Document of
The World Bank

Report No: ICR00003181

IMPLEMENTATION COMPLETION AND RESULTS REPORT
(IBRD-77740 IBRD-81930)

ON

LOANS
IN THE AMOUNT OF EUR 150 MILLION
(US$ 202.63 MILLION EQUIVALENT)

TO THE

CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (HBOR)

WITH THE GUARANTEE OF THE REPUBLIC OF CROATIA

FOR THE

CROATIA EXPORT FINANCE INTERMEDIATION LOAN PROJECT

April 24, 2017

Finance and Markets
Croatia Country Unit
Europe and Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of April 10, 2017)

Currency Unit = HRK
HRK 1.00 = US$ 0.14
US$ 1.00 = HRK 7.01

FISCAL YEAR

ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Assistance
AF	Additional Finance
AM	Aide Memoire
BIS	Bank for International Settlements
CAR	Capital Adequacy Ratio
CEB	Council of Europe Development Bank
CEFIL	Croatia Export Finance Intermediation Loan
CMU	Country Management Unit
CNB	Croatian National Bank
CPS	Country Partnership Strategy
D/E	Debt to Equity
DPL	Development Policy Loan
DSCR	Debt Service Coverage Ratio
EBRD	European Bank for Reconstruction and Development
ECA	Europe & Central Asia
ECB	European Central Bank
EIB	European Investment Bank
EMP	Environmental Management Plan
ESRF	Environmental Safeguards Review Framework
EU	European Union
FDI	Foreign Direct Investment
FIL	Financial Intermediary Loan
FM	Financial Management
FX	Foreign Exchange
FY	Financial Year
GDP	Gross Domestic Product
HBOR	Croatian Bank for Reconstruction and Development
HRK	Croatian Kuna
IBRD	International bank for Reconstruction and Development
ICR	Implementation Completion and Results
IFC	International Finance Corporation

IFI	International Financial Institution
IMF	International Monetary Fund
ISR	Implementations Status and Results
KfW	Kreditanstalt für Wiederaufbau
M&E	Monitoring & Evaluation
MIGA	Multilateral Investment Guarantee Agency
MoF	Ministry of Finance
NPL	Non-Performing Loan
OM	Operations Manual
PAD	Project Appraisal Document
PCG	Partial Credit Guarantee
PDO	Project Development Objective
PFI	Participating Financial Institution
PIU	Project Implementation Unit
ROA	Return on Assets
ROE	Return on Equity
SAFE	Survey on the Access to Finance of Enterprises
SMEs	Small and Medium Enterprises
TTL	Task Team Leader
UN	United Nations
USD	United States Dollar
WB	World Bank
WC	Working Capital

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Country Director:	Arup Banerji
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CROATIA

Croatia Export Finance Intermediation Loan (CEFIL)

CONTENTS

A. Basic Information			
Country:	Croatia	Project Name:	Export Finance Intermediation Loan
Project ID:	P116080	L/C/TF Number(s):	IBRD-77740,IBRD-81930
ICR Date:	04/24/2017	ICR Type:	Core ICR
Lending Instrument:	FIL	Borrower:	CROATIOAN BANK FOR RECONSTRUCTION & DEV.
Original Total Commitment:	USD 141.22M	Disbursed Amount:	USD 188.07M
Revised Amount:	USD 202.46M		
Environmental Category: F			
Implementing Agencies: Croatian Bank for Reconstruction and Development (HBOR)			
Cofinanciers and Other External Partners:			

B. Key Dates				
Process	Date	Process	Original Date	Revised / Actual Date(s)
Concept Review:	04/21/2009	Effectiveness:		11/25/2009
Appraisal:	06/19/2009	Restructuring(s):		08/08/2012 04/16/2015
Approval:	08/04/2009	Mid-term Review:	09/30/2011	09/15/2011
		Closing:	08/31/2013	08/31/2016

C. Ratings Summary	
C.1 Performance Rating by ICR	
Outcomes:	Satisfactory
Risk to Development Outcome:	Moderate
Bank Performance:	Satisfactory
Borrower Performance:	Satisfactory

C.2 Detailed Ratings of Bank and Borrower Performance (by ICR)			
Bank	Ratings	Borrower	Ratings
Quality at Entry:	Satisfactory	Government:	Satisfactory
Quality of Supervision:	Moderately Satisfactory	Implementing Agency/Agencies:	Moderately Satisfactory

Overall Bank Performance:	Satisfactory	**Overall Borrower Performance:**	Satisfactory

C.3 Quality at Entry and Implementation Performance Indicators			
Implementation Performance	**Indicators**	**QAG Assessments (if any)**	**Rating**
Potential Problem Project at any time (Yes/No):	No	Quality at Entry (QEA):	None
Problem Project at any time (Yes/No):	No	Quality of Supervision (QSA):	None
DO rating before Closing/Inactive status:	Satisfactory		

D. Sector and Theme Codes		
	Original	**Actual**
Major Sector/Sector		
Financial Sector		
General finance sector	30	30
Industry, Trade and Services		
Other Industry, Trade and Services	40	40
Other industry	25	25
Agricultural markets, commercialization and agri-business	5	5
Major Theme/Theme/Sub Theme		
Finance		
Financial Stability	50	50
Financial Sector oversight and policy/banking regulation & restructuring	50	50
Private Sector Development		
Business Enabling Environment	50	50
Investment and Business Climate	50	50

E. Bank Staff		
Positions	**At ICR**	**At Approval**
Vice President:	Cyril E Muller	Shigeo Katsu
Country Director:	Arup Banerji	Orsalia Kalantzopoulos
Practice Manager/Manager:	Mario Guadamillas	Lalit Raina
Project Team Leader:	Natalie Nicolaou	Isfandyar Zaman Khan
ICR Team Leader:	Alper Ahmet Oguz	

ICR Primary Author:	Alper Ahmet Oguz	

F. Results Framework Analysis

Project Development Objectives (from Project Appraisal Document)
The PDO is to support the preservation and growth of exports by providing medium and long term working capital and investment finance to exporters and foreign exchange earning companies

Revised Project Development Objectives (as approved by original approving authority)

(a) PDO Indicator(s)

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
Indicator 1 :	Level of exports growth or preservation of beneficiary firms (Number, Custom)			
Value (quantitative or Qualitative)	1	>1		1.189
Date achieved	08/04/2009	08/06/2009		08/31/2016
Comments (incl. % achievement)				
Indicator 2 :	Volume of medium and long-term lending to firms under the project (Amount(USD), Custom)			
Value (quantitative or Qualitative)	0	50 million	202 million	188 million
Date achieved	08/04/2009	08/06/2009	08/08/2012	08/31/2016
Comments (incl. % achievement)	Actual value of the disbursements is USD 188.06 mil. calculated by the date of disbursement. The USD 202 mil. target was calculated based on the date of the loan agreements. The difference is based on the Euro to USD exchange-rate. All loans are long term			

(b) Intermediate Outcome Indicator(s)

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
Indicator 1 :	Quality of Portfolio - Total NPLs as number of loans (%, Custom)			
Value (quantitative or Qualitative)	0	<5	<7	5.1
Date achieved	08/04/2009	08/06/2009	08/08/2012	08/31/2016
Comments (incl. % achievement)				
Indicator 2 :	Quality of Portfolio - Total NPLs in loan amount (Percentage, Custom)			
Value (quantitative or Qualitative)	0	<5	<7	1.05
Date achieved	08/04/2009	08/06/2009	08/08/2012	08/31/2016
Comments (incl. % achievement)				
Indicator 3 :	Level of job creation or preservation (Number, Custom)			
Value (quantitative or Qualitative)	0		>1	1.048
Date achieved	08/04/2009		08/08/2012	08/31/2016
Comments (incl. % achievement)				
Indicator 4 :	Number of firms financed under the project (Number, Custom)			
Value (quantitative or Qualitative)	0		60	70
Date achieved	08/04/2009		08/08/2012	08/31/2016
Comments (incl. % achievement)				
Indicator 5 :	Number of firms with female owners financed (Number, Custom)			
Value (quantitative or Qualitative)	0			4
Date achieved	08/08/2012			08/31/2016

Comments (incl. % achievement)	

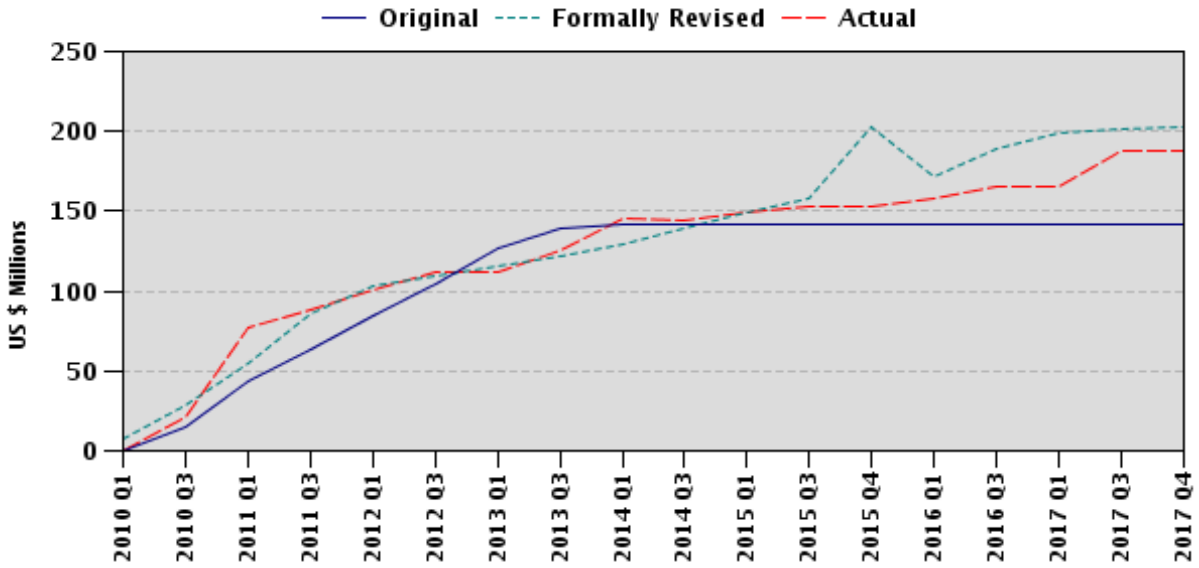
G. Ratings of Project Performance in ISRs

No.	Date ISR Archived	DO	IP	Actual Disbursements (USD millions)
1	03/30/2010	Satisfactory	Satisfactory	21.55
2	10/31/2010	Satisfactory	Satisfactory	77.64
3	05/14/2011	Satisfactory	Satisfactory	88.64
4	11/29/2011	Satisfactory	Satisfactory	100.85
5	06/24/2012	Satisfactory	Satisfactory	112.30
6	12/11/2012	Satisfactory	Satisfactory	125.07
7	07/10/2013	Satisfactory	Satisfactory	125.07
8	01/01/2014	Satisfactory	Satisfactory	144.75
9	09/12/2014	Satisfactory	Satisfactory	148.83
10	02/12/2015	Satisfactory	Satisfactory	152.61
11	11/03/2015	Satisfactory	Satisfactory	158.24
12	03/24/2016	Satisfactory	Satisfactory	165.01
13	06/14/2016	Satisfactory	Moderately Satisfactory	165.01
14	08/29/2016	Satisfactory	Moderately Satisfactory	165.01

H. Restructuring (if any)

Restructuring Date(s)	Board Approved PDO Change	ISR Ratings at Restructuring		Amount Disbursed at Restructuring in USD millions	Reason for Restructuring & Key Changes Made
		DO	IP		
08/08/2012	N	S	S	112.30	The Board approved an additional loan in the amount of Euro 50 million equivalent to HBOR.
04/16/2015		S	S	152.61	(i) Broaden the mode of financial intermediation, (ii) Extend the closing date by one year, and (iii) Amend the results framework

I. Disbursement Profile



1. PROJECT CONTEXT, DEVELOPMENT OBJECTIVES, AND DESIGN

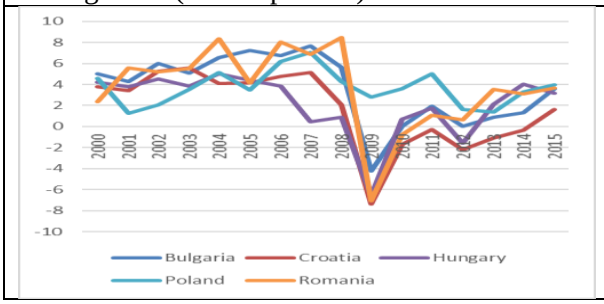
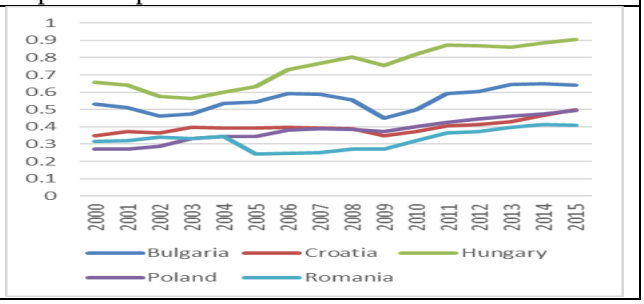
The Croatia Export Finance Intermediation Loan (CEFIL) project was a Financial Intermediary Loan (FIL) from The World Bank to The Croatian Bank for Reconstruction and Development (HBOR). HBOR was a wholesaler for the original loan and lent funds to Participating Financial Institutions (PFIs). The PFIs used the project funds to finance the working capital and investment expenditures for the final beneficiaries - Croatian export companies. In the additional finance loan, HBOR was also a direct lender to Croatian export companies.

The CEFIL Project, which was complemented by additional finance, totaled Euro150 million. The original project approved by the World Bank on August 4, 2009 was a credit line of Euro 100 million extended to the Croatian Bank for Reconstruction and Development (HBOR) with a guarantee by the Government of Croatia. The CEFIL Project was scaled up with additional financing on September 20, 2012. HBOR fully disbursed its original credit line by December 31, 2013. Disbursement under additional financing was completed on February 28, 2017[1]. Although the full amount of additional financing was committed to prior to the closing date of August 31, 2016, US$ 1.217.289,45 remained undisbursed because two sub-borrowers did not meet the disbursement conditions required by HBOR.

1.1. Country and Sector Background

Croatia experienced strong economic growth from 2000 to 2008. This economic growth (over 4 percent on average) was driven by domestic demand and spurred by large capital inflows. Croatia's high growth performance during the years prior to the global crisis, was comparable to country peers in the region and led to a more rapid convergence with the EU. GDP per capita in purchasing power parity (PPP) terms reached 63 percent of the EU-27 average in 2008. While growth was particularly strong in the non-tradable sectors such as retail, construction, and tourism services, this put long term growth sustainability at risk.

Figure 1: Economic Growth and Exports

GDP growth (annual percent)	Exports as percent of GDP
	

[1] The CEFIL Loan were closed on August 31, 2016. The original grace period for disbursements ended on December 31, 2016. The grace period for disbursements was extended to February 28, 2017 due to a currency conversion (Euro to Dollar) performed on December 14, 2016. Because the loan agreement allowed only Kuna and Euro disbursements, the currency conversion required a one-time compliance waiver, with one of the legal provisions in the Loan Agreement for Loan No. 8193-HR applied retroactively, which enabled on-lending and disbursements in USD.

Source: World Bank - World Development Indicators

Croatia was a small and open economy, with exports accounting for around 40 percent of GDP at the time of the appraisal. Croatia's major trading partners were the European Union and South-Eastern European countries. While Croatia's comparative advantage shifted away from traditional exports such as textiles, at the time of the appraisal the overall export structure was lagging in terms of technology intensity. Croatia was falling behind peers such as Bulgaria and Hungary in export performance. The structure of Croatia's exports demonstrated comparative advantage in resource-based manufactured products (mainly agro-processed goods), low-technology manufactured products and selected medium technology products, including shipbuilding. Among quasi-exporting industries[2], tourism has grown rapidly since the late 1990s, and has become a major source of foreign exchange revenue. Tourism comprises almost 40 percent of exports of goods and services.

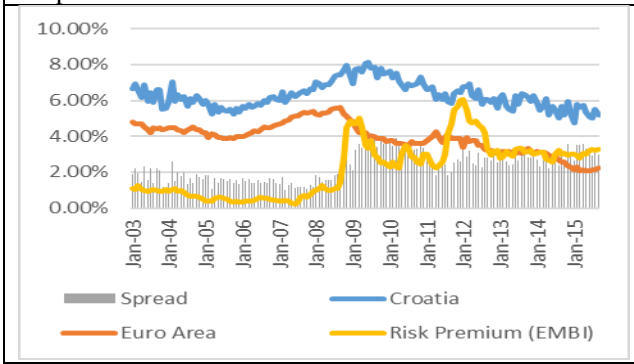
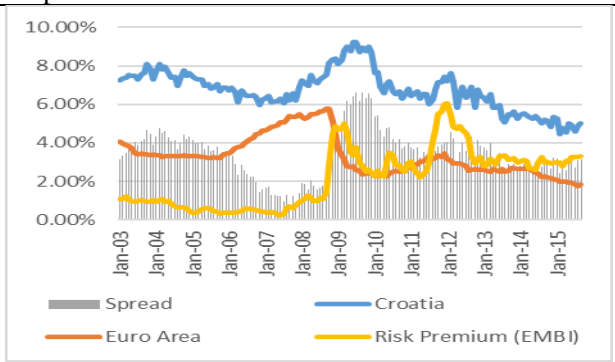
Exports nearly doubled in Euro terms from 2000 to 2008 as industrial production expanded. However, imports outpaced exports, and the trade balance deteriorated significantly (the trade deficit reached 22.9 percent of GDP in 2008). The current account showed a positive and increasing surplus on services, as tourism receipts mounted. Capital inflows helped balance an overall current account deficit due to a deficit in the balance of goods above the surplus of services. In 2009, exports declined more than imports while Foreign Direct Investment (FDI) and capital flows from parent banks slowed, placing significant pressure on external imbalances. At the time of the appraisal, it was expected that exports would decline even further as a result of weakening demand in the EU and with major trading partners.

