

Financing Energy Efficiency in Buildings in Ukraine

- Analysis and Policy Recommendations -

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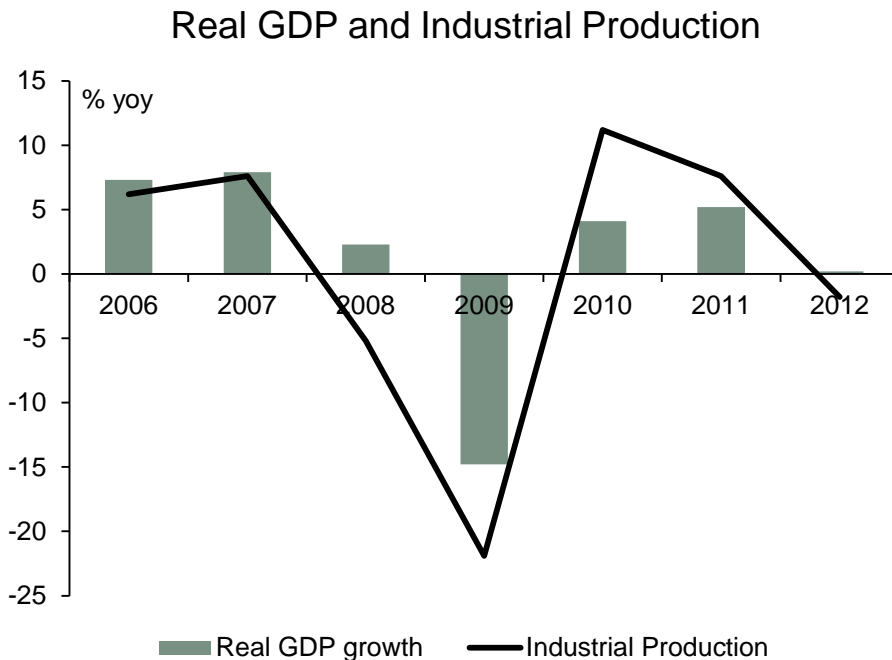
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I. Introduction

- Increasing energy efficiency is of crucial importance for Ukraine for a number of reasons:
 - Reduced energy consumption
 - Security of Supply/ Increased Energy Independence
 - Climate Impact
- The building sector with a 40% share in final energy use is of crucial importance to policy makers in reaching this goal
- Raising this potential in new and existing buildings via more investments into increased energy efficiency requires a clear understanding of the general economic situation, but also of sectoral issues in construction and finance

II. Economic and Financial Context

Macroeconomic Background



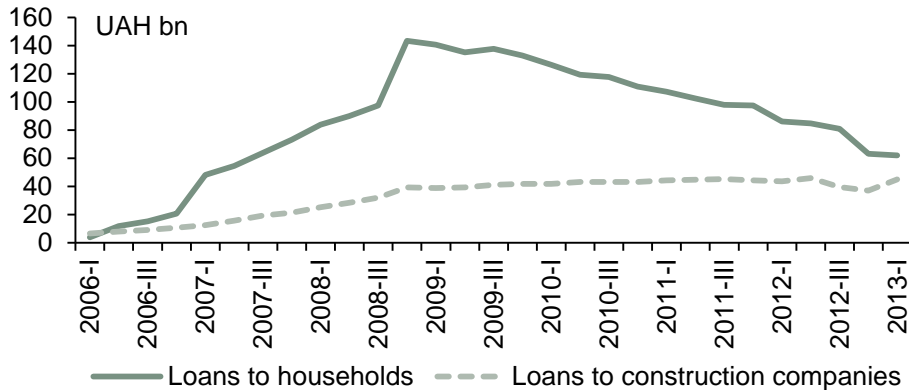
Source: State Statistics Service of Ukraine

- Macroeconomic situation followed a roller-coaster pattern over the last years
- High growth until mid-2008 was suddenly stopped by the arrival of the „Global Financial Crisis“ in Ukraine, leading to a drop of around 15% in GDP, one of the worst results globally
- Recovery started in 2010/2011, but was interrupted in 2012; recession continues into 2013

