIP2 will consist of components as follows:

12. **Component A: Municipal Investment Subloans (€18.5 million).** This component will provide subloans to municipalities for investments in municipal infrastructure, including revenue-generating/cost-saving municipal infrastructure investments and other projects of high priority for the municipalities. Types of investments will include water supply, sewerage including small-scale wastewater treatment, solid waste management, energy efficiency improvements of municipal buildings, local roads, markets, street lighting, storm water drainage, and rehabilitation and limited construction of schools, kindergartens, and other facilities for early childhood development. The eligibility criteria for the subloan will include (a) municipal council decision; (b) data collection for the International Benchmarking Network for Water and Sanitation Utilities; (c) publication of budget and available audit information; and (d) establishment of a citizen feedback mechanism and evidence of conducting public consultation related to the proposed subproject.

13. With a view to ensure a smooth start of the MSIP2 implementation and to accelerate disbursement of the project funds, the PMU has identified the initial pipeline of two potential subprojects to be financed under Component A of MSIP2 in the municipalities of Gazi Baba (water supply) and Kisela Voda (storm water drainage). Technical designs of these subprojects along with the respective safeguards documents such as site-specific EMPs have been developed and reviewed by the Bank.

14. **Component B: Poverty and Social Inclusion Investment Grants (€4.9 million).** This component will provide investment grants to municipalities as an incentive for them to invest in infrastructure improvements in poorer and marginalized communities within their jurisdictions.

15. This component is specifically designed to target poorer and marginalized communities for municipal infrastructure improvements. Such communities will be identified by geographic targeting of neighborhoods within participating municipalities. Based on discussions with stakeholders at the municipal level, it has been concluded that the municipalities themselves are in the best position to identify such a target community in lieu of reliable official community-level statistics. Community-level service coverage data on paved roads, drainage, piped water, public sewers, and kindergartens could serve as a determinant of a neighborhood's poverty status. A more precise set of proxies and the guidelines for targeting procedures will be included in the POM.

16. **Component C: Project Management, Monitoring and Evaluation, and Capacity Building (€1.5 million).** This component supports operational costs of the PMU, assists with project implementation and monitoring, and finances consultancy services and TA for (a) subproject preparation/implementation and local capacity building for municipalities and the

CSEs to improve service delivery and (b) national-level institutional strengthening. This component will strengthen the institutional capacities of municipalities, especially in such areas as capital investment planning and municipal FM, with a view to enabling municipalities to become financially sustainable in the medium term. Support to be provided for capital investment planning at the municipal level could include the following: strengthening of the planning and budgeting process, procurement, and contract management systems. Support for municipal FM will include strengthening municipal revenue and expenditure management systems; putting in place robust accounting, reporting, and audit practices; and strengthening staff skills and capacities in FM through targeted capacity support. In addition, support will also be provided to national-level agencies such as the MOF to put in place a system for monitoring the financial health of municipalities through a rigorous system of analysis of municipal finances with the objective of addressing the contingent fiscal risks arising from subnational lending. Support will also be provided for enhancing the sustainability of municipal lending through the development of suitable policies and practices for loan appraisal and risk management.

17. MSIP2 will be a five-year investment operation with the total cost of €25.0 million provided in the form of the IBRD loan. The borrower will be the country's government, represented by the MOF. The MOF will on-lend the funds to participating municipalities through subloan agreements (under Component A) or in the form of grants through grant agreements (under Component B). The subloans will be provided on the same terms as the Bank loan, but the grace period shall be up to three years and the last repayment date of each subloan shall not exceed the last date of repayment of the Bank loan. The MOF will assume the currency risk since the subloans and grants will be in local currency.

18. **Identified subprojects for the initial pipeline of Component A.**

- (a) **Kisela Voda.** This subproject aims to construct a storm water system along the streets in the Przino District of the Kisela Voda municipality. The main objective of the subproject is to improve the living conditions for local residents, avoiding flooding due to heavy rainfall, and ensuring better and safe traffic along the streets and preventing the damage of houses. The population of the district is about 4,000, and currently only 20 percent of the necessary storm water system has been constructed along 2–3 streets in the district. Under the subproject, the storm water system will be constructed along 13 streets including some shorter branches. These streets are Przino, Milan Mijalkovic, Meglenska, Zelengora, Kavalska, Polog, Kocanska, Malina Pop Ivanova, Kara Trifun, Pejo Jovorov, Pando Kljasev, Blagoja Gojan, and Mariovska. The total length of the planned storm water pipes is around 5,300 m, with different diameters from 300 mm up to 500 mm, and connection pipes with a 200 mm diameter from gullies to the manholes.
- (b) **Gazi Baba.** This subproject aims to construct five primary water supply lines within the drinking water supply network in Rashtak Village, located in Gazi Baba. Currently, around the village has 300 inhabitants, and the water supply network exists only in the lower part of the village and the existing water reservoir cannot cover the water needs of the upper part of the village. While a new reservoir with a volume capacity of 120 m³ is planned to be constructed by the municipality, this subproject will comprise only construction of primary water supply pipelines in the

upper part of the village. The total length of the five pipelines is about 2,350 m (polyethylene pipes PE 100 with pressure of 10 bars).