The global crisis prompted a highly indebted private sector concentrated in non-tradable sectors such as construction. Croatia’s external debt increased from 53 percent of GDP in 2000 to 83 percent in 2008, mainly as a result of financing from parent banks to the banking sector and private sector borrowing. Croatia began 2009 with a significant debt service and debt rollover requirement.

The crisis, and Croatia's resulting economic downturn took a toll on availability and on the terms of the loans. This led to slower loan origination, particularly in the following sectors: hotels and restaurants, transport and communications, food and beverage processing, and chemicals. Interest rates and spreads increased and maturities decreased. Average loan size decreased in industries where credit stagnated, while it stayed the same or grew slightly in industries with positive credit growth. As a consequence of banks becoming more risk averse loans shifted towards more secure government borrowing. This included state-owned enterprises and de-leveraging continued for private enterprises and individual loans.

[2] According to the national exporter definition an exporter is a business entity that generates foreign exchange export revenues. In the case of quasi-exporters such as tourism and logistics firms, the definition means that a business entity can demonstrate that a pre-defined share of its income comes from sales of goods or services to non-resident companies or individuals.

Figure 2: Long and Short Term Interest Rates to Non-Financial Sector

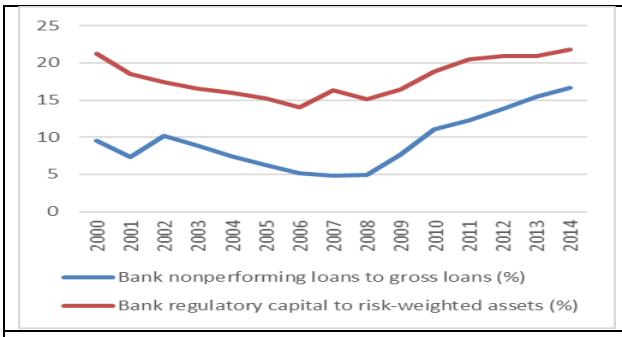
Interest rates on long-term loans to non-financial corporations in Croatia and the euro area	Interest rates on short-term loans to non-financial corporations in Croatia and the euro area
	
Source: Bloomberg, ECB and CNB	

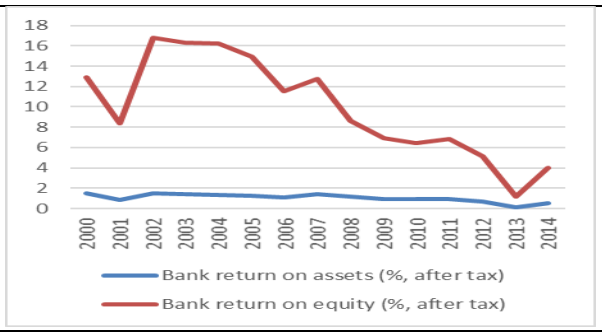
The banking system was more resilient during the global financial crisis in part as a result of participation of foreign banks. By the end of 2008, the banking sector comprised of 33 banks and 5 housing savings banks, with a total of HRK 367.9billion (Euro 50.1 billion) in total assets. Of these, the 16 banks with majority foreign ownership held 91 percent of banks' assets, with Austrian-owned banks accounting for 60 percent of assets. Two state-owned banks held a 4.36 percent of the market share. The Croatian banking market was highly concentrated, with the two largest banks holding 40.78 percent, and the four largest banks holding 63.62 percent of the total market share.

Croatian banks continued to exhibit a level of good, yet deteriorating financial metrics at the end of 2008. All banks reported a capital adequacy ratio above the legally prescribed minimum of 10 percent. All bank groups, particularly large banks, reported a fall in capital adequacy ratios (from 16.4 to 15 percent) due to an increase in risk-weighted balance sheet and off-balance sheet items. Gross earnings had been increasing at the same pace with asset growth, yielding a stable return on average assets (ROAA). At the same time, capital increases outpaced bank earnings, leading to a decline in the return on average equity (ROAE) from 2006/2008. Increasing competition put downward pressure on profitability. Non-performing to total loans ratio was at 4.8 percent at the end of 2008, with a significant potential to increase due to slower growth of new loans and rising debt-service burden for clients operating in a slower economy.

Figure 3: Banking Sector Indicators

Bank non-performing loans to gross loans (%) and Bank regulatory capital to risk-weighted assets (%)	Return on assets and return-on equity (%)





Source: World Bank - World Development Indicators

The global crisis resulted in considerably slower lending by Croatian banks as parent banks curtailed their overall lending in an attempt to deleverage, and reassess their capacity to bear risk, especially in emerging markets. At the end of 2013, external bank exposure to Croatia was 28 percent of Croatia's GDP, compared to 46 percent of GDP in early 2007. To enable sustained growth of the Croatian economy, the Central Bank undertook a number of measures to maintain the needed flow of long-term funds. These measures focused on: (i) reserve requirement adjustment to release liquidity; (ii) money-market interventions to adjust liquidity in order to maintain exchange rate stability; and (iii) continued prudential regulation to preserve stability of the banking sector[3] although some adjustments were made to provide more liquidity.

The government's efforts succeeded in alleviating but not offsetting the full impact of the global crisis. In 2009, GDP contracted by 5.8 percent as a result of the contraction of external demand. While the pace of decline moderated in the second half of 2009, negative feedback to the financial sector from the deterioration of the real sector led to much stronger risk aversion, thus postponing recovery. The recession resulted in a sharp increase of the official unemployment rate from an average of 12.4 percent in 2008, to over 18 percent in the first quarter of 2010. Remaining challenges included sustainable adjustment of the current account deficit, and meeting external financing requirements of the public and private sector.

1.2. Rationale for Bank Assistance

The CEFIL Project was designed to support the Government of Croatia's objective to maintain a steady flow of credit to the private sector, and to assist in enhancing private sector competitiveness in the process towards full European integration. The global financial crisis had profound effects on the operating environment of Croatian economy. The international inter-bank market was more risk averse and liquidity conditions tightened significantly. As a

[3] Except for marginal obligatory reserves and existing high-rates of regular obligatory reserves (17 percent), in 2007, the Croatian National Bank introduced another administrative measure with the purpose of preserving annual credit growth at the level of maximum 12 percent (i.e. 1 percent monthly), and creating additional marginal lending costs for each bank if its credit growth surpassed the threshold monitored on a monthly basis (this limit excluded lending by HBOR or loans to the government). CNB announced the implementation of increase in CAR up to 12 percent until April 2010, in line with EC Capital Adequacy Regulation. In autumn 2008, the marginal obligatory reserve measure was abandoned, regular obligatory reserve was decreased to 14 percent, but the administrative measure of maximum credit growth of 12 percent was still in place. Central Bank interventions also included an increase of the foreign exchange component of the reserve requirement allocated in Kuna, from 50 to 75 percent aimed to maintain the exchange rate stability and ease the depreciation pressure on Kuna vis-a-vis the Euro.

consequence, loan growth in Croatia slowed and banks adjusted their balance sheets to cope with the new environment. The Government directed additional support to strategic sectors including exports, tourism, agriculture and SMEs through HBOR.

Restricted access to medium and long-term finance was a recognized impediment to the growth and sustainability of Croatia's export sector. The project aimed to partially offset the stagnation in capital flows by making available additional medium and long-term funding for investment and working capital expenditures of the exporters and foreign-exchange earning enterprises (e.g. Tourism, Logistics).

The project was consistent with the Financial Year (FY) 09–12 Country Partnership Strategy (CPS)[4] at the time of appraisal and remained fully consistent with the subsequent CPSs[5]. The project was supporting CPS objectives, which included promoting private sector-led growth as a key priority to achieve faster convergence with EU27 per capita income levels. This project was not included in the pipeline of the original CPS, however at the peak of the crisis in 2009, the Government of Croatia sought Bank financing to help mitigate the impact of the crisis[6]. Government of Croatia and The World Bank agreed to add a line of credit for exporters through the Croatian Bank for Reconstruction and Development (HBOR) and two Development Policy Loan (DPL) operations- a US$271 million DPL to support the Government's crisis response package (FY10) and a US$ 2013 million DPL (FY 11) to support the Government's Economic Recovery Program[7]. HBOR's role as a development bank to provide countercyclical support and fill in market gaps in such an environment was critical.

The credit line operation complemented a comprehensive package of the Bank's analytical, advisory, and financial support to Croatia's financial sector development and private sector competitiveness agenda. Croatia formulated a comprehensive regulatory framework for financial institutions, through implementing the Credit Institutions Act, Capital Markets Act, and the Consumer Credit Act[8] supported by the Fiscal Social Finance Sector DPL and targeted Analytical and Advisory Assistance (AAA). The Bank produced a strategic analytical study on labor markets, follow-up analyses to the Doing Business report, and analytical work on science, innovation and technology policy as part of the dialogue aimed at creating an enabling business environment. The EU Convergence Report was a major work undertaken in this area, engaging policymakers and stakeholders on accelerating growth through greater labor force participation, productivity, trade integration and innovation.

The CEFIL Project was complementary with the International Finance Corporation (IFC) and Multilateral Investment Guarantee (MIGA) activities focusing on providing strategic support to enterprises, including through immediate crisis response. IFC's strategic focus in Croatia was underpinned by its regional priorities of increasing access and quality of infrastructure services,

[4] Report No 44879-HR and dated August 13, 2008

[5] CPS FY 14-17 dated June 27, 2013 (Report NO: 77630-HR)

[6] HBOR Letter dated February 25, 2009, addressing the World Bank Country Director and asking for the World Bank support for CEFIL Project

[7] CPS Progress Report dated August 22, 2011 (Report No 61715-HR)

[8] Fiscal, Social and Financial DPL Implementation, Completion and Results Report Dated August 23, 2010 (IBRD-78460)

including through PPPs; addressing climate change; and enhancing competitiveness, including supporting South-South investments. During the FY09-12 CPS period, IFC invested US$ 56.4 million in the post-privatization restructuring of a previously state-owned asset, and supported a Croatian food and retail group in their Euro 40 million expansion in Serbia. IFC's portfolio reached almost US $ 260 million by end-June 2011, focusing on investments in agribusiness, tourism and construction materials. Given the deleveraging and lower capital flows, IFC continued to scale up its presence in Croatia during the FY14-17 CPS period to support Croatian companies, exporters and SMEs through direct lending, equity investment and lending through financial sector institutions. MIGA issued a guarantee of up to US $278.6 million for Unicredit Bank Austria's $200 million shareholder loan to its Croatian subsidiary, Zagrebacka Banka. The coverage was for a period of up to eight years against the risks of transfer restriction, expropriation, and war and civil disturbance. The MIGA guarantee was part of The World Bank Group's Financial Sector Initiative framework which coordinated international response to the global crisis and aimed at contributing to stability in Croatia's banking sector by injecting liquidity.

The project was also complemented with projects by different International Financial Institutions (IFIs) including EIB, EBRD, KfW. These IFIs were also providing financial support to different parts of the market and Bank's funds were complementing and scaling up these efforts.

1.3. Original Project Development Objectives (PDO) and Key Indicators (as approved)

The project specified the following PDO:

The PDO is to support the preservation and growth of exports by providing medium and long term working capital and investment finance to exporters and foreign-exchange earning companies. The outcomes of the project will be measured by the export and investment performance of the sub-borrowers, the amount of medium and long-term lending extended to exporters in Croatia, the payment performance of the sub-borrowers in the project, and the impact on employment in the companies supported.

To measure progress toward the achievement of the PDO, the following performance indicators were approved:

- Croatian exports by sub-borrowers.
- Total loan disbursed.
- Medium and long term (>12 month) loans.

Key indicators for measuring project outcomes were:

- Number of firms financed.
- Total NPL (%).
- Total lending by PFIs to corporate.
- Job creation.

The project was also designed to monitor a broader set of indicators including: (1) financial performance of PFIs and HBOR; and (2) loan distribution by PFIs, firm size, and sector. These additional monitoring efforts aimed to provide sufficient information for a comprehensive assessment of the project's contributions beyond its core objectives.

1.4. Revised PDO (as approved by original approving authority) and Key Indicators, and reasons/ justification

The PDO did not change during project implementation. The indicators were revised at the time of the Additional Financing (AF) to facilitate the measurement of project-specific contributions and adjust the targets to match the amount of the additional finance (Table 1).

Table 1: Amendments to the Original Results Framework

Original indicator	Change	Rationale for change
PDO Indicators		
Preservation and growth of exports by the final beneficiaries	Revised: Level of exports growth or preservation of beneficiary firms	Clarification
	New: Volume of medium and long-term lending by PFIs to firms under the project	Addition; changed target value
Intermediate results indicators		
Amount disbursed to private sector firms	Dropped	Indicator monitored above
Number of medium and long-term loans granted by PFIs under the project	Dropped	Indicator monitored above
	New: Number of firms financed by PFIs under the project New: Number of firms with female owners financed	Addition; changed target value Addition; for information purpose only
Quality of Portfolio - Total NPLs as number of loans Total NPLs (in percent)	Revised: Total NPLs as number of loans Total NPLs (in percent)	Clarification; changed target value
Employment preserved or created	Revised: Level of job creation or preservation	Clarification

1.5. Main Beneficiaries

Project description and the PDO of the CEFIL project identifies two main groups of beneficiaries: (1) exporters and quasi-exporters; and (2) HBOR, and PFIs (commercial banks).

The primary beneficiaries for this project were exporters and quasi- exporters. As defined in the PAD and legal documents, an exporter is every business entity that generates foreign exchange export revenues. In the case of quasi-exporters such as tourism and logistics firms, the definition means that a business entity can demonstrate that a pre-defined share of its income comes from sales of goods or services to non-resident companies or individuals. Exporters would benefit from the provision of medium- and long-term finance to make productive investments at a time of (1) reduced international funding due to the financial crisis; (2) increasing demand for longer term credit; and (3) inability of the financial sector to support these trends at a reasonable cost.

The secondary beneficiaries were the PFIs and HBOR. PFIs and HBOR would benefit from access to medium- and long-term funding to help them expand their medium- and long-term lending activities, while reducing maturity mismatches that lead to both interest rate risk and refinancing risk. In addition, the project's requirements for compliance with banking regulations and eligibility requirements would help ensure that the PFIs remain financially sound. With regard to HBOR, the project would increase its long-term funding and intermediation capacity in the financial sector and primarily support its countercyclical and gap filling functions as a development bank. The ultimate objective was to strengthen and improve the ability of the Croatian financial sector to provide medium- and long-term financial resources to the exporters and quasi- exporters for their productive investments.

1.6. Original Components (as approved)

The Croatia Export Finance Intermediation Loan (CEFIL) Project was a single component project consisting of a credit line to HBOR as the Borrower and Implementing Agency. HBOR would wholesale the funds to private banking institutions (Participating Financial Intermediaries or PFIs), which in turn on-lend to eligible private exporters and quasi-exporters such as the tourism and logistics sector.

1.7. Revised Components

The project was scaled up with AF once. Based on the success of the original Project, additional funds were requested to enhance the development impact. There were no changes to the Development Objective.

The Bank approved a restructuring of CEFIL additional finance project in April 2015 in response to the request by the HBOR[9] and the Croatian Ministry of Finance. As a result, the following changes were implemented:

(i) The mode of financial intermediation was broadened to allow HBOR to lend directly to eligible sub-borrowers, under the same terms and conditions as PFIs, in addition to on-lending to PFIs for final lending to sub-borrowers. This change enabled HBOR to (a) extend risk-sharing loans where both HBOR and commercial banks lend jointly; and (b) refinance existing projects of eligible borrowers.

(ii) The closing date was extended by one year to August 31, 2016 from the previous closing date of August 31, 2015;

(iii) The results framework was amended by changing two indicators in accordance with the change in the mode of financial intermediation and the new closing date.

1.8. Other significant changes

[9] HBOR letter dated December 18, 2014 and Ministry of Finance letter dated March 31, 2015 requesting restructuring of the CEFIL Project

HBOR proceeded with several reallocations among PFIs throughout the life of the project. All the reallocations were undertaken at the original loan phase until the end of 2013.

