



## Session 5

### Project Preparation and Appraisal – How to convince IFI's to part with money, by Stefan Enzelberger

As already mentioned above, IFIs are willing to finance good projects, indeed they are looking for opportunities to extend loans. The reasons for their interest are manifold: generally, banks want to grow and want to lend more money next year than they are doing this year (there may be some years when they want to consolidate, but this is not the norm); often staff members are appraised by how many loans they sign in a given year, so there is an inherent self-interest; or there may be political pressure by shareholders to concentrate on specific countries, regions, or sectors.

In many countries, on the other hand, there is a big need for infrastructure investments. Since many countries do not have the financial resources to finance these investments with own funds and/or commercial lending is too expensive, the obvious solution would be funding by IFIs.

So why is it that many potential projects are not funded by IFIs, while IFIs are looking for investment opportunities? The aim of this session is to explain some of the mistakes which are made by potential clients when they seek IFI financing. The list is not necessarily complete, but it should give guidance to potential clients.

#### **PROJECTS ARE MORE MOTIVATED BY POLITICAL CONSIDERATION THAN ECONOMIC NECESSITIES**

Often, clients approach IFIs with potential projects which are not solutions to acute problems, but are the expression of the political wish of the government. Such projects which are political opportune, although they lack any economic and technical logic, will not be financed by IFIs. Prime examples are new motorways, bridges, airports or metros for which there is no demand. The client will only waste his and the IFI's time and resources if a fake feasibility study is produced to "prove" the necessity of the proposed project.

#### **PROJECTS WOULD SOLVE ACUTE PROBLEMS BUT ARE OVER-DESIGNED AND/OR OVER-ENGINEERED**

Sometimes, potential projects would solve acute problems, but because they are over-designed and/or over-engineered, they are neither financially nor economically justified. Typical examples would be four lane motorways, although it would be perfectly adequate to rehabilitate the existing road; a new high-speed train line, although an upgrade of the existing line would solve the problem; a new light rail transit system, although the traffic problem could be solved by introducing guided buses. Again, clients will only waste everybody's time and resources if a fake feasibility study is produced to "show" the feasibility of the proposed project.



**PROJECTS ARE ECONOMICALLY JUSTIFIED, BUT CAN NOT BE ADEQUATELY MAINTAINED ONCE THE INVESTMENT IS COMPLETED**

IFIs are more and more interested in the sustainability of their investments and want to know how projects will be maintained during the operation. This often necessitates changes to the legal framework within which the sector operates. An example could be the construction of a new road. In order to maintain the road adequately during the lifetime of the project, increases in fuel tax may be necessary. Or the introduction of a light rail transit system requires a fare increase for the passengers. Because of political pressure, clients are often unwilling to increase taxes, thus jeopardising the IFI funding and/or the proper long-term care of the investment. Clients should discuss these issues as soon as possible with the development bank in order to avoid conflicts later on.

**PROJECTS ARE JUSTIFIED PER SE, BUT DO NOT FIT INTO THE OVERALL IFI POLICY**

Clients should always be aware that each IFI has statutes which are guiding principles for the bank's operation. For example, one of the guiding principles for the World Bank is poverty reduction. Therefore, even an otherwise perfect road rehabilitation project in Germany will not be eligible for World Bank financing. One of the guiding principles of the EIB is European integration, therefore, even an ideal urban transport project in Australia will not be financed by the EIB. Clients should discuss the eligibility criteria with the development bank in order to find out whether the project can be funded by the bank.

**OTHERWISE GOOD PROJECTS FALL FOUL OF IFI POLICIES ON ENVIRONMENT, PROCUREMENT, ETC.**

Many of the IFIs have very detailed rules how the environmental impact of a project has to be assessed, how the public has to be involved in the decision process and how procurement has to be handled. These rules can not be changed by the bank's appraisal team and their implementation is mostly outside the responsibility of the appraisal team. Clients should be aware, that a project that passed local legislation, will still have to be assessed according to the IFI specific rules. This sometimes causes frustration when clients are unhappy with the additional delays and costs incurred. Experience shows that clients should involve the development bank in the preparation phase as soon as possible. Clients are not be able to circumvent IFI procedures!

**WHAT ARE GOOD PROJECTS?**

- Projects have to solve a problem

Any investment to be financed by an IFI has to be a practical solution to a concrete problem. The problem must be well demonstrated with studies and must be quantifiable. The problem must either be acute (*the roads are already deteriorated*), or it must be shown that without intervention, the problem will occur (*without proper road maintenance now, the road will deteriorate in future*).

