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MUNICIPAL HEATING REFORM PROJECT (MHR)

REPORT

on Results of the Expert Round Table Meeting
**“FEASIBLE AND RELIABLE SOURCES OF
FUNDING OF INVESTMENT PROJECTS
IN THE AREA OF DISTRICT HEATING”**

June 2010

This document was produced for review by the United States Agency for International Development (USAID).
It was prepared by the Municipal Development Institute within the USAID Municipal Heating Reform Project in Ukraine.

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ENERGY II IQC, TASK ORDER 9
Contract: EPP-I-00-03-00006-00

June 2010

This document was made possible through support provided by the U.S. Agency for International Development. The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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REPORT
on Results of the Expert Round Table Meeting
“Feasible and Reliable Sources of Funding of Investment Projects
in the Area of District Heating”

June 18, 2010

1. Introduction

The meeting was opened by MDI Executive Director I. Slobodenyuk who made a preview of the function.

Deputy Minister of Housing and Municipal Economy O. Mazurchak and MHR Project COP W. Tucker greeted the audience and made opening remarks.

Usually there is a wide variety of sources and instruments for financing investment projects in the sphere of heat energy production, transportation and distribution as well as in the sphere of heat energy consumption. Yet, under condition of the world financial crisis and imperfect Ukrainian legislation there are certain temporary limitations which have a direct impact on reliability and, thus, on identification of appropriate sources of financing investment projects.

Having conducted a thorough review (analysis) of all available in Ukraine potential sources and instruments for financing investment projects we came up with a set of conclusions and recommendations as to their reliability as outlined in our report.

The scope of the Expert Round Table held on June 18, 2010 provided for discussion of our findings and recommendations with experts from the Ministry of Housing and Municipal Economy, Ministry of Economy, municipalities, ESCOs and international financial institutions (see the list of the Round Table participants in Annex 1) before presenting those findings and recommendations to the USAID-financed Municipal Heating Reform in Ukraine Project pilot cities and companies.

The Round Table discussion was preceded by three presentations (see the agenda of the Round Table in Annex 2) made by MDI specialists introducing the conclusions of the analysis of potential sources of financing investment projects, the concept of an EE projects revolving fund model and a model of attracting private capital for capital renovation and EE projects in condominiums.

2. Feasible and Reliable Sources of Funding of Investment Projects in the Area of District Heating

Mr. Stepan Makovyak, MHR Project Sr. Finance and Business Planning Specialist, presented the results of the analysis of potential sources of financing investment projects and the conclusions and recommendations made based on the analysis.

Under conditions of the world financial crisis and imperfect Ukrainian legislation potential sources and instruments of financing investment projects experience certain temporary limitations which directly impact their reliability and hence our selection of the corresponding sources and instruments of financing investment projects.

So, the most reliable sources of financing investment projects in the sphere of heat energy production, transportation and distribution are the following:

1. The most popular source of financing short-term investment projects in the sphere of heat energy production, transportation and distribution are bank loans and commercial (commodity) credits. While bank loans require collateral or state/municipal guarantees, the commodity credits are provided by the sellers to the buyers as deferment of payment for the goods/services sold. Moreover, commodity credits are fast and technically simple to provide and there is no requirement to register them with the National Bank of Ukraine. All this makes the commodity credits from our point of view an optimal instrument of financing short-term investment projects.
2. To finance medium term investment projects, we believe, the most appropriate instrument is financial leasing. Significant advantage of financial leasing is the fact that all leasing payments may be treated as gross expenditures of the company. Moreover as long as the fixed assets purchased may be used immediately while payment for them may be fully settled later on or in partial sums gradually the leasing frees company's working capital for other purposes.
3. Long term investment projects, we believe, require creation of public-private partnerships of which the most efficient form of implementation of long term investment projects we believe to be the concession.

In the sphere of heat energy consumption from our point of view the most reliable sources of financing investment projects seem to be the following:

1. For short-term investment projects the commodity credits coupled with cash contributions by the condominium co-owners seem to be the most appropriate instrument.
2. To finance medium-term investment projects we believe the most appropriate should be the creation by local governments of a revolving fund of co-financing of energy service contracts.
3. Long-term investment projects shall be financed by stimulating private investment by non-financial private intermediaries which will both finance and implement the project.

3. Concept of a Revolving Fund Model for Financing Energy Efficiency Projects

The concept of the revolving fund model was introduced to the audience by Ms. Alyona Babak, MHR Project Consultant on Pricing and Financial Management in Housing and Communal Economy, Team Leader of a group of project consultants on Task 2 “Improvement of Tariff Regulation.”

