CDM-EB91-AA-A06

Concept note

CDM Loan Scheme: Annual Report and Recommendations to the CMP*

Version 01.0

*includes recommendations from the secretariat to the CMP

United Nations
Framework Convention on
Climate Change

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1. Procedural background

1. At the fifth session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP), through decision 2/CMP.5, paragraph 49, Parties requested the Executive Board of the clean development mechanism (the Board) to allocate financial resources from the interest accrued on the principal of the trust fund for the clean development mechanism (CDM), as well as voluntary contributions from donors, in order to provide loans to support certain activities relating to the CDM in countries with fewer than 10 registered CDM project activities.

2. At its sixth session, through annex III to decision 3/CMP.6, the CMP established the guidelines and modalities for the operationalization of a loan scheme to support the development of CDM project activities in countries with fewer than 10 registered CDM project activities (the G&M), and requested the secretariat to select and contract with a public or private institution (an implementing agency) to administer the loan scheme.

3. The secretariat selected the United Nations Office for Project Services (UNOPS) as the implementing agency for the CDM Loan Scheme in late 2011.

4. Pursuant to Chapters V and VI of the G&M, the secretariat is required to provide:

   (a) An annual report to the Conference of the Parties serving as the meeting to the Parties of the Kyoto Protocol (CMP) on the status of implementation of the CDM Loan Scheme (Appendix I to this concept note) (paragraph 21 of the G&M);

   (b) A review (evaluation) of the performance of the CDM Loan Scheme in accordance with paragraphs 15, 17 and 19 – 21 of the G&M.

5. To meet the requirements of paragraphs 15, 17, 19 – 21 of the G&M, the secretariat undertook an evaluation of the CDM Loan Scheme during the first half of 2016.

6. The evaluation involved:

   (a) A survey of CDM Loan Scheme participants (loan recipients, consultants);

   (b) Meetings with the implementing agency (UNOPS) and its technical partner (UNEP DTU Partnership), including discussions with members of the technical review committee engaged by UNOPS for the loan selection process;

   (c) Analysis of a wide range of data and information collected from UNOPS and UNEP DTU Partnership;

   (d) Development of findings by a cross-disciplinary group within the secretariat.

7. The evaluation and its findings served to:

   (a) Form the basis for developing options for recommendations to the CMP by the Board, as described below;

   (b) Form the basis for the secretariat's recommendations to the CMP in relation to the CDM Loan Scheme, pursuant to paragraphs 15, 17 and 19 – 21 of the G&M. See Appendix II for these recommendations.

2. Purpose

8. The purposes of this concept note are to*:*

   (a) Provide the CMP with the annual report on the implementation of the CDM Loan Scheme (see Appendix I). This will be provided to the CMP through incorporation by reference to this concept note (CDM-EB91-AA-A06) into the report of the Board to the CMP;

   (b) Provide options to the Board for recommendations to the CMP in relation to the CDM Loan Scheme. The final recommendations from the Board will be included in the report of the Board to the CMP;

   (c) Inform the Board of the secretariat's recommendations to the CMP in relation to the CDM Loan Scheme (Appendix II). These will be communicated to the CMP by appending the secretariat recommendations to the report to the CMP.

3. Key issues and proposed solutions

3.1. Background on the CDM Loan Scheme

9. The CDM Loan Scheme works in the following way:

   (a) The interest on the trust fund for the CDM is allocated as funds for the CDM Loan Scheme.

   (b) The funds are transferred to the implementing agency, UNOPS, prior to UNOPS committing funds for selected loans.

   (c) UNOPS enters into loan agreements with selected entities in eligible countries. Under those agreements, UNOPS lends money to those entities in order for those entities to develop and proceed with CDM project activities or programmes of activities (PoAs).

   (d) The money is transferred to the entities in in specific instalments in line with agreed milestones that reflect the project development and cycle process;

   (e) The funds become repayable after the project[1] has issued its first CERs;

   (f) As part of its revolving mechanism, repaid funds are then held by UNOPS in order to lend to new projects wishing to receive loan funds.

10. The CDM Loan scheme is, in practice, a very complex system and quite unlike other aspects of the CDM in terms of its regulation and decision-making. The diagram attached to Appendix 2 shows the competencies as set out in the G&M. Key to understanding the purposes of this concept note are the following points

    (a) The CMP is supreme, and is the only body competent to decide the future of the CDM Loan Scheme and modify[2] the G&M;

[1] Project in this document means both project activities and PoAs unless indicated otherwise.

(b) The Board is competent to recommend changes to the G&M to the CMP;

(c) The secretariat oversees implementation of the CDM Loan Scheme by the implementing agency (UNOPS), with which it has an implementing agreement (Memorandum of Understanding (MoU)) and the secretariat has a mandate to report to the CMP on the CDM Loan Scheme.

3.2. Key findings

11. The key findings of the evaluation are:

(a) Finding A: Participants in the CDM Loan Scheme are largely positive about their participation (see section 3.2.1 below);

(b) Finding B: The CDM Loan Scheme has improved participation in the CDM of countries with fewer than ten registered project activities (see section 3.2.2 below);

(c) Finding C: The CDM Loan Scheme is exposed to serious systemic risk due to the persistent low CER price, which means that many funded projects may not achieve registration. As a consequence, the CDM Loan Scheme cannot show that it is effective and also means loans may not be repaid (see section 3.2.3 below).

3.2.1. Finding A: Participants in the CDM Loan Scheme are largely positive about their participation.

12. In relation to participants:

(a) Participants[3] were surveyed about their experience of the CDM Loan Scheme. The survey of loan recipients suggests that the primary motivation was to “Access funding for preparation for CDM documentation not otherwise available through existing project finance channels”[4]. Results from the survey suggest that CDM consultant’s motivations have generally been in response to either known CDM opportunities or direct requests for assistance from loan recipients[5]. On the whole, the overwhelming majority of both loan recipients (86%) and CDM consultants (76%) are either Very Satisfied or Satisfied with their overall Loan Scheme experience (see Figure 1).

(b) The majority of loan recipients seem to be happy with the support being provided by the CDM consultants. In nearly all cases respondents reported that the CDM consultant is active in pushing the funded project activity through to registration and issuance, and that they have been helpful in providing guidance on CDM

[2] Note that the G&M do provide a possibility for interim modification of the G&M by the Board, but as this concept note coincides with the annual recommendations to the CMP, such would not be required and is not covered in this note (or the attachment to Appendix II).

[3] Under the G&M, loan funds are generally transferred by the implementing agency to CDM consultants to pay for work done for the loan recipients in developing the project/programme. Thus, most loans involve two participants.

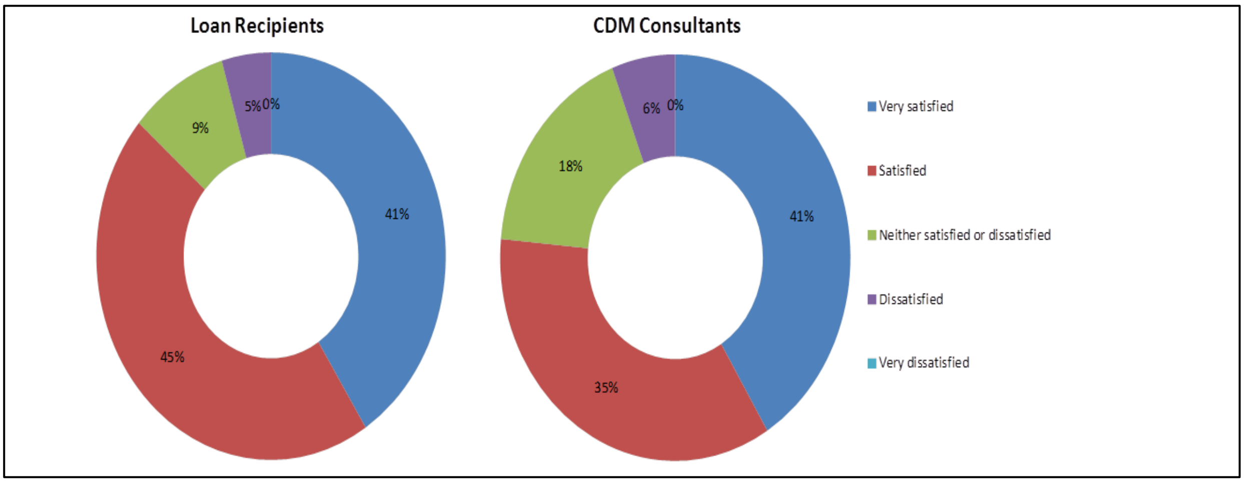
[4] Response rate of Loan Recipients: 41 per cent.

[5] Response rate of CDM Consultants: 68 per cent.

implementation. Only two cases were highlighted where the loan recipient was not satisfied with the CDM consultant. CDM consultants generally report positive experiences in working with loan recipients. In some cases, however, mixed experiences were also reported; in at least three cases problems have been identified, mainly relating to the loan recipient being unresponsive, losing interest in the activity, and/or having concerns about CER prices. In one case, the CDM consultant reports that the loan recipient seems to not understand the reasons for applying for the loan.

