

December 30, 2010

**Proposed decision by mail of CTF funding for EBRD's  
Kazakhstan District Heating Modernisation Framework**

Dear CTF Trust Fund Committee Members,

Please find attached the program document entitled, *Kazakhstan District Heating Modernisation Framework*, submitted EBRD for your review and approval of a CTF allocation of \$42.0 million. This is the first project proposal under the Kazakhstan CTF Investment Plan, which was endorsed by the Trust Fund Committee in March 2010.

The Trust Fund Committee is requested to approve the following decision:

The CTF Trust Fund Committee approves a CTF allocation of \$42.0 million for the *Kazakhstan District Heating Modernisation Framework Project*, submitted by EBRD and circulated for approval of CTF funding on December 30, 2010.

For your information the following table summarizes the allocation of CTF resources for Kazakhstan under its endorsed investment plan. The Trustee has confirmed that there are sufficient resources available for commitment of the resources requested for this project.

<b><u>Kazakhstan: CTF Investment Plan</u></b>	<b><u>USD million</u></b>
Endorsed CTF Allocation (Approved March 2010)	200.00
Projects Approved	0.00
Project Submitted for Approval District Heating Modernisation Framework	42.00
<b><i>Total Allocation remaining if above project is Approved</i></b>	<b><i>158.00</i></b>

If we do not receive an objection to this proposed decision by close of business on January 13, 2011, the decision will be approved.



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- [Projects](#)
- [Project summary documents](#)
- **Kazakhstan District Heating M...**

## Procurement

There are no open procurement opportunities for this project.

## CONTACTS

Ekaterina Miroshnik, Operations Leader  
miroshne@ebrd.com

# Kazakhstan District Heating Modernisation Framework

**Country:** Kazakhstan

**Project number:** 42277

**Business sector:** Energy efficiency

**Public/Private:** Private

**Environmental category:** A

**Board date:** 7 Dec 2010

**Status:** Passed concept review, Pending final review

**PSD disclosed:** 17 Dec 2010

## Project Description

The EBRD is considering to provide up to USD 140 million of loan together with the Clean Technology Fund (CTF) to district heating companies in Kazakhstan. The projects will finance priority investment programmes in district heating networks in several cities in Kazakhstan, aimed at rehabilitation and improving energy efficiency of existing heat distribution networks in these cities. The investments are expected to yield significant reductions in heat losses, CO2 emissions and coal savings, and contribute to market transformation towards sustainable energy use in the district heating sector in Kazakhstan.

EBRD financing will, subject to confirmation by the Clean Technology Fund Trust Fund Committee, be complemented by concessional financing from CTF of USD 42 million to address affordability

development of environmental, health and safety management systems and stakeholder engagement plans; development and implementation of labour and community health and safety requirements for contractors; waste management plans; mitigation measures for reducing noise, vibration and dust nuisances and managing construction-related traffic and minimisation of disruptions to regular supply of heat and hot water; and implementing appropriate asbestos removal, handling and disposal procedure

The ESAPs will be part of the legal agreements between the participating companies and the EBRD. This PSD will be revised once the due diligence and ESAPs are finalised.

## Technical Cooperation

None.

## Business opportunities

For business opportunities or procurement, contact the client company.

## General enquiries

EBRD project enquiries not related to procurement:  
Tel: +44 20 7338 7168; Fax: +44 20 7338 7380  
Email: [projectenquiries@ebrd.com](mailto:projectenquiries@ebrd.com)

## Public Information Policy (PIP)

The PIP sets out how the EBRD discloses information and consults with its stakeholders so as to promote better awareness and understanding of its strategies, policies and operations.

[Text of the PIP](#)

## Project Complaint Mechanism (PCM)

The EBRD has established the Project Complaint Mechanism (PCM) to provide an opportunity for an independent review of complaints from one or more individuals or from organisations concerning projects financed by the Bank which are alleged to have caused, or likely to cause, harm. The Rules of Procedure governing the PCM can be found at [www.ebrd.com/downloads/integrity/pcmrules.pdf](http://www.ebrd.com/downloads/integrity/pcmrules.pdf), the Russian version can be accessed at <http://www.ebrd.com/downloads/integrity/pcmrulesr.pdf>

Any complaint under the PCM must be filed no later than 12 months after the last distribution of EBRD funds. You may contact the PCM officer (at [pcm@ebrd.com](mailto:pcm@ebrd.com)) or the relevant EBRD Resident Office for assistance if you are uncertain as to the period within which a complaint must be filed.

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Project Summary Documents are created before consideration by the EBRD Board of Directors. Details of a project may change following disclosure of a Project Summary Document. Project Summary Documents cannot be considered to represent official EBRD policy.

The EBRD has purchased a stake worth US\$ 50 million.



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From: "Biermann, Andreas" <BiermanA@ebrd.com>  
To: "Zhihong, Zhang" <zzhang2@thegef.org>  
Cc: "Joumana Asso" <jasso@worldbank.org>, "Normak, Tanya" <NormakT@ebrd.com>, "Simonetti, Marta" <SimonetM@ebrd.com>, "Munzberg, Miriam" <MunzberM@ebrd.com>, <jdonovan@worldbank.org>  
Date: 03/21/2011 10:56 AM  
Subject: RE: CTF PRIVATE SECTOR PROPOSAL - EBRD Kazakhstan DHMFF Final2

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Dear Zhihong, dear Jamie, dear Joumana

As requested, please find attached the slightly revised CTF Private Sector Proposal for the Kazakh DHMFF. The changes are highlighted for easier visibility.

