



ADAPTATION FUND

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Adaptation Fund Board  
Eleventh Meeting  
Bonn, September 16 - 17, 2010

## **FUNDING FOR PROJECT FORMULATION COSTS**

## **I. BACKGROUND**

1. The Board at its tenth meeting discussed the issue of awarding funding for project formulation costs and decided:

- (a) To approve in principle funding for project formulation costs for National Implementing Entities;
- (b) To reconsider the issue of project formulation costs for Multilateral Implementing Entities at the eleventh meeting of the Board;
- (c) To request the secretariat to prepare a note on project formulation costs that included a discussion on the practices of international funds when awarding funding for project formulation costs and the need for an amendment to the rules of procedure or the operational policies and guidelines of the Adaptation Fund Board; and
- (d) That that funding for project formulation costs could be awarded retroactively to NIEs once a provision for project formulation costs was made by the Board.

### **(Decision B.10/4)**

2. The present document has been prepared by the secretariat in response to the above mandate.

## II. PRACTICES BY GLOBAL FUNDS ON PROJECT FORMULATION FUNDING

3. This section presents a survey of practices by other global funds to address the cost of project formulation. It reviews the policies of the Global Environment Facility, the Climate Investment Funds, the Multilateral Fund (Montreal Protocol), the Global Fund (to fight AIDS, Tuberculosis and Malaria) and the Global Alliance for Vaccines and Immunization (GAVI).

### a) Global Environment Facility (GEF Trust Fund, LDCF, SCCF)

4. The GEF policies, especially the project cycle, changed between GEF-3 (2002-2006) and GEF-4 (2006-2010).

5. In GEF-4, the project cycle is a two-step process. In the first step, a project identification form (PIF; 4 to 8 pages) is submitted by the Implementing Agency, reviewed by the GEF Secretariat for inclusion in a Work Program and approved by the Council. In the second step, a full project document (CEO endorsement requested; 30 to 100 pages) is submitted by the Implementing Agency, reviewed by the GEF Secretariat, circulated to the Council and finally endorsed by the GEF CEO.

6. As soon as the PIF has been reviewed positively by the GEF Secretariat (and even before the Council Approval), the Implementing Agency can receive upfront a project preparation grant (PPG), based on the formal submission of a request for PPG. This request includes a description of the project preparation activities and a timeframe that has to be less than 22 months. Some activities or items are not eligible (funding of pilot activities during the preparation, cost of capital goods like offices, cars, etc.). Although no ceiling is defined, usually preparation grants are between \$50,000 and \$350,000 (less than 5% of the project amount). In addition, a 10% fee (10% of the cost of the PPG) is immediately granted to the Implementing Agency to oversee the preparation.

7. In most cases, the preparation leads to a full project document that finally gets endorsed by the CEO. In rare cases, local circumstances in the country may request a cancellation of the project before its endorsement by the CEO. In such a case, the PIF and the PPG are cancelled and any unused funding is returned to the Trustee. The funding that has already been used is not reimbursed.

8. In GEF-3 and before, the project cycle was a three step process. In the first step, a project concept was submitted by the Implementing Agency, reviewed by the Secretariat, and included in the projects pipeline. In the second step, the project document (not necessarily fully complete) was prepared and submitted by the Implementing Agency, reviewed by the GEF Secretariat for inclusion in a Work Program and approved by the Council. In the third step, the fully prepared document (including all execution arrangements, a full budget, etc.) was submitted by the Implementing Agency for GEF CEO endorsement.

9. Regarding preparation, there were three different possibilities regarding Project Development Facility (PDF): A, B or C.

- Before step 1 (thus before the submission of a project concept), the country could receive a PDF-A, a funding of up to \$25,000 to prepare a project concept (further revise up to \$ 50,000).
- Before step 2 (after inclusion of the project in the projects pipeline), the country could receive a PDF-B to prepare the project. These grants could be up to \$350,000 for

projects in single countries, and up to \$700,000 for project involving preparatory activities in multiple countries as in the case of regional/global projects.

- Before step 3 (after approval of the project by the Council) and where required for large projects, the country could receive a PDF-C, a grant of up to \$1 million to complete technical design and feasibility work.
- In addition, the Implementing Agency would receive a fee of 9% of the PDF once the project was finally endorsed by the GEF CEO (please note the difference between GEF-3 and GEF-4: in GEF-4, the Agency fee is granted upfront).

