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Special Report

The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies

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Glossary and abbreviations

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AFD: Agence française de développement
AFD is a French public development finance institution that fights poverty and fosters economic growth in developing countries and the French Overseas Provinces. It is the main implementing agency for France's development cooperation.

AIF: Asian Investment Facility

CIF: Caribbean Investment Facility

Concessional loan: A concessional loan is a loan with terms that are significantly more favourable than the terms of loans at market conditions. The IMF calculates the concessionality level as the difference between the loan's nominal value and the sum of the discounted future debt-service payments to be made by the borrower, expressed as a percentage of the loan's nominal value.

EBRD: European Bank for Reconstruction and Development
The EBRD is a publicly owned development bank based in London that promotes transition to open, market-based economies in countries from central and eastern Europe to central Asia and the southern and eastern Mediterranean. It provides project financing for banks, industries and businesses, both new ventures and investments in existing companies. It focuses on the private sector but also works with publicly owned companies.

EDF: European Development Fund
The EDFs are the main instrument for providing European Union aid for development cooperation to the African, Caribbean and Pacific States and overseas countries and territories. The partnership agreement signed in Cotonou on 23 June 2000 for a period of 20 years ('the Cotonou Agreement') is the current framework for the European Union's relations with these countries and territories. Its focus is on reducing and eventually eradicating poverty.

EIB: European Investment Bank
The EIB is the European Union's bank. It is owned by and represents the interests of the European Union Member States and works closely with other EU institutions to implement EU policy by providing finance for investment projects.

EU Delegation: The EU is represented through 139 EU delegations and offices around the world. The EU Delegations are part of the European Commission structure but serve EU interests as a whole.

EuropeAid: Directorate-General for Development and Cooperation — EuropeAid

IFCA: Investment Facility for Central Asia

IFP: Investment Facility for the Pacific

IMF: International Monetary Fund

ITF: EU–Africa Infrastructure Trust Fund

Glossary and abbreviations

05

KfW: Kreditanstalt für Wiederaufbau
KfW is the promotional bank of the Federal Republic of Germany and is based in Frankfurt. The development branch of the bank carries out German financial development cooperation on behalf of the government.

LAIF: Latin America Investment Facility

MRI: Mutual Reliance Initiative
The MRI is a formal framework set up in 2009 by AFD, EIB and KfW with the purpose of increasing effectiveness in co-financing development projects. Its main features are the delegation of most tasks to the lead financier of an operation and the mutual recognition of procedures.

NIF: Neighbourhood Investment Facility

ROM: Results Oriented Monitoring
The ROM system is a review tool for projects and programmes, which provides recommendations for improvement.

WBIF: Western Balkans Investment Framework

Executive summary

I

Blending mechanisms combine loans[1] from financial institutions with grants. Blending gives grant donors the possibility of leveraging their external cooperation funds by mobilising loans from financial institutions. It also allows them to have an impact on the formulation of policies and/or on the way projects are set up and managed. Furthermore, blending loans and grants can promote cooperation between stakeholders in development aid and can enhance the visibility of aid.

II

Since 2007, the Commission and the Member States have set up eight regional investment facilities that cover the Commission's entire sphere of external cooperation. Over the 2007–13 period, the EU allocated 2 106 million euro to such facilities. Development-finance institutions identify projects and apply for grants, which are approved by executive bodies comprising the Commission, Member States and other donors. The financial institutions contract most technical assistance and monitor the projects.

III

The Court's audit covered the regional investment facilities from when they were set up. The Court specifically assessed the effectiveness of blending regional investment facility grants with loans from financial institutions. The audit focused on the set-up and management of the regional investment facilities and on the extent to which the intended benefits of blending were achieved. The audit work consisted of an analytical review, interviews with Commission staff, a survey of 40 EU delegations, 22 of which replied, visits to the four main financial institutions and an examination of a sample of 30 grants awarded to projects.

IV

The Court concludes that blending the regional investment facility grants with loans from financial institutions to support EU external policies has been generally effective. The regional investment facilities were well set up but the potential benefits of blending were not fully realised due to Commission management shortcomings.

V

The Member States and the Commission have ensured that the regional investment facilities were properly set up and they are now firmly established. The lending element of the funding was mainly provided by four European financial institutions, which identified the qualifying investments. Over the last 7 years, they have identified sufficient projects for committing the funding available.

VI

The 30 projects examined by the Court were all judged to be relevant for the regions and countries concerned. However, the approval process undertaken by the Commission was not thorough, and the decisions to award the grants, at a particular level, were frequently not convincingly evidenced. Guidance on what criteria the Commission should use in its decision-making was also lacking. Once grants were approved, the advance disbursements were unnecessarily high. The Commission's monitoring did not ensure that the added value of grants was achieved in all cases.

1 In addition to loans, to a lesser extent there are also other forms of non-grant financing.

VII

The regional investment facilities provided the development partners with a platform for working closely together and for undertaking very large projects, which would have been difficult to finance otherwise. The justification for awarding grants for blending with loans was clear in certain cases, especially where concessionality criteria had to be met. However, in other cases, in fact in about 50 % of the cases examined this was not evident. The Commission did not fully capitalise on the potential for a positive impact on the way projects were set up or for a wider impact on sector policy. The visibility of EU support has been limited so far although the Commission started to address the situation.

VIII

The Court makes a number of recommendations for the Commission to improve the effectiveness of the regional investment facilities. The recommendations concern project selection and grant approval, disbursement of funds, monitoring of the implementation of EU grants, and enhancing the visibility of EU aid.

Introduction

The potential benefits of blending external cooperation grants with loans

01

Blending mechanisms combine loans[2] from financial institutions with grants. The grants may take various forms but, in the case of EU cooperation with developing countries, the most common types of grants are direct-investment grants, interest-rate subsidies, technical assistance and loan-guarantee schemes.

02

The main aim of blending mechanisms is to leverage external cooperation funds by mobilising loans from financial institutions. Blending aims, in particular, to address sub-optimal investment situations in the case of activities or infrastructure that could be viable but do not attract sufficient funding from market sources. The following are the main reasons why projects cannot attract financiers at normal market rates:

(a) they are insufficiently profitable but present high economic, environmental and/or social benefits;

(b) they have excessive risk profiles;

(c) they are located in heavily indebted countries that are subject to International Monetary fund (IMF) requirements for loans (see ***Box 1***).

03

In addition to mobilising loans from financial institutions, blending offers the grant donor the possibility of being involved in the formulation of policies or of having an impact on the way projects are set up and managed. This may, for instance, be by mitigating the negative externalities of projects, such as detrimental environmental or social effects, or by providing additional funding for specific objectives related to the project, such as administrative or technical capacity development.

2 In addition to loans, to a lesser extent there are also other forms of non-grant financing.

Box 1

IMF requirements for loans in heavily indebted countries

The IMF requires that heavily indebted countries only contract loans with terms that are substantially more favourable than loans at market conditions. Such loans are referred to as concessional loans. In heavily indebted countries, the IMF requires the concessionality level to be at least 35 %.

04

There are also other, more general, potential benefits associated with the use of blending:

(a) It promotes cooperation between stakeholders in the sphere of development aid. Blending mechanisms are set up in partnership with European financial institutions in particular, and thus benefit from their specific expertise and knowledge. Increased cooperation may also result in greater transparency, economies of scale and reduced transaction costs for the partner country. It also enables the implementation of projects that are too large to be financed by a single donor or financial institution.

(b) It enhances the awareness by beneficiaries and the general public that investments were financed with the support of donors. Combining interventions by various donors and financial institutions is a means of achieving the critical mass required to create the visibility of aid.

EU blending mechanisms

05

The Commission has been granting interest rate subsidies for a long time. More recently, however, the Commission and Member States have set up dedicated mechanisms that accelerate the use of blending. Since 2007, the Commission has created eight regional investment facilities that cover the Commission's entire sphere of external cooperation (see ***Annex I***). They combine grants funded by the European Development Funds (EDFs) and the EU general budget with loans, mainly from European development-finance institutions. In some cases, direct contributions are also made by EU Member States.

06

The regional investment facilities have a three-tiered structure of governance[3]:

(a) A strategic body[4] that has the task of setting the overall strategy of the financing facility;

(b) An executive body[5], consisting of the Commission, Member States and other donors, which is responsible for approving individual grants;

(c) A technical body[6], consisting of financial institutions and the Commission, which establishes a common project pipeline and selects the projects to be presented to the executive body.

3 The Western Balkans Investment Framework (WBIF) constitutes an exception in that it is governed by a steering committee and a project financiers' group.

4 Referred to as 'strategic board' or 'steering committee'.

5 Referred to as 'operational board' or 'executive committee'.

6 Referred to as 'Project Financiers' Group' or 'Financial Institutions Group'.

07

Following consultations with the respective partner country or countries, the financial institutions propose projects[7]. Development of the project pipeline is led by the financial institutions. They identify and select projects on the basis of their own financial assessment criteria and apply for a grant, specifying the type and amount.
The process of project development involves collaboration with the Commission, notably within the technical bodies and at EU delegation level. The lead financial institution of a project monitors the implementation of the project and reports on its progress. The lead financial institution is entitled to a fee for managing the implementation of projects.

08

The EU–Africa Infrastructure Trust Fund (ITF) is the only regional investment facility that operates as a fund. The European Investment Bank (EIB) acts as treasurer for this fund. In the case of the other regional investment facilities, the Commission in most cases channels the grants to the final beneficiaries via the lead financial institution. The beneficiaries themselves award and manage the underlying contracts. However, the financial institutions implement the technical assistance and monitor the implementation of the blended projects. Each of the regional investment facilities has a secretariat to support the executive bodies. The secretariats are hosted by the Commission[8], except in the case of the ITF, whose secretariat is run by the EIB.

