INFRASTRUCTURE

Building bankability for major projects

Is there a shortage of project finance for energy infrastructure projects or not enough bankable projects? asks *Nicholas Newman*.

Shortage of finance has long been cited as the main cause of the dearth and delays in construction of energy infrastructure, particularly in developing countries. However, industry insiders today more often cite a shortage of 'bankable projects' for the widening gap between supply and demand for power generation, grid and distribution networks.

'Simply put, the dearth of investment-ready projects has led to a widening gulf between what is required and what is delivered', said Thomas Maier, EBRD Managing Director for Infrastructure, in November 2014. Projects are too often presented to potential lenders without sufficient preparation of the commercial, financial and economic case, reported the Institution of Civil Engineering in December 2015.

Bankability issues

Better project preparation is essential to win over lenders. Far too many project proposals are based on out-of-date engineering studies, poor choice of technology, inadequate market demand studies or optimistic financial and demand projections. Luis Nuche at Vaisala, a Finnish company specialising in wind measuring products and services, argues: 'There is a tendency for those new to the technology to often ignore the basic steps, such as not completing a comprehensive wind survey and, because of cost considerations, selecting a product that is not sufficiently robust enough for the location.'

Project preparation is an expensive and time consuming exercise. According to James Leigland, Team Leader of the World Bank's Public-Private Infrastructure Advisory Facility, as a rule of thumb, the cost of project preparation will take at least 5% of a project's investment cost.

The cost of South Africa's 4,800-MW Medupi power plant has risen from an estimated initial R69bn ($4.2bn) in 2007 to around R154bn ($10.1bn) today

Source: Eskom

Key criteria

Presenting a bankable long-term energy infrastructure project to potential lenders involves establishing a project's viability in terms of social, economic, financial, technical, environmental and administrative criteria. It is also necessary to consider government approval and permits and the all-important prospects for a power purchase agreement and cost reflective tariffs, to ensure a reasonable return on investment.

First and foremost is the affordability issue. Can the government afford the project? Can the population afford to pay for the electricity? Will proposed tariffs cover costs? Is the market demand sufficiently large for this scale of project? Such basic fundamental issues lie at the heart of project preparation.

A case in point is the Namibian government's plan to build the $2.3bn, 1,050-MW Kudu gas power plant on its border with South Africa. The project proposal highlights the twin issues of affordability and market size. 'From a fiscal point of view, looking at the current economic climate, we have submitted to cabinet that Kudu is not feasible, since it would put too much strain on the country's national budget,' observed Namibia's Finance Minister, Calle Schlettwein, as reported in *Engineering News*, September 2015. Moreover, the plan's financial viability relies on the certainty of selling 300 MW of power to South Africa's Cape Province, for which there is no real prospect, given the massive ongoing development of new gas, solar and wind generating capacity in Cape Province, which simultaneously encourages South African power exports to Namibia, thereby destroying the case for such a large sized power plant as Kudu.

In contrast, power projects in Mozambique are seen as 'bankable' given the presence of large and accessible domestic gas supplies and proximity to Johannesburg Gauteng, South Africa's leading market for power. As a result, several leading investors such as Gigajoule International, Sasol and Aggreko have constructed power plants in Mozambique designed to supply the Gauteng region, delivering power to the more than adequate grid network that links the two countries.

This record of performance, whilst no guarantee of future returns, generates confidence in future project proposals. Unfortunately, similar power projects have gone badly wrong in gas-rich Nigeria where failure to contract for sufficient gas supplies to newly built gas power plants, ongoing criminal sabotage of gas pipelines, and tariffs which do not cover costs has resulted in power plants lying idle, reported Nigeria's *Herald* in September 2015. This record of failure, in turn, makes potential lenders look critically at proposals for power plants and distribution proposals.

Government support

Another important consideration is the question of government capacity to undertake large-scale energy projects. A case in point is South Africa's giant 4,800-MW Medupi power plant, whose project costs have risen from an estimated initial R69bn ($4.2bn) in 2007 to around R154bn ($10.1bn) today and is seven years late.

Across the world, the availability and amount of government support and guarantees is a major consideration for perceptions of bankability. For example, according to the *Financial Times*, the UK government's withdrawal of substantial subsidies to the renewables industry in October 2015 has resulted in billions of promised new investment being cancelled, since their bankability credentials had been removed.

In many countries, the role of international support can be vital. Overseas aid finance for energy infrastructure, led by governments in the west, China and Japan, alongside many development banks, can soften the stringency of the criteria needed to establish bankability. For example, Ethiopia's ambitious dam building programme relied on very generous terms provided by Chinese banks and civil engineering companies as reported by *AfrElec* (*Africa Power Monitor*) in

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Financial Times

May 2015. However, some countries, such as South Sudan and Malawi, need more help than others to ensure their power projects are built. In their case, strict market rules are being put aside by aid agencies to kick start economic development.

In addition, the involvement of export–import banks and credit guarantee agencies provide additional credence to project bankability. For instance, the failure of the US Congress to renew the mandate of Export-Import Bank of the United States, has forced American-owned General Electric to relocate its main base of construction of gas turbines to France, in order to take advantage of both French and EU export aid. There is also aid in the form of venture funds such as American based Blackrock and sovereign funds like the Norwegian Government Pension Fund.

Lastly, potential lenders nowadays take into account the quality and capacity of the project consortium. That includes their experience, reputation and record of accomplishment from the lead partner down to the smallest sub-contractor, in order to minimise potential delays and cost overruns. This is especially important given the trend to implement various transparency and corruption legislation worldwide.

Creating a bankable proposal

In an attempt to overcome the problem of inadequately prepared packaged project proposals, agencies such as the African Development Bank (ADB), Development Bank of South Africa, and the European Bank for Reconstruction and Development (EBRD), amongst others, have established infrastructure project preparation facilities (IPPF) to provide project proposers with the requisite expertise and funding that underpins the preparation of 'bankable' project proposals. For example, the ADB and EBRD have each allocated around $40mn to their infrastructure project preparation facilities.

The EBRD's IPPF has two windows – a Public Private Partnership (PPP) Window, where private finance is featured and a Sustainable Infrastructure Window (SIW) for commercialised public sector investment projects. The IPPF's objective is to improve the efficiency and replicability of infrastructure projects for the benefit of its clients. It will do this by greatly reducing the 'time to mobilisation' of consultants through use of 'call-off' framework consultants to deliver project preparation, over an initial three-year period from 2015–2017. This approach should also improve the quality of preparation through the application of consistent, market-proven structures that both the public and private sectors will support.

The IPPF's project preparation services are provided in parallel with high-level policy talks with concerned government departments and state-owned utilities to develop a viable case on which both governments and potential lenders can make an evidence-based decision. The IPPF's linkage of policy advice with project preparation will enable true peer-to-peer knowledge-sharing between the public and private sectors, thus enriching and strengthening local capacity.

Fortunately, many energy infrastructure project promoters now realise the importance of doing their homework before they present their case to potential funders. ●