Annex 3: Implementation Arrangements

Project Institutional and Implementation Arrangements

1. **PMU.** The implementation arrangements of MSIP2 will follow the implementation mechanisms of the existing MSIP operation to capitalize on the already established and well-functioning PMU at the MOF. The PMU has been established in the MOF because the project is relevant to fiscal decentralization and the MOF has a key role in approving and overseeing municipal borrowing.

2. The PMU will be responsible for project implementation, according to the requirements of the borrower and the Bank, and will have full responsibility for project FM, supervision of subproject implementation, and M&E. The PMU will promote the project among municipalities and will receive and evaluate proposals for subprojects according to criteria agreed with the Bank and recorded in the POM. The PMU will also request for Bank review and final ‘no objection’ for subprojects. The PMU will then be responsible for finalizing subloan and grant agreements between the MOF and the borrowing municipality and for reviewing service agreements between the municipality and the CSE, where applicable. Due to the lack of capacity and knowledge of the Bank procurement procedures at the municipal level, the PMU will support municipalities for carrying out procurement for subprojects at all stages. The PMU will liaise closely with the Bank on all fiduciary and safeguard issues and on adhering to the Legal Agreements. The PMU will also operate with a roster of consultants for specific expertise, whenever needed.

3. **The POM will describe project procedures for participating municipalities and the PMU and refer to the Bank project documents, including the Procurement Guidelines and Loan Agreement, as part of the POM.** The POM will specify the project objective, description, and financing and include the following:

- (a) Project implementation activities/responsibilities, including fiduciary (procurement and FM procedures) and safeguards (environment and land acquisition/resettlement), and reporting requirements for participating municipalities and the PMU
- (b) Subproject preparation activities and responsibilities, including procedures and formats for subproject proposals for subloans and grants, appraisal, and approval activities
- (c) Application of borrower laws to environment and land acquisition/resettlement
- (d) Application of Bank fiduciary procedures
- (e) Bank safeguard requirements, including the EAMF and the Land Acquisition and Resettlement Policy Framework (LARPF)
- (f) Terms of reference and responsibilities of the PMU staff
- (g) Formats for semiannual project progress reports

4. While the PMU established under the ongoing MSIP has a proven track record of MSIP preparation and implementation, adding a new project will significantly increase the PMU's workload. This is because the PMU is expected to play an important role in reviewing and assisting in improving technical designs prepared by the project participating municipalities and will also need to provide extensive implementation support for the municipalities during tender processes and subprojects implementation. To this end, PMU capacity was carefully assessed to ensure that it has sufficient man power for executing its functions under MSIP2 with respective staffing plan developed and agreed with the Bank and the MOF.

5. As already mentioned, MSIP2 will also use the TA under Component C to support the establishment of a more sustainable and institutionalized financing mechanism for municipal infrastructure development, going beyond the current project-based PMU approach. One of the options currently viewed by the MOF is that the municipal infrastructure financing mechanism could be transferred to the government-owned MBDP in the future. Through its TA component, MSIP2 is prepared to facilitate a transition to the MBDP, if this option is finally taken by the government, or will provide support in identifying alternative options to ensure sustainability of the municipal financing instrument.

6. **Participating municipalities.** Municipalities, as the sub-borrowers from the MOF, will have lead responsibility for preparing and supervising the subprojects with PMU support. Contracts will be signed by authorized municipal representatives and selected contractors. Details of procurement roles and procedures will be elaborated in the POM. Municipalities will prepare disbursement applications and forward them with the supporting documents to the PMU for final verification, recording in the project FM system, processing within the Treasury, and forwarding to the Bank. The PMU will ensure process quality control and will conduct periodic and random checks on participating municipalities. Considerable training and support will be provided to participating local governments during subproject preparation and implementation.

7. **MOF.** The MOF represents the government. The MOF oversees preparation and implementation of MSIP2, chairs the inter-ministerial PCC, and executes the day-to-day functions of project implementation through the PMU established at the MOF.

8. **PCC.** The borrower will ensure that the inter-ministerial PCC that was set up for the ongoing MSIP will continue to function for MSIP2 in a composition and manner satisfactory to the Bank. The PCC will comprise representatives of central agencies and ministries involved, as needed, and will provide a forum for information sharing and advising the PMU on project management. The committee's main responsibilities are to ensure good inter-agency communications about project objectives, rules, and implementation progress; advise the PMU on sectoral or inter-ministerial issues that may affect project-funded activities, such as those pertaining to water and sanitation policies and investments; and reinforce transparency in the selection of municipalities and subprojects. The MOF will chair the committee.

