RESTRUCTURING PAPER

ON A

PROPOSED PROJECT RESTRUCTURING
OF THE
RAILWAYS RESTRUCTURING PROJECT
LOAN 4787 TU, EUR 143.7 MILLION
(US$184.7 MILLION EQUIVALENT)
JUNE 9, 2005

TO THE

REPUBLIC OF TURKEY

JUNE 27, 2012
CURRENCY EQUIVALENTS

(Exchange Rate Effective April 30, 2005)

Currency Unit  =  Yeni Turkish Lira (YTL)
YTL 1.00  =  US$1.369
EUR 1.00  =  US$1.285

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

- APL: Adaptable Program Loan
- ERTMS: European Rail Traffic Management System
- ETCS: European Train Control System
- PDO: Project Development Objective
- RTMS: Rail Traffic Management System
- TCDD: Turkish State Railways

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TURKEY
RAILWAYS RESTRUCTURING PROJECT

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RAILWAYS RESTRUCTURING PROJECT

RESTRUCTURING PAPER

A. SUMMARY

1. The purpose of this restructuring paper is to seek approval by the Regional Vice President for a Level II restructuring of the Turkey Railways Restructuring Project (Loan IBRD-4787, P077328). The proposed restructuring is intended to: (a) extend the project closing date by 18 months from June 30, 2012 to December 31, 2013; and (b) extend the PDO and intermediate indicators’ target dates to reflect the longer implementation period. The extension was requested by the Turkish Treasury in a letter dated June 14, 2012. Regional Vice Presidential approval is required because the cumulative extension of the project is greater than two years. The extension of the project will allow Turkish Railways (TCDD) to complete the main investment component, a signaling system on the Mersin-Toprakkale and Yenice-Bogazköprü lines, and use available technical assistance funds to support the railway sector reform specified in the proposed and recently circulated Law on Liberalization of Railway Transportation in Turkey. Without the extension, TCDD would not be able to complete the implementation of the signaling system using Bank loan funds, which is essential for increased capacity and improved safety.

B. PROJECT STATUS

2. History: The Railways Restructuring Project was approved by the Board on June 9, 2005 and became effective on June 19, 2006. The Project was intended to be the first phase of a two-phase Adaptable Program Loan (APL). The objective of the APL was to improve the financial viability, productivity, and effectiveness of railway operations. The objective of the Project was to support the Borrower’s implementation of the Program over the four (4) year period 2005-2009, to improve productivity and effectiveness of railway operations and to assist the TCDD in reaching a financially sustainable situation and reduce the fiscal burden that TCDD represents for the Borrower.

3. The project has five components:
   - The **Freight Lines Capacity Increase** component to support installation of a signaling and telecommunications system on the Mersin-Toprakkale and Yenice-Bogazköprü lines and extension of station tracks;
   - The **Staff Adjustment and Social Plan** component to support severance payments to TCDD staff under a voluntary retirement scheme to help contain costs;
   - The **Advisory Services to TCDD** component to assist TCDD in carrying out internal reforms;
   - The **TCDD Staff Training and Re-training** component; and
   - The **TCDD Public Communications and Periodic Surveys** component to support customer and stakeholder surveys and public outreach.

4. The Project was originally intended to help TCDD and the Government of Turkey implement new railway legislation aligned with relevant EU directives. However, there were delays in the original timetable for adoption of this legislation and in 2009 the project was
restructured to focus on objectives that could be achieved within Turkey’s existing legislative framework for the railway sector. The Project development objective and the results indicators were revised as part of that restructuring.

5. The revised PDO is to (a) improve the effectiveness of railway operations on the Mersin-Toprakkale and Yenice-Bogazköy lines by increasing capacity and improving service quality, and (b) lay the groundwork for restructuring TCDD by developing experience with financially viable contract arrangements for loss making public services and access pricing of infrastructure. During the 2009 restructuring the Project closing date was also extended by 2 years and 9 months.

6. The Project was restructured again in August 2011 to address land acquisition and renovations of historic railway station buildings that triggered Bank policies on involuntary resettlement (OP/BP 4.12) and physical cultural resources (OP/BP 4.11), respectively. No further changes to the PDO, components and results indicators were made at that time.

7. **Current status:** The Project has suffered from implementation delays, especially of the signaling contract under component 1. The loan has disbursed EUR90 million out of a total loan amount of EUR144 million; EUR53 million of the loan remains to be disbursed in Component 1 (Freight Line Capacity Increase) and the rest remains to be disbursed in Component 3 (Advisory Services), Component 4 (Staff Training), and Component 5 (Public Communications and Periodic Surveys).

8. Detailed implementation status by component is as follows:

   • **Freight Line Capacity Increase component:** General designs, station tracks and reconstruction of buildings to house the signaling equipment have been completed. Installation of signaling equipment, switches, cabling is underway and the system is being tested in the first group of stations. Overall the physical implementation stands at 53%.

