



# Policy and Evaluation Committee

## For information

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**Inquiries to:** Sixto Aquino (extension 2510) or José Linhares Pires (extension 2258)

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**RE-332-2**

***SECOND INDEPENDENT  
EVALUATION OF  
THE EXPANDED PROJECT  
SUPERVISION REPORT EXERCISE***

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***Office of Evaluation and Oversight***

Inter-American Development Bank  
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## ACRONYMS

ECG:	Evaluation Cooperation Group
EMS:	Environmental Management System
ERR:	Economic Rate of Return
ESHS:	Environmental, Social, Health and Safety
FRR:	Financial Rate of Return
GPS	Good Practice Standards
IDB:	Inter-American Development Bank
IRR:	Internal Rate of Return
MDBs:	Multilateral Development Banks
OVE	Office of Evaluation and Oversight
PPA	Power Purchase Agreement
PSA	Power Supply Agreement
SCF	Structure and Corporate Finance Department
XPSRs:	Expanded Project Supervision Reports

## EXECUTIVE SUMMARY

This report evaluates the second exercise of the Expanded Project Supervision Reports (XPSR), prepared by the Structured and Corporate Finance Department (SCF) for a sampling of 14 projects – 13 loans and one guarantee. All projects were approved between 2000 and 2003, and they were selected based on the Evaluation Cooperation Group’s Guidelines, which determine that all projects that achieved early operational maturity should be self-evaluated by SCF annually. While the guarantee covered regulatory risks of a distribution company, the loans financed energy, telecommunication, and transportation and sanitation projects in a context of implementing regulatory models aimed at attracting the private sector. The sampling gathers projects in seven countries and one regional project.

OVE identified progress in the preparation of this XPSR report, if compared with the previous exercise. Indeed, SCF complied with the ECG requirements and self-evaluated all projects that were eligible to be self-evaluated in 2007. SCF also addressed several of OVE’s recommendations made in the first report. SCF’s staff improved its capacity to identify lessons learned from all project dimensions defined by the ECG guidelines, provided justification for the projects’ ratings, sent surveys to Bank clients and provided OVE with the documentation required for the projects’ validation.

However, OVE also identified “challenges ahead” for SCF in the preparing the next XPSR exercise. In particular, the self-evaluation of prepaid projects was jeopardized by the lack of tracked information about their achievements on development objectives and corporate governance additionality. Likewise, feedback from some clients who prepaid their loans was missing as well. Since the sample consisted basically of prepaid projects, the lack of data impacted negatively on the ability to produce evidence about the projects’ contribution.

Few disagreements remained at the end of the process due to a very interactive process between OVE and SCF regarding the project ratings validation. Indeed, OVE only downgraded 19% of the SCF ratings, albeit higher than the previous exercise (13%), when a small number of projects was self-evaluated (5 projects). The majority of the downgrades (57%) were related to the IDB’s profitability, followed by IDB’s Work Quality (24%), IDB’s Additionality (14%) and Project’s Development Outcomes (10%) ratings.

The XPSR analysis underscored that SCF’s projects presented worse results on all ECG dimensions, if compared with the previous exercise. In general, there is no evidence that the projects had highly satisfactory performance, except for 7% of them that achieved that rating for IDB’s additionality. In fact, it was in this aspect that the projects performed better (64% of highly satisfactory and satisfactory against 100% of highly satisfactory in 2006) followed by their contribution to the development outcomes and IDB’s Work Quality (both 43% of satisfactory) against respectively 100% and 80% of highly satisfactory/satisfactory in 2006). Meanwhile, the projects obtained their worst

performance in IDB's profitability, since only 29% were satisfactory, while they obtained 100% of highly satisfactory/satisfactory in 2006.

The XPSRs identified several reasons for these results. As for *IDB's additionality*, the XPSRs' analysis showed that in only one project, Novatrans, the Bank provided financial, regulatory, environmental and corporate governance additionality. Most of the other projects achieved satisfactory because they provided additionality in at least one of these areas. However, there is no evidence that both Edesur/Edenorte and ODJ contributed to any of these additionality dimensions.

Regarding *Project's Development Outcome*, the lack of information about prepaid projects affected negatively the general ratings of the project sampling, since evidence of results could not be produced in several cases. Likewise, the lower ratings for *IDB's profitability* were strongly influenced by the fact that all but one of the loans were prepaid. As a result, though they did not imply loss of capital to the Bank, they generated less than 65% of the original expected interest income, which is the threshold defined by OVE's Guidelines for Implementation of ECG Standards to qualify them as satisfactory.

In turn, the analysis showed that further efforts should be made by SCF in order to improve the *IDB's Work Quality*. The Bank presented worse results on screening, appraisal and structuring work (only 43% satisfactory) than it did on monitoring and supervision quality work, in which 7% of the projects were highly satisfactory and 79% satisfactory. In particular, the XPSRs stressed that flaws in appraisal work, such as the sensitivity analysis and risks mitigation mechanisms, have impacted the achievement of better projects results on the other general performance indicators.

Several lessons learned were identified by the SCF staff during this current exercise. The staff identified the need of the Bank to strengthen its appraisal work in order to raise the probability of achievements on project development outcomes. The staff also underscored the need for flexible products and new contractual mechanisms in order to mitigate the risk of prepayments. Finally, lessons learned about IDB's Work Quality stressed the importance of the Bank strengthening its intra-coordination, enhancing its dialogue with the government, deepening its project's monitoring in order to promptly adopt corrective actions during project implementation, reducing legal costs and, finally, spending additional resources in the project's environmental components.

Based on the lessons learned from the implementation of this second XPSR exercise, OVE has three recommendations. The first is related to the increased number of prepaid operations, which was the main issue that has been underscored since the previous report. The second recommendation is related to improvements in the Bank's Work Quality. Finally, the last recommendation is related to the improvement of project evaluability, in particular to the prepaid projects. Herewith, OVE details its general recommendations to SCF:

The SCF should conduct a *case study* aiming at identifying the causes of the high incidence of prepayments in the SCF project portfolio. This study should address

recommendations to decrease their incidence, taking into account the lessons identified by the Bank's staff in the XPSRs. Additionally, the study should assess how other similar financial institutions are dealing with this issue, which was part of OVE's recommendation addressed in the first validation XPSR report.

The SCF should implement *measures to improve its Work Quality*. In particular, the SCF should identify whether the recommendations raised by the staff in the XSPR reports have been implemented and what their results have been, in particular the issues relating to improving the appraisal work and to reducing legal costs.

The SCF should improve the project's evaluability. First, the SCF should develop contractual mechanisms in order to ensure both tracking and measurement of its projects' economic and financial indicators even in the event the project were prepaid. This requirement should also be included in the client's affirmative covenants, as well as in the need of feed-back to client surveys and the provision of information about outcome indicators during both the implementation and completion phases of the project. Finally, the SCF should improve its analysis of the corporate governance's additionality of the projects, by providing evidence of prudent management practices and other expected benefits from project implementation.

## I. INTRODUCTION

- 1.1. This Second Independent Evaluation Report presents findings obtained from Expanded Project Supervision Reports (XPSRs) prepared by the Structure and Corporate Finance Department (SCF) for projects that have elapsed 5 years from their approval date and prior to 2006, as well as the prepaid projects. The SCF staff prepared the XPSRs in order to comply with the ECG-GPS, which also requires OVE to inform the Board of Executive Directors of the results derived from its validation of the XPSR performance ratings, its findings and lessons learned from the XPSRs.
- 1.2. The process of elaborating XPSRs started in September 2005, after OVE defined the guidelines for implementing ECG Standards for the Private Sector (PS-125).<sup>1</sup> Based on that, in February 2007, SCF sent OVE the final version of its First Report, which related to only some of the projects (five) which had elapsed 5 years from their approval date and prior to 2006,<sup>2</sup> and they were validated by OVE (RE- 332).<sup>3</sup> Despite the short-list of projects self-evaluated, this first exercise brought lessons learned and permitted the refining of the self-evaluating instruments.
- 1.3. This Second Report, which was scheduled to be completed by the end of 2007, took more time than expected for the following reasons. First, preparation began relatively late, in August 2007, which triggered an SCF requirement to extend its deadline – to which OVE agreed - in order to accommodate the XPSR elaboration with the SCF’s schedule. Second, this exercise comprises a larger list of projects, since SCF had committed itself to address OVE’s recommendation in order to self-evaluate a representative sampling of projects. Third, this exercise also involved the updating of the evaluation guidelines towards a third edition compliant with the latest ECG standards. Nevertheless, SCF and OVE agreed to use this XPSR exercise as a transition between the second and the third edition, which will be fully adopted in the next exercise.
- 1.4. The XPSRs rated the projects based on four evaluative performance indicators defined by the third edition of the ECG-MDB Guidelines as: (i) project’s development outcome; (ii) IDB’s investment profitability; (iii) IDB’s work quality ; and iv) IDB’s additionality (Table 1).

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<sup>1</sup> See <http://www.iadb.org/ove/DocumentInformation.aspx?DOCNUM=1281467&Cache=True>. OVE recommended that SCF adopt ECG-GPS in RE-303 “Evaluation of the Bank’s Direct Private Sector Lending Program 1995-2003”, Annex IV.

<sup>2</sup> The ECG-Guidelines state that the sample of projects to be self-evaluated should be in a confidence interval of 95%. It means that for the universe of ten eligible projects, all of them might be self-evaluated. OVE and SCF agreed to apply “five-year-period after the approval” as a proxy for the early operating maturity.

<sup>3</sup> The OVE report was sent to distribution in April 2007 and presented to the Board on October 22, 2007.



**Table 1: Performance Dimension and Standard Ratings**

Performance Dimension	Performance Areas
Project Development Outcome	Project Contribution to Company Business Performance
	Project Contribution to Economic Development
	Project Environmental and Social Effects
	Project Contribution to Private Sector Development
	<i>Project Expected Outcome and Output Analysis (PCR Compliance)*</i>
IDB's Investment Profitability	Project Gross Profit Contribution to IDB
IDB's Work Quality	Screening, Appraisal and Structuring Work
	Monitoring and Supervision Quality Work
IDB's Additionality	Financial, Environmental, Corporate Governance and Regulatory Additionality.

