Responses from AfDB-Approved by Mail
Nigeria: Line of Credit for RE/EE
Responses to Questions from CTF TFC Members on Line of Credit for RE/EE

Prepared by the African Development Bank (AfDB)
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The African Development Bank would like to thank the governments of the United Kingdom (UK), Germany, Canada, and the United States (US) for their written questions and requests for additional information. Please find below the AfDB's responses to questions from these governments and other information as requested.

UNITED KINGDOM

1. How was the Borrower identified as the recipient of this line of credit?

The Financial Institutions Division of the African Development Bank's Private Sector Department employed its business development strategy in selecting the Borrower as the recipient of this line of credit. This strategy takes into account a number of requirements for financial intermediaries, key of which are commercial viability, additionality and development outcome and fit with the AfDB's overall strategic direction. On the basis of these parameters, a number of commercial banks were approached in Nigeria as potential clients. At the same time, it was an opportune moment at the Bank to implement the Nigeria CTF Investment Plan, through financial intermediaries. The selected potential clients were thus requested to consider a CTF – AfDB blended line of credit and the Division settled on the two most promising for the proposed blended facility, given the USD50M envelope, to be divided into 2 portions of USD25M each. The transaction with the Borrower was able to maintain strong traction, up to this stage, while the other bank dropped out at an advanced stage due to transactional costs related principally to information-gathering challenges concerning the CTF element.

2. How will AfDB ensure that the LOC results in lower financing costs for the Borrower's clients?

The Borrower committed itself, at the highest management levels, to transferring the bulk of the concessionality to its clients during the due diligence process. The loan agreement will contain very specific language to ensure that the bulk of the concessionality is transferred. This will be monitored by the Portfolio Division of the Private Sector Department which will receive regular reports capturing this information, conduct visits and will use independent consultants for expanded supervision reports, all of which will ensure that this commitment will be observed. Moreover, disbursement of the line of credit will be done in tranches, and before each disbursement a pipeline of proposed loan facilities will be presented which will be reviewed to ensure concessionality in pricing.

3. Can you provide additional evidence related to the factors that are likely to move the RE and EE markets in Nigeria?

The line of credit is one of the early initiatives that intend to support the development of RE/EE projects. In terms of the enabling environment, there are a number of positive developments at the national level and the regional level including:

- *Draft EE Policy and draft update of the Renewable Energy Master Plan are expected to be finalized later this year*
- *Ongoing effort to establish the Nigeria Clean Energy Facility (NCEF) that aims to facilitate access to finance for RE/EE investments*
- *Adoption of the Economic Community of West African States (ECOWAS) Renewable Energy Policy (EREP) and the ECOWAS Energy Efficiency Policy (EEEP) by the ECOWAS Authority of Heads of State and Government in July 2013*
- *Kick-off workshop on the development of the ECOWAS Renewable Energy and Energy Efficiency National Action Plans and Sustainable Energy for All (SE4ALL) Action Agendas in March 2014*

4. Why is there no room for leveraging additional debt finance for the supply side EE project identified in the pipeline?

The supply side energy efficiency project's work-in-progress business model envisages an investment of around USD 55 million over 5 years with a major focus on rehabilitation in the medium term. Accordingly, to be conservative the Bank estimated the project cost at around USD 28 million, based on the capital expenditure information that we had been provided with. As this company's investment plan becomes clearer it is expected that other banks will also contribute debt financing.

5. How did AfDB arrive at the 153,000 MWh per annum energy savings figure for the supply side EE project? Was this calculated based on the expectation of 3% reduction in distribution losses? If so, is this loss reduction entirely attributable to the $28M investment?

The GHG savings estimate is based on the application of a counterfactual approach. In the case of the EE project, technical losses are expected to be reduced from 10% to 7% over a five year period and considering the estimated power delivered to the grid the savings over a 15 year period (which is the timeframe of the project's draft financial model) amount to 2,298 GWh which is equivalent to 153 GWh or 153,000 MWh per annum. The loss reduction is largely attributable to the $28M investment.

