Report on Realising Priority Infrastructure Projects for Energy Community

Mary O’Mahony
Dec 2014
The Energy Community is an international organisation dealing with energy policy founded by the Energy Community Treaty, which entered into force in July 2006.

The Parties to the Treaty are the European Union and eight Contracting Parties from South East Europe and the Black Sea region: Albania, Bosnia and Herzegovina, Kosovo*, former Yugoslav Republic of Macedonia, Moldova, Montenegro, Serbia and Ukraine. Georgia, Armenia, Norway and Turkey participate as Observers.

The Energy Community’s mission is to extend the EU internal energy market to South East Europe and beyond on the basis of a legally binding framework. The overall objective of the Energy Community Treaty is to create a stable regulatory and market framework in order to:

- Attract investment in power generation and networks to ensure stable and continuous energy supply that is essential for economic development and social stability;
- Create an integrated energy market allowing for cross-border energy trade and integration with the EU market;
- Enhance the security of supply;
- Improve the environmental situation in relation with energy supply in the region; and
- Enhance competition at regional level and exploit economies of scale.

For further information about the Energy Community, please visit our website: www.energy-community.org.

* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.
REPORT ON
REALISING PRIORITY INFRASTRUCTURE INVESTMENTS FOR THE
ENERGY COMMUNITY

PREPARED ON BEHALF OF THE ENERGY COMMUNITY SECRETARIAT

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DECEMBER 2014
This report has been prepared by Mary O’Mahony, as a short-term consultant to the Energy Community Secretariat with contributions from Dr Paul Bernd Spahn.

The report has been prepared on behalf of the Energy Community Secretariat to examine the challenges facing the countries that comprise the Energy Community in realising energy infrastructure investments. It looks at the types of infrastructure projects that are deemed to be a priority by the Energy Community and at the different forms of support available to the Contracting Parties for investments in the energy sector. It also recommends a series of actions for Energy Community Secretariat to consider and to subsequently raise with other stakeholders in the Energy Community to improve the preparation, financing and implementation of the large-scale energy infrastructure projects that are deemed to be of importance for the successful functioning of the Treaty. These recommendations are based upon the views expressed by external financiers as to the main challenges in securing investments and on the financial instruments and support programme currently or likely to be available to the countries concerned.

Acknowledgements

The author would like to express her appreciation to the staff of the Energy Community Secretariat, particularly Violeta Koganiceanu and Janez Kopač for their cooperation during this short assignment. She would also like to thank the officials consulted in the European Commission and IFIs as well as representatives of commercial investors for sharing their insights and experience of preparing and implementing investments in the Contracting Parties to the Energy Community. She is also grateful for the advice and guidance received from Dr Paul Bernd Spahn and Dr Bernard Snoy.

This report has been prepared under the auspices of the Energy Community Secretariat. The content is the sole responsibility of the author and cannot be taken to reflect the views of the Energy Community Secretariat.
Glossary

CBA  Cost Benefit Analysis
CEF  Connecting Europe Facility
CPs  Contracting Parties to the Energy Community Treaty
DCFTAs  Deep and Comprehensive Free Trade Agreements
EBRD  European Bank for Reconstruction and Development
EC  European Commission
ECS  Energy Community Secretariat
EE  Energy Efficiency
EFSI  European Fund for Strategic Investments
EIB  European Investment Bank
ENI  European Neighbourhood Instrument
ETSO  European Transmission Systems Operators
EU  European Union
EUDs  European Union Delegations
ESP  Eastern Europe Energy Efficiency and Environmental Partnership
GDP  Gross Domestic Product
HLRG  High Level Reflection Group on the Energy Community
IDA  International Development Agency (World Bank Group)
IFC  International Finance Corporation (World Bank Group)
IFIs  International Financing Institutions
IMF  International Monetary Fund
IPA  Instrument for Pre Accession
IPA II  Instrument for Pre Accession Programme 2014-2020
IPF  Infrastructure Project Facility
JASPERS  Joint Assistance to Support Projects in European Regions
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>KfW</td>
<td>KfW Development Bank, Germany</td>
</tr>
<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency (World Bank Group)</td>
</tr>
<tr>
<td>MS</td>
<td>Member States (of the EU)</td>
</tr>
<tr>
<td>NIF</td>
<td>Neighbourhood Investment Facility</td>
</tr>
<tr>
<td>PCIs</td>
<td>Projects of Common Interest (in EU Member States)</td>
</tr>
<tr>
<td>PECI</td>
<td>Projects of Energy Community Interest</td>
</tr>
<tr>
<td>PPAs</td>
<td>Power Purchase Agreements</td>
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<td>PPPs</td>
<td>Public Private Partnerships</td>
</tr>
<tr>
<td>REEP</td>
<td>Regional Energy Efficiency Programme</td>
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<tr>
<td>TA</td>
<td>Technical Assistance</td>
</tr>
<tr>
<td>TSOs</td>
<td>Transmission System Operators</td>
</tr>
<tr>
<td>WBG</td>
<td>World Bank Group</td>
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<td>WBIF</td>
<td>Western Balkans Investment Framework</td>
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1. EXECUTIVE SUMMARY

The purpose of this report is to provide input to the Energy Community Secretariat’s deliberations on the recommendations with respect to investment financing made by the High Level Reflection Group (HLRG) in its report of May 2014 regarding the future of the Energy Community Treaty. The report is based on desk research and in particular a series of consultations with the main external financiers (IFIs, commercial investors and European Commission Services) of energy infrastructure in the Contracting Parties to the Treaty.

The Contracting Parties (CPs) face considerable investment needs running into tens of billions of Euros as they seek to decommission or upgrade their existing infrastructure; install new infrastructure to meet the socio-economic demands of their respective countries and comply with their obligations under the Energy Community. The approved list of 35 Projects of Energy Community Interest (PECI) alone has a total investment cost of €13.5 billion. Realising energy infrastructure projects requires funding across the entire project cycle from initial concept to eventual maintenance of the commissioned infrastructure.

The main sources of finance include:

- Government /own resources
- IFIs
- Commercial banks/private investors
- Donor funded blending facilities and TA
- Financial facilities for investments in energy efficiency and renewable energy
- Special development funds and risk mitigation facilities

The impact of the global financial crisis and the on-going weak recovery has placed an immense burden on the economics of the CPs and hence on their state budgets. Public debt and borrowing indicators have begun to show significant stress, which will impede governments’ access to loans over time.

The main international financial institutions active in the energy sector in the Contracting Parties are the EBRD, EIB, KfW and the World Bank. All have financed a substantial portfolio of energy related investments and are actively exploring new opportunities. In general, their energy portfolios are a mixture of loans for infrastructure and financial facilities to promote investments in energy efficiency and renewables. The World Bank also finances Development Policy Loans that can influence the investment climate and are relevant for the development of energy infrastructure. The individual mandate of each IFI affects their capacity to finance different types of energy infrastructure. All have restrictions on financing of projects involving fossil fuel and for some it is imperative to have a state guarantee to provide a loan.

Commercial financiers (banks and investors) are active in the energy sector in the CPs, but are not heavily involved in the financing of large-scale infrastructure. They tend to be more active in smaller renewables and energy efficiency facilities. The economic crisis and changes to banking regulations have reduced the activity of commercial banks in infrastructure projects, while commercial investors often face difficulties due to restrictions in CPs on certain types of investment in state owned infrastructure.

A number of grant-funded instruments are available to support the development of socio-economic infrastructure including energy infrastructure. These can be divided into two
categories – EU led blending mechanisms and TA programmes. The main aim of blending mechanisms is to leverage external cooperation funds by mobilising loans from financial institutions. They provide a platform for the EC, IFIs, bilateral donors and beneficiary countries to work closely together and to undertake large projects, which would have been difficult to finance otherwise. For the Energy Community, the two relevant mechanisms are the Western Balkans Investment Framework (WBIF) and the Neighbourhood Investment Facility (NIF), both of which are currently revising somewhat their approach and methodology.

In general TA programmes are funded by the EC led Instrument for Pre-Accession (IPA) for the Western Balkans and the European Neighbourhood Instrument (ENI) for Georgia, Moldova and Ukraine as well as bilateral donors. They usually provide expertise and capacity building services to the public administrations including local government. The assignments are mostly linked to improving the overall policy climate, regulatory reform and public administration reform.

In recent years more innovative financial facilities funded by the EC, IFIs and bilateral donors have been made available to the CPs to support investments in energy efficiency and renewable energy. Examples of these include the Green for Growth Fund and the Regional Energy Efficiency Programme. These tend to focus on small-scale investments undertaken by SMEs or individuals. Hence they are not so relevant for large-scale infrastructure but they help the Parties in their efforts to meet their energy efficiency and renewable obligations under the Energy Community.

Finding ways to finance substantial investments in critical infrastructure and private sector development is also a challenge in the EU and a number of initiatives have been developed to assist EU Member States. The most recent developments, including the launch on 26 November 2014 by the President of the European Commission, Mr Junkers, of the European Fund for Strategic Investments (EFSI), are focused on leveraging EU resources through financial facilities to attract private capital for strategic investments across all EU Member States.

Given the importance of a secure, efficient and sustainable energy market in the European Union, a number of the new financial facilities for EU Member States including the ESFI and the Connecting Europe Facility include energy as a priority sector. These seek to use grant funding from the EU to leverage additional finance for investments deemed to be critically important to the implementation of the EU’s energy strategy. The experience gained in the development and implementation of such facilities will be of great relevance for the Contracting Parties.

Consultations with the external financiers of energy infrastructure projects revealed a very consistent view that the main obstacle to securing the necessary finance to realise the Energy Community’s priority investments is the challenging investment climate in the different countries. The general opinion was that if well-prepared strategic projects, deemed to be economically viable and clearly supported by the relevant government(s), were presented, suitable financing packages could be assembled despite the difficult economic and financial climate. However, the lack of a properly functioning market in the CPs makes the preparation of such investments a very challenging task. Private capital is discouraged from investing and the scale of investment required dwarfs the availability of so-called “soft finance”, i.e. grants or low cost loans.

When discussing the challenges faced by financiers to advance the type of investment projects deemed as a priority by the Energy Community (i.e. PECI), the main issues raised can be categorised in terms of:
The specific nature of the type of infrastructure investments;
• The current investment climate; and
• Availability and feasibility to utilise different forms of financing.

The PECI investments in general are so-called “big ticket” items. Large-scale projects (power plants, cross border transmission lines, gas pipelines etc) that require public sector involvement and take substantial time and resources to prepare properly. They also have a significant financial cost, some of which needs to be borne by the public purse – a particular challenge as evidenced by the limited fiscal space.

It was stressed that smaller-scale projects, particularly those involving renewable energy such as wind farms or small hydro plants are being financed, often with significant private funding. Given the economic climate, many governments are currently reluctant to commence large-scale construction programmes in the short term as long as they can exploit their old infrastructure and import energy comparatively cheaply from neighbouring countries.

A number of projects that are priorities for governments, including several on the PECI list, involve fossil fuel – coal or lignite. Thus they often face considerable opposition and lengthy preparatory periods due to substantial environmental concerns. Their estimated costs are likely to increase due to the need to comply as appropriate with the Large Combustion Plant Directive or the Industrial Emissions Directive. In addition, EU and IFI financing policies – particularly those revised in recent years – mean that there is extremely limited potential for these organisations to provide financing for such investments.

Cross-border projects are complex from both a political and financial point of view, requiring that the relevant governments are in agreement at the same time regarding the priority of the project, the sequencing of implementation and the allocation of costs. In the Western Balkans, the current lack of gas distribution infrastructure means there is a lack of demand for gas, which severely weakens the investment case for these projects. Such projects could lend themselves to special grant financing by the EU due to the long term strategic nature of the project and the security / diversification of supply benefits to the wider Europe.

The CPs vary widely in terms of the particular type and scale of energy infrastructure investments required due to their different energy mix, currently available infrastructure etc. However there was universal consensus that all suffer from a difficult investment climate, including unstable regulatory regimes open to political interference, opaque pricing systems and weak institutional capacity and expertise, particularly regarding financial issues and procurement.

All the Parties are in transition to a full market economy and several are in the process of acceding to the EU. Therefore these positive processes cause some of the uncertainty in their regulatory regimes. However all financiers felt that the reform process has slowed down considerably in recent years. The reasons behind the slowdown are many but the overall results for the investment climate are usually negative. A vicious cycle exists whereby much of the investment for developing transmission and distribution networks is not creditworthy and requires reforms to make them so, but the lack of reform holds back any investment that might actually push reforms and therefore reduces the incentive to reform.

Corporate finance is not readily available for the Parties’ priority projects at present, and therefore boosting public financing and/ or securing greater private sector involvement generally in a consortium comprising state companies and IFIs will be necessary. Public
finances are expected to remain constrained for the next few years due to the economic situation. In terms of attractiveness for private investors, Ukraine is a sizeable market and (assuming current problems are resolved reasonably soon) is attractive to the major players. The Western Balkans, Moldova and Georgia are often viewed as marginal region/countries for the large investors and therefore really need to ensure a better investment climate.

In terms of reducing the risks associated with an investment project and thereby enhancing its viability, financiers believe that the investment climate and the nature of the energy investments to be financed mean that EU-funded grants would provide considerable value added to an investment project and would not crowd out private sector investment. In addition to straightforward investment co-financing to help narrow financial gaps, financiers saw merit in trying to provide governments and project promoters with facilities that leverage additional capital including through risk insurance or risk guarantees. However, they noted that any such scheme would have to be very carefully designed to avoid creating moral hazard for the government/state-owned company.

