

C L I F F O R D

C H A N C E



**WHITE PAPER**  
**DOING BUSINESS IN AFRICA**  
FINANCING PROJECTS,  
ACCESSING LIQUIDITY AND  
FINDING THE RIGHT PARTNER IN  
A COMPETITIVE MARKET PLACE

APRIL 2020

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# FOREWORD

EDMUND BOYO

PARTNER AND CO-HEAD THE AFRICA PRACTICE

Africa is a continent thirsting for power. A study by McKinsey & Co. estimated that demand for electricity in Sub-Saharan Africa will jump four-fold between 2010 and 2040, representing average growth of 4.5 percent per annum.

In order to realize its full energy potential, Africa will require about \$490 billion of capital for power generation and another \$345 billion for transmission and distribution.

The good news is there's no shortage of funds available. The African Development Bank has \$208 billion, the African Export Import Bank has \$16.6 billion, Africa Finance Corporation brings in \$6.6 billion, Africa 50 has about \$1 billion and the African Development Fund has about \$3 billion in concessional resources. With the additional funds that other international development finance institutions bring, the market believes there is in excess of \$250 billion available for power and infrastructure financing in Africa.

Furthermore, a large number of funds, especially green funds in the renewables sector, make available additional billions of dollars for power and infrastructure financing in Africa.

The challenge for investors in the power and infrastructure sectors then is to put together the optimal financing package, for the right projects, and with an appropriately mitigated counterparty risk.

There's a lot already happening on the African continent, and there's a lot activity to come in the years ahead. With that activity come opportunities.

At Clifford Chance, we are pursuing those opportunities not only through the traditional established offices of London and Paris, but also significantly through our offices here in the Middle East where we are fortunate to have a "unique offering", which combines (i) highly experienced team with market leading expertise in finance (including capital markets and Islamic finance), corporate and private equity, litigation and disputes resolution, project development and financing and construction; and (ii) English, French and Arabic languages capabilities.

We have closed deals in Africa with value in excess of \$20 billion in over 30 countries. In power, we have closed deals with more than 10,000 megawatts of generation capacity.

While it is challenging to implement projects in less developed countries, we have been on the African continent for more than 45 years and have gained invaluable experience in putting together power and infrastructure deals and also allocating risk in a continuously evolving environment ... often developing 'first of the kind' types of structure.

This document captures key elements of the discussion on **Doing Business in Africa** held at the Waldorf Astoria in Dubai on November 26, 2019.

Two major themes were discussed at the meeting of minds:

- Bankability of the power projects, mitigating offtaker and political risks
- Structuring the right blend of financing

I would like to pass on my sincere thanks to our esteemed panelists and to our audience for making it a lively and informative session for everyone. I would also like to extend my thanks to my colleague, Alhassane Barry, Counsel in our Energy, Project and Infrastructure Group, for moderating superbly the session and for sharing his vast experience with the audience.

We hope you find this white paper useful and I would love to hear your feedback on some the issues discussed.

Best regards,  
Edmund Boyo



## Welcome address:

**Edmund Boyo**

**Partner at  
Clifford Chance,  
Co-head of the  
Africa Practice**

Edmund Boyo is Co-head of the Africa Practice, and a member of the Firm's Africa Leadership Group. He specialises in structured finance transactions, in particular project finance, asset finance, corporate banking and restructurings. He acts for sponsors and financiers on all aspects of international project financings (including petrochemicals, mining and ports).

# THE PANELISTS:

The speakers, all veterans of transacting business in Africa, brought expertise from various stakeholder perspectives—of developers, development financial institutions, development and commercial banks, and legal firms.

## **Dr. Adesegun A. Akin-Olugbade**

**Of-Counsel at Clifford Chance and former Executive Director and General Counsel of Africa Finance Corporation and former General Counsel of African Development Bank**

Dr. Adesegun A. Akin-Olugbade is a leading international legal and finance expert with extensive transactional experience and corporate governance expertise. He was previously General Counsel and Senior Director at the African Development Bank (AfDB) and the first Chief Legal Officer and Head of the Legal Services Department of the African Export-Import Bank (Afreximbank).

