



Global Environment Facility

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Leonard Good
Chief Executive Officer
and Chairman

July 23, 2003

Dear Council Member,

The European Bank for Reconstruction and Development (EBRD), an Executing Agency for the project, ***Slovenia: National Pollution Reduction Project***, acting under the policy of expanded opportunities, has submitted the attached proposed project document for CEO endorsement prior to final approval of the project document in accordance with the EBRD procedures. The World Bank has agreed to act as the Implementing Agency for this project.

The Secretariat has reviewed the project document. It is consistent with the proposal approved by the Council in October 2002 and the proposed project remains consistent with the Instrument and GEF policies and procedures. The attached explanation prepared by EBRD satisfactorily details how Council's comments and those of the STAP have been addressed. I am, therefore, endorsing the project document.

We have today posted the proposed project document on the GEF website at www.gefweb.org. If you do not have access to the web, you may request the local field office of the World Bank or UNDP to download the document for you. Alternatively, you may request a copy of the document from the Secretariat. If you make such a request, please confirm for us your current mailing address.

Sincerely,

cc: Alternate, Implementing Agencies, STAP



European Bank
for Reconstruction and Development

Mr Len Good
Chief Executive Officer and Chairman
Global Environment Facility
1818 H Street, N.W.
Washington D.C. 20433
U.S.A

20th June 2003

Dear Mr. Good,

Subject: Slovenia: EBRD / GEF Environmental Credit Facility (formerly entitled Slovenia: National Pollution Reduction Project)

I am pleased to attach final documentation for the above-mentioned project which was approved by the GEF Council at its meeting of 14th – 15th October 2002. As per paragraph 30 of the GEF Project Cycle we are submitting this project for circulation of the members of the GEF Executive Council and, subsequently, for your final endorsement.

Attachments to this letter are:

- A copy of the final documentation submitted to the EBRD Board of Directors.
- A copy of the Bank's response to the GEF Secretariat's Concept Agreement Review.

Please note that we have changed the title of the project to better reflect the exact nature of the project. The aims of the project remain exactly as previously proposed to GEF and approved by the GEF Council.

We look forward to your endorsement in due course and should you require any further information please do not hesitate to contact me or my staff.

Yours sincerely,


Dr Alistair Clark
Director, Environment Department

Cc: K. King, R. Khanna, H. Acquay, A. Duda, R. LeBaron, B. Maser-Mallor,
W. Kennedy, A. Schmidt, M. Hughes

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

**BDS03-17 (Addendum 1)
22 May 2003**

SLOVENIA

**EBRD/GEF ENVIRONMENTAL
CREDIT FACILITY**

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ABBREVIATIONS/CURRENCY CONVERSIONS

BAS	Business Advisory Services programme
DRB	Danube River Basin
EU	European Union
EUR	Euro
FAO	Food and Agriculture Organisation of the United Nations
GEF	Global Environment Facility
ISPA	Instrument for Structural Policies for Pre-Accession
Phare	Poland-Hungary Aid for Restructuring the Economy programme
PB	Participating Bank
PP&R	Procurement Policies & Rules of the EBRD
PTSU	Procurement & Technical Services Unit
SAF	Standard Application Form
SAPARD	Special Accession Programme for Agricultural and Rural Development
SIT	Slovenian Tolar
TC	Technical Co-operation
TMG	TurnAround Management Group
USD	US Dollar

Exchange rates:

USD – EUR: 0.92

SUMMARY FACT SHEET

SLOVENIA EBRD / GEF ENVIRONMENTAL CREDIT FACILITY	
Client:	Potential clients are various commercial Slovenian banks.
EBRD Transaction:	EBRD to provide senior loans in total of up to EUR 45 million to participating commercial banks in Slovenia for on-lending to environmental investment projects. Participating banks will receive a fee and the sub-borrowers will receive grant support, both provided by the GEF for qualifying projects. EBRD will only take the risk of the participating banks.
Project Description / Business Purpose:	<p>Establishment of an environmental credit facility, where local banks would provide loans to private sector companies and smaller municipalities for investment projects that would reduce water pollution entering the Slovenian portion of the DRB.</p> <p>EBRD funds would be blended with GEF grant funding. Grant support amounting to USD 9 million would be used to provide incentives to sub-borrowers as well as administration fees to the local banks for participation in this project.</p> <p>This project is designed as a pilot project to test the viability of the concept in Slovenia for further replication in other Danube River Basin countries, which include the Czech Republic, Slovakia, Hungary, Croatia, FR Yugoslavia, Bosnia and Herzegovina (middle basin); and Romania, Bulgaria, Moldova and the Ukraine (lower basin).</p> <p>This is the first example of GEF working through the private sector in its focal area of international waters. It is further the first GEF co-financed operation with the EBRD</p>
Associated TC (terms of TC reimbursement):	<p>There would be two types of consultancy services, both funded through the non-reimbursable GEF grant:</p> <p>Technical assistance and training (USD 602,900):</p> <ul style="list-style-type: none"> • If need be, assistance in developing solutions to water pollution projects will be made available to a range of industrial, agricultural and municipal entities including (a) assistance in identifying the best solution to water pollution problems, (b) ensuring cost effectiveness in the selection of the appropriate technology (c) structuring any required investments and, (d) assistance in the process of loan application and the formulation of proposals (USD 540,000). • Marketing campaign to inform potential sub-borrowers throughout Slovenia about the Facility (USD 32,500). • Information dissemination activities related to the Facility to inform a wide range of stakeholders about the Facility and pollution reduction results (USD 30,400). • Technical assistance and training will be provided by the TurnAround Management Group (“TMG”)/Business Advisory Services (“BAS”) programme, which is already operating in Slovenia. As with the regular BAS programme, companies using this assistance will pay half of the costs. The operating costs for the BAS programme will be provided through the regular TMG/BAS donor funding sources. <p>Environmental expert (USD 304,750):</p> <ul style="list-style-type: none"> • The environmental expert will ensure that the objectives of the Facility

