



## Global Environment Facility

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December 17, 2004

Dear Council Member:

The World Bank as the Implementing Agency for the IFC-executed projects entitled "Hungary Energy Efficiency Co-financing Program" (HEECP) and "Commercializing Energy Efficiency Finance" (CEEF) has submitted the attached communication regarding a revision to these closely related projects.

According to the communication, the amendment involves authorizing a two-year extension of the HECEP, with cancellation of \$3.1 million of GEF funds, and increasing GEF allocation to CEEF by \$3.1 million.

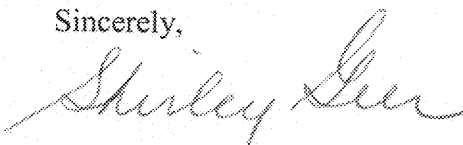
These changes will increase the impact of the HECEP through the transfer of lessons learned to other countries, the extension of the program into additional significant markets and refining the financial products initially used based on experience.

In addition to the support to be provided under the program amendment to other GEF energy efficiency finance programs in the region, the expected benefits of the proposed amendments would include substantial additional deepening of the lending capacity for energy efficiency investment, which will result in increased greenhouse gas mitigation impacts in Hungary.

We consider these changes to be major amendments to the original project documents originally endorsed on May 11, 1997 (HEECP) and on August 11, 2003 (CEEF, Tranch II). We fully expect these to be the final revision or amendment to these projects. In keeping with the GEF procedures, the Secretariat is reviewing these proposed changes with an eye to ascertain their appropriateness in light of the project's objectives.

If by January 14, 2005, I have not received requests from at least four Council Members to have the proposed project reviewed at a Council meeting because in the Member's view the project is not consistent with the Instrument or GEF policies and procedures, I will complete the Secretariat's assessment with a view to endorsing the proposed project document.

Sincerely,

  
for Leonard Good  
CEO and Chairman.

# OFFICE MEMORANDUM

DATE: December 15, 2004

TO: Mr. Leonard Good, Chief Executive Officer and Chairman, GEF

FROM: Steve Gorman, GEF Executive Coordinator, 

EXTENSION: 35865

SUBJECT: **IFC/GEF Hungary Energy Efficiency Co-financing Program (HEECP) and Commercializing Energy Efficiency Finance (CEEF): Update and Proposed Modifications**

## Executive Summary

This memorandum requests CEO approval for amendments to two closely related IFC/GEF projects, Hungary Energy Efficiency Co-financing Program (HEECP)<sup>1</sup> and Commercializing Energy Efficiency Finance (CEEF)<sup>2</sup>. In summary, these amendments would authorize a two-year extension of the HEECP, with cancellation of \$3.1 million GEF funds, and increase the GEF allocation to CEEF, by \$3.1 million. The rationale for these changes is to increase the impact of the HEECP through the transfer of lessons learned to other countries (in response to country demand), the extension of the program into additional significant markets (e.g., cooperative apartment buildings and renewable energy projects), and refining the financial products initially used based on experience.

In addition to the support to be provided under the program amendment to other GEF energy efficiency finance programs in the region, the expected benefits of the proposed amendments would include substantial additional deepening of the lending capacity for energy efficiency investment – and thus increased greenhouse gas mitigation impacts -- in Hungary. These include an additional US\$8-15 million in project investments directly supported by the guarantee facility, and US\$30-80 million in additional investments in efficiency and renewables projects in the Hungarian market which are not directly supported by the guarantee facility but which will result from the program's technical assistance and demonstration effects over the proposed extension period.

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<sup>1</sup> As explained below, HEECP has been supported by two GEF grants, a full size project for \$5 million approved in 1997 and a subsequent MSP approved in 2001.

<sup>2</sup> CEEF entered the GEF work program in May 2002.

## Background

The IFC/GEF Hungary Energy Efficiency Co-financing Program (HEECP) is due to cease operations at the end of December 2004. A series of independent evaluations of the program,<sup>3</sup> including several assessments of the program undertaken as part of GEF portfolio and sector reviews, have indicated that HEECP's impact on the Hungarian lending market has been profound, with substantial GHG benefits generated in a sustainable, market-based manner. HEECP's impact has also been felt beyond Hungary as the model has been replicated in at least 9 other markets. As the program reaches the end of its scheduled life, the Hungarian energy efficiency (EE) lending market continues to serve as an incubator of new financial products which have enabled a deepening of the market by extending the reach of commercial debt products into sectors previously unable to access EE finance. These include residential blockhouse cooperative apartments – a sector representing immense capital requirements across the region – and renewable energy projects, providing further replicable models for use in other programs and markets throughout the region. Significantly, IFC is now adopting some of these financial products for use in other developing country markets on a commercial basis – thus further leveraging the GEF investment in HEECP and mainstreaming energy efficiency finance in markets able to adopt similar products.

Based upon this experience, as well as the opportunity to use the capacity established in Hungary to support GEF's multiple recent investments in new EE finance facilities across the region with other Implementing Agencies, IFC sees a strong case for further leveraging the Hungary facility for an additional two years with re-allocation of resources from the existing GEF funding allocation. In addition to capitalizing on the opportunities which remain in the Hungary market (continuing to move "down market" into new frontier sectors), the proposed extension includes establishment of a focused structured learning facility to capture the unique experience of the HEECP team to support the fledgling efforts of the relatively new program teams executing the GEF-supported EE finance programs across the region patterned on HEECP.

This memorandum describes (i) the rationale behind extending operations in Hungary; (ii) the detailed steps IFC proposes to make this happen; and, (iii), the operational changes associated with the two-year extension for which IFC seeks GEF approval. Specifically, we request:

1. To add Hungary as an operational country of the Commercializing Energy Efficiency Finance Program (CEEF) thus extending the loan origination period in Hungary for an additional two years. Merging operations would bring administrative efficiencies for the two programs and combining the loan portfolios of the six countries would yield risk management benefits for the GEF

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<sup>3</sup> GEF Private Sector Review (2004); HEECP Mid-Term Evaluation – CJ Aron Associates (2000); HEECP Evaluation – Danish Energy Management (2004).

funds and enable a more effective guarantee product – including the ability to support larger renewables projects now emerging in the market.

2. To modify the HEECP guarantee product by harmonizing it with the CEEF financial product, including introduction of the pari passu-based guarantee used in CEEF in Hungary, and establishing the limited use of a (up to 5%) first-loss portfolio-based guarantee for the integrated program (based on the model already demonstrated in the pilot stage of HEECP);
3. To implement a pilot Center of Excellence program in Hungary to provide technical support from the HEECP team for the portfolio of energy efficiency (EE) finance programs being supported by GEF in the region (thus responding with adequate resources to the demand already evident from the inquiries made to the IFC/Hungary team by several GEF program teams in the region), and
4. To restructure HEECP and CEEF by
  - a. canceling \$3.1 million from the HEECP Guarantee allocation, retaining \$1 million in the HEECP Guarantee facility to support existing guarantee commitments in Hungary;
  - b. increasing the GEF allocation to the CEEF Operations and TA account by \$650,000 to support operations and TA in Hungary for two years; and,
  - c. increasing the GEF allocation for the CEEF Guarantee facility by \$2.45 million to support new transactions under the combined Hungary/CEEFF facility [and enabling further leverage of these GEF funds by accessing the IFC commitment of up to US\$75 million to CEEF].<sup>4</sup>

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<sup>4</sup> Combining the GEF and IFC investment for guarantees and harmonizing the CEEF and HEECP guarantee terms would also allow the maximum guarantee liability limit to be increased to \$2m. It would also allow the Hungarian FIs to enjoy a number of other minor modifications to the CEEF guarantee product all of which are designed to increased deal-flow and streamline approval processes.

