

Encouraging banking sector participation in climate finance, the case of Kenya

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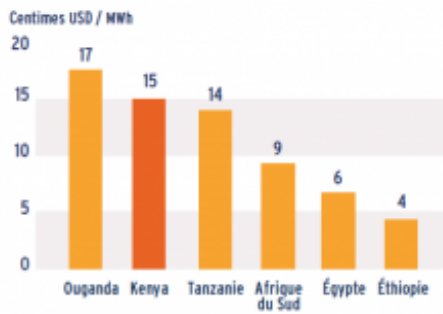
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The development of energy resources and energy efficiency in Kenya is a current necessity as well as a big challenge. To meet that challenge, Kenya's Association of Manufacturers (KAM) has partnered with the Agence Française de Développement (AFD) to provide technical assistance and to promote energy efficiency and the use of the country's plentiful renewable energy resources, encouraging growth while reducing the Kenya's greenhouse gas emissions.

Manufacturing growth has slowed in the last eight years¹ in Kenya, partly because of an increase in energy costs and inefficiencies in its generation and delivery - up to 40% of manufacturers' costs are for energy due to a need for self-generation and a reliance on petroleum products. Indeed, the cost of power in Kenya is one of the highest in the region (*Figure*), blunting its competitive edge. To meet that challenge, Kenya is

FIGURE : TARIFS DE L'ELECTRICITE EN AFRIQUE, 2014



encouraging the development of its considerable renewable energy resources² (RE) and an improvement in energy efficiency (EE), but there are significant uncertainties that deter industrial investors and inhibit long-term investment in that sector. The Kenya Association of Manufacturers's (KAM) involvement is helping to find solutions both to foster energy efficiency in the manufacturing sector and build the capacity and confidence of local financial institutions.

This is especially important in view of the important role manufacturing has to play in helping Kenya attain higher growth through its ability to create productive employment and its close links with all other sectors of the economy.

Promoting energy efficiency

KAM has sought likeminded actors to develop RE and EE solutions, initially forming a partnership with the Global Environment Facility³ to train energy auditors, promote energy optimisation among industries and train technical industrial personnel to track energy use. Proposed measures, however, were rarely implemented, especially high cost measures often associated with significant energy savings, and most of the audited companies reverted to business as usual once the auditors left. The Danish International Development Agency joined KAM's initiative in 2011 to expand its scope and complement its work. In soon became clear, however, that a financing component was missing, and should be provided alongside technical assistance to project developers and banks. This presented a challenge since, at the time, no commercial banks were financing RE or EE projects. Furthermore, RE regulation was still under development. Investors were unaware of the benefits of these projects while over-estimating risks - despite their dynamism and potential profitability.

Combining technical assistance with finance

To meet this challenge, KAM developed a partnership with the Agence Française de Développement (AFD) to provide project developers and banks with technical assistance alongside a credit line for financing EE and RE projects. They launched the Sustainable Use of Natural Resources and Energy Financing programme (SUNREF) includes technical assistance (capacity building, institutional support, training, etc.) and financial tools (loans, grants, guarantees, etc.) to address the various barriers that small and medium sized green investment developers face.

The technical assistance⁴ component, which is mainly focused on conducting due diligence for EE projects to mitigate the technical risks and at the same time reduce the financial risks for the banks, unlocked the market. On the one hand, local banks that needed capacity building and a lot of hand holding to master structuring projects were, therefore, provided with training in project finance and credit appraisal. On the other hand, project developers that needed help in packaging projects to a level that would pass banks' credit-evaluation processes, were helped to improve the quality of their proposals through pre-investment finance support, pre- and post-feasibility screening and financial modeling.

KAM proposed that the financial component should be led by the private sector with local commercial banks acting as lending agencies and AFD providing them with low-rate, long-term finance for refinancing purposes. The SUNREF framework provides local financial institutions with special partnership conditions, allowing them to seize the opportunity of financing climate-change mitigation, and scale on-lending to small-scale developers for small- and medium-sized climate-related projects.

The AFD ran the process of identifying partners (*Box 1*), launching a national tender inviting local interest, and taking the lead in choosing the banks. Initially two banks were selected but only one, the Cooperative Bank5, finally succeeded in becoming a partner; negotiations to identify a partner bank are also on-going in Uganda.

How SUNREF selects and assists its banking partners

Céline Bernadat, project officer of AFD's financial institutions and private sector division

The selection of financial institutions depends on multiple criteria including the institution's credit risk policy. Larger ones are considered, but so too are smaller institutions that are often dynamic and less risk-averse to innovation. Other criteria include the institution's climate finance strategy, its appetite for such activities and the availability of staff to focus on it; whether the client portfolio is concentrated on energy or a related strategic sector and/or is focused on appropriate loans to small- and medium-sized enterprises; as well as its processes from the identification of projects to its credit risk appraisal system. The dialogue with in-country banks is based on an analysis of the local context, including a study of investments that show strong potential for the future, and the barriers that prevent such investment materializing. The technical assistance aims to remove technical barriers both for project developers and local financial institutions, helping them identify a portfolio of bankable projects. It also aims improve the banks' understanding of climate finance and its ability to analyze risks related to such investment. The objective is to support the institutions in adopting an opportunity-based outlook instead of a risk oriented one. Lastly, the support aims to develop or consolidate a green strategy around climate investments, including the setting up of dedicated procedures and the structuring of a sustainable green offer.