10. If the project was cancelled during preparation, the unused PDF amount would be returned to the GEF Trust Fund. An analysis was done of all the PDF-B and PDF-C under GEF-2 and GEF-3 (between 1998 and 2006) and of the results that they had achieved. 708 project preparation grants were approved for a total value of \$227 million (reminder: GEF-2 + GEF-3 = \$5,700 million). This mechanism proved successful: out of 706 approved PDFs, 595 (84%) resulted in full projects being developed, approved and endorsed. The other PDFs, representing a funding value of \$34 million, had been dropped.

b) Strategic Climate Fund (PPCR, FIP, SREP)

11. The Strategic Climate Fund is comprised of three targeted programs: the Pilot Program for Climate Resilience (PPCR), the Forest Investment Program (FIP) and the Scaling-up Renewable Energy Program in Low-Income Countries (SREP). It is channeled through five Multilateral Development Banks (MDB). The operational guidelines for these programs were approved recently or are still under discussion.

12. The PPCR provides for a two-phase process for programming resources in pilot countries and regions. The objective of Phase 1 is to prepare a Strategic Program for Climate Resilience (SPCR) that includes an investment program. Once this strategic program has been approved by the PPCR Sub-Committee, projects are approved by the PPCR Sub-Committee through a decision-by-mail and then by the Board of the respective MDB. (Phase 2).

- Phase 1: SPCR Design. An initial joint mission by the government and the MDB, whose outputs are a work plan, a timeline, and a budget for supporting Phase 1 activities leading to the formulation of the Strategic Program for Climate Resilience. This proposal is submitted to the PPCR Sub-committee for funding. A grant of \$1.5 million is suggested for these preparation activities. This grant is channeled through the MDB. The country then prepares, in collaboration with the MDBs, its Strategic Program for Climate Resilience. This can include an analysis of climate risks, an institutional analysis, knowledge and awareness raising, key capacity building actions, and a consultative planning process to agree on a common vision and strategic approach for climate resilience and to define priority actions and investment needs to implement this approach. A final joint mission by the government and the MDB will produce the final design of the SPCR to be approved by the PPCR Sub-Committee.
- Phase 2: SPCR Implementation. No ceiling is set for the preparation grants for projects under the SPCR. However, funds for project preparation are included within the envelope requested for the SPCR (and thus in the country's envelope). The project preparation grants are disbursed upfront. The country and the MDB prepare the individual investment proposals in detail. The average funds available per country pilot program range from \$ 30-60 million and for the regional pilots from \$ 60-75 million.

13. The FIP provides for a two-step process: an investment strategy (IS) is developed and approved by the FIP Sub-Committee. Based on the approval, program or projects consistent with the IS are prepared. Program or projects are approved by the FIP Sub-Committee through a decision-by-mail and then by the Board of the respective MDB.

- Step 1. Preparation of FIP investment strategy, including project ideas. (1) The FIP investment strategy (IS) is developed through a joint mission led by the government in collaboration with the MDB. A preparation grant of up to \$250,000 is available for analytical and assessment activities necessary to develop a comprehensive IS. Funding is made available upfront. (2) The FIP investment strategy is endorsed by the FIP Sub-Committee. Preparation grants for proposed projects and programs can be approved at the same time by the FIP Sub-Committee. No ceiling is defined for such preparation grants; however, funds for project preparation are included within the envelope requested for the Investment Strategy (and thus in the country's envelope). The project preparation grants are disbursed upfront. (3) The country and the MDB prepare the individual investments proposals in details.
- Step 2. Implementation. The program or project proposals consistent with the IS are to be approved by the FIP Sub-committee through a decision-by-mail and then appraised and implemented by the MDB.

14. The programming modalities of the SREP are still under discussion. On March 17, 2010, during the last meeting of the SCF, a cycle very similar to the FIP's was presented: (1) joint preparation of a Renewable Energy Investment Plan and endorsement by the SREP Sub-Committee; (2) preparation of projects and programs under this plan; (3) approval by the SREP Sub-Committee and by the MDB. As for the FIP, upfront funding can be provided for phase (1) – preparation of the Renewable Energy Investment Plan, and for phase (2) – preparation of projects and program. At this stage, the amounts for preparation are not known.

c) Multilateral Fund for the implementation of the Montreal Protocol (MLF)

15. Since its inception in 1994, the MLF has funded the preparation of Country Programs to allow countries to assess their needs to comply with the Montreal Protocol (Ozone Depleting Substances, ODS). Most of the preparation grants were around \$100,000, but they could go up to \$1.5 million for big countries. The resulting programs often overestimated the countries need for support for phasing out of ODS, which resulted in difficulties in the prioritization of projects and countries.