## **Demand for assistance in Hungary**

The original mandate of HEECP limits the period of project origination under the guarantee facility to December 31, 2004. However, partner financial institutions (FIs) have shown strong interest in working with HEECP beyond 2004 to develop specialized financial products that address the still undeveloped niche markets in the cooperative housing, SME, and renewable energy sectors, which FIs have targeted. These projects require relatively complex credit structures, for which new financial products must be developed in order to support the FIs' interest in systematically developing a commercial lending business. Developing these products typically requires longer preparation time compared to the FIs' existing business. Hungarian FIs are also very interested in using IFC/GEF guarantees for larger transactions than are currently possible with the existing HEECP product.

To date, the Program has had a considerable impact in the markets where it operates, particularly in the area of capacity building among ESCOs and FIs, and in stimulating the development of commercial FI lending products in several EE sectors. Even as bank adoption of EE finance products has been successful, the guarantee portfolio build-up has been slower than expected – in large part because commercial banks have used the fee-based guarantees selectively to enter new market sectors. Yet, the Program's in-country experience has also confirmed the vast potential in this market segment. Therefore, based on market responses, IFC is making the following program modifications to further the penetration of EE finance into more frontier sectors in Hungary during the next two years:

1. **Enhance Incentives for Banks.** We are in the process of making adjustments in how the Program's FI relationships are managed, especially in how the TA program is administered, to enhance the incentives for FIs to systematically pursue the EE market. Insufficient incentives have been an issue in particular for some of the key EE market segments, such as block house renovations, which involve small individual transaction sizes and unfamiliar risk profile and thus large initial transaction cost relative to the transaction sizes.
2. **Products.** Given the relatively sophisticated Central European markets in which HEECP and CEEF operate, the existing loan guarantee product has proven to be somewhat rigid. We have observed considerable interest in guarantees for factoring and forfeiting transactions, a financing model which can be particularly relevant for Energy Service Companies (ESCOs) and energy efficiency type investments.
3. **Approval Procedures.** IFC is introducing streamlined decision making for certain types of projects. The new procedures will significantly accelerate the decision process bringing it more into line with the FI decision cycle

With these changes, IFC estimates that an additional \$8-15 million in loans would be supported directly with guarantees during the extension period in Hungary. This

represents a substantially increased volume of guarantees than has been experienced in Hungary to date. Details are given in Annex 2. Without HEECP's guarantee and TA support, FIs would not be able to develop these new business areas, which represent a further deepening of the Hungarian market beyond the sectors in which HEECP has already established a sustained impact. IFC's management supports the continued operations in Hungary, correspondent to the life of CEEF. However, this pipeline can only be realized with certain structural changes to both the HEECP and CEEF budgets and their guarantee products. These changes are described below.

Beyond the guarantee portfolio, extending HEECP through integration with CEEF would yield continued market development, thus extending HEECP's impact. In addition to the current portfolio, an additional \$30-80 million of energy efficiency investments could be triggered through the sustained impact of the programs on the market. These include transactions initiated by participating FIs which do not utilize the guarantee product, but which would not have emerged without the Program's extended TA and the catalytic effect of the guarantee.

IFC is completing an updated evaluation of HEECP, which is available as of November 2004. It seeks to quantify these important indirect effects of HEECP beyond the value of energy savings and greenhouse gas emissions reductions directly supported by the program's guarantees.

## **Issues for GEF Consideration**

### **Modifications to HEECP/CEEF Guarantee Products**

To date, the HEECP guarantee product is structured as a "subordinated recovery" type guarantee with IFC/GEF exposure limited to a maximum of 35% of loan principle or a maximum value of \$500k. As the market has evolved however, Hungarian FIs have developed three major demands to which the proposed restructured and extended program would respond: guarantees need to be available for larger transactions; guarantees need to be available for more complex transactions; the IFC guarantee approval process needs to be streamlined to better fit the decision process and project cycle of the FI.

IFC has discussed these requested changes with the participating banks and has concluded that the only way such changes might be possible is by also converting the primary guarantee tool into a pari passu structure, as well as offering an additional portfolio-based (but greatly reduced to 5% risk-sharing) first loss guarantee for pools of smaller projects. The FI response indicated that the benefits of this Program improvement would match their needs well, and could stimulate substantial growth in the guarantee portfolio, thus supporting the movement of commercial finance into new sectors. IFC believes that the most efficient way of meeting these needs is to harmonize the terms and conditions of the HEECP product with the CEEF guarantee product, which would be slightly modified to respond to similar demands in the CEEF markets.

The proposed change of the HEECP guarantee to the pari passu structure would also improve the risk profile of the IFC/GEF investment by ensuring symmetrical risk sharing between the Program and the FIs and improve the opportunities for streamlining. Further, the low (<5%) maximum exposure that would be provided on the GEF first loss portfolio guarantee product innovation ensures that the moral hazard potentially implied by a first-loss guarantee is mitigated.

By adopting the CEEF pari passu structure in Hungary, and other innovative credit enhancement structures that are presently being developed by IFC for CEEF<sup>5</sup> (including the 5% first-loss portfolio guarantee), HEECP will also be able to more fully respond to FI needs. This includes portfolio-based approaches and credit scoring mechanisms which do not rely on time-consuming credit approval processes, thus further enhancing deal-flow. The integration with CEEF also enables greater leverage through the ability to guarantee larger transactions, in response to market development and FI demand. These changes are summarized in the table below.

	HEECP2 – CURRENT	HEECP3 - PROPOSED	CEEF
Guarantee type	subordinated recovery – 35%	pari passu –50%	pari passu – 50%
Additional guarantee product	First-loss reserve portfolio product was used in HEECP1 using GEF funds	Portfolio-based (up to 5%) first loss product using GEF funds available as option for appropriate sectors	Portfolio-based (up to 5%) first loss product using GEF funds available as option for appropriate sectors
Max. guarantee %	35%	50%	50%
Max. guarantee size	US\$0.5 million	US\$2 million	US\$2 million
IFC:GEF ratio	Initially 2, up to 3	Initially 2, up to 3.58	Initially 2, up to 5
Availability period	1/1/01-12/31/04	To extend until 12/31/06	1/1/03-12/31/06
Program life	1/1/01-12/31/12	To extend until 12/31/14	1/1/03-12/31/14
Potential for streamlined decision making	Low, only for small exposures, since risk sharing is not entirely symmetrical between the Program and FI	High, with symmetrical risk sharing	High, with symmetrical risk sharing
Eligible project	Excludes all non-private entities	Includes municipally owned enterprises with independent corporate governance	Includes municipally owned enterprises with independent corporate governance
Currency of guarantee	US\$	Reflecting EU-accession and evolution of local market, guarantee could be denominated in Euros or US\$; total exposure of GEF funds not to exceed allocation as defined in GEF Project	Reflecting EU-accession and evolution of local market, guarantee could be denominated in Euros or US\$; total exposure of GEF funds not to exceed allocation as defined in GEF Project

<sup>5</sup> An additional enhancement to the product is that for portfolios of smaller projects, such as the blockhouse market, IFC will offer a 5% subordinated recovery provision within the 50% pari passu structure. This provides an added incentive to FIs to enter these markets.

