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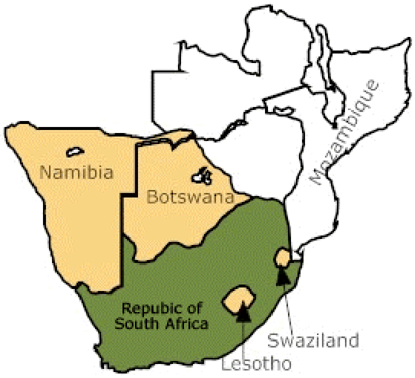

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Evaluation of Borrowing and Lending in Rand

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GLOSSARY

ACP	African, Caribbean, Pacific (countries)
CB	Commercial Bank
CMA	Common Monetary Area
COP	EIB Corporate Operational Plan
DB	Development Bank
DBSA	Development bank of Southern Africa
DIAF	Development Impact Assessment Framework
EDF	European Development Fund
EIB	European Investment Bank
ERR	Economic Rate of Return
EU	European Union
EV	**Operations Evaluation of the EIB Group**
EIA	Environmental Impact Assessment
FB	Final Beneficiaries
FDI	Foreign Direct Investment
FI	EIB Finance Directorate
FI(s)	Financial Intermediaries
FIRR	Financial Internal Rate of Return
GDP	Gross Domestic Product
IDC	Industrial Development Corporation of South Africa Ltd.
IF	Investment Facility (Cotonou Agreement)
IFI	International Financial Institutions
JIBAR	Johannesburg InterBank Agreed Rate
MDBs	Multi-lateral Development Banks
OJEU	Official Journal of the EU
OpsB	EIB Lending Directorate outside the EU
OR	(EIB) Own Resources
PJ	EIB Projects Directorate
RM	EIB Risk Management Directorate
RSA	Republic of South Africa
SACU	Southern African Customs Union
SARB	South African Reserve Bank
SMEs	Small to Medium-sized Enterprises
TDCA	Agreement on Trade, Development and Cooperation between the European Community and the Republic of South Africa
UN	United Nations
USD	United States Dollar
ZAR	South African Rand

References are made throughout this report to the two evaluation reports covering ACP countries that were published in 2006:

- Evaluation of EIB financing through individual loans under the Lomé IV Convention, February 2006 (http://www.eib.org/projects/publications/evaluation-of-eib-financing-through-individual-loans-under-the-lomé-iv-convention.htm);
- Evaluation of EIB financing through global loans under the Lomé IV Convention, May 2006 (http://www.eib.org/projects/publications/evaluation-of-eib-financing-through-global-loans-under-the-lomé-iv-convention.htm).

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NOTICE

The EIB has an obligation of confidentiality in relation to the owners, promoters and operators of the projects referred to in this report. Neither the EIB nor the consultants employed on these studies will disclose to a third party any information that might result in breach of that obligation, and the EIB and the consultants will neither assume any obligation to disclose any further information nor seek consent from relevant sources to do so.

EXECUTIVE SUMMARY AND RECOMMENDATIONS

Following the conclusions of the EU / RSA Cooperation Agreement in 1994, the first mandate was granted to the Bank for lending in favour of operations in the Republic of South Africa (RSA). In parallel, the Bank decided to go on the euro-rand financial market for its borrowing activity. Rand was immediately available for the first operation signed in RSA; rand availability was further extended (2001) to surrounding ACP countries, members of the Common Monetary Area (CMA: RSA, Lesotho, Swaziland, and Namibia) and to Botswana.

Between 1996 and 2006, the Bank committed EUR 1373 million in RSA (3 successive mandates) and EUR 309 million in the four ACP countries on its own resources. During the same period, the Bank borrowed ZAR 17658 million[1] on the euro rand market, of which ZAR 4870 were utilised for EIB lending activity, the complement being used for the Bank's Treasury management. In RSA, 63% of the mandates are disbursed in ZAR while only 23% of own resources lending in the four ACP countries are disbursed in ZAR.

This ex post evaluation covers EIB borrowing in rand and EIB financing in the region between 1995 and 2006. It focuses on the relevance and performance of the operations (lending and borrowing). In addition, the role of the EIB in these activities is evaluated. The specific dimension of associating lending and borrowing in a non-OECD currency is highlighted through an in-depth evaluation of the lending and borrowing portfolios. In-depth evaluations of individual operations are performed on a sample of 9 projects. Finally, the contribution of the Bank to the rand financial markets is analysed.

Relevance

The main focus of the evaluation is on the assessment of the relevance of the whole EIB portfolio for the period 1995 – 2006, both for lending and borrowing.

<u>RSA portfolio</u>: the three mandates, totalling EUR 1,500 million, were fully committed at the end of 2006. Partial cancellations of lines of credit (about 8% of total amount) are compensated by signatures in 2007. Disbursements are reaching a satisfactory level of 85% of the commitments; they follow a regular pattern throughout the years.

<u>ACP portfolio</u>: in the four countries concerned, commitments on own resources amounting to EUR 309 million are 86% disbursed, again in a very regular pattern. When referring to countries' GDP, EIB presence in ACP countries is higher than in RSA, but based on a limited number of operations.

<u>Borrowing activity</u> has been performed for two main purposes:
- 27.5% of total rand amounts raised have been kept in rand for disbursements made for EIB lending operations;
- 72.5% have been swapped to EUR (mainly) for the Bank's Treasury management.

For this assessment, the benchmark is the Agreement on Trade, Development and Cooperation (or TDCA) between the European Community and RSA; although signed in 1999, it is considered the best reference for measuring the relevance of EIB activities in RSA. The Cotonou Agreement (or Lomé IV Convention) is the reference for the four ACP countries.

This evaluation has considered two categories of clients:

a. Borrowers whose resources are only in ZAR and who have limited access to foreign currencies, or necessitate ZAR for on lending.

b. Borrowers whose resources are in foreign currencies and/or have easy access to foreign currency supply.

[1] EUR 1 = ZAR 9.212400 at 31/12/2006

In the first category: SME financing through local banks, municipal infrastructure financing, energy transmission, water sector, transport (roads and urban transport). Projects in this category have a high relevance to the TDCA; they also support sustainable economic development and contribute to poverty reduction.
In the second category, projects are supporting sustainable economic development and are in line with TDCA priorities.

In RSA, 73% of the financing is done in category A projects, the relevance of the Bank's lending portfolio in RSA is GOOD.
54% of the disbursements are made in ZAR for category A projects. Without ZAR, the Bank would not satisfy this demand. It is also reasonable to assess that the EIB would not have been able to commit total mandate amounts without ZAR availability on reasonable terms and conditions.
In RSA, the relevance of the Bank's borrowing in ZAR for on lending in own resources is GOOD.

Similar analyses for the four ACP countries conclude that the relevance of the Bank's lending portfolio (in own resources) is GOOD (81% in category A) and that the Bank's borrowing in ZAR is SATISFACTORY (23% of disbursements only in rand as this facility was introduced later).

The relevance of the Bank's borrowing in ZAR for its own Treasury management is SATISFACTORY; it helps to develop and promote cooperation (TDCA) and corresponds to the demands of the financial markets (see the role of the EIB).

Performance of the operations

Performance has been assessed on a sample of nine operations (five direct loans and four lines of credit), and on the borrowing activity in general.

All five operations financed achieved their key physical objectives without problems, on time for implementation and in line with or below cost expectations (effectiveness: satisfactory or good). Cost benefit analyses show satisfactory or good efficiency for four projects; one transport project is negatively impacted by low traffic and low willingness to pay (toll road). Sustainability is positively rated based mainly on competent promoters able to consolidate results even in a difficult and changing environment, except for one electricity project with a (too) weak maintenance programme. All projects have followed rigorous procedures regarding environment issues and ex post observations are in line with expectations or better.

To summarise, considering that relevance is good for all projects, the overall ratings are SATISFACTORY for the five operations assessed.

Two lines of credit are targeting SMES and two are targeting small and medium sized investment in municipal infrastructures.

The financial intermediaries (eight in total as two operations have multiple intermediaries) are rated satisfactory for two commercial banks and good for four commercial banks and two development banks. The lines of credit are handled with a satisfactory rating (three cases) or good (one case). The anomaly is, as for previous evaluations[2], an over estimation of potential (translating in part to cancellation of signed amounts). Onlending conditions and the quality of final beneficiaries are acceptable. The handling of environmental matters is of good quality, especially with the two development banks.

Overall the two lines of credit with the commercial banks are rated satisfactory while the two lines of credit with the development banks are rated GOOD. These latest ratings are excellent but can be sustainable only if the development banks remain free of political pressures.

[2] Evaluation of EIB financing through individual loans in ACP countries under the Lomé IV Convention, February 2006; Evaluation of EIB financing through global loans in ACP countries under the Lomé IV Convention, May 2006

The performance of the borrowing activities has been measured through the all in cost (after swap equivalent), comparing ZAR to EUR. Emissions in rand have a higher spread for treasury management than emissions in EUR.
In addition the Bank's financial performance is improved by the allocations of the emissions: longer terms for on lending and higher spreads for Treasury management.

