

KOSTT – Kosovo Transmission Development Project

State Sector Project Assessment

Prepared in line with the EBRD's Access to Information Policy¹

Country	Kosovo
Sector	Energy
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Operation Description

Client: KOSTT (the “Company”, or the “Borrower”) is the operator of the Kosovo electricity transmission system established on 1 July 2006 following the legal unbundling of the electricity system in Kosovo (former Korporata Energjitike e Kosoves “KEK”). KOSTT acts as the Transmission System and Electricity Market Operator and its main responsibilities include operation and maintenance of the Kosovo electricity transmission system. KOSTT is also the PPA off-taker for renewable energy sources.

The Kosovo transmission system consists of 400kV, 220 kV and 110 kV transmission lines with an overall length of 1'410.5 km (1'212 km at approval) and operates 37 (34 at approval) electricity substations to date. The transmission system has an installed capacity to support a domestic load of up to (1,700 MW (the current peak load is around 1,260 MW). The Kosovo transmission network is linked to the neighbouring countries through 8 interconnection lines.

KOSTT is 100% owned by the Republic of Kosovo and shareholder rights are exercised through the Ministry of Economy. KOSTT operates as a natural monopoly and its operations are entirely regulated by the Kosovo energy regulator.

EBRD's financing and deal structure: The facility consisted of an unsecured corporate loan to KOSTT in the amount of EUR 30 million that enabled KOSTT to finance purchase and installation of new equipment construction, rehabilitation, and placing into operation selected substations, transformers, and electricity transmission lines in Kosovo , including: i) the 110kV line from substation Rahoveci to substation Theranda, ii) the substation Malisheva, iii), the substation Mitrovica 2, iv) the substation Prishtina 6, v) the substation Fushë Kosova (“the Project”). The Project was part of the 4 year capital

¹ As required by Section IV paragraph 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose information (excluding Confidential information) contained in Operational Performance Assessment (OPA) reports for State Sector Projects selected for extended review, within 60 calendar days after completion of the relevant OPA report.

investment plan approved by the Kosovo Energy Regulatory Office (ERO). The envisaged maturity was 15 year tenor.

Changes to the scope or design of the project following approval: In 2016, the loan agreement was amended to replace Malisheva substation and incorporate Drenasi substation as part of the Project. The amendment was approved through a Monthly Information Report ("MIR").

Previous operations with client: There were no previous operations with this client.

The operation represents the first non-sovereign guaranteed loan to a public company in Kosovo and was intended to serve as a demonstration to both domestic and international financiers. The operation was designed to help KOSTT to improve the stability and reliability of the power system by reducing inefficiencies and bottlenecks in the transmission network. This is a key technical requirement for KOSTT to join the European Network of Transmission System Operators for Electricity (ENTSO-E), which seeks to promote market integration and transparency in electricity transmission. Because of Kosovo's location and the importance of transit across Kosovo for the power market in the region, the Project has important national and regional benefits.

Relevance

The Project was consistent with EBRD's Country Strategy for Kosovo for the period 2013-2016 which emphasised the importance of promoting and supporting sustainable development of the energy sector. The Strategy specified that the upgrade of the network infrastructure was critical to address the transition challenges in the energy sector and EBRD would cooperate with the authorities in Kosovo to support the required investment to ensure security of supply.

In addition, the Project has been consistent with EBRD's Energy Strategy by helping to improve supply side energy efficiency (one of the key pillars of the Energy Strategy). The Strategy noted that the Bank would support investments in electricity transmission and distribution networks which reduce commercial or technical losses' in order to help reduce bottlenecks and improve resource efficiency across the energy value chain.

By participating in this transaction, the Bank has supported Kosovo's Transmission System Operator ("TSO"), a State Owned Entity ("SoE"), to invest in capex upgrades in transmission networks, improving electricity supply and efficiency, and security of supply, consistent with the EBRD's Energy Strategy and Country Strategy. The Bank's loan financed part of the EUR 120m four-year capex programme from 2015 to 2018, approved by the regulator.

Recognising the priority of promoting and supporting sustainable development of the energy sector, the Bank accelerated KOSTT's adherence to ENTSO-E's standards, since the financed rehabilitation of substations and transformers also aimed at meeting the technical requirements for joining ENTSO-E.

The transaction's structure allowed for a successful implementation of the Company's capex plan.

- i) The suitability of the structure for the client and the objectives

Through this Project, the client's objectives were to improve stability and reliability of the transmission network. These represented key technical requirements for KOSTT to join the ENTSO-E (the organisation of

European electricity transmission system operators), which achieved a key milestone in 2021.