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*These changes have now been approved by IFC management, and would become operational upon approval of the GEF.*

*NOTE: "HEECP2" is the current HEECP program, reflecting the addition of a \$12 million IFC investment in the guarantee facility leveraged by a GEF medium-sized project grant provided to expand the technical assistance capacity of the original pilot project."HEECP3" represents the integration of Hungary with CEEF.*

## **“Center of Excellence” in Hungary**

By extending operations, HEECP will be able to pass on experiences gained in Hungary to other EE finance programs in the GEF portfolio. To ensure that the value of keeping the pioneering HEECP program team operational for another two years is realized, part of the proposed HEECP3 budget would be dedicated to supporting a Comprehensive Training Program & Database in the framework of a Pilot “Center of Excellence” Program. The structured learning facility would support the launch and management of similar co-financing initiatives by other implementation agencies (IAs) within the GEF family. This would be a demonstration of the concepts of inter-program learning which has been envisioned by the GEF Secretariat in its strategic planning exercises.

Please see ANNEX 1 for further details regarding the strategic approach, structure, and budget of the Center of Excellence.

## **Funding implications and procedures for integrating CEEF and HEECP**

IFC approved a \$12 million guarantee investment into the HEECP project on the basis of the GEF \$5.7 million support (including \$700,000 in a GEF MSP, as mentioned above). The IFC investment was made conditional upon the GEF allocations for Hungary. Thus, the continued operations of the IFC HEECP investment depends upon the continued availability of the GEF funds allocated for Hungary. This arrangement is also formalized in the IFC/GEF HEECP "Counter-Guarantee Agreement", on the basis of which several transaction guarantees have been issued. At a time when IFC is actively engaged in refining the EE guarantee product in order to develop a sustainable business model for such projects, the cancellation of the pilot HEECP investment would be very visible and could directly undermine this important mainstreaming effort.

Extending the life of operations in Hungary and making the proposed product changes impact three areas:

- Operational costs in Hungary
- The current exposure of the Hungarian portfolio
- Canceling GEF funds from the HEECP Guarantee allocation and increasing the GEF allocation to the CEEF Guarantee and Operations/TA accounts

### ***Operational Costs in Hungary***

Since HEECP will run out of its operational and TA budgets at approximately the end of the Program’s availability period, IFC proposes to allocate \$0.65 million towards operations and TA activities to ensure that the Program remains operational for the two year extension period. These funds would also cover all the costs associated with the proposed Centre of Excellence. We propose that these funds be managed within the CEEF Operations/TA Trust Fund for administrative simplicity, but the operational budget for activities in Hungary would be ring-fenced. Activities in Hungary would be designated as “HEECP3”. Therefore, we would cancel \$0.65 million from the HEECP

Guarantee facility and seek CEO endorsement for an increase in GEF allocation of the same amount for the CEEF Operations/TA account.

### ***Current Loan Exposure in Hungary***

The current total outstanding guarantee liability exposure of GEF funds on outstanding loan principal under HEECP is approximately \$1 million, net of loans which have been paid back. (The actual size of this obligation is changing as new loan guarantees are committed by IFC, thus affecting the specific amount of current liability.) From a legal perspective, it is important to keep separate the existing portfolio of commitments under the HEECP2 guarantee agreement terminology as defined with IFC's legal agreements with Hungarian banks. With GEF in the first loss position relative to IFC, this means that the amount of the outstanding exposure (currently approximately \$1 million) in GEF funds must remain in the HEECP2 trust fund at the time of merging with CEEF in order to cover this exposure.

### ***Canceling funds from the HEECP guarantee facility and increasing the GEF allocation to the CEEF guarantee facility***

In order to be able to support large size deals within the guarantee facility (and respond to FI demand for supporting these deals), IFC needs a large enough guarantee pool to diversify individual project risk across a portfolio. IFC would cancel \$2.45 million available, net of current guarantee commitments, from the current HEECP guarantee facility. By increasing the CEEF guarantee pool by \$2.45 million to integrate HEECP3 in CEEF, the IFC funds committed to Hungary can continue to be leveraged in the facility. Further, the combined CEEF-HEECP portfolio would be adequate to enable exposure on individual transactions in Hungary to be significantly increased. By pooling the GEF funds (\$2.45 million for HEECP3 and \$15 million from CEEF) with the IFC investment (\$12 million from HEECP and up to \$75 million from CEEF), the maximum guarantee liability limit on any one transaction can be increased to \$2 million per transaction in all countries. This is expected to significantly improve deal flow in Hungary, where the FIs have stressed the need to support large projects, as well as in the CEEF countries, where we have already approved two transactions at the previous maximum limit of \$1.875 million.

Thus, new guarantee obligations under HEECP3 will be supported by the CEEF trust fund. As the HEECP2 obligations are reduced through debt service, these amounts would be cancelled from the HEECP guarantee facility and returned to the GEF Trust Fund. IFC may request the GEF CEO to endorse increases of such amounts for CEEF. However, these existing loan obligations will not be fully expired before the end of the CEEF program operation period.

The projected US\$4-7.5 million in new transaction guarantee obligations in Hungary during the program extension period (using the harmonized CEEF/HEECP3 product) would be adequately supported by the combination of the \$2.45 million requested for HEECP3 and IFC's HEECP2 commitment of 2 to 1 (\$4.9 Million) for the facility. This means that all new transactions under HEECP3 will be booked to the CEEF Guarantee Trust Fund.

The table below summarizes HEECP’s budget history from 1997 and recommends a budget for the proposed extension.

**HEECP1-3 BUDGETS - Source of Funds**

FUNDS	BUDGET		
	HEECP1	HEECP2	HEECP3
	1997-2001	2001-2005	2005-2006
GEF Guarantees for HEECP1/2	4,250,000	4,250,000	1,000,000
GEF Guarantee transferred to CEEF	4,250,000	4,250,000	*2,450,000
GEF Operation	450,000	500,000	400,000
GEF Technical Assistance	300,000	200,000	250,000
<b>Total GEF Funding</b>	<b>5,000,000</b>	<b>4,950,000</b>	<b>4,100,000</b>
IFC Guarantee	0	12,000,000	*12,000,000
IFC Management & Operation	300,000	500,000	300,000
<b>Total IFC Funding</b>	<b>300,000</b>	<b>12,500,000</b>	<b>12,300,000</b>
Dutch TA	0	250,000	0
Austrian TA	0	100,000	100,000
<b>Total Donor Funding</b>	<b>0</b>	<b>350,000</b>	<b>100,000</b>
<b>TOTAL</b>	<b>5,300,000</b>	<b>17,800,000</b>	<b>16,500,000</b>

\*Invested through the CEEF program

**DEFINITIONS:**

- “HEECP1” represents the period when the HEECP pilot stage Program which operated 100% from GEF funds. During this period, IFC provided \$0.3 million for management and supervision.
- “HEECP2” means the period between 2001 and 2005 when IFC invested \$12 million into the guarantee fund, and \$0.5 million for management and supervision and donors provided \$0.35 million for TA. This phase was leveraged by a \$700,000 GEF Medium-Sized Project grant.
- “HEECP3” means the proposed two year extension period during which operations of HEECP would be integrated with CEEF to enable further leverage and greater administrative efficiencies.