The performance of the borrowing activity is rated GOOD.

The Role of the EIB

While the contribution of the Bank to the operations evaluated in depth varies from moderate to high, this evaluation focuses mainly on the Bank's contribution to the financial markets.

With a market share of 20% on the Euro Rand financial market, the significant EIB presence shows a high contribution due to consistent issues of substantial amounts of bonds, thereby counterbalancing to a certain degree the volatility of the market (mainly caused by the fluctuation of the ZAR exchange rate against the USD). The EIB is a key player on the Euro Rand market but its input on the domestic market is marginal. The South African government, initially considering the EIB as a competitor, now looks favourably on the Bank, as the EIB helped to establish the ZAR as a currency acceptable to international investors. For the future, the Bank is considering, with prudence, its entry on the domestic market.

The Bank's management of the lending operations is satisfactory or better, and good for the borrowing activity, with a timely move in establishing the "Rand Treasury".

Final conclusions

Borrowing activity in Rand is highly successful, with a good financial performance both for the Bank's Treasury management and for delivering adequate financial conditions for lending. This activity contributes to significantly improving the relevance of the EIB portfolio in RSA.

Lending in RSA and the four ACP countries is successful: relevance is good; the Bank is significantly supporting poverty reduction both in RSA and in the four ACP countries. The mandates and the operations are well managed, although with certain areas for improvement.

OBSERVATIONS AND RECOMMENDATIONS

	EV Observations and Recommendations	Responses of the Operational Departments
1	The utilisation of ZAR for the disbursements of loans in CMA countries other than RSA has been uneven and is low in comparison to RSA. Full advantage of ZAR availability is not taken. Recommendation: The Bank should establish a "regional strategy" taking into account ZAR availability, which would help to improve its development impact.	In our view the seemingly low level of ZAR disbursements in the CMA countries (23%) is due to the fact that they relate to overall disbursements made in the period 1996-2006 whereas ZAR became available only in 1999 and the time-lag between signatures and disbursements (most disbursements in the initial years of ZAR availability were made under non-ZAR finance contracts signed previously). In the period 2002-2006 ZAR disbursements represented over 50%; based on the pipeline of operations currently under appraisal, it is expected that this ratio will increase further, as ZAR availability is fully established and taken into account in the lending and marketing strategy.
2	Lending operations disbursed in Rand were initially structured on a back-to-back basis; The contracts were lacking flexibility with small durations and limited amounts. Limitations appeared after 2 or 3 years of operations. The problem was solved with the introduction of the Rand Treasury. Recommendation: When considering issuances in a new "exotic" currency, with a back-to-back structure, the Bank should already look at the possibility of different and more flexible structuring. Otherwise, that type of operation will not be sustainable. Developing a longer-term strategy will be difficult, if not impossible.	The practice to structure funding and lending operations on a strict back-to-back basis has been suspended in the context of the introduction of the NFR loan pricing system. To the extent possible, new local currency lending operations will be funded and hedged with swaps on the basis of the blue curve. This new practice should also allow for a more flexible structuring of the lending product in terms of redemption profile and maturity, given (at least in principle) the greater flexibility in the derivatives markets.
3	Recommendation: The Bank should introduce a DIAF framework for lines of credit. This would enhance the assessment of the Development Impact. In addition it would allow the definition of adequate indicators to be followed (e.g. in some cases, the increase of the maturity of the EIB portfolio in parallel with the disbursement of the EIB loan).	The preparation of a DIAF/ESIAF framework for Global Loans is under way and expected to be available before end November 2007.
4	Part cancellation of signed amounts in lines of credit is high (50% in the third RSA mandate as well as for one ACP country). Recommendation: The Bank should carefully assess the volumes to be signed and favour repeat operations with smaller amounts.	Given the implementation period of global loans and the economic cycles in the countries concerned, it is very difficult to assess the demand for GLs precisely. In addition, the costs of repeat operations with smaller amounts outweigh the potential benefits; the cancellation of unused funds (which can then be used for new operations) is less resource-intensive than the approval/signature of a repeat operation.
5	Monitoring of allocations is uneven and relatively weak for infrastructure finance. Recommendation: The type of monitoring requested should be clearly set and justified at appraisal stage.	Agreed. The monitoring of OpsB operations in currently under review and the aspect of Global loan monitoring will be addressed in this context.

1 Setting the Picture

The **South African Rand** or **ZAR** is the currency of the Republic of South Africa

This evaluation covers EIB activities in rand (Borrowing and Lending) during the period 1995 – 2006.

For the lending activity, the evaluation focuses on the relevance and performance of the operations and includes both direct financing of projects and indirect financing through lines of credit.

For the borrowing activity, this evaluation is equally focussing on the relevance and performance of the financial operations carried out during the period under consideration.

For both activities, the EIB's contribution and the management of the project cycle is included in the evaluation process.

The evaluation has three essential features: first; to increase transparency vis-à-vis EIB governing bodies; second, as a learning exercise to provide assistance to the Bank's operational directorates, thereby increasing the Bank's value added in future operations; lastly the specific assessment of borrowing and lending in a local currency will give a special highlight on this type of activity, which the Bank is currently promoting.

1.1 Scope and Methodology

Scope of this evaluation

This evaluation is mainly based on the Bank's lending activity in the Republic of South Africa (RSA), which started in 1995. Borrowing activity in Rand started in 1996 and is still ongoing. Countries with monetary policies linked to the rand have been included: Lesotho, Swaziland, Namibia and Bostwana (see box). For these countries, the Bank's lending operations from own resources have been considered over the period 1995 – 2006.

Methodology

The comparison of ex post results with the expectations and objectives at appraisal is the main basis for the evaluation of these operations. In accordance with EV's procedures, ratings are split in four categories: Good, Satisfactory, Unsatisfactory and Poor.

The evaluation was carried out by EV staff with the support of external consultants for lines of credit. The relevant operational directorates (OpsB, PJ, RM and FI) were fully involved in its various stages.

The "**Common Monetary Area**" (CMA) of Southern Africa is a currency union that today comprises RSA, Lesotho, Swaziland and Namibia. Foreign exchange regulations and monetary policies for the CMA are defined by the South African Reserve Bank.

Lesotho, Swaziland and Namibia have their own currencies called the "Loti" (Lesotho), "Lilangeni" (Swaziland) and "Namibia Dollar" (Namibia) that are pegged at par to the ZAR (1:1). Because of the membership to the CMA, the ZAR is also legal tender in these three countries and circulates freely besides the respective national currencies.

.

Botswana is not a member of the CMA (therefore ZAR is not a legal tender there) and has its own currency, the "Pula". The Pula is pegged to a basket of currencies, the composition of which is not divulgated, although apparently strongly related to the ZAR.

The following steps have been implemented in order to get a full assessment of the activities concerned:

- A comprehensive analysis of the policies and strategies, both at EU level and at the EIB level, covering the two sets of activities: Lending and Borrowing;

- A full portfolio review, analysing EIB financing levels over the period, highlighting the proportion of operations financed in rand and looking at the corresponding activity of the Bank on the rand market; given the specific dimension of evaluating both lending and borrowing, the assessment of the relevance is performed from the full portfolio review:

- The in-depth evaluation of selected individual operations, representing different countries and categories of loans (see below);

- The in-depth evaluation of the borrowing activity of the Bank in rand.

In-depth evaluation involves detailed assessment and field visits. This evaluation report is a synthesis of the findings and recommendations compiled from the previous steps.

The operations evaluated in depth include:
- 5 investment loans, 2 in the electricity sector, 1 in the gas sector, 1 transport project and 1 agro-industrial operation;
- 4 lines of credit, 2 for the financing of small and medium scale infrastructures and 2 for the financing of SMEs.

1.2 Country Reviews

	RSA	Lesotho	Swaziland	Namibia	Botswana
Population (m)	47	1.8	1	2	1.5
GDP (bn USD)	254	1.2	2.3	6.2	10.4
GDP/capita (USD)	5400	680	2300	3100	6900
Country rating	Baa1	Ba3	B1	Baa3	A2

a) The Republic of South Africa

Africa's largest economy is home to about 47 million people. GDP per capita[3] is about USD 5,400, but is unevenly distributed. The country is categorized as a medium human development country, but HIV/AIDS has pushed life expectancy down to 48 years. Sound macroeconomic management and policy reforms have resulted in significant macroeconomic progress over the last decade. Annual economic growth has been around 4 to 5%, inflation is under control (3 to 6% p.a.), public debt has been reduced to about 35% of GDP and South Africa's external debt position is manageable (external debt about 20% of GDP). Reflecting the sound macroeconomic fundamentals and the relatively stable political environment, the country is rated **Baa1**.

b) Lesotho

Lesotho is a small, landlocked, low-income country, with limited natural resources and a narrow production and export basis. The population suffers heavily from HIV/AIDS (life expectancy 37.2 years) and the country is ranked 149th out of 177 countries on the UN Human Development Index. The economy is highly open (e.g. imports 90% of GDP), and depends heavily on workers' remittances and

