Financial barriers to investments in INOGATE countries

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Getting credit in INOGATE countries is on average more difficult than in OECD countries

Country Name	Strength of legal rights index (0-10)	Depth of credit information index (0-6)	Public registry coverage (% of adults)	Private bureau coverage (% of adults)	Overall ranking of ease of getting credit (out of 183)
Eastern Europe & Central Asia	7	5	16.2	29.4	N/A
OECD high income	7	5	9.5	63.9	N/A
Armenia	6	6	23.7	46.6	40
Azerbaijan	6	5	15.6	0	48
Belarus	3	5	49.5	0	98
Georgia	8	6	0	29.6	8
Kazakhstan	4	5	0	37.6	78
Kyrgyz Republic	10	4	0	18.7	8
Moldova	8	4	0	3	40
Tajikistan	2	0	0	0	177
Turkey	4	5	23.8	60.5	78
Ukraine	9	4	0	17	24
Uzbekistan	2	3	5	3.6	159

Source: Doing Business 2012

1. Financial sector constraints

- **High cost of borrowing,** especially for longer-term capital investment intense projects, due to

  a) high cost of funds for banks (costs of deposits grew significantly due to reduced liquidity following the economic crisis),

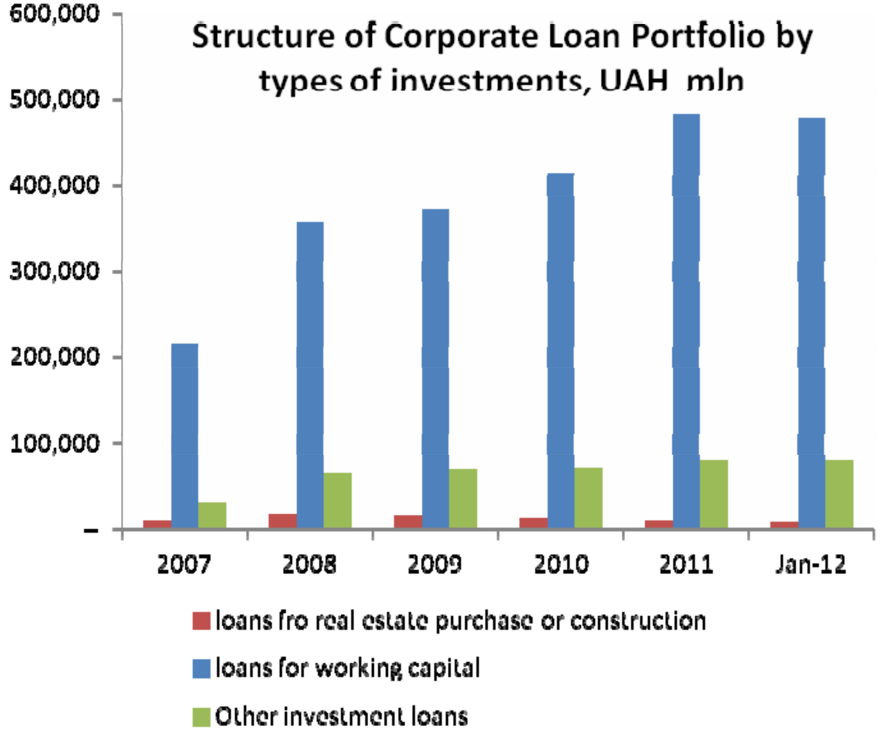
  b) High macroeconomic risks, making credit risks higher, and

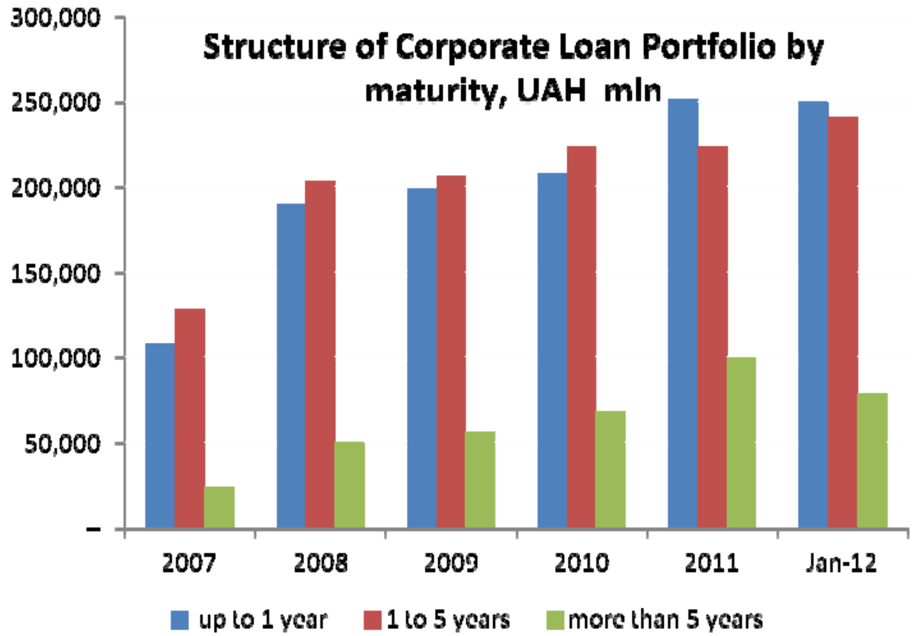
  c) high level of non-performing loans and low level of income generating assets increase banks' losses, requiring higher margins.

