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INNOVATING WITH financial solutions

Effectively mobilizing climate finance depends on innovative financing options, including ones that engage locally-based stakeholders such as Small and Medium Scale Enterprises (SMEs), local banks, and entrepreneurs to provide incentives, help overcome barriers, and support their readiness to make climate-smart investments. The influx of support from AfDB and other MDBs and mechanisms like the CIF can help address this.

Line of Credit for Renewable Energy and Energy Efficiency in Nigeria

One such innovation is the use of a *Line of Credit (LOC)* for a local commercial bank to on-lend to SMEs for renewable energy and energy efficiency projects. In May 2014, AfDB and CIF approved the first $100 million LOC ($75 million AfDB, $25 million CTF) for Nigeria, a first-mover in this approach.

The investment will complement other AfDB efforts to support the private sector to help the country address green energy concerns in the power, agribusiness, transport, telecommunications, and education sectors.

In Nigeria, where half of the country's 160 million inhabitants live without energy services and the energy which the country does generate is oil-dependent, the funding is an opportunity for the country to implement green energy services and apply an innovative approach to private sector financing at the same time.

The funding will stimulate investment in downstream opportunities designed to lead to greater energy efficiency through a range of technologies, including industrial energy efficiency investments, renewable energy, renewable-based hybrid systems, and cleaner fuels and combustion processes.

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Supporting Innovative Financial Partnerships

Kenya's Olkaria project is creating new partnerships between commercial project developers, local banks, local suppliers, and the Government of Kenya.

CIF

Local Currency Lending in South Africa

Another innovation is the use of local currency lending that will be possible through the undertaking of a ***cross-currency swap***, an agreement between two parties to exchange interest payments and principals denominated in two different currencies.

As a path-breaker for the CIF, the first-ever CTF cross-currency swap was initiated by AfDB as a mechanism in South Africa's XiNa Solar One project, to align the CTF loan with the currency of the rest of the lending group. This cross-currency swap mechanism will allow the CTF to lend in South Africa's currency and contribute toward a lower tariff.

XiNa Solar One is a project to design, construct, operate and maintain a 100 MW Concentrated Solar Power (CSP) generation plant to be built in the Northern Cape Province, South Africa as an IPP entered into between the seller and purchaser of the power generated. The project also involves construction of a 3 kilometer (km) transmission line to evacuate the power. Preliminary calculations point to total savings of up to the South African equivalent of $25 million.

Funded Risk Management Swap: An AfDB Innovation

The decision to use the South African cross-currency swap grew out of a CTF request to MDBs for a **study on using local currency funding in private sector projects**. In cooperation with CIF partners, AfDB led the drafting of the *Use of Local Currency for Private Sector Projects under the CTF*, approved in January 2014 and setting principles for CTF local-currency lending. In June 2014, CIF approved AfDB's Fund Risk Management Swap (FRMS), a new financial instrument allowing AfDB to provide local-currency lending through CTF.

The FRMS approach is designed to help reduce foreign exchange risk, enhance viability of projects denominated in local currencies, and enable blending with other non-concessional AfDB financing for green growth.

The FRMS:

- Allows project recipients to receive local currency funding
- Eliminates foreign currency risk
- Mitigates currency and interest rate risk related to CTF lending in local currency
- Avoids commingling of CTF resources with AfDB's capital resources
- Provides the most competitive cross-currency swap pricing
- Protects the CTF loan against foreign exchange, interest rate and translation/conversion risks
- Transforms the African local currency cash flows into US dollar cash flows with a US dollar-based interest rate and margin.