It is important for local governments to identify a legal mechanism to carry out expenditures for investment purposes into objects of communal ownership which need to be financed for a period over one year. The law does not guarantee allocation of funds from a corresponding budget to finance capital investment the implementation of which exceeds the period of one year, therefore is not a stable source of long-term financing, including EE. At the same time local governments wish to stimulate investment into objects of communal ownership and to facilitate private investment into EE in housing.

For that reason it is proposed to create at the expense of local budgets a revolving fund as a mechanism to stimulate private investment. The revolving fund to finance EE projects in housing shall be created at the expense of local budget funds with the aim to widen the scope of financing of EE projects, reduction of expenditures for purchase of fuel for budget institutions, communal enterprises, support of small and medium size entrepreneurs through co-financing of contracts for energy services with local governments.

The revolving fund will function by providing financing to corresponding subjects of entrepreneurial activity to finance EE programs requiring repayment of the funds provided and their multiple use to implement other EE projects.

4. Attraction of Private Capital for General Overhaul and Implementation of Energy Efficiency Measures in Multi-Apartment Residential Buildings

The model of attracting private capital for capital renovation and EE projects was presented by Ms. Victoria Pogorelova, MHR Project Consultant on Social Mobilization, and Mr. Dmytro Levytsky, MHR Project Legal Consultant.

Based on limited financial capabilities of condominium co-owners and limited budget funds the only realistic source of funds for capital renovation and introduction of EE measures in a condominium is borrowed funds. The major issue which arises with borrowing is availability of collateral or guarantee. Unfortunately co-owners associations as legal entities do not own assets which they could pledge. It is highly unlikely that members of the association would pledge their flats either. The only potential asset for pledge in a block of flats is future cash flow for housing and communal services payments and contributions of the association members.

Following are two potential options to attract financing:

- company-contractor conducts renovations at using its own or borrowed funds and offers to the owners association deferment of payment for the work done,
- work done is paid for by a company, which provided certain communal services in this building, for which the owners association concludes a long-term contract with this company on exclusive provision of these services.

5. Comments and Suggestions by Round Table Participants. Conclusions

There was practically no discussion of the findings and conclusions introduced during the first presentation since, in fact, all experts present agreed to and supported the conclusions made by the MHR Project team.

The presentation of the concept of revolving fund financing raised significant discussion. All the experts agreed that it is probably the only available option for local governments to stimulate private investment into EE projects. Yet, this option requires additional effort to streamline current regulations in order to allow efficient creation and operation of a revolving fund.

The two possible options of attracting private capital for capital renovation and introduction of EE projects in condominiums were fully supported by the experts. It was suggested to rely more heavily on energy service contracts while implementing this model.

Mr. Andriy Mitskan, MHR Project Deputy COP, concluded the Expert Round Table discussion with the following summary:

- 1) Funds available for investment projects are very limited and used inefficiently. Therefore there is a strong need to introduce new mechanisms as described during the presentations.
- 2) Recommendations developed by the MHR project team based on thorough review of all available sources of financing of investment projects received expert support and may be offered for use by the MHR project pilot cities.
- 3) There should be created (initially on the basis of MDI) a working group which would include all interested experts present at the round table and to invite experts from the Ukrainian financial sector to join in order to streamline current regulations allowing efficient creation and operation of revolving funds.
- 4) Revolving fund model should be tested by establishing it in one of pilot municipalities.
- 5) Promotion of both models of attracting private capital for capital renovation and energy service contracts should start as soon as possible.

Annexes

Annex 1

**List of Participants on the Expert Round Table
“Feasible and Reliable Sources of Funding of Investment Projects
in the Area of District Heating”**