\* This is only for projects that have logical framework from 2004 on. This rating will not be counted towards Project Development Outcome overall rating.

- 1.5. This second self-evaluation exercise was a very interactive process between OVE and SCF. First, SCF started to submit drafts of XPSRs to OVE with supporting documentation for validation in February 2008 and concluded the preparation of the XPSRs in August of 2008. OVE revised all XPSRs and did not find evidence to support some XPSR's ratings, and found that some supporting information was missing as well. Then, OVE sent its consolidated comments on the XPSR ratings to SCF in September 2008. In turn, SCF incorporated most of OVE's suggestions and sent another version of its XPSRs to OVE in October 2008. OVE reviewed this and sent its comments to SCF in December 2008. Then OVE and SCF spent several working sessions discussing OVE's comments and analyzing additional information provided by SCF to justify some ratings. Finally, the final version of the XPSRs was produced by SCF and presented to OVE in June 2009.
- 1.6. This document is organized into six sections. After this introduction, the next section presents the implementation status by SCF of the OVE recommendations made in the First XPSR exercise. The third section reviews and validates the SCF ratings on the project performance indicators, checks the quality of the rating justification and verifies the completeness of the supporting information necessary to support the ratings. The fourth section focuses on the main findings of the XPSR analysis. The fifth section displays the lessons learned from the XPSRs and, finally, the document brings some conclusions and recommendations to the Management.

## II. IMPLEMENTATION STATUS OF OVE’S RECOMMENDATIONS

Table 2 provides a summary of the implementation status of OVE’s recommendations to SCF on the First XPSR Exercise.

**Table 2 – Implementation Status of OVE’s Recommendations**

OVE’s Recommendation	Implementation Status*
1. SCF should evaluate a representative sample of projects that have achieved early maturity during the 2007 exercise.	<i>Fully Implemented.</i> Applying 5-year-period after the approval as a proxy for the early operating maturity, SCF prepared XPSRs for 14 projects, which include all projects that have elapsed 5 years from their approval date to 2006 plus one prepaid project that was approved in 2003.
2. SCF should increase its efforts to identify lessons learned from all project dimensions, by stimulating the staff to exercise lessons identification from the project implementation experiences.	<i>Fully Implemented.</i> SCF has identified at least one lesson learned for each project dimension. During the XPSR preparation, 7 investment officers and 6 portfolio monitoring officers participated in Peer Review Meetings and provided comments for the project team’s members.
3. SCF should identify how other similar financial institutions are dealing with risks of loan prepayments and legal costs.	<i>Not Implemented.</i> These issues were not identified in the Second XPSR exercise.
4. SCF should comply with the ECG Guidelines based on a predictable schedule agreed between OVE and SCF.	<i>Partially Implemented.</i> The XPSR exercise of 2007 took more time than expected. The SCF asked for a deadline extension and OVE and SCF agreed upon a new schedule, with which SCF complied
5. SCF should implement a systematic effort to fill the data gap presented in the XPSRs, especially those related to the IDB’s Work Quality, such as client prepayment, project fee analysis and client survey links.	<i>Partially Implemented.</i> SCF provided all necessary information to justify ratings as well as presented analysis of IDB’s interests, fees and prepayment premium in all XPSRs, including pre-paid projects. However, some XPSRs’ client surveys were missing. Despite the fact that SCF sent out client surveys, only part of them were answered.
6. SCF should stress whether some of the recommendations raised by the staff have been implemented and what their results have been.	<i>Partially Implemented.</i> SCF provided a status of implementation of lessons learned on the first exercise (see Table 3) and some of them were implemented.

(\*) The implementation status of the OVE’s recommendations was rated based on: (i) fully implemented; (ii) partially implemented; (iii) not implemented.

- 2.1. Table 2 shows that SCF fully implemented the OVE recommendations related to the sample selection and provision of information that justifies the XPSR’s rating. Likewise, SCF fully implemented the recommendations related to identification of lessons learned. Indeed, all XPSRs identified at least one lesson learned for each one of the project dimensions.
- 2.2. By contrast, SCF has not implemented the recommendation related to identifying how similar financial institutions have been dealing with loan prepayments and legal costs.

2.3. On the other hand, SCF partially implemented the OVE recommendations related to setting up a predictable schedule for XPRS implementation. SCF also partially implemented OVE's recommendations regarding efforts to fill the data gap, since some surveys of clients that prepaid their loans were missing. In the same vein, SCF partially fulfilled OVE's recommendation related to identifying the implementation of lessons learned in its operations and what their results have been (see Box below).

**Table 3 - Status of Implementation of Lessons Learned Identified in the 2006 XPSR in the SCF Operations (Statement Provided by SCF)**

Lessons learned 1 Strengthening project evaluability	In March 2008, based on ECG-GPS, SCF introduced the new development effectiveness framework (DEM) in order to improve project evaluability.
Lessons learned 2 Improvement of the coordination intra IDB's areas.	Under the new Matrix organization of the Bank, there is more participation of sector department specialists in SCF projects, benefiting from the expertise of those specialists and enhancing coordination with the rest of the Bank Group.
Lessons learned 3 Promotion of Local Market Interventions	In 2008, SCF made several guaranteed facilities (e.g. IXE, Mexican Housing, and First Caribbean Bank) approved by the Board. These instruments are expected to further promote the use of Partial Credit Guarantee.
Lessons learned 4 Flexibility in Response to Market Conditions	Although there has not been progress in incorporating flexibility into the loan agreement, the Management developed a strategy in order to implement local currency facilities, which is expected to address one of the problems the Bank has regarding lack of flexibility.
Lessons learned 5 Adequate Contractual Mechanism to Mitigate Project Execution Delays	The risks analysis of the SCF projects was strengthened in 2004 with the creation of the independent risk assessment unit under the Executive Vice Presidency. Furthermore, introduction of the new granular risks classifications system is expected to further strengthen the project risk assessment, including the strength of the sponsors.
Lessons learned 6 The need to reduce legal costs	The legal department implemented a mechanism whereby several of the external law firms are shortlisted, and the specific firm to work with a transaction is chosen from the pool. Since the Bank can obtain a discount on legal fees from those shortlisted firms, it is expected to lower the legal cost.
Lessons learned 7 Local knowledge can improve the appraisal work	Although nothing had been done particularly to promote the hiring of local consultants, SCF started a process of decentralization, having staff in country offices. It is expected that this aspect will have positive impact not only for improving appraisals and monitoring of projects, but also for accumulating local knowledge.
Lessons learned 8 Closing monitoring of the project execution	Careful monitoring of the sponsors' overall business as well as of its financial strength is expected to be addressed by the new risk classification system adopted by the Bank.

2.4. The analysis of Table 3 shows that the Bank adopted several of OVE's recommendations. Regarding Bank products, the Bank provided partial credit guarantees envisaging the promotion of local markets. Furthermore, the Bank also developed a strategy to implement local currency facilities in order to enhance its flexibility in responding to market conditions.

2.5. Regarding internal procedures, first, the Bank created a development framework in order to strengthen the project's evaluability. Second, the Bank's new organizational matrix aims at improving the coordination among the Bank's areas.

Third, the Bank introduced a new risk assessment unit in order to mitigate project execution delays. Fourth, the Bank is choosing external law firms from a pool of shortlisted firms, thus aiming to reduce legal costs. Finally, the Bank decentralized staff in order to improve local knowledge and its appraisal and monitoring work.

- 2.6. It's still too soon to verify the effectiveness of these changes.<sup>4</sup> However, it is still a challenge for SCF to address OVE's recommendations to incorporate flexibility into the loan agreement in order to respond to market conditions and to hire local consultants in order to obtain local knowledge to improve appraisal work.

### **III. OVE REVIEW AND VALIDATION OF SELF-EVALUATION**

- 3.1. This section summarizes OVE's review of the 14 XPSRs prepared by SCF during the second self-evaluation exercise. This section briefly describes the projects selected to be evaluated and presents OVE's comments on performance ratings, rating justification, and information supporting the rating justification.

#### **A. The Projects**

- 3.2. In order to accomplish OVE's recommendations, SCF selected all projects from its portfolio that have elapsed 5 years from their approval date and prior to 2006, as well as the projects that might have been evaluated in the previous exercise (approval year in 2000). Finally, this exercise also includes prepaid projects. The projects selected by SCG consist of 13 loans and one guarantee (Table 4). The majority of them (72 %) are from the energy sector – 9 loans and the only guarantee – complemented by two loans for ports (14%), one for sanitation (7%) and another one for telecommunications (7%). The projects financed the construction of power plants, interconnection of power lines, port terminals, desalinization plants and power distribution investment plans. In turn, the guarantee covered regulatory risks of a distribution power company in Brazil.
- 3.3. It is worth noting that only one of the 13 loans related to the 2006 exercise was not prepaid (Dona Francisca), underscoring an issue that prompted an OVE recommendation in the previous exercise.

#### **B. The Ratings**

- 3.4. The XPSRs rated the projects based on four evaluative performances defined by the Third Edition of the ECG-MDB Guidelines: (i) Project's development outcome; (ii) IDB's investment profitability; (iii) IDB's work quality; and (iv) IDB's additionality

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<sup>4</sup> The assessment of the adequacy of DEM as a toll of evaluability is part of the OVE's work plan for 2009.