09

There are also other EU blending mechanisms. The main example is the Investment Facility created in 2003 by the Cotonou Agreement for a period of 20 years. Other examples of blending outside the scope of the regional investment facilities are the Facility for Euro–Mediterranean Investment Partnership (FEMIP) and the Global Energy Efficiency and Renewable Energy Fund (GEEREF).

10

The amount allocated by the EU to the regional investment facilities for the 2007–13 period was 2 106 million euro (see ***Annex II***). By the end of 2013, the Commission had already disbursed 1 205 million euro. The executive bodies of the regional investment facilities had approved 387 projects (see ***Annex III***), the grants for which totalled 2 346 million euro (see ***Annex IV***). These were accompanied by loans totalling 22 152 million euro. So far, the loans have a zero default rate.

11

The projects supported are mainly public investment projects. The sectors covered vary from one facility to another, but the transport and energy sectors receive most funding[9]. The projects range from fairly small, starting at 0,3 million euro, to ones accounting for more than 1 000 million euro. In the majority of cases, more than one financial institution is involved. In some cases, the regional investment facilities do not allocate funding to a single investment project, but to a different facility or fund. In the case of such sub-facilities, the financial institutions select and finance sub-actions, which involve local financier partners.

7 Applications for WBIF grants are mainly made by partner countries.

8 Directorate-General for Development and Cooperation (EuropeAid), with the exception of the WBIF, whose secretariat is provided by the Directorate-General for Enlargement.

9 About 55 %.

12

The four main financial institutions[10] involved in the regional investment facilities from the outset are the EIB, the European Bank for Reconstruction and Development (EBRD), the Agence Française de Développement (AFD) and the Kreditanstalt für Wiederaufbau (KfW). ***Annex V*** provides an overview of the loan amounts they approved over the 2007–13 period for the 387 projects that received support under these facilities.

13

In December 2012, the Commission launched the EU Platform for Blending in External Cooperation in order to examine how to improve the quality and efficiency of regional investment facilities. The process is ongoing and the expected output is a set of recommendations and guidelines on the use of blending in external cooperation and on how to mobilise additional public and private resources to increase the impact of EU external cooperation and development policy.

10 The other eligible financial institutions are: Agencia Española de Cooperación Internacional para el Desarrollo (AECID), African Development Bank (AfDB), Belgian Investment Company for Developing Countries (BIO), Caribbean Development Bank (CDB), Council of Europe Development Bank (CEB), Compañía Española de Financiación al Desarrollo (COFIDES), Finnish Fund for Industrial Cooperation Ltd. (FINNFUND), Inter-American Development Bank (IADB, observer in LAIF), Luxembourg Development Agency (Lux-Dev), Nordic Investment Bank (NIB), Private Infrastructure Development Group (PIDG), Österreichische Entwicklungsbank AG (OeEB), Società Italiana per le Imprese all'Estero (SIMEST), Sociedade para o Financiamento do Desenvolvimento (SOFID).

Audit scope and approach

14

The Court assessed the effectiveness of blending the regional investment facility grants with loans from financial institutions to support EU external policies by focusing on the following two questions:

(a) Have the regional investment facilities been set up and managed well?

(b) Did the use of blending yield the intended benefits?

15

This audit, which was the first by the Court in this particular area, was carried out between May and December 2013 and looked at how the regional investment facilities had performed since their creation. The Court focused its audit on the EU financial allocations and the role of the Commission. The audit work consisted of an analytical review, interviews with Commission staff, a survey of 40 EU delegations[11], visits to the four main financial institutions and a detailed examination of a sample of projects. The sample[12] consisted of 15 projects that received grants from the ITF (see ***Annex VI***) and 15 projects that had received grants under the Neighbourhood Investment Facility (NIF) (see ***Annex VII***). These two regional investment facilities cover both the EDF and the EU general budget, and represent more than 70 % of the grants approved by the regional investment facilities by the end of 2013. They are also the oldest investment facilities and thus have the most advanced projects. Because of their particular characteristics, the audit also included an examination of eight projects relating to the creation of sub-facilities (see paragraph 11) for financing actions with the involvement of local financial institutions (see ***Annex VIII***).

11 22 EU delegations responded to the survey.

12 The Court selected the projects randomly by monetary unit sampling.

The regional investment facilities have been set up in an appropriate manner, but the Commission's management is still affected by shortcomings

16

The Court examined whether the overall set-up of the regional investment facilities and the procedural framework were appropriate. The audit also focused on the procedure for assessing grant applications, the justification for the projects selected and the appropriateness of the type and amount of the grants. Finally, the implementation of the grants and monitoring of the projects were also examined as part of the audit.

The set-up of the regional investment facilities is satisfactory and the regulatory and procedural framework is improving

17

It is appropriate to have eight different regional investment facilities instead of one global investment facility because:

(a) the facilities have different structures for combining the funding from the various donors involved and channelling it to the projects;

(b) EU funding to the geographical investment facilities comes from different financial instruments, which have different legal bases;

(c) the allocation of responsibilities within the Commission and the financial institutions is geographically based;

(d) the parties represented in the various governance bodies (see paragraph 6) vary from region to region.

18

The objectives and priority sectors under all the regional investment facilities are aligned with global EU policy objectives. In the case of the ITF, only projects with a regional dimension were eligible, which limited the potential for blending.

19

The Financial Regulation[13] recently introduced specific rules on blending mechanisms[14]. These rules, applicable from 2014 onwards, significantly improve the regulatory framework by defining concepts and principles, simplifying the management modes used for blending, and providing the legal basis to use innovative financing tools. The Commission is currently further improving the framework by preparing guidelines for the management of the regional investment facilities[15].

20

While the Commission has made some progress in this area, projects were generally initiated by financial institutions with the Commission responding to these proposals and the ensuing grant requests, rather than actively identifying operations.

13 Regulation No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).

14 A new Title VIII, Financial Instruments, was introduced.

15 Practical guidelines that have helped partner countries to understand the requirements connected with WBIF project applications and submissions have existed since 2012.

21
The secretariat of the ITF is operated by the EIB (see paragraph 8). In view of the fact that the EIB is a project financier and irrespective of the fact that the secretariat is ring-fenced from the EIB's banking activities, this is an issue that needs to be addressed.

Suitable projects are selected but the Commission's assessment does not focus adequately on the added value and amount of EU grants

Selection of projects for grants assistance

22
The process for identifying and selecting projects enabled sufficient grant applications to be made in order for the funding allocated to be committed within the planned timeframe. The projects approved were relevant to the development needs of the regions and countries concerned.

23
To request a grant from a regional investment facility, financial institutions need to submit a grant application form[16]. Although they became longer and more detailed over time, the information provided by the financial institutions before grant approval was too general for appropriate decision-making by the executive bodies of the regional investment facilities. Quantified data were lacking on loan conditions, concessionality (see ***Box 1***) and viability (see ***Box 2*** for an example). Furthermore, the expected added value of providing a grant was not well formulated, structured or quantified.

16 The 'Standard Project Submission Form' in the case of the geographical investment facilities managed by EuropeAid, the 'Project Grant Application Form' for the WBIF and the 'Cover Sheet' for the ITF.

Box 2

ITF project — Power rehabilitation in Benin and Togo

The project concerned the construction and refurbishing of electricity transmission lines and substations for a total of 85,7 million euro. It aimed to improve the reliability and efficiency of the electricity supply in Benin and Togo. The ITF granted an interest rate subsidy of 12,25 million euro which enabled the concessionality level of 35 % to be met, as required by the IMF (see ***Box 1***).

Insufficient information provided by the financial institution

The grant application form provided by the financial institutions does not include figures on the financial and economic viability of the project, concessionality and the alignment of the project with the countries' needs even though it was all available in the financial institution's files. Furthermore, the form was unclear about the expected added value of the ITF grant. Without this information, the Commission could not carry out an appropriate assessment of the grant request.

24
An underlying reason why the information provided by the financial institutions was limited was that projects were often still at the preliminary stage when the grant applications were made. The financial institutions decide on their loans at a later stage, i.e. after the feasibility study. Their decisions were therefore based on better, more detailed information than the Commission had when it assessed the grant applications.

25
Although there is no particular guidance for this, the Commission has improved its reviews of grant applications over time. However, the reviews remain largely based on the information presented in the grant application form and are therefore limited by it. For the projects examined, the reviews paid little attention to concessionality, debt sustainability, the grant amount or economic viability. The Commission has not established criteria for the economic viability. In fact, it has no clear rules or guidance as to which type of development investments should be financed by either grants, loans or a blend of the two.

26
The Commission's reviews progressively involved the relevant EU delegations by consulting them when assessing grant applications. The Court's examination of projects and interviews with delegation staff indicated that this involvement was still insufficient, in particular during the identification phase. Only 59 % of the 22 EU delegations that responded to the Court's survey said they were involved in the identification process of blended projects. This limited the extent of ownership of projects by the delegations. However, once financial institutions applied for a grant, the Commission asked most of the delegations to provide their views on the projects selected for their respective countries.

27
The average number of days from introduction in the pipeline to final board approval is 215 for the ITF, 257 for the LAIF and 290 for the NIF[17]. In the LAIF and the NIF, each project needed provisional and final approval at both technical and board level, which was time-consuming. This procedure was somewhat lighter for the ITF, which did not require provisional approvals[18].

Selection of grant type and amount

28
The grant types chosen (see paragraph 1) were appropriate for the added value they intended to achieve. Only the ITF provided interest rate subsidies; the other regional investment facilities did not, even though this was permitted by their regulatory and contractual framework.

17 The information necessary to calculate this was not available for the other regional investment facilities.

18 Although the possibility exists for financial institutions to request a so-called 'Cleared in principle' from the Executive Committee.

