

# **Financing Energy Efficiency in Buildings in Ukraine**

## **- Analysis and Policy Recommendations -**

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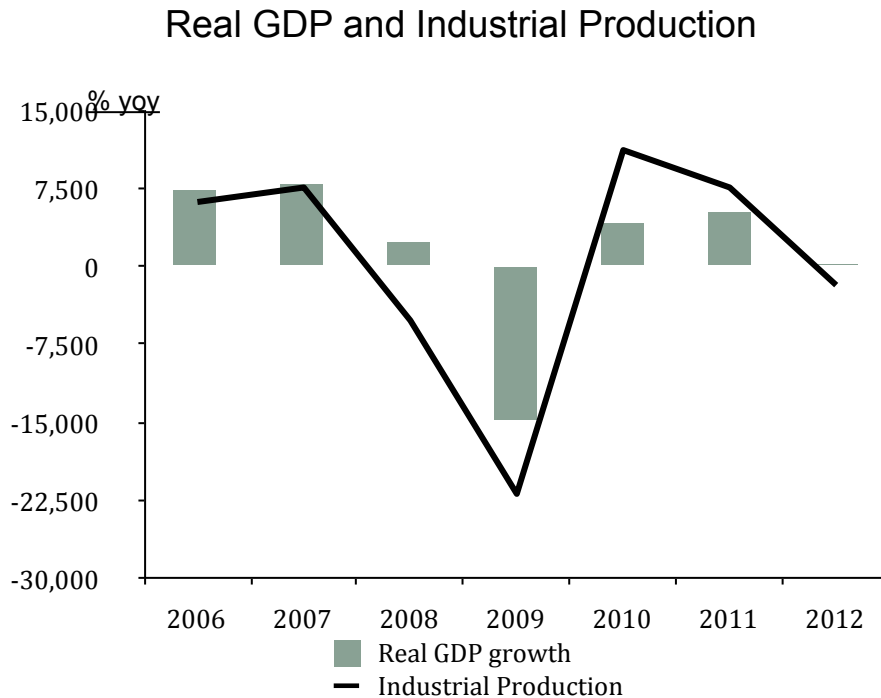
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# I. Introduction

- 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



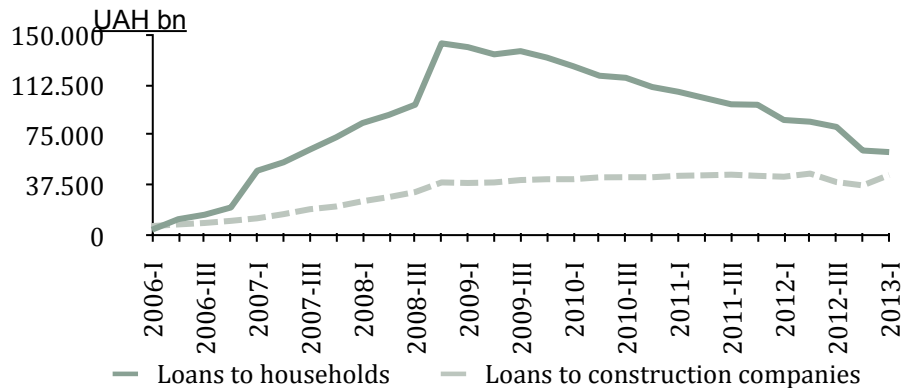
Source: State Statistics Service of Ukraine