**Table 4. The group of projects self-evaluated by PRI**

Project Number	Project Name	Type	Approval Year	Project Description	Total Project Cost (US\$ million)	Total IDB "A" Loan/Guarantee (US\$ million)
<i>BR 304</i>	Cana Brava	Loan*	2000	Construction of a Hydro Power Plant	426	75
<i>BR 315</i>	Dona Francisca	Loan	2000	Construction of a Hydro Power Plant	118	15
<i>BR 350</i>	Light Electricity	Guarantee	2000	Political Risk Guarantee	270	100
<i>BR 354</i>	Termobahia	Loan*	2001	Construction of a Cogeneration Plant	244	58
<i>BR 361</i>	Termopernambuco	Loan*	2001	Construction of a Thermal Power Plant	403	42
<i>BR 398</i>	Nova Trans	Loan**	2003	Building of a Power Transmission Line	427	30
<i>CH 162</i>	Mejillones	Loan*	2001	Construction of a Port Terminal	128	25
<i>CH 171</i>	Antofagasta	Loan**	2003	Construction of a Seawater Desalination Plant	38	7
<i>137</i>	Edesur/ Edenorte	Loan*	2001	Power Distribution Investment Program	142	75
<i>JA 128</i>	Ocean Digital Jamaica	Loan**	2003	Building of a Digital Mobile Telecommunication Network	85	30
<i>ME 229</i>	Monterrey	Loan*	2000	Building of a Thermal Power and Cogeneration Plants	610	75
<i>PN 136</i>	Chorrera	Loan*	2000	Construction of a Thermal Power Plant	92	20
<i>UR 142</i>	M' Bopicua	Loan**	2002	Construction of a Port Terminal	35	10
<i>RG 054</i>	CIEN	Loan*	2001	Building of a Binational Transmission Line	693	74

(\* ) Projects that were originally part of the sample and were prepaid: (\*\* ) Projects that were not originally part of the sample but were included in it because they were prepaid as requested by the ECG Guidelines.

3.5. Each of the performance dimensions is assigned a rating based on a matrix that uses a standard four-point scale for each indicator rating. The scale ranges are (i) Highly Unsatisfactory, (ii) Unsatisfactory, (iii) Satisfactory, (iv) Highly Satisfactory.

3.6. OVE and SCF established such a very interactive rating process that few disagreements remained as it ended. As a result, the mismatch between OVE and

SCF was related to only 19 % of the ratings (27 out of 140 ratings).<sup>5</sup> This was the number of OVE's downgrades at its validation of the SCF final report.<sup>6</sup>

- 3.7. Proportionally, Table 5 shows that the majority of the OVE's downgrades (57 %) are related to the IDB's Profitability (8 out of 14 ratings), followed by IDB's Work Quality (24%), in which 10 out of 42 ratings were downgraded. Otherwise, OVE only downgraded 10 % of the Project's Development Outcomes (7 out of 70 ratings) and 14 % of IDB's Additionality, in which 2 out of 11 ratings were downgraded.

**Table 5. OVE's Validation of the XPSR's Ratings**

Ratings	a. Total	b. Adequate		c. Inadequate	
		Number	% (b/a)	Number	% (c/a)
Project Development Outcomes	70	63	90%	7	10%
IDB's Investment Profitability	14	6	43%	8	57%
IDB's Work Quality	42	32	76%	10	24%
IDB's Additionality	14	12	86%	2	14%
Total	140	113	81%	27	19%

- 3.8. The Table 6 shows the OVE validation of the XPSR's ratings, in which the underscoring ratings represent the ratings downgraded by OVE.

**Table 6. OVE's Validation of the SCF Projects Ratings (\*)**

OVE Ratings	C. Brava	D. Frca	Light	T. Bahia	T. buco	Novatr	Mejillon	Antofag	ESur/No	ODJ	Monterr	Chorrera	M'Bopic	CIEN
<b>Project Development Outcomes</b>	S	S	U	U	U	S	S	U	U	U	S	S	U	U
Company Business Success	U	S	U	HU	HU	S	S	HU	U	HU	S	U	U	U
Private Sector Development	S	S	S	U	U	S	S	S	HU	U	S	HS	S	U
Economic Development	HS	HS	S	U	S	S	HS	U	U	U	HS	S	U	U
ESHS performance	S	S	U	S	HS	S	S	S	S	S	S	U	S	S
<b>IDB Profitability</b>	U	S	S	U	U	U	U	U	U	HU	U	S	U	S
<b>IDB Work Quality</b>	U	U	S	S	U	S	S	S	HU	U	S	U	U	U
Screening, Appraisal and Structuring Work	U	U	S	S	U	S	S	S	HU	HU	S	U	U	U
Monitoring and Supervision Quality	S	S	S	S	S	S	HS	S	U	S	S	S	S	U
<b>IDB Role, Contribution and Additionality</b>	S	S	S	U	U	HS	S	S	HU	U	S	S	S	U

(\*) The ratings highlighted in the Table represent the ratings downgraded by OVE. These downgrades reached down one level from the ratings originally rated by SCF.

HS – Highly Satisfactory; S – Satisfactory; U- Unsatisfactory; HU – Highly Unsatisfactory

<sup>5</sup> Six of these 27 changes were motivated by automatic adjustments in overall performance indicators when changes in specific indicators that are part of them were produced. For instance, because the screening, appraisal and structuring work rating was downgraded for the Chorrera project, its overall indicator for IDB's Operational Effectiveness needed to be modified as well.

<sup>6</sup> The majority of the OVE's downgrades (23 out of 27 ratings), related to the performance dimensions of 11 projects, represented binary outcomes. i.e., they consist of movements from satisfactory ratings to unsatisfactory ratings.

- 3.9. Regarding Project's development outcome ratings, *OVE downgraded 7 ratings related to 5 projects*. The majority of the downgrades were related to the projects' environmental, social, health and safety (ESHS) and contribution to the companies' business success performances, both with 2 downgrades. Regarding ESHS, the Light and Chorrera projects were downgraded from satisfactory to unsatisfactory because they were not in compliance with all performance indicators. Regarding their contribution to company business success, *OVE downgraded* Cana Brava and Antofagasta projects because their Financial Rate of Return (FRR) was lower (Cana Brava) and much lower (Antofagasta) than expected in the appraisal phase. *OVE also downgraded* the Ocean Digital Jamaica (ODJ) project regarding its private sector development performance due to the project's financial turndown and the lack of evidence that this situation was reversed after the project prepayment. Finally, automatically adjustments were made in the overall development outcome ratings for Light and Antofagasta projects due to changes in specific ratings related to this category.
- 3.10. Regarding IDB's Profitability, *OVE downgraded* the ratings of Cana Brava, Termobahia, Termopernambuco, Novatrans, Mejillones, Antofagasta, Edesur/Edenorte and M'Bopicua because none of them achieved the originally expected interest income that OVE's Guidelines for Implementation of ECG Standards define as satisfactory.
- 3.11. Regarding IDB's Work Quality, *OVE downgraded 10 ratings related to 5 projects*. *OVE found* problems either in the appraisal or in the monitoring that justified these downgrades. Five downgrades were related to screening, appraisal and structuring work performance ratings (5 projects): Cana Brava, Termopernambuco and Chorrera were downgraded from Satisfactory to Unsatisfactory and Edesur/Edenorte and ODJ were downgraded from unsatisfactory to highly unsatisfactory. In turn, one downgrade was related to monitoring and supervision quality work performance. Instead of rating Edesur/Edenorte as satisfactory, *OVE considers* it should be rated as unsatisfactory. Finally, four adjustments in the overall Work Quality rating were also required for four projects – Cana Brava, Termopernambuco, Edesur/Edenorte and Chorrera - due to the changes made in specific ratings related to this category.
- 3.12. Finally, *OVE downgraded two of IDB's additionality performance ratings*. The Edesur/Edenorte project was downgraded from unsatisfactory to highly unsatisfactory due to lack of evidence that they provided additionality in any dimension. In addition, *OVE downgraded* the ODJ project from satisfactory to unsatisfactory because there is no evidence that the project provided additionality other than environmental.
- 3.13. It is worth noting that, in contrast to the previous exercise, when *OVE found* problems with some rating justifications, the SCF work quality was significantly improved in the projects analyzed in this report. However, an important issue that affects some ratings was the lack of follow up on the prepaid project results and the project's corporate governance additionality. In particular, since the Bank has

not been tracking prepaid project's results, there is a lack of evidence about their development objective's achievements.

#### IV. THE MAIN FINDINGS OF THE XPSR'S ANALYSIS

- 4.1. This section seeks to present the results from the analysis of the 14 XPSRs. The XPSR analysis (Table 7) shows that the projects presented worse results on all ECG dimensions, if compared with the previous exercise. Even in the better project's performance, which is regarding their IDB role, contribution and additionality (64 % highly satisfactory/satisfactory), the results were worse than 2006, when they performed 100% highly satisfactory. The second better performance was in their contribution to development outcomes and IDB's Work Quality (both 43% satisfactory) against respectively 100% and 80% of highly satisfactory/satisfactory in 2006). Finally, the projects performed worse in IDB's investment profitability, since only 29% of the projects were satisfactory, while they obtained 100% of highly satisfactory/satisfactory in 2006.

**Table 7. General Performance of the Group of Projects Self-evaluated by PRI\***

Ratings /General Performance (%)	Highly Satisfactory	Satisfactory	Unsatisfactory	Highly Unsatisfactory
<b>I. Project Development Outcome</b>	<b>0</b>	<b>43</b>	<b>57</b>	<b>0</b>
<b>II. IDB's Investment Profitability</b>	<b>0</b>	<b>29</b>	<b>64</b>	<b>7</b>
<b>III. IDB's Work Quality</b>	<b>0</b>	<b>43</b>	<b>50</b>	<b>7</b>
<b>IV. IDB's Additionality</b>	<b>7</b>	<b>57</b>	<b>29</b>	<b>7</b>

(\*) Based on the OVE's validated ratings of the XPSRs.

- 4.2. In order to produce a comparative analysis at project level, based on the project performance ratings previously presented in the Table 3, OVE created an overall score rating for the projects (Table 8). NovaTrans was the project that had the best overall performance (+ 3), followed by Dona Francisca, Light, Mejillones, Monterrey III and Chorrera (+ 2) and Cana Brava and Antofagasta (zero). On the other hand, Edesur/Edenorte achieved the worst performances (-6), followed by ODJ (-5), Termopernambuco (-4) and Termobahia, M'Bopicua and CIEN (all of them scoring - 2). The next sections display specific results for each one of the XPSR's ratings.

