

APPLICATION FOR CTF PROJECT PREPARATION GRANT

A. TASK MANAGER FOR CTF FUNDING REQUEST

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| Organization/Unit: Asian Development Bank, Capital Markets and Financial Sectors Division, Private Sector Operations Department | | |
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B. PROPOSAL SUMMARY

1. Geographic Focus of Proposed Activity:

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| <input checked="" type="checkbox"/> Individual Country (<i>please specify</i>): Indonesia |
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2. Project Title:

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| Global Climate Partnership Fund - Indonesia EE/RE Investment Program |
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3. List of Deliverables from CTF Project Preparation Grant

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| <ol style="list-style-type: none">1. Feasibility analyses and due diligence completed2. Program proposal to be submitted for approval by to ADB Board of Directors3. Operational guidelines for Indonesia program operations, including legal documents |
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C. PROPOSAL DETAILS

4. Summary of Proposed Activities

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| <p>The Clean Technology Fund (CTF) investment plan submitted by the Government of Indonesia (GOI) includes an allocation of \$50 million to support a private sector investment program in energy efficiency (EE) and renewable energy (RE) to be administered by the Asian Development Bank (ADB) Private Sector Operations Department (PSOD). The CTF Project Preparation Grant will fund technical assistance (TA) to evaluate and establish the Global Climate Partnership Fund (GCPF) - Indonesia Investment Program (the Program) to be co-financed by the ADB, KfW, other investors, and CTF.</p> <p>The preparation will comprise technical, financial, and legal due diligence to facilitate approval of CTF cofinancing, ADB Board approval, and design and implementation arrangements of the Program. Due diligence will cover: (i) development of a business plan for the Program comprising strategy, conceptual mapping of investment opportunities, and deal sourcing and selection; and (ii) structuring of funding arrangements for CTF cofinancing within GCPF which will comprise the (i) governance structure, (ii) funding flows, (iii) procedures for internal approval, environmental and social safeguards, monitoring and reporting. The outputs will be sufficient for submission of an investment proposal to the ADB Board of Directors.</p> |
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5. Rationale for CTF grant funding, including consistency with CTF Investment Plan:

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| <p><u>Summary of the Program and use of CTF Funds</u></p> <p>The Program is to support the Government of Indonesia (GOI) efforts in promoting energy efficiency and climate change mitigation and the associated reduction of greenhouse gases by leveraging private for EE and RE financing as set out in the CTF Investment Plan for Indonesia. The investment potential</p> |
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in the EE/RE market is estimated to exceed \$4 billion, far beyond the reach of public sector funding. Private sector investors, including Indonesian financial institutions (FIs), face first-mover risk and require investment and advisory support from ADB, GCPF, and CTF.

The Global Climate Partnership Fund (GCPF) has been established by KfW, and is being capitalized by KfW, ADB, and other investors including the International Finance Corporation (IFC). GCPF has recruited Deutsche Bank as fund manager through a competitive process. ADB is considering an investment in GCPF to support its operations in ADB Developing Member Countries. Deutsche Bank will manage the Indonesia Program consistent with its GCPF fund management mandate. The Program to be financed with CTF will be ring-fenced for Indonesia, with investments based on a country-specific business plan integrated into GCPF operations.

ADB has assessed the EE/RE market in Indonesia and has been in dialogue with several candidate FIs over the past 15 months. The proposed investment with GCPF is an efficient platform to expand nascent private sector EE/RE investments in Indonesia by using an existing well established structure with well aligned business objectives. GCPF will facilitate synergies among investment partners and leverage EE/RE project investments, and reduce start-up time and preparation costs. Using GCPF is expected to be more efficient than executing individual transactions, or creating a separate financing structure. Because the CTF-cofinancing will be ring-fenced for Indonesia, the detailed funding structure and operational procedures must be elucidated in the form of a country-specific business plan.