(c) The overwhelming majority of both loan recipients (91%) and CDM consultants (88%) are either Very Satisfied or Satisfied with the way UNOPS has managed the Loan Scheme to date.

Figure 1. Overall satisfaction with the CDM Loan Scheme



3.2.2. Finding B: The CDM Loan Scheme has improved participation in the CDM of countries with fewer than ten registered project activities.

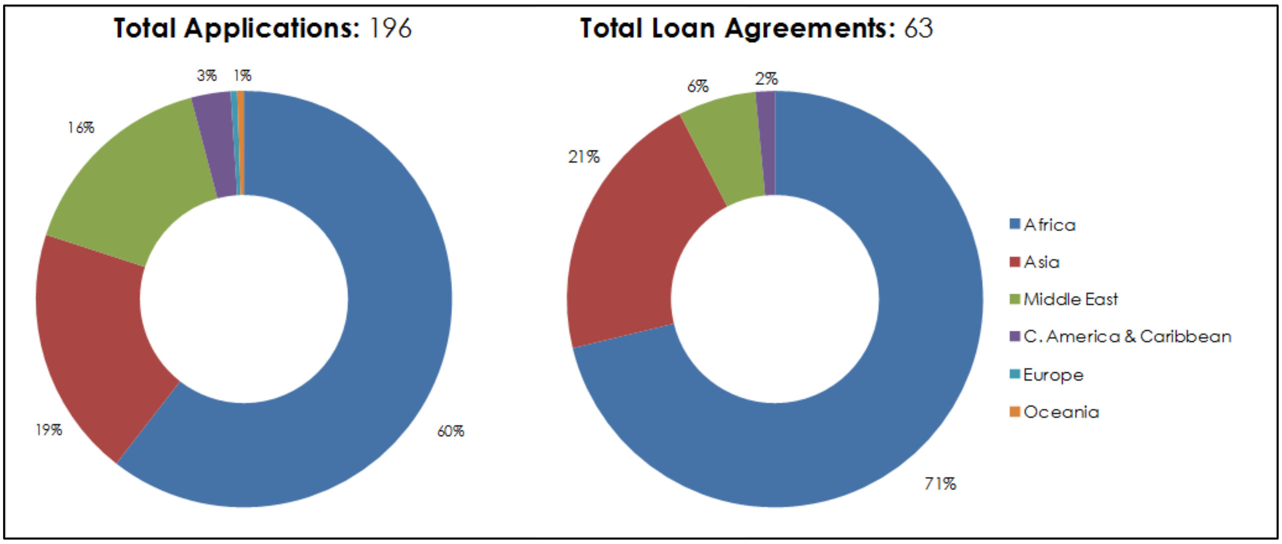
13. In relation to participation:

(a) The regional distribution by project type is reported in annual reports provided by the secretariat to the Board (see Appendix I for this year's report). There are loans to recipients in 30 countries and, as such, the CDM Loan Scheme has helped improved capacity in those countries. The regional distribution shows that countries from Africa have been the most active participants in the CDM Loan Scheme and the most successful region in terms of getting through from loan application stage to entering into loan agreements with the implementing agency. Concerns have been raised in the past about the under-representation of Latin America, the Caribbean and Eastern Europe in the CDM Loan Scheme[6], although as shown below (Figure 2), applications from these regions have been quite low.

[6] CDM Loan Scheme 2014–2015 Annual Implementation and Performance Assessment Report (CDM-EB86-AA-A04)

(b) Data from UNEP DTU Partnership suggests that over the duration of the CDM Loan Scheme, 182 project activities hosted in countries eligible under the CDM Loan Scheme had achieved registration as at May 2016. In relation to the funded projects, 14 funded activities that received funds for pre-registration costs have achieved registration in that time (14 of 182). This suggests that developers have been successful in registering projects/PoAs in eligible countries without CDM Loan Scheme support. While the data does not undermine the effectiveness of the CDM Loan Scheme, it does raise the question of whether the CDM Loan Scheme is a necessary measure for increasing participation in the CDM, and/or whether the choice of eligibility threshold (fewer than ten registered project activities) was adequate or appropriate in focusing attention on severely under-represented regions.

Figure 2. Distribution of Loan Applications and Loan Agreements by Region[7]



3.2.3. Finding C: The CDM Loan Scheme is exposed to serious systemic risk due to the persistent low CER prices, which means many funded projects may not achieve registration. This means that the CDM Loan Scheme cannot show it is effective and means that loans may not be repaid.

14. In relation to the design of the CDM Loan Scheme and persistent low CER prices:

(a) Under the loan agreements[8], guidelines for which are set out in the G&M, loans are disbursed by the implementing agency against milestones[9] and become repayable after first issuance of CERs (with a standard grace period of one year

[7] Total Loan Agreements includes a loan agreement entered into but that did not enter into force, for completeness.

[8] 63 loans were entered into by the implementing agency in its seven application windows. 7 of these loans are no longer active in that they are in the category of withdrawn/cancelled/repaid or being withdrawn/cancelled/repaid (although they may still be legally valid).

[9] Milestones are related to the CDM project cycle.

for repayment after that first issuance[10]). The loans are interest-free as per the G&M. As per the G&M of the CDM Loan Scheme, loan instalments are transferred to consultants (directly for the work to get the project through the project cycle) whereas the repayment comes from the project participant (who theoretically repays from the profit on the sale of the CERs). Issuance of CERs (milestone 7 under the loan agreements) triggers an obligation to repay the loan funds (as per the G&M). Issuance has become increasingly difficult for some project types to justify, given the persistently low price of CERs (e.g. cook stoves, for which CER revenue is the only material source of income). The loan is an uncollateralized loan except in so far as the G&M and the loan agreements provide for withholding of CERs by the secretariat where loan funds are not repaid after issuance of CERs. Where there is no issuance of CERs, there is no collateral.

(b) The persistent low price for CERs has disincentivized funded projects from progressing through the CDM project cycle to reach the final milestone, i.e. issuance of CERs. As the ability to repay depends on CER revenue, the trend of low CERs prices significantly impacts future repayment of funds.

(c) Largely because of this CER price issue, the loan portfolio is now in arrears; even taking into account amendments to half of all the loan agreements to recognize delays. At the end of June 2016, the implementing agency provided figures in its second quarter report to the secretariat that indicate that a conservative estimate of overall portfolio delay (expected/contractual repayment date compared to the anticipated/likely repayment date) comprises the following: 26 loans are approximately on schedule, 16 are up to one year delayed, 10 are one to two years delayed, and four are two to three years delayed. Note also that of the 63 loans entered into, seven are in the category of being withdrawn/cancelled/repaid. These delays imply repayment dates beyond 2019 for up to a third of the loans, even without any further delays accruing.

(d) As part of loan agreement obligations, CDM consultants provide a self-assessment of the likelihood of repayment and likely repayment date[11]. As repayment would ordinarily become due until after first issuance, this information can also be used to indicate whether a project is likely to achieve registration by a certain date. <u>While overall this information cannot be relied on for accuracy, because it is self-assessed, when it is aggregated it can serve to be indicative</u> of success in terms of likely completion of the project under the CDM Loan Scheme (first issuance of CERs) and repayment. The implementing agency provided statistics that indicate that:

(i) Around 50 per cent of the funded projects (in number of projects) are expecting to achieve first issuance of CERs and repay by the end of

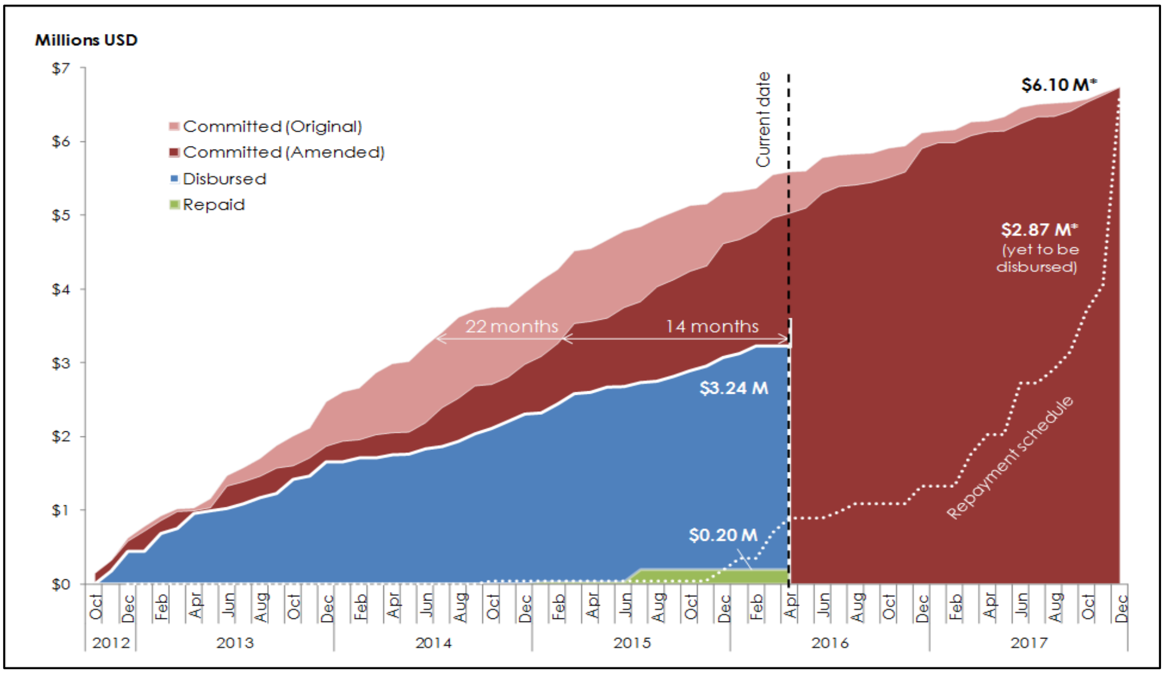
[10] However, with UNOPS' prior authorization, the repayment can be amortized over a period of up to thirty six months.

