



OPERATIONS EVALUATION

OVERVIEW REPORT 2005



Message from the President



This 2005 Overview is a new Report prepared by Operations Evaluation, now part of the independent Inspectorate General Department. It demonstrates the Bank's achievements through the retrospective analysis of projects financed by the Bank. These analyses are based on International Criteria, agreed with other multilateral financial institutions, which are consistent with the Bank's three pillars of Value Added.

I note that Operations Evaluation's conclusions based on these International Criteria of Relevance, Effectiveness, Efficiency, Sustainability confirm that the EIB's contribution to the projects and its management of the project cycle are generally in the Good or Satisfactory categories. Nevertheless, there are still opportunities for improvement as some scores fall below that. Some of these are suggested by the recommendations that are further elaborated in the six synthesis reports that Operations Evaluation issued to the Board of Directors during 2005.

I therefore underline the lessons that are there to be learnt and the importance of implementing the recommendations that have been made, especially in the context of the new strategy of the Bank approved by our Board of Governors in June 2005.

Philippe Maystadt
President of the EIB

A handwritten signature in black ink, which appears to read 'P Maystadt'. The signature is stylized and written in a cursive-like font.



This report summarises the view of Operations Evaluation (EV) on how the Bank conducts its operations. It is based on 92 project / loan evaluations which were captured in six thematic reports that can be found on the EIB website (www.eib.org/projects/evaluation). The six themes relate to:

- Loans to Air Infrastructure projects;
- Loans to Railways projects;
- Loans for Public Private Partnership (PPP) projects;
- Global loans to SMEs in the EU;
- Loans to individual projects in the Mediterranean Partner Countries (MPCs);
- Global loans for SME financing in the MPCs.

Through this publication, the Inspectorate General wishes to enhance communication on EIB activities and to highlight both areas of success and areas where progress can still be made.

The report covers:

- Policies and strategies: how relevant are the operations to EU policies, EIB strategies and beneficiaries' requirements?
- What is the performance of the operations financed in terms of effectiveness, efficiency and sustainability?
- What is the EIB contribution to the success of these operations?
- Is the EIB both efficient and effective in the management of the project cycle from identification to completion?

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1. PURPOSE AND BACKGROUND

Purpose:

The 2005 overview report synthesizes the findings of the EIB's Operations Evaluation Department (EV) during the 2005 exercise.

These were made through 92 project/loan evaluations which were captured in six thematic ex post evaluations published in 2005:

- Air Infrastructure projects (mainly in the EU)
- Railways projects in the EU (EU15)
- PPP (Public Private Partnership) projects
- SME global loans in the Enlarged Union (EU25)
- Global loans in the MPCs (Mediterranean Partner Countries)
- Individual loans to projects in MPCs

Methodology

EIB operations are assessed using internationally accepted evaluation criteria and include an examination of EIB performance (see also Annex).

- "Relevance" measures the extent to which the objectives of a project are consistent with EU policies and EIB strategies, as well as country or beneficiaries requirements.
- Project Performance is assessed on three criteria:
 - "Effectiveness": the extent to which the objectives of the projects have been achieved;
 - "Efficiency": the extent to which project benefits / outputs are commensurate with resources / inputs;
 - "Sustainability": the likelihood of continued long-term benefits and the resilience to risk over the intended life of the project.

- EIB contribution is measured through the EIB financial value added; other EIB contributions, such as Technical Assistance or expert advice can also be identified.
- EIB management of the project cycle: rates the Bank's handling of the operations, from project identification to post-completion monitoring.

On each criterion, projects are rated on a 4-step scale: Good - Satisfactory - Unsatisfactory - Poor.

Thematic ex-post evaluations consider a range of operations financed under the focus concerned. When editing synthesis reports, EV is also considering how EU policies have been translated into the Bank's guidelines and priorities, and thereafter into operations. From the findings, EV proposes a series of recommendations. The Bank's services comment on these and agree on specific actions that need to be taken.

Role of EV:

Operations Evaluation carries out ex post evaluations in the EIB; its manager, the Inspector General, is answerable to the President; EV's reports are submitted to the Board of Directors and then published on the EIB's website.

The objective of an evaluation is to assess the Bank's operations with a view to identifying both the impact of the projects it has funded, and opportunities to improve operational performance, accountability and transparency

The approach of the evaluations presented:

Each evaluation is based on a theme (rail, etc.) or on a mandate. In the preparation of each evaluation, EV considered the portfolio of signed operations between 1990 and 2001 for large projects and between 1993 and 2003 for other types of operations, in order to allow sufficient time for the projects to be implemented. The respective portfolios were very large: EUR 7 bn for air infrastructure projects, EUR 14 bn for railways, EUR 14.7 bn for PPP operations and EUR 12.7 bn for projects (individual and global loans) in the MPCs.

A comprehensive review of these portfolios was then undertaken, the main purpose of which was to:

- Identify and elaborate on the main issues;
- Analyse the strategies and the policies (both EU and EIB) in the themes concerned;
- Collect all the necessary information for the next steps.

From the review of completed projects based on the documentation available, the main focuses of in-depth evaluation were defined.

A final list of representative projects was selected for in-depth analysis, with on-site visits and detailed evaluation. These normally represent between 15% and 25% of the initial population identified.

For the above evaluations, EV considered 19 projects for the air infrastructure sector, 16 for the railways, 10 for PPPs, and 32 in the MPCs (of which 22 are individual projects and 10 global loans). The SME global loan evaluation dealt with 15 global loans representing 15 financial intermediaries spread over 14 countries.

This report will also present several case studies in order to illustrate the results of the various evaluations implemented.





2. POLICIES AND STRATEGIES: RELEVANCE OF THE OPERATIONS

Evaluations take account of the strategies and policies that related to the operations evaluated at the time the operation was appraised and approved. Having identified, when justified, sector or mandate characteristics, EV evaluated the impact of EU regulations on projects and companies, and even the constraints, in order to define challenges facing the EIB. Based on this analysis, the relevance of the operations in relation to EU policies, EIB strategies and beneficiaries' requirements are assessed.

