

European Fund for Sustainable Development (EFSD) Guarantee

Potential areas to be covered by Investment Windows

Title: Sustainable Energy and Connectivity

1. Policy Rationale

Background analysis: Potential Investment Windows in this area will contribute to achieving the United Nation's Sustainable Development Goal (SDG) #7 on “Access to affordable, reliable, sustainable and modern energy”; SDG #9 on “Building sustainable and resilient infrastructure development”; and SDG #13 to “Take urgent action to combat climate change and its impacts”. This window will target sectors such as renewable energy, energy efficiency and transport, enhancing energy security and sustainable development while addressing climate risks and helping countries deliver on their commitments to implement the Paris Agreement.

Production and access to renewable and sustainable energy is fundamental in reducing poverty and developing sustainable inclusive economies and societies. This has been confirmed at global level by the 2030 Agenda and the Paris Agreement, at EU policy level by the European Consensus on Development and the support to initiatives like the Sustainable Energy for All (SE4All) and the Africa Renewable Energy Initiative (AREI) and at practical level by the increasing interest and investments of the private sector in climate-friendly energy projects. Climate change and lack of sustainable and reliable energy access exacerbate poverty, weaken development efforts and are among the root causes of migration. Despite rapidly rising cost-competitiveness of renewable energy technologies, the financing of renewable energy projects is still difficult in many parts of the world. More is needed to meet energy and climate change goals. Limiting the global mean temperature rise to below 2°C would require around \$3.5 trillion in energy-sector investments each year until 2050: fossil-fuel investment would be offset by 150% increase in renewable energy supply investment, but also in energy efficiency and transmission and distribution grids. The transformation of the energy sector requires ambitious policy measures, as well as unlocking private capital, in particular from institutional investors, through risks mitigation.¹

The lack of creditworthy offtakers is one of the key factors deterring investment in this sector, as identified in several sector studies². The weak balance sheets and poor payment track records of many national utilities is one of the reasons why many commercial banks have been unwilling to fund projects, reducing competition and increasing the cost of capital. In addition, policy and regulatory barriers, market barriers, macro-economic conditions, poor governance, grid/infrastructure constraints and investment risks, including a lack of reliable investment data, are, among other reasons, currently obstructing the development and financing of both renewable energy

¹ Perspectives for the energy transition – investment needs for a low-carbon energy system ©OECD/IEA and IRENA 2017.

² See for example: IRENA (2016), ‘Unlocking Renewable Energy Investment: The Role of Risk Mitigation and Structured Finance,’ IRENA, Abu Dhabi

and energy efficiency. Combined effort of public institutions, the financial/banking sector and the private investors are therefore necessary to meeting the growing energy demands while addressing climate change risks.

As regards transport, the key priorities are to make transport links between the EU and its Neighbours and Africa, as well as intra-regional connections, more sustainable, safer and more efficient; to support the improvement of logistics systems; to remove infrastructure and non-infrastructure bottlenecks; and to promote greener transport modalities.

EU Policy objectives: In line with the revised European Neighbourhood Policy³, the New European Consensus on Development⁴ and the Council Conclusions on Energy and Development⁵, support under this window would be required to stimulate the private sector investment by reducing risks, to mobilise commercial funding in order to have a catalytic impact on low-emissions and climate-resilient inclusive growth as well as job creation. Investments should respond to the specific situation and needs of a given country or region, they should respect social and environmental principles and standards, including gender equality, and ensure sustainability and efficient maintenance of investments. This window could group several instruments (proposed under separate PIPs), targeting sectors of intervention including those indicatively listed in the next section.

Geographic area: Sub-Saharan Africa and the Neighbourhood regions.

Domain: Access to affordable, reliable, sustainable and modern energy; Renewable energy generation; Energy efficiency; and Sustainable transport.

Sectors of intervention: The window will support the development of new climate resilient opportunities across sustainable energy and potentially transport sub-sectors such as: (i) on-grid renewable electricity projects such as solar, wind, geothermal and climate resilient hydropower generation including efficient transmission and distribution infrastructure for renewable electricity deployment; (ii) off-grid and decentralised renewable energy systems, including storage and hybrid systems, providing for social, domestic and productive uses of energy; (iii) renewable energy, including heating and cooling and combined heat and power energy efficiency investments both in the industrial sector and in buildings, targeting residential, public and commercial buildings; (iv) smart-grid technologies and demand side management actions; and (v) investments in climate-smart transport logistics chains (terminals/platforms), including intermodal hubs (sea and dry ports,) transport services and equipment, investments in airports and ports and related to the greening of the transport sector (based on a sustainable transport model).

2. Operational Concept

The EFSD guarantees shall be structured in such a way as to lower actual and perceived

³ https://eeas.europa.eu/headquarters/headquarters-homepage/330/european-neighbourhood-policy-enp_en

⁴ COM(2017) New European Consensus on Development

⁵ Energy and Development — Foreign Affairs Council conclusions (28.11.2016), 14839/16.

risks including those associated with the credibility of power off-takers, create conditions for mobilising private funding, including institutional investors and crowdfunding platforms, and developing the local capital market.

