The Project
In 2007 the Board approved an investment in the Company for the development of a number of retail centres (the "Project"). The investment consisted initially of an equity subscription followed by a loan in 2008 to support the completion of one of the retail centres as part of the Bank's crisis response package, as a commercial bank loan became unavailable. The Project supported a real estate company that would construct and own a number of retail centres in the regions of one of the EBRD's countries of operations, to be leased on long-term contracts. In total, one leading retailer, an unrelated party (the operational company), was to lease around 80 per cent of the total rental space. The Bank's exit is planned through a trade sale or an initial public offering (IPO). If a full exit has not taken place by the predetermined date or exit proposal falls below those criteria, the Bank has the right to market the Company through an independent broker.

Financing plan. The financing plan considered a moderate leverage of up to 41 per cent of total Project cost as equity provided by the shareholders and up to 60 per cent from the Bank's debt. The shareholders provided additional capital in stand-by equity to face possible cost deviations. The contribution became necessary in 2008, as Project costs exceeded the initial budget. As the planned external debt became unavailable due to the impact of the financial crisis, the Bank responded by approving an additional loan in 2008 to finance the completion of one of the subprojects under construction.

Project rationale and relevance
The Project is consistent with the Bank's strategy for the country of operations, which calls for *"higher efficiency, competitiveness and diversification of the economy, improving corporate governance standards in the local private sector and assisting foreign direct investment"*; and specifically in regards to similar projects to *"promote the development of logistics and warehouse infrastructure and increase the supply of […] modern format retail premises in major cities."* The Project is also consistent with the Property Operations Policy which calls in early/intermediate countries to *"selectively support projects that promote better logistics and retail infrastructure in response to demand"*. It should be noted that consistency with the Bank's policies and most of the transition impact (TI) achievements are directly related to the ultimate support to the expansion of the retail chain, not just the real estate project. The support through a pure equity investment was also consistent with the Bank's Property Operations Policy for early/intermediate countries, which foresees that *"in select cases, pure equity may be considered when the risk/return balance can be justified by market circumstances"*. The continued support with a loan for the development of one of the centres under construction was also consistent with the Bank's crisis response package.

Achievement of objectives
The overall achievement of the Project objectives is rated ***Satisfactory***. A number of subprojects have been completed (one of them with a delay of nearly two years, delaying the generation of income). As the unfinished centres were those of larger size, the completed projects represent just under 60 per cent of the total initially envisaged area. Overall, cost deviation of the completed projects has been around 26 per cent over the budget. Although the performance must be taken into consideration in the context of the financial crisis, it should be noted that some of the unfinished centres have failed not due to the market circumstances specifically derived from the financial crisis but due to unavailability of the land plot in one case and to the Company's decision to withdraw from the second one to due to increased competition. The constructed centres are fully leased, generating revenue in line with projections.

Overall assessment
The Project is rated overall as ***Partly Successful***. The Bank's financial performance is directly affected by the lower-than-expected completion of Project objectives, as the Bank's exposure is through direct equity, and (based on the most recent valuation) would represent a decrease in the Bank's investment, providing for an *Unsatisfactory* Bank's investment performance.

TI is overall rated ***Good/Satisfactory***. Some positive elements have taken place mainly in relation to the market expansion and demonstration effect resulting from the development of a modern retail distribution chain. Expansion in the regions has, however, been limited, as only a half of the developed centres are out of the capital's region, but the commercial viability of the business model provides positive expectations as to the future development in the regions. Although the support of the Bank has been to the real estate company, most of the TI achievements are related to the expansion of the operational company. While the investment in the Project was structured through a real estate subsidiary, the assessment of the Project cannot limit itself to the real estate investment, and TI and financial performance of the operational company are relevant to the overall assessment of the Project. However the lack of access to the operational company's financial performance provides concern about the TI attached to it and is viewed as a structuring flaw.

