



Emilia Battaglini

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33232 ECSSD

Subject: Hungary - Rehabilitation and Expansion of Small Hydro Plants on the River Raba MSP (CC-STRM): Re-submission

Dear Yasemin,

please find attached the revised Project Brief for the above-mentioned Medium-Size Grant. The Project Brief was submitted to GEFSec for review on April 12, 2002. The revised Project Brief hereby attached addresses the GEFSec's comments received on 5/30/02 and the additional clarifications requested on 7/15/02. GEFSec's comments have been addressed as follows:

- **Country Priority.** Attached you will find a letter from the Ministry of Economy dated November 27, 2002 highlighting the high priority given by the government to the proposed Raba project for the development of small hydro power through the private sector. The project is endorsed particularly for its high demonstration and replication effect both within Hungary and in the region as well as its contribution to achieving EU accession targets for the use of renewable energy. A letter from the Ministry of Economy (Energy Department) highlighting the relevance of the project for the country renewable energy development agenda dated June 19, 2002 is also attached for your files. The endorsement letter from the GEF Focal Point was submitted to GEFSec in April and is already in GEFSec's files.
- **Cost-effectiveness and incremental cost analysis.** The proposer was able to adjust the project cost estimates downward based on additional offers for works and equipment that were received more recently and the actual cost of a similar turbine rehabilitation work recently carried out by the company in Germany. On the basis of the revised cost estimates, which are fully endorsed by the Bank's team, the cost per ton of CO₂ is US\$2.67 for the Koermend plant and US\$2.45 for the Csoeroetnek plant, with an average project cost of US\$2.53 and a UAC of US\$9.28.
- **STRM and GEFSec Strategic Priorities.** The proposed project meets the criteria for short-term climate change projects as defined in the GEF Operational Strategy (please see point (a) below). Whether it fits the "strategic priorities for climate change" more recently developed by GEFSec is ultimately a GEFSec decision. In making this decision we would like you to consider the following additional factors:
 - (a) **Likelihood of success.** The project is considered as very low-risk. The risk of electricity price falls after market liberalization in 2005 is mitigated by the long-term electricity purchase agreement with EDASZ. The technological risk associated with the rehabilitation is negligible due to the owners' experience with small hydro plants. The river hydrological data is quite reliable. The risk of an occasional draught year and lower than expected output and revenues is mitigated by the favorable (long term) financing terms the proposer would be able to obtain if GEF grant is made available.
 - (b) **Replicability.** The demonstration value of this project is very high for Hungary where the government is very actively encouraging the private sector to develop renewable energy, but also for Eastern Europe and Central Asia. Particularly in Central Asia, small hydro can make a significant difference since countries have limited fossil energy resources, are in severe economic difficulties and have limited access to world energy markets. However, it will take years until bankable small hydro projects can be developed in these countries, particularly with the private sector. The situation in Central Europe is much more favorable and the proposed project could set an example for future projects in the further east. The project proposers own a small-hydro installation that serves as an international information center and intend to expand and modernize further this facility to reach out to more countries.
 - (c) **Leveraging ratio.** The GEF grant of US\$405,000 would leverage long term financing from KfW of Germany as well as additional grants from both Austria and Hungary and equity from the owners, with a

co-financing ratio of US\$ 5.6 for each dollar from GEF.

(d) **Private sector involvement.** The proposed project would set a useful example of private sector involvement in GEF projects. The company's commitment to the project's objectives is unquestionable and the proposer made incredible efforts to adjust the proposal to meet both GEF' and Bank's requirements. Any further delay in approving the MSP will certainly cause the loss of co-financing. From an investment and operational point of view the eligibility criteria and approval process for such projects should be streamlined to make them really appealing to private investors.

(e) **Bank/GEF country commitment and reputational risk.** The proposed project was prepared and submitted to GEFSec in April 2002, after several months of preparation work. A revised version of the proposal was resubmitted in June 2002. Since then, the approval has been on hold pending a GEFSec decision on strategic priorities for STRM. The project has been extensively discussed with government, other co-financiers and the NGO community over the last 12 months and enjoys a broad-based support in the country. Withdrawing from this operation on the ground of "new rules of the game" would seriously damage both the Bank' and the GEF's image in our client countries and would also set a very bad example for new partners such as the private sector. Since the project was prepared and submitted for review before the emerging strategic priorities were presented to Council last May it should enjoy the same "transitional arrangements" agreed for full size projects in advanced stage of preparation and should therefore be grandfathered as long as it meets the criteria set in the Operational Strategy.

Please let me know if you need any additional information to complete your review.

Many thanks for your prompt response.

Attachments:

- Revised MSP Project Brief:



HungarySmall-HydroMSPBrief.doc



Annex 2 Add Info on Promoter May-30-02.doc



Fin Projections May-30-02.xls

- Ministry of Economy support letters:

11/27/02



GM letter.tif

6/19/02



MoEnergy support letter.jpg

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