CIF CLIMATE INVESTMENT FUNDS

SCF – SREP (Scaling Up Renewable Energy Program)

PROJECT TITLE: KHARKHORIN SOUM CLEAN HEATING SYSTEM

COUNTRY: MONGOLIA

MDB: ASIAN DEVELOPMENT BANK (ADB)

Concept Note for Project/Program Approval Request[a] Scaling Up Renewable Energy Program in Low Income Countries			
Country/Region	Mongolia	**CIF Project ID#**	**Auto Generated by CCH**
For Regional/Global (country classification) Please list all applicable **sub-countries** under **Regional/Global** country tagging (separated by semicolon ";")			
Tier[1]	☐ Tier 1	☐ Tier 2	☒ Tier 3
Type of CIF Investment:	☒ Public	☐ Private	
Project/Program Title	Kharkhorin Soum Clean Heating System		
Sector/Pillar **(Please select all that apply)**	☒ Renewable Energy ☐ Agriculture and Landscape Management ☐ Climate Information Systems and Disaster Risk Management ☐ Coastal Zone Management ☐ Enabling Environment ☐ Infrastructure ☐ Urban Development ☐ Water Resources Management ☐ Agriculture and Food Security ☐ Agroforestry ☐ Capacity Building / Institutional Strengthening and Governance Reform ☐ Forest Monitoring / MRV ☐ Indigenous Peoples / Local Communities ☐ Landscape Approaches ☐ Sustainable Forest Management ☐ Other (_____)		
Technology/Area **(Please select all that apply)**	☐ Bioenergy ☐ Capacity Building ☐ Cookstoves ☒ Geothermal ☐ Hydropower ☐ Mixed RE ☐ Multiple ☐ Solar ☐ Waste to Energy ☐ Wind ☐ Other (_____)		
Project Lifetime (MDB Board/Management) approval to project closure) (in years)			

[1] Country Tier definition as Per FY25 approved Pricing policy (page 8,9,19-25)

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[e] Per MDBs' own Paris alignment climate finance tracking methodologies.

Is this a private sector program composed of sub-projects?	☐ Yes ☐ No	
Financial Products, Terms and Amounts		
	USD (million)	**EUR** (million)[b]
PPG (Project Preparation Grant)		
Grant	2.2	
MDB Project Implementation and Supervision Services (MPIS)[2]	0.11	
First loss guarantee		
Second loss guarantee		
Equity		
Senior loan		
Senior loan in local currency hedged		
Senior loan in local currency unhedged **(EXCEPTIONAL REQUEST)**		
Subordinated debt/loan/ mezzanine instrument with income participation		
Subordinated debt/loan / mezzanine instrument with income participation local currency unhedged **(EXCEPTIONAL REQUEST)**		
Subordinated debt/loan /mezzanine instrument with convertible features		
'Convertible/contingent recovery' grant/loan/guarantee (loans convertible to grants or vice versa)		
Convertible Loans (convertible to equity only)		
For loans and guarantees – is this a revolving structure? [3] ☐ Yes ☐ No		
Specify local currency type here		
Other (please specify)		
Total	2.31	

Co-financing		
	Please specify as appropriate	**Amount (in million USD)**
Asian Development Bank (ADB)		5.0

[2] MPIS - CIF Operational Modalities For New Strategic Programs here

[3] With a revolving structure, after the loan or guarantee matures, instead of returning the funds to the Trustee, the funds are redeployed as a new loan or guarantee.

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Japan Fund for the Joint Crediting Mechanism (JFJCM)		2.65
Energy Transition Mechanism Partnership Trust Fund (ETMPTF)		0.60
Government		
Private Sector		
Bilateral		
Others (please specify)		
Total Co-financing		**8.25**
CIF Funding		
Total Financing (Co-financing + CIF Funding)		**10.56**
Proportion of Total Financing for Adaptation		
Proportion of Total Financing for Mitigation[e]		

CIF Financial Terms and Conditions Policy	Link Is this request in accordance with the CIF Financial Terms and Conditions Policy? ☒Yes ☐No (if no, please specify detailed information under the justification section)
Justification (exceptional request) [c][d]	
Implementing MDB(s) *(please enter full name, job title and email address)*	
MDB Headquarters-Focal Point:	Christian Ellermann Senior Climate Change Specialist
MDB Task Team Leader (TTL)	Alfredo Bano Leal Senior Energy Specialist
National Implementing Agency *(please enter full name, job title and email address)*	
Country Focal Point/s	
Brief Description of Project/Program (including objectives and expected outcomes) [c][d]	

