

# Africa's shift to funding sustainable power in local currencies: The opportunity for ECAs

**Is Africa's policy shift towards PPAs in local currencies an opportunity for ECAs to support the long term sustainability of the energy sector? By Harald Hirschhofer, Senior Advisor at TCX and Vivek Mittal, CEO of African Infrastructure Development Association.**

In the late 1990s and early 2000s Export Credit Facilities provided up to 40% of capital investments for IPPs in developing countries, but their participation waned and today only a very modest share of project costs are covered by ECA finance. Is an ongoing policy shift to local currency (LCY) Power Purchasing Agreements (PPAs) an opportunity for ECA finance to support the climate finance agenda?

## **Better risk allocation and management is needed to accelerate investment into renewable energy**

PPAs facilitate private sector led independent power project (IPP) financings by contractually securing long term revenues. PPAs in African IPPs are usually denominated in, or indexed to, US dollars or other hard currencies. South Africa and CAF countries are rare exceptions. PPAs are typically enhanced by Multilateral Guarantees from the likes of AfDB and World Bank, but in the first instance are guaranteed by



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national treasuries. However, the first line of payment are citizens and customers of these countries who bear a pass through of the generation costs from IPPs. As soon as a drought, flood, pandemic, or other shock hits a country, the currency of a developing country is likely to depreciate instantly, increasing tariffs and energy costs for already vulnerable local consumers. This is not only socially unsustainable, but also

inefficient from a financial risk management point of view.

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The move towards local currency PPAs started in the late 1990s, following the Asian currency crises. Dramatic currency depreciations triggered step increases in tariffs of US dollar linked contracts to IPPs and other infrastructure and added stress to scarce currency reserves of treasuries and central banks. Importantly, the subsequent adoption of local currency PPAs and better

accelerating the debate around adopting local currency PPAs.

### **An important opportunity for ECAs**

ECAs can play an important role in supporting the adoption of local currency for PPAs in Africa. Based on Berne Union data for the three-year period 2018-2020, ECA long term commitment in Africa has averaged \$12 billion annually, of which approximately 20% is estimated to fund private sector projects. Renewable energy has only received \$452 million between 2019-2020. To put this in context, the infrastructure funding gap in Africa is estimated at \$50 billion annually. While this is significant in terms of existing ECA flows to African infrastructure, there should be capacity judging from the annual global ECA led infrastructure flows of \$140-160 billion, and overall ECA backed flows of trade of \$1.1 trillion annually.

### **Kenya's case**

Consider the specific case of Kenya to explore how ECA can support a shift to LCY. In September 2021, a Presidential Taskforce on PPAs recommended the increased use of Kenyan Shillings (KES) along with several other energy sector reforms to improve how energy projects are planned, procured and managed. Such reforms are geared to accelerate investment flows, improve risk resilience of consumers and the utility, and make monetary and fiscal policies more flexible.

Kenya currently has approximately 2800 MW power sector capacity operating and in construction – of which approximately 1100MW is private sector led in the form of IPPs. It is expected that over the next 10 years, the country could deploy a further 1000-2000 MW of additional capacity, mainly in solar, wind, and geothermal energy and associated storage. The existing and pending private sector capacity could increase current IPP generation from 2.8

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protection of consumers and taxpayers from currency risk in South Africa, India, Vietnam, and Brazil boosted investment and improved access to affordable energy because it was accompanied by other significant reforms including massive accelerations in administrative processes to license power projects.

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billion kWh a year by two to three times in 2030 and increase the annual spend of from \$350 million on IPP procurement by the same factor. The investment required for this 1000-2000 MW capacity addition is estimated at \$1.0-2.0 billion (in current terms), and approximately 40-50% of this could be eligible for ECA backed financing.

The Kenyan financial system is arguably already deeper and more developed than many of its peers in other African countries. Local debt markets are growing at a good pace and innovative international efforts such as TCX and Guarantco are delivering new solutions and instruments in both funding and risk markets to support a shift to local currency PPAs.

For example, TCX offers hedging contracts with tenors of up to 20 years and is working with local and international banks to build a swap curve in KES. Despite the impact of the COVID crisis, it is possible to hedge a total volume of about \$500 million, and perhaps even more, each year in the KES swap market. Combined with the domestic debt market and domestic savings, there is sufficient funding and hedging capacity to address a good part of the renewable energy sector investment requirements.

### How can ECAs help?

ECAs can contribute to this shift to LCY finance in several ways, including with innovation and the capacity of the global ECA finance market for fostering trade in capital good and technology transfer. Effective guarantee solutions are needed to address credit risk associated with long term local currency lending operations and to support green bonds issued to finance renewable energy projects which have local currency PPAs.

Convertibility risk protection will still be needed for synthetic local currency lending

(which is disbursed and repaid in hard currencies, but debt service is fixed in local currencies), which are an effective new instrument in the project finance tool kit. Although solar projects are less technically complex and easier to implement than many traditional technologies, there remains a missing link in relation to guarantees for construction finance.

ECAs are very well placed to accept and manage the resulting currency risks and step up their participation in global currency risk markets, thereby expanding their [LCY] scope and depth. Standardised instruments already exist and their adoption would be relatively easy. Such derisking activities and associated tenor extensions could also allow local banks and pension funds to become more active and crowd in local savings.

By supporting the adoption of local currency PPAs and protecting vulnerable populations from currency risks, ECAs would become an important channel to realise some of OECD Governments' 2009 Copenhagen commitments to facilitate technology transfer and fund climate related adaptation and mitigation investments in developing countries to the tune of \$100 billion per year. 'Concessionality' needs to be geared towards achieving the manifold impacts of this green transition target.

Going back to our initial example of Kenya. There is a strong political commitment to get a better allocation and control of currency risks and shifting towards PPAs in KES. Assuming these reforms are successfully implemented, then it stands to reason that other countries will take such initiatives as well. Similar proposals are already being considered in Nigeria, and it is likely that other African nations, including Uganda, Ghana, Zambia and Egypt will follow suit. A good reason for ECAs to stay tuned in and not miss the opportunity. ■

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