

CLIMATE INVESTMENT FUNDS

June 15, 2010

PILOT PROGRAM ON CLIMATE RESILIENCE (PPCR): FINANCING MODALITIES

I. Purpose of Document

1. In 2009, the PPCR Sub-Committee approved the paper “Programming and Financing Modalities for the SCF targeted programs: the Pilot Program for Climate Resilience”, dated July 16, 2009. The paper provides guidance regarding financing modalities, recommending that countries and MDBs use the range of financing instruments available (e.g. grants, investment loans, development policy loans, guarantees), and that, where possible, PPCR funding be combined with that of other MDB and/or development partner operations.
2. Both grants and concessional loans will be available to finance the additional costs necessary to make a development activity resilient to the impacts of climate change. ***Countries may choose to only access PPCR grant resources.*** When concessional loans are provided, the grant element of the loan will be sufficient to cover the additional costs of integrating climate risk and resilience into development activities. Financing terms for concessional loans are more concessional than standard IDA terms.
3. The Sub-Committee agreed to keep the programming guidelines under review in order to allow for flexibility to respond to challenges that may arise during implementation of the PPCR. The CIF Administrative Unit and the MDBs were requested to report on experience in carrying out the program so that the Sub-Committee can review the programming procedures and financing modalities. This document takes into account experience to date in applying the PPCR programming guidelines.
4. These financing modalities will be reviewed by the PPCR Sub-Committee on the basis of actual experience in their application and that the MDBs prepare a report for consideration by the Sub-Committee within 24 months of start-up of investment operations to identify, if necessary, any changes that would serve to enhance the effectiveness of the PPCR.
5. Finally, this document should be considered along with document PPCR/SC.6/9 *Proposal for the Allocation of Resources to PPCR Pilots.*

II. Additional Costs and Risks of Integrating Climate Risk and Resilience into Development

6. The objective of the PPCR is to pilot and demonstrate ways to integrate climate risk and resilience into core development planning, while complementing other ongoing activities. The pilot programs implemented under the PPCR should be country led, build on National Adaptation Programs of Action and other relevant country studies and strategies, and be strategically aligned with the Adaptation Fund and other donor funded activities to provide pilot finance in the short term so as to learn lessons that will be useful in designing scaled up adaptation financing¹.

¹ *PPCR Design Document*, November 2008

7. The PPCR aims to contribute to achieving the objectives of the SCF by seeking to provide incentives for scaled-up action and transformational change in integrating consideration of climate resilience in national development planning consistent with poverty reduction and sustainable development goals.

8. PPCR financing will address the additional costs and risks associated with integrating climate risk and resilience in core development activities, which adversely affect the viability of investments. Financing modalities will be designed and deployed to meet the specific requirements of removing financial and institutional barriers. The key drivers of additional costs and risks for climate resilient development are the following:

- a) *Higher investment costs*: Even though development activities receive national and international financing, the integration of climate risk and resilience into these activities tend to have higher initial capital costs. This makes the cost of climate resilient development activities more dependent on the cost of capital than conventional development activities.
- b) *Lack of access to capital*: Developers of climate resilient development activities may lack access to capital to invest and finance a development project that integrates climate risk and resilience considerations because of typically more complex requirements relative to conventional sector-oriented development projects, poor creditworthiness, and uncertainty about mid-and long-term climate variability and vulnerability.
- c) *Real and perceived risks associated with climate change*: Climate change and variability increase the risk or the perception of risk for conventional development interventions, if there is limited information and experience with them how to integrate climate-related factors. These perceptions may increase required rates of return and result in less capital available.
- d) *Lack of technical or commercial skills and information*: Skilled personnel who can integrate climate risks and resilience considerations into development activities may not exist in large numbers, while lenders and government officials often lack information about characteristics associated with climate change and variability. The lack of skills and information may increase perceived uncertainties and block decisions.
- e) *Constrained ability to pay*: The upfront cost of making development interventions climate resilient is a serious barrier as the success of those interventions remains uncertain in the context of climate change, in particular climate variability.

