AFRICAN INFRASTRUCTURE GUARANTEE SCHEME

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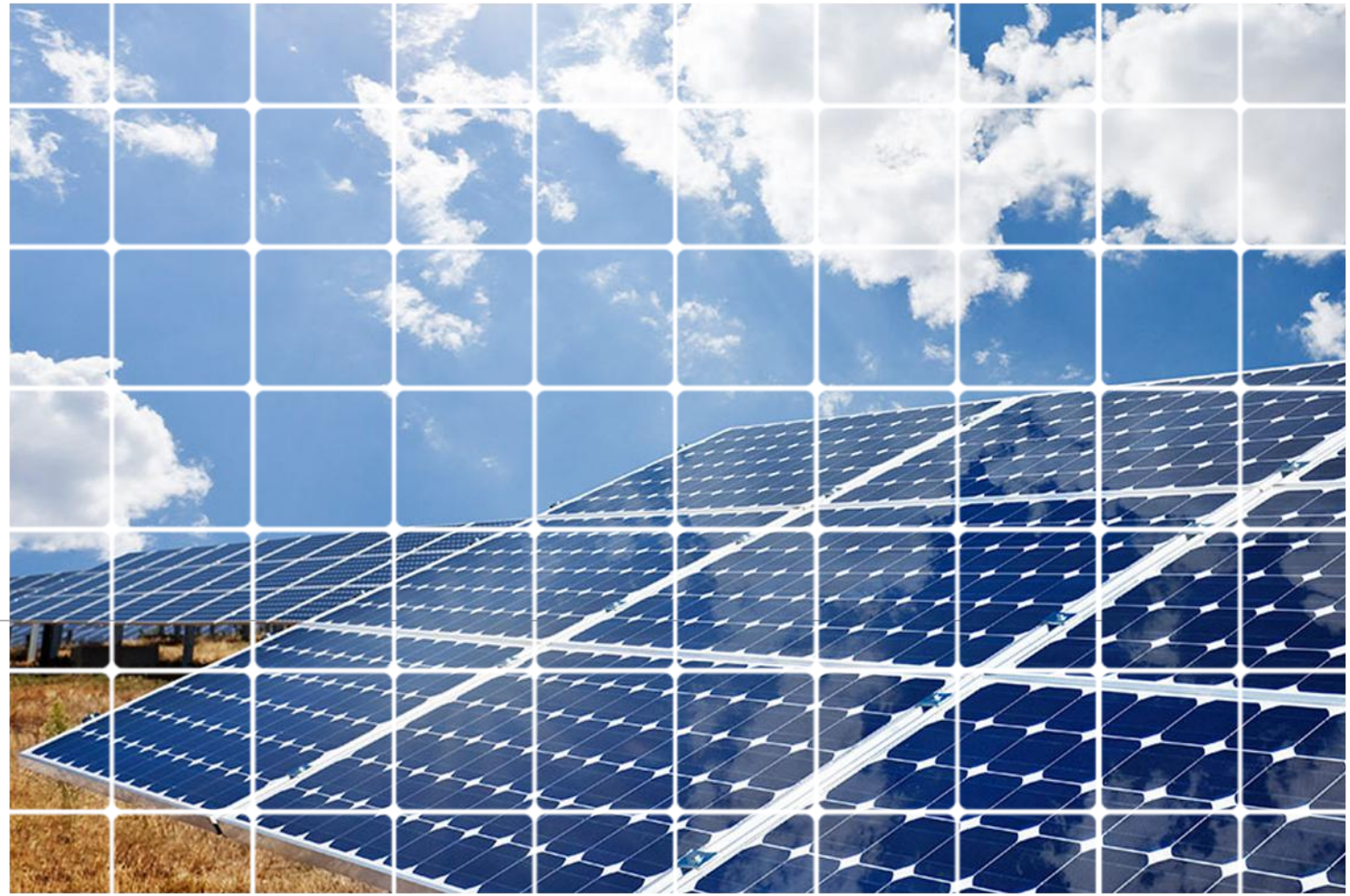

