A Tool to Attract Investments in Renewable Energy

The Frustration of the Public Sector

Many African countries have tried to attract private investors to improve the access to energy for its population and industries. Governments and utilities have grown increasingly frustrated in this, as they deliver licenses and sign PPAs without any tangible outcome.

There are many reasons that can explain the gap and they vary from country to country, but one concern has been reported by the private sector over and over: the liquidity risk.

IPPs, and especially their banks, fear that they will not be paid on time for the power that they deliver and as a consequence that they will not be able to service their loans.

For a project finance project, cash flow is key. Lenders will ask for various guarantees and buffers to ensure that the IPP can continue to operate and service its debt even if there are payment defaults by the off-taker.

The standard solution is to obtain:

(1) a guarantee by the Ministry of Finance and
(2) a liquidity buffer, usually in the form of a stand-by letter of credit that can be called if the off-taker does not pay on time.

However, in most cases the bank providing the L/C will ask for up to 100% cash collateral, and usually this has to be provided by the utility.

Most utilities are unable to provide this collateral, and thus many power projects don’t reach financial close because the liquidity risk cannot be mitigated.

Even if the utility has cash available, it is frustrating because the money that is blocked could be put to use in more productive ways.

The Regional Liquidity Support Facility (“RLSF”) has been specifically designed to address this problem. It provides the L/C bank with cash collateral and additional guarantees that will give it enough comfort to issue the L/C at a reasonable cost, so that the IPP can continue to operate for at least 6 months in the event of off-taker default.

Stakeholders

The African Trade Insurance Agency (ATI) will implement the RLSF. ATI is a multilateral investment insurer of credit and political risks with a paid up capital in excess of $220 M. It has an A rating from S&P. Its main shareholders include 13 African member countries as well as the African Development Bank. Its mission is to attract investments and facilitate trade in and with its member countries. Over the last 5 years, ATI has underwritten transactions for a total amount of $ 8.5 Billion.

With the support of the European Investment Bank (EIB), ATI has developed a thorough expertise in the energy sector and insured IPPs in several member countries.

The RLSF will benefit from ATI's expertise and preferred creditor status with ATI member countries. The 2016 annual report of ATI can be found on their website: http://www.ati-aca.org/images/2016_English_Annual_Report.pdf

KFW initiated the RLSF. Funds for the cash component and to set up the RLSF have been provided by the German Federal Ministry for Economic Cooperation and Development (BMZ). In December 2016, the BMZ approved a total investment grant amounting EUR 31.6 million as well as a grant TA component amounting EUR 1.3 million.

Eligibility

1. In the first phase, the RLSF will mainly consider IPPs in **ATI member countries** (Benin, Burundi, Cote d'Ivoire, Democratic Republic of Congo, Ethiopia, Kenya, Madagascar, Malawi, Rwanda, Tanzania, Uganda, Zambia, Zimbabwe). Projects in other countries can be added.

2. Projects with an installed capacity **up to 50 MW,** in exceptional cases up to 100 MW.

3. Supported technologies: **Solar PV, Hydro, Onshore wind, Geothermal, Biomass** (using waste-to-energy)**, Cogeneration** (using a renewable feedstock).

4. Projects will be **underwritten by ATI** and assessed according to its internal guidelines (financial sustainability, environmental and social impact, off-take risk and government support, etc.).

5. **Sufficient support of the host government and the utility** for the project and the role of ATI (see below).

Product Description

ATI, as manager of the facility, will select a bank (or banks) to issue L/Cs to approved IPPs with the backing of the RLSF.

The facility has two components:

1. A funded cash component as a first loss collateral buffer. German Cooperation through KfW has made EUR 30,000,000 available for this.
2. An unfunded on-demand guarantee of ATI for the same amount, which can be called in case the first loss portion is exhausted.

Potentially the facility can cover 100% of the risk, but the L/C bank will be encouraged to keep a certain uncollateralized retention on its own books.

ATI will enter into an umbrella agreement with the bank that sets the terms and conditions under which the bank will issue Letters of Credit. ATI will assess each potential transaction, ensure that the project has the full support of the utility and the Host Government, and activate its preferential relationship with the Government (as a preferred creditor) in the case of payment delays. Once ATI has approved a transaction, it will ask the bank to issue the L/C to the IPP.