[3] In current prices (U.S. dollar), source: IMF World Economic Outlook Database, April 2007

on receipts from the Southern African Customs Union (SACU). GDP per capita is low and recent economic growth has been around 2% per annum. Macroeconomic imbalances persist (e.g. inflation about 4% p.a., public debt and external debt each about 50% of GDP).

c) Swaziland

Swaziland is an equally small, open, landlocked economy within the SACU. Economic performance has been modest (GDP growth below 2% p.a.), and macroeconomic imbalances persist but seem manageable (e.g. inflation about 6% p.a., external debt about 20% of GDP, public debt 15% of GDP). The population suffers from high rates of unemployment (30%) and income-inequality (Gini coefficient[4] 0.61), from frequent food shortages (20% of population requires food aid), and from the highest HIV/AIDS infection rate in the world (almost 40% of adult population). With a high dependence on external factors (e.g. sugar prices, SACU revenues), a poor track record for macroeconomic management and a general lack of political reform, overall prospects for sustained socio-economic development are low.

d) Namibia

Namibia's **Baa3** rating reflects the increasing diversity of the economy; it's large natural resource basis and the stable macroeconomic and political situation. Recent economic performance has been good (real GDP growth around 4.5% p.a.) and is reflected in the per capita GDP. Other key economic parameters are also sound (e.g. public debt 30% of GDP, external debt 20% of GDP, current account in surplus). The highly uneven distribution of incomes (Gini coefficient 0.6), high unemployment (35%) and high HIV/AIDS infection rates (20% of adult population) are major challenges for the future. Membership in the CMA gives Namibia free access to South Africa's mature capital and monetary markets but severely limits the country's ability to follow own monetary and foreign exchange policies.

e) Botswana

With real GDP growth rates of about 8% p.a. over the past three decades, Botswana has been among the world's fastest growing economies, largely driven by the diamond sector (35% of GDP, 75% of exports and 45% of government revenues). GDP per capita is the highest in the region. A stable political environment, good governance and sound economic policies have contributed to this African success story that includes surpluses in public finance, external debt of below 5% of GDP, foreign reserves of about USD 7.5 bn, and a well developed social and physical infrastructure. However, the wide spread of HIV/AIDS (25% of adults), uneven distribution of incomes (Gini coefficient of 0.57) and an unemployment rate of over 20% indicate that not everybody has benefited from this rapid growth in national wealth. Botswana is a member of SACU but not of the CMA.

1.3 Policies and Strategies

Lending

Following the RSA elections in 1994, the European Union signed a Cooperation Agreement with the Republic of South Africa. The objective was to promote harmonious, balanced and sustainable social and economic development in RSA.

In December 1999, the Agreement on Trade, Development and Cooperation (TDCA) between the European Community and RSA was signed. It is one of the most important Agreements, still in force, governing EU/RSA relations. It includes elements of relevance for the Bank' activity.

Republic of South Africa

1994	**First democratic government**
Oct 1994	EU/RSA Cooperation Agreement
June 1995	First EIB mandate (2 years) EUR 300 M
June 1997	Second EIB mandate (3 years) EUR 375 M
Dec 1999	TDCA: Agreement on Trade, Development and Cooperation EU/RSA
Feb 2000	Third EIB mandate (7 years) EUR 825 M
2007-2013	New EIB external mandates EUR 900 M

[4] The Gini coefficient is the measure of inequality of a distribution of income and is defined as a ratio with values between 0 and 1 with 0 corresponding to perfect income equality and 1 to perfect income inequality.

Between 1995 and 2006 three successive mandates governed EIB activities in RSA totalling 1500 M EUR for lending on EIB own resources. All these activities were covered by the Guarantee Agreements in force during the corresponding periods.

> **TDCA : Economic Cooperation (art. 50)**
>
> The Parties agree to develop and promote cooperation on economic and industrial matters to their mutual advantage and in the interest of the Southern African region as a whole, by diversifying and strengthening their economic links, promoting sustainable development in their economies, supporting patterns of regional economic cooperation, promoting cooperation between small and medium-sized enterprises, protecting and improving the environment, promoting the economic empowerment of historically disadvantaged groups, including women, protecting and promoting worker and trade union rights.
>
> See also annex 2: TDCA excerpts

The objective of the Bank's financing was broadly to contribute to the economic development of RSA – principally by promoting growth in the economy. During this period, the objectives of the European Commission were adding more specific requirements to its grant activity, i.e. in order to keep an eye on the historical disparities between different segments of the population and the need to improve the living conditions and economic "empowerment" of historically disadvantaged people.

In 1999, the TDCA introduced objectives applicable to all parties, i.e. including the EIB. As shown in the adjacent box, it calls for cooperation in the whole region and highlights support to historically disadvantaged groups. More specific objectives for the Bank are included for sectors such as SMEs, Energy and Transport, but also related to enhancement of living conditions and delivery of basic social services. The assessment of the relevance of the RSA portfolio (§ 2) will refer to TDCA objectives.

The Bank's activities in the neighbouring countries (Lesotho, Swaziland, Namibia and Botswana) followed the pattern of the ACP mandates, that is the Lomé IV Convention between 1990 and 2000 and the Cotonou Agreement thereafter. These mandates have been described in the report on individual loans in ACP countries under Lomé IV. The Bank can provide risk capital funding as well as own resources funding. Disbursements in Rand were possible on own resources financing.

ACP

1990 → 1991	Lomé IV Convention
1995 → 1998	Lomé IV bis Convention
2000 → 2003	Cotonou Agreement and creation of Investment facility

(NB: the second date indicates the entry into force)

Borrowing

The decision of November 1995 to develop borrowing in the currencies of non-OECD countries was moderated by two factors to be considered in the choice of a currency:

- The existence of a financial market, offering medium and long-term instruments, in the country of the currency concerned and, in the case of an international operation, relatively substantial demand implying the creation of a market between issuers and subscribers;
- The existence of financial mechanisms for the currency in which the borrowing operation is denominated, enabling the Bank to ensure servicing of the loan, whatever the circumstances.

Borrowing

1995	EIB Board authorisation to borrow in the currencies of non-OECD countries
1996	First EIB bond of ZAR 100 million issued on Euro Rand market. On lent on back to back and disbursed in ZAR
1999	Creation of a Rand Treasury Use of ZAR for disbursements in neighbouring countries

Rand market: in parallel the Bank looked at the possibility of supporting the implementation of the EIB mandate with the provision of rand for the financing of RSA projects.

- the domestic market was closed (and still is today) to international borrowers by virtue of South Africa's exchange control regulations;
- on the international rand market (so-called Euro-Rand market), there was a recurrent demand from international investors looking for high yields and accepting the forex risk on the rand, which is counter-balanced by the fact that it is a "natural resources" based currency.

Rand borrowing started in 1996 on the Euro-Rand market (see § 2.1 for more details), disbursed initially on a back-to-back basis to clients.

This activity was reinforced in 1999 though the establishment of a Rand Treasury in the Bank, which allowed for the structuring of loans in accordance to the usual EIB rules.

Following this latest decision, the Bank opened the possibility of disbursing loans in rand to neighbouring countries in 2001, namely Lesotho, Swaziland, Namibia and Botswana.

2 Relevance

This section starts with a global description of the Bank's OR portfolio, both in RSA and in the four ACP countries associated.

Relevance can be analysed well through the sector breakdown of the lending activity. Adding a new dimension, i.e. the currency of disbursement requested by the borrower, further illustrates the relevance not only of the lending activity but also of the borrowing activity. The impact of changes in the exchange rate between ZAR and EUR or USD is analysed. This chapter ends with the conclusions on relevance.

2.1 Portfolio Analysis

2.1.1 Lending: overall figures

RSA: 1995- 2006	EUR M
OR signatures	1373
OR disbursements	1164

<u>Signatures</u>
Own resources signatures in RSA (net of EUR 140 million of cancellation at 21/12/2006) amount to EUR 1373 million. Amounts still available under the third mandate (about EUR 114 million) have been signed before 31/07/2007.

<u>Disbursements</u>
At 31/12/2006, EUR 1154 million with 52.6% disbursed in Rand and 47.4% in other currencies (mainly USD and to a lesser extent EUR). All loans signed before 31/12/2003 have been disbursed (or partially cancelled), which shows an active portfolio.

The comparison with the four ACP countries is justified by the difference in size of the economies. ACP countries represent 8% of RSA GDP and 13.4% of the population; EIB/ACP own resources signatures amount to more than 20% of RSA signatures).

For the purpose of this evaluation, only the own resources (OR) portfolio will be considered for all countries.

ACP: 1995- 2006	EUR M
OR signatures	309
OR disbursements	267
"EDF" signatures	59

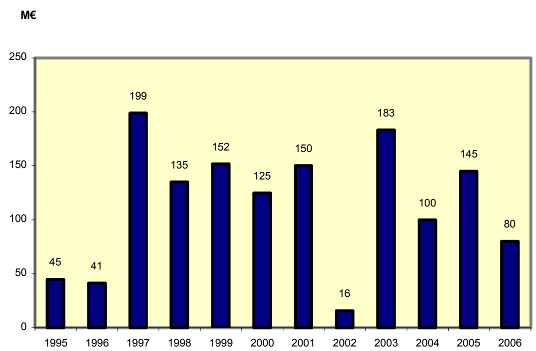
<u>Signatures</u>
Own resources signatures amount to EUR 309 million, with Botswana 59, Lesotho, 52, Namibia 139.5 and Swaziland 53.5. For information, EDF* resources signatures amount to EUR 59 million (Botswana 2, Namibia 9, Swaziland 48).