9. Table 3.1 describes the roles and responsibilities in subproject implementation of the municipality, CSE, PMU, MOF, and PCC.

Table 3.1. Subproject Implementation Roles and Responsibilities

Function	Municipality	CSE	PMU	MOF	PCC
Propose subprojects	Local council approves	Proposes to municipality	–	–	–
Prepare subprojects (designs, technical specifications, bidding documents)	With technical support from project-funded consultants, as needed	With technical support from project-funded consultants, as needed	–	–	–
Appraise subprojects	–	–	With ‘no objection’ review by the Bank	–	–
Select subloan terms and funding approval	–	–	Recommends to the PDD (MOF) and finalizes subloan and performance grant agreements with municipalities	The PDD (MOF) issues positive opinion on borrowing by municipality and terms of subloan (grace and repayment periods)	–
Procurement	Participates in procurement activities under the PMU responsibility; municipal representative signs contracts with suppliers	–	Supports the municipalities for carrying out procurement for subprojects at all stages, manages and assures quality of all stages of procurement, with post review by the Bank on at least 20 percent of contracts	–	–
FM	Submits disbursement requests to the PMU; makes payment to suppliers upon receipt of funds from the MOF	–	The PMU verifies completion and documentation, and forwards to the Treasury for payment; oversees all FM procedures; manages the project DA and makes payments from the DA to the denar accounts of participating municipalities	–	–
Supervise works (contract implementation and acceptance of deliverables)	For subprojects of direct municipal responsibility. Also confirms	For subprojects concerning CSE services and activities	Makes periodic and random checks on completion of works	–	–

Function	Municipality	CSE	PMU	MOF	PCC
	the CSE supervision of works				
Environmental and social safeguards	Responsible for applying the EAMF/LARPF to the subproject	Responsible for applying the EAMF/LARPF to the subproject	Certifies that the Bank and national safeguard policies observed according to the EAMF/LARPF, with the Bank review	–	–
M&E	Reports to the PMU	Reports to the municipality	Reports to the Bank and PCC	–	–
Inter-ministerial coordination	–	–	Quarterly reporting to the PCC for information sharing and transparency	–	Quarterly meetings to review reports

Financial Management

10. **The overall FM residual risk is rated as Moderate after mitigation measures.** The FM performance of the ongoing project implemented by the MOF is Satisfactory. There are no outstanding IFRs or audit reports under the current project. The appointed auditors have carried out the project audit in accordance with acceptable auditing standards, that is, International Standards on Auditing and have issued an unmodified (clean) opinion on the project financial statements as of December 31, 2014. The project management letter mentioned that no accounting or internal control deficiencies were identified during the audit.

11. **Staffing.** The project will continue to use the financial staff within the PMU established for the implementation of the ongoing MSIP and further supplemented, as agreed during the preparation of the EU IPA-funded grant. There is a finance officer assigned with the FM responsibilities of the project and supported by a recently recruited finance assistant. Both possess appropriate experience and expertise in accounting and FM and the finance officer has substantive experience with the Bank procedures and requirements in this area. The existing FM capacity is assessed as sufficient. It will continue to be revaluated regularly and it may be supplemented if required.

12. **Planning and budgeting.** The PMU has adequate planning and budgeting capacity with regard to the availability of quality information and monitoring. A single budget will be prepared for all project components based on the Procurement Plan and will be complemented by best estimates of outflows with respect to signed contracts. As the budget will also include loans and grants to municipalities, the process of collection of data and communication between the PMU and the municipalities should be closely monitored. Planning and budgeting will involve more risk due to the need to estimate actual expenditures at the municipalities' level. Significant variances of actual versus budgeted figures should be monitored on a regular basis and appropriately analyzed and followed up.

13. **Accounting system and procedures.** The project will follow the same accounting software and basis of recording transactions as for the current MSIP. For accounting and reporting, the MOF uses the Treasury system, which was assessed in the country diagnostic work

as sound, with reliable reporting and ex ante controls. For the ongoing MSIP, the Bank and the PMU agreed that due to the complex project design and the need for reliable, transparent, and timely information, the Edusoft software would be used for project accounting and reporting and that it will supplement the Treasury reports. Edusoft can generate IFRs automatically and accounting data will be backed up regularly. The software will be upgraded by effectiveness to the same level of detail as under the ongoing project, to accommodate the records of the new source of financing.

