CASE STUDY 5: UGANDA - WEST NILE RURAL ELECTRIFICATION PROJECT

Barriers	Lack of long term debt financing
Instrument	Two-step financing backed by liquidity guarantee
Application	Bullet repayment of initial 8-year loan with new 7-year loan with amortization payments on the two loans profiled to match a 15-year loan. Liquidity guarantee of funds for new 7-year loan
Amount	n/a

PROJECT BACKGROUND AND OBJECTIVES

The Government of Uganda has set the rural electrification as one of the main priorities and key to poverty alleviation. However, one of the challenges to increase the rural electrification was the replacement of the conventional government-led rural electrification, with a private sector-led, commercially oriented program. While there was government willingness to pursue the rural electrification through this program, there were no institutional capacity and appropriate institutional framework to lead such program. In addition, there was a lack of [local] financing options necessary to attract private sector to develop such projects. The existing loans in Uganda were limited by the national banking regulation to longest maturity of eight years. However, this maturity makes them inadequate for most of the renewable energy financing needs.

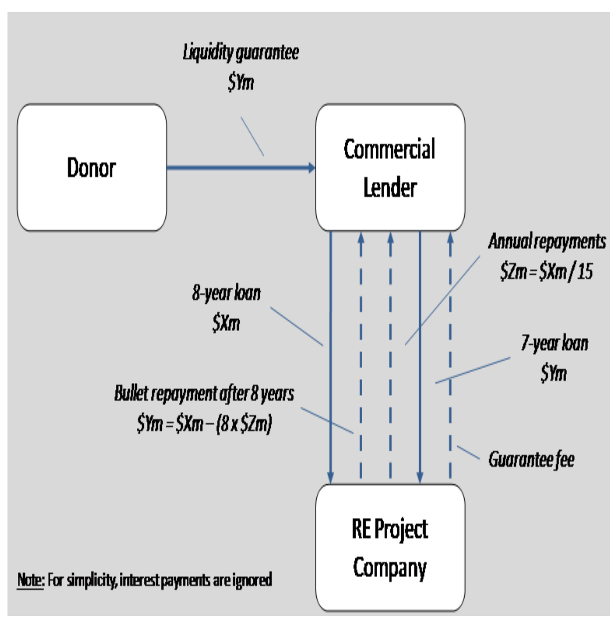
INSTRUMENTS USED

Under the West Nile rural electrification project, the World Bank has devised a means to circumvent this restriction through the use of a liquidity guarantee and a two-step financing mechanism.

INSTITUTIONAL ARRANGEMENTS

A commercial lender, in this case Barclays Bank, makes an eight-year loan to the West Nile Rural Electrification Company (WENRECO) which holds a 20-year concession to operate a 1.5 MW thermal generator and construct a new 3.5 MW hydro generator. The amortisation profile of the loan is calculated as if it has a term of 15 years, but with a bullet payment of the outstanding principal at the end of the loan term. At the end of the eight-year term, Barclays extends a new seven-year loan to the borrower, with a principal equal to the outstanding principal on the original eight-year loan. The new seven-year loan is then repaid under the same amortisation schedule as previously applied. The effect is to create an amortisation profile for the borrower equivalent to a 15-year loan while ensuring repayment of the first loan in full to Barclays after eight-years.

This arrangement creates a liquidity risk for Barclays in



that repayment of the initial eight-year loan is dependent on Barclays having sufficient available funds to lend to the borrower at the end of this first loan's term—as the borrower is reliant on this second loan to repay the outstanding principal on the first loan. The liquidity guarantee offered by the World Bank gets around this. For a guarantee fee, the World Bank agrees to provide the necessary funds to make the second seven-year loan in the event that Barclays is unable to do so. The cost of the guarantee fee is passed to the end borrower in the form of an increased interest charge.

The liquidity guarantee, therefore, offers a low-cost means of extending the term of the loan to the RE developer from eight years to 15 years. The same arrangement could be applied where other restrictions (e.g., internal credit policies) prevent loans being extended for the term lengths necessary for RE projects to be viable.

Even with this guarantee, however, the resulting commercial loan represents only 10% of the project cost. However, if successful, it can be expected that the mechanism can be extended in future.

OUTCOMES

Since the start of its concession, WENRECO has experienced persistent cash flow difficulties. These led to suspension of work on the hydro plant in 2008 and, in March 2009, to the shutdown of the operations of the thermal generator. WENRECO blamed these difficulties on delays in the payments of government subsidies that cover 60% of the project costs, non-payment of electricity bills and failure to implement tax exemptions. The government blamed the problems on poor management while the regulator drew attention to an overshoot of costs for the mini-hydro project and the failure of the main fuel supplier to meet its commitments. In April 2009, a new arrangement was reported to have been reached whereby the government would pay for fuel costs for the thermal plant. The most recent reports are that reconstruction on the hydro project finally resumed in August 2010 following the appointment of a new contractor and the taking of a 10% stake by the government, with the project now expected to commission by end-2011.

Further reading

Sunday Vision, WENRECO hit by cash crisis, 2009 – click here

Sunrise, Anger mounts in Arua over Power, 2011 – click here