**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

Approved by the Board of Directors on 3 July 2024[1]

MONTENEGRO

CGES SS BREZNA

[Redacted in line with the EBRD's Access to Information Policy]

[Information considered confidential has been removed from this document in accordance with the EBRD's Access to Information Policy (AIP). Such removed information is considered confidential because it falls under one of the provisions of Section III, paragraph 2 of the AIP]

[1] As per section 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose Board reports for State Sector Projects within 30 calendar days of approval of the relevant Project by the Board of Directors. Confidential information has been removed from the Board report.

For the avoidance of any doubt, the information set out here was accurate as at the date of preparation of this document, prior to consideration and approval of the project.

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ABBREVIATIONS

CAPEX	Capital Expenditure
CEDIS	Crnogorski Elektrodistributivni Sistem
CGES	Crnogorski Elektroprenosni Sistem
COTEE	Crnogorski operator tržista električne energije
CPI	Consumer Prices Index
E&S	Environmental and Social
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortization
ECEPP	EBRD Client E-Procurement Portal
EPCG	Elektroprivreda Crne Gore a.d. Nikšić
ESAP	Environmental and Social Action Plan
ESDD	Environmental and Social Due Diligence
EU	European Union
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GW	Gigawatts
GWh	Gigawatt hours
HPP	Hydro Power Plant
HV	High Voltage
IMS	Integrated Management System
KPI	Key Performance Indicator
KV	Kilovolt
LTA	Lenders' Technical Advisor
MW	Megawatts
MWh	Megawatt hours
NECP	National Energy and Climate Plan
O&M	Operations & Maintenance
OCF	Operating Cash Flow
OHL	Overhead Line
PP&Rs	EBRD Procurement Policies and Rules
PV	Photovoltaics
RAB	Regulatory Asset Base
RE	Renewable Energy
REGAGEN	Energy and Water Regulatory Agency of Montenegro
RES	Renewable Energy Sources
RRaR	Regulated Rate of Return
RReR	Regulated Return on Revenue
SC	Supply Chain
SEP	Stakeholder Engagement Plan
SPP	Solar Power Plant
SPV	Special Purpose Vehicle
TPP	Thermal Power Plant
WBIF	Western Balkans Investment Framework
WPP	Wind Power Plant
WTG	Wind Turbine Generator

Montenegro uses the Euro as its currency

WEIGHTS AND MEASURES

1 Megawatt (MW)	=	1,000 kilowatts (10^3 kW)
1 Gigawatt (GW)	=	1 million kilowatts (10^6 kW)
1 Megawatt-hour (MWh)	=	1,000 kilowatt-hours (10^3 kWh)
1 Gigawatt-hour (GWh)	=	1 million kilowatt-hours (10^6 kWh)

PRESIDENT'S RECOMMENDATION

This recommendation and the attached Report concerning an operation in favour of Crnogorski elektroprenosni sistem AD ("CGES", or the "Borrower", or the "Company"), a majority state-owned transmission system operator of Montenegro, are submitted for consideration by the Board of Directors.

The facility will consist of a sovereign-guaranteed loan to CGES in the amount of up to EUR 28 million to finance the upgrade of Brezna substation from 110 kV to 400 kV (the "Project") and, if approved by the European Western Balkans Joint Fund (EWBJF), an investment grant [REDACTED]under the European Union's Western Balkans Investment Framework ("WBIF"). [REDACTED]. The EBRD loan will benefit from the sovereign guarantee to be provided by the Ministry of Finance, on behalf of Montenegro.

The primary transition impact of the Project comes from Resilience TI quality, as the Project strengthens the grid and supports the regional market integration through market-coupling with Italy, thus facilitating private investments in at least 200 MW of new renewable energy assets. The expected secondary transition impact of the Project comes from Green TI quality, as it will lead to the reduction of transmission losses by 13 GWh per annum.

Furthermore, the Project is anticipated to bolster energy stability, enhance security and it lays the groundwork for a prospective power link to Sarajevo (BiH), an initiative supported by EBRD in its preliminary feasibility studies.

TC support for this Project is provided under the WBIF.

I am satisfied that the operation is consistent with the Bank's Strategy for *Montenegro 2021-2026, Energy Sector Strategy 2024-2028, Green Economy Transition Approach 2021-2025* and with the Agreement Establishing the Bank.

I recommend that the Board approve the proposed loan substantially on the terms of the attached Report.

