2030 - 300GW

Africa Renewable Energy Initiative

Initiative Africaine pour les Énergies Renouvelables

AFRICAN RENEWABLE ENERGY FORUM

Cairo – Egypt

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De-risking and the private sector

AREI phase II

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- **Analysing risks is essential to identify De-risking trajectories to facilitate private investments in Renewable Energy in Africa**

Introduction

1. **Private sector approach: market challenges risks and returns**
2. **Understanding and defining country-level risks**
3. **Understanding and defining project risks**
4. **Conclusions and recommendations**

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Investment push policy pull and …….money

Blending :How to move on? An example the European Investment Plan: Three Pillar Approach

European Fund for Sustainable Development (EFSD)

- New guarantee to reduce risk
- Blending loans and grants
  - Africa Investment Platform
  - EU Neighbourhood Investment Platform

Technical Assistance

- Support local authorities and companies preparing bankable projects
- Improving the investment climate in close engagement with the Private Sector

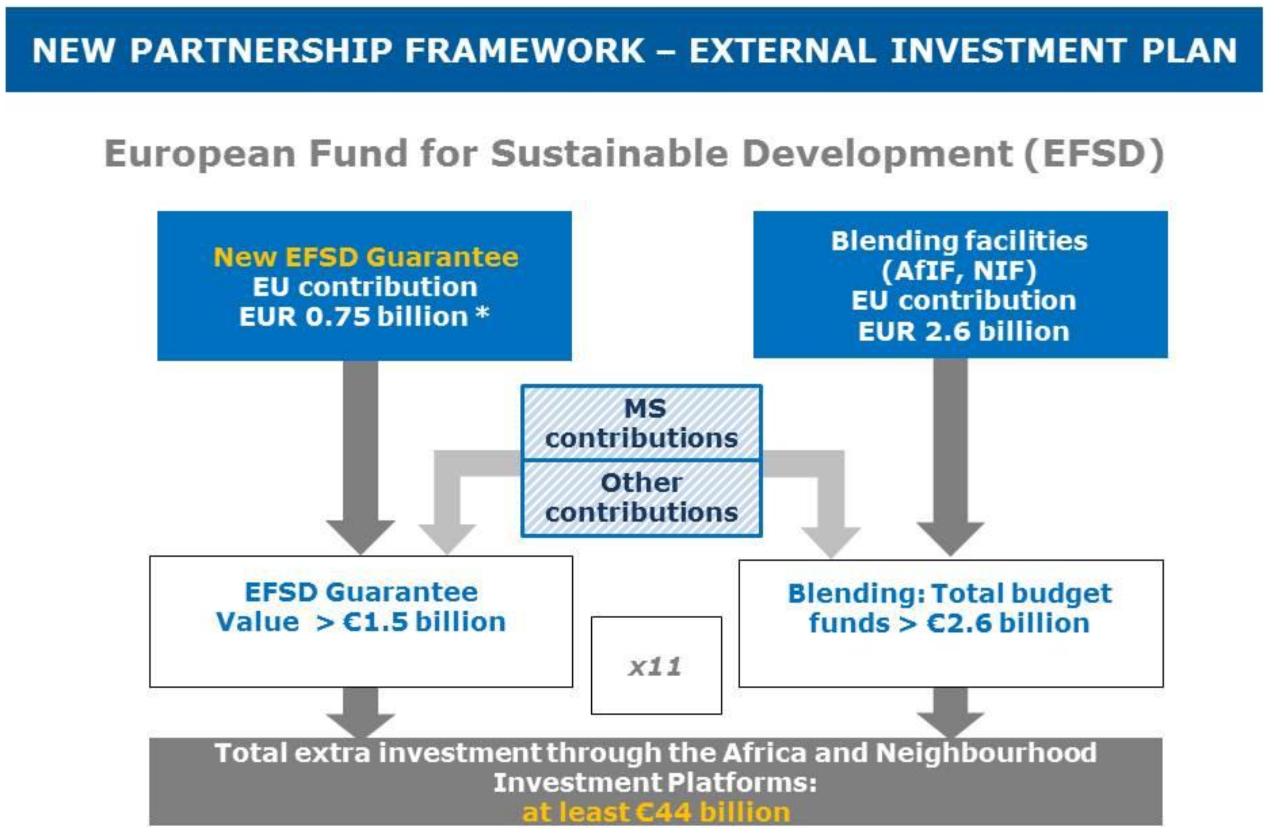
Investment Climate

- Structured dialogue with business
- Market Intelligence & Analytics
- Policy and political dialogue
- EU Cooperation

