

December 16, 2013

**Comments from Germany— Approval by mail: Ukraine: District Heating Energy Efficiency - IBRD (CTF)**

Dear Patricia and IBRD Ukraine Team,

in principle, we consider this project a good and valuable project to increase energy efficiency in Ukraine.

As far as we can see - and we have noted the valuable comments provided already by UK - , the project design is well done. The combination of investment in energy efficient DH utilities, selection of DH companies by commitment, linking the (hoped for) progress in the population's willingness to pay with a substantial increase in the quality of heating - all this is well thought through. The TA seems acceptable, even though the advisors on procurement are likely to face a steep battle when it comes to local vs. international procurement.

But as the analysis provided in part I. of the proposal seems very realistic, and especially taking the current political situation into account, this needs to be carefully considered before approving CTF funding for the project.

GoU is in charge of approving / setting the tariffs for DH / gas supplied to DH utilities. If one follows the recent GoU statements on a possible gas price hike for residential, it appears extremely unlikely that a cost recovering tariff will be achieved by 2017. It would have to start gradually in 2014 - well before the election. This is the key point deciding on success / failure of the entire project and IBRD is right in qualifying the risk as "substantial" itself.

We are convinced that the investments will improve physically the energy efficiency of the DH utilities. But given the CTF criteria, especially transformational impact, demonstration effects etc. - and such indicators will crucially depend on GoU willingness and ability to raise tariffs -, this does not appear to be sufficient for project approval. If the communal DH companies are not provided with the opportunity to service their debt achieving the results of the project is highly questionable.

As a consequence, we do not feel comfortable to give our go ahead to the project at present.

We would suggest instead that further discussions/consideration are required: these could possibly entail the question of postponement of the project until a reasonably stable political situation would make the necessary regulatory decisions more likely, possibly triggers for tabling the project proposal again, incentives and phasing, appropriate risk mitigation instruments etc.

We would welcome a conference call after the holiday season to discuss all this.

Warm regards  
Annette