III. Financing Modalities: General Principles

9. In support of this objective, the PPCR may support the following two types of activities:

- a) The PPCR may provide funding for *technical assistance* to enable developing countries to build upon existing national work to integrate

climate risk and resilience into national or sectoral development plans, strategies and financing.

- b) The PPCR may provide additional financial resources to help fund a program of public and private sector *investments* identified in national or sectoral development plans or strategies addressing climate change.
10. The PPCR is designed to deliver additional finance to countries for integrating climate risk and resilience into development planning and investments, including the blending of grant and highly concessional loans with domestic public and private financing.
 11. A significant portion of funding under the PPCR is expected to be provided in the form of grants. A pilot country may also making use of the availability of additional concessional lending that may be blended with existing sources of concessional funding and national resources to increase the resilience of existing development priorities to the impacts of climate change.
 12. A number of financing products (such as grants, concessional loans and guarantees) will be available under the PPCR. All PPCR financing will be denominated in US dollars.²
 13. A key feature of the PPCR will be its ability to provide the MDBs with the instruments to blend PPCR resources with other sources of financing to tailor terms to a target level of concessionality, which will vary depending on project-specific factors. Adding grants and other forms of concessional finance from PPCR to the financing package could help unlock demand for the financing of climate resilient projects and programs. Blending PPCR resources and multilateral development bank loans could augment the volume of financing available, and better tailor concessionality to needs, with the degree of concessionality calibrated to achieve transformative investments which would otherwise not proceed.
 14. It will be important to ensure that concessional terms of PPCR financing do not displace or substitute investments that might have taken place anyway using commercial or regular MDB borrowing or guarantees. PPCR financing should be designed to minimize market distortions and potential disincentives to private investment.
 15. It is proposed that the PPCR provide the multilateral development banks (MDBs) with a menu of blending options to accommodate different needs of client countries and program interventions. The PPCR could co-finance MDB loans and grants or provide additional financing of new components within ongoing investment operations, on more concessional terms. PPCR technical assistance grants could complement investment or development policy operations by supporting specific tasks related to their preparation and implementation (such as institutional arrangements, staffing methods, and technical, physical or financial resources in key agencies). Resources from the PPCR would thereby

² The MDBs may denominate PPCR financing according to their policies and procedures, subject to the MDB assuming the exchange rate risks.

increase the concessionality of the overall financing, as well as leverage other resources, for the project. The development of such co-financing arrangements can be done in a relatively low-cost manner when fully embedded in the MDBs' project preparation and supervision process.³

16. Co-financing from the PPCR may be provided through a variety of financing instruments utilized by the MDBs for investment and development policy lending. For example, these would include instruments that:

- a) Support the creation, rehabilitation, and maintenance of economic, social and institutional infrastructure, more climate resilient land and water management and agricultural systems, and improved access to weather related information;
- b) Provide phased support for long-term development programs through a series of loans that build on lessons learned from the previous loan(s) in the series;
- c) Build institutional capacity;
- d) Provide long-term resources to local financial institutions to finance real sector investment needs;
- e) Provide fast-disbursing loans or grants to help a borrower/recipient address actual or anticipated development financing requirements through a program of policy and institutional actions; and
- f) Provide loans or grants for investment in public and private projects that need to consider the risks of and impacts to climate change and variability.

IV. Financing Modalities for Public Sector Involvement

17. Strategic Programs for Climate Resilience (SPCR) have the overall goal of mainstreaming climate risk and resilience into development investments, and different elements of the program are closely related. The overall grant/credit blend would be determined at the time the SPCR is submitted by the participating country.

18. PPCR funds used for public sector initiatives will seek to avoid market distortion and crowding out of the private sector. PPCR funds will not be priced or structured to displace commercial financing or to set unsustainable expectations in a market. PPCR funds will be used to "crowd in" the private sector by enabling projects and investments to happen that otherwise would not by catalyzing those investments with their concessionality.