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Background. Mongolia's heating sector is responsible for a significant share of energy demand in the country. Given that Mongolia has significant geothermal resources, the technology has a great potential to play an important role in the heating generation mix. In particular, medium-deep ground-sourced heat pump technology (MDGSHP) is increasingly applied in cold countries, particularly in northern Europe, as well as in China and Japan, proving clear examples of its technical and financial feasibility. Demonstrating successfully the utilization of medium-deep geothermal resources would offer evidence that a new and scalable solution for sustainable, cleaner, and efficient heating in the country is possible and affordable.

To advance the decarbonization of heating in Mongolia, it is essential to overcome numerous obstacles, such as (i) identifying and mainstreaming the most suitable technological choices through demonstrative projects, (ii) implementing regulatory measures to bridge the viability gap including through heating tariff reform, and, (iii) raising awareness and technology acceptance and capacity development. The pilot Kharkhorin Soum clean heating system, ADB's ongoing and future clean heating technical assistance (TA), in conjunction with initiatives of the Mongolian government and other donors, will address these challenges and pave the way for bankable MDGSHP projects.

Proposed pilot project. The envisioned project will harness medium-deep geothermal energy to transition Kharkhorin Soum, the capital of a district-level administrative unit with about 3,400 urban inhabitants, from its dependency on coal to an efficient ground-source heat pump system. In practical terms, this will see the replacement of five low-efficiency coal boilers with an MDGSHP system and an electric boiler. The proposed system will involve drilling four boreholes down to 2,000 meters, setting up four 450 kW heat pumps, a 3,500 kW heat exchanger, and a 1,500 kW electric boiler. Medium-depth heat wells will be located at least 30 meters away from each other, and the heating water temperature will be adjusted depending on the required outlet temperature range of 70-80°C. The production potential of MDGSHP systems is highly dependent on subsurface properties, but the benefit is that only one borehole at 2,000 m deep can typically produce the same amount of energy as about 100 shallow-depth boreholes. Drilling and laying down collector pipes represent about 70% of the total project cost.

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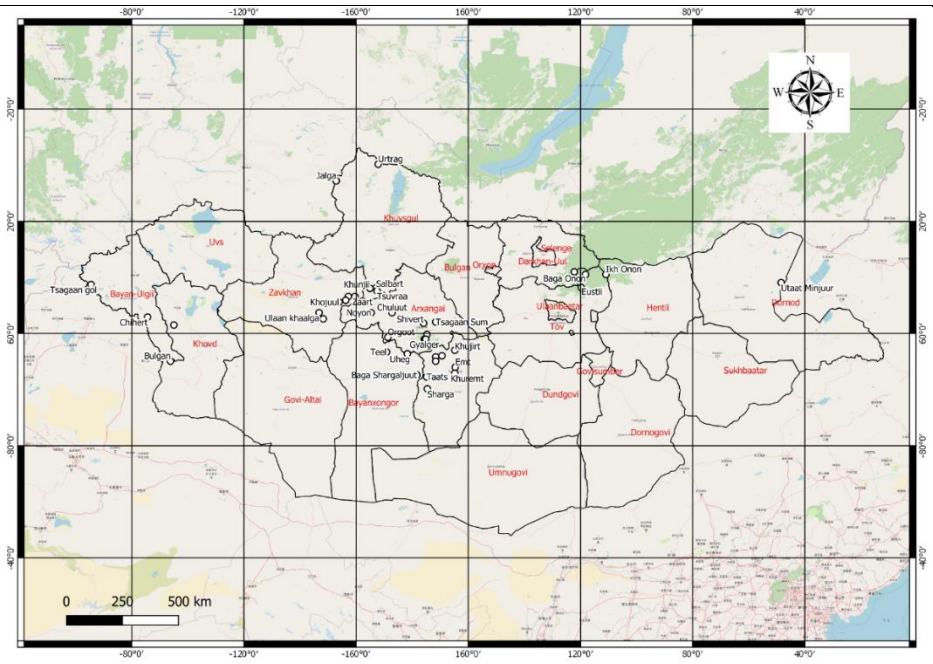

Figure 1: Hot springs in Mongolia.