2.1. EV findings in air infrastructure and railways sector

In 2005, two individual sectors were evaluated: air infrastructure (i.e. airports and air traffic management – ATM), and railways in the EU.

Air infrastructure:

The sector has been characterised by strong traffic growth (+ 40% between 1995 and 2005) requiring the expansion of airport capacity, and by a rapidly changing air transport market, involving bankruptcies as well as the rise of low-cost carriers. Pressure on airport capacity is likely to persist.

EU initiatives were aimed at the liberalisation of the air services, the free circulation of citizens (Schengen) and air safety regulations. The main constraint on the sector will be environmental concerns over airport development (operations and construction).

The challenge for the EIB is to give priority to investments which increase the efficiency of airports, taking into account all regional developments foreseeable in the same region.

Railways:

Over the last 20 to 30 years, the sector has been characterised not only by stagnation of its capacity but also by a significant loss of market share: from 32 to 14% in freight and 10 to 6% in passenger transport.

On the positive side, rail transport is environmentally less damaging than other modes of transportation, socially more acceptable, and can offer some economic advantages. On the negative side, the lack of flexibility, fiscal and policy distortions, and institutional problems related to state monopolies favoured road and air transport; the sector also shows weaknesses such as inefficient management and the lack of international integration.

EU support has been continuous, through many regulations aiming at increased competition and the progressive liberalisation of the sector, but the implementation of these is low and uneven amongst EU countries. The EIB has given, and will likely continue to give, full support to the sector. Therefore, it is essential that the Bank works closely with all parties concerned.

Relevance of air infrastructure and railways projects:

The Bank's lending has taken proper account of both EU transport policies and EIB objectives and operational priorities. All the projects were in line with the corresponding national priorities of growth (air infrastructure) and modernisation/viability (railways).

For projects financed in the European Union, 85% were part of the TEN while others were justified for the growth of less developed regions; outside the EU, the Bank financed projects of common interest between the EU and non-member countries. Two projects (out of 35) received a lower rating, the first one because it provided premature capacity and the second one because it was more justified by local considerations than by common EU interest.

Given the high level of relevance ratings, EV recommendations are essentially aiming at increasing the Bank's involvement in the early stage of policies and strategies preparation.

Recommendations (at sector level)¹

- In the financing of airport infrastructures, strategy reviews for regions or areas where multiple investments are foreseen should be prepared, thus enabling the development of appropriate lending priorities.

The consideration of the broader context of an airport investment is now an integral part of the appraisal of airport projects.

- The Bank should increase its contribution in the railway sector by strengthening its participation with the relevant Commission/Parliament/member state committees dealing with railway policies and projects.

The dialogue with the Commission has been reinforced with the establishment of a Memorandum of Understanding with DG TREN. The Bank is now also involved in the project preparation of large scale cross border projects (Lyon-Turin). Policy dialogue should continue to be reinforced but will necessarily face resource constraints.

¹ Throughout this paper, EV recommendations will be followed by the answers (in terms of proposed or already achieved actions at the end of 2005) of the Bank's directorates concerned.



Case study:

Evaluation of the financing of 18 airports in the EU – Extracts from the Air Infrastructure Evaluation

These 18 projects are spread over 8 countries: Denmark, Finland, France, Germany, Italy, Portugal, Spain and the United Kingdom. They concerned mostly the modernisation and expansion of existing facilities; new airports were only funded on environmental grounds or if the existing facilities were wholly unsuitable for modern air services.

EU strategies were duly taken into consideration in all projects, which were also in line with national objectives; all of them have a TEN status. The evaluation took into account sector characteristics such as air traffic growth of almost 40% (1995 to 2002) requiring the expansion of airport capacities, changes in the airline industry such as bankruptcies and the rise of low-cost carriers. The liberalisation of air services (through EU initiatives) will significantly increase competition between airports and future development will also be impacted by existing factors such as environmental restrictions.

In this context, future EIB financing in this area should look at regional multi development enabling to develop appropriate lending priorities.

The implementation of all the projects is satisfactory, reflecting the quality of the promoters while efficiency varies according to traffic growth observed; in most cases, traffic growth was initially higher than expected, then impaired by 9/11, followed by a slow recovery, leading to an overall satisfactory performance, except for airports in remote places where traffic growth expectations were overestimated.



2.2. PPP: Public Private Partnership

Definition:

Private sector contribution and operations of infrastructure which should otherwise have been provided by the public sector.

The growth of PPPs may be seen as being part of a wider change in the role of the State from a direct provider of services to that of a facilitator and regulator. The role of the EIB has been increasing over time and results as being one of the largest lenders to PPPs in the EU: total loans signed between 1990 and 2003 amount to EUR 14.7 bn, 62% being in the road and motorway sector with the remainder spread over various other areas. This evaluation examined ten projects in depth, as well as considering PPPs included in other evaluations; EV considered projects in a large variety of sectors: roads (and motorways), rail, energy (production and generation) and education.

The evaluation has not analysed the sectors as such, but focused on the impacts of the PPP mechanism on the projects and on the EIB (see also chapter 4 and the case study "Evaluation highlights of the year"). The approach was different from other evaluations carried out by EV. As well as evaluating the project's impact, the structure and risk sharing mechanisms involved in the PPPs were put at the heart of the evaluation.

Relevance:

All PPP projects were in line with EU and EIB strategies in the sectors concerned and were fully compatible with the country objectives, including strategy for the privatisation of these sectors.

2.3. Financing of SMEs through global loans in the EU

In order to fund small investments (meaning, for the EIB in the EU, less than EUR 25 m), a global loan is made to a financial intermediary (FI), which in turn provides funding to its smaller clients, the final beneficiaries. The FI is responsible for identifying the client, appraising and approving their fund request, distributing and monitoring the sub-loans; the FI takes the credit risk.

