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SmartLessons
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Maximizing World Bank Group Synergies through Collaboration and Innovation: Lessons Learned from the Thika Power Generation Project in Kenya

The Thika Project represents the first time that an international commercial bank has provided long-term financing to a power project in Kenya on a limited recourse basis. Previous power projects have been financed by international development finance institutions. The project has successfully drawn upon the resources, expertise, and instruments from all three institutions of the World Bank Group (WBG), including IDA, IFC, and MIGA. The innovative project financing and credit structure helped the sponsor successfully raise the project debt while minimizing the government's contingent liabilities associated with the government support that was needed to make the project bankable in Kenya. This SmartLesson addresses some of the challenges that were faced during project preparation and execution and the lessons learned by the one World Bank Group (WBG) team that worked to overcome them.

Background

The Thika Project consists of the development, design, construction, and operations of an 87MW power plant on a 20-year "build, own, and operate" basis in Kenya. It is being developed by Thika Power Ltd., a special-purpose company registered under the laws of Kenya. The sponsor of the project is Matelec Group from Lebanon, an existing IFC client. The total project cost is approximately US$146 million, financed on a 75:25 debt-to-equity ratio. The 15-year debt was provided by three parallel co-lenders, Absa Capital, the African Development Bank (AfDB), and IFC.

Kenya has had an urgent need to expand its power generation capacity for a long time, but the Government of Kenya (GoK) did not have the resources to meet the huge investment required for its long-term capital investment plans for the sector. As the GoK embarked on implementing its Least Cost Power Development Plan (LCPDP), one of the key challenges it faced was the issue of attracting private investment to create a self-sustaining and financially viable power sector, while limiting the level of government fiscal support.

Kenya has over a 16-year track record of successfully working with independent power producers (IPPs). The WBG's engagement with IPPs in Kenya dates back to 1999, when IFC made a groundbreaking investment in Kipevu II (74MW), the first Kenyan IPP to be financed on a limited-recourse project finance basis, which subsequently resulted in the country building a successful track record of implementing a number of follow-on IPPs. The WBG has supported the energy sector reforms for several years, and the country and sector have since developed to provide a benchmark for power sector reform in the Sub-Saharan Africa region as well as the attraction of IPPs—it has a relatively strong and commercially viable off-taker,

Kenya Power & Lighting Company (KPLC), the national utility of Kenya, with a history of never defaulting on its power purchase agreement (PPA) obligations; a strong independent regulator with a transparent and consistent tariff-setting regime; and a track record of competitive tariff-based bidding processes to award IPP concessions.

Despite this track record, Kenya was embarking on an ambitious power development program, the LCPDP, which required the development of several power plants over the next 10 years in order to meet its Vision 2030 plans of becoming a middle-income country. KPLC understood that it is necessary to provide support for the power purchase agreement that it would be signing with multiple private producers. A potential source of such support was a GoK guarantee; government guarantees have been deemed to be one of the key requirements by many lenders and sponsors to move forward. However, the GoK was limited in its ability to provide a sovereign guarantee due to the tight debt ceiling agreement with IMF, and the potential contingent liabilities associated with such guarantee. Moreover, given Kenya's track record with IPPs, the GoK was reluctant to provide guarantees to support what it considered to be a credit-worthy off-taker, and a self-sustaining power sector.

A short-term liquidity facility (that is, a revolving letter of credit (L/C), backed by a sovereign guarantee and full cash collateral, was an alternative option, following the standard practice for private power projects of this type in Sub-Saharan Africa. However, given the scale of the LCPDP, KPLC also wanted to avoid the "cash trap" in the traditional L/C structure in order to maximize the use of its capital and cash balance. As such, even for a relatively well-run and profitable off-taker such as KPLC, the off-taker would need some form of support in order for investors and lenders to be comfortable with its ability to raise L/Cs to back its short-term obligations under the power purchase agreements to be entered into.