The Program aims to establish FI business lines for private EE and RE investments by providing FIs with critical knowledge in the evaluation and realization of energy and other resource savings through investments. Monetizing the energy savings and avoided energy costs would represent a significant evolution in financial services that has yet to be developed at scale. New business lines in Indonesian FIs will support the development of the EE/RE finance market, as the first-mover success can be replicated and gradually open up the larger market potential. This Program will promote Indonesia's transition into a low carbon economy with more sustainable use and management of resources.

Rationale for CTF Program Preparation Support

The proposed Program requires grant support for the preparation and due diligence that precede the investment by ADB and CTF. Both ADB and KfW will incur additional expenses to design the ring fenced Program targeted to Indonesia. This includes assessment of candidate EE and RE investments consistent with CTF eligibility criteria and customized legal documentation to effectively identify and demarcate the Program investment activity from other GCPF activities. ADB's Private Sector Operations Department normally passes due diligence costs onto the client, while GCPF expects that a portion of its establishment costs would be recovered from the investors. In this case the development costs could be rolled into GCPF overhead and recovered from financing costs imposed on project-level end-users of the funds. In the interests of reducing these overhead and financial costs, grant funding is justified to expedite preparation, approvals, and disbursements.

6. Government Approval of Country-Specific Activities

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| Name of responsible official: Mr. Singgih Riphath | | |
| Position: CTF Coordinator | | |
| Ministry/Agency: Ministry of Finance, Fiscal Policy Office | | Country: Indonesia |
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D. IMPLEMENTATION AND FINANCING PLAN

7. Implementation Approach

Executing Agency: ADB will administer the CTF grant and will manage procurement and oversight of consulting services and any other grant-funded expenditures. The implementation timeline is summarized in Table 1 below.

Procurement: The technical assistance (TA) will utilize international and local consultants for technical and financial advisory services and an international law firm for legal services. Consultants will be recruited and managed in accordance with ADB's *Guidelines on the Use of Consultants 2010*.

Disbursement: Disbursements will be made in accordance with ADB procedures.

Reporting: Requirements are included in the terms of reference for consulting services (Annex I).

8. Implementation Schedule: Major milestones are listed in Table 1 below, for details see Annex I.

Table 1: Preparation Activities and Milestones

| Major Milestones | Expected Completion Date |
|--|---------------------------------|
| ADB internal approval of TA activities | March /April 2012 |
| Consultant Recruitment | April / May 2012 |
| Start of Services | April / May 2012 |
| Completion of Services | December 2012 |
| Financial closure of TA | March 2013 |

TA = technical assistance

Source: Asian Development Bank.

9. Cost Estimates and Financing Plan:

The total cost is estimated at US \$450,000 equivalent, which will be financed on a grant basis by the Clean Technology Fund. The indicative cost estimate is presented in Table 2.

Table 2: Cost Estimate (\$'000)

| Item ^a | Total Cost (US \$'000) |
|--|-------------------------------|
| 1. Consultants | |
| a. Remuneration - International consultants (8 person-months) | 200.0 |
| Remuneration – Legal Counsel (lump sum) | 125.0 |
| b. International and local travel ^b | 80.0 |
| c. Reports and communications ^c | 15.0 |
| 3. Miscellaneous administration and support costs ^d | 10.0 |
| 4. Contingencies | 20.0 |
| Total | 450.0 |

^a Financed from the Clean Technology Fund. Government counterpart financing will not be required.

^b Includes international and in-country air fare, per diem, and other in-country travel for visits to project sites.

^c Includes third party technical review.

^d Includes translation and interpreter services.

Source: Asian Development Bank estimates.

E. SUPPLEMENTARY INFORMATION AND MATERIALS

10. Additional Information:

The outline terms of reference for consulting services are in Annex I. The project context in the CTF Indonesia Country Investment Plan is in Annex II.

