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A select group of developers and lenders are nursing through to close sub-Saharan power projects in a market that spent several years recovering from the exit of US developers, most prominent among them AES. Some US firms, AES among them, have returned to the region, and development banks like the Netherlands' development bank Financieringsmaatschappij voor Ontwikkelingslanden (FMO) continue to prop up power development in a number of countries. Developers like Blackstone's Sithe Global and Aldwych International are also making some headway.

The most high-profile deal to close, from December 2007, was the Ugandan Bujagali hydroelectric power plant financing. The sponsors of the financing were Sithe Global and Aga Khan Fund for Economic Development, which stepped in after AES ducked out of the deal four years earlier. Bujagali, a large, long-planned hydroelectric project, does not offer all the answers for sponsors that want to build smaller and more nimble gas-fired and diesel-fired plants.

But developers will look to learn from the lengthy Bujagali process, as proactive governments and increasing power requirements of many sub-Saharan countries create opportunities for new deals throughout the region. But sponsors, even if they are encountering more opportunities and more receptive governments, are still reliant on multilateral and bilateral lending, and political risk insurance is still the norm for commercial lenders.

FMO's commanding presence

FMO has built up a substantial presence in power deals south of the Sahara, and not just because of its government links. FMO has also demonstrated a willingness to take on equity risk early in the project development stage and work tightly with developers, according to Bernhard van Meeteren, a senior investment officer at FMO. FMO has a global investment portfolio of Eu3.4 billion ($4.6 billion), is 51% owned by the Dutch government and has an AAA credit rating from Standard and Poor's.

"Infrastructure project processes are often lengthy in Africa and by committing to equity risk early in the process, the bank helps get projects moving at the development stage," says van Meeteren. By using its access to government funds and concentrating sufficient resources on the African market, the bank has become an important player in the region. "It's a market niche, which nobody was filling – there was a need to get funds to develop projects," he adds. "FMO enters a project at the development stage and funds like a developer would do. If the project is successful, there is an equity return." This could mean FMO agrees to receive an equity stake in the successful project, or obtains the option to acquire a stake. "That sets us apart from most of the competitors," says van Meeteren.

For example, FMO helped set up Aldwych International as a response to the lack of developers willing to work in the region following the temporary exit of AES. Not coincidentally, several of Aldwych's senior management have a background at AES. While there is equity capital focused on Africa, there are few developers able to represent this capital in negotiations with government.

FMO signs, on average, 12 to 15 African projects per year, most of which are power deals. "I still see enough capital and enough financing for the projects ... a project that is well-developed can be financed. There are more than enough equity funds focusing on Africa ... but there are not enough projects that get to the point where they can be financed," says van Meeteren.

FMO look-alikes

Governments have hastened to fund similar ventures. The Private Infrastructure Development Group (PIDG) consists of the UK Department for International Development, the Swiss State Secretariat for Foreign Affairs, the Netherlands Ministry of Foreign Affairs, the Swedish International Development Cooperation Agency, the Austrian Development Agency, the Irish Aid agency and the World Bank. The PIDG has provided funding for Emerging Africa Infrastructure Fund, which provides debt, GuarantCo, a local currency guarantee provider, and InfraCo, a developer.

"The reason for Infraco being funded by government was that three years ago the perception was that there was plenty of money available for good projects, but what really was the choking point was the constraint of a lack of developers to put together attractive deals. And is that still the case? Yes," says Infraco's managing director Richard Parry.

"African governments have a limited capacity to set up structures that are attractive to investors; a process that is just way under most countries in Asia, even emerging markets in South America," says Ebbe Hamilton, an Infraco director. The other big factor is that African countries lack the revenues to channel into infrastructure projects.

Most African power deals still depend on offtake contracts with state-owned utilities, making sponsors and lenders dependent on government creditworthiness, and tend to tie up government resource. Given government constraints, in terms of manpower and revenues, power projects are unlikely to happen in batches. "If you look at a country [in Africa], they do one, or maximum two, IPP projects at a time ... there is limited capacity within the governments to follow and to build on these projects," says van Meeteren.