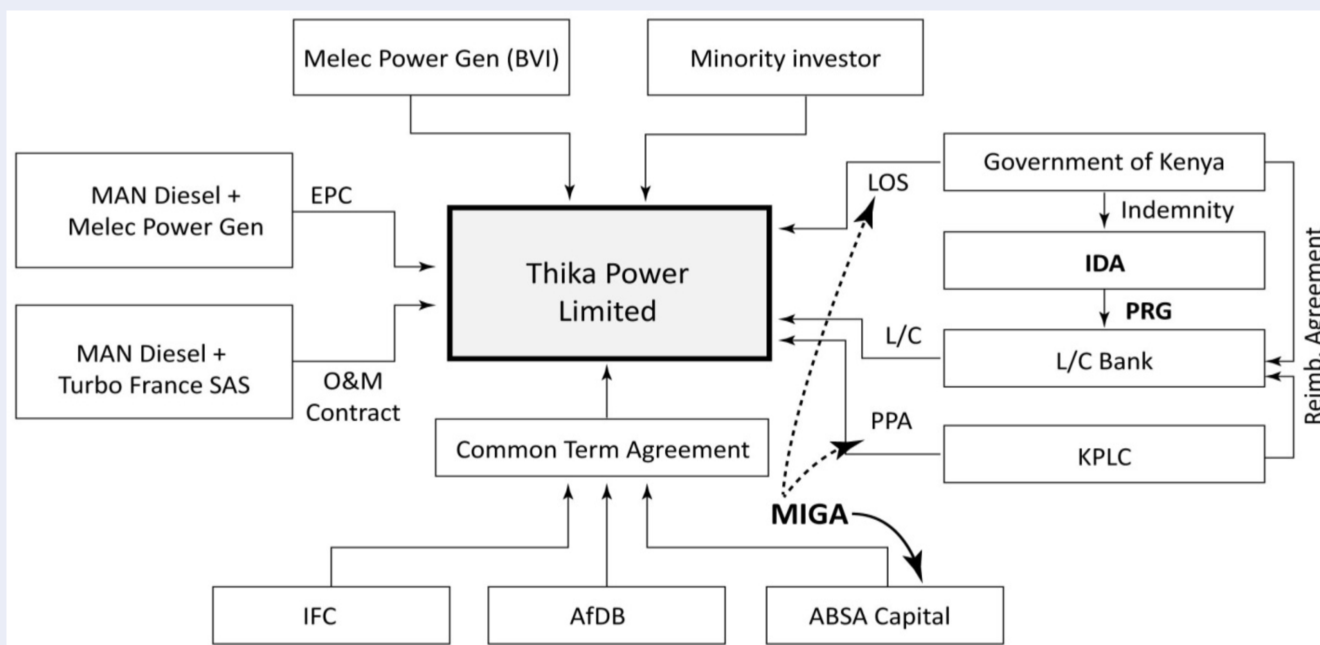
The key challenge was therefore to find a payment security arrangement that was acceptable to all key parties involved, including the GoK, KPLC, and the international lenders and investors. If structured successfully, the Thika Project's contractual and financing structure would serve as a benchmark for other projects as the GoK embarked on implementing its ambitious LCPDP; the Thika Project was expected to be the first IPP to be developed under the WBG program utilizing IDA and MIGA guarantee products and with financing from IFC.

The WBG Solutions

Facing the challenges, the World Bank Group provided a new solution by combining the IDA Partial Risk Guarantee (IDA PRG) to support the short-term liquidity (i.e., backing KPLC's obligations to the L/C issuing banks), a relatively small amount, to the project company, with the MIGA termination guarantee for a relatively larger amount under the key project agreements; this allowed commercial lenders to complement the long-term financing provided by IFC. This innovative structure brings valuable benefits to the GoK by reducing its contingent liabilities, as it might otherwise have to guarantee the entire power purchase obligations of KPLC.

There are three key elements to this innovative payment security arrangement: KPLC L/Cs backstopped by IDA PRG to support short-term liquidity, a PPA with KPLC and a Letter of Support (LOS) with the GoK focusing on political force majeure events, both of which have termination payment

Figure 1. Thika Project's contractual structure.



clauses that will be guaranteed by MIGA's breach of contract cover. The chart in Figure 1 illustrates the project's contractual structure.

The L/C has been issued by Citibank for a period of 15 years. It is intended to cover KPLC's short-term payment obligations, mainly three months of capacity and energy payments and two months of fuel payments, under the PPA. The IDA PRG is for 15.5 years for up to $45 million in total to cover the repayment obligation of KPLC and the GOK, respectively, to the L/C bank in case of a drawdown by Thika Power Ltd. under the L/C according to the PPA or LOS. This was the first time that commercial banks issued a long-term L/C facility in Kenya, which are usually issued for a one-year period and renewed every year. Subsequently, due to the support by IDA PRG, KPLC was able to avoid tying up a large amount of cash as collateral. Most critically, this allowed the World Bank to have a seat at the table to ensure that, in case of defaults, the Bank can use its convening power to ensure that the KPLC (and the GoK) follow through on their obligations under the project agreements.

MIGA has provided termination guarantees to cover commercial lender Absa Capital's principal, interest, and interest rate swap exposure through its breach of contract coverage against the PPA with KPLC and the GoK LOS for up to 15 years. Without MIGA guarantees and IDA PRG, few international lenders would be interested in providing long-term loans to power projects in Kenya.

