This project is funded by the European Union

Municipal Finance Study on Energy, Climate and Environment Sectors in Eastern Partnership Countries

The Eastern Partnership (EaP) is a joint policy initiative which aims to deepen and strengthen relations between the European Union (EU), its Member States and its six Eastern neighbours: Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine.

Why this project?

- Municipalities are crucial because they provide their citizens the most necessary services for every aspect of daily life: from access to clean drinking water, heat, education, some health services, rubbish collection, and sometimes housing and urban transportation.
- Municipalities need significant financial resources to provide, expand, and improve services.
- Municipalities play an increasingly essential role in climate change mitigation and adaptation.
- The EU recognizes this importance and offers many instruments to support municipalities, from technical assistance to grants and a combination of grants and inexpensive loans.
- In order to prepare for the new EU budget cycle, new instruments and projects, and to reflect the new Green Deal, the EC requested this study including a set of recommendations.

Objectives of the project

- To assess the gaps in municipal investments in the renewable energy, energy efficiency, climate and environment sectors in EaP countries and present recommendations for future EU interventions, which would help to address this gap and contribute to better sustainability of municipal investments in these sectors. This means assessing the viability of a variety of instruments that go beyond action grants and budget support, including blended finance, financial instruments and de-risking tools for projects. Focus for the project is cities with a population less than 300,000 i.e. below the oblast level cities which already have reasonable access to funding.
- To provide an analysis of state of play of municipal financing in all EaP countries, with particular focus on renewable energy, energy efficiency, climate and environment.
- To identify the investment gaps in these sectors, while taking into account absorption capacity and other limitations in municipalities.
- To develop an overview of and recommendations for 1) different financing modalities and instruments and 2) thematic sub-sectors of municipal investments that could be supported by the EU through those financial modalities.

Municipal Finance Study on Energy, Climate and Environment Sectors in Eastern Partnership Countries' is being implemented by Landell Mills International Ltd. Linpico and Danish Energy Management as the lead implementing partner

Landell Mills

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FINDINGS

Too many small municipalities

CONCLUSION

- Municipal size, project development capacity and financial resources are **a big constraint** on project development.

RECOMMENDATIONS

- **Support needed at national level for administrative-territorial and fiscal decentralisation reform** to push for consolidation, decentralisation, multi-annual budgets and financial planning. Municipal borrowing limits should reflect the ability to repay the loan. **Inter-municipal co-operation** in providing services and in project preparation/implementation should be promoted.

FINDINGS

Urban planning needed as well as sectoral plans

CONCLUSION

- Support is needed at municipal level **for integrated urban planning and sectoral planning.**

RECOMMENDATIONS

- **Support is needed at municipal level** for integrated urban planning and sectoral planning
- **Visions for smaller cities**
- Expansion of **EBRD's Green Cities concept**

FINDINGS

Successful financial models are quite complex

CONCLUSION

- **Two successful financial models to build municipal capacity** as well as implement investments: for larger cities with loans, and smaller cities with grants.

RECOMMENDATIONS

- **Continue these successful models** with two additional instruments:
  - **Competitions for new buildings:** Building new demonstration kindergartens and/or schools with a zero-carbon target (instead of refurbishment).
  - **EU Cities grants for project concepts:** Extend this EU scheme to EaP, with funds for consultancy, short travels to other cities, for project concept preparation, to be administered by EU Delegations.

FINDINGS

How best to bundle projects?

CONCLUSION

Two other models:

- Bundling cities with similar technical projects (E5P / NEFCO or EIB)
- Centralised implementation management through Energy Agency / UNDP / SuperESCO / Municipal Development Fund

RECOMMENDATIONS

- **Smaller cities should be bundled** to promote projects for clusters of small cities and project management units for clusters of cities (after amalgamation or with minimum size) to ensure experienced staff with competitive salaries.

FINDINGS

Technologies adopted only to renovate, not build new facilities

CONCLUSION

- **Always based on renovation of existing installations**. Some opportunities missed as a result.

RECOMMENDATIONS

- **Electricity generation from Biogas** from Waste Water Treatment Plant (WWTP) sludge
- **Floating PV on water supply reservoirs**
- Land for land-based PV
- **Broad scale net-metering and/or Renewable Energy Clusters**
- Best practice recommendations for cities where DH is abandoned
- **Supply chains for biomass** materials (including non-forestry sources)

FINDINGS

Large investment financing needs

CONCLUSION

- **Tens of MEUR in investments are needed**, even for small cities.
- **Municipal budgets are not enough** to finance infrastructure investments.
- Municipal credit worthiness varies by **country, exchange rate risk for loans in foreign currency** is a problem.

RECOMMENDATIONS

- **Governance reforms**
- **Continued Tariff reform**, make utilities creditworthy
- **Financial Instruments:** revolving funds or soft loans with EU support, Mitigation of **exchange rate risk for IFI loans under loan guarantees**
- Co-operation with local banks that have (EE) expert network

FINDINGS

Information exchange with EU needs improvement

CONCLUSION

- **CoM objectives are being updated from 2020 to 2030.**
- The CoM-East activities have been focussed on **information exchange within and between the EaP countries, and on technical and financial issues** for specific projects in the region.
- Not enough information sharing with EU countries.