	<p>are met by checking and confirming the eligibility of sub-projects against the pre-agreed set of criteria and by making recommendations in regards to the environmental aspects of the project.</p> <ul style="list-style-type: none"> • In addition, the environmental expert will ensure that for municipal projects to be financed under the Facility, EBRD and local procurement rules have been followed. • These services are to be provided by an independent environmental expert with offices in Slovenia. The environmental expert will be selected and supervised by EBRD. <p>In addition to the above, a total of USD 124,691 in TC funds (USD 87,284 from GEF and USD 37,407 through EBRD’s framework contract with FAO, managed by the EBRD Agribusiness Team) were used to prepare the project. Of this amount USD 18,250 were used by the TMG/BAS programme in Slovenia to undertake a demand study, while the rest was used to employ specialists from the FAO to prepare the Project Brief. This is the main document submitted to GEF for approval of the whole project.</p>
Key Parties Involved:	<ul style="list-style-type: none"> • The Global Environment Facility, a multidonor facility established to assist in the protection of the environment and promote environmentally sound and sustainable development. • Slovenian banks • TurnAround Management Group • Independent environmental expert

1. THE CLIENT AND THE PROJECT

1.1 BACKGROUND

The EBRD and the GEF are proposing to establish an Environmental Credit Facility for Slovenia. EBRD would provide credit facilities to local banks and the GEF would contribute grant support to the Facility. The local banks would on-lend money to private sector companies and smaller municipalities planning to undertake investments which would reduce water pollutants entering the Slovenian portion of the Danube River Basin (“DRB”). GEF has approved a total of USD 9.9 million in grant financing. USD 9.0 million GEF grant funding would be blended with up to EUR 45 million EBRD funds on a project-by-project basis. The GEF grants would be used to provide financial incentives to local private sector companies and smaller municipalities as well as administration fees to local financial institutions to participate in this project. The remaining grant funding will be utilised for training, technical assistance and information dissemination.

The project contributes to the implementation of the “Convention for Co-operation for the Protection of Sustainable Use of the Danube River”, which addresses the major transboundary environmental issues in the DRB. So far, eleven DRB countries, among them Slovenia, have signed the Convention. The DRB is a priority area for GEF support.

The GEF is an independent international financial mechanism created to provide grant financing from multilateral sources to environmental projects in the areas of biodiversity, climate change, ozone depletion international waters, land degradation and persistent organic pollutants. GEF provides both grants for financing investment projects and grants for preparing projects. Since its creation in 1991, the GEF has

allocated USD 4 billion in grants to support more than 1,000 projects in 140 developing nations and economies in transition. GEF projects are implemented by the United Nations Development Programme, the United Nations Environment Programme, the World Bank and the Asian Development Bank (Implementing Agencies). The EBRD currently acts as an Executing Agency of the GEF, meaning that it cannot receive investment funds directly from the GEF but must work through one of the Implementing Agencies. The EBRD can receive project preparation funds directly from the GEF and has done so for three projects. The EBRD hopes to receive the status of an Implementing Agency from the GEF in the near future.

In line with Slovenia's EU accession process, its environmental legislation is being adapted to reflect EU standards. Slovenian companies and municipalities have an urgent need to invest in water pollution reduction projects due to meet tight legislative deadlines for emission reduction, stricter enforcement and monitoring as well as an increasing waste water tax burden. This has been confirmed in a demand study, which was completed by the TurnAround Management Group's ("TMG") Business Advisory Services ("BAS") programme in Slovenia in May 2002. According to this study, demand for financing of water pollution reduction investments exceeds by far the supply of available financing for this type of investment. Further information on the demand study and potential sub-projects is included in Annex 2.

1.2 CREDIT FACILITY

The Facility will be demand driven and EBRD funds will be allocated to local banks committed to the Facility. Loans will be granted at commercial rates. Separate loan agreements will be concluded with each participating bank. It is expected that 4-6 banks will participate in the Facility and that each will receive between EUR 5-15 million, depending on the demand, the individual credit analysis, the due diligence and the overall exposure of EBRD to the banks or their groups.