The reason for the changes are a clerical error that as we progressed in our appraisal of the projects, it became clear that the financial constraints of the borrowers are requiring us to aim for a lower than expected leverage ratio.

The changes are:

A) a clarification that we will approve sub-projects at Board level, and that CTF funds will then be requested for this sub-project only; and

B) a correction of two errors:

(i) Where we originally stipulated that the ratio of EBRD:CTF funds would not be lower than 4:1 (page 2), what we meant was (EBRD+co-finance+project sponsor):CTF would not be lower than 4:1.

(ii) where it was stated that the overall ratio CTF:EBRD/Project Sponsor was to be 1:5 (table page 8), this was a typo, and as in the text on page 2 this was meant to say 1:4, and all other calculations (e.g. lifetime cost) were based on a 1:4 assumption.

These corrections do not breach the rule that CTF funding should not be above 20% of the total funding in any project, but primarily address the composition of the 80% of non-CTF funding in a project.

C) A clarification that EBRD funds alone (excluding co-finance and project sponsors) are expected to be invested on a ratio of 1:2.4 (CTF:EBRD).

D) A clarification that the CTF cost effectiveness of the programme refers to lifetime emissions reductions.

We hope that these changes are acceptable. <<CTF PRIVATE SECTOR PROPOSAL - EBRD Kazakhstan DHMFF Update 210311.doc>>

With kind regards

Andreas Biermann

-----Original Message-----

**From:** Biermann, Andreas  
**Sent:** 10 March 2011 16:54



File In IRIS Status: Submitted for processing into IRIS

**Approval by mail - Kazakhstan District Heating Modernisation Framework**

to: gbsbsk, bskusum, coordinator, kistlife,  
snakhooda, omarnunez, Steve.Sawyer,  
stuart.marcd, Kaveh.Zahedi,

12/30/2010 10:33 AM

CIF Admin Unit veerle.vandeweerd, mbarbut, sylvie.lemmet,  
cynthiaannpage, jsareen, Hilary.French,  
pbhandari, hwuester, omizuno, amy.fraenkel,  
cristina.colon, bo.lim, sdobardzic

Sent by: Lesley Wilson

Cc: Joumana Asso, Esther Regina Victoria Pormes, Jamison  
Lowell Donovan, Lesley Wilson

Bcc: IRIS4Mail PRD

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Dear CTF Trust Fund Committee Observers:

Please find below the link to the PID document for the EBRD: Kazakhstan District Heating Modernisation Framework circulated today to CTF Trust Fund Committee members for approval of a CTF allocation of \$42.0 million.

Sincerely

CIF Administrative Unit  
1818 H Street NW  
Washington, D.C. 20433  
[www.climateinvestmentfunds.org](http://www.climateinvestmentfunds.org)

---

Dear CTF Trust Fund Committee Members,

Please find attached the program document entitled, *Kazakhstan District Heating Modernisation Framework*, submitted EBRD for your review and approval of a CTF allocation of \$42.0 million. This is the first project proposal under the Kazakhstan CTF Investment Plan, which was endorsed by the Trust Fund Committee in March 2010.

The Trust Fund Committee is requested to approve the following decision:

The CTF Trust Fund Committee approves a CTF allocation of \$42.0 million for the *Kazakhstan District Heating Modernisation Framework Project*, submitted by EBRD and circulated for approval of CTF funding on December 30, 2010.

For your information the following table summarizes the allocation of CTF resources for Kazakhstan under its endorsed investment plan. The Trustee has confirmed that there are sufficient resources available for commitment of the resources requested for this project.

bcc: Lesley Wilson  
Iris4Mail Prd

## CTF PRIVATE SECTOR PROPOSAL

<i>Name of Project or Program</i>	–Kazakhstan District Heating Modernisation Framework (DHMFF)	
<i>CTF amount requested</i>	Investment Advisory services component Implementation and supervision budget Knowledge Management Component	USD 39 million equivalent USD 2.4 million equivalent USD 286.000 equivalent USD 314,000 equivalent
<i>Country targeted</i>	Kazakhstan	
<i>Indicate if proposal is a Project or Program</i>	The request is for a programme to support the energy efficiency improvement through refurbishment in Kazakh district heating networks.	
<i>Transfer of Funds by the Trustee to the Implementing Entity</i>	Express authorization of the CTF Trust Fund Committee is requested to allow for the full up-front transfer of CTF resources required for the Investment Component to EBRD prior to the first commitment by EBRD pursuant to a signed loan agreement with a participating borrower (the Investment Component).	

### DETAILED DESCRIPTION OF PROGRAM

#### **Fit with the Investment Plan**

The investment plan allocated USD42 million to EBRD's district heating facility. This proposal is for the full amount of this allocation. More than 1/3<sup>rd</sup> of this volume is in advanced stage of project preparation and internal review.

#### **Description of the Programme**

##### *General*

The Project is to provide EBRD loans to heat suppliers in Kazakhstan co-financed by Clean Technology Fund (CTF) concessional loan funds for energy efficiency investments. The project will be part of an IFC/EBRD joint initiative to develop sustainable energy financing facilities under the CTF Investment Plan for Kazakhstan, endorsed by the CTF Trust Fund Committee in March 2010, and revised in November 2010. Each sub-project under the framework will be individually EBRD Board approved, and CTF finance will then be requested from the Trustee for the approved subproject only.

