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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL
Twenty-eighth Meeting
Montreal, 14-16 July 1999

REPORT ON CONCESSIONAL LENDING
(A Discussion Paper by the Secretariat)

This discussion paper is submitted by the Fund Secretariat in response to the Decision 27/84 under which the Executive Committee decided:

(a) To request the Secretariat, in cooperation with the Implementing Agencies, to prepare a document for the Twenty-eighth Meeting of the Executive Committee containing a compendium of past decisions and describing experiences so far with loan components;

(b) To request the Secretariat and the Implementing Agencies to collaborate on real-life scenarios, highlighting issues and problems that might be associated with them, including such concerns as the lack of management capacity in some countries and the fear of augmenting the national debt of countries that were already in economic crisis;.

(c) To consider this subject again at the Twenty-eighth Meeting.

The paper includes two parts: Part I is a compendium of the decisions of the Meetings of the Parties and of the Executive Committee on loans and the experiences of the Multilateral Fund on loans and projects with loan components. Part II is a discussion of the real-life scenarios of funding ODS phase out with loans in Article 5 countries.

PART I

(A) A COMPENDIUM OF DECISIONS AND EXPERIENCES OF THE MULTILATERAL FUND ON CONCESSIONAL LOANS

Decisions

1. Time: 1990

   Context: London Amendment adopted at the 2nd Meeting of the Parties:

   Decision: " The Multilateral Fund shall, meet on a grant basis or concessional basis as appropriate, and according to criteria to be decided upon by the Parties, the agreed incremental costs."

2. Time: 1991

   Context: Implementation Guidelines and Criteria for Project Selection approved at the 3rd Meeting of the Executive Committee:

   Decision: " Assistance for investment projects shall generally be provided in the form of grants. However, where the investment project has a short payback period (e.g. one to two years), financing may take the form of highly concessional loans. If an Implementing Agency believes that a highly concessional loan is appropriate for a particular project, it shall recommend this action at the next meeting of the Executive Committee. The Committee shall make the final decision on the terms of assistance."

3. Time: 1995

   Context: Consideration of operating cost and savings in the halon portable fire extinguisher sub-sector at the 16th Meeting of the Executive Committee:

   Decision: " The World Bank should be asked to prepare a study on how to set up a concessional loans mechanism; i.e., what options were available given current Implementing Agencies and their procedures, what steps would be required to put the mechanism in practice, and to what extend could the Bank use its resources or the resources from other sources for phase out in Article 5 countries."

4. Time: 1995

   Context: Actions to Improve the Financial Mechanism for the Implementation of the Montreal Protocol, taken at the 7th Meeting of the Parties:

Decision: " Action 10: The study by the World Bank on the establishment of a concessional loan mechanism, requested by the Executive Committee at its Sixteenth Meeting, should be completed as soon as possible, and analyzed and discussed by the Executive Committee at its Nineteenth Meeting, and a decision on suitable future steps be taken by the Executive Committee by its Twentieth Meeting or by the Meeting of the Parties in 1996, as appropriate, with a view to starting the use of the concessional loans by the end of 1996, to the extent that the need and demand exist."

5. Time: 1996

Context: Consideration of a joint paper by the Secretariat and the World Bank on concessional loans at the 20th Meeting of the Executive Committee:

Decision 20/39: The Executive Committee decided:

"(a) To take note of the joint World Bank/Fund Secretariat document on concessional lending for ODS phase-out;

(b) To take note of the information provided during the discussion in the Committee on the interest expressed by the Inter-American Development Bank in providing concessional loans for ODS phase-out and the possibility of mobilizing funding from other sources, including the private sector;

(c) To note also the reservations expressed by some members of the Committee with respect to the provision of concessional loans from the Multilateral Fund;

(d) That, in the light of the discussion at the current meeting of the Executive Committee, there was a need for a wider examination of the various possibilities of concessional lending for ODS phase-out;

(e) To request the Secretariat and the World Bank to prepare for submission to the Executive Committee, through its Sub-Committee on Financial Matters, a further report exploring the practical options for providing concessional loans for ODS phase-out in Article 5 countries, *inter alia*, through regional development banks and the private sector."