Commenting on the High Level Reflection Group’s specific recommendation for a dedicated risk enhancement/mitigation facility for the Energy Community countries, financiers highlighted the legal, financial and fund management expertise required to design and implement such facilities and costs associated with this. The biggest concern related to the fact that a certain level of scale is required to make such a facility an economic proposition. There was a general belief that the available “deal flow” in the Contracting Parties would be insufficient to make such a dedicated instrument viable. However all financiers saw merit in allowing the CPs to benefit where possible from EU financial facilities for infrastructure investment both in terms of lessons learnt and ideally access to finance via a special “window”.

Given the overwhelming view that the difficult investment and regulatory environment is the main obstacle to realising energy infrastructure rather than availability of finance per se, the recommendations submitted to the Energy Community Secretariat for consideration are grouped into two categories:

(i) Actions to secure financing and commence construction of an agreed list of priority projects considered to be comparatively investment ready;

(ii) Actions to advance improvements in the overall investment climate for energy infrastructure and to bring the next set of agreed priority projects from the preparatory phase to a more investment ready phase.

All the recommendations seek to build upon the ECS’ unique mandate whereby it provides a comprehensive technical and administrative platform for all stakeholders including the EC and external financiers to provide support to the CPs for the implementation of the Energy Community in a coordinated manner. Once the ECS has determined the appropriateness of the various recommendations they can raise these with the relevant stakeholders and determine how best to take them forward.

Actions recommended under group (i) are aimed at:

- Securing consensus from Energy Community stakeholders - governments and financiers – on a strategic sub-set of investment ready projects. “Investment ready” in this context would mean that preparatory work for the investment has been completed – e.g. feasibility study etc, there is a positive assessment from external financiers that the project is financially viable and the governments concerned outline their willingness to facilitate the realisation of the project.
• Securing greater grant financing for TA, co-financing and risk mitigation from WBIF and NIF and strengthening the strategic and management processes used to evaluate and implement such grants for energy projects

• Facilitating access by the CPs to EU financial and risk mitigation facilities such as the Connecting Europe Facility and the Marguerite Fund and improving their capacity to utilise some facilities. This would allow CPs to “piggyback” on the size and expertise of such funds and overcome the economies of scale issue that affect the viability of facilities dedicated to the CPs only.

The provision of such soft support for these priority projects is not intended to substitute for private investment but rather to attract it. This support is meant to ensure the financial viability of the investment by providing a combination of finance, guarantees, technical and other support so that external financiers – both IFIs and commercial investors have the necessary confidence to provide capital and know-how for the project and the infrastructure can be realised.

Actions recommended under group (ii) seek to:

• Ensure that the Energy Community Secretariat still has a clear, formal consultative role under the new WBIF methodology and that both the officials who evaluate the applications and the contractors who design and implement the TA under WBIF benefit from the Secretariat’s knowledge and expertise in the energy sector on a systematic basis.

• Encourage the NIF to consider applications for preparatory work on priority projects given the complexities of developing large-scale infrastructure investments.

• Promote the establishment of a dedicated TA facility (e.g. under the EC’s IPA and ENI programmes) that can finance tailored short-term technical assistance to CP governments and relevant institutions on the investment environment for energy. Assistance could include legislative analysis, advice on drafting primary and secondary legislation, development of detailed guidelines for implementation of EIA and ESIAs in energy subsectors and of technical and environmental standards, elaboration of procurement procedures etc. The needs could be identified (i) in the regular consultations between the ECS and the individual CPs; and (ii) on the advice from external financiers. The Secretariat should have an advisory role in identifying the need for such assistance and on the services provided.

• Making greater use of different Energy Community structures to address investment climate issues. This includes availing of the unique convening power of the Secretariat to bring together national authorities and financiers using fora such as the EC Regulatory Board, the Environmental Task Force or the Investors’ Advisory Panel to discuss issues of common interest and agree on steps to improve the situation. This could be an efficient and effective way to discuss issues that impact all CPs and external financiers in an appropriate and transparent format.

• Enhance the Secretariat’s communications programme, particularly its outreach to IFIs and Commission Services and Delegations. A regular exchange of information on status of the PECI list and the overall progress being made by the respective country in the implementation of the Treaty would be of benefit to all.
2. **INTRODUCTION**

The purpose of this report is to provide input to the Energy Community Secretariat’s deliberations on the recommendations made by the High Level Reflection Group (HLRG) in its report of May 2014 regarding the future of the Energy Community Treaty. The report addresses the HLRG’s request for efforts to increase investments in priority energy infrastructure in the Contracting Parties in order to realise the main benefits of the Treaty. The Contracting Parties are Albania, Bosnia and Herzegovina, Croatia, former Yugoslav Republic of Macedonia, Kosovo*, Moldova, Montenegro, Serbia and Ukraine.

The report is based on desk research and in particular a series of consultations with the main external financiers of energy infrastructure in the Contracting Parties to the Energy Community Treaty (CPs), namely the IFIs active in this sector (EBRD, EIB, KfW and World Bank, a selection of private investors and relevant Directorate Generals at the European Commission. Given that Western Balkan countries are the longest standing Parties to the Treaty greater information on the experience in this region was available. However, the findings and conclusions are relevant for all Contracting Parties. A list of persons consulted is contained in Annex 1.

These consultations, carried out in close cooperation with the Energy Community Secretariat (ECS), focused on the main challenges to realising the so-called Projects of Energy Community Interest (PECI) as the priority infrastructure projects agreed by the 2013 Ministerial Council; and on the instruments currently available and potential options to expedite the financing, construction and commissioning of such large scale investments.

The report is structured such that:

- Chapter 3 provides an overview of the estimated investment needs in the energy sector in the CPs and outlines the 35 key investments that comprise the PECI;
- Chapter 4 describes the sources of finance currently available for the preparation and realisation of energy infrastructure and specific features of these;
- Chapter 5 summarises the view of external financiers regarding the key issues that must be addressed to facilitate greater investments; and
- Chapter 6 sets out a series of recommendations for the ECS to consider and to take forward as appropriate with its relevant stakeholders – the national authorities, EU, IFIs and other external financiers.

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1 *This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence*
3. **Overview of Investment Needs and Priority Infrastructure Projects**

For transition economies such as the CPs, investment in gross fixed capital formation is crucial for the transition process as it underpins economic growth with investments in infrastructure and technology. However compared to the level of their investment needs, the level of gross capital formation in the CPs is not as high as it should be. The relatively low scores all of the countries receive on the Infrastructure Development Indicators in the EBRD's annual Transition Report demonstrate this. In general investment in infrastructure has declined steadily in recent years. For example, in the Western Balkans in 2008, average Gross Capital Formation was 31% of GDP. However as illustrated in Table 1, this figure has fallen sharply over the past few years with some specific exceptions.

**Table 1. Gross Capital Formation as % of GDP**

<table>
<thead>
<tr>
<th>Country</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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<tbody>
<tr>
<td><strong>Western Balkans</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Albania</td>
<td>28</td>
<td>29</td>
<td>26</td>
<td>24</td>
</tr>
<tr>
<td>BiH</td>
<td>19</td>
<td>21</td>
<td>23</td>
<td>-</td>
</tr>
<tr>
<td>Kosovo</td>
<td>31</td>
<td>32</td>
<td>30</td>
<td>-</td>
</tr>
<tr>
<td>FYR Macedonia</td>
<td>26</td>
<td>26</td>
<td>37</td>
<td>31</td>
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<tr>
<td>Montenegro</td>
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<tr>
<td>Serbia</td>
<td>17</td>
<td>20</td>
<td>21</td>
<td>-</td>
</tr>
<tr>
<td><strong>Eastern Neighbourhood</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Georgia</td>
<td>22</td>
<td>26</td>
<td>29</td>
<td>25</td>
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<tr>
<td>Moldova</td>
<td>24</td>
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<td>24</td>
<td>24</td>
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<tr>
<td>Ukraine</td>
<td>20</td>
<td>21</td>
<td>20</td>
<td>16</td>
</tr>
</tbody>
</table>

*Source: World Bank Development Indicators*

Despite this decline, CPs - like EU Member States (MS) - face considerable investment needs in the energy sector as they seek to decommission or upgrade their existing infrastructure and to install new infrastructure to meet the socio-economic demands of their respective countries. As part of the Energy Community Energy Strategy produced in December 2012, an attempt was made to quantify the energy investment needs on the basis of a number of scenarios (with caveats with regard the comparability and consistency of the available data). While tentative, the figures below indicate the scale of the investment challenge facing the CPs.

**Table 2: Results of the Scenario Analysis for Investments Required Between 2012 and 2020**

<table>
<thead>
<tr>
<th></th>
<th>Current Trends</th>
<th>Minimum Investment Cost</th>
<th>Low Emissions/Sustainable Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Required excl Ukraine</td>
<td>6.1 billion</td>
<td>15.1 billion</td>
<td>32.3 billion</td>
</tr>
<tr>
<td>Total Investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Required incl Ukraine</td>
<td>18.1 billion</td>
<td>39.1 billion</td>
<td>73.6 billion</td>
</tr>
</tbody>
</table>

*Source: Energy Community Energy Strategy December 2012*

In line with the EU’s approach to prioritise critical energy infrastructure by identifying Projects of Common Interest (PCI), in November 2012 the Energy Community invited promoters to submit their project proposals in the area of electricity, gas and oil infrastructure. Any project
promoter, within or outside the Energy Community, was able to apply to be recognised as one of the PECI (Projects of Energy Community Interest) subject to the following conditions:

- The project is located in at least one Contracting Party and,
- It will impact at least two Contracting Parties, or a Contracting Party and a EU Member State.

The submitted project proposals covered the Energy Community Contracting Parties area. Following an intensive period of assessment, including comparative cost analysis and an engineering assessment to identify outliers, data errors and inconsistencies, all projects were classified and then subjected to a rigorous assessment including:

- Application of an economic Cost-Benefit Analysis (CBA) for each project (or project cluster);
- Assessment of additional qualitative and quantitative criteria and integration with the results of the CBA;
- Calculation of a single score for each project or project cluster; and
- Ranking of all eligible projects according to the calculated scores with separate lists for electricity infrastructure, power generation and gas infrastructure.

Following this process, 35 projects spanning generation, electricity infrastructure, gas infrastructure and oil infrastructure were adopted in October 2013 as Projects of Energy Community Interest with a total investment cost of € 13.5 billion.

The ECS as mandated by the Ministerial Council in October 2013 developed a PECI monitoring system based on inputs from the Western Balkans Investment Framework (WBIF) and the Neighbourhood Investment Facility (NIF), and from responses to the Secretariat’s own questionnaire sent to all PECI project promoters, in April and May 2014.

A summary of these monitoring results is presented in the tables below\(^2\).

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\(^2\) It is important to note that the exact implementation potential related to every single project can only be established by a detailed analysis of the project specifics and the legal and regulatory framework in the specific country (including compliance with environmental legislation). Furthermore the assessment does not imply any conclusion on pending court cases on individual project proposals.
Table 3: List and Status of PECI – Electricity Generation

<table>
<thead>
<tr>
<th>No.</th>
<th>Contracting Party</th>
<th>Project</th>
<th>Estimated Investment (mil. €)</th>
<th>Capacity (MW)</th>
<th>Commissioning year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AL</td>
<td>Hydro Power Plant Skavica</td>
<td>550</td>
<td>350</td>
<td>2015</td>
</tr>
<tr>
<td>2</td>
<td>AL</td>
<td>Wind Park Dajc, Vipava</td>
<td>283</td>
<td>186</td>
<td>2015-2020</td>
</tr>
<tr>
<td>3</td>
<td>BH</td>
<td>Combined Heat and Power Plant KTO Zenica</td>
<td>250</td>
<td>390</td>
<td>2016</td>
</tr>
<tr>
<td>4</td>
<td>SH</td>
<td>Hydro Power Plant Doblar</td>
<td>177,56</td>
<td>159,15</td>
<td>2018</td>
</tr>
<tr>
<td>5</td>
<td>BH + HR</td>
<td>Hydro Power Plant Dobrek (Phase II)</td>
<td>175,03</td>
<td>304</td>
<td>Assumed 2019</td>
</tr>
<tr>
<td>6</td>
<td>BH + RS</td>
<td>Hydro Power Plants Upper Dina (HPP Bučišča, HPP Foka, HPP Plavča, HPP Plavča, HPP Spletno)</td>
<td>580,42</td>
<td>223,13</td>
<td>Assumed 2020-2023</td>
</tr>
<tr>
<td>7</td>
<td>SH + RS</td>
<td>Hydro Power Plants Middle Dina (HPP Tegar, HPP Rogatica, HPP Dobrince)</td>
<td>670,13</td>
<td>321,45</td>
<td>Assumed 2020</td>
</tr>
<tr>
<td>8</td>
<td>Kosovo*</td>
<td>Kosovo e Ro Power Plant (KRPF)</td>
<td>1260</td>
<td>600</td>
<td>2020</td>
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<tr>
<td>9</td>
<td>ME</td>
<td>Hydro Power Plants Lim River</td>
<td>107</td>
<td>93</td>
<td>2017</td>
</tr>
<tr>
<td>11</td>
<td>RS</td>
<td>Thermal Power Plant Kolubara B</td>
<td>1300</td>
<td>760</td>
<td>2020</td>
</tr>
<tr>
<td>12</td>
<td>RS</td>
<td>Thermal Power Plant Nikola Tesla B3</td>
<td>1100</td>
<td>744</td>
<td>2020</td>
</tr>
<tr>
<td>13</td>
<td>RS</td>
<td>Combined Heat and Power Plant Novi Sad</td>
<td>490</td>
<td>450</td>
<td>2016</td>
</tr>
<tr>
<td>14</td>
<td>RS</td>
<td>Hydro Power Plants Barcica (10 HPPs)</td>
<td>350</td>
<td>118</td>
<td>2016-2021</td>
</tr>
<tr>
<td></td>
<td>Kosovo*</td>
<td>Hydro Power Plants Velika Morava (HPP Ljubović, HPP Trnovci, HPP Bujanov, HPP Mljetnica, HPP Vranje)</td>
<td>302</td>
<td>148</td>
<td>2016-2021</td>
</tr>
</tbody>
</table>

