GERMAN and FRENCH FINANCIAL COOPERATION WITH GEORGIA

Declaration of Intent

between

Government of Georgia, represented by
the Ministry of Finance of Georgia
("GoG")
and

KfW, Frankfurt am Main
("KfW")

and

Agence Française de Développement, Paris
("AFD")

– Support of the Energy Sector Reform of Georgia –
Project ID: 39885

1. Introduction

Representatives of the Government of Georgia (GoG), German Development Bank KfW and the French Development Agency (AFD) gathered in Tbilisi, Georgia between February 5 and February 8, 2018 to discuss the possible support of GoG's ambitious reform agenda in Energy Sector. This initiative started in early 2017 when the GoG approached KfW with a request to assess options for a Policy Based Lending (PBL) operation to support Georgia's reform processes within the strategic frameworks of its full membership in the Energy Community (EnC) and the EU Association Agreement. It is understood by the parties that this Declaration of Intent is not defined as an agreement entered into by parties with the intention of creating legal obligations.

The Road Map 2018-2021 and the corresponding Policy Matrix 2018 (see Annexes 2 and 3) were developed jointly with the Ministry of Finance and the relevant line Ministries (Ministry of Energy merged end of 2017 to the Ministry of Economy and Sustainable Development). Other relevant stakeholders, especially the Energy Community and the EU4Energy regional office in Tbilisi were involved in development of the reform programme from an early stage.

The exchange with the EU Delegation and the French Development Agency (AFD) were particularly fruitful and culminated in the envisaged close cooperation on the PBL operation between the AFD and KfW and a preliminary indication of the EU Delegation's willingness to support the sector reform process with technical assistance.

The proposed PBL is structured along a Road Map covering the years 2018 until 2021, specified in a policy matrix and tracked over a multi-year PBL approach. The policy matrix will be revised and updated on annual base depending on necessity. An update of the Road Map in consent of the signing parties as and when required is considered between the signing parties as an option. It is agreed that it will be task of the Steering Committee as stipulated in chapter 3 to make any necessary adjustments of the Road Map.

KfW would like to highlight that all given terms and conditions as well as the commitment of funds are given on a strictly indicative basis and are subject to the results of a due diligence ("Due Diligence") and to the approval of both KfW's management and the German Government. The Due Diligence will encompass an analysis of the financial situation of the borrower and plausibility of the planned implementation and operation concept.

AFD would like to highlight that nothing in this declaration of intent constitutes an offer or a commitment from AFD to provide financing to the Government of Georgia. AFD's decision to make funding available will be subject inter-alia to (i) the positive conclusion of a comprehensive due-diligence process on the identified programme, in particular on climate impact (ii) satisfactory agreement on terms and conditions of the financing, (iii) approval of AFD's decision-making authorities, (iv) absence of any material adverse change in the financial situation of the borrower and/or market conditions and (v) negotiation and execution of all the related contractual documents satisfactory to AFD. The figures and amounts are for reference only and may be subject to change in the future.

KfW would also like to highlight that for all items of the project to be financed by KfW need to be procured according to KfW's Guidelines for the Procurement of Goods, Works and Services as well as the Guidelines for the Assignment of Consultants (if relevant), which requires No-Objections of KfW to relevant procurement steps.

AFD would also like to highlight that all items of the project to be financed by AFD need to be procured according to AFD's procurement rules.

2. Next steps and timeline

The Government of Georgia, KfW and AFD will launch the next steps for the Due Diligence and project preparations.

These include:

No.	Who	Item	Tentative Timeline
	MoF	Signing of Financial Agreement by Georgia, represented by the Ministry of Finance, and KfW on behalf of the German Government for a grant, provided by the German Government to finance a consultant for the project development.	April 2018
	KfW	KfW-internal appraisal and proposal to the German Ministry for Economic Cooperation and Development	March 2018
	KfW	Contracting of a consultant for the project development.	April 2018
	AFD	Contracting of a consultant for conducting part of the associated technical measures foreseen for 2018-2019	May 2018
	KfW	KfW-internal loan approval	May 2018
	AFD	AFD internal loan approval	July 2018
	KfW - AFD	Assessment of the fulfilment of the relevant triggers for 2018	August 2018
	KfW – AFD - MOF	Signing of the first loan agreements (in case of positive result of the assessment) between the KfW and Georgia, represented by the Ministry of Finance and also between the AFD and Georgia, represented by the Ministry of Finance	September 2018
	KfW- AFD - MOF	Disbursement of Loan Funds from first loan agreements (after ratification of loan contracts by the Georgian Parliament)	December 2018

3. Structure and Rational of the Envisaged Cooperation

Objective of the program is to contribute to the implementation of the EnC Treaty and the EU Association Agreement, fostering economic growth through cross-border electricity trading, the reduction of greenhouse gas emissions via an enhanced energy efficiency in consumption of electricity, the creation of additional export capacity for electricity through reduced domestic consumption due to energy efficiency measures (especially in electricity transmission and buildings) and creation of skilled jobs with future potential, e.g. in a future oriented construction sector, reflecting EU standards in construction.