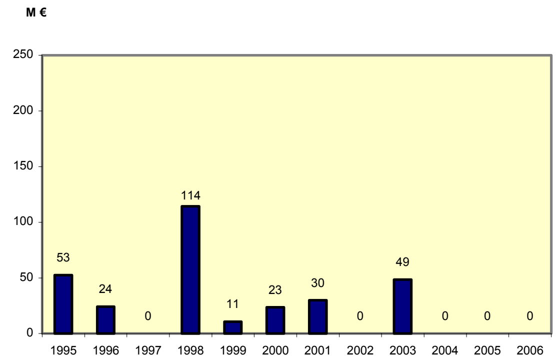
As already noted in a previous evaluation (see reference), these countries belong to the category of "bankable countries" where OR lending exceeds EDF lending and where initial targets are surpassed. These countries have a high level of economic development compared to the average of ACP countries.

<u>Disbursements at 31/12/2006</u>
EUR 267 million are disbursed with 23% in Rand and 77% in other currencies. Only 2 loans signed in 2003 have a remaining amount to be disbursed.

* EDF signatures under the Lomé IV convention between 1995 and 2002 and under the Investment Facility from 2003 onwards.

Lending: OR Signatures per year

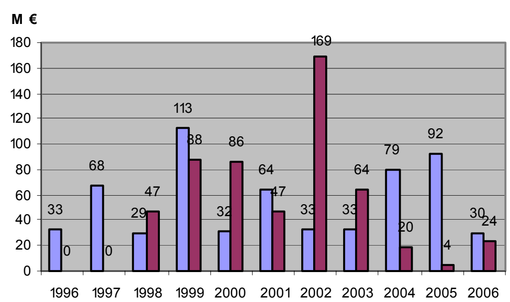


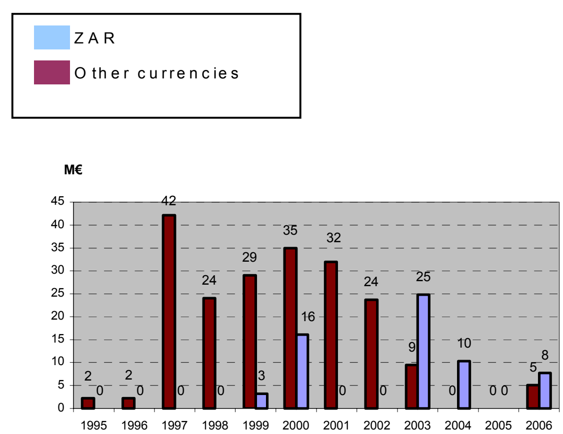


RSA mandates were allocated within the time period allotted. All operations signed until end 2003 have been fully disbursed, except EUR 140 million cancelled. As already indicated in a previous evaluation, the amounts signed on lines of credit are often too optimistic. All cancellations under the third mandate (EUR 126 million) are related to lines of credit. The remaining balance of the third mandate (i.e. EUR 114 million) is being allocated to direct operations

Signatures per year are less regular in the **ACP countries** (Botswana, Lesotho, Namibia and Swaziland). This reflects a smaller potential of sustainable operations and a less organised country strategy. There is no clear rationale for the few signatures during the last three years, with many explanations ranging from the difficulty to set up a project to probably lower priority given to these countries. The preparation of a "regional strategy" could be justified.

Lending: OR Disbursements per year



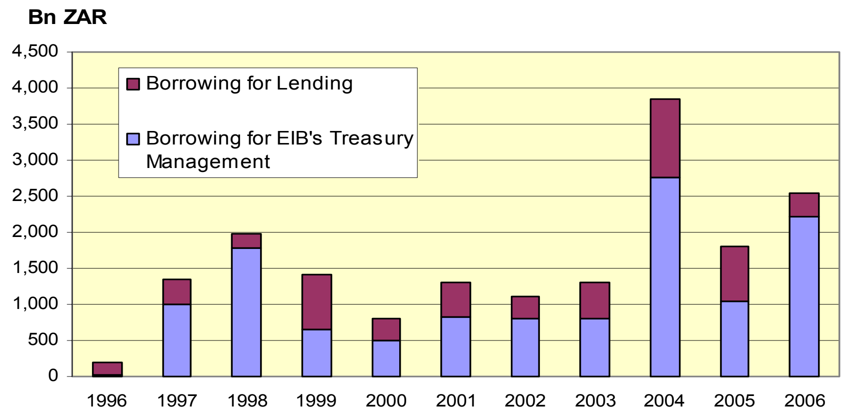


Disbursements in RSA have followed a regular pattern; the obligation to design back-to-back operations translates into relatively quick disbursements. With the introduction of the Rand Treasury, the trend could have changed. Nevertheless, disbursements remain at a high level with only three operations signed recently not fully disbursed (EUR 219 million). The alternative use of rand has always been possible. The following paragraph will explain the yearly changes by the impact of exchange rate movements between ZAR and the other currencies.

Disbursements in the four ACP countries follow the pattern of a few large projects with rather limited time spent between signature and disbursement. At the end of 2006, two projects remained with undisbursed amounts, one water project in Botswana and one irrigation project in Swaziland (both signed in 2003).

2.1.2 Borrowing

During the period under review, the EIB borrowed ZAR for a total amount of ZAR 17,658 million (about EUR 2.3 - 2.4 billion) compared to total disbursements in ZAR of 4,870 million. The difference has been used for the Treasury management of the Bank and swapped mainly against EUR and USD; it accounts for 72.5% of total EIB issues in Euro-Rand.



As the conditions set up by the EIB Board for issuance in non-OECD currencies were met, the first back-to-back operation was made possible before the end of 1996. During the following years, emissions exceeded the need for on lending as there was a demand from the financial market and the financial terms were attractive to both the market and the EIB. In four years, issues reached ZAR 5 billion for only ZAR 1.5 billion of disbursements for EIB loans.

Very quickly, the shortcomings of the back-to-back disbursement structure were critical:

- only 5 (maturity to short) or 10 years (grace period to long) bullets,
- no amortising structure possible for repayment
- smaller loan amounts difficult to accommodate.

Following a clear demand expressed by some borrowers, such as the RSA electricity company, the creation of an EIB Rand Treasury was considered in the late 1990s. This was achieved on 8 June 2000 after an agreement was signed with the South African Reserve Bank (SARB).

Since then the EIB not only offers fixed rate or fixed spread loans in ZAR on a back-to-back bullet base, but also variable rate and variable spread loans to borrowers in the CMA. The utilization of interest rate derivatives (Bank treasury activities) allows to mitigate to a very large extent the interest rate risk borne by the Bank's Treasury. EIB loans with a variable interest rate and a variable spread are currently priced at about JIBAR flat (Johannesburg Inter Bank Agreed Rate). With this funding structure the EIB is in the position to offer long-term amortising loans at competitive interest rates suitable to the RSA and neighbouring market.

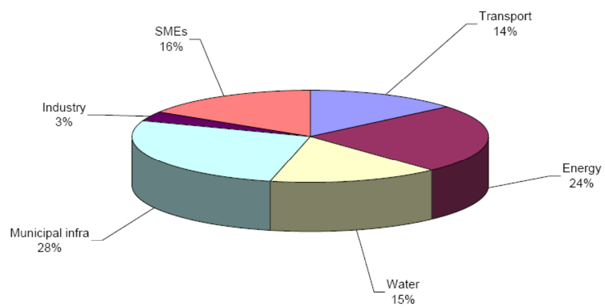
2.2 Sector Breakdown and Currencies of Disbursement

2.2.1 Sector breakdown (on signatures)

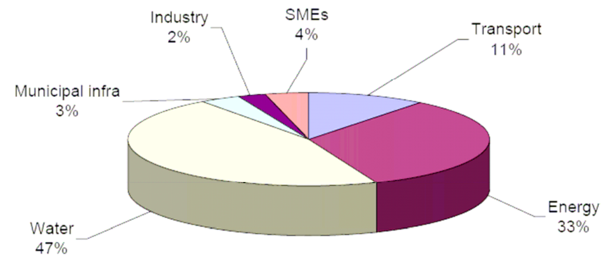
Use of the funds has been grouped within 6 main sectors:

- Transport and Telecommunications (roads, metro)
- Energy (electricity and gas);
- Water (water production and distribution) and irrigation;
- Municipal infrastructure (through lines of credit) with a large variety of sub sectors;
- Industry;
- SME support (through lines of credit).

In RSA, the spread is over all sectors.



In ACP countries, the water sector is largely dominant with priority given by the Bank to the financing of drinking water supplies.



This sectorial breakdown can be refined considering the capacity of the EIB borrowers to take a foreign currency risk and therefore their appetite for ZAR financing.