**TOTAL:** | 8,030,14 | 4,976,73 |

*Source: ECS Investment Report on PECI June 2014*

Table 4: List and Status of PECI – Electricity Infrastructure

<table>
<thead>
<tr>
<th>No.</th>
<th>Contracting Party</th>
<th>Project</th>
<th>Estimated Investment (mil. €)</th>
<th>Transmission capacity</th>
<th>Commissioning year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AL, FYR of MK</td>
<td>400 kV CHL SS Bistrica (FYR of MK) – SS Elbasan (AL)</td>
<td>21,5 (AL) 37,3 (MK)</td>
<td>1330 MW Thermal Limit</td>
<td>2019</td>
</tr>
<tr>
<td>2</td>
<td>HR, HRA and HRI internal line reinforcement</td>
<td>400 kV CHL Baro Luka (BR) – Luka (HR)</td>
<td>187</td>
<td>1200 / 1320 MW</td>
<td>2020</td>
</tr>
<tr>
<td>3</td>
<td>FI - AL</td>
<td>400 kV HVDC SS Viso - Bari West</td>
<td>150</td>
<td>1000 MW</td>
<td>2014</td>
</tr>
<tr>
<td>4</td>
<td>Kosovo* - AL</td>
<td>400 kV CHL Trinca (AL) – Prishtina (Kosovo*)</td>
<td>33,5 (RO) 51,1 (AL)</td>
<td>1330 MW</td>
<td>2016</td>
</tr>
<tr>
<td>5</td>
<td>MD - RO</td>
<td>400 kV CHL Bati (MD) and Suceava (RO)</td>
<td>90,5</td>
<td>1000 MW</td>
<td>2019</td>
</tr>
<tr>
<td>6</td>
<td>ME - RS - BH and WE internal line reinforcement</td>
<td>400 kV CHL SS Bajina Basta (RS) - SS Pjenje (WE) - SS Vojvodina (BH)</td>
<td>183,3</td>
<td>2000 MW / 1320 MW</td>
<td>2020 2015</td>
</tr>
<tr>
<td>7</td>
<td>RS</td>
<td>400 kV CHL SS Kragujevac - SS Kolubara</td>
<td>25</td>
<td>1000 MW</td>
<td>2016</td>
</tr>
<tr>
<td>8</td>
<td>RS</td>
<td>400 kV CHL SS Bajina Basta - SS Kragujevac</td>
<td>90</td>
<td>1000 MW / 2000 MW</td>
<td>2020 2019</td>
</tr>
<tr>
<td>9</td>
<td>RS - RO</td>
<td>400 kV CHL SS Resida (RO) - SS Pancevo (RS)</td>
<td>26 (RO) 25 (RS)</td>
<td>2000 MW / 1320 MW</td>
<td>2018 2019</td>
</tr>
</tbody>
</table>

**TOTAL:** | 895,60 |

*Source: ECS Investment Report on PECI June 2014*
Table 5: List and Status of PECI – Gas Infrastructure

<table>
<thead>
<tr>
<th>No.</th>
<th>Contracting Party</th>
<th>Project</th>
<th>Estimated Investment (mil. €)</th>
<th>Capacity</th>
<th>Commissioning year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AL-ME-HR-BH</td>
<td>Italian Adriatic Pipeline (API)</td>
<td>620</td>
<td>up to 5 bcm/a</td>
<td>2020</td>
</tr>
<tr>
<td>2</td>
<td>GR-AL-T</td>
<td>Trans Adriatic Pipeline (TAP)</td>
<td>1500 (subject to revisions due to route)</td>
<td>10 bcm/a</td>
<td>2018</td>
</tr>
<tr>
<td>3</td>
<td>AL</td>
<td>EAGLE LNG Terminal</td>
<td>700 (terminal + pipeline)</td>
<td>4.8 bcm/a (LNG floating vessel), 215,000 cm³ (LNG storage)</td>
<td>2017</td>
</tr>
<tr>
<td>4</td>
<td>BH - HR</td>
<td>Interconnection Pipeline BH - HR (Sloboština-Bosanski Brod-Zenica)</td>
<td>94</td>
<td>up to 5 bcm/a</td>
<td>2019</td>
</tr>
<tr>
<td>5</td>
<td>BH - HR</td>
<td>Interconnection Pipeline BH - HR (Zagreb - Porečka - Novi Trnava with a main branch to Modra)</td>
<td>16 HR 82 BH</td>
<td>1.5 - 2.5 bcm/a</td>
<td>2019 (BH - HR)</td>
</tr>
<tr>
<td>6</td>
<td>BH - HR</td>
<td>Interconnection Pipeline BH - HR (Lička Jesenica-Trzac-Bosanska Kupa)</td>
<td>49.2</td>
<td>1 - 1.5 bcm/a</td>
<td>2023</td>
</tr>
<tr>
<td>7</td>
<td>HR</td>
<td>LPG Terminal in Croatia + Pipeline Zidari-Bodojevo-Sokol-Koćanac-Sloboština</td>
<td>635,8 terminal, 300 pipeline</td>
<td>6 bcm/a</td>
<td>2018 terminal 2019 pipeline</td>
</tr>
<tr>
<td>8</td>
<td>HR - RS</td>
<td>Interconnection Pipeline HR - RS (Sloboština-Srebrenik Bajkla Novo Selo)</td>
<td>87 RG 86 HR</td>
<td>8 - 7 bcm/a</td>
<td>2023</td>
</tr>
<tr>
<td>9</td>
<td>RS</td>
<td>Interconnection Pipeline RS (Novi Dintrogrožac) to BG (in SR)</td>
<td>67.5</td>
<td>1.8 bcm/a</td>
<td>n/a</td>
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<tr>
<td>10</td>
<td>BG</td>
<td>Interconnection Pipeline RS (Nivo-Dintrogrožac) to BG (in BG)</td>
<td>47.4</td>
<td>1.8 bcm/a</td>
<td>2016, 2017</td>
</tr>
<tr>
<td>11</td>
<td>UA</td>
<td>Modernization of Ušćanski-Pomarny-Užgorod pipeline</td>
<td>296</td>
<td>29.2 bcm/a</td>
<td>2015</td>
</tr>
<tr>
<td></td>
<td><strong>TOTAL:</strong></td>
<td></td>
<td></td>
<td></td>
<td>4,567.70</td>
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</table>

Source: ECS Investment Report on PECI June 2014

Table 6: List and Status of PECI – Oil Infrastructure

<table>
<thead>
<tr>
<th>No.</th>
<th>Contracting Party</th>
<th>Project</th>
<th>Estimated investment (mil. €)</th>
<th>Capacity</th>
<th>Commissioning year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>HR</td>
<td>Project of Inspection, Evaluation, Rehabilitation, Upgrading and Reconstruction of the existing JANAF Oil Pipeline</td>
<td>54</td>
<td>Existing storage: 1,000,000 m³, planned new: 240,000 m³ pipeline capacity, designed: 14.4 MTA installed: 3-20 MTA</td>
<td>2015-2016</td>
</tr>
<tr>
<td>2</td>
<td>UA-PL-CZ-GR-LT</td>
<td>Construction of the Brody – Adamowo oil pipeline</td>
<td>307.4 first stage - 499.0</td>
<td>Existing storage: 815,000 m³, planned new: 460,000 m³ pipeline capacity: 30 MTA</td>
<td>2015</td>
</tr>
</tbody>
</table>

Source: ECS Investment Report on PECI June 2014
4. SOURCES OF FINANCE FOR THE DEVELOPMENT & REALISATION OF PRIORITY ENERGY INVESTMENTS

Realising energy infrastructure projects requires funding across the entire project cycle from initial concept to eventual maintenance of the commissioned infrastructure. Funding must be sufficient to cover a range of services, equipment and works at the different stages.

In general, a number of sources of finance are tapped to provide the overall funding required for an individual infrastructure project. The main sources of finance include:

- Government /own resources
- IFIs
- Commercial banks/private investors
- Donor funded blending facilities and TA
- Financial facilities for investments in energy efficiency and renewable energy
- Special development funds and risk mitigation facilities

The scale of the investment needs in the CPs - e.g. €13.5 billion for the PECI alone - means that government and/or public finance will only ever be able to finance part of the costs and it is vital that private investment is secured.

The various sources of finance are outlined below along with any key features or specificities relating to their use in the Energy Community CPs.

4.1 Government/state resources

At present, government /state financing is currently the primary source of financing for PECI style projects given the extent of state ownership of the energy sector in the CPs, the scale of many of the priority infrastructure projects and the nature of the investments. As the CPs progress with the implementation of the Energy Community, the governments’ role should shift more towards facilitating investments by ensuring that the energy market functions properly and that the investment climate attracts external capital.

Government financing can be provided as one of, or a combination of, the following: a straightforward allocation of public funds; revenues from the energy services provided by the state company involved; the provision of state guarantees for loans assumed by state companies for specific investments; or financing of incentives (e.g. grants to cover R&D costs or subsidise the purchase of new technology) to encourage private sector investors.

Energy infrastructure projects must compete with many other areas of government expenditure for public financing including other infrastructure sectors such as transport, environment and social infrastructure as well as government funded services such as health, education and social welfare. The impact of the global financial crisis and the on-going weak recovery has placed an immense burden on the economies of the CPs and hence on their state budgets. This has had a direct impact on capital expenditure including expenditure on energy infrastructure.

As Tables 7 and 8 below indicate that, while both total government expenditure and capital expenditure have fallen, there has been a steeper decline in capital expenditures as governments cut back on investments in infrastructure to finance current expenditure.
including social benefit outlays and public debt that have been raised by the economic crisis. Moreover there is a remarkable difference in the CPs’ budget structure. While capital spending as a share of total government spending is above one quarter in Kosovo, and 20 per cent in Georgia, it is below 10 per cent in Montenegro and in Serbia where the propensity to invest public resources is lowest.

Table 7: Total Government Expenditure and Capital Expenditure as % of GDP 2009-2014

<table>
<thead>
<tr>
<th>Country</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tbody>
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<td>Western Balkans</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Albania</td>
<td>35.5</td>
<td>9.0</td>
<td>30.2</td>
<td>5.9</td>
<td>29.4</td>
<td>5.5</td>
</tr>
<tr>
<td>BiH</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Kosovo</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>29.0</td>
<td>10.9</td>
</tr>
<tr>
<td>FYR Macedonia</td>
<td></td>
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<td></td>
<td></td>
<td>33.8</td>
<td>4.1</td>
</tr>
<tr>
<td>Montenegro</td>
<td>47.8</td>
<td>8.4</td>
<td>45.9</td>
<td>5.3</td>
<td>43.6</td>
<td>4.2</td>
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<tr>
<td>Serbia</td>
<td>46.7</td>
<td>3.4</td>
<td>47.4</td>
<td>3.6</td>
<td>45.7</td>
<td>3.6</td>
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<td></td>
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<td></td>
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<tr>
<td>Georgia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>31.8</td>
<td>7.5</td>
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<tr>
<td>Moldova</td>
<td>45.3</td>
<td>5.0</td>
<td>40.8</td>
<td>4.8</td>
<td>39.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Ukraine (excl Crimea)</td>
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</table>

<table>
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</tr>
</thead>
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<td>Western Balkans</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Albania</td>
<td>32.0</td>
<td>5.0</td>
<td>31.7</td>
<td>5.0</td>
<td>30.6</td>
</tr>
<tr>
<td>BiH</td>
<td></td>
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</tr>
<tr>
<td>Kosovo</td>
<td>28.7</td>
<td>9.5</td>
<td>28.5</td>
<td>9.5</td>
<td>28.8</td>
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<td>3.9</td>
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<td>3.5</td>
<td>33.7</td>
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<td>4.4</td>
<td>42.3</td>
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<td>42.2</td>
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<td>48.9</td>
<td>3.8</td>
<td>49.3</td>
<td>3.9</td>
<td>49.4</td>
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<tr>
<td>Georgia</td>
<td>30.1</td>
<td>6.4</td>
<td>29.8</td>
<td>6.4</td>
<td>29.8</td>
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<tr>
<td>Moldova</td>
<td>42.2</td>
<td>7.9</td>
<td>41.5</td>
<td>7.4</td>
<td>41.6</td>
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<td>Ukraine (excl Crimea)</td>
<td>46.6</td>
<td>2.0</td>
<td>45.4</td>
<td>2.2</td>
<td></td>
</tr>
</tbody>
</table>

Table 8: Total Government Expenditure and Capital Expenditure as % of GDP 2015-2019

In general throughout the CPs, the governments’ ability to generate resources for infrastructure development is impaired by insufficient fiscal space, a reluctance to tax and difficulties to implement (appropriate) user charges for public services. The economic crisis has exacerbated this situation by depressing employment, and hence the tax base; and by additional social spending needed to fight poverty. Public debt and borrowing indicators have begun to show significant stress, which will impede governments’ access to loans over time.