Bujagali lessons

Some projects, like Bujagali, can tie up government resources for a long period of time. The Ugandan government would have been stretched to handle any other project alongside Bujagali. "I'm not sure if they had been trying to do two projects in parallel they would have been able to do it," says Jason Oliver, Sithe Global's project manager for Bujagali.

"For the internal Ugandan transparency of process, when we were negotiating the power purchase agreement and the implementation agreement, the government had a tremendous number of personnel – all of the key decision makers – present at each negotiation," says Oliver. This meant there was little chance of objections at a later stage by government members. The first, AES-led, version of the project was scuttled because of corruption allegations, although AES exited because of its 2003 restructuring.

Oliver notes that involving the higher levels of government helped to push the project through stages where it might have been held up by unreasonable demands from lower-level officials. "Since we had the ear of the Minister and, if needed, the President, we did not have to put up with the lower-level corruption issues," he says. John Beardsworth, a partner at law firm Hunton & Williams, advised the Ugandan government on Bujagali and notes that "they had to bid a fixed amount of costs on top of the engineering, procurement and construction [EPC] contract – so that was set – and then the EPC contract had to be done by way of an international competitive bid."

The dangers of challenges to a plant's procurement have been illustrated in the difficult progress to close of the Eu119 million Rabai power project in Kenya. The winners of the tender – Aldwych, Burmeister & Wain, IFU and FMO – faced a challenge from Simba, a losing bidder that claimed it offered the lowest price. By the time the legal challenges had been dismissed, the sponsors were struggling to hold their pricing on the Eu84.6 million debt financing, a senior and mezzanine package led by Emerging Africa Infrastructure Fund (EAIF), DEG and Proparco.

The project is the first independent power deal to close in Kenya since 2000, and involves the construction of an 88MW disel-fired power project that would sell power to Kenya Power & Light under a 20-year power purchase agreement. The deal was initially believed to be priced 350bp over Libor on the senior and 750bp margin on the mezzanine, though pricing struggles have marked the financing's recent history.
While having a large cast of involved government participants might have smoothed the progress of Bujagali, the large number of lenders on that deal led to a delay of around nine months as the sponsors tried to iron out concerns of all the

lenders at an early stage.

In hindsight, Oliver believes, the developer should have negotiated the financial sheet documents with two or three of the larger lenders before taking the terms to the remaining lenders. "There would have been more of an ability for the other lenders to go to their management and say 'look these documents are already negotiated, you might want to change a little here and there, but it's really a question of are we in, or out, based on these documents'. I think that it would have saved a great deal of legal expense on both the equity and the debt side."

Can miners replace government?

One way to dispense with the large cast of government players, and at least some of the multilaterals, is for developers to make deals directly with mining companies in Africa. Persuading a large and creditworthy offtaker like BHP Billiton to commit to buy power exposes lenders to a shorter and more straightforward list of commercial risks. In the resource-rich continent, power intensive mining companies can benefit from direct access to power plants, which can improve the efficiency of their mining operations.

Mining company power purchase agreements can serve as anchors for an expanded facility, which then supplies the surrounding region with (often subsidised) electricity. "Something that interests us is to leverage off large commercial enterprises ... 95% of that would be from mining projects," says Infraco's Hamilton. "You can create commercially viable deals in areas that would otherwise would not be able to attract capital," he adds.

BHP, for instance, is looking like being key to the Inga hydroelectric project scheme in the Democratic Republic of Congo. BHP has been among the producers that has suffered from periodic blackouts in South Africa, and wants to build a $3 billion, 800,000 tonnes per year aluminium smelter in the DRC.

BHP Billiton and the DRC government signed a memorandum of understanding under which the smelter would buy up to 2,000MW of capacity from what would be the third phase of Inga, a hydroelectric facility with a total capacity of 4,320MW. Beyond that a 40,000 MW Grand Inga hydro plant is proposed, which could potentially push power as far south as South Africa, but this project is in the early stages of talks.

The prospect of tapping into the South African market is attractive. South Africa's power utility Eskom has widely publicised generation deficit problems, and although recently put on credit watch by Standard & Poor's, is still seen as the only truly creditworthy utility in the region. Hydro projects attract particular attention, so long as they are located in areas where the cost of transmission to users is not prohibitive. Forthcoming deals include a large hydroelectric power project in Mozambique, which one industry source said would be comparable in size to the 2,000MW Cahora Bassa plant.

