

November 9, 2011

Comments from Norway on SREP Investment Plan of Nepal

Dear all,

Thanks for constructive and intense dialogue in D.C. last week. In general we would like to congratulate Nepal for a very good investment plan (IP). However, as the time was limited in the Subcommittee meeting, we did not have the space to convey all our comments on the Nepal investment plan during the meeting, and these are thus included below. In addition we have highlighted in yellow what was important for us to convey during the meeting and relevant to the discussion which took place.

All the best, and look forward to the response.
Thanks and regards,
Bente

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Comments on Nepal's SREP Investment Plan

Summary Comments

Overall, we are impressed by the level of detail and analysis that underpin the envisioned interventions. We are in agreement with the heavy focus of the IP on the gaps in the availability of long-term capital at reasonable rates. We view this as an area that SREP can potentially provide real value added. To this end, the IP already appears to go quite far in identifying specific intervention modalities/financing products that could offer solutions. Given the active private sector and steadily maturing financial markets for such projects, this appears to be a proper focus of SREP in Nepal.

We are pleased to see the amount of planning that has gone into ensuring that SREP financing makes an integral contribution to achieving well established goals by means of existing programs. Further, the IP places the SREP contribution in the overall context of RE policy and support schemes in a very comprehensive and convincing manner. Finally, the fact that the IP, already at this stage, has identified the implementing agencies and local champions for the financing adds a great deal of credibility to the potential for success.

We are however of the view that we would have preferred to see increased focus (funding) on the SHP program, albeit at the cost of the mini- and micro- energy program (biogas-program) (see further points to this issue below, under specific comments SHP). We are of the view that

this would be consistent with an IP targeting the leveraging of (private) commercial financing, and less on leveraging grant financing. The donor community appears to be rather effective in delivering grant financing to rural energy solutions and it is not clear what value added/demonstration effect SREP funding will provide. Also, donor coordination on rural access programs through the ESAP (and soon to be called RREP) seems to have functioned well. This could be an argument to top up with SREP money. However, it may also be a risk to introduce SREP funding into a functioning partnership, as it may for example introduce new conflicting criteria and/or stretch the capacity of implementing staff.

Accordingly, we would like to challenge Nepal regarding the use of SREP-funding to support a more ambitious and comprehensive plan to improve the enabling environment for private investment in small-, medium and large-hydropower. For example, while it is recognized that the IP envisions using SREP funding primarily to address financing barriers, we would have liked the IP to detail how Nepal intends to address other critical and politically-sensitive barriers such as those concerning “NEA and PPA Issues” and “Legal and Enforcement Issues”, both identified as important barriers in Annex 9.

Selection of Specific Comments/Observations

- **Selection of projects for SREP financing.** Norway notes that the first pillar applied to the screening process is “Leverage: ability to attract additional credit and grant funds”. Norway is uncertain as to why attracting additional grant funds should be a primary goal. In some cases, SREP funding may be effectively coupled with other grant funds. In other cases, SREP funding should preferably crowd out other grant/concessional sources which can then be redeployed elsewhere. We do not see why the potential for “leveraging grant funds” should award specific interventions a high score. It is our view that the focus should be on leveraging commercial financing – i.e. public and private funds seeking a return (albeit sometimes low), both in the short- and long-term. As an example, the SHP intervention receives a lower score due to it is low “grant leveraging effect”. It is our view that this exemplifies the above issue. It is Norway’s view that exactly because no other donors are interested or tooled to be able to support SHP is a key reason why SREP should.
- **Financing Modalities.** Norway is pleased to see the degree of technical precision employed to assess the financing bottlenecks. We tend to agree that both the authorities and private sector are sophisticated enough to ensure the emergence and development of viable projects. The financial sector and/or unavailability of long-term financing at reasonable rates does appear to be a key barrier to realizing renewable energy investments. And, it appears that the investment plan has gone quite far in terms of identifying potentially useful entry points.
- **Small hydro power.** Norway views this as a highly effective use of SREP funding. Despite the combination of i) a severe power shortage, ii) substantial potential, and iii) a private/public sector active in project development; the realization of a large number of projects appears far off. SREP appears to correctly assess the wide range of challenges in realizing this potential, largely citing the enabling environment and inadequate

financing terms. Further given that this sub-sector will not likely attract other grant or donor support, a dedicated MDB effort could be what is needed to finally reconcile the need for the power with the large potential.

Finally, while it is recognized that the IP envisions using SREP funding to address financing barriers, we would have liked the IP to detail how it intends to address other more economic/fundamental barriers such as those concerning “NEA and PPA Issues” and “Legal and Enforcement Issues”, both in Annex 9.

- **Mini- and micro-energy.** Norway views this as a worthy use of SREP funding but sees many more risks than the SHP program that are not necessarily off-set by higher expected impacts. We are impressed by the detailed diagnostics involved in identifying rather specific entry points for SREP. Further, we note and respect that this investment is fully in line with GON’s own goals and policies. The Embassy confirms the overall impression given by the IP that i) there are large number of donors involved in this space with rather large commitments, and ii) together the donors and GON are achieving good results from their programs. While the IP states that the SREP efforts will be complimentary, international experience also tells that the sudden introduction of another large donor/MDB with its own procedures and rules could potentially introduce complications and/or delays to an already well functioning (set of) programs. Further, it is clear that the yet to be established CREF is rather central to the SREP’s efforts, and the potential for delays in setting up the fund must be significant. And, while CREF aims to be the primary channel for all grant funding in this space, experience tells us that many donors will often resist such a set up.
- **Prefer greater weight to the SHP program.** The scale of the challenge and the corresponding potential up-side associated with developing small hydro power in Nepal are substantial. The following arguments would point in the direction of even further focus on the SHP program over the mini- and micro- program.
 - At least 100MW could be immediately targeted for support/financing, but SREP will only be able to target 50MW in the first stage.
 - The list of enabling environment barriers confronting investors (Section 3.4 pt 62) is extensive and if SREP is to provide sufficient scale to motivate and enable changes, the commitment should be significant.
 - The overall aim of SREP should be to leverage commercial financing, preferably private, and the SHP program offers greater potential.
 - If SREP succeeds in contributing to demonstration projects, it could also contribute to improve the overall credit standing of the sector and thus also help enable medium and large IPPs.
 - Both the short- and long-term impacts could be significant and would require limited set-up of any new institutions or facilities, as opposed to CREF.
 - The donor community appears to be rather effective in delivering grant financing to rural energy solutions and it is not clear what value added/demonstration effect SREP funding will provide.

- **Positive to (TA) support to the establishment of CREF.** Having said the above, Norway sees the value of SREP assisting with the establishment of the CREF so as to ensure it complies with MDB guidelines and can thus access future financing from these sources. Actual financing of the specific windows by SREP may however appear a bit premature and does not appear to offer any significant value added (compared with other potential donors).
- **Positive to a one-stop shop for private investors in RE space.** While Norway is confused by the relevance and applicability of the section on “Contribution to Road Map for Low Carbon Development”, we would agree with the recommendation presented there. Specifically, given the range of policy, support schemes, etc, the idea of an “institution with the authority and responsibilities necessary to serve as single-stop shop for RE development” may be a good initiative within or in parallel to the SREP program. Such a one-stop shop should however specifically target commercial investors, with a focus on hydro-power. The IP however does not specify any specific plans for such an institution.
- **Result based financing.** We would encourage Nepal in collaboration with the cifadmin unit/ESMAP/MDB to look into the possibility of piloting result based financing in one or more components.