Despite being a public company in Kosovo, KOSTT aimed to raise CAPEX funding on commercial basis, without having to seek sovereign support, supported by the regulatory framework in place that would allow the Company to recover investment through long term tariff revenues. The Bank's financing structure matched the Company's regulatory environment and ability to finance investment and repay the financing.

The Project was implemented in accordance with the Bank's environmental and social policy and the Bank's involvement ensured that transparent and efficient procurement procedures were followed.

- ii) The integration of elements such as donor funded activities and policy dialogue with financing

The Bank was able to mobilise TC funds used to support KOSTT to prepare and implement the investment programme and to build in-house capacity to manage new responsibilities arising with ENTSO-E membership. Key ENTSO-E responsibilities include management of cross border capacity and interconnections, and provision of ancillary services such as balancing, frequency control, voltage support and compensation of active power losses. Consultants worked alongside KOSTT to accommodate investment implementation with internal capacity building. This support was critical to KOSTT during the pre ENTSO-e membership phase. In addition, KOSTT has benefitted from associated TC also in relation to Environmental and Social due diligence.

- iii) The completeness and clarity of specification of results

The anticipated results from the transition impact brought by this operation stemmed from demonstration effects, expansion of competitive markets and setting of standards of corporate governance and business conduct.

The results were specified by the overall goal of the ENTSO-E membership but also included more granular steps and sub-components that would allow the Company to reach the main objectives (e.g. completion of relevant investments, acquiring technical capacity to independently perform the role of System and Market Operator, having adequate systems and procedures in place to conduct business etc.). Overall specification of results was thorough and clear.

- iv) The adequacy of TIMS benchmarks and other indicators to monitor and measure results

TIMS benchmarks were largely aligned with the project's objectives and covered a number of components in addition to the physical completion of investments.

- v) Integration of risk assessments and experience from earlier projects in helping to shape design

Following the risk mapping analysis on this Project there were two main risk areas anticipated and incorporated in the project design as follows:

Regulatory context and tariff affordability: Prior to approval, the Project obtained support from the Energy Regulator, which agreed to include the related capex within the regulated asset base of the TSO over the five-year regulatory period. Furthermore, the ERO implemented tariff increases following the loan disbursement and this led to improved debt service capacity of the Borrower receiving sufficient revenues to recover its investment and financing cost.

Procurement and Project Implementation: KOSTT had some earlier experience in implementing international bids under IFIs funded projects, although it was a new client for the EBRD. Prior to approval, the project team's Senior Business Procurement Specialist undertook a Capacity Assessment of KOSTT, focusing on sections relating to legal framework, organisation, staffing, records, procurement planning & cycle and project risk.

The Project' scope also included external support by international consultants to the established Project Implementation Unit (PIU) within KOSTT, staffed with experienced local experts. The PIU supporting assignment was part of the TC financing package provided by the EBRD Shareholder Special Fund (EUR 0.8m) and the New Norway Cooperation Fund (EUR 1.2m).

The additionality aspect of the Project is fully compliant with the identified criteria at the Board approval stage. This operation anticipated three dimensions for the Bank's additionality which have been duly achieved and completed:

- i) Unavailability of long term debt financing in Kosovo: The Bank's participation was essential for the realisation of this Project due to the lack of available long term debt financing capacity in Kosovo which is still observed to the present date.
- ii) This was the first public sector loan in Kosovo without sovereign guarantee: This transaction was the first and remains the only loan provided to a Kosovo SoE without obtaining a sovereign guarantee. Local commercial banks are to this date not participating in financing SoE with this risk profile. Hence, the Bank proved to be additional in the financing of this Project.
- iii) EBRD environmental and procurement requirements: the Project has been implemented in accordance with the Bank's environmental and social policy requirements. The Bank's involvement ensured that transparent and efficient procurement procedures were followed. The Bank required the establishment of a PIU, supported by experienced international consultants, responsible for implementing the Project. The ESAP implementation was covenanted and the Borrower has duly met this requirement.

Effectiveness

The majority of Project's TI benchmarks have been achieved. The final TI assessment for the Project was completed in 2021. The Project's PTI/Risk were rated Good/Negligible with a PTI rating of 90, above the original ETI score envisaged at 80.

TIMS ratings	Original	Conclusion
Transition impact risk	High	Negligible
ETI / PTI	80	90

Transition impact objectives

i) Expansion of competitive markets interactions in other sectors.

- a. Kosovan transmission system becomes fully compliant with N-1 criteria - ACHIEVED

KOSTT became technically ready and compliant, as confirmed upon signing the Connection Agreement with ENTSO-E (effective by end of 2020) which allowed KOSTT to operate independently in the newly established Kosovo-Albania Regulatory block, under the synchronous area of Continental Europe. This is an important milestone on the way to attain ENTSO-E membership and to integrate in the regional energy market. Moreover, KOSTT is now able to manage its border capacity providing additional transition impact through the improvement of cross border allocation.

