Financing Development Projects - the EU blending mechanisms

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Outline

1. Introduction - What, Who, and How
2. Blended Finance - The ultimate model of development finance?
3. Project Examples and Evaluation
4. Conclusions, Outlook, and Perspectives

1. Introduction

What, Who, and How

…a few basics

- Who is involved in development projects?
  - Donors, Partner countries, implementing agencies, private investors
  - Interests? Business models?
- Which instruments are used to finance investments?
  - Public sector
  - Private sector
- Why lending? When grants?
  - Incentives
  - Debt sustainability, market failure, additionality

Multilateral Development Banks

- What are they trying to achieve?
  - Development policy objectives
  - Financial return
- How is the organisation structured?
  - HQs: appraise projects, most core functions
  - Country offices: client relations, management of portfolio of ongoing projects
- How are projects selected?
  - Multiannual Country Strategies
  - Instruments: (concessional) loans, grants (from Trust Funds or bank income), equity
  - Viable projects developed for lending, supported by grants


Country Partnership Strategy/
Regional Cooperation Strategy
Preparation
Approval
Implementation
Completion/
Evaluation
ADB
Project
Cycle

What is needed to implement a project?

- Identification
- Preparation: pre-feasibility studies, project design
- Develop the project for approval:
  - Concept of viability (economic/financial)
  - Feasibility studies, technical design
  - Environmental, Social, other impacts
  - Comply with bank rules
- Provide loan for the investment (capital expenditure)
- Implementation
  - Procurement processes
  - Construction supervision
  - Monitoring of results
- Evaluation
  - Assessment of outcome, impact

Additionality through grant support

- Via Trust Funds or annual income of MDB's
- Enable project identification, preparation
- Increase financial return to match economic return
- Demonstrate viability of new approaches
- Absorb risk
- Increase quality of the project
  - Improve technical quality
  - More targeted design (poverty, climate change)
  - Incentivise higher standards by demonstration
- Speed up implementation

- How to credibly demonstrate beforehand?

2. Blended Finance

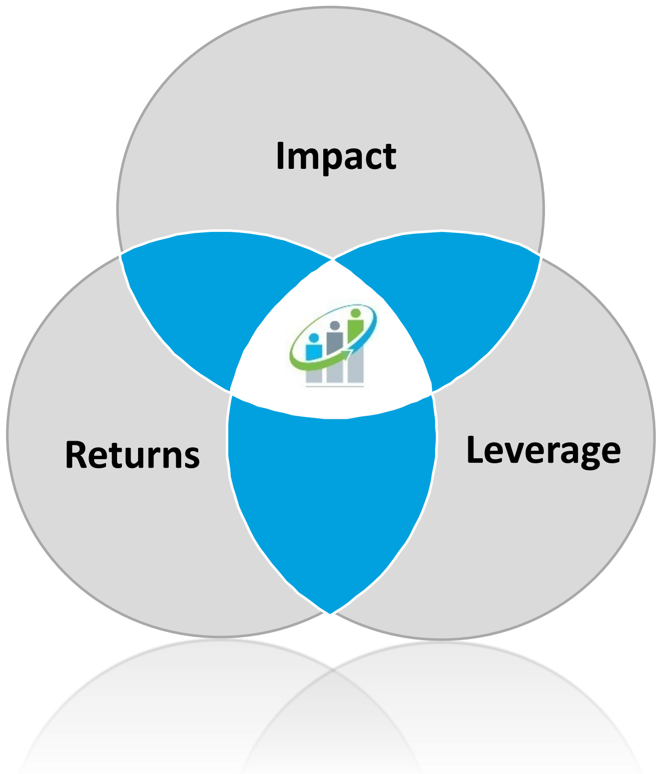
The ultimate model of development finance?

Blending?