While public debt is still generally manageable across the CPs, there has been a strong increase in the last five years in all countries, partially due to infrastructure loans, but also due to substantial borrowing in support of general budgets and accumulation of arrears in some cases.
As a result of increasing debt and large non-discretionary current spending, particularly in the Western Balkan countries, the fiscal space for financing infrastructure investment has shrunk significantly. The growth rates expected in the coming five years are insufficient to stimulate socio-economic development and sustain the build-up of growth-enhancing infrastructure including energy infrastructure. In addition to reduced revenues, government face increasing difficulties to assume sovereign guarantees for loans from IFIs as informal ceilings are breached and obligations under IMF programmes have to be respected.

Another issue of relevance when trying to attract investment capital is the investment rating assigned to the country by main international ratings agencies. As can be seen from Table 11 below, most of the CPs are currently rated as highly speculative. Therefore securing finance from IFIs and accessing donor funded mechanisms to provide more risk capital and risk mitigation is critically important for the CPs.

### Table 9: GDP Growth at Constant Prices

<table>
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<tr>
<th></th>
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<tbody>
<tr>
<td><strong>Western Balkans</strong></td>
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</tr>
<tr>
<td>Albania</td>
<td>1.14</td>
<td>0.44</td>
<td>2.10</td>
<td>3.30</td>
<td>4.20</td>
<td>4.50</td>
<td>4.50</td>
<td>4.70</td>
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<tr>
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<td>-1.21</td>
<td>2.10</td>
<td>0.70</td>
<td>3.50</td>
<td>3.70</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
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<td>Kosovo</td>
<td>2.81</td>
<td>3.39</td>
<td>2.74</td>
<td>3.35</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.00</td>
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<tr>
<td>Montenegro</td>
<td>-2.55</td>
<td>3.50</td>
<td>2.26</td>
<td>3.40</td>
<td>3.26</td>
<td>3.32</td>
<td>3.34</td>
<td>2.96</td>
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<td>-1.52</td>
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<td>-0.54</td>
<td>1.04</td>
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<td>2.20</td>
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</tr>
<tr>
<td>Georgia</td>
<td>6.18</td>
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<td>5.03</td>
<td>5.00</td>
<td>5.04</td>
<td>4.97</td>
<td>4.97</td>
<td>4.97</td>
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<td>Moldova</td>
<td>-0.73</td>
<td>8.85</td>
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<tr>
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<td>0.25</td>
<td>-0.04</td>
<td>-6.50</td>
<td>1.00</td>
<td>4.00</td>
<td>4.00</td>
<td>4.50</td>
<td>4.50</td>
</tr>
</tbody>
</table>

International Monetary Fund, World Economic Outlook Database, October 2014

**Graph 1: Budget Deficit as % of GDP**

Source: International Monetary Fund, World Economic Outlook Database, October 2014
Graph 2: Government Gross Debt as % of GDP

![Graph showing government gross debt as % of GDP for various countries over the years 2012 to 2019.](image)

Source: International Monetary Fund, World Economic Outlook Database, October 2014

Table 10: Government Gross Debt as % of GDP

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Western Balkans</strong></td>
<td></td>
<td></td>
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International Monetary Fund, World Economic Outlook Database, October 2014

Table 11: Investment Ratings of CPs by International Ratings Agencies

<table>
<thead>
<tr>
<th>Ratings</th>
<th>S&amp;P**</th>
<th>Moody’s**</th>
<th>Fitch**</th>
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<td>Local Currency Rating</td>
<td>Foreign Currency Rating</td>
<td>T&amp;C assessment* **</td>
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<td>BB-</td>
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<td>Serbia</td>
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<td><strong>Eastern Neighbourhood</strong></td>
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</tr>
<tr>
<td>Ukraine</td>
<td>B-</td>
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</tr>
</tbody>
</table>

* As of 23 October 2014
** As of 16 Aug 2014
*** An assessment of country transfer and convertibility
4.2 International Financial Institutions

The main international financial institutions active in the CPs are the EBRD, EIB, KfW and the World Bank. All have financed a substantial portfolio of energy related investments and are actively exploring new opportunities including projects on the PECI list. The IFIs participate in projects on an individual and on a joint basis, and several projects in the CPs have two or more IFIs involved. The tendency to cooperate has been strengthened by the participation of all the IFIs in the EU-led Western Balkan Investment Framework (WBIF) and the participation of the European IFIs in the Neighbourhood Investment Facility (NIF) (see section 4.4 below). These EU led facilities provide EU grant funding to complement loan financing of infrastructure projects in the Western Balkans and Eastern Partnership countries respectively. Most of the IFIs also provide financial facilities in (some of) the CPs that promote investments by SMEs in energy efficiency and renewable energy – see section 4.5.

4.2.1 European Bank for Reconstruction and Development

The EBRD’s energy portfolio in the CPS is focused on electricity infrastructure (transmission), renewable energy and energy efficiency. It can provide a combination of public and commercial financing. For renewables and energy efficiency the EBRD has developed a series of financial facilities often delivered through commercial banks in the region that provide loans for relatively small scale investments in renewable energy by industry and energy efficiency projects by industry, municipalities and individuals (residential). In terms of large-scale energy infrastructure, the EBRD lending to the CPs stands at nearly €2 billion since 2006. The majority of its infrastructure investments to date have been backed by sovereign guarantees. It has recently approved a loan to the state-owned TSO in the former Yugoslav Republic of Macedonia for investments in transmission infrastructure without a state guarantee. Such loans are more expensive that loans accompanied by a sovereign guarantee. The EBRD is currently exploring possible options to expedite the development of transmission infrastructure projects in the Western Balkans.

In addition to the provision of debt financing, the EBRD also has access to its own Technical Cooperation funds that it can use to assist the government/project promoters to prepare particular projects. Given the substantial need for assistance in the CPs to prepare investment projects to the necessary standards, EBRD staff has found the WBIF a very useful mechanism. As well as the policy analysis work undertaken by its Chief Economist’s Office, the EBRD also engages in policy dialogue with governments regarding the investment climate. It has recently launched an Investment and Corporate Governance Initiative to support efforts to improve the general business climate. To date governments in four CPs - Albania, Moldova, Serbia and Ukraine - have expressed interest in this initiative. Activities are now underway to establish different services, e.g. a business ombudsman or a national investors council, to provide structures that government and business can use to ensure better policies and practices.

4.2.2 European Investment Bank

The EIB provides public and commercial financing. Operations in the CPs are covered under the Bank’s external mandate, which means that it can leverage its AAA rating with the EU Guarantee for EIB Loans outside of the EU to provide comparatively low cost public financing with longer tenors. In the energy sector globally the EIB provides a combination of financial facilities and advisory services. It is active in generation (particularly renewable), rehabilitation and expansion of transmission and distribution lines and substations as well as energy efficiency.
In the CPs, its energy related operations have to date focused on infrastructure. EIB energy infrastructure related lending to CP countries since 2006 stands at approximately €2.54 billion and it has provided loans for the rehabilitation of a number of renewable (hydro) plants as well as transmission lines. It has a particular focus on the extension of the EU’s Trans-European Networks to CP countries.

EIB can provide up to 50% of the total investment cost and therefore it often co-finances investments with other IFI, bilateral or commercial banks together with equity providers in case of private sector operations. Sovereign guarantee for loans to public sector entities are usually required. The EIB has a large in-house team of economists and engineers who screen projects before, during and after lending and can provide some technical assistance inputs. It has found the WBIF and the NIF very useful mechanisms to markedly improve the quality of preparatory documents. In recognition of the need for greater assistance for project preparation in CPs compared to its EU operations, it has recently established a technical assistance facility for Eastern Partnership countries funded by bilateral donors.

The recent agreement to expand the EU financed JASPERS programme to all enlargement countries means that this advisory facility, managed by the EIB and co-sponsored by the European Commission and EBRD, is now available to provide upstream management advice and quality control services for the preparation of major infrastructure projects to CPs in the Western Balkans. See 4.4.3.

### 4.2.3 KfW Development Bank

KfW’s mandate in the CPs is provided by the Federal Ministry for Economic Cooperation and Development (BMZ), and is mainly focused on programmes and projects that involve public sector players. In the energy sector, KfW products are aimed at renewable energy, access to energy and energy efficiency. In the CPs it has focused on transmission infrastructure, smaller scale renewable projects and energy efficiency (often via financial facilities delivered through intermediate banks in the different countries). It is also a key player in the Green for Growth Fund that operates throughout all CPs. In conjunction with the EBRD is has recently established a Municipality Infrastructure Facility for the Western Balkans that can, among other areas, facilitate financing of energy efficiency investments at municipal level.

KfW’s portfolio of lending for infrastructure in the CPs since 2006 stands at approximately €1.2 billion. All KfW infrastructure loans are provided against a state guarantee.

While KfW can access some internal grant funds to support project development, like the other IFIs, it finds that the scale of assistance required is such that WBIF style facilities are very important. In other regions, KfW has explored various ways in which to improve the viability of energy projects including increasing grant assistance for preparatory work by assembling a pool of donor grants and paying top-ups to feed in tariffs for approved projects.

KfW is also examining options to leverage greater private sector financing for infrastructure in transition and developing markets. It is at an early stage in exploring a potential special market vehicle that would specialize in guaranteeing and insuring long-term development projects in those countries where EU led blending mechanisms are in operation, while re-insuring itself on the private insurance market.

The concept is to transform the 7-year commitments the private sector will take (for statutory reasons private insurers will not work beyond 7 years) into longer-term commitments more suitable for large-scale infrastructure projects by revolving the funding. This new vehicle would have to have its own rating and own capital base. The risks it will take include economic as well
Commercial investors are active in the CPs and are monitoring future potential prospects. KfW has discussed this with the EC and other European IFIs and is currently undertaking an exploratory study. This is should be completed in early 2015.

4.2.4 World Bank

The World Bank’s operations in the CPs fall under its Europe and Central Asia (ECA) region where its strategy is to focus on (i) improving competitiveness and shared prosperity through jobs and (ii) environmental, social and fiscal sustainability. The ECA region is the most energy intensive in the world and the World Bank works with CPs governments to improve both the overall policy climate and infrastructure for energy through loans to support policy reforms (often known as Development Policy Loans) as well as loans for public investment in infrastructure. All public sector loans must be backed by a sovereign guarantee. The World Bank can also provide Partial Risk Guarantees for publicly financed investment projects. These provide guarantees to investors for the payment performance of a state entity. These guarantees contain a counter guarantee that the World Bank has the option to request from the government if their guarantee is called in and it is deemed that the government did not undertake appropriate action. Hence these guarantees tend to be guarantees of last resort. To date only one Partial Risk Guarantee has been issued in the CPs - to support the privatisation of the state energy utility in Albania.

Other members of the World Bank Group – the International Development Agency (IDA), the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) are also active in the CPs. Moldova is the only CP still eligible, in a limited way for concessional IDA Credits and exclusively for projects specifically aimed at poverty alleviation. Moldova’s access to IDA resources will be phased out over the 2014-17 Country Partnership Strategy.

The IFC provides finance and advisory services for private sector development. While its financial products are directed to the private sector it provides advisory services to both the private sector and governments. In the energy sector it is focused on renewable energy and energy efficiency, and it is active in all the CPs. The IFC often works in conjunction with MIGA, which provides political risk insurance guarantees to private sector investors and lenders. MIGA’s guarantees protect investments against non-commercial risks and can help investors obtain access to funding sources with improved financial terms and conditions. Two MIGA guarantees are current in CP countries - in Albania and Moldova.

4.3 Commercial Finance

Commercial financiers (banks and investors) are active in the energy sector in the CPs, but are not heavily involved in the financing of large-scale infrastructure such as the PECI. Many of the commercial banks active in the region are subsidiaries of European banks and they have reduced their overall exposure in the region following the financial crisis. In general these banks provide financing for investments in energy efficiency to companies and to individuals. The majority of these facilities are supported by credit lines from IFIs such as EBRD, EIB and KfW, and in some cases technical assistance is given to the banks, to promote and manage these products that are new to the region. See section 4.5.

Commercial investors are active in the CPs and are monitoring future potential prospects. Potential investors include commercial arms of large European utilities and Transmission
System Operations (TSOs), e.g. E.ON, RWE, OMV, TERNE; European and global power companies such as Statkraft, Edison Gruppe and BP; as well as smaller private companies and equipment manufacturers. Some are active in the region through their involvement in larger trans-European infrastructure projects, e.g. the Trans-Adriatic Pipeline or as suppliers of equipment and services to publicly financed projects.

In terms of financing infrastructure investments these investors tend to focus on smaller renewable projects – e.g. hydropower and wind power as well as energy efficiency. While the overall investment climate presents challenges, investor restrictions placed by governments on state-owned energy infrastructure in some CPs limits the ability of commercial investors to participate in certain projects. In addition, the scale of some of the larger PECI means that a commercial investor may face difficulties to secure the finance necessary to participate in the project.

4.4 Donor Funded Blending Facilities and TA Programmes

A number of grant-funded instruments are available to the CPs to support the development of socio-economic infrastructure including energy infrastructure. These can be divided into two categories – EU led blending mechanisms and TA programmes.

The main aim of blending mechanisms is to leverage external cooperation funds by mobilising loans from financial institutions. Blending aims, in particular, to address sub-optimal investment situations in the case of activities or infrastructure that could be viable but do not attract sufficient funding from market sources. They provide a platform for the EC, IFIs, bilateral donors and CPs to work closely together and to undertake large projects, which would have been difficult to finance otherwise. For the CPs the two relevant mechanisms are the Western Balkans Investment Framework (WBIF) and the Neighbourhood Investment Facility (NIF).