14. **Financial reporting.** Project-management-oriented IFRs will be used for project monitoring and supervision. The format of the IFRs will be similar to the one used under the ongoing MSIP and has been agreed with the Bank at negotiations. The PMU will produce a full set of IFRs for each calendar quarter throughout the life of the project, including transactions related to subloans and grants. The first set of reports to be prepared will cover the calendar quarter period in which disbursement has started. Such reports will be prepared on International Public Sector Accounting Standards cash basis in the loan currency and will be due 45 days after the end of each quarter. The IFRs will comprise the following reports presented in the agreed format: (a) Project Cash Receipts and Payments; (b) Uses of Funds by Project Activity; (c) DA Statement; (d) Units of Output by Project Activity; (e) Breakdown of Subloans and Grants; and (f) Accounting Policies and Explanatory Notes.

15. **Internal controls.** An adequate system of internal controls and procedures was instituted as part of the ongoing MSIP. Such a system is assessed as reliable and will continue to be applied to the new project as well. The current management control framework is described in the FM section of the existing POM for the MSIP which was last updated before the signing of the EU IPA-funded grant. The current FM section will serve as the basis for the development of the respective chapter of the new project's POM that will be prepared by loan effectiveness. Key internal controls to be applied for the project include (a) appropriate authorizations and approvals; (b) segregation of duties (with no single person having the responsibility for all phases of transaction); (c) regular reconciliations between records and actual balances, as well as with third parties; and (d) complete original documentation to support project transactions.

16. For the more complex components related to subloans and investments grants, the POM should detail key aspects such as (a) the criteria for eligibility of beneficiaries and subprojects; (b) evaluation and selection procedures; (c) procurement process; (d) flow of funds; (e) monitoring of expenditures at the level of each beneficiary; and (f) reporting mechanism and relevant templates.

17. The decentralized municipal investments under Components A and B require a strong monitoring mechanism and enhanced controls over the use of funds, including (a) regular reporting from beneficiaries on the expenditures financed under the subloans and grants; (b) clear definition of eligibility criteria in the POM for project-supported beneficiaries and subprojects and fiduciary requirements; and (c) extended scope of the project audit to ensure that subloans/grants have been provided to municipalities for the purposes intended, in accordance with the applicable conditions and that the agreed outputs are delivered in an efficient manner.

18. Municipalities publish tenders and are contract signatories. Municipalities receive an invoice and forward it to the PMU with supporting documentation to prove that works, goods, or

services have been received in line with the contract. A PMU engineer will perform on-site visits to check that the delivery quality and quantity align with contracts. The finance officer will also regularly join on-site visits to ensure proper understanding of the fiduciary requirements in the early stages of implementation and adequate application is in practice during the subproject duration. Before the payments, independent consultants may also be contracted to verify that delivered goods, services, or works are acceptable. The invoice is then reviewed by the PMU finance officer, who registers and checks the invoice and initials it. The invoice is next reviewed by the project procurement staff. All relevant documentation shall be attached to the invoice enabling the project director to immediately evidence that the necessary checks have been performed. Payment orders and the invoice with all the designated approvals and signatories are submitted for payment. In the cases of loans/grants, the funds are transferred to municipalities, which are obliged to transfer the funds to suppliers in the shortest possible time. Any future request for payment by municipalities needs to be supported by appropriate documentation that the previous payments have been properly executed. Loan/grant-supported municipalities are responsible for preparing and supervising projects with PMU support.

19. DA bank statements are received daily by the PMU, and the Treasury reports on a regular basis. Municipalities submit statements of their Treasury accounts to the PMU on a regular basis and frequency is defined by the on-lending agreement. Based on the account statements, the PMU finance officer will record executed payments and perform due reconciliation of the bank balances.

20. Contract management will be carried out through the Edusoft software by keeping an individual fiche for each contract. These fiches will be updated every time an invoice is received or a payment is made on each contract. These fiches will show key data for each contract as the contract value; schedule of payments; date, reference, and amount of invoices received; date and amount of payments made; and the contract value remaining to be paid. The quarterly IFRs will provide financial information on the actual expenditures incurred under each ongoing contract during the analyzed quarter and on a yearly and cumulative basis.

21. **External audit.** The PMU is responsible for the timely compilation of the annual project financial statements for the independent external audit. Separate project financial statements will be audited by an independent auditor acceptable to the Bank. The audits will be conducted in accordance with the International Standards on Auditing as issued by the International Federation of Accountants. The agreed terms of reference for the audit have been attached to the minutes of negotiations and will be attached as an annex to the POM. Similar to the MSIP, given the more complex subloans and investment grant schemes, the project financial audit will continue to have an extended scope to also check if loans/grants have been provided to beneficiaries for the purposes intended in accordance with the applicable conditions, to ensure that agreed outputs are delivered in an efficient manner. In addition, the auditors are expected to deliver a management letter in relation to the project. Each management letter will identify internal control deficiencies and accounting issues, if any. The PMU has an audit contract in place for the MSIP, covering the remaining implementation period. It is envisaged that a new selection will be carried out for the audit of MSIP2, and the contract will be extended based on the satisfactory performance of the auditors. The audit reports, audited financial statements, and management letter will be delivered to the Bank within six months of the end of each fiscal year. The audited project financial statements will be made publicly available on time and in a manner

acceptable to the Bank. The audit fee for project financial statements will be financed from the loan proceeds. Any audits of municipalities performed by the National Audit Office should be submitted to the Bank.