But hydroelectric schemes sometimes attract negative attention, especially where they flood carbon sinks or displace populations. Even coal, though, can interest sponsors. CIC Energy, part of mining and power development group Tau Capital, wants to use Botswanan coal resources to develop the 1,200MW Mmamabula coal-fired power plant. It says it expects Eskom and local utility Botswana Power Corporation to purchase power from the project under power purchase agreements of up to 40 years.

CIC, which is pursuing the project in a joint venture with International Power, hopes to announce the EPC for the power station before the end of the year with a view to plant start-up in late 2012 or early 2013. But the project has been through several iterations, the most recent of which includes the promise to explore the use of carbon capture technology at the site. The project was recently reduced from 2,400MW, after the developers failed to find an EPC contractor that would guarantee the entire project, and neither sponsors nor offtakers would agree to step up.

High finance in deep places

Mining customers can make some extremely aggressive financial structures possible, although they also require some very risk-tolerate equity partners. FMO, with 18%, and Aldwych, with 2%, were among the minority investors in the 2006 management buyout of Copperbelt Energy Corporation (CEC), a Zambian power distributor. Around 90% of the

$60 million buyout was debt financed through different tranches of debt from Standard Bank, FMO and DBSA. "It was a combination of mezzanine debt or deeply subordinated funding, and senior debt," says FMO's Per van Swaay, investment officer for the CEC deal.

CEC buys power from state-controlled utility ZESCO and sells it to mining companies in the Copperbelt province. CEC owns a high-voltage transmission system, a distribution system and 80MW of gas-fired power generation capacity. CEC earns a dollar tariff by passing through power from generator to user, making it a relatively low risk business.

The deal involved the acquisition of 77% of Copperbelt by ZEC, of which a group of CEC-linked individuals owned 60%, and Development Bank of South Africa (with 20%), FMO and Aldwych the remainder. The sellers were National Grid and Cinergy, which wanted to concentrate on core businesses elsewhere. Some 20% of CEC remained indirectly in the hands of the Zambian government and 3% with a group of individuals that had owned shares since privatisation.

Repeating this type deal elsewhere will require shareholders with enough appetite for project risk, says FMO's van Swaay. "The sponsors had to put up their own personal assets to acquire the cash to invest. To see a management buyout of a strategic utility initiated by local entrepreneurs and supported by government, is fairly unique ... and it was highly leveraged," he adds.

A condition of the financing was the subsequent listing of CEC on the Lusaka Stock Exchange, which allowed a greater number of Zambian retail investors to own shares in the borrower, but also substantially reduced this leverage. Roughly 25% of CEC was listed on the exchange in January 2008, after which ZEC's share fell to 52%. The remaining debt was then refinanced, in the wake of the listing and strong copper prices. "ABSA came in and DBSA went out," says van Swaay; "The whole risk profile of the company had decreased, so the terms of the new debt were an improvement for ZEC."

Gas prospects lag pipeline development

The West African Gas Pipeline offers a slew of opportunities for governments along its route to install gas-fired generating capcity. The 678km offshore pipeline would run from Nigeria to Ghana, passing close to the coasts of Benin and Togo. Its shareholders are Chevron (36.7%); Nigerian National Petroleum Corporation (25%); Shell (18%), the Takoradi Power Company (16.3%), Societe Togoliase de Gaz (2%) and Societe BenGaz (2%). The $620 million pipeline, which has been under consideration since 1982, entered commissioning in May 2008. FMO lent Benin and Togo, $18 million each to fund their equity stakes, which were contributed through the above two gas companies.

Infraco is developing a 300MW combined cycle gas turbine plant at Kpone, within an industrial zone on the coast of Ghana would take gas from either the WAGP, or Ghana's Jubilee offshore oil and gas field, which was discovered last year. The project's cost is $300 million, and Infraco is under negotiations over equity funding. "We have received four attractive proposals," says Infraco's deputy managing director Gad Cohen. Infraco is also finalising PPA discussions with the Electricity Company of Ghana and is awaiting proposals for the plant's EPC contract.
One Togolese project also hopes to run on gas from the pipeline, but has been careful to line up an alternative fuel supply. ContourGlobal, a developer that numbers former AES manager Joe Brandt among its executives, plans to build a 100MW plant that runs on gas, heavy fuel oil, or distillate diesel, with the gas to come from the WAGP. Contour's shareholder include Reservoir Capital, a New York-based hedge fund that also has a stake in Sithe.

