# RENEWABLE ENERGY AND GREEN BOND ACTIVITIES OVERVIEW

## OVERVIEW

The African Local Currency Bond (ALCB) Fund was established by KfW with a mandate to develop local capital markets and increase the flow of bankable opportunities for domestic institutional investors. In 2019, the Fund was rated Baa2 by Moody's.

The Fund acts as an anchor investor and provider of technical assistance (to cover transaction costs such as legal/accounting advisers, credit ratings and green bond certification). Its target sectors include infrastructure, financial inclusion, affordable housing, agribusiness and health/education.

The Fund is also active in renewable energy, including solar and hydro, and can invest in corporate bonds, project bonds, securitisations and bonds issued by financial institutions. The Fund is unlike traditional debt providers such as development finance institutions or banks – it helps developers and companies create structures that are appropriate for the capital markets. While the Fund's focus is on local currency, it can consider hard currency investments for renewable energy and prioritises Green Bonds.

## STRATEGY

The ALCB Fund sees a number of opportunities for bond market transactions in the renewable energy space, including: (i) corporate and project-level bonds for run-of-river hydro and solar assets, where smaller transaction sizes (<USD 20 million) can be tested; (ii) utility-scale project refinancing, where there is a more established investor base; and (iii) structured finance transactions for off-grid solar at the household, commercial rooftop and industrial-level (i.e. where revenues are explicitly in local currency).

The Fund is able to support such issuers in the following ways

- **Connecting companies to local arrangers and markets actors who are able to navigate the issuance process;**
- **Providing technical assistance for local legal counsel, green certification and other transaction costs;**
- **Streamlining technical and environmental due diligence among investors;**
- **Identifying other potential anchor investors, including both domestic and regional asset managers;**
- **Acting as an anchor investor for up to the USD 10 million in local currency;**
- **Providing liquidity products, such as warehouse loans for structured finance transactions;**
- **Arranging cross-currency swaps for issuers and other counterparties;**
- **Engaging with local investors and selling down its position (effectively as a partial underwriter).**

## DOMESTIC CAPITAL MARKETS

There is wide variation in the level of sophistication of different African capital markets. However, regulatory reform, economic growth and demographics means that the potential and scale for domestic financial assets is strong. According to Standard Bank, the combined volume of assets in pension, insurance and other corporate savings amounts in twelve of its non-SA markets (Ghana, Nigeria, Kenya, Rwanda, Tanzania, Uganda, Angola, Botswana, Mauritius, Namibia, Zambia and Mozambique) equates to USD 147 billion. In the UEMOA and CEMAC regions using single currencies in low-interest rate environments, the investor base is also viewed as large with appetite for corporate and project bonds.

Pension funds in particular are looking for stable, long-term cash-flows to match their liabilities. In the infrastructure and renewable energy space, this can include performing (operating) projects, established companies with a track-record, and asset-backed structures such as securitisations. Third-party credit enhancement is also available from organisations such as GuarantCo and Infracredit to provide comfort to investors. However, today few projects are financed through the capital markets.

Domestic capital markets face a number of challenges in reaching their full potential as a source of funding for the renewable energy/ infrastructure space. Investors, arrangers and regulators lack experience of simple corporate bond structures, let alone more complex transactions. Documentation is often sub-standard and local banks generally struggle to play an intermediating role for infrastructure projects. There is also a lack of "credit culture" in most markets. The ethos of the ALCB Fund is to work with local institutions, improve transaction standards and create deal experience through bonds and private placements that can be replicated in the market.

### CASE STUDY: NYANGANI RENEWABLE ENERGY

The ALCB Fund invested the equivalent of USD 2.25 million in a USD 15 million private bond issued by HHPC, the holding company for Nyangani Renewable Energy. The bond was issued to fund the development of new mini-hydro assets in Eastern Zimbabwe, which will take the total capacity of the country's only grid-connected IPP to more than 35mw of small-hydro and solar capacity. Co-investors were local asset managers and other institutions.

Photo: Construction of Nyanga run-of-the-river hydro station in rural Zimbabwe

While end users mostly pay in local currency, utility-scale power projects in most markets include take-or-pay tariffs denominated in hard currency, specifically to attract long-term debt from foreign lenders including DFIs. While this debt is generally on terms better than those available in the local market, it introduces currency risk (borne by the customer, utility or government). Furthermore, the pricing appetite of domestic investors – who do not price country-related risks – remains untested. They typically require a lower spread than international lenders for like-for-like credit risks. While some domestic investors have appetite for USD, there is an arbitrage opportunity for local currency funds swapped into USD (and eventually to partially redenominate tariffs in local currency).

## GREEN BONDS

The global market for Green Bonds has grown to USD 156 billion since 2013. While this market has partly evolved in response to investor demand for sustainable assets, it has also itself succeeded in stimulating investor demand.

While evidence on the pricing impact of Green Bond Certification is only beginning to emerge, the opportunity most Issuers see is the ability to broaden and diversify their investor base. Green bonds can also demonstrate Issuer capacity and governance standards; by creating transparency around use of proceeds and ensuring efficient reporting.

In more nascent markets, creating awareness of sustainable investing can have a self-reinforcing impact on investor appetite. In South Africa, the City of Cape Town, Growthpoint Properties and Nedbank issued Green Bonds in recent years (the latter to part-fund four renewable energy projects). In Nigeria, the first corporate Green Bonds were recently issued by North South Power (to refurbish a legacy hydro plant) and Access Bank (for various sustainability projects). These are in addition to Sovereign Green Bonds issued by Nigeria.

Issuers must develop a so-called Green Bond Framework – identifying the qualifying use of proceeds, quantifying their environmental impact against baseline data, and outlining ongoing reporting procedures. This Framework and the bond documents containing the Framework must be verified pre-issuance by an accredited service provider (and potentially post-issuance). Verification can be under the ICMA "Green Bond Principles" or the Climate Bond Institute's "Climate Bond Standards". The ALCB Fund has supported this process in several markets.

## CASE STUDIES

### NORTH SOUTH POWER

ALCB Fund participated in the first corporate Green Bond in Nigeria, issued by NS Power and wrapped by Infracredit with a 15-year tenor. The Fund advised the issuer on achieving verification under the Green Bond Principles for the refurbishment of generating hydropower turbines at one of the country's most important power plants. The bond was over-subscribed, with significant participation from pension funds.

### MULILO

ALCB Fund has provided technical assistance to a leading South African renewables developer in preparing for Green Bond refinancing of its projects. This has included financial modelling support as part of the value proposition to government and support of pre-issuance Green Bond verification.

### NEDBANK

ALCB Fund supported the benchmark Green Bond issued by Nedbank in 2019, the first corporate bond in SA certified under the Climate Bond Standards. The use of proceeds is to finance four new projects under the country's renewable energy program. The Fund worked with Nedbank over several years and was the first international investor in the bond.

### FEDGROUP

ALCB Fund is supporting a commercial rooftop solar company in establishing a domestic funding program in the South African structured finance market. This is initially a ZAR 100 million private deal alongside local asset managers. FedGroup has signed the Green Bond Pledge as stepping-stone to a future Green Bond issuance.

Top to Bottom: FedGroup commercial office solar cells, NS Power dam, Mulilo solar PV Prieska 20 MW project

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