Relevance:

The 15 global loans evaluated in depth, as well as the 10 other global loans which were reviewed in-house, were in conformity with the established objectives (rating: good and satisfactory).

All the operations evaluated were intended to fund investments by SMEs, and many of the investments also supported a range of other EU policies, e.g. regional development, rational use of energy, etc.

However, it was difficult to demonstrate relevance to the EU policy of increased access to funding. The issue is mainly the lack of an adequate mechanism for assessing the overall policy impact of global loans. Nevertheless, the evaluation identified many examples of improved access, particularly in the new member states and with new intermediaries.

Recommendations

To demonstrate more clearly the Bank's support to EU policy objectives, the Bank should:

- Present clear, deliverable objectives for each global loan;
- Clarify its own SME policy objectives.

The new appraisal framework for global loans now in place requests a better formalisation of objectives and ex post performance assessment.

Furthermore, the Bank has included SME financing as one of its core priorities in its recent strategy paper, which has been viewed at the level of the EIB Group (Towards a new Strategy for the EIB Group, 20 June 2005).



Case study:

Global loan for SME financing in the EU

The Bank has long standing relations with the Financial Intermediary (FI) concerned, almost exclusively through repeated global loans (the first one being granted in 1988, the evaluated one being signed in 2000), unlike other FIs which often serve also as guarantors or intermediaries for larger operations.

The FI is a local organisation with a large number of local branches. Its natural constituency is the SME, the FI having little exposure to large companies.

The FI is considered fully sustainable; continuous improvements are foreseen with, in particular, a major risk management programme under way. Non-performing loans are stable at a relatively high level (4.3%) for the EU, but do not create any problems.

The EIB global loan was disbursed and allocated quickly and exclusively for SME finance: average sub loan size is EUR 165,000.

The global loan has represented a significant part of the FI's MLT loans and supported the increase of the FI lending activity (+8% per annum). The FI has established a procedure to quantify the benefits (from the EIB conditions) passed on to the final beneficiary. The EIB financial value added was considered significant although the FI management expressed some concerns over pricing for the future.

2.4. EIB financing in the Mediterranean Partner Countries (MPC)

The EIB activities in the Southern and Eastern non-member countries of the Mediterranean region have developed within the framework of the mandates given by the EU to the Bank. The level of EU assistance and co-operation to the region has widened and deepened over time, which has also led to a more prominent role for the EIB. The setting up of the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) in 2002 is the latest development, again increasing the Bank's lending activity in the region and placing a particular emphasis on helping to foster the development of the private sector.

This evaluation covers EIB financing with own resources during the period 1993 – 2003. The Bank signed 272 operations, the bulk of which were on own resources. Own resource lending reached EUR 12.7 bn, with the main recipient countries being Turkey (21%), Egypt (17%), Morocco (16%), Algeria (14%) and Tunisia (13%). Energy, transport, water and sewerage sectors received the largest share, while the financing of SMEs through global loans represented about 13% of the total.

The main objectives set up in the mandates, in particular following the 1995 Barcelona Declaration, can be summarised as follows:

- Upgrading of economic infrastructure, including that necessary to encourage inter-regional trade such as telecommunications, transport and power;
- Private sector development, including support to SMEs and to joint investments between the EU and MPCs' enterprises.



Relevance:

All the individual projects and all the global loans evaluated are considered as relevant (satisfactory or better).

In general, all the operations financed have contributed to economic growth and to job creation.

The infrastructure projects have contributed to covering the basic needs of the population, or to overcoming substantial economic development bottlenecks of the respective MPCs. Industrial projects supported the development of the private sector in the region.

The global loans mostly targeted SMEs and contributed equally to the development of the private sector, while some different objectives were also included, i.e. such as upgrading economic infrastructure, environmental investments and energy-saving investments by enterprises. The evaluation shows that the EIB definition of SMEs often relates to large entities in MPCs and further attention should be devoted to smaller companies.

Recommendations

The Bank should establish detailed lending priorities in cooperation and coordination with MPCs and other stakeholders such as the European Commission and other donors, including sectoral and country strategies when appropriate.:

Sector and country work is now under implementation under the FEMIP, with country papers under preparation and sector strategies (specifically for infrastructure projects). In addition, Memorandums of Understanding have been signed with the EC, the IBRD and the AfDB

Support FIs that aim at developing financing to smaller enterprises, when necessary by setting support programmes.

Financing smaller enterprises was not a specific objective of the MED mandates. Under the new FEMIP, instruments are provided to contribute to this objective although the final responsibility (and risk taking) is with the FIs.

2.5. Relevance in a nutshell

97% of the projects were considered as fully relevant (good or satisfactory) which demonstrates the strong coherence between the operations financed by the Bank and EU policies translated in the Bank's strategy.

This confirms the observation made between 2001 and 2004 on 6 major evaluations, where equally 95% of the operations evaluated were fully relevant.

Case study:

Financing the private sector in MPCs

The promoter was engaged in the manufacturing of intermediary products (based on local raw material) in a large MPC with strong local demand; the company was also significantly export oriented.

The project financed included the modernisation of an existing plant and the construction of a new one allowing the diversification in the same sector.

To that end, the family-owned company developed a joint venture with a European partner for both technical expertise and commercial partnership. After some initial difficulties, this co-operation has significantly contributed to the borrower's exports.

The EIB financing contributed to the development of the private sector and was fully in line with EU / EIB and country objectives: employment creation, integration in the EU mandate, increased competitiveness, increased foreign investments.

The project was implemented below budget in 2 phases, the second being delayed given the economic slowdown of the country. Profitability, both financial and economic, was above 40%, more than expected at appraisal.

The company is now fully sustainable and has repaid the participation indirectly financed by the EIB (at the initial value in euro although the local currency has been devaluated by 50%). The borrower considered the EIB financial value added high with both an equity participation and a long term loan with significant grace period. Nevertheless, the promoter had difficulties in renewing the guarantee and had some criticism of the EIB's policy of not taking project risk.