- b. KOSTT fully participates in the CAO - ACHIEVED

KOSTT is a shareholder in and member of SEE CAO and following the Connection Agreement with ENTSO-E, started the capacity allocation auctions.

- c. KOSTT operationally and procedurally ready to become a full member of ENTSO-E - ACHIEVED

KOSTT has signed the Connection Agreement with ENTSO-E during 2020.

ii) Setting standards for corporate governance and business conduct

- a. KOSTT to independently manage cross border capacity and interconnections and provision of ancillary services - ACHIEVED

KOSTT is an independent control block and able to manage its cross border capacity autonomously.

- b. Transmission losses remain below 2% - ACHIEVED

Recurring Technical Losses have been around 1.7%-1.8% in recent years.

- c. Have a system in place to accurately monitor and manage Average Interruption Time (AIT) based on recognised measures System Average Interruption Frequency Index (SAIFI) and System Average Interruption Duration Index (SAIDI) - ACHIEVED

A system has been put in place and the Company is able to monitor AIT based on SAIFI and SAIDI.

- d. The training of staff responsible for System and Market Operation Completed - ACHIEVED

A consultant has been working with KOSTT on Capacity Building² and the assignment on staff training has been completed.

iii) Demonstration of new replicable behaviour/activities

a. Successful disbursement of the loan - ACHIEVED

The loan agreement was signed in 2014 while the Bank started disbursing in November 2016. EUR 28m out of EUR 30m were ultimately disbursed and EUR 2.1m cancelled due to project cost savings and improvements in operational cash position of KOSTT.

b. At least two significant non-sovereign guaranteed loans signed in Kosovo without EBRD involvement - PARTIALLY ACHIEVED

No loans provided by commercial banks in Kosovo could be identified as “significant” or considered as a result of the demonstration effect by the Bank’s Project with KOSTT, although the overall level of the commercial lending in Kosovo increased significantly since the Project signing.

The Project has played major role in demonstrating that the Kosovo energy sector is self-sustainable and well governed / regulated, which led to RES framework discussions and ultimately to EUR 220m investment in wind projects, co-financed by commercial banks. In addition to this, the success of the Project became an important reference point to EBRD in its internal and external discussions and other preparation work that ultimately led to several other commercial (non-sovereign) loans to other energy SOEs in the Western Balkans and as such was a precursor to many private energy projects (co-financed by commercial banks) in the region. As such, the demonstration of the Project’s features and success contributed to EBRD’s efforts and results in developing sustainable energy market in the Western Balkans region. This result was reflected in the PARTIALLY ACHIEVED assessment.

The overall business results of the Project were

i) capex implementation within budget and timeline

Overall the project implementation was expected to be completed by end of 2018, but had been delayed mainly due to permitting procedures of some parts of the Project taking longer than anticipated. Contracts were extended and the revised implementation was partially completed in 2019, with some contracts being extended to 2020 and further to 2021 (partly due to Covid-19). All substation works have been completed and the substations are operational. There were no significant cost overruns. The Company mostly achieved the operational objectives of the Project. The capex implementation was completed by 2021 and the investments resulted in improved quality and efficiency of electricity transmission in Kosovo and agreement with ENTSO-E.

ii) Procurement and timely delivery

All procurement under the project was successfully managed via the Bank’s ECEPP (EBRD Client E-Procurement Portal) system, and the procurement of works contracts was completed by the end of 2016, about two years after the EBRD Loan signing (in October 2014). The Client KOSTT was in fact one of the pilots using the newly developed ECEPP system. KOSTT

successfully managed to use the system with the assistance of the PIU Consultant. The works contracts under the project consisting of (i) GIS Substations, (ii) Power Transformers and (iii) Transmission Lines and Cables were effectively implemented and completed with minor delays.

iii) Compliance with financial and other covenants

Since the loan disbursement, the Borrower has mostly complied with the covenanted requirements. The increase of tariffs in 2018 helped the Company improving its financial indicators, whereas the current energy crisis and higher costs of importing electricity are starting to cause liquidity pressure to KOSTT.

The Company has been facing limitations in identifying local insurance companies willing to take over its assets, and to date it has not yet been able to put in place an insurance programme. The Company has progressed internally by producing a risk management policy that includes its approach to insurance and also sought to cooperate with other TSOs to understand the approach and market practice with regards to insurance. The Company intends to keep exploring ways to attract potential interested insurers.

