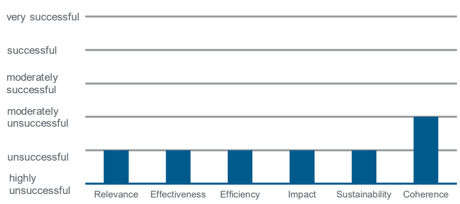
KfW Development Bank

Ex post evaluation Municipal Infrastructure Development Fund, south-eastern Europe

Title	Municipal Infrastructure Development Fund (MIDF)
Sector and CRS code	Formal sector financial intermediaries (CRS no. 24030)
Project number	2012 36 553
Commissioned by	Federal Ministry for Economic Cooperation and Development (BMZ)
Recipient/Project-executing agency	Municipal Infrastructure Development Fund (MIDF)
Project volume/ Financing instrument	*EUR 15.0 million (FC component)*
Project duration	*2012–2018*
Year of report	2022
Year of random sample	2020

Overall rating: unsuccessful



Objectives and project outline

The outcome objective of the FC project was to contribute to improving the public infrastructure in the Western Balkans. To this end, local commercial banks were to be enabled to grant medium and long-term investment loans to municipal utilities services providers or directly to municipalities.

At impact level, this was intended to reinforce municipal self-government and make an additional contribution to deepening and broadening local financial systems.

Key findings

The project was terminated because the fund did not fulfil its diversification criteria due to a lack of investment in various countries. As a result, it had little developmental effectiveness. The project was therefore rated as unsuccessful.

– One of the fund's core problems appears to be in its design phase, which had some shortcomings. These were mainly due to the analysis of the demand of local banks and municipalities for credit products. In addition, the interest rate environment deteriorated further over time, which had a negative impact on the attractiveness of the loan fund (Relevance).

– Due to donor-financed grants and subsidised loan offers, the fund was partially displaced. Large-volume grant programmes were still common at the time the fund was established, but were further expanded in the relevant time period (Coherence).

– Despite appropriate objectives, the development policy objectives were clearly not achieved. However, some local infrastructure projects were initiated through intensive relationship management and technical assistance (Effectiveness).

– Although no significant impact can be determined due to the early liquidation of the fund (overarching developmental impact), it was possible to transfer the initiated infrastructure projects to the partner banks and complete them (Sustainability).

Conclusions

– The analysis of the market for a credit fund requires a detailed ex-ante competition analysis and a precise evaluation of debt capacity.

– The design of a fund requires a great deal of technical and regulatory know-how in order to properly assess the market environment ex ante and to be able to adjust it during the project design.

– Intensive communication and coordination with other donors in the region are necessary to ensure that the various projects dovetail.

Rating according to DAC criteria

Overall rating: 5

Ratings:

Relevance	5
Coherence	4
Effectiveness	5
Efficiency	5
Overarching developmental impact	5
Sustainability	5

Breakdown of total costs

		(planned)	(actual)
Investment costs	in EUR million	75.20	17.20
Counterpart contribution	in EUR million	0	0
Financing	in EUR million	75.20	17.20
Of which budget funds (BMZ)	in EUR million	15.00	10.00

Relevance

At the time of the project appraisal (PA) in 2012, there was a large shortfall in financing for infrastructure projects in the Western Balkans, with municipal infrastructure being particularly affected. Countries in this region exhibited significant weaknesses in terms of motorways, railways and electricity, but also in terms of water and sanitation, in comparison with other European countries.[1] For example, Serbia was ranked 119th out of 148 on the global list of public road conditions. Banks in the target countries of Albania, Bosnia and Herzegovina, Kosovo, Macedonia and Montenegro (with the exception of Serbia) also had very little or no experience in financing and executing municipal infrastructure projects. The financial sector in these regions was still heavily burdened by the 2008 ff. financial crisis, particularly in the area of lending. Overall, economic development in these countries was rated as poor. Even today, the level of municipal infrastructure in the Western Balkans is still considerably lower than that of Central Europe and therefore requires substantial capital inflows.