2.2.2 Sectors and Type of Borrowers

Two main categories are defined:

<u>Category A</u>

Borrowers whose resources are only in ZAR and who have limited access to foreign currencies, or necessitate ZAR for on-lending
Local banks for SME financing
All banks for municipal financing
Energy; distribution and modernisation
All water sector
Transport: roads and urban transport

<u>Category B</u>

Borrowers who have resources in foreign currencies and /or easy access to foreign currency supply.
International banks for SME financing

- Energy: gas fields, large gas pipelines

Telecommunications

- Industry largely export-oriented

a. The RSA Portfolio

The following table illustrates the relation between the 2 categories and the currency of the disbursement used for EIB loans. It is based on disbursements at the end of 2006 adding expected disbursements for the full utilisation of the three mandates.

RSA		**Disbursements**		
	%	**Rand**	**Other**	**Total**
Financing	**Category A**	**54**	18.8	**72.8**
	Category B	9.4	17.8	27.2
	Total	63.4	36.6	100

- Category A
  72.8% of the financing has been done in category A projects. All of them have a high relevance.
  - They all contribute to the EU policy of supporting sustainable economic development.
  - They support activities which have been defined as common priorities in the TDCA agreement (see annex), be it in the water, energy, transport sectors or by financing municipal projects or SME investments.
  - In addition, they all contribute to poverty reduction and all projects are in conformity with article 65/3 of the TDCA: "(…) priority shall be given to supporting operations, which help the fight against poverty".

- Projects in category B also fit the corresponding priorities, although they do not necessarily satisfy the parallel objective of the fight against poverty.

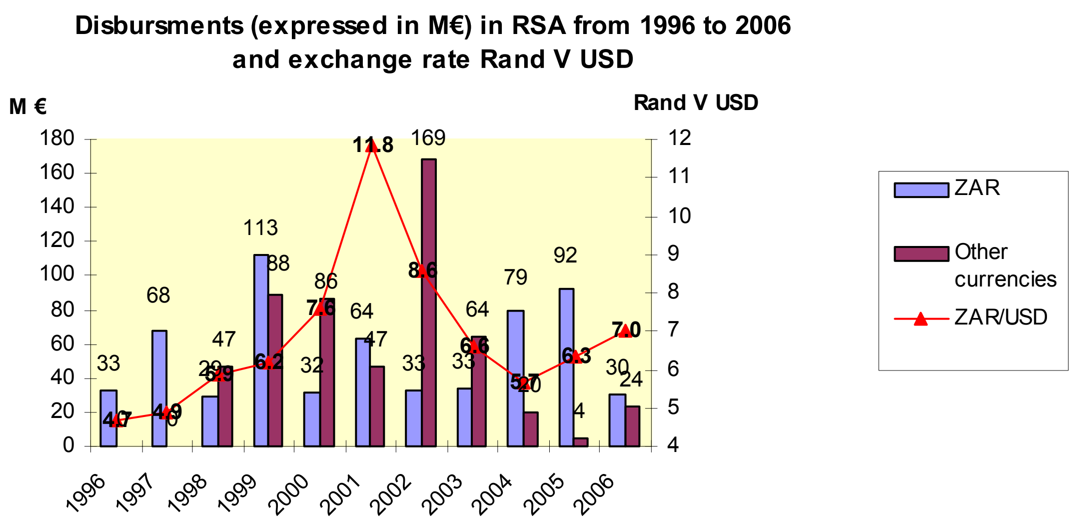
b. *The four ACP countries portfolio*

These conclusions cannot be strictly confirmed for the operations in the four ACP states. The possibility to lend from EDF funding (risk capital) influences the portfolio in the Bank's own resources; under EDF funding, the foreign currency risk is generally supported by the EIB.
In addition, most disbursements took place at a time when rand was not readily available in these countries, or when the exchange rates justified requests for disbursement in other currencies.

Projects in category A represent 81% of the portfolio, which gives a good relevance to this portfolio, but rand availability had no impact on the portfolio's constitution (23% of disbursements in rand).
This confirms the usefulness of a "regional strategy" taking into account rand availability

2.3 Relation between exchange rate fluctuations and disbursements in ZAR

The following graph will help to understand why disbursements have sometimes been made in foreign currency for borrowers in category A and vice versa.
Although projects necessitated ZAR, borrowers took advantage of the movement in the exchange rates between ZAR and USD (similar case for the Euro), as is well illustrated for the year 2002. Ex post, these were good decisions on this point.



Finally, 54% of the disbursements have been made in ZAR to projects (borrowers) which needed ZAR for their activities and who could not manage a currency risk (category A).

2.4 Conclusions on Relevance

a. RSA mandates

Question 1: Would the Bank have access to clients in category A, who received ZAR, (during the same period) without proposing ZAR?
The answer is NO, based on these observations and on client, as well as on EIB staff, interviews
Question 2: Would the Bank have been able to fully commit and disburse its RSA mandates (in time) without access to ZAR?
72.8% of the portfolio corresponds to clients who came to the Bank requesting ZAR. The Bank would have needed to find other clients in category B for the same amounts. Then, the relevance of the EIB portfolio would be less satisfactory with many projects not directed towards country priorities. Based on the interviews, it is reasonable to assess that the EIB would not have been able to commit the EUR 1500 million of the three mandates.

Conclusions:

- **Relevance of the Bank's lending portfolio in RSA: GOOD, with significant or high development impact**
- **Relevance of the Bank's borrowing in ZAR for lending own resources: GOOD**

b. ACP mandates

Conclusions:

- **Relevance of the Bank's lending portfolio in the four ACP countries: GOOD**
- **Relevance of the Bank's borrowing in ZAR for lending in own resources: SATISFACTORY, but still to be confirmed in practice.**

c. Relevance of ZAR borrowing activity for EIB treasury management

- Borrowing in ZAR answers to the financial markets' demand for rand. Investors were and are looking for high yields on a certain percentage of their activity; they find it in ZAR with a related foreign exchange risk they accept.
- The activity has been performed in conformity with the guidelines expressed by the EIB Board of Directors in 1995.
- It helps to develop and promote regional cooperation (TDCA art. 50) and supports the development of instruments towards the progressive integration of the South African economy into the world economy and trade (TDCA art. 66b).

Conclusion: Relevance of the Bank's borrowing in ZAR for its own treasury management is SATISFACTORY.

d. Relevance of individual operations (evaluated in-depth)

All nine operations evaluated in depth are rated GOOD on relevance. They all contribute to the EU policy of supporting sustainable economic developments in these countries.

The three projects in ACP are amongst the priorities established with the respective countries. One agro-industrial project contributes successfully to the reinforcement of countries' balance of payment, while the two other operations support SMEs and improve electricity supply.
In RSA, the three operations directed towards municipalities helped to develop basic infrastructure; this is also a clear objective set up in the TDCA (art. 66: "enhancement of living conditions and delivery of basic social services"; art. 67: "eligible beneficiaries being "(…) national, provincial and local authorities"). The TDCA refers also to energy priorities, which correspond to two projects evaluated as well as improvement in transport connections (one project evaluated).

3 Performance of the Operations Evaluated

In this chapter, the performance will be assessed under 3 different types of activities:
i) projects financed through individual loans (5 operations);
ii) lines of credit to IFIs for lending mainly to SMEs (4 operations);
iii) borrowing for the Bank's treasury management.

3.1 Performance of the Projects Financed through Individual Loans

Project Performance, relating to EIB's second pillar of value added, is assessed using three core evaluation criteria, mainly Effectiveness, Efficiency and Sustainability, from which an Environmental rating is extracted.

3.1.1 Effectiveness

All projects achieved their key physical objectives without problems, on time for implementation and in line or below initial cost expectations. Operations handling is always satisfactory with management able to face difficulties and take adequate decisions.

Good	2
Satisfactory	3
Unsatisfactory / Poor	0

The two electricity projects invest in transport in order to satisfy an increasing demand and / or to rationalise and serve all regions. In RSA, it contributes to the improved access of the population to electricity, which moved from a low 40% to 70% in the last 10 years. They both achieved their physical objectives, in one case with the addition of a component improving the reliability of the electrical system. Both projects were implemented on schedule and below initial cost expectations. Management is satisfactory, with the ability to take into account changing parameters; one project nevertheless is facing incidents demonstrating that maintenance procedures are inadequate and should be improved.

The gas project is related to a gas field extension with the objective of increasing the country's internal supply of energy. The reserves proved to be below expectations (-42%); all the other elements are in line with the initial assessment (schedule, cost).

The transport project is one component of the Spatial Development initiative in RSA. Its physical implementation conforms to the initial description; cost remains as expected while there are small delays in the implementation. Overall, the project's effectiveness is satisfactory.

The agro-industrial project follows a similar good pattern: implemented ahead of time with cost in line with expectations. Its objectives of increased production, modernisation of equipment and reduction of water consumption were all achieved.

3.1.2 Efficiency

Good	2
Satisfactory	2
Unsatisfactory / Poor	1

One electricity project is confirmed as the least cost solution for electricity exchange between two countries and is rated good. The second one improves the reliability of transmission lines and is satisfactory. The extension of the gas field evidenced an ERR of about 10% as expected, and has a financial rate of return below estimations, as the reserves are lower than anticipated, but still satisfactory.