A one-stop-shop for public and private investors

An example of integrated approach to De-risking : EU docet

EU-External Investment Plan Strong financial incentives from EU resources



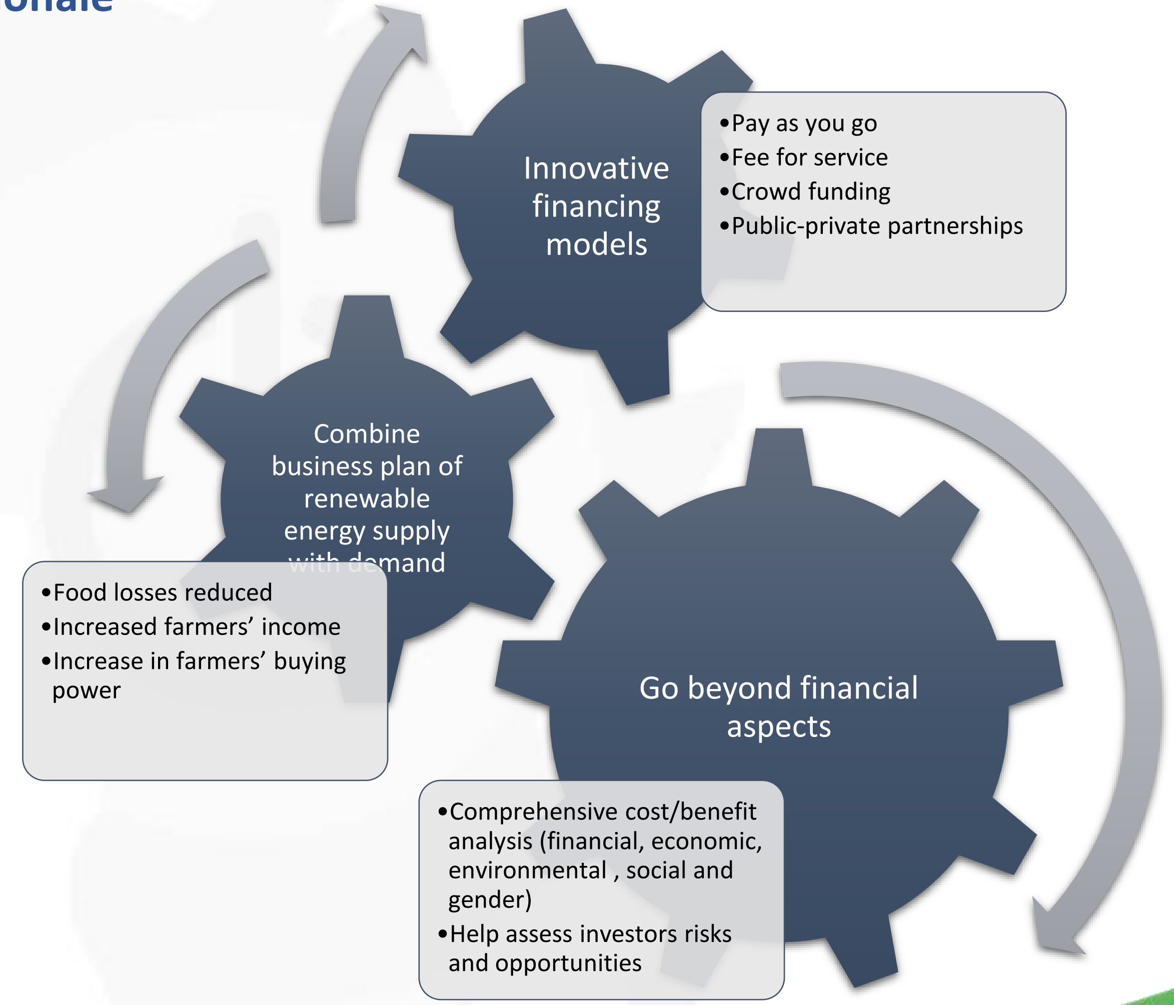
* Plus a EUR 0.75 billion contingent liability.