Sub-borrowers will be private companies, smaller municipalities or municipal companies. Examples of potential sub-projects financed through this Facility include the recycling of cooling waters at a glass production company, the upgrading of waste water treatment at a textile company, the re-use of waste waters at a pulp and paper mill, the construction of a new biological waste water treatment facility at a food processing company and the upgrading of a municipal waste water treatment plant. Sub-projects will come from existing companies. Sub-borrowers have to pass the participating banks' financial and legal due diligence and sub-projects have to comply with the Facility's environmental eligibility criteria to qualify for financing and grant support from the Facility. Sub-borrowers will mostly be already existing and creditworthy clients of the banks. Maximum sub-loan size would be EUR 3 million, on an exceptional basis the amount could go up to EUR 4.5 million. According to the demand study, the majority of the projects will be in a range from EUR 100,000 to EUR 1,000,000.

It is expected that the majority of sub-projects will come from the private sector and that overall less than 25% of the Facility will be allocated to public sector projects. A ceiling of 50% of the total loan amount granted to each participating bank will apply to public sector projects.

The USD 9.0 million GEF investment grant will be used to provide incentives to both sub-borrowers and local banks to participate in the Credit Facility.

- **Sub-borrowers:** The primary objective of the Credit Facility is to speed up necessary water pollution reduction investments in Slovenia. Sub-projects that will help borrowing companies meet relevant national and EU regulatory requirements earlier than the legislative deadline or that reduce emissions beyond the standards required by relevant EU/national legislation, will be eligible. To induce sub-borrowers to make such investments, they would receive a completion fee. The fee would become available only after an independent local environmental expert has confirmed successful implementation and completion of the environmental project.
- **Participating banks:** Fees will be paid to the participating banks as an incentive to roll out this Facility. In addition, it will compensate them for restricted use of funds and additional administrative requirements such as close co-operation with the environmental expert and reporting tasks. For outstanding amounts on-lent to sub-borrowers, banks will receive an administration fee, up to a maximum of five years, which will be deducted from the margin applied to the commercial loan. In addition, they will receive a completion fee following the successful implementation of the sub-project.

Two thirds of the USD 9.0 million investment grant available will be allocated to the sub-borrowers and one third to the local financial institutions.

1.3 TECHNICAL CO-OPERATION

Training and Technical Assistance

To ensure that the objectives of the Facility are met, an independent and locally based environmental expert will be hired. The expert will check the environmental eligibility of each proposed sub-project, confirm the environmental monitoring plan and undertake technical monitoring of investment projects financed by the Facility. In addition, the environmental expert will have to confirm each sub-project's successful implementation, which will entitle the borrower to receive the completion fee.

Project preparation assistance will be provided by the donor financed TMG/BAS programme, which is already active in Slovenia. Activities will include assistance in process optimisation and wastewater minimisation within companies; ensuring cost-effectiveness in the selection of the most appropriate technology; scoping borrowing requirements and preparation of loan application and formulation of technical proposals to ensure conformity with GEF, EU and national environmental criteria. This assistance will be made available to any industrial, agricultural or municipal entity and does not necessarily have to result in a loan application to one of the participating banks.

Information Dissemination

To reach clients beyond the established client base of the participating banks and to ensure that a great number of potential borrowers the Slovenian portion of the DRB are informed about the Facility, national-level marketing workshops will be organised and related information distributed. In addition, funding will be available for informing a wide range of stakeholders and the general public to raise public awareness, promoting the replication of the project concept and the innovative technologies demonstrated by the project as well as sharing experiences and lessons learned with its stakeholders. These activities will be carried out mainly by the TMG/BAS programme.

GEF has approved, in principle, an amount of USD 907,650 for technical co-operation for this Facility to finance the environmental expert and the TMG/BAS programme activities.

1.4 FUTURE STRATEGY

The Slovenia project has been designed as a pilot to test the concept of reaching sub-borrowers planning to undertake investments in water pollution reduction projects and supporting them with grants and access to financing through local financial intermediaries. Slovenia was chosen because of its advanced and solid banking system and its environmental legislation, which is being updated to be in line with EU accession requirements.

Provided the concept can be implemented successfully, GEF has indicated that they may wish to replicate it in other DRB countries and provide similar grant support to complement EBRD financing. The replication potential is implied by the similarities in other DRB countries in environmental and some industrial/socio-economic terms. After successful implementation of the pilot project, EBRD plans to roll out a follow-on project in other selected countries in the Danube River Basin, including Romania and Bulgaria. EBRD is investigating which of the countries are most suited for replicating the project. A framework facility might be proposed, which would cover a number of DRB countries. In addition, this pilot project could open the door for future water pollution reduction projects to be implemented between EBRD and GEF in other regions.