Table 2: Reallocations among PFIs

Million Euro	Initial Distribution (Sub loan agreements signed between November 2009-January 2010	First reallocation - May 2010	Second Reallocation – 2012-13	Third Reallocation – End of 2013
CEFIL I- Loan No. 77740				
ERSTE- Erste & Steiermärkische Bank d.d., Rijeka	30	33	31.84	31.84
SGS- Societe Generale – Splitska banka d.d., Split	20	20	19.57	24.47
ZABA- Zagrebačka banka d.d., Zagreb	30	19	15.06	15.06
RBA- Raiffeisenbank Austria d.d., Zagreb	20	20	20	27.1
OTP banka d.d. Hrvatska		8	1.4	1.4
Unallocated			12.1	0.12
Total				99.88

A currency conversion was completed during the grace period: In August 2016, prior to the Closing Date, HBOR approved 4 sub-loans to eligible sub-borrowers. The Sub-Loan Agreements for these sub-loans were signed prior to the Closing Date, while actual disbursement of the committed funds to sub-borrowers was expected to take place within the 4-month grace period after the Closing Date, by December 31, 2016, as per the Disbursement Letter. One of the clients requested to receive the loan in US$ as the beneficiary was an exporter generating revenues in US$ and had expenses in US$ but not in Euro. US$ liabilities were more suitable for proper currency matching of the beneficiary's balance sheet. HBOR disbursed the sub-loan out of its own funds and asked the Bank for a USD conversion for the Euro 22.8 million amount. USD disbursement was not included in the Loan Agreement and a restructuring would have been needed. Conversion was conducted with a Country Director approval of a onetime waiver granted for compliance with legal provisions and extension of the grace to February 28, 2017[10].

2. KEY FACTORS AFFECTING IMPLEMENTATION AND OUTCOMES

2.1. Project Preparation, Design and Quality at Entry

The project's preparation, design, and quality at entry were mostly in line with lessons learned from previous line of credit projects in different countries and regions including Ukraine, Turkey, India, and Armenia. Project preparation benefitted from a productive and close

[10] Memo dated December 21, 2016 for one-time waiver of compliance with a legal provision of the Loan Agreement on sub-loan currency denomination

collaboration with the Croatian Ministry of Finance (MoF), Croatian National Bank (CNB), exporter and SME associations, and the financial sector community in the design of the project and selection of the instrument.

Critical design features of the CEFIL project are detailed as follows:

(i) Consistency with Bank and government priorities. The project supported the government's strategic priorities and was aligned with the FY09–12 Country Partnership Strategy (CPS) at time of appraisal and remained fully consistent with the subsequent CPSs. The project was enhanced by strong government commitment.

(ii) The macroeconomic environment and financial sector framework: A stable macroeconomic environment is critical for the success of the line of credit, as a distorted or disturbed macroeconomic environment could undermine the realization of the project. Appraisal of the original loan acknowledges the vulnerabilities in the macro stability such as high external debt and high current account deficit but also lists some mitigating factors including prudent monetary and fiscal policies, substantial international reserves and well-capitalized banking system. However, in the additional finance phase the macroeconomic environment was much more challenging with a deepened recession, increasing unemployment, deleveraging of banks, increasing NPLs and high debt burden along with fiscal consolidation challenges. Additional finance project paper would have better elaborated and justified the availability of the macroeconomic environment which posed significant risks to the implementation capacity of the project, and accordingly should have reviewed the associated mitigation measures.

(iii) Simple and somewhat flexible design, with a minimum of statutory requirements.

- Currency and interest rate: The World Bank's loan included the built-in option for the borrower to convert loans into an "approved currency," or from variable to fixed interest rate (and vice versa). Therefore, the borrowers were able to better manage currency and interest rate risks. In addition, design of the CEFIL project was preventing accumulation of currency risk on the final beneficiaries as final beneficiary exporters and quasi-exporters were foreign currency earners who could better bear currency risk. The Kuna/ Euro exchange rate was a relatively stable one which was closely managed by CNB.

- Eligible sectors: the definition of exporters was expanded to include service exports (i.e. tourism) in line with the national definition. This feature was included to cover the tourism and logistics sectors because they have strategic importance in Croatia's economy. No additional sector restrictions were included in the design. This was in line with the best practices recommending avoidance of such restrictions which proved to be counterproductive. Experience has shown that sector restrictions lead to providing financing to unviable projects simply because they are in a particular sector.

- Sub-loan lending requirements: The terms and conditions of subsidiary loans were flexible by design. Loans could be granted for both working-capital and investment purposes, and could be denominated in local currency (sub loans could be denominated in Euro, HRK or FX linked). Notably, the entire project was intended to be based on cash-

flow, as opposed to an asset-based, collateral lending model. Sub-loan lending requirements required banks to conduct a cash flow analysis and meet a minimum debt service coverage ratio during the term of the loan. Loans based on cash flow do not fully rely on collateral. Instead, they are based on the expected income of the company and the banks' assessment of its capacity. This approach considerably improves the access to finance for enterprises which may not have sufficient eligible collateral, but can present highly profitable investment proposals.

(iv) Quality of borrower and PFIs:

Borrower: HBOR was selected on the basis of sound bank analysis and audited financial performance data. The World Bank's appraisal team conducted detailed assessments of the HBOR. The Borrower was deemed well-capitalized and profitable, with a sound loan portfolio. HBOR, at the time of the appraisal, was rated by both Moody's (A3) and Standard and Poor's (BBB) at investment grade and above. The World Bank also conducted a financial intermediary loan assessment (World Bank Operational Policy 8.30) and determined that the proposed project qualifications met the requirements.

PFIs: The team reserved sufficient focus to identify strong PFIs able to disburse funds effectively and efficiently to viable sub-projects consistent with project objectives. The team followed the Bank policy and criteria to identify viable intermediary institutions: (a) adequate profitability, capital and portfolio quality as confirmed by audited financial statements prepared; (b) acceptable level of loan collections; (c) appropriate capacity, including staffing, for carrying out subproject appraisals (including environmental assessment); and (d) appropriate prudential policies, administrative structure and business procedures. All selected PFIs had to comply with the prudential norms as required by the CNB and were certified annually by the PFIs external auditors. Based on pre-qualification criteria, the team identified prospective PFIs at appraisal stage, which saved time and improved effectiveness.

(v) Wholesale and retail lending:
Wholesale Lending: Under the CEFIL Project, HBOR wholesaled funds to private banking institutions (Participating Financial Intermediaries or PFIs), which in turn on-lent to eligible private exporters and quasi-exporters such as the tourism and logistics sector. HBOR carried the credit risk of selected PFIs, and PFIs carried the credit risk of selected exporters. Selection of the project participants rested on the entities that were most capable of identifying good financial intermediaries and exporting firms. Criteria for selection of PFIs and exporters were set out in the project documents and monitored during supervision to help ensure that choices were made on a sound basis. Market development and competition was supported through a wholesale structure.

Direct Lending: Global crisis triggered debates about the role of development banks, and encouraged governments to utilize them more extensively. Although there are mixed results and continuing debates about the role of development banks, they should broadly serve two main roles: (i) countercyclical support and interventions during times of economic contraction; and (ii) provide a gap-filling function by operating where private sector financial institutions are not active. Development banks generally serve as a second tier market-

making role rather than conducting direct intervention unless it is targeted and justified. Original loan and additional finance has a wholesale structure while the restructuring in 2015 introduced a direct-lending opportunity for HBOR. The Restructuring paper[11] argues that this change was introduced due to a risk aversion by the commercial banks in the face of a protracted recession. It also enabled HBOR to address this market failure and fill a gap not fulfilled by private sector commercial banks.

(vi) Alternative intermediation channels: Croatia and the rest of the ECA region have a bank-dominated financial sector. The Bank's team and HBOR preferred to identify only commercial banks as potential PFIs and set pre-qualification and selection criteria for this group during appraisal based on bank domination in the financial sector, and HBOR's preference to work with commercial banks. On the other hand, Croatia had a vibrant leasing sector where leasing assets were around 11 percent of the GDP, and there were 26 leasing companies (mostly bank subsidiaries) operating during the appraisal. Although investment demand, which is highly correlated with the leasing demand, was curbed due to the recession, leasing would have been another channel for intermediation and would have expedited disbursements. The utilization of leasing proved effective in credit line projects in other countries and regions. HBOR's Annual Financial Statements Report 2015 indicates that HBOR started to work with leasing companies as PFIs later in 2015, but leasing intermediation was not utilized in CEFIL project.

(vii) Complementarity with development policy loan programs and analytical studies: The CEFIL project was complementary with development policy loan and analytical study programs targeting financial sector development and enhancing private-sector led growth. The CEFIL project documents benefitted from the findings and recommendations of Croatia's Convergence Report – Reaching and Sustaining Higher Rates of Economic Growth. The project was also complimentary with the Fiscal, Social and Financial Development Policy Loan, which included a financial sector pillar and policy actions to improve financial crisis preparedness, risk management and supervision.

(viii) Possible risks and associated mitigation measures: Possible risks and associated mitigation measures were properly covered in the project documents. Main risk groups identified were: (i) macroeconomic instability and impact of global financial crisis; (ii) changes in the demand for project funds either through a deepening slowdown or improving conditions in the financial sector; (iii) credit risk of exporters; (iv) political influence on implementation; and (v) delays due to The World Bank fiduciary and safeguards requirements. Mitigating factors included strong capacity of the CNB in monitoring and implementing measures, resilience and strong capital base of the banking sector, long term nature of funds, wholesale design and technical capacity of private sector PFIs in allocating resources and managing risks, and HBOR's experience with different IFIs. The Bank team had confidence in HBOR's institutional, financial, and technical capacity, based on their prior experience successfully managing foreign credit lines with different IFIs. Commercial bank's increasingly risk adverse behavior and deleveraging from corporate loans, while increasing their exposure to public institutions, was not considered as a risk down the road.

[11] Restructuring Paper dated April 16, 2015 (Report No RES17712)

The Bank team assumed that there would be demand for medium to long-term loans in the case of a prolonged recession.

2.2. Implementation

The project was implemented over a period of seven years, from effectiveness in November 2009 to closing on August 31, 2016. Overall, the implementation arrangements worked well. The original CEFIL project was approved on August 4, 2009 and became effective on November 25, 2009. The project was scaled up with additional finance of Euro 50 million equivalent, which was approved on September 20, 2012 and became effective on October 19, 2012. A request received on December 18, 2014 to conduct a project restructuring was approved on April 17, 2015. The original loan was fully disbursed by December 2013 (within the four-month grace period after the closing date of August 31, 2013). Additional finance was fully committed on the extended closing date of August 31, 2016. Final disbursements could only be completed in the extended grace period for submission in the final statement of expenditures by February 28, 2017. US$ 1.217.289,45 remained undisbursed because two sub-borrowers did not meet HBOR disbursement conditions.

The CEFIL project was implemented in a challenging macroeconomic environment during a prolonged recession in Croatia, which resulted in significant difficulty, particularly with the disbursement of additional finance. The challenging country and sector context during project implementation is detailed in the Annex 10 and the main challenges during implementation are summarized below.

Implementation performance during original loan versus additional finance:

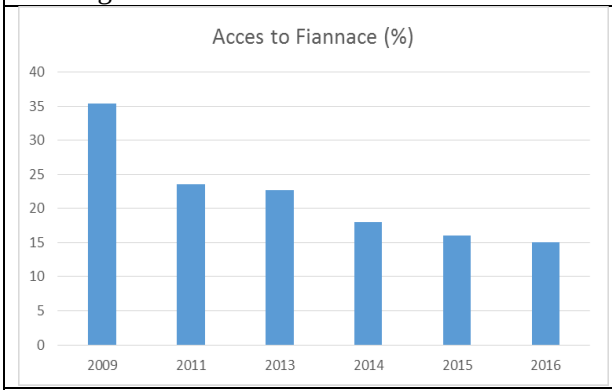
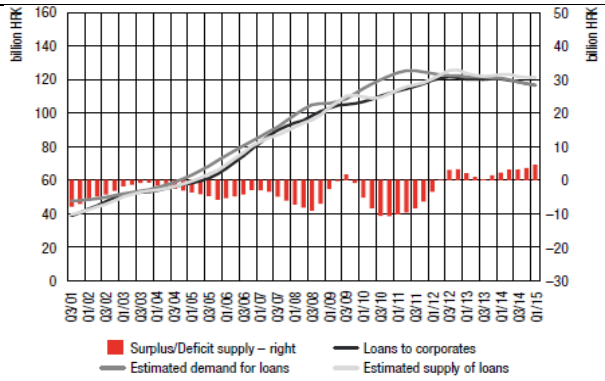
Credit demand and supply factors played significant roles during the life of the project. According to research conducted by CNB[12], the pre-crisis period was primarily marked by surplus demand for loans, which is in line with the real and financial sector developments in that period. A significant part of this demand was met abroad. The annual growth rates of loans to the corporate sector were mostly positive between 2009 and 2012, despite the absence of any economic recovery. This helped the successful implementation of the original loan. Since 2011, credit demand had been gradually declining because of the low level of economic activity, negative future expectations, and to a certain extent because of the stabilization in the international financial markets and easier access to foreign capital. The period from 2012 onward was marked by surplus supply of loans over demand. This confirmed that lack of domestic demand constrains credit recovery for the corporate sector, particularly after 2012. As a result, the CEFIL Project also suffered from lack of demand in the additional finance phase after 2012. A result of the Survey on the Access to Finance of Enterprises (SAFE)[13]conducted by the

[12] Delayed Credit Recovery in Croatia: Supply or Demand Driven? Mirna Dumicic and Igor Ljubaj, January 2017-Croatian National Bank Working Paper W-45

[13] SAFE surveys are conducted by ECB every 6 months. The survey covers micro, small, medium-sized and large firms and it provides evidence on the financing conditions faced by SMEs compared with those of large firms during the past six months. In addition to a breakdown into firm size classes, it provides evidence across branches of

European Central Bank (ECB) provides a parallel evidence. Results show that access to finance was the firm's most pressing problem until 2012, while it dropped on the list of priorities afterwards. Financial institutions became much more risk averse after 2012 due to increasing NPLs, high indebtedness by the corporates and weakened balance sheets. While the original loan launched in 2009 was quickly absorbed due to strong demand from corporates and bank willingness to finance them, the additional finance phase coincided with a lack of demand from corporates for the new loans, and high risk aversion by the banks, which resulted in the deleveraging of corporate portfolios.

Figure 4: Credit Market Indicators

Pecentage of respondents indicating access to finance is the most pressing problem for their firm's growth	Estimated supply and demand for corporate loans
	
Source: European Central Bank SAFE Survey and Croatian National Bank Working Paper W-45	

The Bank team conducted the appraisal of the additional finance in a highly uncertain environment which presented significant challenges to predict the demand for loans. A more thorough analysis at the additional finance phase would have revealed some of these dynamics and enhanced planning for the intervention including identification of the right instrument, timeframe, objectives and the relevance of the additional finance.

Other factors, including an abundance of IFI loans, restriction of additional finance to investment projects in the tourism sector by HBOR, heavier IBRD safeguards, and procurement and loan conditions compared to other IFIs influenced implementation performance during the additional finance phase. These are further discussed below.

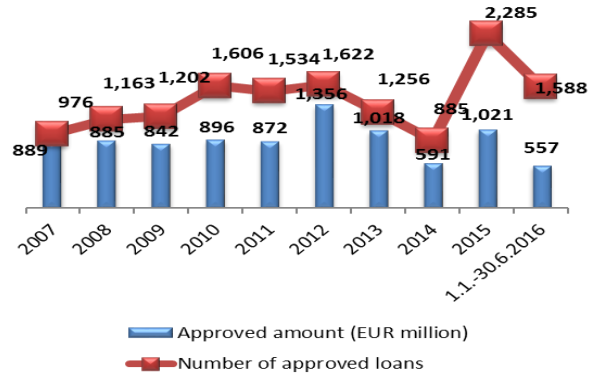
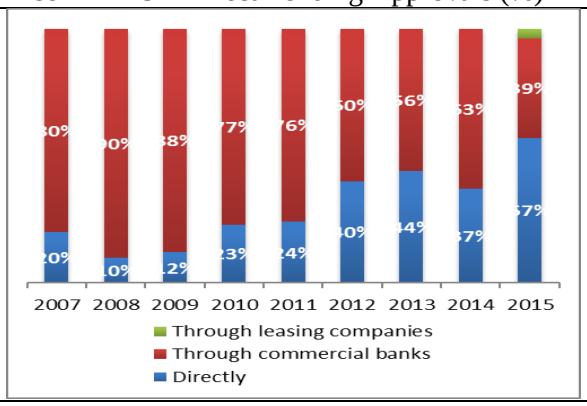
Restructuring:

The rationale for the restructuring was based on the private commercial banks' lack of interest to supply credit (Restructuring Paper dated April 16, 2015). The paper stated that Croatia continues to experience weak or stagnant credit growth conditions, which is to some extent driven by weak supply of credit by banks. Reduced supply might be partly explained by the reduced risk appetite of banks in the context of the economic recession and a reorientation of bank lending towards the relatively lower risk government sector. HBOR's total loans to banks decreased from December

economic activity, euro area countries, firm age, financial autonomy of the firms, and ownership of the firms. The first wave of the survey was held in June-July 2009.

2012 to December 2016 whereas direct loans to other customers increased. The restructuring paper stated that these dynamics highlight HBOR's significant role in providing credit to the economy in the context of credit stagnation without crowding out commercial banks. Restructuring aimed to revise the mode of financial intermediation in order to allow HBOR to lend directly, in addition to the wholesale model. Restructuring would also allow HBOR to (a) co-finance loans to eligible borrowers where both HBOR and commercial banks lend jointly, and (b) refinance existing projects to eligible borrowers.