Small and medium-sized communities in the Western Balkans were particularly affected by this problem. Due to the lack of participation by local banks in the financing of public infrastructure, south-eastern Europe was heavily reliant on foreign donors to fill the gap. The financing volumes required by small and medium-sized municipalities were often too small for typical programmes of these foreign donors (no critical size given), which led to difficulties accessing municipal infrastructure financing and further disadvantaged the smaller municipalities. In the areas identified, there was generally a lack of economic development, high unemployment and a considerable trade deficit. This is still a major problem today. The average income in the Western Balkans is only about 30% of the EU-15 income.[2] This has not changed significantly since the financial crisis. Coupled with increasing requirements in terms of infrastructure on the part of the EU, which are important for the entry of Balkan countries with candidate status (EU standards higher than local standards), the discrepancy between targets and reality has been widened even further. Against this background, the Federal Ministry for Economic Cooperation and Development (BMZ) supported the project to improve infrastructure in the region and to promote the expansion of municipal infrastructure. The project was in line with other BMZ projects and also corresponds to the priorities in the

[1] https://www.eib.org/attachments/efs/infrastructure_investment_in_the_western_balkans_en.pdf

[2] https://www.elibrary.imf.org/view/journals/087/2018/002/article-A001-en.xml

strategy papers of the respective countries to this day.[3] The project's approach of deepening and broadening the financial sector through cooperation with local banks is in line with the general decentralisation movement in the regions. However, it must also be mentioned that in some countries (particularly Albania and Kosovo), the relevant Ministry of Finance is acting against increased debt on the part of the municipalities and this makes cooperation between banks and the public sector more difficult. In general, coordination between the municipal level and the state level is limited, which leads to a distorted allocation of investment expenditure.[4]

Consequently, the project was based on the following impact chain: Support for local banks in setting up and expanding financial services for municipal infrastructure → Broadening, deepening of local financial sectors → Access to investment financing expands scope for action, particularly for small and medium-sized municipalities, and thus reinforces the already advanced decentralisation process → The resulting improvement in infrastructure improves the capability of municipal utilities services providers and acceptance among the population → Local construction companies are given opportunities by the investments and the project therefore also has an impact on local employment.

The impact chain underlying the project is fundamentally coherent and the gap in infrastructure financing is still pertinent in the Western Balkans from today's perspective. Economic development, particularly in comparison with EU countries, is poor and the participation of local banks is low, so a partnership with local banks appears consistent with long-term secured financing. However, from today's perspective, a critical evaluation is required of the extent to which the concept or approach was adapted to overcoming the problem.

One of the fund's central problems appears to be in its design phase or the collaborative process. Specifically, the market study, project feasibility and fund strategy were drawn up by an independent team of consultants and without the involvement of the fund manager appointed at a later date. Consequently, the strategic course that had already been set had to be accepted. Although this procedure is not uncommon, it has contributed to difficulties in the allocation of funds in the present project due to shortcomings in the market study, which, from today's perspective, was a partial reason for the subsequent liquidation of the fund. The shortcomings in the market study were mainly the conclusions on the demand from banks and municipalities, as well as a distorted picture of the debt capacity of public borrowers. It can also be added that a long lead time was required for this market study and the market environment did not change for the benefit of the fund during this period. For example, the interest rate environment deteriorated.

In summary, it can be stated that the basic problem was still relevant and properly identified, but the concept developed for the problem is flawed from today's perspective (and also from the perspective at the time) in terms of addressing the problem. For this reason, the relevance is rated as unsuccessful.

Relevance rating: 5

Coherence

The project is generally in line with EU initiatives and projects of other donors. The EBRD also promotes the expansion of municipal infrastructure on a broad scale.[5]

Due to the poor condition of the infrastructure in comparison with other EU countries, there are various projects and initiatives from other donors. In some cases, the projects achieve very high total volumes. One example is the Western Balkan Investment Framework (WBIF), which provided around EUR 2.8 billion in loans and around EUR 300 million in grants between 2010 and 2014.[6] There are also projects, such as the Sustainable Transport Project, which had a total volume of EUR 10.6 billion from 2009 to