[11] This self-assessment is a legal obligation on the CDM consultant when reporting, but it is important to note that both the loan recipient and CDM consultant are under a legal obligation to inform UNOPS of anything that may affect the project from progressing or affect repayment of funds, as a standard lending term.

December 2017. Around 27 per cent are unlikely to do so and 23 per cent are very unlikely to do so;

(ii) In terms of total loan funds, projects likely to repay by December 2017 represent 40 per cent of loan funds, projects unlikely to repay by December 2017 represent 27 per cent of loan funds, and projects very unlikely to repay by December 2017 represent 33 per cent of loan funds.

Figure 3. Loan portfolio cash flows over time (actual and scheduled) (as at April 2016)[12]



(e) Figure 3 depicts the delay in the portfolio, as at April 2016, using the scheduled repayment dates under the loan agreements (and depicting amendments to loan agreements to reflect delays in repayment obligations). It also depicts the disbursed amounts (blue), amounts committed (red) and amounts repaid (green). It shows that only just over half of the funds had been disbursed as at April 2016. The dotted repayment schedule is based on contractual obligations, but as described above, this schedule is no longer realistic.

(f) As at the end of June 2016, 3.26 million USD had been disbursed under the loan agreements of a total USD 6.21 million committed (USD 6.10 million after cancelled loans are excluded). Approximately USD 0.2 million has been repaid, all of it before the issuance of CERs milestone was reached (i.e. early) and because the recipients no longer wanted/needed the funds or the loan was withdrawn/cancelled by the implementing agency.

(g) While the CDM Loan Scheme has demonstrated good regional distribution (see Appendix I) only 14 of the 43 projects that received loans for pre-registration

[12] The amount for committed funds in this figure is the amount adjusted for cancelled loans as at April 2016.

costs have achieved registration. This means 29 projects that received loans for pre-registration costs are still not registered under the CDM, four years into the operation of the CDM Loan Scheme. In a number of the projects, this delay is due to problems outside the control of actors in the CDM Loan Scheme; for example, delays in obtaining a letter of approval from a designated national authority (DNA) notwithstanding the considerable efforts of UNOPS and the secretariat through the regional collaboration centres (RCCs). However, in most projects, this lower than expected performance is attributable to the persistent low CER price and a related absence of floor price for CERs in the CDM Loan Scheme design that would have suspended the scheme during such periods.

(h) 16 projects received loans for verification onwards only, so whether they have achieved registration or not is not directly relevant to the performance of the CDM Loan Scheme. Only two of those 16 have achieved issuance of CERs, which may also be attributable in some part to the persistent low CER prices.

(i) The persistent low CER price not only affects the ability of projects to repay their loans, but also arguably undermines the fundamental rationale for the CDM Loan Scheme overall: If there is no realistic expectation for return on investments in CDM projects/PoAs due to the persistent low CER price, there is limited incentive for developing CDM projects/PoAs under the CDM Loan Scheme as well. Secretariat analysis also found that “tweaking” the CDM Loan Scheme by revising the G&M is not likely to improve the operation of the CDM Loan Scheme enough to make it effective as the persistent low CER price has such a strong impact on the projects in the portfolio.

(j) All of the above analysis demonstrates that it is now fully apparent that it is unlikely that all loan funds will be repaid, notwithstanding that the design of the CDM Loan Scheme through the G&M is predicated on repayment, and such repayment is required under all the loan agreements.

(k) This means there is a significant likelihood that some disbursed funds will have to be written-off in accordance with the relevant procedures of the implementing agency and the secretariat, resulting in a loss to the total interest on the trust fund for the CDM. This is important to report to the CMP and is included in the annual report at Appendix I. This loss implies a reduction in available future funds for the CDM Loan Scheme or for other purposes to which the CMP may allocate the interest on the trust fund for the CDM.

3.3. Analysis and impact of evaluation findings

15. Analysis and impact in relation to current implementation of the CDM Loan Scheme

(a) Under the terms of the MoU between the secretariat and the implementing agency (UNOPS) for the implementation of the CDM Loan Scheme and pursuant to the G&M, paragraph 8, the secretariat was recently required to decide whether to extend the term of the MoU beyond its expiry in 2017. As a result of the evaluation findings, the secretariat decided to: seek the guidance of the CMP and make recommendations to the CMP; and not to extend the term of the MoU with the implementing agency, UNOPS. The implementing agency also agreed that the term should not be extended.

(b) As a result of the non-extension of the period/term of the MoU, the implementing agency will not launch any further “application windows” for new loans. In any event, there have been no new application windows since March 2015. UNOPS will continue to administer the current loans in accordance with the existing MoU (which contains obligations beyond its expiry in March 2017 in order to maximize recovery of funds and ensure proper financial and operational closure by end 2017), and the G&M (under the oversight of the secretariat) and its own internal financial rules.

16. Analysis and impacts in relation to future implementation of the CDM Loan Scheme

(a) Contracting a new implementing agency (in order to be able to issue new loans) and allocating a reasonable level of funds for new loans would cost more than the remaining/returned interest on the trust fund of the CDM.

(b) While the G&M require the secretariat to carry out a procurement process for a new implementing agency after the expiry of the term of the current MoU (see paragraph 8 of the G&M, the secretariat considers that provision to be problematic, and, absent specific guidance from the CMP to engage in a new procurement process, would not do so, due to its financial responsibilities in relation to the interest on the trust fund for the CDM. Given that limitation, in order for any new CDM Loan Scheme loans to be issued, guidance of the CMP to the secretariat in relation to paragraph 8 of the G&M would be required, specifically to find and engage a new implementing agency.

(c) A new implementing agency and new loans is problematic because:

(i) The secretariat has assessed that the unallocated interest on the trust fund for the CDM (approx. 1.5 million USD[13]) is insufficient to cover the costs of a contract with a new implementing agency and allow for a reasonable level of loan funds for new loans. Almost all of the interest on the trust fund for the CDM is already allocated under the current MoU for implementing the CDM Loan Scheme: Since 2012 and up to the end of June 2016, USD 8,378,464 has been transferred to UNOPS loan scheme accounts, of which USD 7,038,819 has been allocated to loans and USD 1,339,645 has been allocated for UNOPS service charges (UNOPS administrative fees account). This is compared to approx.1.5 million USD unallocated (from which any further administrative fees for the current implementing agency would be required to be sourced for the remaining term)).

(ii) As explained in Finding C above, it is unlikely that all loan funds disbursed under current loans will be recovered, so the “pot” of funds for new loans will not be fully replenished as had been anticipated in the original design of the CDM Loan Scheme. This thus limits the “recycling” of the repaid funds to new borrowers/loans for new projects and leads to the conclusion that there are insufficient certain funds for new loans.

[13] The current figure unallocated as at end of June 2016 is USD 1,750,446. However, further costs in implementing the current CDM Loan Scheme will be incurred from that amount. Further interest on any funds was not included. Repaid funds that would then be unallocated are also excluded. As such 1.5 million is the estimated figure of available funds.

(d) As a second aspect of this issue, it does not appear viable to issue new loans (i.e. through a new implementing agency) within the current CDM time horizon.

(e) If future loan application windows were to be opened, such application windows would be unlikely to occur before early 2018. This is because it would take time to carry out procurement (estimated conservatively at six months based on experience and the secretariat's assessment of likely lack of interest) and negotiate a contract with a new implementing agency (estimated conservatively at six months), and establish the rules for those applications.

(f) Using, as means of example only, 2024 as a final date for new loans to complete the project cycle (by assuming a five year contract with a new implementing agency, running from 2018, with a short financial closure period of one year); it becomes apparent that only certain types of project activities would be capable of completing the whole project cycle in that time. Given the persistent low CER price and the country eligibility criteria of "fewer than ten registered project activities", the pool of interest is likely to be too small to justify new loans.