29

Eleven of the 30 grants examined by the Court aimed to ensure that the loan met the minimum concessionality level of 35 % required by the IMF (see ***Box 1***). For seven of these 11 grants, the Court could not obtain evidence from the Commission or the financial institutions showing that the concessionality level was not higher than needed to meet the IMF requirement. In one case, the concessionality level exceeded the minimum of 35 % without the Commission being informed of it.

30

There were no established criteria for setting the amounts of grants where the main objective was other than compliance with IMF requirements. In the cases examined, it was often unclear how amounts had been decided upon. Furthermore, the Commission did not consider it necessary to carry out a rigorous verification of the way the grant amounts requested by financial institutions have been calculated.

31

In theory, financial institutions could set an interest rate that is higher than normal and have it accepted by the beneficiary by including a grant in the financial package. Consequently, there is a risk that the benefit of grants is not fully transferred to the beneficiary. Although the public development financial institutions are responsible for providing the most appropriate financing conditions, neither the Commission nor the Court can exclude that this risk may materialise as they don't have the means to examine this due to the confidentiality of how interest rates are set[19].

The Commission makes advance disbursements that are unnecessarily high

32

Once grants have been approved and agreements signed, considerable advance disbursements were made. The Commission had the funds available and transferred these before they were needed. The beneficiary used these funds slowly because it took time to set up the project and contract the necessary services and works and because of the duration of implementation. The funds transferred remained therefore unused for long periods of time, contrary to the principles of sound financial management (see ***Box 3*** for an example). As a consequence, the budgetary outturn does not reflect the actual underlying activity of the facilities.

33

For the ITF, the Commission makes transfers to the fund and then the EIB, as manager of the fund, transfers grants from the fund to the lead financial institution. The ITF's executive board approves grants for a total that does not exceed the cash balance available in the fund. With this prudent approach, the ITF ensures that it will be able to meet its commitments. As it takes time before project implementation actually starts, the beneficiary will disburse the respective amounts only some years later. As a result, a large amount of money lies dormant in the fund's bank account for years (see the ***Figure***).

19 As already observed by the Court in paragraph 3.2 of Special Report No 3/99 on the management and control of interest rate subsidies by the Commission (OJ C 217, 29.7.1999, p. 1).

Box 3

NIF project — Second phase of the Tunis fast railway network

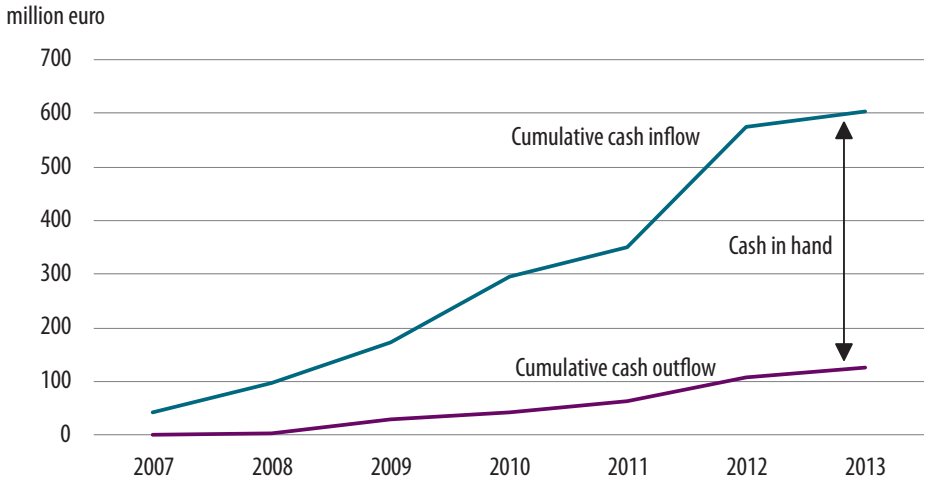
This 550 million euro project finances the construction of priority sections of two new lines of the high-speed urban railway network of Tunis. The NIF grant of 28 million euro provides technical assistance to the contracting authority and the supervisor.

Unnecessarily high advance disbursement of the NIF grant

In 2010, the Commission transferred the entire grant to the beneficiary. The financial institutions disbursed their loans only when the beneficiary needed the funds. As the project experienced significant implementation delays, the first loan disbursement took place only in 2013. Due to the delays, 24,5 million euro of the NIF grant was left unused for more than 3 years.

Figure

ITF Cash flow movements



Source: ITF Secretariat.

In the case of sub-facilities, the criteria for awarding sub-loans were vague or broad

34

For the eight sub-facilities (see paragraph 11) examined by the Court (see ***Annex VIII***), there was no provision that the activities to be financed by the sub-facility should be individually approved *ex ante* by the Commission and in only one case were they approved by the financial institution. At the same time, the criteria for selecting activities eligible for sub-loans were vague or very broad in the majority of the cases[20], with no mention of the sectors and priorities concerned. The Commission could not therefore be certain that the expenditure focused on EU priorities (see ***Box 4*** for an example).

20 With the exception of the Geothermal Risk Mitigation Facility.

Box 4

NIF project — SME Finance Facility

The SME Finance Facility, which had a total of 150 million euro to allocate consisted of two products. The first provided technical assistance to the local partner financial institutions and a loss risk sharing facility to loan portfolios. The second provided technical assistance and interest-free loans in order to reduce interest rates and provide a loss/risk-sharing cushion. The NIF grant for this project was 15 million euro.

Broad criteria for selecting activities to be financed by the sub-facility

The grant application form provided by the financial institutions did not clearly indicate at which level the sub-loans needed to be approved. It also failed to specify the responsibility of the lead financier in the appraisal and selection process. There was no provision for the selection process to take account of the EU priorities as the eligibility criteria accepted investments in all sectors. Furthermore, reporting requirements for project follow-up were not clearly specified.

The extent of the Commission's monitoring of the implementation of grants varied

35

The secretariats of the regional investment facilities are responsible for overall financial monitoring of the facilities. The financial institutions monitor the implementation of the projects themselves. At Commission level, responsibility for following up grants lies with the EU delegations. The extent of their follow-up varied due to the absence of clear internal guidelines (see paragraph 19) and the different levels of involvement by the delegations in the identification of projects (see paragraph 26). In addition, contractual arrangements with the financial institutions to provide information were unclear and insufficiently demanding.

36

Performance monitoring has been limited and unstructured so far. Within the EU Platform for Blending in External Cooperation, a results-based monitoring system is being designed to include a set of standard indicators for monitoring purposes.

37

As with other development projects financed by the EU, the Commission randomly selected blended projects for Results Oriented Monitoring (ROM). This exercise consisted of short, focused, on-site assessments by external experts following a consistent methodology. The ROM assessments looked at many aspects of project implementation on the basis of five criteria: relevance, efficiency, effectiveness, potential impact and likely sustainability. However, the assessments did not focus specifically on the added value of the grants. Regarding the results of the ROMs, it was not clear whether the financial institution or the EU delegation was expected to take action on the conclusions and recommendations. Projects supported by the ITF, however, were not subject to ROM.

The intended benefits of blending grants and loans have not been fully achieved so far

38

The Court assessed the extent to which the intended benefits of blending have been achieved. These include mobilising additional non-grant financing, being involved in the formulation of policies, having an impact on the way projects are set up and managed, improving donor coordination and enhancing the visibility of European development cooperation aid (see paragraph 4).

The need for a grant to enable the loan to be contracted was demonstrated for only half of the projects examined

39

Projects that received support from the regional investment facilities also attracted significant funding from non-European financial institutions as well as from beneficiaries. For the sample of projects examined by the Court, the European financial institutions together provided 45 % of the total investment costs, some 20 % was raised by non-European financial institutions and 25 % from own contributions from beneficiaries. The latter is good practice in order to ensure that the beneficiaries take responsibility for the investments. Funding was thus provided, in the main, by institutional development banks and private sector lending has been low to date.

40

The ITF provided interest rate subsidies with the aim of making the financial institution loan concessional according to IMF criteria (see paragraph 29). The grant therefore enabled the investment to take place. At the end of 2013, 14 of the 71 projects for which ITF support was committed had this objective. They represented 217 million euro out of a total of 494 million euro committed by the ITF.

41

The regional investment facilities also funded a significant number of activities during the pre-investment phase. These were mostly studies, such as feasibility studies, necessary for setting up an investment project and for which financial institutions in general had only limited financial resources available. These projects accounted for 46 % of the ITF projects examined, 20 % of the NIF projects examined and 70 % of all WBIF projects[21]. The vast majority of these studies led or will most likely lead to actual investment projects and can therefore, at least to some extent, be said to have facilitated the investment financed by a loan (see ***Box 5*** for an example).

21 This corresponds to 18 % of ITF committed amounts, 10 % of NIF committed amounts and 35 % of WBIF committed amounts.

Box 5

ITF project — Maputo Airport

The ITF financed consultancy services during the preparation phase of works at the international airport in Maputo (Mozambique). The planned investment concerns the rehabilitation and improvement of the runways, taxiways and airfield ground lighting. The consultancy services cost 0,6 million euro and consisted of a feasibility study for the design of the project and the preparation of the tender process.

Good practice of technical assistance during the pre-investments phase leveraging the financing for an investment

The technical assistance successfully prepared the project. The investment cost of 52 million euro is financed by loans provided by European financial institutions. Construction work will start in the second half of 2014.

