March 21, 2017

[APPROVAL BY MAIL] RWANDA: RENEWABLE ENERGY FUND PROJECT (WORLD BANK) (SREP)-- XSRERW058A

Responses from the World Bank to comments from Switzerland

Thank for these follow up comments. For ease of reference, we have copied them below along with our responses.

C1. Comment from Switzerland

Regarding answers 1 a-e:

The argument that the considered co-financing is very conservative was already used to justify that in the IP the leverage factor of 1:2.66 is well below the 1:4 targeted by SREP. The leverage factor in the IP also did not consider reflows from loans. We therefore think that a leverage factor above 1:2.5 excluding the reflow effect is adequate for this project. We do concur however that co-financing from the private sector should not be over-estimated, i.e. it is adequately stated at $40 million. To achieve an adequate leverage factor, the project should either receive additional commitments from MDBs, GoR or other developing partners, or the requested SREP funding should be adjusted (reduced).

A1. Response from the WB

The design of the proposed REF Project is fully aligned with SREP objectives, including the investment criteria that refers to maximizing co-financing from non-SREP sources, including development partners and private sector. All co-financing amounts included in the Rwanda Investment Plan (IP) were considered tentative and subject to confirmation during project preparation. The World Bank team pointed this out in the responses to comments from Switzerland during the Rwanda IP approval stage. We also noted then that the final amount of IDA co-financing for the REF Project would depend on availability of scarce IDA resources for Rwanda, which Government of Rwanda (GoR) commits to the energy and other sectors (e.g., agriculture, social protection, education, and refugees) taking into consideration competing needs and priorities in these sectors. Besides playing a fundamental role to achieving the off-grid targets stated in the Rural Electrification Strategy, the REF Project will be part of the World Bank's comprehensive engagement in the country's energy sector. That's why, despite the unavailability of IDA17 financing (IDA17 cycle expired at the end of June 2017 and all funds had been allocated to other projects), GoR has committed US$7 million IDA funds from the IDA18 cycle for the REF Project, after carefully considering competing needs across sectors, current and projected engagements in the energy sector (including budgetary support for policy reform covering the off-grid electricity sector and improving the enabling environment for mini-grid development), and the expectation that the REF facility will attract additional financing from other sources in the medium term.

As mentioned during the Rwanda IP approval stage, it is expected that once established and operationalized, the REF facility will attract additional co-financing from development partners (MDB, bilateral) and private sector. GoR has stated strong commitment to utilize the REF facility as the main mechanism for raising funds for off-grid electrification in Rwanda. Discussions with development partners active in the energy sector have revealed potential opportunities for co-financing in the short- and medium-term. For example, the Swedish International Development Cooperation Agency (SIDA) has recently initiated the process to design and implement a guarantee facility that will help expedite and catalyze the delivery of REF-supported investments. Preliminary conversations with SIDA indicated that REF capitalization levels (in US$ million) –among other factors– will inform the size of the guarantee instrument. Moreover, the African Development Bank (AfDB) will follow the development of the off-grid electricity sector very closely and explore opportunities of co-financing some of the beneficiaries of the REF facility once the facility becomes fully operational. The potential co-financing from additional sources, together with the likely financing reflows which were not included in the REF financing plan, may eventually increase the leverage factor to levels that are more aligned or even exceed those anticipated in the Rwanda IP. GoR and the World Bank team will make all efforts to attract additional co-financing for the REF facility throughout the implementation of the REF Project.

Q2. Comment from Switzerland

Regarding answers 2a.b and d:

There are two core indicators for SREP, including "additionally generated energy/electricity from RE sources" and "number of people benefitting from improved energy access/supply from RE sources". All projects report to both core indicators and there is no such thing as a pure access project. Moreover, the massive reduction of additional energy generated from RE sources is primarily due to less focus on mini-grids, which was initially defined as receiving 24% of SREP contribution in the IP and for which Switzerland requested a stronger focus. The weakening of this component in the project application goes against this recommendation, which was notably motivated by the SREP objective to focus on productive use of energy. The objectives should be revised to reflect at least the split between mini-grid and off-grid announced in the IP. We do not agree with the argument that the market alone should drive the fund allocation from REF, since the grant and concessional loan funding of REF introduces itself a (potential) market distortion.

C2. Response from the WB

We apologize for the misunderstanding, but the previous response did not imply that the REF Project should be categorized as a pure access project. The REF Project will report on both core indicators, as the objective of the REF Project is to increase electricity access in Rwanda through off-grid renewable energy-based technologies.

