MILLENNIUM CHALLENGE CORPORATION
UNITED STATES OF AMERICA

Kosovo Renewable Energy IPP and Commercial Finance Facilitation

Advisory Council Presentation

For Discussion Purposes

April 19th, 2018

Kosovo Threshold Program: Catalyze Renewable Energy (RE) commercially based financing

Kosovo Threshold Program

$49 million, signed into force on Sept 12th, 2017, addresses two key constraints to growth:

1. Unreliable supply of electricity
2. Weakness in rule of law, government accountability and transparency

Potential MCC Investment(s) to Unlock Kosovo Renewable Energy IPP Development

- ***Component 1:*** **Project Preparation:** Focus **on project preparation to consolidate and pool existing renewable energy IPP licenses** into a portfolio through the technical assistance facility. Thereafter, DFIs would lead a consortium with local banks to provide project financing.

- ***Component 2*****: Guarantee De-risking Mechanism:** Catalyze Kosovo banks in extending project financing directly to renewable energy IPPs. MCC would provide funding support to the existing Kosovo Credit Guarantee Fund to **develop and offer financial product(s) designed to address specific financial barriers identified during the root cause analysis**.

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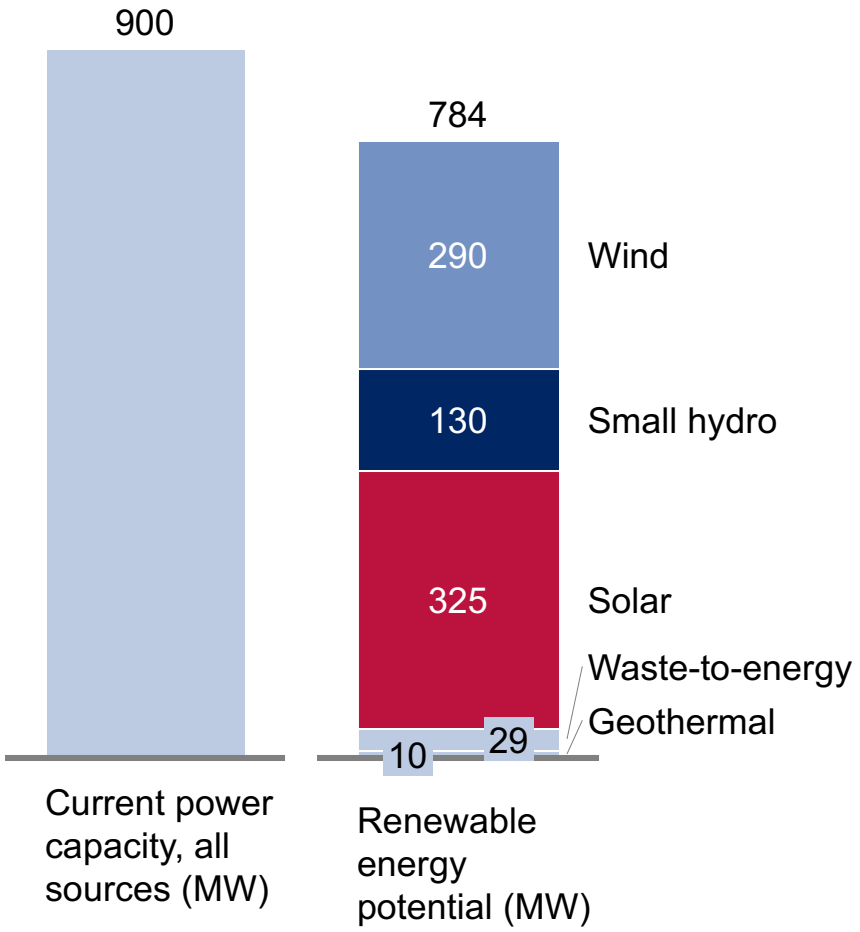
Background: Kosovo has the potential to develop significant RE capacity by financing projects already in the pipeline

Kosovo has the significant renewable energy resources relative to its total power demand …



… along with a pipeline of renewable projects ready for financing

	Applications under review at ERO		Preliminary authorization		Final authorization	
	#	Capacity (MW)	#	Capacity (MW)	#	Capacity (MW)
Wind	1	51	3	88.0	1	1.350
Hydro	10	513	11	90.0	13	76.000
Solar	2	6	5	9.4	2	0.867
Total	**13**	**570**	**19**	**187.0**	**16**	**78.000**

1 Additional energy market analysis should inform design of specific investment priorities and strategy

SOURCE: MCC Kosovo Task 1 Report; Energy Regulatory Office of Kosovo (May, 2016). Regulatory Support for Renewable Energy Regulatory Framework and Grid Integration. Accessed here; World Bank (2013). Energy Infrastructure in Kosovo. Accessed here.