The Kazakh DH sector is considered to be of high energy intensity when compared with comparable sectors in more developed countries, and in high need of modernisation investment. The proposed Framework aims to make a significant transformational impact in three critical areas in addressing climate change challenges in Kazakhstan by (i) enhancing energy security by improving energy efficiency in DH through reducing heat losses by at least 10% over the medium term; (ii) supporting a clean energy transition by reducing reliance on fossil fuels in the generation of heat through increased efficiency of DH systems and by focusing on meeting energy needs in an environmentally sustainable manner, thereby reducing GHG emissions; and (iii) increasing/supporting existing private sector involvement in the delivery of heat supply.

The proposed Project will help Kazakhstan to address its energy and climate change challenges by making a major contribution in three critical areas:

- Enhancing energy security – by improving energy efficiency and increasing reliability of heat



Amount:	Up to USD 39,000,000 equivalent
Tenor:	Up to 20 years; with up to 10 years grace period followed by semi-annual repayments
Pricing:	Minimum interest rate of 75 basis points
Fees	No fees
Expected Commitment Date:	January 2011 to end of calendar year 2012
Expected Disbursement Date:	February 2011 to end of calendar year 2013

## **Market Transformation**

### *Background*

Energy efficiency investments have significant benefits and are normally financially viable. However, experience with energy efficiency investments in other countries shows that many energy efficiency projects remain unfinanced and unimplemented because of key barriers, despite its large potential. These barriers include:

- Low tariffs: Low prices of heat for the end user have also blocked such energy efficiency projects in the past. Phasing out the production subsidy for district heat (provided from the city budget to the heating company) has been the cornerstone of district heating sector reform in neighbouring states, including Russia. The recently announced increase of the heating tariff in Almaty by 21% - to 3,542 KZT/Gcal (5.64 US\$/GJ) - indicates that the regulatory agency in Kazakhstan is increasingly willing to allow the heat supplier to cover the production costs through the tariffs. The tariff at this level is thought to be sufficient to cover the justifiable operating expenses of the energy utility and the housing management company.
- A potential increase to cover the costs of capital modernization will be viable only if the scope of the modernization program allows the customers to save energy and/or switch from DH to an alternative affordable heat supply. Otherwise tariff increases for captive customers would risk being unaffordable to a large number of households. Should further affordability issues arise the municipal authorities will be encouraged to provide fiscal support mechanism in the mid-to long term once concessional financing is no longer available. Sub-projects will covenant schedules for tariff increases and regulatory policy dialogue and TC will support systemic tariff reforms.
- Supply-driven business model. Heat suppliers need to be incentivised by the competitive pressure and regulation and convinced that they can benefit from allowing the customers to save energy, and the need for active collaboration between the energy utility (district heating company) and the municipality/housing authority.
- Absence of advanced technology to allow demand-driven business. Due to an insufficiently developed market for equipment required for modernization of DH systems in the former Soviet Union, the high unit price of equipment such as individual heating substations (IHS), known in Russian as "ITP" for *individualnyi teplovoi punkt*), as well as the absence of e.g. advanced metering technology and thermostats in the apartments level, has been a serious barrier for broader introduction of this technology.

Given this context, it is concluded that awareness raising and capacity building efforts through technical

Eligibility criteria for EBRD financing will follow the Bank's standard operating principles. More specifically, use of proceeds under the Framework will focus on projects with (i) economical and financial viability, (ii) a Priority Investment Programme in line with a long-term strategic investment plan, (iii) good or higher transition impact and provision of replicable model for other places in Kazakhstan, which will be a function of ownership, tariff increases, the strength of demonstration effect of energy efficiency improvements, DSM measures and regulatory reforms leveraged), (iv) application of the best available techniques in the EBRD region which result in increased energy efficiency on the heat supply side beyond business as usual, but of minimum 15 per cent over the monitoring period of the project and consequent reduction of GHG emissions, and (v) introduction of meters and improved control equipment allowing for institutional improvements and regulatory reforms.

Where appropriate depending on transaction size, the EBRD will seek to mobilise co-financing for individual transactions from other IFIs and development partners, where required. The specific terms of the CTF-financed component of each loan will be determined by the EBRD in accordance with its procedures. Concessionality will be determined in line with the guidelines adopted in the establishment of the EBRD CIF Special Fund, and will be guided by the principles of focus on the underlying problem and minimum concessionality to overcome them.

#### *CTF Additionality*

The need for the concessional financing is demonstrated by its ability to achieve real long-term benefits. The kind of long-term financing for energy efficiency investment in district heating utilities in the maturities and terms required is unavailable from commercial banks, the local bond market, and IFIs. Additionality is reinforced by the EBRD's detailed industry knowledge and the ability to evaluate and assess the risks related to the sector. The CTF adds significant value to the programme by enabling institutional development, skill transfer and commercialisation.

Concessional co-finance is utilised to enable the borrowers to undertake the volume of investment required to achieve a transformational change in the approach to business in the sector in Kazakhstan. By providing lower-priced and long-term finance, borrowers can undertake measures that they would normally be prevented from undertaking due to affordability constraints of their clients. Combining the concessional finance with technical assistance and policy dialogue enables the Bank to pursue a holistic approach to sector reform and changing the business model under which borrowers operate.

