

ANNEX 3 – ANNUAL ACTION PROGRAMME 2012 FOR UKRAINE PART 1

1. IDENTIFICATION

Title/Number	Third EU Contribution to the Eastern Europe Energy Efficiency and Environment Partnership Fund (E5P) CRIS: ENPI/2012/023-716		
Total cost	EU contribution: EUR 15 million Pledged co-financing: EUR 51,812,618 (see breakdown in section 2)		
Aid method / Method of implementation	Joint management with the European Bank for Reconstruction and Development (EBRD)		
DAC-code	23010	Sector	Energy policy & Administrative Management

2. RATIONALE

The Fund was officially launched at a Pledging Donors Conference in Stockholm on November 26th, 2009, co-chaired by the EU, as part of the Eastern Partnership. The EU has pledged a contribution of EUR 40 million over the period 2010-2013 and has already paid in EUR 25 million.

The third EU contribution to the E5P Fund will come after positive development on the start of operational implementation of the first E5P Funded projects approved during the first Assembly of Contributors that took place in London on November 11, 2011.

The Assembly approved 7 energy efficiency projects, with a total budget of EUR 143 million of which a maximum of EUR 31 million in grant funding from the Fund. The cities in which these projects are to be implemented are Zhytomyr (Rehabilitation of the district heating system implemented by EBRD), Mykolaiv (EIB - drinking water and waste water treatment), Rivne (pilot District Heating project implemented by NEFCO), Lviv (Rehabilitation of the district heating system implemented by EBRD), Ternopil (Rehabilitation of the district heating system implemented by EBRD) and Zaporozhe (Rehabilitation of the district heating system implemented by EBRD), as well as 10 pilot projects to be implemented in small to medium size cities in Ukraine under the NEFCO's DemoUkraine Project.

As EUR 51 million had already been paid into the Fund by 29 February 2012, which allows the financing of all the projects agreed at the first Assembly's meeting and a remaining EUR 20 million to finance further projects. A table summarising the instalment as of 29 February 2012 is given here after.

The promising pipeline of projects call for this third contribution:

- Two projects already presented for information during the first Steering Group (Donetsk Oblast District Heating by EBRD and Lviv) will required a EUR 12.5 million of grant financing
- Six projects presented during the 3rd Steering Group on 30 March 2012 (NEFCO/EBRD Cherkassy district heating project, EBRD's public buildings energy efficiency projects in Dnipropetrovsk, EBRD Donetsk district heating project, NEFCO/EBRD Donetsk project on district heating rehabilitation in Voroshilovskiy Kievskiy districts, EBRD Lutsk district

heating project, EBRD Sevastopol district heating project and NEFCO's Zhytomyr energy efficiency in public buildings) will require further grant financing in the range of EUR 21 million.

- The Ukrainian Government has presented six interesting projects that constitute opportunities for the coming years (these projects will have to be developed by an Implementing Agency to be considered by the Assembly of Contributors).

A EUR 15 million EU 3rd contribution will allow the funding of the above mentioned projects that have already been proposed by Implementing Agencies.

A further contribution could be envisaged depending on the need of the Fund, on the will of other contributors to increase their pledges, on the results achieved by the first project and on the progress made by the reforms in the sector.

Contributor	CA Signed	Pledged	Paid in
Denmark	✓	5,000,000	2,689,871
Estonia	✓	160,000	64,000
EU	✓	40,000,000	25,000,000
Finland	✓	2,000,000	500,000
Iceland	✓	56,842	56,842
Latvia	✓	50,000	10,000
Lithuania	✓	28,962	28,962
Norway	✓	5,000,000	3,819,751
Poland	✓	191,814	191,814
Sweden	✓	24,000,000	16,367,722
Ukraine	✓	10,000,000	2,000,000
USA	✓	5,325,000	1,184,179
Total, Euro		91,812,618	51,913,141

Summary of contributions to the E5P Fund, 29.02.2012

2.1. Sector context

Ukraine has inherited a very inefficient energy system from the USSR, which was still affordable when energy (mostly imported from Russia) was relatively cheap. This is no longer the case today with rising energy prices. The authorities are therefore committed to improving energy efficiency in all spheres (industries, housing) in order to decrease energy consumption.

