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Developing a Procurement Package

Navigant

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— Agenda

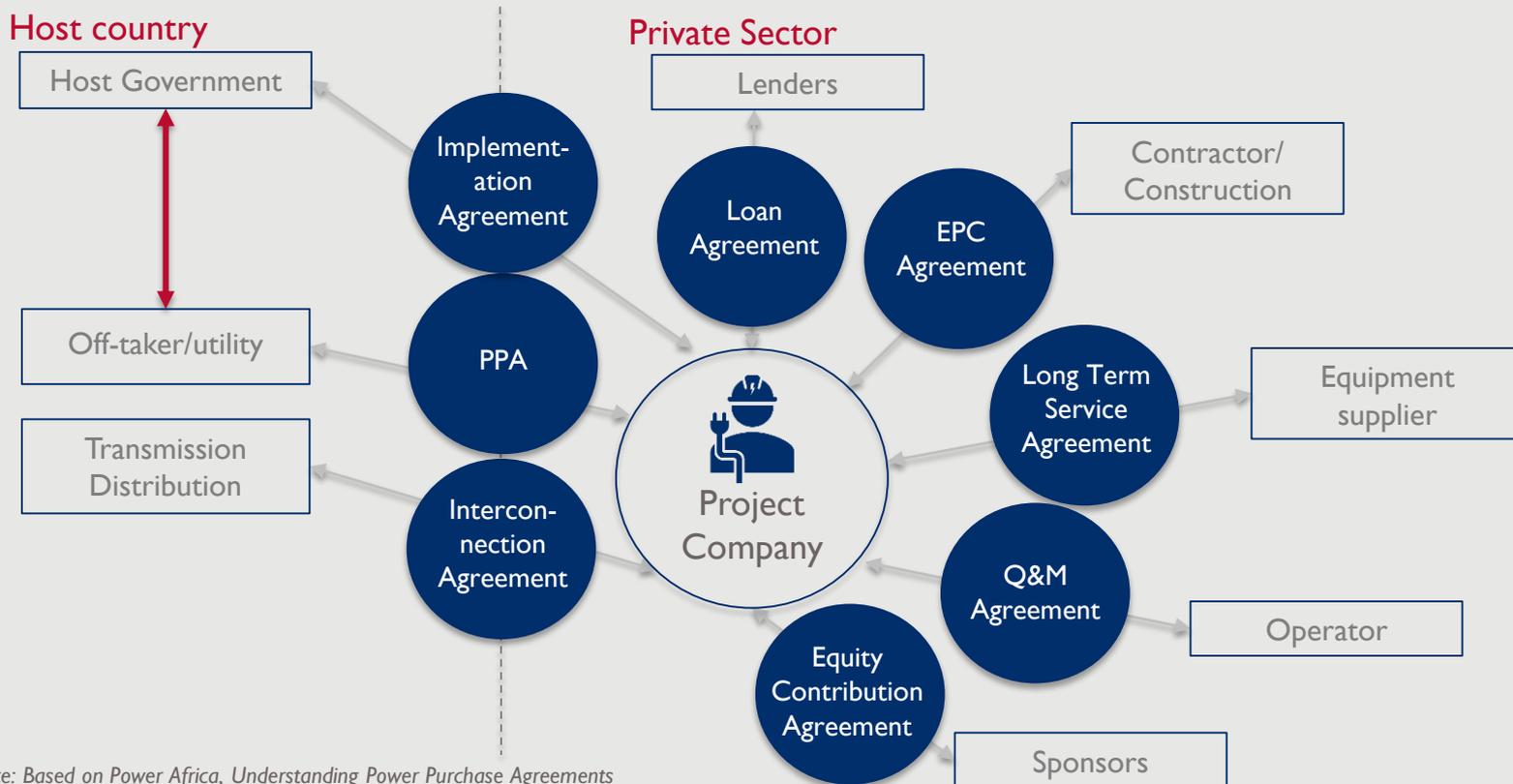
- Procurement design
- Project agreements
 - PPA
 - Implementation agreement
- Guarantees
- Facilitated financing: example staple financing
- Key take-aways



Requirements stemming from procurement design can be similar to some requirements of banks for project bankability

- **Certified resource measurement** (e.g. probability of exceedance values such as P90 or P75) give signal of likely revenue and inform acceptable equity/debt ratio and interest rate by lender.
- **Required permits** such as land lease, grid connection reduce risk of project delay/failure.
- **Supply commitments** that accommodate the seasonality and daily feed-in profile of RE (e.g. intra-day supply blocks) lower merchant (price) risk.