Odile Renaud-Basso

BOARD DECISION SHEET

MONTENEGRO – CGES SS BREZNA - DTM 54749	
Transaction / Board Decision	Board approval[2] is sought for a sovereign-guaranteed loan of up to EUR 28 million and, if approved by the EWBJF, an investment grant [REDACTED]under the WBIF in favour of Crnogorski elektroprenosni sistem AD ("**CGES**", or the "**Borrower**", or the "**Company**"), the majority state-owned Montenegrin transmission system operator, to finance the upgrade of the substation Brezna (SS Brezna) from 110/35 kV to 400/110/35 kV by installing two power transformers 400/110 kV, including the works supervision (the **"Project"**). Procurement will be carried out in accordance with the Bank's PP&Rs.
Client	Borrower: CGES, an existing client of the Bank, is the sole transmission system operator (TSO) of Montenegro, majority state-owned (55%), with other large investors including the Italian TSO Terna (22%) and the Serbian TSO EMS (15%). The Company, and therefore the country, represent an important energy hub connecting the Balkans' power network with Western Europe, primarily by the under sea cable connection with Italy. CGES is listed on the Montenegro Stock Exchange [REDACTED]. Guarantor: Montenegro (the "**Guarantor**") through the Ministry of Finance ("**MoF**").
Main Elements of the Proposal	Transition impact: **Primary quality – Resilient.** The Project includes a dedicated TC programme in favour of the energy regulator and other key local stakeholders in support of Montenegro's integration into the EU and regional energy market, and the improved energy security. The project will support integration of more than 200 MW new renewable energy sources into Montenegrin energy system. **Secondary quality – Green.** The Project implementation will lead to reduction of transmission system losses by 13 GWh annually. Additionality stems from tenor which is longer than commonly available to clients in the market, and the EBRD's support with the application [REDACTED]. WBIF investment grant. Sound banking: the Project has standard pricing for sovereign guaranteed loans. The Project benefits from a sovereign guarantee.
Key Risks	Construction delay/cost overrun risk are mitigated through the inclusion of Project capital expenditures in the CGES Regulated Asset Base (RAB) as they occur, and appointment of an international consultant to assist with project preparation, design, procurement, implementation and supervision. Regulatory risk/affordability risk are mitigated by the demonstrated support for the Project from the Regulator. EBRD has a long-standing dialogue with energy-related local authorities, including the Government and respective ministries, the Regulator, the Montenegrin electricity market operator (COTEE), EPCG, CGES and CEDIS.
Strategic Fit Summary	**Strategy for Montenegro 2021-2026**, focuses among others on deepening Montenegro's Green Economy Transition through increased energy and resource efficiency and climate resilience as well as improved performance, service delivery and sustainability of infrastructure. **Energy Sector Strategy 2024-2028**, envisages focusing on investments in modernising and expanding power networks (including transmission, distribution, microgrids) to facilitate electrification, integrate renewables, grow decentralised energy sources, foster energy efficiency and improve loss reduction. **Green Economy Transition Approach 2021-2025**, focuses on aligning its activities with the principles of international climate agreements, including principally the Paris Agreement, and on scaling up investment by innovating across a set of specific environmental and climate mitigation and adaptation thematic areas.

[2] Article 27 of the AEB provides the basis for this decision.

ADDITIONAL SUMMARY TERMS FACTSHEET

EBRD Transaction	Sovereign-guaranteed loan of up to EUR 28 million and, if approved by the European Western Balkans Joint Fund, an investment grant [REDACTED] under the WBIF in favour of CGES, the Montenegrin transmission system operator, to finance the upgrade of the Brezna substation (SS Brezna) from 110/35 kV to 400/110/35 kV. The total project budget amounts to EUR 36 million, with an EBRD-supported WBIF investment grant [REDACTED]. The EBRD loan will be guaranteed by Montenegro. [REDACTED].
Existing Exposure	**CGES**: Total debt (all sovereign guaranteed): EUR 26.3 million (operating assets) under Montenegro: Lastva - Pljevlja Transmission Line (OpID 42768). **Sovereign**: The Bank's total sovereign portfolio in Montenegro as of 7th June 2024 stood at EUR 264 million [REDACTED]. This includes sovereign loans of EUR 26.3 million under the Lastva - Pljevlja Transmission Line (OpID 42768), EUR 35.1 million under the Local Roads Reconstruction Project (OpID 43060, OpID 48169 and OpID 51798), EUR 26.4 million under the main Roads Reconstruction project (OpID 49075), while the remaining exposure is represented by other sovereign guaranteed loans.
Maturity / Repayment	10 years tenor [REDACTED].
Use of Proceeds - Description	The loan and grant proceeds will be used to finance the upgrade of the substation Brezna from 110/35 kV to 400/110 kV by installing two power transformers 400/110 kV and connecting them to the transmission network.
Investment Plan	[REDACTED]
Financing Plan	[REDACTED]
Key Parties Involved	- The Borrower: CGES - The Guarantor: Ministry of Finance (MoF), on behalf of Montenegro - The ministry in charge of energy industry: Ministry of Energy and Mining (MoEM)
Conditions to subscription / disbursement	[REDACTED]
Key Covenants	[REDACTED]
Security / Guarantees	Sovereign guaranteed from Montenegro (S&P: B/B positive outlook / Moody's B1 stable outlook).
Other material agreements	Guarantee Agreement with Montenegro.
Associated Donor Funded TC and Blended Concessional Finance	**Technical Cooperation (TC)** *Pre signing* - TC1: Feasibility Study, ESIA and Preliminary Design for SS Brezna was completed in 2018. Total costs of EUR 600,000 funded by WBIF. An update of the Environmental and Social Impact Assessment and Preliminary Design was completed in December 2022. Total additional costs EUR 450,000 also funded by WBIF. - TC2 Preliminary design for SS Brezna update: The main objective of the assignment is to obtain an Update of the Preliminary design for SS Brezna, including the final geodetic studies for the finalization of documentation. It supports the investment by providing the final document needed for launching the procurement, including an update of the project's total investment budget. Confirmed TC budget of up to EUR 35,000 to be financed from EBRD Shareholder Special Fund (SSF). - TC3: Cross Sectoral Supplementary Environmental and Social Due Diligence and Monitoring Programme. Confirmed TC budget of up to EUR 55,000 to be financed from EBRD Shareholder Special Fund (SSF).