22. **FM conditions and action plans.** To further strengthen the project FM arrangements, there is one condition for effectiveness which should be implemented as indicated in table 3.2.

Table 3.2. Condition to Strengthen FM Arrangements

Condition	Due Date
Complete the FM section of the POM, describing the specific financial and disbursement procedures instituted for the new project	Effectiveness

23. Also as an action to be completed before effectiveness, it was agreed that Edusoft will be upgraded to the level of detail of the existing project to accommodate the records of the new loan.

Table 3.3. Action to Strengthen FM Arrangements

Action	Due Date
Upgrade the existing project accounting software to accommodate the records of the new project	Effectiveness

24. The transaction-based disbursement method will be used for the project. A DA in the loan currency (euro) will be opened in the National Bank of the Republic of Macedonia (NBRM). A Treasury mirror account will be opened in Macedonian denars for payments to local suppliers. The mirror account will be a transit account with no material balances held. The subloans and performance grants beneficiaries will maintain separate accounts in the Treasury and appropriate supporting documentation for the purpose of the financing received under the IBRD loan. The PMU will transfer the funds required for the municipalities through the mirror DA, based on payment requests, supporting documents, and evidence that the previously received funds have been used as intended. The beneficiaries will transfer the funds received to the suppliers within a maximum of five business days.

Flow of Funds and Disbursement Arrangements

25. Project funds will flow from the Bank—as an advance, through a DA to be opened in the NBRM, which will be replenished under the transaction-based disbursement method and managed as described in this annex, *or* by direct payment on the basis of direct payment withdrawal applications, *or* via a special commitment on the basis of applications for issuance of special commitment and subsequent payments under the issued special commitments.

26. The procedures relating to the flow of funds, including paths for authorization and approval of payments, will be described in detail in the FM section of the POM. The procedures should clearly describe all steps of the process as well as authorized signatories for administering the account funds. Bank statements indicating turnover and balance on the denar subaccount will be available to the PMU on a daily basis. The PMU will include balances on all project-related accounts in the quarterly IFRs.

27. The DA ceiling is indicated in the Disbursement Letter agreed on at negotiations. Applications for replenishment of the DA will be submitted at least quarterly. Documentation requirements for replenishment will follow standard Bank procedures as described in the Disbursement Handbook. Bank statements of the DA, which have been reconciled, will accompany all replenishment requests.

Procurement

28. **Risk assessment for procurement.** An assessment of the capacity of the adequacy of the procurement and related systems in place within the MOF and the capability of the PMU to conduct procurement under the project was initiated during pre-appraisal of the project and completed during appraisal in October 2015.

29. The overall coordination, management, implementation, and oversight of procurement will be carried out by the PMU at the MOF, which is responsible for the implementation of the ongoing MSIP operation. The PMU is functioning well and experienced in managing procurement under Bank-financed investment lending. It has a proven track record of preparation and implementation of the ongoing MSIP. Given the nature of the project, selected municipalities that will benefit from the project will be involved in various stages of the procurement. Due to the lack of capacity and knowledge of Bank procurement procedures at the municipal level, the PMU will take the lead for quality assurance and management of the subproject procurement process. Municipalities, with support from the PMU, will carry out procurement under the subprojects on behalf of the municipalities, with their participation in all stages of the procurement process.

30. It is not envisaged that the project will finance large value and complex contracts. Given the demand-driven nature of the project, the subprojects to be financed through grants from the project will be identified, reviewed, and approved by the MOF during the life cycle of the project. The PMU will be responsible for official correspondence with the Bank on fiduciary issues and for adhering to the requirements in the project and legal documents.

31. The risk associated with procurement, after implementation of the mitigation measures as outlined in table 3.4, is rated as Moderate.

Table 3.4. Agreed Mitigation Measures

Sl. No.	Mitigation Measures	Timeline for Completion	By Whom
1	Procurement under the project will be carried out in accordance with the relevant and most recent Procurement and Consultant Guidelines and standard bidding and proposal documents of the Bank.	During project implementation	PMU
2.	If needed, an additional procurement specialist and/or a civil engineer will be hired in the PMU, given that for a certain period the PMU will be responsible for implementing the ongoing MSIP and the new MSIP2 in parallel.	After project effectiveness	PMU
3.	The procurement staff, municipalities' representatives, members of evaluation committees, and other technical staff involved in project procurement will be trained in Bank Procurement and Consultant guidelines and procedures on a regular basis during project implementation.	During project implementation	PMU and the Bank
4.	The POM will elaborate the procurement arrangements, roles, and responsibilities with regard to project procurement in general and procurement under the subgrants in particular.	By project effectiveness	PMU
5.	The procurement and review thresholds for the project will be in accordance with the agreed procurement plan.	Thresholds to be set at project appraisal and updated as relevant during project implementation	PMU and the Bank
6.	The particular prior and post review arrangements will be specified in the Procurement Plan agreed with the Bank.	At project appraisal and updated as relevant during project implementation	PMU and the Bank
7.	The initial summary procurement plan for the first 18 months of project implementation shall be agreed during negotiations, and will be updated during project implementation annually or on an as-needed-basis.	At project appraisal and updated as relevant during project implementation	PMU