6. Time: 1997

Context: 21st Meeting of the Executive Committee:

Decision 21/39:

"(a) To invite the Secretariat and the implementing agencies to submit for the consideration of the Executive Committee an innovative proposal for a demonstration project or projects to illustrate how concessional lending and other forms of innovative funding, including financing from the private sector, can be used to advance the phase-out of ozone-depleting substances by providing funding for projects and activities that may or may not otherwise be eligible for full funding in the form of grants from the Multilateral Fund;

(b) To approve the request of the World Bank for US $60,000 toward the cost of a concessional financing study to be carried out by the International Finance Corporation with a view to providing the Executive Committee with a comprehensive report that would:

(i) Explore ways in which private-sector finance can be mobilized to assist Article 5 countries in phasing out ozone-depleting substances, particularly in sectors with a good return on investments in ozone-friendly technologies;

(ii) Provide a final theoretical overview of ways in which concessional funding and other forms of innovative funding, including on-lending, can be used to augment and make most effective use of the resources of the Multilateral Fund."

7. Time: 1997

Context: Consideration of the chiller replacement project from Thailand at the 23rd Meeting of the Executive Committee:

Decision 23/30:

"(a) To request the World Bank to consider how innovative funding could be applied to this or a similar project;

(b) That any project along these lines should be considered in the context of the paper on concessional loans currently being prepared by the World Bank."

8. Time: 1998

Context: Consideration of a concept paper from the United States on concessional loans at the 24th Meeting of the Executive Committee:

Decision 24/62:

"(a) To request members of the Executive Committee to submit their thoughts on the issue of concessional loans, in writing, to the Secretariat by the end of April;

(b) To request the Secretariat to circulate those views to all members of the Executive Committee before the Twenty-fifth Meeting of the Executive Committee;

(c) To request the World Bank to submit to the Twenty-fifth meeting of the Executive Committee the results of its study on concessional loans, and to resubmit its project proposal on concessional loans in accordance with Decision 23/30; and

(d) To undertake substantive discussion on the subject of concessional loans at its Twenty-fifth Meeting."

9. Time: 1998

Context: Consideration of a study by the International Finance Corporation of the World Bank Group on the scope for a non-grant financing facility for ODS phase out at the 25th Meeting of the Executive Committee:

Decision25/53: "establish an open-ended contact group, with no specific terms of reference to consolidate all views and formulate a consensus on concessional lending. The group should begin its discussions immediately and should report back to the next meeting of the Executive Committee."

10. Time: 1998

Context: Consideration of the report from the convenor of the open-ended group at the 26th Meeting of the Executive Committee:

Report of the open-ended group:

"Progress was made by the Group in getting a better understanding of both the fears of countries in initiating concessional financing, and the broad conceptual framework under which such financing could exist;

There was agreement that it would be useful to more fully develop potential models for such financing, and provide examples, which, to the degree possible, describe how the fears were addressed;

There was agreement that it would be useful to ask implementing agencies, bilateral donors, Article 5 countries and companies to, if they desired, bring forward innovative ideas in this area for the Executive Committee's consideration."

11. Time: 1999

Context: Consideration of a paper from the United States on concessional loans at the 27th Meeting of the Executive Committee:

Decision 27/84:

(a) "To request the Secretariat, in cooperation with the Implementing Agencies, to prepare a document for the Twenty-eighth Meeting of the Executive Committee containing a compendium of past decisions and describing experiences so far with loan components;

(b) To request the Secretariat and the Implementing Agencies to collaborate on real-life scenarios, highlighting issues and problems that might be associated with them, including such concerns as the lack of management capacity in some countries and the fear of augmenting the national debt of countries that were already in economic crisis.

(c) To consider this subject again at the Twenty-eighth Meeting."

(B) EXPERIENCE OF THE MULTILATERAL FUND WITH LOAN COMPONENTS

12. With the exception of the Thai chiller project approved at the 26th Meeting, funding from the Multilateral Fund has been in the form of grants. In a few cases, the grants were transferred either partially or entirely into loans. Experiences of USEPA, UNDP and the World Bank in this respect were shared with the Secretariat. UNIDO referred to a project which it is currently preparing jointly with bilateral partners in Cuba for chiller replacement and which has a lending component, but did not provide any detail.