By joining the Energy Community on February 1, 2011, Ukraine has now the obligation to implement part of the *acquis communautaire* related to energy efficiency, e.g. implementation of the directive 2010/30/EU on the indication by labelling and standard product information of the consumption of energy and other resources by energy-related products, the directive 2010/31/EU on the energy performance of buildings, and the directive 2006/32/EC on energy end-use efficiency and energy services. Implementation of the *acquis communautaire* requires

the preparation of a National Energy Efficiency Action Plan that will give to Ukraine a framework to foster the development of its energy efficiency potential.

The Ukrainian Energy Strategy till 2030, adopted in 2006 and currently under revision, calls for substantial energy-saving measures in all industries, as well as for a noticeable increase in the use of renewable energies, from current 0.1 billion kWh up to 2.0 billion kWh by 2030. The Government has launched a number of measures to promote investments in renewable energies, starting with the introduction of green tariffs and tax incentives, and has set ambitious targets to replace or upgrade obsolete equipment in the industrial and residential sectors, in order to significantly decrease energy consumption and CO2 emissions.

These efforts can lead to concrete results only if they are supported by private investment and significant public funding. In this perspective, the Swedish Presidency of the EU had in the context of the Eastern Partnership proposed in mid-2009 the creation of a Donors Fund that would help countries in the region to finance, through a combination of loans and grants, projects aimed at improving energy efficiency and promoting the use of renewable energies. The initial geographical focus is Ukraine but the Initiative is likely to expand, as appropriate, to the other countries of the Eastern Partnership (Armenia, Azerbaijan, Belarus, Georgia and Moldova).

2.2. Lessons learnt

The EU has already contributed to ERBD-led Funds in Ukraine (e.g.: Chernobyl Shelter Fund) and cooperation with the Bank is good. EBRD also implements a number of investment projects in Ukraine under the Neighbourhood Investment Facility.

For what concerns operations in Ukraine, however, special attention will have to be paid to the complex regulatory framework around renewable energies, energy efficiency and environment. This framework is expected to evolve positively with Ukraine having joined the Energy Community. Technical and financial cooperation provided by several donors (including a large EU budget support, EU funded technical assistance including upcoming twinning) will strongly contribute to this improvement.

2.3. Complementary actions

The launch of the E5P initiative coincided with the Copenhagen conference on climate change. Environment/energy issues are still high on the global agenda, as well as in the EU and in Ukraine.

All major donors have been supporting reforms towards the improvement of energy efficiency in Ukraine for many years. Of particular relevance are the following ongoing initiatives and projects:

- The **EUR 63 million on going EU Budget Support** on Energy Efficiency. The Budget Support focuses on five areas: policy framework (review of the national energy strategy, implementation of state programmes), legislative framework, public finance management (performance analysis of the EE programmes); EE measures (energy balance, public awareness, and access to financing); policy outcomes (reduction of energy intensity; reduction of losses). This Budget Support is accompanied by a EUR 3.2 million technical assistance and a call for proposals targeting energy efficiency measures in small Ukrainian municipalities. 10 small grant projects will be financed for a total budget of EUR 1.5 million. An EU Twinning project is being implemented.

- The **EU's INOGATE** energy programme has been assisting Ukraine (and other countries in the region) to pave the way for investments in the field of renewable energy and energy efficiency through assistance to legislative and policy reforms. In the frame of INOGATE, the regional Energy Saving Initiative in the Building Sector (ESIB) project was launched in January 2010 for four years; furthermore, the project 'Support to Market Integration and Sustainable Energy' (SEMISE) provides support to the creation of a positive environment for sustainable energy investments including in cooperation with IFIs.

