Private Infrastructure Development Group

Green Africa Power (GAP): Overview

Background and need: More than 700 million inhabitants of Sub-Saharan Africa lack access to electricity. There is a shortage of all power generation projects in Africa, but particularly of renewables. Pronounced market failures inhibiting the growth of renewables in the Region are:

1. Lack of cost reflective tariffs;
2. High upfront cost which makes projects less easy to finance, particularly when only short-term loans are available from local banks;
3. Specific risks e.g. of construction delays and off-taker payment default, deterring potential financiers.

Objective and intervention: GAP is to encourage renewable energy generation projects in Africa. It aims to address the above barriers by:

- reducing the upfront cost of capital, while maintaining overall commercial returns;
- providing cover for specific construction phase risks;
- policy dialogue to move towards cost reflective tariffs.

GAP incorporates key design **principles** of clear policy and project additionality (GAP is explicitly restricted to projects that would be highly likely not otherwise to proceed because of existing market failures), minimum subsidy, demonstration effect, minimum distortion and strong governance.

Instruments: GAP will deploy two financial instruments and one policy instrument, each of which will be individually negotiated and tailored to fit the specific circumstances of the project concerned:

1. **GAP Quasi Capital:** A tranche of long term capital which, in the event of insolvency, will rank junior to all other senior and mezzanine loans but above equity. It would have the key characteristic that a minimum coupon would be paid as soon as Financing Agreements with other lenders allow but the remainder of the coupon (to achieve an overall reasonable return on capital established on a project by project basis) and the capital repayment, would not be paid until a threshold IRR had been achieved by equity participants. If the project generates cashflows in line with expectations (see paragraph 3. below) then the effect of these terms would be to "back-end load" the cashflows received by GAP beyond the first few years of the project.
2. **Contingent Line of Credit**: A guarantee that provides additional comfort to lenders on top of the debt service reserve account, to be drawn down in case of delays or cost over-runs in construction. If drawn the advance would have the same features as detailed in paragraph 1. above.
3. **Policy Dialogue**: GAP will encourage host countries to move towards cost-reflective tariffs, providing them with support to do so and buying them time to build political and public support for tariff increases. The offtaker and its government sponsors and regulators might agree a power purchase agreement ('PPA') with a graduated rise in tariffs to the level required for the project to be viable, with the low GAP return enabling the project to achieve financial viability in early years. The additional cashflow in the later part of the PPA period would allow GAP support to be repaid and a reasonable return delivered, while allowing the developer to make a fair equity return, and supporting on commercial terms a conventional

debt package making up the full amount of capital needed for the project. In this way, GAP will help over time to "nudge" client power systems towards cost reflectivity for their renewable plants.

For the proportion of funding that GAP receives from the UK's International Climate Fund (about 50%), GAP will seek commitments from projects that they will not register for Carbon Emission Reduction Certificates (CERs) or if they do so, the CERs will be assigned to and cancelled by GAP. For the remaining projects it finances, GAP will require that it be assigned the majority of the available CERs, which may be sold on at the Board's discretion.

Results: GAP aims to support projects that will install ~270MW of renewable energy in DAC I, II and III countries in Africa in 4 years, avoiding an estimated 2.3 million tonnes of CO_2 emissions. It is expected to leverage twice as much private sector finance and an equal amount from Development Finance Institutions. GAP would be a long term source of financing support to projects meeting its Investment Policy to facilitate such projects achieving financial close and being successfully implemented.

Management: GAP is an initiative of the Private Infrastructure Development Group (PIDG - www.pidg.org). PIDG is a multi-donor organisation to promote private sector investment in infrastructure in the poorest countries, principally Africa. Like all PIDG activities, GAP is aimed at supporting specific, discrete projects. The PIDG structure and system of governance involves, wherever possible, PIDG operating units, also known as facilities, being established as public-private partnerships in which management is contractually entrusted to for-profit private sector managers selected through competitive procurement exercises to select the optimum combination of effectiveness and value-for-money. Balancing on one side, the donors' principal concern for development impact and diminution of the market failures reducing private investment in infrastructure in the poorest developing countries, and on the other side, the manager's pursuit of profit, are: PIDG's governance system, together with its code of conduct; each specific facility's "made-to-measure" investment policies and operating procedures; and the oversight of the particular facility's independent Board of Directors. An advantage of the PIDG system is that private sector actors make commercial judgments and development policy officials make development policy decisions which come together to create shared value. GAP will therefore be implemented as a new PIDG facility under the PIDG Trust, with an independent Board and, under the Board's aegis, a Manager procured competitively. Project level decision making will be the responsibility of the GAP Board, in response to recommendations from the Manager. GAP expects to become operational in 2013.

Funding: The UK has approved funding of up to £95 million to capitalise GAP and £3 million for Monitoring and Evaluation and knowledge management. This includes contributions from DFID's Climate and Environment and Private Sector Departments and from the Department of Energy and Climate Change (DECC), via the International Climate Fund. Norway and Sweden are also considering co-financing GAP.