## **Dr. Mansur Noibi**

**Head of Legal at Islamic Development Bank**

Dr. Noibi is currently the Director for the Legal Department at the Islamic Development Bank in Jeddah. He has previously served within the legal field for over 10 years, giving him strong competences within domains such as law, corporate finance, project finance and banking. He also holds vast experience working on different types of projects operating in the sphere between public and private sector.

## **Charles Liebenberg**

**CFO at AMEA Power**

Charles is Chief Financial Officer at AMEA, prior to this he has worked in investment banks for 16 years with a focus on corporate finance and project finance. Charles successfully established the first IPP company in South Africa alongside building the first private power projects in the region. He went on to develop an enviable portfolio of power and infrastructure projects throughout the African continent.

## **Tshifhe Ramabulana**

**Senior Legal Counsel at Standard Chartered Bank**

Tshifhe is a Senior Legal Counsel, Global & Commercial Banking, Africa & the Middle East at Standard Chartered Bank. He is responsible for transactional and product legal coverage in Global & Commercial Banking products in Africa and the Middle East. His experience covers project finance, transaction banking, restructuring, leverage finance, structured trade finance, syndicated lending and structured commodity finance. Tshifhe was previously based in Johannesburg where he played key roles in structuring the financing of power, infrastructure, mining and oil & gas projects across the continent.

## **Alhassane Barry (speaker and moderator)**

**Counsel at Clifford Chance, Member of the Africa Group**

Alhassane Barry is Counsel in the Energy, Project and Infrastructure Group and a member of the Firm's Africa Group. Alhassane specialises in international project development and finance. He has vast experience in advising on transactions within the power, infrastructure, telecommunications, metals/mining, oil & gas and natural resources sectors with a strong emphasis on emerging markets such as Africa and Middle-East. He advises sponsors, financiers and developers and his experience spans over 25 countries in Africa and in the Middle-East. Alhassane is a recognised leading expert for project development and financing transactions in Africa.

# THEME 1: BANKABILITY OF THE PPA AND MITIGATING COUNTERPARTY AND POLITICAL RISK

A bankable power purchase agreement (PPA) and a reliable and creditworthy counterparty are the basic essentials required to get a power project off the ground.<sup>1</sup>

The PPA sets out the framework for the financing, development, construction, operation and maintenance of the project. It is one of the most critical project documents for the success of the project because it is the revenue generating contract. Tariff payments under the PPA sustain the economic viability of the project as they ensure the return on investment for equity investors and the repayment of debt for the financiers.

From offtaker and the government perspective, the PPA also sets out the rights and obligations (including technical and environmental) of the project company.

On the offtaker and the government's sides, it is important to ensure the project is awarded to an entity (or consortium) that will be able to build a sound and robust infrastructure, and which has good managerial capability, efficient operational practices and robust billing mechanisms.

Very often, however, the counterparties of the project company, which are usually government utilities, are perceived to be (or indeed, prove to be) poorly managed and/or in dire financial and economic conditions. They, therefore, heighten the risk of default under the PPA. The key in structuring power and infrastructure projects in Africa is to devise the "right solution" to mitigate this risk in order to secure funding from investors and financiers. While historically the expectation was for a host government to guarantee the payment obligations of the counterparties, questions arise as to whether such model is sustainable and viable going forward (especially, with the mounting pressures on government's foreign currency reserves), and if it is not, what alternative solutions could be implemented.

**Charles Liebenberg**, said: *"Unfortunately, the majority of the utilities in Africa are not bankable, which means we need government policy and regulation, support from Development Financial Institutions (DFIs) and the insurance providers to all work together in order set the foundation where the developer can then actually step up and take the counterparty risk."*

**Dr. Mansoor Noibi**, said that not only does his institution, which is active in the energy space across Africa, aid member countries but also helps developers by creating sustainable and ethical financing structures that help underpin the bankability of projects in Africa.

The IsDB approach is to engage - from a group perspective - by not only securing financing, but also putting together various types of credit enhancement and risk mitigation instruments to facilitate and mobilize funding. *"This is done by ensuring a comprehensive partnership of all stakeholders and working closely with them to develop a structure that would be attractive to developers,"* he said.