Based on due diligence, key challenges to renewable energy project financing are related to both supply of projects and financing constraints

	Key findings
Regulatory environment	▪ Supportive and responsive to needs of renewable energy sector ▪ Revised PPA timing and new licensing parameters being proposed
Demand side	▪ **Competent IPPs exist that can develop project financeable sites** ▪ Numerous licenses issued to non-creditworthy speculative sponsors ▪ Potential need for technical verification and project financing preparation
Supply side	▪ **Stable financial sector with interest and willingness to explore RE** ▪ **Need for TA and finance facility to address identified barriers** ▪ Opportunity and interest for risk diversification through energy bond
Other factors	▪ DFI have renewable energy focused initiatives addressing critical issues ▪ Opportunity for MFK to work with others to catalyze RE financing

Within financing, there are several barriers in the renewable energy market that could be addressed by a Donor

Barrier	Impact	Potential resolution
Inexperience to underwrite / macroeconomic risks[1]	▪ Causes banks to require high collateral requirements from IPP developers	▪ Catalyze non-recourse financing from commercial banks by addressing specific barriers relevant to commercial bank lending
Small overall market size	▪ Causes banks to assign a lower priority to evaluating renewable energy sector deals ▪ Banks do not invest in capability and will not take risks on sector	▪ Aggregating the current pipeline and development of a new pipeline of projects driving banks to dedicate resources and risk to the sector
Conservative nature of banking sector	▪ Causes banks to delay developing new project financing projects ▪ Banks will not engage with or develop relevant structures and products	▪ Incentivize the development of new financial products that can be applied utilized in other sectors

Recommendation: joint approach of providing technical and financial support to support the short-term capacity increase of the renewable energy sector through project finance

1 Include Kosovo country risk and concerns about stability of the renewable energy feed-in-tariff (REFIT)

Proposed solutions should address financial and technical barriers identified as major barriers to deal execution

	Identified barriers	Proposed solution
Financial barriers	**A** **Investment barriers increase the costs of commercial finance** **B** **Domestic banks lack experience structuring renewable energy deals with IPPs** **C** **Domestic banks are small relative to the size of projects being funded**	▪ Guarantee facility to support viable IPP-led renewable projects ▪ Leverage Existing Kosovo Platform
Technical barriers	▪ **Lack of quality source input data** (e.g. wind and hydrology maps) to generate technical reports ▪ **Limited human capital** to develop this data and perform subsequent local analysis ▪ **Limited financial management capacity** at most IPPs	▪ Technical support facility to aid IPPs in developing viable proposals
Regulatory barriers[1]	▪ **Lack of standardized project documents** for feasibility studies, business plans, and financial models ▪ **No process for issuing energy certificates of origin** identified as a long-term issue	▪ Technical support facility to standardization documents

1 Regulatory environment generally seen as positive for renewable energy

Solution: a Guarantee facility and targeted technical assistance that will address constraints and that leverages an existing platform, Kosovo Credit Guarantee Fund.

Financing Guarantee Facility

Supply-side barriers addressed:

- New project-finance option for a funding constrained energy sector
- Fit-for-purpose, long-tenure, market-linked loans for the sector
- Creation of a viable, replicable business-model

Demand-side barriers addressed:

- De-risking through sector development
- De-risking of later stages of project development and operation by funding riskier early-stage activities
- Signaling to banks and highlighting high-quality project sponsors, via financial support for such sponsors
- Instruments like guarantees can reduce risk perception

Technical Assistance Facility

Supply-side barriers addressed:

- Capacity building of financial institutions, for credit appraisal
- Technical assistance and capacity building for better balance-sheet and loan structuring
- Ecosystem / secondary market development

Demand-side barriers addressed:

- De-risking through sector development
- Improved project planning by developers
- Professionalization of the pre-feasibility process
- Better financial structuring, project packaging, and project development by developers based on bank needs
- Promotion of a friendly regulatory and market ecosystem, including improvement in financial structure of off-taker, and market linked pricing

Guarantee Model: Leveraging an established and Local Partner

Kosovo Credit Guarantee Fund (KCGF)

Established

- 2016, backed by USAID and KfW
- Independent government entity established through Parliamentary law
- Governed by a board of directors

Mandate

- Incentivize traditional SME lending by working with financial institutions (banks, MFIs, NFBIs) donors, the Government of Kosovo, the Central Bank, and MSMEs/SMEs.
- Broadly defined charter with the GoK backing to diversify into other sectors