(g) As a third aspect of this issue, the persistent low price of CERs has been the material factor in the delays in the progress of the projects. The Board is mandated to recommend changes to the G&M, but the secretariat analysis is that "tweaking" the G&M is not capable of making the CDM Loan Scheme effective in a persistent low CER price environment.

17. Analysis and impacts in relation to CMP reporting and guidance:

(a) The findings A-C and the impacts above clearly indicate a need for CMP guidance given the CMP is supreme in relation to the future of the CDM Loan Scheme. In particular, the CMP should be requested to give its guidance on the overall future of the CDM Loan Scheme in order to balance the importance of encouraging participation in the CDM in under-represented countries against the risk of non-repayment of interest on the trust fund for the CDM.

3.4. Options for recommendations to be made to CMP

18. The Board has a mandate to make recommendations on possible changes to the G&M.

(a) As noted above, the Board is competent under the G&M to recommend changes to the G&M to the CMP. Its mandate is limited to the G&M themselves, thus generally to suggesting limited revisions to the G&M; for example, revisions to eligibility of countries, or revisions to repayment principles for loans. Generally, recommending another way of using the interest on the trust fund for the CDM would not fall within that competency, but such a recommendation would be part of the Board's general role as supervisory body for the CDM. Options for recommendations are set out below.

(b) Insofar as the Board may wish to consider the alignment of its recommendations and those of the secretariat, the recommendations of the secretariat to the CMP are set out in Appendix II.

19. Described below are a set of options derived from the evaluation undertaken by the secretariat, the findings and impacts in section 3 above and also the initial discussions held by the Board at EB 90.

(a) **Continue but no new loans**: The Board could recommend that the CMP continue the CDM Loan Scheme in its current form but provide guidance that no new loans will be issued.

(i) Taking this option, the Board could also recommend that the CMP provide guidance to the implementing agency and secretariat in relation to review of which projects are still progressing and related write-off of disbursed funds so that a case-by-case approach to repayment may be developed. For example, that write-off/non-repayment may be in a wider range of circumstances than the G&M (and so loan agreements) currently provide for – for example for certain project types.

(ii) Once funds are written off, such projects would not then receive further CDM Loan Scheme funds.

(iii) In this option, the Board would need to inform the CMP that CMP should also request the secretariat not to undertake a new procurement process after the expiry of the term of the MoU with UNOPS.

(iv) This option, with its various sub-recommendations, protects the interests of the current loan recipients while recognizing their difficulties and the limitations of the CDM Loan Scheme in a persistently low CER price environment. It has limited financial implications insofar as the costs of this approach are unlikely to exceed the funds allocated to the CDM Loan Scheme to date, although it should be noted that with wider write-off flexibility, fewer disbursed funds would be recovered.

(v) This approach also implies that the Board could make recommendations on the potential use of the unallocated interest on the trust fund for the CDM (see below) as those funds would likely remain available.

(b) **Terminate the CDM Loan Scheme**: The Board could recommend to the CMP to terminate the CDM Loan Scheme.

(i) If this option is taken by the CMP, under the loan agreements, UNOPS would be entitled to cancel all the loans but not seek acceleration (a requirement to repay loan funds received immediately).

(ii) The impact of this would thus likely be cancellation but no acceleration of a large proportion of loan agreements. In this case, it is expected that most loans would not repay disbursed funds, and UNOPS would then, following consultation with the secretariat, proceed to write-off those funds, leading to the non-recovery of loan funds disbursed. Loan funds committed but not disbursed would not be disbursed.

(iii) The impact on loan recipients is twofold: they would receive no further funds, but they would not necessarily be required to repay any funds disbursed.

(iv) While some projects may have non-CDM revenues that might mean they could still progress to registration or find means to replace the cancelled funds, the majority of the project portfolio would likely cease to continue

developing as potential CDM projects or cease continuing to seek issuance of CERs.

(v) The impact on the interest on the trust fund for the CDM is that funds committed but not disbursed would no longer be disbursed. Given the secretariat and the Board are aware of the difficulties with repayment of disbursed funds by loan agreements, this option is most conservative in terms of safeguarding the interest on the trust fund for the CDM, which is a duty of the secretariat and is relevant to the Board as supervisory body of the CDM as a whole.

(c) **Allocate further funds to the CDM Loan Scheme**:

(i) The Board could recommend that the CMP continue the CDM Loan Scheme in its current form, allocate additional funds to the CDM Loan Scheme and request the secretariat to commence a new procurement to select a new implementing agency that would issue new loans.

(ii) This approach continues the objective of supporting improved regional distribution of the CDM.

(iii) However, it requires a level of funds that is not currently available, and in practice, as described above, which may not be recovered if provided as loans. A new round of loans may attract a low level of interest given the persistent low CER price. In this scenario, the CMP would also need to give guidance on how to address the issue of low likelihood of repayment of loans due to the persistent low CER price.

(d) **Create a grant programme**: The Board could recommend that the CMP create a grant programme. Note that this is not a recommendation in relation to the G&M of the CDM Loan Scheme. This option can be combined with the options in relation to the CDM Loan Scheme itself, but only if new funds are available (see below). This potential approach was raised by the Board during its discussions at EB 90 but did not form part of the findings of the evaluation (see below). Analysis of the grant approach has identified the following:

(i) The CDM Loan Scheme as set out in the G&M cannot be “converted” into a grant programme because it would require retroactively changing the rules for the CDM Loan Scheme and renegotiation of all loan agreements and the implementing MoU with UNOPS. However, note above in option (a) that the CMP could give guidance that funds can be written-off in a wider set of circumstances than is currently the case, which may provide relief from repayment obligations to a wider sub-set of the loan recipients, thus enabling a loan design to become grant-like in certain individual circumstances.

(ii) A grant programme for the CDM could be developed. Additional funds, beyond the unallocated interest on the trust fund for the CDM would be required to do so – thus requiring contributions from Parties or other donors. It would likely require an implementing agency through a procurement process or a pro bono offer to carry out the grant activities (the conditions of provision of such pro bono activities would have to

comply with UN financial regulations and rules). In any form, it would take some time to design and implement.

(iii) It would seem sensible to make access to such a grant programme possible for loan recipients under the CDM Loan Scheme; allowing them (but not obliging them) to choose to convert their loan into a grant. In this regard, in order to avoid a “double benefit” of a grant plus the value of any CER sales, it would be possible to require the mandatory cancellation of the CERs generated from that project activity. This would effectively also demonstrate the CDM’s role as a results based finance tool.

(iv) In order to allow any such grant programme to be developed fully, it would seem sensible to recommend to the CMP that it request the Board and secretariat to analyse and develop a grant programme for its consideration at CMP.13. Overall, however, currently no funds are secured that would be sufficient for such a programme.

(e) **Use of the unallocated interest on the trust fund for the CDM**: The Board could make recommendations to the CMP on how to use the unallocated part of the interest on the trust fund for the CDM. This would only be combinable with (a) above. Such recommendations could include using the funds for capacity building activities; activities relating to the RCCs, and/or activities relating to the Paris Agreement insofar as it has a bearing on the CDM.

4. Impacts

20. The impacts of the evaluation findings are set out in section 3 above. The choice of the recommendation would determine the impacts, as highlighted above.

5. Subsequent work and timelines

21. The Board’s recommendations to CMP will be included in the annual report of the Board to the CMP. Any further work depends on guidance of the CMP, and would be undertaken in 2017, in order to report back to the CMP at its thirteenth session.

6. Recommendations to the Board

22. The secretariat recommends that the Board select the most appropriate option(s) set out in paragraph 19 above to recommend to the CMP.

23. In addition, the Board may wish to propose alternative uses for the remaining part of the interest of the trust fund for the CDM that could be more effective in supporting regional uptake of CDM than the CDM Loan Scheme is able to do under current conditions.

Appendix 1. Annual Report to the CMP (To be read in conjunction with CDM-EB91-AA-A06)

1. Background

1. At the fifth session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP), through decision 2/CMP.5, paragraph 49, Parties requested the Executive Board of the clean development mechanism (the Board) to allocate financial resources from the interest accrued on the principal of the trust fund for the clean development mechanism (CDM), as well as voluntary contributions from donors, in order to provide loans to support certain activities relating to the CDM in countries with fewer than ten registered CDM project activities.

2. At its sixth session, through the annex to decision 3/CMP.6, the CMP established the "guidelines and modalities for the operationalization of a loan scheme to support the development of CDM project activities in countries with fewer than 10 registered CDM project activities" (the G&M), and requested the secretariat to select and contract with a public or private institution (an implementing agency) to administer the loan scheme.

3. The secretariat selected the United Nations Office for Project Services (UNOPS) as the implementing agency for the loan scheme in late 2011.

4. The CDM Loan Scheme was officially launched in April 2012 and through seven loan application windows, 63 loan agreements were entered into with eligible project developers and their CDM consultant.