	Post-signing TC4: Support for policy dialogue. Estimated TC budget up to EUR 400,000 planned to be financed by IPA Pillar III. Cost *sharing:* The Company will be responsible for paying all VAT and other indirect taxes that are applied to the post-signing TC assignments where the Company is the contracting party as a Parallel Contribution to the project (VAT is levied at 21 percent in Montenegro). In addition, the Company will make a further Parallel Contribution by financing the cost of the PIU Support consultant and Lenders' Technical Advisor from the proceeds of the loan. The combined cost of these items is expected to be EUR 3,000,000. **Investment Grant**: The Borrower is seeking investment grant support from the EU through the WBIF. [REDACTED]. Public infrastructure investments co-financed with investment grants under the WBIF are exempt from the Blended Concessional Finance Guidelines.

[REDACTED]

INVESTMENT PROPOSAL SUMMARY

1. STRATEGIC FIT AND KEY ISSUES

1.1 STRATEGIC CONTEXT

Investments in renewable energy (RE) and grid infrastructure are crucial for enhancing energy supply, bolstering security, and accelerating decarbonization efforts in Montenegro and the wider Western Balkans region. By diversifying the energy mix with renewables and strengthening transmission networks, countries can reduce reliance on fossil fuels, improve grid reliability, and mitigate the impacts of climate change. These investments not only contribute to a more sustainable energy future but also support economic development and regional cooperation.

Montenegro has emerged as a crucial transmission hub within the Balkans and the European Union, particularly due to its development of undersea cable connections with Italy and transmission lines such as Lastva-Pljevlja, financed by the EBRD (OpID 42768) connecting the cable to the towards the northern part of the country, and the borders with Serbia and Bosnia-Herzegovina. Further strengthening this infrastructure, notably through the development of the SS Brezna substation, will bolster energy security by increasing capacities and attracting investments in renewable energy. This includes several upcoming projects, with an expected addition of at least 200 MW of renewable energy capacity.

The operation will aid Montenegro and the wider Western Balkans region in reducing dependence on coal and lignite for electricity generation. The development of SS Brezna and subsequent renewable energy projects will contribute to increasing the share of green energy production, consequently reducing reliance on coal-fired power plants such as TPP Pljevlja. Currently, the Thermal Power Plant (TPP) Pljevlja with installed capacity of 225 MW supplies 38% of the annual production in Montenegro (data from 2023, varies depending mostly on hydrology due to reliance on two hydro power plants).

Additionally, existing projects such as the operational WPP Krnovo and the future WPP Gvozd (both EBRD-financed) stand to benefit from improved reliability and reduced losses of Brezna SS. The Bank is actively engaged in discussions to support the financing of additional renewable energy capacity, signalling a commitment to furthering Montenegro's renewable energy ambitions and solidifying its position as a key player in the region's energy landscape. The SS Brezna project will also enhance regional connectivity and integration with neighbouring countries, particularly by enabling the construction of the OHL Brezna – Sarajevo (BIH) 400 kV transmission line. EBRD is actively supporting this initiative through technical assistance to develop feasibility studies and environmental assessments.

Moreover, EBRD's collaboration with CGES, Montenegro's transmission system operator, is well-established. The proposed loan for SS Brezna includes favourable tenor and grace periods not typically available in the market, and EBRD is supporting the company's application for an investment grant within the Western Balkans Investment Framework (WBIF). Moreover, in 2023, EBRD has signed a loan extension of the Lastva-Pljevlja project, to urgently procure a critical asset (variable shunt reactor) to secure the stability of the network amid changes in energy demand that caused unacceptable high voltages.

The Project's significance is further underscored by EBRD's close collaboration with Montenegro's Ministry of Energy and Mining to enact new renewable energy (RE) legislation and international auctioning standards, as part of a EUR 1,450,000 comprehensive technical assistance assignment. Montenegro's dedication to aligning its policies with the green

transition acquis is evident, for example by being the first WB country to commit to build no new coal capacity, by launching the first CO2 emissions trading scheme in the WB, in February 2020, or through initiatives such as its participation in the Powering Past Coal Alliance and its commitment to shutting down its coal-fired power plant by 2035. The Government is developing its National energy and climate plan (NECP) with the aim to finish it by the end of June 2024. These initiatives underscore Montenegro's proactive approach towards sustainable energy policies and its position as a leader in embracing the green transition.

Moreover, the Bank has established a productive cooperation with CGES, mainly with the project Transmission Line Lastva-Pljevlja (OpID 46768). EBRD has also signed a loan extension in 2023, to urgently procure a critical asset (variable shunt reactor) to secure the stability of the network amid changes in energy demand that caused unacceptable high voltages. Now, the proposed loan also brings several additional financial aspects, including: 1) tenor and grace period which are longer than available to the client in the market, and 2) the Bank supporting the Company's application for [REDACTED] investment grant within the Western Balkans Investment Framework (WBIF). The Project also benefits from a sovereign guarantee.

The Bank is strongly supporting RE integration and related energy infrastructure investments. Following the proposed loan, EBRD is supporting several further projects, including in the transmission development as well as new RE plants planned by private investors. In 2023, on top of the abovementioned loan extension, the Bank has signed the WPP Gvozd (OpID 50427) with EPCG, the national utility company.

The project is aligned with: 1. **Strategy for Montenegro 2021-2026**, which focuses on deepening Montenegro's Green Economy Transition, 2. **Energy Sector Strategy 2024-2028**, which focuses on investing in the expansion and upgrade of network infrastructure, and 3. **Green Economy Transition Approach 2021-2025**, which focuses on aligning its activities with the principles of international climate agreements.

1.2 TRANSITION IMPACT

The table below sets out the TI Objectives and details of the project.