**Alhassane Barry**, explained that the history of African PPAs has to a large extent been the continuous pursuit of innovation to improve the credit risk or finances of the counterparties and the States.

Traditionally, there has been a classic state guarantee behind the offtaker to cover payment default. But with foreign currency reserve pressures building up on governments and the number of PPA increasingly significantly, most governments, investors and financiers fear the risk of the governments being unable to continue to stand behind these guarantees, also exposing the domestic market to a systemic risk that could concern all the PPAs.

*"The market is gradually moving away from (or combining with) the traditional model to other structures, such as a liquidity partial risk guarantee with letters of credit to enhance the credit risk; but that solution too is evolving toward new products, partly due to difficulties in a number of jurisdictions to find*

<sup>1</sup> In certain jurisdictions, the PPA is accompanied by a concession agreement or an implementation agreement. For the purpose of this note, we will only refer to the PPA.

## THEME 1: CERTAIN BANKABILITY ISSUES IN POWER PROJECTS AND MITIGANTS (CONT.)

*acceptable issuers of letters of credit at a commercially viable pricing, such as direct guarantees (one that flows directly to the project company in respect of offtaker and state's obligations) and other structured financing”* he said.

Another innovation of the market referred to by Mr. Barry is the concept of a PCOA (put/call option agreement) that was set up for Nigeria's first private IPP, the Azura Edo project. The PCOA, which effectively replaces the sovereign back-stop, ensures that in case of offtaker default, the project company has an option to sell the asset, or a share of the project, to the government for an agreed purchase price that would cover the debt. Reciprocally, there would be a call option from the government to do the same.

However, the PCOA mechanism has yet to find wide acceptance. According to Dr. Adesegun, in light of the World Bank negative pledge, there is a question as to whether the PCOA is deemed to be a contingent liability of the sovereign.

**Dr. Adesegun A. Akin-Olugbade**, agreed that most governments are unable to continue providing guarantees, especially for foreign currency denominated debt or equity when the revenues under the PPA are in local currency, because it means a higher exposure to defaulting risk. As a result, debt sustainability becomes an issue, as many of the sovereigns are stretched in terms of exposure, whether measured by the debt-to-GDP ratio or even by the revenues-to-GDP ratio, Dr. Adesegun noted. This unwillingness by sovereigns to take on financial obligations is forcing the market to innovate new solutions.

A number of sovereign entities also operate under constraints set by the International Monetary Fund or the World Bank (the World Bank Group) when it comes to giving guarantees since they benefit from financing provided by those institutions that come with negative pledge clause that forbids a public borrower from securing external debt that is preferential to that of the World Bank Group.

A third challenge in this context is the commercial viability of counterparties, which makes their privatization economically, politically and socially difficult.

*“So I think that's where a key challenge is. We're going to have to consider a paradigm shift; look at market-based innovative solutions for the problem, and not look to governments for solutions,”* Dr. Adesegun said.

Political risk, according to **Tshifhe Ramabulana**, is also a key concern for commercial banks involved in power and infrastructure projects.

Because of the risk associated with changes that may occur within a country's policies, commercial laws, or investment regulations, commercial banks have to be very careful in the selection of projects. This is particularly significant in the run-up to national elections.

*“We have to be very mindful of what might happen to the deals we strike around election time. There are potential reputational risk issues involved in those so called “election deals”,”* Ramabulana said.

An allied challenge comes from the sustainability of a project, both in terms of financing and environmental and social issues. Ramabulana said most commercial banks are signatory to the Equator Principles and hence have to manage environmental and social risk in projects. Needless to remind that development financial institutions have heightened scrutiny for environmental and social risk in projects.

*“That is a huge factor in terms of selecting our partners—developers, and multilaterals—as they also play a key part in allaying these key concerns relating to the bankability of projects,”* he added.

## THEME 2: STRUCTURING THE RIGHT BLEND OF FINANCING

The DFIs, who provide loans and/or arrange financial guarantees for most power and infrastructure projects in Africa, generally extend funding in hard currency, partly because they are funded themselves in hard currency, while the revenues from the projects are in often local currency (either directly or in local currency equivalent of foreign currency converted at an agreed rate. This unhedged currency exposure can lead to exchange rate losses which, in the past, used to be guaranteed by the host government.

