Annual Evaluation Overview

1. Scope, standards, and methodology

According to the BSTDB's Evaluation Policy, the Office of Independent Evaluation of the Bank presents this annual evaluation overview to highlight key findings and trends from the conducted ex-post-evaluations, since the commencement of the Bank's operations in 2000.

This overview and referenced evaluation products ensure accountability and quality management improvement of the Bank's performance, based on a rigorous, internationally harmonized independent evaluation of the BSTDB operations. Each annual evaluation overview is presented to the Management, the Board of Directors and the Board of Governors to highlight key findings in operational and institutional performance.

The evaluation overviews aggregate and compare the findings of the independent evaluations on an annual cumulative basis. They focus on the degree of mandate and strategy fulfilment as well as important trends and causal links. These reports do not contain commercially sensitive / operation-specific information and, therefore, represent the main vehicle for broader disclosure and accountability on the Bank's performance, inter alia within a dedication section of the Bank's Annual Report.

The current annual evaluation overview presents a synthesis of the findings of the evaluation of the implementation of the Bank's Medium-Term Strategy and Business Plan 2019-2022 (MTSBP). This evaluation was conducted to ensure both accountability and learning from past performance, to support an informed and more resilient further strategy, based on evidence and lessons learned. The evaluation distills and analyzes lessons learned through the implementation of Strategy 2019-2022, reflecting the existing and emerging development challenges of the Bank's shareholders, as well as the key findings of all evaluation overviews performed in the last 4 years.

The BSTDB Evaluation Policy commits the independent evaluation to Good Practice Standards on Evaluation, as maintained by the Evaluation Cooperation Group (ECG) of the Multilateral development Banks (MDBs). These standards, inter alia, ensure the organizational and behavioural independence of the evaluation function, safeguarding the important accountability role of the evaluation to the Boards of Directors/Governors. The Independent Evaluation Office officially became a member of ECG in 2014, following years of pro-active role in enhancing and applying the respective MDB-specific evaluation standards, as well as a comprehensive peer review by the ECG on the evaluation methodology, rigor and credibility.

The MDB-harmonized evaluation methodology uses 4 ratings (scores) for ranking performance of operations, 2 positive and 2 negative: Excellent, Satisfactory, Partially Unsatisfactory, Unsatisfactory. These ratings apply to each of the 5 evaluation criteria:

RELEVANCE: Consistency of operation objectives with the BSTDB mandate;
EFFECTIVENESS: Extent to which objectives are achieved;
EFFICIENCY: Extent to which benefits are commensurate with inputs;
SUSTAINABILITY: Likelihood that results will be maintained;
INSTITUTIONAL IMPACT: Covers improvements in norms and practices.

The ratings on those 5 criteria form the overall rating, a single measure of mandate-centered operation's performance.

2. Implementation of key targets of the 2019-2022 strategy

A central strategy goal was to achieve a 12% average annual growth of the outstanding portfolio. The evaluation considers this very ambitious and unprecedented for BSTDB which maintained a conservative and balanced growth in all previous strategy periods (the evaluation of the strategy 2015-2018 revealed that even the targeted 7.5% was challenging as it set a quantitative focus that implied various quality and sustainability concerns). The 12% annual growth is substantially higher than previously sustained growth rates (since 2009, the Bank's average targeted and actual growth was mostly in the 6-9% range) and therefore inherently implied a strong quantitative focus and increase in project size, inter alia.

Already within the first year (2019) BSTDB exceeded its annual base case targets for new operations and delivered a rapid growth of 36% of its outstanding portfolio, followed by 12%, 15% and (-13%) in next 3 years. Clearly, the negative impact of the Russia-Ukraine war is very substantial and offsets the achievements prior 2022 not only in terms of volume (almost 13% decline) but also in multiple aspects of quality (non-performing loans exceeded 14% while sustainability of development impact of evaluated operations deteriorated within 2022 from over 60% to 48% (Table 2).

Table 1 below outlines the key strategy targets and the respective independent evaluation on their achievement while the respective evaluation conclusions are presented further on.