Blended Finance

The deliberate and strategic alignment of public-private capabilities and capital to accelerate social and economic growth in emerging and frontier markets

Impact: investments in emerging and frontier markets that deliver transformative social and economic progress



Returns: market-based, risk-adjusted returns that meet business goals and fiduciary duties

Leverage: systematic and strategic use of development and philanthropic funds to mobilize and engage private capital at scale

What is blending?

- Combine public with private funding
- Combine grants with loans
  - To better leverage tax-payers money for policy priorities
  - To crowd-in private sector financing
  - To boost investment in emerging markets
  - To increases effectiveness of aid

  - «From millions to trillions»

- EU established regional blending mechanisms starting 2008 with the Neighbourhood Investment Facility

Blended Finance

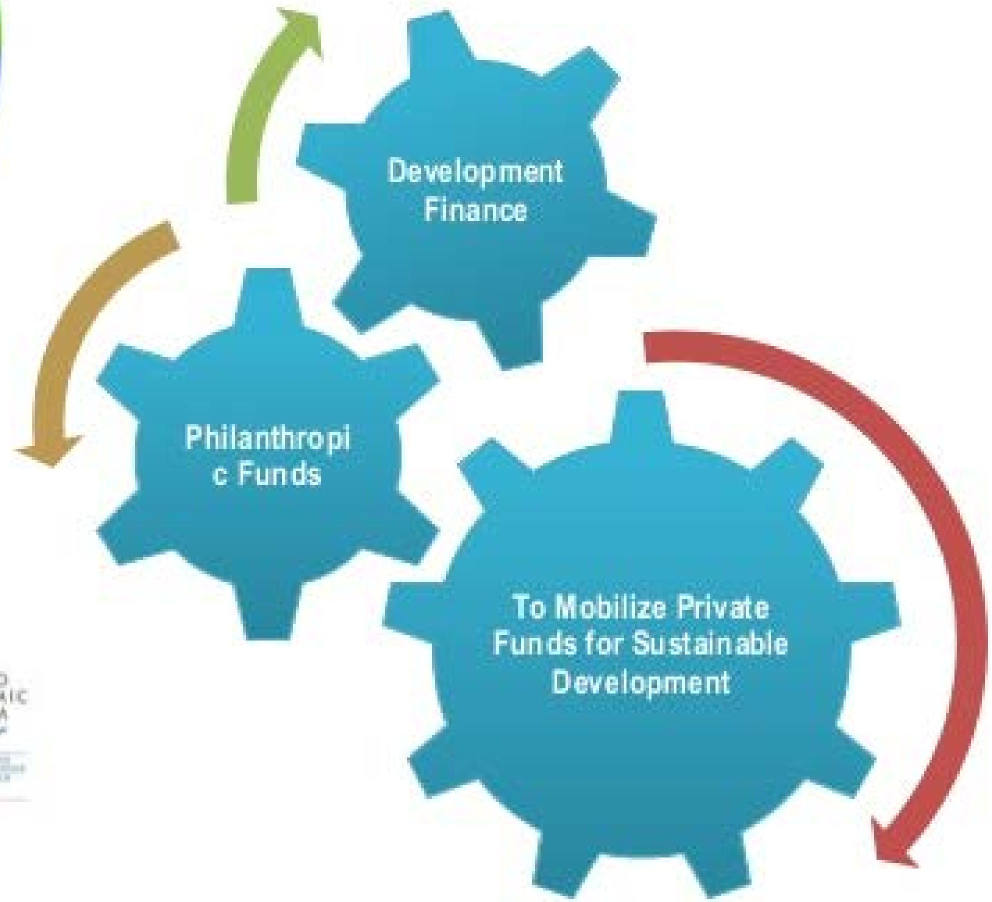

OECD

WORLD ECONOMIC FORUM

Redesigning Development Finance Initiative
A joint initiative of the World Economic Forum and the OECD

Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders

An overview of the strategic use of development finance and philanthropic funds to mobilize private capital for development