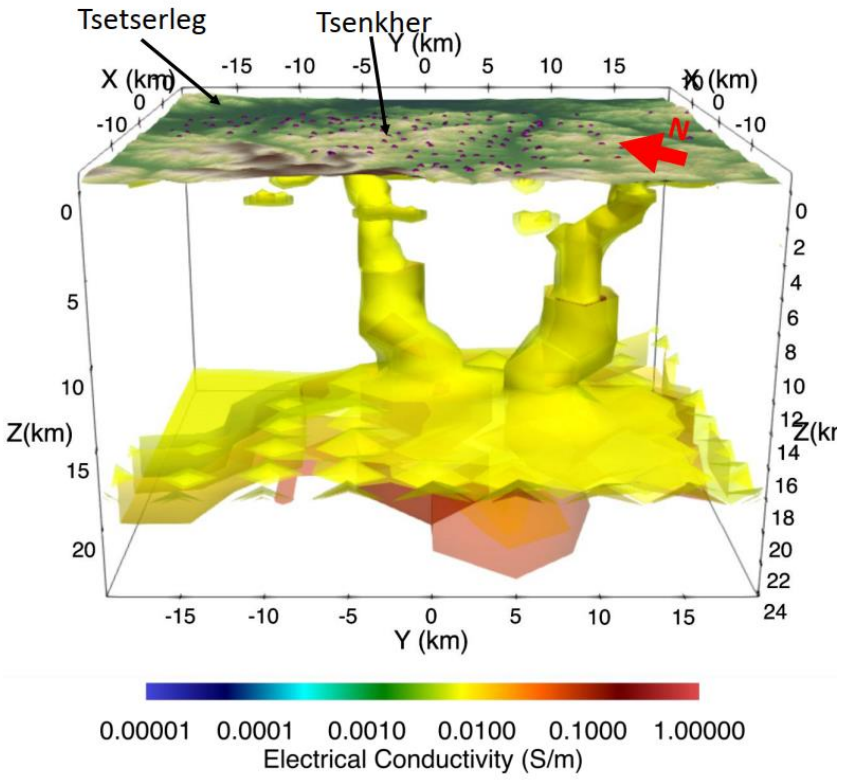

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Figure 2: A preliminary 3D magnetotellurics model describing subsurface electrical conductivity which indicate heat sources.

Expected results. The system will provide a steady heat supply to an existing district heating network covering 14 buildings, including all key public buildings of the soum, plus 17 new consumers planned to be connected to the system with increased annual heat demand to 10,113 MWh/year. This project offers substantial environmental and societal benefits. The new system will reduce CO_2 emissions by about 40% and dramatically reduce the air, water and soil pollution that burdens the local environment and affects the health of the local population, particularly the poor.

Intended future impact. MDGSHP systems, if validated in the Kharkhorin Soum project, could reshape Mongolia's heating landscape. Clean geothermal energy might emerge as the primary solution for district heating in specific capacity ranges. While Mongolia has made inroads with certain low-carbon heating systems for individual buildings, the next leap requires scalable solutions for larger district heating systems. With over 300 soums in Mongolia often relying on outdated, pollution-heavy district heating systems, a considerable market awaits a cleaner, more efficient solution.

Concessional financing needs. Conventional fuel-fired boilers are the cheapest heating source in Mongolia, well accepted by the population. Considering the wide availability and low cost of conventional fuels, as well as subsidized district heating tariffs in Ulaanbataar city, there is a strong perception that clean heating technologies are not affordable, or even technically viable. To change this perception and promote clean heating mainstreaming, we need to implement demonstrative projects that show case the technical viability of MDGSHP in Mongolia, but also show that the cost is affordable. However, due to limited availability in the country, equipment supply chains and economies of scale of these technologies, it is necessary at these earlier stages to mobilize concessional resources.

Consistency with investment criteria (please refer to design document)[4][c][d]

[4] Link to SREP Design Document here

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The Kharkhorin Soum MDGSHP project aligns well with SREP's investment criteria, demonstrating strong economic, social, and environmental benefits, economic viability, and scalability potential. However, financial viability remains a major constraint, requiring substantial grant financing (95%) to proceed. If implemented successfully, the project could serve as a model for scaling up geothermal heating across Mongolia, supporting the transition to cleaner and more sustainable heating solutions.

