

Memorandum of understanding  
between the Ministry of Environment of the Republic of  
Estonia, the Ministry of Environmental Protection and  
Regional Development of the Republic of Latvia, the Ministry  
of Environmental Protection of the Republic of Lithuania, the  
European Bank for Reconstruction and Development and the  
Nordic Environment Finance Corporation  
on Cooperation establishing a Green Equity Scheme  
for Environmental Investments in the Baltic Countries

The Ministry of Environment of the Republic of Estonia, the Ministry of Environmental Protection and Regional Development of the Republic of Latvia, the Ministry of Environmental Protection of the Republic of Lithuania, EBRD and NEFCO hereinafter referred to as the "Parties",

considering the Agreement between the Government of the Republic of Estonia, the Government of the Republic of Latvia and the Government of the Republic of Lithuania on cooperation in the field of environmental protection signed on 21 July 1995 in Tallinn, as the basis for the Baltic environmental cooperation,

considering "Green Equity" as an important financing instrument to provide risk capital for environmental beneficial, revenue generating investments,

taking into account practical steps done towards establishment of a Green Equity Scheme for the Baltic Countries on October 6th in Riga

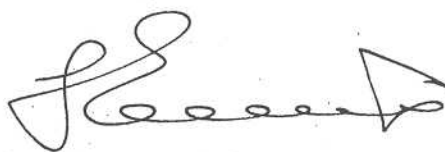
declare herewith their readiness to cooperate establishing a Green Equity Scheme in the Baltic Countries.

The parties declare also their interest to establish the scheme as it is described in Annex 1 and are inviting the Europe Union and other interested organisations to consider possible participation in this activity.

Done in Sofia on 25th October 1995 in five copies in English.



For the Ministry  
of Environment of the  
Republic of Estonia



For the Ministry of the  
Environmental Protection  
and Regional Development  
of the Republic of Latvia



For the Ministry  
of Environmental  
Protection of the  
Republic of  
Lithuania



For the European  
Bank for Reconstruction  
and Development



For the Nordic Environmental  
Financing Corporation

## **A Green Equity Scheme for Environmental Investments in the Baltic Countries - Executive Summary**

### **The Baltic Green Equity Scheme**

"Green Equity" is a financing instrument to provide risk capital for environmental beneficial, revenue generating investments. Operations are carried out according to prudent private sector equity financing principles and policies.

Green Equity addresses the needs to enhance environmental investments with a high leverage for donors and a cost-effective use of scarce financing resources. Green Equity proceeds are recycled for new investments. Such a scheme enables also a financing of small and medium sized projects in the Baltic countries in an international partnership.

Green Equity supplements grant and loan financing, including soft loans and environmental loan guarantees. For the project promoter, Green Equity is beneficial by not adding to the project's debt service burden, and by facilitating partial loan financing.

The purpose of Green Equity is to enhance additional environmental investments. Suitable investments include industrial modernisation for cleaner production and energy efficiency projects, agricultural pollution reduction projects, production plants for equipment, material and services for the environmental sector, and waste management and recycling projects.

Green Equity is mainly for technically and economically feasible private sector projects that are close to being financially viable. Municipality projects may also be financed, provided that they are carried out through self-financing autonomous companies, which requires an adequate legal framework and transparent concession policies.

The Baltic Green Equity is a regional scheme. This is justified (i) by that many of the environmental projects have a regional benefit, (ii) by obtaining initially a "critical mass" for the project financing operations and (iii) by facilitating donor funding.

Green Equity requires an appropriate capitalisation of the scheme. A partial grant funding of a Green Equity scheme enables to finance projects which have a too high financing risk for "pure" market based financing, or projects with a too long repayment period for such financing. On the other hand, Green Equity will share the future "upside" potential of environmental projects, thus enabling a mobilisation of financing resources for additional investments in this sector. The upside could comprise future cost savings, higher usage volumes and/or increased user charges.

A Baltic Green Equity scheme would be set up and managed in close co-operation with the Estonian, Latvian and Lithuanian environmental protection funds and international financial institutions like NEFCO, EBRD or IFC, with the participation and support of the European Union PHARE programme, as well as interested bilateral donors and development financing institutions. A private sector participation is also envisaged.

The Baltic Green Equity scheme is proposed initially to be capitalised with 20 mECU. Donor support could be in the form of equity and grant funding to capitalise a scheme, and as technical assistance for institutional development, project preparation and staff training. In addition, financing can be mobilised through cofinancing.

### Summary Business Plan

A detailed preliminary business plan for a Baltic Green Equity scheme ("B-GE") has been prepared to facilitate further analyse, considerations and decisions. Key assumptions for the business plan, such as the income prospective from environmental project investments, are mainly based on NEFCO's experience of its own ongoing operations. The projections in the business plan are for a 15 year "going fund", without equity replenishment nor repatriation of profits. Thus, it is assumed that the proceeds from project investments are recycled for new investments during the 15 year period.

The main features of the business plan are as follows:

#### (1) Capitalisation of the scheme

It is assumed that the B-GE is capitalised in the following way (in mECU):

<i>Sources</i>	<i>to be paid in</i>					<i>total</i>
	<i>year 1</i>	<i>year 2</i>	<i>year 3</i>	<i>year 4</i>	<i>year 5</i>	
<i>core funding:</i>						
- ordinary IFI equity (EBRD, NEFCO)	2.0	2.0	2.0			6.0
- subordinated equity from						
Estonia						
Latvia						
Lithuania						
<i>Baltic shares together:</i>	0.6	0.6	0.6	0.6	0.6	3.0
- PHARE	1.7	1.7	1.6			5.0
<i>subtotal:</i>						14.0
<i>supplementary funding from bilateral sources:</i>						
	1.2	1.2	1.2	1.2	1.2	6.0
<b>total</b>	<b>5.5</b>	<b>5.5</b>	<b>5.4</b>	<b>1.8</b>	<b>1.8</b>	<b>20.0</b>

The three Baltic countries would agree on their shares among themselves. The purpose of the PHARE grant funding is to enable the B-GE to "reach out" for additional environmental investments, for which pure market based financing is non-available.

It seems feasible to initially set up the B-GE with mainly IFI and public sector financing, and gradually privatise the scheme, when it becomes well established and sufficiently profitable for the purpose. The business plan indicate that a privatisation could become possible after about 10 years of operations.

The *core equity* capitalisation is from the three Baltic countries, PHARE and EBRD/NEFCO, enabling the B-GE to be set up and commence operations. The *supplementary equity* capitalisation is intended for subscriptions from bilateral