RECOMMENDATIONS

- **More webinars/twinning/ mentoring** as provided through EU CoM. **More online communications and cross border activities with EU.**
- More general technical awareness: **updating on new technological developments** especially awareness on climate change adaptation relevant to municipalities' responsibilities.

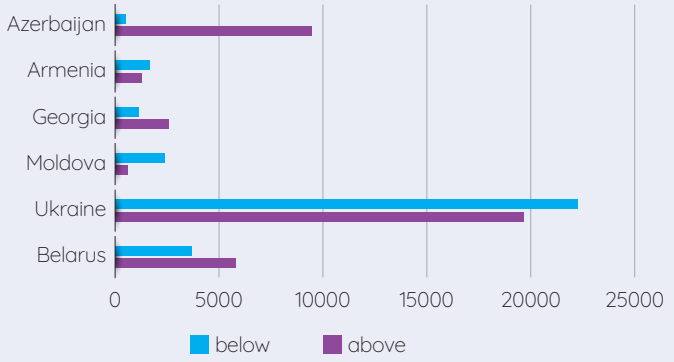
Why are municipal investments so important?

HIGHLIGHTS

Size of municipalities

In most EaP countries, around 20% of all cities have populations greater than 50,000. Cities of this size typically have some capacity to develop projects because they are able to hire and maintain some qualified and experienced staff for this purpose. While larger cities benefit from scale and influence (particularly capital cities), cities below 50,000 population will lack technical knowledge, human resources capacity, and social capital to develop their own projects.

Population living in municipalities below and above 50,000 threshold



Successful financing

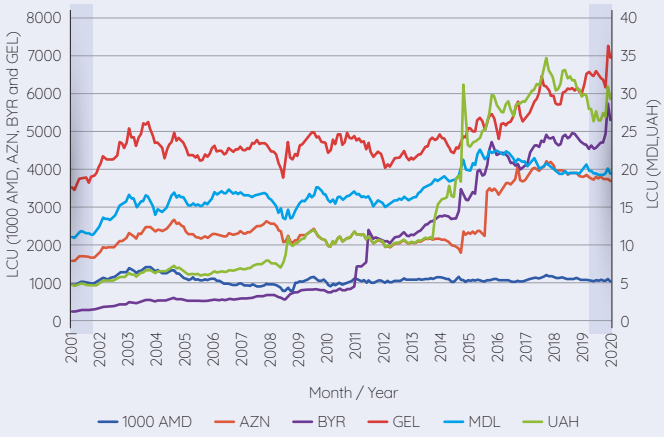
The small community of Festelita in Moldova is implementing the CoMDeP project "Creation of an excellence centre through piloting demonstrative new energy efficiency technologies and renewable energy sources in the Festelita community". Due to the community's small size, local co-financing of the project is particularly difficult. A decision was made to organize an online crowd funding action where citizens, as well as families working abroad and others, could support the project. The community also received the first loan from NEFCO in local currency.

Loan conditions

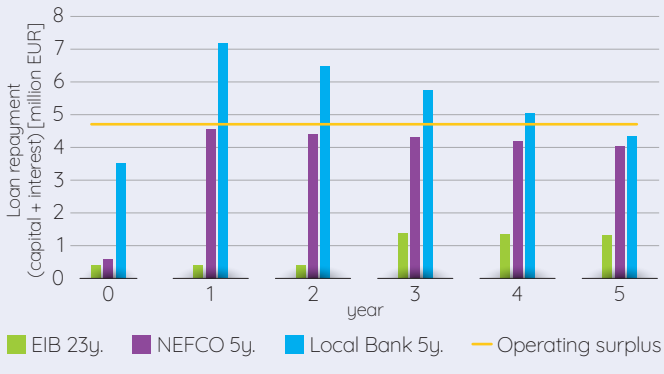
In all EaP countries interest rates on loans in local currency are typically 10% or more and banks tend to offer mid-term loans to municipalities. If such an expensive loan has to be repaid in 5 years, annual repayments will be very high and often exceed municipal financial capacity. Thus, loans are provided for 20-30 years and the interest rate is low, such as 2% in the case of EIB, municipalities will be able to repay the loan and will be keen to take advantage of such conditions. Unfortunately, IFIs only offer loans in EaP countries in foreign currency and taking into account exchange rate fluctuations, such loans entail significant risk for municipalities.

NEFCO in recent years tested low-cost loans at 3% interest in local currency for 5 years. For many small municipalities, this was their first use of loan financing.

Official exchange rates to EUR



Loan repayment for different conditions



Use of technology a high Feed-In-Tariff (FIT)

In the city of Slavutych, in northern Ukraine, the first private energy cooperative was established in cooperation with the city. The cooperative will take advantage of high FIT and utilize the roof surface areas of public buildings. Although the cooperative is private, 5% of the profit will be used for municipal development projects.