42

For 15 of the 30 projects examined by the Court, there was no convincing analysis to show that a grant was necessary in order for the loan to be contracted (see ***Annex IX***). Depending on the case concerned, there were indications that the investments would also have been made without the grant:

(a) In one case, the purpose of the grant was to render the loan concessional but the beneficiary country was no longer bound by the IMF rules on concessional lending;

(b) In two cases, a significant proportion of the investment was directly financed by the EDF. A grant was therefore not necessary to render the financing package concessional;

(c) In four cases, the grant was marginal compared to the total investment cost and did not significantly increase the overall financial profitability of the project;

(d) In one case, the project was financially viable even without the grant;

(e) In one case, the government was very committed to making a high profile investment with environmental benefits even though the financial profitability was very low. Awarding a grant was not necessary in order for the government to commit to covering possible future losses;

(f) In five cases, the grant served mainly to help the financial institutions to propose a financial package that was likely to be accepted by the governments of the beneficiary countries, for instance by matching the other financiers' offers for the projects concerned;

(g) One case involved the creation of a sub-facility for providing credit-enhancement support. The sub-facility consisted of two identical products one of which was able to operate successfully without any grant funding.

The potential for Commission involvement in the formulation of policies and for having an impact on the way projects were set up and managed was not fully exploited

43

Grants from regional investment facilities often have a positive impact on the way projects are set up and managed (see paragraph 3). For the 30 projects examined by the Court, this was achieved in various ways depending on the project:

(a) In 11 cases, the grant made it possible to introduce project components that would most probably not have been financed otherwise. Examples of such components included useful technical assistance and introducing a pro-poor emphasis for the project (see ***Box 6*** for an example);

(b) In three cases, the Commission was directly involved in setting up the project because it made the project proposal, financed the feasibility study and/or co-financed the project through a direct contribution;

(c) In two cases, the grant financed feasibility studies, which were an important element for deciding on the nature and scope of investment projects;

(d) In one case, the grant enabled the project to have a significantly wider scope.

Box 6

ITF project — Lake Victoria Water and Sanitation — Kampala Water

The project concerned the enhancement of the financial and operational capacity of the National Water and Sewerage Corporation in Kampala (Uganda). It aimed at increasing the reliability of and access to water supply services for the population of Kampala and the surrounding areas. The total project cost was 212 million euro. The ITF financed technical assistance worth 8 million euro for project preparation, as well as an interest rate subsidy of 14 million euro, which ensured a concessionality level of 35 % as required by the IMF.

Good practice on impact on the set-up of the project

The grant brought about social benefits through the pro-poor focus of the project. In particular, the project improved the supply of drinking water and basic sanitation in the poorer areas around Kampala. The grant benefits were transferred to the final beneficiaries by providing water to the poorest households at reduced rates. Without the grant funding, the project would have focused solely on richer areas.

44
In the 13 other projects examined by the Court, however, there was no evidence that the contributions from the regional investment facilities had any influence on the way projects were set up.

45
Of the projects examined by the Court, there were 10 cases where the grant has also had a positive impact on the policy of the beneficiary country in the sector concerned. In most of these cases, the grant reinforced an already existing policy dialogue with the Commission in the sector in which the projects were implemented. The potential of policy dialogue was greater when the grant actually mobilised additional financing (see paragraph 42).

46
In the 20 other projects, there was no evidence that grants had a wider impact on policy in the sector in which support was provided. When the financial institution attached conditions to its loans, in most cases they were directly related to the implementation of the project. The Commission was not involved in monitoring and assessing compliance and in most cases did not require the regional investment facilities to attach conditions to the grants that related to the policies of the sectors concerned.

Blending enhanced donor coordination but the visibility of EU funding has been limited to date

Donor coordination

47
The regional investment facilities encourage coordination between development partners by providing a framework for the financial institutions to meet and discuss their investment plans and to coordinate their efforts in a way which goes beyond the projects themselves. This is good development practice, in line with the Paris Declaration principles[22].

48
Of the 38 ITF and 73 NIF investment projects[23] for which the executive boards committed grants by the end of 2013, 26 and 52 projects received loans from more than one source.

49
Blending enabled the funding of large projects by combining different sources of funding within individual projects. At the end of 2013, the ITF and the NIF committed support to, respectively, 22 and 26 investment projects that received loans of a total value of more than 100 million euro. Such projects would have been difficult to finance by a single financial institution.

50
The Mutual Reliance Initiative (MRI) established by three European financial institutions further enhanced cooperation and coordination. The MRI is a formal framework set up in 2009 by AFD, EIB and KfW with the purpose of increasing effectiveness in co-financing development projects. Its main features are the delegation of most tasks to the lead financier of an operation and the mutual recognition of procedures. This reduces transaction costs for the beneficiary, which is in line with aid effectiveness principles. However, decisions and contracting remain with each financial institution.

Visibility of EU funding

51
The regulatory framework of the regional investment facilities stipulates general visibility rules[24]. The main principle is that the lead financier ensures EU visibility which is at least equivalent to its own visibility. Contractual arrangements relating to individual projects generally also stipulate the need for adequate visibility[25] although they fail to provide concrete rules or instructions. The Court's examination of individual projects and the survey of EU delegations showed that the financial institutions have so far provided only limited visibility of EU grants in blended projects. There are a number of underlying reasons for this:

(a) The contractual framework does not contain clear and concrete rules or instructions for financial institutions with regard to visibility;

22 The Paris Declaration (2005) outlines the following principles for making aid more effective: ownership, alignment, harmonisation, results and mutual accountability.

23 Not taking account of the 33 ITF and 18 NIF pre-investment projects (see paragraph 41).

24 For instance, in Article 10 of the agreement laying down the implementation rules of the ITF and paragraph 13 of the NIF framework agreement between the financial institutions and the Commission.

25 In the case of NIF-type facilities, all contribution agreements include a clause that requires the financial institution explicitly to mention the support of the European Union through the NIF.

(b) With the exception of the Communication and Visibility Manual for EU External Actions, which was drawn up for projects implemented by the Commission, there are currently no particular rules or guidelines adapted to the specific characteristics of blending;

(c) With the exception of a few cases, there are no budgets allocated to visibility;

(d) Reporting on efforts to provide EU visibility is not required.

52

The Commission is currently stepping up its efforts to improve EU visibility of blended projects. In the latest version of the grant application form, the planned communication and visibility activities need to be described. Furthermore, in some cases the Commission required financial institutions to draw up a communication plan, which is good practice. Although clear guidelines are lacking, some EU delegations have taken the initiative to help publicise the grants of the regional investment facilities.

Conclusions and recommendations

Conclusions

53
The Court concludes that blending the regional investment facility grants with loans from financial institutions to support EU external policies has been generally effective. The regional investment facilities were well set up but the potential benefits of blending were not fully realised due to Commission management shortcomings.

54
Together with the Member States, the Commission successfully launched the regional investment facilities and their overall set-up is appropriate. A number of European financial institutions were attracted that identified sufficient projects for the funding available. The audited projects were relevant to the development needs of the regions and countries concerned. Although the grant types were appropriate, the Commission's review of grant applications was based on incomplete information and has not focused enough on the added value of grants. Once grants were approved, the advance disbursements were unnecessarily high and the Commission's monitoring did not ensure that the added value of grants was achieved in all cases.

55
The regional investment facilities facilitated coordination between development partners at various levels, which has made it possible to fund projects that would be too large for financing by a single donor or financial institution. However, the other potential benefits of blending grants and loans have not yet been fully achieved. In half of the cases, blending has enabled loans to be contracted for instance by making them concessional, in line with IMF requirements. In the other half of the cases, however, there was no convincing analysis to show that a grant was necessary for the financial institutions to contract the loans. Furthermore, the Commission did not fully capitalise on the potential for a positive impact on the way projects were set up or for a wider impact on sector policy. The visibility of EU support has been limited so far, although the Commission has started to address the situation.

Recommendations

56
After 7 years experience with the regional investment facilities, the Commission is seeking to improve their set-up and operation, for instance by preparing guidelines and participating in the EU Platform for Blending in External Cooperation. In this process, the Court invites the Commission to take account of the following recommendations.

57

The Commission should ensure that the allocation of EU grants is based on a documented assessment of the added value resulting from the grants in terms of achieving EU development, neighbourhood and enlargement objectives. In doing so, the Commission should:

(a) ensure that adequate guidelines are adopted and implemented in order to steer the Commission's involvement at all stages of the approval and follow-up process;

(b) take a more proactive role, in particular at EU delegation level, in identifying and selecting projects;

(c) ensure that grant applications submitted to executive boards for final approval concern only mature projects and contain complete information. More specifically, the grant applications should detail the need for and added value of the grants and clarify how the amounts have been established;

(d) shorten the average duration of the approval process by reviewing the systematic need for provisional approvals.

58

The Commission should disburse funding only when the funds are actually needed by the beneficiary.

59

The Commission should improve its monitoring of the EU grant implementation. In doing so, the Commission should:

(a) implement a results-measurement framework that includes indicators for following up the impact of EU grants;

(b) provide clear instructions to EU delegations regarding their role in monitoring EU support for blended projects;

(c) include the ITF in the ROM process and adapt ROM methodology to the specific characteristics of blending.

60

The Commission should increase its efforts to ensure that appropriate visibility is afforded to EU funding by defining clear visibility requirements for financial institutions and requiring the EU delegations to be involved in visibility actions.