ANNEX I: Summary of Draft Terms of References of Consulting Services for Preparation of the Global Climate Partnership Fund - Indonesia Investment Program

A. Background

1. The grant will fund TA to develop a private sector led investment Program for EE and RE in Indonesia. The outcome of the TA will be an investment proposal for consideration by ADB's Board of Directors, and related documentation. The TA will identify initial candidate investments, review operational guidelines, and facilitate the prompt start-up of the Program. The TA will produce relevant due diligence information not reflected in GCPF's existing global business plan, and CGPF's Fund Management Contract.

B. Major Activities, Outputs, and Consulting Services¹

2. Financial and technical consultants will assist in (i) setting out the approach and mechanisms for estimating and monitoring the performance of RE and EE investments to achieve maximum GHG reduction for financially viable investments; (ii) designing appropriate implementation arrangements to facilitate the timely take up of investments in Indonesia; and (iii) identify candidate investments for immediate screening by GCPF.

3. ADB expects to retain individual consultants for technical and financial assessments, and an international law firm for legal services. Consultants will be recruited and managed in accordance with ADB's *Guidelines on the Use of Consultants*.

4. Key outputs will be delivered as described below.

Task 1: Business Plan Development

5. The business plan includes:

- (i) Mapping of EE and RE investment opportunities and the identification of potential investment sponsors and FIs;
- (ii) Deal sourcing process with investment sponsors and FIs;
- (iii) Investment selection and approval procedures;
- (iv) Preliminary identification of investment pipeline;
- (v) Estimate of required staff and financial resources, including their cost and financing; and
- (vi) Viability of the Program.

6. The draft business plan will be completed within 3 months of mobilization, and will be further fine-tuned reflecting the outputs pursuant to Task 2.

7. Subject to a satisfactory business plan, a third party technical review will be commissioned as required by CTF guidelines.

8. The services will require an EE/RE engineer (3 person-months/p-m) and an EE/RE financing expert (3 p-m).

¹ The scope and terms of reference will be flexible to avoid duplication of ongoing efforts between GCPF, Deutsche Bank, and ADB.

Task 2: GCPF Indonesia Program Structuring

9. This task includes definition and specification of the following:
 - (i) CTF special funding arrangements within GCPF,
 - (ii) Governance structure, funding flows, and financial modeling (including indicative pricing for loans and other financial instruments);
 - (iii) Investment approvals, monitoring, and reporting policies and related documentation;
 - (iv) Safeguards processes and management; and
 - (v) Review and analysis of legal, regulatory, and tax frameworks for Program operations.

10. As the proposed investment will be a pioneering arrangement for Indonesia, risk mitigation options must be identified and incorporated into the investment Program operations, including the following considerations:
 - (i) **Legal and Regulatory Risk.** All legal, regulatory and taxation issues must be evaluated to confirm that the GCPF structure, organization, policies, and procedures will be consistent with current and foreseeable laws and regulations which affect country- and project-level investments. In particular, the evolution of the electricity regulatory framework, including tariffs and “open access” provisions may adversely affect project investments.
 - (ii) **Political, Economic, and Social Risks.** GCPF investments must be consistent with the host country development strategies and policies, especially those pertaining to energy security and climate change. Financial market crises, business cycle movements, and force majeure events (e.g., natural disasters such as earthquakes and tsunamis) may have adverse material effects on the performance of the economy and capital markets, with negative impact on the GCPF portfolio.
 - (iii) **Management Risks.** GCPF will be managed by an experienced fund manager, which will interact with FIs and end-users who have limited experience in clean energy investment and project implementation. The management team must achieve synergy with partner FIs and project owners in Indonesia to ensure prompt start of operations.
 - (iv) **Accounting and Disclosure Risks.** Accounting, financial and other reporting standards in Indonesia are converging with generally accepted international practice, but some adjustments may be required for partner FIs for consistency with international standards on financial reporting and auditing for those reports submitted to international investors including ADB.
 - (v) **Deal Structuring and Business Development Risks.** EE and RE projects may involve first-use of technologies in Indonesia. Project-level investments may entail above-average development and transaction costs. Deal structure and portfolio diversification should be optimized by the GCPF in-country operations team.
 - (vi) **Currency Exchange Risks.** The ADB investment and the CTF cofinancing will be denominated in US dollars, while in-country investments and returns will be denominated in local currency. Currency hedging options will be identified consistent with ADB and CTF guidelines.