In general TA programmes are funded by the EU and bilateral donors and provide expertise and capacity building services to the public administrations including local government in the CPs. The assignments are usually linked to improving the overall policy climate, regulatory reform and public administration reform.

4.4.1 WBIF

The WBIF was established in 2009 to support socio-economic investments in the Western Balkans, namely infrastructure investments in energy, environment, transport and the social sector as well as energy efficiency and private sector development (see www.wbif.eu). The WBIF blends grants from the EC’s Instrument for Pre Accession (IPA), IFIs and several bilateral donors, with loans from the participating IFIs (CEB, EBRD, EIB, KfW and the World Bank3). To date applications for grants have been submitted by the partner countries - supported by an IFI – in response to biannual calls for proposals issued by the WBIF Secretariat based at DG Enlargement. The majority of grants have been for technical assistance services to prepare investment projects, i.e. to carry out feasibility studies, Environment Impact Assessments, preliminary design and detailed design. Some TA grants have been approved to accompany actual investments (e.g. to provide technical expertise to a project implementation unit) and a limited number of co-financing grants have been approved. In general, grant applications must be for a specific investment project. However in 2011 a small “strategic studies” window was introduced to finance more “up-stream” studies that could facilitate better identification of priority investments in different sectors, e.g. the “Gas to Power study” that seeks to

3 The World Bank participates in the WBIF as a lead financier for projects in Kosovo and as a co-financier of projects in other countries.
determine options to develop Public Private Partnerships (PPPs) to support the development of gas infrastructure in the Western Balkans.

Between 2009 and 2013, WBIF grants to a value of approximate €74.9 million were approved for energy related projects. This figure includes €23.3 million for the Regional Energy Efficiency Programme – a financial facility (see section 4.5) and a co-financing grant for a district-heating project in Pristina. The remaining grants are mostly focused on preparation of energy projects, including a number of renewable energy investments such as wind farms and hydro-power stations. As indicated in Table 2 – 4, 10 of the PECI have received grants under the WBIF, 4 in electricity infrastructure, 5 in gas infrastructure and one in oil infrastructure – all of these grants have been for preparatory work, and to date none of these projects have moved to the financing stage.

The IPA II budget (2014-2020) envisages a financial allocation of €800 million to WBIF, and a revised approach and methodology for the submission and evaluation of applications as well as the forms of assistance available is being considered. Amongst other things, a substantial increase in investment grants for mature projects that have a financing gap is foreseen.

The revised approach under WBIF is likely to be influenced by the call for greater regional cooperation and further integration with the EU made by several EU MS at the high level Western Balkan Conference in Berlin in August 2014. The discussions at this high level event and subsequent follow-up meetings have emphasised the importance of investments that connect the countries to each other and to EU markets. It is expected that the topic of investments that encourage such “connectivity” will feature at the next high level conference scheduled for Austria in summer 2015.

4.4.2 NIF

The NIF has been designed to finance capital-intensive infrastructure projects in partner countries covered by the European Neighbourhood Policy (ENP) as well as to support their private sector. It covers infrastructure projects in transport, energy, environment and the social sector as well as SME development. The Facility brings together grants from the European Commission and the EU Member States with loans from European public Finance Institutions including EBRD, EIB and KfW, as well as own contributions from the partner countries. NIF East covers Armenia, Azerbaijan, Georgia, Republic of Moldova and Ukraine as well as regional east-wide projects. NIF South covers the Southern Neighbourhood region of North Africa and the Mediterranean.

Energy infrastructure investments in Ukraine, Moldova and Georgia have received approx. €48.2 million in NIF grants to accompany preparation and implementation of investments with a total estimated cost of €4.2 billion. Investments include transmission lines, generation plans (hydropower) and gas transit and storage facilities. NIF has also allocated substantial grant funding for financial facilities aimed at boosting investments in energy efficiency and small scale infrastructure at municipal level. The EC has earmarked grants of €1 billion under the NIF budget 2014 – 2020. To date, NIF East has received approximately one third of the financial assistance available under NIF and this proportion is expected to remain the same under the new financial perspective.

The strategic orientations for NIF 2014-2020 have been adopted recently and activities to support the recently signed Deep and Comprehensive Free Trade Agreements (DCFTAs) will be a priority, possibly signalling greater attention to private sector development actions. However energy infrastructure, particularly extensions of the EU’s Trans-European Networks will continue to receive substantial attention.
Under NIF procedures, the relevant IFI applies for a grant to support a specific investment and the majority of grants awarded are to co-finance mature investments. This emphasis on investment-ready projects is expected to continue into the future.

### 4.4.3 Energy Related Technical Assistance Programmes

A number of EC and bilateral donor financed TA programmes are available to enhance the overall environment for investment in the CPs. The main EC financed programmes that relate specifically to support for energy infrastructure are outlined below. In addition both IPA and ENI programme can finance ad hoc assignments and capacity building via twinning and TAIEX. Other programmes funded by bilateral donors are also of relevance including the energy component of GIZ’s Regional Open Fund for South Eastern Europe. USAID has recently commenced roll out of its Low Emissions Development Strategy Programme – a follow-on to its Synergy programme.

**Inogate**

Ukraine, Moldova and Georgia are all beneficiaries of the EC-financed Inogate programme (see [www.inogate.org](http://www.inogate.org)) a long running technical assistance programme that provides short-term expertise and capacity building on energy related matters. Topics covered include energy policy, standards, tariffs, renewables, energy efficiency and statistics. The programme covers the Eastern Partnership countries and Central Asia, and assisting CPs to meet Energy Community obligations is a key issue. It is managed by an Inogate Secretariat that has 3 offices throughout the region – the head office is in Kiev. The programme is currently being reviewed by DG Development and Cooperation to assess how best such assistance can be provided going forward.

**JASPERS**

JASPERS (see [www.jaspers-europa-info.org](http://www.jaspers-europa-info.org)) was originally created to help improve the quality of the major projects to be submitted by new EU Member States for grant financing under the Structural and Cohesion Funds. The assistance is geared towards accelerating the absorption of the available funds and JASPERS experts can undertake a number of tasks including

- Project review and recommendations
- Strategic support
- Capacity building
- Selective implementation support during project preparation

JASPERS operates on the basis of country specific action plans prepared annually with each beneficiary country and the European Commission. Under IPA II, it is expected that JASPERS will be extended to all enlargement countries, and funding for these will come from both the national IPA allocations and the multi-beneficiary programme. The programme is managed by EIB on behalf of the European Commission. For activities in EU Member States, the budget comes from DG Regional Policy, while IPA funds (both the multi-beneficiary programme and national IPA allocations) finance activities in the Western Balkans and Turkey.

Moving forward, the focus in enlargement countries will be on the up-stream work required to identify infrastructure projects. The exact allocations are still being finalized but Serbia is likely to have a budget of € 1.5 million for 2015-2016 and the multi-beneficiary programme has allocated an initial sum of € 3 million to be drawn down mainly for activities of regional importance. The management of JASPERS agreements in the enlargement countries will shift from DG Regio to DG Enlargement. Further work is planned by DG Enlargement to ensure that
the services provided by JASPERS are complementary to the services provided by the IPF under the WBIF.

4.5 **Financial Facilities available in Contracting Parties**

There are a number of financial facilities funded by the EC, IFIs and bilateral donors available to CPs to support investments in energy efficiency and renewable energy. These tend to focus on small-scale investments undertaken by SMEs, municipalities or individuals. Hence they are not so relevant for the PECI but should help the CPs in their efforts to meet their energy efficiency and renewable obligations under the Energy Community.

**Green for Growth**

This fund (see www.ggf.lu) is a public private partnership with a layered risk/return structure. It seeks to enhance energy efficiency and foster renewable energies in the Southeast Europe Region including Turkey and in the European Eastern Neighbourhood Region, predominantly through the provision of dedicated financing to businesses and households via partnering with financial institutions and direct financing. It works by:

- Refinancing Financial Institutions (local commercial banks, non-bank financial institutions such as microfinance institutions and leasing companies and other selected financial institutions) providing loans to households, businesses, municipalities and public sector for energy efficiency measures or renewable energy projects. Investments through Financial Institutions constitute the majority of GGF’s investments.

- Providing direct financing to Non-Financial Institutions (energy service companies, renewable energy companies or projects, small scale renewable energy and energy efficiency service and supply companies) that meet GGF energy saving and/or emissions targets, and comply with the technical criteria and GGF exclusion list.

**Regional Energy Efficiency Programme (REEP)**

REEP is financed under the WBIF and managed by EBRD. It provides a combination of financing instruments, technical assistance and policy support to create a sustainable market for energy efficiency and renewable energy in the region.

The programme builds on two EBRD managed facilities: the Western Balkans Sustainable Energy Direct Financing Facility (WeBSEFF); and the Western Balkans Sustainable Energy Financing Facility (WeBSEFF). Both programmes combine investment financing, technical assistance and investment incentives to encourage energy efficiency and renewable energy projects. The Direct Financing Facility works directly with companies on larger investments, particularly for renewables, while the WeBSEFF - aimed at energy efficiency investments - is channelled to SMEs, individuals and public entities through commercial banks in the region.

In recognition of the challenges faced by the public sector to secure financing for energy efficiency investments, the REEP has developed a policy dialogue window that facilitates intensive policy dialogues with the authorities in the region. The work aims to enhance the regulatory frameworks and overcome market barriers to encourage investment in energy efficiency and allow ESCO markets to emerge.
**Eastern Europe Energy Efficiency and Environmental Partnership ("ESP")**

The ESP brings together the Eastern Partnership countries, the European Commission, a range of bilateral donors, and the main IFIs active in the region to coordinate and accelerate the implementation of important energy efficiency and environmental projects. It is particularly aimed at supporting municipalities by assisting them to leverage IFI loans. The eligibility of projects for grant support is measured in terms of energy saving potential, capacity to reduce pollution, demonstration effects and potential to promote policy dialogue and regulatory reform. Originally launched in Ukraine, it has recently been extended to Armenia, Georgia and Moldova.

**Energy Efficiency Credit Lines**

Research carried out by the WBIF’s IFI Coordination Office in March 2013 (see [www.wbif.eu/Financing+Energy+Efficiency](http://www.wbif.eu/Financing+Energy+Efficiency)) identified 34 individual funds offering financial and/or technical assistance to improve EE in the Western Balkans. Fifteen are regional funds such as Green for Growth or REEP – and of these regional funds 12 are loan funds (most with their own or associated technical assistance), and three provide technical assistance services only (sometimes with small grants). Two guarantee funds were identified in the region both provided by USAID/SIDA with one in Bosnia and Herzegovina and one in the Former Yugoslav Republic of Macedonia. The total funding available through regional facilities is approximately €1.1 billion (up from €830.36m in 2011), 98% of which is loan funding (including associated technical assistance and grants).

In addition, 19 country-specific financial facilities were identified, bringing the total amount of financing available to over €1.5 billion. Although the report focuses on funds and facilities that have EE as their primary objective, it must be noted that there are also a number of general SME credit lines active in the region, often financed by EIB, that include EE as one of the eligible activities for borrowing.

**4.5 EU Energy Infrastructure Finance Facilities of Relevance**

EU Member States also face substantial infrastructure investment requirements and securing the appropriate financing is a common challenge, particularly in the aftermath of the financial crisis. Initiatives to address this investment deficit have been the focus of much effort by the EU MS, the EC and IFIs, particularly the EIB. The most ambitious initiative yet – a European Fund for Strategic Investments (EFSI), guaranteed with public money from the EU budget and the EIB was announced by Commission President Junckers on 26 November 2014. The Fund aims to mobilise €315 billion in investment over the next three years by leveraging EU guarantees and EIB loans to attract private investment. The Fund is based on three pillars – the provision of finance, a credible project pipeline backed by a technical assistance programme to link investments to mature, growth-generating projects of European significance and a road map to remove red-tape and regulatory bottlenecks. The further development and operation of this Fund should provide valuable experience for policy makers and financiers that could be subsequently used for the CPs.

Prior to the recent launch of the EFSI, the EU has already examined a number of options to alleviate some of the obstacles. It has reviewed its Financial Regulations to expand the range of instruments that it can utilise. Given the importance of a secure, efficient and sustainable energy market in the Union, a number of new financial facilities have been introduced that focus on this sector. These seek to use grant funding from the EU to leverage additional finance for investments deemed to be critically important to the implementation of the EU’s
energy strategy. The Connecting Europe Facility and the Marguerite Fund seem particularly relevant for the CPs.

4.5.1 Connecting Europe Facility

CEF is aimed at supporting the implementation of the EU’s energy, transport and digital strategies through targeted infrastructure investment at the European level. It particularly focused on the Trans European Networks for Energy and Transport (TEN-E and TEN-T) and builds on previously existing budget lines in these sectors. The Facility is centrally managed by the EC and focused on the development of high-performing, sustainable and efficient interconnected trans-European networks in the fields of transport (€23.2 billion), energy (€5.1 billion) and broadband infrastructure (€1 billion). The investments to be financed are projects of common European interest, selected on a competitive basis in line with agreed priorities such as contributing to security of supply, integrating renewables to the energy grid or completing interconnections between EU MS. CEF financing should plug the gaps that cannot be filled if market-based instruments, or existing public-sector instruments, are the only options available.

CEF provides grants for technical assistance for preparatory studies and grants for works and supplies. In addition it is also designed to attract private sector investment to infrastructure through a number of financial risk-sharing instruments, including special lending, guarantees and equity investments. These instruments aim to give credibility to infrastructure projects and to lower their risk profiles. The goal is to offer an alternative to the traditional grant funding which often simply matches the funds. The EC will work closely with the EIB and other financial institutions to take advantage of capital market investors’ interest in long-term investment opportunities with stable revenues. Following the in-depth assessment of market needs and its financing capacities, distinct financial instruments will be rolled out in cooperation with financial institutions. In particular projects bonds are to become part of the arsenal of financing tools under the CEF and pilot programme is underway led by EIB.