The Togo plant consists of six Wartsila 18V50DF engines and has a 25-year PPA with state utility Compagnie Energie Electrique du Togo. It recently lined up into $147 in direct lending and $62 million in political risk insurance from the Overseas Private Investment Corporation. The financing, when closed, would be the first independent power project in the country.

But the pipeline, and its attendant power projects, were conceived when Nigeria was projecting a large surplus of gas. Its thirst for gas to fuel new power plants in Nigeria has given Infraco extra challenges on its Kpone project. "There is a huge demand for gas in Nigeria which was not foreseen, or expected, when they started building the [WAGP] pipeline," says Infraco's Hamilton, project manager of the Kpone project.

The danger of terrorism in the Escravos region of the Niger Delta, which is supplying the pipeline, comes second to domestic economic growth as a factor that might disrupt plant development in West Africa. Oil and gas companies with producing assets in Nigeria are forming consortiums with power companies to take advantage of stranded gas from Nigeria's fields, most of which is currently flared, says James Douglass, a partner at Linklaters.

The Nigerian government, along with the country's national utility, the National Electric Power authority, are coming up with new ways to get more power plants built by foreign investors. "The idea is that [the energy companies] get a concession from the Nigerian government to build a gas pipeline from that field to a power station and sell the electricity back to the state offtaker," says Douglass. Both foreign power and oil and gas companies have shown interest in the scheme.

Debt still a multilateral matter

Debt packages are still heavily weighted towards bilateral and multilateral funding, and commercial banks still prefer to be covered by partial risk or political risk guarantees, supplied by institutions like the World Bank's International Development Agency. These guarantees cover such risks as a government's inability to meet contractual obligations, and currency inconvertibility. While African power project costs are usually paid in hard currency like US dollars, the power tariff will sometimes be paid in local currency, although this is often indexed to the dollar.

FMO has started to offer local currency support to projects through its TCX Fund, which launched in September 2007. Through the fund, the 12 seed investors, which also include ABN Amro and KfW, are able to offer a hedge to borrowers in sectors such as business, energy and infrastructure, with the aim of covering $1.2 billion in investment. Already popular with telecoms projects, FMO is offering the local currency funds to energy projects, an idea that has helped it move on financings, says van Meeteren.

Before TCX was founded, it was up to FMO to manage its currency risk and make appropriate hedging decisions. The TCX Fund now manages this risk for FMO and the other investors in the fund. "FMO itself is too small to manage local currency risks, so we have pooled this with other development banks to provide for more market volume," says van Meeteren. The TCX Fund provides hedging products to its investors, which use these products to provide local currency loans, or risk management products, to their clients. The fund has a portfolio of at least 20 currencies in emerging and sub emerging markets, in countries, which between them have a lack of correlation in event risks. This lack of correlation provides an effective hedge against the event risk in any single currency.

The fund also optimises its diversification by trading short-term emerging market basis swaps with regular market parties, in currencies that show low correlation with the investor trades. After 2010, TCX plans to start offering hedging products to non-seed investors.
Before the turmoil in equity markets in recent weeks, commercial banks were becoming more comfortable with the idea of investing in projects in Africa without multilateral support, Infraco's Cohen says. "New funds were available, looking for high returns, for them Africa was attractive for the last three years or so," adds Infraco's Hamilton.

The calamitous equity markets may have dampened this confidence as liquidity dries up, he said. "Over the next couple of months, or perhaps even longer, realistically it will be very challenging to do a purely commercial bank deal," Cohen says. "A year ago there was a lot of liquidity in the market, everyone was looking for good returns, and that was great for emerging markets, and Africa. Today all that liquidity has gone, all these institutions are now sitting on their cash," he adds.

Debt margins on power deals were falling until the start of the credit crunch, says FMO's van Meeteren. "Up until one year ago there was a downward pressure, and since then we have seen margins go somewhat back, basically going back to where they came from."

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