6. Please could you confirm that any credits sold to the carbon market will be reported?

At this juncture, carbon credits are not envisaged. If carbon credits related to the projects are sold this would be reported accordingly.

7. Other CTF financial intermediation projects include a technical assistance component. Why is this not required with this project?

The AfDB went through a period of extensive consultations with the proposed Borrower concerning the expected outcomes of this facility as well as the implementation and reporting requirements associated with the RE/EE portion of the LOC. During the appraisal process, both the Borrower and the AfDB agreed that given the Borrower's financial and technical capacity there would be no need for dedicated technical assistance under this LOC.

8. What is your view on the replication potential within local financial institutions in Nigeria following successful demonstration through the Borrower?

During discussions with the Borrower, and other financial institutions in the market, bankers have expressed a degree of optimism about the potential of RE/EE. Though the Bank cannot be certain of future replication, it is the Bank's view that this facility and any RE/EE financing under it will serve to *elevate the profile of the RE/EE sector in the local market, potentially stimulating not only interest but also financing by other financial institutions that may not have existed otherwise but for activity under the proposed facility.*

GERMANY

1. Power Sector Nigeria: More information on the power sector in Nigeria would be helpful especially with respect to the legal and institutional framework for renewable energies and independent power producers, feed in tariffs, level of competitiveness of renewable resources in comparison to thermal power generation, etc.

The institutional framework that provides support for renewable energy includes several elements such as the National Energy Policy (2003), the Electric Power Sector Reform Act (2005) and the Renewable Energy Master Plan (2005) which is being revised along with an Energy Efficiency Policy which is being finalized. The feed-in-tariffs introduced in 2012 are considered to be attractive e.g. over USD 0.4 /kwh for solar but there is a view that these tariffs are high and hence in practice the power purchase agreements that the National Bulk Electricity Trading Company is expecting to sign in 2014 will be significantly lower – albeit taking into consideration project costs and appropriate return for investors. Accordingly, a review of the feed-in-tariffs is expected by the end of 2014.

2. The Borrower:

a. We would like to see more information about the Borrower's role and position in the Nigerian market as well as get details on the Borrower' credit rating.

The Borrower is a major financial institution in Nigeria in terms of asset size and has an investment-grade rating.

b. In addition, we would like to understand why the Borrower is not in a position to offer better loan terms.

The Borrower's loan tenures have to be in line with the tenure of its sources of funding. Like other Nigerian banks, it relies predominantly on customer deposits which account for a significant portion of its funding base. These are contractually short-term in nature which has implications for the tenure of the loans it can offer its clients and hampers its ability to provide medium to long-term loans to its customers. Access to medium to long-term funds, particularly USD-denominated, remains difficult in Nigeria.

The interest rates offered are a function of cost of funds and clients' credit risk based on the Borrower's internal risk-rating model.

c. Provide further details on the Borrower's strategy on RE/EE. Is there a dedicated team at the Borrower working on these projects?

The Borrower has a general strategic focus on energy and infrastructure projects and SMEs.. There is a lot of opportunity for RE/EE financing, especially to SMEs.

d. What is the Borrower's previous experience/track record in the field of EE/RE projects? Is AFDB providing TA support to the Borrower to expand the project pipeline, number of project approved?

Given the emerging nature of the RE/EE sector in Nigeria, the Borrower's experience is limited; however, it has expressed an increasingly strong interest in expanding its activities in the sector. The AfDB went through a period of extensive consultations with the proposed Borrower concerning the expected outcomes of this facility as well as the implementation and reporting requirements associated with the RE/EE portion of the LOC. During the appraisal process, both the Borrower and the AfDB agreed that given the Borrower's financial and technical capacity there would be no need for dedicated technical assistance under this LOC.

3. The proposed projects:

a. Provide project briefs of the individual projects including information on project sponsors, financing structure, time schedule, etc.