#### *Safeguards and Procurement*

All sub-projects will be categorised in accordance with the Bank's Environmental and Social Policy 2008 (the "ESP"), and any sub-project classified as an "A" category project will be subject to EBRD Board approval.

Detailed financial analysis and assessment will be provided for each sub-project under the Framework during the appraisal stage. This analysis will focus on debt capacity of each Sub-Borrower, available Sponsor/ third party support, required tariff increases and affordability constraints, long-term demand for district heating, implementation capacity and macroeconomic risks. Number of stress scenarios will be run to prove viability of proposed investments, so that the decision to provide additional funding to a specific project under the Facility is very well justified.

In accordance with the integrity due diligence procedures, all sub-projects involving high risk clients, including Politically Exposed Persons would be referred to the EBRD's Office of the Chief Compliance Officer early to determine whether the Bank's engagement is warranted and what safeguards, if any, need to be put in place to mitigate residual risks.

efficient and effective approaches delivering heat services through changes to the business model designed specifically to overcome the current, supply-driven approach. Moreover, TA provided when necessary will strengthen corporate management and if required promote corporate restructuring. This is eminently scalable and replicable given the potential in Kazakhstan, and it is expected that other heat suppliers will develop these approaches to scale-up the potential impact of the Project. The project will deliver significant benefits to service users, many of which live on low incomes, by providing them with improved levels of service and more reliable and controllable heat supply, thereby raising comfort levels.

The Project is also expected to transfer and build expertise, among both borrowers, related to energy efficiency investments and improved service delivery. The project is expected to contribute to lowering the transaction costs for financing sustainable energy investments.

#### *Investment Component*

The Facility will address the market and policy barriers to energy efficiency investments through (i) the provision of medium and longer term funding to borrowers for modernisation investments; (ii) structuring the concessional CTF resources, with lower interest rates and longer tenors, to entice borrowers to actively engage in developing new business approaches that will (i) make DH companies competitive without subsidies and (ii) enhance the political feasibility of gradual tariff increases towards cost recovery. The risk of creating subsidy dependence and distortion to competition will be mitigated at the project level by appropriate structuring, and at the Framework level through regulatory TC and policy dialogue.

The use of concessional funds will help to optimize the pace of investments in modernization of the DH assets while gradually improving tariff structures and increasing the end-user tariffs to cost recovery levels subject to affordability constraints. Currently residential customers are mostly billed on the basis of estimated (based on norms) rather than actual consumption. Existing norms are often below actual consumption and limit incentives for customers to reduce energy use and for providers to invest in improvements of the infrastructure to reduce heat losses. Concessional funds will be instrumental in triggering tariff reforms while enabling investments in increased energy efficiency, thereby widening the project scope within the existing affordability constraints.

The enhanced project scope will go beyond the current standard practice by Kazakh DH utilities to carry out ad hoc repairs of pipeline breaks. It will include heat metering and control equipment that empower heat consumers as well as providers to improve efficiency of heat supply and distribution including reduction of losses, and thereby will enhance the commercial viability of DH companies. Once the beneficial effects of the programme have been demonstrated in the market and investment costs are brought down by supplier entry, other utilities will be able to invest in similar programmes with greater confidence, while at the same time, the cost for individual technology elements have been brought down.

#### *Technical Assistance Component*

The Facility will be supported by a comprehensive technical assistance programme to provide feasibility studies and implementation support to borrowers, and reform support including: (i) corporate development and financial improvement programmes; and (ii) institutional support to government aimed at (a) improvement of sector regulations in line with good regulatory practices; (b) enhancing competition in the provision of heat services in order to decrease the need for regulation; (c) the improvement of heat tariff methodologies with adequate protection of vulnerable households, including full cost-recovery tariffs; (d) improved service quality including the creation of incentives for demand response and DSM and accelerated metering programme, empowering consumers to control and reduce demand; and (e) the related information dissemination and awareness raising activities which will lead to

Demonstration effects	Reduction of heat losses by 10 per cent Sub-project-specific coal savings Sub-project-specific reduction of CO2 emissions	During implementation, annual reporting covenanted
Setting standards: setting standards for corporate governance and business conduct	Completion of corporate development programmes and its implementation Continued implementation of the metering programme by district heating companies under sub-projects Annual publication of performance targets by district heating companies under sub-projects Increased service quality	Timing differs depending on the sub-project 100 per cent meter-based billing in line/ ahead of national legislation During implementation and repayment

### **Risks**

Risks relate to whether there will be an uptake of loans by borrowers and whether the performance of the underlying investments will succeed in improving energy efficiency. These risks will be mitigated by CTF resources which offer an attractive incentive to borrowers to participate in the Project and the planned technical assistance, including comprehensive marketing and awareness raising will ensure the development of a strong portfolio of demonstration projects. Introducing a number of borrowers will ensure demonstration and transformation effects and will enhance the ability of future prospective investors to access funding and technical support.

The use of CTF resources, however, creates its own set of transformation risks, such as the risk of subsidy dependence, distortion to the heat supply market and substituting concessional finance for much needed tariff reforms, thereby delaying transition to commercial viability and competitiveness of the DH companies. These risks will be mitigated through an investment focus on demand response measures (which may not be in the immediate commercial interest of DH companies), linking CTF finance to tariff increases and reform of tariff and billing methodologies as well as by the fact that in many regions district heating is already the lowest-cost source of heat supply. The provision of technical assistance focusing on the sound policy development and regulation will also mitigate these risks.

