AFRICAN DEVELOPMENT BANK

SUSTAINABLE ENERGY FUND FOR AFRICA: CONVERSION TO A SPECIAL FUND AND SCALE UP

June 2019

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Abbreviations

AfDB	African Development Bank Group
ADF	African Development Fund
AREF	Africa Renewable Energy Fund
BoD	AfDB's Board of Directors
DFI	Development Finance Institution
FEI	Facility for Energy Inclusion
FIRM	AfDB's External Resource Mobilization and Partnerships Department
GC	Governing Council
GMG	Green mini-grid
MDP	Market Development Program
PERN	AfDB's Renewable Energy and Energy Efficiency Department
PEVP	AfDB's Power, Energy, Climate Change and Green Growth Complex
SEFA	Sustainable Energy Fund for Africa
TA	Technical Assistance
TRC	Technical Review Committee
USD	United States Dollars

1. INTRODUCTION

1.1 **The objective of this proposal is to restructure the Sustainable Energy Fund for Africa (SEFA) into a special fund to widen its suite of financial instruments and amplify its impact.** The restructuring of SEFA incorporates lessons from seven years of operational experience and consultations with internal and external stakeholders. The new structure adapts SEFA to meet the needs of the evolving energy markets in Africa, and will enable SEFA to provide financial instruments beyond technical assistance (TA) grants. The proposed restructuring enjoys a broad support from existing and prospective donors. There is also growing demand from the African Development Bank's (AfDB) teams and external clients for catalytic finance and technical support to scale-up sustainable energy solutions. The new structure will also enable SEFA to align with current trust funds practice regarding allowable instruments in other Multilateral Development Banks. It will also strengthen SEFA's role in unlocking investments in fragile countries.

1.2 **The proposed restructuring of SEFA as a special fund will place AfDB at the forefront of blended finance.**[1] SEFA will be restructured to provide both TA and concessional investments[2] for private sector projects to lower technology and financing costs and/or ensure risk mitigation along the project cycle, from early stage development to project commissioning. SEFA concessional investments will, in most cases, be "blended" with AfDB resources (i.e. structured as co-financing alongside AfDB Non-Sovereign instruments), but on flexible terms to improve project economics and ideally attract more investments from private entities. This proposal builds on the express recommendation of an independent external review commissioned by the SEFA donors and carried out in 2018.

1.3 **The SEFA Special Fund will be capitalized exclusively with grant contributions from existing and new donors (Figure 1).** These grant contributions will be extended to projects and programs in the form of grants, concessional debt, and equity. These instruments are drawn from the suite of AfDB's instruments and will follow standard policies and procedures for approval and implementation.[3] The definition of terms and conditions, such as interest rate and tenor for concessional loans or subordination and return cap for concessional equity, will be established and assessed independently from origination teams in line with best practice principles for blended finance.[4]

[1] The specific definition of blended concessional finance for the private sector operations of DFIs, adopted by the DFI Working Group on Blended Concessional Finance for Private Sector Projects ("DFI Working Group") is: combining concessional finance from donors or third parties alongside DFIs' normal own account finance and/or commercial finance from other investors, to develop private sector markets, address the Sustainable Development Goals, and mobilize private resources.

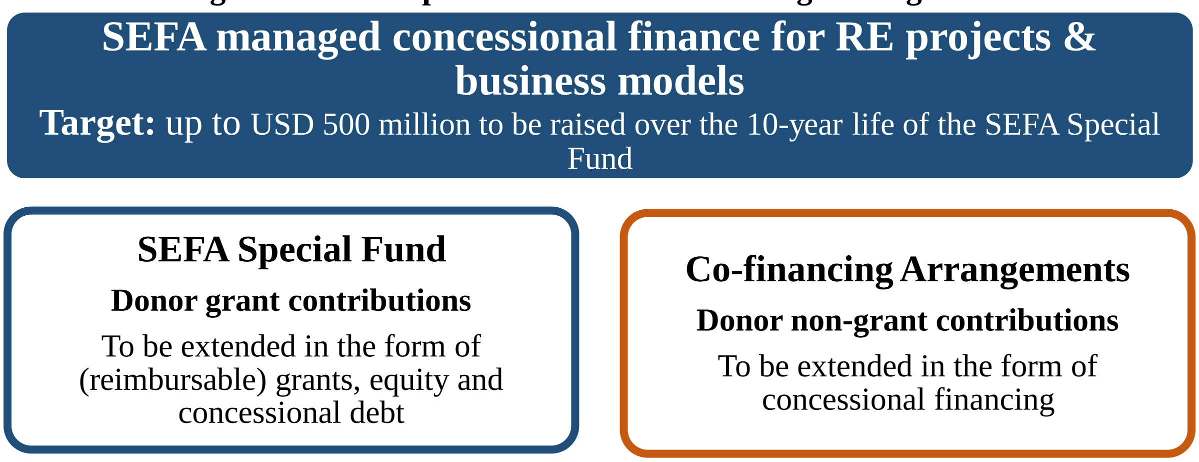
[2] Including but not limited to reimbursable grants, concessional debt and equity. Concessional debt refers to loans extended on terms and conditions set below and/or are more favorable than the prevailing market. Concessional equity refers to equity participation below (capped) market returns and/or positions with higher risk (first loss or junior equity positions).