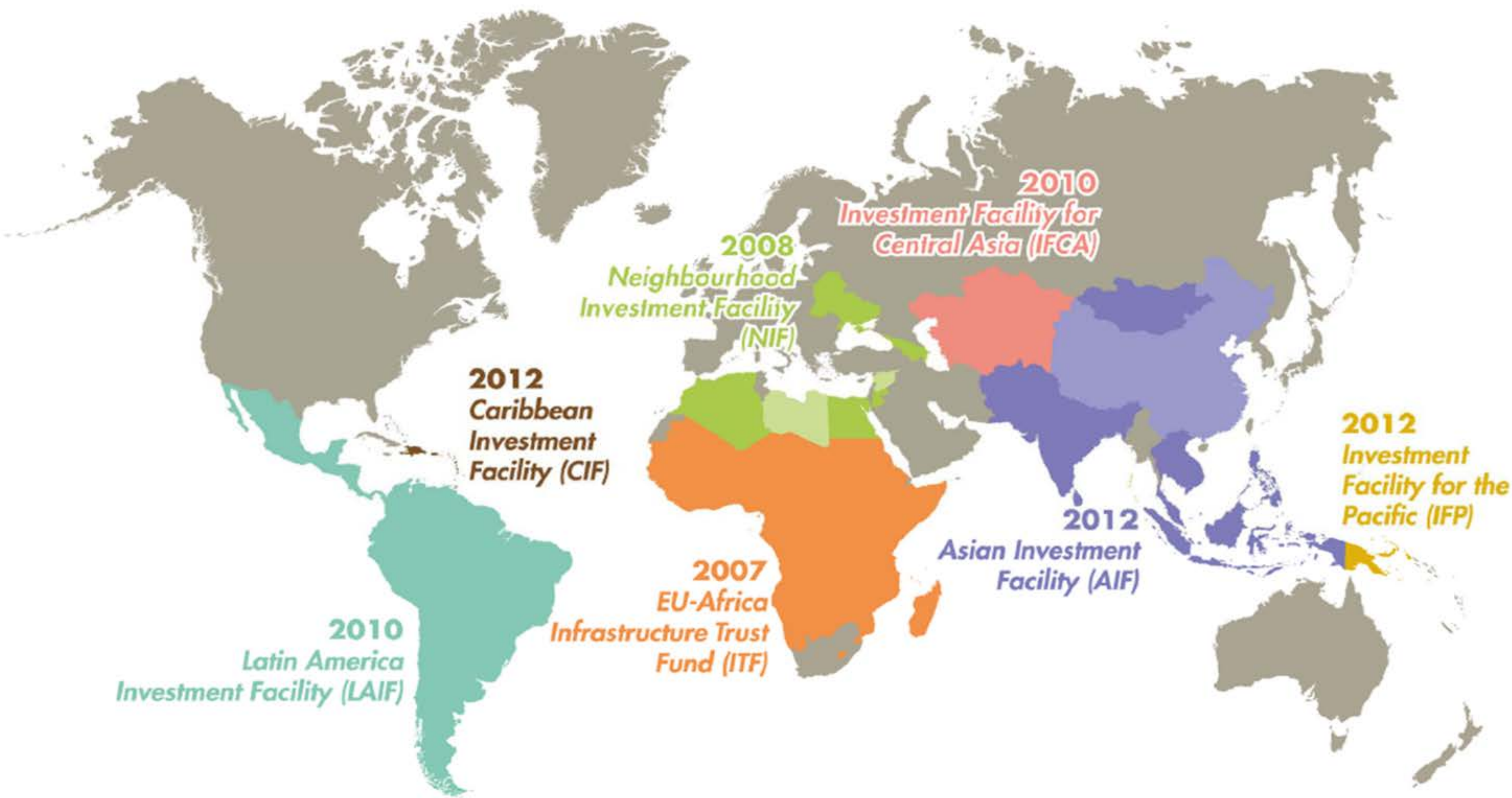
European Union

- What are they trying to achieve?
  - EU policy objectives (various)
  - Spend given budget for most impact
- How is the organisation structured?
  - EC in Brussels – DG DEVCO, DG NEAR
  - EEAS in partner countries – EU Delegations
- How are projects selected?
  - Political negotiations
  - Policy instruments
  - Regional Indicative Programs – Brussels
  - National Indicative Programs – Delegations
  - Grants (EU budget, EDF)

Why Blending? The EU approach.