The transport project, defined as the construction of a toll road, suffers from lower traffic (although the forecasts were already considered conservative). The willingness to pay is low and congestions on alternative roads are lower than anticipated. Efficiency is unsatisfactory.

The agro-industrial project confirms ex post a high level for both financial and economic rates of return, concluding positively on efficiency.

3.1.3 Sustainability

Good	1
Satisfactory	3
Unsatisfactory / Poor	1

One electricity company is well managed and benefits from the full support of the authorities on a realistic tariff policy, which concludes as good on the sustainable criterion. The maintenance programme of the other electricity company is significantly weak, which translated into power failures. The company has to develop a comprehensive recovery plan in order to gain on sustainability.

Sustainability for the gas project is satisfactory for a well-managed operation. Financial sustainability is ensured until reserves are exhausted.

The toll road, although its financial return is low, turns out to be sustainable. The management is competent and has been able to decrease operating costs and is planning to reach break-even within the next two years.

The agro-industrial project performance is linked to the price of a basic commodity. This is one important risk, which can be significant some years but should be acceptable in the long term.

3.1.4 Environment

Good	1
Satisfactory	4
Unsatisfactory / Poor	0

All projects have followed rigorous procedures regarding environmental issues and ex post observations are in line with expectations or better.

As expected, the electricity projects were covered by an Environmental Impact Assessment. Results of the EIA have been considered and mitigation measures were executed. Both projects deserve a “Satisfactory” rating on environment.

For the gas project (rated “Good” on environment), a complete environmental impact assessment was performed with public consultation. The environmental impact is a constant priority for the promoters and the environmental quality of the projects has been greeted by specific label and reward.

An Environmental Impact Assessment equally covered the transport project; independent control took place during the construction and regular reviews allow the permanent implementation of mitigation measures.

Components of the agro-industrial projects were specifically dealing with pollution reduction; these investments are in operation.

Conclusions:
Overall, project ratings based on Relevance and Performance (Effectiveness, Efficiency, Sustainability and Environment) are SATISFACTORY for the five operations assessed.

3.2 Performance of the Lines of Credit

Two lines of credit are targeting small and medium-sized investments in municipal infrastructure in RSA. The other two are targeting the financing of SMEs (one in RSA, one in ACP).

Following the assessment of the relevance of these four operations, the report will deal with two other aspects:

- The evaluation of the Financial Intermediary: organisation, financial situation and sustainability;
- The evaluation of the EIB loan: amounts disbursed versus signatures, on lending conditions, quality of the projects financed.

3.2.1 Financial Intermediaries

For the two operations targeting small and medium-sized investments in the infrastructure sector, one is intermediated by a development bank and one by two commercial banks. The financing of SMEs is intermediated by a development bank in one operation and by four commercial banks in the last case.

The ratings for the eight intermediaries are summarised in the table below:

FI rating (nb)	Good		Satisfactory		Unsatisfactory		Poor	
	DB	**CB**	**BD**	**CB**	**DB**	**CB**	**DB**	**CB**
Experience	2	4		2				
Organisation & Management	2	2		3		1		
Financial Sustainability		4	2	2				
Overall	**2**	**4**		**2**				

The experience of the FIs is good in most cases, the FI being selected for their capacity to provide the funds to the final beneficiaries targeted by the Bank. Two commercial banks were opening new market areas for themselves, i.e. financing small and medium-sized infrastructure schemes. This proved to be less successful and was confirmed by the follow-on operations with them: the EIB then targeted SMEs and not infrastructure. The development banks had been established by the Government with specific development mandates that fitted well with the Bank's country objectives, namely infrastructure development and industry support.

The organisation and management of the FIs is adequate; the recent revamping of a commercial bank is now delivering good results. The main weakness is the ability to estimate adequately the potential use of EIB's lines of credit (see also $ 3.2.2).

All the FIs analysed have strong balance sheets with return on equity ranging from 5/6% for the development banks to around 30% for the commercial banks. One commercial bank has a return on equity of 7% but after a restructuration, which is considered successful, numbers should improve. The capital adequacy ratio for the commercial banks is good (from 9 to 20%), while the development banks demonstrate a prudent management of their commitments. Non-performing loans are reasonable for the development banks (8 and 12%, reasonable given the sector targeted and the mandate); NPL are low for the commercial banks (between 1 and maximum 8%) given the country's macroeconomic context.

Financial sustainability is rated satisfactory for the development banks and good for most of the commercial banks (four good, two satisfactory). One concern that could affect the financial sector and, in particular, state-owned FIs is the political pressure (whether real or perceived) to support Black Economic Empowerment, transactions and funding of non-creditworthy municipalities. Despite this, all the FIs have the capacity, both managerial and financial, to operate successfully over at least the medium-term.

3.2.2 Performance of EIB's lines of credit

The performance of the EIB's lines of credit has been assessed on four main aspects:

- quantitative measure of disbursements vs signed amounts, taking into consideration the effective allocations;
- on lending conditions, i.e. interest rates (and/or margins) and duration;
- quality of the final beneficiaries;
- environmental performance.

The results can be summarised as follows:

	Good	Satisfactory	Unsatisfactory	Poor
Quantitative assessment*	3		1	
On lending conditions	1	3		
Environmental performance	1	3		
Quality of FB	1	2	1	
Overall	**1**	**3**		

* See specific remark on follow-on operations

Quantitative assessment
The global loan in one ACP country was only 55% disbursed to final beneficiaries. This feature was already indicated in many lines of credit analysed in the ACP evaluation report on global loans.

The three loans in RSA were fully disbursed. Following this success, the EIB set follow-up operations with the same FIs, but with higher amounts. The FIs and the Bank overestimated the demand. From a total amount of EUR 230 million signed, half of it has been cancelled. More attention should be paid to the amounts fixed in a contract while, as indicated in the ACP report, the introduction whenever feasible of appraisal and commitment fees would allow for better handling of the lines of credit.

On lending conditions
On lending conditions were satisfactory in all cases, with transfer of term and cost advantages to the FBs (Final Beneficiaries). In one case, these conditions mirrored the EIB conditions. In another case, sub-loan duration (on lending for infrastructure) was longer than the EIB loan duration. This is a situation that should be avoided, and which was partly the consequence of the EIB contract; the Bank had to respect the rules of a back-to-back operation (borrowing-lending) and was not able to provide longer maturities. This is now resolved with the treasury management in rand (see Borrowing).

Environmental performance
The handling of environmental matters by the DB financing infrastructure is rated GOOD. It has a large team of environmental specialists who deal with every investment financed by the DB. Guidelines based on national regulations are in place; in addition, large projects are always submitted to a full EIA (Environmental Impact Assessment). The DB provides training and support to the municipalities in order to set up in-house Environmental Management Systems. Evidence of this care was found in almost every allocation financed by the EIB.

The second development bank has a specific department in charge of questions relating to environment, health and safety. Its procedures are based on RSA regulations and it provides assistance to its clients. The allocations financed with EIB funding were adequately handled; but the DB global portfolio shows some weaknesses on former investments, which are subject to corrective actions.

The two commercial banks dealing with infrastructure finance have a comprehensive Environmental Management System, based on RSA legislations and incorporating rules set up by the World Bank Group. EIA are requested in justified cases and the handling of the Bank's allocations was satisfactory.
The environmental management in the commercial banks financing SMEs is well established and is reflected in sub loan agreements. Awareness of environmental sensitivity is clearly communicated to the FIs and to the FBs. Project visits confirm compliance with EIB requirements with a justified modulated approach.

Quality of Final Beneficiaries
When financing SMEs, the overall quality of the components financed is considered satisfactory, both on questions of relevance and of performance.

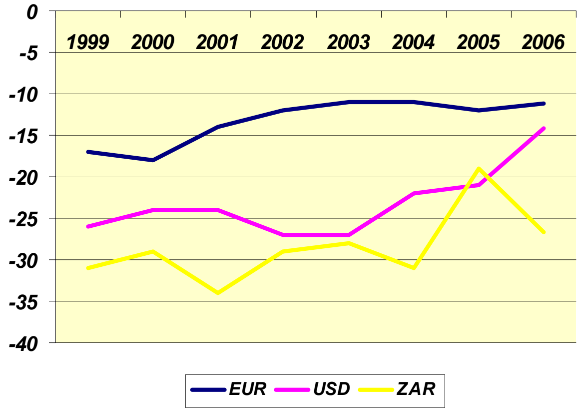
When financing small and medium-sized investments in infrastructure the link between the EIB loan and the final beneficiary is less strict; FBs are often not informed of the origin of the funds and financial conditions from EIB loans serve the whole portfolio of the FIs; nevertheless, it has allowed the FIs to extend their lending to riskier clients.

FBs were mostly municipalities that range in size from most of the largest cities to small municipalities in rural areas across the country. Final investments financed include water and sanitation as well as power projects, often in areas inhabited by low-income and disadvantaged people.
For one global loan directed through two commercial banks towards infrastructure investments, some allocations are facing repayment difficulties; this is due to the lack of experience of the CBs in this sector; later these CBs withdrew from this market.