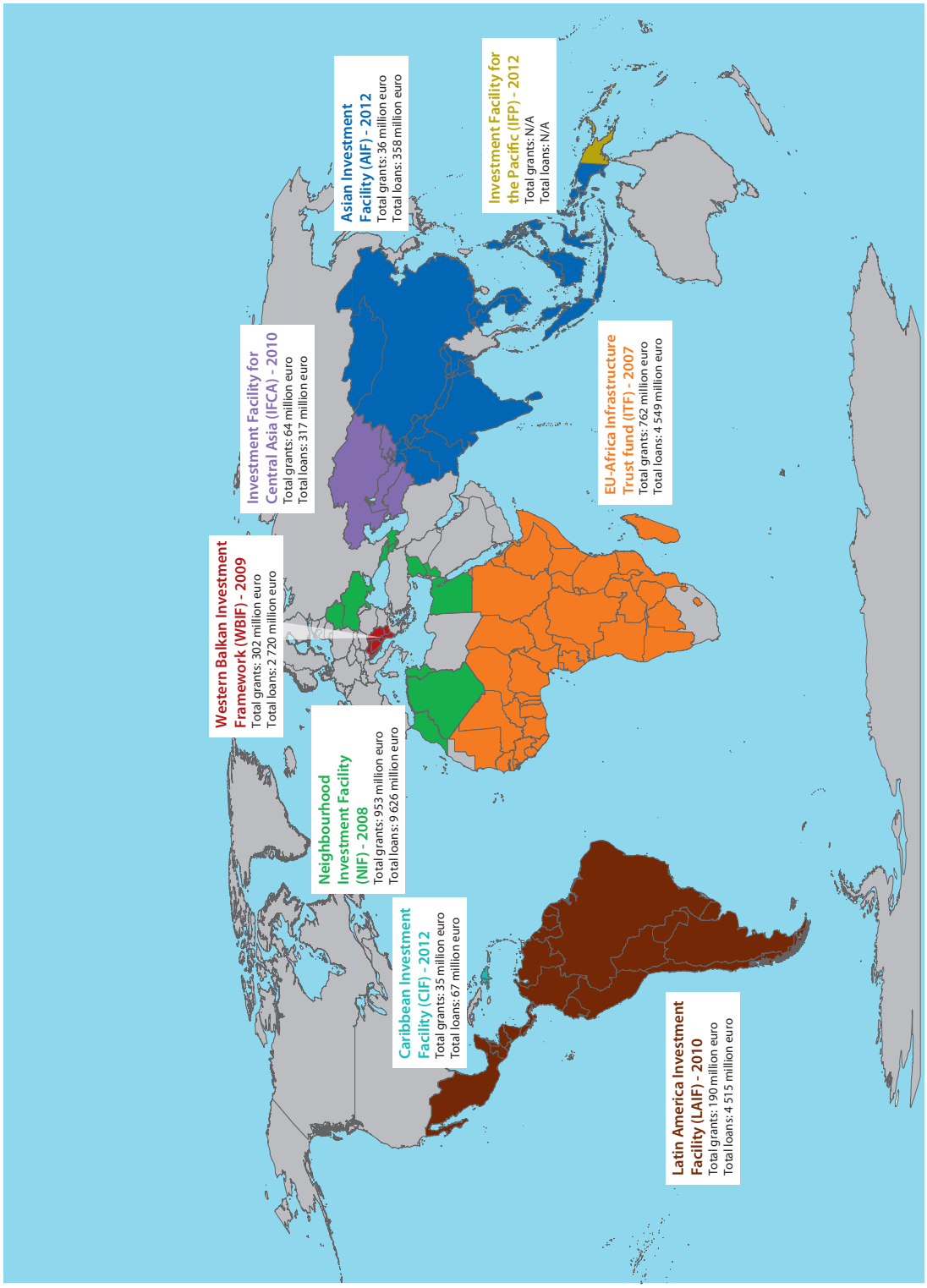
This report was adopted by Chamber III, headed by Mr Karel PINXTEN, Member of the Court of Auditors, in Luxembourg at its meeting of 8 July 2014.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

Annex I

Global coverage of regional investment facilities



Source: Databases held by the secretariats of the regional investment facilities.

Amounts committed, contracted and paid by the Commission per regional investment facility as at 31.12.2013

(million euro)

	Committed	Contracted	Paid
ITF	638	638	459
WBIF	274	260	214
NIF[1]	789	477	422
LAIF[1]	179	160	78
IFCA	86	66	22
AIF	60	34	9
CIF	70	2	1
IFP	10	-	-
Totals	2 106	1 637	1 205

1 This does not include an additional 17 million euro committed in 2011 for Climate Change Facility to be shared between NIF and LAIF.

Source: European Commission.

Annex III

Number of projects approved by regional investment facility for the 2007–13 period

	2007	2008	2009	2010	2011	2012	2013	Totals
ITF	4	4	9	13	13	11	15	69
WBIF	-	18	47	16	42	31	24	178
NIF	-	14	13	15	15	18	17	92
LAIF	-	-	-	5	3	12	5	25
IFCA	-	-	-	1	3	3	4	11
AIF	-	-	-	-	-	3	5	8
CIF	-	-	-	-	-	-	4	4
Totals	4	36	69	50	76	78	74	387

Source: Databases held by the secretariats of the regional investment facilities.

Annex IV

Contributions to the 387 projects approved by the regional investment facility for the 2007–13 period

(million euro)

		ITF[1]	WBIF	NIF	LAIF	IFCA	AIF	CIF	Totals
GRANTS									
Investment facility	**Commission**	383	226	696	190	64	36	35	1 630
	Other donors	114	-	-	-	-	-	-	114
National/regional indicative programmes		80	-	200	-	-	-	-	280
Other donors		185	76	57	-	-	-	-	318
Total grants		762	302	953	190	64	36	35	2 342
LOANS									
EU	**Multilateral**	1 237	2 360	7 095	209	312	110	-	11 323
	Bilateral	1 127	360	2 531	1 992	5	248	37	6 300
Non-EU	**Regional**	1 174	-	-	2 314	-	-	30	3 518
	Multilateral	826	-	-	-	-	-	-	826
	Bilateral	185	-	-	-	-	-	-	185
Total loans		4 549	2 720	9 626	4 515	317	358	67	22 152

1 ITF Commission and other donors' contributions calculated as pro rata of the payments made to the Fund.

Source: Databases held by the secretariats of the regional investment facilities.

Financial institution loans by regional investment facility for the 2007–13 period

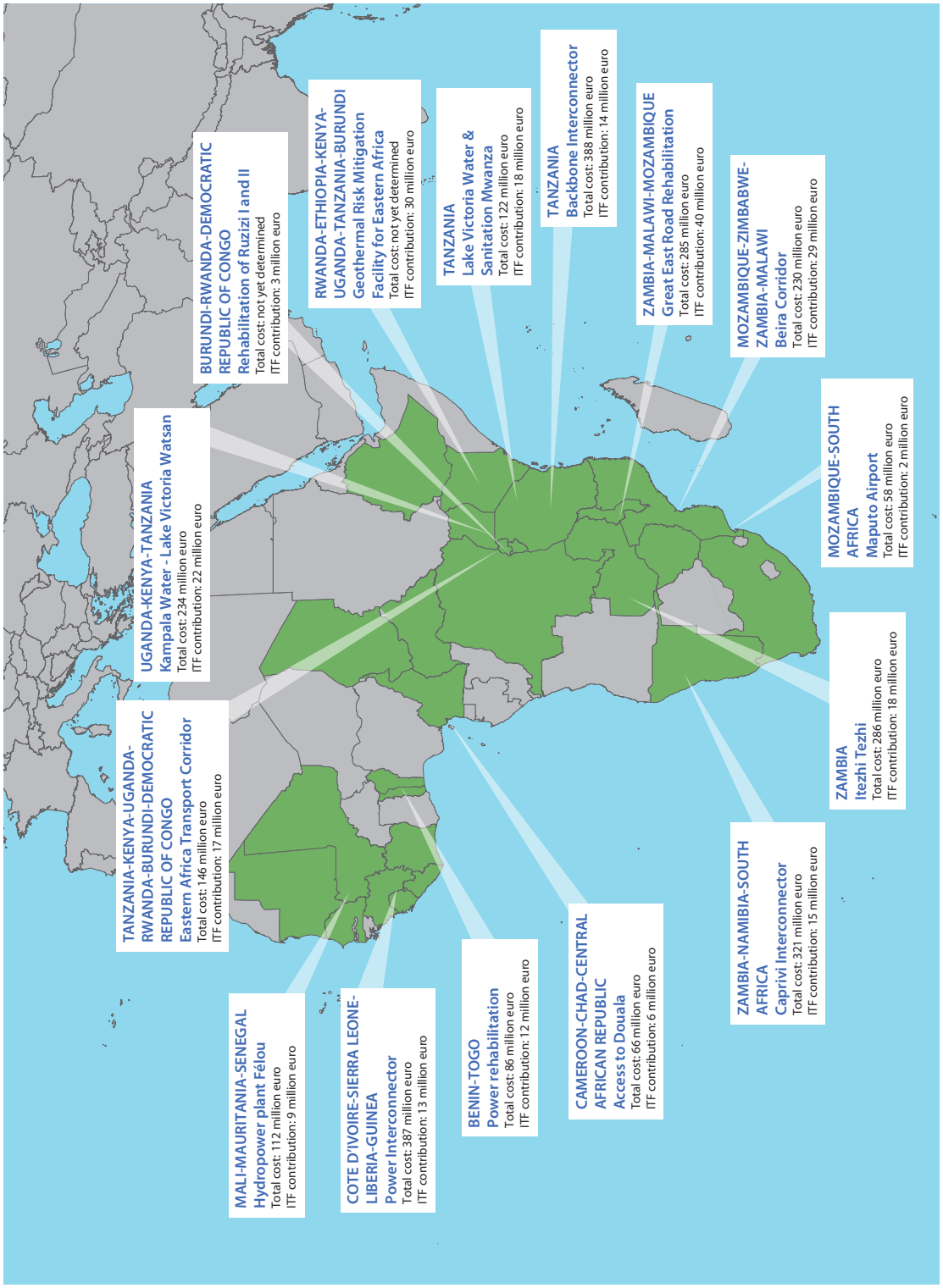
(million euro)

	EIB	EBRD	AFD	KfW	Other financial institutions	Total
ITF	1 237	-	881	246	-	**2 364**
WBIF	1 760	600	200	160	-	**2 720**
NIF	4 498	2 588	1 100	1 429	11	**9 626**
LAIF	209	-	823	772	397	**2 201**
IFCA	170	142	-	4	1	**317**
AIF	110	-	203	45	-	**358**
CIF	-	-	37	-	-	**37**
Total	**7 984**	**3 330**	**3 244**	**2 656**	**409**	**17 623**

Source: Databases held by the secretariats of the regional investment facilities.