Source EC 2017

Agenda 2030 as a stron driver for AREI: the rationale

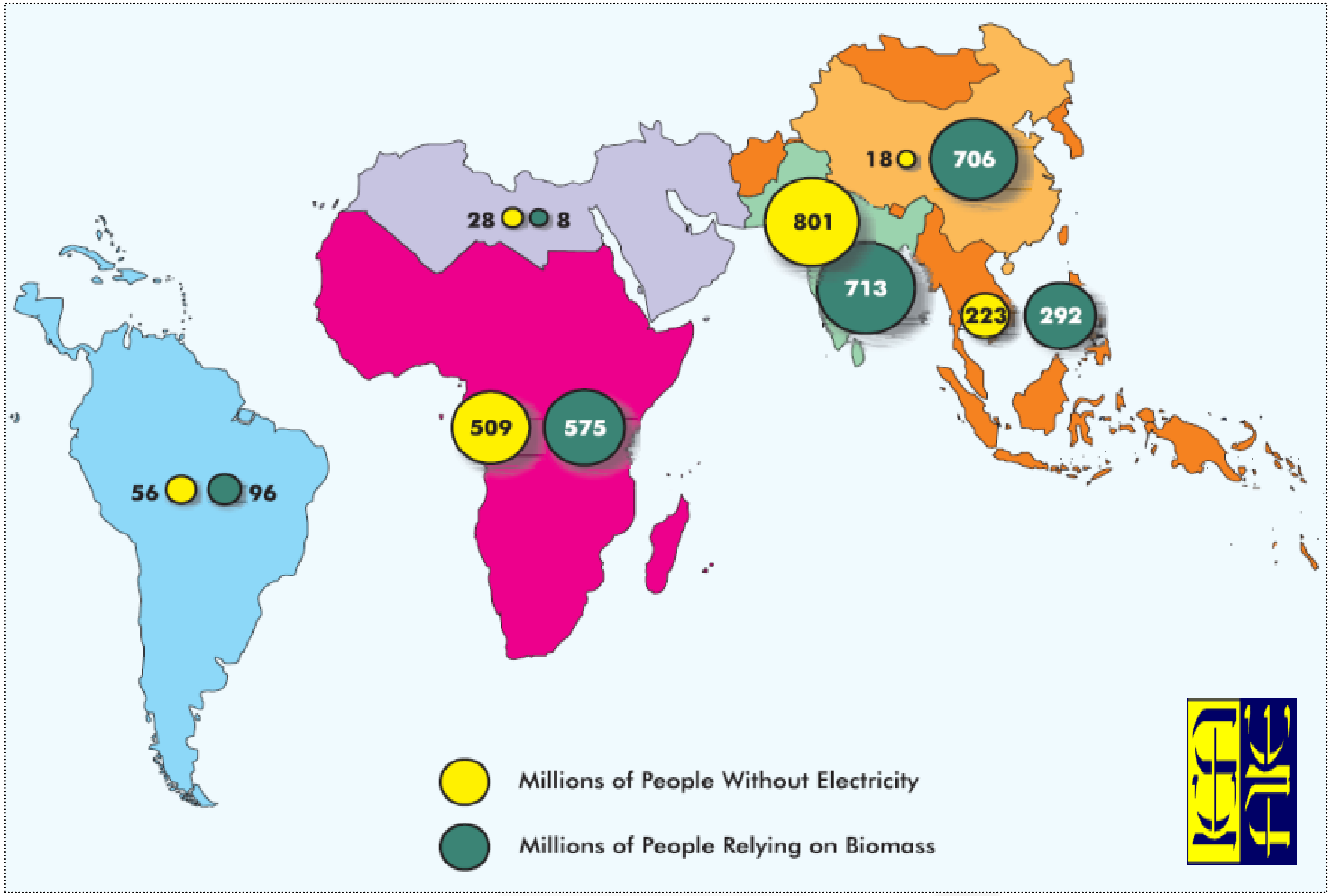
Policy sdg driven incentives

Tackling on sdg (7) to make food production (various sdgs) more sustainable



New avenue for AREI phase II:

Number of equity funds dedicated to small and medium sized projects



Source: International Energy Agency (IEA)