Additionality is rated ***Verified in All Respects***. By providing an equity investment, the Bank was participating in the full equity risk in an almost venture capital stage of the Project, which was highly relevant to the ambitious expansion plans of the Company that the capital markets at the time were not in a position to provide. The further support provided by the loan to one of the subsidiaries as part of the Bank's crisis response package was highly additional given the market circumstances, unavailability of commercial bank funding and the crucial stage of the subproject to be completed.

Bank handling of the Project is rated ***Unsatisfactory***. A number of issues leave room for improvement and provide the basis for the lessons learned. These mainly relate to the structuring and monitoring of the Project: lack of access to financial information of the operational company, delay in appointing an independent CEO and limited due diligence in relation to the status of "ownership" of the land plots, the Company's entry valuation, absence of phasing and monitoring of environmental issues.

Key issues and lessons learned

Lesson: Project monitoring requirements should consider including provision of financial performance of relevant related parties. When the performance of an investee company relies heavily on the financial performance of a related party, the structuring of the monitoring requirements should contemplate access to the performance and financial information of such related party.

Lesson: Importance of incorporating mitigating measure in cases of potential conflicts of interest between shareholders. In cases where there may be a conflict of interest between shareholders due to potential related party risks, it is important to incorporate provisions in the Project agreements to protect the Bank's and other minority shareholders' rights, including the appointment of an independent CEO, and to make sure that such commitments are effective and met in due course.

Lesson: When valuing companies in an early stage of development for the purposes of pricing the Bank's entry, discounted cash flow (DCF) alone may not be the best method of valuation. It should consider what the most adequate methods of valuation are, including initial shareholders' contributions, nominal value of the shares, valuation of the company's assets and DCF. DCF on its own may not provide an adequate value given the early stage of development and risk of not full completion. A scenario analysis related to the chances of certain degrees of completion of the project envisaged could provide insight on the expected risks and returns.

Lesson: Importance of transparency in disclosing effective entry value for the Bank's investment and return implications for the Bank. It is important to disclose clearly in the internal documents the effective price paid by the Bank when entering in equity transactions that involve additional compensation mechanisms and to provide clarity on the implications of such compensation for the expected return on the Bank's investment at exit.

Lesson: Considering the possibility of phasing-in projects where a number of independent facilities are to be developed. While it is advisable to develop a comprehensive business plan that reflects the strategy of the company to develop an extensive network of centres, the project design and the provisioning of funds from the Bank could contemplate a phased development to better monitor the completion of each of the centres, extract lessons from the successes/failures in the development of the first centres to be implemented in the development of the subsequent centres, making the provisioning of funds for the new centres conditional to achieving certain monitoring milestones. The nature of the Project allowed for phasing of the Project that could have provided for a better and more gradual assessment of the Bank's involvement and commitment.

Lesson: PD (Procurement Department) and OCCO's (Office of the Chief Compliance Officer's) early involvement is important to make sure that there is no doubt on the integrity of the process by which

the clients gained access to the land plots. The process of granting access to land plots, especially through acquisition of long-term leases from municipalities and government institutions, is often not sufficiently transparent in many of the Bank's countries of operations. The new integrity guidelines require OCCO's involvement in all real estate projects. Early involvement of PD and OCCO is important to make sure that procurement processes are in line with the Bank's Procurement Policies and Rules (PP&R) and that there is no doubt on the transparency and integrity of the process by which the clients gained access to the land plots.

Lesson: Realistically assess possibilities of construction cost deviations and put mitigating measures in place. In projects with a long development horizon it is important to consider the possibility of increased cost overruns, especially when the inception of the project takes place in a moment of booming markets, and to anticipate alternative means of financing of possible cost overruns. Stand-by equity to be provided by all shareholders if needed can minimise financial stress and guarantee the completion of the Project if a cost overrun situation comes along.

Lesson: Early coordination with energy efficiency and climate change (E2C2) for identifying and exploring energy efficiency potentials. When presented with opportunities, the Banking team should work with the E2C2 team and its financial institution (FI) partners to capitalise on the opportunity to actively promote energy efficiency in our countries of operations.