### **Sector Background**

District heating is a major component in Kazakhstan's energy balance. The official statistics reported the total production of commercial heat in 2007 (before losses in transmission and distribution) at 93.4 million Gcal (108.6 TWh). This is more than the amount of electric energy produced in Kazakhstan (76.4 TWh in 2007). District heating remains the most cost-effective way of supplying heat to the majority of people in the average post-Soviet city with lower-middle income urban residents as main beneficiaries.

Nonetheless, Kazakhstan's district heating sector is characterised by a history of underinvestment over the last 20 years and a more recent history of rapid demand growth given rapid urbanisation in major metropolitan and industrial centres. This has resulted in a stock of ageing and inefficient assets with poor environmental performance, which struggle to meet demand reliably. The centralised heat supply networks in Kazakhstan are depreciated by 80 per cent on average and are under particular strain. As a result, average technical losses that are passed through the heat distribution tariff are 26 per cent.

## Annex A

### Indicative Budget for Technical Assistance Program CTF Advisory Services Component<sup>1</sup>

<b>Activity Overview</b>	<b>Year 2011-2013</b>	<b>CTF Contribution</b>	<b>EBRD Contribution</b>
<b>Policy Dialogue</b>	500,000	150,000	350,000
<b>Feasibility Studies</b>	2,500,000	2,000,000	500,000
<b>Capacity Building</b>	500,000	250,000	250,000
<b>CTF/CIF Knowledge Management</b>	314,000	314,000	0
<b>Total</b>	<b>3,814,000</b>	<b>2,714,000</b>	<b>1,100,000</b>

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<sup>1</sup> Assuming five sub-projects under the framework

## CTF PRIVATE SECTOR PROPOSAL

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financial viability, (ii) a Priority Investment Programme in line with a long-term strategic investment plan, (iii) good or higher transition impact and provision of replicable model for other places in Kazakhstan, which will be a function of ownership, tariff increases, the strength of demonstration effect of energy efficiency improvements, DSM measures and regulatory reforms leveraged), (iv) application of the best available techniques in the EBRD region which result in increased energy efficiency on the heat supply side beyond business as usual, but of minimum 15 per cent over the monitoring period of the project and consequent reduction of GHG emissions, and (v) introduction of meters and improved control equipment allowing for institutional improvements and regulatory reforms.

Where appropriate depending on transaction size, the EBRD will seek to mobilise co-financing for individual transactions from other IFIs and development partners, where required. The specific terms of the CTF-financed component of each loan will be determined by the EBRD in accordance with its procedures. Concessionality will be determined in line with the guidelines adopted in the establishment of the EBRD CIF Special Fund, and will be guided by the principles of focus on the underlying problem and minimum concessionality to overcome them.

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#### *Safeguards and Procurement*

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In accordance with the integrity due diligence procedures, all sub-projects involving high risk clients, including Politically Exposed Persons would be referred to the EBRD's Office of the Chief Compliance Officer early to determine whether the Bank's engagement is warranted and what safeguards, if any, need to be put in place to mitigate residual risks.

Due diligence on integrity and anti-money laundering policy will be conducted on each participating borrower under the Framework in accordance with normal EBRD due diligence process.



Tenor:	Up to 20 years; with up to 10 years grace period followed by semi-annual repayments
Pricing:	Minimum interest rate of 75 basis points
Fees	No fees
Expected Commitment Date:	January 2011 to end of calendar year 2012
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## **Market Transformation**

### *Background*

Energy efficiency investments have significant benefits and are normally financially viable. However, experience with energy efficiency investments in other countries shows that many energy efficiency projects remain unfinanced and unimplemented because of key barriers, despite its large potential. These barriers include:

- Low tariffs: Low prices of heat for the end user have also blocked such energy efficiency projects in the past. Phasing out the production subsidy for district heat (provided from the city budget to the heating company) has been the cornerstone of district heating sector reform in neighbouring states, including Russia. The recently announced increase of the heating tariff in Almaty by 21% - to 3,542 KZT/Gcal (5.64 US\$/GJ) - indicates that the regulatory agency in Kazakhstan is increasingly willing to allow the heat supplier to cover the production costs through the tariffs. The tariff at this level is thought to be sufficient to cover the justifiable operating expenses of the energy utility and the housing management company.
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- Absence of advanced technology to allow demand-driven business. Due to an insufficiently developed market for equipment required for modernization of DH systems in the former Soviet Union, the high unit price of equipment such as individual heating substations (IHS), known in Russian as "ITP" for *individualnyi teplovoi punkt*), as well as the absence of e.g. advanced metering technology and thermostats in the apartments level, has been a serious barrier for broader introduction of this technology.

Given this context, it is concluded that awareness raising and capacity building efforts through technical assistance alone would not be sufficient to unleash the potential for sustainable energy investment in Kazakhstan's DH sector, and concessional co-finance is required to ensure that sufficient volume of



necessary will strengthen corporate management and if required promote corporate restructuring. This is eminently scalable and replicable given the potential in Kazakhstan, and it is expected that other heat suppliers will develop these approaches to scale-up the potential impact of the Project. The project will deliver significant benefits to service users, many of which live on low incomes, by providing them with improved levels of service and more reliable and controllable heat supply, thereby raising comfort levels.