The impact of these proposed changes on the HEECP and CEEF Trust Funds is illustrated below.

**Impact of Proposed Changes On GEF Funds Administration**

	Before changes	After Changes
HEECP Guarantee TF	4 100 000	1 000 000 <sup>1</sup>
HEECP Operations/TA TF	700 000 (almost fully spent)	0 <sup>2</sup>
IFC Investment in HEECP Guarantee Facility	8-12 000 000 (will be transferred to CEEF)	0

CEEF Guarantee TF	15 000 000	17 450 000
CEEF Operations/TA TF	3 000 000 (partially spent)	3 650 000
IFC Investment in CEEF Guarantee Facility	75 000 000	87 000 000

<sup>1</sup> The HEECP guarantee Trust Fund account would retain approximately \$1million (or whatever the outstanding loan obligations of the GEF funds at the time of merging with CEEF) to cover current obligations under the present HEECP2 subordinated recovery guarantee product, just as it would if HEECP operations in Hungary were to be terminated.

<sup>2</sup> The HEECP2 operations & TA Trust Fund account would be closed and terminated with zero balance. \$700 000 represents the original GEF budget allocation for operations and TA, which should be exhausted by the end of 2004. IFC would maintain responsibility to manage the merged guarantee portfolios and operations & TA payments from the CEEF Trust Fund accounts for the six countries, including Hungary.

IFC's management approved the recommended changes in June, 2004.

### ***IA Supervision Budget***

IFC would require access to the remaining funds in the HEECP2 supervision budget in order to continue its direct supervision of the Hungary program operations. No additional fees are requested for GEF approval. IFC's continued direct engagement in Hungary from the GEF EE project supervision team is particularly critical given the proposed role of Hungary as an incubator of new EE finance approaches and the creation of the Center of Excellence, with its central role in coordinating information sharing with other GEF programs and the other IAs. This requires substantial engagement from the Washington, DC – based program management, both to ensure access to IFC's broad experience in project and EE finance, and to fully engage the network of IAs with interest in the area. This role for Washington staff is not supported out of the program budget.

### ***Exit and sustainability strategy***

HEECP has demonstrated a sustainable impact on the commercial EE finance market in Hungary. The replication of the Program's approach has also been demonstrated throughout the region. However, there remain a number of other elements of the Program which can be mainstreamed and replicated elsewhere. The continued refinement of program operations and product delivery, and the development of EE finance products are uniquely delivered through the HEECP program, given its current status and the capacity and experience IFC has established in the country team.

EXAMPLE 1 – Helping partner FIs and ESCOs to replicate their EE activities in other countries: HEECP has been working with dynamic Hungarian FIs and ESCOs which have already started operations in Central Eastern and Southern European countries including Slovakia, Romania, Bulgaria, Croatia, Albania. HEECP can have a key role in the coming years to support these FIs and ESCOs to replicate their Hungarian EE activities in other countries and develop sustainable EE finance models in these countries. Negotiations have already started with OTP and Raiffeisen banks on this subject, as well as with ESCOs like Kipcalor and Caminus from Hungary.

EXAMPLE 2 – Developing co-guarantee facilities with other institutions and companies: HEECP is working with other institutions and companies to structure complementary credit enhancement facilities which can continue to support the deepening of the

Hungarian financial market in the future. FOTAV, the Budapest District Heating Company and the Hungarian Developmental Bank have entered into discussions with IFC regarding collaborations which would support the integration of the guarantee mechanism into their strategy of supporting SMEs and housing cooperatives' EE and other investments.

IFC is evolving a sustainable business model based on the experiences of HEECP and CEEF. This is a critical stage in program development. GEF's support is essential to support the development of these models for sustainable environmental finance products.

Finally, the HEECP program extension would also be linked to further mainstreaming of the EE finance product into IFC's investment operations. IFC senior management approved (June 2004) substantial operational changes in the management of the HEECP-CEEF investment which are intended to enable the unified program to demonstrate a viable business model for IFC investment through financial intermediaries into frontier sectors, including EE. Included in these modifications are adjustments to the credit approval procedures, product pricing, and guarantee structure to better respond to market conditions and FI needs, and more efficiently utilizing investment department staff.

### **Summary of GEF Approvals needed**

In order to respond to new FI demand and transition the product being offered in Hungary, IFC seeks approval of the following requests:

- a. To add Hungary as an operational country of the Commercializing Energy Efficiency Finance Program (CEEFF), thus extending the Hungary-based operations an additional two years;
- b. As part of the operational merger of HEECP and CEEF, the guarantee products would be harmonized, including modifying the HEECP guarantee product to offer a 50% pari passu guarantee for project loan guarantees, and adopting a portfolio-based first-loss guarantee product using GEF funds (with a limited risk-sharing of up to 5%) consistent with the use of the GEF guarantee resources already established in HEECP and which has been approved by GEF under the next generation Financing Energy Efficiency in Russia (FEER) project.
- c. To implement a pilot Center of Excellence program in Hungary to provide technical support from the HEECP team for the portfolio of energy efficiency (EE) finance programs being supported by GEF in the region.
- d. To increase the GEF allocation for the CEEF Operations and TA account by \$650,000.
- e. To increase the GEF allocation for the CEEF guarantee facility by \$2.45 to support new transactions under the combined Hungary/CEEFF facility.
- f. To retain the remaining \$1 million (or whatever amount of debt obligations remain in force at the time of the merger of the HEECP and CEEF guarantee facilities) in the HEECP Guarantee Trust Fund to support existing guarantee liability commitments

Cc: Messrs. Rohit Khanna, Samuel Wedderburn, Chandra Govindarajalu (ENVGC);  
Alan Miller, Russell Sturm (CESGE); Richard Hosier (GEF).

## ANNEX 1: Centre of Excellence in Hungary

### Objectives

Capture the knowledge and the experiences gained in Hungary, develop them into a Comprehensive Training Program & Database and make it available for other EE programs within the GEF portfolio. The Centre of Excellence would serve as a benchmarking and mentoring focal point for developers and managers of EE finance programs throughout the Central and Eastern European (CEE) region for the sharing of best practices to improve the efficiency and the impact of EE programs. The Center would focus primarily on supporting the various energy efficiency finance programs approved by GEF over the past three years which are modeled on HEECP.