Annex VI

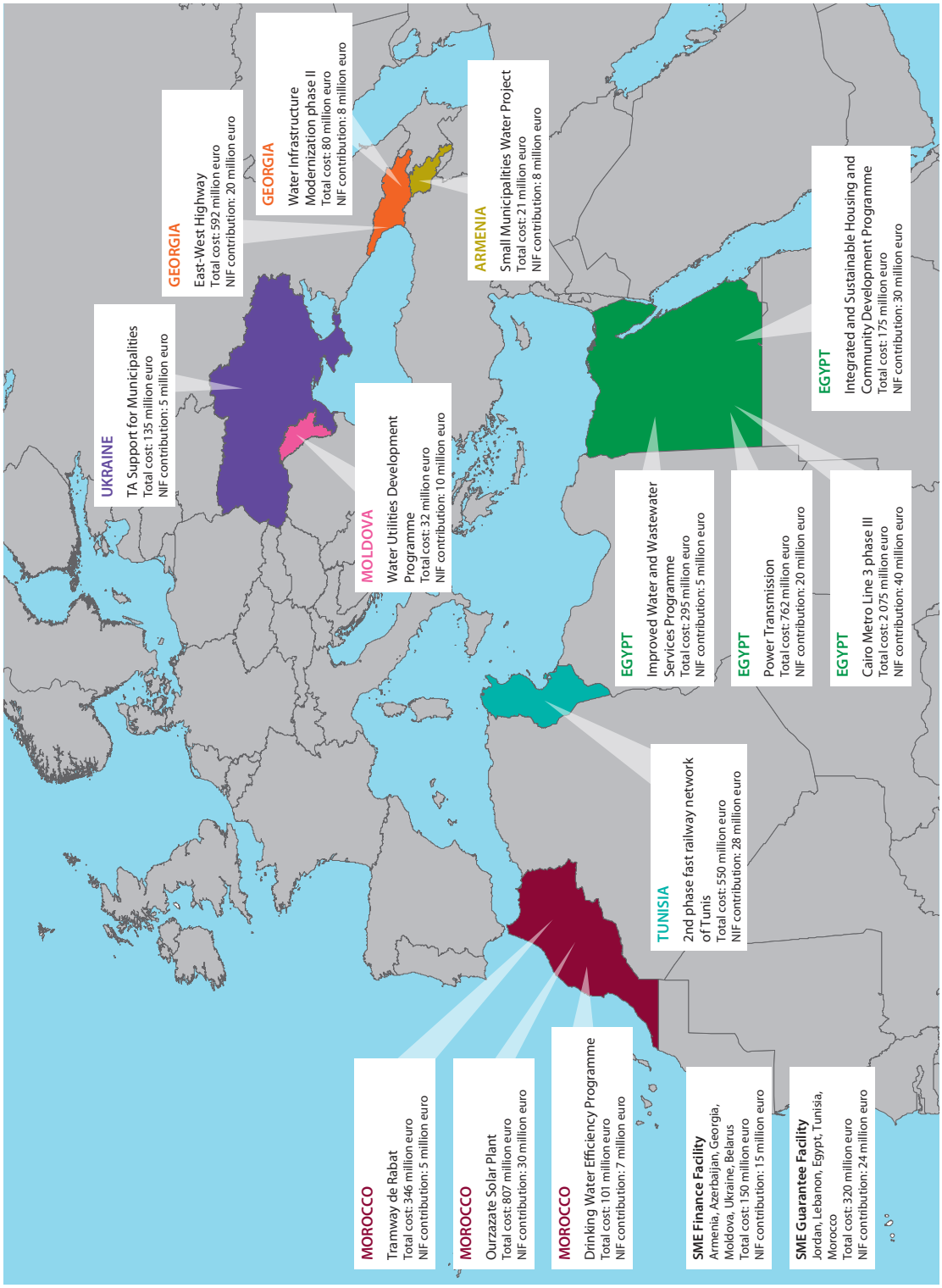
Sample of 15 ITF projects examined



Source: Databases held by the secretariats of the regional investment facilities.

Annex VII

Sample of 15 NIF projects examined



Source: Databases held by the secretariats of the regional investment facilities.

Annex VIII

Audit sample of projects for the creation of sub-facilities

Facility	Title	Tool	Grant amount *(million euro)*	Country/region	Lead finance institution	Other sources of external financing
ITF	Africa Energy Guarantee Fund	Technical Assistance	1	Regional	EIB	-
ITF	African Sustainable Energy Facility	Technical Assistance/Grant	8	Regional	EIB	-
ITF	Geothermal Risk Mitigation Facility	Grant	30	Rwanda, Ethiopia, Kenya, Uganda, Tanzania, Burundi	KfW	-
NIF	SME Guarantee Facility	Grant	24	Jordan, Lebanon, Egypt, Tunisia, Morocco	EIB	AFD, WB, OFID
NIF	SME Finance Facility	Technical Assistance/Grant	15	Armenia, Azer-baijan, Georgia, Moldova, Ukraine, Belarus	EBRD	EIB, KfW
NIF	MENA fund for Micro, Small and Medium Enterprises	Technical Assistance/Grant	10	Regional	KfW	-
IFCA	Kyrgyzstan sustainable energy efficiency financing facility	Technical Assistance/Grant	7	Kyrgyzstan	EBRD	-
IFCA	SME Finance Facility for Central Asia	Technical Assistance/Grant	11	Regional	EBRD	-

Annex IX

Projects referred to in paragraph 42

Facility	Project title	Tool	Grant amount *(million euro)*	Country/region	Lead finance institution
ITF	Power interconnector	Interest rate subsidy	13	Cote d'Ivoire, Sierra Leone, Liberia, Guinea	EIB
ITF	Caprivi interconnector	Interest rate subsidy	15	Zambia, Namibia, South Africa	EIB
ITF	Great east road rehabilitation	Interest rate subsidy	25	Zambia, Malawi, Mozambique	EIB
ITF	Eastern Africa transport corridor	Interest rate subsidy	17	Tanzania, Kenya, Uganda, Rwanda, Burundi, Democratic Republic of Congo	EIB
ITF	Itezhi Tezhi	Interest rate subsidy	18	Zambia	EIB
NIF	Improved water and wastewater services programme	Grant	5	Egypt	KfW
NIF	Tramway de Rabat	Technical assistance	5	Morocco	AFD
NIF	2nd phase fast railway network of Tunis	Grant	28	Tunisia	AFD
NIF	Water infrastructure modernisation II	Technical assistance/Grant	8	Georgia	EIB
NIF	SME Finance Facility	Technical Assistance/Grant	15	Armenia, Azerbaijan, Georgia, Moldova, Ukraine, Belarus	EBRD
NIF	Power transmission	Technical assistance/Grant	16	Egypt	EIB
NIF	East–West highway	Grant	20	Georgia	EIB
NIF	Ouarzazate solar plant	Grant	30	Morocco	EIB
NIF	Drinking water efficiency programme	Technical assistance/Grant	7	Morocco	KfW
NIF	Cairo Metro Line 3, phase III	Technical assistance/Grant	40	Egypt	AFD

Reply of the Commission

Executive summary

I

The Commission welcomes this special report as well as the draft recommendations that will further enhance the management of the blending facilities, an innovative approach to development cooperation financing.

Investment needs in EU partner countries are substantial. Government and donor funds are far from sufficient to cover these needs. Countries need to attract additional public and private financing to drive economic growth as a basis for poverty reduction.

The Agenda for Change emphasises the support of inclusive growth and job creation as a key priority of EU external cooperation. In this context, blending is recognised as an important vehicle for leveraging additional resources and increasing the impact of EU aid.

By bridging financing gaps in investment projects, the EU grant often enables projects as a whole and can therefore mobilise more additional financing than loans from financial institutions. In addition, the public financial institutions directly participating in blending also provide financing beyond loans such as equity or subordinated debt, for example.

IV

The Commission is responsible for the set-up of the facilities, assessed positively in the report. The management of the projects is carried out in partnership. The Commission administers the facilities while the development finance institutions are responsible for the daily management of the projects. They implement the budget tasks that have been entrusted to them, in compliance with the rules of the indirect management mode laid down in the Financial Regulation.

The Commission has devised this set-up taking full account of the potential benefits of the facilities and considers that its management has been adequate.

The Commission considers that the realisation of the potential benefits should take into account the nature of the grants (e.g. technical assistance) and the results of the implementation of the projects.

VI

The Commission considers that the approval process was thorough: all relevant stakeholders are adequately involved and the Commission adapts the consultation process to the specificities of the projects. Sufficient and complete information is available during the decision-making process.

Added value is assured in all cases: Projects are submitted to the competent Operational Board only when all the project components have been clarified and its added value is apparent.

The arrangements for advance disbursements are being reviewed in the new contract templates for financial instruments.

VII

The Commission considers that justification for the financing was clear in all cases. These cases are described in paragraph 42 of this report and have been duly contested and justified by the Commission. Please see Commission's reply to paragraph 42, (a) to (g).

In all cases, the priorities of the facilities have been aligned to EU sector policies for each of the regions (clearly stated in their respective Strategic Orientations).

Nevertheless, the Commission will look into ways for the achievement of a wider impact on sector policy as well as for enhancing visibility of EU support.

VIII
The Commission notes that the recommendations made by the Court are totally aligned with the reform of the facilities that the Commission has started at the end of 2013 and which is now entering the approval phase.

Introduction

Box 1
The IMF no longer sets loan-by-loan concessionality requirements, instead it sets an overall average weighted concessionality rate for all borrowings. Hence this mechanistic approach will not automatically apply in the future.