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Some market challenges are preventing the further scale-up of IPPS:

- an **inefficient governance of the sector** and implementation of policies.
- an **unfriendly business environment**, most notably for foreign investors.
- a **lack of transparent competition** and project procurement **rules**.
- a weak financial sustainability of public counterparts to offtake energy
- high-perceived risk environment linked to **perspective investors' perception** of efficiency and reliability of the project-hosting country on market structure, legal framework, currency issues.
- **coherence and transparency of government policies and regulations** regarding power sector governance and private sector participation.
- **soundness of sectorial development plans** and project procurement rules.
- **weak financial sustainability of public counterparts (off-takers)**.
- **general lack of legal and technical capacities in local institutions** to efficiently manage project phases, from preparation to operation

De-risking is essential

- **Pressure from investors and shareholders for increased disclosure and transparency about sustainability in company reporting will drive investors to hold companies accountable**. The financial segment can share due diligence processes and methodologies, including certification to reduce system costs and encourage standardization on the high upper end of the spectrum of quality. The tools conceived for business will have to have the same metric of certification, validation schemes to be used in loan appraisal and investment design. Indexes will be based on the same metrics too.
- **However, we know that the pure private financial sector will not take any more risks tomorrow than those that they are ready to take today** . For this reason, we need to connect the blended finance techniques and the development banks world to the commercial finance in a way that is instrumental to the policy incentives and the schemes that public authorities will decide to implement.

AREI phase II : Elements for a strategy : private sector on sustainable finance

The **DEVELOPMENT OF A NEW ECOSYSTEM** is necessary policy alone will not be sufficient.

The centrality of finance institutions and commercial banks is crucial to enhance sustainable investments

SUSTAINABLE INVESTMENTS

move beyond **POLICY PULL**

- Creation of enabling environment

towards **INVESTMENT PUSH**

- Impact investing
- Benefit-driven business models

Understanding and defining country-level risks

- **Investors when they look at a country, they start looking at ratings. Ratings are built around data. Unfortunately, African countries have not built reliable basis of data or indexes.**
- Long-term credit ratings assigned by the major credit rating agencies (S&P, Moody's, Fitch) reflect this: only 8% of African countries, depending on the rating agency, benefit from an investment grade rating above BBB- relative to 44% of the other developing countries
- Arei phase two could enhance **partnerships with initiatives providing substantial resources on de-risking providing them with essential political backing and institutional linkages.**

Institutional framework risks of countries

- The diversity of countries and the different political structures and approaches make it hard to propose a single framework. However, there are some common and fundamental aspects:

  • **governments and public institutions to display a strong and long-term commitment** to the advancement of renewable energy solutions and necessary energy policy reforms.

  • **national legal and regulatory framework to be stable, clear, and transparent**, avoiding retroactive changes that would impact business models' stability of **projects**.

  • **consistent and reliable energy planning methodologies**, based on technical capabilities, to support an appropriate energy mix and ensure predictability of country's strategic choices.

  • **independent capable energy regulatory bodies** responsible for good **governance** of electricity markets and their implementation (i.e., market rules, license issuing, grid codes, etc.).

  • **energy planning institutions** dedicated to identifying the necessary investments to meet the projected demand at the lowest cost.

- **AREI has carried out a study in MAY 21 on the uptake of policies (general RE policies not for private sector investments)**

Table **Uptake of Renewable Energy / Energy Efficiency Policies by African Countries**		
	Countries with high uptake of RE/EE policies (Number of policy instruments adopted in bracket)	**Countries needing improvements in uptake of RE/EE policies (Number of policy instruments adopted in bracket)**
Central Africa	High uptake of RE/EE policies: Angola (5)	Burundi (2), Cameroun (3), CAR (1), Chad (1), DR Congo (2), Eritrea (2), Rep. of Congo (2)
East Africa and Indian Ocean	High uptake of RE/EE policies: Kenya (8), Rwanda (6), Tanzania (8), Uganda (5) On-course towards high uptake of policies: Ethiopia (4)	Comoros (2), Djibouti (2), Sao Tomé (2), Sudan (3), Somalia (1), South Sudan (1)
North Africa	High uptake of RE/EE policies: Algeria (6), Egypt (7), Morocco (5), Tunisia (7)	Libya (3), Mauritania (2)
Southern Africa	Lesotho (8), Malawi (8), Mozambique (6), South Africa (8), Zambia (6), Zimbabwe (5)	Eswatini (2)
West Africa	High uptake of RE/EE policies: Burkina Faso (6), Cabo Verde (7), Ghana (10), Mali (5), Mauritius (6), Madagascar (4), Nigeria (7), Senegal (7), Mali (5) On-course towards high uptake of policies: Côte d'Ivoire (4), Liberia (4), Niger (4)	Benin (3), Gambia (3), Guinea (3), Guinea Bissau (3),), Sierra Leone (2), Togo (3)