### Services

The Center of Excellence will offer the following services:

- **Site Visits and Training at Counterpart Program Offices in the Region:** The HEECP/CEEF team, based on the experiences of the Hungary program, and acting upon request of the local program teams in the region, will visit and provide assistance to the regional EE programs in developing program strategies and in establishing and modifying operational systems. Specific areas of focus might include market assessment of local markets, strategy development, client cultivation, financial product development, refining credit procedures, and increasing deal flow by building up feasible project pipelines.
- **Demonstrating Effective Program Management:** The Center would also host visits to Hungary from other EE programs in the region to demonstrate the systems, approaches, and strategies developed in Hungary over the past six years.
- **Organize and Facilitate Regional Workshop Collaboratives:** The Center would organize and facilitate regional workshops with participation from interested program teams in the region. These would be topically focused, driven by common needs of the local teams. An initial interest has already been expressed by several regional counterparts for a workshop focused on approaches to stimulating dealflow for local FIs. A similar workshop for the HEECP-CEEF team in April 2004 yielded substantial outputs which have been adopted by the programs. A similar experience-sharing workshop by UNDP and World Bank-supervised teams in the region would further enrich the range of approaches considered and more widely expand the opportunities for replication and adaptation.
- **Participation on Conferences:** The Center will also seek opportunities to generate a wider influence in the regional and global market through participation in regional conferences and other professional forums. The HEECP team is widely sought after for such a role because of its history as a pioneer in the field. The creation of the Center – and the explicit prioritization of this information-sharing role – would enable the team to more actively participate in such opportunities.

The primary focus of the Center's services are the existing and future EE finance programs within the GEF family. The establishment of the Center would directly support GEF's interest in institutionalizing structured learning within the GEF by facilitating inter-program knowledge sharing. While informal working relationships have evolved piecemeal between some of the regional programs, the creation of the Center of Excellence would formally support these linkages, thus enabling the development of a network of information sharing and cooperation.

Given the substantial investment made by GEF in these EE sector contingent financing approaches, such a Center represents an insurance policy of sorts that seeks to mitigate the risk of repeated errors and long startup times for multiple projects implemented in parallel. This is a particularly acute risk because these programs are being implemented in large part by Implementing Agencies (IAs) and program teams without directly relevant program or sectoral experience.

Upon approval of the extension of HEECP, the GEF Secretariat will be contacted by HEECP to plan a program launch workshop in Washington. The workshop would be intended to introduce the concept and the services of the Center to task managers from the GEF IAs, to share lessons-learned from HEECP and CEEF which could inform future program designs, as well as to tailor the services of the Center to the specific needs of the different IAs' programs.

The Center will also serve as an internal knowledge resource for IFC's own Energy Efficiency endeavors. As IFC continues to integrate sustainable energy finance into its mainstream investment strategy, the leverage potential of such a Center will continue to grow. For example, HEECP is presently supporting development of the strategy for the new Environmental Finance Group established this summer within IFC's Global Financial Markets Department, thus marking a significant milestone in the mainstreaming of EE finance within IFC and representing a substantial commitment of resources to EE finance by IFC which is directly the result of the IFC experience in HEECP and CEEF.

### **Indicators of Success**

The objective of the Center of Excellence is to leverage GEF's investments by facilitating information flows and providing direct advice and technical support to the network of EE finance programs operating or being developed in the CEE region. This effort is intended to support the broader goal of increasing investment in energy efficiency through development of a sustainable regional market for energy efficiency finance. In pursuit of this goal, the Center would support regional teams in increasing their effectiveness, accelerating deal flow, and maximizing the environmental impact of GEF's resources. The impact of the Center's work will be monitored through the integrated monitoring and evaluation program for CEEF/HEECP. The monitoring system will track outputs of the Center and, by extension, provide measures of the indicators of success. However, it is impossible to determine with validity what relative impact the sharing of information from HEECP will have on the beneficiary programs, as determining the baseline of the relative success of what the programs would have achieved without the Center's support is impossible. However, in order to best approximately measure the effectiveness of the

Center, the M&E program will use questionnaires from beneficiary program participants from the region in order to measure the degree to which they adopt measures and practices as a result of the information provided through the Center. The M&E program will also monitor the outputs of the Center in order to determine its effectiveness in delivering services. Thus the ultimate indicators of success – improved program effectiveness – must be implied by an effective sharing of information, and supplemented by the questionnaires for participant-beneficiaries. The outputs which will be tracked include: number of workshops conducted; number of on-site consultations; number of email and telephone consultations; number of requests for information; documents and other information products developed and disseminated; number of visitors hosted; conferences supported (and audience members addressed). The indicators of program impact which will supplement this from the questionnaires will include: program practices influenced by the Center, materials and HEECP models used by program managers, and the participants’ subjective scoring of the value of the services provided.

**Organization and Time Allocation**

The Center will function within the extended HEECP program and organization. Professional program staff will allocate an average of 15% of their time for the operations of the Center. In the short term no new staff will be hired, as the Center will draw upon the expertise of the current HEECP staff. Administration and daily management of the Center will be the responsibility of the HEECP program administrator who has introduced operational and accounting systems this year which will enable her to focus on the Center. If necessary, supplemental administrative staff and information specialists will be deployed on a part-time basis. With the integration of HEECP and CEEF, administrative, information sharing, and training responsibilities can also be shared across the broader CEEF team.

Staffing requirements thus are as follows:

Position	Tasks	Staff Member	Max. Time Allocation
<b>Regional Coordinator</b>	<ul style="list-style-type: none"> <li>▪ First point of contact for Center</li> <li>▪ Coordination of time and task allocation of professional staff</li> <li>▪ Coordination of Center events</li> <li>▪ Updates Databases</li> <li>▪ Coordination with GEF</li> </ul>	<ul style="list-style-type: none"> <li>▪ HEECP team administrator</li> </ul>	40-50% of time
<b>Professional Staff</b>	<ul style="list-style-type: none"> <li>▪ Development of the Comprehensive Training Program &amp; Database</li> <li>▪ Development and delivery of the Center's services</li> <li>▪ Reporting to GEF</li> </ul>	<ul style="list-style-type: none"> <li>▪ 3 HEECP staff members</li> <li>▪ CEEF staff members when needed</li> </ul>	15% of time
<b>Part Time Administrative Assistant</b>	<ul style="list-style-type: none"> <li>▪ Assistance to Program Coordinator</li> <li>▪ Assistance to Professional Staff</li> </ul>	<ul style="list-style-type: none"> <li>▪ HEECP local staff member</li> </ul>	tbd

**Budget**

The Center will operate within the context of HEECP's extended budget for the years 2005-2006. Budget expenditures associated with the Center represent 22% of HEECP's total budget for FY2005-2006.