32. **Applicable guidelines.** Procurement for the proposed project will be carried out in accordance with the Bank's 'Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers' dated January 2011 and revised July 2014. Consulting services will be procured following the Bank's 'Guidelines Selection and Employment of Consultants under IBRD Loans and IDA Credits & Grants by World Bank Borrowers' dated January 2011 and revised July 2014, as well as the provisions stipulated in the Loan Agreement.

33. **A general procurement notice** of the project will be published after project negotiations in the United Nations Development Business website, the Bank's external website, in the Macedonian official gazette, and on the MOF's website.

34. **Anticorruption measures.** Through the PMU, the implementing agency will follow the Bank's anticorruption measures and will not engage the services of firms and individuals debarred by the Bank. The list of debarred firms and individuals is available at <http://www.worldbank.org/html/opr/procure/debarr.html>.

35. The Bank Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credit and Grants, dated October 15, 2006 and revised on January 2011, will also apply.

36. **Summary Procurement Plan.** A summary Procurement Plan for the proposed project, covering at least the first 18 months of the project was prepared during the appraisal stage and its final version as agreed during project negotiations (see table 3.5). It includes, at the minimum, (a) a brief description of the goods, works, and non-consulting and consulting services required for the project; (b) the proposed method of procurement; (c) the Bank's review requirements; and (d) the timeline for initiation of procurement, including contract commencement and completion. After loan negotiations, the Bank shall arrange for the publication of the agreed initial Procurement Plan and all subsequent updates on its external website, once it has provided a no-objection.

37. **Post review arrangements and frequency.** The specific review arrangements for the respective contracts are indicated in the Procurement Plan. Contracts not subject to prior review will be post reviewed once a year by the Bank's procurement specialist assigned to the project. At a minimum, 1 out of 10 contracts will be randomly selected for post review.

38. The general description of various items under different expenditure categories is provided below. For each contract to be financed by the loan, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame would be agreed between the borrower and the Bank team and reflected in the Procurement Plan.

Table 3.5. Summary Procurement Plan.