Which ministry and on which desk my energy investment dossier is blocked?

- **The situation in countries with low uptake on RE EE regulations must be changed radically.**
- **To act on this, political leaders must know which different authority in a country is responsible for which different risk**
- Various ministries hold the following risks:

- Land rights
- Local labour content
- Technology transfer requirements
- Licensing/permitting
- Host country law imposed for dispute resolution
- Investment laws

Understanding and defining country-level risks

- RE investors face the risk of asset expropriation or nationalization, foreign exchange and convertibility restrictions, access to land or taxation, connectivity issues, as well as overall political stability.
- Steps taken to address these areas of risk may include adopting investment laws that provide a level of protection
- However foreign investors prefer to have the right to resort to international law and/or arbitration for investment dispute resolution and settlement purposes, national governments are often against such options.

Understanding and defining country-level risks

- **The Ministry of finance and the central bank** hold the following risks:

- Investment laws
- Import duties
- Withholding taxes
- Foreign exchange: Availability – Convertibility - Transferability

Understanding and defining country-level risks

- Servicing hard/foreign currency debts **is difficult their foreign currency reserves are often limited, no budgetary flexibility to commit to additional debt significant exchange control restrictions capital transfer limitations**

- A solution is providing convertibility guarantees or foreign- currency denominated contracts

- Withholding tax on interest payments **is another risk**

- One solution is for national governments to consider providing individual projects with incentives, such as partial tax breaks and exemptions or granting the best favourable conditions offered by the countries in the competition for award.

- An umbrella solution that can be resorted is procuring insurance cover for political risks, as well as force majeure events

Understanding and defining country-level risks

- **Ministry of energy and/or authorities emanated from it, hold the following risks:**
- Generation-intermittency
- Transmission-connectivity
- Distribution-payment collection
- We need RE /EE institutions able to perform the work.
- From the study of AREI May 2021

Understanding and defining country-level risks

- **IN the sphere of influence of Ministry of Energy major problems could come from the absence of clear rules, such as grid codes,**
- **At a practical level, in general** developers may face bureaucratic and redundant licensing and permitting requirements, all of which need to be obtained from several different governmental departments
- **Then there are many other public authorities….**
- Private investors typically react to the country-level risks outlined above by requiring further guarantees and assurances. These reactions are somehow irrational as the investors see the financial coverage as a coverage not only for the financial risks but for the whole list of risks. These requests by the private investor end up in complicating the matter further as they are often in the form of additional contractual provisions defined in the PPAs that add more layers of complexity to contract negotiation and increase the risks of failure.

Understanding and defining country-level risks

- THE RISK OF NOT HAVING DOMESTIC RESOURCES MOBILISED

DRM It is a complex issue, but it shows domestic commitments and tractions behind the rhetoric of RE which is necessary to show counterpart funds, national sources for guarantees insurances, subsidies for the poorest. In other words, it is essential for AREI to assist countries in this effort that gradually must become prevalent in the range of instruments.

- DRM as a policy advocacy push is within the scope of AREI

Domestic resource mobilization (DRM) domestic financial resources include both private (household and institutional savings channeled towards investment, for example, through commercial finance market) and public (taxation, public borrowing) resources.

AREI RE/EE phase two agenda on DRM

- **Fiscal/budget allocation to the RE/EE sector**: the first step

- **Potential energy efficiency-related savings: for** Sub-Saharan Africa, this saving could amount US3.3 billion savings per year

- **Domestic and regional green bonds**: The size of debt capital markets in sub-Saharan Africa is US$300 billion small. African countries and regional DFI should occupy this space

- **Pension assets**: This area is very promising and politically powerful. Let us invest in our own country. **African political and financial authorities should consider reforms and laws aimed at allowing their public pension funds to invest directly in Africa.**

- **Regional/intra-African FDI:** Regional FDI is essential : increased awareness of intra-African FDI and proactive promotion of such investments through relevant platforms, including the identification of the concerned investors and the facilitation of such investments

AREI phase two: De-risking project risks
Before the project materialise, we have the fundamental issue of procurement.