**Total HEECP Budget 2005-2006**

	FY2005		FY2006	
Travel	\$20,000	10.3%	\$20,000	10.3%
Communication	\$12,000	6.2%	\$12,000	6.2%
Local staff	\$115,000	59.3%	\$127,000	65.5%
Office rent & related exp.	\$40,000	20.6%	\$40,000	20.6%
Miscellaneous	\$7,000	3.6%	\$7,000	3.6%
<b>Total</b>	<b>\$194,000</b>		<b>\$206,000</b>	

**Total CENTER of EXCELLENCE Budget 2005-2006**

	FY2005		FY2006	
Travel	\$10,000	5.2%	\$10,000	5.2%
Communication	\$1,800	0.9%	\$1,800	0.9%
Local Staff	\$26,000	13.4%	\$28,000	14.4%
Direct costs—workshops/mtgs	\$6,000	3.1%	\$6,000	3.1%
<b>Total</b>	<b>\$43,800</b>		<b>\$45,800</b>	

<b>% of HEECP Budget</b>	<b>22.6%</b>		<b>22.2%</b>	
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## ANNEX 2

### **Background on HEECP project objectives, benefits and status**

HEECP was developed and has been implemented by the International Finance Corporation (IFC) since 1997. The program is financed jointly by GEF (\$5.7 million), IFC (\$12 million plus \$0.8 million in management, credit review, and legal operational cost contributions) and IFC's Trust Funds (\$350,000). HEECP works in partnership with local financial intermediaries (FIs) to build a sustainable commercial lending business in Hungary for energy efficiency (EE) investment across a range of sectors. IFC uses a set of market development tools created for the Hungarian market to support development of the Hungarian EE lending market through the establishment of specialized financial products and building new capabilities among Hungarian FIs and project developers to undertake investment in the EE sector. The two primary tools used by IFC include a partial risk guarantee provided to Hungarian FIs, and a portfolio of technical assistance (TA) support for FIs and project developers.

#### *Impact*

To date, the loan portfolio that HEECP has directly supported with guarantees represents HUF 1.45 billion (\$ 5.9 million) worth of energy efficiency investments (total of 35 EE projects and 1,500 contracts in the gas retail portfolio). Also, HEECP has provided TA advisory support to 30 additional transactions, as well as supporting the development and establishment of four specialized financial products which are actively being marketed by participating FIs. These products have yielded a substantial sustained pipeline of new investment supported by HEECP's partner FIs, only a portion of which transactions have utilized the guarantees. Today, the Hungarian market features a dynamic and competitive EE lending business. IFC continues to work with local FIs to further deepen the EE finance market, developing new financial products to address important niche markets not previously accessible to commercial lending. As such, the Hungary market provides the follow-on IFC/GEF CEEF program (and the other regional programs) with an important incubator of new approaches. The Hungarian market has thus emerged as a place where new financial products can be piloted, with replication possibilities in other markets.

#### *Lessons Learned*

IFC has learned key lessons from the HEECP experience regarding the guarantee product. We are sharing these lessons with other program implementers, while applying them in further evolving the HEECP model to other markets, including the Czech Republic, Slovakia, Estonia, Latvia, Lithuania, and now Russia. Key among the lessons is IFC's experience with the sustainability of the guarantee approach. IFC undertook HEECP with the expectation that the guarantees would no longer be required by FIs after the program life in order for EE projects to continue to be financed, ie, that the impact of the guarantees would be sustainable. This basic program thesis was proven early in the program life. In fact, the FIs have come to adopt the guarantee as a surgical instrument, which they have used on a strategic basis to support early stage development of new

sector markets and first-of-a-kind transactions. IFC has found that the participating FIs quickly gain comfort with the new financial products and the risk profiles of the new EE sector deal types, and then continue lending without use of the guarantee. As such, the guarantees have proven to have an important role (in complement to the TA program) in affecting sustained market development. As a result, the volume of guarantee exposure has been less than anticipated, even as apparent market impact -- the program objective of HEECP (measured by FI lending) -- has met expectations.

#### *Evolution of the Model and Increased Mainstreaming*

Finally, as IFC has increasingly mainstreamed the HEECP/ EE finance program into its operations, the Corporation has refined the guarantee instrument, and the mechanisms for administering the guarantees, in order to provide a more responsive and marketable guarantee product. The proposed integration of HEECP and CEEF would enable a full adoption of these innovations, thus enabling IFC to fully respond to the Hungarian market demand, and allowing HEECP to capture two important emerging pieces of the market -- including both smaller and much larger deals. These modifications will allow the FIs to more fully utilize the guarantee resources, further deepening the financial markets. The integration will support the continued mainstreaming of the EE finance product into IFC's investment operations. IFC's increasing levels of financial and management commitment to the HEECP model, including its successor investments in Central Europe and now Russia, has most recently manifested itself institutionally in the establishment of an Environmental Finance group within the Financial Markets investment department. Reflecting the high level of attention EE finance has now achieved within IFC's mainstream operations, senior management approved in June 2004 a host of pioneering operational modifications in the execution of the EE finance products to enable more responsive and effective marketing and support for participating FIs in CEEF and HEECP. Such operational changes, including streamlined credit approval procedures, and dynamic pricing structures, are not a common feature of IFC's corporate culture and reflect a strong commitment to supporting the success of HEECP and CEEF as a basis for establishing a sustainable investment product for IFC going forward.

*Specific objectives* of the HEECP are to: (i) reduce credit risk on EE financing for eligible local FIs (making transactions possible and gaining credit approval for use of the FI's own funds); (ii) provide targeted technical assistance (in support of partner FI marketing and delivery of EE financing services and preparation of projects and programs for investment); (iii) reduce transaction costs borne by project participants; and (iv) provide or make possible longer term financing (to lower annual finance payments, finance longer payback "deep retrofit" projects and make EE projects more attractive to the end-user by allowing them to be self-financing from energy cost savings). The primary objectives of the HEECP will be reduction of credit risk and reduction of transaction costs.

*Status:* During the course of the years, HEECP has been involved in the development of several different types of Energy Efficiency investments, such as:

- Street lighting projects
- Boiler retrofit projects
- Gas engine installations (cogeneration)
- Building envelope insulation and heat distribution network up-grades
- District heating reconstruction

The portfolio HEECP has directly supported with guarantees represents HUF 1.45 billion (\$5.94 million) worth of energy efficiency investments (total of 35 EE projects plus 1,500 contracts in the gas retail portfolio).

Completed Projects	Transaction Size (HUF)	Transaction size (US\$)	Guarantee %	Guarantee Liability (US\$)	Outstanding Guarantee Liability (US\$)
<b>Gas Retail Portfolio</b>	<b>345,000,000</b>	<b>1,500,000</b>	<b>11.4%</b>	<b>170,573</b>	<b>170,573</b>
Hospital gas-fired heating system	32,513,667	115,707	50.0%	57,854	0
Meat packing plant gas boiler system	32,410,540	115,340	50.0%	57,670	0
Railroad station gas heating system	232,078,462	825,902	50.0%	412,951	231,345
Hospital heating project	145,661,689	518,369	50.0%	259,185	161,090
Block House Heating Project	8,000,000	37,268	50.0%	18,634	0
Block House Heating Project	19,230,235	68,435	50.0%	34,218	7,973
<b>TOTAL HEECP1 excl. Gas Retail</b>	<b>469,894,593</b>	<b>1,681,021</b>	<b>50.0%</b>	<b>840,511</b>	<b>400,408</b>
<b>TOTAL HEECP1 incl. Gas Retail</b>	<b>814,894,593</b>	<b>3,181,021</b>	<b>31.8%</b>	<b>1,011,084</b>	<b>570,981</b>
Street Lighting Projects (16 Municipalities)	65,624,764	227,371	50.0%	113,686	52,339
Street Lighting Leasing Projects (5 Municipalities)	48,139,700	165,918	50.0%	82,959	71,634
Block House Window Change Project (2)	28,682,166	114,213	35.0%	39,975	37,414
District Heating Reconstruction and Enlargement	60,000,000	253,507	35.0%	88,727	88,727
Block House Heat Distribution Pipes Reconstruction	10,000,000	47,286	35.0%	16,550	16,550
Municipality Street Lighting	144,000,000	640,000	35.0%	224,000	224,000
Hotel Cogeneration	252,000,000	1,200,000	7.7%	92,400	92,400
Block House Heating reconstruction	15,327,118	72,671	35.0%	25,435	25,435
Block House Heating reconstruction	8,000,000	38,126	35.0%	13,344	13,344
<b>TOTAL HEECP2</b>	<b>631,773,748</b>	<b>2,759,092</b>	<b>25.3%</b>	<b>697,076</b>	<b>621,844</b>
<b>TOTAL HEECP1-2 excl. Gas Retail</b>	<b>1,101,668,341</b>	<b>4,440,113</b>	<b>34.6%</b>	<b>1,537,586</b>	<b>1,022,252</b>
<b>TOTAL HEECP1-2 incl. Gas Retail</b>	<b>1,446,668,341</b>	<b>5,940,113</b>	<b>28.8%</b>	<b>1,708,159</b>	<b>1,192,825</b>