16. Subsequently, first project-by-project approaches were undertaken, taking only limited account of the country programs. With increasing experience of countries and implementing agencies, sector plans were undertaken, later also national plans. These plans are result based, multi-phased undertakings, where after an initial payment agreed subsequent tranches are only funded if agreed quantifiable and verifiable national targets have been met. A new set of plans is presently under initial discussions and will be approved for the majority of the 142 eligible countries before the end of 2011.

17. The MLF Secretariat performs country need assessments for all eligible countries based on quantitative objectives prescribed by the Montreal Protocol. These needs assessments are the basis to include or not projects in the business plan of the MLF; additional projects, in particular for demonstration purposes, can be included if the Executive Committee decides to do so. If a project has been included in the business plan, the country can then access funding for

preparation. Generally, these preparation grants range from \$20,000 to \$30,000. Once the project is included in the business plan, preparation funding approval and, subsequently, project approval are typically decided based on increasingly detailed criteria; therefore, typically preparation grants are not cancelled. Cancellation is possible through a well defined, multi-step process, often related to local barriers to implementation such as various forms of crisis; in this case the unspent balance is returned to the Trustee.

18. The most recent development are national plans called HPMP (for HCFC, or Hydrochlorofluorocarbon Phase-out Management Plan). The preparation of these plans is currently ongoing, and with the exception of China all 141 MLF eligible countries with consumption of HCFC received funding. The funding provided ranged between US\$ 85,000 and US\$ 595,000, using an agreed distribution key based on the countries substance use, for a set of activities that includes: (1) survey/inventory of HCFC in the country, (2) development of policies and regulations on HCFC, (3) preparation of activities to phase-out HCFC and of a related overarching plan. Separate arrangements were found for countries with no use of the substances (US\$ 30,000 to prepare activities ensuring sustainability) and for China due to preparatory work previously undertaken and the overall large amount of production and use of the related chemicals (more than 50% of global figures). The plans to be developed will be based on individual agreements between the countries involved and the Multilateral Fund, which establishes national annual targets to be fulfilled by the countries. The fulfillment both on the activity as well as the result level is closely and in many cases independently monitored, and failure to reach the targets can lead to delay in funding of the next installment or even to reductions of the overall funding level. These projects can only be submitted for review once the country put certain regulatory measures in place, which were supported by the preparatory funding and are required to achieve and monitor compliance with the agreement and the Montreal Protocol.

d) Global Fund (GF)

19. The grant life cycle of the Global Fund is comprised of several phases: (1) Following the annual call for proposals, country and regional applicants develop and submit proposals to the Global Fund Secretariat. Proposals are screened by the Secretariat to ensure they meet eligibility criteria, and the Technical Review Panel reviews the technical merit of eligible proposals. The proposals recommended for funding are then sent to the Global Fund Board for approval or rejection. (2) Once a proposal has been approved, the terms of the grant agreement are negotiated. The grant agreement is legally binding and includes specific and measurable results to be tracked during grant implementation. (3) Over the course of a grant's life cycle, the Principal Recipient regularly reports to the Global Fund on expenditures, agreed programme activities and results achieved. The Global Fund implements performance-based funding, whereby lack of progress triggers the Secretariat to request corrective action or reduce regular disbursement amounts.<sup>1</sup> (4) Towards the end of the first two years of implementation ("phase 1"), a thorough review of performance is conducted, and the grant is renewed for three years ("phase 2") if the project is making sufficient progress. (5) After the first five years of the project,

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<sup>1</sup> The Global Fund Board has recently approved a new grant architecture. This new grant architecture will bring important changes to the organization's operating model in the coming years, including how countries apply for funding, how financing is structured, how performance management is conducted and how decisions about future funding are made. For more information, refer to the Global Fund website (<http://www.theglobalfund.org/en/grantarchitecture/?lang=en>).

high-performing grants may be eligible to receive additional funding for a period of up to six years (through the “Rolling Continuation Channel”).