Grants

³ In addition to efficiency gains from cost sharing for project preparation, appraisal and supervision, blending with MDB operations provides other advantages, particularly: (1) full integration with the MDBs' country and sector policy dialogue, and (2) application of the MDBs' quality assurance and risk management practices.

19. Countries may choose to only access grant resources under the PPCR. This section describes the use of grant funding.

Grants for Preparation Activities

20. PPCR grants may be used for *preparation activities*

- a) Preparation of the Strategic Program for Climate Resilience (Phase 1), where needed.
- b) Preparation of PPCR co-financed projects.

21. *Preparation of Strategic Programs for Climate Resilience (SPCR)*: In countries lacking an adequate basis for preparing strategic programs, the PPCR may provide financing for the preparation of such programs.

22. The maximum total preparation grant for a SPCR will be US\$1,500,000. The request for a SPCR preparation grant may be submitted to the PPCR Sub-Committee for approval. The Phase 1 proposal should provide detailed information on a workplan and budget for Phase 1 and be submitted to the PPCR Sub-Committee through the CIF Administrative Unit by the participating country(-ies).

23. *Project preparation grants*: The purpose of project preparation grants is to develop a quality investment project or program by financing feasibility studies and associated analytical and design tasks. These grants could also support project or program preparation-related consultations, workshops and training.

24. No cap will be set for a PPCR preparation grant for projects and programs. Funds for project preparation grants would be included within the envelope requested for the SPCR. Proposals for project preparation grants should be included in the SPCR, and the PPCR Sub-Committee would be requested to approve the requested funding when it endorses the SPCR.

25. Proposals for project preparation grants should be included in the SPCR and the PPCR Sub-Committee would be requested to approve the requested funding when it endorses the SPCR. Annex A provides guidelines for the approval and management of PPCR preparation grants for SPCR and projects.

Grants for Public Sector Investment Programs/Projects

26. PPCR grants may be deployed as upfront capital in a number of different ways to support the integration of climate risk and resilience into development activities. This includes supporting capacity development and policy analysis/formulation for climate risk and resilience issues, especially where national public sector financing is limited. The need for capacity building and technical assistance is likely to be the great in PPCR pilots.

27. Nearly every economic sector of a country is affected to varying degrees by the impacts of climate change and variability. Countries with economies that are mainly

based on the use of natural resources are especially affected. In most cases, these countries are also low income and low capacity countries that have difficulties to even mobilize sufficient national capital to address the basic development needs. Other countries with better access to capital markets see often the challenges that there is limited in-country knowledge on how to integrate climate change risk and resilience in regular development activities, such as infrastructural development, public health, agriculture or hydropower. While investments in some of these sectors will result in an economic return, others are not.

28. Hence, a key determinant in selecting the appropriate intervention is access to finance in the targeted sector:

- a) *Decrease Costs (including financing costs) through capital or buy-down grants*, which are used to lower the cost of a development project that needs to integrate climate risks and resilience considerations. Buy-down grants can come in the form of co-investment funds, which are typical for demonstration projects, or in the form of rebates, which are more common in the case of market development. Grants could also be deployed for seed capital, long-term and/or low interest loans, and loan guarantee programs in the pilot country, in order to overcome the problem of inadequate access to capital, short loan tenors, high interest rates and severe collateral requirements that may not match the needs of climate resilient development projects.
- b) *Maintain revenue or reduce revenue volatility through including climate risk and resilience*, in sectors that are economically viable yet at risk to lose revenue due to the impacts of climate change and variability.

29. PPCR grants will also be used to finance knowledge management components within investment projects. Box 1 provides further information on the objectives and scope of PPCR's support for knowledge management.

Box 1 Grant Financing of Project-based Knowledge Management (KM) Components

One of the cornerstones of the proposed CIF Knowledge Management Program is *the inclusion of a CIF grant supported KM components in every CIF funded project*. The grant would involve a fixed entitlement under each CIF funded project (proposed at \$250,000). Its purpose is to ensure that maximum opportunity is taken at the frontline of CIF operations to capture early experiences and lessons coming out of project implementation, share such lessons with local stakeholders, and contribute to the building of CIF's broader knowledge capital. For this to happen, partner countries have to be incentivized through dedicated grant funding.