June 18, 2010, Kyiv

No.	City	Organization	Participant	Position
1.	Kyiv	Ministry of Housing and Municipal Economy of Ukraine	Oleksandr Mazurchak	Deputy Minister
2.	Kyiv	Ministry of Housing and Municipal Economy of Ukraine	Olga Romanyuk	Deputy Minister
3.	Kyiv	Ministry of Housing and Municipal Economy of Ukraine	Maryana Synyushko	Chief Specialist, Department for Foreign Economic Activities and International Relations
4.	Kyiv	Ministry of Housing and Municipal Economy of Ukraine	Yury Tyma	Chief Specialist, Department for Maintenance and Development
5.	Kyiv	Agency for Development of Housing and Municipal Economy, State Enterprise	Lesya Pliska	Головний економіст
6.	Kyiv	Ministry of Finance of Ukraine	Svitlana Suprun	Deputy Director, Department for Cooperation with International Finance Institutions
7.	Kyiv	U.S. Agency for International Development (USAID)	Andriy Nesterenko	Energy Program Coordinator, USAID Regional Mission to Ukraine, Belarus, Moldova
8.	Kyiv	International Resources Group (IRG)	William Tucker	COP, Municipal Heating Reform in Ukraine Project
9.	Kyiv	International Resources Group (IRG)	Andriy Mitskan	Deputy COP, Municipal Heating Reform in Ukraine Project
10.	Kyiv	International Resources Group (IRG)	Olena Kotlyarska	PPP Manager, Municipal Heating Reform in Ukraine Project
11.	Kyiv	Nordic Environment	Yulia Shevchuk	Sr. Advisor on

No.	City	Organization	Participant	Position
		Finance Corporation (NEFCO)		Investments, NEFCO Ukraine
12.	Kyiv	Institute for Budgetary and Socio-Economic Research, All-Ukrainian Public Non-Profit Organization	Iryna Scherbyna	Managing Director
13.	Kyiv	ESCO-Centre, Central Energy Service Company, Ltd.	Valery Henzitsky	Managing Director
14.	Kyiv	ESCO-Centre, Central Energy Service Company, Ltd.	Oksana Pagels	Finance Director
15.	Kyiv	IBK Hyrdokor – Ukraine Hydraulic sealing of industrial and public buildings	Andriy Misyura	EE Project Manager
16.	Kyiv	KINTO	Olena Vasylchenko	Project Manager
17.	Kyiv	Municipal Development Institute, All-Ukrainian Charitable Organization	Igor Slpbodenyuk	Executive Director
18.	Kyiv	Municipal Development Institute, All-Ukrainian Charitable Organization	Alyona Babak	Consultant in pricing and financial management in the area of housing and municipal services; head of the team of consultants under the task on improving tariff regulation
19.	Kyiv	Municipal Development Institute, All-Ukrainian Charitable Organization	Dmytro Levytsky	Consultant in Legal Issues, Municipal Heating Reform in Ukraine Project
20.	Kyiv	Municipal Development Institute, All-Ukrainian Charitable Organization	Nadiya Lysenko	Consultant in Business and Tax Accounting, Municipal Heating Reform in Ukraine Project
21.	Kyiv	Municipal Development Institute, All-Ukrainian Charitable Organization	Stepan Makovyak	Senior Finance and Business Planning Specialist, Municipal Heating Reform in Ukraine Project
22.	Kyiv	Municipal Development Institute, All-Ukrainian Charitable Organization	Victoria Pogorelova	Consultant on Social Mobilization, Municipal Heating

No.	City	Organization	Participant	Position
				Reform in Ukraine Project, Motor HOA leader
23.	Kramatorsk	City Council	Stanislav Zakharov	Deputy Mayor
24.	Kherson	Regional Council of Entrepreneurs, Kherson Oblast Public NGO	Fedir Barulin	Chairman of the Board

Annex 2

**Agenda of the Expert Round Table
“Feasible and Reliable Sources of Funding of Investment Projects
in the Area of District Heating”**

June 18, 2010, Kyiv

Timing	Topic	Speaker
9:30 – 10:00	Registration of participants	
10:00 – 10:10	Introduction. Welcoming address to participants	Ministry of Economy of Ukraine, Ministry of Housing and Municipal Economy of Ukraine, USAID Municipal Heating Reform in Ukraine Project
10:10 – 10:30	Most feasible and reliable sources of funding of investment projects in the area of district heating	Stepan Makovyak
10:30 – 10:50	Concept of a revolving fund model for financing energy efficiency projects <ul style="list-style-type: none"> ▪ Purpose of establishment ▪ Choosing an organizational and legal form ▪ Important things for carrying activities out 	Alyona Babak
10:50 – 11:10	Debate on the revolving fund model	Comments and suggestions from the Ministry of Economy, Ministry of Housing and Municipal Economy, and other participants
11:10 – 11:30	Attraction of private capital for general overhaul and implementation of energy efficiency measures in multi-apartment residential buildings	Victoria Pogorelova
11:30 – 11:55	Debate on the model of attraction of private capital	Comments and suggestions from the Ministry of Economy, Ministry of Housing and Municipal Economy, and other participants
11:55 – 12:30	Conclusions	Andriy Mitskan
12:30	Lunch	All participants