The Project is also expected to transfer and build expertise, among both borrowers, related to energy efficiency investments and improved service delivery. The project is expected to contribute to lowering the transaction costs for financing sustainable energy investments.

#### *Investment Component*

The Facility will address the market and policy barriers to energy efficiency investments through (i) the provision of medium and longer term funding to borrowers for modernisation investments; (ii) structuring the concessional CTF resources, with lower interest rates and longer tenors, to entice borrowers to actively engage in developing new business approaches that will (i) make DH companies competitive without subsidies and (ii) enhance the political feasibility of gradual tariff increases towards cost recovery. The risk of creating subsidy dependence and distortion to competition will be mitigated at the project level by appropriate structuring, and at the Framework level through regulatory TC and policy dialogue.

The use of concessional funds will help to optimize the pace of investments in modernization of the DH assets while gradually improving tariff structures and increasing the end-user tariffs to cost recovery levels subject to affordability constraints. Currently residential customers are mostly billed on the basis of estimated (based on norms) rather than actual consumption. Existing norms are often below actual consumption and limit incentives for customers to reduce energy use and for providers to invest in improvements of the infrastructure to reduce heat losses. Concessional funds will be instrumental in triggering tariff reforms while enabling investments in increased energy efficiency, thereby widening the project scope within the existing affordability constraints.

The enhanced project scope will go beyond the current standard practice by Kazakh DH utilities to carry out ad hoc repairs of pipeline breaks. It will include heat metering and control equipment that empower heat consumers as well as providers to improve efficiency of heat supply and distribution including reduction of losses, and thereby will enhance the commercial viability of DH companies. Once the beneficial effects of the programme have been demonstrated in the market and investment costs are brought down by supplier entry, other utilities will be able to invest in similar programmes with greater confidence, while at the same time, the cost for individual technology elements have been brought down.

#### *Technical Assistance Component*

The Facility will be supported by a comprehensive technical assistance programme to provide feasibility studies and implementation support to borrowers, and reform support including: (i) corporate development and financial improvement programmes; and (ii) institutional support to government aimed at (a) improvement of sector regulations in line with good regulatory practices; (b) enhancing competition in the provision of heat services in order to decrease the need for regulation; (c) the improvement of heat tariff methodologies with adequate protection of vulnerable households, including full cost-recovery tariffs; (d) improved service quality including the creation of incentives for demand response and DSM and accelerated metering programme, empowering consumers to control and reduce demand; and (e) the related information dissemination and awareness raising activities which will lead to the sustainability of the modernisation investment approaches beyond the reach and life of the EBRD/CTF Facility.

Demonstration effects	Reduction of heat losses by 10 per cent Sub-project-specific coal savings Sub-project-specific reduction of CO2 emissions	During implementation, annual reporting covenanted
Setting standards: setting standards for corporate governance and business conduct	Completion of corporate development programmes and its implementation Continued implementation of the metering programme by district heating companies under sub-projects Annual publication of performance targets by district heating companies under sub-projects Increased service quality	Timing differs depending on the sub-project 100 per cent meter-based billing in line/ ahead of national legislation During implementation and repayment

### **Risks**

Risks relate to whether there will be an uptake of loans by borrowers and whether the performance of the underlying investments will succeed in improving energy efficiency. These risks will be mitigated by CTF resources which offer an attractive incentive to borrowers to participate in the Project and the planned technical assistance, including comprehensive marketing and awareness raising will ensure the development of a strong portfolio of demonstration projects. Introducing a number of borrowers will ensure demonstration and transformation effects and will enhance the ability of future prospective investors to access funding and technical support.

The use of CTF resources, however, creates its own set of transformation risks, such as the risk of subsidy dependence, distortion to the heat supply market and substituting concessional finance for much needed tariff reforms, thereby delaying transition to commercial viability and competitiveness of the DH companies. These risks will be mitigated through an investment focus on demand response measures (which may not be in the immediate commercial interest of DH companies), linking CTF finance to tariff increases and reform of tariff and billing methodologies as well as by the fact that in many regions district heating is already the lowest-cost source of heat supply. The provision of technical assistance focusing on the sound policy development and regulation will also mitigate these risks.

### **Sector Background**

District heating is a major component in Kazakhstan's energy balance. The official statistics reported the total production of commercial heat in 2007 (before losses in transmission and distribution) at 93.4 million Gcal (108.6 TWh). This is more than the amount of electric energy produced in Kazakhstan (76.4 TWh in 2007). District heating remains the most cost-effective way of supplying heat to the majority of people in the average post-Soviet city with lower-middle income urban residents as main beneficiaries.

Nonetheless, Kazakhstan's district heating sector is characterised by a history of underinvestment over the last 20 years and a more recent history of rapid demand growth given rapid urbanisation in major metropolitan and industrial centres. This has resulted in a stock of ageing and inefficient assets with poor environmental performance, which struggle to meet demand reliably. The centralised heat supply networks in Kazakhstan are depreciated by 80 per cent on average and are under particular strain. As a result, average technical losses that are passed through the heat distribution tariff are 26 per cent.

