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EXPORT CREDIT FINANCING FOR COAL-FIRED PROJECTS - A THING OF THE PAST?

Climate change is at the forefront of policy decision making, particularly given the signing of the Paris Agreement at COP21 in December 2015. Its implications for banks, insurers, investors, the labour market and the economy has been the subject of much debate. There is a renewed focus on "clean energy" in South Africa, as its commitment to achieving its Intended Nationally Determined Contributions goals comes under global scrutiny.

A document which has received less attention within the South African market is the OECD Arrangement on Officially Supported Export Credits (the Arrangement), which may have far wider implications than the Paris Agreement itself.

What is the Arrangement?

The Arrangement initially came into effect in April 1978; its purpose is to provide a framework for the orderly use of officially supported export credits. On 17 November 2015, those members of the Organisation for Economic Co-operation and Development(OECD) which are party to the Arrangement (that is, Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland and the United States), introduced a new sector understanding to the Arrangement. The New Sector Understanding sets out the financial terms and conditions that apply to officially supported export credits relating to contracts for coal-fired electricity generation projects.

The New Sector Understanding is due to come into force in January 2017, with a review scheduled for 2019 to potentially strengthen its terms and conditions.

Main features of the New Sector Understanding

The New Sector Understanding encourages both exporters and buyers of coal fired power plants to move away from low efficiency towards high-efficiency technologies. It seeks to limit the export credit financing available for the construction of new, large, inefficient coal-fired plants, by stipulating the use of efficient, ultra-supercritical technologies.

The New Sector Understanding distinguishes between coal-fired electricity generation projects as follows:

The limits imposed by the New Sector Understanding can be summarised as:

1. Where a coal fired plant uses ultra super critical technology, it remains eligible for export credit financing subject to a maximum 12-year repayment term, irrespective of the size of the plant.

2. Where a coal-fired plant uses super critical technology, large plants are ineligible for export credit financing. Medium and small plant will be eligible for export credit financing subject to a maximum repayment term of 10-years AND provided that the project is located in an IDA eligible country, a country whose National Electrification Rate (as per the most current IEA World Energy Outlook Electricity Access database) is reported as 90% or below, or in a country that is not IDA eligible but is located in a geographically isolated location where less carbon-intensive alternatives are not viable.

3. Where a coal-fired plant utilises sub-critical technology large and medium plants are ineligible for export credit financing. Small plants will be eligible for export credit financing provided that such support is subject to a maximum repayment term of 10-years AND the project is located in an IDA eligible country, or in a country that is not IDA eligible but is located in a geographically isolated location where less carbon-intensive alternatives are not viable.

Implications of the New Sector Understanding within the South African market

OECD export credit agencies (ECAs) have contributed billions of dollars to coal-fired plants, especially within the past 10-years. According to the OECD website, over two-thirds of the coal-fired power projects receiving official export credit support from participants between 2003 and 2013 would not have been eligible for support under the New Sector Understanding.

It is important to note, however, that South Africa's NER is approximately 85%, which means that a coal-fired plant based in South Africa can use supercritical technology and will still qualify for OECD export credit finance, provided the plant is smaller than 500MW. Even if South Africa's NER surpasses the 90% mark, project companies can still seek export credit financing from countries not party to the Arrangement, such as China and India.

In the context of the South African Coal-Baseload IPP Procurement Programme, the New Sector Understanding is likely to have a notable influence on the availability and terms of ECA funding. Although South Africa is not party to the Arrangement, it remains to be seen whether local commercial banks and DFIs will align their approach to financing coal-fired power projects with that of the OECD ECAs.

The New Sector Understanding marks a seminal point in the development of rules for export credit financing. With equipment manufacturing groups such as General Electric launching their *"Smarter. Cleaner. Steam Power"* initiative, which focuses on high-efficiency solutions, it seems inevitable that the Arrangement will slowly but surely shape the South African power market going forward.

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A copy of the Arrangement can be accessed at: http://www.oecd.org/tad/xcred/theexportcreditsarra...

1. According to the World Bank at as 2012 (the figures have yet to be updated) South Africa's NER is 85.4%. This figure is second highest in Sub-Saharan Africa to Gabon whose NER is 89.3% These figures are high in comparison to countries such as Nigeria (41.8%),Tanzania(15.3%), Kenya(23%),Mozambique(20.2%)andDRC(16.4%).

2. South Africa is not an IDA eligible country. Nigeria, Tanzania, Kenya, Mozambique and DRC are eligible IDA countries.

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