- Under the **EU Covenant of Mayors** initiative, 23 cities of Ukraine have now taken the commitment to go beyond the target of 20% CO2 reduction by 2020 through the implementation of Sustainable Energy Action Plans.. Implementation of those Sustainable Energy Actions Plans should be supported by the Fund created under the E5P initiative where possible. A specific technical assistance project in support of the Covenant of Mayors in the region has started and a branch office of the Secretariat is based in Lviv.

- The EU financed **Community Base Approach (CBA)** running until 2011 (EUR 13 million) has been supporting the creation of an enabling environment for long-term self-sustaining social-economic and community development at the local level by promoting local self-governance and community-based initiatives. 60% of the projects implementing under CBA have targeted energy efficiency. The 2nd phase of the project, which was signed on the 31/05/2011, targets energy efficiency as well.

- The EU **Support to the Joint Cooperation Initiative in Crimea**, signed on the 13/05/2011, has identified support to social and municipal infrastructures as a priority, including heating. Synergies can be developed with this Fund.

- The **Neighbourhood Investment Facility (NIF)**, available to Ukraine and other ENP countries with an Action Plan, can be used to further support and leverage IFI lending in support of the initiative;

- The **EBRD**, through its Sustainable Energy Initiative (SEI), has been providing large scale loans to private and governmental/municipal facilities to support the introduction of environmentally clean and sustainable equipment. Energy consumption has decreased by up to 40% in facilities supported by this initiative.

- The **World Bank** has been supporting since the mid-1990s large projects aiming at improving energy efficiency, with a focus on large public buildings in Kiev. A new programme to support energy efficiency has been signed in April 2011 with the government of Ukraine; it aims through sub-lending to finance energy efficiency projects in the private sector and at municipal level. For the latter, the World Bank is considering the use of E5P Fund.

- **GIZ** has been supporting the Ministry of Regional Development and Construction of Ukraine since October 2007 (till mid-2013) to improve energy efficiency in commercial and private buildings. The main focus of the project is to introduce energy management at local level and implement pilot projects in four Ukrainian cities.

- **USAID** has been supporting large projects (amounting to a total of \$13 million) since early 2009 in district heating in no less than 36 Ukrainian cities. For each city, energy audits are being carried out. These audits will serve as a good basis for the identification of future technical projects to be financed by the Fund. Coordination of interventions will be ensured by the fact that the US count amongst the main contributors to the Fund.

2.4. Donor coordination

Donor coordination is formally ensured in Ukraine by the Government, via thematic working groups, but meetings have however not been regular. The donor coordination in this sector is led by the World Bank thanks to regular coordination meeting where donors and IFIs participate.

Relations between donors in the frame of the proposed intervention are regulated by the "Rules of the Eastern Europe Energy Efficiency and Environment Partnership Fund" developed by the EBRD as Fund manager. Donors joining the Initiative will have to comply with those rules.

Those rules state that the governing body of the Fund will be the Assembly of Contributors (one representative per donor), which shall be responsible for the overall policy of the Fund and supervise its implementation. The EBRD, the European Investment Bank (EIB), the Nordic Investment Bank (NIB), the Nordic Environment Finance Corporation (NEFCO) and the World Bank Group shall act as implementing agencies of the Fund. A steering group proposes projects and subsequent grant requests to the Assembly of Contributors which decides if the projects shall be supported with the resources of the Fund. Agreement of the beneficiary country will always be sought. Grants will be sized in proportion to environmental benefits and/or gains in terms of energy efficiency, quantified in monetary terms. This will allow measuring the efficiency of the action.

3. DESCRIPTION

3.1. Objectives

The purpose of the Fund is to allow a harmonised and effective delivery of international financial support over several years by pooling contributions from a group of donors and beneficiaries, to be used primarily for supporting energy efficiency and environmental projects, resulting in an improved energy security situation for both Ukraine and the EU as well as significant reduction of carbon dioxide (CO₂) and other greenhouse gases (GHG) emissions.

3.2. Expected results and main activities

The E5P has an important role in helping the transition to a more energy efficient economy by providing grant funding to energy saving projects. In order to reach full impact, policy changes are required especially adequate tariff settings. This partnership will thus foster the reforms needed in the municipal sector to release the energy saving potential. In the first place, the reform of the tariff policy for municipal should be addressed. Other policies should also be covered, such as the development of home owners associations and the metering of energy and water consumption.