The preparation of these KM components would be broadly defined as part of the regular project preparation process with the support of MDB task teams and with finance from the CIF project preparation grants. It would be expected to address *three basic elements*: (i) communications with local stakeholders, including CSOs and the private sector on project activities, results and lessons; (ii) capture of lessons during the project implementation

process; and (iii) the sharing of such lessons with other CIF country partners.

As part of early project implementation, local project implementing agencies working with the involvement of local stakeholders with the support of from the CIF KM component grant would develop the above mentioned three KM elements in more detail. There would be no fixed model for addressing these requirements. Rather they would be determined based on local conditions and priorities. Each developed KM component should have identifiable outputs which should be included in the project's monitoring plan.

Some of the elements of the project based KM components would need to be linked to CIF program-wide platforms for accessing and sharing information and knowledge. The Global Support Program Team of the CIF Administrative Unit would address this requirement and provide necessary guidance and training to country project teams

MDB task teams would be expected, as part of their regular project supervision activities, to review progress in the implementation of CIF project learning components and work with local project implementing entities to help these components achieve their objectives.

The implementation of these project-based KM components will by themselves generate information and knowledge on what works well and what does not. These experiences and lessons need to be captured to help inform KM design of subsequent projects. Each project team would therefore be expected to share the experiences and lessons with respect to KM component implementation with other CIF project teams. Effective mechanism for such lessons sharing would be developed for the programs of CTF and for PPCR FIP and SREP.

Source: CIF Knowledge Management – Creating the Capacity to Act (CTF-SCF/TFC.4/4, March 2010).

Concessional Loans

30. MDBs may provide PPCR financing support through: (a) lending to national governments; (b) lending to national governments for on-lending to sub-national entities (which include state-owned enterprises); or, (c) lending to sub-national entities⁴. The PPCR loan will have the same legal ranking as the MDB loan for the project (i.e., if the MDB loan is unsecured, the PPCR loan will be unsecured and if the MDB loan is collateralized, the PPCR loan would also be collateralized). MDBs' standard appraisal criteria will address credit risk through their assessments of borrower creditworthiness, financial viability, corporate governance, and safeguards against irresponsible borrowing.

31. Consistent with MDBs' standard lending practice, they will not seek any guarantee or security for PPCR loans to sovereign governments. If a PPCR loan is made to a sub-national entity, the member country, where appropriate, will be required to guarantee the grant or loan, where MDB sub-sovereign lending requires such guarantees.

⁴ Sub-national entities would be eligible for support under either the public or the private sector window depending upon the source of complementary multilateral support. PPCR financing could also be provided to special purpose vehicles owned either by the private sector or owned in part by the private sector and the government to carry out a project on a limited recourse basis where the resources for the project are derived from government entities. Such entities would be eligible for support under either the public or private sector windows depending upon the source of complementary multilateral support.

Country Circumstances and Eligibility for Concessional Borrowing

32. The country financial and macro-economic circumstances differ in the selected pilots. While only one PPCR country is currently eligible to borrow on standard MDB loan terms, others may access only subsidized credit through a variety of windows, some are eligible through the country strategy assistance cycle, under the financing terms and envelope agreed periodically with the MDBs, for a mix of credit and grant financing and some only for grant financing. In this context, the **countries' risk of debt distress should be assessed**. It is proposed that the risk ratings follow the same practice as in IDA and the relevant Regional Development Banks, that is from country-specific forward-looking debt sustainability analyses. For IDA, this is based on the joint IMF-World Bank debt sustainability framework (DSF) for low-income countries. The IDA grant framework then translate these debt distress risk ratings into "traffic lights", which in turn determine the share of IDA grants and highly concessional IDA credits for each country: high risk or in debt distress ("red" light) is associated with 100 percent grants, medium risk ("yellow" light) with 50 percent grants and 50 percent credits, while low risk ("green" light) is associated with 100 percent credits and zero grants.

