



OPS4 Technical Document #4

The Catalytic Role of the GEF

Case Study: The Slovenia EBRD/GEF Environmental Credit Facility

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Abbreviations

BAS	Business Advisory Services
BEERECL	Bulgarian Energy Efficiency and Renewable Energy Credit Line
CEO	Chief Evaluation Officer
EBRD	European Bank for Reconstruction and Development
EIA	Environmental Impact Assessment
EUR	euro
EU	European Union
GEF	Global Environment Facility
IPPC	Integrated Pollution Prevention and Control
PDF	project development facility
SME	small and medium enterprises
STAP	Scientific and Technical Advisory Panel
TAM	Turn Around Management

1 Introduction

The implementation approach of the Slovenia EBRD/GEF Environmental Credit Facility project is an example of an innovative model of project execution through financial intermediaries/private sector partnership that is of great interest to the Global Environment Facility (GEF). This case study summarizes the key strengths and weaknesses of the model used by the project, assesses its catalytic effect and its replication potential based on information collected during the project terminal evaluation. These findings together with the findings from other projects implemented through private sector partners will feed into the Fourth Overall Program Study (OPS4) of the GEF to be completed by August 2009.

2 Description of the Project Design

The European Bank for Reconstruction and Development (EBRD), in co-operation with the GEF, conducted an Environmental Credit Facility project in Slovenia. The project was implemented through the GEF International Water focal area, under the waterbody-based operational program (OP#8). The project became operational in 2004 and all sub-projects were completed at the time of the terminal evaluation mission conducted in October 2008. This project was the first GEF project executed by EBRD.

EBRD has provided EUR 45 million under the Facility, which was on-lent to commercial banks in Slovenia. From these funds, the participating commercial banks provided sub-loans to private and municipal entities investing in water pollution reduction and prevention projects.

GEF supported the Facility with \$9 million in grant. Out of these grant funds, the participating private and municipal entities were entitled to receive, after successful completion of sub-projects, completion fees (equivalent to 12 percent of the loan borrowed under the Credit Facility). The participating commercial banks received administrative and completion fees (equivalent to 2 percent of the loan lent under the Facility) to compensate them for the additional risks and administrative work associated with the implementation of the Credit Facility.

An additional \$0.907 million of GEF funding was used to support technical assistance and marketing activities and a variety of support services related to the Credit Facility. In particular, an independent environmental expert was hired to assist sub-borrowers to identify their investments needs, to confirm that each planned sub-project complied with the required eligibility criteria, to undertake monitoring and reporting on sub-projects, and to verify that the sub-projects had been implemented according to the eligibility criteria. The Facility was also supported by the Turn Around Management (TAM) and Business Advisory Services (BAS)

Programs¹ to provide support to companies and municipalities wanting to develop and implement water pollution reduction projects.

The primary objective of the Facility was the reduction of nutrient load in the Danube river basin. It also financed investments achieving reductions in other water pollutants, primarily toxic substances. The main focus intended to be on industrial companies, small and mid-sized municipalities, and large livestock farms to reduce their pollution of surface and groundwater in the Danube river basin. Specifically, the project was designed to contribute to the following expected outcomes:

- Outcome 1: Reduction of industrial, municipal and agricultural point-source water pollution (nutrient and toxic substance) in Slovenia
- Outcome 2: Demonstration of project concept based on financial intermediary/private sector partnership in pollution reduction

The GEF component of the project was to generate global environmental benefits (in the form of reduction of trans-boundary water pollution in the Danube river basin) through the provision of technical support and incentives that intended to achieve one or more of the following:

- Help the beneficiaries in meeting national emission reduction standards earlier than required by legislation
- Help the beneficiaries in reducing emissions beyond national standards
- Promote the introduction of innovative pollution reduction technologies and contributing to their widespread adoption

3 Project Achievements

The project did result in direct investments in water pollution reduction and pollution prevention projects in Slovenia. The EUR45 million lent by EBRD to participating banks was quickly and entirely disbursed to eligible sub-borrowers. All of the 49 sub-projects financed through the Credit Facility directly assisted companies and municipalities in meeting national and European Union (EU) environmental standards, including Environmental Impact Assessment (EIA) and Integrated Pollution Prevention and Control (IPPC) EU Directive.

¹ BAS is an EBRD multi-donor program which co-funds specific consultancy projects with micro, small and medium sized enterprises, improving their quality and competitiveness. TAM is another multi-donor program which provides industry specific advisors to small and medium sized enterprises, enhancing the knowledge and capabilities of their management during the transition to success in market driven economies.