<u>USEPA/UNDP: The global mobile air-conditioning (MAC) project</u>

<u>Project Data:</u>

Date of project approval by the Executive Committee:
First phase of the project approved in Oct. 1992
Second phase approved in Nov. 1996, and
Third phase approved in Nov. 1998.

Nature of funding (loan v. grant): Grant from the Multilateral Fund to 20 participating countries however in 4 of these countries the grants from the Fund <u>are managed as a combination of grant and a revolving fund</u>. These countries include Colombia, Costa Rica, Dominican Republic, and Guatemala.

Objective of the project: Implement a national CFC recovery and recycling programme in the MAC sector in the participating countries.

Level of funding approved:
US$ 318,584 for the first phase,
US$ 500,000 for the 2nd phase
US$ 250,000 for the 3rd phase.

Project impact (to-date): Data not available.

Status of implementation: On-going.

Management structure:

USEPA and UNDP: The division of labour between UNDP and USEPA under the project is that UNDP is responsible for procurement and delivery of the equipment and USEPA is responsible for the training and field management of the project.

USEPA and the local agent: In the four countries where the revolving fund is implemented, local agents involved include ozone office in three countries, Colombia, Dominican Republic and Guatemala and a local bank in Costa Rica. To regulate the relationship between USEPA and the local agents, the arrangement under the existing institutional strengthening project is used for the ozone offices however a separate agreement will be signed in Costa Rica where a local bank is used.

Management cost: The administrative cost which is paid to the local agent is collected from the funds which is paid back by the enterprises which participate in the revolving fund programme. In percentage-wise, it comes to a range between 9% to 30% of the funds paid back.

Operating procedure:

The basic structure of the programme in each of the 4 countries is the same. The grant from the Fund is used to pay for the training of the garage owners on the recovery and recycling equipment, as well as for the purchase of the equipment. A percentage of the equipment cost, ranging between 10% to 40% of the cost has to be paid back by the owners over a period of time..

The funds paid back are used to pay the administrative cost of the local agent and the procurement of additional equipment for another group of garage owners.

In the case of Costa Rica, the scheme will be implemented by a local bank using a small business-lending programme subsidized by the Government. The participating garages will be required to pay back 60% of the equipment cost which is provided as a loan.

Eligibility criteria: A willingness to participate, demonstrated by readiness to attend full day training and to remodel the garage to accommodate the new equipment; access to electricity; operating at a fixed location to store the equipment overnight and safeguard it against theft.

Review/appraisal process: Data not available.

Monitoring: Data not available.

Conditions of financing:

Interest rate (as against local commercial rate): In three of the 4 cases, the programme operates on an interest-free basis for the part of equipment cost that has to be repaid. In

Costa Rica, the interest rate from the local bank managing the programme is going to be 18%.

Need for collateral; Not required.
Grace period: A few months.
Payback period: One year.
Default rate : Data not available.

Experiences and Lessons

13. Based on the information provided on the implementation of the grant-based revolving fund under the global MAC project, the experiences and lessons learnt so far can be summarized as follows:

(a) Clear policy statement from Multilateral Fund that for certain types of projects concessional lending is the only alternative.

(b) Sustained incentive of local agent to ensure: the equipment selection meets the local needs, the equipment is transferred to local operators in timely manner and is not charged taxes, money is repaid and the continued use of the equipment.

(c) The necessity of a legal and administrative infrastructure to deal with the programme.

(d) The rate of repayment by participating garage owners should be reasonable to provide an incentive.

(e) A 10% administrative cost collectable from repaid funds is reasonable.

The World Bank

14. The World Bank provided information on the Thai chiller project, the Multilateral Fund's only loan programme to-date. However, the Bank could not provide any information on the implementation of the on-lending programme in Turkey, the first of such programmes of the Multilateral Fund.

The chiller replacement programme in Thailand:

Project Data:

Date of project approval by the Executive Committee: Nov. 1998
Nature of funding (loan v. grant): Concessional loan.
Objective of the project: Implement a pilot chiller replacement programme using loans.
Level of funding approved: US$5 million (including US$2.5 million from GEF)
Project impact (to-date): 13.2 ODP tonnes from direct phase out
Status of implementation: On-going

Management structure:

World Bank and the local agent: As this is a lending from the Multilateral Fund, this project is not governed by the existing grant agreement between the World Bank and the Government of Thailand for the grant-based programme. Instead a new loan agreement will have to be signed and for that the approval from the Thai Cabinet is necessary.