Therefore, GoG, KfW and AFD express the joined understanding about the following:

Aim of the PBL

- The objectives of the PBL are

  (1) the regional market integration with reference to the EnC Treaty wherever possible to strengthen Georgia's position as a regional energy hub and to assure the economic sustainability of the investments into the transmission infrastructure of Georgia, supported by the international donor community and, closely linked to a sustainable marked development,

  (2) Energy Efficiency (especially in buildings), referring to the National Energy Efficiency Action Plan (NEEAP, released 2017) and the definition and implementation of respective Energy Efficiency Standards, it's further development and Georgia's obligations under the EUEC treaty.

Structure of the PBL:

- The envisaged 4-year strategy is outlined in the Road Map (Annex 3), specified in a Policy Matrix (Annex 2). The Matrix contains clearly defined indicators on the required progress of the reforms in the respective fields of action (smart triggers, see Annex 1).
- The Policy Matrix in Annex 2 is agreed between GoG, KfW and AFD after consultation with the relevant stakeholders (esp. MoESD, GNERC, GSE, ESCO etc.) and discussion with relevant donors in the sector.

Steering Structure and Coordination

- GoG, KfW and AFD share the common understanding that the necessary support for achieving the stated goals as outlined in the Road Map requires a high level of coordination within the GoG, between GoG and the donor community but also between the donors themselves regarding their different programs on energy sector reform and energy efficiency. Therefore, an effective steering structure will be established. The composition of this structure will be agreed on as a next step to assure that the relevant stakeholders in the sector are sufficiently represented. The designated steering structure for the PBL (Steering Committee) intends to facilitate the initiative of GoG for more advanced donor coordination in the sector.
- The Policy Matrix will be continuously updated taking into consideration of the Road Map for the following phases in the 3rd quarter of 2018, reflecting the achievements in the 1st phase.

Phasing, Disbursement and Evaluation of Results

- The disbursement of loans out of the PBL is linked to the positive evaluation of the indicators, defined in the Policy Matrix (triggers) as part of the implementation of the reforms in the respective fields of action of the individual subsectors (Annex 1).
- The first phase of the PBL is scheduled to start in 2018 to allow under the precondition of an adequate level of fulfillment of the agreed obligations a disbursement of the first

tranche timely to be considered in the 2018 budget. Subsequent phases follow with an annually evaluations for the years 2019-2021.

Visibility

- A correspondingly ambitious policy matrix in connection with a relevant funding volume guarantees the visibility of the program and of the joining partners (GoG, KfW (BMZ), AFD and potentially EU) in the sector dialogue.

Borrower will be Georgia, represented by the Ministry of Finance. Responsible for the design and implementation of the sector reforms agreed under the program is the Ministry of Economy and Sustainable Development.

The program should provide important impetus for structuring and implementing a comprehensive sector reform and bringing it into the political reform process. To achieve this, it is necessary to reach an agreement on the total volume over the entire amount of the funds in order to ensure an interlocking settlement of all four phases since the follow-up phases can only be triggered after successful completion of the previous phase and the achievement of the defined payout indicators.

For the PBL tentatively loan commitments of EUR 74 million p.a. are foreseen for at least the years 2018-2021 with potential extensions (Total loans: EUR 296 million), subject to KfW's and AFD's Board approvals each year during the whole implementation period of the program. KfW and AFD agree on a share of their commitments in a two-to-one ratio (KfW approximately two thirds of the total loan amount, AFD one third of the total loan amount). EU TA funds, if applicable, would support the fulfilment of the criteria of the policy based loan.

The final funding volume shall be determined on the basis of a written request from the Government of Georgia.

All parties are looking forward to a successful cooperation in order to implement a successful sector reform in Georgia's energy sector.

Tbilisi, ...May...14 2018

For:

Government of Georgia

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Mr. Mamuka Bakhtadze
Minister of Finance of Georgia

For KfW:

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Dr. Klaus Veigel
Director KfW Office Tbilisi

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Hans Rieck
KfW Senior Project Manager

For AFD:

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Gaëlle Assayag
Head of AFD representative office
for the South Caucasus

Annexes:

Annex 1: Monitoring Scheme
Annex 2: Trigger Matrix 2018
Annex 3: Road Map 2018-2021