This project is structured as a financial intermediation investment. The pipeline included in the project proposal is indicative and subject to change given market conditions and the due diligence of the Borrower on its clients. Only before each disbursement (the line of credit will be done in tranches) will AfDB have access to information regarding the specific pipeline of proposed loan facilities which will be reviewed to ensure alignment with the CTF and Bank's RE/EE criteria.

c. Why is the proposed tenor only 7 years with CTF funding with a tenor of 20 years? In our experience similar projects usually have tenors of 12-15 years.

Given the huge demand in the Nigerian market, and given limited resources, AfDB typically offers loans of tenure of 7 years to enable recycling and refinancing. Please note that the CTF funding will have a similar tenure of 7 years.

4. Environmental issues: Provide details especially with respect to the two smaller RE projects, if, how and which environmental standards are observed especially concerning the use of "Palm kernel waste".

The line of credit transaction was evaluated in accordance with the AfDB's environmental and social management guidelines and procedures. Vide the loan agreement, the Borrower will be required to adhere to AfDB's ESMS standards which will be actively monitored by the Private Sector Department's Portfolio Management Division.

5. Demonstration effect: Explain how the proposed individual projects will be used for demonstration purposes?

The largest of the RE projects is one of the first photovoltaic utility-scale projects or possibly the first photovoltaic utility-scale project and hence will have significant demonstration impact. The switch to organic waste- based generation from diesel too has demonstration impact as several businesses that use small-scale generation units have the potential to realize cost savings from moving away from diesel based generation to organic waste or maybe gas which is becoming increasingly available. On a larger scale, the grid rehabilitation project addresses a crucial need and opportunity in a context where network losses are significantly high and a concern for stakeholders.

6. Financial sustainability: Is AfDB rendering support to the Borrower to assess and evaluate RE/EE projects beyond the 4 projects currently proposed?

The AfDB went through a period of extensive consultations with the proposed Borrower concerning the expected outcomes of this facility as well as the implementation and reporting requirements associated with the RE/EE portion of the LOC, including the technical assessment and evaluation of RE/EE projects. Both the Borrower and the AfDB agreed that given the Borrower's financial and technical capacity the assessment and evaluation of RE/EE projects beyond the 4 projects currently proposed and which are subject to change, can be performed by the Borrower.

However, AfDB will remain on hand to support the Borrower in terms of any queries that they may have on various technical aspects of potential RE/EE projects, especially in terms of eligibility i.e. whether potential sub-projects meet CTF criteria, especially for applications featuring projects with unique or novel features. Secondly, AfDB expects that the Borrower and the downstream borrowers will, in some cases, require its assistance in understanding, measuring and gauging data required to be collected at sub-project level for regular transmission to AfDB or in designing in-house collection measures for these data, and will remain on standby to deliver timely assistance in this regard.

UNITED STATES

1. Is there sufficient capacity and expertise within the Borrower to do proper due diligence on renewable energy and energy efficiency projects and to identify and evaluate the risks associated with these projects?

Yes, based on AfDB's evaluation of the Borrower, the Borrower has the relevant capacity and expertise to properly appraise RE/EE projects both from technical and financial points of view, in line with the CTF requirements.

2. Has AfDB evaluated the projects currently in The Borrower's pipeline?

In line with its modus operandi (MO) for line of credit transactions for financial intermediaries (FIs), AfDB has reviewed the pipeline of projects from the perspective of development outcomes as well as from the RE/EE standpoints. It is also noteworthy that this is an indicative pipeline which may therefore be subject to change, but the parameters of any new sub-projects must adhere to the requirements laid out for the RE/EE tranche.

3. Will AfDB do its own due diligence on the projects before the LOC can be accessed by the Borrower, or will AfDB depend entirely on the loan vetting processes of the Borrower?

