Financier’s Perspective

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Session Objective:

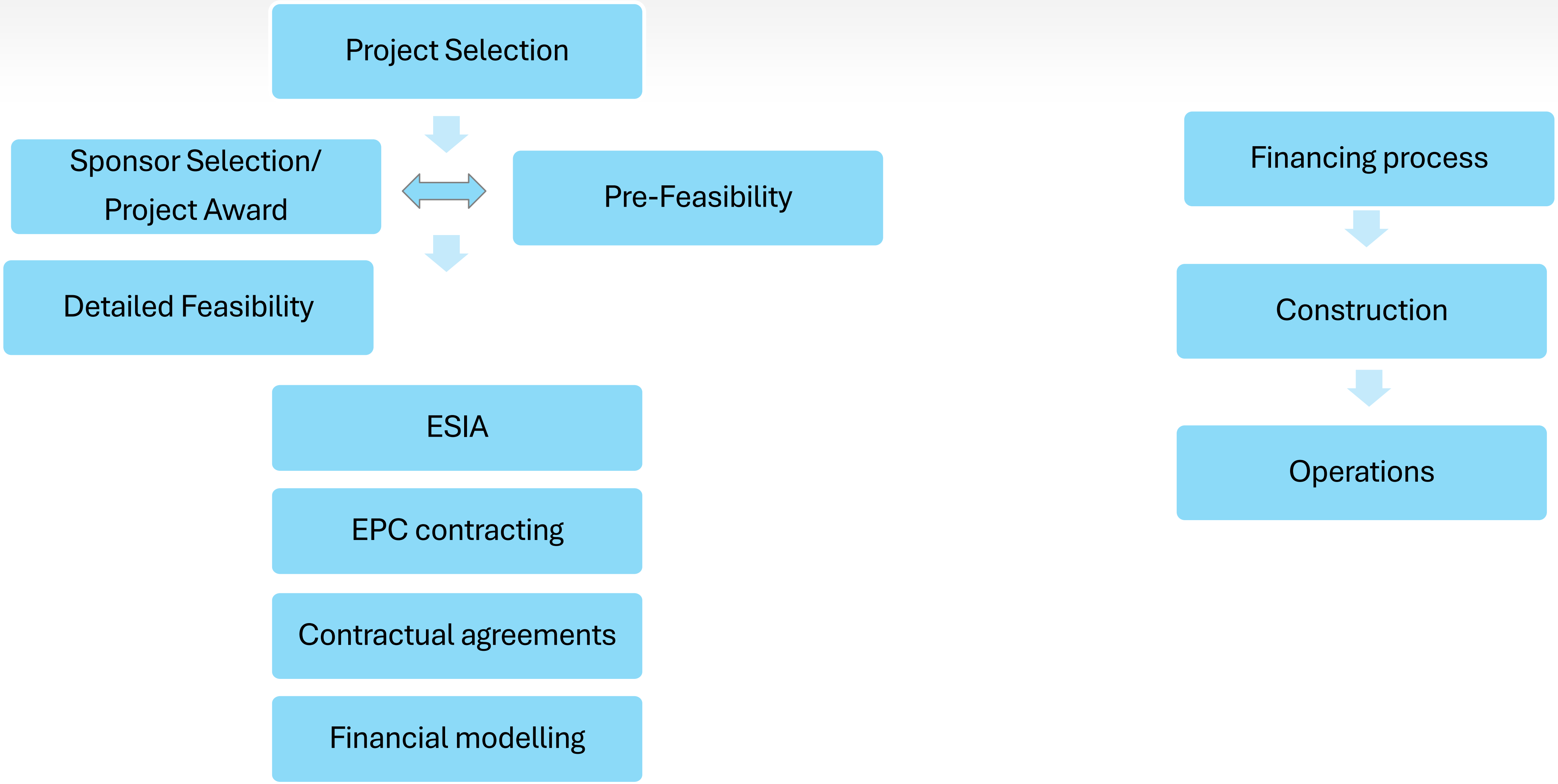
Objectives:

1. To understand the key steps/milestones in preparing and developing an IPT:
2. Be able to assess the current and required capacity to be able to deal with IPT’s

Outline

1. Project steps/Milestones
2. Project selection/rationale
3. Funding options
4. Role of DFIs
5. Project award/sponsor selection
6. E&S requirements/process
7. EPC process
8. Legal requirements/process
9. IPT Structure
10. Financing process

Project Development: Key Milestones



Project Selection/Rationale

- Planning, Planning & Planning!!
  - Before even talking about an IPT, it is critical that **a proper planning exercise is been put in place**, to evaluate & prioritize the possible transmission project. This exercise must ideally be done by the utility together with a **technically competent and independent agency** to identify a comprehensive transmission expansion plan or, at least, a short list of transmission infrastructures with defined characteristics to be built **and when**.