08
The Commission is now considering modifying the ITF in order for it to be managed like the other six regional facilities having the same rules for all and therefore increasing transparency and predictability of the process for all partners and ensuring equal rights to all Member States in operational boards. Furthermore the special funds allocated by the Member States to blending can be still managed by the EIB if they so desire.

12
The Commission is actively promoting the involvement of more Member States agencies in the implementation of the facilities to ensure equal opportunities and increased exchange of best practices.

Observations

16
The Commission considers that the management of the regional investment facilities has been adequate.

The Commission is responsible for the set-up of the facilities, assessed positively in the report. The management of the projects is carried out in partnership. The Commission administers the facilities while the development finance institutions are responsible for the daily management of the projects. They implement the budget tasks that have been entrusted to them, in compliance with the rules of the indirect management mode laid down in the Financial Regulation.

The Commission has devised this set-up taking full account of the potential benefits of the facilities.

18
The Commission is addressing the governance of ITF and the limitation identified by the Court such as the restrictions to regional programmes (e.g. opening to national programmes, different sectors-same voting rights, management by the Commission).

20
The identification of projects is a result of interactions and discussions between different stakeholders, including the partner countries or relevant regional organisations, the Commission and EU delegations, other donors, the financial institutions and in some cases, private sector as well as civil society representatives.

The identification of projects builds on the programming process and on the approved policy priorities by the Commission, EEAS and partner countries. The identification of projects further builds on the strategic discussions held within each blending facility in the context of the strategic board/steering committee and on the discussions held on the analysis of the portfolio of approved projects and on the pipeline of projects.

Being **systematically** 'at the initiative' is not an operational objective in itself for the Commission. The Commission rather strives to maximise efficiency and division of labour in the identification process and build on all stakeholders operationals strengths. This will be further streamlined by the reform of the blending in its approval phase.

21

The Commission envisages reviewing the set-up of the facilities for the Africa region. Please see Commission's reply to paragraph 18.

Common reply to paragraphs 22 to 31

22

Due to the flexible nature and extensive sector coverage of the facilities, the process for establishing a common indicator for value added for all the projects is necessarily complex and almost impossible.

Added value of the grant is always assessed and this assessment has been strengthened over time, in particular, in the context of the work undertaken by the EU Platform.

23

The Commission considers that relevant data required at different stages of approval (provisional and final) were at the disposal of the Commission. Financial data at a provisional approval stage is likely to change. However, at a final approval stage this information is assessed.

Additionally, certain loan conditions might change between the request and the final approval due to economic fluctuations. Therefore, the FIs can finalise negotiations regarding the exact conditions of their loan (interest rate, tenor years, etc.) after the Facility Board's approval.

It is the responsibility of the financiers to carry out the necessary calculations according to international standards, the principle of due diligence and agreed methods in a context of partnership and efficient division of labour.

In-depth project appraisal is made by specialised teams of the FIs in accordance with the principles of due diligence.

The underlying studies are primarily carried out by the lead European Financier and are available whenever there are concerns regarding the suitability of the projects or whenever additional information is requested over and above the information contained in the application.

The Commission does not consider it necessary for financiers to provide the studies in a systematic way as this will only increase the administrative burden without real added value in most of the cases.

24

The Commission underlines that EU contributions have been approved only when the necessary information underlying compliance with the main requirements set out in the Strategic Orientations has been obtained.

All the information needed for taking a decision has been produced and factored in the decision-making process. In accordance with the Financial Regulation and in the context of indirect management, the Commission can rely on the work already done by the entrusted entity, in line with the principles of due diligence and division of labour at the core of our partnership with the financial institutions.

Only sufficiently mature projects are considered for approval. Subsequent feasibility studies aimed at further strengthening project set-up in line with beneficiaries' needs can still be done, thereby enhancing the quality of the project.

Box 2
As recorded in the minutes of the 9th ITF Executive Committee meeting, additional information on this project was provided to its members upon prior request.

This project was approved in 2009. Since then, the grant application form has considerably improved in order to complement the information provided by the financial institutions.

25
All projects financed under the facilities are analysed both from an economic and debt sustainability perspective. One of the main objectives of the Commission and of the financiers is to preserve the envisaged investment and its long term sustainability and development impact.

Still, uniform criteria, such as minimum thresholds, cannot be established for assessing economic viability. The Working Group on the additionality of grants in the framework of blending mechanisms concluded in 2009 that the very nature of the blending operations calls for a case by case approach in terms of assessment of the amount, form and nature of support needed. This approach has been confirmed in the context of the more recent work of the EU Platform for Blending in External Cooperation (EUBEC).

The EIRR (Economic Internal Rate of Return) for projects is always assessed as part of due diligence. Grant allocation decisions are made based on the economic and financial analysis of the projects, as well as the expected social benefits (affordability, impact on health, social situation).

This review is based on the information provided in the grant application form, as well as additional information stemming from exchanges between different Commission services and its delegations, the FI and any relevant stakeholder, before, during and after the technical meetings.

Concessionality, debt sustainability, grant amount and economic viability are all elements at the core of the analysis undertaken by the financial institutions and the Commission.

26
The Commission involves the Union delegations in the review of the suitability of the grant and their advice is sought whenever relevant for the selection process.

96 % of the responding delegations stated that they are involved in the selection process. The lower figure (59%) corresponds to the early identification stage as part of the overall selection process.

The Commission endeavours to further engage Union delegations in the preparation and follow-up of blending operations. This is essential to assure coherence of EU activities, increase EU visibility and strengthen the EU's weight in policy dialogue.

27
The start date for the calculation should not be the entry in the pipeline. The pipeline is only a preliminary indication of potential projects with a very different level of development and different degrees of maturity.

The Commission is of the view that the most suitable indicator is the time elapsed between the approval by the Technical Board and the adoption by the Operational Board at the time of the final approval.

This leads to a result of around 4 months for LAIF projects, 3 months for CIF, 6 ½ months for NIF, 5 ½ months for AIF and around 4 months for IFCA. This timeframe appears to be reasonable considering the technical complexity of blending projects and the potential number of partners involved.

The proof that the length of the procedure is appropriate and reasonable is that there has been no evidence so far that any relevant project was not implemented due to delays in the approval procedure. On the contrary, the approval process has sufficient flexibility to take into account the need of partners allowing speeding up the process, if necessary.

29
The Commission would like to clarify that achieving IMF concessionality levels may be necessary, but not sufficient, in the light of project-specific issues. Meeting the 35 % threshold can be considered a first, necessary precondition for the financing package to be accepted by a beneficiary under IMF restrictions. However, it is not automatically sufficient condition in itself. Certain projects might require a higher grant element of the financing package than 35 % without putting into doubt the significant development impact they provide.

30
The justification for grant amounts requested can vary considerably according to the specific market barrier being addressed, target group affordability, project maturity, local market conditions, availability of funds from other financiers and the capacity and risk appetite of the project implementers, among other conditions. This variance, coupled with the dearth of reliable market information in partner countries, makes it challenging to establish criteria for setting the amounts of grants covering every possible intervention in every possible dynamic market context. Ultimately the Commission has to rely to some extent on the ability of partner finance institutions to negotiate the best deal, i.e. the minimum grant amount, to catalyse a specific project. There are no viable alternatives to this 'pricing' process for some projects. For example, the size of a first loss guarantee for lending to SMEs is not generally determined by historical experience (if there is any) but rather by the lenders' perceived risk — a subjective parameter that can only be determined through skilled negotiation.

Whilst the assessment was challenging in the absence of comparisons between similar projects in the early years of the blending facilities, the Commission builds on experience acquired over the years to refine the assessment process.

Indeed, with the reform of blending discussed and agreed recently, the grant amount provided as financing will be further subject to comparability and increased value for money.

31
There is no evidence to suggest that it has materialised so far. The Commission's partners are development banks, not commercial banks; their main objective is to contribute to development funding. Nevertheless, the confidentiality around pricing models and decisions has indeed hindered widespread use of the interest rate subsidy instrument.

Where interest rate subsidies are used, the Commission relies, in particular, on its own supervision of the multilateral institutions (e.g. through the pillars assessment) and on national oversight and regulation governing the bilateral institutions as elements mitigating this risk.

The calculation of interest rates made by the banks will be subject to scrutiny and benchmarking.

32
In indirect centralised or joint management the advance disbursements were indeed high at the moment of the creation of the first facilities. This was motivated by the need to launch a new aid modality and encourage the financial institutions to take over the management of complex projects.

The arrangements for advance disbursements have been reviewed in the new contract templates for financial instruments and result in a decreased level of prefinancing.

Box 3
The Commission proceeded in full compliance with the applicable rules and regulations.

The disbursement arrangement explained in Box 3 was done in 2010. For the NIF, the Commission has changed this disbursement policy in 2012. (cf. paragraph 32).

In addition, the assessment of this NIF project shall dully take into account the exceptional situation and events that took place in the partner country from January 2011 and that have had an impact on the implementaion of the project.

33
It is envisaged to review the system of advance payments for the ITF.

34
Projects under these facilities are approved and selected directly by the European financial institutions in full compliance with the objectives, activities and criteria established for the project. The selection of the sub-loans and guarantees is determined by the project-related parameters (detailed in the fiche), in particular those spelling out the goals pursued by the project. Due diligence standards of the financial institutions are applied during the approval and selection procedures. These procedures follow an agreed and cost-efficient division of labour among partners which include arrangements for the selection of the subordinated actions. The eligible financial institutions report in detail on the projects included in the facility on a regular as well as on ad hoc basis or when requested by the Commission.

Box 4
The Commission considers that all necessary elements were apparent in the grant application form of the NIF project of the SME Finance Facility.