Primary Quality: Resilient

Obj. No.	Objective	Details
1.1	*The project entails a policy dialogue initiative that has been assessed as Strong Good by the sector economist.*	In line with EU and Energy Community requirements, transmission system operators (TSOs) including CGES have a key role to play in supporting regional market integration through market coupling, in turn supporting energy security and RE penetration at scale (which requires deep/flexible supply and demand outlets to be able to balance RE intermittency at least cost). The latter presupposes and takes place under the guidance, monitoring, and safeguards provided by National Regulatory Authorities (NRAs), which are tasked with ensuring efficient regional market integration and a level-playing field for private sector RE project development and operations. The TC will accordingly assist REGAGEN, Montenegro's NRA, and other key local stakeholders in

Obj. No.	Objective	Details
		dispensing in full their role as effective counterparty to CGES in Montenegro's market coupling process and enabler of a level-playing field for RE in the country, through targeted capacity building and drafting of methodologies wherever appropriate. Also, the implementation of the policy dialogue and the Project will result in the development, construction, and connection to the grid of over 200 megawatts of new renewable energy capacity.

Secondary Quality: Green

Obj. No.	Objective	Details
2.1	*The percentage of EBRD use of proceeds that supports a green economy transition and therefore qualifies as GET finance is 15% or higher.*	The Project is attributed 100% GET. This share has been calculated in line with 2.11 - Brownfield efficiency improvement or reduction of CO2e emissions in transmission or distribution of electricity, heat, cold, low-carbon gases, or CO2. Loss reduction will be achieved as the project will enable delivery of energy from plants connected to Brezna substation directly into higher voltage 400 kV network, instead of overloaded 110 kV network Brezna – Kličevo – Nikšić – Podgorica.
2.2	*The project results in energy savings that exceed 0.1% of annual national energy consumption, so significantly contributes to improved energy efficiency.*	The implementation of the project will result in an annual reduction of 13 GWh in energy losses within the transmission system, equivalent to 0.4% of annual national energy consumption. Additionally, it will result in an annual reduction of 6,133 tCO2e emissions.

1.3 ADDITIONALITY

Identified triggers	Description
A subsequent/consecutive transaction (issuance) with the same client/group either with the same use of proceeds or in the same destination country (**repeat transaction**).	Since 2013, the Bank has been financing the construction and operation of 400 kV high voltage transmission line from the onshore termination of the Italy to Montenegro undersea cable to Pljevlja in Northern Montenegro (OPID 42768). EBRD assistance is needed now to address the CGES`s investment needs, as the required tenor for the transaction is longer than commonly available to CGES on market.
Additionality sources	**Evidence of additionality sources**
Financing Structure: EBRD offers financing that is not available in the market from commercial sources on reasonable **terms and conditions**, e.g. a longer grace period. Such financing is necessary to structure the project.	EBRD is offering financing, which is not available on market. The loan will be provided with a 10-year tenor, including a [REDACTED] grace period.

Standard-setting: helping projects and clients achieve higher standards Client seeks/makes use of EBRD expertise and resources on **best international procurement standards**	EBRD funding and application of Bank's PPR will ensure wider market outreach, particularly in the current high-risk environment.

1.4 KEY RISKS

Risks	Probability / Effect	Comments
Construction delay and cost overrun	Medium / High	Project implementation could be more complex than anticipated, leading to delays and additional cost. ***Mitigation:*** The Project's CAPEX is included into the regulated asset base (RAB) of CGES as they occur, providing a substantial contingency reserve. [REDACTED]. Moreover, the Project will benefit from the expertise of an experienced Project Implementation Unit (PIU) established by CGES. The PIU, with its proven track record in overseeing complex projects, will play a pivotal role in ensuring the efficient and timely implementation of the Project, further enhancing its prospects for success. Also, a Lender's Technical Advisor will be appointed. [REDACTED].
Regulatory risk / affordability risk	Low / High	[REDACTED]. ***Mitigation:*** The Regulator has demonstrated support for the Project. EBRD has a long-standing dialogue with energy-related local authorities, including the Government and respective ministries, the Regulator, EPCG, etc. [REDACTED].
Creditworthiness of the Borrower	Low / Medium	[REDACTED]. ***Mitigation:*** The Team has conducted stress test scenarios in the financial model, demonstrating the Company`s resilience to adverse changes in operational and market conditions and the ability to service its debt in full even if any of those scenarios materialises. The risk is also mitigated by sovereign guarantee from Montenegro.
Sovereign Risk	Low / High	**Montenegro has never defaulted on any of its obligations and its economic outlook remains stable.** S&P affirmed its B/B credit rating with positive outlook on 1 March 2024 and Moody's affirmed its B1 credit rating with stable outlook on 12 September 2023. **Debt sustainability risks are elevated, but manageable.** General government debt peaked in 2020 at 107 per cent of GDP and moderated to 72 per cent of GDP in end-2022 on the back of public debt repayments and strong economic growth. IMF (Staff Concluding Statement of the 2024 Article IV Mission) expects general government debt to decline to around 62 per cent in end-2023, before gradually increasing to 77 per cent of GDP by 2028 due to the anticipated fiscal impact of the reform package 'Europe Now' which IMF expects to lead to permanently lower revenues. Continuing fiscal consolidation and keeping a non-negative primary balance would be needed to reach the debt limit of 60 per cent of GDP. **At 3Q 2023 public debt stood at 60% of GDP**, while the GoM expects public debt

		to increase to 63% of GDP in 2024. Draft Budget 2024 envisages new debt in 2024 to be used for debt repayment and capital investments. Primary income is expected to cover current expenditures, while **budget deficit is projected at 3% of GDP by GoM**.