Given the high degree of EIB involvement in the project, monitoring could have been higher.



The overall performance of this project is good, with a significant impact on the private sector development and high EIB financial value added.



3. PERFORMANCE OF THE OPERATIONS

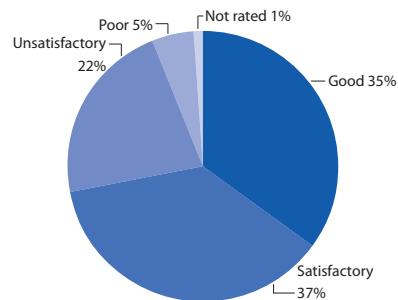
Looking more specifically at the in-depth evaluations of individual operations financed by the Bank, EV presents its findings on three criteria:

- **Effectiveness:** relates to the extent to which the objectives of the project have been achieved;
- **Efficiency:** is the measure to which project benefits / outputs are commensurate with resources / inputs, often measured through the economic and financial rate of returns.
- **Sustainability:** is the likelihood of continued long-term benefits and the resilience to risk over the intended life of the project.

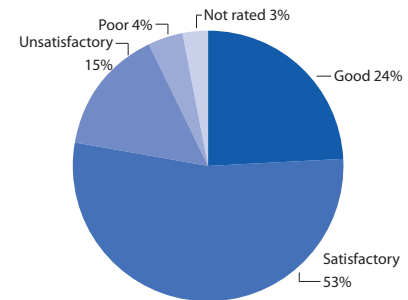
These criteria equally apply to global loans, but focusing on both the performance of the Financial Intermediaries and the performance of the global loan as such.

For a global view about the performance of projects financed by the EIB, 6 other evaluations performed between 2001 – 2004 have been considered: Energy (Enlarged EU), Solid Waste Projects, Transport in the EU, Urban Development, Airlines financing and the ALA (Asia, Latin America) Mandate. Altogether EV considers that a view on almost all sectors financed by the EIB have been considered between 2001 and 2005 (excluding ACP countries which are currently being evaluated).

2001-2004



2005



Overall, the performance of the projects was satisfactory or good for 77% of the in-depth evaluations presented in 2005 (and 72% for the average of evaluations over the previous four years).

The performance of the operations included in this 2005 overview is illustrated in the table below.

As the sectors are totally different, the comparison between the 2 periods is only marginally relevant but the full picture provides a good reference for future evaluations. This result is further analysed below, and has led to an appropriate set of recommendations.

Performance criteria

In number of operations	Effectiveness		Efficiency		Sustainability		Overall	
	G/S	U/P/NR	G/S	U/P/NR	G/S	U/P/NR	G/S	U/P/NR
Individual operations								
Air Infrastructure	16	3	11	8	17	2	13	6
Railways	12	4	8	8	15	1	11	5
PPP operations	10		6	4	7	3	8	2
MED individual	18	4	21	1	16	6	19	3
Subtotal	56	11	46	21	55	12	51	16
Global loans (GL)								
			FI performance	GL performance				Overall
SME EU global loans	15		14	1			14	1
SME MED global loans	6	4	5	5			6	4
Subtotal	21	4	19	6			20	5
Total							71	21

G/S: Good / Satisfactory
U/P/NR: Unsatisfactory / Poor / Not rated

3.1. Individual operations

Effectiveness:

86% of the operations evaluated are satisfactory or better. On the whole, staff or promoters' management of the projects were considered competent and efficient, except when competence was lost in heavy administrative bodies.

Two factors influencing effectiveness have been further detailed.

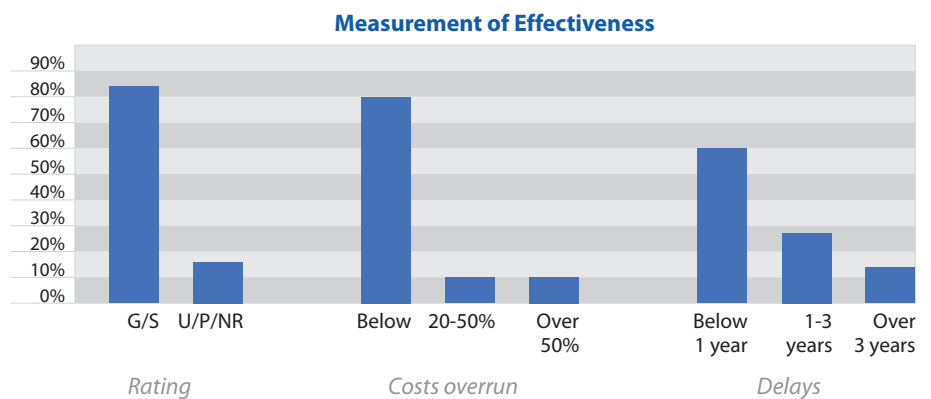
- **Costs:** 80% of the project costs were on target or with an increase of less than 20%, which is a satisfactory outcome. 10% of the projects had cost increases between 20 and 50%, without any specificity as to sector concerned. This was often linked to changes in the definition of the projects, decided by the promoters in order to improve the project scope in agreement with the Bank.

Cost overruns of more than 50% are mostly concentrated in the railway sector, where the Bank often decides to finance a large project at a very early stage. These projects have frequently changes in the scope of works and necessitate an increased monitoring activity of the Bank, which has not always been present.

Reduction in costs concerned 30% of the projects evaluated, often with private sector management looking carefully at scope and suppliers. This was significant in the Mediterranean region where half of the projects were below initial costs estimates, mainly due to scope optimisation (private sector) and increased competition (transport sector).

- **Delays:** up to 1 year had a low impact on the success of the projects (60% of the evaluation). With delays between 1 and 3 years, projects were still doing well when this was due to changes in the project definition which justified the delays. These cases were in general well controlled by the project promoters. Delays above 3 years are more problematic and it should be noted that these were mainly concentrated in two sectors: again, the railways sector (in all, half the projects had delays of more than 1 year) and air traffic management projects developed outside the European Union (lack of preparation); one project was delayed due to the outbreak of a civil war.