- In theory - the criteria must account for several costs & benefits
  - Reliability improvement, System operation cost reduction, Market building at national & regional levels, Market power mitigation, Implementation of energy policies (environmental targets, broad transmission overlays)
  - **but in practice just reliability & operating cost reduction** are the main ones considered.

- Evaluation should be done by the MoE / Regulator and once the project is approved, **no further economic justification is needed.**

- Priority Projects should be included in the National Transmission Plan

Funding Options and Related Requirements

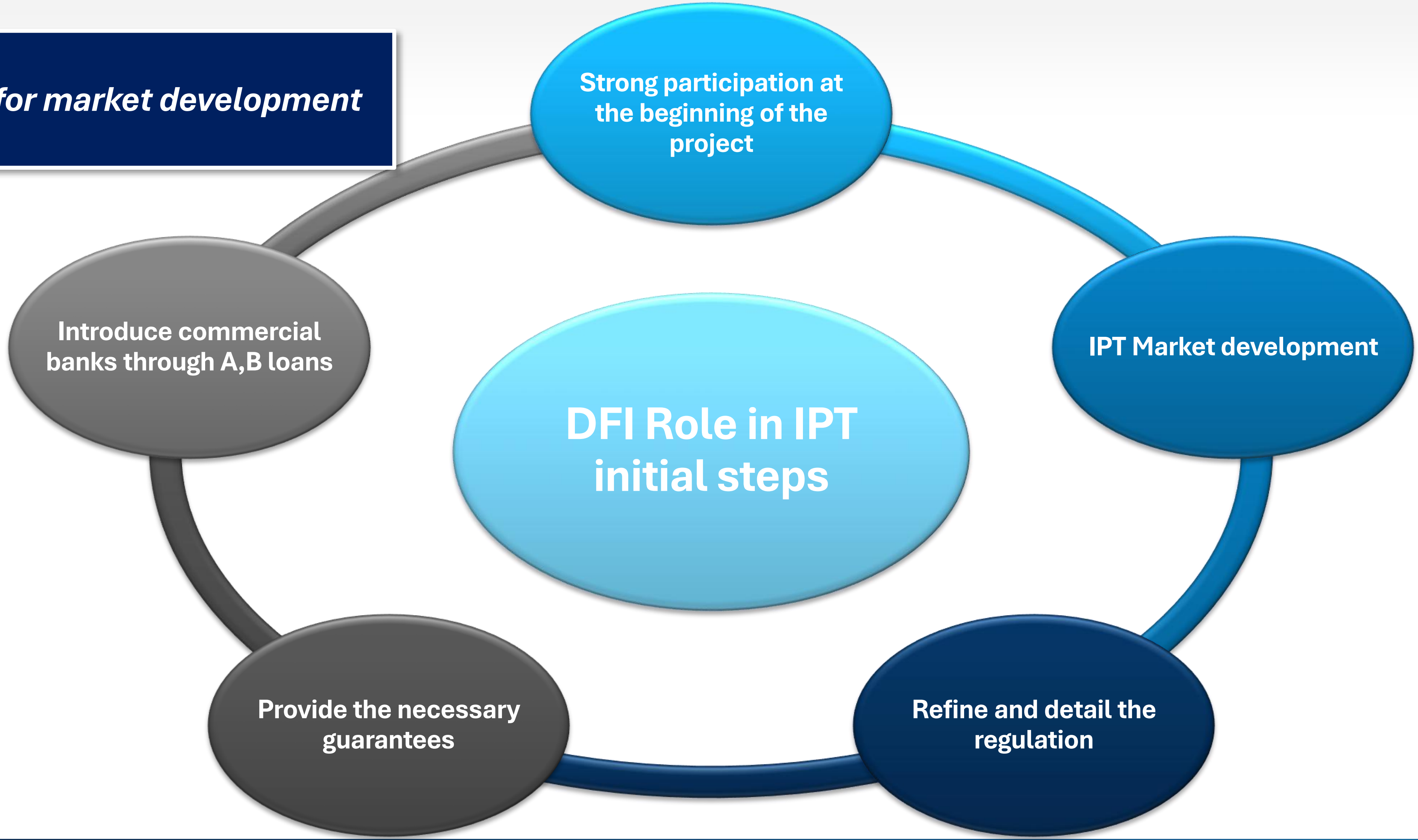
- The commercial case for the IPT project: what projects are suited for an IPT business model?
  - Projects included with **priority** in the national transmission plan.
  - Project with clear and **high utilization expectations** (critical for both investors and lenders!)
  - Projects that can be delivered **faster by the private sector**.