Loan Terms for Public Sector Projects

33. The following concessional loan terms for public sector projects are proposed. It is proposed that the PPCR Sub-Committee review these terms after experience is gained in developing PPCR programs and projects.

	Maturity	Grace Period	Principal Repayments Year 11-20	Principal Repayments Years 20-40	FY10-11 Service Charge a/	Grant Element b/
Credit	40	10	2%	4%	0.10%	75%

a) The service charge is charged on the disbursed and outstanding loan balance. Principal and service charge payments accrue semi-annually to the PPCR trust fund. Service charge is similar in concept to an interest rate

b) Grant element is calculated using the IDA methodology (assumptions: 6.33% discount rate for harder loans; 6.43% discount rate for softer loans; semi-annual repayments; 8-year disbursement period)

34. Consistent with the objective of simplified loan administration procedures and streamlined project processing, it is proposed that the PPCR will have uniform financing terms, rather than terms varying by country and/or projects, or each MDB applying different terms. Increasing or decreasing the proportion of PPCR concessional financing blended in the overall financing plan would calibrate the grant element to the country, sector and project contexts.

Guarantees

35. Guarantee instruments are used to improve conditions for investment in, or lending to, projects by mitigating risks that lenders and investors would not be willing or able to accept. PPCR resources may be deployed as guarantees to promote climate risk and resilience projects and programs which would otherwise fail to attract adequate capital. Proceeds from the PPCR may be used to issue such guarantees by the MDBs, in

accordance with their policies for determining eligible beneficiaries, eligible forms of investment, maximum tenor and maximum amounts. While guarantee support can be structured flexibly and may take various forms, these guidelines are intended to set generic parameters to guide MDBs in designing proposals which include the use of guarantees and similar risk mitigation mechanisms.

36. MDBs will appraise whether risk mitigation instruments could be an efficient and effective means to facilitate the mobilization of debt capital to finance the project, instead of, or in combination with, loan support from the PPCR. Risk mitigation instruments should also be considered if the government or sub-national entity is not able to borrow debt on terms required for financial viability or attract financing without support, or if there is a perceived technology risk.

MDB Fee for public sector programs and projects

37. The MDB fees are to reimburse the MDB for its incremental staff, consultants, travel and related costs of project development, appraisal, implementation support, supervision and reporting.

38. It is proposed that a simplified system be used to determine the MDB fee on each public sector project and program, and that such fees be approved at the time that an investment plan is endorsed by the Sub-Committee.

39. It is proposed that the same system for determining fees be used for all SCF targeted programs. A proposal, based on the MDB experience in preparing and supervising projects through their normal lending activities is under discussion by the MDBs. Once this proposal is agreed by the MDBs, it will be submitted to the Sub-Committee for approval.

V. Financing Modalities for Private Sector Involvement

40. MDBs will seek to use PPCR funds in private sector markets where the risk/reward profile of initial project entrants are not balanced (i.e. when the investment return on the initial projects do not compensate sponsors for the risks they experience) but where the risk/reward profile for future projects are eventually expected to be sufficient to encourage private investment without future subsidies (i.e. where risks come down because of the track record established from the early projects and where costs go down – and returns go up - because precedents are set which facilitate project implementation). Given the probability that some PPCR interventions will start at an earlier stage of development, the time lag from initial interventions to achieving long term sustainability will likely take longer in the PPCR.

41. Because each country, sector and project faces a unique set of barriers, PPCR financing will not be uniformly offered to all private sector companies but will be tailored to address the specific barriers identified in each project and intervention. Below is a

description of the main types of PPCR instruments that may be structured to address development barriers as well as the principles for use of PPCR funds in private sector investments to address the specific barriers identified in each project and intervention.

42. It is expected that concessional finance will be preferred in funding revenue-generating projects. The level of concessionality should be adjusted according to the projected project revenue which partly depends on commercial and technical risks.