For TA and co-financing grants, CEF works on the basis of calls for proposals based on a list of pre-identified projects on the core network in the three sectors – these are known as the Projects of Common Interest (PCIs). The energy list includes projects of interest to the CPs such as the North-South electricity and gas interconnections in Central Eastern and South Eastern Europe and the Southern Gas Corridor.

The EU regulation governing CEF (1316/2013) notes in its preamble that:

“Some of the infrastructure projects of common interest might need to link with and pass through neighbourhood, pre-accession and other third countries. The CEF should offer simplified means of linking and financing those infrastructures, in order to ensure coherence between internal and external instruments of the Union budget.

When third countries and entities established in third countries participate in actions contributing to projects of common interest, grants should be available only if the action is unlikely to be adequately supported by other forms of financial assistance under the CEF or under other Union programmes.”

The first grants awards under CEF grants were made in October 2014 when 34 projects received grants totalling €647 million. The grants can be broken down as follows:

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4 Some of the funds currently allocated to CEF may be re-allocated to the new ESFI
• 16 grants are in natural gas and 18 grants in the electricity sector;
• 28 grants are for studies, such as environmental impact assessments (€91.4 million); and
• 6 grants go to construction works project (€555.9 million).

None of the projects awarded a grant has a component on the territory of a CP and therefore it is not yet clear how CPs would fare in an application for CEF support.

4.5.2 The Marguerite Fund

The 2020 European Fund for Energy, Climate Change and Infrastructure (known as “Marguerite”) was established with the backing of six major European financial institutions to make capital-intensive infrastructure investments in the 28 EU Member States. The Core Sponsors are:

• EIB
• KfW
• Caisse des dépôts et consignations, France
• Cassa Depositi e Prestiti, Italy
• Instituto de Crédito Oficial Spain
• PKO Bank Polski SA, Poland

Each of the six Core Sponsors has committed €100 million to the Fund. In addition, three further investors (including the European Commission) have committed an incremental €110 million to the Fund, bringing current commitments to €710 million. The Fund is managed as specialised investment fund (SICAV-FIS) formed as a public limited liability company in Luxembourg. The advisory company is independently owned and the core sponsors sit on the management board.

The fund focuses on transport, energy and mature renewables and has specific targets for greenfield (65% of the fund) and brownfield investments (35%). To date it has invested in 10 projects in Western and Eastern Europe. While the CPs are not currently eligible for assistance under this fund, the experience gained in the establishment and initial operation of this facility is relevant for the CPs.
5. **Challenges to the Realisation of Priority Infrastructure Investments**

Consultations with external financiers of energy infrastructure projects in the CPs (IFIs, private investors and European Commission services) revealed a very consistent view that the main obstacle to securing the necessary finance to realise the Energy Community’s priority investments was the overall investment climate in the different countries. The general opinion was that if well prepared projects, deemed to be economically viable and clearly supported by the relevant government(s), were presented, suitable financing packages could be assembled despite the difficult economic and financial climate.

Financiers noted that for the types of investment projects that are the subject of this report – i.e. PECI, financing would normally be provided on a project-by-project basis with substantial public finance involvement. Corporate financing as used for particular types of energy infrastructure in several EU Member States was not seen as particularly feasible at this point for these large-scale investments.

When discussing the challenges faced by financiers to advance the type of investment projects deemed as a priority by the Energy Community (i.e. PECI), the main issues raised can be categorised in terms of:

- The specific nature of the type of infrastructure investments;
- The current investment climate in CPs; and
- Availability and feasibility to utilise different forms of financing.

The key points made by the different financiers are summarised below under these headings.

### 5.1 Nature of investments

#### 5.1.1 Large Scale Investments

The PECI investments in general are so-called “big ticket” items. Large-scale projects (power plants, cross border transmission lines, gas pipelines etc) that require public sector involvement and take substantial time and resources to prepare properly. They also have a significant financial cost, some of which needs to be borne by the public purse – a particular challenge in many of the CPs as evidenced by their limited fiscal space and large public investment programmes across several sectors. It was stressed that smaller-scale projects, particularly those involving renewable energy such as wind farms or small hydro plants are being financed throughout the CPs often with significant private funding.

Large-scale generation projects are not attractive to any of the stakeholders (governments or financiers) at present due to a lack of demand partially caused by the economic downturn and political and economic uncertainties in the longer run. While most CPs recognise that investment in energy infrastructure is critical for the medium to long-term, governments are reluctant to commence a large-scale construction programme in the short term as long as they can exploit their old infrastructure. In some cases in the Western Balkans, they can at present import energy relatively cheaply from neighbouring EU Member States, e.g. Bulgaria and Hungary where prices are below the returns on new plants or even their amortization.

Grants are often an indispensable element of the preparation and implementation of such large projects, but grant expiry dates are an issue for large complex projects that are usually subject to a variety of technical, regulatory and political delays. Such delays lead to revised
time schedules that may mean that the grant intended to finance a particular element of the preparation/implementation is no longer available. In other cases the outputs of grant funded assistance, e.g. feasibility studies, may be out of date and have to be updated. All of these outcomes delay the project further and increase costs.

Investors in large pipeline or generation projects usually seek guarantees for off-take (ideally in the form of power purchase agreements - PPAs). Such agreements are difficult to obtain in the CPs due to the unstable regulatory regime (see below). The EC has some concerns regarding the general use of such agreements in the context of unbundling and the transition to a market economy given potential risks of contravening state aid and anti-trust regulations. Financiers expressed interest in exploring options to make some form of PPA feasible in line with the opening up of the market, e.g. varying the volume to be guaranteed over time and allowing the price to fluctuate in accordance with the market.

5.1.2 Fuel Mix

A number of projects seen as priorities by governments including several on the PECI list involve fossil fuel – coal or lignite. Thus they often face considerable opposition and lengthy preparatory periods in the CPs due to substantial environmental concerns. The CPs obligations under the Large Combustion Plant Directive and/or the Industrial Emissions Directive (which ever applies) may increase the estimated cost of such projects. In addition EU and IFI financing policies – particularly those revised in recent years – mean that there is extremely limited potential for these organisations to provide financing for such investments – including rehabilitation of existing plants. It is too early to assess if the proposal in the European Energy Security Strategy published in May 2014 to support, in specific circumstances, the sustainable production of competitive fossil fuels, taking into account the decarbonisation priorities, will have any future impact on current financing policies.

Some financiers expressed a view that while smaller renewable projects are currently relatively attractive, they may be reassessed as feed-in tariff regimes change and the sustainability of some financing schemes for renewable projects was also questioned.

It was suggested that as certain gas or renewable projects can boost competition in the market (a stated aim of the Energy Community) due to new technologies being made available on the market, such projects could be eligible for higher volumes of grant funding to cover some of the costs of the technology acquisition.

5.1.3 Complexity of Projects and Cross-border Projects

All of the PECI contain a mix of sectoral rationale, commercial interests and foreign policy interests which can make it very difficult to develop an appropriate investment plan.

Cross-border projects are complex from both a political and financial point of view, requiring that the relevant governments are in agreement at the same time regarding the priority of the project, the sequencing of implementation and the allocation of costs. This usually leads to a long preparatory period for such projects, as the necessary studies and detailed design can be very challenging to undertake, given different regulatory regimes and sometimes changing political priorities. The implementation of the Third Energy Package by the CPs could improve the capacity to implement cross border project as it contains several instruments to enhance cooperation.
While much improved, the political will for cross-border/regional projects in the Western Balkans still faces some limitations, and current events in Ukraine clearly mean such projects are highly uncertain.

Several parties advanced the view that given such complexity additional attention and possibly higher volumes of “soft” financing should be directed to cross-border projects such as interconnectors and gas pipelines. This was also deemed relevant for projects deemed to bestow benefits to a wider population than that of the particular CPs, such as pipelines or transmission lines that allow diversity of sources or security of supply on a European level.

5.1.4 Specific challenges of gas infrastructure in the Western Balkans

From a strategic point of view, provision of gas infrastructure in the Western Balkans would bring a new fuel to the energy mix and contribute to climate change objectives in the region. However all financiers consulted noted the “chicken and egg” situation as the current lack of distribution infrastructure means there is a lack of demand for gas which severely weakens the investment case for these projects. Gas currently plays only a small role in the power generation mix of the Western Balkans countries, where hydro and lignite dominate. Furthermore current gas prices are not competitive compared to lignite.

While all IFIs fully recognise the development objective of such investments, they cannot completely ignore the “bankability” of a project. In addition the assessment procedures within some IFIs do not take into account benefits such as security of supply/diversity to other parties when assessing project for internal approval.

There was a general consensus that such projects could lend themselves to special grant financing by the EU due to the long term strategic nature of the project and the security / diversification of supply benefits to the EU itself.

5.2 Overall Investment Climate

CPs vary widely in terms of the particular type and scale of energy infrastructure investments required due to their different energy mix, currently available infrastructure etc. However there was universal consensus that all suffer from a difficult investment climate, including unstable regulatory regimes open to political interference, opaque pricing systems, weak institutional capacity and expertise, particularly regarding financial issues and procurement.

From the point of view of private investors, the “business case” is often missing due to investment climate issues such as lengthy permitting procedures, gaps in legislation or application of legislation. The long pay-back period for many energy infrastructure projects often means that the regulatory regime is often too unstable to secure the necessary financing.

5.2.1 Impact of the Transition Process

All of the CPs are in a process of transition to a market economy, and thus some of the instability in the investment climate is caused by the nature of this transition, which requires that new legislation be adopted and implemented, new institutions and procedures established and instigated, and capacity and expertise in different legal and financial systems be developed.

These positive developments can result in delays or substantial changes to particular investment projects. For example the privatisation process creates delays as public utilities and bodies are transferred to private ownership and legal issues are finalised. The capacity of
IFIs to provide financing may change, as may the particular types of financing available as these depend on the public or private nature of the borrower. Thus in addition to delays, privatisation may result in some IFIs not being able to finance an investment or providing finance at a higher cost where state guarantees are no longer feasible.

Several financiers noted that the process of “unbundling” was challenging in EU Member States. The roll out of a similar unbundling process in the CPs presents even greater hazards for investors given the weak legal and institutional environment.

The gap between political desires/pressures to meet EU accession criteria (e.g. renewable targets) and the subsequent commitment to highly ambitious targets on one hand, and the feasibility of financing and implementing the necessary infrastructure to meet these targets on the other, was mentioned. A number of investors questioned if the pace of implementation of the EU Third Energy Package was appropriate for the development of new infrastructure in relatively underdeveloped markets such as those of the Western Balkans and Eastern Neighbourhood. It was noted that the adoption of EU acquis under the Treaty already included flexibility such as longer transition periods and some exemptions. However some investors suggested that a more phased approach could be considered such that the scale of ambition is deemed credible given the level of institutional development.

5.2.2 Unstable Regulatory Regimes and Slow Pace of Reforms

Financiers in general accepted the necessary lags caused by the transition process and acknowledged that (uneven) progress had been made in all CPs. It was noted that many of the problems encountered in the CPS also affect investments in EU Member States, particularly in Central and Eastern Europe. However in general the problems in the CPs were more difficult to overcome and all financiers bemoaned the slow pace of reform - several recalled the title of the EBRD’s 2013 Transition Report – “stuck in transition”.

The reasons behind the slowdown in the reform process are many but the overall results for the investment climate are usually negative. A vicious cycle exists whereby much of the investment for developing transmission and distribution networks is not creditworthy and requires reforms to make them so, but the lack of reform holds back any investment that might actually push reforms and therefore reduces the incentive to reform. The low level of investment is evidence of the impact of this cycle, as governments do not have capacity to finance investments from state resources but have not created a functioning market and investment climate to attract the necessary external finance – public or private.

There was a general view that the electoral calendar exerts too great an influence on the regulatory regime and in particular the capacity to put the state utilities onto a sustainable financial footing. TSOs are in general still operating with government regulated tariffs for transmission and distribution and there are often regulated prices for end users. While things are improving and efforts being made to improve tariff sustainability and collection rates (e.g. the recent crackdown launched by the Albanian government on non-payment of electricity charges), many utilities continue to face pressure not to raise prices or in some cases to even reduce them. Prices for some categories (mainly residential and small businesses) are in general not cost reflective and not at the level required for financial sustainability and this is further exacerbated by the difficulties in enforcing payments and collection rates in several CPs.

Many governments have opted to keep regulated prices low for end users, mainly in the households’ category rather than to raise them to the appropriate level and protect vulnerable groups through targeted social benefit payments. Where prices are subsidised for all, it is the
better-off who benefit more. Increasing the cost to end users combined with targeted social benefits would not only reduce poverty, by ensuring that government subsidies are provided to that in need rather than to all, but also boost the financial sustainability of utilities and distributors.

While substantial amounts of primary legislation have been transposed in line with the EU *acquis*, implementation remains a critical obstacle. Translating the new legislation into the necessary procedures and processes is often extremely slow and exacerbated by limited institutional capacity and lack of technical expertise. This impacts on all stages of the project cycle, leading to delays, higher costs and a negative impact on the overall viability of the investment.