## Annex A

### Indicative Budget for Technical Assistance Program CTF Advisory Services Component<sup>1</sup>

<b>Activity Overview</b>	<b>Year 2011-2013</b>	<b>CTF Contribution</b>	<b>EBRD Contribution</b>
<b>Policy Dialogue</b>	500,000	150,000	350,000
<b>Feasibility Studies</b>	2,500,000	2,000,000	500,000
<b>Capacity Building</b>	500,000	250,000	250,000
<b>CTF/CIF Knowledge Management</b>	314,000	314,000	0
<b>Total</b>	<b>3,814,000</b>	<b>2,714,000</b>	<b>1,100,000</b>

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<sup>1</sup> Assuming five sub-projects under the framework

December 10, 2010

**European Bank for Reconstruction & Development (EBRD)  
Clean Technology Fund (CTF) Private Sector Proposal  
Kazakhstan District Heating Modernization Framework (DHMFF):  
Independent Review Letter**

1. Endorsement. I have reviewed the EBRD CTF private sector proposal for the Kazakhstan District Heating Modernization Framework (“DHMFF” or “Project”). On the basis of this review, I strongly support and endorse this CTF proposal for the reasons summarized below. My review covers: (i) overall strategy and rationale for the district heating (DH) system investment program; (ii) finance structure and justification for CTF funds; (iii) plans for tariff reform; (iv) potential for end-use energy efficiency (EE) investments; and, (v) risks and conclusions.
2. Overall Strategy and Rationale for the District Heating System Investment Program. District heating systems remain the most energy efficient and cost effective way to heat concentrated groups of buildings, provided the systems are well maintained. DH systems in Kazakhstan suffer from a history of chronic underinvestment, a common situation in post-Soviet transition economies. A key reason for underinvestment is that tariffs have been below full cost recovery levels as calculated with proper attribution to capital investment and system maintenance requirements. The DHMFF investment program is critically needed to restore these systems to efficient operations, overcome the legacy of underinvestment and foment a virtuous cycle of reinvestment. The investment program includes heat metering, building level substations and controls which are essential for implementing tariff reform. These are basic technologies but, as their deployment has been limited in Kazakhstan, their prices remain relatively high; the scale of the investment program can reduce prices for these needed system retrofits. The Program incorporates a technical cooperation component supporting preparation of investments through the full project development cycle with the investee DH enterprises plus cooperation with the regulator AREM and other stakeholders on the necessary policy and tariff reforms. EBRD has extensive experience with district heating system and enterprise investments for many years throughout the region and existing relationships with many of the target DH system investee companies and is therefore strongly and uniquely positioned to carry out this investment program and related technical cooperation. The project pipeline appears strong, building on existing EBRD client relationships, so that Project resources and CTF funds should begin disbursing quickly.
3. Finance Structure and Justification for CTF Funds. The CTF funding with its long 20 year tenor, 10 year grace period and low (75 bp) interest rate will lower annual debt service payments for the investment program and therefore greatly facilitate the Program’s main objectives. With lower debt service, energy and operating cost savings associated with the investments will offset a larger portion of debt service payments. This will make the investment program more affordable and will also support the needed tariff reforms. Similar long term funding is not available from commercial financial institutions or local capital markets. The 4:1 ratio of EBRD and CTF resources provides reasonable leverage of CTF funds and an estimated cost of \$8 of CTF funds per TCe GHG emissions reduction, which is a slightly high but certainly reasonable. Blending CTF with EBRD funds provides attractively priced and structured financing for the investment program and gives incentives to all parties to proceed.
4. Plans for Tariff Reform. The DHMFF investment program can be instrumental to tariff reform and will support tariff reform in multiple ways. The EBRD loan provides a basis for tariff reform conditionalities to be negotiated with the DH system borrowers. Conditionalities for tariff reform are appropriate as they are central to long term sustainability of the DH systems. Second, the Program

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**Approval by mail - Kazakhstan District Heating Modernisation Framework**

01/13/2011 02:21 PM

CIF Admin Unit to: BiermanA  
3-4733

Sent by: Joumana Asso  
Patricia Ass-Guest, Jamison Lowell Donovan, Lesley  
Cc: Wilson Asso@worldbank.org

Dear Andreas,

As mentioned, attached is the approval note from the UK.

Best regards,

CIF Administration  
1818 H Street NW 433  
Washington, DC  
[www.climatefunds.org](http://www.climatefunds.org)

by Joumana Asso/Person/World Bank on 01/13/2011 02:20 PM -----

----- Fr "Simon Ratcliffe" <S-Ratcliffe@dfid.gov.uk>  
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**Approved by mail - Kazakhstan District Heating Modernisation Framework**

01/20/2011 05:49 PM

CIF Admin Unit  
3-4733

to: Frank.Fass-Metz, shinji.taniguchi,  
eulalia.ortiz, jean-bernard.carrasco,  
cyril.rousseau, william.pizer, G-Briffa,  
asa.andrae, zfakir, syang, vicfodeke, info,  
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Sent by: **Lesley Wilson**

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Katharine.thoday, Deborah.Fulton, tanakaj, m-anderson,  
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CARTERP, Daniel.Riley, vmlitvak, Tim.Suljada,  
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gsargsyam, ndube, lsilva, gloriav, calatorre, abasnyat1, lmonari,  
tbhargava, Foyewole, dlaohapakakul, rdelacruz1, m.duarte,  
Jessicat, xtalero, cdileva, Tduvalliii  
Bcc: IRIS4Mail PRD

Dear Trust Fund Committee Members,

We are writing with regard to the proposal for CTF funding for the EBRD *Kazakhstan District Heating Modernisation Framework*, which was circulated for approval by mail.