However, with the increasing pressure on sovereign foreign currency reserves has led many African governments to tighten their exchange control regimes. For instance, it has become more and more difficult over the years to set up offshore accounts or onshore foreign currency denominated account. Many countries that rely on commodity exports often see their currencies fluctuate sharply along with commodity prices, leading to situations where the governments have to hedge or absorb the exchange rate risk.

**Charles Liebenberg**, said it is very difficult for a many African countries, due to limited exports and therefore limited availability of foreign currency, to take on additional foreign currency debt while guaranteeing the private sector's obligations in hard currency.

Debt liabilities in foreign currencies increase in local currency terms when the local currency depreciates—as many African currencies do. With the cash flow from the offtaker, who sells power in the domestic markets denominated in local currency, developers often face the need to convert the local currency to foreign currency to make payments abroad. This doesn't always work well with the national budget and the state's balance of payments.

Dr. Noibi said IsBD has in the past leveraged its special creditor status and credit enhancement mechanisms to transfer specific risks to host countries while ensuring that there was no exchange risk limitation on the bank. However, he said, IsBD did have a situation in a major oil producing African country *“where we faced default and we had to sustain the member country in order to get payments in.”*

According to Barry, there are no easy solutions even in the CFA zone where 14 African countries share a common currency scenario, the CFA franc, which is pegged to the euro at a fixed parity. *“In this system, we basically have the French Treasury providing the support for the convertibility risk. However, while there is no convertibility risk between the CFA and the euro because of the fixed parity guaranteed by the French treasury, that comfort comes with a lot of constraints for African member states, their central banks and in terms of foreign exchange control regime for investments in those countries ; and considering the intense criticism that the system is under, it is expected to evolve significantly in a near future”* he said.

One solution to foreign exchange controls is local currency financing. Having liabilities in the local currency is the safest strategy to hedge against risks of currency devaluations and the mismatch between the currency of the debt and that of the revenues, panelists agreed.

DFIs have therefore worked with local and international commercial banks to find ways to mobilize local currency financing in power and infrastructure projects alongside foreign currency denominated debt. For example, in the Nachtigal Hydro IPP financing in Cameroon (closed 2019), the local currency financing represented approximately 20% of the US\$880 million debt financing for a total capex of approximately US\$1.2 billion.

*“When we look at the debt sustainability challenges of member countries, we realize that it is in their interest to be able to obtain financing in a local currency,”* said Dr. Noibi.



## THEME 2: STRUCTURING THE RIGHT BLEND OF FINANCING (CONT.)

For the developer too, there would be a lot of comfort if the debt is local and he has to hold only a small part of the equity, said Mr. Liebenberg.

A good way to raise local financing, he added, is to target state pension funds and other local institutions that seek good investment options in addition to the local stock exchanges, which are often small and yield low returns.

*“Create infrastructure bonds denominated in local currency for these funds to invest in. The tariff, which is in the local currency, can be used to service the debt, which would reduce pressure on the government. This is one way to innovate financing structures,”* said Mr. Liebenberg.

Mr. Ramabulana agreed that the involvement of local pension funds to take care of a large proportion of financing such projects would to some extent relieve the commercial banks of the pressure to manage debts.

Dr. Adesegun, however, pointed out that while everybody recognized that pension funds can play a big role in infrastructure financing of Africa, one of the constraints is national legislations that restrict pension funds from being invested outside of the country where the pensions are generated. *“I am hoping that with the establishment of the African common free trade area, which is creating a common market, some of those restrictions will be lifted. That would allow for free flow of pension assets, outside of their national jurisdictions,”* he said.

## CASE STUDY

### Good government support helps bring in the funds

The South African renewable energy program has put almost seven gigawatts onto the transmission network with an investment of about \$40 billion, of which nearly 98 percent is local debt.

It has explicit government guarantee behind the PPAs with inflation-indexed escalation, implying a ‘risk-free return’ from a financial risk perspective.

Most of the banks that have the \$40 billion debt don’t keep it on their books. They have offloaded it on to other institutions, such as insurance companies.

Overall, with the right government backing and will to raise local funding, it is possible to bring a successful investment into the economy.