Again the private sector has shown a strong control of implementation time; in the public sector some delays were justified by the difficulties to finalise the financing structure, the technical management being satisfactory.





Case study:

Financing the construction of a high-speed railway line

The loan was granted for the financing of a section (about 28%) of a long, new line. The project is very large and fully in line with EU objectives, being a priority TEN. The project has experienced extensive delays (9 years) and is still not in operation. Scope changes were introduced by local and regional authorities for realignments and environmental impact mitigations. The risk of these

delays implicitly included in the national procedures for the implementation of such a project, was underestimated by the promoters and the Bank. Scope changes are then translated into high cost overruns (estimated at over 60%).

Although unsatisfactory on costs and delays, effectiveness should be satisfactory regarding all factors related to the introduction of high-speed train services (capacity, speed, safety and comfort).

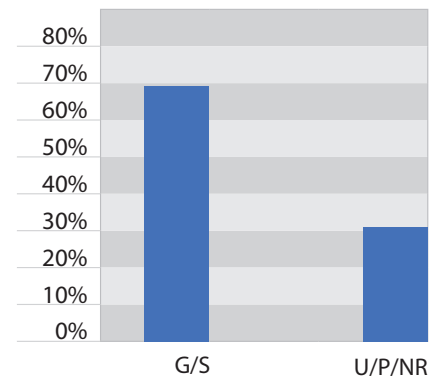
Efficiency has been rated poor, not only because of the costs overruns, but also in relation with new demand forecasts well below initial estimates.

The sustainability of the project is guaranteed by the state involvement.

Given all the difficulties, the Bank decided to hire the services of a consultant for the monitoring of the project; this allowed the Bank to be kept informed and to follow carefully the changes in the institutional organisation of the whole project, mainly prompted by costs and delays which were no more affordable in the initial structure.

Despite all the implementation difficulties, in the end (i.e. once in operation), this should be a satisfactory investment for the client.

Efficiency:



The financial and economic performance of the projects has been uneven; results demonstrate that more than two thirds of operations financed had satisfactory or good efficiency ratings.

In the transport sector, efficiency has been impacted by traffic outcomes; traffic was lower than expected in 4 airport projects and one PPP project, which translated into an unsatisfactory rating. High cost overruns and large delays had a direct negative result on efficiency in 12 projects (mainly the railway sector and ATM projects).

Efficiency has a favourable picture on completed PPP projects thanks to careful preparation before the Bank was officially engaged.

In the Mediterranean region, all projects except one (water sector, tariffs were not increased as expected) show good and satisfactory rating on efficiency; in general ex post economic rates of return are higher than foreseen, often linked to increase in revenues (prices in the energy sector and traffic in transport projects).

Recommendations

Railways

As the Bank is involved at an early stage, some problem areas are seen at the time of appraisals of the majority of railway projects:

Weak project preparation; Imprecise definition of project output; Unsystematic risk analysis; Unquantified external benefits (mainly environmental) used to justify projects.

The Bank should examine the above areas at the project identification stage, so as to ensure that projects with a high risk of limited economic justification are identified and weaknesses addressed. External benefits used in the justification of a project should be quantified as far as possible

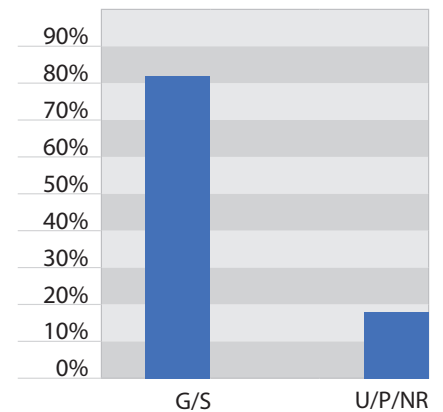
It is a fact that highly complex large-scale projects can lead to significant performance risks during project implementation, or that rearrangements in phasing or in scope are introduced by responsible authorities for different reasons. These issues must be fully analysed at appraisal and best efforts are being made in that regard.

Air Infrastructure

ATM projects evaluated in-depth, mainly outside the EU, show consistent implementation weaknesses and very limited incentives for economic efficiency. Appraisals should systematically include an analysis of project management capacity, operational efficiency and cost effectiveness of the promoter. Consideration should also be given to using contract conditions to require weak promoters to establish project implementation units.

The findings were accepted by the Bank's operational directorates with comments: "The institutional and regulatory environment can be at least as important to project success as implementation capacity, and should be fully analysed during appraisal"; "[ATM projects] are not representative of other operations in the air infrastructure sector."

Sustainability:



Finally, project sustainability, which offers a better picture, is particularly influenced by 2 factors:

- Competent promoters which can turn around the project quality;
- State support which can transform a defaulter project into a viable one.

3 projects were not rated under this criteria (projects far from being implemented). 6 public sector projects in the MPCs have low rating on sustainability. In this region, the State is not always strong enough to compensate for deficiencies. This is in particular the case for 4 water projects, where tariffs are too low and the water companies face permanent shortcuts in their financial equilibrium, which darken future perspectives.

On the other hand, even low performing infrastructure projects (e.g. railways in the EU) on efficiency are sustainable. The State involvement is high, covering financial gaps and ensuring completion and start-up of the projects, even after huge delays.

Airport projects show in their large majority good results on sustainability thanks to consistent levels of traffic; the negative impact of 9/11 has been overcome. PPP



projects are all expected to be sustainable, with the (private) providers having sound incentives to maintain them properly and, in general, satisfactory level of long-term revenues.

In almost all energy and transport projects in the MPCs, sustainability is rated satisfactory or good; this reflects the fact that the promoters were competent and that they are strongly supported by their respective governments (e.g. by keeping tariffs at a reasonable level).

Private sector projects are also satisfactory thanks to the ability of the promoters to adapt to changes in the markets.