Table 1: Evaluation of the external strategic goals (2019-2022)

Strategy Goal	Rationale	Metrics	Evaluation Findings
At a minimum to maintain the current credit ratings from Moody's (A2 Stable) and Standard & Poor's (A-/A-2 Positive) and more ambitiously - an upgrade of one notch.	Substantially reduce the cost of borrowed funds, relative to borrowing costs of any of the Bank's Member States	Credit Ratings assigned by Moody`s and S&P	31 Dec 2022: Moody`s: Baa1/P-2, S&P: 'A-/A-2 BSTDB obtained long-term credit ratings of "A2" from Moody's and "A-" from Standard & Poor's. On the 25th of Nov 2021, S&P upgraded BSTDB`s rating to "A" as the approved capital increase decision illustrated shareholders' support of the Bank's mandate, enhancing a resilient and strong financial risk profile. BSTDB had weathered the financial repercussions of the pandemic with only a mild impact on asset quality. Unfortunately, the Bank attained the rating increase only for a couple of months as in early 2022 S&P downgraded BSTDB back to "A-" right after and due to Russia's military actions in Ukraine, reflecting anticipated and actual erosion of the quality of the loan portfolio and respective impact on the capital adequacy position since 30% of loans were extended to borrowers in Russia and Ukraine. Moody`s also downgraded BSTDB's long-term issuer rating to Baa1 from A2 with the same rationale. While the evaluation acknowledged a temporary achievement of this goal, it renders a negative score as the final outcome, caused by the portfolio quality distress as a result of the war, is a rating downgrade with long-term implications. **Evaluation score: Partly Unsatisfactory**
Attract an AAA rated shareholder (major IFI) and/or other BSEC countries that are not yet shareholder	Strong presence in the capital market	AAA rated new shareholder; New shareholder from BSEC	The Bank interacted with various partnering IFIs and deepened respective cooperation, but this did not result in an extended membership. The evaluation acknowledges the effort towards this goal which remained beyond the Bank's outreach. Unfortunately, the initiatives for Serbia's membership in the Bank have been inconclusive for many years. **Evaluation score: Unsatisfactory**
Portfolio growth (to €2.137 billion outstanding and €2.3 - €2.4 billion signed operations by end 2022)	Balanced growth: increase the outstanding portfolio to €2.4bn by end 2020 and to €2.55bn by end 2022	The total amount at end of 2022	BSTDB had a very ambitious growth target of 12% p.a. on average, as addressed further. It made an immediate rapid (as opposed to the "balanced" intention) growth of 36% already within 2019, followed by 12% and 15% in 2020 and 2021 respectively, thus achieving the target within the end of 2021. The economic repercussions of the COVID-19 pandemic have had a limited financial impact on the Bank`s portfolio. BSTDB demonstrated a consistent commitment to its rapid expansion agenda, despite a temporary slowdown in disbursements in 2020 after a conservative lending approach was adopted during the pandemic. In 2022, the Bank had to substantially restrict its lending (reduction of 13% in outstanding portfolio) to safeguard liquidity and mitigate portfolio quality erosion due to the sudden economic and financial stress caused by the Russia-Ukraine war and the respectively restricted access to funding. Subsequently, the initial growth was not sustained and the 2022 target of €2.55 bn was not met as the actual outstanding amount reached €2.070 Billion, at the end of 2022. **Evaluation Score: Partly Unsatisfactory**

