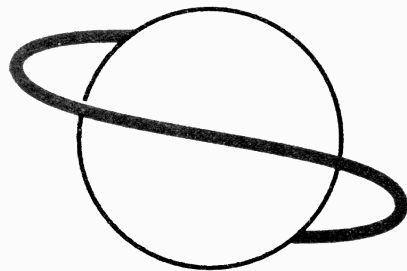




# Hungary Energy Efficiency: An Innovative\* GEF Project

*\*Innovative, Sustainable, Highly Leveraged, Replicable and Efficient!*



GEF



FTF Brazil

April 2003

# Project Overview

## Objective

**Expand availability of commercial financing for energy efficiency projects in Hungary**

**Energy efficiency improvements generate:**

### *GEF Benefits*

**Decreased GHG emissions from avoided power generation**

### *Economic Benefits*

**Decreased operating costs for companies and hence increased international competitiveness for Hungary**

# GEF Support

- ① ***Innovative***: Project complements and catalyzes private sector activity by combining non-grant financing and targeted, limited grants
- ② ***Sustainable***: Creates self-sustaining market expansion that continues *after* donor funding ends
- ③ ***Highly Leveraged***: Catalyzes at least 20x GEF funding in commercial financing
- ④ ***Replicable***: Design can be – and currently is being – replicated elsewhere
- ⑤ ***Efficient***: Private sector uses latest technology and management techniques

# The Problem and the DIAGNOSIS

## Problem

**In Hungary in mid-1990s, local financial intermediaries (FIs) were not lending for much-needed energy efficiency improvements**

**DIAGNOSIS: *The underlying cause was not ...***

- **Lack of funds – sufficient liquidity in financial system**
- **Lack of loans – FIs were lending (but only to ‘blue chips’)**
- **High interest rates – common problem for all borrowers**
- **Lack of incentives – energy prices were rising**

# The DIAGNOSIS continues ...

## Two key barriers were identified:

- **Perception of high credit risk by FIs**
  - FIs had little experience with energy efficiency (EE), project finance or SMEs (except using grants/subsidies)
- **Poor capacity to prepare projects**
  - High preparation costs and weak preparation capacity by sponsors and Energy Service Companies (ESCOs)

## And several potential opportunities:

- **Liberalizing markets**
- **Maturing FIs**
- **Increasing competition – openness to new products**

# The Prescription

*Break down the barriers:*

- **Risk Management Tool**
  - Share the risk by providing partial guarantees for loans from domestic FIs such as leasing companies and banks
  - FIs take the lead: find projects, review credit, etc.
- **Capacity Building Tool**
  - Technical assistance (TA) to FIs, ESCOs, and SMEs using targeted, limited grants
  - TA helps FIs and ESCOs to prepare projects and market services

*And exploit market forces:*

**Competition for new business makes EE attractive**

*Avoid conventional approaches, such as:*

- **Grants to end users or government institutions**
- **Interest rate subsidies**

# The Programs

## *Pilot Program – Funded by GEF*

- US\$ 4.25 M partial risk guarantees
- US\$ 0.30 M technical assistance grant
- US\$ 0.45 M program administration grant

## *Expanded Program – Funded by IFC, GEF, Bilaterals*

- US\$ 12-16 M partial risk guarantees:
  - \$8-12 M from IFC on commercial terms
  - \$4 M from GEF *supporting IFC guarantee* (carry over from pilot)
- US\$ 0.55 M technical assistance grants:
  - \$0.35 M grants from Austria and the Netherlands
  - \$0.20 M from GEF
- US\$ 0.50 M program administration grant from GEF (new)

# Results from Pilot Program

- **3 FIs were active in Pilot Phase**
  - Start-up was slower than expected
- **Substantial development of ESCO capacity**
  - ESCOs showed interest but needed support to structure bankable projects
- ***Lesson Learned: TA element is critical***
  - In Pilot Program, TA funds were used primarily to train specialized loan officers in FIs and to help ESCOs develop projects
  - Going forward, need to expand TA applications in order to:
    - Increase focus on ESCOs in order to accelerate deal flow, expand sectors covered, and strengthen ESCOs
    - Upgrade effort with FIs in order to broaden staff training

*Independent mid-term evaluation of Pilot Program available on request*

# Impact of Expanded Program

- **IFC investment of \$12 M approved January 2001**
  - Major expansion of guarantee facility
  - Program administration mainstreamed at IFC
- **Broad engagement by FIs**
  - 4 more FIs now joining the program, following success of initial 3 FIs in creating profitable market niche
  - FIs expected to join program represent 80% of total banking assets
  - Over \$75 M of deal flow anticipated
  - Multiple FI participants is key to spur healthy competition
- **Increasing demand from ESCOs**
  - TA funds to support expanded marketing capacity by ESCOs
  - Helping ESCOs to identify other sources of capital, JV partners, etc.

*No additional donor funding expected at end of Expanded Program*

# GEF Perspective: *Innovative*

Careful Diagnosis



Identification of Real Barriers



Design of Appropriate Tools

Stay as close as possible to commercial viability

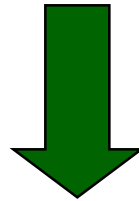
Prefer non-grant financing

Minimize use of donor funding

Maximize leverage of donor funding

# **GEF Perspective: Sustainable**

## **Appropriate (Market-Led) Approach**



### **Self-Sustaining, Post-Donor Activity**

**Understanding of risks and rewards**

**Capacity built in financial & industrial sectors**

**Market-driven competition for new business**

# GEF Perspective: Highly Leveraged

## Donor Funding

\$4 M GEF non-grant (guarantees) + \$2 M grants



## IFC Funding

\$12 M commercial-rate guarantees



## FI Funding

\$76 M loan

+

## Sponsor Funding

\$19 M equity

**TOTAL LEVERAGE OF GEF FUNDS: >20x**

**Likely much higher if loan losses at expected rates**

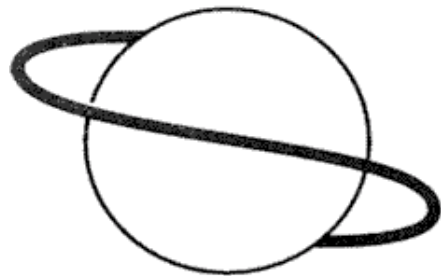
# GEF Perspective: Replicable

## Commercializing Energy Efficiency Finance (CEEF)

- CEEF is a multi-country project based on the Hungary EE project
  - 5 countries: Czech Republic, Estonia, Latvia, Lithuania, Slovak Republic
- Initial GEF approval May 2002
  - Project document circulating now for final endorsement
  - IFC approved up to \$75 M in co-guarantees in June 2002
  - Grant co-financing recently committed by Finland; potential support from Spain and US
- \$15 M donor guarantee (GEF) + \$4.4 M donor grants (GEF, bilaterals)
  - ↓
  - \$30-75 M IFC guarantee
  - ↓
  - \$90-180 M FI funding (loans) + \$22.5-45 M sponsor funding (equity)

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