Some of the most common problems mentioned included:

- High cost and time required for exploratory studies including onerous licensing and permitting procedures;
- Long delays between feasibility study, detailed design and construction leading to greater financing costs;
- Difficulties in developing and implementing appropriate procedures for Environmental and Social Impact Assessments including public consultation obligations in line with EU regulations;
- Lack of information available from national authorities (due to a lack of data, knowledge and/or unwillingness or fear to share documents - particularly with private sector investors);
- Constraints in terms of level of knowledge and expertise to evaluate technical, legal and financial options or to develop the necessary commercial/financial aspects of the investment; and
- Opaque procurement procedures - this was stressed by every financier consulted.

A common suggestion was the need for technical assistance to be provided throughout the whole project cycle as many delays and problems arise even when national authorities and financiers have approved the investment. As said, assistance with procurement procedures was highlighted as a particular need.

For private investors having an IFI clearly involved in the early stages of a project, particularly for large scale investments, provides a valuable signal that the appropriate procedures will be followed thus making it easier to secure external financing.

5.3 Availability and Feasibility of Different Types of Financing Support

As noted earlier, the type of investment project and the investment climate in the CPs mean that little corporate finance is readily available for priority projects, and therefore the discussions focused on boosting public financing and/ or securing greater private sector involvement generally in a consortium comprising state companies and IFIs.
5.3.1 Public Finance

All of the IFIs have capacity to lend to the CPs and are pursuing potential projects. However the limited fiscal space available to some governments reduces the capacity of these governments to take loans or to provide sovereign guarantees for loans to state organisations. The availability of state guarantees is also influenced by the treatment of such guarantees under national laws. As noted in Chapter 4, for some IFIs, e.g. KfW and the World Bank, a sovereign guarantee often a prerequisite for lending to the public sector.

Most of the TSOs and other utilities in the CPs are state companies whose credit ratings are based on that of the state and thus, if this is less than investment grade, it reduces the capacity for IFIs to lend them. In general TSOs do not have the balance sheet necessary for substantial investment programmes although some IFIs felt that modest programmes that bundle small investments could be viable.

Ideally utilities in the CPs would blend the low cost of running current plants with the cost of new investment so as to get new capacity to carry out a rolling renewal of current infrastructure. However they are largely unable to do so as (i) they are not allowed to raise prices or (ii) unable to get an increased transfer of budget from the state.

With regard to projects that are on both the EU’s list of Project of Common Interest and the PECI, some financiers raised the issue of the substantial differences in grant financing available for the same project between EU Member States and CPs. This often means that that the CP in question is very reluctant to make the necessary investments.

5.3.2 Private investors

Private investors are active in the CPs both implementing projects and prospecting for new ones. While they may have the necessary scale to finance smaller investments, the scale of the PECI means that they would often seek to be part of an overall financing package either dealing with a specific element of the project or as part of an overall consortium.

Interest by commercial banks in financing infrastructure (including the energy sector) has waned both in the EU and the CPs due to the financial crisis and the impact of regulatory changes such as Basel III. In addition, the long-term nature of the projects to be developed (i.e. 15 years +) compared to the financing terms (5-7 years) normally available from commercial banks mean that they are not so suitable for PECI type projects.

This “mismatch” of loan maturity with lifetime of investment project is a common issue throughout the EU as well as CPs.

It is understood that changes in the German energy market have reduced the investment activity of large German utilities companies such as RWE in the CPs, particularly in the Western Balkans. This removes a potential source of finance – especially for bigger projects.

In terms of attractiveness for private investors, Ukraine is a sizeable market and (assuming current problems are resolved reasonably soon) is attractive to the major players. The Western Balkans, Moldova and Georgia are often viewed as marginal region/countries for the large investors and therefore really need to ensure a better investment climate. Several investors are increasingly looking at investment opportunities in nearby North Africa and the Mediterranean.
Third country financiers (usually public sector) from emerging markets such as China, Russia and Brazil are increasingly active in the CPs and have greater freedom within a particular investment project in terms of type of fuel/mix, percentage of investment costs to be covered etc than the IFIs. Given the scale of investment required, the fact that more sources of finance are available is generally seen as positive. However IFIs and EU based investors would like to see more information and greater transparency with respect to the terms and conditions on which such 3rd country financing is made available as well as coordination of activities.

5.3.3 Use of Risk Mitigation and Other Financial Facilities

In terms of reducing the risks associated with an investment project and thereby enhancing its viability, financiers believe that the investment climate and the nature of the energy investments to be financed mean that EU-funded grants would provide considerable value added to an investment project and would not crowd out any private sector investment. Thus such financing would meet key criteria set by the EU for the use of grant funding.

It was noted that in addition to financial facilities, grant funding for technical assistance is a risk mitigation measure as it can ensure that investment projects are prepared more thoroughly and implementation procedures are followed correctly.

In terms of securing funding to close a financing gap, the easiest form of risk mitigation is a straightforward co-financing grant that reduces the amount of funds that need to be obtained through borrowing. However the scale of the investment needs dwarfs the availability of grant financing.

Financiers saw merit in trying to provide governments and project promoters with some financing for risk insurance or risk guarantees, but noted that any such scheme would have to be very carefully designed to avoid creating moral hazard for the government/state-owned company which, to quote one financier, “should have skin in the game”. This is why the World Bank’s partial risk guarantee scheme (available for publicly financed investment projects) that provides guarantees for the payment performance of a state entity contains a state counter guarantee. The World Bank retains the option to call upon the government if its guarantee is called in and it is deemed that the government did not undertake appropriate action to ensure the sustainable financial performance of the state entity. Hence it is a guarantee of last resort.

IFIs also noted that the terms of which such guarantees are provided are crucial when the project is being screened for internal approval, and their Risk Assessment team would carefully assess the impact on the percentage of funding to be provided by the state entity/project promoter. Another concern is who benefits from the guarantee. If it is a commercial bank or private investor then it can be considered beneficial for the development of the market. It would not be appropriate for the beneficiary to be an IFI.

Given the scale of financing required, EU co-financing (particularly given that they use public funds) should leverage additional funds rather than simply match funds as attracting additional capital is vital. As evidenced by the recent announcement of the European Fund for Strategic Investments, the use of financial instruments – often managed by EIB and implemented by independent fund managers – to stimulate additional private capital for infrastructure investments in EU Member States is a key pillar of the EU’s strategy for critical investments.

When asked to consider the potential for a dedicated risk enhancement/mitigation facility for the Energy Community countries, financiers highlighted the legal, financial and fund management expertise required to design and implement such facilities and costs associated with this. The biggest concern related to the fact that a certain level of scale is required to
make the facility an economic proposition. The funds also tend to use relatively sophisticated financial architecture namely special purpose vehicles and project bonds that would be challenging (albeit not impossible) to set up for investments in the CPs alone.

In conclusion, most felt that the likely scale, scope and deal flow from the CPs would not make a dedicated Energy Community facility viable. The suggestion instead was to seek to “piggyback” on existing EU funds if permitted by the EU’s financial regulations.
6. **RECOMMENDATIONS**

As outlined in Chapter 5 the overwhelming view from the external financiers consulted is that the main obstacle to securing financing and realising even priority energy investments is the difficult investment and regulatory environment rather than availability of finance *per se*. Therefore the recommendations suggested below to expedite the realisation of priority energy infrastructure projects in the CPs are grouped into two categories:

Category 1: Actions to secure financing and commence construction of an agreed list of priority projects considered to be comparatively investment ready.

Category 2: Actions to advance improvements in the overall investment climate for energy infrastructure in the CPS and to bring the next set of agreed priority projects from the preparatory phase to a more investment ready phase.

These recommendations are intended to provide “food for thought” for the ECS that they can then subsequently raise and advance with various Energy Community stakeholders – the national authorities, EC, IFIs and other financiers. The recommendations are based on an assessment of the:

- Proposals outlined in the report of the High Level Reflection Group;
- Views of the key external financiers as summarised in Chapter 5 on different aspects of project financing and the investment climate;
- Recent developments in some of the financial support mechanisms available for CPs as well as new initiatives for EU MS; and
- The unique mandate of the ECS which provides a comprehensive technical and administrative platform through which support from a range of stakeholders including the EC, IFIs, bilateral donors and others can be provided to the CPs in a coordinated and integrated manner.

6.1 **Specific Priority Project Financing and Realisation**

6.1.1 **Agree Sub-Set of Priority Projects**

As the “umbrella” structure that brings all interested parties together under the Energy Community, the ECS could facilitate joint consultations with the CPs, IFIs, interested investors and the European Commission to identify a sub-set of priority PECI projects that can be considered “investment ready”. “Investment ready” in this context would mean that preparatory work for the investment has been completed – e.g. feasibility study, Environmental Impact Assessments, (at least preliminary) cost benefit analysis - and that there is a positive assessment from external financiers that the project is financially viable albeit with a financing gap. Where a lead IFI has not already been identified for a specific project this should also be agreed.

In identifying a subset of projects, the level of political commitment/support in the CPs for the individual projects should be taken into consideration and their support clearly expressed. The governments concerned should outline their willingness to facilitate the realisation of the project, including their willingness to provide finance, the signing of necessary loans and ensuring that the relevant regulatory and procurement procedures are followed. Such clearly expressed support is particularly vital for cross border projects where allocations of costs and benefits and sequencing and coordination of investment realisation is vital. This “prioritisation
of priorities” process should be repeated as necessary to ensure that there is a dynamic pipeline of suitable investment-ready projects.

The stakeholders would then coordinate closely to actively seek support to close the financing gap and to assist in the realisation of the investment. The ECS should launch consultations with governments, IFIs and other financiers as soon as possible to try to reach consensus on a first subset of priorities. Following the first exercise, it is suggested that the next iteration of such a subset could take place as part of the probable review of the current PECI in 2015/6. Such a review is important in view of the changing market conditions including new technologies and regulations.

The sources of support include:
  • Grant support from EU blending mechanisms currently open to the CPs (WBIF and NIF);
  • Applications for assistance under CEF for those projects that are also PCIs; and
  • Opening access for CPs to other current and future EU financial facilities, in some cases through the creation of an Energy Community window.

The provision of such soft support for these priority projects is not intended to substitute for private investment but rather to ensure the financial viability of the investment by providing a combination of finance and other support that can allow IFIs to provide greater funding and attract greater private investment. It will also facilitate a more effective implementation of the project.

The evaluation process for considering applications for grants to investment projects in the CPs should systematically include a request for the ECS’ opinion on the nature and relevance of the project to Energy Community. This currently works well as part of the WBIF procedures as the ECS has the most up-to-date knowledge of the legislative and administrative environment in all the CPs with respect to the energy sector.

6.1.2 Grant Support from WBIF and NIF

Applications for grant funding for the agreed sub-set of projects can be submitted by the appropriate stakeholder to the relevant EU blending mechanism – WBIF for projects in the Western Balkans and NIF for projects in Ukraine, Moldova, and Georgia.

The grant funding sought should contribute to all the remaining steps in the investment cycle. While the exact requirements will vary from project to project, they could include funding for:

  • TA for any remaining preparatory work, e.g. full cost benefit analysis, detailed design;
  • TA to assist the project promoter in the CP with developing and securing the specific financing package;
  • TA to accompany implementation, particularly procurement and overall supervision;
  • Co-financing - i.e. financing of part of the financing gap through an investment grant for supplies or works or, where deemed possible, contributing to the cost of risk mitigation measures, allowing interest rate subsidies, financing of a completion bonus or (partial) payment of a risk premium or guarantee. Where grant financing is used to finance risk guarantees, attention must be paid to ensuring that moral hazard on the part of the relevant state institution or project promoter is avoided; and
  • Institutionalized forms of financing such as specific purpose vehicles that could draw on project bonds, equity, and other private finance in the context of PPPs or other joint ventures.
Current WBIF and NIF procedures could be reviewed to ensure that such jointly agreed investment-ready projects are prioritised during the evaluation of applications. Suggestions include:

NIF

- In line with WBIF procedures, the ECS be systematically asked for its opinion on applications for funding for energy related projects in Contracting Parties.

WBIF

- As the new proposed procedure for applications for WBIF assistance (e.g. a single sector pipeline endorsed by a National Investment Committee) will take some time to be put place, the jointly agreed projects should be given immediate priority in the allocation of WBIF grants in the short-term. In the longer term, the revised WBIF procedures should ensure that projects in the individual energy sector pipelines endorsed by the Energy Community stakeholders are prioritised.

- If the new methodology proposed by the European Commission for WBIF is adopted, the EC and the structures managing the TA component need to ensure that the single EC-financed TA provider foreseen has the capacity to all the services foreseen for the TA component of any approved grant in a timely manner. Several TA assignments have been delayed under the current IPF contracts, as the TA provider must deal with uneven volumes of approved grants and unexpected delays on assignments when deploying resources. In addition it will take some time to put the contracts for the new TA facility into place. Therefore, to reduce the potential for delays to TA accompanying investment grants, it is suggested that the option for the lead IFI to contract and manage such TA should be retained in the new system. This IFI will anyway manage the investment co-financing grant approved by WBIF via a delegated agreement with the EC.

6.1.3 CPs to be given access to existing and future EU funded financing facilities

The pipeline of investment-ready projects in the CPs is unlikely to provide the necessary volume (deal flow) and scale of financing necessary to make a separate financing or risk mitigation facility dedicated only to Energy Community CPs economically feasible. Therefore better use of existing facilities and access to new EU facilities should be encouraged for all Energy Community projects.

Connecting Europe Facility

In the case of CEF, as noted in Chapter 4, the regulations imply that grant financing could be available for those cross-border elements of a project in a CP country that link to a Project of Common Interest (PCI) in an EU Member State. While the first set of grants awarded under the CEF in October 2014 did not contain any PCI with a component on the territory of a CP, there are a number of such PCIs. For example, the transmission line between Resita (Romania) and Pacevo (Serbia) or the gas interconnection between Bulgaria and Serbia.