PPA and Implementation Agreement (IA) are essential project agreements between producer and off-taker/government



Clear risk allocation in PPA gives more certainty about the amount and price of generation (I/IV)

- The PPA is crucial to bankability → it is the source of revenue for RE producer → if no revenues flow under PPA, there are no funds to repay lenders and to pay operating expenses.

PPA elements

- PPA term should be long enough to allow debt to be repaid or refinancing of the remaining debt.
 - For solar and onshore wind projects often 15-20 years, exact duration depends on the market.
 - In general, lenders aim to reduce merchant risk exposure → shorter terms can be acceptable if alternative source of revenue exist (off-take by a large company)

— “How can I be certain I will be connected on time?”

“What happens if I’m not?”



Clear risk allocation in PPA gives more certainty about the amount and price of generation (II/IV)

- **Commercial operations date (COD)**
should be compatible with project development cycle since delays trigger:
 - Penalties such as liquidated damages for each day of delay from required COD
 - Default event from RE producer (seller) and PPA termination
- **Interconnection:**
 - Responsibilities between the off-taker and the RE producer need to be spelled out
 - Timeline of construction and COD should be compatible
 - Failure of off-taker to connect triggers „deemed completion“

— “How can I be sure that I will get paid for the delivery of energy?”



Clear risk allocation in PPA gives more certainty about the amount and price of generation (II/IV)

- **Deemed energy:** energy RE producer is deemed to have generated during a curtailment event.
 - **Take-or-pay clause:** off-taker takes & pays a fixed tariff for energy delivered. If output is “curtailed,” energy will be calculated and paid for on a “deemed” delivered basis.
- **Liquidity support:** A limited amount of cash which is ‘on demand’ to RE producer (letter of credit, bank guarantee or escrow), generally equivalent to 3-12 months of PPA revenues (but depending on jurisdiction and lender requirements).

Examples of deemed energy

- Annual threshold of hours of allowed grid outage (e.g. 100 hours).
- Annual cap on deemed energy aggregated with actual production to ensure that the developer is not over-compensated during a contract year of good generation followed by a curtailment.

— “What happens if the law changes against my contracts?”



Clear risk allocation in PPA gives more certainty about the amount and price of generation (III/IV)

- Changes in Law and Tax:

PPA should explicitly state which party takes the risk of the law or tax regime changing after the date of the agreement.

- Governing law and dispute resolution:

- Local governing law of the PPA and IA is generally acceptable.
- International arbitration (ICC, LCIA , UNCITRAL) with a foreign seat is important to developers; arbitration may be located in close physical proximity (e.g. Singapore).
- A waiver of sovereign immunity by the off-taker is essential.

— “How is the tariff paid?”



Clear risk allocation in PPA gives more certainty about the amount and price of generation (IV/IV)

- **Billing and Payment:** The billing period from the off-taker to the producer should be frequent enough (monthly) to ensure schedule of debt service payments is adhered to.
- **Currency indexation:** In less developed lending market there can be a mismatch between the off-taker's revenues (in local currency) and the debt of RE producers (in hard currency).
 - **Key questions:** Convertibility & repatriation of revenues

PPA design considerations

- Key considerations before should be taken as guidance.
- The **importance of legal counsel**: The off-taker should seek the advice of qualified legal counsel when preparing the PPA.
- The PPA should also be **satisfactory to the lender**
- If PPA has been signed, **amendment** could be contained in an addendum to the PPA, or in the “direct agreement“.
- **Direct agreement**: entered into by the off-taker, the producer, and the lenders.