2. KEY TERMS AND CONDITIONS

Transaction	EBRD to provide senior loans in total of up to EUR 45 million to participating commercial banks in Slovenia. Participating banks, as well as the sub-borrowers, will receive financial incentives provided by the GEF grant for qualifying projects.
Financing Plan	Separate loan agreements to be entered into by the Bank with selected commercial banks, such banks to be determined after the individual due diligence. It is expected that individual loan amounts will be in a range of EUR 5 – 15 million and that 4-6 banks will participate. Loan amounts will depend on the demand, the individual credit analysis, the due diligence and the overall exposure the EBRD has with the banks or their groups.
Repayment	Repayment of equal semi-annual instalments, to begin 24 months after signing of the loan agreement. Tenors will have an upper limit of 10 years. The majority of the loans are expected to have tenors of 5 years.
Use of Proceeds	Financing will be provided to private companies as well as smaller municipalities for investment projects, which reduce water pollution flowing into the Slovenian portion of the Danube River. A ceiling of 50% of the total loan amount granted to each participating bank would apply for public sector projects. It is expected that less than 25% of the Facility will be allocated to public sector projects. Sub-

	projects will have to meet the credit criteria of the participating banks as well as the environmental eligibility criteria. The independent environmental expert will have to confirm that the latter have been met.
Conditions to subscription/ disbursement	Standard conditions for loan agreements. <ul style="list-style-type: none"> • Confirmation that the banks have approved qualifying sub-loans for a total amount of at least equivalent to the requested disbursement amount. • Confirmation by the environmental expert that these sub-loans meet the environmental eligibility criteria.
Key Covenants	Covenants applicable to the banks will focus on project management and reporting issues, in addition to the usual financial and operational covenants (e.g. capital adequacy, liquidity, and total equity). For the sub-projects, specific covenants will apply for environmental eligibility criteria.
Other Material Agreements	Policy Statement Environmental Eligibility Criteria Contract and Terms of Reference for consultants
Documentation Approach	Standard loan documentation.

3. RATIONALE FOR THE BANK'S INVOLVEMENT

3.1 TRANSITION IMPACT AND BANK STRATEGY

Transition impact potential is good as the project may have demonstration effects throughout the region on how to provide private sector financing through local financial intermediaries for investments resulting in environmental compliance. The project deals with compliance issues of particular complexity as it addresses transboundary pollution problems. By working together with the environmental expert and the specialists provided through the TMG/BAS programme, participating banks will increase their experience in financing environmental investments thus potentially enlarging the number of products that they can offer to their clients. The project will further promote and demonstrate environmental good practice to private and public sector entities, in Slovenia and the whole region. As the majority of sub-loans are anticipated to be below EUR 1 million, it is expected that many SMEs will access the Facility. The demonstration effect on how environmental investments can be financed will be particularly important for this group, as SMEs are among the biggest polluters per unit of output.

The project is in line with the Bank's strategy for Slovenia by contributing to product innovation in the financial sector and to lending to local companies. Including several participating banks in the Facility will ensure competition among banks. The project supports the Bank's Environmental Policy and will promote the implementation of harmonised environmental regulations and standards following EU requirements.

Risk to transition might lie in potential market distortions through the provision of subsidies, the performance of the participating banks and the uncertain sustainability of the programme once the subsidies dry up. To minimise potential market distortions, grant funds have been reserved to carry out broad based marketing campaigns to reach potential sub-borrowers all over the country. Including several participating banks in the Facility will have the same aim. Local banks, some of

which already have a business relationship with the EBRD, will be carefully selected, screened and monitored to ensure good performance.

Sustainability without GEF support will depend on environmental legislation and enforcement in each country. In EU accession countries, pressure on companies to comply with environmental standards and norms will continuously be stepped up over the next years. Firms will sooner or later be forced to invest in environmental projects to reduce fines and certain production costs. By then, participating banks will have acquired skills in financing environmental projects.

As to the replicability of the pilot scheme in other DRB countries, banks welcome the access to long-term financing, which is otherwise still difficult to obtain, particularly in less developed countries in the region and for this type of investments. The participating banks might value the acquisition of new skills, the enlargement of their product line and the extension of their client base. In less developed countries of the DRB, these aspects are expected to be even more important.

3.2 ADDITIONALITY

Additionality is achieved by promoting environmentally oriented operations, which might not be undertaken at this point in time without the provided grant support, thus speeding up the clean up of tributaries of the Danube River. Subsidised funding for this type of projects appears to be limited. The local, state-owned EcoFund provides subsidised financing for environmental projects, but it can not satisfy the demand for environmental investment financing. In addition, the EcoFund has to comply with Slovenian state-aid rules and sub-borrowers have to meet the set conditions. EBRD's involvement is additional because of its capacity to mobilise grants and combine them with commercial financing. Further, EBRD has the capacity to structure the distribution of these funds in an efficient and less distorting way than other mechanisms by co-operating with existing financial intermediaries in the region. Additional value is provided through the Bank's TMG/BAS programme.

This is one of the limited examples of GEF working through the private sector. GEF has stated that one of its key priorities is to increase the involvement of the private sector in GEF financed activities. Benefiting from EBRD's position in the region, GEF funds will be channelled through an existing network of financial intermediaries to the sub-borrowers in an efficient way. The co-operation between the two institutions will result in leveraging GEF grants five times. GEF has stated that this is considerably higher than the average leverage, estimated at 1:2, it has achieved with its projects in the past.