Macedonia - SECOND MUNICIPAL SERVICES IMPROVEMENT PROJECT - MSIP																		
Procurement estimates & monitoring																		
in EUR																		
No.		Municipality		Type	Number of Contract	Contract Cost estimate/budget (EUR)	Procurement Method	Prior / Post Review	Bidding documents submission date	WB No Objection	Issue of Bidding Documents	Bid Opening	BID ER sent to the WB	WB NO on ER	WB No objection on Contract Award	Contract Award	Contract Start Date	Contract Duration (Month)
A. MUNICIPAL INVESTMENTS																		
1	GAZI BABA	Construction of primary water supply network at 5 branches in high zone in village Rastirak	P	Works	1		NCB	Post	8-Apr-16	16-Apr-16	20-Apr-16	20-May-16	30-May-16	16-Jun-16	16-Jun-16	20-Jun-16	25-Jun-16	6
			A															
2	KISELA VODA	Construction of the storm water system in the district Pazino, in Kisele Voda municipality	P	Works	1		ICB	Prior	30-Apr-16	16-May-16	20-May-16	6-Jun-16	25-Apr-16	6-May-16	6-May-16	19-May-16	16-May-16	12
			A															
3	DELCEVO	Construction/reconstruction of local streets in Delcevo	P	Works	1		NCB	Prior	10-May-16	25-May-16	1-Jun-16	1-Jul-16	15-Jul-16	25-Jul-16	25-Jul-16	30-Jul-16	5-Aug-16	10
			A															
4	CITY OF SKOPJE	Construction of new main street	P	Works	1		ICB	Prior	8-Aug-16	20-Aug-16	26-Aug-16	9-Oct-16	26-Oct-16	10-Nov-16	10-Nov-16	18-Nov-16	26-Nov-16	18
			A															
	Other municipalities	In process of funds allocation																
Total Component A: Municipal Investments																		
B. POVERTY/SOCIAL INCLUSION INVESTMENT GRANTS																		
1	GAZI BABA	TBD	P						TBD									
			A					SH	Post									
2	KISELA VODA	TBD	P					NCB	Post									
			A															
3	DELCEVO	TBD	P															
			A				NCB	Post										
4	CITY OF SKOPJE	TBD	P															
			A				NCB	Post										
	Other municipalities	In process of funds allocation																
Total Component B																		
C. PROJECT MANAGEMENT, MONITORING AND EVALUATION, AND CAPACITY BUILDING																		
C1: Project Management Unit (PMU)																		
	Director*		Consultant	1			SIC	Prior									30-Nov-17	37
	Financial Specialist*		Consultant	1			SIC	Prior									30-Nov-17	37
	Procurement Specialist*		Consultant	1			SIC	Prior									30-Nov-17	37
	Civil Engineer*		Consultant	1			SIC	Prior									30-Nov-17	37
	Civil Engineer*		Consultant	1			SIC	Prior									30-Nov-17	37
	Civil Engineer*		Consultant	1			SIC	Prior									30-Nov-17	37
	Civil Engineer*		Consultant	1			SIC	Prior									30-Nov-17	37
	Translator*		Consultant	1			SIC	Prior									30-Nov-17	37
	Administrative/Operative Assistant*		Consultant	1			SIC	Prior									30-Nov-17	37
	Financial Assistant*		Consultant	1			SIC	Prior									30-Nov-17	37
	Civil Engineer*		Consultant	1			SIC	Prior									30-Nov-17	37
	Civil Engineer*		Consultant	1			SIC	Prior									30-Nov-17	37
	Procurement Assistant*		Consultant	1			SIC	Prior									30-Nov-17	37
	Interpreter		Consultant	1			SIC	Prior	01-Jan-16	04-Jan-16	6-Jan-16	20-Jan-16	25-Jan-16	30-Jan-16	30-Jan-16	1-Feb-16	1-Feb-16	60
	Economist		Consultant	1			SIC	Prior	01-Mar-16	4-Mar-16	5-Mar-16	20-Mar-16	25-Mar-16	30-Mar-16	30-Mar-16	1-Apr-16	1-Apr-16	60
	Civil Engineer		Consultant	1			SIC	Prior	01-Mar-16	4-Mar-16	5-Mar-16	20-Mar-16	25-Mar-16	30-Mar-16	30-Mar-16	1-Apr-16	1-Apr-16	60
Total C1																		
C2: Technical assistance for (i) sub-project preparation/implementation and local capacity building for municipalities and CSEs to improve service delivery, and (ii) national level institutional																		
	TA for project preparation		Consultant	multiple			SIC	Prior	TBD									
	Safeguards Specialist (environmental)		Consultant	multiple			SIC	Prior	TBD									
	TA for capacity building for municipalities/CSEs to improve service delivery		Consultant	multiple			CQ	Prior	TBD									
	TA for capacity building of national level institution		Consultant	multiple			CQ	Prior	TBD									
	TA for verification of poverty/social inclusion grants		Consultant	1			CQ	Prior	TBD									
	Other Specialists		Consultant	multiple			SIC	Prior/Post	TBD									
Total C2																		
C3: Project Financial Audit (Multiple)																		
Total C3																		
C4: Other costs																		
	IT equipment		Goods	1			SH	Prior										
	Vehicle		Goods	1			SH	Prior										
	Other operating costs		Goods	multiple			SH	Post										
	Training for FIU staff		Training	multiple			Training	Prior	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD	
Total C4:																		
Total C																		
Front end Fee																		
Total Loan funds						15,960,600												

* All positions are contribution from the MSIP project and Additional Financing

Environmental and Social (including safeguards)

39. The borrower, represented by the MOF and its PMU, has the knowledge and capacity to comply with the Bank requirements for environmental and social safeguards gained in the course of the implementation of the MSIP operation. The EAMF and POM under the MSIP detail the implementation roles of the borrower and the Bank in preparation, approval, and execution of the EMPs for each subproject. As part of subproject identification, the PMU undertakes environmental screening for each of the proposed subprojects and develops the respective EMPs, which are subsequently included in the bidding documents. Environmentally related activities and procedures are carried out by the borrower as designed, with due diligence and sufficient attention to details. Compliance with measures prescribed in subproject-specific EMPs is reviewed by the PMU staff at regular intervals and written reports on findings are prepared and filed in the PMU. Contracts for civil works under the project are subject to screening for environmental impacts by the Ministry of Environment in the borrower country. All studies and bidding documents related to civil engineering works include measures to minimize and/or mitigate potential environmental damage. Separate EMPs or site-specific EAs/EIAs and EMPs are prepared for each subproject. Even if the EA/EIA studies are not required by the national legislation, the borrower observes requirements set in the EAMF Report and the respective EMPs prepared for this project. Those EMPs/EAs/EIAs are reviewed and endorsed by both the responsible environmental entity in the borrower country and the Bank. Monitoring compliance in accordance with the findings of the EA Report and requirements of the relevant EMPs, including progress monitoring on EMP implementation, is undertaken by the MOF and reported to the Bank twice per year in the semiannual progress reports.