Figure 5: HBOR Direct Lending

HBOR Approved Loans Annually (million Euro)	Rise in HBOR Direct Lending Approvals (%)
	
Source: HBOR	

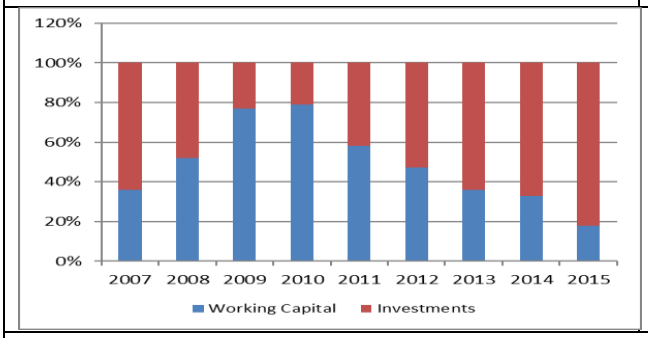
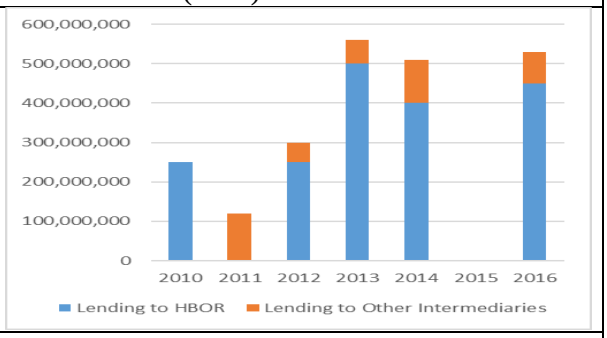
Restructuring conducted for the additional finance did not create the expected impact, especially during 2015. This was partly due to the lack of demand for new loans from exporters and weak supply of funds from the banks as well as due to the slow implementation performance of the project. Restructuring was completed in April 2015. The September 2015 mission Aide Memoire recorded that there was no progress on disbursement in spite of the completion of the restructuring that allowed HBOR for direct lending, risk sharing and refinancing. The Bank team asked HBOR to prepare a pipeline for eligible co-financing and refinancing projects. By the end of 2015, the Bank team intensified implementation support and began more frequent monitoring on the pipeline and increased mission visits until the project close in August 2016. The Bank team and HBOR also visited prospective borrowers. HBOR focused on some large loans towards the end of the project, which required longer internal credit approval processes. HBOR increased efforts to strengthen the pipeline for new loans, but slow disbursements from CEFIL funds was puzzling while HBOR's direct lending activity was increasing.

Allowing HBOR to lend directly supported HBOR's countercyclical intervention in the market when private banks were tightening credit conditions. In this regard, restructuring achieved its objective, however the bigger constraint was about weak demand for corporate loans and restructuring was not addressing this problem. Therefore, restructuring achieved its objective but only partially addressed the problem in the credit market where both weak loan demand and weak supply of credit by commercial banks were constraining loan growth. Eventually, although HBOR was allowed to lend directly, disbursements remained slow. Additional finance included both wholesale and direct lending modalities. Euro 12 million of the additional finance was disbursed by a PFI through a wholesale arrangement, while the remaining part was disbursed directly through HBOR.

Abundance of International Financial Institution (IFI) Loans:

There were additional reasons for slow disbursements such as abundance of IFIs loans to HBOR in that period primarily through European Investment Bank (EIB). Total EIB financing in Croatia equates to 1.2 percent of GDP, representing the third highest figure among EU Member States[14]. HBOR's borrowing from IFIs between 2008 and 2016 totaled Euro 2.6 billion. Abundance of funds required a prioritization by HBOR considering the narrower pool of eligible corporate demand. The World Bank loan was predominantly used to finance the working capital expenditures of the exporters while HBOR was increasing the investment loan portfolio either from EIB or from its own sources. HBOR's prioritization of the investment loans was a result of the mandate given to HBOR by the Croatian Government to support the new investment cycle. This process was evident especially during the additional finance phase after 2012. Ultimately, CEFIL funds complemented other IFI loans by providing long term working capital finance to exporters.

Figure 6: HBOR Lending and EIB Loans

HBOR Working Capital versus Investment Loans (percent)	New EIB Credit Lines (SMEs, enterprises and Mid-Caps) to HBOR and Other Financial Intermediaries (EUR)
	
Source: EIB and HBOR	

Heavier loan conditions of IBRD funds is one of the reasons why CEFIL was not utilized in extending investment loans. Results from the interviews with PFIs confirm that IBRD loans have heavier conditions which include safeguards, procurement, financial covenants and eligibility compared to most of the other IFI loans. For instance, a significant difference between the IBRD and EIB safeguard monitoring lies in the intensive implementation support and monitoring of the IBRD during the project implementation as compared to EIB. For credit line projects, the EIB is primarily focusing on the assessment of environmental compliance monitoring capacity of the financial intermediary in the due diligence phase rather than carrying out an intensive implementation support[15]. HBOR and PFIs tended to prioritize other IFI (i.e. EIB) funds to respond to customer demand more quickly. This effect is more pronounced in the case of

[14] www.eib.org, press release dated February 22, 2017

[15] EIB Environmental and Social Practices Handbook 2013

investment finance, which require more detailed due diligence to verify compliance with environmental and procurement rules.

Restricting Additional Finance to Investment Loans in the Tourism Sector:

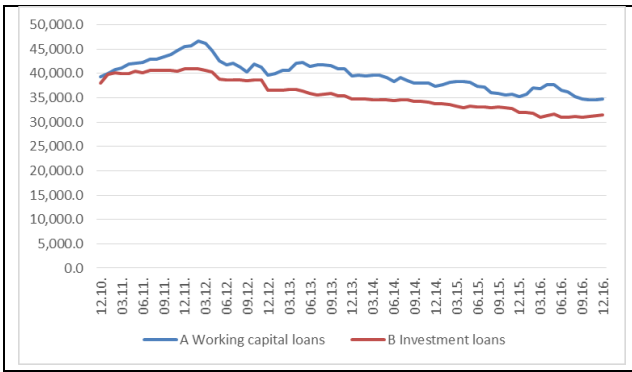
Although the additional finance loan agreement or other project documents were not restricting funds to any sector or region, HBOR allowed the use of the additional finance funds until December 2014 only for investment loans in the tourism sector. This was part of the mandate given to HBOR to reinvigorate the investment cycle and in line with the government program. While these restrictions were introduced with good intentions, most of the time proved to be counterproductive. Between the effectiveness in November 2012 and December 2014, only two firms were financed in the tourism sector by ZABA Bank and a total of Euro 12 million was disbursed. In December 2014, HBOR agreed to lift this requirement and made the loan available for all exporters. Limiting loans to one sector and only for investment purposes at a time of weak demand and supply for loans and low investment appetite simply suspended implementation. According to the feedback at the beneficiary meetings, another possible reason why the IBRD loan was not in demand for investment purposes is because the safeguard requirements were perceived to be heavy compared to national standards and other IFIs.

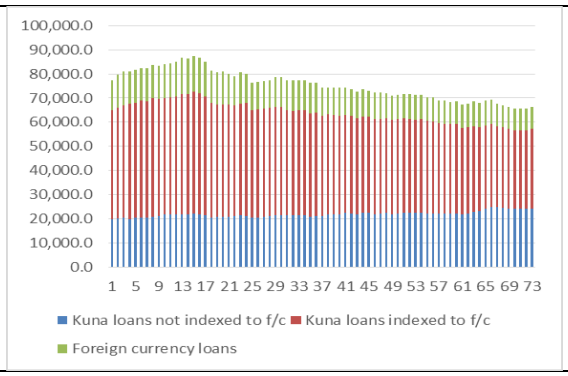
Loan Types (Investment & Working Capital) and Currencies:

CEFIL was predominantly used for financing working capital expenditures and loans were disbursed mostly in Euro. Ninety-two percent of the financing was used for working capital purposes. The deepening recession curbed most of the investment demand and firms were trying to refinance their loans and extend the term. As a countercyclical tool, beneficiaries appreciated most the long term funds during the beneficiary round table meetings. Market trends also confirmed the higher demand for working capital loans during the prolonged recession. Soon after the crisis, investment loan demand was still active in 2010. After 2011, it has been in decline. Currency choice under the loan was mainly Euro. Eighty-three percent of the loan has been disbursed in Euros and the remainder was converted to US$ at the end of the project to adjust for the specific need of some sub-borrowers. No Kuna loan was disbursed, although it was an available currency under the loan agreement. This was an expected outcome since the loan was targeting exporters. Exporters are naturally hedged and they were better able to manage FX risk. In addition, the Kuna/Euro rate is closely managed and relatively stable. For this reason, non-financial corporates mostly prefer FX indexed Kuna or FX loan (mostly Euro).

Figure 7: Loan Types and Currency in Croatia

Working Capital versus Investment Loans	Currency





Source: Croatian National Bank (CNB)

Market Failure:

CEFIL was primarily a crisis response intervention rather than designed to address a structural long term gap in the financial sector (i.e. financial inclusion). Croatia had a relatively well-developed financial sector before the crisis, with financial inclusion and access to finance indicators close to high income country levels. The percentage of firms with a loan was 71 percent in 2009[16] and 88 percent of adults had a bank account in 2011[17]. Before the crisis, loan-to-deposit ratios were close to 130 percent, while banks had been growing quickly. Long-term financing was not scarce compared to many other developing countries. In 2010, 41 percent of the non-financial sector corporation loans and 63 percent of all loans had maturity above 5 years. When the crisis began, interest rates in the domestic money market exceeded 18 percent for the short-term financing with the drying up liquidity. Long-term finance was practically not available in the market. The impact on the credit market and scarcity of long-term financing was extended with the prolonged recession. CEFIL played a significant role in response to the crisis. It is expected that once the recovery fully sets in, CEFIL and similar other fund's relevance will be diminished. On the other hand, the banking sectors liability structure has also been changing since the crisis with the deleveraging of foreign banks. Domestic banks have been tapping into domestic deposits, which is on average shorter term while loan maturities have not been significantly shortened. This indicates a widening maturity mismatch on bank balance sheets, which may increase the importance of sustainable long-term funding sources like CEFIL going forward.

2.3. Monitoring and Evaluation (M&E) Design, Implementation and Utilization

The project's Monitoring and Evaluation (M&E) framework was comprehensive and well-designed. The framework-designed PDO indicators were in line with the project's objectives. The indicators were in line with the project's activities and adequately measured the project's impact (export performance of the beneficiary exporters, amount of medium to long-term finance, employment preservation and generation performance, number of beneficiaries financed

[16] Croatia's EU Convergence Report: Reaching and Sustaining Higher Rates of Economic Growth, 2009, World Bank
[17] World Bank Findex Database.

and quality of portfolio of PFIs). There was one unclear point related to investment performance of exporter beneficiaries - PDO paragraph lists investment performance among other indicators to measure the outcomes of the project. However, there was no specific monitoring indicator set for investment performance. Working capital and investment loans were monitored and reported by the PIU.

M&E arrangements were clear and well-implemented. The PAD and the project's operations manuals provided explicit M&E arrangements, as well as a clear definition of expectations in terms of reporting. Some of the indicators were refined and revised to improve the clarity and to reflect the increased scale of the loan in the additional finance phase. Targets for the indicators were improved in the additional finance documentation with all indicators assigned a target. The Operations Manuals designed appropriate reporting templates for consistency and reliability purposes. Indicators were effectively monitored during project supervision. Almost all Aide Memoires (AM) and Implementation Status and Results Reports (ISRs) provided updated information for the results framework. Despite the lack of mention in the results framework, financial indicators of HBOR and PFIs were monitored closely and reported in all the AMs. As a result, the consistency and quality of data received for this ICR was satisfactory.

Considering the increasing portfolio of credit lines in the Croatia program, including the new Partial Credit Guarantee Project, a more comprehensive and systematic analysis of the impact of the credit lines would be useful. Ideally, an evaluation of the impact of a credit line on the performance of final beneficiaries would require a randomized experiment, including a control group that is similar in all respects to the target group, except for access to credit. This is not easily implemented since the commercial interest of the participating bank is to grant credit to all creditworthy and qualified SMEs as long as funding is available. Evaluating the impact of bridge financing on the development of access to finance conditions for enterprises would be beneficial for the Bank, HBOR and for the guarantor in order to improve the design of these programs.

2.4. Safeguard and Fiduciary Compliance

Overall, safeguard and fiduciary compliance was satisfactory during the project period. HBOR established a Project Implementation Unit (PIU), fully staffed and funded by HBOR. The well-developed Operational Manual and experienced PIU staff helped ensure the effective implementation of safeguards and fiduciary compliance. Periodically, the World Bank team reviewed the systems established by the PIU to monitor the implementation of the project and selected samples that would be verified at the branch level. On field visits, World Bank staff met with the branch managers or the customer relationship officers in the branches, reviewed the files and documents of selected beneficiary exporters, and visited their projects. In general, compliance was positive.

The presence of the Bank procurement and safeguard teams on the ground ensured efficient implementation and intensive support to HBOR and PFIs. Almost all the loans were for working capital expenditures and therefore did not require a thorough due diligence in terms of safeguards. Well-developed national environmental and commercial practice frameworks, low

level of informality, and experience of commercial banks in compliance with international standards facilitated safeguards and fiduciary compliance.

During the beneficiary meeting for the ICR, several final beneficiaries brought up onerous safeguards standards of the World Bank, especially for investment loans. Some PFIs made similar comment on the onerous safeguard standards when comparing the World Bank and other IFI conditions. This might have some implications on the final disbursement portfolio, which predominantly consists of working capital loans. Procurement (including requirement to keep and verify invoices) and loan's financial covenants (D/E, DSCR) were not brought up as difficulties during implementation.

2.5. Post-completion Operation/Next Phase

The CEFIL project has the provision to recycle the funds for financing exporters when it is paid back to HBOR from PFIs. HBOR can continue providing medium to long-term funding to the export sector through the wholesale model or lend directly to exporters. Since the World Bank funds are long-term, up to 30 years, re-flows will be recycled multiple times and increase the leverage of World Bank financing. Funds will continue supporting HBOR in strengthening its wholesale banking functions, support exporters with building credit history with PFIs, and improve the financial records and documentation required for bank loans, thus improving their ability to gain access to credit.

In 2016, an innovative credit line project was launched to continue support for exporters in Croatia. A new Partial Credit Guarantee (PCG) Project became effective in May 2016 to support exporters and foreign-exchange earners in Croatia by enhancing HBOR's capacity to mobilize medium and long-term financing. Cooperation with Croatia on financial sector development evolved into a new phase to facilitate new and innovative instruments. The PCG for HBOR is innovative in that the Bank guarantees a financial intermediation loan, with a goal to assist HBOR in accessing international financial markets. HBOR utilized Euro 40 million of the guarantee coverage and raised Euro 50 million from the market to be on lent to exporters through PFIs. The on-lending part of the PCG project has a similar design with CEFIL and allows HBOR to use the wholesale structure through PFIs and allow HBOR co-finance directly with PFIs. Future guarantees, supported by MIGA, will be explored.

As the volume of financing provided to the Croatian exporters and enterprises increases, a more systematic approach of monitoring the impact may be useful to ensure sustainability. Authorities may consider introducing an impact evaluation framework that would use a combination of experimental, non-experimental and qualitative methods to understand whether and how CEFIL and PCG projects impact outcomes at the PFI and exporter level. Particularly, the impact evaluation will ask whether offering longer-term maturity funds to PFIs (i) increases the maturity of the loans provided to exporters; (ii) changes the composition of exporters that receive loans (e.g., new firms, new products to the same type of exporters), and (iii) improves exporter growth and performance. A more systematic monitoring of the HBOR portfolio would also be useful to track achievements. HBOR has various credit lines channeled to different sectors (SMEs, innovation, exports other) funded by different IFIs (EIB, KfW, CEB, IBRD). IFIs can only track achievements during the life of their specific project. A more comprehensive and systematic

approach implemented by the Guarantor, Ministry of Finance (MoF), to monitor the outcomes and impact of HBOR lending in the longer term would be very useful to ensure sustainability at the sector level.

3. ASSESSMENT OF OUTCOMES

3.1. Relevance of Objectives, Design and Implementation

The project remains highly relevant to Croatia's development priorities. The project was in line with the 2009-12 CPS priorities at the preparation level, and with the subsequent 2014-17 CPS introduced during implementation. The project is consistent with the FY09-12 Country Partnership Strategy which includes promoting private sector-led growth as a key priority to achieve faster convergence with EU27 per capita income levels. This project was not included in the pipeline for the CPS, however, due to the specific circumstances derived from the financial crisis, the Government approached the Bank and requested financial resources to support HBOR. The significant role of the development bank in such an environment, and the need to continue supplying long-term funds to Croatian companies were key motives for the authorities, and consistent with the strategic goal of the Government to foster competitiveness and employment in the economy and to support recovery.

