
How to de-risk clean energy projects and cultivate the project pipeline in sub-Saharan Africa

Large-scale clean energy projects are capital intensive, which makes them difficult to finance when project risk – real or perceived – is high. Finding ways to de-risk projects is critical to unlocking the potential for private capital to develop energy infrastructure in sub-Saharan Africa.

What risks drive up costs for clean energy in African countries?

Political and sovereign risk

The risk level an investment carries due to the government or political environment of the host country.

- **Examples** - Political instability, low creditworthiness of government borrowers, and weak policies and regulations pertinent to the investment (such as property laws).
- **Indicators** - Long-term credit ratings assigned by the major credit rating agencies (S&P, Moody's, Fitch).
- **Effects** - Higher perceived risk of expropriation of equipment, nationalization, or government default increases cost of capital and narrows the investor pool.

Financial and economic risks

These risks stem from the health of local financial markets and broader economic conditions in the country.

- **Examples** - High inflation, availability of foreign currencies, and high-interest rates.
- **Indicators** - Presence of development banks, commercial banking operations, and other actors in a mature financial market. Datapoints such as central bank interest rates and historic inflation rates.
- **Effects** - Higher interest rates directly increase the cost of capital. Inflation and foreign exchange issues can undermine the viable cash flow of a project.

Project-level/technical risks

Risks due to the inherent project-specific context or the technology and hardware used in the implementation of the project.

- **Examples** - Poor transportation access, hardware inappropriate to the local environment, low-quality construction labor, and land disputes.
- **Indicators** - While generalizations can be made at a country or regional level, typically these risks are assessed prior to or during the procurement process.
- **Effects** - The perceived prospect of unexpected delays, cost overruns, and performance shortfalls will lead investors to demand a higher expected return from a project, or lenders to demand higher rates on loans.

Mechanisms to de-risk projects to attract private capital

In order to attract Independent Power Producers to the market, which are the main model of clean energy development in Africa, there are three main avenues to reduce risks and improve the investment environment:

1. Well-designed Financial Incentives

Subsidies through variability gap funding or blending facilities (i.e., a transfer from a government or development finance organization to a provider or consumer) would make a difference in the origination of bankable renewable energy projects in SSA. Subsidies vary in application. Four main categories include international grants or output-based aid, special purpose funds, government subsidies, and cross-subsidies. Subsidies help to mitigate lack of affordability or willingness-to-pay risks. In the context of PPP/IPP energy or other infrastructure projects, subsidies can be provided via a Generation-based Incentive such as Feed-in-Tariff or Power Purchase Agreement contract and/or via a Blended Finance Facility.

2. Policy De-Risking Instruments

The diversity of political structures and approaches in the Sub-Saharan region makes it hard to propose a single de-risking framework. However, there are some common and fundamental aspects that need to be in place in all cases and in all countries. These include the need for:

- **Credible Commitments** - Governments and public institutions should display an achievable and long-term commitment to the advancement of renewable energy solutions and necessary energy policy reforms.
- **Clear legal and regulatory rules** - Frameworks must be, above all else, stable, clear, transparent, and avoid retroactive changes that would impact business models' stability of projects.
- **Consistent and reliable energy planning methodologies** - Energy plans should use credible evidence to support an appropriate energy mix and ensure predictability of the country's development choices and therefore business environment.
- **Independent regulatory bodies** - These bodies ensure good governance of electricity markets and their implementation via market rules, license issuing, and grid codes, for example.

3. Financial De-Risking Instruments

Political Risk Insurance is a great de-risking instrument for fragile states. PRI provides coverage against risks with respect to expropriation. Another efficient measure is a good quality PPA. PPA contracts that define and secure project revenue streams typically require the off-taker to buy all or most of the electricity produced at a pre-determined price and can reduce these risks for investors.

Furthermore, the creditworthiness of the electricity output purchaser (off-taker), which in the African context is often a state-owned enterprise, is key to ensuring the stability of project revenues. Public utilities in Africa face a multitude of challenges that undermine their financial stability. One way of addressing this is for governments to provide public counter-guarantees on the off-take payments. When the off-taker cannot pay, its obligations are assumed by the

government and added to the nation's outstanding debt. These guarantees are meant to ensure the reliability and predictability of project revenue streams to developers and lenders, ensuring that these are sufficient over the life of the project to both repay debt and provide an appropriate return. However, power contracts with a direct or indirect sovereign guarantee should be carefully considered and disclosed to prevent public debt risks.