EGYPT SOLAR FEED-IN TARIFF ROUND 2

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The 2GW solar Feed-in Tariff programme launched by the Egyptian government in September 2016 (Feed-in Tariff Round 2) resulted in a substantial increase in the number of projects achieving financial close, in comparison with Round 1 of the Feed-in Tariffs programme (the Round 1 Programme), which ended in October 2016.

The Feed-in Tariff Round 2 was amongst the most significant renewable projects in the Middle East and Africa in 2017, taking home the title of Global Multilateral Deal of the Year at the PFI Awards 2017. Clifford Chance advised the financiers, European Bank for Reconstruction and Development (EBRD), Islamic Development Bank (IsDB) and Islamic Corporation for the Development of the Private Sector (ICD) on six projects in this scheme (and separately EBRD on two projects in the scheme). These projects give an overview of the financing of projects in Feed-in Tariff Round 2:

Feed-in Tariff Round 2 overview

The initial objective of Feed-in Tariff Round 2 was to produce 2GW and, although this ambitious target will not be achieved, the programme has nonetheless impressively achieved between 1.4 GW and 1.8 GW of additional renewable generation capacity at a competitive tariff of US$8.4 cents/KWh, which was a significant step-down from the tariff of the Round 1 Programme (US$14.34 cents/KWh). Although exact numbers are difficult to ascertain, the Feed-in Tariff Round 2 is also expected to provide more than 10,000 jobs during its construction and more than 4,000 jobs during its operation. The electricity produced under the Feed-in Tariff Round 2 will help Egypt meet its emission reduction targets under the Paris Climate Agreement by replacing approximately 350,000 tons of CO2 emissions per year with clean energy, and will further diversify the energy mix in the Egyptian power sector by exploiting the country's renewable energy potential. It is an integral part of the Egyptian government's 2035 Sustainable Energy Strategy, which is aiming for 20% of electricity generation in Egypt to derive from renewable sources by 2022.

The projects in Feed-in Tariff Round 2 are concentrated in the Benban area, in the Aswan Governorate of Egypt. Spread across a 37km^2 plot of land, divided into 41 plots and allocated to the New and Renewable Energy Authority (NREA), the Benban solar complex is set to be, upon completion, the largest solar installation in Africa, and amongst the largest solar complexes in the world.

Project and financing structures

Each project in Feed-in Tariff Round 2 is structured around a harmonised set of project agreements to be entered into between relevant project companies and various State entities. Each project company is issued a licence by the Egyptian Electric Utility and Consumer Protection Regulatory Agency (Egypt ERA), and shall implement its project under the following contractual arrangements:

- a 25-year take-or-pay power purchase agreement (PPA) with the Egyptian Electricity and Transmission Company (EETC)
- a usufruct agreement setting out the terms and conditions under which the NREA makes available project sites to the project company
- a network connection contract in which the project company is granted the right to connect the generation facilities to the transmission system and deliver electricity
- a cost-sharing agreement between EETC, NREA and the project company, under which EETC and NREA undertake to carry out certain infrastructure works (namely, the construction of certain interconnection facilities and road infrastructure), and the project company undertakes to pay its share of the costs associated with such infrastructure works in exchange for the right to participate in Feed-in Tariff Round 2 (together, the Government Agreements).

The Egyptian government engaged in a consultation process with a number of multilateral agencies and development financial institutions ahead of the release of the project documents of Feed-in Tariff Round 2 and during the preparation stage of the Government Agreements, in order to ensure improved bankability and wide acceptance by these institutions, a significant step-up in comparison to the Round 1 Programme.

Although some projects adopted different approaches, the construction strategy adopted by a large number of them included a lump-sum EPC contract structure, adjusted to implement a tax split in order to meet tax considerations and local content requirements. The operation and maintenance services are performed under O&M agreements, and one of the sponsors (or an affiliate thereof) is generally the EPC contractor and the O&M contractor.

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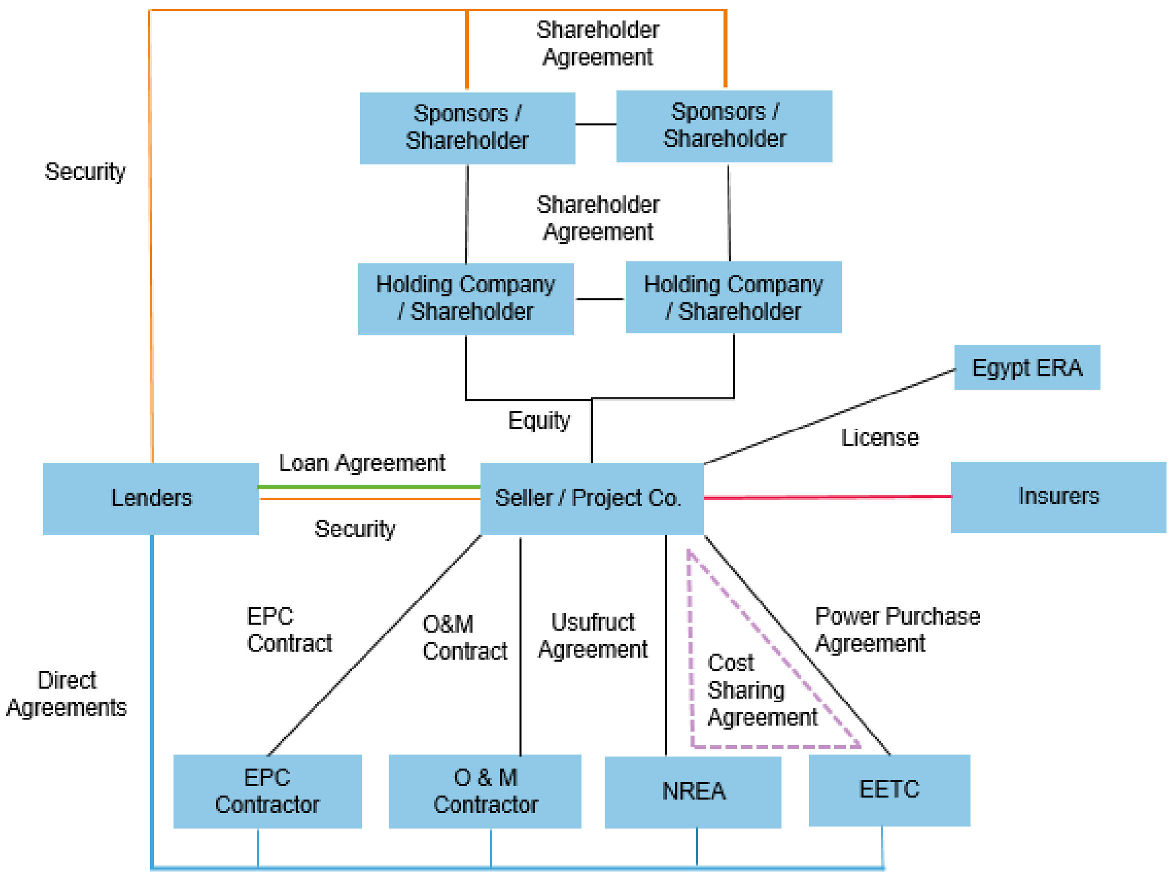
Figure 1: Feed-in Tariff Round 2 – Example of a contractual structure