35
Following the project approval, the Union delegations and/or the Commission Headquarters (depending on the scope of the project) secure adequate follow-up.

Commission services are in regular contact with the Bank's national offices in the relevant countries, meetings take place with the delegation and the local project coordinators of the lead financial institutions. The lead financial institutions have the contractual obligation to submit reports annually to the delegation. Furthermore, as foreseen in contracts signed within delegated cooperation, the Commission is involved, informed and invited to monitoring missions carried out by the lead financial Institution on the ground.

The contractual arrangements are sufficiently clear for adequate monitoring.

By increasing the earlier involvement of delegation in the process, follow up and monitoring will also increase. Instructions to delegations will be updated to this effect.

36
The Commission acknowledges the reference to the ongoing work on results-based indicators to be used by the finance institutions for monitoring and reporting purposes and stresses that performance monitoring is carried out by the lead finance institution.

37
All the projects are submitted to monitoring and evaluation(s). Some mid-term evaluations have been finalised, like in the case of NIF, or will be launched shortly, like in the case of LAIF.

Furthermore, the Commission would like to stress that:

(i) ROM procedures for the DEVCO-managed regional investment facilities are the same as for the other DEVCO projects; and

(ii) DEVCO takes the necessary actions to address ROM results: for projects which have undergone the ROM process the results are sent to the EU delegation/units in Headquarters involved in the project management. A reply is expected from the delegation and is usually submitted to the lead finance institution. If necessary a contradictory meeting is organised aiming at clarifying the findings of the ROM. Additionally the Commission's representatives are meeting with the consultants who carried out the ROM visits for regular debriefing sessions in order to be informed about the situation on the ground.

It is envisaged to review the management of ITF projects in the future in order to possibly align it with the other facilities.

Common reply to paragraphs 39–42

39

The Commission does not share the analysis of the Court on the demonstration of the need for grant support to enable the loan. The grant application form provides the basis for assessment, which is a considered judgement based on inputs from thematic and geographic units, as well as EU delegations and the secretariat, often supplemented by additional queries. The assessment of the Commission supported by technical meetings with financial institutions and operational Boards with the presence of the Member States is solid and well grounded. The Commission considers that the selection process of the grants gives sufficient assurance and proof of its need.

42

The Commission does not share this analysis for the following reasons:

42 (a)

The possible financing without ITF contribution under the IMF programme had indeed a ceiling for non-concessional lending (see Table 1 of the IMF Country Reports for 2009 and 2010), therefore any additional lending had to be concessional. The decision of any given project being considered for concessional or not lending is a sovereign decision of Zambia, after discussion with the international community depending on the economics of each project.

42 (b)

The EDF grant alone had proven insufficient to close the financing of the projects. The additional funding, necessary to close the funding gap, was made possible only by the mobilisation of financial institutions resources through the ITF contribution.

42 (c)

Grants may have high added value even if small in size, for example in completing a financing gap, in improving the project quality, etc. In three of these cases the grant helped soften the overall financial conditions, as the financing package proposed by the co-financiers was not considered fully acceptable by the borrower. For the other project, the grant allowed the increase of the potential impact of the projects including the financial benefits.

42 (d)

The Commission does not share the Court's conclusion. The final beneficiary could have chosen another alternative that would have been more profitable but would have brought negative environmental impacts. The ITF grant helped facilitate the investment into the environmentally preferred option and compensating for the higher investment costs.

42 (e)
The Commission does not share the Court's conclusion for which there is insufficient evidence.

The NIF grant was necessary to unlock the overall investment package of the project and was completely in line with policy objectives of the EU and of the partner country.

42 (f)
The Commission does not share the assessment. It implies that the grant was required for the related loans to be accepted by the beneficiary, and that the blended package was comparable with other financial offers and was not overly subsidised.

42 (g)
This observation does not take into account that the 'unsubsidised' product operated on the assumption that the subsidy would come. The NIF contribution in such a scheme is certainly needed for the EFIs to be able to provide loans at a rate that incentivise banks to on-lend to SMEs. The fact that the NIF contribution is not (or partly) spent is rather a sign of success. It paves the way for a follow-up facility with a lower level of NIF contribution (without implying that the NIF grant should be lower in the case of another first operation in a country).

44
The Commission is proactively influencing the set-up of the projects. The type of influence will very much depend on the type of project since projects have different objectives and different expected impacts. Blending projects are set up in a context of partnership and of sharing of responsibilities among donors. The Commission has a key role in this partnership, exercising a wide influence in all relevant aspects of the projects.

46
The Commission is of the view that the facilities generally leverage considerable policy gains.

The policy environment is an integral part of the project appraisal. Each project has its own specific objectives and expected impacts, which differ according to the nature of the project. A single project is not expected to impact on all objectives (furthermore, it is not advised to do so).

In the case of ITF, when the project coincides with the delegation's focal sector, there is indeed scope to commonly influence the sector policy. This is different in cases where a project does not fall in the delegation's focal sector while, nevertheless bearing a regional reach.

51
For political and strategic reasons, the Commission (even though considering that EU visibility guidelines were respected) will step up visibility arrangements and further involve delegations in the process.

51 (a)
There are specific articles in all the contracts (both in the general conditions and in annex providing the description of the action) for the projects financed under the regional blending facilities. These articles stipulate that the lead finance institution shall ensure appropriate visibility of the grant.

In addition, in the new Indirect Management Delegation Agreement which will be used as from 2014 for all the projects contracted under the Regional Blending Facilities there is an annex particularly foreseen for a Communication and Visibility Plan which will be established for each individual project.

As for what refers to WBIF, DG Enlargement has ensured via its technical assistance contracts (IPF and IFICO) that all communication and promotional tools (website, reports, guidelines fact sheets, seminars, workshops, etc.) indicate the EU's role in the mechanism. Furthermore, greater cooperation with the communication units of the IFIs is being developed and increased references to the EU and WBIF are now evident. Greater visibility and consistency should be further improved as all WBIF communications activities will be centralised in the new expanded IFICO contract.

52
The Commission stresses that the Communication and Visibility Manual for EU external actions is valid and applicable to all projects in the external actions area.

Conclusions and recommendations

53
The Commission is responsible for the set-up of the facilities, assessed positively in the report. The management of the projects is carried out in partnership. The Commission administers the facilities while the development finance institutions are responsible for the daily management of the projects. They implement the budget tasks that have been entrusted to them, in compliance with the rules of the indirect management mode laid down in the Financial Regulation.

The Commission has devised this set-up taking full account of the potential benefits of the facilities and considers that its management has been adequate.

The Commission considers that the realisation of the potential benefits should take into account the nature of the grants (e.g. technical assistance) and the results of the implementation of the projects.

54
The Commission considers that the approval process was thorough: all relevant stakeholders are adequately involved and the Commission adapts the consultation process to the specificities of the projects. Sufficient and complete information is available during the decision-making process.

Added value is assured in all cases: Projects are submitted to the competent Operational Board only when all the project components have been clarified and its added value is apparent.

The arrangements for advance disbursements are being reviewed in the new contract templates for financial instruments.

55
The Commission considers that justification for the financing was clear in all cases. These cases are described in paragraph 42 of this report and have been duly contested and justified by the Commission. Please see Commission's reply to paragraph 42, (a) to (g).

In all cases, the priorities of the facilities have been aligned to EU sectoral policies for each of the regions (clearly stated in their respective Strategic Orientations).

Nevertheless, the Commission will look into ways for the achievement of a wider impact on sector policy as well as for enhancing visibility of EU support.

57
The Commission accepts the recommendation. The new application form clearly indicates the different forms of the added value the grant can provide.

57 (a)
The Commission accepts the recommendation. Guidelines on revised governance to steer Commission's involvement at all stages of the approval process as well as on project follow-up are under way in the context of the EU Platform.

57 (b)
The Commission accepts the recommendation. This is an ongoing process, with likely completion at the end of 2014.

57 (c)
The Commission accepts the recommendation. In the revised set up of the governance of the blending facilities it has been proposed that projects will be only submitted for final approval (no provisional approval anymore). The application form includes detailed descriptions of the need and added value of the grant, as well as how the amount has been determined/calculated.

The process must involve preliminary analysis and discussions of the projects included in the pipeline to be clarified before submission for final approval so as to ensure maturity of the projects, impact and value for money.

57 (d)
The Commission accepts the recommendation.

58
The Commission accepts the recommendation. In the future, cash needs will be factored in before disbursing. A new contract template for financial instruments is currently under preparation. The measure will be likely in place by the end of 2014.

59
The Commission accepts the recommendation.

59 (a)
A results measurement framework has already been included in the application form, with the accompanying guidelines clarifying the information requested. The impact of the specific EU grant can often not be separated from the overall project. However, regarding the EU grant the added value has to be clearly pointed out (see above).

59 (b)
Instructions have been sent to all EU delegations, and guidelines are under elaboration.

59 (c)
The Commission partially accepts the recommendation. The Commission will consider the opportunity to adapt the ROM methodology to the specific characteristic of blending.

60
The Commission accepts the recommendation.

A new Indirect Management Delegation Agreement for all the projects contracted under the Regional Blending Facilities is under preparation. This contract template will include an annex particularly foreseen for a Communication and Visibility Plan which will be established for each individual project.

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The Commission and the Member States have set up eight regional investment facilities to support EU external policies. These investment facilities aim at pooling together (blending) grants provided by the European Commission with loans from financial institutions. They contribute to finance key infrastructure projects that require considerable financial resources.

The Court examined the effectiveness of blending EU grants with loans from financial institutions. The Court concludes that this blending has been generally effective. The regional investment facilities were well set up but the potential benefits of blending were not fully realised. The Court makes a number of recommendations for the Commission that concern project selection and grant approval, disbursement of funds, monitoring of the implementation of EU grants, and enhancing the visibility of EU aid.

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