Ex Post-Evaluation Brief
South-East Europe: Interest Rate Reduction Fund (IRRF) for South-East Europe

Sector	Financial intermediaries in the formal sector (2403000)	
Programme/Client	Interest Rate Reduction Fund (IRRF) for South-East Europe BMZ No: 2001 40 517	
Programme executing agency	ProCredit Bank Macedonia, ProCredit Bank Romania, Banca Transilvania, Raiffeisen Bank Kosovo (and potentially other financial institutions)	
Year of sample/ex post evaluation report: 2008*/2012		
	Appraisal (planned)	Ex post-evaluation (actual)
Investment costs (total)	EUR 14.70 million	EUR 43.76 million
Counterpart contribution (company)	EUR 10.10 million	EUR 41.00 million
Funding, of which budget funds (BMZ)	EUR 4.60 million EUR 4.60 million	EUR 2.76 million EUR 2.76 million

* random sample

Project description: The Interest Rate Reduction Fund (IRRF) provided funds to subsidise medium- and long-term loans from KfW to banks in Kosovo, Macedonia and Romania. At the time of ex-post evaluation (EPE), a total of five loans have been issued in this manner, to (1) ProCredit Bank Macedonia, (2) ProCredit Bank Romania, (3) Banca Transilvania and (4) Raiffeisen Bank Kosovo. As at the time of the EPE (which was implemented due to the long term of the project), IRRF funds have not yet been fully disbursed.

Objective: Overall objective: Support regional stabilisation and reconstruction in South-East Europe (by widening and in particular deepening the financial sector according to needs). Programme objective: Mobilise capital market funds for selected investment projects in South-East Europe in order, firstly, to tackle deficiencies in social and economic infrastructure (including deficiencies within the financial sector) and, secondly, to subsidise loans from market funds to an appropriate, lower level.

Target group: The immediate target group is the population of South-East Europe.

Overall rating: 3

We have assessed the project's overall outcome as satisfactory.

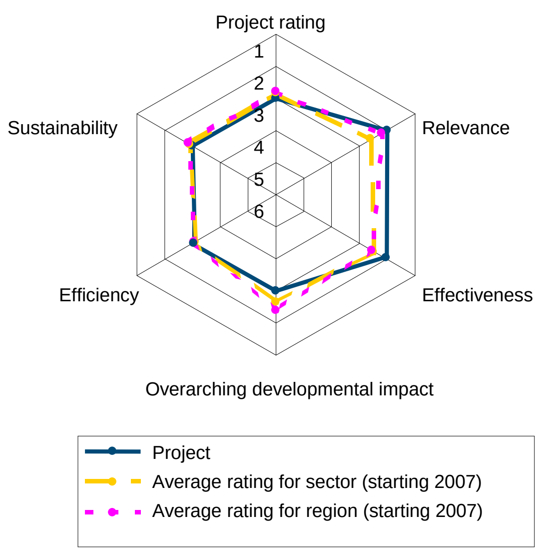
Positive:

- high leverage in mobilising market funds (funding potential)
- some of the investments that were financed were of an innovative nature
- high degree of sustainability in the banks which received financing

Negative:

- the funding potential was insufficiently used - currently the production and allocation efficiency of the banks that received financing is reduced
- limited impact for the final-borrowers

Rating by DAC criteria



EVALUATION SUMMARY

Overall rating: From an overall assessment, we have graded the project as Rating: 3. This overall rating is composed of the following subsidiary scores:

Relevance: The funds for the IRRF come from the commitments made by the German Federal Government to the Stability Pact for South-Eastern Europe, which became the Regional Cooperation Council (RCC) in 2008. Germany is represented on the RCC Board, whose main objective continues to be securing political, legal and economic stability in the South-East Europe region. The priority areas for German involvement through the RCC are (1) infrastructure reconstruction, (2) reviving economic strength at a local level, particularly among small and medium-sized companies, and (3) re-shaping the general environment in favour of democratic structures that reflect social needs and market demands. These topics were also highly relevant at the time of project appraisal. The present relevance of the RCC and its mission can in particular be seen in the latest unrest in Kosovo, whose roots lie primarily in the country's below-average development, its lack of economic strength, and the high level of youth unemployment which this brings. Sustainable economic development is also the objective of numerous other development organisations, who are addressing the shortcomings in this area on different levels. Alongside bilateral initiatives, cooperation in the region is increasingly adopting a regional form, as seen for example in the European Fund for Southeast Europe (EFSE). The IRRF fits equally into the development strategies of the countries receiving support (within a bilateral context), and into the regional priority areas for cooperation with South-East Europe. For the most part, German DC activities in partner countries are designed to work in a complementary fashion.