Type of operations: Different types of eligible operations may be included, such as:

- Guarantees instruments to mitigate various types of investment risks including guarantees for utility demand side programmes and for vendor finance agreements with suppliers of green technologies and guarantees to support the use of energy performance contracting in order to scale up private sector participation in energy efficiency investments.
- Guarantee cover for equity/subordinated loans for renewable energy and/or related-infrastructure investments; it could cover innovative renewable energy and related technologies to address key risks that currently deter private sector participation, such as exploration, ramp-up risks, connection to the grid for off-grid actions etc.
- Guarantees covering fully or partially the offtake agreements in renewable energy investments aiming to reduce the overall financing cost and the risk perception for sustainable energy related investments.
- Guarantees used also to promote the launch of capital market instruments for energy efficiency/ renewable energy investments and/or investments in appropriate transmission/distributions systems.
- Credit enhancement for investment funds attracting private institutional investors into developing country investments in renewable energy and energy efficiency.
- Any other innovative solutions addressing key project risks in renewable energy or transport projects.

The operations listed above are indicative and non-prescriptive/exhaustive. Priority will be given to inclusive initiatives optimising leverage and cost efficiency, mobilising funding from multiple sources and countries/regions where private sector participation is currently low.

Type of risks: Risks to be mitigated may include: i) Commercial risks (e.g. payment risk, off-taker payment not honoured, off-taker bankruptcy, etc.); ii) Political and country risk (e.g. expropriation, coup d'état, civil war etc.); iii) Legal and regulatory risk (e.g. change in law, cancellation of licenses, nationalisation, tariff adjustments etc.); iv) Currency risks (e.g. exchange rate fluctuation, convertibility, transferability, etc.); and v) Climate change and environmental risks (e.g. droughts, extreme weather events, temperature rises, etc.).

Expected Additionality: i) Improved potential to mobilise both local and international private sector investment; ii) Catalysing and demonstrating the effect of sector reforms; iii) Demonstrating innovative technologies; iv) Improved project sustainability via project structures designed to facilitate the commercial scale up and replication of financially sustainable projects; v) Innovation through the demonstration of the viability of new business models or technologies, lowering market barriers and changing entrenched behaviours; vi) Improved gender-responsiveness gender equality; and vii)

EU climate, social and environmental standards are promoted, including using EIAs, SEAs and CRAs and Best Available Techniques.

The EU's experience in rolling out enabling policy and regulatory frameworks for regional integration, outreach to strategic public and private partners at home and internationally promoting an enabling business environment and investments and EU private sector excellence in clean energy technologies represents a pool of practice that can be exported and replicated to induce change in other markets, fostering knowledge-and technology-transfer and cooperation.

Envisaged Impact: i) Increased and improved access to affordable, reliable, sustainable and modern energy and improving quality of life; ii) Increased renewable energy generation capacity installed; iii) More efficient and rational use of energy resources, including energy efficient appliances; iv) Reduced local pollution and greenhouse gases emissions improving public health and environmental quality and helping countries to achieve their international climate change pledges; v) Low-emissions and climate-resilient inclusive growth, decent job creation particularly for youth and women and balanced territorial development, enabling of productive and social activities and other economic benefits widespread to the society, hence tackling some of the root causes of irregular migration; vi) Contribution to energy security and energy supply cost reduction related to the fossil fuel import bill; vii) sustainable transport and logistics chains improved.

Complementarity/Risk of potential overlap with other Investment Windows: Complementarity and potential overlaps exist with all the Investment Windows, e.g.: Waste-to-energy, renewable energy and energy efficiency in agri-business (Agriculture); Climate services, smart-metering (Digitalization); Renewable energy, energy efficiency in urban and peri-urban environments (Sustainable cities); ESCOs and small sustainable energy companies (MSME Financing).

3. Supporting Policy Actions (links to pillars 2 and 3)

Links will be established between the investment pillar (pillar 1) and enabling policies (pillar 3) to foster stable investment climate and conducive business environments as well as technical assistance (pillar 2). Implementation of this window may thus be accompanied by sector policy dialogue with the partner countries and by in-country reform processes supported by the Commission, in order to foster an enabling environment including alignment of energy and transport policies, regulations and planning with climate change objectives, under which the policy goals can materialise and increased investments can take place.

Supporting policy actions may include:

- On the energy sector enabling environment and governance side, the need is to consolidate suitable legislative and regulatory frameworks that facilitate investments and mobilise funding for energy projects; electricity masterplans that allow the integration of renewable sources' into the grid; electricity and rural electrification masterplans that foresee a role for innovative financing and private

sector concessionaires; tariff reforms towards increased cost reflectiveness and balanced and cost reflective tariff structures that ensure long term financial stability of utilities; utility financial reforms and possible financial restructuring towards becoming creditworthy; review of fossil fuels energy subsidies' policy and other existing market distortions; promoting the implementation of transparent market and utility practices; as well as demonstrating the benefits of well-structured public/private partnerships.

- Policies to promote energy efficiency (in particular in the building sector by developing, adopting and enforcing "green building codes" legislation). The existence of Sustainable Energy Action Plans (SEAPs) and National Energy Efficiency Action Plans (NEEAPs) in several countries across Africa and the Neighbourhood Regions can provide a framework for gap assessment, prioritisation and monitoring.
- On transport, frameworks for the management of multimodality, for the clear prioritisation of national investments related to the extension of the TEN-T network, and reforms related to the railway system should be in place.
- On investment preparation in the energy sector, the needs are to improve the creditworthiness of the off-takers; to increase transparency and ensure the equitable availability of country/sector/project information; to enable the public sector to consult with industry and stakeholders in designing project support schemes such as FIT; to ensure a level playing field and increase awareness of existing risk mitigation instruments; and raising awareness among the public of the benefits of renewable energy.