Recommendations

Individual loans in the MPCs

The Bank should promote institutional reforms, notably to contribute to increasing the efficiency of the public sector (often involving the private sector). This implies that the EIB is involved in institutional aspects and more upstream in the project cycle than in the past.

The TA component (Technical Assistance Support Fund launched in 2003 and the FEMIP Trust Fund launched in 2004) provides FEMIP with a strong instrument to improve the quality and the development impact of its lending operations in MPCs. As a consequence, FEMIP is now more proactive and selective, putting more emphasis on sustainability and development.

These observations on sustainability have no financial impact on the EIB; the evaluation has not identified one single case where the Bank could be at risk as far as repayments of its own resource loans are concerned.



Case study:

Extension of a waste water collection and treatment system in a large MPC city

Relevance is good:

The project financed is an important component of the city's waste water system; crucial for the protection of public health. However, waste water final disposal at the country level is still unsatisfactory as bacteriological pollution is not controlled.

Project overall performance is satisfactory:

- The project was implemented with only a short delay (less than six months) and was almost on cost, with an extended definition in line with the initial technical description.
- The economic profitability should be better than expected given the extended characteristics of the projects, including significant unquantified economic benefits.
- But sustainability is unsatisfactory: the waste water company is dependent on public sector decisions for tariff increases. Against contractual undertakings, tariffs have not been increased and the financial sustainability of the company is in danger.

The EIB financial value added is high, as the loan benefited from a 3% interest subsidy (financed through the EC MEDA budget), being an environmental loan in the MED mandate. The Bank also provided implicit political support, helping to secure government financing of the project.

The Bank's role at the definition stage was important: a **METAP study** (EIB grant through the "Mediterranean Environmental Technical Assistance Programme") helped to clearly define the scope and the calendar of the project. It demonstrates the importance of Technical Assistance in complex infrastructure projects. However, **monitoring was then unsatisfactory**, with fewer contacts and weak reactions to the absence of increase in tariffs.

On the whole, the project is considered satisfactory, having contributed to the improvement of living standards in a large country, illustrating the difficulties which a "non productive public investment" faces. More involvement of the Bank would be needed during the project cycle.



3.2. Global loans

- a. In the European Union, the performance of global loan operations has been evaluated from the Financial Intermediary perspective, which has been satisfactory or better.

This has been achieved through a long cooperation with most of the Financial Intermediaries (FIs) and a well-established financial product which has evolved with time and adapted itself to a changing environment.

The Financial Intermediaries were all in good standing with the Bank, the various rating agencies, and their national regulator. All complied with normal prudential ratios and all except one had wholly satisfactory levels of credit losses. The exception was a FI which specifically accepts higher risk operations in line with government policy. All FIs evaluated were considered sustainable.

Commitments and disbursements of the global loans were satisfactory, except for 2 operations which experienced some delays due to the learning curve. Clients were informed of the EIB funding. On-lending conditions were satisfactory, while the quality of the investments financed could be implicitly considered satisfactory through the measure of the quality of relevant portfolios in the FIs.

- b. In the MPCs, the performance of global loan operations is less regular, given the diversity of the intermediaries and less mature financial sectors.

The FI performance was satisfactory in 6 cases out of 8 (while no rating was established for 2 operations signed with multiple FIs). The main problems facing the banking sector in the region is the high proportion of non-performing loans;

with one exception, these represented between 22 and 45% of loan portfolios. Despite the challenges faced, all FIs react quickly and positively to economic changes. All except one FI were considered sustainable, the exception being a state-owned mono-sectoral bank, with heavy, unsustainable, government-driven policies (this bank has now been completely restructured).

The global loan performance is uneven: only half of the operations were good or satisfactory. In 2 cases, the allocation period had to be significantly increased together with sector eligibility. One specialised global loan (financing environmental projects) was not utilised, the loan product being replaced by grants. Finally, in one case, the Bank stopped its disbursements when the FI's difficulties became too severe (see exception in previous paragraph).

Recommendations

Global loans in MPCs

When necessary, the Bank should assist FIs through technical assistance, thereby encouraging their development and financial sector reform. Such programmes also need to be carefully co-ordinated with other donors to avoid over-lapping or duplication of effort.

The Bank is already assisting FIs in the region, when appropriate, using the FEMIP Technical Assistance (TA) facility. The main objective of on-going TA operations is capacity building at the FI level, where other donors are rarely found. TA is being considered for sector reform under the Trust Fund, in full coordination with other donors.

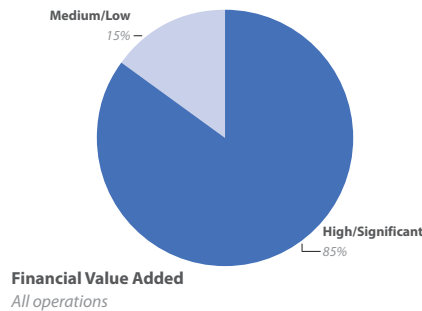




4. EIB CONTRIBUTION

4.1. Financial Value Added

One of the important contributions made by the Bank to a project or towards a promoter is its “Financial Value Added” (the third pillar on EIB’s value added). In addition, the Bank’s expertise can be utilised in some sectors, or for some specific actions, when required and /or justified.



The Financial Value Added of the Bank is broadly significant. The terms of the EIB loans are appropriate and particularly interesting for the grace periods and the durations offered.

In a number of cases, which were more reflected in the global loans within the financial sector, the promoters signalled some concerns about the future. This further emphasizes the need for a change in policy towards SME finance as mentioned above for the EU (see § 2.3) and below outside the EU.

EV identified the more specific role the Bank could play when dealing with innovative operations combining financing technology and new organisation or management structure such as PPPs (see evaluation highlights).

In the MPCs, the financial products offered by the Bank were deficient for the development of private sector operations where the Bank guarantee requirements are too costly, and for global loans where the need of local currency finance is critical.

4.2 EIB as a facilitator

The Bank is often considered as a facilitator for the consolidation of financial resources.