Weak growth environment persists, posing a direct challenge for the construction sector

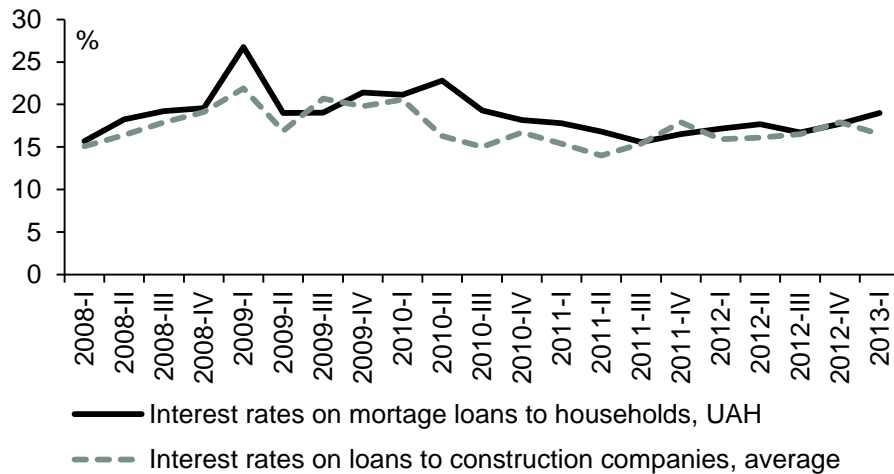
Bank Finance to Construction Sector

Mortgage and Construction Loan Volumes



Source: NBU

Interest Rates



Source: NBU, own calculations

- Demand-side finance (i.e. mortgage loans) is continuously shrinking
 - Mainly due to prohibition of FX lending, and high interest rates (and short maturities) for UAH loans
- Supply-side finance (i.e. loans to developers and construction companies) is stagnant since terms are commercially unattractive
- Low level of state support due to tight budgetary situation and focus on current spending

Overall situation worse than in general banking sector

III. The Construction Sector in Ukraine



Current Situation

Construction Sector Developments

	2006	2007	2008	2009	2010	2011	2012
Construction output (current prices), UAH bn	72	107	129	84	87	109	113*
Growth rate, % yoy	38.3	49.0	20.4	-34.9	3.6	25.3	3.5*
Completed construction works (fixed prices, index 2006=100)	100	116	97	50	48	53	46
Growth rate, % yoy	9.9	15.6	-15.8	-48.2	-5.4	11.0	-14.0
Average annual number of employees engaged in construction (1,000)	668	679	653	509	447	409	n/a

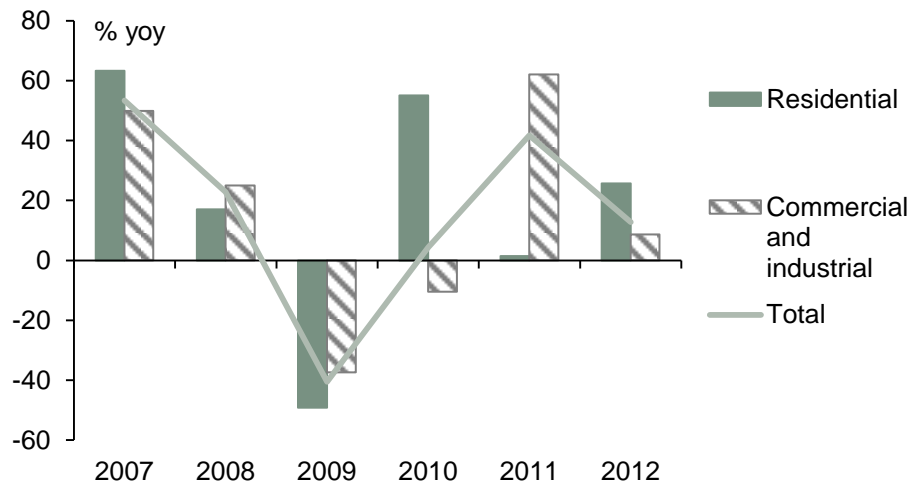
Source: State Statistics Service of Ukraine, * estimated