5. The purpose of this report is to provide the CMP, through the Board, with the mandated facts and figures in relation to implementation of the CDM Loan Scheme.

6. The period reported in this appendix is from June 2015 to June 2016.

7. There have been no new application windows since the end of May 2015. As such, application data have not changed since last year. Please consult last year's report for detailed information in relation to applications for loans as that information is not reproduced here in depth. Information that relates to eligibility of countries for loans has not been reported below as no new application windows have been opened.

8. The secretariat carried out an evaluation of the CDM Loan Scheme in 2016, the key findings of which are reported in document CDM-EB91-AA-A06. Where that document covers information usually reported annually, shorter form information is included in this appendix, for succinctness.

2. Activities completed during the reporting period

9. The secretariat has completed the following tasks:

    (a) Evaluation of the CDM Loan Scheme (included inCDM-EB91-AA-A06), including using an independent expert in accordance with paragraph 17 of the G&M.

    (b) Review of quarterly narrative reports from UNOPS on the implementation of the loan scheme;

(c) Review of the 2016 annual business plan, budget, and forecast of loan disbursements;

(d) Review of the audited certified financial statements for 2014 submitted by UNOPS. The 2015 annual certified financial statement has fallen due and is expected from UNOPS shortly, and will then be reviewed by the secretariat;

(e) Where assistance was requested, the regional collaboration centres continued to support the funded projects and provide clarifications on the issues linked to the CDM Loan Scheme in consultation with UNOPS as needed.

10. UNOPS, together with its technical partner UNEP DTU Partnership, has completed the following activities;

(a) Execution of four new loan agreements for funding of verification costs (Malawi, Mauritius (2) and Zambia);

(b) Disbursement of loan funds;

(c) Submission of required documentation to the secretariat for approval;

(d) Support to loan recipients and CDM consultants in relation to obstacles faced (such as with obtaining letters of approval);

(e) Work with the secretariat in relation to the evaluation by the secretariat of the CDM Loan Scheme.

11. There were no new loan application windows during this period. As such, limited promotional activities were carried out.

3. Implementation status

12. In relation to applications received during the seven application phases (which ran for periods in 2012 to 2015):

(a) A total of 191 applications were received over the seven loan application windows. No new windows were opened for the reporting period. See figure 1 in the attachment.

(b) 58 per cent of the applications were from least developed countries (LDCs).

(c) A total of 78 projects were approved to receive loans. The regional distribution of these is set out in figure 1 in the attachment. Their distribution by project size is set out in figure 2 in the attachment.

13. In relation to signed loan agreements:

(a) Of the 78 projects approved to receive loans, 63[14] of them entered into loan agreements (four in the reporting period).

(b) A further one loan recipient cancelled the loan before the funds were disbursed and the loan agreement was cancelled.

[14] Two loan agreements never entered into force and so are not included in this number.

(c) Of the 62 remaining loan agreements, three have already completed repayment. These were early repayment at the choice of the loan recipient, and the project cycle was not completed using loan funds.

(d) As such there are 59 loan agreements that are still active. Two are in the process of being cancelled and for one loan the loan recipient is repaying, but repayment is not yet completed.

(e) As a result of the above, there are now 56 active project activities/programmes of activities (PoAs) being implemented under the CDM Loan Scheme.

14. In relation to funds:

(a) Interest on the trust fund of the CDM transferred to UNOPS to end of June 2016:

(i) USD 8,378,464 has been transferred into UNOPS loan scheme accounts, of which

a. USD 7,038,819 has been allocated for disbursements of loans (UNOPS loan account);

b. USD 1,339,645 has been allocated for UNOPS service charges (UNOPS administrative fees account).

(b) Total of loan commitments to end of June 2016 is equal to USD 6,214,901;

(c) Total disbursements as at the end of June 2016 by UNOPS to loan recipients USD 3,267,434;

(d) Total loan repayments as at the end of June 2016 USD 167,500;

(e) Under the original 62 loans, USD 6,214,901 million was committed.

(i) Figure 3 sets out the distribution by host country;

(ii) Figure 4 sets out the distribution by project type;

(iii) Figure 5 sets out the distribution by project size.

(f) The maximum net amount for administration fees, as per the MoU with UNOPS is USD 1.89 million over the term (until end March 2017);

(g) By the end of December 2015, according to UNOPS financial statements (currently being audited), USD 1.46 million has already been incurred by UNOPS as administration expenses.

15. In relation to disbursements of loan funds to recipients:

(a) Under the 62 loans, USD 6,214,901 million was committed. UNOPS have disbursed a total of USD $ 3,267,434 to date; 53 per cent (see Table 1 in the attachment). Much of this is still at early stages of the project cycle despite the four years of the operation of the CDM Loan Scheme. This is largely a result of the persistent low CER prices – see evaluation findings C in the body of the document CDM-EB91-AA-A06 and see figure 6 in the attachment.

(b) As can be seen in the evaluation findings, the portfolio is suffering delays due largely to the persistent low CER price. In accordance with its obligations under the G&M and the MoU, and after discussion with the secretariat in its oversight role, UNOPS is actively identifying with loan recipients where delays hinder progress significantly. See figure 7 for estimated delays.

16. In relation to repayments: As noted above, three loans repaid early, a total of approximately USD 0.2 million has now been repaid and one loan is in repayment, having completed the project cycle under loan funds.

17. In relation to write-offs: One loan recipient wrote to the Board requesting write-off of the loans disbursed. The secretariat advised the Board and redirected the recipient to UNOPS. While no formal write-offs have yet occurred, UNOPS and the secretariat consider that the next reporting period could produce a large number of cases where write-off will be necessary.

18. In relation to distribution of loans entered into:

(a) Of the 62 loans, LDCs represent 68 per cent of the by number of the loans entered into. Africa represents 74 per cent of the same.

(b) Since the start of the loan scheme's operation, eight countries have crossed the "fewer than ten registered projects" threshold. The countries that are no longer eligible but are hosting a project funded through the CDM Loan Scheme are the following: Bangladesh, Cambodia, Iran, Kenya, Laos, Nigeria, Rwanda and Uganda.

(c) PoAs represent 48 per cent of active loans (28 of 59 legally active loans). Small-scale projects represent 20 per cent (12 of 59) and large-scale, 32 per cent (19 of 59).

(d) See Figures 3, 4, and 5 in relation to country, project type and size distribution of the loan amount.

19. In relation to success rate through the project cycle:

(a) 14 of the 43 funded projects that received funds for registration related processes have now achieved registration. 29 project activities/PoAs that received funds for registration related processes have not yet achieved registration.

(b) A further 16 projects received funding for post registration costs. Two of those 16 have achieved issuance of CERs. 14 have not yet done so.

(c) During the reporting period, 3 projects receiving loan funds for registration were registered.

(d) One of the 62 is repaying the loan, having completed the project cycle.