The Project incorporated associated donor-funded activities with an overall amount of donor funds allocated to the TCs at EUR 2m (out of which EUR 0.8m from EBRD Shareholder Special Fund and EUR 1.2m from The New Norway Cooperation Fund). The TC included:

- i) Project Implementation Support to PIU to provide organisational and technical assistance to KOSTT's PIU to ensure the successful procurement and implementation of investment components funded by the EBRD in accordance with the Project Implementation Plan ("PIP") and with the Bank's requirements stipulated in the Loan Agreement.
- ii) Capacity Building to assist KOSTT in the management of responsibilities assumed under ENTSO-E membership, and in responding to developments in the liberalisation of Kosovo's power market.

The TC supported the Company and the objectives of the Project. The Borrower had limited financial resources and needed an experienced international consultant to work alongside its own PIU to procure and implement the EBRD funded investment. The PIU Consultant assisted KOSTT in the preparation (procurement by using ECEPP, tendering, and contracting) of the EBRD funded investments and support KOSTT in building capacity that allowed the company to independently manage responsibilities assumed under ENTSO-E membership and to deal with developments in power market design that require revision of the Kosovo network codes.

Efficiency

The implementation of the Project did not require any significant changes to the original structure except for a minor change in use of proceeds. The intended use of proceeds occurred without material changes to the initial

² Consultant's responsibilities included drafting a procedure for Congestion Management in the SEE region, assisting in preparation of operational procedures for the Control Room, developing procedures for commercial purchasing of transmission losses, provision of ancillary services, balancing mechanism, implementation of ENTSO-E Operational Handbook etc.

budget. The disbursements under the Loan were slightly delayed and there was a small unutilised portion which was cancelled at the end of the expiry period. There have been no procurement issues. All procurement processes by using the Bank's ECEPP system have been completed successfully.

The overall monitoring, reporting and covenants compliance has been in good order. The team has been involved with the Company to accommodate extensions to contract timelines as a result of permitting/construction delays.

The Bank's support to implement the Project was critical for the Client to progress on the ENTSO-E membership. The Bank has a good relationship with the client management with regular communication. The team is closely monitoring the business conditions and challenges that KOSTT has been facing from time to time. There are no particular concerns observed that could undermine the client relation so far.

The Bank also had an important role in supporting the Company to meet the actions agreed in the Environmental and Social Action Plan (ESAP).

The project introduced good international EHS management practices to strengthen the institutional processes.

The Project was considered as Category B at Board Approval and was structured to meet National Legislation, relevant EU directives and EBRD Environmental and Social standards. The new 110 kV lines were not located within sensitive ecological habitats (equivalent to Natura 2000 areas) nor within residential areas. Hence the Project is not associated with significant environmental and social impacts.

Each of the 110 kV lines was subject to National permitting and public consultation and some sub projects required an EIA under National legislation /Annex II of the EU EIA Directive. The Company has followed the EIA process for these sub projects. In addition, in order to supplement the local permitting process and allow public consultation of each sub project, the Company developed and disclosed locally additional Non-Technical Summaries (NTS) of each sub project. This was done as part of the Banks' PR10 implementation.

Through the ESAP provisions and the Bank's assistance, the Project helped the company to strengthen environmental, health and safety management as well as stakeholder engagement attaining international EHS management standards. The ESAP includes the requirement to implement i) EHS management systems in accordance with ISO 14001 and OHSAS 18001 standards; ii) additional CSR program in line with GRI reporting standards.

The Project also supported the Company in meeting the ENTSO-E requirements and connecting to the ENTSO-E network. This allowed KOSTT's integration into the deeper European power market and independent management of its transmission system (prior to that the ancillary services for the Kosovo grid have been provided by the Serbia's TSO).

In addition, the implementation of a system to monitor and manage Average Interruption Time (AIT) based on recognised measures System Average Interruption Frequency Index (SAIFI) and System Average Interruption Duration Index (SAIDI) has significantly enhanced KOSTT's ability to monitor its technical performance and communicate the results to the Energy Regulator Office. This, in turn, supported ERO's future tariff decisions for sustainable financial performance of the Company.

Implementation Summary

The Project supported KOSTT in improving the stability and reliability of the power system by reducing inefficiencies and bottlenecks in Kosovo's transmission network and meeting the ENTSO-E's technical requirements. KOSTT became technically ready and compliant, and signed the Connection Agreement with ENTSO-E by end of 2020 allowing the Kosovo TSO to operate under the synchronous area of Continental Europe and manage its border capacity.

The Project was implemented in accordance with the Bank's environmental and social policy and the Bank's involvement ensured that transparent and efficient procurement procedures were followed. Through the Environmental and Social Action plan developed, the Project helped the company to strengthen environmental, health and safety management as well as stakeholder engagement attaining international EHS management standards.

As a part of its wider Transition Impact, the Project contributed to successful implementation of country and energy sector strategy and set standards for corporate governance and business conduct.