**Table 8. XPSR's Score Ratings**

OVE: XPSR's Scores	C.Brava	D. Frca	Light	T.Bahia	T. buco	NovaTrans	Mejillones	Antofag	ESur/Norte	ODJ	Monterr	Chorrera	M'Bopicua
Development Outcomes	1	1	-1	-1	-1	1	1	-1	-1	-1	1	1	-1
IDB Profitability	-1	1	1	-1	-1	-1	-1	-1	-1	-2	-1	1	-1
IDB Work Quality	-1	-1	1	1	-1	1	1	1	-2	-1	1	-1	-1
IDB Additionality	1	1	1	-1	-1	2	1	1	-2	-1	1	1	1
Overall Score	0	2	2	-2	-4	3	2	0	-6	-5	2	2	-2

Scores: HS = +2; S = +1; U = -1; HU = -2.

##### A. Project Development Outcome

- 4.3. For the Project Development Outcome dimension, the overall rating is constructed by measuring four standard indicators: (i) Project Contribution to Company Business Success; (ii) Project Contribution to Private Sector Development; (iii)



Project Contribution to Economic Development; and (iv) Project ESHS Impact and Sustainability. Each standard indicator was rated following specific benchmarks.

- 4.4. Table 9 shows that the project contribution to economic development had the best ratings among the development outcome indicators (29% highly satisfactory), followed by the project contribution to ESHS standards and private sector development (both with 7% highly satisfactory). In contrast, the project contribution to the company business success achieved relatively lower performance (none highly satisfactory).

**Table 9. Development Outcome Performance of the Group of Projects Self-evaluated by SCF\***

Ratings /General Performance (%)	Highly Satisfactory	Satisfactory	Unsatisfactory	Highly Unsatisfactory
<b>Development Outcome Performance</b>	<b>0</b>	<b>43</b>	<b>57</b>	<b>0</b>
a. Company Business Success	0	29	42	29
b. Private Sector Development	7	57	29	7
c. Economic Development	29	29	42	0
d. ESHS Impacts and Sustainability	7	79	14	0

(\*) Based on the OVE's validated ratings of the XPSRs.

- 4.5. The projects' performances on *contribution to economic development* were confirmed by ex-post economic evaluation that found the economic rate of return (ERR) above 20% in the cases of Cana Brava, Dona Francisca, Mejillones and Monterrey III - highly satisfactory projects – and the ERR lower than 20% (but higher than their ex-ante ERR) in another four projects that achieved satisfactory (Light, Termopernambuco, NovaTrans and Chorrera). The other six projects of the sampling reached either an ex-post ERR lower than the ex-ante ERR or did not present evidence that the ex-ante ERR was reached.
- 4.6. These results reflected a wide range of project benefits regarding the boost of productive activities and the expected positive impacts on improving overall local living conditions, as with the highly satisfactory projects. Despite the lack of tracked outcome indicators, the ex-post ERR of some projects indicated that they enhanced a reliable supply of energy and reduced generation costs (Cana Brava, Dona Francisca and Monterrey III) and provided additional port capacity, reduced vessel waiting time and saved land transportation costs (Mejillones).
- 4.7. At the satisfactory level, the Termopernambuco, NovaTrans and Chorrera projects contributed to increase the overall capacity and to improve reliability of the electricity system (Light, Novatrans, Termopernambuco and Chorrera). It is worth emphasizing that in the case of Light, SCF provided other sources than the project document to underscore the project contribution. Since Light was a guarantee, the project did not have an economic model to estimate the economic rate of return of the projects.
- 4.8. On the other hand, some projects rated unsatisfactory because they had not been operating (Termobahia) or they presented worse economic and operational indicators than were expected in the appraisal phase, such as lower revenues at the initial stages of the project (Antofagasta), higher electricity losses

(Edesur/Edenorte), lower demand of services (ODJ) or lower operational levels (M'Bopicua and CIEN).

- 4.9. In turn, the ratings for the *project contribution to the private sector development* ranged from highly satisfactory (Chorrera) to highly unsatisfactory (Edesur/Edenorte). Yet it is worth noting that most of projects were rated either as satisfactory (eight projects) or as unsatisfactory (four projects).
- 4.10. The analysis of the Chorrera project found evidence that the project produced positive demonstration effects by attracting other private investors to the sector after its implementation in the country. In fact, the project was one of the pioneers after the set up of a new regulatory model and had the effect of encouraging other investments. On the other hand, though the Edesur/Edenorte project was consistent with the reforms in effect in the Dominican Republic's electricity sector, the project rating for its contribution to private sector development was highly unsatisfactory, because the poor operational project performance motivated the government to take over of both companies, in a context in which the government was pulling back the regulatory reforms it had implemented before.
- 4.11. Therefore, though the other projects supported a private sector model, their demonstration effects are yet to be observed. Indeed, Cana Brava, Dona Francisca, Light, Novatrans, Mejillones, Antofagasta, Monterrey III and M'Bopicua contributed to supporting private models in a context of implementing new regulatory frameworks.
- 4.12. Otherwise, the projects of Termobahia, Termopernambuco, ODJ and CIEN rated unsatisfactory by the same benchmark. As for the Brazilian projects, although they were part of the government emergency plan and helped the country to raise generation capacity in the context of an energy crisis, OVE (2004)<sup>7</sup> has already noted that these projects also contributed to integrating the electricity industry (Termopernambuco, in the segments of distribution and generation) and the industries of electricity and natural gas (Termobahia), which was contradictory to the Brazilian government's efforts at the time of project implementation. Otherwise, in the case of the ODJ and CIEN projects, there is no evidence that the projects supported or improved regulatory, institutional and legal frameworks that promote private sector investments in the sector in a sustainable way. Indeed, while ODJ failed in becoming a viable player in the sector, the CIEN project was negatively impacted by changes in the electricity model of both countries.
- 4.13. As for the *ESHS impacts*, the majority of the projects achieved satisfactory (79 %) and highly satisfactory (7%) ratings. i.e., they are in compliance with all the Bank's safeguard policies regarding environmental and social impacts and risks procedures. In particular, the Termopernambuco project achieved the best results among all projects, since the project helped the company to acquire the ISO 14001

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<sup>7</sup> OVE: Evaluation of the Bank's Direct Private Sector Lending Program 1995-2003, RE-303, 2004.

certificate of Environmental management – the first thermal plant in the Brazilian Northeast and the second in the country to acquire this certificate.

- 4.14. Otherwise, the Light and Chorrera projects achieved unsatisfactory ratings in this benchmark because they were in non-compliance with some environmental issues during the project execution such as noise (Chorrera). In particular, in the case of Light, there is no evidence that the client complied with the company Corrective Action Plan agreed upon with the Bank.
- 4.15. Finally, it was related to the *project contribution to company business success* that the projects achieved relatively lower performances. Dona Francisca, NovaTrans, Mejillones, and Monterrey achieved satisfactory ratings because, in accordance with the ECG Guidelines, their financial rate of return (FRR) was similar to their ex-ante FRR. However, most of the projects, such as Cana Brava, Light, Edesur/Edenorte, Chorrera, M'Bopicua and CIEN, were unsatisfactory because their FRRs were lower than expected in their appraisal phase. Finally, four projects achieved highly unsatisfactory ratings because their FRRs were much lower than their ex-ante FRR, such that they are operating sporadically (Termobahia), operating at lower levels than expected (Termopernambuco and Antofagasta) or operating with financial losses (ODJ).

#### **B. Project Investment Profitability for IDB**

- 4.16. The rating for Project Investment Profitability for IDB is based on its Gross Profit Contribution to IDB, by comparing the amount of fees and interests collected by IDB during the life-cycle of the project with the amount expected to be received by IDB at the time of project approval.
- 4.17. As previously shown by Table 6, the performance in this dimension was satisfactory for only 29% of the projects. These results were strongly influenced by the fact that all but one of the loans in the sample (Dona Francisca) were prepaid. As a result, though they did not imply loss of capital to the Bank, they generated less than 65% of the originally expected interest income, which is the threshold defined by OVE's guidelines for the implementation of the ECG Standards to qualify them as satisfactory.
- 4.18. Among the prepaid projects, only three projects achieved satisfactory because they permitted the Bank to receive more than 65% of the expected revenues - Chorrera (68%), CIEN (72%) and Light (100%). This was also the case of Dona Francisca, when the Bank received 68% of the expected revenue, and the loan has been paid as scheduled.
- 4.19. Finally, only one project was rated as highly unsatisfactory to the Bank's profitability performance. With the ODJ project, the Bank only received 50% of the expected revenues, since the outstanding amount was only partially prepaid.

The remaining debt was written off. Otherwise, the loan was in “non-accrual” status and classified as “impaired”.<sup>8</sup>

### C. IDB’s Work Quality

4.20. For IDB’s Work Quality, the rating is constructed by measuring two standard indicators: (i) Screening Appraisal and Structuring work; and (ii) Monitoring and Supervision Quality.

4.21. Table 10 shows the projects’ overall performance on Work Quality. It underscores that 43 % of the projects were rated satisfactory, 50 % unsatisfactory and 7 % highly unsatisfactory. This overall performance hides paradoxical results related to the two indicators that comprise the “Work Quality” indicator. Indeed, the projects achieved much better results in monitoring and supervision (7% of highly satisfactory and 79% of satisfactory) than in screening, appraisal and structuring work (none highly satisfactory and 43 % satisfactory).

**Table 10. IDB’s Work Quality of the Group of Projects Self-evaluated by SCF\***

Ratings /General Performance (%)	Highly Satisfactory	Satisfactory	Unsatisfactory	Highly Unsatisfactory
<b>IDB’s Work Quality</b>	<b>0</b>	<b>43</b>	<b>50</b>	<b>7</b>
a. Screening, Appraisal and Structuring Work	0	43	43	14
b. Monitoring and Supervision Quality	7	79	14	0

(\*) Based on the OVE’s validated ratings of the XPSRs.