Monitoring & Evaluation

40. The PMU will be responsible for M&E of the project progress and outcomes, reporting, and discussions with the Bank. The PMU will conduct pre- and post-evaluations of the PDO indicators to determine the project impact on the performance of municipalities and the CSEs. The PMU will collect significant indicators agreed in the POM on the municipalities' technical and financial situation before and during project implementation, conduct analysis of indicator data, and monitor progress in preparing and implementing subproject investment programs. The M&E of project progress against plans will be reflected in the semiannual progress reports prepared by the PMU and provided to the Bank. The progress report should include FM reports and updates of the procurement plans; narrate progress against plans, highlight issues, and propose solutions; and include a section on monitoring indicators and evaluation of outcomes and results that could be discerned at the time of the report and provide results of stakeholder workshops and surveys. The reports will also outline any corrective actions needed to sustain or improve the project implementation progress. Details of performance indicators, target values, data collection, and reporting methods are presented in Annex 1: Results Framework and Monitoring.

41. The Bank will provide close supervision and implementation support to the project to monitor and evaluate its results and achievement of the PDO, and recommend timely actions, whenever needed, to ensure successful completion of the project-supported activities, including project restructuring. The Bank will carry out regular implementation support missions and an in-depth midterm review including experts outside the immediate task team.

Role of Partners

42. The MOF will be the main partner representing the borrower. The key roles of the MOF are defined in paragraph 7 of this annex.

Annex 4: Implementation Support Plan

Strategy and Approach for Implementation Support

1. The Implementation Support Plan articulates the Bank's approach to help the country achieve the expected results and objectives under the project based on its nature and risk profile. It identifies the inputs and actions required to facilitate better risk management, better results, and increased institutional development while ensuring compliance with the Legal Agreements to meet the Bank's fiduciary obligations. The required resources have been identified taking into account the needs to (a) monitor and evaluate results on the ground; (b) facilitate timely implementation of the risk management measures, and (c) provide necessary technical advice to the borrower's implementing agencies for capacity strengthening.

2. The Bank task team will comprise local and international technical experts assigned to the particular aspects of the project activities. The project is expected to have a task team leader based in headquarters and the core team members mostly based in the region. In particular, a senior social development specialist, who will also be the team's focal point in FYR Macedonia, will be based in Skopje. A senior economist will be based in Vienna, a senior operations officer will be based in Moscow, an environmental specialist and an FM specialist will be based in Bucharest, and a procurement specialist and an engineer (senior water supply and sanitation specialist) will be based in Zagreb. They will all be expected to travel periodically to the country and conduct field visits to the project sites. This blend of staffing will ensure an appropriate balance between local knowledge and responsiveness and global expertise.

Implementation Support Plan

Focus	Skills Needed	Resource Estimate (in Annual Staff Weeks)
Project coordination, client management, and overall technical and operational support	Task team leader	8
Economist	Senior economist: operational and technical support	4
Engineer	Technical support and advice	5
Social safeguards, citizens engagement, vulnerable communities involvement	Social development specialist: operational and technical support	8
Urban: operational and technical support	Senior operations specialist: operational and technical support	5
FM and disbursement	FM specialist	2
Procurement	Procurement specialist: technical support	4
Environmental safeguards	Environmental management specialist: technical support	2
Administrative support	Program assistants: administrative and logistical support	4
Total	—	42

Skills Mix Required

Skills Needed	Number of Staff Weeks (Annual)	Number of Trips (Annual)	Comments
Task team leader (international)	8	3	Washington, D.C. based
Senior economist	4	2	Vienna based
Engineer (senior water and sanitation specialist)	5	3	Zagreb based
FM specialist	2	1	Bucharest based
Procurement specialist	4	1	Zagreb based
Environmental safeguards specialist	2	2	Bucharest based
Senior social specialist	8	0	Skopje based
Senior operations officer	5	3	Moscow based
Program assistant (international)	1	0	Washington, D.C. based
Program assistant (local)	3	0	Skopje based
Total	42	15	–

Partners

Name	Institution/Country	Role
MOF	FYR Macedonia	Implementing agency

FM Implementation Support and Supervision Plan

3. During project implementation, the Bank will supervise the project's FM arrangements in two main ways: (a) review of the project's IFRs, as well as the annual audited project financial statements and the auditor's management letter and (b) on-site supervision with the frequency based on the assessed project's risk and performance (first supervision within a maximum of 12 months after the assessment) to review the project's FM and disbursement arrangements to ensure compliance with the Bank's requirements. The on-site supervision will include a review of the following areas of the project's financial management: accounting and reporting, internal control procedures and external audits, planning and budgeting, funds flow, and staffing arrangements. A sample transactions review will also be conducted, including a walk-through of selected transactions under the subloans and grants. Implementation support and supervision will be performed by the Bank-accredited FM specialist.

Annex 5: MAP