According to EETC, by the deadline of 29 October 2017, 30 projects secured financing imposed under Feed-in Tariff Round 2 and only six developers failed to reach financial close. Compared to the Round 1 Programme, which featured no multilateral agencies, the financing of Feed-in Tariff Round 2 was heavily driven by multilateral agencies and development financial institutions, and the most involved were EBRD, which mobilised funding for 16 projects, International Finance Corporation of the World Bank Group, which mobilised funding for 13 projects and PROPARCO (the entity of the French Development Agency (Agence Française de Développement) that provides financing to the private sector), which financed four projects alongside EBRD and one project on their own. In addition, Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group offered political risk insurance to a dozen projects.

The funding was raised through a combination of own account loans (A loan), B loan participations and parallel loans from various other multilateral agencies and development financial institutions, as well as funding from solar energy development dedicated funds. Certain projects also involved Islamic loan tranches, in addition to conventional loans. On average, the loan tenor is approximately 18 years, door-to-door, with one year for the construction period and a gearing ratio of 75:25. In a number of cases, the developers that were initially awarded the projects resorted to forming joint ventures with new developers in order to meet the lenders' financing requirements (such as benefiting from offshore share pledges). On its part, the Egyptian government required that the lead developer awarded the project maintain a minimum shareholding of 25% in the project until two years after the technical completion date. This resulted in complex shareholding restructurings in order to meet the shareholding requirements of the programme, while at the same time meeting lenders' financing requirements.

Export credit agencies were not involved in Feed-in Tariff Round 2, unlike in the Round 1 Programme, in which export credit agencies had a limited involvement. Nor did international commercial banks extend any credit, while local commercial banks' involvement focused primarily (and almost exclusively) on acting as facility agent, security agent, account bank, issuer of letters of credit, guarantors, providers of working capital facility or bonds. The financing documentation was standard for a project finance structure, and the lenders entered into direct agreements with the respective project companies' counterparts under the Government Agreements, the EPC and O&M contracts. The direct agreements in relation to the Government Agreements were also standardised across the programme and benefited from the consultation process with the multilateral agencies and development financial institutions ahead of the launch of the Feed-in Tariff Round 2 programme.

Other notable points

Disputes resolution

A major difference with the Round 1 Programme is that the Government Agreements provided for a dispute resolution mechanism through international arbitration in cases where attempts at amicable settlement and resolution by the Egypt ERA fail. The applicable international arbitration rules are those of the Cairo Regional Centre for International Commercial Arbitration, with the seat of the arbitration court being in Paris, France. The arbitration shall be conducted in English.

State guarantee

The offtaker's payment obligations under the power purchase agreement are backed by a sovereign guarantee of the Egyptian Ministry of Finance, which is included in the PPA direct agreement.

Termination amount

Upon termination of the PPA prior to its term, the termination amount shall cover, in all cases, lenders' outstanding debt (including hedging close-out amounts) as at the calculation date, without reduction.

Environment and social requirements

Environmental, health, social and safety standards are set at the highest applicable standards in order to comply with the stringent requirements of the multilateral agencies and development financial institutions involved in the financing.

Conclusion

The successful launch of Feed-in Tariff Round 2 is an important milestone for Egypt. Despite recurrent political turbulence, the programme boosts investor confidence in Egypt, as it illustrates the ability of the country to attract significant investment from financiers and equity investors from around the world. It will be a great catalyst for unlocking more financing for the vast renewable energy potential of the country, particularly from commercial banks and export credit agencies, which may play a bigger role in Round 3 of the renewable energy development scheme. This scheme will certainly be closely scrutinised by other countries in search of developing their own renewables potential. This success also echoes the successful closing of the Gulf of Suez 250MW wind farm power project, the first IPP tendered on a BOT basis to reach financial close since the projects which closed in the late 1990s. A number of wind IPP projects structured on a BOT basis have already been announced and are expected to be progressed in 2018.

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