   • The **Staff Adjustment** component financed the end-of-employment, lump sum payments for retirement of 1,596 TCDD staff. All retirements were voluntary with no layoffs. The component was completed in 2009.

   • The **Advisory Services to TCDD** component has financed studies on: (a) Internal Financial Controls Risk Assessment; (b) Freight Marketing; (c) Rationalization of Passenger Services and Public Service Obligation (PSO); and (d) Maintenance Practices Benchmarking and Improvement. TCDD has also carried out pilots supporting reforms on public service contracts and infrastructure charging. These pilots and studies are designed to prepare TCDD to implement reforms, but they can only be meaningfully implemented after the necessary Railway legislation has been passed.

   • The **TCDD Staff Training** component has financed trainings on: (a) non-destructive testing of rolling stock components and rail track; (b) project management; (c) providing distance (on-line, computer based) training; and (d) training of trainers.

   • The **TCDD Public Communications and Periodic Surveys** component supported two surveys of TCDD customers and stakeholders. A third survey is currently underway.
and will be completed in June 2012. With the third survey, this component will be completed.

9. Project performance on environmental and social safeguards is satisfactory; procurement performance is satisfactory; and financial management performance is moderately satisfactory due to delayed entity audit reports with disclaimer of opinions, mostly related to TCDD asset inventory and valuation of fixed assets. The Project audit report for the year ended December 31, 2010 has been received on time and there are no financial management issues at the project level. There are no outstanding audit reports or reports that are not satisfactory to the Bank.

10. **Request and rationale for extension:** With over EUR 50 million under component 1 undisbursed and physical implementation 53% complete, it became clear in early 2012 that completion of the project and achievement of its objectives with respect to improved capacity and quality of railway services on a key freight route was unlikely to be achievable by the project’s revised closing date in June 2012. At the same time, intensive efforts were made by TCDD and the contractor implementing the signaling contract to resolve contractual disputes, which had been a cause for delay in implementation. The resulting agreements were officially recorded and a detailed implementation plan was prepared that would allow completion of all project activities by December 2013. This plan has been reviewed by Bank experts and the supervision consultant retained under the project and is regarded as credible. On the basis of these agreements, the borrower requested an 18 month extension on June 14, 2012.

11. The rationale for a second extension and corresponding project restructuring is as follows:

- **High priority commercial investment:** The requested 18-month extension would allow the main investment component, installation of a new signaling system on the Mersin-Toprakkale and Yenice-Bogazköprü lines, to be completed. The investment is a high priority for TCDD. It would increase capacity and improve safety on two congested main lines. This will allow TCDD to handle more freight traffic from the port of Mersin, which is the third largest port in Turkey and is expected to expand further in coming years. Currently, TCDD carries less than 5 percent of the traffic to/from the port. TCDD is building a logistics village at the junction of the two lines (at Yenice) to serve containers and other traffic from the port. TCDD management at all levels emphasizes the commercial importance and hence high priority of these investments.

- **EU compatibility:** The project supports the first installation in Turkey of a European-compatible train control system with in-cab train controls and wayside balises.¹ Signaling systems are safety critical and the project provides for professional technical supervision of the design and installation of the system through consultants experienced with European signaling systems. Halting the project in the middle of implementation could lead to additional delays and increased safety risks.

- **Renewed momentum in railway reform:** The government of Turkey is taking steps to revive the railway sector reforms. In November 2011, the Ministry of Transport,

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¹ The system complies with European Rail Traffic Management System (ERTMS) Level 1 specifications.
Maritime and Communications (MoT) issued a decree law, which reorganized the Ministry into twenty service units and created a Railway Regulation Directorate with responsibility to regulate the railway industry. In May 2012, MoT circulated a draft Law on Liberalization of Railway Transportation expected to move the reform agenda forward. MoT plans to submit the law to Parliament before the 2012 summer recess. These are important steps for aligning the Turkish rail transport regulation with the European Union Acquis for railways. Extension of the project would allow TCDD to use technical assistance funds remaining in the Project to support: (a) the restructuring of TCDD including the separation of TCDD into an infrastructure and an operations company; (b) implementation of access charging; and (c) training on safety in the new operating environment.

12. **Risks and risk mitigation:** Given the project’s record to date, there is a considerable risk that implementation of the key signaling contract continues to lag. This risk has been mitigated to some extent by the agreement of a specific action plan with concrete time-bound milestones that will be continuously monitored by the borrower and the Bank. Moreover, all sides are aware that failure to adhere to this action plan may trigger remedial action by the Bank prior to the revised closing date of December 2013.

13. The residual implementation risk is outweighed by the failure to achieve the PDO and associated reputational risks to the Bank and the borrower should the project close end June 2012. This second project extension of 18 months is proposed in due consideration of the balance of risks discussed above.