Transformative Impact

The Kharkhorin Soum MDGSHP Project represents a transformational shift in Mongolia's heating sector by demonstrating the viability of medium-depth geothermal heat pump (MDGSHP) systems as a clean alternative to coal-fired district heating. The project will significantly reduce CO_2 emissions, improve air quality, and enhance energy security, setting a replicable model for over 300 soums in Mongolia. Through CIF concessional financing, and ADB's institutional capacity building, and policy support, the project will de-risk geothermal heating investments and catalyze private sector participation. This will accelerate Mongolia's transition to sustainable, low-carbon heating solutions.

The project will be supported by a TA focusing on heating sector policy and regulation to address the viability gap of all renewable heating solutions, including geothermal. The viability gap is due to an interplay of several factors including that (i) coal deposits are geographically ubiquitous, with proven reserves identified in most provinces of Mongolia, most having opportunity to low cost surface mining, (ii) excluding externalities (dust, ash, health impacts, CO2, water contamination) from the cost of coal, (iii) the government provides direct and indirect support to state-owned coal industry, and (iv) the heating sector lacks the financial strength and institutional coherence necessary to support major investment in next-generation heating solution, this being contributed by its fragmented structure, with numerous small-scale and undercapitalized entities operating in isolation in rural population centers—in Kharkhorin alone there are four heat network operators— and sometimes with separated responsibilities across supply, distribution and maintenance, (v) and the regulated tariffs are set to be hardly sufficient to cover the amortization and O&M of simple coal boiler systems thus not enabling organic expansion of the heating systems by municipalities or the private sector. Finally, in this operating environment, heat consumers' willingness-to-pay has been shaped over time by low heat prices, resulting in generally low expectations regarding heating costs.

For a detailed breakdown of the project's impact, refer to the Theory of Change statement and framework.

Theory of Change Statement

IF CIF provides concessional financing to de-risk investments to enable clean heating solutions, and facilitates knowledge-sharing on geothermal district heating, **THEN** Mongolia will demonstrate the viability of medium-depth geothermal heat pump (MDGSHP) systems, enhance institutional capacity for clean heating, and attract additional financing for large-scale deployment. **THIS WILL RESULT IN** reduced reliance on conventional fuels, improved air quality, increased access to stable and renewable heating, and strengthened regulatory frameworks, accelerating Mongolia's transition to a low-carbon and sustainable heating sector.

Figure 3 - Project Theory of Change

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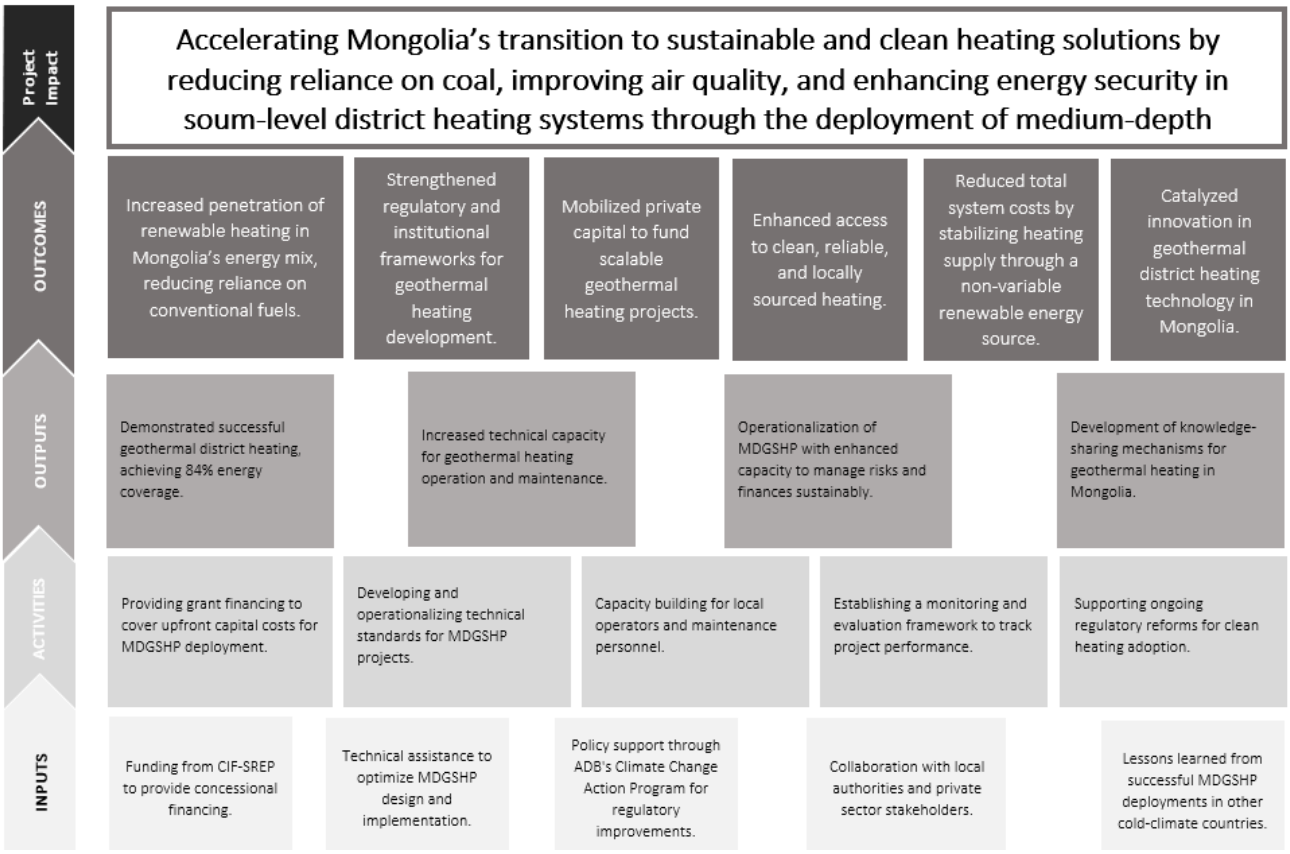