- Since construction is very dependent on external finance, adverse macro and banking sector developments since 2008/09 hit the sector exceptionally hard (see row 1 and 2)
- However, looking at real (i.e. price-adjusted) figures reveals an even more dramatic picture (row 3 and 4)

While in current prices, output is close to 2008 peak, real output has more than halved

Focus: Residential Construction

Residential and Commercial Construction Investments



Source: State Statistics Service of Ukraine

- How do individual segments of the construction sector look like, specifically residential construction?
- Higher volatility than overall trend
- Crisis in 2009 was followed by quick rebound 2010, but rather lacklustre performance afterwards
- Interesting observation: Commercial and industrial construction (including infrastructure) jumped 2011 (pre-EURO 2012), but declined afterwards

Drag on sector performance in 2011/2012

IV. Financing Increased Energy Efficiency in Buildings

Existing Financing Options (1)

1) State Programs and Government Projects

- Several initiatives targeted at housing construction:
 - **Affordable Housing for Young Families**
 - **70/30 Affordable Housing**
 - **13/3 Subsidized Mortgage**
 - Subsidized Loans to HOA
 - State Economic Programme 2013/14 (partly)
 - Municipal Initiatives (Covenant of Mayors)
- However, share of state budget spending on housing programs is very low in international perspective:
 - EU-15: 3.3% of annual budget
 - EU (Eastern Europe): 1-4% of annual budget
 - Ukraine (2012): **0.04%** of annual budget

Existing Financing Options (2)

2) IFI and Donor Activity

- Significant IFI/Donor-support for pilot energy efficiency projects in buildings
- Technical, legal, regulatory and financial assistance
- Some examples:
 - IFC “Ukraine Residential Energy Efficiency Project”
 - GIZ “Energy efficient pilot project” / “Energy Efficiency in buildings”
 - Other donors include: KfW, Green for Growth, EU, World Bank, USAID, EBRD,....

3) Dedicated Initiatives for HOAs

- Most IFI/Donor-sponsored projects are aimed at private sector and municipalities
- Some initiatives try to create lending facilities for energy-efficient modernizations of buildings by HOAs:
 - Kredobank (IFC-supported)
 - Metabank
- No loans disbursed so far

Energy Service Companies (ESCO)

- Definition of ESCO: Natural or legal person that delivers energy services to a user's premises, and accepts some degree of financial risk in so doing. The payment for the services is based on the achievement of energy efficiency improvements and on other agreed performance criteria
- Activities of ESCOs have been developing rapidly over recent years in the EU and the US
- Ukraine: Different constraints for implementation in the official sector, e.g.:
 - Lack of ESCO definition in legal framework
 - Different procurement process to launch ESCO-type projects
 - Lack of protection against non-payments from public parties

V. Policy Recommendations

Policy Recommendations

- Financing energy efficient investments in the building sector in Ukraine is currently held back by a combination of negative factors
- This challenging background calls for a multi-pronged response by policy makers, thereby setting the right incentives for private actors:

1. Energy tariff policy

- Cost-recovery in heat, warm water and gas supply is of crucial importance for stimulating energy savings by households

2. Supply of credit

- Establish coherent macroeconomic policy framework
- Tackle the still existing structural deficiencies in the banking sector, e.g. non-performing loans

3. Target structural problems in construction sector

- “Doing Business” 2013: Ukraine ranks 137 (out of 185)
- Sub-index “Dealing with Construction Permits” – Rank 183 (out of 185 countries (!), worse than 2012)
- Significantly above peer group in number of procedures, time and costs

4. New financing instruments and programs

- Donor-driven pilot projects are very important steps, but need to be complemented by further instruments to broaden the impact
- State should play a more active role, which implies a change in the structure of budget outlays: Capital spending versus current spending
- ESCOs could provide a further financing channel, but supporting legislation needs to be firmly established

Thank You!

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