In terms of generating global environmental benefits in the form of reduction over and above the baseline, project results can be summarized as followed:

- The long set-up period for the Facility lead to a relatively late set up of the Credit Facility as compared to the timeline² under the national legislation for the full compliance with EU Directives limited the project benefits in terms of potential for early actions. In depth interviews with about 25 percent of the sub-borrowers indicate that only in a very few cases did the Credit Facility and its grant component enable sub-borrowers to invest earlier than they could have otherwise.
- In most cases, the sub-projects financed thought the Credit Facility permitted to achieve reductions in emissions over and above the national and EU standards. The great majority of sub-borrowers simply used demonstrated best available technologies which performances already surpass the standards.
- The promotion and demonstration of innovative water pollution reduction technologies did not materialize.

4 Strengths and Weaknesses of the Project Concept

The Slovenia EBRD/GEF Environmental Credit Facility project has been designed as a pilot to test the concept of using local financial intermediaries as a way of reaching out to public and private sector water polluters planning to undertake investments in water pollution reduction and prevention projects and supporting them with grants and access to finance to encourage them to undertake investments in more aggressive pollution reduction and prevention projects at an earlier date than they would have otherwise. The Credit Facility was developed as a mechanism of bundling together sub-projects which would otherwise be too small to benefit directly from EBRD finance for environmental investments. Slovenia was chosen because of its relatively advanced and solid banking system and its tightening environmental legislation, which is being updated to be in line with EU accession requirements.

However, given the context in which the Credit Facility was implemented in Slovenia, the project did not permit to assess whether the model was truly effective in stimulating sub-borrowers interest in water pollution reduction investments.

A large part of the success of the Credit Facility could be attributed to the sub-borrowers readiness to invest. At the time the Credit Facility was set up, the vast majority of sub-borrowers met during the terminal evaluation stated that they were not only interested in investing but they were already in the process of setting up financing plan for their upcoming water pollution reduction investments. At the time of project implementation, credit was very abundant and affordable for potential borrowers on the Slovenian market. The limited-time-grant-offer attached to the loan attracted the sub-borrowers to the participating banks. However, the sub-

² Increasing penalties in the form of taxation for polluters over the period from Accession in 2004 to 2007.

borrowers met during the project terminal evaluation clearly stated that they would have proceeded with the water pollution reduction investment with or without the loan from the Credit Facility and the grant component. Using their own words, the sub-borrowers simply and logically went for “the best offer on the market at the time.”

It thus remains to be proven that such a Credit Facility can significantly accelerate investment in water pollution reduction technologies, lead to more aggressive reductions and promote the demonstration of innovative water pollution reduction technologies. Nevertheless, the remaining of this note presents what appear to be the main model strength and weaknesses as well as the catalytic effect of the project and the replicability potential of the model.

4.1 Model Strengths

- **The model has been successful in securing the participation of national financial institutions:** Four national banks successfully participated in the Credit Facility. Beside the financial incentives provided to the participating banks and to their prospective clients (the sub-borrowers), at least two other elements of the project design were key in securing national bank participation: i) **the excellent technical support** provided by the environmental consultant for the environmental screening and monitoring of the sub-projects, and ii) **the potential for an enhanced Credit Facility** in Slovenia and for the set up of other Credit Facility in the Danube river basin discussed during early negotiations with participating banks.
- **The model allowed for a relatively quick disbursement to sub-borrowers.** Overall, EBRD designed user-friendly and efficient procedures for the disbursement of loan to sub-borrowers compared to the alternative sources of financing in Slovenia. **The financial intermediary approach coupled with the support of external and independent environmental consultants and a pre-determined disbursement period (two years) has given rise to the a rapid allocation of the resources.** In addition, an important factor in the efficiency of the model was the relatively short time (two weeks) which the environmental consultants were given to evaluate and rapidly provide an assessment of the eligibility of applicants for potential sub-projects. GEF projects have often been criticized for being too slow to implement to be responsive to private sector needs. Although opportunities were missed given the relatively long set up stage of the Credit Facility, the actual implementation of the Facility was in line with private sector pace.
- The cash incentive component of the Credit Facility was very attractive for sub-borrowers and its disbursement at project completion was an effective strategy for encouraging the prompt completion of the sub-projects. According to participating banks and sub-borrowers, application and project monitoring procedures were kept simple and overall commensurate to the benefits of using the Credit Facility. The sub-borrowers considered the 12 percent cash incentive as more appealing than a concessional loan that would have included an equivalent grant component. Several of the sub-borrowers met during the project terminal evaluation claimed that the fact that the 12 percent cash

incentive was disbursed to them at project completion encouraged them to complete their project more rapidly.