We greatly appreciate the comments received from Switzerland during the Rwanda IP stage on strengthening the focus on mini-grids; these comments encouraged the delivery of a thorough assessment of the potential and opportunities for mini-grids in Rwanda, which shaped the preparation of the financing window for mini-grids under the REF. As anticipated during the endorsement of the Rwanda IP, the REF design would be flexible to allow channeling funds based on readiness and demand for the different technologies; it is a key principle of the REF design that funds are not earmarked to any particular technology. This basic principle of REF Project design was approved as part of the endorsement of the Rwanda IP in November 2015. In line with this principle, the financing plan for the REF Project shows tentative allocations for off-grid solar systems vis-à-vis expected demand and readiness for mini-grid investments during the project implementation period; this represents a conservative lower bound expectation of how much funds will be drawn by the mini-grids window vis-a-vis other financing windows. We do agree with Switzerland about the importance to maintain a strong focus and foster mini-grid development despite the aforementioned expectations for different technologies and investment readiness. Following the comments from Switzerland at the Rwanda IP stage, the World Bank team explored opportunities of collaboration with other donor-funded programs to accelerate the readiness of mini-grids investment proposals; the discussions focused on the development of a mini-grid pipeline that could be financed under the REF facility. The REF Project proposal describes the different activities supporting mini-grid development in Rwanda (e.g., SEFA/AfDB, EnDev, SOGER, BTC-funded technical assistance and capacity building program). Moreover, activities under the technical assistance component will specifically focus on facilitating the readiness for mini-grid development and financing, as well as promoting productive uses of electricity through mini-grids and solar systems.

We address your comment on market distortion in response 3-a below.

C3. Comment from Switzerland

Regarding answer 3a:

We understand conceptually that some grant financing may be needed to mitigate notably the currency risk, although the SREP non-grant contribution is in itself already heavily concessional. However, your explanation does not justify and quantify the level of grant financing that is needed and possible without introducing market distortions. We would appreciate if you could model the financial flows implied in the project to quantify the needs for grants and concessional SREP loans. Such modelling should also take into account the present market rates (or spreads) for loans and prices/costs for solar products.

A3. Response from the WB:

Loan and grant financing from SREP will be blended to support investments through the REF facility. Since the off-grid market is nascent in Rwanda, and particularly a new market segment for SACCOs and banks, as well as one that is perceived to be very risky because market dynamics are not well understood, the rates at which financing is offered to these institutions need to be attractive enough for them to become interested in participating in the REF facility. That's why offering long-term financing denominated in local currency, with GoR absorbing FOREX risk, will be fundamental to stimulate the engagement of local financial institutions in the off-grid lending market. The attractiveness of the SREP loan/grant financing package has been essential to encourage GoR taking FOREX risk, given the instability of the Rwandan Franc.

Regarding market distortion, we would like to note that the market would get distorted in the event that on-lending costs of the financial institutions are not fully covered and need to be subsidized. This is not the case in the proposed REF project where all institutions will fully cover their administrative costs and risks within the corresponding spread. Moreover, financial institutions are barely lending to the off-grid sector and there is essentially no market that could be distorted as reference interest rates for these products have not been established yet. That said, necessary measures will be taken to ensure that interest rates align with rates offered for similar products at similar tenures while the financing market for off-grid products develops. Furthermore, measures will be taken to ensure that no institution makes an unnecessarily high profit from these engagements. Spreads can be adjusted at BRD level to manage the profit margin that SACCOs/ banks can charge. The difference between the rates that SACCOs/ banks will have to pay to BRD and the lowest possible on-lending rate BRD could offer can be set aside in the revolving fund, so that the funds are available for additional investments in the same sector.

C4.Comment from Switzerland

Regarding answer 3b:

We do not agree with your statement that "there is virtually no financing for off-grid solar products at the moment". As announced only recently, leading global off-grid company BBOXX has successfully concluded a US$2 million debt facility in local currency with Banque Populaire du Rwanda and announced readiness to inject another US$200 million into the sector [http://www.newtimes.co.rw/section/article/2017-02-16/208062/]. Also, Ignite Power, the biggest solar financing company in Rwanda, claims that Rwanda people already have the most affordable solar home systems in Africa leading a US$38 million solar project [https://constructionreviewonline.com/2017/02/rwanda-offers-most-affordable-solar-home-systems-in-africa/]. Unless this published information is entirely incorrect, your statement above is not accurate. Under these circumstances, it cannot be assumed that this heavily grant subsidized project does not introduce any market distortions.