The AfDB MO for line of credit projects is to evaluate the FI's policies, systems, expertise and practice in vetting projects from the point of view of credit risk, development outcomes and any technical requirements, which, in this case, is RE/EE. If these parameters are found to be satisfactory to AfDB, AfDB then relies on the FI to apply them in evaluating potential transactions and in its lending processes. Secondly, the loan agreement contains language to ensure that relevant considerations are implemented by the client in the on-lending process. Thirdly, AfDB extensively monitors this through its Portfolio Management Division of the Private Sector Department. This MO will be applied in this project.

4. How will losses resulting from defaults by the borrowers be managed? Will the Borrower still owe the entire amount taken under the LOC facility, or will there be loss sharing between the Borrower, AfDB, and CTF?

AfDB's and CTF exposure for the LOC will be to the Borrower only. Hence, there will be no sharing of any losses arising from any non-performing loans issued by the Borrower to its customers.

5. How does this LOC help the borrower's access additional debt financing, as stated on page 8? Does the LOC take disproportionate/first losses in the case of default?

Given limitations for Nigerian banks to obtain cost-effective and medium-long tenured financing in Nigeria and in the Eurobond markets, the LOC makes it possible for the Borrower to obtain reasonably-priced and medium-long tenured funds. The Borrower can therefore pass on this reduced cost of funds to its borrowers, and more importantly, expand the span of potential borrowers that it can support, with a wider pool of funds. In the particular case of the CTF funds, The Borrower will be incentivized to reach out to more project sponsors with RE/EE projects than it would have without the LOC. The LOC does not take any losses in case of default as AfDB and CTF credit exposure is purely to the Borrower.

6. How long will the LOC remain open?

The Borrower can draw the LOC over a 3-year period.

7. On page 11, the document states that, in addition to the LOC, there will be "implementation support from the AfDB". What does this implementation support entail?

AfDB will remain on hand to support the Borrower in terms of any queries that they may have on various technical aspects of potential RE/EE projects, especially in terms of eligibility i.e. whether potential sub-projects meet CTF criteria, especially for applications featuring projects with unique or novel features. Secondly, AfDB expects that the Borrower and the downstream borrowers will, in some cases, require its assistance in understanding, measuring and gauging data required to be collected at sub-project level for regular transmission to AfDB or in designing in-house collection measures for these data, and will remain on standby to deliver timely assistance in this regard.

CANADA

1. We note the proposed intervention is expected to be amongst one of the first attempts to use the financial intermediation approach to support the development of renewable energy (RE) and energy efficiency (EE) investments. We would appreciate learning more about what other attempts have been made or are in the process of being made under this approach. If they have involved the AfDB, what has been its experience?

For AfDB, this is the first time to use financial intermediaries to support development of RE/EE investments in Nigeria. The RE/EE continues to be an emerging sector. The AfDB is in constant dialogue with its local financial institution partners and will continually seek to leverage all of its available resources to facilitate the development and financing of viable RE/EE projects which demonstrate high potential in the delivery of development outcomes consistent with the AfDB's strategic objectives. Moreover, the Bank is aware of efforts by other bilateral development institutions to scope the market for RE/EE opportunities from the perspective of potential intermediary financing but has not received information of these initiatives having reached a stage of program or project approval.

2. We would appreciate an explanation of why the proposed maximum size of the projects funded by the line of credit is USD$20 million, which does not seem consistent with the overall USD$50 million size of the AfDB-CTF line of credit. We note that the indicative pipeline includes two projects, the Utility scale [RE] farm and the [EE project], that, if approved, would account for 80 percent, or USD$40 million, of the line of credit.

While the facility does not stipulate a maximum size for projects funded under the LOC; the AfDB has noted the potential concentration of funding represented by two projects in the indicative pipeline. Despite this concentration, the AfDB is comfortable with these funding levels as the projects are representative of current, unmet financing needs in the local market. In the view of AfDB, financing of these projects under the facility would not only address the financing challenges faced by current RE/EE projects on the market but also provide for the greatest project demonstration effect in the near term. The projects were selected from a pipeline of potentially viable sub-projects provided by the Borrower. This indicative pipeline was developed mainly based on an initial credit-risk assessment of projects; however, each project will be subjected to the Borrower's rigorous full credit risk analysis and other financial and legal requirements. Based on this pipeline, the Borrower , guided by AfDB, drilled down into the sub-projects to determine potentially eligible projects subject to CTF criteria as well as availability of sufficient information from the sponsors (at this pre-appraisal stage). For these reasons, AfDB adopted an approach that is flexible enough to accommodate the nature and financing needs of eligible projects in the pipeline, the requirements of the Borrower as well as other requirements of AfDB in terms of potential development outcomes.