11. A legal counsel will assess the Investment Program’s legal status, structure, and financing mechanisms, financial management, procurement, anticorruption, policy and legal, capacity, and other relevant institutional issues. Legal counsel will prepare draft investment and implementation agreements in accordance with ADB and GCPF procedures.

12. The key output of this task will be a preliminary term sheet and inputs to investment agreements for ADB Board consideration. Task 2 will be completed within 2 months of mobilization, and may overlap with Task 1.

13. The services required include a financial structuring expert (2 p-m) and a legal services firm (fixed-price / lump sum).

ANNEX II. Program Context

This proposal is consistent with Indonesia's CTF Country Investment Plan (CIP) which was endorsed by the CTF Trust Fund Committee in March 2010. Indonesia's CIP describes the country's GHG emissions profile and indicates that energy efficiency (EE) and renewable energy (RE) are key strategic areas to apply CTF resources, including through direct private sector initiatives. The Indonesia CIP specifically endorses the multilateral development banks to facilitate financial sector transformation for EE, RE, and cleaner production (CP).²

The Government of Indonesia (GOI) is committed to mitigating climate change. Of developing countries, Indonesia has elucidated arguably the most aggressive climate change mitigation objectives: at the G20 meeting in 2009, President Susilo Bambang Yudhoyono announced that Indonesia would reduce greenhouse gas (GHG) emissions by 26 percent by 2020, and make further reductions up to 41 percent with international support. The Government also joined the G20 pledge to phase out subsidies for fossil fuels. Indonesia is developing a strategic, multi-year policy and investment program for low-carbon growth, as outlined in the National Action Plan for Climate Change (NAP 2007) and the Development Planning Response to Climate Change (2008). The President has established the National Council on Climate Change (NCCC) with representation from 15 ministries to coordinate Indonesia's climate change policies and international positions. The Government is establishing a climate change trust fund, and has developed a Green Paper and prepared its Second National Communication to the United Nations Framework Convention on Climate Change (UNFCCC).

The GOI has identified GHG reduction priorities in the energy sector, including (i) EE, particularly in the industrial sector, and commercial buildings (apartments, hotels, and offices); and (ii) RE for power generation, primarily geothermal, but also biomass, small hydropower, solar, and wind.

The Program is part of an initiative to create "green lending" activities – new business lines -- on the part of Indonesia's commercial financial institutions. The program will initially target EE and RE investments implemented by industrial enterprises and independent power producers (IPPs), which require commercial [third-party] financing which is currently unavailable. EE investments will focus initially on projects in energy-intensive industrial sectors, then extending to commercial and residential sectors. Initial projects would likely be implemented with traditional engineering, procurement, and construction (EPC) contract modalities; subsequent projects could include other implementation modalities (e.g., ESCO performance contracting and financing for leasing companies). RE investments will focus on decentralized and distributed generation in the form of industrial bio-mass power and co-generation and small hydropower; and may be expanded to include solar and wind power projects. The typical RE project scale will be 50 megawatts (MW) or less.³

² EE, CP, and RE investments are commonly integral and/or complementary. E.g., using waste biomass for power generation may be considered as CP. Industrial waste heat recovery for power generation may be considered as both EE and CP. Replacing separate boilers and generators with a single cogeneration plant using waste biomass is an example of integrated EE, CP, and RE.

³ In this proposal, RE refers to projects which are typically 50 MW or less although some larger capacity projects may be considered.