Principles for using PPCR funds in private sector investments

43. PPCR funds used in private sector investments will adhere to the principles outlined below.

44. *Minimum concessionality*: MDBs will seek to provide the minimum concessionality needed to catalyze projects and programs within a sector. In order to honor this principle, PPCR funds will be structured on a case-by-case basis to address the specific barriers identified in each project/program. The amount and terms of PPCR funding offered to an individual client will be determined between the MDB and the client on the basis of efficient and effective use of PPCR and MDB resources. While an attempt will be made to quantify the additional costs faced by early entrants and compare that with the subsidy element implicit in the financing terms being offered, country, industry and individual company dynamics will impact the amount of concessionality a company will accept in order to undertake a project. Finding the right amount of concessionality⁵ is largely a matter of client needs, market conditions and negotiation, and is dependent on information not flowing between the companies or being available in the market. MDB's will always seek the minimum concessionality necessary to enable projects to happen and will justify the amount of concessionality requested in each PPCR proposal.

45. *Avoiding distortion and crowding out*: PPCR funds will not be priced or structured to displace commercial financing or set unsustainable expectations in a market. PPCR funds will be used to “crowd in” the private sector by enabling projects and investments to happen that otherwise would not by catalyzing those investments with their concessionality.

46. *Leverage*: PPCR funds will seek to catalyze and maximize the amount of MDB and other bilateral financing as well as commercial financing available for its projects and programs. A key feature of the PPCR will be its ability to unlock both MDB and other private sector financing for climate adaptation investments and catalyze ongoing sustainable investments in these sectors beyond the initial PPCR investments.

⁵ Concessionality (or the subsidy element) of a PPCR investment is calculated as the difference between the hypothetical market interest payments and the actual PPCR interest payments over the life of the loan and discounted using the relevant zero-coupon swap curve in the relevant currency; divided by the amount of PPCR financing. For non debt products the interest payments in this calculation would be substituted by the relevant investment payments (e.g. guarantee fees).

47. *Financial Sustainability*: PPCR programs will be developed to maximize the probability of long-term financial sustainability once the PPCR funds are no longer available/have been used. The project or program should at a minimum have the potential to achieve a substantial reduction in the need for subsidies in similar future projects beyond the initial few projects supported by PPCR.

Private Sector PPCR Instruments

48. Private sector engagement will generate both private and public benefits. For example, grants for the private sector may be justified when the intervention has clear demonstration effects that provide benefits beyond the company itself. Such public benefits could accrue to communities or advance market development. PPCR funding to the private sector will encompass both grant and concessional finance.

49. Below is a description of the types of PPCR instruments (list is not exhaustive) that may be structured to address the barriers identified in each case and justify the use of PPCR funds in private sector investments.

Grants

50. Grants for investment may be used for private sector investments to decrease costs through buy-downs and to increase revenue or reduce volatility through performance based payments to make a project climate resilient.

Concessional Loans

51. PPCR will offer concessional finance to support private sector projects and programs that have the potential of being replicated in the future without further subsidies. The terms and structures of each financial investment would be determined on a case by case basis to address the specific barriers identified in each case. These barriers could include:

- a) High costs of early entrants (the additional costs associated with being among the first players to implement a project in a given sector, under new regulations or work through unprecedented systems); they could also include higher input costs because economies of scale have not been achieved for the technology;
- b) Concessional pricing and repayment structures can offset these costs and make early stage projects with cash flow uncertainty bankable;
- c) Perceived and real risk. Subordinated debt products can help mitigate risk for financiers that wouldn't otherwise support the project;
- d) Combined risk and cost barriers.

Guarantees and Risk Sharing

52. Guarantees and risk sharing products are typically used for the same reasons in the private sector as they are in the public sector, e.g. to mitigate risks and improve the investment conditions (risk-reward balance) for initial market projects. PPCR would seek to use guarantees and risk sharing products to mitigate risks in the project cycle with the objective of establishing a project performance track record which would then entice future private investment without the need for future subsidies/risk mitigants.