- **Financial leverage**
  - Donors and lenders can finance more, bigger and better projects with a limited volume of grant resources.
- **Political leverage**
  - Larger projects and programmes potentially have greater influence over the policies of the recipient countries. In addition to project-related issues such as tariff reform, this may include broader economic reform, as well as political objectives, such as support to democracy, human rights, combating terrorism, etc.

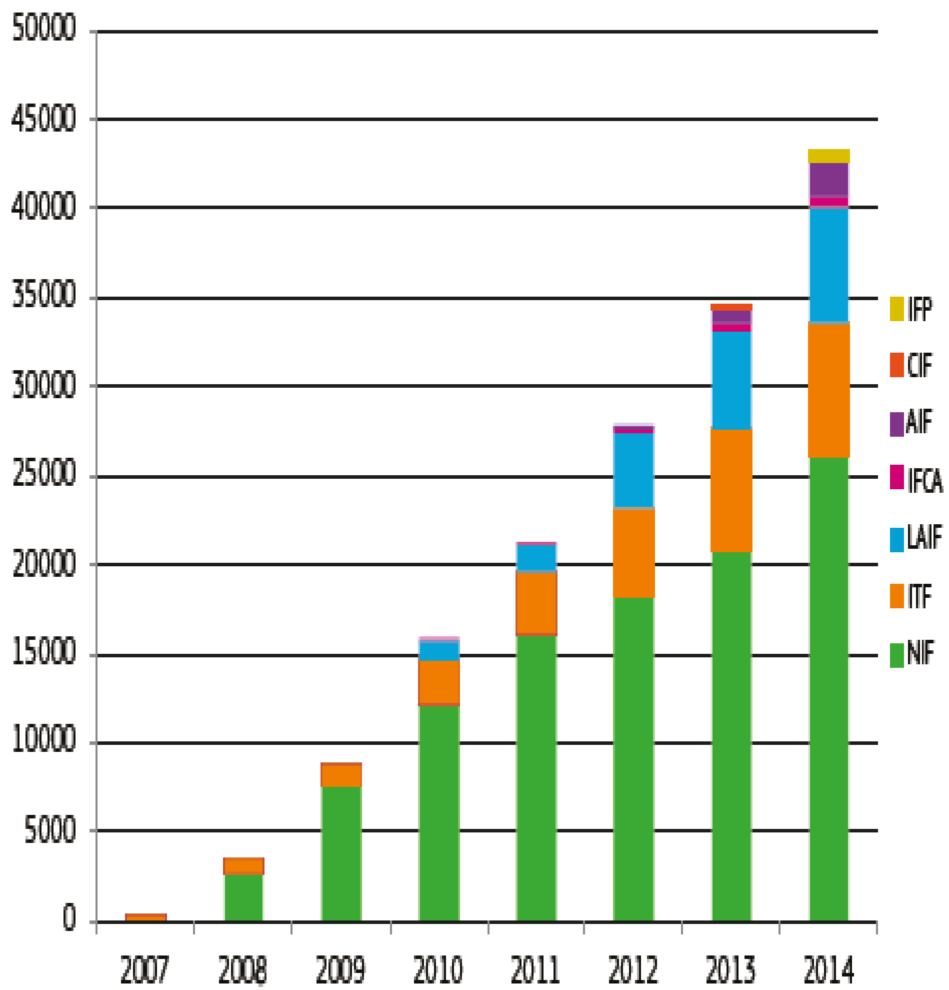
EU regional blending facilities



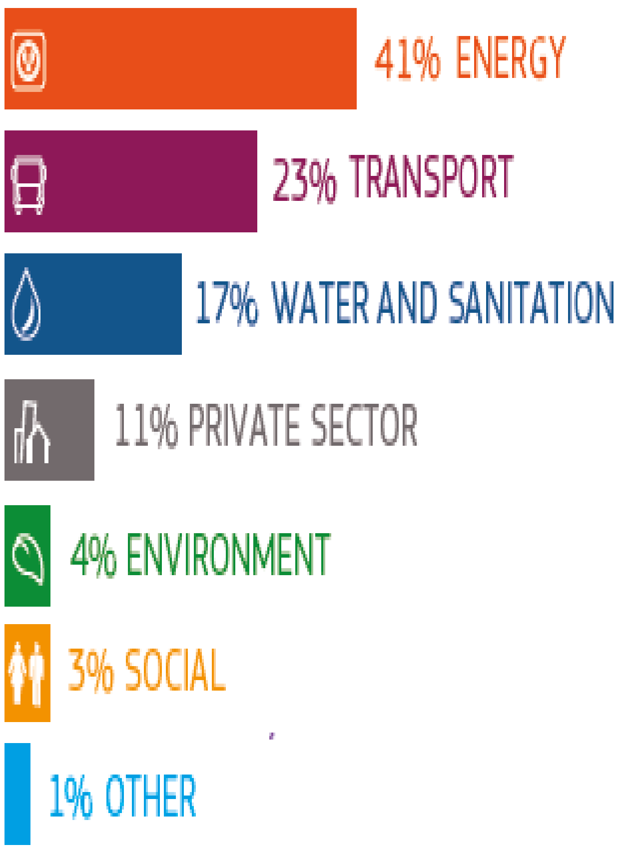
Neighbourhood Investment Facility (NIF)

- Budget: EU budget, EUR 1.2 bn* 2014 2020
- Accessible to: **EIB**, **EBRD**, CEB, NIB, **AFD**, **KfW**, AECID, OeEB, SIMEST, and NEFCO
- Eastern Neighbourhood : Armenia, Azerbaijan, Georgia, Republic of Moldova, Ukraine, regional
- Southern Neighbourhood : Egypt, Jordan, Lebanon, Morocco, Tunisia, regional

€ Millions TOTAL VOLUME OF INVESTMENTS SUPPORTED THROUGH BLENDING (CUMULATIVE)



APPROVAL OF GRANTS BY SECTOR



European Investment Bank

- What are they trying to achieve?
  - Financial return (but non-profit)
  - EU policy objectives (various)
- How is the organisation structured?
  - HQ in Luxembourg
  - Small country offices, not everywhere
- How are projects selected?
  - Business Plan
  - Opportunistic financing
  - Can finance 50% of a project (up to 75% for CC-projects)
  - Implements mandates financed by EU (e.g. Cotonou, Juncker-Plan)

NIF: Types of support

- *Investment Grant:*
  - using the grant from the NIF to finance part of a project's total cost; this reduces the projects financial burden and improves its bankability
- *Technical assistance:*
  - recruiting experts or consulting firms to support the project preparation and its implementation
- *Financial instruments:*
  - specifically aiming at the development of the local private sector. These operations can take several forms, such as co-investment together with local intermediaries, investment in micro-finance institutions, taking stakes in private equity funds or guarantees

Application process: NIF-eligibility

- Blending in two cases:
  - market failures
  - higher socio-economic than financial returns
- Demonstrate additionality:
  - Project would not materialise otherwise
  - Faster implementation
  - Higher quality of implementation
  - Better support for EU policy objectives
- Justify amount requested
- Demonstrate complementarity to other projects in the country, alignment with priorities