- The availability and cost of alternative funding sources are limited:
  - Like funds existing in the budgets at the national, ministerial, or utility level; available funding from donors; sovereign debt constraints; priorities in the use of available funds.
  - Public Funds can only be spent ones, so if interest from private sector is available …

- Size matters: IPT is **unlikely** to be a suitable solution for small projects (e.g. <US$50 million). It start to make sense from **around US$100 million** and above

Role of DFIs

DFIs are key for market development



Sponsor Selection/Project Award

Competitive tender process or negotiated agreements?

<u>Pro's & Cons' of both options</u>

- **<u>Competitive process:</u>**
  - If well prepared, will result in the best possible tariff
  - However: In order to be successful, they require a lot of preparational work, resources (incl prefeasibility studies, ESIA) and competencies, which may just not be readily available or would need capacity building
  - They may be very lengthy processes and do not always result in the expected outcome (if not prepared well)
  - Are you ready and is the market, lenders & private sector perceiving you to be ready?
- **<u>Negotiated deals:</u>**
  - By far, simpler and quicker process
  - Allows you to offload the bulk of the project preparation/development to the selected sponsor (incl costs and risks)
  - Allows you to learn whilst doing and prepare the ground for competitive processes for future projects

<u>If you opt for negotiated agreement:</u>

- Need to check own regulatory framework and check whether this is actually possible
- **Need for a strong sponsor with solid financials and track record !**
- Need for transparency in expected financial return and in cost calculation process

Environmental and Social (E&S) Considerations

- During the prefeasibility: absence of specific challenges, like environmental or social risks.
  - Any critical habitats (Natura 2000)
  - Any endangered species?
  - Social impact: Amount of Physical and economic resettlements

- A **comprehensive feasibility study** to reaffirm the need for the project. The Environmental and social impact assessment (ESIA), is usually conducted by third-party consultants. **Early consultations** with all the key stakeholders are essential.

- Land acquisition: selection of the optimum transmission line route, environmental and social impact assessments
  - Lenders will want to see a multi-option analysis, which is trying to minimize the E&S impacts (whilst not compromising the economical justification of the project)
  - **Resettlement Action Plan (RAP):** To be done in **close coordination with public entities**

EPC Strategy

- Development of an EPC procurement strategy **is done by the IPT**. The IPT company typically runs a process to choose an EPC contractor, or separate suppliers of equipment and a contractor for civil works.

- The risk allocation between the transmission utility, project company, and construction contractors may become complex, **but needs to be agreed** before being able to launch the EPC tender process

- The ToR and any specific technical requirements, are to be discussed and agreed with the Utility or transmission company who will operate the line.

- But even the line will be privately financed, the **more additional features** that are requested, the **more expensive the tariff will be**.

Legal Requirements/Considerations

Contractual framework usually consists of the following main agreements:

- Concession Agreement (CA)
- Transmission Service Agreement (TSA)
- Government Guarantees (support agreement)

Negotiation capacity: Not rocket science, negotiating these agreements **do require quite some understanding of Non-Recourse Project Finance**.

If this capacity is not available inhouse, it is **strongly recommended to have external council** to assist in the negotiations of these agreements