HEECP's Technical Assistance funds (\$ 850,000) were used to finance the following market capacity development activities:

- Direct financial assistance to FIs in building their internal EE capacity (partial reimbursement of direct costs)
- Other FI support activities (staff training seminars, client workshops, product development support)
- ESCO/SME consultation support
- Selected End-User segment seminars and workshops
- Financing of feasibility studies and comprehensive energy audits for selected end-users
- Program marketing and research
- Program monitoring

## *HEECP: A Market Development Approach*

Apart from providing direct guarantees for energy efficiency projects, one of the key rationales behind extending the life of the program derives from an understanding that HEECP's impact on the Hungarian market cannot be measured simply by looking at the size of the Program's guarantee portfolio. (See Annex A.) HEECP's contribution to the development of the EE finance market in Hungary goes way beyond the direct influence of approved guarantees.

By combining the use of TA resources and the guarantee facility, IFC has built upon its role of facilitating the expansion of the energy efficiency market to new end-users, and new technologies with new financial products.

Using its TA resources, HEECP mobilizes international and local experts to provide direct assistance to FIs or project developers in coming to terms with the different types of EE investments. HEECP shares IFC's experiences with Hungarian partners, transfers international best practice, as well as directly spurring the development of all sorts of EE projects.

IFC/HEECP brings a considerable knowledge and experience to enable the development of new financial products at FIs where the market opportunities otherwise would be ignored and lending opportunities automatically rejected. This has been demonstrated in Hungary by introducing new lending approaches for block house, CHP and street lighting EE projects.

The following examples demonstrates HEECP's role as a catalyst of Hungary's market development:

*EXAMPLE 1 – Facilitating the expansion of block house financing:* HEECP's impact on the block house market is one of the clearest examples of IFC using its reputation and experience to facilitate the expansion of a new market. HEECP early involvement and financial consultancy were the crucial factors in motivating Raiffeisen Bank to embrace modern risk assessment techniques and move away from an exclusive reliance on mortgage based lending. Raiffeisen responding to the challenge; coming out with a radically new concept in block house renovation project finance was the real starting point for the market in Hungary. What has restated a competitive commercial lending market for block house renovations provides an important model for the entire region, where a massive infrastructure of dilapidated privatized blockhouses represents capital investment requirements which for outweigh available public funds. IFC's role continues in further developing block house lending approaches and piloting and mainstreaming the new types of financial products in this sector.

*EXAMPLE 2 – Pioneering in CHP and Street Lighting:* The IFC guarantee made possible one of the first large scale CHP investments implemented by an ESCO in Hungary, as well as supported the first few ESCO-type municipal street lighting credit facilities. The demonstration value of these pilot projects combined with the favorable market conditions helped trigger a wave of similar investments where IFC guarantee was not necessary anymore. Now, as FIs continue to develop new markets, IFC’s guarantee is necessary for pioneering projects with small municipalities and villages.

*EXAMPLE 3 – Brokering useful multi-project finance facilities to mobilize debt capital for ESCOs:* One of the HEECP FI partners traditionally required 100% owners’ guarantee from a newcomer ESCO company to secure its EE loan. IFC helped the company to negotiate more realistic collateral terms by working with the FI to structure an commonly acceptable credit configuration which allowed the ESCO to take the loan and enter the market.

### **ANNEX 3: Project Pipeline**

HEECP experienced a slower start up than expected. As a pilot operation, there was no experience from similar programs before implementation. Among the key lessons of the HEECP experience was the need to invest substantial time and effort to build EE lending businesses in FIs where there was no prior experience, and the vast importance of TA support for building that FI capacity. During the life of the program it turned out that the learning curve was longer and building capacity and create demand for the guarantee product required more up front investment from the program than was expected – a lesson which has been taken into account with a very intensive TA effort in CEEF. A related lesson is that the absolute volume of guarantees required by the FIs in building an EE lending business is lower than anticipated. Specifically, while the guarantees have proven to be a key element in the HEECP toolkit, and the absolute volume of EE lending is comparable to what was projected, the FIs have used the guarantees selectively – typically to support first-of-a-kind transactions. The projected sustainability of the EE lending business (past guarantee program) has proven to be demonstrated already on a sector-by-sector basis, with the FIs graduating from the guarantee product for the more developed lending sectors, and continuing to access the guarantee on a selective basis in more frontier sectors. To date, HEECP has spent \$1.45 million on operations and TA and utilized 90% of the TA and 85% operation budget. \$14.6 million in guarantee funds remain available to support transactions through the guarantee facility. From the perspective of the program objective of EE lending market development, the program is successful. The \$1.4 million TA investment undertaken in HEECP has yielded specialized EE products for 7 different FIs, provided training for ESCOs, FIs and different stakeholders, and supported the establishment of institutionalized EE credit decision-making approaches within the participating FIs’ (representing 95% of all debt financing in the Hungarian market) to support more EE transactions.

In order to further stimulate dealflow which is directly supported by the guarantee facility at partner FIs, and ensure that the guarantee product remains relevant to the market and is delivered in an efficient manner, IFC recently conducted an HEECP-CEEF team workshop to assess the program and fine-tune the financial product and its delivery. Reflecting the importance placed upon HEECP-CEEF as a replicable model for mainstreaming EE investment within IFC, senior management participated in this exercise and committed to a number of modification of the product and its delivery which are intended to streamline procedures and create a more marketable guarantee product. Included in these modifications is a new credit approval system to encourage FIs to develop standardized EE products and build loan portfolios based on these products backed by the guarantee product. The first standardized product has been developed for Raiffeisen Bank in Hungary. Under the framework of this block house EE finance product, the local country manager approves transactions and issues transaction guarantee agreements on behalf of IFC based on pre-approved criteria. By implementing and piloting these new approval approaches IFC expects that FIs will be incentivized to make greater use of the guarantee.