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3 https://www.gtai.de/de/trade/kosovo/entwicklungsprojekte/laenderstrategie-kosovo-2022-2027-822044; https://www.gov.bg/en/Press-center/News/Prime-Minister-Kiril-Petkov-meets-Romania%E2%80%99s-President-Klaus-Iohannis

4 https://www.elibrary.imf.org/view/journals/087/2018/002/article-A001-en.xml

5 https://www.ebrd.com/news/2019/ebrd-approves-new-fiveyear-country-strategy-for-north-macedonia-.html; https://www.srbija.gov.rs/vest/en/148956/serbia-2025-project-worth-14b.php and https://www.gtai.de/de/trade/kosovo/entwicklung-sprojekte/laenderstrategie-kosovo-2022-2027-822044; https://www.gov.bg/en/Press-center/News/Prime-Minister-Kiril-Petkov-meets-Romania%E2%80%99s-President-Klaus-Iohannis; https://www.ebrd.com/downloads/research/brochures/balkans.pdf

6 https://wiiw.ac.at/infrastrukturinvesittionen-am-westbalkan-dlp-3660.pdf

2021 and awarded EUR 965.5 million in grants.[7] In addition, there are grant activities that directly financed municipal infrastructure, such as projects in the Alpine region in Albania, where EUR 3 million in grants are made.[8] The World Bank is also active in the Western Balkans and supports municipal infrastructure projects with the aim of strengthening municipal self-government.[9]

Although a wide range of projects from other donors strive for the same objectives, it seems from today's perspective that there was no intensive coordination between donors and that projects did not dovetail well enough as a result. The availability of grants from other donors amounting to billions (both at EU and national level) meant that the competition for the fund was too great and ultimately this contributed to the significantly more difficult allocation of funds. Although many projects did not directly target municipal infrastructure and the project can therefore be seen as complementary to other interventions, it can be assumed that these grants sent a strong signal so that municipalities did not wish to raise loans at market conditions. The municipalities understandably preferred the often non-repayable grants, so that the fund simply had too little demand with its loan conditions at market prices. Although the donor initiatives and the fund approach were complementary, the parallel offering led to a crowding-out effect from the fund's perspective. We therefore conclude that the fund approach was simply not viable in the time/local context or that the various donor initiatives in the Western Balkans were not sufficiently coordinated to "dovetail" with the fund approach. At the same time, however, it should be noted that coordinated initiatives such as the WBIF are of enormous importance and significance.[10] Cooperation between the various donors within the fund (KfW, EBRD, SECO, Frankfurt School) appears to have been intensive and constructive. There were regular updates and a continuous flow of information. This applies both between the various donors and between the fund manager and the participants of the Technical Assistance Facility (TAF).

In summary, the fund's overarching objective was consistent with other donor initiatives. Furthermore, the cooperation within the project between the various stakeholders appears to have been coordinated. However, in many cases the fund was crowded out by other initiatives and in this sense it was not complementary to these initiatives. Reasons for this appear to be limited interaction with these donors and unfavourable conditions in comparison with other projects. This is why coherence is rated as moderately unsuccessful.

Coherence rating: 4

Effectiveness

The target achievement at outcome level is summarised in the table below:

Indicator	Baseline and target value PA 2012	Actual value EPE 2022 (2018 data)
(1) Funded infrastructure projects in the second to fourth year of the fund term (p.a.)	Baseline value: 0 Target value: 6	Actual value: 2[11]
(2) Projects funded together with a local partner bank in each country (at the end of the fourth year of the fund term)	Baseline value: 0 Target value: 6	Actual value: 0.33

[7] https://wbif.eu/storage/app/media/News/2022%20Endorsed%20flagships%20February/WBIF%202022%20Endorsed%20Flagship%20Projects%2024.02.22.pdf

[8] https://wbif.eu/project-detail/PRJ-ALB-SOC-003

[9] https://www.worldbank.org/en/news/feature/2017/01/04/enhancing-cities-performance-and-regional-connectivity-in-the-western-balkans

[10] https://www.wbif.eu/who-we-are

[11] In some cases, the projects refinanced by the MIDF to a municipal ultimate borrower comprised a large number of very small projects. In these cases, the projects were evaluated as one project.