The proposed Facility is additional to the EU accession and structural adjustment funds. While EU funds are substantial, they can not cover all the needs of the country in respect to environmental financing. Additional funding is expected from other financing sources such as the EBRD. Annex 1 provides further information.

3.3 ENVIRONMENT

This project, which is in essence an environmental project, is well in line with the Bank's Environmental Policy. It will provide financing for the alleviation of environmental problems, utilise EBRD's operations to contribute to the implementation of multilateral environmental agreements and contribute to the

building up of the necessary capacity for environmental management in its countries of operation. In addition, it matches EU requirements and should help Slovenian companies and municipalities meet EU water quality standards and norms. Participating banks will increase their knowledge of extending financing to environmental projects and their awareness for environmental matters. The independent environmental expert will ensure that GEF's environmental objectives are met, following the model that was successfully used in the Budapest Bank Environmental Credit Line.

3.4 PROCUREMENT

The Facility will be available to finance private and public sector projects. Under the Bank's Procurement Policies and Rules ("PP&R", section 4.4), public sector recipients of EBRD financing channeled through private banks must apply the Bank's public sector rules. To ensure compliance with these rules, the services of a procurement specialist will be financed through the GEF grant.

- For works contracts under EUR 5 million and goods contracts under EUR 200,000, local competitive tendering in accordance with Slovenian national procedures will be acceptable to the Bank. The procurement specialist will satisfy himself that the sub-borrower's proposed tendering process and tender documentation are in accordance with the national procedures.
- For goods contracts above EUR 200,000 and works contracts above EUR 5 million, open tendering procedures are to be applied. A procurement specialist will review, on an ex-ante and no-objection basis, the tender documents, the tender evaluation report and the contract. A project will only become eligible for financing if the specialist confirms compliance with the Bank's PP&R. The sub-loan amount for this Facility may go up to a maximum of EUR 4.5 million. It is therefore assumed that mandatory open tendering for work contracts greater than EUR 5 million is not necessarily an issue.
- Once the loan has been disbursed to the sub-borrower, the procurement specialist will check that agreed procedures have been followed and that the proceeds of the loan have been used for the purpose of the loan. This will be conducted on an ex-post basis.

3.5 MEASURING / MONITORING SUCCESS

The Facility will be monitored at the level of each participating bank as well as on an aggregate basis. The Bank will monitor each participating bank. Participating banks would be required to provide semi-annual reports on the sub-loans disbursed under the Facility to ensure that the funds are allocated in compliance with the requirements of the Facility, as well as on the bank's financial performance.

To measure the environmental impact and to ensure that the objectives and requirements of the Facility are met, the environmental expert will monitor each sub-project individually. Summary reports after completion of each sub-project as well as a semi-annual aggregate report will be provided to establish the overall results of the Facility, in particular the reduction in water pollution of each sub-project as well as the overall quantity. A procurement specialist will review sub-projects submitted

from public entities to ensure compliance with public procurement rules and the EBRD will be monitoring the review process.

The Bank will monitor the Facility as a whole, aggregating information received from individual monitoring and reporting to GEF on a semi-annual basis. The transition impact will be measured by reporting on the fraction of loans to SMEs, the number of water pollution reduction projects that obtained assistance from the TMG/BAS programme, the number of sub-projects funded through the Facility as well as the number of sub-projects, which have been successfully completed. The latter has to be confirmed by the environmental expert. The broadness of fund availability under the Facility will be measured by reporting on the aggregate market share of all the participating banks. Information dissemination will be measured by the number of hits on the website, which will be created to provide information about the Facility.

4. FINANCIAL / ECONOMIC ANALYSIS

Financial viability for each bank loan will be assessed during the due diligence process. The economic benefits of the project are expected to be higher than its financial return because it will generate substantial global and domestic environmental benefits, which justify the utilisation of grant contributions. Global benefits include (i) reduction of transboundary water pollution in the DRB, (ii) accelerating compliance with national standards before the deadlines established in the legislation, (iii) promoting emission reductions beyond national/EU requirements and (iv) demonstrating innovative nutrient pollution reduction technologies with replication potential in the DRB.

Domestic benefits will accrue to Slovenian companies, municipalities and the society as a whole. Reasons are larger emission reduction as well as the introduction of more cost-effective ways of reducing water pollution to comply with national and EU legislation through the adoption of new technologies. Further replication benefits will be generated by the demonstration of these new technologies, as it will contribute to raising awareness and capacity of Slovenian companies and municipalities to undertake environmental investments. Socio-economic benefits are (i) reduced water treatment costs for municipalities and firms, (ii) reduced costs of compliance with national/EU environmental standards, (iii) reduced health costs due to cleaner water and (iv) improved quality of life in neighbouring communities.