The E5P programme offers a suitable platform to host this dialogue since the relevant Ukrainian institutions are represented (Ministry of Economic Development and Trade, Ministry of Regional Development and Municipal Economy, State Agency for Energy Efficiency, State Agency for Ecological Investment, Heat and Water Regulator) and main donors and IFIs are actively participating to support the Government in implementing the necessary reforms.

This dialogue has started at the First Assembly of Contributors in November 2011, in consequence of what the heat and water regulator presented the tariff policy in place during the 3rd Steering Group Meeting.

In addition to these policy issues, the action will contribute to the Fund to reach the results:

- A reduced energy consumption in Ukraine, thanks to a more efficient use of available energies. This will be achieved through the implementation of projects contributing decisively to this objective. Implementation of those projects will be supported by the Fund resources, on a proportional basis;
- A decrease in CO₂ and other greenhouse gases emissions in the region, thanks to decreased energy consumption;

The proposed initial thematic focus of the Fund's activities is housing and district heating. Both sectors consume together more than half of the energy used in Ukraine. It is however envisaged that the Fund will also support other investments for energy efficiency or environmental projects. Where possible the fund should contribute to the implementation of the sustainable energy action plans of cities that signed up to the Covenant of Mayors.

3.3. Risks and assumptions

1. It is assumed that the National Commission for Regulation of Public Utilities will allow municipal heat and water companies to set cost recovery tariffs in order to ensure sustainability of energy efficiency investment projects;
2. Important reforms such as the reform of the legislative and regulatory framework of the housing and communal services, and the systematisation of energy and water metering for households as well as the empowerment of Home Owners Associations are also instrumental in realising the energy efficiency potential in municipalities. Their implementation should be carefully monitored;
3. Use of grants shall be carefully monitored in order not to over subsidise investments that were already planned by IFIs or public sector utilities; more generally the use of grants should be necessary for the feasibility and affordability of the project financed; A specific working group has been set up to tackle this issue, a first meeting took place in Kyiv on 28 March 2012. The working group should agree on refined grant sizing criteria that will be presented during the next Assembly of Contributors, aiming at improving the leverage effect of the grants invested in the E5P funded projects.
4. Synergies with other EU initiatives such as the Covenant of Mayors shall be emphasised by the Fund Manager, who will be made aware of specific opportunities in this regard;
5. The Fund is in its nature similar to the Neighbourhood Investment Facility (NIF). Attention will be paid on avoiding overlap between the two financing instruments and underlining their specificities;
6. Political interference in city councils can hamper the approval of projects;
7. A particular attention will have to be paid to the questions of procurement and follow-up of costs during the implementation of the Fund.

8. Payment by the Ukrainian Government of its pledged contribution is a mandatory condition for the Fund to operate. It is assumed that the four remaining instalments worth EUR 2 million each will be paid on time and in full amount.

3.4. Crosscutting Issues

Environmental sustainability and climate change are the main cross-cutting issues raised by this project. The project will directly contribute to climate change mitigation and to reducing pollution due to power generation from fossil fuel.

3.5. Stakeholders

The main stakeholder of the proposed intervention is the Government of Ukraine, represented by the following institutions: Ministry of Economic Development and Trade, Ministry of Regional Development and Municipal Economy, State Agency for Energy Efficiency, State Agency for Ecological Investment, Heat and Water Regulator.

The beneficiaries of the E5P funded projects are the Ukrainian municipalities. Other stakeholders are municipal companies, NGOs, home owner associations, etc. Ownership of the interventions is reflected by the intensive policy dialogue, which brought results already in 2011 with amendment to the Budget Code in Ukraine made that allow municipalities to provide guarantees for IFI loans. The amendment lifted previously set limitations and increased ceilings for municipal debt.

4. IMPLEMENTATION ISSUES

4.1. Method of implementation

The method of implementation will be joint management, through the signature of a standard contribution agreement with the EBRD in accordance with Article 53d of the Financial Regulation. As for the first and second contributions no Financing Agreement will be signed with the Government of Ukraine.