Economic, Social, and Environmental Development Impact

The Kharkhorin Soum Medium Depth Ground Source Heat Pump (MDGSHP) project presents a significant opportunity for economic, social, and environmental development in Mongolia. The existing heating system, consumes approximately 5,814 tons of coal per year to produce 10,113 MWh of heat, resulting in 7,965 tons of CO_2 emissions annually. By transitioning to an MDGSHP system, CO_2 emissions will be reduced by 56%, with annual emissions dropping to 3,519 tons of CO_2. This transition will also eliminate the release of particulate matter (PM2.5 and PM10), NOx, and SOx, substantially improving air quality and public health in the soum.

The project has direct economic benefits through reduced energy costs. The MDGSHP system is projected to generate operating cost savings compared to the existing coal-fired system. However, while the project is operationally sustainable, it is not commercially viable under current conditions due to the limited ability to recover investment costs. Socially, the project will provide stable and reliable heating to 14 existing buildings and 17 additional planned consumers, ensuring energy security for public facilities, including schools and government offices. The project also has strong demonstration potential, showing that medium-depth geothermal heating can be a viable and scalable solution for Mongolia's more than 300 soums that currently rely on outdated coal-based heating.

Economic and Financial Viability

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The financial assessment of the project indicates that while the operating costs of the MDGSHP system are lower than the existing conventional fuel boiler system, the financial internal rate of return (FIRR) is -16%, which is well below the weighted average cost of capital (WACC) of 2.9%. This negative FIRR indicates that without significant concessional financing, the project cannot be implemented on a purely commercial basis.

The total capital expenditure for the project is estimated at $5 million, with major cost components including the drilling of four 2,000-meter boreholes ($3.6 million), heat pumps ($340,000), and an electric boiler ($40,000). While the financial analysis suggests that the project is not viable on purely commercial terms, the economic analysis presents a different picture. The project has an economic internal rate of return (EIRR) of 10%, exceeding the 6% hurdle rate typically applied to environmentally focused projects. This positive economic assessment is driven by the value of avoided CO_2 emissions, reduced pollution, and lower fuel costs.

Despite the operational sustainability of the project, the financial analysis indicates that 95% of the investment cost needs to be grant-financed to make the project viable for the asset owner. The project's financial feasibility is constrained by subsidized heating tariffs in Mongolia, which limit cost recovery through customer payments. Without concessional finance, private sector or local investors lack incentives to adopt similar projects, even though the operational cost savings are evident.

Leveraging of Additional Resources

The MDGSHP project is aligned with ADB's Country Partnership Strategy (2021-2024), which emphasizes the promotion of cleaner heating systems through financial and knowledge assistance. The project's feasibility study confirms that concessional funding is required due to the capital-intensive nature of the MDGSHP system, particularly the high upfront costs of borehole drilling and equipment procurement.