The extended time period provided for submission of comments and any objection to the approval of the CTF financing for the project proposal (close of business January 20, 2011) has now expired.

No objections were received.

We are, therefore, pleased to inform you that the following decision is approved:

The CTF Trust Fund Committee approves a CTF allocation of \$42.0 million for the *Kazakhstan District Heating Modernisation Framework Project*, submitted by EBRD and circulated for approval of CTF funding on December 30, 2010.

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December 30, 2010

**Proposed decision by mail of CTF funding for EBRD's  
Kazakhstan District Heating Modernisation Framework**

Dear CTF Trust Fund Committee Members,

Please find attached the program document entitled, *Kazakhstan District Heating Modernisation Framework*, submitted EBRD for your review and approval of a CTF allocation of \$42.0 million. This is the first project proposal under the Kazakhstan CTF Investment Plan, which was endorsed by the Trust Fund Committee in March 2010.

The Trust Fund Committee is requested to approve the following decision:

The CTF Trust Fund Committee approves a CTF allocation of \$42.0 million for the *Kazakhstan District Heating Modernisation Framework Project*, submitted by EBRD and circulated for approval of CTF funding on December 30, 2010.

For your information the following table summarizes the allocation of CTF resources for Kazakhstan under its endorsed investment plan. The Trustee has confirmed that there are sufficient resources available for commitment of the resources requested for this project.

<b><u>Kazakhstan: CTF Investment Plan</u></b>	<b><u>USD million</u></b>
Endorsed CTF Allocation (Approved March 2010)	200.00
Projects Approved	0.00
Project Submitted for Approval District Heating Modernisation Framework	42.00
<b><i>Total Allocation remaining if above project is Approved</i></b>	<b><i>158.00</i></b>

If we do not receive an objection to this proposed decision by close of business on January 13, 2011, the decision will be approved.





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## Procurement

There are no open procurement opportunities for this project.

## CONTACTS

Ekaterina Miroshnik, Operations Leader  
[miroshne@ebrd.com](mailto:miroshne@ebrd.com)

# Kazakhstan District Heating Modernisation Framework

**Country:** Kazakhstan

**Project number:** 42277

**Business sector:** Energy efficiency

**Public/Private:** Private

**Environmental category:** A

**Board date:** 7 Dec 2010

**Status:** Passed concept review, Pending final review

**PSD disclosed:** 17 Dec 2010

## Project Description

The EBRD is considering to provide up to USD 140 million of loan together with the Clean Technology Fund (CTF) to district heating companies in Kazakhstan. The projects will finance priority investment programmes in district heating networks in several cities in Kazakhstan, aimed at rehabilitation and improving energy efficiency of existing heat distribution networks in these cities. The investments are expected to yield significant reductions in heat losses, CO2 emissions and coal savings, and contribute to market transformation towards sustainable energy use in the district heating sector in Kazakhstan.

EBRD financing will, subject to confirmation by the Clean Technology Fund Trust Fund Committee, be complemented by concessional financing from CTF of up USD 42 million to address affordability

development of environmental, health and safety management systems and stakeholder engagement plans; development and implementation of labour and community health and safety requirements for contractors; waste management plans; mitigation measures for reducing noise, vibration and dust nuisances and managing construction-related traffic and minimisation of disruptions to regular supply of heat and hot water; and implementing appropriate asbestos removal, handling and disposal procedure

The ESAPs will be part of the legal agreements between the participating companies and the EBRD. This PSD will be revised once the due diligence and ESAPs are finalised.

## Technical Cooperation

None.

## Business opportunities

For business opportunities or procurement, contact the client company.

## General enquiries

EBRD project enquiries not related to procurement:

Tel: +44 20 7338 7168; Fax: +44 20 7338 7380

Email: [projectenquiries@ebrd.com](mailto:projectenquiries@ebrd.com)

## Public Information Policy (PIP)

The PIP sets out how the EBRD discloses information and consults with its stakeholders so as to promote better awareness and understanding of its strategies, policies and operations.

[Text of the PIP](#)

## Project Complaint Mechanism (PCM)

The EBRD has established the Project Complaint Mechanism (PCM) to provide an opportunity for an independent review of complaints from one or more individuals or from organisations concerning projects financed by the Bank which are alleged to have caused, or likely to cause, harm. The Rules of Procedure governing the PCM can be found at [www.ebrd.com/downloads/integrity/pcmrules.pdf](http://www.ebrd.com/downloads/integrity/pcmrules.pdf), the Russian version can be accessed at <http://www.ebrd.com/downloads/integrity/pcmrulesr.pdf>

Any complaint under the PCM must be filed no later than 12 months after the last distribution of EBRD funds. You may contact the PCM officer (at [pcm@ebrd.com](mailto:pcm@ebrd.com)) or the relevant EBRD Resident Office for assistance if you are uncertain as to the period within which a complaint must be filed.

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Project Summary Documents are created before consideration by the EBRD Board of Directors. Details of a project may change following disclosure of a Project Summary Document. Project Summary Documents cannot be considered to represent official EBRD policy.

The EBRD has purchased a stake worth US\$ 50 million.



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