EBRD is currently subject to an external review in relation to Article 53d of the Financial Regulation. In anticipation of the results of this review the authorising officer deems that, based on the long-standing and problem free cooperation with this organisation, joint management can be proposed and the standard contribution agreement with an International Organisation can be signed in accordance with the provisions laid down in Article 43 of the Implementing Rules to the Financial Regulation.

The Manager of the Fund and contact person on the EBRD side is based in London at EBRD headquarters during a first phase of the Fund's operation, and its Deputy has been appointed in EBRD's office in Kiev. The EU Delegation in Ukraine will follow-up and ensure coordination with the local EBRD offices as appropriate.

The Delegation coordinates relations with the Bank and other donors involved in the Initiative, with support from Commission services in Brussels.

The largest donor, i.e. the EU (represented by the Commission), will chair the Assembly of Contributors to the Fund, unless otherwise decided by the Assembly. The Chair will convey, together with the Fund Manager, meetings of the Assembly and might invite, as relevant,

representatives of governments, other institutions and entities to attend specific agenda items. The Chair can as well call special meetings of the Assembly, when deemed necessary.

The change of management mode constitutes a substantial change except where the Commission "re-centralises" or reduces the level of tasks previously delegated to the beneficiary country, international organisation or delegatee body under, respectively, decentralised, joint or indirect centralised management.

4.2. Procurement and grant award procedures

All contracts implementing the action are awarded and implemented in accordance with the procedures and standard documents laid down and published by the EBRD.

4.3. Budget and calendar

The Fund is foreseen to remain active until 31 December 2019 unless otherwise decided by the Assembly of Contributors to the Fund. The proposed third EU contribution to the Fund is EUR 15 million. The implementation period of this Action will start from the date of signature of the Contribution Agreement with EBRD, which is expected to take place in the first half of 2013 at the latest. In order to ease the monitoring of the EU contribution, it is proposed that the implementation duration of this action coincides with the period of activity of the Fund, i.e. until at least 31 December 2019.

4.4. Performance monitoring

The monitoring of the day to day implementation of the proposed action will be carried out by EBRD under its standard procedures based on benchmarks to be agreed with the donors contributing to the Fund. The effectiveness of the action will be evaluated using key indicators like:

1. Number of requests made to the Fund over a certain reporting period;
2. Number of grants considered, selected and approved during this period;
3. Share of the Funds disbursed;
4. Fund's effectiveness ratio, comparing the environmental benefits and/or gains in terms of energy efficiency converted in monetary terms with the amount given from the Fund.

Energy efficiency will be measured for example by the saving of energy (kWh p/a), reduced use of natural gas (cubic meters p/a), electricity efficiency (MWh p/a) and its equivalent in monetary terms (UAH, EUR p/a) and environmental benefits by the decrease of CO₂/NO_x emissions (tonne p/a), decrease in water use (cubic meters p/a) and the consumption of treated water (cubic meters p/a).

4.5. Evaluation and audit

No funds from this EUR 15 million contribution should be put aside for financing evaluation(s) or audit. Evaluation and audit will be under the responsibility of EBRD. Should the need arise, the EU would finance additional evaluation(s) and/or audit(s) from other budgetary resources. The provisions of the contribution agreement to be signed with EBRD will apply where relevant.

4.6. Communication and visibility

Communication and visibility activities will follow the Communication and Visibility Manual for EU External Actions (http://ec.europa.eu/europeaid/work/visibility/index_en.htm) and the provisions of the contribution agreement to be signed with EBRD will apply where relevant. The projects will aim for a widespread dissemination of its achievements and results as well as awareness-raising and image building through inter alia, project websites, electronic newsletters, outreach to the media, etc. Once the activities have started, communication and visibility plans should be prepared and submitted to the EU Delegation for approval, as per the Communication and Visibility Manual for EU External Actions. Any events organised as part of or related to the project should include the participation of the contracting authority.