

October 19, 2011

Approval by mail: Project Preparation Grant for Ukraine: Energy Efficiency Project (UEEP)

Dear CTF Ukraine team,

thank you very much for a well drafted proposal, which we are happy to support. Pls find attached some detailed comments, which also mention our own engagement in the sector in Ukraine. We would be grateful for a coordinated approach.

Kind regards

Dr. Annette Windmeisser
Klimapolitik und Klimafinanzierung
Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung

**Comments on CTF PPTA Grant Proposal
“Ukraine – Energy Efficiency Project”**

Financial Volume: 1m. USD Grant for project preparation

Purpose of the PPTA: The project preparation technical assistance (PPTA) serves to prepare the implementation of municipal energy efficiency (EE) measures in the framework of the planned Ukraine – Energy Efficiency Project.

Assessment of the Proposal

We have no objections to the proposed project preparation technical assistance grant.

Summary of ToR:

Underlying investment project: The CTF Investment Plan for Ukraine (IP) includes the Ukraine Energy Efficiency Program with a total volume of 1,050 m USD including 125 m USD CTF financing¹. The Program is designed to improve energy efficiency in Ukraine by financing

¹ Note inconsistency of figures on p. 62 of IP: CTF financing components IBRD (50 m USD) and EBRD/IFC (75 m USD) do not add up to stated total CTF financing of 150 m USD. Considering other stated sources of financing, to reach the total volume of 1,050 m USD, total intended CTF financing is assumed to be 50+75=125 m USD.

a broad-based EE program that implements the Government's ambitious target to reduce energy intensity of the economy by 50% by 2030. It would include the following components: (1) the reconstruction and refurbishment of municipal & mixed ownership housing stock in order to improve their energy efficiency; (2) upgrading Government-owned buildings such as schools, kindergartens and hospitals; (3) decreasing losses in district heating supply; and (4) support for energy efficiency in industry.

PPTA Terms of Reference: The proposed PPTA will include four activities: (1) development of screening criteria, proposal template, and proposal guidelines for municipal EE investment projects; (2) development of a quality municipal investment pipeline and six fully prepared and bankable pilot projects, as well as concrete solutions to remove critical impediments to the implementation of pilot projects; (3) information and outreach campaign for development of municipal EE subprojects pipeline; and (4) assessment of the poverty and social impacts of UEEP.

Detailed comments on ToR:

- The proposed PPTA focuses on the implementation of energy efficiency (EE) projects on the municipal level. According to the IP, industrial EE is also to be targeted under the Ukrainian CTF EE programme. It is, however, assumed that additional separate TA is planned for the preparation of these components, considering that a total amount of 2m. USD is foreseen for PPTA for the EE programme in the IP.
- It is recommended that the TA when developing screening criteria, pilot project pipeline should bear in mind and account for the CTF investment criteria.
- Considering the difficult institutional environment (e.g. slow policy reforms and law enactment, lacking law enforcement and cost-covering tariff models in the targeted sectors, lack of commercially managed municipal service providers) in Ukraine, it is reasonable to build upon existing project successes to show the huge potentials in the area of EE. Building up on positive results with existing projects, e.g. in pilot municipalities which already cooperate with other donors (USAID, EU etc.) is likely to boost the knowledge base with those partners and create solid grounds to multiply the positive effects.
- Significant attention is to be given to the issue of financial closure both from the aspect of the final borrower (e.g. municipality, service company) as well as of the financial intermediary. Considering the current Ukrainian legislation, the debt capacity of the municipalities / service companies is fairly restricted to enter larger-scale investments. Furthermore, the vast majority of municipalities / service companies do rarely dispose of practical experience in terms of orderly planning and servicing loan financed investments. Likewise the majority of the Ukrainian banks dispose of restricted knowledge base, experience and resources (financial, human, IT etc.) in developing a municipal loan portfolio, its structuring or diversification to sustainably cover the area of EE in municipalities and the industry sector. While these topics may be included under the bullet point "Recommend practical solutions to crucial impediments..." it seems

essential to underline the importance of the above parameters towards a comprehensive and sound further preparation, as they are decisive for the success of the value (delivery) chain.

- Depending on the magnitude of the investment activities (feasibility study?), the estimated amount of 110.000 USD per project may not be sufficient to prepare mid-scale to large-scale investments in the targeted area. Considering the in many cases dilapidated municipal infrastructure it may be wise to follow a more comprehensive approach of sustainably tackling EE in the municipal segment, thereby providing municipalities with a long-term vision and plan on EE and investment prioritization to realize the plan.

Additional information:

- On behalf of the German Government, KfW is already implementing an energy efficiency (EE) project via the banking sector. The focus is set on EE with SME's and the housing sector. Considering the tremendous energy saving potential in these segments, KfW is currently conducting preparatory activities to expand the support in this area by applying the same mechanism. In addition, preparations are ongoing for the launch of a new EE project in the area of municipal service provision (e.g. water supply, wastewater, solid waste).