**C. PROPOSED CHANGES**

14. The following changes are proposed to the project.

- **Closing Date.** The project closing date would be extended by 18 months, from June 30, 2012 to December 31, 2013.

- **Indicators.** The PDO and intermediate outcome indicators and targets remain the same, but the target dates are adjusted in line with the proposed additional 18 months of implementation (see Annex 1).

15. No changes are proposed to the Project’s Development Objective, components, safeguards classification, institutional arrangements, financing, financial management or procurement.
## ANNEX 1:
Revised Results Framework and Monitoring
TURKEY: RAILWAYS RESTRUCTURING PROJECT

<table>
<thead>
<tr>
<th>PDO Level Results Indicators</th>
<th>Core</th>
<th>D=Dropped</th>
<th>C=Continue</th>
<th>N= New</th>
<th>R=Revised</th>
<th>Unit of Measure</th>
<th>Baseline 2008</th>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>Data Collection and Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicator One: Annual traffic volume on Mersin-Toprakkale and Yenice-Bogazköy lines increases²:</td>
<td>☐</td>
<td>C</td>
<td></td>
<td></td>
<td></td>
<td>Passenger-km</td>
<td>270,400</td>
<td></td>
<td>302,500</td>
<td>310,000</td>
<td>Annually Single report finalized by March 31 of following year</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Freight ton-km</td>
<td>886,800</td>
<td></td>
<td>891,000</td>
<td>923,000</td>
<td>TCDD Operating Systems</td>
</tr>
<tr>
<td>Indicator Two: Average Commercial Freight Train Speed³: Mersin-Toprakkale Yenice- Bogazköy</td>
<td>☐</td>
<td>C</td>
<td></td>
<td></td>
<td></td>
<td>Km/hour</td>
<td>35</td>
<td></td>
<td>35</td>
<td>45</td>
<td>Annually Single report finalized by March 31 of following year</td>
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<td>25</td>
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<td>25</td>
<td>35</td>
<td>TCDD Operating Systems</td>
</tr>
<tr>
<td>Indicator Three: Increase in share of net tons of traffic to/from Mersin Port handle by rail</td>
<td>☐</td>
<td>C</td>
<td></td>
<td></td>
<td></td>
<td>%</td>
<td>5.9%</td>
<td></td>
<td>6.3%</td>
<td>6.5%</td>
<td>Annually Single report finalized by March 31 of following year</td>
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<td>TCDD Operating Systems &amp; port of Mersin</td>
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<tr>
<td>Indicator Four: PSO</td>
<td>C</td>
<td>na</td>
<td>No experience with PSO contracts</td>
<td></td>
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<td>Annually Single report finalized by March 31 of following year</td>
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<td></td>
<td>TCDD Planning &amp; Coordination Department</td>
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<tr>
<td>Indicator Five: Infrastructure Access</td>
<td>C</td>
<td>na</td>
<td>No experience with access pricing or</td>
<td></td>
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<td></td>
<td></td>
<td>Full Network Statement prepared</td>
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<td>TCDD Planning &amp; Coordination Department</td>
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² Defined as the sum of Freight ton-km reported by TCDD for component line segments.
³ Commercial speed is the average speed at which a train traverses the line, including waiting time. This contrasts to design speed, which is the “speed limit” or maximum speed at which a train can traverse the line, if no delays.
<table>
<thead>
<tr>
<th>PDO Level Results Indicators</th>
<th>Core</th>
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<th>Unit of Measure</th>
<th>Baseline 2008</th>
<th>Year</th>
<th>Frequency</th>
<th>Data Source/Methodology</th>
<th>Responsibility for Data Collection</th>
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<tr>
<td></td>
<td></td>
<td></td>
<td>network statement</td>
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<td></td>
<td>TCDD with monitoring of Ministry of Transport and World Bank</td>
</tr>
<tr>
<td><strong>Intermediate Result indicator One:</strong> Share of project works completed</td>
<td>C</td>
<td>%</td>
<td>0</td>
<td>77</td>
<td>100</td>
<td>Annually</td>
<td>Supervision Consultants Report</td>
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<td>Single report finalized by March 31 of following year</td>
</tr>
<tr>
<td><strong>Intermediate Result indicator Two:</strong> Number of staff trained during the project is 2500.</td>
<td>C</td>
<td>Staff trained</td>
<td>0</td>
<td>400</td>
<td>400</td>
<td>Annually</td>
<td>TCDD Training Department Data</td>
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<td></td>
<td>Single report finalized by March 31 of following year</td>
</tr>
<tr>
<td><strong>Intermediate Result indicator Three:</strong> Independent surveys carried out (3)</td>
<td>C</td>
<td>Survey conducted</td>
<td>0</td>
<td></td>
<td></td>
<td>One report every two years</td>
<td>Report by specialized consultant</td>
<td></td>
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<td>TCDD with monitoring of Ministry of Transport and World Bank</td>
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