53. Guarantees and risk sharing products can be for financial institutions lending to climate adaptation projects by assuming a portion of the risks of the new investment portfolio.

MDB Fees for private sector programs and projects

54. *Project specific budget allocation for implementation and supervision costs:* Private sector projects will vary in tenor and complexity resulting in the need for different supervision budgets for each project (e.g. a five year investment will typically require less supervision budget than a 10 year investment). As a result, private sector projects will not receive a standard percentage fee allocation per project, but will submit a customized budget request to cover supervision costs over the life of the project along with each project/program submission for Sub-Committee approval. Extraordinary costs associated with complex restructurings or exists would require the submission of a request for additional budget to the PPCR Sub-Committee.

55. *Project and sub-project implementation includes:* sub-project due diligence; structuring, approval preparation and review; preparation and negotiation of legal agreements; and, board approvals; project and sub-project loan/grant disbursement management; oversight of, or management costs related to, sponsor capacity building or completing knowledge management products; and procurement and management of consultants;

56. *Project and sub-project supervision includes:* monitoring and completion of reports, site visits, negotiation and implementation of waivers and restructurings; monitoring and evaluation of individual projects including independent evaluation of completion/performance reports.

Annex A
Guidelines for the approval and management of PPCR preparation grants for Strategic Programs for Climate Resilience and Public and Private Sector Projects/Programs

1. Objectives. The purpose of PPCR preparation grants is to develop a quality investment portfolio by: (i) strengthening consensus among key national stakeholders and development partners; (ii) enhancing capacity of national institutions for robust policy reform and priority setting; (iii) ensuring that PPCR investments are based on sound analytical work linking relevant sector investments to economic growth and poverty-alleviation strategies; and, (iv) assessing the poverty and social impacts of programs and projects.
2. Grant Execution Arrangements. Preparation grants will be generally recipient-executed, but may be executed by an MDB if justified. All preparation grants will be supervised by the MDB in order to ensure compliance with its operational policies and procedures, including procurement and financial management guidelines. The closing date of grants should not exceed 2 years from the date of signature of the grant agreement by the MDB.
3. Eligible Grant Activities. Preparation grants may be used for developing SPCRs and preparing PPCR co-financed projects by recipient countries. The following activities will be eligible:
 - a) analytic work to inform a country's policies and programs,
 - b) design of policy reforms and preparation of legislation and regulations,
 - c) consultation workshops,
 - d) training,
 - e) institutional development,
 - f) feasibility studies,
 - g) environmental and social impact assessments, and
 - h) technical⁶, managerial, and financial project design.
4. Maximum total PPCR preparation grant allocation for preparation of a SPCR will be US\$1,500,000.
5. Preparation grants for projects. There will be no maximum allocation for a project preparation grant. The grant amount will be included in the PPCR funding available for the SPCR endorsed by the PPCR Sub-Committee but will be made available prior to approval of PPCR funding for the project to finance country-driven preparation activities.
6. Eligible Expenditures. The preparation grant will finance expenditures for: (i) consultants' services, local training, workshops and seminars and, (ii) operating costs and

⁶ Including environmental and social consultants.

office equipment for the implementation management of grant activities not to exceed 10% of the grant amount.

7. Ineligible Expenditures. The following expenditures will be ineligible: (i) salaries for civil servants in recipient countries hired as consultants or otherwise; (ii) purchase of vehicles; (iii) foreign training and study tours; and (iv) salaries and travel of MDB staff and consultants.

8. Reallocation of Grant Activities and Funds. If the reallocation requires a formal amendment to the grant agreement according to the MDB's policies, then the MDB will seek approval from the PPCR Sub-Committee prior to amendment. If no amendment is required according to the MDB's policies, the MDB may reallocate according to its procedures and will inform the PPCR Sub-Committee upon such revision.

9. Grant Cancellation Policy. In addition to the requirement of the relevant MDB's policy on cancellation, the balance of preparation grants may be subject to cancellation under the following circumstances: (i) the grant agreement has not been signed six months after approval of the grant; or (ii) there has been no implementation progress, including zero disbursements for 12 months after signature of the grant agreement. The MDB may approve exceptions on the basis of a satisfactory explanation, which will be reported to the PPCR Sub-Committee.