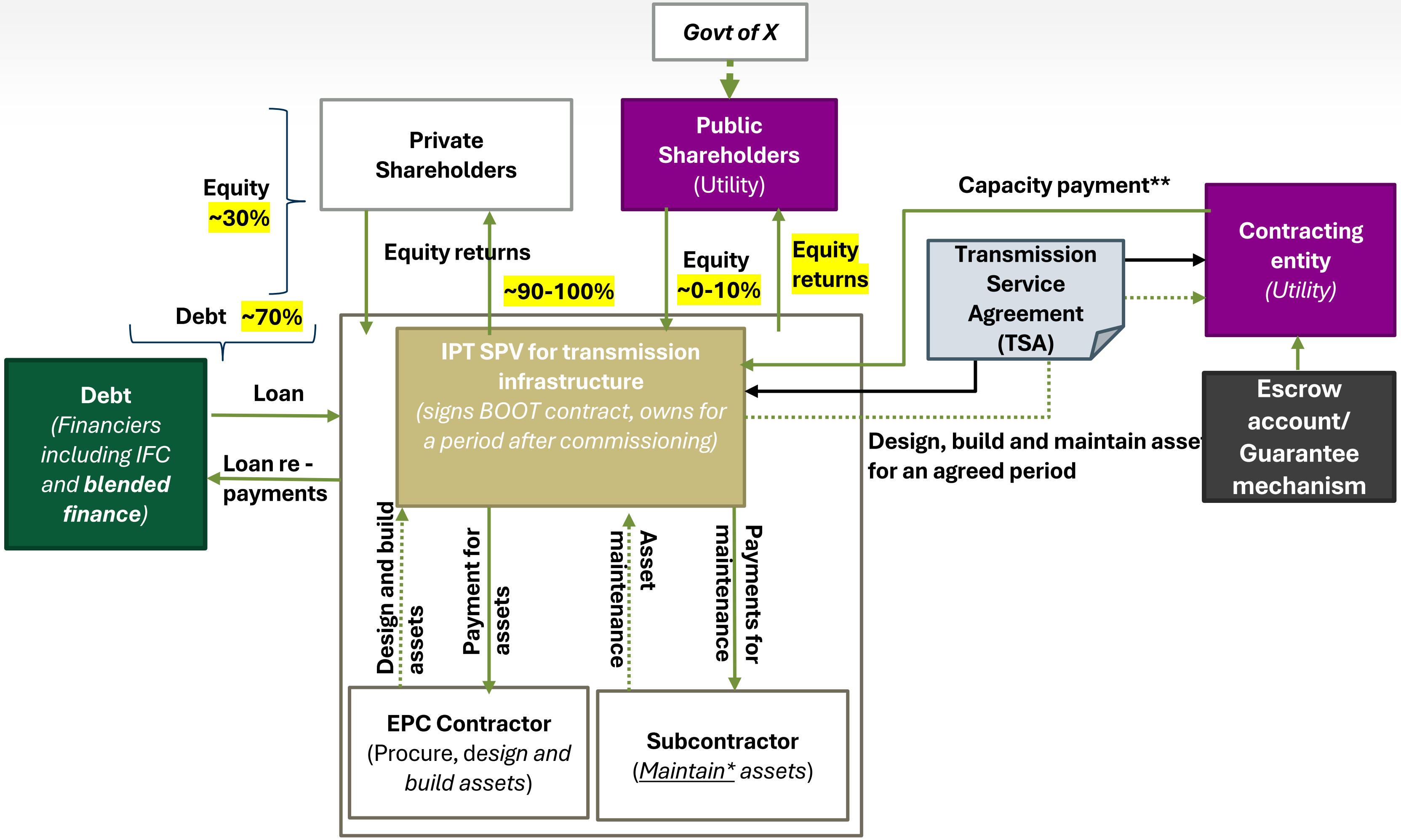
- Tariff structure (capacity payment vs merchant risk)
- Overall Risk allocation (some risks cannot be born by private sector …)

Fiscal framework

- Knowledge and availability of the fiscal incentives are critical to ensure a **competitive tariff**. Having buy-in from the MoF at an early stage, is essential to be able to take the available incentives into account in the Financial Model calculations