4.22. In order to understand these results, Table 11 below shows the problems that affected the project appraisal work quality – the poorer result of the two indicators for Work Quality. OVE’s main findings below include those findings obtained through OVE’s evaluation of the private sector operations.<sup>9</sup> They are related to underestimation of risks that affected the project’s implementation. However, other factors, such as time and costs, were also included in the analysis presented in the Table 11.

4.23. Regarding *monitoring and supervision quality* indicators, most of the projects achieved satisfactory because during implementation the Bank promptly took corrective action to either fulfill ESHS issues that were addressed during the appraisal phase, as with Cana Brava, or took timely action when needed, as with Dona Francisca.

4.24. The exceptions were two projects that achieved unsatisfactory, such as the Edesur/Edenorte and CIEN projects, and the Mejillones, which was rated as highly satisfactory. In the case of Edesur/Edenorte, as cited by the XPSR, “*several events occurred during the supervision including the regulatory changes, devaluation, increased fuel prices and continued electricity losses. The project team conducted independent evaluation in May 2003 to analyze the potential course of actions, but*

<sup>8</sup> The Bank approved a repayment proposal in which the borrower agreed to repay US\$ 14.5 million (48.3% of the outstanding debt of US\$ 30 million). The remained debt of US\$ 15.5 million was written off by the Bank.

<sup>9</sup> OVE (2004), Evaluation of the Bank’s Direct Private Sector Lending Program 1995-2003, RE-303.

*before taking specific actions, the companies made prepayment. The Bank could have acted sooner once the regulatory changes were introduced in September 2002. The Bank dialogued with the government; notwithstanding, the Bank decided to follow the WB's lead in dealing with regulatory issues."*

- 4.25. The CIEN project was also rated unsatisfactory, but for the following reasons. The XPSR cited that *"the Bank's actions did not seem to be sufficient in response to the emergence of regulatory issues"* and that *"there is no evidence that the Bank actually met with Brazilian authorities to discuss specifically issues related to Copel's Power Supply Agreements (PSAs). Furthermore, there was no evidence either of the Bank's action to solve the problem of back up capacity restrictions imposed by ANEEL in 2005."*
- 4.26. Finally, the Mejillones project achieved the best performance, highly satisfactory. Indeed, its reports had been periodically prepared and all of which rated the project credit risk as satisfactory. In fact, the project had acceptable levels until the project prepayment, without any kind of non-compliance with any of the technical covenants specified in the contract.

#### **D. IDB's Additionality**

- 4.27. Regarding IDB's additionality, the most projects achieved satisfactory ratings (57%), followed by unsatisfactory (29%) and highly satisfactory and unsatisfactory (both 7%). Table 12 below shows the main contributions of the projects.
- 4.28. The analysis of the XSPRs underscores that financial additionality was the most important contribution of the projects, followed by the environmental, corporate governance and regulatory contributions. Indeed, there are a plentiful number of projects that provided financial additionality, by offering better terms and mobilizing B-lenders in the case of Cana Brava, Novatrans, Mejillones and Chorrera. However, OVE (2004) has not found evidence that some projects, such as Monterrey III, Termobahia and Termopernambuco provided financial additionality. In the Mexican project several previous operations had already been launched in the market, involving several B-loans and local trustees. Likewise, in both Brazilian projects, the clients had already had access to financing in the national and international markets.<sup>10</sup>
- 4.29. In terms of environmental additionality, the XPSR found evidence that Mejillones, Antofagasta, Monterrey, Termopernambuco, and Termobahia provided environmental additionality by requiring compliance with higher environmental and social standards than were prevailing at the time of project approval. Chorrera

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<sup>10</sup> In particular, Iberdrola implemented similar projects in Brazil without IDB funding (such as the 325 MW Termoacu cogeneration thermo plants) which were presented to SCF for financing but were completed without its participation. For more details, see OVE's Templates of the. Evaluation of the Bank's Direct Private Sector Lending Program 1995-2003, RE-303, 2004.

and Light projects, however, failed in this regard, since there is no evidence that these projects reached all ESHS provisions addressed by the loan proposal.

**Table 11. Problems that Affected the Project Appraisal Work Quality\***

Project/(Rating)	OVE's Main Findings
Cana Brava (U)	Although " <i>construction risks were mitigated</i> " and " <i>environmental and social impacts were listed as one of the potential risks for the project</i> ", specific risk which emerged during its implementation was not fully anticipated in the LD, such as a miscalculation about the maximum operational levels of the reservoir, which implied in issues related to resettlement plan and other environmental requirements, which delayed project completion. In addition, project costs and preparation times were higher than average SCF's projects.
Dona Francisca (U)	The Loan Proposal underestimated market risks because the Company signed the Loan Agreement without a Power Purchase Agreement (PPA). As a result, the company was negatively exposed to spot prices fluctuations. In addition, project costs and preparation times were higher than average SCF's projects.
Termoper-nambuco (U)	Although the LD identified " <i>discriminatory acts as one of the major regulatory issues</i> ", the LD failed to predict that the government could enforce the vertical disintegration between generation and distribution. The issue had been discussed by the government at the due diligence and should be taken into consideration. The " <i>confirmation obtained from discussions with the regulatory agency (ANEEL)</i> " should not be considered sufficient in order to mitigate regulatory risks. Indeed, there was a context of sectorial crisis, the regulatory model had been in transition and ANEEL was not the main regulatory authority at the time of the project approval. In addition, project costs were higher than average SCF's projects <sup>11</sup> .
Edesur/ Edenorte (HU)	Although the LD identified risks of " <i>continue losses and government related-regulatory potential company's governance issues</i> " and mitigations, such as " <i>comfort letter by GODR, resolution to define tariff structure, and sponsors guarantee for all the project risks</i> ", the LD does not adequately mitigate several risks (electricity technical losses, regulatory issues, fuel cost increase and exchange devaluation) that affected credit performance of the project. In addition, it miscalculated the government's commitment to the reforms, which could be crucial for the project sustainability. The " <i>comfort letter provided by the government</i> " should not be considered sufficient in order to mitigate project's regulatory and political risks, since the sector regulatory framework was unstable, the political environmental was adverse to private sector participation and the government lacked political support to enforce resolutions aimed at establishing sustainable tariffs at the time of the project approval. In addition, project preparation times were higher than average SCF's project
ODJ (HU)	The Loan Proposal underestimated market risks that negatively affected project performance, such as the project's feasibility given other market competitors. Furthermore, as stated by the XPSR, the traditional project finance structure applied to the project did not allow much flexibility and was not effective in mitigating market risks. The Bank wrote off about 50% of the original debt.
Chorrera (U)	Although the LD identified " <i>low revenue risk due to forced outages and planned overhaul</i> ", it was underestimated. Likewise, the LD underestimated market risks (lack of long term PPA) and regulatory risks (disadvantage of thermal plants). In addition, project costs and preparation times were higher than average SCF's projects.
M'Bopicua (U)	The Loan Proposal underestimated "market risks" that negatively affected project performance, such as the project feasibility given other market competitors. Indeed, one of the port's potential users, a pulp mill investor, decided to build its plant in another place further from the port. In addition, project costs and preparation times were higher than average SCF's projects.
CIEN (U)	The Loan Proposal underestimated the vulnerability of the regulatory reforms in Brazil and Argentina and their impacts on project revenues. The project only contracted 79% of its output (61% will expire in 2009) and needed to sell electricity into an incipient spot market and that was in reformulation at the time of project approval, or through new PSAs. In addition, project costs were higher than average SCF's projects. (*) The project's rating for this dimension is displayed in parenthesis. Elaboration: OVE, based on the XPSR's and in OVE(2004) "Evaluation of the Bank's Direct Private Sector Lending Program 1995-2003, RE-303".

<sup>11</sup> The Bank has discussed with Aneel who has confirmed the unlikelihood of discriminatory actions on the part of the regulator. Moreover, the presence of the Bank in the financing is perceived to mitigate such risk. Termoper-nambuco's Loan Document, paragraph 6.89, pg. 39.

4.30. Regarding regulatory additionality, there are some projects, such as NovaTrans, Light, and Chorrera, in which the Bank participation was very important in both providing political comfort to the sponsors (Novatrans and Light) and supporting the regulatory model that was being implemented at the time of project approval (Chorrera). However, in the cases of Termobahia, Termopernambuco, and Monterrey, these projects produced mixed signs regarding the regulatory framework that the governments had been implementing at the time the projects were approved. In Brazil, both projects promoted vertical integration into the energy industry in the context of implementing a competitive model, while in Mexico the project contributed to strengthening the CFE's monopoly when the government was trying to approve a law partially privatizing and introducing competition in the market.<sup>12</sup>

**Table 12. Project Contribution to the IDB's Additionality\***

Additionality	Projects
<i>Financial.</i> The project provided a longer term than the available commercial financing average terms at the time of the loan approval or/and the project mobilized financing from newcomer commercial lenders (B- loan)	Cana Brava (S), Novatrans (HS); Light (S), Chorrera (S), Dona Francisca(S). Mejillones (S), Antofagasta (S), M'Bopicua(S), CIEN (U), ODJ (U)
<i>Environmental</i> The project guaranteed compliance with higher environmental and social standards	Novatrans (HS), Termopernambuco (U); Termobahia (U), Mejillones (S), Antofagasta (S), Monterrey (S)
<i>Corporate Governance.</i> The project introduced covenants to ensure prudent, accountable and ethical management practices	Dona Francisca (S), Cana Brava (S), Monterrey(S), M'Bopicua(S)
<i>Regulatory.</i> The project gave political comfort to the sponsors by mitigating regulatory risks, and strengthened the country's regulatory framework.	Novatrans (HS), Light (S), Chorrera (S)

(\*) The project's rating for this dimension is displayed in parenthesis.

4.31. Finally, despite the fact that the majority of the projects included covenants to ensure prudent management practices, as with Dona Francisca, Cana Brava, Monterrey and M'Bopicua, the XPSR forwent better analysis of the corporate governance feature in order to provide evidence of the project's achievements. In particular, there is no evidence that Termopernambuco and Termobahia provided this additionality, since they supported vertical integration. By doing so, they potentially reduced contracting transparency and sectorial efficiency, thus jeopardizing the corporate governance additionality aimed for by the projects.