Overall, the environmental impact and as a result the economic impact of the Facility are estimated to be significant. It is, however, impossible to quantify these impacts as the exact nature of the sub-projects and their contribution to the above benefits are not known in advance. Economic benefits will further accrue from the demonstration effect on the financial intermediaries on how to deal with environmental projects. Local banks will be encouraged to engage in this business in the future, thus increasing the range of financing available to private and public entities in Slovenia.

5. KEY RISKS AND SENSITIVITY ANALYSIS

5.1 SENSITIVITY ANALYSIS / RISKS

Risks	Effect	Comments
Credit risk of participating banks (“PB”)	Repayment may be jeopardised	This risk is mitigated by carefully selecting the PBs, some of which already have a business relationship with EBRD. Credit risk will be assessed for each potential PB.
Risk that PBs will not provide loans to sub-borrowers in a timely fashion	Failure to achieve environmental and transition impact	EBRD would have the right to cancel the loans to banks if they are not disbursed in the drawdown period. Unutilised amounts will be transferred to those banks which are disbursing loans the quickest. The administration fee seems attractive to the banks. They will obtain these fees only if disbursements are made to qualifying projects during the availability period.
Low demand for financing	Non-disbursement of funds	With Slovenia’s expected entry into the EU in 2004, pressure to comply with EU standards and state-enforcement for compliance with legislation has increased for polluting companies and municipalities. In preparation of the Facility, a demand study was carried out which confirmed a demand many times more than the EUR 45 million available through this Facility for this type of investments.
Sub-loan quality	Poor project quality at entry may result in disbursement delays and failure to meet the targets of the Facility	The environmental consultant and the associated technical assistance and training will mitigate the risk of not meeting the environmental objectives. The banks will apply their loan approval criteria to ensure the creditworthiness of the sub-borrowers and the soundness of the project from a financial point of view.
Procurement	Non-compliance with EBRD procurement rules and regulations for public sector projects	Each public sector project submitted for obtaining funding from the Facility would have to demonstrate compliance with EBRD and Slovenian procurement rules and regulations. A procurement specialist, financed with GEF grant money, would have to confirm compliance before a public project becomes eligible for a sub-loan from the Facility.
Replicability	Failure to meet objectives of the Facility would have negative impact on subsequent replication in other DRB countries	Slovenia was chosen as a pilot country because its EU compatible environmental legislation creates pressure on companies and municipalities to comply with environmental requirements thus increasing demand for this type of investment financing. Following factors mitigate the risk of non-replicability in other DRB countries: (i) A key element of the concept is to channel funding through the local banks. EBRD has relationships with financial institutions in all its countries of operation.

		<p>(ii) The Facility includes a minimum of pre-determined requirements, which can be easily adapted to different settings.</p> <p>(iii) The Facility makes available grant funding which should facilitate replication in countries with severe constraints on grant funding for environmental purposes.</p> <p>(iv) Environmental compliance is becoming important for all of the DRB countries through their participation in the Danube River Protection Convention. In addition, many of them are in the EU accession process.</p> <p>(v) The GEF is keen to expand the co-operation with EBRD and to channel funding for environmental purposes through the private sector. The GEF has expressed an interest in replicating this Facility, provided its implementation is successful.</p>
Market distortion	Provision of financial incentives to sub-borrowers could distort the market	To mitigate this risk, it needs to be ensured that all potential sub-borrowers have access to the Facility. This will be achieved by including several participating banks in the Facility. Further, the Facility will be advertised broadly throughout the country and beneficiaries will have access to financing on a first come, first served basis. Concessional financing will only be available for specific projects meeting the eligibility criteria, which have to be confirmed by the environmental expert.

5.2 PAST EXPERIENCE

The following paragraphs focus on the Budapest Credit Line and the EBRD/EU SME Financing Facility, which have been chosen as examples of past experience because of their relevance to the proposed Facility. In both cases, the channelling of grant funds via EBRD through its network of financial intermediaries to a large number of sub-borrowers has been efficient and effective.

In December of 1996, the EBRD extended a revolving environmental credit line to Budapest Bank in Hungary, providing funds for on-lending to companies investing in projects with specific environmental benefits. By blending the funds with interest free funds from Phare, sub-loans were on-lent at below commercial interest rates. An independent environmental expert was assigned to prescreen projects, verify the meeting of eligibility criteria and monitor final completion.

Another example of a grant-supported credit line targeting specific types of projects is the EBRD/EU SME Finance Facility. Participating banks in EU accession countries receive a commercial credit line from EBRD, supported by technical assistance and the granting of a performance fee funded by the EU. This facility has been very successful and was extended for the third time in September 2002. As of end of 2002, commitments of EUR 373 million have been granted to 25 banks in 10 countries.

Experiences gathered and lessons learned from the above projects have been taken into consideration for this new Facility. To ensure broad regional coverage and mitigate market distortions, several banks will be included in the Facility. In addition,

extensive marketing campaigns will be carried out to ensure that a large number of potential sub-borrowers learn about the Facility and have a chance to apply for financing. Delays or cancelling of the Facility resulting from slow processing of grant funding by the donor will not apply in this case, as GEF donor funding has already been approved and no delays in disbursements should occur. For this Facility, particular attention has been given to set up the required procedures in an efficient way, keeping the bureaucracy and the time spans associated with sub-project approval to the necessary minimum. To ensure that funds allocated to banks are not laying idle, the drawdown period will be short and funds might be reallocated to more efficient competitors if banks do not manage to disburse them in due time.