Attachment to Appendix1. Figures for the Annual Report to the CMP

Figure 1. Number of loan applications and loans approved per region

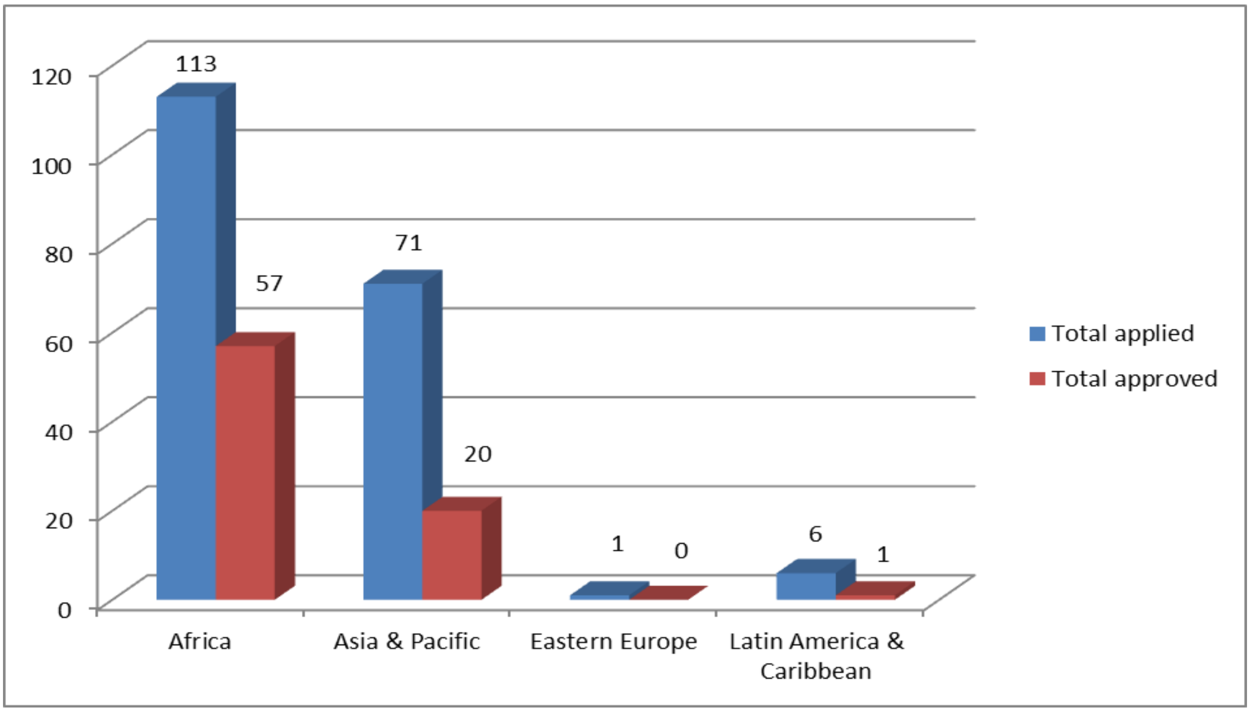


Figure 2. Approved loans per project size

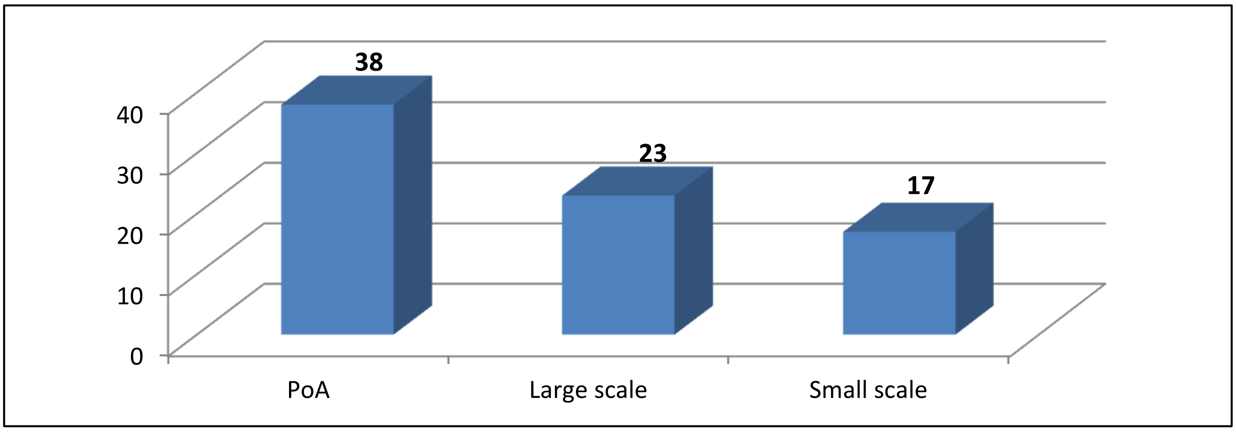


Figure 3. Loan funds committed per country (in United States dollars)

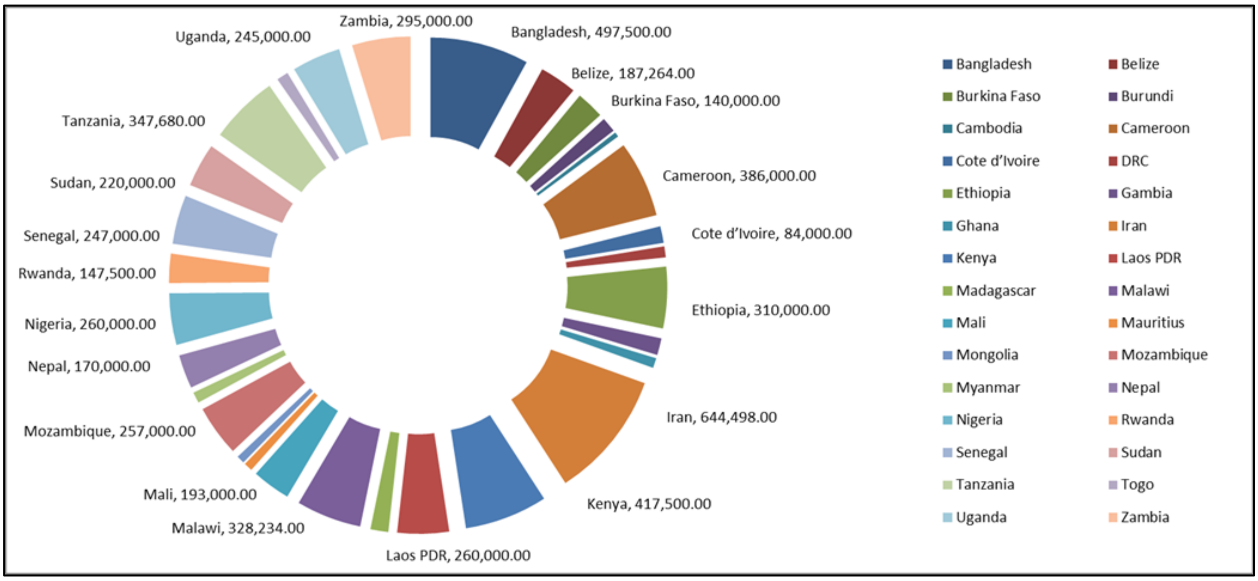


Figure 4. Funds committed per project type (proportion of committed funds)

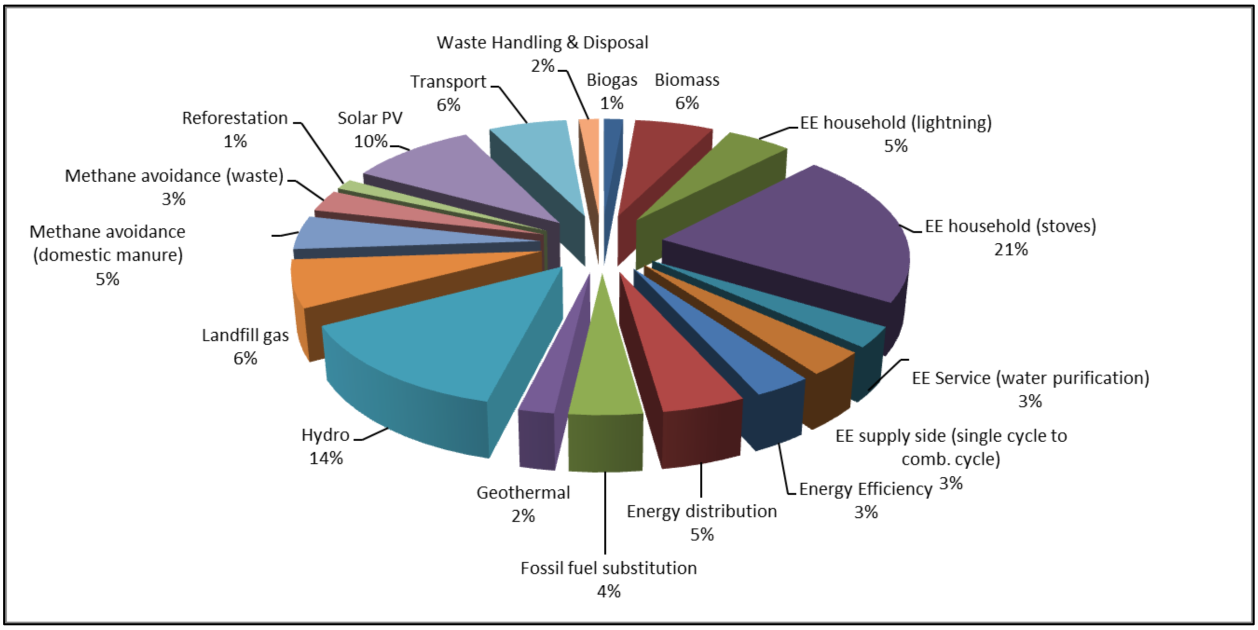


Figure 5. Funds committed per project size (in United States dollars)

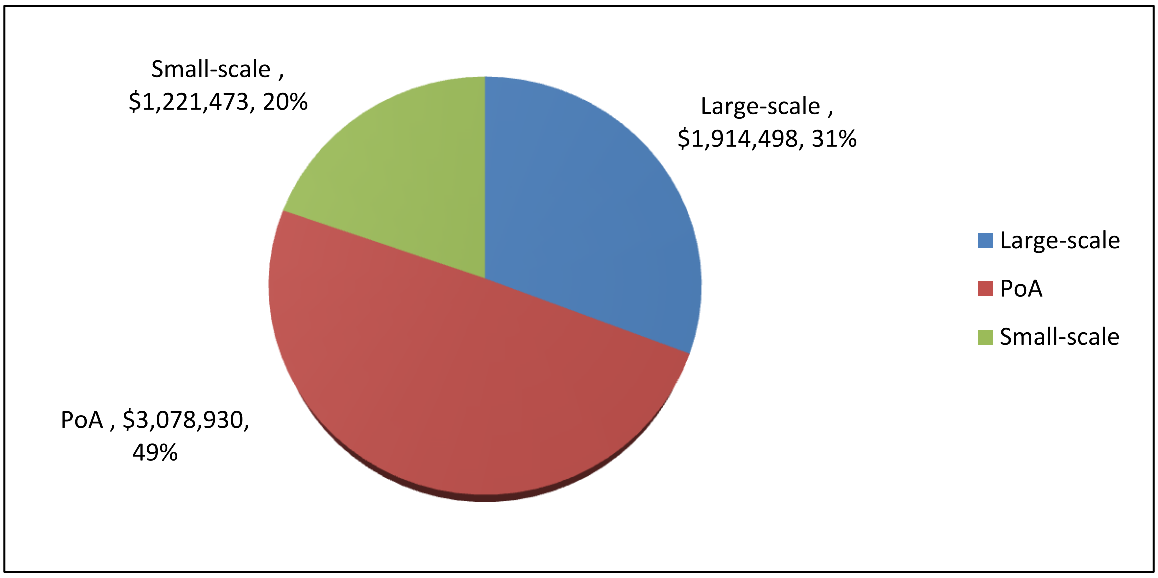


Table 1. Total funds disbursed as a percentage of total funds allocated, based on UNOPS 2016 second quarter progress report