Implementation Agreement indicates responsibilities for the buyer and the producer during project implementation

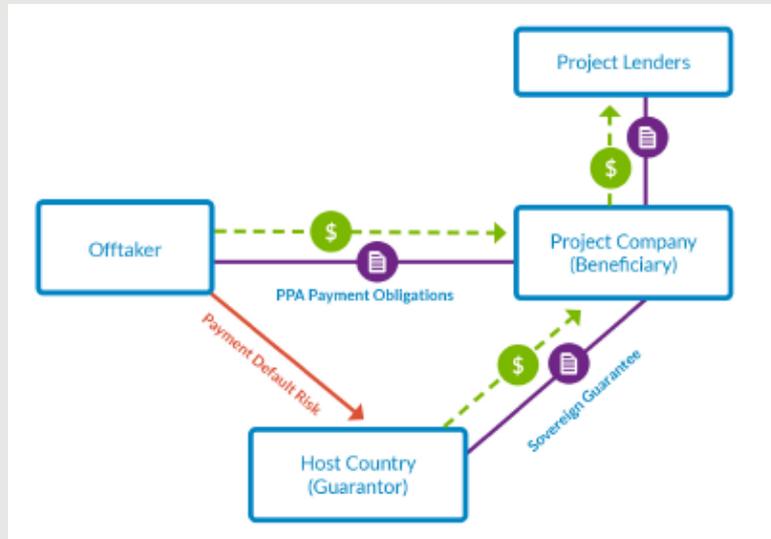
- **Implementation Agreements = concession agreement:** granting the right to RE producer to develop the project is the core of this agreement.
- **Primary support obligations from Government** on issues such as land, access, permitting, relief from import restrictions
- RE producer will also have **reciprocal obligations to the Government**, such as limitations on change of control, decommissioning of the project and compliance with law.
- **IA covers risks not fully covered in the PPA**, such as
 - political events,
 - force majeure,
 - change in law and change in tax,
 - convertibility and repatriation and expropriation.

— “What if the credit strength of the buyer is an issue?”



A sovereign guarantee backs payment obligations under the PPA

Sovereign Guarantee Structure



Source: Power Africa, Understanding Project Finance

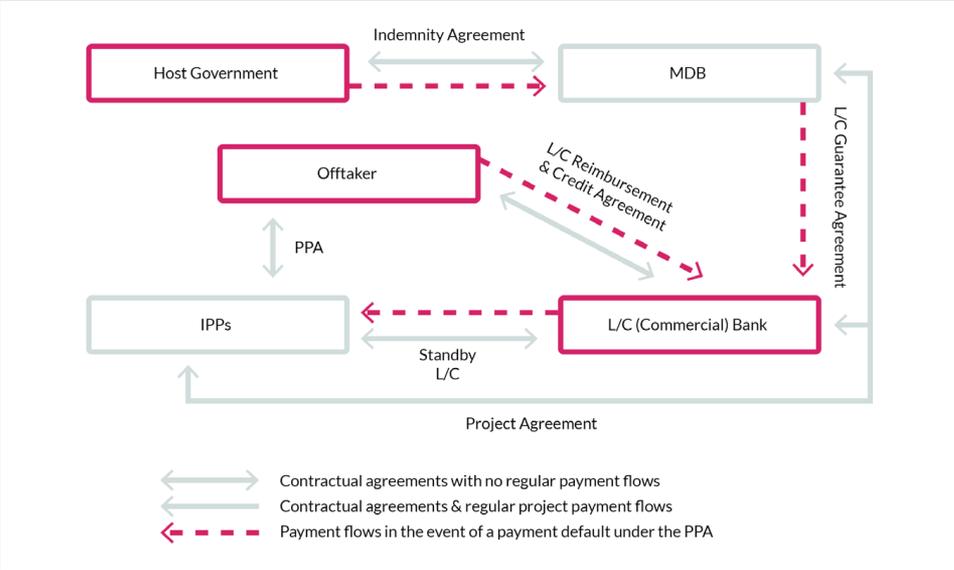
- A sovereign guarantee is a **contingent liability** on the government's balance sheet.
 - Government should weigh up the cost of providing the guarantee (contingent liability) against the economic stimulus benefits of the project.
- Lenders consider **strength of government guarantee** (credit quality of the host government), i.e. can the guarantee be enforced?

— “What if the credit strength of the government is an issue?”