10. Schedule. Requests for preparation grants for SPCRs should be submitted to the PPCR Sub-Committee. Upon approval by the PPCR Sub-Committee, the appropriate authority in the MDB will be authorized to sign a grant agreement.

Annex B
MDB Public Sector Project Development and Supervision Costs

1. Cost recovery for the MDBs' expenditures related to managing the project cycle will be based on MDB fees approved by the PPCR Sub-Committee. All fees will be paid by the SCF trust fund. The MDB fee will reimburse the MDB for its incremental staff, consultants, travel and related costs of project development, appraisal, implementation support, supervision and reporting. In particular, the MDBs will carry out the following tasks:

2. Project Preparation

- a) project concept review,
- b) quality enhancement and assurance to meet quality at entry standards,
- c) risk management,
- d) financial management and procurement assessments of project implementing entities,
- e) country dialogue on and appraisal of the sector policy, technical, economic, financial, institutional, fiduciary, environmental and social aspects of projects;
- f) preparation and negotiation of legal agreements, and
- g) board approvals.

3. Project Supervision

- a) implementation status reporting,
- b) adaptive management of project strategy and design,
- c) loan/grant disbursement management,
- d) implementing project at-risk systems,
- e) supervision of project monitoring, evaluation, environmental and social safeguard measures, procurement and financial management by borrower/recipient,
- f) implementation completion reporting, and
- g) independent evaluation of completion reports.

4. PPCR financing will generally be seamlessly blended with MDB financing, resulting in significant transaction cost savings. However, there will be some incremental costs to the MDBs for mobilizing PPCR co-financing for clients, due diligence, and reporting, which will be recovered through the MDB fee. Such costs include:

- a) analysis of consistency with PPCR investment criteria,
- b) additional financial analysis to justify PPCR concessional financing,
- c) inclusion of climate change adaptation specialists in operations teams,
- d) monitoring and evaluation for PPCR results measurements system, and

- e) additional cost of legal, loan and accounting departments to administer SCF trust fund resources.
5. The MDBs will provide an annual report to the PPCR Sub-Committee on their project processing and supervision costs, which may provide the basis for any adjustments to the MDB fee by the PPCR Sub-Committee.

Annex C
Private Sector Operations:
Project and Project proposals and Administrative and Project Management Costs

1. Private sector program proposal should include relevant country and program information. When submitting a proposal each MDB will have to balance the level of detail required to present to the Sub-Committee with the need to manage client expectations. Each MDB may choose when, within its own internal process, to submit a proposal. However in all cases the program approval must be obtained prior to the MDB's final approval of the first sub-project in the proposal. The request for approval should indicate the proposed financing modality to be used in the project (e.g., grant, concessional loan). Such approval may be sought through a decision by mail of the PPCR Sub-Committee."
2. *Project specific budget allocation for implementation and supervision costs:* Private sector projects will vary in tenor and complexity resulting in the need for different supervision budgets for each project (e.g. a five year investment will typically require less supervision budget than a 10 year investment). As a result, private sector projects will not receive a standard percentage budget allocation per project, but will submit a customized budget request to cover supervision costs over the life of the project along with each project/program submission for Trust Fund Committee approval. Extraordinary costs associated with complex restructurings or exists would require the submission of a request for additional budget to the Trust Fund Committee.
3. *Project and sub-project Implementation includes:* sub-project due diligence; structuring, approval preparation and review; preparation and negotiation of legal agreements; and, board approvals; project and sub-project loan/grant disbursement management; oversight of, or management costs related to, sponsor capacity building or completing knowledge management products; and procurement and management of consultants;
4. *Project and sub-project Supervision includes:* monitoring and completion of reports, site visits, negotiation and implementation of waivers and restructurings; monitoring and evaluation of individual projects including independent evaluation of completion/performance reports.