Until recently, most of the financing on the African continent used to be undertaken by international banks or DFIs as country-level loans. Of late, however, local banks have begun to develop an appetite to lend to such projects.

*“In a number of projects today, you see a fairly sizable local tranche, sitting alongside the foreign denominated currency. In certain countries, for examples, Cameroon, Nigeria, Kenya, Egypt or Morocco – to name a few countries - there is available local currency funding sufficient to finance entirely in local currency small to medium projects”* Mr. Barry said.

However, Ramabulana said his bank, with its different cost structures, didn’t compete with local banks for a number of reasons. *“One reason is that if we have an over-configuration of local debt it will raise liquidity issues.”*

Another reason is the distribution strategy of the commercial bank. *“We would not want to hold a debt for 12-15 years; we have to sell it down at some point. So, unlike a local bank holding a local currency debt, a key consideration in how we manage our capital and portfolio would be to make sure we are able to sell that debt down the line,”* Mr. Ramabulana added.

Also, some countries have the single borrower limit—restricting the amount that a bank can lend to a particular borrower—and that would also limit the loans that banks are able to advance to large power projects.

If the banks take on too much local debt they could end up being overly exposed to offtaker risk, which is essentially government risk because of the underlying government back up.

*“If not carefully considered, an international bank may risk finding itself stuck carrying a large chunk of local debt and that affects your future capital allocation,”* he said.

In addition to growing local banks markets, there is also a number of funds including “green” and “blue” funds (especially in the renewables projects) that are set up and endowed with additional funding available to power and infrastructure projects in Africa. Those funds work well with DFIs as well. For examples, they can make available to DFIs, through separate program wide funding arrangements, funds that DFIs can use to finance project, and those funds will therefore benefit from the same protections granted to DFIs (such as the preferred creditors status). Those funds also take comfort from the scrutiny of the procurement process undertaken by DFIs and their high environmental and social standards.

Another major source of funding is, of course, from Chinese investors and financiers. China today is among the largest investors in Africa—as suppliers, EPC contractors, debt provider, or equity providers. China also holds a staggering amount of sovereign debt, and therefore, makes available to states and public entities important funds to finance their needs for infrastructure and power projects.

Here as well, the market has evolved and we see happening a shift in the traditional Chinese financing model. *“There is a trend to structure the Chinese investment as a typical limited recourse project financing because a number of Chinese supplier contractors, and behind them Chinese banks that finance their operations, have found themselves in grave difficulties on some projects where the particular project risks were not well segregated,”* Mr. Barry said.

In an evolving model, one might also expect Chinese banks to come into a financing as an equity provider or set up a joint venture with the developer. Together, the JV will be able to access funding from Chinese banks, but also from institutions like DFIs and commercial banks.

**“WHEN WE LOOK AT THE DEBT  
SUSTAINABILITY CHALLENGES OF  
MEMBER COUNTRIES, WE REALIZE  
THAT IT IS IN THEIR INTEREST TO  
BE ABLE TO OBTAIN FINANCING IN  
A LOCAL CURRENCY”**

Dr. Mansur Noibi

# OUTCOMES

Following a lively panel discussion and interesting questions from the audience, the following outcomes were observed.



One of the biggest challenges in structuring a bankable PPA is the lack of credible and reliable offtakers in Africa.



More support from the government, more credit enhancement measures from DFIs and innovative insurance products are some of the measures that help lay the foundations for a sound project.



Political risks and concerns relating to the social and environmental sustainability of the projects play a big part in stakeholders' selection of partners.



A critical need for projects in Africa is local currency financing as this eliminates exchange rate risk for the host government.



Infrastructure bonds provide a key investment option for local financing through pension funds and other entities.



Local financing deepens local capital markets, and also, by enabling local participation in economic activity, fosters an investment-friendly ecosystem in the country.



Watertight procurement rules and a strict adherence to them can mitigate the dominance of a single category of investors in African projects.

## CONTACT US

For more information about our series of Doing Business in Africa Seminars, please contact Roshan Khan, Head of Business Development, Middle East on [Roshan.Khan@CliffordChance.com](mailto:Roshan.Khan@CliffordChance.com)

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