In South-East Europe micro, small, and medium-sized enterprises (MSMEs) are the driver of economic growth, and hence of prosperity. This is due in particular to the structural change that followed the collapse of the former Soviet Union. Consequently, promoting this sector is of great importance. Innovative financial services - oriented towards demand, and offered on a sustainable basis - are an important factor of production for MSMEs and private households. To date, the IRRF has provided funding exclusively for such services. Although the IRRF was conceived as an open programme it was reasonable in principle to focus on the financial sector in view of the great need in this area and the limited size of the fund volume.

Because promoting small and medium-sized enterprises is highly relevant and still remains an important priority in South-East Europe, and especially because the IRRF fits into the regional initiatives of other development organisations, we have judged the overall relevance of the IRRF as "good". Sub-Rating: 2

Effectiveness: seen (among other places) at the Raiffeisen Bank in Kosovo. Here, since introducing its environmental loan product, the bank has only been able to issue loans to around 50 % of the volume committed for this purpose. However this does not preclude the possibility that this slow pace of fund outflow could have its origin in the fall in demand for borrowing, due in turn either to the after-effects of the financial/ economic crisis, or to the bank being less than ideally positioned for the implementation of new environmental products. Hence a staff support measure is currently being drafted for the bank. At the ProCredit Bank in Macedonia, a similar programme is presently under implementation. Since marketing this product will not start until this programme has been completed, at the present time the ProCredit Bank in Macedonia has yet to make any environmental loans available. However, we consider that this parallel staff support measure is a prerequisite for the successful establishment of environmental lending. Meanwhile, the loan provided to the ProCredit Bank in Romania and both the loans provided to Banca Transilvania were swiftly allocated to end-borrower loans.

Two out of three project objectives were attained. The leverage achieved on the IRRF funds deployed was better than anticipated. The majority of refinancing thus far has gone toward final loans to MSMEs and private households for the purposes of innovation and/ or to address regional deficiencies. Without the support of the IRRF, these loans would very probably not have come into being. Taking all the foregoing into account, we have judged the project's effectiveness as having just merited a grading of "good". Sub-Rating: 2

Efficiency: Three of the four banks supported by the IRRF concentrate on MSME financing, and for the most part they are increasingly focusing on the SME sector. Since 2008, business development at these banks has been significantly influenced by the financial crisis. Whereas, before the financial crisis, credit portfolios, staff numbers and year-end surpluses were continuously climbing, since 2008 reduced growth or even contraction has been evident in every area. In view of the economic development seen within the region these responses should not be thought unusual, nor - if they contribute to increasing institutional stability as part of a deliberate consolidation of business activities - should they necessarily be seen as negative. A good indicator here is the non-performing loan portfolio (NPL), which has climbed markedly since 2008 in all the banks supported by the fund. However, not every institution is in a position to keep its NPL ratio within reasonable bounds. Only the ProCredit Bank in Macedonia and the ProCredit Bank in Romania came close to this position. The situation at Banca Transilvania in Romania, which has an NPL ratio of 21.3% (2010: 33%), looks particularly dramatic; in contrast to the ProCredit Bank in Romania, this bank focused on further growth rather than on (temporary) consolidation. However, it must be positively noted that the portfolio quality of housing loans disbursed by Banca Transilvania and subsidised by the IRRF (around 60% of all loans that received IRRF support) is around 10%. In addition, despite the crisis, three out of the four banks supported by the fund continue to report year-end surpluses. We have therefore assessed the production efficiency of the IRRF as satisfactory, and allocation efficiency as still being satisfactory.