2. MEASURING / MONITORING SUCCESS

TI indicator(s), primary Quality: Resilient

Obj. No.	Monitoring indicator	Details	Baseline	Target	Due date
1.1	Legal, institutional or regulatory frameworks in target areas improved	At least 50% of REGAGEN professional staff receives training under EBRD TC	No	Yes	[REDACTED]
1.2	Legal, institutional or regulatory frameworks in target areas improved	REGAGEN initiates regular internal trainings in areas of competency	No	Yes	[REDACTED]
1.3	Legal, institutional or regulatory frameworks in target areas improved	Intraday trading on organized market completed (through launch of intraday market)	No	Yes	[REDACTED]
1.4	Legal, institutional or regulatory frameworks in target areas improved	Methodologies for setting appropriate fees for the nominated electricity market operator drafted and approved	No	Yes	[REDACTED]
1.5	Legal, institutional or regulatory frameworks in target areas improved	Cross-zonal trade capacity reaches at least 70%	No	Yes	[REDACTED]
1.6	Legal, institutional or regulatory frameworks in target areas improved	Single Intraday Coupling and Single Day Ahead Coupling with an electricity market in an EU country completed	No	Yes	[REDACTED]
1.7	Legal, institutional or regulatory frameworks in target areas improved	200 MW of new renewable energy capacity installed	No	Yes	[REDACTED]

TI indicator(s), secondary Quality: Green

Obj. No.	Monitoring indicator	Details	Baseline	Target	Due date
2.1	Primary energy saved (GJ/year)	The implementation of the project will result in an annual reduction of 13 GWh of energy losses in the transmission system.	0	46,800	[REDACTED]
2.2	CO2 emissions savings	The implementation of the project will result in an	0	6,133	[REDACTED]

		annual reduction of 6,133 tCO2e emissions reduced			

3. KEY PARTIES

3.1 BORROWER / INVESTEE COMPANY

CGES, the Montenegrin electricity transmission system owner and operator, underwent legal unbundling from EPCG in March 2009. As a joint stock company under Montenegrin law, it is predominantly owned by the government of Montenegro (55%), with significant stakes held by Terna SpA (Terna, the Italian TSO) (22%) and Elektromreža Srbije a.d. Beograd (EMS, the Serbian transmission system operator) (15%). The remainder of CGES's shares are held by investment funds and retail investors, with trading conducted on the Montenegro Stock Exchange.

In 2023, CGES recorded revenues of EUR 111 million, EBITDA of EUR 53 million, and net profit of EUR 37 million, employing 344 staff as of March 2024.

CGES's primary assets comprise electricity transmission lines and substations, alongside operation of the National Dispatching Centre responsible for electricity dispatch and power system operation. Montenegro's electricity system is interconnected with Albania, Bosnia and Herzegovina, Serbia, and Kosovo, with Montenegro presently functioning as a net electricity importer. Domestic generation primarily relies on hydro power, which proves notably cost-effective compared to imports.

REGAGEN, the Energy Regulatory Agency of Montenegro, established in January 2004, regulates CGES's revenues. REGAGEN issues transmission tariff methodologies, determines CGES's permitted revenues, and sets transmission tariffs. CGES operates under a triennial regulatory period specified in the tariff methodology. The regulator determines permitted revenues and resulting transmission tariffs for each of the three years before the commencement of the regulatory period. This methodology enables CGES to recover operating costs and capital expenditures, including those for the Project, which are reflected in the regulator's latest tariff determination for the upcoming regulatory period.

3.2 GUARANTOR

The Guarantor for the project is the Government of Montenegro ("GoM"), represented by the Ministry of Finance. In September 2023, Moody's affirmed Montenegro's long-term sovereign credit rating at 'B1', with a stable outlook. Similarly, in March 2024, S&P confirmed Montenegro's long- and short-term foreign and local currency credit ratings at B/B with a positive outlook.

Montenegro, one of Europe's smallest countries in terms of both area (13,812 km2) and population (620,000 inhabitants), operates as an open economy heavily reliant on tourism. The service sector, constituting nearly 60% of GDP and employing 73% of the workforce, has experienced consistent growth, averaging below 3% annually over the past decade. The 2020 pandemic-induced downturn resulted in an 85% decrease in foreign tourist arrivals, leading to a 15.2% GDP contraction. However, the economy rebounded vigorously in 2021 and 2022, with growth rates of 12.4% and 6.1%, respectively. During the first nine months of 2023, growth accelerated to 6.6%, driven by a 6% rise in household consumption and significant arrivals from abroad, particularly Russian and Ukrainian immigrants.