To this date, EBRD has received GEF project development funds for the preparation of three projects. Besides this Facility, these include a municipal energy efficiency project in Poland and a geothermal power plant in Mutnowsky, Far East Russia.

ANNEXES

ANNEX 1: EU PRE AND POST ACCESSION ASSISTANCE

Pre Accession:

During the period 2000 – 2006 financial assistance from the European Communities to the candidate countries of central and eastern Europe is being provided through three instruments:

1. The Poland-Hungary Aid for Restructuring the Economy (Phare) programme (Council regulation 3906/89);
2. The Instrument for Structural Policies for Pre-Accession (ISPA, Council Regulation 1267/99), and;
3. The Special Accession Programme for Agriculture and Rural Development (SAPARD, Council Regulation 1268/99)

Phare:

Phare focuses on two main priorities - institution building and *acquis*-related investment. Institution building accounts for some 30% of the budget and is defined as the process of helping the candidate countries to develop the structures, strategies, human resources and management skills needed to strengthen their economic, social, regulatory and administrative capacity. *Acquis*-related investment consists of:

- co-financing of investment in the countries' regulatory framework to strengthen the regulatory infrastructure needed to ensure compliance with the *acquis*;
- co-financing of investment in economic and social cohesion through measures similar to those supported in Member States through the European Regional Development Fund and the European Social Fund.

In 2001, Slovenia was allocated MEUR 21.3 for national programmes and MEUR 7.0 for cross-border co-operation programmes. In 2002 the total Phare allocation for Slovenia was MEUR 41.9¹.

ISPA:

ISPA provides financial support for investment in the areas of environment and transport in order to speed up compliance with European legislation. For the transport sector, funding is aimed at the development of railways, roads, waterways and ports and airport infrastructure. Up to now 50% of the ISPA budget has been spent on railways, with roads being the second most important sub-sector. In the area of environmental infrastructure, ISPA concentrates on the investment heavy directives which concern drinking water, waste water treatment, solid waste management and air pollution. The minimum size of investment is MEUR 5 although individuals projects can be smaller where a number are grouped together. The private sector projects targeted by the Facility would not be eligible for ISPA financing.

¹ The Enlargement Process and the three pre-accession instruments: Phare, ISPA, Sapard – European Commission Enlargement Directorate General, Feb 2002

SAPARD:

SAPARD aims to support efforts to prepare for participation in the Common Agricultural Policy (“CAP”) and the Single Market. The two major objectives of SAPARD are:

- to help solve the priority and specific problems in agriculture and rural development;
- to contribute to the implementation of the *acquis communautaire* concerning CAP and other agricultural policies.

Support under SAPARD should relate to one or more of fifteen measures including agricultural production methods designed to protect the environment and maintain the countryside. Agri-environment schemes proposed by Candidate Countries to date include the management of nature conservation areas, the development and promotion of organic farming, the prevention of erosion and pollution, and the maintenance of farming (particularly extensive grazing) in areas of high natural value. SAPARD funds amount to MEUR 540 (at 2001 prices) and in 2001 the largest allocation was to Poland at MEUR 175 and the smallest to Slovenia at MEUR 6.6. SAPARD funds are to be used for the part financing of proven expenditures incurred by beneficiaries and in no case is the Community contribution to precede the national component of any project.

Post Accession:

Following accession, Candidate Countries should become eligible for the same support as current Member States. After expenditure on CAP, structural operations are the EU’s largest expenditure. The largest portion of resources for structural operations is allocated to the Structural Funds and a smaller portion to the Cohesion Funds. During 2000-2006, the European Union will grant its member states Structural and Cohesion Fund grants totalling €213 billion to undertake projects in a variety of sectors. Many of these projects will be performed by the private sector, in partnership with public authorities.

Structural Fund grants are given to national, regional, and local authorities for, among others, infrastructure and industrial projects in such sectors as telecommunications, energy, tourism, environment, transport, etc. Structural Funds are non-reimbursable grants given to projects which are assessed/approved by relevant local and regional authorities. There are four Structural Funds: the European Regional Development Fund, the European Social Fund, the European Agricultural Guidance and Guarantee Fund and the Financial Instrument for Fisheries Guidance. The objectives of the Structural Funds for the period 2000 – 2006 are:

- to develop regions lagging behind in development;
- the economic and social transformation of areas in structural difficulty;
- the modernisation of policies and systems of education, training and employment.

The Structural Funds also support four Community initiatives, Interreg, Leader, Equal and Urban which target on different themes such as the development of rural areas (Leader).