Working with the NIF

- Informal consultations
  - with EU Delegations
  - with DG NEAR
- Lead IFI submits application form to EC
- Technical Assessment Meeting
- NIF Board Meeting
- Delegation Agreement with EC – fees to IFI
- Grant Agreement with beneficiary
- Implementation
- Reporting

3. Project Examples and Evaluation

Project examples

- Jordan: NEPCO Green Corridor
- Morocco: Ouarzazate Concentrated Solar Power
- Southern Neighbourhood: Risk Capital Facility

NEPCO Green Corridor

- Transmission line network in central Jordan desert area, where opportunities for renewable generation are most favourable.
- Financing:
  - Loans: EIB (66mn), KfW, AfD (50mn)
  - Grants: NIF (14mn IG, 3 mn TA)
  - National Electric Power Co. (NEPCO): 11mn

Ouarzazate Concentrated Solar Power

The estimated project cost is evaluated between 760 to 855 m EUR*

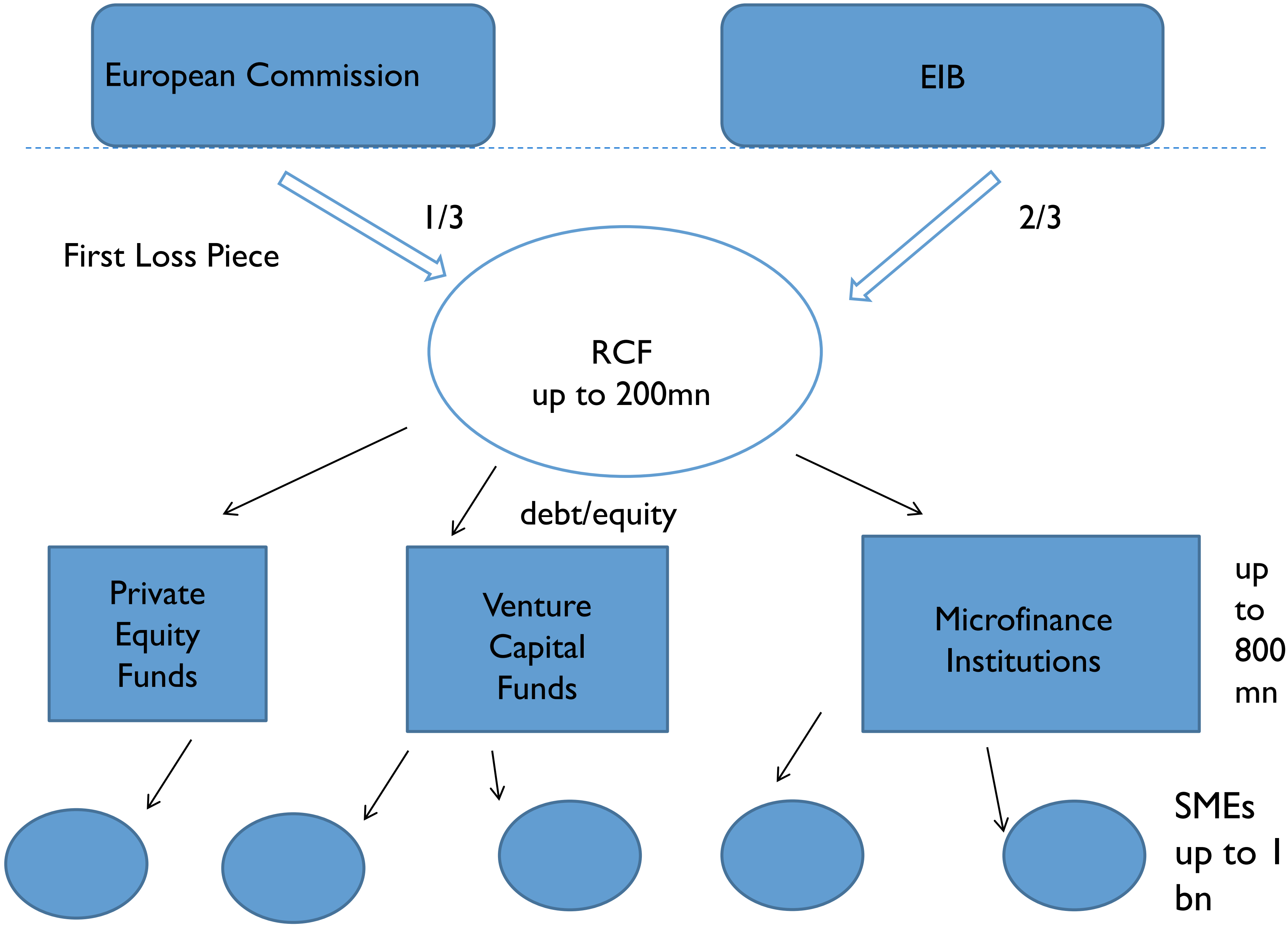
Noor I (2013): 160 MW
Noor II: 150-200 MW
Noor III: 100-150 MW
Noor IV: 50 MW Photo Voltaik