4. MARKET CONTEXT

- Montenegro has made considerable progress towards meeting its Energy Community Treaty obligations and in liberalising its energy sector. Generation, transmission and distribution are fully unbundled. The transmission system is operated by Crnogorski Elektroprenosni Sistem (CGES), which is entirely independent of EPCG. The transmission and distribution tariffs are regulated by an independent regulatory body.
- The wholesale market is formally deregulated. Montenegro has an open market without regulatory obstacles for new entrants and competition. However, market concentration remains very high with the incumbent covering the whole retail market.
- Montenegro's electricity market has an installed capacity of 1,050 MW, primarily owned by state utility EPCG (874 MW, 82%). The capacity includes two major hydroelectric power plants (HPPs) totalling 649 MW and a coal-fired Thermal Power Plant (TPP) Pljevlja with a capacity of 225 MW. HPPs contribute approximately 44-55% of Montenegro's total electricity output, varying based on annual hydrological conditions.
- The power exchange company BELEN has awarded a contract for providing of day-ahead trading, clearing and settlement platform services to a consortium of companies, paving the way for a soon-operational MEPX (Montenegrin Power Exchange).
- Montenegro's strategic geographical position makes it a significant hub for energy trade within the Balkans, with interconnections to Bosnia-Herzegovina, Serbia, Kosovo, Albania, and a recent link to Italy via an undersea cable. The undersea cable capacity is expected to double to 1,200 MW by the end of 2024. This expansion underscores the growing importance of Montenegro as a key player in regional energy systems and positions the country to further capitalize on opportunities for energy trade and market integration by coupling its market with Italy and other neighbouring countries.
- The construction of a high-voltage transmission line, funded by the EBRD, strengthens Montenegro's connectivity and facilitates electricity exchanges between regions.
- Montenegro's decarbonization initiative includes commitments to abstain from developing new coal capacity and significant investments in renewable energy.
- Initiatives such as the region's inaugural CO2 emissions trading scheme and a pledge to shut down the coal-fired power plant by 2035 highlight Montenegro's dedication to environmental responsibility.
- Montenegro is developing a National Energy and Climate Plan (NECP) with assistance from German GIZ, serving as a roadmap toward sustainable energy practices.
- The government, with support from the EBRD, aims to attract private investments in renewable energy through organized auctions, accompanied by reforms to the regulatory framework and technical assistance in drafting legislation.
- The forthcoming adoption of a new Renewable Energy Law is anticipated to further accelerate Montenegro's transition to a greener and more resilient energy landscape.

  Please, see more details in *Annex 7*.

5. FINANCIAL / ECONOMIC ANALYSIS

5.1 FINANCIAL PROJECTIONS

[REDACTED]

5.2 SENSITIVITY ANALYSIS

[REDACTED]

5.3 PROJECTED PROFITABILITY FOR THE BANK

[REDACTED]

6. OTHER KEY CONSIDERATIONS

6.1 ENVIRONMENT

Category B (ESP 2019). The upgrade of an existing medium-voltage substation is not associated with significant environmental and social risks. The site is not in a sensitive area or subject to ongoing Environmental local permitting following screening by the environmental authority. The ESDD have been carried out by a third-party consultant and included a visit of the site, review of the E&S studies already available and an E&S assessment of the project against EBRD PRs. Key risks identified are occupational and community Health & safety during construction phase.

Overall, the ongoing ESDD has shown that CGES has E&S policies and procedures in place to the project, which will be further updated with the impact mitigation measures outlined in the E&S assessment. The E&S management system, including OHS management, will be cascaded to the Project's EPC and subcontractors for implementation, along with construction-ESMPs. The Client will cascade its HR policy to the whole workforce, including contractors and subcontractors. Any workers' accommodation set-up will comply with the corresponding IFC-EBRD standard; albeit the number of personnel during the construction will be small. Although the project is a brownfield development, additional geotechnical studies have been carried out and concluded that the characteristics of the ground would allow the extension.

Soil, air emissions, water, noise, waste and traffic management plans will be prepared by the contractor prior to construction. Electromagnetic field and noise monitoring plan will also be prepared prior to operation phase to further comply with the Montenegrin regulation.

It is anticipated that the land acquisition process will involve several private owners, which will be based on a willing buyer-seller approach and PR 5 will not be triggered. However, the Company will prepare a Land Acquisition and Livelihood Restauration Plan as part of its management system. The project will have limited impacts on biodiversity and appropriate mitigation measures will be implemented to address corresponding residual impact in line with Montenegrin laws and EBRD corresponding requirements. No evidence of tangible or intangible cultural heritage has been found, confirmed by the competent national authorities.

While early engagement with the authorities and adjacent communities has been provided by the consultant responsible of the E&S assessment, it is expected that CGES expand the presentations and consultations related to the project to the relevant stakeholders.

Based on the ESDD, an Environmental and Social Action Plan (ESAP), Non-Technical Summary (NTS) as well as a Stakeholder Engagement Plan (SEP) have been developed to structure the project in line with EBRD PRs and will be agreed with the Client prior to Board. SEP and NTS will be disclosed together with PSD on the Bank website.

CGES will report on the E&S performance of the project and ESAP progress to the Bank annually.

6.2 INTEGRITY

In conjunction with OCCO, integrity due diligence was undertaken on CGES, its Board of Directors and executive management. [REDACTED].

All actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the Project, and the Project files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the Project.

6.3 OTHER ISSUES

Concessional Finance – The Project will be supported with [REDACTED] investment grant by WBIF [REDACTED].

The project will support alignment with the basic goals of EU and Montenegrin energy policy with the main outcomes contributing to increasing production of electricity from the renewable energy sources, improvement of security of supply through cross-border electricity connection, integration of renewable generation and rational use of energy resources.