- Projects have to be rational solutions to a problem

The proposed investments have to be practical and economical solutions to problems. To confirm the viability of the investments, feasibility studies have to be conducted. Such studies will investigate the technical aspects of the investments and calculate the economic cost/benefit ratio. It is advisable to hire reputable consultants to



prepare such feasibility studies and not to be overoptimistic with the input parameters. The IFIs will review the methodology and input parameters of the study and any mistakes and errors will be spotted. In some cases, the bank may reject the entire a and a different consultant has to be hired to conduct a new feasibility analysis. The additional costs and delay can be substantial.

- Projects have to be sustainable

IFIs are more and more insisting that investments financed as part of the project can be maintained in the long run. Development banks want to ensure that infrastructure does not deteriorate because of lack of maintenance and will often insist on adequate funding. This often involves changes to the sector policy which can be controversial, especially if the changes touch engrained social attitudes. A policy dialogue between the bank and the client will be necessary which can encompass many government departments.

- Projects have to be eligible for IFI financing

Each IFI has eligibility criteria which have to be fulfilled if the project is to be financed by the bank. The World Bank prepares a Country Assistance Strategy which lists the operational priorities for the next years. The EIB has detailed lists what it can, or can not, finance in a given country or region.

It is advisable for a potential client to contact the IFI at the beginning of the project preparation process to discuss whether any eligibility issues may exist.

- IFIs have a set of rules which govern their appraisal process

Each IFI has its own rules on how it appraises projects. These rules may look confusing and long winded, but the bank's appraisal team will have to stick to the regulations. Because of the complexity of some of the rules, the client should discuss the requirements early in the project preparation so that the process can be coordinated with the bank.

- SEE THE IFI AS A PARTNER, AND NOT AS AN ENEMY

The most important point is that the client and the IFI work in partnership during the entire project preparation and project appraisal process. To prepare and appraise projects for IFI funding can be an intense and longwinded procedure. A personality conflict will make the process more complicated and jeopardises the implementation of an otherwise perfect project.

# MEDITERRANEAN TRANSPORT INFRASTRUCTURE NETWORK PROJECT (MTIN)

## PROJECT PREPARATION AND APPRAISAL - How to convince IFIs to part with money

Stefan Enzelberger  
Istanbul, Turkey - May/June 2006



MEDA Transport Infrastructure Network Project



REPUBLIC OF TURKEY

in association with



## IFIs WANT TO FINANCE PROJECT

---

- IFIs are looking for *good projects*:
  - banks want to grow and lend more money this year than last year
  - staff members are often appraised by how many loans they sign
  - political pressure by shareholders to lend funds for certain projects, or/and to certain countries
- Why are there so many frustrated clients?



REPUBLIC OF TURKEY

in association with



## WHY DO IFIs NOT FINANCE SOME PROJECTS 1/3

---

- Projects are more motivated by political considerations than by economic necessities
  - There is no problem which the proposed project would solve
- Projects would solve acute problems but are over-designed and/or over-engineered
  - IFIs only finance projects which have adequate Economic Rate of Return



in association with



COMISO & ASSOCIATI

RAND Europe

## WHY DO IFIs NOT FINANCE SOME PROJECTS 2/3

---

- Projects are economically justified, but cannot be adequately maintained once the investment is completed
  - IFIs are more and more concerned about sustainability
  - Sustainability often requires changes in policy
- Projects do not fit into the overall IFI policy
  - IFIs have eligibility criteria, projects have to fulfill these criteria



in association with



COMISO & ASSOCIATI

RAND Europe

## WHY DO IFIs NOT FINANCE SOME PROJECTS 3/3

---

- Projects fall foul of IFI policies
  - Each project is appraised according to many criteria, such as
    - Environment
    - Procurement
    - Social impact
    - etc..
- What are *good projects*?



in association with



COMISO & ASSOCIATI

RAND Europe

## WHAT ARE *GOOD PROJECTS* 1/3

---

- Projects have to solve a problem
  - Problem has to be demonstrated by studies
- Projects have to be rational solutions to a problem
  - practical and economical feasibility has to be proven by studies
- Projects have to be sustainable
  - changes to sector policy have to be agreed with IFIs and various government departments



in association with



COMISO & ASSOCIATI

RAND Europe

## WHAT ARE *GOOD PROJECTS* 2/3

---

- Projects have to be eligible for IFI financing
  - World Bank: Country Assistance Strategy
  - EIB: detailed lists of eligibility criteria
- Projects have to pass IFI appraisal process
  - IFIs have stricter and more encompassing requirements than most countries' governments
    - Environment
    - Procurement
    - Social impact
    - Etc.



in association with



RAND Europe

## WHAT ARE *GOOD PROJECTS* 3/3

---

Most importantly:

- SEE THE IFI AS A PARTNER, NOT AS AN ENEMY
  - Use their sector experience
  - Combine it with your local experience
  - Act as the local go-between between the IFI and your government
  - Play by the rules
  - Be honest
  - Have fun



in association with



RAND Europe