HEECP's role in Hungary is to promote new types of investments that have not yet gained momentum in the market. In 2003, program activities were characterized by moving away from the EE market sectors where the financial market is now strong and experienced enough to sustain commercial lending, and moving into territories where HEECP is much needed. This includes particularly small transactions and borrowers (villages, SMEs), and particularly large transactions (where FIs seek to share risk). The FIs seek IFC's expertise and guarantee support to help break down initial barriers in these sectors, and facilitate the continued expansion of commercial financing for energy efficiency.

HEECP started developmental work in 4-5 new market niches in 2003. The result is a very strong project pipeline for the up-coming 2-3 years, based on several multi-project finance facilities and streamlined credit vehicles which IFC has brokered and structured with our partner FIs. These include a very strong pipeline of projects focusing on block housing reconstruction, SME and lighting initiatives. These areas have been neglected by FIs historically in Hungary. As the market's sophistication has increased through HEECP-FI collaboration, and competition has grown, FIs have continued to look 'down market' for new areas of opportunity. Thus, IFC's ongoing participation is crucial in moving forward with creating the viable financing products which markets commercial financing a reality in these key remaining market niches. Withdrawal from the market would set back the unfolding development, especially because there are no alternative programs available with a similar commercial orientation. From a broader perspective, Hungary now serves as an important laboratory for developing and demonstrating innovative financial products which are replicable in other, less developed markets. In addition, integration into CEEF will allow HEECP to book larger size transaction and further improve project pipeline and guarantee volume.

With no additional commitment of project funds from GEF, an extended life for HEECP could facilitate \$30-80 million in additional private sector investment in energy efficiency in Hungary. IFC would project using an additional \$610 million in guarantee resources to directly support loans with guarantees, and avoid an additional approximately 63.9 million tonnes/year of CO<sub>2</sub> emissions.

The table below summarizes HEECP actual guarantee portfolio numbers (in bold), and the projections. [NOTE: The market impact numbers – including the volume of lending which participating FIs have undertaken which has been directly supported by the HEECP TA facility, but without guarantees – will be quantified in the M&E report to be completed in September 2004. IFC expects the resulting volume of lending which results from HEECP, as reflected by these numbers, to meet or exceed program expectations.]

<b>HEECP1 [1997-2001]</b>							
US\$	Guarantee %	Guarantee amount			Credit exposure	Investment size <sup>1</sup>	Leverage
		GEF	IFC	Total			
Original projection*	15-50%	4,250,000	0	<b>4,250,000</b>		25,500,000	1:5
Revised projection**	50%	4,250,000	0	<b>4,250,000</b>	8,500,000	11,333,333	1:1.6
<b>Actual numbers</b>	<b>32%</b>	<b>1,011,084</b>	<b>0</b>	<b>1,011,084</b>	<b>3,181,021</b>	<b>4,241,361</b>	<b>1:3.2</b>
	50%	840,511			1,681,021	2,241,361	
	11%	170,573			1,500,000	2,000,000	

\* Original numbers in the decision book; it was calculated along the assumption of a gearing ratio = 2.

\*\* Maximum EE portfolio size according to a best case scenario, when the entire guarantee facility is exposed

<b>HEECP2 [2001-2004]</b>							
US\$	Guarantee %	Guarantee amount			Credit exposure	Investment size <sup>1</sup>	Leverage
		GEF	IFC	Total			
Original projection*	35%	4,000,000	12,000,000	<b>16,000,000</b>		70,000,000	1:3.4
Revised projection**	35%	4,000,000	12,000,000	<b>16,000,000</b>	45,714,286	60,952,381	1:2.8
<b>Actual numbers</b>	<b>25%</b>	<b>697,076</b>		<b>697,076</b>	<b>2,759,092</b>	<b>3,678,789</b>	<b>1:4.3</b>
<b>HEECP1+HEECP2</b>	<b>29%</b>	<b>1,708,159</b>		<b>1,708,159</b>	<b>5,940,113</b>	<b>7,920,151</b>	<b>1:3.6</b>

\* Original numbers in the decision book

\*\* Maximum EE portfolio size according to a best case scenario, when the entire guarantee facility is exposed

<b>HEECP3 [2005-2006]</b>							
US\$	Guarantee %	Guarantee amount			Credit exposure	Investment size <sup>1</sup>	Leverage
		GEF	IFC	Total			
Original projection*	50%	3,600,000	12,000,000	<b>15,600,000</b>	31,200,000	41,600,000	1:1.7
Medium case scenario	50%		7,150,000	<b>7,150,000</b>	14,300,000	19,066,667	1:1.7

\* Maximum EE portfolio size according to a best case scenario, when the entire guarantee facility is exposed

<sup>1</sup> It is calculated with an average 25% own equity portion

#### **ANNEX 4: Terms of Reference for HEECP Evaluation.**

IFC is completing an independent evaluation of HEECP which is intended to capture the market impact of HEECP, recognizing that the guarantee volumes do not reflect fully the market impact that this instrument has had. . The report will be available in October, 2004 for review. The brief summary of the terms of reference is the following:

Deliver a concise statement of the avoided GHG emissions stimulated to date by the HEECP program: An evaluation exercise is currently underway to calculate the GHG emissions reductions from projects where IFC has issued transaction guarantees. During the course of the years, HEECP has been involved in the development of several different types of Energy Efficiency investments, such as street lighting, boiler retrofit, gas engine installations (cogeneration), building envelope insulation and heat distribution network up-grades and district heating reconstruction.

The portfolio HEECP has directly supported with guarantees represents HUF 1.45 billion (\$ 5.9 million) worth of energy efficiency investments (total of 35 EE projects plus 1,500 contracts in the gas retail portfolio).The consultants will supplement this with an assessment of GHG emissions reductions from projects implemented that have indirectly benefited from the HEECP market development activities. These activities have included:

- Direct financial assistance to FIs in building their internal EE capacity (partial reimbursement of direct costs)
- Other FI support activities (staff training seminars, client workshops, product development support)
- ESCO/SME consultation support
- Selected End-User segment seminars and workshops
- Financing of feasibility studies and comprehensive energy audits for selected end-users
- Program marketing and research

These consultants should estimate the GHG emissions reductions from:

- EE projects for which loans were granted by participating institutions post-program entry;
- EE projects for which IFC funded technical assistance or where IFC provided advice on project structuring;
- EE projects carried out by EE project developers (ESCOS) whose business was supported by the HEECP program.

*Assessment of Critical Success Factors for HEECP:*The HEECP program is assumed to have been a success, based on its replication within IFC in five additional Central and Eastern European countries (Czech Republic, Estonia, Latvia, Lithuania and Slovakia) and on the numerous other EE financing programs emerging that also use partial credit guarantees.

The consultants should test the hypothesis that HEECP has been a success, then evaluate and document the factors that have most contributed to the HEECP program success. The consultants should also assess the barriers that the program has had to overcome, and which may still hamper its further progress. The consultants will base their conclusions on interviews with the key program stakeholders: IFC implementation team (both in Washington DC and the field), financial institutions, members of the HEECP Advisory Committee, Hungarian ESCOs.

The deliverables for this task will be a report for review by IFC, WB ENV and the GEF plus a succinct report for dissemination to interested external parties.