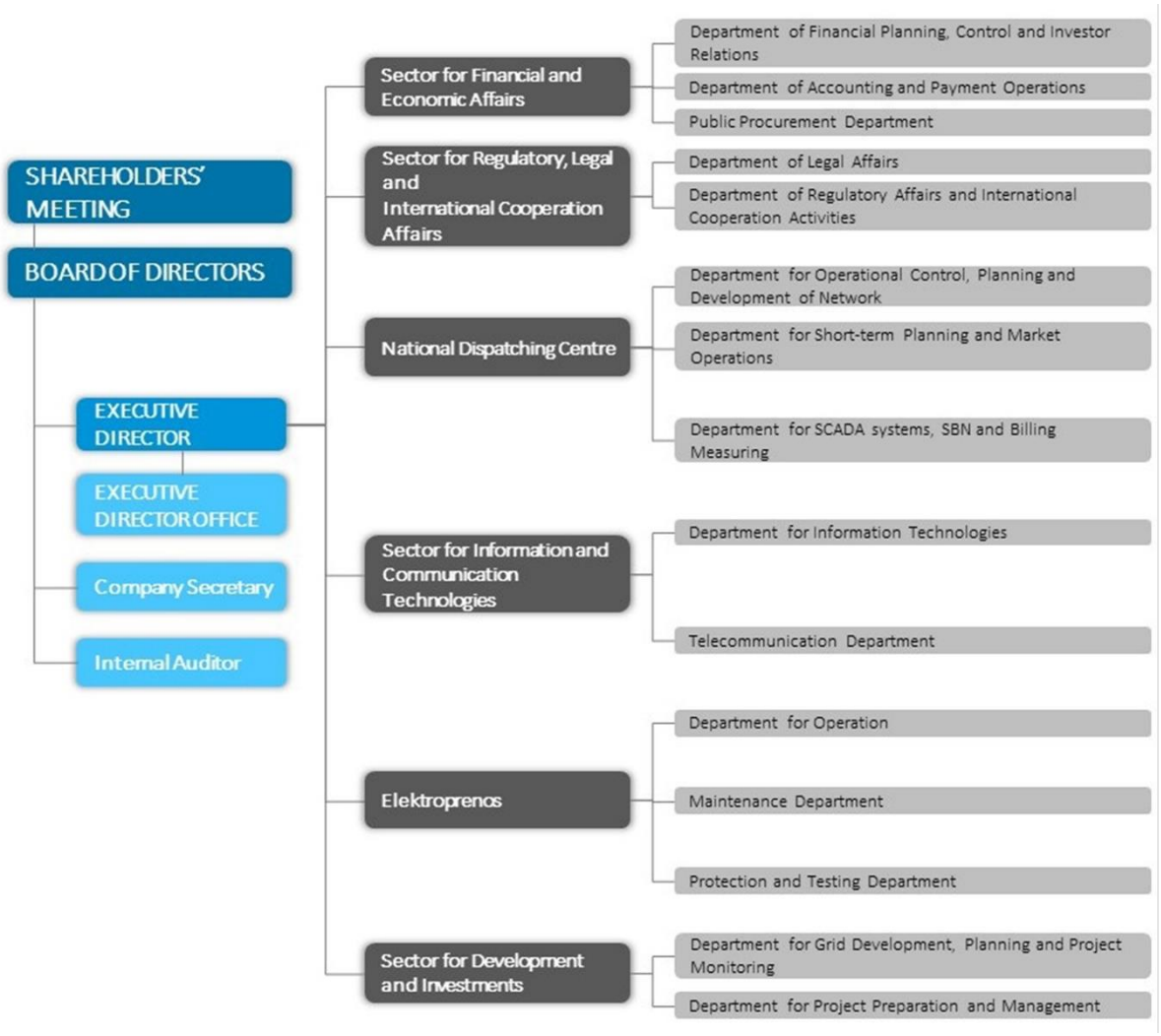
The investment grant by WBIF is required to secure timely implementation of the project and ensure that the risk of cancelation/delay will be mitigated with the higher grant amount. [REDACTED].

ANNEXES TO OPERATION REPORT

ANNEX 1	Shareholding Structure and Organisation Chart
ANNEX 2	Historical Financial Statements
ANNEX 3	Project Implementation (Procurement Plan)
ANNEX 4	Transition Impact Scoring Chart
ANNEX 5	Green Assessment Summary

ANNEX 1 – SHAREHOLDING STRUCTURE AND ORGANISATION CHART

Owner	% of shares
Montenegro	55.4%
Terna - Rete elettrica nazionale S.p.A.	22.1%
Elektromreža Srbije Beograd	15.0%
Other <0.5% each	7.5%
Total	**100%**



ANNEX 2 – HISTORICAL FINANCIAL STATEMENTS

[REDACTED]

ANNEX 3 – PROJECT IMPLEMENTATION (PROCUREMENT PLAN)

Procurement classification – *Public sovereign*

Project risk assessment:

[REDACTED]

The Client is CGES, the Montenegrin transmission system operator that owns and operates substations and transmission lines at 400kV, 220kV, and 110kV voltage level. CGES is an existing client of the Bank. The company has limited previous experience with IFIs, and some familiarity with EBRD rules and procedures.

CGES will establish the Project Implementation Unit (PIU) for the purpose of implementation of the project. Given the limited experience, the PIU will be supported by a PIU support consultant, appointed competitively in accordance with the EBRD Procurement Policies and Rules ("PP&R).

Contracts risk assessment - *High/Moderate*

The contract proposed to be co-financed from the Bank's loan and WBIF investment grant is detailed in the attached Procurement Plan. The support of an experienced consultant will ensure that technical specifications, employer's requirements and tender documents are suitable for open tendering and aligned with the Bank's PP&R.

The nature of the CAPEX contract, which includes the upgrade of the sub-station and the procurement of the power transformers, is generally considered of high/medium complexity, and has an equivalent degree of implementation risk. The risk will be mitigated by the appointment of an implementation consultant what will support the Client along the entire project cycle.

Project implementation arrangements:

The project will be implemented by CGES, which oversees the operation and maintenance of the transmission system in Montenegro. The PIU will be established by CGES and will be supported by an international consultant. These arrangements will address the risks and ensure smooth project implementation.