- 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



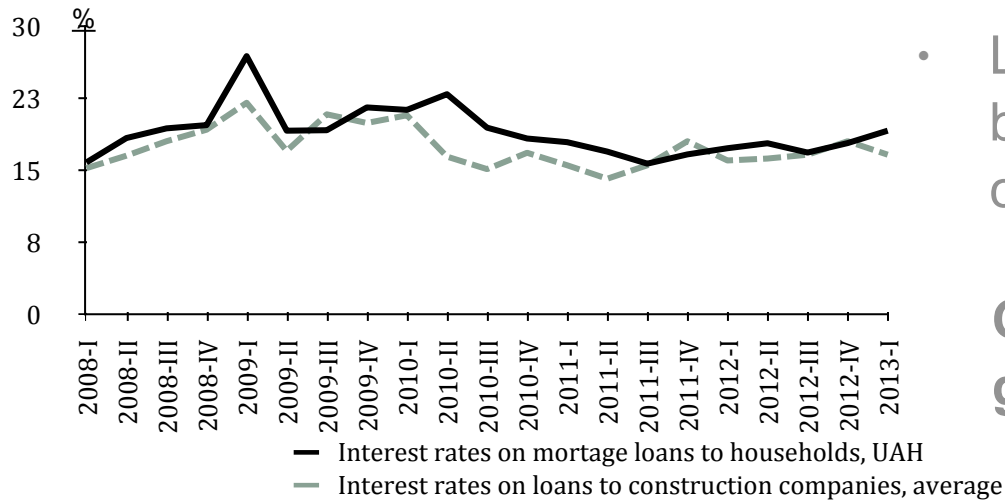
- Demand-side finance (i.e. mortgage loans) is continuously shrinking
  - Mainly due to prohibition of FX lending, and high interest rates (and short maturities) for UAH loans

- 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**

Source: IMF, Interest Rates



# III. The Construction Sector in Ukraine



# Current Situation

## Construction Sector Developments

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

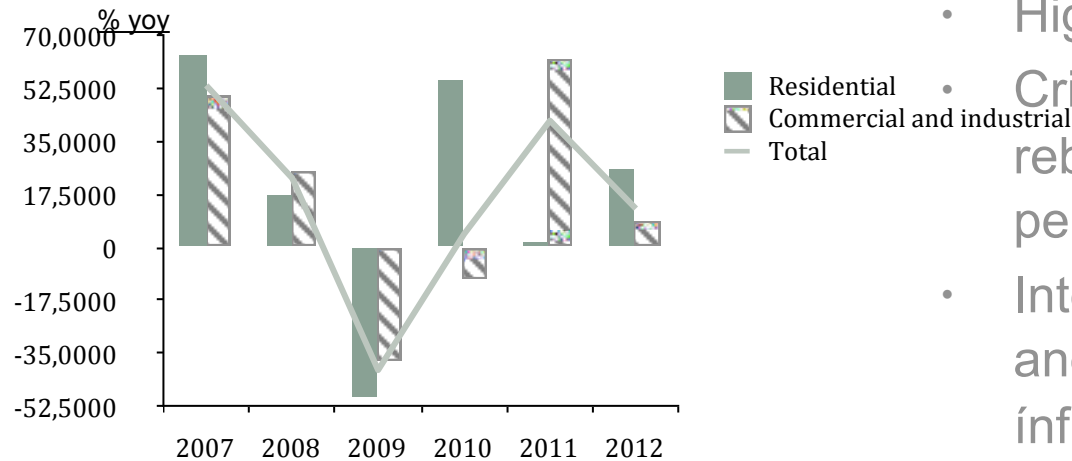
Source: State Statistics Service of Ukraine, \* estimated

- 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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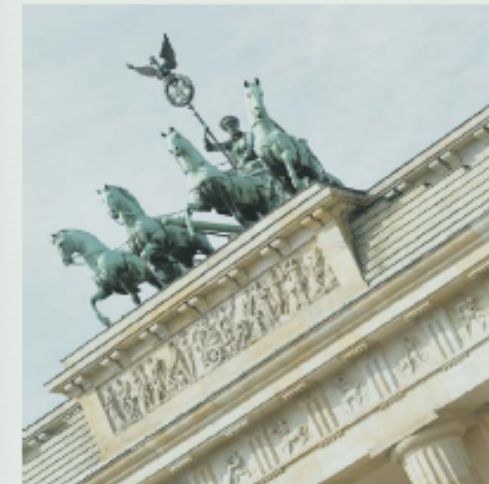
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