(3) Projects funded by the partner bank in at least 4 of the 6 countries at full own risk at the end of the fourth year of the fund term	Baseline value: 1 Target value: 6	Actual value: 1
(4) Municipal loan portfolio at risk of default at each partner bank at the end of the fourth year of the fund term	Baseline value: n.a. Target value: 10% (PAR > 90 days)	Actual value: not available, according to information none of the funded projects are at risk of default

4) Changed from PAR>90 to PAR>30 and then back to PAR>90 in the final inspection during the course of the project.

None of the outcome objectives were achieved and, except for indicator (4), the indicators were significantly missed.

The fund, which had several asset classes/risk categories, was liquidated in 2017 due to the very difficult portfolio construction and the resulting breach of its own diversification criteria. Firstly, the acquisition of potential projects was difficult and the projects initially funded could not be fully funded (by the fund) due to the liquidation of the fund. The main reasons were diverse and varied by country. In Kosovo, for example, borrowings were only marginal. This is due, among other things, to historical reasons, as Kosovo receives large amounts as direct grants (see Coherence section). Albanian municipalities were already under pressure at the time of the fund due to high debt ratios and were not prepared to take on further debts. In Montenegro, there were large regional differences, with many regions already being heavily indebted.

However, with regard to indicators (1) and (2), successes can be recorded in some cases. The fund initiated several projects in two countries, including a bridge project in Gostivar, Macedonia, the financing of a primary school in Skopje, Macedonia and bundled projects in Nis, Vranje and Naissus, Serbia (including various projects such as road construction or wastewater projects). These projects came about after consultation with the relevant stakeholders through intensive cooperation between the fund manager on site and the local banks. In this sense, it can be stated to a limited extent that municipal infrastructure was supported by the fund. This also took place in cooperation with the selected local partner banks.

The TAF, funded by SECO in Switzerland and the budget funds of the Republic of Austria, played a central role in the implementation. The partner banks received training and support on various topics, such as project development, public procurement and municipal bonds. In addition, the partner banks were offered on-the-job training as required. A total of 25 workshops were held on the side of the partner banks with 309 participants. Technical assistance for the ultimate borrowers (municipalities) also covered various areas, such as the identification of suitable projects, support in the tendering process and monitoring of existing projects.

Indicators (3) and (4) cannot be fully and conclusively evaluated due to the liquidation of the fund. Although the above-mentioned projects were funded by the partner banks after the fund was closed, a certain level of risk assumption and sustainability (see below) can be assumed, although this was forced. An actual value for indicator (4) was not reported, but according to the fund manager, at no time was a project at risk of default.

Although a number of projects were initiated as part of the MIDF, cooperation with the TAF was able to achieve some positive effects. Nevertheless, the objective at outcome level was clearly missed. Effectiveness is therefore rated as unsuccessful.

Effectiveness rating: 5

Efficiency

At the start of the project, partner banks were acquired in five out of six countries over a period of three years, which does not correspond to the target value, but at the very least enabled the countries to be covered fairly well. Partnering with local banks was difficult as risk sharing between the bank and the fund was rather unattractive from the banks' perspective. Although the division of income and risks between banks and fund was ultimately consistent (50/50), it was still too unattractive from the banks' point of view. Although this was able to considerably reduce the banks' risk, a significant risk remained with the banks, while risk reduction was purchased with the fact that only half of the profit was generated in more attractive projects. In addition, the risk-sharing agreements were structured in a complex way, for which some banks lacked the necessary expertise. According to the information provided, partnerships with the banks were only established through intensive relationship management and existing contacts. The funds were forwarded by the fund in EUR; hedging would have further deteriorated the attractiveness of the funds. In almost all cases, the exchange rate risk is likely to have been with the ultimate borrowers.

The fund manager was selected within schedule. In addition, according to some information, the cooperation and communication between the various parties involved was also effective. However, the time required in relation to the output can generally be assessed very critically. The setting up of a rather complex fund and the associated resources were enormously high in comparison with the results.