Local arrangement: Two options are being explored: One is to have the Electricity Generating Authority of Thailand (EGAT) to be the borrower from the Multilateral Fund through the World Bank while the Ministry of Finance will be the guarantor of the loan. In order to have the Ministry of Finance to be the guarantor, approval by the Cabinet of the project is needed.

Option Two is to have the financial intermediary, the Industrial Finance Corporation of Thailand (IFCT) to be the borrower. For that IFCT needs to include a provision to borrow these funds from the Multilateral Fund and GEF in its annual debt-repayment plan. As the major shareholder of IFCT is the Thai Government or the Ministry of Finance, IFCT requires a cabinet approval of its debt-repayment plan.

Management cost: Since the World Bank will hold the local agent responsible for the commercial risk, the local agent will require a management fee to cover the risk and the administration. The actual rate is being negotiated.

Operating procedure:

There will be an agreement/contract between the borrower (EGAT or IFCT) and the chiller suppliers for providing the equipment, installation and service for the life of the chiller. The borrower will maintain the ownership of the chillers and the building owners will pay nothing at the time of installation. Every month after installation of a chiller, the borrower will send a bill to the building owner an amount equal to the value of the electricity savings resulting from the replacement of the old chiller. The proceeds so collected will be used to repay the loan from the Multilateral Fund and GEF, and buy new chillers for another group of building owners and cover the cost of programme management incurred by the borrower.

Eligibility criteria: Criteria for selecting candidates for the programme include willingness of the building owners to repay a portion of the energy savings to the borrower, age of the chiller, CFC leakage rate of the chiller, amount of CFC in the chiller, and baseline energy consumption.
Review/appraisal process: Will be done by the local agent on the basis of financial profitability as a loan application in addition to the criteria above.
Monitoring : Will be done by the local agent, with periodical report to the World Bank.

Conditions of financing:

Interest rate (as against local commercial rate): An interest-free loan from the Multilateral Fund. The rate charged by the local agent on the building owners is not known.
Need for collateral: The local agent will require all participating owners to provide a letter of credit from their banks with the value equal to the amount of the outstanding loan.
Grace period: None. Repayment starts once the new chiller is up and running.
Payback period: Four to seven years..
Default rate : Not applicable.

PART II

REAL-LIFE SCENARIOS OF CONCESSIONAL FUNDING OF ODS PHASE-OUT IN ARTICLE 5 COUNTRIES

Background

15. Decision 27/84 emanates from the Executive Committee discussion on a paper on concessional lending submitted by the United States to the 27th Meeting which tried to address the fears of the Article 5 countries associated with initiating a lending programme either under the Multilateral Fund or through external financing. While acknowledging the concepts proposed in the paper, the Executive Committee wished to see how those concepts could be put to practice under the real situations in Article 5 countries and in the process highlighting issues and problems that might be associated with them, including such concerns as the lack of management capacity in some countries and the fear of augmenting the national debt of countries that were already in economic crisis.

16. Based on the experiences the Fund has acquired on funding loans and project with loan components, the following scenarios are developed for a discussion of the issues raised by the Executive Committee. The last one is included to show other potential use of loans.

17. Scenario 1. The use of a loan to cover a portion of the costs of conversion of a refrigerator manufacturer - on lending.

In the Arcelick project approved for Turkey, the government decided independently of any Fund requirement, that the refrigerator manufacturer was in such sound financial condition, that it did not need a full grant for the conversion. Accordingly, the government proposed that it would take the full grant that the firm was eligible for under existing Executive Committee rules, and provide a portion of those funds to the firm in the form of a loan. It further proposed that the loan money paid back to the government would be used by the government to fund additional ODS reduction activities.

18. Issues Raised by the Executive Committee:

(a) **Management Capacity**: In this case, the government assumed the responsibility for collecting the loan money from the firm. In some cases, governments and/or ozone units may not have the management capacity or authority to collect money directly from a private firm. In such cases, the collection task could be given to an outside entity, such as a bank. The outside entity would have to be given some amount of money to cover its costs of collection and management of the funds.