Average annual portfolio growth of around 12%	As above	% of total outstanding portfolio	The dynamics and causes reflected above apply hereby as well. Average portfolio growth rate per signed operations per year as follows: 2019: 36.29%; 2020:11.77%; 2021: 14.55%, 2022: (-12.66) **Evaluation Score: Partly Satisfactory**
Balance sheet size of about €2.3 billion at end 2022. Revised at mid-term to €2.8 - €3.0 billion	Stronger market position, in line with high growth targets	As above	The financial balance sheet reflected the dynamics and causes reflected above, in line with the evaluated portfolio growth. The respective figures for the end of 2021 and 2022 are respectively €3,235.1 million and €2,950 million (including USD/EUR exchange rate fluctuations effects). **Evaluation Score: Satisfactory**
Sign new operations ranging from €300 million in 2019 to €560 million in 2022	Economy of scale; growth	Total amount p.a.	In the first year (2019), the Bank has overachieved the targeted amount. The momentum was slowed down by Covid-19. Nevertheless, in 2021, BSTDB managed to get the figures to the same level as the first year of the strategy. The drop in 2022`s figures is entirely due to the war between Russia and Ukraine, as noted above (the Bank tented to a self-protecting approach for its liquidity and financial ratios). 2019: €842.8M, 2020: €624M; 2021: €820.7M; 2022: €120.9M. **Evaluation Score: Satisfactory**
Share of public sector in the total outstanding active portfolio - up to 35%	Balanced growth and diversity	Up to 35% at end of 2022	The share of the public sector in the total outstanding active portfolio at year-end-2022 reached 24.8%, which indicates the Bank did not finance as many public operations as planned. Looking at the other year-end shares (2019: 27.2%, 2020: 28.6%, 2021: 26%), even without the effects of Covid-19 and the war, the results consistently remain below the target of 35% of the total portfolio. Several recent evaluation studies attribute this shortcoming to the inherently low relative competitiveness of BSTDB vis-à-vis AAA-rated MDBs who offer large-size loans to the public sector at very attractive terms. **Evaluation Score: Unsatisfactory**
Increase the share of sovereign public sector operations to 25%	Increase pricing flexibility and guarantee	% of the total outstanding portfolio	The share of the sovereign or sovereign guaranteed operations in the total outstanding portfolio in 2022 is 16.45%. Looking at the other year-end figures (2019: 19.13%, 2020: 17.15%; 2021: 15.03%), even without the effects of Covid-19 or the war, the actual share falls consistently short of the intended target 25% of the total portfolio. The main cause for the shortfall is the inherent low relative competitiveness, as noted above. **Evaluation Score: Unsatisfactory**
Private sector lending of 65-70% of the total outstanding active portfolio	Balanced growth	% of the total outstanding portfolio at end of 2022	The share of the private sector in the total outstanding active portfolio in 2022 is 75.2%. Likewise, the year-end figures are within the target (2019: 72.8%, 2020: 9%, 2021: 73.93%). The key reason for the relatively high share is the inability to increase the public sector share, as addressed above. **Evaluation Score: Satisfactory**

Increase average number/amount of newly signed operations per banking team from about 4/ €86 million in 2018 to 5/€112 million in 2022	Balancing workload and efficiency (upscaling)	Average Number of Operations and amount per team	2019: 5.2, 2020: 4, 2021: 6.4, 2022: 1.8 operations per banking team; 2019: €168.6M, 2020: €122.1M, 2021: €164.1M, 2022: €22M per banking team. These figures reflect the rapid portfolio growth in 2019, as well as a slowdown during the first year of the pandemic. During 2022, the war caused a major interruption of new operations, as addressed above, resulting in very low level of efficiency. **Evaluation score: Partly Satisfactory**

New operations will continue to increase in size on average to around €22m	Portfolio growth, efficiency	Amount of average size	2019: €32.4M; 2020: €31.2M; 2021: €25.6M, 2022: €15.1M. Again, the Covid outbreak had a slight effect on the portfolio mainly due to the imposed restrictions. After the Russian-Ukrainian war, uncertainty in the market and the downgrading of credit ratings, the Bank had to adopt restraints in investing and focus on liquidity. **Evaluation Score: Satisfactory**
Increasing the average tenor for non-financial projects to 4.5 years	increase efficiency, revenues, and reduce cost of holding expensive liquidity	Number of years	The average tenor of Bank projects stood at approximately 3.5 years at end 2018. During the strategy period real sector (including real estate) average tenor is 3.85 years. (2019: 4.25 years, 2020: 3.92 years, 2021: 3.86 years; 2022: 3.37 years.). BSTDB inherently maintained relatively short tenors due to its orientation to corporate finance as opposed to project finance profile. **Evaluation Score: Unsatisfactory**

Increase total borrowings to around €1.5 billion (revised to 2bn) by end 2022.	As per base case scenario - mobilizes its resources through its borrowing programme	Amount of total borrowing	Since all but €100 million of the existing end 2018 borrowings mature during the four year period, this implies new borrowings of around €1.4 billion. Although the Bank increased total borrowings to the targeted levels and it was very close to even go beyond, after the war and its impact on the BSTDB rating, this amount has dropped. The total borrowings at the end of 2022 reached 1,96M (unaudited). **Evaluation Score: Satisfactory**