Partial risk guarantees (PRGs) can alleviate concerns about government’s ability to meet contractual obligations

PRG structure



- A payment guarantee may cover a number of different payment obligations:
 - **Recurring payments** by the off-taker to the RE producer under a PPA
 - **Early termination payments** by the government to RE producer

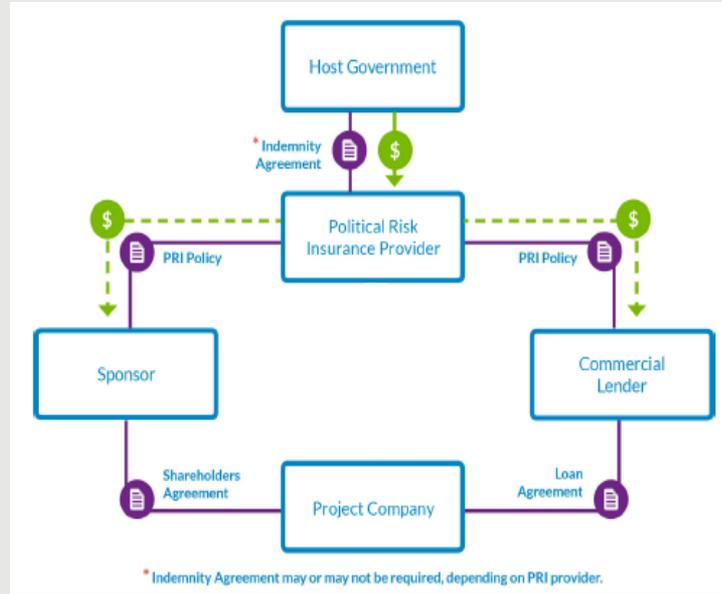
Country example: AfDB Partial Risk Guarantee: Kenya, Lake Turkana wind project, 310 MW

- Risks: delays in transmission line interconnection & payment default.
- AfDB PRG €20 million + €70 million from the government = €90 million in escrow account.
- Ensured first 6 months of payment obligations.

Source: Power Africa, Understanding Project Finance

Political risk insurance (PRI) covers risks outside the PPA or to back stop those risks

PRI Structure



Source: Power Africa, *Understanding Project Finance*

- Risks covered:
 - war/terrorism/civil disturbance
 - currency inconvertibility and inability to transfer fund abroad
 - breach/repudiation of contract by the utility
 - expropriation
- **Example:** PRI policy could cover currency inconvertibility for the portion of the currency that was not provided by the government.

— “What are acceptable financing terms for the market?”



Staple financing is a pre-arranged financing package offered to bidders

- **For RE producer:** speeds financial closure, especially for new market entrants
- **For banks:** another lender has determined that the structure is bankable (and thus is comfortable with the risk)

Zambia Scaling Solar, 2016

Concessional element	Estimated tariff reduction
Staple financing: 33% concessional loan tranche (LIBOR flat)	\$0.5 cents/kWh
Staple financing: 33% OPIC (US Government) financing (longer tenor)	\$0.3 cents/kWh
Site selection and pre-development: development costs funded (US Government) (\$2m)	\$0.2 cents/kWh
Total	\$1.0 cents/kWh

Consult widely with the market before launch of the procurement package

- **Conflicting expectations between off-taker and buyer:**
 - Buyer expects prices from other markets w/o corresponding design & risk allocation.
 - Producer cherry picks risk allocation but expects high returns.
- **Feedback from the market occurs before or after the auction**
 - If after the auction: risks of implementation delay or undersubscription
- **Consider road testing a hypothetical project structure** (RfP with procurement design, PPA, Implementation Agreement), but also:
 - regulatory, agency roadblocks in procuring generation licenses, connection permits etc.
 - possible due diligence, legal road blocks, land, permitting, security structures

Key messages

- **Clear risk allocation in PPA** gives more certainty about the amount and price of generation. The off-taker should seek the **advice of qualified legal counsel** when preparing the PPA
- **Implementation Agreements** indicate responsibilities for the buyer and the producer during project implementation.
- A **sovereign guarantee** backs payment obligations under the PPA. Depending on the strength of the guarantee, lenders might require additional instruments such as guarantees backed by development finance institutions (DFIs)
- **Consult widely with the market** before launch of the procurement package.