Leveraging additional resources will be critical to scaling up the technology beyond Kharkhorin Soum. The feasibility study identifies the potential for similar geothermal heating solutions in other soum centers, but the success of this initial project will determine the willingness of additional investors and donors to fund similar projects in the future.

Implementation Capacity

ADB has a strong technical and financial capacity to execute the project. The National Energy Centre (NEC) is expected to be the executing agency responsible for operating the MDGSHP facility.

From a technical standpoint, the project requires a qualified EPC contractor to oversee borehole drilling, installation, and commissioning, as well as specialized personnel for long-term system maintenance. The MDGSHP system's operation is highly automated, with annual maintenance requirements limited to refrigerant level checks, filter cleaning, and general inspections.

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Figure 4: Possible locations of boreholes close to existing boiler house.

Capacity-building measures will be implemented to ensure that local operators can effectively manage the heating system. Additionally, regulatory support, such as tariff reforms, will contribute to creating enabling environment for further clean heating investments in Mongolia.

The lack of drilling rigs was identified as a key barrier to implementation of geothermal projects. The feasibility analysis identified some relevant firms with drilling experience in Mongolia. Mongolia's strong mining industry has supported the presence and development of drilling operators within the country.

"Critical Mass" for Implementation

The project has the potential to achieve critical mass in implementation, provided that concessional financing is secured. The feasibility study finds that the MDGSHP system has significant scalability potential, as similar projects could be replicated across Mongolia's 300+ soums that currently rely on conventional fuel-fired heating. However, achieving critical mass will require demonstrating technical feasibility and financial sustainability through this initial pilot in Kharkhorin Soum.

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One of the key benefits of the MDGSHP system is its high energy density. A single 2,000-meter borehole can produce as much energy as 100 shallow-depth boreholes, making the technology space-efficient and suitable for urban heating networks. The feasibility study confirms that if successful, this project could pave the way for a major shift in Mongolia's heating sector, with geothermal district heating emerging as a viable alternative to conventional fuels.

The project reflects a level of technological and industrial maturity that is supported by proven commercial applications, although it has not yet achieved widespread mainstream adoption. The project will therefore generate evidence and insight for learning for the benefit of sustainable heating development in Mongolia and elsewhere in East and Central Asia and the Caucasus.

Social Inclusion and Stakeholder Engagement [c][d]

The Kharkhorin Soum MDGSHP Project will contribute to social inclusion by ensuring equitable access to clean, reliable heating for public institutions and residential consumers. The project will replace coal-fired heating in 14 existing buildings and extend service to 17 additional consumers, including government offices, schools, and healthcare facilities, benefiting the broader community, particularly vulnerable groups affected by air pollution.

The feasibility study highlights the importance of engaging local stakeholders, including government authorities, heating system operators, and end-users, to ensure the successful adoption of geothermal heating technology. The National Energy Centre (NEC) is expected to lead implementation, while the local soum administration and private boiler operators will be engaged in awareness-raising activities to address concerns regarding affordability, technical reliability, and operational capacity.

Gender Considerations [c][d]

Gender Analysis (Please insert the text from the project document on the analysis of gaps in access to services, markets, and jobs by women in relation to the project sectors)	The preliminary analysis conducted in the project's feasibility study indicates that air pollution is a critical issue in Kharkhorin Soum due to heating fuel combustion. Women, children, and the elderly are more vulnerable to respiratory illnesses caused by particulate matter (PM2.5, PM10), NOx, and SOx. The transition to a geothermal heating system will improve air quality, leading to better health outcomes, particularly for women and children who spend more time indoors. Additionally, the automation of the MDGSHP system eliminates the labor-intensive task of manually operating coal boilers, potentially creating new technical roles that could be accessible to women if capacity-building efforts are inclusive. The project due diligence includes a poverty, gender, and social impact assessment. Potential findings if available will be reflected in the submission of the project cover note.