3. We would appreciate further background from the AfDB on the proposal to on-lend USD$20 million per project, via the Borrower, rather than to directly fund and monitor the projects within the AfDB. Relatedly, we reiterate our proposal that for programmatic approaches, projects above a certain material threshold (e.g., ranging between USD$5-10 million) or breaching certain risk/policy criteria should be reviewed and approved by the Trust Fund Committee on a no-objection basis, consistent with the delegated authority approval processes used by the MDBs.

AfDB's Private Sector Department's Infrastructure Financing Division continues to process applications for direct financing of stand-alone energy projects depending on market demand. For this particular transaction, however, the selection of eligible indicative projects was within the context of the financial intermediary's immediate funding reach. The purpose of this facility is to encourage financing of projects by private sector financial intermediaries in order to expand access to funding for these projects and deepen the engagement of the private sector. The AfDB will continue to use its direct resources to complement these efforts, providing funding for those projects as appropriate.

4. We are pleased to hear that the Borrower's engagement with RE/EE projects will be facilitated by the fact that it is part of a bank group. We would appreciate an elaboration of how this will assist- the Borrower to develop its own technical capacity and expertise in this area.

The Borrower has a team of experienced bankers within its infrastructure and energy teams, who are linked to counterparts in other markets with whom they continually confer. Given that the RE/EE sector in such markets is more developed than the Nigerian one, the Borrower will have continued access to a repository of expertise for consultation on emerging and evolving technical energy issues especially during deal origination and structuring. The continued demand for the RE/EE line of business will provide the institution with the opportunity to potentially explore specific training sessions to transfer the knowledge to the Borrower and strengthen its technical expertise in this field.

5. In addition, we would also request clarification about the statement on page 8, which indicates that the AfDB will be providing a backstop to the Borrower on monitoring and evaluation.

AfDB will remain on hand to support the Borrower in terms of any queries that they may have on various technical aspects of potential RE/EE projects, especially in terms of eligibility i.e. whether potential sub-projects meet CTF criteria, especially for applications featuring projects with unique or novel features. Secondly, AfDB expects that the Borrower and the downstream borrowers will, in some cases, require its assistance in understanding, measuring and gauging data required to be collected at sub-project level for regular transmission to AfDB or in designing in-house collection measures for these data, and will remain on standby to deliver timely assistance in this regard.

6. We note that the estimated CTF investment is USD$22.5 million (pg 9); please clarify how the remainder of the CTF funds (USD$2.5 million) would be allocated.

This project is structured as a financial intermediation investment. The pipeline included in the project proposal is only indicative and subject to change given market conditions and the due diligence of the Borrower on its clients. Only before each disbursement (the line of credit will be done in tranches) will AfDB have access to information regarding the specific pipeline of proposed loan facilities which will be reviewed to ensure alignment with the CTF and Bank's RE/EE criteria, as well as total funding commitments.

7. Finally, to ensure the sustainability of the projects funded and the CTF's impact, we note that, as the line of credit is negotiated, it will be important to ensure that the costs related to the upkeep and maintenance of the funded projects be addressed.

Given that this is a line of credit, which will form only a portion of the financing for each project, the downstream borrowers will have to demonstrate, as part of the pre-approval credit appraisal process, the overall financial and operational viability of their projects. The Borrower will apply its very rigorous credit- risk appraisal process. This will ensure that financing will only be provided if the projects are financially viable and sustainable in terms of take-off and maintenance.