In the face of an unprecedented international liquidity crisis, the project provided for a quick disbursement instrument at reasonable cost. The original loan was disbursed quickly and provided an effective countercyclical support to alleviate the negative impact of the global crisis on Croatia's export sector. The loan was absorbed quickly and 52 percent was disbursed in the first year until the end of 2010. Until the end of 2012 when the additional financed introduced, 84 percent of the loan had already been disbursed.

The CEFIL project scaled up HBOR's countercyclical support capacity during the crisis. State banks tend to be more tolerant of risk during such periods compared to private banks.[18] As the balance sheets of private banks deteriorated and they curtailed their lending activities, many countries used state-owned banks to step up their financing to the private sector (for example, Brazil, China, and Germany). Other countries have used guarantees to encourage continued private sector lending or conditioned access to cheap central bank financing for on-lending to the real sector. Over the medium-term, such direct state support to the economy will need to be wound down to avoid entrenching distortions in the allocation of financial resources. However, in the context of an unprecedented international liquidity crisis, CEFIL proved an agile and robust instrument for countercyclical support.

The project relied on multiple delivery models: wholesale and retail. Original loan and additional finance adopted a wholesale structure where PFIs (commercial banks) were on-lending to exporters. After the restructuring in 2015, HBOR was allowed to lend directly to exporters in the context of the low risk appetite of the commercial lenders. In the additional finance phase, only one PFI (Zagrebacka Banka – ZABA Bank) made disbursements. Zaba Bank disbursed 25

[18] Global Financial Sector Development Report, 2012, World Bank

percent of the additional finance while HBOR was disbursing directly the remaining 75 percent. At the end of the project, HBOR's direct lending totaled to 24 percent of the overall disbursements of the original and additional finance loan proceeds. These co-existing models have provided greater reach to different group of exporters. Wholesale lenders were able to reach several diversified group of exporters with the end-goal of exposing a potentially larger number of exporters to the project's benefits, a positive result of an extended branch network, clientele, and product offering of PFIs. Leasing companies which would have provided access to a different type of clientele, typically smaller SME exporters - were missing. The dual delivery model reflects itself in the average loan size of the original loan and additional finance. Average loan size in the original loan was Euro 1.5 million while average loan size of the additional finance was Euro 4 million, which is mostly attributable to HBOR lending to large exporters.

The project suffered from slow disbursement performance at the additional finance phase. This was mainly due to the deepened recession, low investment demand, deleveraging of corporate portfolios and high risk aversion of commercial banks. The project was restructured to address the disbursement constraints and allowed HBOR to directly lend and share risk with PFIs. Both demand and supply factors impacted the slow corporate credit growth. The constraint in the market was more rooted in the demand side rather than supply side. Restructuring addressed the supply side problem related to the low risk appetite of commercial banks by allowing HBOR to step in and provide funding to exporters directly, but it was not a remedy for low demand from enterprises for corporate loans.

3.2. Achievement of Project Development Objectives

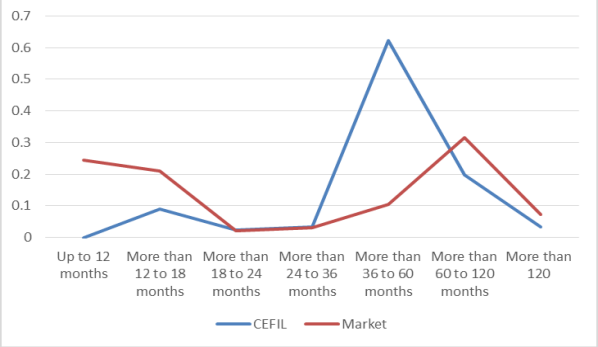
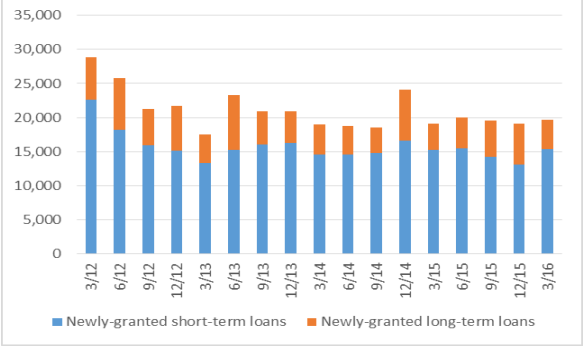
The project's main development objective to support the preservation and growth of exports by providing medium and long-term working capital and investment finance to exporters and FX-earning enterprises (e.g. tourism, logistics) was fully achieved. All project development indicators were achieved or exceeded their end-project targets. At closing, the project's achievements were substantial.

Exports: The project contributed to export growth and helped increase the amount of medium-term financing for exporters at a time of growing global credit constraints. Beneficiary companies increased exports by 18.9 percent collectively. Median growth rate was 25 percent. Overall beneficiary exporters increased their exports by Euro 225 million during the project. This is an impressive growth considering the 3.3 percent average export growth for Croatia between 2008 and 2015. Further analysis shows that project impact was higher during the first years after the crisis. This is also consistent with the increase in Croatia's export in 2010 by 18 percent, after collapsing by 21 percent in 2009. In 2015, the total amount of the exports by project beneficiary exporters corresponds to 12 percent of county's total exports. The export multiplier (measuring incremental exports of firms divided by total loan amount) was 1.52 - for every Euro 1 disbursed in loans, participating firms increased their exports by Euro 1.52.

Volume of medium and long-term lending: Although there was no restriction in the legal agreements set as a minimum lending maturity to final beneficiary exporters, all the sub-loans had above a 1-year maturity. The target set for the medium to long-term finance was increased to 100 percent of the loan at the additional finance PAD, from 50 percent in the original project

documents. HBOR and PFIs met this target successfully. Average loan maturity at the end of the project was 63 months and weighted average maturity was 70 months. 8.2 percent of the total loans were investment loans, the rest were disbursed as working capital loan. When compared to market data on the maturity of Euro-denominated working capital loans CEFIL loan's weighted average maturity was higher. CEFIL loan's average maturity was 70 months while Euro-denominated working capital loans in the market had a weighted average maturity of around 52 months (based on stock of loans). In addition, CEFIL project's performance was outstanding compared to the newly granted loans in the market. Among PFIs, there were differences in terms of offered maturities. Loan maturity for the PFIs in the lowest end were 12-60 months, while PFIs on the highest end offered maturities between 12-288 months. Average maturity in the original loan was 50 months, while average maturity in the additional finance realized at 124 months. This is a reflection of HBOR's and ZABA Bank's longer-term loans in the additional finance phase.

Figure 8: Maturity Profile

Comparison of CEFIL Loans Average Maturity with Euro Denominated Non-Financial Corporation WC Loans in the Market	Average Maturity of Newly Granted Non – financial Corporation Loans in the Market
	
Source: Croatian National Bank (CNB)	

The project's impact on providing long-term finance for the export sector will be much more important as banks' funding sources become more and more short term. Foreign banks have mostly deleveraged and domestic savings, which is increasingly kept in demand deposit and in Kuna replacing foreign bank funding. World Bank funding has a maturity of almost 30 years and could be recycled several times for the same purposes. Project documents stated that funds will be used for the same purpose when it flows back to HBOR. However, no system or mechanism was designed in the documents for reflows. Aide Memoires have consistently advised HBOR to monitor re-flows. However, there is no system yet to report on this.

Number of firms: Seventy exporters were financed under the project through PFIs and by HBOR. Seventy-eight loans were extended to finance these borrowers. Although in the original PAD there were no targets set for number of exporters financed, additional finance included a target of 60 exporters. The project comfortably exceeded the target. Average loan size is Euro 1.7 million. Most of the loans (62 percent) are in the Euro 1-5 million range.

Non-performing Loans (NPLs): The project NPL ratio was 5.1 percent (4 loans) in number (below the 7 percent target) and 1.05 percent in volume (below the 7 percent target). Considering the very high NPL ratios in the market during the crisis, which increased to 17 percent in total, and up to 31 percent for corporate sector, NPL numbers generated by the project have been minimal. With this taken into consideration, the project achieved the NPL target (below 7 percent). It should be noted that that NPL targets could be difficult to estimate. If the target is set too low, there is the risk of promoting risk-averse behavior at the expense of developmental outcome and leave out enterprises really in need of financing. If the target is set too high, the project may take excessive risks. Rather than setting a target, comprehensive monitoring of NPLs would work better and help the team manage mid-project PFI corrections.

Employment preservation and generation: About 60 percent of the exporters created additional employment while 7 percent of the firms kept their initial level of employment. In total, 964 new jobs were created under the project, which translates to a 4.8 percent employment growth for the beneficiary exporters during the project. Firms that preserved (kept the same employment level throughout the project) employed 806 employees. For every Euro 153,000 disbursed to an exporter, 1 job was created. The unemployment level increased sharply to 17 percent during crisis. Employment generation in this challenging environment demonstrates the resilience and competitiveness of the CEFIL borrowers.

At the additional finance phase, a gender-based intermediate indicator was added in the result framework for monitoring causes without imposing a target. This indicator has been monitored during the life of the project. 4 out of 70 firms financed have a female owner with two of them 100 percent owners, and other two are 50 percent owned by a female owner. This low level of firms with female owner requires further analysis. Data to be collected through the PCG project will enrich the sample.

3.3. Efficiency

The project was highly efficient in generating exports and employment. Beneficiary exporters increased exports by 18.9 percent collectively. This is an impressive growth when compared to the 3.3 percent export growth in Croatia during project implementation. The export multiplier (measuring incremental exports of firms divided by total loan amount) was 1.52 - for every Euro 1 disbursed in loans, participating firms increased their exports by Euro 1.52. Similarly, the export performance project achieved a remarkable level of employment generation performance. Overall employment growth was 4.8 percent while the unemployment rate increased to above 17 percent levels during the crisis. For every Euro 153,000 disbursed to an exporter, 1 job was created

The project allowed banks to provide financing to exporters over a long period of time, thereby providing financing to accompany these firms as they grow. 35 out of 70 beneficiaries were SMEs[19] and the project accompanied 3 firms graduating from SME status.

[19] Since the project did not collect sales or turnover information, number of employees was used to identify SME status

3.4. Justification of Overall Outcome Rating

Rating: — Satisfactory

The project met its development objectives, which remain highly relevant for Croatia. It helped the Government and HBOR to increase the amount of medium to long-term financing and scale up support for the real economy and exporters at a time of growing global constraints on credit. The project helped client exporters to increase or preserve their export volumes and maintain a reasonable level of activity and avoid major layoffs. Despite the crisis context and challenges related to slow disbursement at the additional finance phase, the project exceeded its development objectives at a comfortable level.

3.5. Overarching Themes, Other Outcomes and Impacts

(a) Poverty Impacts, Gender Aspects, and Social Development

Specific poverty and social development indicators were not collected during and after the implementation of the project. The project is the first financial intermediary loan in Croatia to collect and monitor gender-related indicators. This indicator started when data was collected in the additional finance phase. The indicator is tracking the number of firms with female owners financed under the project. No target is set and data is collected more for diagnostic and analytical purposes in line with The World Bank gender initiative in its projects. There have been 4 firms among the beneficiary exporters which has a female owner (two with 50 percent and the other two with 100 percent ownership by a female owner). Finally, this indicator will continue to be applied in the PCG Project.

CEFIL was designed as a crisis response instrument providing medium to long-term finance to exporters and financial intermediaries to support export performance and employment growth. CEFIL firms achieved 4.8 percent employment growth in an environment where unemployment rates increased to 17 percent. Financial inclusion was not a primary objective. However, the profile of the exporters reveals that 55 percent of the beneficiaries have SME status. It is highly likely that project contributed to positive results, particularly on social and poverty outcomes, given the significant importance of SMEs for employment in Croatia, and the specific effects of the credit line on employment in client firms reported above.

(b) Institutional Change/Strengthening

The project helped strengthen credit appraisal procedures among PFIs and ensured PFIs' compliance with strict prudential standards (prudential ratios were monitored throughout the project). In addition, the five banks that participated in the project experienced a significant learning curve due to their initial lack of familiarity with similar World Bank operations (although some of them were familiar with IFC operations). All five participating financial intermediaries have successfully demonstrated that medium and long-term lending is a viable

business proposition, even in periods of economic downturn. PFIs built the capacity to assess the environmental risks and impacts of borrowing firms.

Collateral is one of the significant obstacles to access to finance, particularly for smaller firms in Croatia. During the ICR roundtable meeting, beneficiaries confirmed that collateral-based financing is very common in Croatia and a significant constraint in access to finance. Enterprise Survey 2013 data verifies this finding; 87 percent of loans require collateral and required collateral is on average 193 percent of the loan. Both indicators are above regional averages and Croatia's peers. The CEFIL project supported cash-flow based lending by requiring PFIs to conduct the loan evaluation based on a cash flow analysis and debt-service coverage and debt-to-equity indicators. In this way, CEFIL supported the capacity of PFIs to encourage cash-flow based financing.

(c) Other Unintended Outcomes and Impacts (positive or negative)

PFIs, through their participation in CEFIL loans, built the infrastructure and capacity to work with other IFIs, and have a greater awareness of available sources of funding.

3.6. Summary of Findings of Beneficiary Survey and/or Stakeholder Workshops

N/A

4. Assessment of Risk-to-Development Outcome

Rating: Moderate

Risks to the development outcomes relate to general country and financial sector risks and export performance going forward, as well as the project-specific risks. Country risks include the regional context and turbulence in the financial markets. Croatia has been gradually recovering from a six-year recession, mostly as a result of stronger exports, increased tourism activity, and private consumption. These factors, as well as better absorption of EU structural and investment funds are expected to give a moderate boost to economic growth. GDP remains well below its pre-crisis level and unemployment is gradually improving, but still very high.[20] Vulnerabilities remain high due to elevated public and external debt levels. Despite continuing household and corporate deleveraging, there are mild signs of a bottoming-up in lending the corporate sector. Recognizing the downside risks to growth, rating agencies confirmed the current non-investment grade credit rating of BB with negative outlook, as the country plans refinancing of more than 13 percent of its external debt in 2017[21]. These trends indicate an improving country outlook, however still with significant risks to further recovery.

Project-specific risks are related to the future performance of HBOR and PFIs, and the end-beneficiaries. The financial performance of financial intermediaries has been monitored during supervision missions and, during challenging times. All of them complied with project

[20] IMF Article 4 Report, 2016, IMF
[21] Croatia Macro Monitoring Quarterly Report 2016, World Bank

requirements. With regard to demand, there are signs of potential demand from the corporate sector and exporters, especially for medium to long-term funds.

Options for leveraging the development impact of projects of this type across the economy may need to be identified. While it can be a very effective tool, the pace of IFI bridge financing may not be sustained in the long-term. Means must be found to (i) leverage IFI resources with greater commercial funding, which is increasingly available at longer terms, and pushing such funding towards more risky market segments, (ii) increase the availability of domestic longer term savings instruments so that the competition for term funding is increased and reliance on external resources reduced, and (iii) create a sustained demand for investment financing from domestic enterprises (exporters and SMEs) by improving the investment climate and levels of financial transparency.

The World Bank's engagement with Croatia on improving availability of long term finance for private sector investments has been evolving to the next phase, which will ensure sustainability of development outcome of credit line projects. The Partial Credit Guarantee Project, which became effective in early 2016, is particularly aiming to leverage World Bank funds for greater commercial funding and therefore, is making progress to provide a more sustainable source of long term funding for HBOR and Croatian enterprises.

5. Assessment of Bank and Borrower Performance (relating to design, implementation and outcome issues)

5.1. Bank Performance

(a) Bank Performance in Ensuring Quality at Entry
Rating: Satisfactory

The project design was highly relevant to the strategic priorities for Croatia. Bank responded to the request from the Croatian government for a quick assistance to the financial sector at the time of global financial crisis and its effect on the Croatian economy. The project was designed to support exporters through providing medium to long-term funding during the crisis in order to enable beneficiaries to increase or preserve their export and employment performance.

The project's risk assessment framework was comprehensive and candid, and mitigation measures were appropriate. At the appraisal and preparation stage, the Bank conducted a thorough analysis and incorporated many lessons learned from earlier credit line experiences in different countries and regions. An important example is the adoption of wholesale structure in the beginning of the project to disburse the World Bank funds through a wide network of commercial banks, which helped different sized exporters and encouraged competition in the banking sector. It would have been better to include the leasing sector and widen the distribution channels. Inclusion of the leasing sector would have also increased share of investment loans in the project portfolio.

The project ensured that project beneficiaries reflected the national definition of exporters and also included quasi-exporters (tourism and logistics) to increase the impact of the project.

Flexible design of the project without further sector and regional restrictions, and focus on an efficient financial intermediation was another important feature of the design. The project was successful in developing selection criteria, conducting due diligence and monitoring the soundness of the financial intermediaries.

The monitoring and evaluation (M&E) framework was well written and focused on the impact of the project. The M&E framework was improved during the additional finance phase with clarification of some indicators, the addition of new indicators and targets for each indicator to better capture the impact of the project. Although the PAD mentioned investment performance among the performance criteria, there was no specific indicator assigned to track and measure this in the results framework.

The overall quality of design, including strategic relevance and approach, realism of project design and risks, implementation arrangements, and fiduciary and safeguards aspects were satisfactory. The project achieved a 99.2 percent disbursement with an unallocated amount of US$ 1.2 million at the end of the project as a result of two sub borrower who failed to fulfill HBOR's disbursement conditions. Overall, the project achieved almost full disbursement.