Indicator	USD or percentage (%)
Total amount allocated for loans	6,214,901
Total amount disbursed for loans	3,267,434
Percentage disbursed	53%

Figure 6. Funds committed compared to funds disbursed per cost item (in USD)

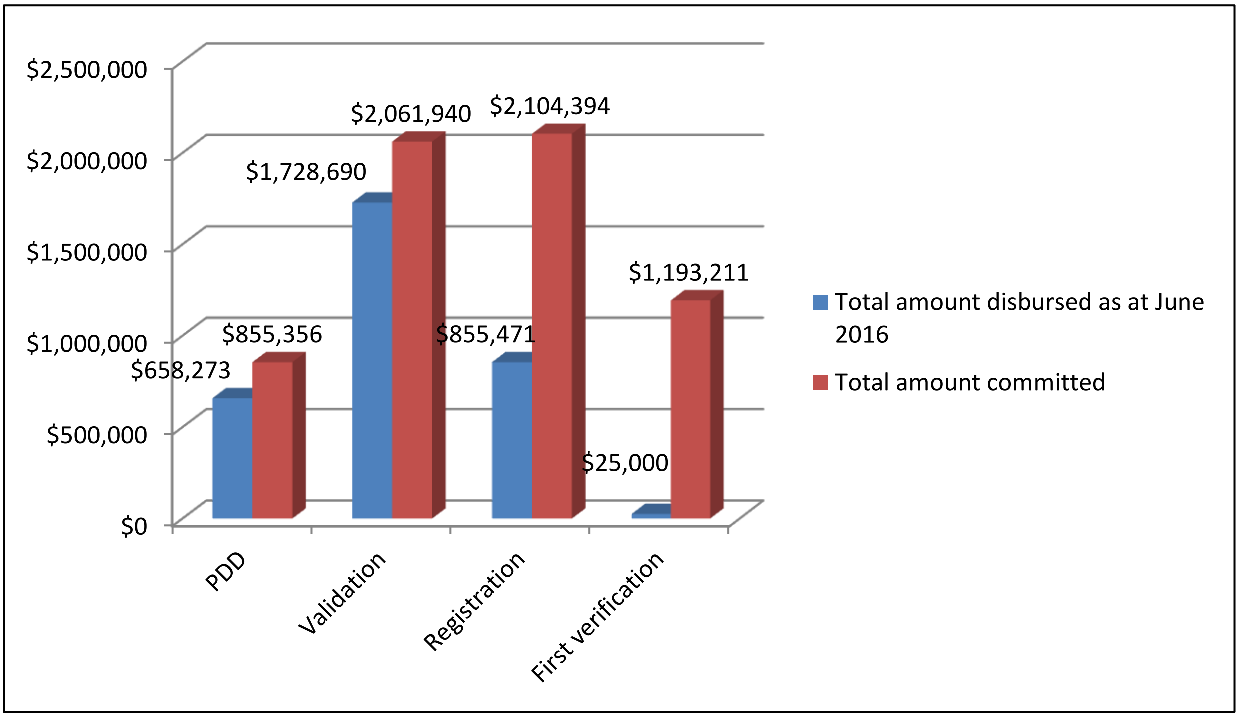
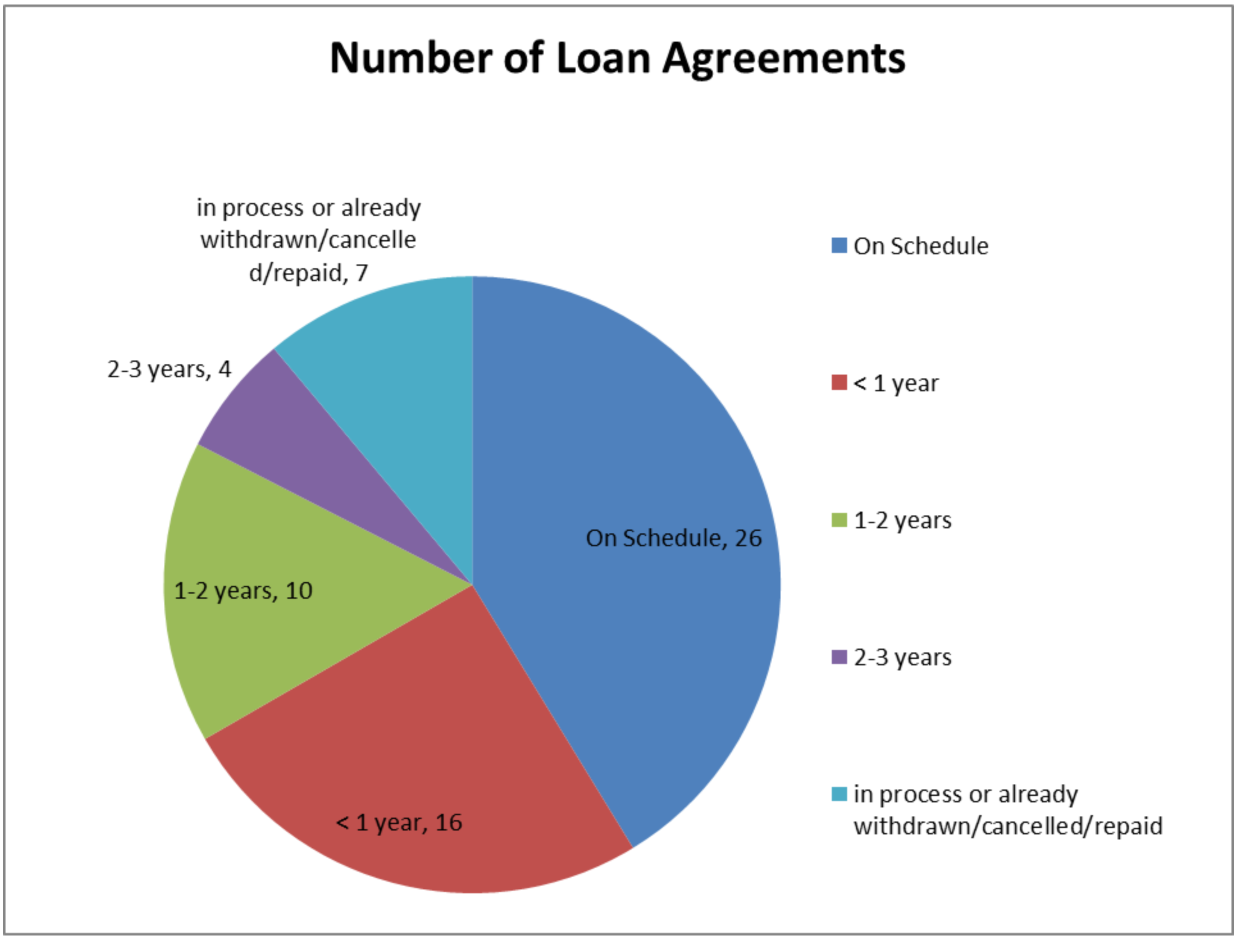


Table 2. Allocation of available loan funds

Total amount available for loans and administrative expenses	9,873,028	Based on total interest accrued until 31 December 2015
Total amount spent on administrative expenses	1,460,474	As of 31 December 2015 based on the financial statement total cost submitted by UNOPS plus adjustment item
Maximum net amount for administration fees	1,890,000	As per the MoU between UNOPS and secretariat
Percentage used of the total amount for administration fees	77%	
Total amount allocated to loans (excluding administrative expenses)	6,214,901	As of 30 June 2016, based on the UNOPS 2016 Q2 progress report
Percentage allocated	74%	

Figure 7. Estimated delays for repayment of the loan from the dates on loan agreements



Appendix 2. Secretariat recommendations to the CMP

1. Background

1. At the fifth session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP), through decision 2/CMP.5, paragraph 49, Parties requested the Executive Board of the clean development mechanism (the Board) to allocate financial resources from the interest accrued on the principal of the trust fund for the clean development mechanism (CDM), as well as voluntary contributions from donors, in order to provide loans to support certain activities relating to the CDM in countries with fewer than ten registered CDM project activities.