Moreover, it has been determined that the timetable forecast in the project appraisal report for the allocation of IRRF funds (3 years) and for their disbursement (5-10 years) has already been significantly exceeded in some areas, although no plausible reasons for this could be identified during ex-post evaluation. In particular, the funding potential generated by the substantial leverage achieved by the IRRF (cf. Effectiveness), i.e. using the interest rate reduction funds for further loans with the same leverage within the term of the project, was not put to use, even

though it would have been permissible to take a flexible approach and apply the funds to other sectors. In view of the large liquidity needs in the countries of south-east Europe it can be assumed that the remaining funds of the IRRF will be used promptly. A loan agreement with a further partner bank will be signed shortly.
Production efficiency overall is satisfactory in the banks supported by the fund, allocation efficiency is considered still satisfactory, the funding potential of the IRRF was not utilised and programme implementation was substantially and inexplicably delayed. Due to all the foregoing, we have assessed the efficiency of the IRRF as satisfactory. Sub-Rating: 3.

Overarching developmental impact: When IRRF funds were deployed, the average leverage achieved in mobilising market funds was certainly substantial (1:15 actual vs. 1:5 and 1:3 scheduled in the PAR), and the IRRF funds are being used to promote needs-based financial services, especially in the case of environmental financing in Macedonia and Kosovo. However, up to the present time only a few loans have been issued in this area (in Kosovo: around 50 % of the funds committed; in Macedonia: to date, none at all). The impact on the financial sector has been correspondingly small. Both of the loans made to Banca Transilvania to refinance their housing loan business were fully allocated to final-borrower loans. Although the banks' NPL ratios of the past years are considered dramatic (cf. Efficiency), the portfolio segment (housing loans) addressed by the KfW loans weathered the financial crisis comparatively well with a current share of NPL of 10.3% (2010: 8.6%). Although such ratios suggest below-average effects on the final-borrower level they can be considered as still satisfactory. We therefore consider the achievement of the overall objective as still sufficient.

Based on the contribution made to innovative financial products, yet the small number of final loans granted at the present time, and the limited effect, which is however still considered satisfactory, for the final borrower due to the poor portfolio quality we have assessed the overarching developmental impact of the IRRF, taken altogether, as still satisfactory. Sub-Rating: 3.

Sustainability: Despite the stretched economic situation that prevails as a result of the financial crisis at most of the institutions which the fund financed, their stability is not presently under threat. Due to a substantial backlog (from a historical perspective) of short-term liabilities, the liquidity position is certainly below average; however, during the crisis this has not led to any major financial difficulties at these institutions. The same holds true for the reduction (or limited growth) of equity capital that has resulted from increases in credit default. Given the support which they receive from solvent shareholders, it is also reasonable to assume that these institutions will grow in future, in line with overall economic growth trends. The same applies to the loan products newly developed by the institutions, particularly those in the environmental area. It is likely that the institutions will expand these areas of their business in the future.

Due to the high rate of late payment, the investments financed by the banks must be rated as just barely sustainable altogether. This applies in particular to the housing loans financed by Banca Transilvania. However, given the present revival of the business situation in South-East Europe, it is likely that late payment rates will fall in future.

The design of the environmental products, combined with the interventions planned as part of the staff support measure (a simple energy savings calculator, specifications for minimum energy saving, efforts toward product standardisation), point towards a successful implementation. Furthermore, we assume that - provided it proves possible to get the environmental products successfully established - since both ProCredit Bank in Macedonia and the Raiffeisen Bank in Kosovo are embedded into the group networks of international holding companies (ProCredit Holding and Raiffeisen International Bank Holding), institutional learning can take place and strong multiplier effects can be achieved. At this point in time however, these effects are not yet apparent.

Taken overall, due to the strong sustainability (even in times of crisis) of the institutions financed by the fund, who in all probability will further expand their business in future, and the fact that the fields of business refinanced by the IRRF will also very probably continue into the future (even though this cannot be foreseen at the current point in time), we have assessed the sustainability of the IRRF as satisfactory. Rating: 3.

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

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

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

Ratings 1-3 denote a positive or successful assessment while ratings 4-6 denote a not positive or unsuccessful assessment

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability) The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

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. Ratings 1-3 of the overall rating denote a "successful" project while ratings 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" (rating 3).