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Gender Activities (Please insert the text describing gender-specific activities included in the project)	It is acknowledged that women are underrepresented in the clean energy workforce due to several factors, including limited access to education and training in STEM disciplines, and limited women's participation in economic and social spheres. The project will incorporate measures to reduce gender gaps, such as interventions for generating gender-inclusive job opportunities, training and capacity building for women in renewable energy and energy efficiency, increasing women's leadership representation in the energy sector, and entrepreneurship opportunities for women in the renewable energy sector. Details on actions and indicators will be provided at a later stage, which will incorporate training and capacity building programs targeting women. As part of the mentioned associated TA on heating policy and regulatory reform, consideration for gender inclusive policies will be added.
Gender Indicators (Please insert the text on selected gender specific indicators, including annual targets. from the Project Log Frame that the project is committing to report on)	SREP Co-Benefit 2: Number and Percentage of women trained in green energy technologies and entrepreneurship opportunities. This will be further developed during the submission of the project cover note.
Just Transition [c][d]	
Just Transition Analysis	The feasibility study also highlights the need for capacity-building efforts to ensure that local operators can manage the new system effectively. While the MDGSHP system requires fewer manual laborers, it presents new opportunities for technical training and employment in system operation, maintenance, and refrigerant handling. This will be further developed during the submission of the project cover note.
Just Transition Activities	The project will take effort to keep the labor of the existing heating units and support just transition to geothermal heating through staff training and reskilling in cooperation with the current operator TSTR LLC as appropriate. This will be further developed during the submission of the project cover note.
Just Transition Indicators	This will be further developed during the submission of the project cover note.
Expected Results (M&R)	
Project/Program Timeline	
Expected MDB Board Approval date[d]	Q4 2025
Expected project closure date[d]	
Expected lifetime of results in years (including beyond project closure)	The project has an estimated operating life of 25 years
SREP Core Indicators	**Project-Defined Indicators/Targets**
Please identify which of the indicators below are relevant to the project proposal, list the corresponding project-defined indicator(s), and report all targets, including disaggregated targets. *(See the SREP Monitoring and Reporting Toolkit for additional guidance.)*	

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SREP 1: Annual electricity output from renewable energy, as a result of SREP interventions (MWh)	
Wind	
Solar	
Hydro	
Geothermal	10,113 MWh/year
Other/Mixed	
TOTAL	10,113 MWh/year
SREP 2: Number of women, men, businesses and community services benefitting from improved access to electricity and/or other modern energy services, as a result of SREP interventions	
Male	
Female	
Businesses	
Women-Owned Businesses (if feasible)	
Community Services	14 existing buildings and extend service to 17 additional consumers.
TOTAL (i.e., in persons)	14 existing buildings and extend service to 17 additional consumers.
SREP 3: Increased public and private investments in targeted subsectors, as a result of SREP interventions ($)	*$ 8.25 million co-financing*
SREP 4: Installed capacity from renewable energy, as a result of SREP interventions (MW)	
Direct	1 MW of heat pump system, and 2 MW of electric boiler and heat exchanger.
Indirect	2 MW heat pump system, and 5 MW of electric boiler and heat exchanger.
TOTAL	3 MW heat pump system, and 7 MW of electric boiler and heat exchanger.
SREP Co-Benefit Indicators	**Project-Defined Indicators/Targets**
Please identify one or more co-benefit indicators that the project will track and report. Add lines as needed.	

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SREP Co-Benefit 1: Increased/strengthened regulatory, institutional, and policy frameworks to support the use of renewable energy	
SREP Co-Benefit 2: Gender	Number of women trained in green energy technologies and entrepreneurship opportunities (to be determined in later approval stage).
SREP Co-Benefit 3: GHG emissions avoided (mt CO_2 eq)	• Baseline emissions from coal boilers: 7,965 tons CO_2 per year • Projected emissions from the MDGSHP system: 3,519 tons CO_2 per year • Total CO_2 reduction: 4,446 tons CO_2 per year (0.0044 Mt CO_2 eq annually)
Other SREP Co-Benefit: (*Please specify)*	
Please also submit the full project results framework to the CIF Secretariat upon MDB Board approval of the project.	
Expected Date of Committee Approval	
Expected Date of MDB Approval	Q4 2025
Additional Details (to Members)	

Version: October 2024

Link to Documents Management – here

CCH – here

CIF Website – here

CIF Pipeline Management and Cancellation Policy - here

CIF Financial Terms and Conditions Policy updated for FY24 - here

CIF Operational Modalities For New Strategic Programs - here

SREP Programming Modalities and Operational Guidelines - here

FY25 Pricing Policy - here

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