The Bank's quality at entry is rated satisfactory.

(b) Quality of Supervision
Rating: Moderately Satisfactory

Project supervision was undertaken regularly and entailed field visits to borrowers, PFIs, and end-beneficiaries. Aide-memoires and ISRs following implementation support mission were submitted on time and provided updated information on economic developments in Croatia and their impact on CEFIL Project. The World Bank team conducted 10 formal implementation support missions between July 2010 and April 2016, and filed 12 Implementation Status and Results (ISR) Reports. Midterm review was conducted on time, as planned. The field-based presence of the fiduciary, disbursement and safeguards team was appreciated by the borrower. Financial intermediaries were visited for this ICR and they praised the Bank team's effective collaboration and proactivity. ISR ratings were in line with project performance and ISRs were comprehensive. The Bank strengthened the M&E framework during the additional finance phase, and indicators were consistently tracked.

The project suffered from slow disbursement in the additional finance phase. The original loan which was launched in 2009, was quickly absorbed by strong demand from corporates and bank's ability to finance them. The additional finance phase coincided with a lack of demand from corporates for new loans and high risk aversion from the banks, which resulted in the deleveraging of corporate portfolios. The Bank team conducted the appraisal of the additional finance in a highly uncertain environment, making it a challenge to predict the demand for loans. However, a more thorough analysis at the additional finance phase would have revealed some of these dynamics and helped better planning the intervention, including identification of the right instrument, timeframe, objectives and the relevance of the additional finance.

The Bank was responsive for borrower requests. Discussion about the restructuring and alternatives to be considered occurred late, towards the end of the project. Additional finance became effective in November 2012, but HBOR continued to commit and disburse the original loan until the end of 2013. During the first half of 2014, HBOR underwent an institutional change. In addition, in 2013-14 the team started discussions about a new PCG project with HBOR. Both instances distracted from the additional finance and when combined with a shrinking demand for loans, there has been no new sub-loan approvals by HBOR in the additional finance loan between mid-2014 and end 2015. Alternatives and a possible restructuring considered only after 2 years into the implementation and 8 months before the closing of additional finance. No funds were allocated since the introduction of additional finance, except for one PFI for tourism loans. HBOR further restricted the additional finance to the tourism sector and only for investment loans, although additional finance was allowing all exporters to benefit from the loan without sector restriction in its design. Alternatives such as removing this restriction, expanding the PFI pool, including leasing could only realistically be undertaken by the end 2014. A restructuring allowed HBOR to directly lend to exporters and risk-share with commercial banks. Restructuring addressed the supply side problem due to the risk aversion of the commercial banks. It could not address the demand-side problem related to low demand for loans from corporates.

The Bank provided intensive implementation support towards the end of the project and almost all of the funds have been disbursed. Bank supervision was heightened after the restructuring, and included more frequent supervision missions (every two months), introduction of pipeline reporting with targets for HBOR, and coordinated dialogue with the Country Management Unit (CMU). The supervision team flagged main issues in ISRs and AMs and reflected the lagging disbursement in the project ratings.

High quality implementation support and considerable efforts extended by the Bank team towards the end of the project ensured successful disbursement of the funds. On the other hand, introduction of the additional finance phase in an environment with shrinking demand and less proactive action to restructure the project caused some delays in implementation.

The Bank's quality of supervision is rated moderately satisfactory.

(c) Justification of Rating for Overall Bank Performance
Rating: Satisfactory

Taking into account the satisfactory rating of design and the moderately satisfactory rating of supervision, the overall rating for Bank performance is satisfactory considering all the development objectives are achieved.

5.2. Borrower Performance

(a) Government Performance
Rating: Satisfactory

The Government's performance as a guarantor was Satisfactory. The Government demonstrated strong ownership of the project and commitment to its objectives. The Government was committed to a structural reform agenda in the financial sector and completed several reforms and actions within the scope of the Fiscal, Social and Financial Development Policy Loan. Triggers included increasing capital adequacy ratios above 16 percent, improving financial sector crisis preparedness framework, and improving risk management at investment firms. The Government and the Central Bank has been successful in keeping the financial sector stable and the banking sector healthy and well-capitalized under the challenging conditions. Monetary policy was able to maintain an accommodating position throughout the recession, ensuring financial system stability and addressing liquidity concerns swiftly through the active use of regulatory requirements and FX interventions. Going forward, the MoF may be interested in developing a systematic monitoring and evaluation system to track the impact of the growing number of financial intermediation projects targeting exporters and SMEs provided through IFIs such as IBRD, EIB, KfW and others.

(b) Implementing Agency or Agencies Performance
Rating: Moderately Satisfactory

HBOR complied with requirements throughout project implementation, and effectively staffed the PIU. The project management unit promptly discussed and addressed shortcomings in compliance identified in financial management and procurement reviews, and ensured good quality reporting. HBOR effectively placed funds through PFIs in the original loan and managed reallocations proactively. Implementation delays for this project can be partly attributed to the market conditions and low demand for loans, and partly attributed to the slow action when addressing challenges. In particular, response was slow for considering alternatives such as expanding the PFI pool by new banks and leasing companies, and to remove sector restrictions in the additional finance phase which was implemented by HBOR although original loan did not include any restrictions[22]. HBOR's countercyclical role was evident from increasing direct lending in their balance sheet including their disbursement of investment loans from EIB and other sources, while decreasing wholesale lending to financial intermediaries. Although restructuring lifted restrictions in the direct lending of the project funds, the disbursement process was slow and CEFIL funds had not been prioritized. HBOR successfully committed all the funds by the closing date of the project. To allow submission of the disbursement documentation as well as a currency conversion to US$, grace period had to be extended, from December 31, 2016 to February 28, 2017. HBOR was able to disburse 99.2 percent of the loan in January 2017.

(c) Justification of Rating for Overall Borrower Performance
Rating: Satisfactory

Taking into account the satisfactory rating of the Government and the moderately satisfactory rating of the Implementing Agency, the overall rating for the Borrower performance is satisfactory considering all the development objectives are achieved.

[22] Additional finance was reserved only for investment loans in the tourism sector until December 2014.

6. LESSONS LEARNED

Flexibility of project design and responsiveness to market conditions reduced implementation delays. For projects, the design context is inevitably different from the implementation context. Market conditions evolve during implementation, and adjustments are necessary to minimize implementation delays and maximize the project's developmental impact. Eligibility restrictions of any kind including sectors and regions are thus counterproductive, especially during times of hardship. Sector, geographical and gender-based restrictions although motivated by strong development objectives, often fail to account for a possible over-sensitivity of the specific target beneficiaries to adverse market conditions. Rather than restricting the scope of benefits, the project should seek to achieve supplemental developmental outcomes through incentives[23]. Both The World Bank and borrowers need to have the ability to respond swiftly to evolving needs. This includes the ability to quickly adapt activities, increase resources, or amend project arrangements, as needed, in response to deteriorating economic conditions. Legal documents should provide for the inevitable small adjustments that enable the project to perform better during implementation.

The World Bank's experience with line of credits suggest that a wholesale model is preferable to a retail lending model unless there is a strong justification (i.e. unavailability of PFIs, targeted lending, countercyclical support). A wholesale design increases the project's overall impact. First, a wider range of financial intermediaries increases the number and diversity of potential project beneficiaries and may ultimately lead to funding for underserved firms. Second, the wholesale design enables new financial intermediaries to gain experience in working with international organizations, which will help them develop other sources of funding. Third, wholesale lending encourages healthy competition and causes less market distortion than retail lending, as the benefits are spread over a large share of the financial sector.

Implementation support missions and midterm reviews provide opportunities for strengthening the project. In the CEFIL project, implementation support missions included regular visits to PFIs and field visits to branches and beneficiaries. In addition to providing insights for overall implementation bottlenecks, up-front training and capacity-building on fiduciary and environmental safeguards procedures is highly beneficial for stakeholders. Results achieved in the CEFIL project can be largely attributed to the intense supervision undertaken towards the end of the project, including field visits. Bank teams should take advantage of midterm reviews to assess performance holistically and set expectations for end-project results. While project restructuring can be highly administrative and may put undesired attention on a project, quick restructuring is advisable to avoid losing momentum in project implementation and may yield higher-than-expected results.

7. COMMENTS ON ISSUES RAISED BY BORROWER/IMPLEMENTING AGENCIES/PARTNERS

(a) Borrower/implementing agencies
N/A

[23] Supplemental development outcomes could be achieved by rewarding PFIs with higher proportion of loans to targeted groups (gender, MSME, regional or investment) through providing them longer maturity, higher allocation limits or similar incentives according to the project design.

(b) Co-financiers
N/A

(c) Other partners and stakeholders
(e.g. NGOs/private sector/civil society)
N/A

Annex 1. Project Costs and Financing

(a) Project Cost by Component (in USD Million equivalent)

Components	Appraisal Estimate (USD millions)	Actual/Latest Estimate (USD millions)	Percentage of Appraisal
Total Baseline Cost	141.22	202.63	143%
Physical Contingencies	0.00	0.00	
Price Contingencies	0.00	0.00	
Total Project Costs	141.22	202.63	143%
Front-end fee PPF	0.00	0.00	

Front-end fee IBRD	0.35	0.50	143%
Total Financing Required	141.57	203.13	

(b) Financing

Source of Funds	Type of Co-financing	Appraisal Estimate (USD millions)	Actual/Latest Estimate (USD millions)	Percentage of Appraisal
Borrower		0.00	0.00	
International Bank for Reconstruction and Development		141.22	202.63	143%

Annex 2. Outputs by Component

(a) Results Framework

PROJECT DEVELOPMENT OBJECTIVE INDICATORS			
Indicator Name	Baseline (August 2009)	Closing (August 2016)	End Target (August 2016)
Level of Exports - growth or preservation	1.00	1.189	1.00
Volume of medium and long-term lending to firms under the project	US$ 0.00mn	US$ 188 mn (b)	US$ 202.60mn
INTERMEDIATE RESULTS INDICATORS			

Number of firms financed under the project	0	70	60
Number of medium and long-term loans granted from the WB's proceeds	0	78	n/a
Jobs created or preserved (multiplier)	1.00	1.048	1.00
Quality of Portfolio - Total NPLs a) number of loans and b) percentage	a)0 b) 0.0	a)5.1 b) 1.05	a)7 b) 7
Number of firms with female owners financed	0	4	n/a
Total loan disbursed from the Designated Account	US$ 0.00mn	US$ 188 mn (b)	US$ 202.60mn

Notes:

(a) All indicators are calculated based on the combined original and additional finance loan.

(b) Actual value of the disbursements is USD 188 million calculated by the date of disbursement. A USD 202 million target was calculated based on the date of the loan agreements. The difference is based on Euro/USD exchange rate differences. 100 percent of the sub-loans are medium to long term.

(b) Loans by Size

LOAN SIZE	NUMBER OF SUB-LOANS	AMOUNT APPROVED	SHARE
< € 1,000,000	37	17,143,238.1	11.58%
€ 1,000,000 - € 5,000,000	37	91,197,376.4	61.58%
> € 5,000,000	4	39,759,653.7	26.85%
TOTAL	**78**	**148,100,268.14**	100.00%

(c) Distribution of Loans by Maturity

Maturity (month)	No. of sub loans	AMOUNT APPROVED	Average Interest Rate
<12	0	0.00	0

12	11	13,449,416.13	5.14
13-35	4	4,403,834.55	4.27
36-59	15	19,410,363.88	4.41
60-83	42	76,704,524.72	4.67
84-120	5	29,132,128.86	4.21
>120	1	5,000,000.00	3.88
	78	**148,100,268.14**	

(d) Export and Employment Performance of Firms

Year	Increase in Employment %	Increase in Exports %
2010		
2011	1.9	20.8
2012	3.7	24.4
2013	2.6	14.7
2014	0.6	11.5
2015	4.8	13.8
2016	4.8	18.9

(e) Distribution of Loans by Sector

SECTOR	**AMOUNT (€)**	**SHARE**	**NUMBER OF SUB-LOANS**	**SHARE**
Energy	2,069,378.54	1.4	1	1.3
Basic Metals and Fabricated Metal Products	14,779,691.74	10.0	8	10.3
Pharmaceuticals and Chemicals	16,480,185.93	11.1	4	5.1
Rubber and Plastic Products	2,146,227.38	1.45	3	3.8
Other Non-Metallic Mineral Products	2,953,526.75	2.0	5	6.4
Textiles	7,618,867.47	5.1	7	9.0
Food Products and Beverages	28,924,953.04	19.5	15	19.2

Machinery and Equipment N.E.C.	11,865,416.30	8.0	12	15.4
Pulp, Paper and Paper Products, Publ.&Printing	4,779,365.17	3.2	2	2.6
Agricultural Production and Fishing	5,693,079.55	3.8	3	3.8
Waste management	1,034,689.27	0.70	1	1.3
Refined petroleum products	833,472.48	0.56	1	1.3
Furniture and wood products	3,272,039.97	2.2	4	5.1
Tourism	16,588,420.84	11.2	6	7.7
IT	8,310,565.36	5.6	2	2.6
Other manufacturing products	272,229.03	0.2	1	1.3
Transportation and storage	17,837,292.52	12.0	2	2.6
Construction	2,640,866.80	1.8	1	1.3
TOTAL	**148,100,268.14**	**100.0**	**78**	**100.0**

Annex 3. Economic and Financial Analysis

A traditional economic/financial analysis cannot be undertaken for this project, given that project costs cannot be determined. Project outcomes for the beneficiaries have been measured and discussed in other sections of the ICR.

Annex 4. Bank Lending and Implementation Support/Supervision Processes

(a) Task Team Members

Names	Title	Unit	Responsibility/ Specialty
Lending			
Isfandyar Zaman Khan	Task Team Leader Financial Sector Specialist	ECSPF	
John Gabriel Goddard	Economist	ECSPF	
Matija Laco	Research Analyst	ECSPE	
Lamija Hadzagic	Financial Management Specialist	ECSPS	
Natasa Vetma	Operations Officer	ECSSD	
Nicholay Chistyakov	Senior Finance Officer	CTRFC	
Claudia Pardinas Ocana	Senior Counsel	LEGEM	
Antonia Viyachka	Procurement Specialist	ECSPS	
Dubravka Jerman	Program Assistant	ECCHR	
Nasreen Bhuller	Team Assistant	ECSPF	
Djurdjica Ogenjenovic	Consultant	GTCEU	
Supervision/ICR			
Natalie Nicolaou	Task Team Leader- Financial Sector Specialist	GGO02	
Isfandyar Zaman Khan	Program Leader	ECCU5	
Natasa Vetma	Senior Environmental Specialist	GEN03	
Lamija Marijanovic	Financial Management Specialist	GGO21	
Antonia Viyachka	Procurement Specialist	ECSPS	
John Gabriel Goddard	Lead Economist	GTC13	

Matija Laco	Operations Officer	ECCEU	
Lijilana Tarade	Operations Officer	ECCHR	
Ruzica Jugovic	Program Assistant	ECCHR	
Alper Ahmet Oguz	ICR TTL/ Author - Senior Financial Sector Specialist	GFM03	
Ivana Ivcic	Consultant		
Sanja Zivkovic	Consultant	GFM03	

(b) Staff Time and Cost

Stage of Project Cycle	Staff Time and Cost (Bank Budget Only)	
	No. of staff weeks	USD Thousands (including travel and consultant costs)
Lending		
FY09	25.11	131,897.6
FY10	11.99	35,761.5
Total:	37.1	167,659.1
Supervision/ICR		
FY10	23.44	85,984.17
FY11	23.49	86,477.41
FY12	18.08	72,534.38
FY13	19.86	88,994.19
FY14	20.23	94,546.84
FY15	23.51	125,327.10
FY16	14.92	78,500.58
FY17	3.28	19,911.66
Total:	146.81	652,276.33

Annex 5. Beneficiary Survey Results

N/A

Annex 6. Stakeholder Workshop Report and Results
N/A

Annex 7. Summary of Borrower's ICR and/or Comments on Draft ICR

1. INTRODUCTION

The Borrower's ICR summarizes the results of the monitoring and evaluation activities, as well as the achievement of the objectives of the Croatia Export Finance Intermediation Loan (CEFIL) in the period starting from the effectiveness of the first loan of EUR 100 million signed in 2009 i.e. November 25, 2009 and ending with expiration of the disbursement deadline for the second loan of EUR 50 million i.e. February 28, 2017.

The World Bank's Board approved the project on August 4, 2009. The Loan Agreement in the amount of EUR 100 million and its Guarantee Agreement were signed on September 2, 2009. The Ministry of Finance as the guarantor and HBOR as the borrower arranged the necessary legal opinions and publication of the international agreement in the Official Gazette. Following approval by the Parliament, signing of subsidiary loan agreements with two participating financial intermediaries (Erste & Steiermärkische Bank d.d., Rijeka and Zagrebačka banka d.d., Zagreb) and adoption of the Operational Manual by the HBOR's Managing Board, The World Bank declared the project effective on November 25, 2009. The closing date of the project was August 31, 2013.