- **How many MWs are to be installed? By when? What is the process to procure them?**
- **The adoption of a transparent and, as much as possible, competitive procurement procedure to allow governments to procure the best infrastructure at the least cost, and to allow project developers to benefit from the advantages of a common and level playing field can reduce the procurement risks.**
- **PPPs policies are as good as the people posted to implement them. Fine lawyers, fine financial and technical specialists in the negotiating role are desperately needed and to a certain extent they must be in-house. In procurement the value chain of energy needs to be defined. How the MW will be evacuated?** Transmission lines, sub-stations, and a grid that can evacuate energy without destabilization or cuts.
- The case of Turkana wind project in Kenya has demonstrated this.
- *Guidelines for successful PPP implementation, European Commission, 2003 edit. R Ridolfi https://ec.europa.eu/regional_policy/sources/docgener/guides/ppp_en.pdf*

AREI phase II : execution risks

- The private sector holds the following risks (some of them must be hedged completely if we want to see the project to materialise) We distinguish during construction:

- Cost overruns
- Delays
- Performance shortfall
- Expropriation/nationalization risk
- Site selection risk
- Land dispute risk

A way to address the execution risks is an **EPC contract (engineering/procurement/ construction)** that envisages penalties and liquidated damages for a delay in the construction or cost overruns and ensures that these risks are totally or partially transferred from the project to the EPC contractor.

AREI phase II: De-risking project risks

- **For project financial risks tools exists like the EIP investment plan guarantees of the EFSD (EU) and before them the blended finance approach of the EU. We can also mention IFC's Private Sector Window for guarantees. But this can only work if the other risks listed are also properly understood and proactively managed.** During management we have different risks:

- Expropriation
- Nationalization
- Strikes
- Riots
- War
- Sabotage & terrorism

A good quality PPA contract to define and secure project revenue streams, typically requiring the off taker to buy all or most of the electricity produced at a pre-determined price can reduce these risks.

Freely adapted from M MORGAN LANDY, SENIOR DIRECTOR GLOBAL INFRASTRUCTURE AND NATURAL RESOURCES, INTERNATIONAL FINANCE CORPORATION (IFC) WORLD BANK GROUP

AREI phase two: De-risking project risks

- **Some forms of indexation, either to a hard currency and/or to inflation**, to ensure the adequacy of revenue streams defined by the PPA may reduce the currency risk further.
- **Contractual provisions,** also considered inside the PPA structure, must deal with some other important risks, such as curtailment compensation, force majeure (typically exempting both parties from their obligations for a limited period) and termination (covering the default risk from either the off-taker or the generator side).
- Risks within the off taker of the PPA:
- Revenue flow
- Off-taker creditworthiness/payment risk
- Termination payment risk

AREI phase II: De-risking project risks

Public utilities in Africa face a multitude of challenges which undermine their financial stability.
One way of addressing this is for governments to provide public counter-guarantees on the off-take payments.

Risks with lenders

- Debt
- Foreign exchange
- Availability risk
- Convertibility risk
- Transferability risk

In many African countries, strong political direction, and budgetary/fiscal allocations to the sector, via renewable access energy funds are critical and are one of the most important objectives of AREI phase 2.

- **The lesson from the analysis of existing de-risking schemes and tools is that we need one stop shop where all these are offered. Otherwise, different procedures by donors and lenders, different timing different political priorities will make the project derailing.**

- Some practical principles that must direct actions emerge as conclusions from the analysis and understanding of project related risks.

(i) project risks are typically best addressed by those entities most suited to bear and manage them,

(ii) (ii)finding appropriate risk coverage is clearly fundamental to the ultimate success or failure of a project, successfully achieving this will also require a high degree of collaboration and cooperation amongst all project stakeholders

(iii) effective and locally fit-for-purpose risk mitigation products and de-risking instruments will be fundamental to build other success stories.