Conclusions:
The overall rating is based on the relevance of the operations, the quality of the Financial Intermediaries and the performance in the use of the lines of credit, including the handling of the environmental impact.

The two lines of credit with the commercial banks are rated SATISFACTORY, while the two lines of credit with the development banks are rated GOOD. The latter assessment has to be noticed as, in the past evaluation of lines of credit under the Lomé IV convention, development banks were less performing than commercial banks. This rating can be sustainable only if these development banks remain free of political pressure (see § 3.2.1).

3.3 Performance of the Borrowing Activity



The first analysis has been performed on the main criteria for which data is available on a significant period (1999 to 2006): this is the all-in-cost (after swap equivalent), comparing ZAR to EUR and USD.

This first graph shows that emissions in rand have a higher comparative value than emissions in EUR or USD.

Looking more specifically at the year 2006, ZAR can be used for financing in EUR (after a cross currency swap - CCS) or in rand (after an interest rate swap - IRS). The second table shows that funds left in ZAR have the longer maturities, which better match the demand on the lending side. Funds swapped in EUR have the better EURIBOR spread which gives more value for EIB Treasury management.

2006	After Swap cost		Life
	ZAR	EUR	Years
CCS	-19	-32	2.2
CCS	-22	-30	3.0
CCS	-25	-29	4.0
CCS	-24	-26	7.1
CCS	-29	-26	7.1
CCS	-24	-26	7.2
CCS	-23.5	-25	7.3
CCS	-24	-25	7.3
CCS	-27	-25	7.3
IRS	-18	-24	7.1
IRS	-26	-21	7.9
IRS	-27	-24	8.1
IRS	-27	-26	8.2
ALL	-23.8	-26.1	6.4
CCS	-24.3	**-27.7**	5.3
IRS	-23.2	-24.3	**7.7**

<u>Conclusion</u>:
The performance of the Borrowing Activity is rated GOOD.

4 Role of the EIB

EIB contribution to the borrowers essentially takes the form of a financial contribution in these countries. The EIB contribution to the financial markets is also being assessed.

The role of the EIB is also a consequence of its performance in handling the operations from fund raising to completion.

4.1 Contribution to the Operations Financed

	High	Significant	Moderate	Low
Direct operations		4	1	
Lines of credit	2	1	1	

Concerning individual loans:

- For two operations in RSA, the borrowers accepted a loan from the EIB because it could be delivered in rand. They both appreciated the terms of the loan (interest rate and, particularly, the long duration in one case).
- For two other operations, one disbursed in rand, the other in USD, the characteristics of the EIB lending are considered particularly attractive. In one case (ACP countries), an interest rate subsidy was provided.
- One borrower considered the EIB loan moderately advantageous; the loan was disbursed in rand and in a foreign currency.

Concerning lines of credit:

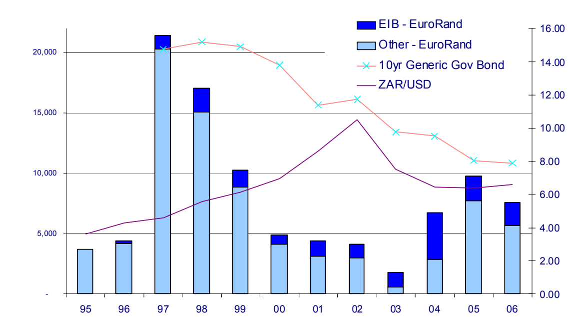
- At the time of lending to the two development banks, funds' availability was limited, therefore, the impact of the EIB lending was high, and given also that it was disbursed in rand. The two development banks would have refused a loan in a foreign currency.
- For the commercial banks in RSA, the impact was only moderate; the need for rand availability was not critical.
- For the FI in ACP countries, the terms and conditions of the EIB loan were considered attractive.

4.2 Contribution to the Financial Markets

As the EIB borrowed ZAR 17.65 billion and used ZAR 4.87 billion, a significant amount (ZAR 12.7 billion) was dedicated to EIB treasury management and could have had an impact on the financial market.

4.2.1 EIB on the Euro Rand Market

As this graph shows, during the 10 year period from October 1996 to October 2006 the EIB issued Euro Rand Bonds for a total of ZAR 17.5 billion while other issuers raised ZAR 74.7 billion on the Euro Rand market. This gave the EIB a market share of almost 20% on the Euro Rand market.



While the total volume of issues on the Euro Rand market varied considerably on an annual basis (between ZAR 22 billion in 1997 and ZAR 2 billion in 2003), the EIB **consistently** issued substantial amounts of bonds on the market, thereby counterbalancing to a certain degree the annual volatility caused mainly by changing market conditions such as the 2001 - 2003 exchange rate crisis that resulted in a substantial devaluation of the ZAR against the USD (see above graph).

With the exception of one zero coupon bond issue, all EIB Euro Rand bond issues have been "plain vanilla" fixed interest rate medium term (5 to 10 years) bonds. Therefore, the EIB presence on the Euro Rand market did not result in any substantial broadening of the market by introducing innovative new products or other innovative features of financial products. However, the constant presence of the EIB as a major issuer has resulted in a deepening of the Euro Rand market and has given it stability in particular at times of great market volatility caused by interest and exchange rate movements (e.g 2001 – 2003).

This deepening of the Euro Rand market, which includes the secondary market, has also promoted the reputation of the ZAR as an internationally acceptable currency for global investors. This will also make it easier to attract foreign investors to the domestic capital market (spill-over benefits) once the still existing exchange controls that are about to be lifted have been abolished and foreign investors get access to the domestic market.

4.2.2 Euro Rand versus Domestic ZAR Market

For the 10 year period from 1995 to mid-2006, total EIB Euro Rand issues of ZAR 17.5 billion compare to ZAR 74.75 billion of other Euro Rand issues, giving the EIB a market share of 19%.

On the other hand, the Euro Rand market is relatively small in volume terms as compared to domestic capital markets. EIB emissions represent about 2.5% of total emissions in rand (local market and Euro-Rand), based on outstanding amounts.

While the EIB is a key player on the Euro Rand market, its impact on the domestic capital market is then marginal in terms of impact on prices / interest rates or exchange rates.

4.2.3 Access to Domestic Capital Market and Market Conditions

In the past the RSA Government saw the EIB and other potential foreign borrowers primarily as a competitor for ZAR funds that had to be prevented from tapping the domestic market. With a much reduced budget deficit and low interest rates, Government is now less concerned about a potential crowding out effect of EIB borrowings on the domestic market and now looks very favourably at EIB borrowing activities in ZAR, as they help to establish the ZAR as a currency that has become acceptable for international investors - even in times of a currency crises such as in 2001 - 2003.

Against this background, Government has recently relaxed its exchange control regulations that have previously prevented non-resident borrowers, such as the EIB, from entering the domestic capital market. Local institutional investors, such as the "Government Employees Pension Fund" (GEP), that has assets of about USD 85 billion to be invested are looking forward to "AAA" based long-term investment opportunities in the local capital market.

A remaining key obstacle that may prevent the EIB from entering into the domestic market is **pricing**. While the EIB has been able to raise ZAR on the Euro Rand market at rates of JIBAR minus 30-35 basis points that reflect our "AAA" status, domestic investors use the Government ("BBB+" rated) as benchmark and may not be prepared to accept an interest rate below what Government is offering.

Because of the tight competitive situation on the lending side, the EIB would price itself out of the market if it would pay higher interest rates for domestic bond issues than what it is currently paying on the Euro Rand market – which would result in EIB lending rates of above JIBAR flat; this may not be attractive to most local borrowers who either have direct access to the domestic capital market themselves or to relatively attractive loan finance offered by local and foreign banks.

4.3 EIB Management of the Operations

4.3.1 Borrowing Activity

<u>The management of the borrowing activity is GOOD</u>.

The borrowing activity has been initially ahead of the Bank's lending operations. In the first year, the two were associated but, immediately afterwards, the borrowing activity was almost independent from the lending, except when requested by the lending side.

When borrowers made it clear that it was not possible to continue with back-to-back operations, the Bank looked at the possibility of creating a "Rand Treasury". This was done relatively quickly after negotiations with the RSA financial authorities.

The Bank has never been short of ZAR for its lending activities and the balance has been swapped against other currencies with full benefit.

4.3.2 Lending Activity

<u>For all projects evaluated, the management of the operations is considered SATISFACTORY or better</u>.

At the appraisal stage handling by the Bank has always been satisfactory and, in two cases, the clients appreciated the innovative proposals made by the EIB for the terms of the loans.

At the monitoring stage some weaknesses were observed, which never translated into specific problems or difficulties. Monitoring was also easy given the quality of the management of all borrowers. In the lines of credit for infrastructure, the final beneficiaries are often not informed of the origin of the funds. Reciprocally, the Bank is later informed of the allocation of funds; nevertheless, all funds have been utilised in line with the purposes initially defined.

The handling of the question relating to environmental management is satisfactory (see also chapter 3).