While no formal marketing efforts were made in Kenya, 50 projects were identified in the first three months, mostly by word of mouth, which demonstrated the huge potential and was greatly motivating. In addition, the initiative had a clear role in supporting advocacy and lobbying for RE and EE - the adoption of Kenya's feed in tariff in December 2013 was one of its major achievements.

From obstacles to achievement

Of course there have been challenges, especially during the first year. Apart from credit officers being very protective of their credit appraisal processes and procedures, inadequate project finance skills and the risk averseness of bankers proved to be a huge obstacle. Then, project developers and especially process-industry owners are yet to fully appreciate the importance of and opportunities offered by EE. Additionally, although a number of banks were initially interested, only one was used in the programme's first phase. The SUNREF team believe that while its interest was in small and medium scale projects, the banks were interested in targeting much larger ones: this has been an important lesson and has helped shape SUNREF's approach to other banks. Green energy financing has also faced challenges as developers often have limited project development skills and cannot afford to pay for professional services - effectively, partner banks have had to train their clients on RE and the importance of EE management in their organizations. Partner banks' growing confidence and knowledge, including how renewable energy could benefit customers, have been important in creating a sustainable model to support a financing programme.

Despite these challenges, the SUNREF team has helped develop 80 projects that together have the potential to have a significant effect. Between 2012 and 2014, the team evaluated and certified 20 projects as being eligible for financial consideration, eight of which have received loans totaling USD 37 million, and are ongoing or have been completed. And four of these projects have benefited KAM members.

Prior to this manufacturers would more often than not opt to increase their production without doing an in-depth evaluation of the efficiency of their energy use - increased production with inefficient energy use frequently resulted in less than expected returns. The SUNREF team has, however, been instrumental in changing manufacturers' thinking, creating an awareness of the importance of EE and the effects this has on companies' competitiveness and bottom lines.

To date, the programme has helped reduce Kenya's annual carbon dioxide emissions by 65 kilotonnes through the installation of 22 MW of RE capacity, expected to produce 120 GWh/year. An example of how the funds have been used is the solar photovoltaic project at Strathmore University (Box 2). By harnessing RE through a roof-top photovoltaic system, generating 600kW at peak output, installed with the assistance of SUNREF, power outages are a thing of the past and the university stands to save USD 93,000 a year on its energy costs.

SUNREF'S project support for solar roof panel

SUNREF provided a photovoltaic specialist to review Strathmore University's 0.9 MW solar roof panel project's bankability, help draft technical terms of reference for feasibility studies including a comparative analysis of available technologies and network connections; review specifications and issue a certificate of technical and financial eligibility, all the while keeping the bank informed of progress. Once the certificate had been obtained, the university could request its loan and the bank pre-reserve funds from AFD financing. This was not a disbursement, but a guarantee that the bank, if it requested a disbursement, could have AFD funds. That assured the bank's credit committee that the AFD funds would be available to meet the project's long maturities and lower rates to ensure its feasibility. The technical assistance can also help prepare the bank's credit committee and help the initiator anticipate questions. Once the credit committee accepts the proposal, the bank can request a disbursement from AFD. Once that has been made by AFD and the project launched, the technical assistance monitors the project's implementation and its impacts - Kwhs actually generated, etc.

To date, the SUNREF programme has seen more than USD 55 million invested in RE and EE, Phase 2 of the project has received funding of Euros 60 million from AFD, and, due to the success of the first phase, has attracted interest from three more banks. Ultimately it is KAM's hope that the local financial sector will be able to develop and propose tailor-made EE and RE products from its own resources. But is important to reiterate that the success of the programme has been underpinned by the availability of appropriate financing and support from an able technical assistance team.

Footnotes:

1 It is growing at 3.1% compared to overall GDP growth of 5% (World Bank, 2014).

2 Solar, wind and geothermal generation.

3 The Global Environment Facility is a partnership bringing together 183 countries with international institutions, civil society organisations and the private sector, to address global environmental issues.

4 The technical assistance is carried out by KAM via its regional technical assistance team and is supported by AFD and the EU-Africa Infrastructure Trust Fund (EU-ITF).

5 The Cooperative Bank is modeled along the cooperative movement model - small likeminded businesses pool resources and lend these at minimal interest rates. The bank mainly targets the small- and medium-scale businesses and has been recognized as the Most Green Bank at the 2013 Energy Management Awards for achieving the fastest turnaround time for renewable energy and energy efficiency financing for SMEs and Large Enterprises, actively promoting green financing among clients and for being the bank with the largest number of projects seeking green energy financing.

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<http://documents.worldbank.org/curated/en/2014/12/24193201/kenya-economic-update-anchoring-high-growth-can-manufacturing-contribute-more>

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