The Cohesion Funds are designed to support Member States with a per capita GNP less than 90% of the Community average. They support projects in the fields of

environment (50%) and transport (50%) and, currently, cover only four countries: Spain, Portugal, Ireland, Greece. Most of the money is spent on establishing infrastructure such as highways and bypasses in the transport sector, and in the environment sector, on water availability, waste water treatment and solid waste management.

Discussion:

The EU's Agenda 2000 action programme recognised the difficulties that Candidate Countries would face in complying with the requirements of the environmental *acquis*. Even with the assistance of programmes such as ISPA and SAPARD it is estimated that only 4% of investment needs would be covered by EU funds². This means that the vast majority of funding required for environmental investment would need to come from the Candidate Countries themselves. As it is, the Candidate Countries already expend, on average, twice the proportion of their GDP on environmental protection, in comparison to the amount expended in EU Member States currently. It is not immediately evident therefore, how they will find the additional resources required to meet the environmental *acquis*.

Taking the Urban Wastewater Treatment Directive as an example it is estimated that the costs to Slovenia of implementing this directive are 914 MEUR for sewage only, an average of 457 EUR per capita³.

Conclusions:

In terms of the impact of EU funds on the effectiveness of the EBRD/GEF Environmental Facility the following can be said:

- Phare, ISPA and SAPARD funds have well defined objectives, are provided for very specific purposes and are accompanied by a series of clear eligibility criteria.
- These funds are generally provided through public sector bodies and only cover a certain portion of any investment. Other funding is expected from other financing sources such as EBRD.
- For the period 2004 – 2006, the funds allocated to Slovenia by the EU for all environmental purposes amounts to EUR 100 million. Given the needs identified in the demand study for water pollution reduction projects, there is room for additional EBRD financing.

² <http://europa.eu.int/comm/environment/agenda2000/enlargement.htm>

³ Technical Report on Enlargement – J. Jantzen, J. Cofala, B.J. de Haan, Nov. 2000

Annex 2: Summary of Demand Study and Table of Projects

The Demand Study (“the Study”) was initiated in May 2002 as part of the preparatory work for the EBRD’s GEF project submission. It was prepared by the TurnAround Management Group’s Slovenian Business Advisory Service, a grant financed programme aimed at promoting the development of SMEs through the provision of practical business advice.

The main purpose of the Study was to estimate the total demand, within the Slovenian portion of the River Danube Basin, for finance to implement water pollution reduction projects. The principal drivers of that demand include the need for companies and municipalities to comply with current and future environmental legislation and the need for companies to improve their efficiency and reduce costs. The Study covered three key sectors – industry, smaller municipalities and agriculture – and covered a number of issues including:

- current legislation and the current status of the implementation of EU environmental legislation by Slovenia;
- the Slovenian waste water and water use taxation system and future developments;
- water quality status and industrial effluent monitoring;
- other credit and technical assistance available for similar purposes.

Most importantly the Study included the results of a detailed survey of 36 companies to understand their basic business, their current problems with regard to water pollution issues and the solutions envisaged including potential financing needs. Most of the companies surveyed were located in two areas/basins – the Lower Sava (Sevnica, Krško, Brežice, Jrastnik) and the Middle Sava (Ljubljana and Domžale). The survey also includes some companies from other areas to get a broader sectoral spread. From this survey an extrapolation was made to produce an indication of the national demand for water pollution financing.

The Study estimated that total demand for investments aimed at reduction of water pollution in the Danube area of Slovenia (covering 81% of the surface) in the private/industrial sector would be € 384 mio. This demand is covering the timeframe of 2003-2007.

The Study also estimated that, for the public sector Waste Water Treatment Programme, an additional € 593 mio. would be required in the timeframe of 2002-2010. At least € 168 of this sum is to be expected as requirement for additional funding i.e. potentially from a targeted credit facility such as that proposed by EBRD.



European Bank
for Reconstruction and Development

Mr Len Good
Chief Executive Officer and Chairman
Global Environment Facility
1818 H Street, N.W.
Washington D.C. 20433
U.S.A

20th June 2003

Dear Mr. Good,

Subject: Slovenia: EBRD / GEF Environmental Credit Facility (formerly entitled Slovenia: National Pollution Reduction Project)

I am pleased to attach final documentation for the above-mentioned project which was approved by the GEF Council at its meeting of 14th – 15th October 2002. As per paragraph 30 of the GEF Project Cycle we are submitting this project for circulation of the members of the GEF Executive Council and, subsequently, for your final endorsement.

Attachments to this letter are:

- A copy of the final documentation submitted to the EBRD Board of Directors.
- A copy of the Bank's response to the GEF Secretariat's Concept Agreement Review.

Please note that we have changed the title of the project to better reflect the exact nature of the project. The aims of the project remain exactly as previously proposed to GEF and approved by the GEF Council.

We look forward to your endorsement in due course and should you require any further information please do not hesitate to contact me or my staff.

Yours sincerely,


Dr Alistair Clark
Director, Environment Department

Cc: K. King, R. Khanna, H. Acquay, A. Duda, R. LeBaron, B. Maser-Mallor,
W. Kennedy, A. Schmidt, M. Hughes