20. To date, the Global Fund does not provide preparation grants for the initial proposal, although in many cases international development partners provide technical assistance in the programming and drafting process and a number of toolkits have been developed to provide guidance. Nonetheless, a number of options to strengthen technical assistance mechanisms to improve grant performance and the quality of projects were presented to the Board in April 2010. Several suggestions are still on the table, including funding of “operational plans” (to prepare proposals) or inclusion of a budgeted technical assistance plan in the project submissions (to improve performance of the projects).

e) Global Alliance for Vaccines and Immunization (GAVI)

21. Requests for GAVI are made by governments of eligible countries by specific deadlines set for each year. Proposals are screened by the GAVI Secretariat for eligibility and completeness, then each proposal is pre-assessed by a World Health Organization expert group that writes a report to the Independent Review Committee (IRC). The IRC recommendations are sent to the GAVI Board for decision.

22. The types of support available are health system strengthening support, new vaccine support, injection safety support, immunization services support, and civil society organization support. Countries can request up to \$50,000 to prepare proposals on health system strengthening support. In addition, technical support to prepare proposals is provided by WHO, UNICEF or bilaterals.

### III. POSSIBLE ISSUES FOR THE ADAPTATION FUND

23. Under the Adaptation Fund, proposals undergo either a one-step or a two-step project cycle.

- Under the two-step process, a brief project concept is approved first. When such a concept is approved, then a “preparation grant request” can be submitted by an NIE or an MIE to prepare the full project document. This is typically the model used in GEF or the MLF.
- Under the one-step process, there could be three options:
  - upon request, a country could receive a fixed, low grant (e.g., \$20,000) upfront to prepare its project (with NIE or through MIE);
  - a country could submit a preparation grant request for a project that it intends to submit, even if this project has not been approved by the Board yet. This request for project preparation would be submitted to the Board;
  - a country could be reimbursed for the preparation of a project once the full project is approved, through the project budget.

24. If the project is cancelled during preparation or if the project is not submitted, the practice by other funds is generally that only the unused preparation grants are returned to the Trustee.

25. Other issues to consider include:

- the remuneration of the Implementing Entity for the preparation of the project (should it be a percentage of the preparation grant or a flat rate or another option);

- the list of activities and items eligible under the preparation grant (should the Fund finance only studies or also capital goods; should there be any limitation on international consultants, etc.);

- the maximum amount of the preparation grant (should it be a percentage of the project amount, or a flat amount, and/or should there be a ceiling),

- the maximum timeframe for preparation (should it be 12 months, 18 months, or more).

#### **IV. POSSIBLE AMENDMENTS TO EXISTING RULES**

26. The rules of procedure do not contain operational rules. Hence, none of the rules prevents the funding of project formulation costs.

27. As to the operational policies and guidelines, there is only one reference that could prevent the funding of project formulation costs in the sentence at the end of footnote 15 that refers to the two-step approval process:

*A brief project concept is approved in the first step followed by the review and approval of a fully-developed project/document in the second step. A two-step process, while time-consuming minimizes the risk that a proponent does not invest time and energy in fully-developing a project or programme document that fails to meet the criteria of the Fund. Funding will only be reserved for a project after the approval of a fully-developed project document in the second step.*

28. The above mentioned rule has been modified when the Board approved an exemption to it by decision B.10/4 allowing funding for project formulation costs for NIEs<sup>2</sup>.

29. In a future review of the operational policies and guidelines, the Board may want to consider introducing new rules that regulate the funding for project formulation costs.

30. It is proposed to introduce a new section in the operational policies and guidelines between paragraphs 41 (review and approval of regular projects and programmes) and 42 (disbursement) on funding for project formulation costs. This new section would introduce the decisions that the Board may adopt at the present meeting regarding project formulation costs.

31. Footnote 15 could also be modified accordingly by inserting the underlined words to its last sentence:

*Funding will only be reserved for the implementation of a project after the approval of a fully-developed project document in the second step.*

#### **V. RECOMMENDATION**

32. The Board may want to

- a) Consider the present document, in particular the options outlined under its section III on the modalities to provide funding for project formulation costs;

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<sup>2</sup> The operational policies and guidelines have been adopted by decision B. 7/2. Decisions can be amended by the same decision-making body, by approving a new decision that modifies the previous one.

- b) Decide on the level of funding for project formulation costs to be granted to NIEs and, eventually to MIEs; and
- c) Approve the necessary amendments to the operational policies and guidelines in order to include the decisions adopted in its text.