4.2 Model Weaknesses

- **The relatively late set up of the Credit Facility limited the benefits in terms of potential for early actions.** One of the project objectives was to help the beneficiaries meet national emission reduction standards earlier than required by legislation. **At this level, benefits could have been more significant if i) the Credit Facility had been put in place at an earlier date and ii) the marketing strategy had been more aggressive at a very early stage.** Given the time spent on the design of the Credit Facility and for its approval at various levels, the Credit Facility was only operational in 2004,³ although the concept was discussed as early as 2000. The Credit Facility was operational only three years before several of the sub-borrowers had to invest in order to comply with ICCP Directive and thus only a small window of opportunity remained for accelerating investment patterns.⁴ Moreover, several of the stakeholders met in the context of the evaluation mentioned that the marketing strategy with potential sub-borrowers was initially not as clear and as effective as it could have been which led to further delays in the implementation of the sub-projects.
- **The model was not adequately designed to promote the demonstration of innovative pollution reduction technologies and to contribute to their widespread adoption.** The loans were allocated on a first come first served basis provided that the projects proposed by the sub-borrowers met the eligibility criteria. Although the environmental consultants had to ensure that the projects proposed were meeting the upcoming standards, they mainly promoted the use of demonstrated best available technologies which environmental performance already surpassed the upcoming national and EU environmental standards, including EIA and IPPC EU Directive. Moreover it appears that the promotion of non-proven technologies through demonstration projects would have been slightly incongruous with the commercial bank financing of the sub-project. Overall, the grant component provided to sub-borrowers and participating banks and financed by the GEF was not perceived and promoted as an incentive to convince beneficiary industries and municipalities to invest in innovative water pollution reduction technologies.

³ The first loan agreement with a national bank was signed on 2 December 2003. Three further loan agreements were signed in May, September, and December 2004.

⁴ This reflects the challenges of dealing, for the first time, with the dual bureaucracies of GEF and EBRD. This included securing the PDF funds, organizing and conducting the demand study, drafting the project brief, running the project through STAP, the GEF Secretariat and Council, and obtaining CEO endorsement. All these activities were new to EBRD, had to be done via a GEF implementing agency (The World Bank), and both EBRD and the mechanisms/model we were proposing were new to the GEF.

Although most of the demonstrated technologies used by the sub-borrowers reduced pollution discharge to water bodies to practically zero or at least to a fraction of what would be allowed under the new standards, **a greater emphasis on the promotion of an integrated approach to pollution reduction including sludge management could have been relevant.** In fact, while most of the sub-borrowers solved their water pollution issues through their recent investment, some of them are now facing sludge management issues. This appears to be an area in which more research and demonstration is needed in Slovenia and elsewhere.

- **The model was biased in favor of support to the financially healthiest and largest industrial companies.** Although targeted beneficiaries included industrial companies, small and mid-sized municipalities, and large livestock farms, the Credit Facility primarily benefitted large industrial companies in excellent financial condition. About a third of the loans available under the Credit Facility were allocated to small and medium enterprises. However, less than five percent of the loans available were allocated to public sector sub-borrowers and none to large livestock farms. In fact, one of the participating banks explicitly narrowed the number of potential sub-borrowers by excluding municipalities (due to a more demanding approval process) and small companies since they would have had to be served by credit officers in the branch network that would have required additional capacity building and instructions which the bank was not ready to provide. In order to get best results out of the Credit Facility with as little efforts as possible, another bank simply approached potential large borrowers among their existing clients, which proved to be a successful strategy to disburse the loan quickly but at the expense of SMEs, municipalities and large livestock farms.

The demand study realized at project design stage stated that the companies that were then in a stable financial condition – and therefore attractive to commercial banks were already investing in water pollution reduction facility. This demand study also highlighted that if the credit line was to be implemented through local commercial banks, there would be a need to take into account that a good share of the companies that would actually need assistance the most were not in good financial shape and therefore much less attractive for commercial banks operation.

Naturally, participating banks were more inclined to sign loan agreement with sub-borrowers in excellent financial conditions which resulted in a zero default rate on the loans so far. However, this potentially excluded sub-borrowers that would have needed this particular loan and its grant component the most in order to proceed with the water pollution reduction investment unlike the majority of the sub-borrowers that apparently actually did benefit from the Credit Facility.

Unsurprisingly, the marketing strategy that consisted in advertising the availability of and the access to the Credit Facility at the national level across sectors to foster portfolio diversification could not counterbalance participating banks' preference in favor of the large and most credit worthy clients. In the context of a replication, it should be noted that the Credit Facility model is not the most appropriate structure to

channel funding to enterprises which are not the most financially sound but sometimes the ones that need financial assistance the most in order to proceed with environmental investments.

- **The model has not been successful at increasing the participation of the private financial institutions in financing water pollution investment under normal market terms and conditions:** The participating banks stated that their participation in the Credit Facility was opportunistic and none of them had the explicit intention of pursuing proactively the financing of water pollution investments. Participating banks claimed that they could be open to financing similar projects in the future on a commercial basis but most likely as a component of a greater investment package and on an opportunistic basis as they did before the Credit Facility was set up. **Overall, the project did not have an impact on participating banks marketing strategy in the water pollution reduction sector nor on their perception of the potential of the sector as a promising business line. This is not surprising given that we are talking about a relatively narrow market.** The result might be very different in the context of the financing energy efficiency projects for instance where the market would be much more attractive for any financial institutions.