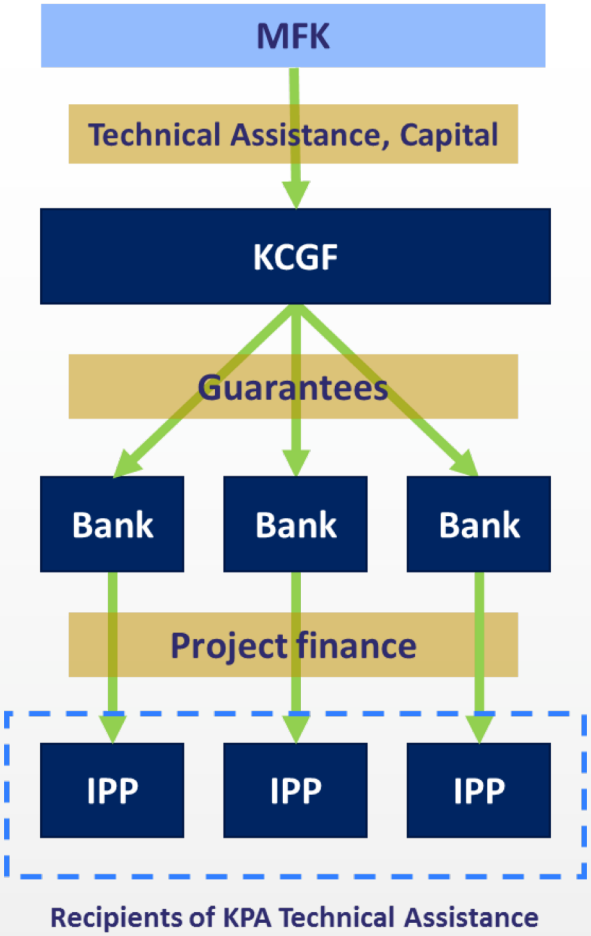
Existing Portfolio

- KCGF has signed agreements with 7 commercial banks
- 8,263,720 euro in guarantees generating 17,041,600 euro (distributed over 416 loans
- **Guaranteeing on a 50% basis at a 1:1 ratio of reserve funds, with 5:1 authorization**
- **Has SIDA backstop guarantee over entire portfolio**

Diversification

- KCGF is in the process of expanding instruments through an Agro-lending Guarantee
- **MCC investments would catalyze a similar RE Guarantee as a standalone product**

Guarantee Model: Leveraging an established and Local Partner



MCC grants through MFK fund:

1) ***Project Accelerator*** **delivers IPPs to financial close**

2) **Technical Assistance and initial capital enable KCGF to offer renewable energy guarantees through a dedicated "Window"**

- Technical assistance enacting required regulatory, legal and internal policies to enable KCGF to offer renewable energy guarantees.
- Technical assistance to develop and structure market-appropriate guarantees that will catalyze renewable energy project financing.
- Initial capitalization fund KCGF staff and organizational costs for the renewable energy guarantees as well as assist in raising any additional capital required.

- **Bring a select portfolio of renewable projects** to financial close with 12-18 months.
- **Attract an international developer/ renewable energy fund** to co-invest & co-develop RE IPPs.
- MCC investments cover **operational expenses funded through MKF** against a defined business plan and pipeline developed after an initial market assessment.
- **Staffed with a core development team and consultants** incentivized to deliver to financial close.

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Guarantee Model: Benefits for MCC, MFK, and Kosovo under the Threshold Program

- KCGF expands mandate and generates greater capacity to support Renewable Energy projects that address the MCC Constraints Analysis
- Technical Assistance prepares bankable projects through market standardization (feasibility support, legal support negotiating documents, financial analysis/business planning, etc.) enables project sponsors, banks, and government to develop financeable projects
- Utilize guarantees to catalyze commercially driven project finance
- MCC investments catalyze other donors to actively enter the space alongside MCC through a scalable and adaptable model
- Provides a diversifiable model applicable to other sectors of the economy after RE projects are exhausted

Questions for discussion

(1) Initial reactions and concerns?

(2) Based on the options presented do you think the current proposed approach will achieve objectives without a financing component?

(3) What aspects of the model do you have questions about? Anything particular that you like or dislike?

(4) If MCC addresses the project preparation and development issues, will local or regional bank realistically then take on project financing risk or will they continue to sit on the sideline?

(5) Is there a moral hazard created by a guarantee model to incentivize banks to enter the project financing market?

(6) Is the idea of a demonstration effect real in your mind?

(7) For a small country such as Kosovo (with a high-risk reputation) how can we attract quality international project developers – should we pool IPP generators into a portfolio – to pursue investments along MCC and other DFIs?

Discussion

Guarantees could be structured by stage to catalyze private investment participation while leveraging existing funders