4.32. It is worth noting that the specific rating achieved by each project is the result of a combination of the individual ratings obtained in each dimension of project additionality. Novatrans attained the best performance among the projects. Its highly satisfactory performance derives from the project's financial, environmental

<sup>12</sup> OVE: Evaluation of the Bank's direct Private Sector lending Program 1995-2003, RE-303, 2004.

and regulatory additionalities provided by the Bank. Indeed, the Bank provided both longer term financing and also mobilized commercial resources through its B-loan program. The Bank also ensured compliance with international environmental and social standards and was coherent with Bank strategy.

- 4.33. As noted before, the majority of the projects (eight) achieved satisfactory for their additionality performance, the reason being that they addressed two out of the four additionality dimensions analyzed in the Table 12 above. Meanwhile, four projects rated unsatisfactory – Termobahia, Termopernambuco, ODJ and CIEN – because there is evidence that they contributed to only one of the additionality dimensions defined by the ECG Guidelines.
- 4.34. On the other hand, two projects were rated as highly unsatisfactory regarding additionality – Edesur/Edenorte and ODJ – because there is no evidence of the Bank’s additionality in any areas. In Edesur/Edenorte, OVE (2004) has already underscored the fact that the Bank preferred pressing for a voluntary prepayment of the loans rather than to intercede as a political umbrella in order to mitigate lender regulatory risks. By so doing, the Bank frustrated the client’s expectation, since the lender expected that the Bank would provide support under circumstances of political uncertainty.<sup>13</sup>

## **V. LESSONS IDENTIFIED FROM THE XPSRS**

- 5.1. Lessons learned represent one of the most important issues in the XPSR exercise, because their identification brings the opportunity to improve SCF investment as well as its role and its development effectiveness in the future. From the XPSR analysis, OVE found an important improvement in the SCF team’s capacity to extract operational lessons from the operations in order to provide guidance for future Bank performance. In addition, the Peer Reviews also helped to raise issues regarding all project rating dimensions.
- 5.2. In this current XPSR exercise, lessons were identified from all ECG Guidelines. As in 2007, the positive aspect was that most of the lessons were extracted from the indicators with the poorest performances. It is worth noting that most lessons have already been identified in the previous XPSR exercise. It is also worth noting that all the lessons discussed in the following sections were drawn by SCF Officers themselves, not by OVE.

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<sup>13</sup> OVE (2004) stressed that due to the full guarantee of the loan by Union Fenosa, there was no commercial reason to press for prepayment. After the project failures, UF gave up signing a contract with the Bank in Guatemala. UF was frustrated with the Bank’s disengagement from its DR project after it became highly controversial in the country, despite the fact that it was precisely in this type of situation that the UF required the Bank’s backing (From OVE’s interview notes with Mr. Jeauss Marcos, chairman of UF Internacional. Background Paper. CPE Dominican Republican, 2004.)



- 5.3. Following the ECG Guidelines, OVE classified the lessons learned extracted from the XPSRs into three out of the four general categories of indicators, as follows: (i) project development outcome; (ii) project investment profitability for IDB; and (iii) IDB's additionality. The lessons learned through Work Quality, which consists of the Bank's appraisal and monitoring work, were addressed by the analysis of the lessons learned from the other dimensions. The lessons learned from the XPSRs are shown in the next sections.

**A. Project Development Outcome**

- 5.4. The XPSRs underline 5 issues in their lessons learned regarding the project development outcome performance, all of which relate to the project appraisal work: (i) strengthening of the project evaluability; (ii) improving coordination intra IDB's areas; (iii) strengthening sectorial knowledge; iv) improving risks mitigation mechanisms and project sensitivity analysis and; (v) other appraisal issues that affect project development outcome.
- 5.5. *Strengthening Project Evaluability.* Like the previous XPSR exercise, some XPSRs stressed the importance of better defining indicators that capture the development impact of projects. It is worth noting that the projects that are part of the sampling did not have logical frameworks (LF), which were only prepared by SCF starting in 2004. This fact impaired both the definition and verification of project development objectives.

**Box 1: Lessons Learned as stated in the XPSRs**  
*Strengthening Project Evaluability*

“Hydro power generation would have relatively high economic viability, due to low overall generation costs and positive impact on the reduction of carbon emission. However, the direct benefit may be difficult to be felt by the customers, as the plant is connected either to national system and/or provides electricity to specific distribution companies with large energy demand.” (*Dona Francisca*).

“There were various social and economic issues in the region of the Cana Brava Project, which negatively affected creation of jobs and economic activities. They were likely the result of a depressed local economy and it was unrealistic to imagine that one single project could change this context.” (*Cana Brava*)

- 5.6. *Improvement of coordination intra IDB's areas.* The projects' execution stressed the importance of an in-depth coordination among the public and private branches of IDB Group to boost implementation of overall structural reforms in the sector put in place concomitantly with the project.

**Box 2: Lessons Learned as stated in the XPSRs**  
*Improvement of coordination intra IDB's areas*

“The involvement of the Bank in the preparation of specific projects would still contribute to the improvement of the country’s regulatory framework. Proper sector analysis and coordination with the Regional Department would be the key in this regard.” (*Monterrey III*).

“The failure of the GDR’s efforts in promoting private sector participation in 2002 (...) also showed the importance of commitment of the government with the reform (...), in which increase of tariff was inevitable to absorb the increased costs and to make the new model becomes sustainable. The importance of the political commitment also applies to the issue of illegal connections and fraud, as technical improvement alone would not solve these problem.” (Edesur/Edenorte).

“The success of the public-private partnership developed as a recommendation of the Social Audit (economic and social development fund) is an indication of the potential for maximizing the impact of Bank investments when the public and private sectors of the Bank work together in specific projects when important developmental effects are needed or expected.” (Cana Brava)

- 5.7. *Strengthening of sectorial knowledge.* The XPSRs also identified the need to better staff’s specialization in areas where the Bank has not much experience. Indeed, the Bank supported some Greenfield operations in ports, helping the governments to develop new concession models for the private sectors, and some issues arose from project implementation that impacted its results, such as demand overestimation and competition with other agents in the industry.

**Box 3: Lessons Learned as stated in the XPSRs**  
*Strengthening of sectorial knowledge*

“The Bank should improve its capacity in preparing development plans of new ports. Likewise, the Bank should strengthen its expertise in maritime transportation.” (M’Bopicua)

- 5.8. *Improving of the identification of risks mitigation mechanisms and project sensitivity analysis.* The XPSRs also highlighted the need of better identifying risks mitigation mechanisms in order to avoid negative impacts on project results.

**Box 4: Lessons Learned as stated in the XPSRs**  
*Improvements in the Risk Identification and Sensitivity Analyses*

*Long- term purchase agreements with off-takers*

“The Bank should enhance risks mitigation mechanisms (...) by both extending the tenure and maximizing the coverage of traffic secured by off-take agreements.” (M’Bopicua).

“The fluctuation of spot market confirmed the importance of having PPA to ensure stable financial performance of projects.” (Dona Francisca)

“The competitive environment in the energy market forced the private sector operators to agree on the tariff which was much lower than their long-run marginal costs. This put constrains for the financial return of the project.” (La Chorrera)

*Sensitivity analysis*

“The project had never operated - The cost of electricity in Brazil fell dramatically due to the sudden increase in rainfall after the plant had been built. Most of the power was generated via hydro plants in Brazil and incremental costs of a gas plant could never compete with the hydro plants built. This indicates the challenges to predict the financial and economic benefits of the thermal power plant. The sensitivity scenario for the thermal plant should take this situation as the worst case scenario.” (Termobahia)

“Market share projections cannot be over emphasized in a context of Greenfield projects.” (ODJ)

- 5.9. *Other appraisal work issues that affected project development outcomes.* Finally, the XPSRs' lessons addressed some other appraisal work issues that should be addressed by the Bank in order to avoid negative impacts in the project development outcomes. Indeed, the XPSRs identified the need for improvements in both sectorial and sponsor background analysis as well as the importance of changes in the corporate deal structure to speed project completion.

**Box 5: Lessons Learned as stated in the XPSRs**

*Improvements in other appraisal work issues that affect project development outcomes*

*Background Analysis of the Sector*

"[The regulatory authority] ANEEL never let [the project] operate. The project closed without ANEEL's final approval. At the end of the day, even if the project could run economically, ANEEL would have restructured the PPA to disallow Petrobras from operating and selling to itself. The Project should not have closed without ANEEL's final approval. Plus there should be a provision requiring Petrobras to prepay the loan if ANEEL determines that the current structure would prohibit the project from operating. Retrospectively, this project may have contradicted itself with the energy sector reform pursued by the Brazilian government." (Termobahia)

*Background analysis of the sponsors*

"The level of support, knowledge and experience of the sponsor of the operator are very important for the success of Greenfield projects launch in very competitive markets such as mobile telecommunications." (ODJ)

*Corporate deal structure to speed project completion*

"The Bank should structure its corporate deals in order to encourage the client to reach the project completion phase, by tying the spread increase to a security release or a specific date instead of the project completion date. As a result, the client would not have the incentive to delay the project completion in order to benefit from the lower rate valid during the pre-project completion phase of the project cycle." (Monterrey III).

## **B. Project Investment Profitability to IDB**

- 5.10. Lessons about prepayment are the main issues highlighted in the lessons learned regarding project investment profitability to IDB. In this particular, the reports underscored the need of: (i) flexibility to response to market conditions; and (ii) changes in project design to mitigate clients' prepayment. In addition, the XPSR also assessed general lessons from the Bank's operations that affected the Bank's profitability regarding guarantee and loan operations.

**a. *Reasons for Prepayment:***

- 5.11. *Flexibility in Response to Market Conditions.* Several XPSRs identified changes in the market conditions that led clients to prepay the loan. The occurrence of Loan prepayments could be evidence that the clients have been finding better market alternatives to replace their financial obligation with the Bank. Therefore, the

XPSR addressed that the Bank should develop new mechanisms in order to maintain strategic clients in the Bank's portfolio.