The implicit support was particularly relevant in the PPP operations financed, where suggestions are made for increasing the role of the Bank. However, it was also true for the railway sector, where the Bank has shown itself to be innovative, and in the MPCs where the financing of the Bank was sometimes decisive for the realisation of the projects.

Recommendations

PPP

A number of promoters would have benefited from guidance and support when variable rate funding was being swapped into fixed. The Bank could offer guidance to less experienced promoters.

Promoters on PPP projects normally employ financial advisors who are best placed to offer guidance and support on these matters. For less sophisticated promoters, who do not have access to suitable advisors, support can be envisaged on an ad-hoc basis

PPPs offer substantial opportunities for the Bank to add value. The Bank should therefore reinforce the existing Centre of Expertise (CoE) and consider establishing a horizontal department specialised in structured finance operations including PPPs.

The Bank can provide significant value added in the case of PPP structures and the CoE guarantees the sharing of experiences. Externally, this is also reflected by the work related to the setting up of the European PPP Expertise centre (EPEC). Internally, this is complemented by the creation as of January 2006 of a horizontal department (AGI, Action for Growth Instruments), which follows EPEC, provides PPP support to the geographical lending units and also co-ordinates the existing CoE.

4.3 Other Contributions

With the expertise available at the EIB, the Bank's contribution could be improved in other areas such as project preparation, institutional development and project implementation. The use of Technical Assistance Funds, when available, could be decisive.

The various remarks below were already mentioned but should be highlighted in order to improve the Bank's non-financial contribution.

In the infrastructure sector, an enhanced co-operation with the European Commission could improve the soundness of projects while the EIB experience with PPPs should be disseminated. Outside the EU, the Bank's contribution was high in the preparation of projects in the water sector and in the transport sector, although improvements are now possible with the use of TA funds.

In the MPCs, EV identified the need for improvements in the financial sector which could not be provided and lead to deficiencies in the management of some operations.

The TA funds are now used for capacity building, the TA is being considered for sector reform under the Trust Fund in full coordination with other donors.

Recommendations

Individual loans in MPCs

In order to increase its financial value added when financing private projects, the Bank needs to expand its range of products, in particular taking more risks.

With the reinforced FEMIP, the "Special FEMIP Envelope" (SFE) aims to address some of the constraints created by the MPCs' relatively poor credit ratings and the Bank's usual requirements on private sector borrowers.

Global loans in MPCs

Adapt guarantee requirements for global loans, enabling the Bank to finance more private sector banks without the requirements of a government guarantee and offer new products, such as financing in local currencies.

The Bank's operational directorates have accepted this recommendation with limitations due to local context for local currency issues and lending.

With the "Reinforced FEMIP", the Bank can lend to eligible local banks without government or international guarantees under the "Special FEMIP Envelope". Consideration is given to the provision of financing in local currencies in order to enhance the competitiveness of the Bank's loans.



EVALUATION HIGHLIGHTS OF THE YEAR

Private-Public Partnerships: Pre-requisites for Prime Performance

The growth of PPPs may be seen as being part of a wider change in the role of the State from a direct provider of services to that of a facilitator and regulator. There is clear EU support for the use of private funding for public infrastructure, and for the EIB to play a major role in that process.

These vary from country to country and sector to sector, but they normally involve the private sector building, operating and maintaining a well-defined piece of public infrastructure for a set period, with a sharing of risks between the public and private sectors.

The Impact of PPPs on project implementation

The Bank is one of the largest lenders to PPPs in the EU and has funded projects in most EU countries as well as in some partner countries. A particular challenge for the Bank is the dual role it has to play: lender to the private sector provider, and mentor to the public sector promoter which may have much less experience in PPPs than the Bank. There is a danger of a confusion of objectives and loyalties in this type of situation but the Bank, or to be more accurate the staff involved, handled the transition well.

In each of the cases taken into consideration, the main reason for choosing the PPP route was to launch investment programmes that would not have been possible with the available public sector capital budget within a reasonable time.

The evaluation found that there was a genuine sharing of risks between the public and private sectors. The EIB's analyses of these projects confirmed the economic benefits, and usually found ancillary environmental or social benefits.

It has been argued that PPPs foster innovation in design and operation of a project because while the public sector defines a specified output, it is normally the private sector provider who determines how it is delivered. However, the evaluation found only anecdotal evidence to support this thesis. It is also suggested that PPPs have the potential to bring private sector management and implementation skills to the public sector. Again, the Evaluation found no evidence to support this and did find one case of technical skills being transferred from the public sector to the private sector. Finally, one could argue that lenders bring external discipline to the project. This argument was supported by the findings. In several of the projects evaluated, both the public and private partners agreed that intervention by the lenders, including the EIB, in the PPP contract and subcontract negotiation processes produced a better deal.

EIB value added

While issues of loan term and repayment profile were important, the most important reason for the EIB being brought into the projects was its lower 'all-in' cost of financing. However, other types of value added from the Bank's presence could also be identified, particularly in new PPP markets: the development of third party funding, scale of involvement, the transfer of PPP experience from one country to another, the willingness to stay aboard for the long-term, and political effects. Public sector promoters saw the exposure to the Bank's skills and the opportunity to learn from the Bank's experience as a valuable aspect of having the Bank involved. Overall, although not a Bank policy objective, it was clear that the Bank has a positive impact on institutional development, particularly in countries at an early stage of PPP development.

Pre-requisites for Prime Performance

There is no general formula for successful PPPs; but there are clear indications on how to avoid problems. One is that projects should have clear boundaries and a fixed definition/specification. The contractual complexities of most PPPs mean that change will be expensive. Another indication is that the underlying project must be economically and financially sustainable: the PPP mechanism will tend to magnify project deficiencies. Thirdly, competition must be maintained to minimise costs. Finally, for PPPs to provide value for money, the private sector providers need to carry risk - but it must be risks which it can quantify, mitigate and manage.