5 Project Replicability

5.1 Replicability plans

At project design stage it was considered that successful replication could take several forms, including: (i) establishment of other water pollution credit lines/facilities disbursed through private channels and subsidized by GEF or other public funding sources; (ii) providing support for other non-grant financing modalities (guarantee facilities, contingent financing facilities etc.) involving both public and private institutions and funding sources; and (iii) increased participation of private financial institutions in financing water pollution investment under normal market terms and conditions. Replicability of the project was also to be addressed through the increased user confidence in, and cost-reductions of, innovative water pollution reduction technologies demonstrated through project investments.

The implementation of the project in Slovenia was expected to provide EBRD, the GEF and other stakeholders with experiences, which would help with further developing the project concept and management.

It was also expected that the experiences could be used to streamline the approach thus moving it closer to commercial terms and reducing the level of concessional funds required in future replication.

5.2 Project actual catalytic effect

At the time of the project terminal evaluation, the catalytic or replication effect of the project was not up to expectation.

So far, there has not been any follow-up project establishing other water pollution reduction credit lines/facilities or other non-grant financing modalities (guarantee facilities, contingent financing facilities, etc.) disbursed through private channels and subsidized by GEF or other public funding sources. In that regard, EBRD representatives mentioned that it was expected that the GEF would make new grant money available to replicate the Credit Facility in the region but that the GEF has not been responsive so far to such a proposal. So far, despite a relatively successful experience with the Credit Facility in Slovenia, EBRD has not proactively searched for other potential donors to participate in such a Credit Facility in the water pollution reduction sector. EBRD representatives mentioned that the dialogue with GEF is on-going and that future similar projects are not ruled out. Moreover, EBRD is successfully using a comparable model in the field of industrial energy efficiency in other countries. The Bulgarian Energy Efficiency and Renewable Energy Credit Line (BEERECL) has been developed by EBRD in 2004 in close cooperation with the Bulgarian Government and the European Union. The facility extends loans to participating banks for on-lending to private sector companies for industrial energy efficiency and small renewable projects.

Participating banks claimed that they would be open to a replication of such a project. One thing that was learned through the project by the participating banks was how to sell such a project to bank management. Participating banks clearly stated that the experience could be relatively easily replicated as they felt that the project was overall very successful from their point of view. However, based on EBRD monitoring reports and on interviews conducted by the project terminal evaluation team with all participating banks, it cannot be concluded that the project resulted in an increased participation of participating financial institutions in financing water pollution investments under normal market terms and conditions. None of the participating banks show any intention to actively pursue water pollution reduction and prevention financing in the future. In sum, **the experience with the Credit Facility did not persuade the participating banks to structure a specific financing where the knowledge and experience gained with the project would be used on a larger scale. Again it should be noted that this is not surprising given that we are talking about a relatively narrow market.**

As discussed earlier in this report, the majority of the sub-borrowers have used standard cost-effective proven technologies in the context of their water pollution reduction investments. The Credit Facility model was not appropriate to promote **the use and dissemination of innovative technologies and consequently replicability did not occur as a result of increased user confidence in, and cost-reductions of, innovative water pollution reduction technologies demonstrated through project investments.**

Overall, at the time of the project evaluation, the project had no important catalytic impact mainly due to the following factors:

- The executing agency relied too heavily on the GEF to provide additional grant money to support the replication of the Credit Facility in the region. A better replication strategy relying on other donors/stakeholders should be promoted.

- The model did not adequately promote a sustainable increase in the financing of water pollution reduction and prevention projects within the participating banks or within the executing agency on a more commercial basis.
- The model was not adequately promoting the use of innovative technologies and thus led to a rather insignificant demonstration effect at this level. As some of the sub-borrowers are facing sludge management issues, this could be, in the context of replication, an area in which more innovative technologies and demonstration projects could be promoted.
- The comprehensive stakeholder involvement and information dissemination strategies anticipated at project design did not materialized in part due to the early closure of the program that was entrusted with stakeholder involvement and project dissemination responsibilities. In the context of a replication, adaptive management measures should be taken to ensure that such responsibilities are promptly reassigned when a project partner can no longer be involved in the project.

Overall the potential for replication of the project remains. The experience in Slovenia is not conclusive on the potential to trigger early investment in more aggressive water pollution reduction and prevention facilities through such a Credit Facility. However, under the new global context in which credit is becoming less accessible, the model could be valid providing that some of the issues highlighted through this case study are taken into consideration.