- **Short-term loan maturities:** Banks' funding structures are typically short term deposits since interbank market and capital markets/bonds market are small and insufficient. A long-term, local currency capital market/funding base is often lacking - institutional investors such as investment, mutual, pension funds are limited and their investment volumes are low compared to bank loan books. As a result, banks prefer to lend short term which is inefficient for project finance.

- **Foreign exchange risk/currency mismatch:** Project financing is often available in foreign currency, but is limited to export/FX generating companies for a maturity of up to 10 years, funded primarily by parent banks or IFIs. In some countries, such as Ukraine, FX lending is prohibited for households and corporates without FX proceeds.

1. Financial sector constraints – Example Ukraine





The majority of corporate loans are loans for working capital purposes with maturities of up to 1 year

1. Financial sector constraints (cont'd)

- **General reluctance to lend after the economic crisis**, due to
  - ongoing high loan loss provisions
  - impact of de-leveraging of European banks on subsidiaries in other countries

- **Poor payment discipline of borrowers** (e.g. in the case of politically influential clients) increase risks and reduce banks' appetite for new lending.

- **Poor contract enforcement:** Contract enforcement, creditors rights protection and judicial system need to be strengthened to renew active banking sector lending to the economy.

- **Limited banking sector skills and capacity of project financing**, **including in energy efficiency and renewable energy:** Specialty knowledge in new business areas such as lending for EE and RE projects and ability to oversee complex projects is still insufficient, often limited to banks' physical control of collateral and monitoring of clients' payment discipline, with limited control and understanding of sector and project risks (macro and micro) and without proactive involvement in project management (and restructuring if necessary)

2. Real sector (borrower) constraints

- **Limited creditworthiness** due to
  - Unstable sector environment including legal framework
  - Tariffs at below cost-recovery levels do not allow to recover investments
  - Over-indebtedness of utilities
  - High overheads (such as labor costs)
  - Weak corporate governance and government interference, especially in case of SOEs

- **Lack of capacity to prepare bankable projects in EE and RE**
  - Potential borrowers such as municipal utilities or homeowner's associations are often not familiar with requirements of IFIs or commercial banks
  - Limited funding available for technical feasibility studies (e.g. for municipal utilities)

How IFIs can help – World Bank Instruments and Services

- **Financial Instruments**
  - Long-term Investment Loans (IBRD loans; IDA credits) to finance EE and RE projects directly (borrower: sovereign/sub-sovereign entity with sovereign guarantee)
  - Long-term Credit Lines to commercial banks for EE and RE projects
  - Development Policy Loans (DPLs) – to address policy requirements such as tariffs
  - Partial Risk Guarantees (PRGs) – IBRD and IDA – credit enhancement
  - Clean Technology Fund (CTF) – Global Trust Fund for climate action – co-financing of EE projects
  - Carbon Funds – Green Investment Schemes; GEF-Grants – co-financing of EE projects
  - <u>Some project examples:</u>
    - *Ukraine Energy Efficiency Project*: USD 200 mm credit line to UkrExIm Bank and other participating banks for EE projects in the industrial and municipal sectors
    - *Turkey Private Sector RE and EE Project*: USD 500 mm credit line to two private commercial banks for EE and RE projects, USD 100 mm co-financing from CTF
    - *Turkey Energy and Environment Development Policy Loan Program* to support energy sector reforms, climate change strategy, environmental management

Knowledge Services

- Technical Assistance – including trust funds and fee-based services (FBS)
- Sector Studies (regional study on EE ongoing)
- Policy Advice and Dialogue

How INOGATE can help

- Financing bankable feasibility studies for EE and RE projects
- Conducting training for commercial banks in analysis, evaluation and approval of EE and RE projects
- Reviewing commercial banks’ credit procedures, systems and approvals and facilitating modernization/upgrades