The implementation and allocation efficiency is insufficient. Setting up the complex structure and interacting with various stakeholders (consultants, partner banks, municipalities and communities) and marketing the fund required a great deal of effort in retrospect. It is therefore not surprising that the fund's administrative expenses are high in comparison with revenues or investments. For example, the fund suffered losses right from the start, so the question arises as to whether alternative solutions (such as direct financing or subsidised loans) could have achieved an effect in a more efficient manner.[12] As some such initiatives already existed and still exist, such projects appear to be achieving some success.

Alternatively, more intensive technical support at the level of local banks or municipalities could have been more successful, as some information indicates that the actual financing can be carried out efficiently, but often the know-how in the creation and actual implementation of municipal infrastructure projects is lacking from the ground up. In addition to the complex structure, the agreements with the local banks were also laboriously structured, which also prevented efficient processing.

Efficiency is rated as unsuccessful, as the output is rather sparse compared to the effort incurred and the creation of a complex fund and cooperation with several stakeholders were unable to achieve the intended effects.

Efficiency rating: 5

Overarching developmental impact

The objective at impact level was to further reinforce municipal self-government and to contribute to deepening and broadening the local financial systems. As the fund was liquidated in 2017, the achievement of the objective (even partially) is to be viewed rather critically.

No indicators were defined for the impact objective during the project appraisal because it was implicitly assumed that, if the outcome objectives were achieved, the impact objective would also be achieved. This is also logically correct and justified in retrospect; however, the necessary condition for three of the four outcome objectives is an appropriate portfolio construction of the fund. Since the outcome objectives were significantly missed, the contribution to the impact objective can also be classified as low. Due to its liquidation, the fund will also not make any further contributions to the impact objective.

Nevertheless, it should be noted that the fund achieved a certain development policy contribution with the implementation or initiation of projects and financing by local banks, but overall this fell significantly short of the original expectations. For example, the bridge project in Gostivar made it possible to establish a vital transport connection and thus improve traffic flow. At the very least, the intensive work of the TAF for the partner banks made it possible to contribute to the further development of the financial systems. From 2006 to 2018, approximately EUR 12.2 billion was invested in the Western Balkans transport sector alone.[13] The fund has probably been able to contribute to this. However, this contribution is very small and

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[12] Loss in 2016 over EUR 1 million, loss in 2017 close to EUR 750,000.

[13] https://www.eib.org/attachments/efs/infrastructure_investment_in_the_western_balkans_en.pdf

certainly no “moving-the-needle” effect has been set in motion. No unwanted effects from the measures were found.

Since the fund’s results at outcome level were significantly below expectations, this also applies to its developmental impact, which is therefore rated unsuccessful.

Overarching developmental impact rating: 5

Sustainability

In principle, the project did not achieve sustainability, as the fund had to be liquidated a few years after it was founded. Moreover, the fund was unable to operate in a financially sustainable manner (covering costs). In addition to the problems already explained, the market conditions also became increasingly unfavourable. There was an increasing low interest rate environment in the region. Although this appears more conducive in a lending context, it had an effect on competitiveness and, in turn, on the fund’s cost coverage. For this reason, sustainability can be classified as unsuccessful.

However, as already mentioned, the fund initiated a number of projects, all of which were then completed despite the fund’s liquidation. This is remarkable and demonstrates a certain level of sustainability in financing in cooperation with the partner banks.

It is also worth mentioning that the workshops and training sessions conducted by the TAF have had a long-term impact. These were continuously reviewed and material was handed over to the partner banks. This closed any gaps in knowledge and expertise in the area of municipal infrastructure financing. However, the extent to which banks will cooperate with the public sector in the future is ultimately hard to assess and will depend not least on the regulatory environment and the further development of other (subsidised) sources of financing.

Due to the low level of impact achieved at outcome and impact level, the sustainability of the fund, which did not cover its costs at any time, also has to be rated as unsuccessful.

Sustainability rating: 5

Notes on the methods used to evaluate project success (project rating)

Projects are evaluated on a six-point scale, the criteria being **relevance, coherence, effectiveness, efficiency, overarching developmental impact** and **sustainability**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (level 3).