The PIU consultant will assist the PIU in all aspects of implementation and in meeting the requirements of the Bank's Financing Documents. In particular, the consultant will provide support in the areas of project preparation, preparation of tender documents (including technical specifications), and works supervision.
As it is envisaged that the same PIU will be also implementing the project OHL Vilusi – Herceg Novi (Op ID 55011), it has been foreseen that the same consultant will work on both projects. The assignment will be entirely financed through the proceeds of this project.

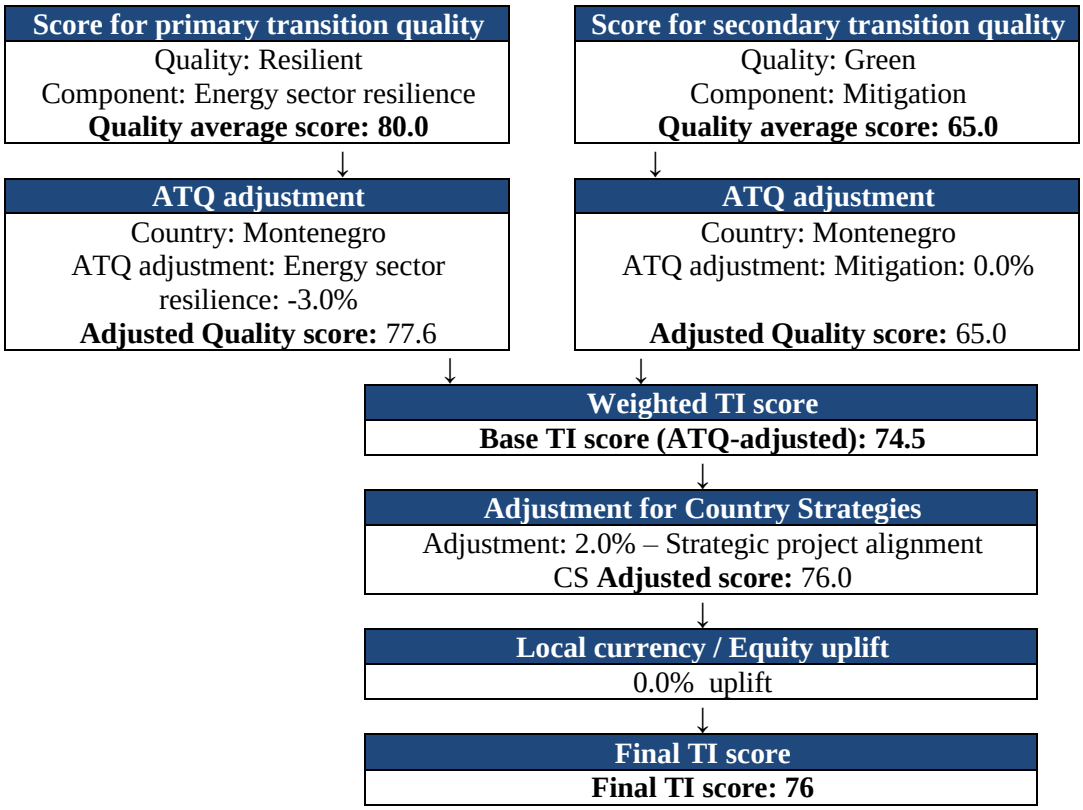
Procurement arrangements:

It is envisaged one CAPEX contract covering civil works for upgrading the substation and procuring the power transformers. The contract will be co-financed by the proceeds of the Bank's loan and WBIF investment grant. The contract will be procured following open tendering procedures in accordance with the requirements of the Bank's PP&R for public sector operations. The related tender documents will be based on the latest version of the Bank's standard procurement documents for procurement of works.

The project also envisages one technical cooperation contract for PIU support consultant, which will be selected through competitive selection procedure.

The contracts will be tendered via the EBRD Client E-Procurement Portal (ECEPP) and will be subject to prior review. [REDACTED].

ANNEX 4 - TRANSITION IMPACT SCORING CHART



ANNEX 5 – GREEN ASSESSMENTS

SUMMARY

- The Project is determined **aligned with both mitigation and adaptation goals of the Paris Agreement.**
- The project is attributed **100% GET.**
- [REDACTED]**.**

PARIS ALIGNMENT ASSESSMENT

Alignment with the mitigation goals of Paris Agreement

The project is determined as aligned with the mitigation goals of the Paris Agreement based on the application of the Bank's Paris alignment approach for direct finance.

- The projects activity is included in the 'MDBs' aligned list' under the category "electricity transmission and distribution, including energy access, energy storage and demand-side management".
- There are no activities included in the 'non-aligned list'.

Alignment with the adaptation goals of Paris Agreement

The project is determined as aligned with the adaptation goals of the Paris Agreement as it satisfies all three steps of the assessment. The physical climate risks identified under the screening have been assessed as non-material.

GET ATTRIBUTION

The Project is attributed 100% GET. This share has been calculated in line with 2.11 - Brownfield efficiency improvement or reduction of CO_2e emissions in transmission or distribution of electricity, heat, cold, low-carbon gases, or CO_2. Loss reduction will be achieved as the project will enable delivery of energy from plants connected to Brezna substation directly into higher voltage 400 kV network, instead of overloaded 110 kV network Brezna – Kličevo – Nikšić – Podgorica. Expected savings are estimated at 13.02 GWh/year, translating into emissions savings of 6,133 CO2/annum using the firm grid emissions factor for Montenegro.