**Box 6: Lessons Learned as stated in the XPSRs**

*Flexibility in Response to Market Conditions*

“The Bank should introduce *flexible adjustments* in its lending rate while safeguarding the Bank's financial return and market-based pricing principles. (Monterrey III).

“The Bank should create *financial products more adjustable to the market trends*. A clear understanding of the changing conditions in the financial market should be taken into account in order to avoid unexpected prepayments. In countries like Chile, with domestic financial system relatively well developed and integrated with international capital markets, the Bank conditions have become uncompetitive and therefore a different approach should be taken. (...) [The project] was pre-paid due *to the borrower preference for a local currency facility*.”(Antofagasta)

“The loan was prepaid in May 2005 based on the corporate financial policy decision made at the level of the Sponsor's parent company (Suez Group) *to no longer hold dollar-denominated debt*.” (Cana Brava)

“Novatrans was prepaid as a result of the *high liquidity in the market and access to the Borrower of alternative financing sources*, even though the Bank indicated the possibility of lowering interest rates in order to avoid the prepayment. This prepayment occurred in a context of several other prepayments, providing evidence that when highly liquidity market conditions are present, it is difficult for the Bank to compete using its both current financing instruments and contract requirements, which are not usually present in commercial operations.” (Novatrans)

5.12. *Changing contractual mechanisms.* The XPSRs identify the importance of contractual obligations to mitigate clients' prepayment such as additional fees or even reduction of collateralization.

**Box 7: Lessons Learned as stated in the XPSRs**

*Adequate Contractual Mechanisms to Mitigate Project Prepayment*

“The Bank should structure the loan in order to protect it against prepayments since the contract's prepayment premium could not be enough to deter prepayments.” (Monterrey III)

“*Additional fees* were justifiable for both the additional work required by the project and by the client's prepayment and they should be encouraged for the futures since they are in line with the market price.” (CIEN).

“Although the projects that are financed by the Bank as "project finance" assume that at a certain point in time the corporate guaranty provided by the Sponsor(s) will be released with the achievement of Technical Completion and Project Completion, (...) In case, for any reason, (...) milestones are not achieved, both the corporate guaranty and the project-related security package will remain in place. Although this is beneficial to the Bank from a credit standpoint, from the project's point-of-view this might be seen as an *over-collateralization*, which can potentially lead to efforts made by the Borrower to prepay the Bank loans (although this is not the case in this project).”(Dona Francisca).

**b. Other issues that Affected IDB's Profitability**

5.13. *Improvement in the Design of Guarantee Operations.* The XPSRs also identified some issues concerning the implementation of guarantee operations. The report addressed some recommendations in order to reduce the risk of eventual claims from the Bank's clients.

**Box 8: Improvement in the Design of Guarantee Operations**

"A clear identification of the main risks and mitigation mechanisms are important in Guarantee transactions. In this regard, a clear understanding of legal conditions upon the Guarantee agreement is very important in order to protect the Bank for eventual claims. Improvements to the standard Guarantee Agreement were recommended based upon the experience of Light transaction, including fine-tune of the mechanics of calculating fees. Consistency among the various guarantee/reinsurance agreements for payment calculation conventions are preferred (i.e. number of days in year, business day convention, coverage period to apply, etc)." (Light)

5.14. *The need to identify of strong sponsors.* Likewise the lessons learned regarding Development Objectives, the XPSR identified the importance of a strong sponsor to avoid negative impacts in the project's development which, as a result, could affect the project's creditworthiness, thus affecting IDB's profitability.

**Box 9: Lessons Learned as stated in the XPSRs**

*Need of Stronger Sponsors*

"The evaluation of ... sponsor [capacity] in Greenfield projects [is critical] in a context of very competitive conditions." (ODJ);

"[A] strong sponsor is a guarantee to backstop any potential risks which would affect creditworthiness of the project." (Edesur/Edenorte).

"When all stakeholders are not well defined (in this case the privatization process of ESSAN), sponsor support to the project becomes critical to mitigate other risks related to the project." (Antofagasta).

5.15. *Tariff Structuring.* The XPSRs are not conclusive about how to define the project's tariff structure in order to encourage project profitability. Indeed, while one XPSR suggested increasing the variable part of the tariff in order to encourage client productivity, other XPSR did the opposite, crediting the fixed part of the tariff (capacity tariff) for fully covered the loan debt service.

**Box 10: Lessons Learned as stated in the XPSRs**

*Tariff Structure*

“The appraisal phase of port operations should define tariff structures that provide incentive for the company to handle more cargo volume than secured under the take-or-pay arrangement by setting a higher tariff for the variable payment portion.” (M’Bopicua).

“The structure of the loan did accommodate for the risk of the competitiveness of the plant, because Petrobras fully guaranteed the tolling arrangement with guaranteed payments. All of the capacity payments covered the debt service, both senior loans (IDB’s) and sub debt.” (Termobahia)

- 5.16. *Long-term purchase agreements with off-takers.* The XPSRs also identified the importance of long-term purchase agreements for guaranteeing project profitability.

**Box 11: Lessons Learned as stated in the XPSRs**

*Long-term purchase agreements*

“The project showed the challenge for the Bank to provide a long term loan to the project which has short term PPA. The sales to the spot market tend to be volatile and increase the credit risk to the Bank.” (La Chorrera).

**C. IDB’s Additionality**

- 5.17. This section will focus on the lessons learned from IDB’s additionality, i.e., the aspects that arose from the Bank’s attempts to improve the country’s financial, regulatory and ESHS conditions as well as the company’s corporate governance through the Bank’s support of its operations. In order to capture the Bank’s additionality contribution, this section will also include issues related to the client’s perception of the Bank intervention as to regulatory, financial and environmental additionality.
- 5.18. Most of the projects were implemented during an early stage of implementation of new regulatory models in the private sector. In that vein, from the private sector standpoint, pursuing “regulatory comfort” could be an appealing motivation to work with the Bank.
- 5.19. As discussed in the section three, some XPSRs found that the Bank had an important role supporting the Novatrans project, one of the pioneers in the power transmission subsector. Likewise, the guarantee provided to Light was important in supporting the continuity of the Brazilian distribution company’s privatization in a context of economic and political instability.
- 5.20. However some XPSRs, supported by survey analysis, found that the client’s expectations were frustrated in some cases when more dialogue with the government and more coordination with other Bank departments were necessary to fulfill the client’s need for regulatory comfort.

*a. Need of Better Dialogue and Coordination*

**Box 12: Lessons Learned as stated in the XPSRs**

*Need of better dialogue and coordination: the client's standpoint*

“The Bank should try to meet the client expectation by directly engaging in the dialogue with the government to solve regulatory aspects emerged during the implementation of the project. Indeed, since the credit risk for the Bank was mitigated by the sponsor guarantee, the Bank was less proactive than the client expected.” (CIEN)

“[I]t does not appear to be justifiable that the Bank took 33 months from eligibility to approval and an additional 16 months to closing. For the project’s clear additional factors, this project deserved a much faster processing, with a Bank’s more active intervention at the local and federal levels (as needed) to ensure the quick implementation of the project.”(Antofagasta)

“[T]here was a conflict of interests and Petrobras, Ministry of Energy and [the Regulatory Authority] ANEEL had different agendas. However, the loan proposal emphasized “private nature” of the project. As SCF is going to work for more public sector projects under the NSG mandate, SCF would need to find a better way to deal with projects with high political aspects. If anything could be done, it would need to be arranged before the closing. Furthermore, it also became clear that the Bank needs to make sure that the regulatory framework is sound, rather than try to being involved in a project while regulatory framework is in premature stage. In this case, more collaboration with the Sovereign Operations side of the Bank as well as with MIF would be needed.” (Termobahia).

“In order to address the regulatory issue faced by the project, the Bank also contacted ANEEL, the Brazilian electricity sector regulatory agency, and Petrobras, the project's natural gas supplier, and exchanged views and opinions with these entities throughout the restructuring process. This was very helpful in gathering information and in understanding all aspects of the issue. Therefore, it would be important that the Bank optimizes its access to authorities, regulatory entities and other public entities, in case there is any need to do so, in light of the situation of the projects.” (Termopernambuco).

*b. Need to Reduce Transaction Costs*

- 5.21. In addition to the regulatory risk’s mitigation, which is the comfort provided by the Bank’s additionality, the clients also expected to fulfill their need for better tenors through the Bank’s financial provision. However, lessons learned from the XPSR demonstrated that these needs were not always met. To overcome this problem, the XPSR addressed some recommendations for the Bank’s appraisal phase in order to avoid negative impacts in client satisfaction, in particular related to the need to reduce the Bank’s legal costs.
- 5.22. High transaction costs leave the Bank at a competitive disadvantage vis-à-vis other financial institutions. The XSPRs brought evidence of client dissatisfaction with the IDB’s transactional costs, primarily linked to due diligence. Some of them stressed the need to hire local lawyers in order to mitigate these costs.

**Box 13: Lessons Learned as stated in the XPSRs**

*The need to reduce legal costs*

“The Bank would need to examine carefully whether its warranties, pledges conditions and shareholder support requirements after operation starting are in market practice and whether they are not undermining attractiveness of the Bank's financing.” (Mejillones)

“The Bank should speed the closing deals while the funds are still relevant to the project. In the case of Antofagasta, sponsor incentives to close the deal have [been] reduced after obtaining a bridge loan from a private bank.” (Antofagasta).

“In order to avoid the excess of breakage costs, it would make sense that the Bank does not require hedge ... [from] to the client during construction. Otherwise, the Bank could at least change the periodicity of the interest payments during the construction period from monthly to quarterly to avoid the excess breakage costs. Both changes could avoid the problems ... [that arose] during the project implementation since the project was structured to repay interest on a monthly basis both during construction and operation at the same time that [it] had monthly disbursements and monthly breakage costs. As the Bank required [the client] to hedge during both periods, there were unavoidable breakage costs during the construction period which did not always match the notional values contemplated in the construction curve.” (Termobahia).