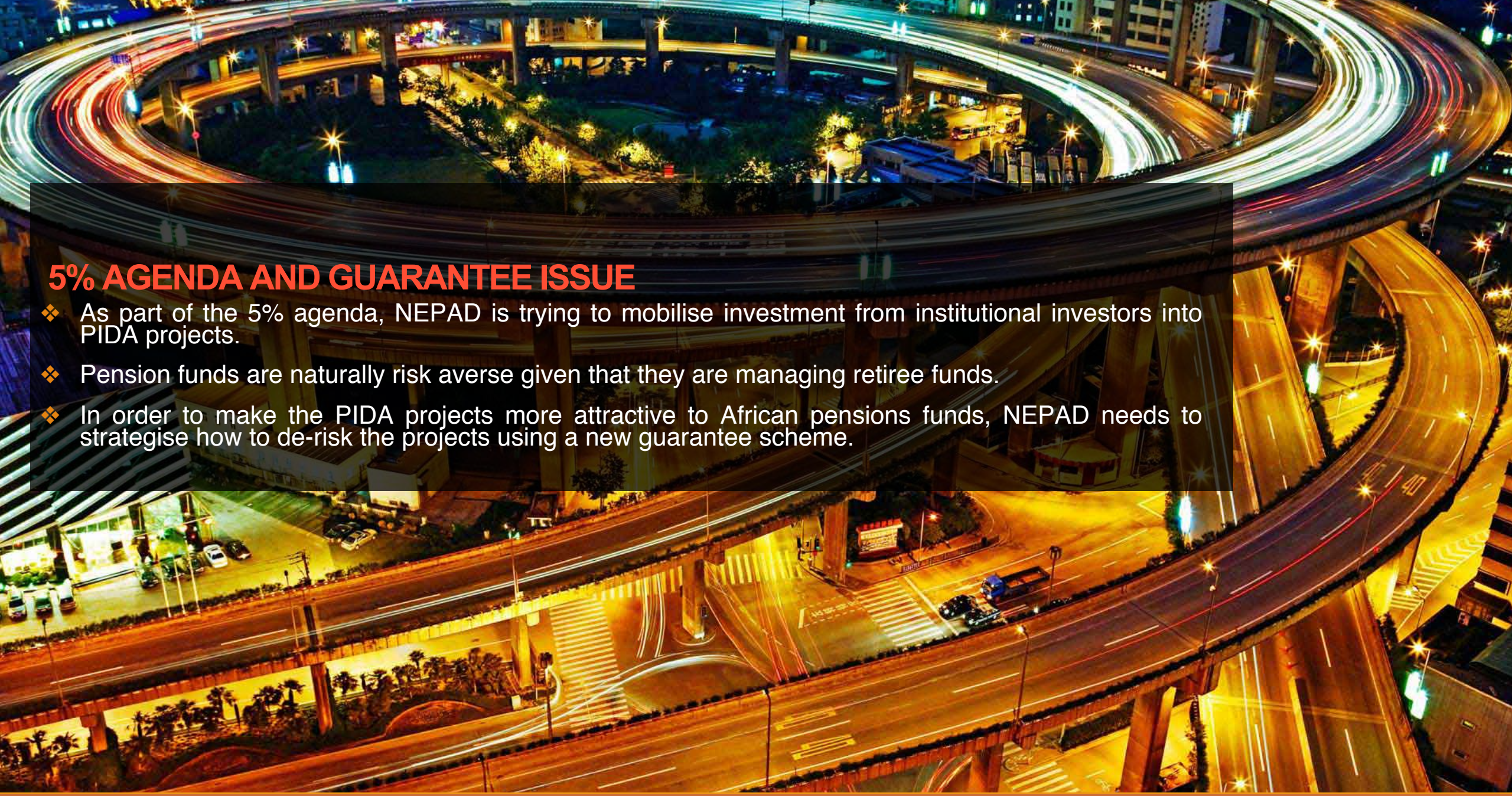

5% AGENDA AND GUARANTEE ISSUE

- As part of the 5% agenda, NEPAD is trying to mobilise investment from institutional investors into PIDA projects.
- Pension funds are naturally risk averse given that they are managing retiree funds.
- In order to make the PIDA projects more attractive to African pensions funds, NEPAD needs to strategise how to de-risk the projects using a new guarantee scheme.

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INFRASTRUCTURE RISKS

When investing in PIDA projects, which range across several sectors, institutional investors will face several major risks that could be reduced:

- Development risk: a major concern for pension funds is the early stage risk of a project.
- Construction risk: issues that might arise during the construction phase of the project.
- Political risk: e.g. force majeure, civil unrest
- Currency risk : protection against volatile exchange rates and repatriation issues.
- Payment risk: major issue in Africa is the credibility of off-takers and their ability to stick to contracts and payment schedules. Big issue in power.

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THE ELUSIVE SOVEREIGN GUARANTEE

Due to a lack of credible off-takers, investors started asking for sovereign guarantees from governments. Essentially Ministry of Finance stating if the off-taker defaults they will pick up the bill from central budget. However governments and donors can dislike them because:

- **Long term commitment:** they are a long term commitment despite what changes might happen e.g. technology prices decreasing / government policy change.
- **Issues with Donors:** sovereign guarantee are a liability on a government's balance sheets. Can reduce borrowing ability.
- **Not 100% reliable:** Even when sovereign guarantees are issued governments still might not pay e.g. TANESCO not paying Songas in Tanzania.