From the financing side, IFC has provided a 15-year senior loan of US$36.5 million. The long tenor is critical in an environment where such long tenor is scarce. IFC also played an important role in the project's structuring and in bringing valuable perspectives of private participation as well as promoting South-South investments.

Lessons Learned

The structure of combined IDA PRG with MIGA insurance has optimized the limited resources of the host government and led to the more efficient use of various instruments of the WBG to help mobilize more private sector capital to fund the critically needed infrastructure in Kenya. The instruments from IDA, IFC, and MIGA are complementary, while the teams from the three WBG institutions have been working closely together throughout the entire process coordinating and sharing due diligence, which has maximized the efficiency and reduced the burden on the sponsor and other lenders. It is expected that similar structures can be considered in other developing countries where appropriate.

There are a number of important lessons learned in this innovative joint project. Traditionally the joint IDA, IFC, and MIGA projects have been limited to relatively very large, complex projects in high-risk sectors or countries where the instruments from all three institutions are needed, such as the Bujagali Power Project in Uganda. The Thika Project has demonstrated that cross-WBG collaboration and synergies

Thika power plant during construction.

can go beyond this. It is a good example of innovative and efficient use of WBG instruments for the best interests of our client investors as well as the host country. Here are some of the key lessons learned:

Lesson 1: Maximize synergies, risk sharing, and leveraging on each other's strengths among the WBG for the benefit of our clients.

By working together, IDA PRG, IFC, and MIGA were able to play on our own strengths and go the extra mile to find a creative solution to better serve our client, as already mentioned. From MIGA's perspective, since IFC and MIGA are following the same principles and performance standards on environmental and social compliance, MIGA was able to rely on IFC's environmental and social due diligence work to avoid redundancies and reduce the burden on clients. In return, the IFC team was also recognized for its cross-support through the IFC corporate scorecard and mobilization ratio. In addition, this is also one of the first times that MIGA has offered to cover the risk of a state-owned enterprise off-taker on a stand-alone basis with reasonable pricing. This was made possible largely due to the IDA PRG support in the same project.

Lesson 2: Cross-boundary knowledge and experience are critical for innovation and collaboration across the WBG.

A recent study by scientists has shown that innovation is not about how smart we are but how well connected we are.[1] In seeking creative solutions for our clients to have

1 The Origins of Creativity by Heather Pringle in Scientific America, March 2013.

Thika power plant control room.

a better development impact, we all need to have a better understanding of each other's products and offerings, in order to be able to think outside our individual institutional boundaries. Such cross-boundary knowledge and experience can only be built on appropriate training, project experience, and practice and can be promoted through staff mobility and knowledge sharing. In the Thika Project, the key task team leaders from all institutions have some prior knowledge and experience working with each other, which helped facilitate the process. In addition, those task team leaders have demonstrated true teamwork, collaboration, and knowledge sharing to make the final project structure accepted by all parties and successfully tested by the market.

Lesson 3: Be proactive in promoting WBG collaboration and instruments at an early stage of the project preparation.

The structure of combined application of IDA PRG and MIGA guarantees was proposed by the WBG to the host government and KPLC at a very early stage of the project preparation and was offered in the original bidding documents issued to prospective investors. Such a proactive approach was very effective and well received by the host government and private sector investors. The approach has helped to improve the success and bidding result for the GoK and KPLC, as it has increased the interest, confidence, and numbers of interested investors and bidders.

Lesson 4: It is important to harmonize the policies and procedures across the WBG.

This is particularly important for public-private partnership (PPP) projects of this type. During the project preparation and due diligence phase, the social and environmental policies and procedures among the World Bank and IFC/MIGA were not entirely aligned in some aspects, such as the project's environmental and social category and public disclosure period. Such inconsistencies can be one of the bottlenecks affecting the project execution and timelines for our clients. The good news on this is that, starting July 2012, projects that are developed for the private sector with Bank support can deploy Bank Performance Standards (which are the same as IFC's performance standards), thus harmonizing the environmental and social requirements of the three agencies of the group.

Conclusion

The development challenges of our client countries and investors often differ from country to country and from project to project. One single instrument from any one of the WBG institutions may not be sufficient. However, by working together as one World Bank Group, we may be able to provide better and more creative solutions to better serve our clients' finance and risk-mitigation requirements. To make that happen, we need a true spirit of innovation and collaboration, which requires cross-boundary knowledge and experience. In addition, by streamlining and improving some of the internal policies and procedures, we can improve the process and the quality of delivery to better serve our clients.

DISCLAIMER

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