On September 20, 2012, the World Bank's Board approved the Additional Financing for Export Finance Intermediation Loan Project (CEFIL AF). The Loan Agreement in the amount of EUR 50 million and the Guarantee Agreement were signed on October 29, 2012. Following the approval by the Parliament and the publication of the Loan Agreement in the Official Gazette, the Loan Agreement became effective on January 24, 2013. The closing date of the project was August 31, 2016.

Project Implementation Unit (PIU) was located in the Croatian Bank for Reconstruction and Development (HBOR), Zagreb.

During the implementation of the project, several site visits to the final beneficiaries conducted by The World Bank and HBOR.

IBRD's missions were held as follows:

- 16 – 23 February 2010
- 14 – 19 June and 5 – 6 July 2010
- 17 – 21 January, 14 – 19 February 2011
- 15 – 22 September 2011
- 2 November 2011
- 24 – 30 May and 26 – 27 June 2012
- 28 January – 1 February 2013
- 29 October – 2 November 2013
- 2 – 9 June 2014
- 2 – 5 December 2014
- 28 September – 1 October 2015
- 7 – 9 December 2015

- 9 – 11 February 2016
- 11 – 15 April 2016

The project was rated satisfactory until the mission held in September/October 2015. Although the project was advancing towards achieving its development objectives, disbursement for the additional finance was lower than expected and the project was rated moderately satisfactory during the last mission held in April 2016.

2. PROJECT DESCRIPTION

Lending instrument

The lending instrument was a Financial Intermediary Loan (FIL), using IBRD funds, with HBOR as the borrower and implementation agency. The currencies of the FIL were EUR and USD. In addition to lending through participating financial institutions (PFIs), the funds were also lent directly to the final beneficiaries.

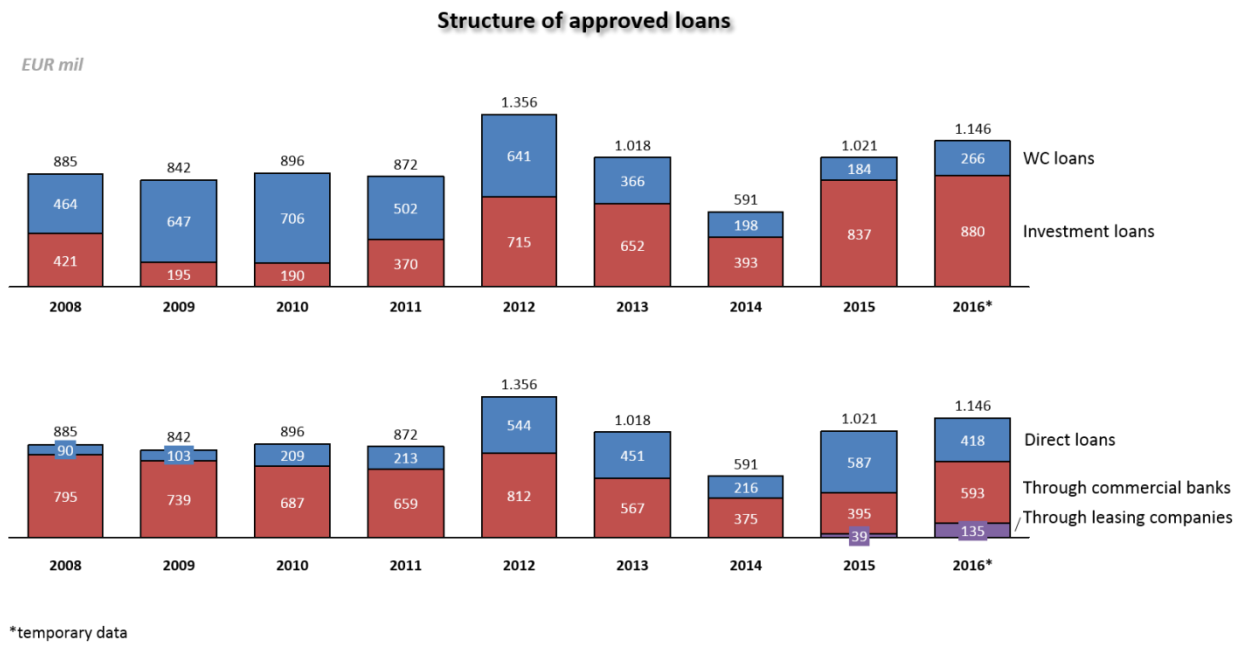
Project development objective and key indicators

The project's primary objective was to support the preservation and growth of exports by providing medium and long-term working capital and investment finance to exporters and FX-earning enterprises (e.g. tourism, logistics). The outcomes of the project were measured by the export and investment performance of the sub-borrowers, the amount of medium and long-term lending extended to exporters in Croatia, the payment performance of the sub-borrowers in the project, and the impact on employment in the companies supported.

During the critical period at the outbreak of the economic and financial crisis, the agreement of the CEFIL credit line in 2009 enabled HBOR to provide additional finance for Croatian exporters, which is particularly significant if the shortage of finance is taken into account that was chronic in the global and domestic money markets in that period. Additionally, interest rates in the domestic money market exceeded 39 percent for short-term financing, whereas long-term finance was practically not available in the market. At that time, HBOR had a key role in the securing of adequate long-term sources of funding for domestic entrepreneurs considering the lack of finance in the commercial banking sector. Therefore, the CEFIL credit line was of considerable significance. The chart illustrates the countercyclical activities of HBOR and stresses the clearly visible adjustment of the funding to the needs of the national economy through HBOR's strong support for the liquidity of domestic entrepreneurs in the initial period of the crisis and through the shift in the focus on investment finance again from 2012.

In the last three years, the situation in the domestic money market changed significantly compared with that at the beginning of the economic crisis. Market liquidity was exceptionally strong, and the decline in interest rates was considerable, which resulted in a decline in demand for HBOR's funding among commercial banks. Taking into account the gap in the financing of domestic entrepreneurs (according to the data of the Croatian National Bank, there has been a trend of decline in the portfolio of loans to commercial non-financial companies), this is the reason why HBOR strengthened its direct finance of domestic economic entities. As a result of the above change in the financial environment, it was necessary to adjust the CEFIL instrument

to enable the direct funding. To a certain degree, this change resulted in a slow-down in the disbursement of the CEFIL funds compared with the initially planned dynamics.



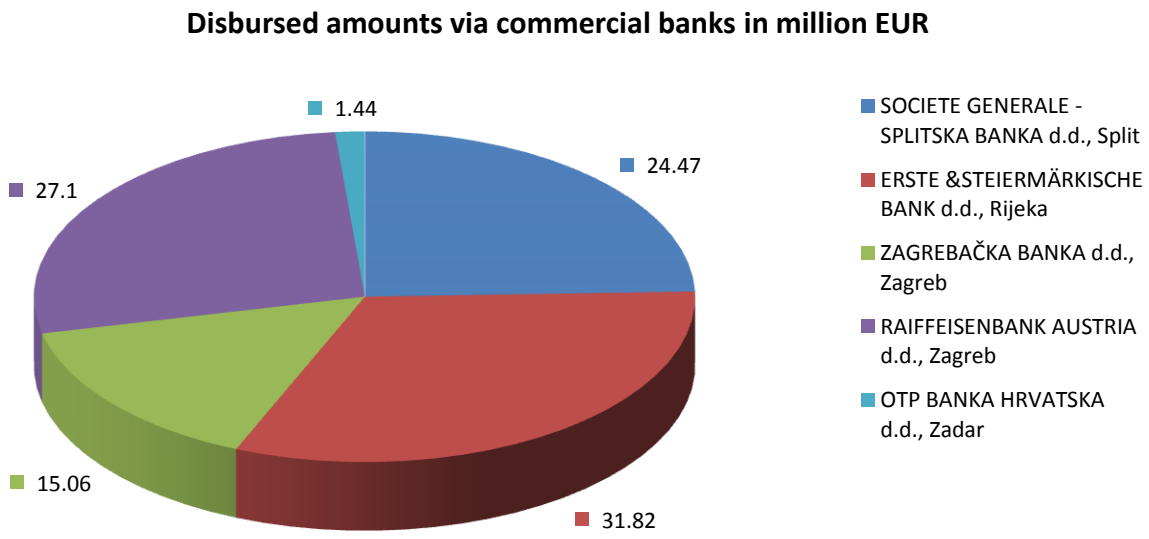
Project components

The eligibility criteria for PFIs reflected their creditworthiness, review of internal operating practices and compliance with prudential norms. The procedures for pre-qualification and eligibility were determined by The World Bank in close collaboration with HBOR. The World Bank carried out a detailed due diligence on a number of banks and pre-qualified 6 banks whose combined assets represented greater than 90 percent of the sector. These banks were selected based on their financial strength, qualitative assessment of management, ability to intermediate resources efficiently to the desired enterprise segment and compatibility with the parameters of the project.

SLAs were signed with 5 participating financial institutions involved in the implementation of the first loan in the amount of EUR 100 million:

Commercial banks participating in the implementation of CEFIL

Societe Generale – Splitska banka d.d., Split	**Erste & Steiermärkische Bank d.d., Rijeka**	**Zagrebačka banka d.d., Zagreb**	**Raiffeisenbank Austria d.d., Zagreb**	**OTP banka Hrvatska d.d., Zadar**
Contract dated 20 November 2009	Contract dated 20 November 2009	Contract dated 20 November 2009	Contract dated 26 January 2010	Contract dated 4 April 2011
Disbursed amount: EUR 24.47 million	Disbursed amount: EUR 31.82 million	Disbursed amount: EUR 15.06 million	Disbursed amount: EUR 27.1 million	Disbursed amount: EUR 1.44 million

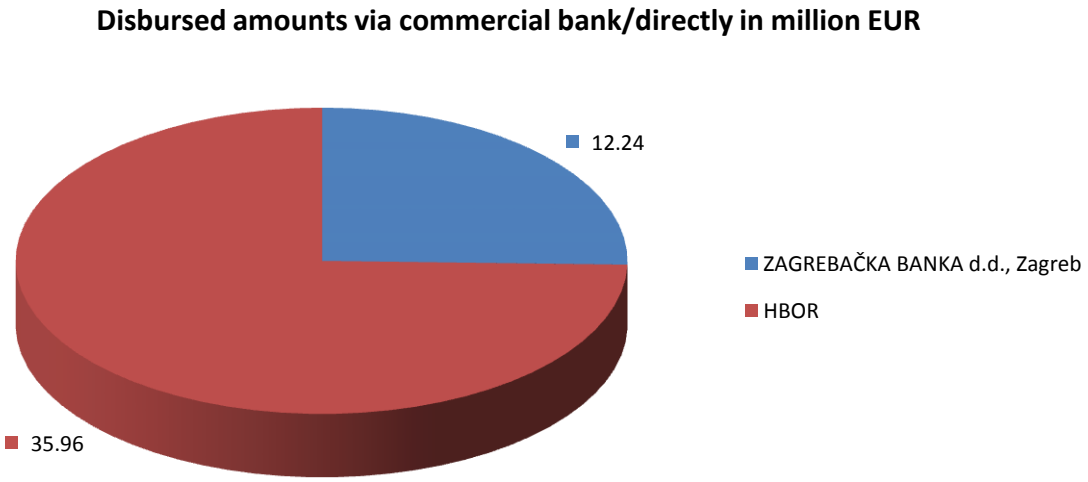


By the closing date of the original loan, an unallocated and undisbursed amount of EUR 118,436.29 was prematurely repaid to the IBRD on 24 December 2013.

For the implementation of the second IBRD loan No. 81930-HR in the amount of EUR 50 million, HBOR signed subsidiary loan agreements with 4 participating financial institutions:

Commercial banks participating in the implementation of CEFIL AF

Societe Generale – Splitska banka d.d., Split	**Raiffeisenbank Austria d.d., Zagreb**	**Zagrebačka banka d.d., Zagreb**	**Erste & Steiermärkische Bank d.d., Rijeka**
Disbursed amount: EUR 0.00 million	Disbursed amount: EUR 0.00 million	Disbursed amount: EUR 12.24 million	Disbursed amount: EUR 0.00 million



The total disbursed amount to final beneficiaries via commercial banks under the second loan agreement was EUR 12.24 million. The disbursement of loan funds via commercial banks decelerated due to a decrease in lending activity. At the beginning of 2015, HBOR received a large number of loan applications that referred to direct financing and requested approval from The World Bank for the direct financing out of CEFIL AF funds. HBOR also requested the extension of the Closing Date that was originally dated August 31, 2015.

In April 2015, The World Bank concurred with the requests for direct financing and for the extension of the Closing Date. The Closing Date was extended for the additional 12 months, to August 31, 2016.

As HBOR had a need for the USD currency in the balance sheet and there was a demand from one final beneficiary for the CEFIL AF funds in USD, HBOR decided to convert the full undisbursed amount, i.e. EUR 22.8 million, to USD. Currency conversion from EUR to USD on the unwithdrawn amount of the IBRD loan 81930-HR was executed in December 2016. The unwithdrawn amount of EUR 22,800,000.00 was converted to USD 24,277,440.00. Due to the unallocated part of the loan, the unwithdrawn balance amounts to USD 1,217,289.45.

3. PROJECT RESULTS

In total, 70 companies were financed from CEFIL and CEFIL AF through 78 loans for financing working capital and investment purposes ranging from EUR 34,124.28 to EUR 17,638,061.6324 with a maturity from 1 to 24 years. The majority of loans had working capital purpose i.e. 75 loans, while 3 loans had investment purpose. CEFIL enabled the commercial banks and HBOR to finance working capital and investments of local entrepreneurs with longer repayment periods. The usual financing of working capital at domestic commercial market is with repayment periods of up to 1 year, whereas the CEFIL credit line provided longer maturities. The average loan maturity under CEFIL is 4 years.

The portfolio under the project remains strong and there are 4 NPLs at the moment which account for 1.04% of the portfolio. A large increase in export revenues was recorded by CEFIL-funded companies, as much as 16.2 percent. Collectively, companies recorded 4.8 percent increase in employment.

Most of the financing was provided to the food and beverages and transportation and storage industries. Some of the financed companies, which were making investments during the economic downturn, confirmed that CEFIL helped optimization of capital structure and liquidity and managed to free some of their own funds for continuation of investment.

[24] The amount of EUR 17,638,061.63 was disbursed in USD

Sub-loans by Sectors and Loan Size

SECTOR	AMOUNT (€)	SHARE	NUMBER OF SUB-LOANS	SHARE
Energy	2,069,378.54	1.4	1	1.3
Basic Metals and Fabricated Metal Products	14,779,691.74	10.0	8	10.3
Pharmaceuticals and Chemicals	16,480,185.93	11.1	4	5.1
Rubber and Plastic Products	2,146,227.38	1.45	3	3.8
Other Non-Metallic Mineral Products	2,953,526.75	2.0	5	6.4
Textiles	7,618,867.47	5.1	7	9.0
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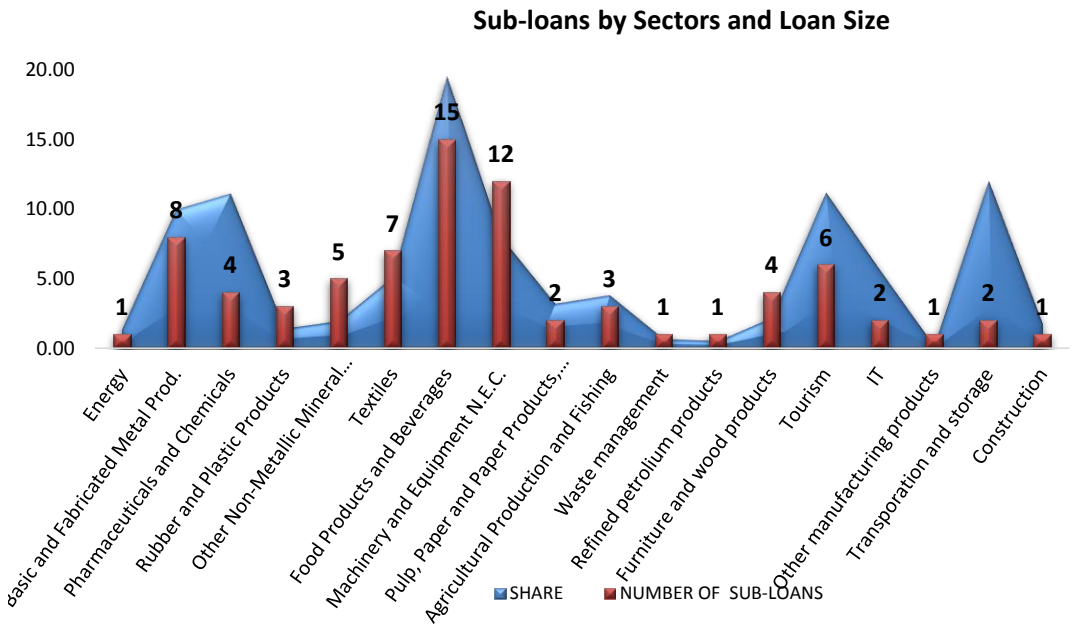
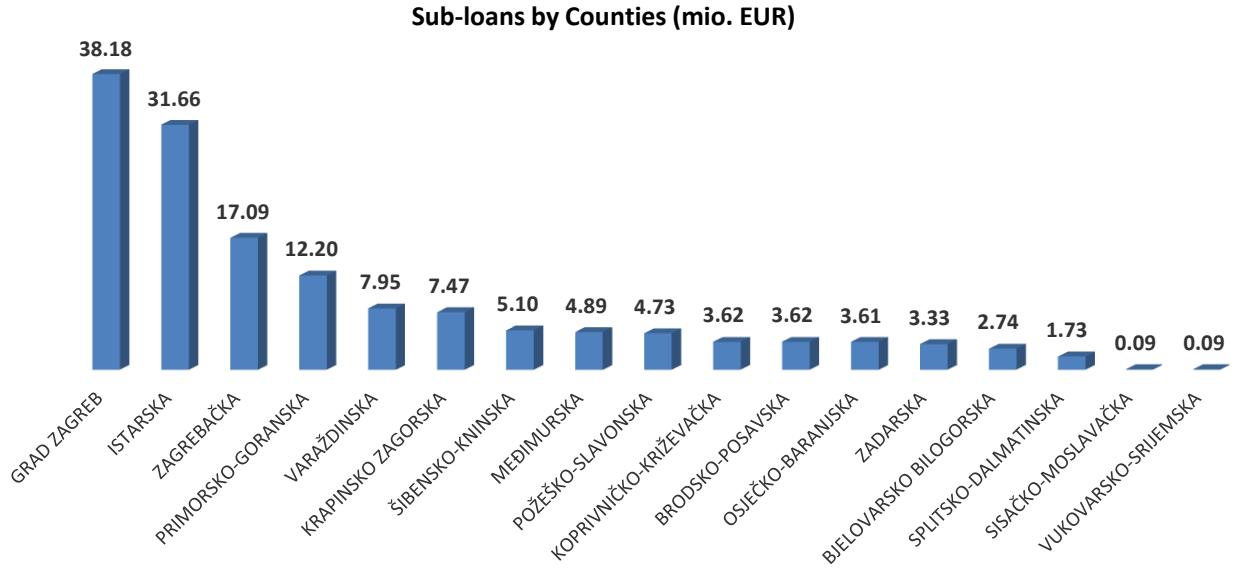
Agricultural Production and Fishing	5,693,079.55	3.8	3	3.8
Waste management	1,034,689.27	0.70	1	1.3
Refined petroleum products	833,472.48	0.56	1	1.3
Furniture and wood products	3,272,039.97	2.2	4	5.1
Tourism	16,588,420.84	11.2	6	7.7
IT	8,310,565.36	5.6	2	2.6
Other manufacturing products	272,229.03	0.2	1	1.3
Transportation and storage	17,837,292.52	12.0	2	2.6
Construction	2,640,866.80	1.8	1	1.3
TOTAL	**148,100,268.14**	**100.0**	**78**	**100.0**