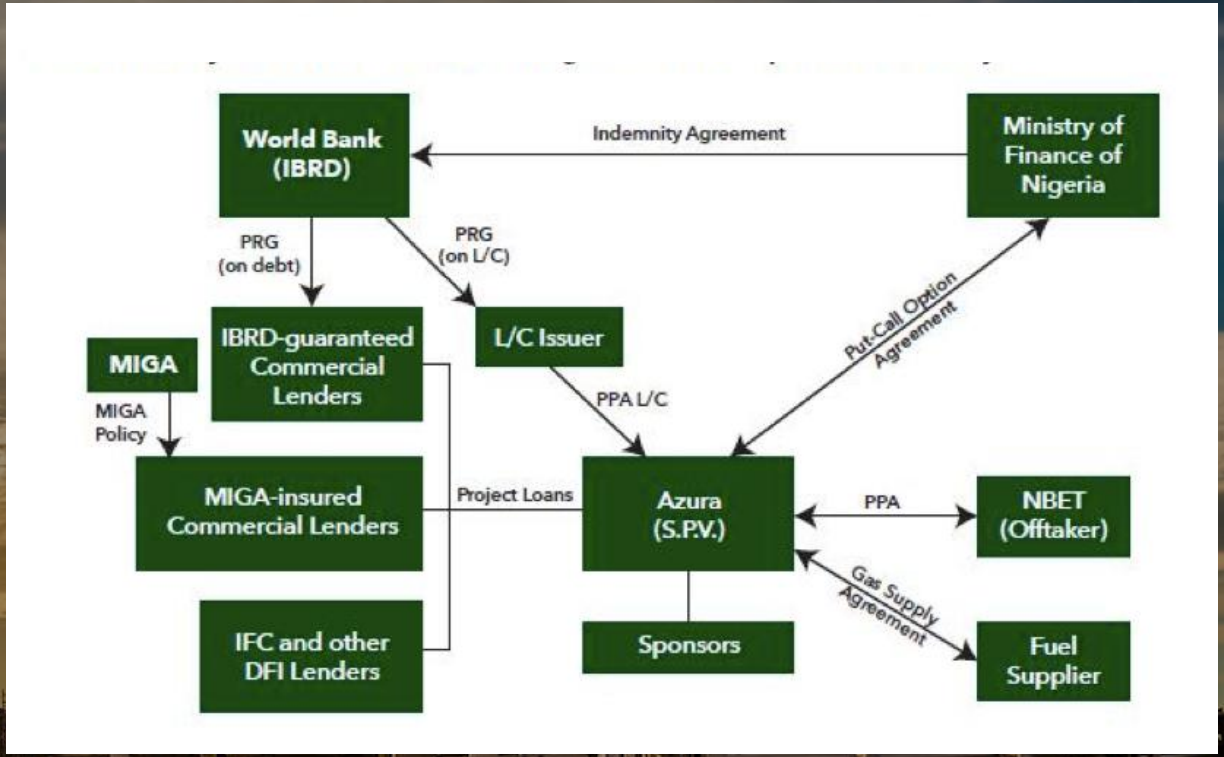
ALTERNATIVES TO SOVEREIGN GUARANTEES

Due to the various issues with sovereign guarantees several alternatives have emerged:

- **Letter of support:** an alternative to sovereign guarantees is a letter of support to show government commitment to the project.
- **Liquidity facility:** gives the project company protection against short term defaults / revenue interruption. normally up to six months. Also escrow accounts can be an option.
- **Partial Guarantees:** normally offered by DFIs like World Bank / AfDB these will protect the lender up to a certain value. *(Over reliance on DFIs)*
- **Political Risk Insurance** - *force majeure e.g. MIGA*
- **Put Call Option**: if either side breaches the contract then this gives the project company the ability to initiate 'call' option requesting the government to buy back the asset / shares in SPV. Alternatively, the 'put' option enables the government to request the same from project company. *(Governments can't afford asset or operate)*

CASE STUDY: AZURA-EDO (NIGERIA)

- **A US$877 million** 450-500 MW gas plant located in the North Eastern outskirts of Benin City in Edo, Nigeria.
- Nigeria has a 6000MW **capacity** but **only 300MW** is running, **poor payment collection** so off-takers have high payment risk and history of defaults.
- Twenty major investors came together to make much needed project happen and worked with the World Bank for for an **adequate credit wrapping**.
- The result, was a '**put-call' option**, plus a letter of credit for liquidity and a MIGA policy covering up to $420 million. Plus having the world bank involved gave extra confidence to investors.
- Good example of how **several layers of credit** enhancement mechanism can help a project reach financial close. (Janaury 2016)



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CASE STUDY – THAMES TIDEWAY, LONDON, UK