“Th[e] project faced substantial regulatory issues and had to be fully restructured. This resulted in extremely high legal costs (related to the Bank's international and local counsel), which were incurred by the Borrower. Although extensive involvement of international and local legal counsel was inevitable in this case, there could have been a more significant involvement of the Bank's legal department, what could have reduced legal costs paid by the Borrower. At least in [a] problematic transaction like this project, where there is extensive involvement of legal counsel, the Bank could charge some legal fees to the Borrower and hire additional staff, as this would still be less expensive to the Borrower than to pay the Bank's external legal counsel.” (Termopernambuco).

“Despite efforts of the Bank during the project structuring and monitoring, the clients (the sponsors and companies) were not fully satisfied with the work done by the Bank staff. In addition to the continuing efforts to shorten project preparation time and reduce transaction costs, the Bank would also need to reduce turnover of the staff, and change the culture where the Bank is seen [as] less flexible and attentive to the client needs. This project was one that had to face several difficulties (ranging from the company's non compliance with loan covenants, to having to deal with an expired PPA and to operate as a Merchant plant), including the issues [that] emerged with one of the two the B-lenders. Consequently, this demanded a lot of time from a portfolio management perspective.” (Chorrera)

***c. Contractual flexibility in order to allow the client to operate in competitive markets.***

5.23. The XPSR identified some market contexts in which the speed of the client's answer is crucial to the project surviving in this environment. In this regard, the Bank should design corporate deals that allow the client more flexibility during project implementation.



**Box 14: Lessons Learned as stated in the XPSRs**

*More Contractual Flexibility for Clients Operating in Competitive Markets*

“(…) In a very competitive context and dynamic market, loan agreement and covenants should be more flexible to allow the borrower to respond quickly to the market conditions.” (ODJ).

**d. The Need for Additional Resources for Environmental Components.**

- 5.24. The sensitivity of environmental issues related to infrastructure projects requires more spending of resources by the Bank in the project’s appraisal phase in order to provide the Bank’s additionality. Lessons from XPSR addressed the Cana Brava project’s independent investigation’s recommendation regarding the strengthening of the Bank’s capacity in dealing with environmental issues. Indeed, this recommendation could help avert both client dissatisfaction and side effects during project implementation.

**Box 15: Lessons Learned as stated in the XPSRs**

*Additional Bank Resources for Environmental Components*

“It was unfortunate that the Bank and the Borrower/Sponsor could not reach an agreement (…) as the Borrower had its own plan to address resettlement issues and was no longer to commit to implement the Corrective Action Plan and otherwise comply with the Environment Requirements of the Bank. (…) It was very difficult for the Bank to have the Borrower (…) implement Corrective Action Plan when there were different views on who should be responsible to take the necessary measures to resolve certain issues, especially when the project was executed by a private company in an area affected by economic and social problems before the initiation of the project. (…) There were also some findings and recommendations addressed in the report created in the process of the Independent Investigation Mechanism. The entire Board of the Bank supported the Independent Panel’s recommendation related to additional social and environmental safeguard staff and budget resources, sufficiently early resettlement component screening, and clarification of lines of communication and authority between SCF and Country Offices for SCF operations.” (Cana Brava)

**e. Close monitoring during the project implementation**

- 5.25. The XPSRs recommend contractual changes and the reduction of the periodicity of financial statement accounts in order to improve the Bank’s capacity to monitor its projects.

**Box 16: Lessons Learned as stated in the XPSRs**

*Close monitoring during the project implementation*

“In order to reduce the risk of no reporting of Annual Operations, the Bank should ensure that the contract between the borrowers and third parties defines the reporting requirements from the third party.” (M’Bopicua)

“[T]he Bank should shorten the periodicity of the financial statement accounts, from annual to quarterly, in order to permit more objective reports.” (Monterrey III)

## VI. CONCLUSIONS AND RECOMMENDATIONS

### A. Conclusions

- 6.1. This second XPSR exercise was a very time consuming and interactive process. In fact, it took much more time than expected, since it was originally scheduled to be done on December, 2007. However, it is also true that the process benefitted from the several working sessions that OVE and SCF spent discussing ratings and analyzing evidence from the project documents. Another positive aspect was that the number of SCF staff involved in the process rose considerably.
- 6.2. As a result, the current exercise presented clear advances if compared with the previous exercise. Indeed, SCF complied with the ECG requirements and self-evaluated all projects that were eligible to be self-evaluated in 2007. SCF also addressed several OVE recommendations made in the first report. SCF's staff improved its capacity to identify lessons learned from all project dimensions, provided justification for the project's ratings, sent surveys to Bank clients and provided OVE all documentation required for the project's validation.
- 6.3. On the other hand, this XPSR exercise also identified the need of improvement in several aspects, most of them related to the challenge of evaluating self-evaluated prepaid projects, the main issue that surrounds the XPSR analysis. Indeed, the XPSRs missed tracked information about project achievements on development objectives and corporate governance's additionality and lacked feedback from client surveys as well.
- 6.4. In general terms, regarding the project ratings validation, OVE downgraded 19 % of the SCF ratings – more than in the previous exercise (13%). The majority of the downgrades (57%) were related to IDB profitability, followed by IDB's Work Quality (24%), IDB's additionality (14%) and Project's Development Outcomes (10%) ratings.
- 6.5. The XPSR analysis underscored that SCF's projects presented worse results on all ECG dimensions, if compared with the previous exercise, when a smaller sampling of projects were self-evaluated (only five projects). Even in the better project's performance, which is regarding their IDB additionality (64% of highly satisfactory/satisfactory), the results were worse than 2006, when they performed 100% highly satisfactory. The second better performance was in their contribution to the development outcomes and IDB's Work Quality (both 43% of satisfactory) against respectively 100% and 80% of highly satisfactory/satisfactory in 2006. Finally, the projects performed worse in IDB's profitability, since only 29% were satisfactory, while they obtained 100% of highly satisfactory/satisfactory.
- 6.6. In terms of *IDB's additionality*, the analysis of the XPSRs underscores that financial additionality was the most important project contribution, followed by environmental, corporate governance and regulatory contributions. In this regard, Novatrans illustrated the best-case scenario, in which the project provided

regulatory, financial and environmental additionality. On the hand, the analysis of Edesur/Edenorte project did not find evidence of Bank's additionality in any dimension.

- 6.7. In terms of *Project's Development Outcome*, the lack of information about prepaid projects negatively affected the general ratings of the project sampling, since evidence of results could not be produced in several cases. Therefore, projects achieved only 29% for both highly satisfactory and satisfactory for economic development. They rated 7% highly satisfactory and 79 % satisfactory on ESHS contribution and 7% highly satisfactory and 57% satisfactory on private sector development. Finally, they achieved no highly satisfactory and only 29% satisfactory on company business success.
- 6.8. Likewise, the lower ratings for *IDB's profitability* were strongly influenced by the fact that all but one of the loans were prepaid. As a result, though they did not imply loss of capital for the Bank, they generated less than 65% of the original expected interest income, which is the threshold defined by OVE's guidelines for implementation of the ECG Guidelines to qualify them as satisfactory. The highly incidence of prepayments among the Bank's projects has already been identified by the staff as one the main issues in the previous XPSR exercise. In fact, these events deserve an in-depth analysis by the Bank, because the financial additionality is only one of the expected results from the Bank's support to the project. The guarantee that the project's development objectives as well other additionality dimensions are met is directly related to the Bank's continuing support to the project by monitoring its implementation and by learning from its results' evaluations.
- 6.9. In terms of *IDB's Work Quality*, the analysis showed that further efforts should be made mainly regarding screening, appraisal and structuring work, which presented worse results (only 43 % of satisfactory) than in monitoring and supervision quality work, in which 7% of the projects were highly satisfactory and 79% satisfactory. In particular, the XPSRs stressed that shortfalls in appraisal work, such as the sensitivity analysis and risks mitigation mechanisms, have impacted the achievement of better project results on IDB's development objectives and IDB's additionality performance indicators.
- 6.10. Several lessons learned were identified by the SCF's staff during this current exercise for each one of the ECG guidelines. The staff identified the Bank's need to strengthen its appraisal work in order to raise the probability of achievements on project development outcomes. The staff also underscored the need for flexible products and new contractual mechanisms in order to mitigate the risk of prepayments. Finally, lessons learned regarding IDB's Work Quality stressed the importance that the Bank strengthens its intra-coordination, enhances its dialogue with the government, deepens its project monitoring in order to adopt promptly corrective actions during project implementation, reduces legal costs and, finally, spends additional resources on the project's environmental components.

## B. Recommendations

- 6.11. Based on the lessons learned from implementing this second XPSR exercise, OVE has three recommendations. The first is related to the increased number of prepaid operations, which was the main issue that has been underscored since the previous report. The second recommendation is related to improvements in the Bank's Work Quality. Finally, the last recommendation is related to the improvement of the project evaluability, in particular to the prepaid projects. OVE details its general recommendations to SCF:
- 6.12. OVE recommends that SCF conduct a *case study* aimed at identifying the causes of the high incidence of prepayments in the SCF project portfolio. This study should address recommendations to lessen their incidence, taking into account the lessons identified by the Bank's staff in the XPSRs. Additionally, the study should assess how other similar financial institutions are dealing with this issue, which was part of OVE's recommendation addressed in the first validation XPSR report.
- 6.13. OVE recommends that SCF address *measures to improve its Work Quality*. In particular, the SCF should identify whether the recommendations raised by staff in the XPSR reports have been implemented and what their results have been, in particular the issues related to improving appraisal work and reducing legal costs.
- 6.14. OVE recommends that SCF enhance the project's evaluability. In so doing, SCF may require reinforcement of *contractual mechanisms in order to ensure both tracking and measurement of its projects' economic and financial indicators, even for those projects that end up being prepaid*. This requirement might also be included in the client's affirmative covenants regarding the need for client participation in SCF surveys, and the provision of information about outcome indicators during both the implementation and completion phases of projects. Finally, the SCF should *improve its tracking of the corporate governance's additionality of the projects*, by providing evidence of prudent management practices and other expected benefits from the project implementation.