With regard to the distribution of loans by counties, Grad Zagreb reached the highest peak with EUR 38.18 million and it is followed by Istarska County with EUR 31.66 million financed loans.



4. CONCLUSION

The characteristics of CEFIL are such that it successfully addresses a key market failure – access to long-term financing. By offering long maturities, companies benefited from capital which helped them strengthen their long-term business opportunities, and more importantly, weather the crisis. With the crisis leaving many people jobless, access to favorable medium-term finance through CEFIL enabled most of the companies to preserve the current workforce and even create new jobs. Impressive results have been achieved with exports. CEFIL-funded companies experienced a large increase of their export revenues, by as much as 16.2 percent.

In order for the Croatian economy to be successful, to achieve a higher growth of GDP, to reach a higher standard of living and a higher employment rate, HBOR shares the same view that support should be given to the private export-oriented companies.

Croatian companies still face serious difficulties in obtaining funding for investment projects with maturities from 15 to 20 years, in particular in the tourism sector, energy industry and complex technological restructuring in the industry sector, even though there is a clear and substantial interest. By providing CEFIL funds, Croatian companies, exporters in particular, remained competitive.

In brief, the key advantages and benefits under the CEFIL credit line were:

i. Addressing a key market failure – access to long-term financing for Croatian companies which is related to the fact that Croatian companies are not able to obtain long-term financing for the financing of investment projects with maturities from 15 to 20 years. At the moment this type of financing is not available in the market;
ii. CEFIL is the source of financing with the longest maturity for HBOR. This source of funding is unmatched by any other international financial institution;
iii. achievement of impressive results with Croatian exporters;
iv. solid demand for this source of financing in the food and beverages sector, transportation and storage sector, tourism sector and pharmaceuticals and chemicals sector;
v. positive impact of this credit line on the overall economy;
vi. ensuring the competitiveness of Croatian companies, exporters in particular.

The benefit that the program has brought to the companies in the form of competitive cost of capital supported them in strengthening their long-term business opportunities and overcoming the consequences of the crisis.

The CEFIL AF project restructuring together with the extension of the Closing Date significantly contributed to the full draw-down of the credit line funds.

Collaboration with the World Bank during the implementation of the project was strong. Close collaboration with the bank's offices in Washington, Brussels and Zagreb were productive and assisted the project.

Annex 8. Comments of Co-financiers and Other Partners/Stakeholders

N/A

Annex 9. List of Supporting Documents

1. Original Loan

i. Decision meeting comments and note
ii. PAD
iii. Legal Documents: Loan Agreement, Subsidiary Loan Agreements
iv. Operational Manuals
v. Aide Memoires, ISRs

2. Additional Finance

i. Concept memorandum, Decision Note
ii. Project paper
iii. Legal Documents: Loan Agreement
iv. Operational Manual
v. Aide Memoires, ISRs, Midterm review
vi. Restructuring paper

3. Country Partnership Strategies

Annex 10. Challenging Country and Sector Context During Project Implementation

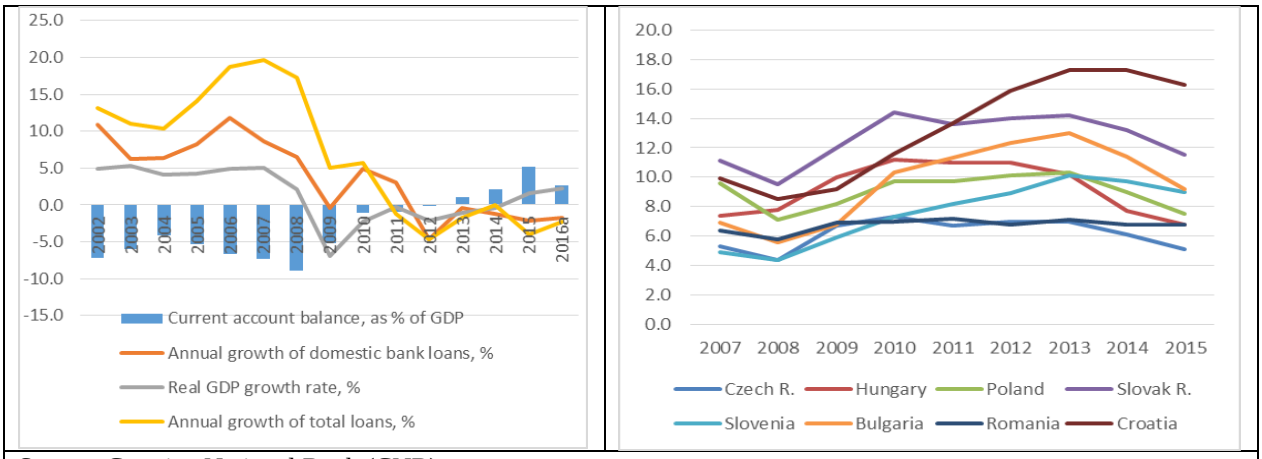
Challenging country and sector context and project implementation:

After more than half a decade of recession, Croatia returned to positive growth in 2015. Structural weaknesses exposed by the global financial crisis have yet to be fully addressed. Since 2008, Croatia has witnessed a protracted recession. GDP declined by more than 13 percent and unemployment doubled to over 17 percent, with youth unemployment reaching 50 percent, and poverty rates rising. The fiscal deficit averaged around 6 percent of GDP, resulting in a steady increase in public debt, which more than doubled to 88 percent of GDP by 2016. Corporate sector debt remained relatively high and the banking sector continued to deleverage and constrain credit, driven by declining profitability and high levels of non-performing loans. These factors increased Croatia's vulnerability to shocks and continue to slow growth.[25]

Figure 1: Growth Indicators

Protracted Recession- Key Indicators	ILO unemployment rate vs. peers (%)

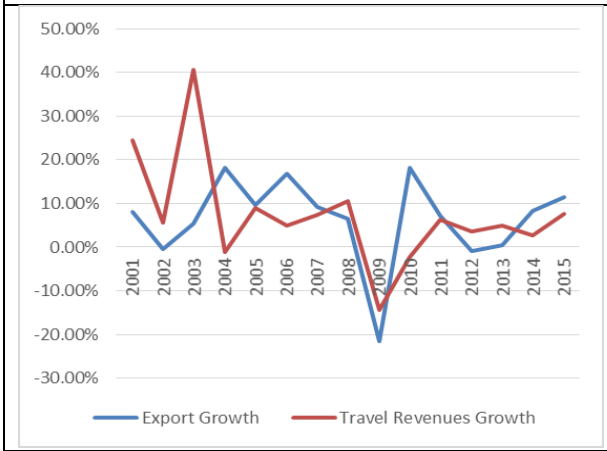
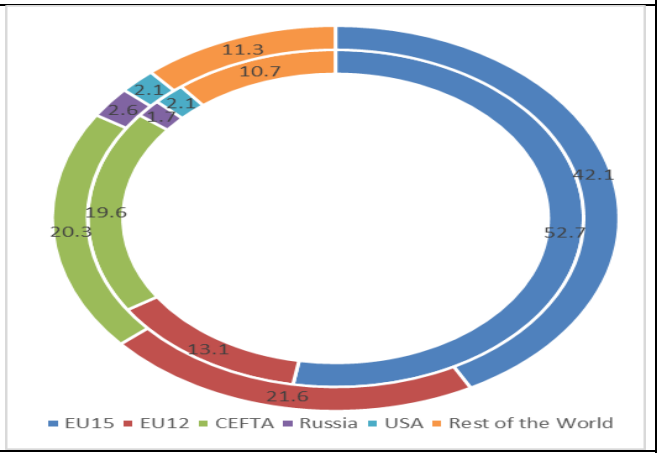
[25] Croatia Policy Notes 2016, World Bank



Source: Croatian National Bank (CNB)

In 2009, Croatia's export performance recorded a sharp drop of 21 percent as a result of the financial crisis. Recovery has been slow and Croatia did not exceed 2008 export levels until 2014. This is attributed to the impact of the crisis in Croatia's target markets and its subdued export competitiveness. Croatia's export performance has been lackluster, characterized by low export diversification, loss of competitiveness, lack of product sophistication, and limited expansion of new products and markets. Croatian exports grew by 4.1 percent on average per year during 2006-2014. This was the slowest export growth compared to double-digit growth in Poland and the Slovak Republic, and stronger growth in Hungary and Slovenia. The EU represents Croatia's largest trading partner, with its shares of total exports and imports of goods in 2015 at 66 percent and 78 percent. Tourism revenues were also hit by the crisis and recorded a contraction of around 15 percent. Tourism revenues are critical to compensate for the trade deficit, and comprise more than 45 percent of the overall exports of goods and services. 2008 tourism revenue levels could only be caught up by 2015.

Figure 2: Exports and Tourism

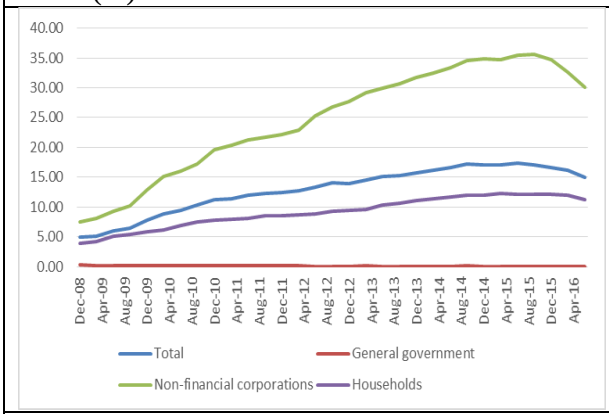
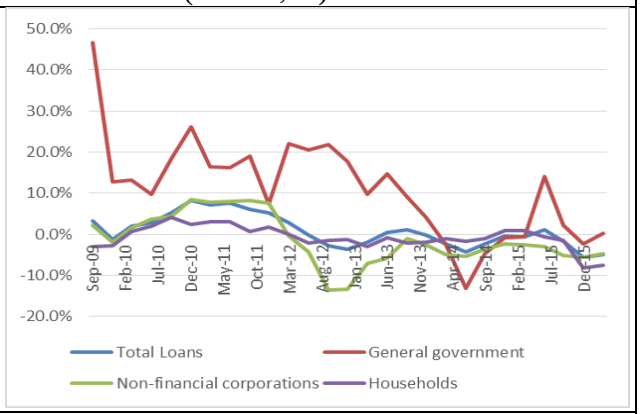
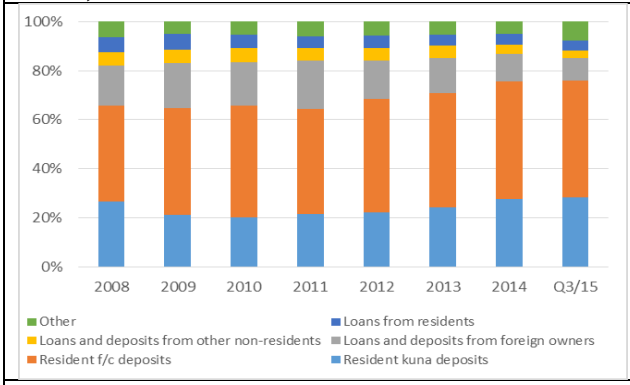
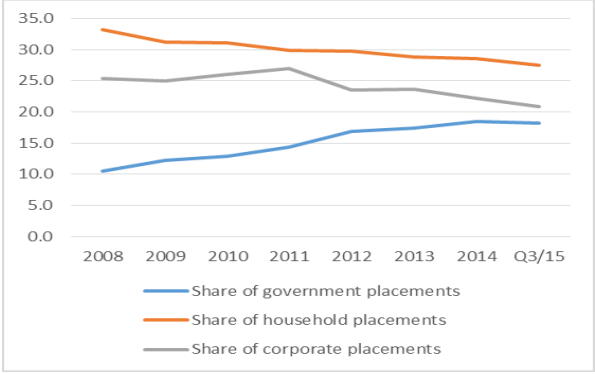
Exports and Tourism Revenue Growth (%)	Croatia Export Market Distribution Comparison 2002-2014 (%) -Inner circle 2002/ exterior circle 2014
	
Source: Croatian National Bank (CNB)	

Croatia underwent the prolonged recession with a relatively stable banking system in spite of the elevated risks. Macro-prudential measures taken during the pre-crisis years that aimed to prevent overheating led by abundant foreign capital inflows played a critical role in maintaining a stable banking sector. Croatia's banks had faced comparatively larger reserve requirements rates (including the marginal rate on foreign exchange capital flows), as well as larger requirements on capital adequacy than its European peers. Throughout the period, monetary policy continued to operate a tightly managed Kuna/Euro exchange rate with little volatility. Monetary policy was able to maintain an accommodating position throughout the recession by ensuring financial system stability, and addressing liquidity concerns swiftly through active use of regulatory requirements and Foreign Exchange (FX) interventions.

The banking sector was not immune to negative spillovers from worsening corporate balance sheets. The share of non-performing loans (NPLs) to total loans increased from 4.9 percent in 2008 to 17 percent in September 2015, led by the corporate sector NPLs which quadrupled to 31 percent in 2015. Profitability indicators reached their lowest level since 1998. Due to the growth of NPLs, provisioning surged from 48.7 percent in 2008 to 53 percent in June 2015. In addition to declining loan quality and high level of provisions, bank profitability declined as a result of banks' lending focus on lower-yield government financing. Consequently, return-on-average asset and return-on-average equity fell to 0.5 percent and 2.8 percent in 2014 respectively, compared to 1.6 percent and 9.9 percent in 2008. Despite decreasing profitability, the banking sector demonstrated a satisfactory capacity to absorb potential losses with the average capital adequacy ratio (CAR) for the system, reaching 22.3 percent in June 2015 (compared to 15.2 percent in 2008), the region's highest.[26]

Figure 3: Banking Sector Indicators

[26] Croatia Financial Stability Report, 2016, CNB

NPLs (%)	Credit Growth (Annual, %)
	
Reduced reliance of banks on cross-border funding sources (banking sector liabilities, as % of total assets)	Bank exposure to government units continued to Increase (% of total assets)
	
Source: Croatian National Bank (CNB)	

Instability in the Euro Area continued to exert pressures on bank funding, fueling financial sector deleveraging. Bank assets decreased for the fourth consecutive year in 2015 (by 0.5 percent), primarily due to the absence of credit growth and continued bank deleveraging, particularly vis-à-vis majority foreign owners. Such developments were under the additional influence of the increased sale of placements and regulations on the conversion of loans in Swiss francs into loans in Euros. Domestic banks were also deleveraging their corporate portfolios and increasing their exposure to lower risk government units.[27]

The CEFIL project was implemented in this very challenging environment, which resulted in significant difficulty, particularly with the disbursement of additional finance.

[27] Croatia Banks Bulletin, 2016, CNB