In sum, PPPs are not a panacea for public expenditure. They create new problems for the public sector promoters, private sector providers and financing bodies to solve. However, in the right circumstances, they can make public infrastructure available earlier, more effectively, and more efficiently than traditional public procurement.





5. EIB MANAGEMENT OF THE PROJECT CYCLE

EV has considered three main steps in the management of the project cycle: identification, appraisal, and monitoring, both during implementation and after completion.

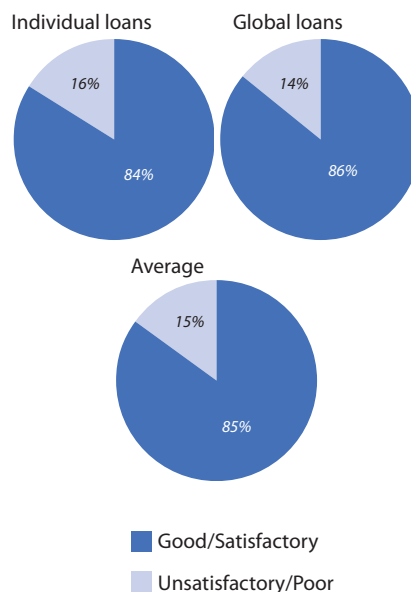
5.1 Identification and selection

Projects and / or Intermediaries supported by the Bank are often identified through ongoing relationships with public authorities, sector representatives and existing promoters or borrowers. The selection process allows an examination of project eligibility and the likelihood of a positive outcome of the appraisal process, based on preparatory work generally performed by the promoter.

As such, the identification process of the operations to finance was considered satisfactory in all cases analysed.

Nevertheless the negative outcome of certain projects justifies some recommendations for improving the role of the Bank in this phase in order to support better preparation of the investments, either by working more closely with other stakeholders such as the European Commission, or by making full use of Technical Assistance Funds, when available. This has already been signalled for the railways sector (see § 2.1 and § 3.1) and in the MPCs (see § 3.1).

5.2 Appraisal



The appraisal process in the Bank is well managed and follows strict procedures which is reflected in the 85% of satisfactory / good appraisals.

Various issues were addressed to in the evaluations presented, which were translated in some specific recommendations.

Recommendations

- Improvements in economic analysis for large-scale and long-term transport projects.

Procedures have already been updated.

- Improvements in the analysis of the Financial Intermediaries' ability to work with the Bank (for global loans).

The new "appraisal framework for global loans" is dealing with this; outside the EU, the use of FEMIP TA funds is considered when appropriate.

5.3 Monitoring

Only 66% of the operations evaluated were rated good or satisfactory as far as monitoring is concerned.

This situation had already been flagged in previous evaluations. At the end of 2004, the Management Committee took decisions in favour of the reinforcement of the monitoring during implementation and of self-evaluation. Effective results are expected during the year 2006 as this involves job creations and new staff training.

The main targets of these new procedures are investment loans and framework loans. More specifically, in the railways sector, the evaluation recognised the already high level of monitoring but still recommended it to be better performed, given the low rating on delays and costs, i.e. project implementation.

For global loans in the EU, long-established relations with the FIs allow for a sound knowledge of their competences and therefore light monitoring of the operations. Outside the EU, weaknesses identified by the evaluators demonstrate the uneven levels of relations with the FIs.

Case study:

Global loan for financing SMEs in an MPC

The Financial Intermediary (FI) is a public sector bank providing equity, loans and services supporting, as a priority, export oriented firms and tourism development. The objective of the global loan is to strengthen competitiveness of exporting companies and forex earnings in the SME sector. These objectives have been complied with and were fully in line with EU and country objectives.



The FI is well managed and presents satisfactory financial statements; nevertheless, due to downturns in the local economy, non-performing loans have sharply increased between 2000 and 2003 (to a high ratio of 22%); this situation is under control: provisions have increased and the FI has introduced risk management control. This situation deserves more attention from the EIB (increased monitoring).

The global loan was fully allocated to 14 investments; 80% of the Final Beneficiaries (FB) were companies of more than 100 people, illustrating the fact that the FI concentrates on the larger end of the SME sector. All the projects are performing well; the FI complies with EIB requirements for environmental management (an environmental fiche was always annexed to the allocation request sent to the EIB).

The financial value added is high for both the FI and the FBs who are aware of the EIB funding. The EIB loan has financed 31% of the overall projects costs.

To the question: "Would TA have improved the performance of the operation?", the evaluation answer is yes, for developing the FI's ability to finance smaller enterprises.



Annex:

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 which defines the mission of the Bank. Outside the Union, the main reference 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.

3. EIB contribution

- EIB Financial value added (Third Pillar of value added sheet for individual operations) 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.



GLOSSARY

ACP	Africa, Caribbean and Pacific
AfDB	African Development Bank
ALA	Asia, Latin America
ATM	Air Traffic Management
CoE	Centre of Expertise
DAC	Development Cooperation Directorate of the Organisation for Economic Cooperation and Development
DG TREN	Directorate-General Energy and Transport of the European Commission
EC	European Commission
ECG	Evaluation Cooperation Group
EIB	European Investment Bank
EIB Group	European Investment Bank and European Investment Fund
EU	European Union
EV	Operations Evaluation of the EIB
FB	Final Beneficiary
FEMIP	Facility for Euro-Mediterranean Investment and Partnership
FI	Financial Intermediary
IBRD	International Bank for Reconstruction and Development
MED mandate	Mediterranean mandate
MEDA	Financial instrument of the European Union for the implementation of the Euro-Mediterranean Partnership
METAP	Mediterranean Environmental Technical Assistance Programme
MLT loan	Medium to Long Term loan
MPCs	Mediterranean Partner Countries
OECD	Organisation for Economic Cooperation and Development
PPP	Public Private Partnership
SFE	Special FEMIP Envelop
SMEs	Small and medium-sized enterprises
TA	Technical Assistance
TEN	Trans-European Networks



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