Consequent to the borrowing goal, achieve a ratio of about 1:2 (revised to 1:2.5) of own capital to borrowed funds	As the Bank's cost of borrowing is higher relative to other IFIs. Finance long term high value projects with strong development impact.	Ratio of own capital to borrowed funds	The ratio is an indicator of mobilization and is symbolically significant in the mandate fulfilment context. The ratio of own capital to borrowed funds is roughly 1:3. (The ratio of own capital to borrowed funds: 35.92%) **Evaluation Score: Satisfactory**

Prior to maturity in 2021, consider liability management (in 2020) whereby BSTDB buys back the outstanding bond and issue a new five-year USD bond.	Even without buy-back consider issuance in 2020. Maintain liquidity, facilitate lending, sound balance sheets	liability management exercise	A benchmark 5-year 400 Mn USD bond was executed in 2019. In 2020, Treasury completed a liability management exercise as per MTSBP where a piece of the 2021 maturing bond was bought back from investors and an additional ticket of 150mn USD was added to the 2024 notes. No other new benchmark USD bond was printed in 2020. **Evaluation Score: Satisfactory**

The aggregate average lending margin at the end 2022 to remain above 3.50% (expected to further fall to 3%)	Focus on a more specific pricing for each asset class; Pricing advantage in the market	Percentage	The aggregate average lending margin at the end of 2022 is 3.49%. (2019: 3.52, 2020: 3.52, 2021: 3.36 2022 – 3.55.) **Evaluation Score: Satisfactory**
Keep Non-Performing Loans (NPLs) within 3% of total portfolio by work-outs, tailored strategies, restructuring, sale of assets, and/ or write-offs	protect the financial stability and lending ability	Percentage of total portfolio	During the 4-year strategy, the Bank kept the NPL ratio within 3% of the total portfolio only in 2019. In 2020 and 2021 ratios are moderately above the targeted level. In 2022, the impact of the Russian-Ukrainian war caused NPL ratios to suddenly exceed the limit substantially as many of the loans in the two countries were promptly assigned as Stage 3 as per IFRS-9.[1] **Evaluation Score: Unsatisfactory**

Notes: Some financial figures are not yet audited; some financial figures on portfolio dynamics imply USD-EUR Exchange rate conversions

3. Evaluation conclusions and lessons learned

The evaluation concluded that the Bank implemented the main goals of its 2019-2022 Strategy only with partial success (7 of 17 evaluation ratings are rendered negative) due to unexpected high-impact events. During the four-year period, two important events took place that had an impact all over the world and caused the Bank's operations to be disrupted. One is the Covid-19 pandemic and the other is the war between Russia and Ukraine in 2022. As can be seen in Table 1, the effects of Covid-19 and the strict quarantine rules applied by the states, including the closing of the borders, adversely affected the loans within the Black Sea region. However, it is evident that the negative effects were rather contained and appropriately mitigated and a subsequent recovery took place already in 2021 when portfolio data improved compared to 2020. Unfortunately, as the evaluation of 2022 figures reveals, the war between Russia and Ukraine had a much more severe effect than Covid-19, as it suddenly affected the Bank's portfolio and called for an immediate effort to conserve cash and recover loans that account for about 30% of the portfolio (mostly in Russia and Ukraine). Consequently, the Bank had to limit its operations substantially, downsize its portfolio and adopt protective measures with a more conservative approach in order to shift from initial rapid growth to addressing portfolio deterioration and respective liquidity constraints.

At the starting year of the strategy, 2019, the Bank grew its portfolio of outstanding operations very rapidly by an unprecedented 36.3%, in contrast to the projected average annual growth of 12% and actual growth rates in earlier periods. This called for a review and an update to the strategy plan was published in 2019, revising some of the original goals for the remaining three years. The evaluation reveals that exceeding the already high growth targets has shifted the focus on quantitative aspects and respective portfolio handling, as opposed to the intended "balanced" growth and mandate fulfilment.

As Table 1 illustrates, in 2022 many key strategic goals were not attained due to the disruptive impact of the war in the region. The evaluation acknowledged that the Bank responded swiftly to address the issue of sudden deterioration in the share of the portfolio in Russia and Ukraine, undertaking various measures towards the disposal of the company loans falling under sanctions, demonstrating ongoing efforts to bring loan performance to more manageable levels.

While the Bank consistently paid attention to the target of a 35% share of public sector operations, it came short of reaching it, as it happened in earlier strategies when this target was just 20%. Hence, the evaluation has to raise again the issue of feasibility and competitiveness, addressed in several evaluation studies so far. The two underlying reasons for this shortcoming are (i) the insufficient price competitiveness relative to AAA-rated MDBs who offer public sector lending at flat low rates, as well as (ii) the limited experience and capacity of the Bank to structure deals in the public and quasi-sovereign domain.

