Seminar on African Electrical Interconnection

Module 6 - Financing Interconnection Projects
Module 6 - Financing Interconnection Projects

Contents

1) Major Financing Features
2) Basic Financing Approaches
3) Project Financing Process
4) Twelve Financing Steps
Module 6 - Financing Interconnection Projects

Highlights

- Strategic importance of an approach to ensure attracting international investors and lenders
- Necessity of a well structured and systematic financing process
- Imperative need to properly mitigate the potential risks associated to a project
- Advantage of making financial advisors and other experts part of the project team at an early stage
Module 6 - Financing Interconnection Projects

Contents

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4) Twelve Financing Steps
Major Financing Features

- Large investments usually required for significant regional projects
  - Large hydroelectric power plants
  - Extra High Voltage long transmission lines
  - Often beyond the capabilities of local capital markets in developing countries

- Allowing a suitable participation of all regional energy players
  - Determining the role of the public and private sectors in the responsibility of a project

- Identification of the major risks
Module 6 - Financing Interconnection Projects

Contents

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Corporate Financing Approach

The traditional approach for power utilities
Involves the existing utilities as for any other type of financing activity

- Funding is put together by each utility
  - On its own balance sheet
  - For a given share of a project
- Risks (and profits) are shared by the utilities

- Financing success rests on the financial strength of the utilities
Project Financing Approach

May be the only alternative in some cases

- Poor financial situation of the utilities
- Insufficient local capital markets
- High level of risk

Involves the establishment of an entity **exclusively dedicated to a specific project**

- Funding is raised through equity and loans dedicated to the project

Financing success rests on the **financial strength of the project itself**
Module 6 - Financing Interconnection Projects

Contents

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Project Financing Approach

Especially complex and demanding

- Must be focused on a specific project to be fully characterized

Justifies setting up a team of experts very early in the financing process

Requires strictly adhering to a detailed and comprehensive series of well defined steps
The Stakeholders’ Challenge

STAKEHOLDERS
Governments
Utilities
Regulatory bodies

Constant support
Years of concerted efforts

UNDERLYING RISKS?
MANY JURISDICTIONS?

Conducting in-depth evaluations of the project
Proving the economic and financial viability of the project

INTERNATIONAL INVESTORS AND LENDERS

Constant support
Years of concerted efforts

Convincing international investors and lenders
An Important Requirement

Setting up, as early as possible, a team of experts

- Financial advisors
  - Proven economic and social awareness
  - Familiar with international financial organizations

- Legal advisors / Investment bankers
  - Competent in risk assessment and project structuring

- Technical experts
  - For a proper project definition and technical justification

To successfully raise the financing needed
In the best interest of the stakeholders

- The same can be expected from the promoters
Module 6 - Financing Interconnection Projects

Contents

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3) Financing Process

4) Twelve Project Financing Steps
Project Financing Steps

1. Commitment from decision-makers
2. Project definition
3. Risk analysis
4. Seeking international interest and support
5. Financial and operational structures
6. Legal environment
7. Independent review of the project
8. Information memorandum
9. Assessing investors/lenders interest
10. Debt and equity proposals
11. Negotiations and contractual agreements
12. Meeting disbursement conditions
Step 1 - Commitment from Decision-Makers

Leadership of the project determined
Concerns and objectives well understood
Roles and responsibilities clarified

Full commitment to the project

STAKEHOLDERS

STAKEHOLDERS

STAKEHOLDERS
Providing a Strong Political Support

Confirming a full commitment to the project

- To provide a strong political support by the stakeholders

- One of the most important element for a successful project
  - A crucial pre-requisite to secure the support of international investors

Can take the form of:

- Policy Statement
- Memorandum of Understanding
- Inter-Governmental Agreement
- Multi-Lateral involvement
Step 2 - Project Definition

Producing a Project Definition Document

- Summary of the preliminary studies
- Engineering
- Marketing
- Financial modeling

- Description of preliminary financial and operational structures

- Information on the electricity sectors in the countries involved

Communication tool

- Rapid understanding of the project
- Basic information for risk assessment

Preliminary version of the Information Memorandum

- Essential for the next three steps
- Facilitates obtaining grants and support from international institutions
Step 3 - Risk Analysis

Identification of risks and their impact on the project

Concerned with the risks perceived by investors/lenders

- Construction and operation?
- Electricity market?
- Contractual obligations?
- Finances?
- Political and legal context?