The commercial banks benefiting from a line of credit have integrated environmental verification into their appraisal procedures in response to EIB environmental policy objectives. The development banks have well developed environmental management policies and departments. No cases of non-compliance were found in the sample of allocations visited or investigated.

Annex 1 – Evaluation Process and Criteria

Project performance is assessed using the core evaluation criteria as defined by the Evaluation Cooperation Group (ECG), which brings together the operations evaluation units of the multilateral development banks (World Bank group, regional development banks, and EIB), in line with the work of the OECD- DAC Working Party on Aid Evaluation, and adapted to meet the particular operating needs of the EIB. Evaluations take due account of the analytical criteria used in the ex-ante project appraisal and the strategy, policies and procedures that relate to the operations evaluated. Changes in EIB policies or procedures following project appraisal, which are relevant to the assessment of the project, will also be taken into account.

1. RELEVANCE TO EU, EIB AND COUNTRIES POLICIES

(First Pillar of value added sheet for individual operations)

Relevance is the extent to which the objectives of a project are consistent with EU policies, as defined by the Treaty, Directives, Council Decisions, Mandates, etc.., the decisions of the EIB Governors, as well as the beneficiaries' requirements, country needs, global priorities and partners' policies. In the EU, reference is made to the relevant EU and EIB policies and specifically to the Article 267 of the Treaty that defines the mission of the Bank. Outside the Union, the main references are the policy objectives considered in the relevant mandates.

2. PROJECT PERFORMANCE

(Second Pillar of value added sheet for individual operations)

- **Effectiveness** (or efficacy) relates to the extent to which the objectives of the project have been achieved, or are expected to be achieved, taking into account their relative importance, while recognising any change introduced in the project since loan approval.

- **Efficiency** concerns the extent to which project benefits/outputs are commensurate with resources/inputs. At ex-ante appraisal, project efficiency is normally measured through the economic and financial rates of return. In public sector projects a financial rate of return is often not calculated ex-ante, in which case the efficiency of the project is estimated by a cost effectiveness analysis.

- **Sustainability** is the likelihood of continued long-term benefits and the resilience to risk over the intended life of the project. The assessment of project sustainability varies substantially from case to case depending on circumstances, and takes into account the issues identified in the ex-ante due-diligence carried out by the Bank.

- **Environment:** a specific assessment of the environmental impact is introduced. It deals with the effectiveness and the sustainability of all actions related to minimising and controlling the impact on environment.

3. EIB CONTRIBUTION

(Third Pillar of value added sheet for individual operations)

- **EIB Financial contribution** identifies the financial value added provided in relation to the alternatives available, including improvements on financial aspects as facilitating co-financing from other sources (catalytic effect).
- **Other EIB contribution (optional)** relates to any significant non-financial contribution to the operation provided by the EIB; it may take the form of improvements of the technical, economic or other aspects of the project.

4. EIB MANAGEMENT OF THE PROJECT CYCLE

EIB Management of the project cycle rates the Bank's handling of the operation, from project identification and selection to post completion monitoring

Annex 2 – TDCA Extracts

Agreement on Trade, Development and Cooperation between the European Community and its member States, of the one part, and the Republic of South Africa, of the other part

Economic Cooperation	*Art. 50 [General]* The Parties agree to develop and promote cooperation on economic and industrial matters to their mutual advantage and in the interest of the southern African region as a whole, by diversifying and strengthening their economic links, promoting sustainable development in their economies, supporting patterns of regional economic cooperation, promoting cooperation between small and medium-sized enterprises, protecting and improving the environment, promoting the economic empowerment of historically disadvantaged groups, including women, protecting and promoting worker and trade unions right.
	Art. 54 [SME] The parties shall aim to develop and strengthen micro enterprises (MEs) and small and medium-sized enterprises (SMEs) in South Africa, as well as to promote cooperation between SMEs in the Community and in South Africa and the region in a manner that is sensitive to gender quality.
	Art. 55.a [Telecommunications] (The aim of cooperation shall be to:) improve the access of South African public and private entities to means of communications, electronics and information technologies through support to the development of infrastructural networks, human resources and appropriate society policies in South Africa.
	Art. 57.b [Energy] (Cooperation in this area shall include the aim of cooperation in this area shall be:) to reorganize and modernize the energy producing, distributing and consuming subsectors so that appropriate services are provided on optimum terms of economic efficiency, social development and environmental acceptability.
	Art. 59.a [Transport] (The aim of cooperation in this area shall be:) to improve the access of South Africans to affordable, safe and reliable modes of transport and to facilitate the flow of goods in the country through the support to the development of intermodal infrastructure networks and transport systems, that are economically and environmentally sustainable.
Development Cooperation	*Art. 65.3* Within this context, priority shall be given to supporting operations, which help the fight against poverty.
	Art. 66.a (The areas of development cooperation will mainly concern the following) support for policies and instruments towards the progressive integration of the South African economy into the world economy and trade.
	Art. 66.b (The areas of development cooperation will mainly concern the following) enhancement of living conditions and delivery of basic social services.
	Art. 67 Cooperation partners eligible for financial and technical assistance shall be national, provincial and local authorities.

<u>Note</u>: EIB activity falls normally under the heading of Development Cooperation. For this evaluation, EV has also considered other headings in order to give a full picture of EIB activities against the full agreement.

EUROPEAN INVESTMENT BANK
OPERATIONS EVALUATION (EV)

In 1995, Operations Evaluation (EV) was established with the aim of undertaking ex-post evaluations both inside and outside the Union.

Within EV, evaluation is carried out according to established international practice, and takes account of the generally accepted criteria of relevance, efficacy, efficiency and sustainability. EV makes recommendations based on its findings from ex-post evaluation. The lessons learned should improve operational performance, accountability and transparency.

Each evaluation involves an in-depth evaluation of selected investments, the findings of which are then summarized in a synthesis report.

The following thematic ex-post evaluations are published on the EIB Website :

1. Performance of a Sample of Nine Sewage Treatment Plants in European Union Member Countries (1996 - available in English, French and German)
2. Evaluation of 10 Operations in the Telecommunications Sector in EU Member States (1998 - available in English, French and German)
3. Contribution of Large Rail and Road Infrastructure to Regional Development (1998 - available in English, French and German)
4. Evaluation of Industrial Projects Financed by the European Investment Bank under the Objective of Regional Development (1998 - available in English, French and German)
5. An Evaluation Study of 17 Water Projects located around the Mediterranean (1999 - available in English, French, German, Italian and Spanish).
6. The impact of EIB Borrowing Operations on the Integration of New Capital Markets. (1999 – available in English, French and German).
7. EIB Contribution to Regional Development A synthesis report on the regional development impact of EIB funding on 17 projects in Portugal and Italy (2001 – available in English (original version), French, German, Italian and Portuguese (translations from the original version)).
8. Evaluation of the risk capital operations carried out by the EIB in four ACP countries 1989-1999 (2001 - available in English (original version), French and German (translations from the original version)).
9. EIB financing of energy projects in the European Union and Central and Eastern Europe (2001- available in English (original version), French and German (translations from the original version))
10. Review of the Current Portfolio Approach for SME Global Loans (2002 – available in English (original version), French and German (translations from the original version)).
11. EIB Financing of Solid Waste Management Projects (2002 – available in English (original version), French and German (translations from the original version)).
12. Evaluation of the impact of EIB financing on Regional Development in Greece (2003 – available in English (original version) and French (translation from the original version)).

EUROPEAN INVESTMENT BANK
OPERATIONS EVALUATION (EV)

13. Evaluation of Transport Projects in Central and Eastern Europe (2003 – available in English (original version).
14. EIB Financing of Urban Development Projects in the EU (2003 – available in English (original version), French and German (translations from the original version)).
15. Evaluation of the Projects Financed by the EIB under the Asia and Latin America Mandates (2004 – available in English (original version), French, German and Spanish).
16. Evaluation of EIB Financing of Airlines (2004 – available in English (original version) French and German)
17. Evaluation of EIB Financing of Air Infrastructure (2005 - available in English (original version))
18. EIB financing with own resources through global loans under Mediterranean mandates (2005 - available in English (original version) German and French.)
19. Evaluation of EIB Financing of Railway Projects in the European Union (2005 - available in English (original version) and French.)
20. Evaluation of PPP projects financed by the EIB (2005 - available in English (original version).
21. Evaluation of SME Global Loans in the Enlarged Union (2005 - available in English (original version) and German.)
22. EIB financing with own resources through individual loans under Mediterranean mandates (2005 - available in English (original version) and German.)
23. Evaluation of EIB financing through individual loans under the Lomé IV Convention (2006 - available in English (original version) and French.)
24. Evaluation of EIB financing through global loans under the Lomé IV Convention (2006 - available in English.)
25. Evaluation of EIB Investments in Education and Training (2006 - available in English.)
26. Evaluation of Cross-border TEN projects (2006 - available in English.)
27. FEMIP Trust Fund (2006 - available in English.)
28. Evaluation of Borrowing and Lending in Rand (2007 - available in English.)

These reports are available from:EIB website: http://www.eib.org/publications/eval/.
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