- Even in developed markets like Europe there is still a need for government guarantees to support risky and ground-breaking infrastructure projects.
- Pensions funds were interested to invest in the project but were concerned by early stage risks.
- Government stepped in to de-risk the development stage and construction risks.
- Investors will receive income from day one and covered by tax payers.
- Government will guarantee against construction risks, financial risks, and even if debt cannot raised then there is a liquidity mechanism.
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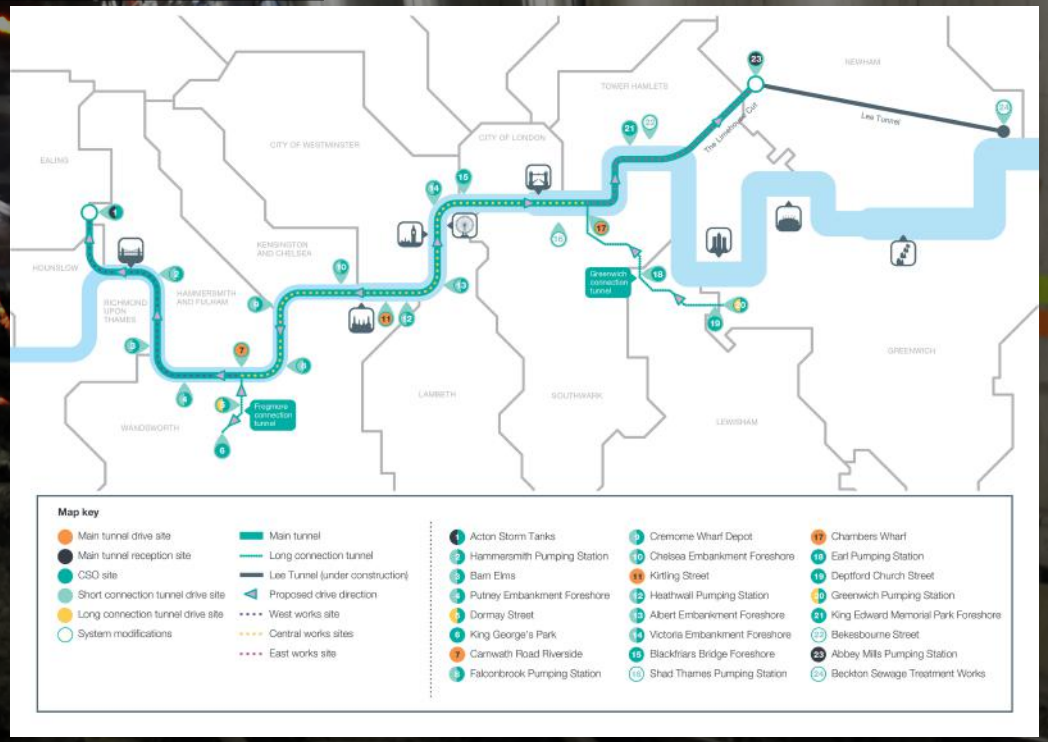

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INNOVATIVE INFRASTRUCTURE INITIATIVES

In the last couple of years, several initiatives have been developed to mobilise investment in the African infrastructure sector and reduce reliance on sovereign guarantees. Below is a few great examples:

- **Scaling Solar:** an initiative by IFC to streamline and de-risk the development of solar in Africa. One 'stop shop'. Access to suite of World Bank risk guarantees and optional finance.
- **InfraCredit**- 100% guarantee facility In Nigeria
- **African Energy Guarantee Facility** : Guarantee by EIB for $1 billion, insured by African Trade Insurance Agency (ATI) and reinsured by Munich RE. Private insurance solution with 15 year tenor, a long tenor for Africa.
- **African GreenCo:** by acting as intermediary off-taker, the initiative aims to structurally reduce the reliance on sovereign guarantees.
- **European Fund for Sustainability Development** - a new facility that will be a one stop shop for finance and guarantees.

THE NEPAD GUARANTEE SCHEME

- Despite some good initiatives already in place, it has been highlighted that there is a need for a new scheme in order to attract institutional investors for the 5% agenda.
- Replicate the African Energy Guarantee Fund financing model: get blended finance to guarantee insurance companies. Have long tenors. Not just renewables but all PIDA infrastructure projects.
- Learn from scaling solar and make it tender based – cut out development times and project to project negotiations. Use DFIs and developers to develop the PIDA projects and de-risk before going to pension funds. Development insurance / guarantees
- Scheme could become a one-stop shop for PIDA projects - most of development done, governments on board, development de-risked. PIDA projects tendered with sufficient guarantees in place.

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FOR DISCUSSION

- International private insurance companies don't want to take on Africa, need incentives to crowd in private insurance companies. Donor first loss. (e.g. Allianz and IFC)
- How can we find solution that do not rely too much on DFI resources - more market driven / private sector solutions.
- Guarantees are not the only issue – how can the scheme improve governance issues, capacity issues etc
- Lastly, there are various guarantee facilities emerging so there is a need to be complimentary and coordinated.