The ECS could monitor the CEF work programme to ensure that CPs are fully informed as to the calls for proposals etc (next call is expected in early 2015). The ECS could also use its access to ETSO to raise awareness of the possibility of joint applications from EU Member States and CPs for PCI projects that have a component in a CP.

CPs should be encouraged to cooperate with relevant EU MS to submit joint applications for future calls for proposals under CEF. In order to do so effectively, it would be useful for the
ECS, in cooperation with the EC, to ensure that CPs have the appropriate information regarding:

- The specific grounds on which a project in a CP could be eligible for grant financing under CEF;
- The terms on which such financing would be available (the regulation speaks of simplified means of linking and financing such elements and also ensuring that CEF only finances that part of the project that cannot be financed from other EU programmes); and
- The forms of financial assistance that could be provided (e.g. grant funding for TA, grant funding as co-financing for supplies and works, access to financial instruments).

Some capacity building may be required to assist the CPs to prepare CEF applications. The ECS could organise, again in conjunction with the EC and perhaps interested EU MS a workshop or seminar on this topic when calls for proposals are issued.

**Marguerite Fund, European Fund for Strategic Investments and other Financing Facilities**

The ECS should raise with the relevant services of EC and other stakeholders the feasibility of opening an Energy Community window, financed by contributions from the IPA and European Neighbourhood programmes, so that suitable projects in CPs (with or without direct links to a project in an EU MS) can avail of the services of EU funded financial and risk mitigation facilities such as the Marguerite Fund. This would allow the CPs to benefit from the economies of scale and leveraging effect inherent in such funds that span a large number of countries and projects. Where CPs are given access to any such Funds, the ECS should encourage the Fund managers to develop a promotion and capacity building element that will allow the national authorities acquire the relevant skills and experts to utilise the facility in the most appropriate manner.

The development and implementation of the recently announced EFSI should be monitored by the ECS to determine if particular features or elements are relevant for the CPs. Regular discussions between the ECS, the EC and financiers could determine if useful features of the EFSI could either be incorporated into facilities open to the CPs or if access by the CPs to the EFSI via a special window should be considered.

**KfW Concept for Special Market Vehicle to Leverage Funding from Private Insurers**

For the longer term, the ECS should monitor the progress made by KfW in advancing its concept of a special market vehicle that would specialise in guaranteeing and insuring long-term development projects while re-insuring itself on the private insurance market thereby leveraging additional funding in countries where EU blending mechanisms are in operation. If such facility is deemed feasible, the ECS should encourage the financiers to ensure that priority Energy Community projects can be submitted to this facility for assistance.

### 6.2 Ensuring Future Investment Project Development and the Improving the Overall Investment Climate

Given the urgent need for governments in the CPs to intensify their reform efforts to create a transparent business climate more conducive to investment, the ECS and external financiers should reinforce their activities that focus on encouraging and supporting the governments in the area of energy related investments.
Specific recommendations include:

6.2.1 Ensure on-going ECS involvement in WBIF mechanisms for the development of single sectoral pipelines of investment projects and implementation of TA

Assuming that the new methodology for submission of WBIF grant applications is adopted, and hence the calls for proposals are replaced by a semi-annual submission of a single pipeline of potential investment projects agreed via the new National Investment Committee (NIC) framework, the ECS with the EC will need to make special efforts to ensure that the ECS still has a clear, formal consultative role in the screening of the individual energy projects that comprise the energy pipelines from each country. ECS’ staff resources mean that they are unlikely to be able to participate in the deliberations of the six NICs, and hence they should be involved in the overall review process of the biannual submissions from each country.

It would be good if the EC-financed IFI Coordination Office, responsible for preparing the Terms of Reference for all EC-financed TA approved under the WBIF develops a systematic working relationship with the ECS. This would allow it benefit from the ECS’ expertise and knowledge to ensure that the ToR for energy sector projects takes account of Treaty issues in the CP and relevant aspects of the regulatory environment for the particular type of investment project. Subsequently, the Infrastructure Project Facilities (IPFs) – that implement the EC-financed TA under WBIF – should also be asked to systematically consult the ECS during the TA assignment, including highlighting specific challenges they meet to project preparation and implementation. This would allow the ECS to raise these issues with CPs bilaterally or in ECS’ institutions and taskforces as appropriate and where possible resolve them earlier.

The JASPERS’ team preparing the work programme for their inputs in the Western Balkan countries could also consult with ECS regarding issues relating to the preparation of energy projects.

6.2.2 Ensure that Assistance for Preparatory Work on Energy Infrastructure Investments is available under NIF

Similar to the Western Balkans, there is a substantial need for assistance to prepare energy investments in Ukraine and Moldova if the countries are to have a healthy, dynamic pipeline of potential investments under preparation. Therefore, in addition to the current focus on co-financing for mature projects, applications for preparatory work including feasibility studies, environment impact assessments, preliminary design etc. should be considered under NIF. Ideally, grant assistance for such preparatory work should only be for projects that are identified as a priority for the Energy Community and for which an IFI has clearly expressed its intention to invest. Again the systematic consultation of the ECS on such applications would facilitate the targeting of grant assistance on priority projects, and allow the application to benefit from the ECS’ awareness of the specific aspects of the regulatory environment that must be addressed.

6.2.3 Creation of Facility for Upstream/Non Project Specific Technical Assistance

It is recommended that a facility be established that can finance short-term targeted technical assistance to CP governments and relevant institutions on the investment environment for energy. A range of technical assistance services could cover tailored support on specific aspects of the regulatory environment identified by the ECS as being problematic. Assistance could include legislative analysis, advice on drafting primary and secondary legislation, development of detailed guidelines for implementation of EIA and ESIAs in energy subsectors and of technical and environmental standards, elaboration of procurement procedures etc.
The need for specific forms of assistance could be identified (i) in the regular consultations between the ECS and the individual CPs on different aspects of their implementation of the Treaty; and (ii) on the advice from external financiers who encounter regulatory obstacles.

It is understood that the regulations governing IPA and the ENI mean that a joint facility for all Energy Community CPs is not possible. However options to provide such support could include:

- Creation of a dedicated TA facility for energy related investment climate issues under (i) the multi-beneficiary IPA and (ii) the regional ENI programmes. The individual facilities would comprise a contract providing for a small management team and a pool of experts covering different aspects of energy policy/investment climate. The expertise to be drawn down by governments of the CPs in accordance with agreed criteria. The CPs and the management team would consult with the EC and the ECS regarding the requests and the specific TA to be provided.
- For CPs falling under the ENI, the development of such a tailored facility could be a component of regional support programmes such as Inogate;
- Greater use could be made of the “strategic studies window” under WBIF (this may require some adaptations to the WBIF procedures that currently limit the amount of annual funding available for such studies);
- The creation of a similar “strategic studies window” under NIF that can provide such grants that are not directly linked to a specific investment but which are deemed to be crucial to allow such investments proceed.

The ECS’ in-depth knowledge of the regulatory environment in each CP, could assist the management/decision making bodies of such facilities in identifying the specific TA required, and hence generate a flow of individual assignments that support implementation of the Treaty as well as the investment climate. In addition consideration should be given to the ECS participating in the Steering Committee, or other such body, that supervises such assistance programmes as it could play a valuable role in overseeing the individual TA projects.

6.2.4 Strengthen coordination among Energy Community Institutions

The Investors’ Advisory Panel managed by the ECS provides a unique forum for securing input from actual and potential private sector investors in the CPs in an efficient and coordinated manner. In addition to an exchange of information and updating on Energy Community initiatives and progress, the meetings of this panel could be designed to provide an opportunity to focus on specific topics of particular interest. Discussion papers prepared by the ECS, individual investors or external actors could provide a basis for such discussions and eventual identification of recommendations.

This could be developed further by using the convening power of the ECS to arrange special joint events (seminars/workshops/briefing meetings) between members of the Investors’ Advisory Panel, IFIs and other Energy Community institutions with government representatives such as the EC Regulatory Board, the Energy Efficiency Coordination Group, the Renewables Task Force or the Environment Task Force on particular topics of mutual interest. This could be an efficient and effective way to discuss issues that impact all CPs, exchange points of view and to agree on possible actions by different actors. The provision of such a forum by the ECS would help to overcome the difficulties sometimes faced by both investors and government representatives to find an appropriate and transparent venue for consultations.
6.2.5 Enhance the Overall ECS Communications Programme

The ECS enjoys a positive image among all its interlocutors and has a good communications programme including events, reports/publications and an up-to-date website. It is understood that the website will be augmented further with more information on the status of energy investments. However, it could strengthen its direct contacts and outreach particularly with organisations and programmes that have an investment climate focus. Enhanced communication and contact with the following organisations is particularly recommended.

European Commission Services

Given the enhanced role to be played by the EU Delegations (EUDs) in each WBIF and NIF beneficiary, the ECS should ensure that the Head of Operations, the Programme Manager for energy and the Economic Adviser in each EUD is regularly informed about the status of the PECI list and the overall progress being made by the respective country in the implementation of the Treaty including any particular progress or issues of concern.

Such information can also be useful for the annual progress reports that are compiled by the EC on the different countries. In the case of the Western Balkans, following the recommendation in the Enlargement Strategy of 2013, the enlargement countries will now also submit National Economic Reform Programmes in January of each year. Given the importance of developing sustainable and reliable energy markets as part of the transition to a market economic, the ECS could provide input to the authors of these reports in DG Enlargement with regard to energy related reforms.

IFIs

All IFIs are positively disposed towards the ECS and some have developed good working relations on specific topics, e.g. EBRD and on energy efficiency facilities, World Bank on energy efficiency in buildings. However a greater exchange of information and more consultation would be of mutual benefit. IFIs should be encouraged to take a more active role in ECS taskforces and to consult the ECS more systematically during the preparation of new investment projects or programmes. Senior management at the ECS should consider a regular programme of missions to IFIs.

Investment Related Initiatives

ECS should keep a watching brief on investment-related initiatives funded or managed by the EU, IFIs and other international organisations. A good example is the EBRD’s recently launched Investment Climate and Governance initiative, which is in the process of being established in four CPs - Albania, Moldova, Serbia and Ukraine. Activities under such initiatives, e.g. establishment of a “Business Ombudsman” in Ukraine or a National Investors Council in Albania, should have a positive influence on the overall climate and provide structures whereby Energy Community issues are brought to the attention of a wider audience including decision makers.

Another potential useful mechanism for monitoring reforms are World Bank Development Policy Loans that provide quick-disbursing assistance to countries with external financing needs to support structural reforms in an economic sector or in the economy as a whole. Tranches are released when the borrower complies with stipulated release conditions, such as the passage of reform legislation, the achievement of certain performance benchmarks, or other evidence of progress toward a satisfactory macroeconomic framework.
ANNEX 1 LIST OF ORGANISATIONS AND PERSONS CONSULTED

European Commission

DG Development Cooperation

Mathieu Bousquet, Acting Head of Unit, Regional Programmes, Neighbourhood East
Natalja Miola, Regional Programmes, Neighbourhood East
Helene Ryding, Team Leader, Global Assessment of the EU Support in Energy to EaP and CA countries

DG Energy

Bartłomiej Gurba, International Relations Officer, International Relations and Enlargement
Milosz Momot, Policy Officer, Economic Analysis and Financial Instruments
Nicole Versijp, Policy Officer, Infrastructure Development

DG Enlargement

Gerhard Schumann Hitzler, Director Regional Programmes
Davor Kunc, Programme Manager, Energy and Transport, Regional Programmes
Elodie Loppe, Programme Manager, Environment, Regional Programmes
Olav Reinertsen, Head of WBIF Secretariat

EBRD

Louis Borgo, Senior Banker, Power and Energy
Ian Browne, Head of EBRD Office, Sarajevo
Caroline Clarkson, Donor Co-Financing
George Holroyd, Head of Multilaterals, Donor Co-financing
Ewa Manik, Associate Manager – NDEP / ESP
Holger Muent, Director, Western Balkans
Peter Sanfey, Chief Economists Office
Franklin Steves, Senior Counsellor, Investment Climate and Governance

EIB

Antonio Almagro, Projects Directorate
Alexander Antonyuk, Projects Directorate
Georgia Koutsiana, Directorate for Operations (Georgia)
Michel Marciano, Transaction Management and Restructuring Directorate
Lionel Rapaille, Directorate for Operations (Ukraine and Moldova)
Matteo Rivellini Directorate for Operations (Western Balkans)
Jacek Podkanski, Projects Directorate
Kari Punkka, Projects Directorate
Joao Fonseca Santos Transaction Management and Restructuring Directorate
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Jens Drillish, Principal Energy Economist
Jürgen Kern, Head of Division, Energy & Transport, Southeast Europe & Turkey
Carsten Kobel, Senior Manager Promotional Instruments and Financial Products
Karin Spranger, Principal Country Manager, Southeast Europe & Turkey
Rainer Sünnen, Principal Manager, Energy & Transport, Southeast Europe & Turkey
Julia Mohs, Project Manager, Energy, Caucasus and Central Asia

World Bank

Raymond Bordeaux, Program Leader, Southeast Europe
Stephanie Gill, Senior Energy Specialist

Investors

Anthony Marsh, Chief Executive Officer, Frontier Markets Funds Managers, UK
Andrea Testi, Gruppo Edison, Italy
Rory O’Neill, Europagrid, Ireland
Antonio Iliceto, International Relations with Grid Operations, Terne, Italy