- The provision of these products and instruments can then create the market conditions for more attractive risk/reward profiles, helping to shift an unattractive investment opportunity into a commercially attractive one in the minds of private investors

Other than commercial financing..

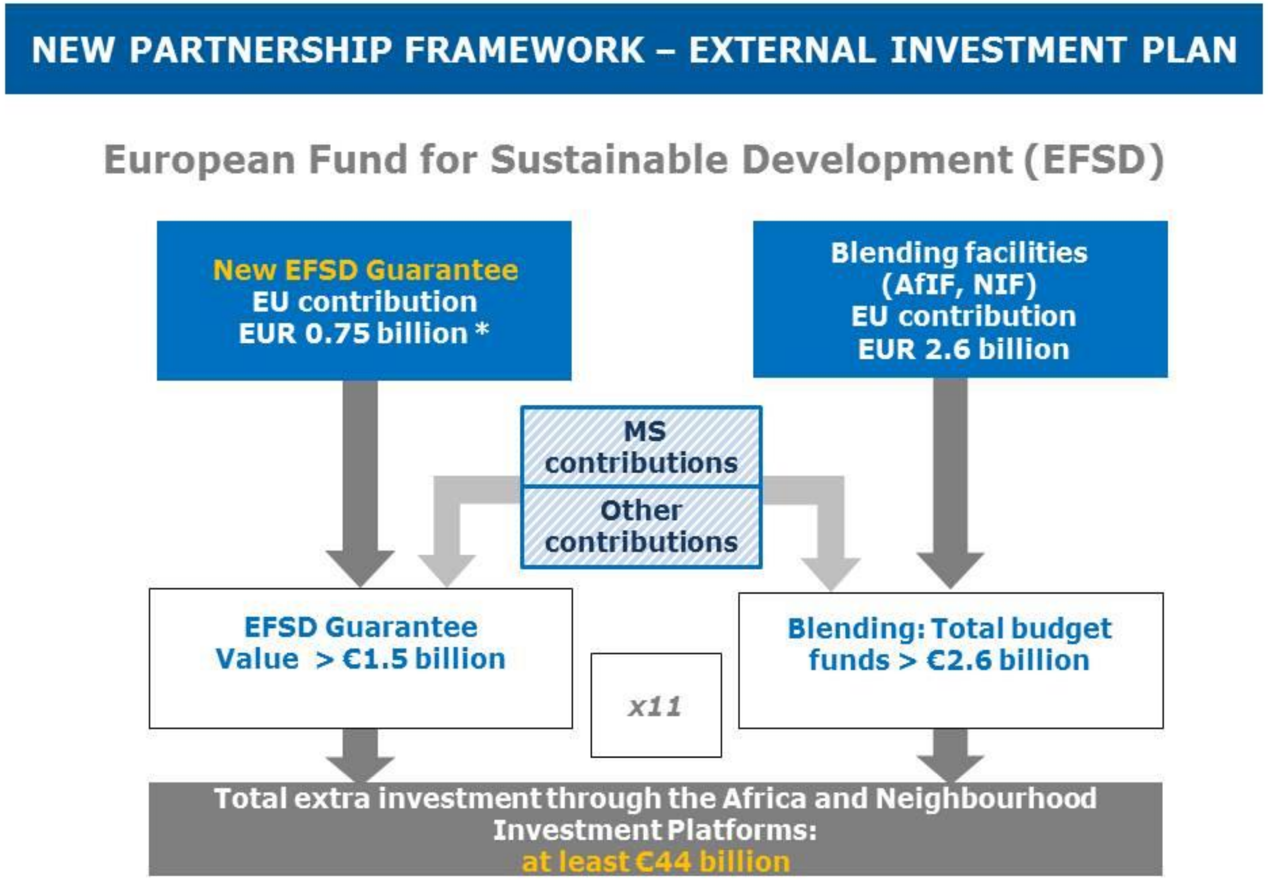
- Private sector investments
- International Finance corporation
- The European Development Finance Institutions
- BMGF Rockfeller Bezos Ikea others
- Impact investors
- Dedicated funds
- etc

- The most interesting innovation in the last 15 years is blending

- 25.3

end

EU-External Investment Plan
Pillar 1 - Resources from EU and leverage



* Plus a EUR 0.75 billion contingent liability.