2. At its sixth session, through the annex to decision 3/CMP.6, the CMP established the guidelines and modalities for the operationalization of a loan scheme to support the development of CDM project activities in countries with fewer than 10 registered CDM project activities (the G&M), and requested the secretariat to select and contract with a public or private institution (an implementing agency) to administer the loan scheme.

3. The secretariat selected the United Nations Office for Project Services (UNOPS) as the implementing agency for the CDM Loan Scheme in late 2011.

4. Pursuant to Chapters V and VI of Annex III to decision 3/CMP.6 (Guidelines and Modalities for operationalization of a loan scheme to support the development of clean development mechanism project activities in countries with fewer than 10 registered clean development project activities (in this paper the “G&M”)), the secretariat is required to provide:

    (a) An annual report to the Conference of the Parties serving as the meeting to the Parties of the Kyoto Protocol (CMP) on the status of implementation of the loan scheme (Appendix I to this concept note) (paragraph 21 of the G&M);

    (b) A review (evaluation) of the performance of the loan scheme in accordance with paragraphs 15, 17 and 19 – 21 of the G&M.

2. Guidance sought and recommendations

5. The findings of the evaluation are set out in document CDM-EB91-AA-A06. Based on those findings:

    (a) The secretariat requests the guidance of the CMP in relation to the following:

        (i) For the reason set out in the evaluation, the secretariat decided not to extend the term of the implementing

agreement (Memorandum of Understanding (MoU) and the implementing agency agreed that the term should not be extended. Paragraph 8 of the G&M requires the secretariat to seek a new implementing agency after the expiry of that MoU. The secretariat, therefore, requests the guidance of the CMP on whether, given the findings in relation to the CDM Loan Scheme, the CMP still considers that a new implementing agency is required for implementation of the CDM Loan Scheme. The secretariat informs the CMP that such new implementing agency would only be required should the CMP wish new loans to be offered under the CDM Loan Scheme.

(ii) Due to its financial responsibilities in relation to the interest on the trust fund for the CDM, the secretariat considers the provision relating to a procurement process for a new implementing agency to be problematic, and, absent specific guidance from the CMP to engage in a new procurement process, would not engage in any procurement, or other process to find a new implementing agency.

(b) The secretariat makes the following recommendations to the CMP:

(i) The secretariat, as a result of its responsibilities in respect of the proper management of the interest on the trust fund for the CDM, and the obligation to ensure the maximum recovery of loan funds disbursed, recommends that the CMP terminate the CDM Loan Scheme because of the persistent low CER price and the consequent impact on the likelihood of repayment of disbursed loan funds. If the CMP were to terminate the CDM Loan Scheme, under the loan agreements, UNOPS may cancel the loans but not seek acceleration (a requirement to repay loan funds received immediately). The impact of this would thus likely be cancellation but no acceleration of a large proportion of loan agreements and it would have to be expected that many loans would not repay the disbursed funds (a total of USD 3.24 million). UNOPS would then, following consultation with the secretariat, proceed to write-off those funds, leading to the non-recovery of loan funds disbursed. Loan funds committed but not yet disbursed would not be disbursed. The impact on loan recipients is twofold: they would receive no further funds, but they would not necessarily be required to repay any funds disbursed. While some projects may have non-CDM revenues that might mean they could still progress to registration or find means to replace the cancelled funds, the majority of the projects portfolio would likely cease to continue developing as potential CDM projects or cease to continue to seek issuance of CERs. The impact on the interest on the trust fund for the CDM is that funds committed but not disbursed would no longer be disbursed. Given the

difficulties with repayment of disbursed funds by loan agreements, this option is most conservative in terms of safeguarding the interest on the trust fund for the CDM, which is a duty of the secretariat. However, the secretariat fully recognizes that this approach, while safeguarding the interest of the trust fund for the CDM, in some cases could have severe impacts for the loan recipients and their projects.

(ii) As an alternative, the CMP may wish to continue the CDM Loan Scheme but in such a manner that the limitations of the CDM Loan Scheme in a persistent low CER price environment are recognized. In this alternative, the CMP could continue the CDM Loan Scheme but provide guidance that:

a. The implementing agency will not issue any new loans but should continue should to manage the current loans to conclusion in accordance with the G&M and the MoU;

b. The secretariat should not seek a new implementing agency after the expiry of the term of the current MoU with the current implementing agency;

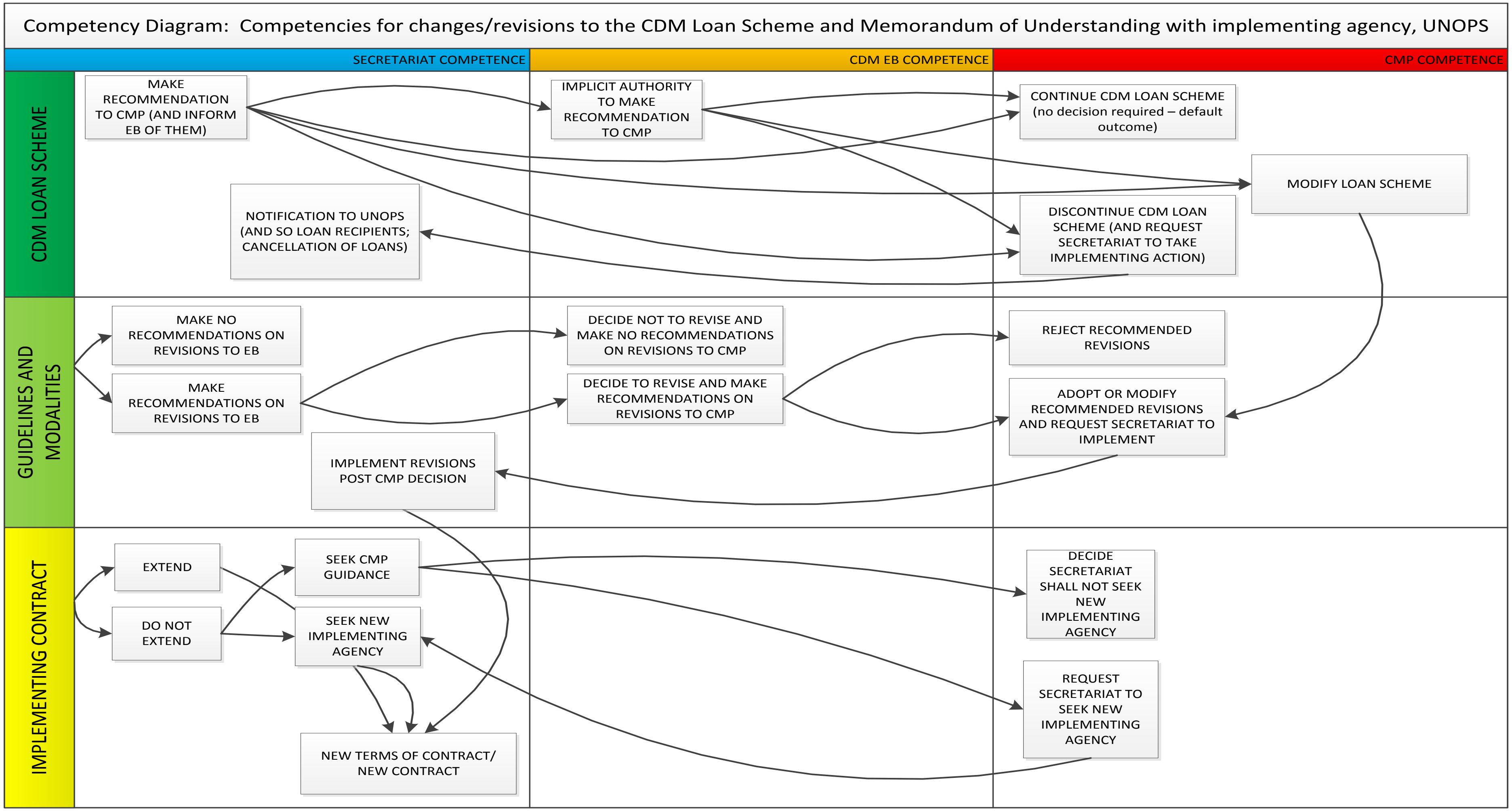
c. Material modification of the G&M of the CDM Loan Scheme is not required at this time;

d. The implementing agency may, in addition to the provisions in the loan agreements and the G&M, write-off disbursed payments under individual loans where, in consultation with the secretariat, it considers that, taking into account the project type and location, it is not possible for the loan recipient to repay as a result of the impact of the persistent low CER price on that project, with such projects then not receiving further CDM Loan Scheme funds;

e. That the secretariat report back to the CMP at its thirteenth session on the implementation of the requests of the CMP

Attachment to Appendix. II

Table. Competency Diagram for the CDM Loan Scheme



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