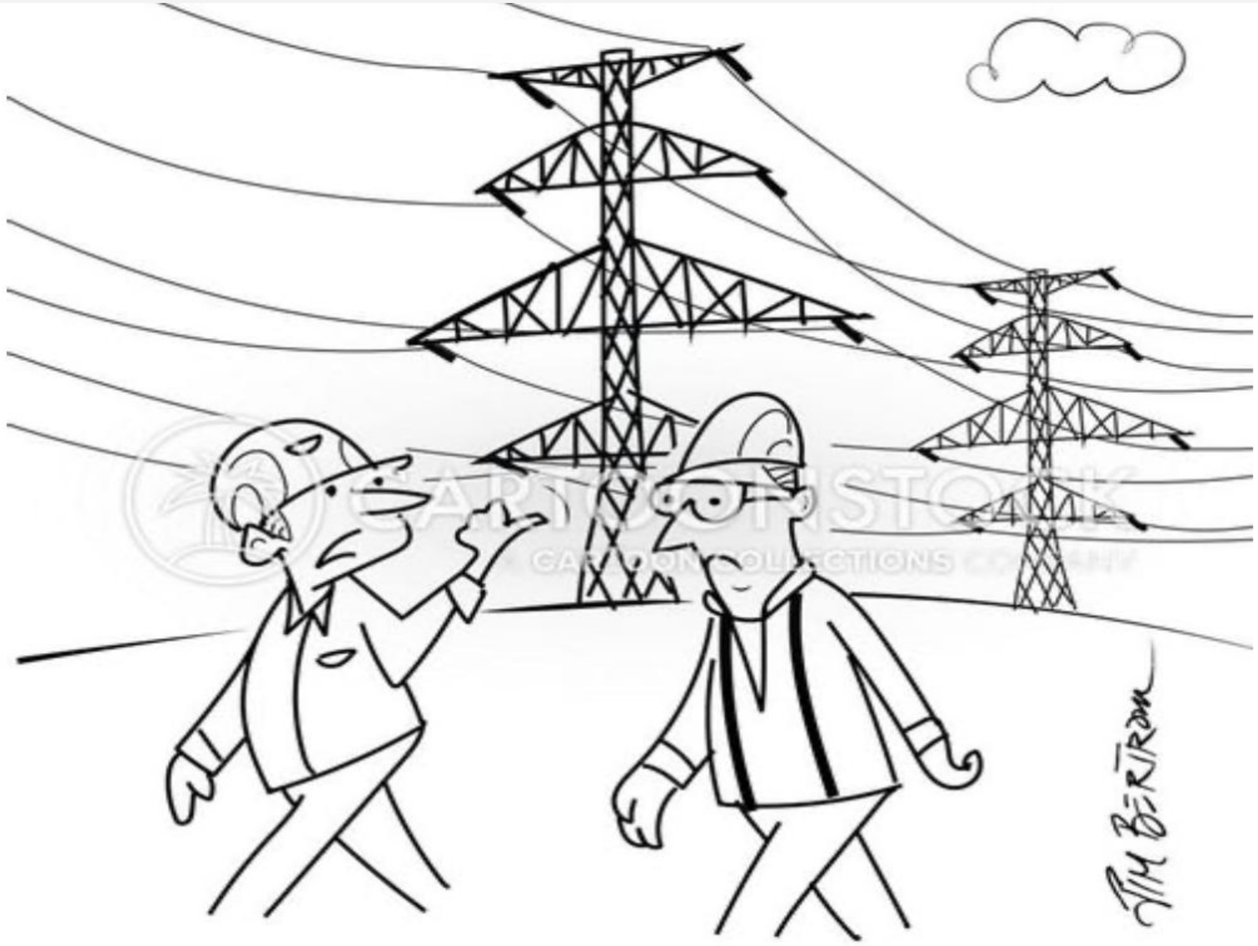
HOW WOULD AN IPT STRUCTURE LOOK?

- ✓ **SPV** to be established to Construct, Build and Own the transmission line to ringfence the revenues and ensure low risk of paying off the infrastructure costs.
- ✓ Utility could be a (minority) **shareholder of the SPV** and equity could be public/grant funded. Private shareholders could bring in further equity and expertise.
- ✓ **Utility does not lose control** over the grid and remains the System Operator on the use/operations of the line and network.
- ✓ **The SPV is responsible for the availability** of the line and can **subcontract this to the Utility, securing revenues**.
- ✓ **Africa is familiar with this structure which is like IPPs.**



* Operations remains with Utility **Fixed annual/semi-annual payment EPC- Engineer, Procure and Construct
***Only for late-stage tendering, else land risks lie with the SPV

Financing Process



"That line gets its power from burning the paperwork to approve that line."

Financing Process Requirements

- **Why are financing processes so lengthy and complicated**
  - Non-recourse project financing
    - Sponsors finance about 30% of the total project costs
    - **Lenders finance about 70%** of the total cost

- **Process:**
  - Signing of a Mandate letter with Lead arranger (who will structure the financing and mobilize the debt financing)
  - Lenders due diligence (DD)
  - Discussion/signing of financing agreements
  - Conditions Precedent (often including project agreement amendments)
  - Financial Close (first disbursement, start of construction)

- **Project finance agreements characteristics**
    - Lender's step-in rights (through direct agreements) & security rights
    - Applicable law
    - Currency/convertibility/transferability
    - Termination provisions
    - Guarantees

Interactive Discussion and Group Exercise

Interactive Discussion:

Do you currently have the capacity to go through the different steps (and engage with private sector expectations and requirements) and what competencies are you currently missing?

Group Exercise:

Identify possible mitigants to overcome the identified gaps

NO TRANSMISSION
NO TRANSITION

THANK YOU

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