Source EC 2017

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The EFSD Guarantee

Investment Windows – Suggested areas

1. **Sustainable Energy and Connectivity**
2. **Micro, Small and Medium Sized Enterprises (MSMEs) Financing (including agriculture and agribusiness)**
3. **Sustainable Agriculture, Rural Entrepreneurs and Agribusiness**
4. **Sustainable Cities**
5. **Digital for Development**

AREI PHASE II: THE PUBLIC ACTION TO MOBILISE PRIVATE INVESTMENTS

Policy and political dialogue within African countries countries

- Enable business to operate formally, increase the level of investment and innovation, encourage the creation of jobs
- Reducing business costs
- Reducing risks and uncertainty
- Addressing anti-competitive behaviour and opening up markets

Structured dialogue with business

- United voice for the local private sector – advocacy, networking and exchange of information
- Informed policy dialogue on the business environment
- Business fora - important partners in supporting partner country development AND the partnerships of foreign businesses

Country wide energy policy value chains analysis

- Intelligence: regulatory environment, judicial security, contract enforcement, investment protection, skills, market intelligence, land tenure, access to finance, etc
- Broader investment climate (financial markets, rule of law, political stability, logistics, infrastructure, etc)
- RE and EE specific constraints

Coordination and coherence

- Look for different initiative contributions (project prep , DRM, TA on policy)
- Key role for political support to financial and technical initiatives
- African initiatives coordination

Promoting a conducive investment climate

We can define Domestic Resource Mobilisation

THE STRATEGIC USE OF A LIMITED

AMOUNT OF GOVERNMENT RESOURCES TO MOBILISE

ADDITIONAL FINANCING FROM PARTNER COUNTRIES, FINANCIAL INSTITUTIONS

AND THE PRIVATE SECTOR.

THE OBJECTIVE IS TO ENHANCE THE DEVELOPMENT IMPACT OF INVESTMENT PROJECTS

AREI phase II De-RISKING:walking the talk: putting the money where the mouth is

Objectives of DRM

- **Financial Leverage** additional public and private resources for stronger development impact.
- **Non-financial** Improve project sustainability & speed. More financial discipline & ownership by national agencies and ministries.
- **Policy Support to reforms**. More weight in policy dialogue and international negotiations.
- **Cooperation & coordination of often competing donors, investors and initiatives.**
- **Increased visibility of the government on international negotiations COP, etc**

AREI phase II : De-risking Conclusions 1/4

- **AREI may:**

1. **assist countries to identify the most relevant market challenges via studies and peer to peer:**

- Inefficiencies in governance of the sector and implementation of policies.
- Fitness of business environment.
- Fitness of competition and project procurement rules.
- Financial sustainability of public off-takers.
- Fitness of market structure, legal framework, currency issues.
- coherence and transparency of energy regulations regarding private sector participation.
- general lack of legal and technical capacities in local institutions to efficiently manage project phases, from preparation to operation

1. **assist governments using peer to peer approaches and examples from African countries complemented by technical assistance:**

- **to display a strong and long-term commitment** to the advancement of renewable energy solutions and necessary energy policy reforms.
- **stabilise national legal and regulatory frameworks** avoiding retroactive changes that would impact business models' stability of **projects**
- **in drafting consistent and reliable energy planning methodologies**, based on technical capabilities, to support an appropriate energy mix and ensure predictability of country's strategic choices.
- **ensure independent capable energy regulatory bodies** responsible for good **governance** of electricity markets and their implementation (i.e., market rules, license issuing, grid codes, etc.).
- **to make clear to investors** which different authority in a country is responsible for which different risk. In this report the various risks were attributed not in general to the public or to governments but specifically to different ministries or agencies.

1. **Promote Domestic resource mobilization at the highest political level to those opportunities exist and to push for:**

- **Fiscal/budget allocation to the RE/EE sector**
- **Potential energy efficiency-related savings**
- **Domestic and regional green bonds**
- **Pension assets:** African political and financial authorities should consider reforms and laws aimed at allowing their public pension funds to invest directly in Africa.
- **Regional/intra-African FDI**

AREI phase II: De-risking for the private sector 4/4

1. **assist in the training of officials and dissemination** of best practices to analyse and **understand** project risks in public bodies and agencies

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Thank you