1 The Independent Evaluation Office did not assess NPL ratios as such because in the reviewed period BSTDB applied IFRS-9 financial reporting that does not use the term NPL. The evaluation assessment regarding this KPI was therefore based on review of the respective Stage-3 data which includes NPL and loan impairment combined. The term NPL is no longer an integral part of the accounting standard governing provisions.

By increasing the average size of operations, the Bank was able to temporarily increase targeted efficiency, but the respective concentration also contributed to the issue of loan performance in terms of quality and viability. This reflects the revealed focus on volumes and approvals that in turn caused concern regarding quality and development mandate, challenging the development profile of the institution.

The strategy addressed portfolio quality, inter alia, through a single key performance indicator. It states that the positively rated operations upon independent ex-post evaluation should be at least 70% at any given year. As this is a complex composite indicator, involving measurement time-lags (5-year moving average, reflecting operations maturity dynamics), its actual value will be measured and presented during the next strategy period. However, the data from the last 4 years indicate a stagnating and even deteriorating development performance of the new additions to the portfolio.

Table 2: Independent ex-post evaluation ratings of completed operations

Criterion / Period	Before/After		Comment / Recommendation
Positive ex-post ratings	End-2018	End-2022	
Relevance	70%	68%	Trendsetting ex-ante forward indicator, at margins, revisit
Effectiveness	73%	73%	Adequate, but modest ex-ante targets
Efficiency	56%	52%	Scale-driven, capital-cost constrained, dropped rapidly in 2022
Sustainability	60%	48%	Constrained by focus on volumes
Institutional Development Impact	51%	47%	As above, high potential
Overall (MTSBP target: 70% or more)	70%	64%	First time well below target, relevance-sensitive
Ex-ante/ex-post alignment (evaluations)	67%	66%	Further ex-ante / monitoring rigor/incentives needed

While overall performance in terms of mandate fulfilment decreased over the years, the share of operations rated excellent at ex-post has also declined from 17% in earlier periods to 4% during the last 4 years. This merits attention as highly successful operations are a benchmarking source of valuable learning, motivation and replication. The diminishing cases of excellently rated operations reflect a combination of unrealistic expectations (ex-ante mandate compliance optimism driven by efforts to obtain approval) and lower actual achievement. There are several cases which imply that a closer alignment of operations with country analysis/strategies tends to deliver a higher number of outstanding performances, both at operational and institutional planes.

The two most frequent key causes of mandate-related underperformance are: (i) risks identified at due diligence that were not covered by adequate covenants and/or monitoring; (ii) mitigating the risk of poor corporate governance is very challenging, particularly when not done at the outset of operation handling. Contrary to certain prejudice, development performance is positively co-related (79%) to general portfolio quality and financial outcomes.

There are recent examples when the Bank enhanced its relevance and risk sharing by an effort to become more responsive to clients, e.g. by the increase in local currency finance that turned particularly valuable to non-exporting borrowers, as their currency risk exposure was better mitigated. While this is acknowledged, the evaluation notes its limitations, based on the risk absorption and fund-raising constraints.

Along with the outlined external strategic goals in Table 1, the Bank pursued a number of supportive internal goals, with a broader level of relative success. For example, it made substantive progress in establishing sound IT digitizing tools and processes. While some of them were triggered by the requirements of working remotely to address the pandemic challenges and were implemented in due course, the implementation of others continues beyond 2022. On the negative side - the establishment of some new functions and teams, reflecting intended organizational enhancements geared towards the strategic needs, has been interrupted right after the decision to shrink the portfolio, in early 2022.

Given the magnitude of external factors that abruptly affected the Bank's operations, as well as the attainment of strategic goals deemed to be reached already at mid-term, the key question to be addressed in the future is the feasibility of outlining and implementing a relevant strategy with ensuring a higher degree of resilience. The evaluation acknowledges the effort to anticipate certain external disturbances within the context of lower-case scenarios envisaged by the strategy. However, it is evident that the experienced external shocks and disruptions within the region were well beyond the scope of any of the worst-case assumptions used by the Bank within this, as well as earlier, strategies.