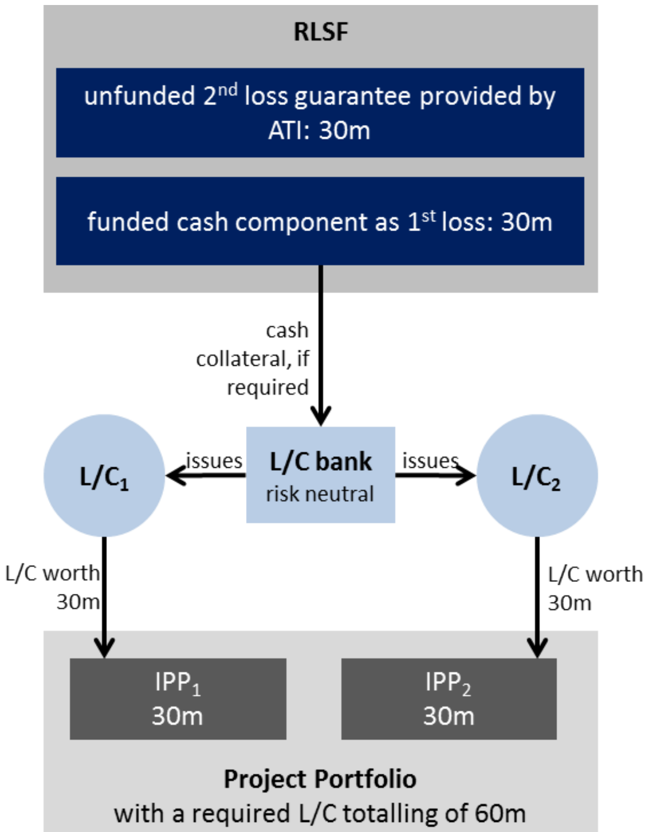
Whereas such L/Cs are traditionally valid for 1 year, the banks will be able to issue L/Cs with tenors of multiple years.

Alongside the RLSF facility, ATI will continue to offer its traditional products of political risk insurance and ATI can also insure the PPA termination risk, albeit the different covers are not necessarily linked.

ATI expects to finalise the selection of the L/C Bank during the 3rd quarter of 2017.

How does it work?

The illustration below assumes a project portfolio that reaches the maximum the RLSF can support, i.e. L/Cs covering a total exposure of EUR 60 million. For illustrative purposes, it is assumed that only two projects make up this portfolio, and that each requires an L/C for EUR 30 million.



The bank providing the L/C is protected by the funded cash component that serves as a first loss buffer. The cash will be deposited in an escrow account and will be available immediately upon drawdown under the L/C.

The second loss guarantee is provided by ATI and matches the funded component 1:1. It is available on-demand to the L/C bank in case the first loss tranche is exhausted. Accordingly, the L/C bank does not take any risk except its pre-agreed share of retention on its own books.

When an IPP experiences payment delays, it can immediately draw from the L/C and thus continue debt repayment to its lender(s). It replenishes the L/C as soon as it is paid by the utility.

The L/C bank will make a commitment for the whole program, and will continue to issue L/Cs up to the maximum capacity of the facility irrespective of the level of utilized cash component (i.e. the bank is taking some second loss / excess credit risk on ATI).

The Support from the Government for RLSF

The RLSF will operate in countries where ATI is confident that payment delays will be resolved in good time, whatever the problems a utility may encounter.

ATI has a preferred creditor status ("PCS") in its member countries, and the RLSF will benefit directly from this.

The PCS has been described in the contractual agreements between ATI and each member country, and stipulates, among others, that

a) ATI has to notify the government each time that it insures government risk (including the risk of nonpayment by parastatals and state-owned enterprises);
b) If ATI faces a loss caused (directly or indirectly) by the government, the government has to take all necessary actions to solve the problem;
c) If ATI has to pay a claim, the Government has to reimburse ATI;
d) If the Government does not reimburse ATI, ATI can deduct the amount that is due from the equity that the country has invested in ATI.

This mechanism has been set up so that ATI can inspire confidence to the private market and thus attract investments into its member countries.

ATI will not only notify the Government of its commitments under the RLSF, but will also ask for a formal acknowledgement from the Ministry of Finance, the Ministry of Energy and the utility itself, so that all parties are aware of ATI's rights.

In non-member countries ATI will endeavor to develop a similar relationship and ask for a formal commitment from the Ministry of Finance, Ministry of Energy and the utility to solve any payment problems in time and compensate ATI for any losses that the facility incurs.

The details may vary from country to country, but ATI can provide a template.

Transparency

ATI is also convinced that the liquidity risk that justifies the request for the collateralized LC is often more a perceived risk than a real threat to the IPP.

In order to correct this perception the RLSF project will additionally develop a web based platform where IPPs will report the actual payment made by the off-takers, and the actual aggregate performance of each utility will be made public. Part of the no–objection mentioned above will include the agreement to make such payment data public.

The hope is that this transparency will over time provide an objective view on the actual performance of the utilities, compared to their perceived risk. This in turn should help banks and other lenders to adjust their pricing and even to reassess their need for collateral.

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