- Increase Morrocco Renewable Energy to 42% of mix by 2020
- PPP

Sources	MEUR	
Promoters' own resources	121	137
EIB	132	150
KFW	286	324
AFD	44	50
CTF, WB, AfDB	127	144
NIF subsidy*	50	
TOTAL	760	855

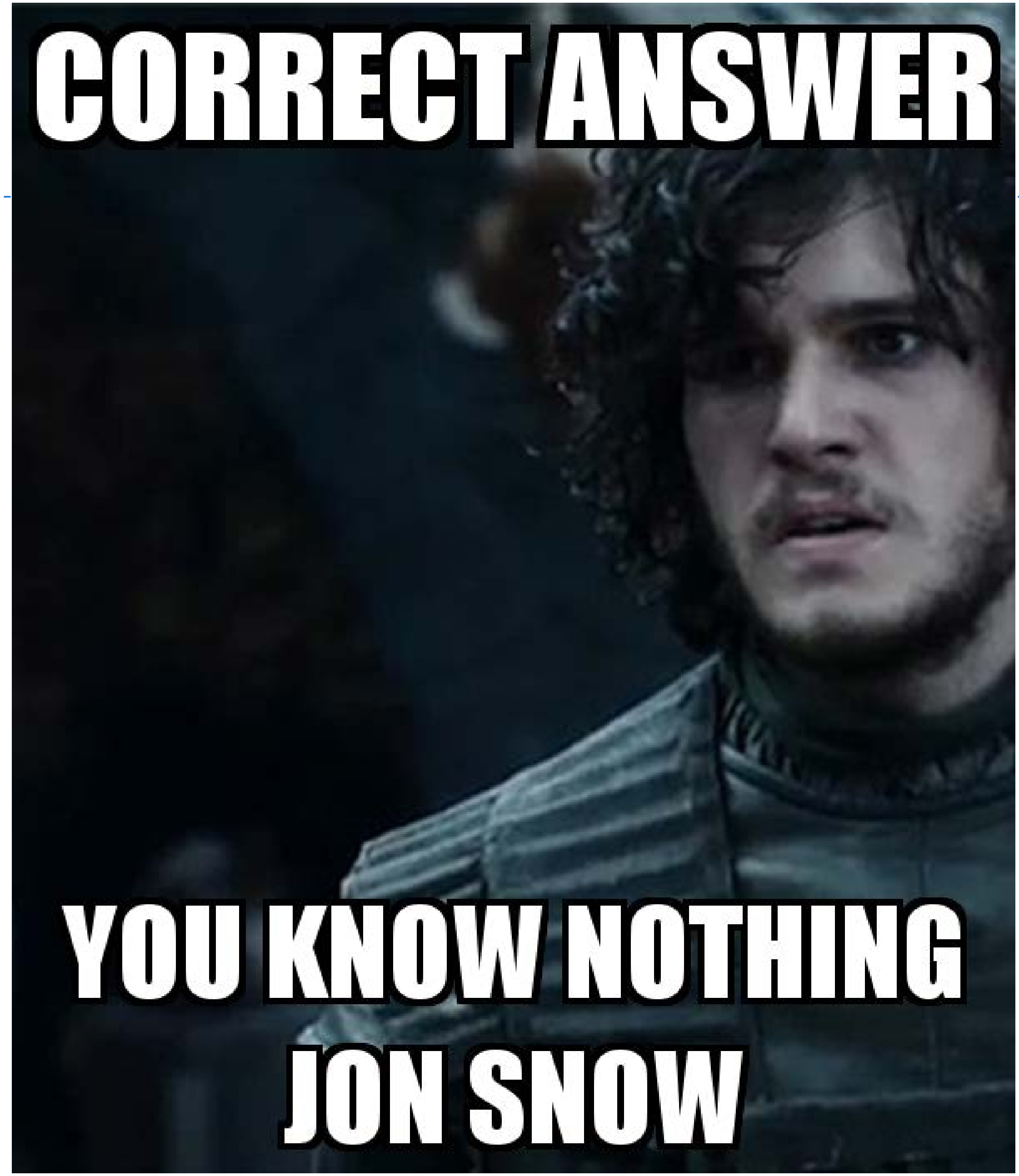
Risk Capital Facility

- For the Southern Neighbourhood Countries
- Access to equity and debt finance to SMEs
- Private sector development, inclusive growth and job creation
- 100mn EIB, 50mn EC (first loss piece)


European Commission
EIB
1/3
2/3
First Loss Piece
RCF
up to 200mn
debt/equity
Private Equity Funds
Venture Capital Funds
Microfinance Institutions
up to 800 mn
SMEs up to 1 bn

Question in 2013:

- Is the mechanism working well and achieving its goals?


CORRECT ANSWER
YOU KNOW NOTHING
JON SNOW

Evaluation by Europ. Court of Auditors

- Blending to support EU external policies has been generally effective, but…
- EC approval process undertaken not thorough – decisions to award the grants frequently not convincingly evidenced
- Guidance on what criteria the Commission should use in its decision-making was also lacking.
- advance disbursements were unnecessarily high
- Blending can increase cooperation between development financiers and partners

Evaluation (cont.)

- Potential benefits of blending not fully realised in half of the examined projects:
  - The Commission did not fully capitalise on the potential for a positive impact on the way projects were set up or for a wider impact on sector policy.