A4. Response from the WB:

We definitively welcome these positive news for the off-grid sector in Rwanda. However, we would hesitate to draw conclusions about the availability of financing for the sector based on the limited information provided in the articles. Our previous statement that "there is virtually no financing for off-grid solar products at the moment" derives from ample technical due diligence which started during the development of the Rwanda IP and continued throughout the preparation of the proposed REF Project. This due diligence included consultations with development partners, banks and solar companies, including those entities cited in the articles. This background work makes us believe that announcements by individual companies do not reflect the broader availability of the right type of financing in local currency at reasonable terms that will result in a rapid scale-up of electricity access in Rwanda. While the conditions of draw down remain confidential, we believe that the pricing, balance sheet ratios, and seniority conditions are not yet at competitive levels or could be replicated at scale. Moreover, the article refers to an individual transaction that is "first of its kind in the industry", which confirms the findings of the above mentioned due diligence, and also suggests that this news should not be utilized to draw fair conclusions about the current state of financing markets for off-grid products in Rwanda.

Please refer to response 3-a above regarding market distortion.

C5. Comment from Switzerland

Regarding answers 4a and c:

We requested a "more detailed description of capacity building and TA activities" with our endorsement of the IP, which was "agreed" by the WB and GoR. At that stage, the budget for these activities was US$2.5 million. We are thus surprised that such detailed description is missing and qualified as "usually not included" in the PAD or its annexes. We thus reiterate our request that such a detailed description with corresponding detailed budget positions shall be made available to SREP Subcommittee members in order to have this position approved. Besides, your last sentence, providing for a potential reallocation of funding from component 2 (TA) to component 1 (line of credit) indicates that there is some doubt whether the full requested amount for TA is actually needed.

A5. Response from the WB:

The successful implementation of the proposed REF Project will require significant technical assistance (TA) and capacity building, as well as project implementation support due to the innovative nature of the REF facility and nascent stage of the Rwandan off-grid market. TA and capacity building component will be used to facilitate capacity and knowledge building/ sharing of market enablers, primarily for SACCOs and mini-grids windows. Public awareness campaign on the benefits of the off-grid technologies and availability of the affordable financial products to buy those is also included in the component. Lessons learned from World Bank's experience and SREP consultations revealed the importance to build adequate sectoral knowledge and implementation capacity of market enablers in order to fast-track project implementation and, hence, market development. Moreover, given that off-grid lending is a new business area for the BRD, significant amount of resources will be required to establish the Project Implementation Unit (PIU) over the timeline of the REF Project, ensuring that the PIU has enough capacity not only to operate in a new sector and effectively perform M&E activities, but also facilitate the successful cooperation and partnership of all market enablers. The size of the component is in line with the technical assistance, capacity building, and project implementation support components of other innovative projects financed by the World Bank. We have summarized below the provisional budget for TA and capacity building, as well as project implementation support – amounts are tentative and may change during project implementation.

TA and capacity building (US$2.25 million)

(i) TA and capacity building for participating SACCOs and banks to ensure their successful partnerships with private sector, including M&E (US$0.75 million). The task will include implementing TA capacity building framework at the level of each participating financial institution; the framework is being developed as a part of project preparation. The framework will be adopted to the individual needs/ capacity gaps of each SACCO and bank participating in the project and will include capacity building of participating SACCOs and banks to manage energy credit lines (including management, operational, and monitoring and evaluation capacities).

(ii) TA and capacity building to BRD to develop a pipeline of mini-gird projects (US$1 million). The task will support will support identification of bankable projects, preparation of pre-feasibility studies and development of bankable proposals.

(iii) TA and capacity building for BRD and participating entities on quality assurance and enforcement of technical standards for off-grid solar systems (US$0.50 million). This task will include development of the quality assurance procedures to be followed by BRD and participating financial institutions, training on monitoring and enforcement of the standards, etc.

Project implementation support (US$2.69 million):

(iv) Establishment of the Project Implementation Unit (PIU) and provision of operational support to the PIU in the areas of project management, supervision, and monitoring (including incremental costs) (US$1.25 million).

(v) Public awareness campaigns to final beneficiaries on the benefits and opportunities of off-grid electrification (stand-alone systems and mini-grids) (US$0.50 million). This activity will include radio advertising, road shows in all districts, printed advertising, etc.

(vi) Preparation of project-related studies, including impact assessment surveys (US$0.50 million).

(vii) Outreach to key off-grid market enablers; potential direct project beneficiaries; knowledge-sharing events between participating project entities; sector-wide knowledge-sharing and project results dissemination workshops (US$0.24 million).

(viii) Preparation of consolidated annual project audits (US$0.20 million)