Risk management strategy

A key criterion used by investors and lenders to evaluate large infrastructure projects
Risk Management Strategy

May have a determining impact on the financial and operational structures (step 5)

<table>
<thead>
<tr>
<th>Mitigation actions to reduce the risks</th>
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<tbody>
<tr>
<td>Proper allocation of risks</td>
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<tr>
<td>Capacity to bear the risks</td>
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STAKEHOLDERS

STAKEHOLDERS

STAKEHOLDERS
Step 4 - International Interest and Support

To bring comfort to the investors/lenders

- Equipment and construction costs
  - Paid in strong currencies

- Energy infrastructure projects
  - Low-income consumers
  - Local currencies of very indebted countries

- Revenues

High sensitivity of investors/lenders to risks

- May be a prerequisite to obtain financing
- Will open the doors for public and private funding
- Will allow obtaining grants from international organizations
  - To proceed with independent reviews of the project
Step 5 - Financial and Operational Structures

Concerns the relationship between stakeholders and sponsors

To establish the financial viability of the project

The most appropriate corporate ownership, capital structure and operating responsibility

Build Own Operate Transfer

Build Own Operate

Build Transfer Lease

Contractual liens between sponsors and stakeholders (Eventual modifications to regulations)

A list of pre-qualification criteria (For potential equity investors and lenders)

Types of contracts and the content of calls for tenders

With a substantial stake by the operator

To mitigate risk

Operators and other parties
Step 6 - Legal Environment

1) To provide the group of stakeholders a legal status

2) To establish the legal framework governing their relationships and commitments
   - Making the stakeholders commitments official
   - Allowing to secure international financing

   - Typically results in a Shareholders’ agreement or a Concession agreement

   - Should private ownership or private operating structures be adopted
     - Financing process carried out by the sponsors
     - Limited involvement from the stakeholders
Step 7 - Independent Review of the Project

To add knowledge and credibility to the project and confirm its feasibility in a convincing way

- Requires independent well recognized experts
  - Proven track records
  - Successful financing achievements

- A key factor of success
  - A useful tool to follow-up on time and budget schedule to assure completing the project on schedule and without deficit

Provides the information needed to finalize the Information Memorandum

- Especially regarding the risk management strategy
Step 8 - Information Memorandum

To provide interested parties with all the information to decide on their eventual involvement in the project

Compilation of the information produced and revised throughout the previous stages

- Support from international organizations
- Financial structure of the project
- Risk analysis
- Description of the contracts between stakeholders and sponsors

Used as a prospectus

INVESTORS | FINANCIAL INSTITUTIONS | CONTRACTORS

Should be exhaustive

SPONSORS
Step 9 - Assessing investors/lenders interest

To identify potential investors and lenders and confirm the financial conditions

Usually performed by sponsors with a limited participation by the stakeholders

List of potential OPERATORS

List of potential INVESTORS and LENDERS

Suggested appropriate financial structure

Financial Plan

Funding schedule

Preparing a “road show”

Indications (letters) of interest

Will likely result in a lead institution putting together a consortium of lending institutions which will share the loan
Step 10 - Debt and Equity Proposals

Negotiating with the best parties to secure a preliminary agreement

- Equity from investors-operators
- Loans from international institutions or private sources

Two possible approaches for the stakeholders

<table>
<thead>
<tr>
<th>Great deal of interest in the project</th>
<th>Limited interest in the project</th>
</tr>
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<tbody>
<tr>
<td>Call for bids</td>
<td>Seeking potential offers</td>
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<tr>
<td>Pre-Qualified investors and lenders</td>
<td>Negotiating contractual conditions</td>
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Should result in the selection of one or two investors-operators and one or two lenders
Step 11 - Negotiation and Contractual Agreements

To secure the best financial conditions possible and obtain legal commitments

- With the winning bidders (investor-operator and lender) and usually focused on:
  - Risk mitigation
  - Loan conditions (rate, reimbursement term, etc.)
  - Loan guarantees, etc...

- The negotiation process is generally long

- Results in signed financing agreement(s)
  - Preferable to keep a second runner-up just in case negotiations with the winning bidder fail
Step 12 - Meeting Disbursement Conditions

Making sure that all the conditions required by the investors/lenders are met, in accordance with the agreements

- To safeguard the good reputation of the stakeholders and the sponsors

Likely to involve the appointment of an independent trustee

- To control cash disbursements and monitor the overall project realization