  - The visibility of EU support has been limited.
  - EC's monitoring did not ensure that the added value of grants was achieved in all cases.
- EC's reaction -> stricter procedure, higher requirements, more responsibilities for IFIs
- Increased budget for 2014-2020 to € 3bn, compared to € 2bn over the last budget period

4. Conclusions

Outlook and perspectives

No silver bullet, put part of the toolkit

- Economic fundamentals trump financial structuring
  - Fixing the investment climate and regulatory/tariff framework is more important than project structuring
- Risk transference is not the same as risk mitigation
  - Risks should be borne by parties capable of mitigating it
- If not used carefully, blending will distort markets
  - Calibrate grant amounts to needs
  - Loans and efficiency/impact: incentives to use resources productively
- Heavy procedures and competition
  - Pros and cons

What's next?

- Trending Blending – new mechanisms:
  - AfIF (€1.8 billion)
  - EU Regional Trust Fund in Response to the Syrian Crisis (Madad Fund, €730 million)
  - MENA Concessional Financing Facility ($1 billion)
  - Turkey Financing Facility (€2 billion?)
  - Green Climate Fund (GCF, $10 billion)
  - New types of cooperation: GIZ+EIB
- Public: Competition for good projects
- Private: Financial Instruments and Risk Sharing
- Standardization, big tickets, bulk approval of similarly structured projects

Thank you

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