(b) **Increasing foreign debt burden**: In this case, the grant from the Fund is managed by the country as a loan, and the government did not assume a debt to the Fund or to any other institution. Indeed, even if the firm defaulted on the loan, the government would owe no one any funds.

19. Additional Practical Issues for Wider Implementation:

(a) **Development of guidance for determining when a loan would be warranted**: The Executive Committee might like to consider identifying the circumstances under which a firm might not need full grant funding to effectuate its phaseout.

(b) **Determining what rules, if any, should guide expenditure of funds paid back from the loan**: The Executive Committee might like to consider rules guiding how the funds repaid can be expended on activities such as other national projects or the enhancement of institutional strengthening funds.

20. Scenario 2 – Development of a recycling project:

In the case of the US recovery and recycling project in the Dominican Republic, the US agreed with the Dominican Republic to deploy 23 sets of recovery and recycling machines. Participating shops were required under the project to pay 40% of the costs of the equipment as follows: 5% at the time of training, 20% when the equipment was delivered, and then 3 monthly payments of 25%. The ozone unit collected the payments and was given $2,000 (approximately 10% of the sum collected) as a management fee. The funds collected were used primarily to purchase a second round of equipment for additional shops. Shops that did not make their payments had their equipment confiscated for redeployment to other shops.

21. Issues Raised by the Executive Committee:

(a) **Management Capacity**: In this case, the ozone unit assumed the responsibility for collecting the loan money from the firm. In some cases, governments and/or ozone units may not have the management capacity or authority to collect money directly from a private firm. In such cases, the collection task could be given to an outside entity, such as a bank. The outside entity would have to be given some amount of money to cover its costs of collection and management of the funds.

(b) **Increasing foreign debt burden**: In this case, the grant from the Fund was managed in the country as a loan. The government did not assume a debt to the Fund or to any other institution. Indeed, even if the firm defaulted on the loan, the government would owe no one any funds.

22. Scenario 3 – A Concessional Loan for Chiller Replacement in Thailand:

In this case, a local institution in Thailand will get chiller owners to submit letters of credit to secure a loan for the purchase of new chillers. On this basis, the government of Thailand would be able to guarantee repayment of the loan in the case of default by any of the chiller owners. With this arrangement, the Multilateral Fund and GEF were able to provide a loan to the government to facilitate the purchase of 24 new CFC-free chillers.

This project was designed to demonstrate that the purchase of new energy efficient chillers was cost effective in its own right.

23. Issues Raised by the Executive Committee:

(a) **Management Capacity**: In this case, the government will delegate the collection and loan management task to a local institution which would be given a fee to undertake this task.

(b) **Increasing foreign debt burden**: The case of the Thai chiller project approved by the Executive Committee is different from the two cases above, in that in the Thailand case, the Multilateral Fund can be seen as the direct lender, and the country is responsible for repayment of the loan in the case of failure. While this can be seen as potentially increasing the foreign debt of the country, by securing letters of credit from the chiller owners prior to accepting the loan, the government has ensured that any losses would be covered by the chiller owner and not the government.

24. Scenario 4 - Loans from a bank - Loan Guarantees/Interest buy downs by the Fund:

In this scenario, a refrigerator manufacturer who is found to be financially secure and not in need of a full grant to effectuate its conversion, is seeking to have 50% of the cost of the project in the form of a loan. The firm notifies the relevant implementing agency of its primary lender, and the Fund/agency agrees with the lender to guarantee the loan. Because the loan is guaranteed by an international funding entity, and risk is reduced, the lender can afford to charge an interest rate that is lower than the typical one charged in the country. The Fund may also chose to buy down that interest rate further.

25. Issues Raised by the Executive Committee:

(a) **Management Capacity**: In this case, the government would assume no management role. The role would be assumed by a bank.

(b) **Increasing foreign debt burden**: In this case, the government did not assume a debt to the Fund or to any other institution. Indeed, even if the firm defaulted on the loan, the government would owe no one any funds. Instead, the Fund would have to repay the loan.