[3] This builds on the AfDB's experience with blending concessional resources from the Climate Investment Funds (CIFs) and Global Environment Facility (GEF).

[4] In line with the DFI Working Group on Blended Concessional Finance for Private Sector Projects and further details in the AfDB's forthcoming Approach to Blended Finance: Principles, Governance and Procedures.

1.4 **The AfDB will also be mobilizing non-grant contributions as an additional source of co-financing of SEFA's pipeline of projects and programs.** Accessing complementary donor capital beyond grants will provide more concessional financing options and catalyze more investment in renewable energy technologies and business models. These co-financing resources (e.g. in the form of concessional debt) will be structured under separate financing arrangements and will not be commingled with the SEFA Special Fund's resources. The co-financing agreements would, however, be deployed for SEFA-eligible projects and utilize SEFA's origination and appraisal processes. Each agreement will be developed on a case-by-case basis as and when non-grant providers want to partner with SEFA. The AfDB piloted the co-financing structure in 2018 with the mobilization of USD 10 million non-grant contribution from the Global Environment Facility (GEF) to structure a project preparation facility for the AfDB-sponsored Facility for Energy Inclusion (FEI). SEFA played the lead role of mobilizing this contribution without passing through the SEFA trust fund.

Figure 1: SEFA Special Fund & Co-Financing Arrangements



2. BACKGROUND

2.1 **SEFA is currently a multi-donor trust fund designed to catalyze private sector investments in early stage renewable energy and energy efficiency markets.** SEFA was established in June 2011 with initial funding from the Government of Denmark. Thereafter, SEFA was restructured as a multi-donor trust fund pursuant to which USAID's Power Africa, the United Kingdom's Department for International Development (DFID), the Government of Italy and the Norwegian Agency for Development Cooperation joined the multi-donor arrangement. Cumulatively, donor contributions to SEFA amount to USD 105 million. The SEFA multi-donor trust fund expired on 20 June 2019, but the parties agreed to extend its duration until 31 December 2019, pending the establishment of the SEFA Special Fund.

2.2 **SEFA complements existing climate finance initiatives and has supported innovative and transformational opportunities led by the private sector.** SEFA has engaged the AfDB and other financiers in small and medium scale renewable energy projects before renewable energy technologies became mainstream and least-cost. In this way, SEFA expects to play a key role in demonstrating the viability of such business models in the African context. SEFA has also influenced AfDB's energy sector priorities towards sustainable, privately-led renewable energy solutions, particularly in smaller scale and off-grid contexts. SEFA prioritizes first-of-their-kind projects in African markets by taking on early stage risks, thereby enabling investment by commercial investors. Compared to other climate funds, SEFA is unique insofar as it is focused on (i) a hands-on early stage approach; (ii) renewable energy and energy efficiency; (iii) Sub-Saharan Africa; and (iv) leveraging AfDB financing and expanding its scope of operations.

2.3 **SEFA provides a vehicle for AfDB's delivery on the New Deal for Energy for Africa (NDEA) objectives and contribution to the Sustainable Development Goal number 7 (SDG7).** The NDEA is a partnership-driven effort with the aspirational goal of achieving universal access to energy in Africa by 2025. To achieve this goal, the AfDB is working with governments, the private sector, and bilateral and multilateral energy sector initiatives to develop a platform for public-private transformative partnerships for innovative financing in Africa's energy sector. SEFA is a clear example of this effort, as its overarching objective is to contribute to universal access to sustainable, reliable, and affordable energy services in Africa, while addressing several key themes of the NDEA, namely early-stage project finance, renewable energy, off-grid connectivity and energy sector country programs. SEFA has supported the development of Investment Plans under the Scaling-up Renewable Energy Program and SEforAll Action Agendas and Investment Prospectuses. More recently, SEFA has supported the Africa Energy Market Place (AEMP), with two of the five inaugural edition countries – Ethiopia and Zambia – benefitting from SEFA TA identified in the AEMP action plans.

2.4 **SEFA has to date committed USD 74 million to 51 projects which are expected to lead to 335,000 new connections providing access to over 1.6 million people, and 600 megawatt (MW) of renewable energy generation capacity, with an equivalent reduction of 12 million tons of CO_2.** SEFA interventions have often been complementary to AfDB operations and some of the most mature projects have been included in AfDB's operational pipeline.[5] SEFA has also been spearheading AfDB's engagement in green mini-grids (GMG), both through the Market Development Program (MDP)[6] and country-focused enabling environment support.[7]

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[5] Examples include Achwa I and II hydropower projects in Uganda, and the Corbetti Geothermal project in Ethiopia.

[6] The MDP has provided quick response to policy makers and regulators, and supported 79 African developers and 700 entrepreneurs in improving their energy businesses in the GMG and productive-use subsector, and contributed to 2,800 new connections providing sustainable energy access to about 17,000 people.

[7] Examples include Burkina Faso, the Democratic Republic of Congo, and Nigeria – which have recently developed GMG programs with AfDB's support and leveraging co-financing from the Green Climate Fund.

2.5 **SEFA is a cornerstone in the development of blended finance initiatives championed by AfDB.** SEFA played a catalytic role in the preparation and financial close of the Africa Renewable Energy Fund (AREF, 2013), and contributed with an equity investment of USD 25 million.[8] AREF mobilized USD 200 million in equity from fifteen development finance institutions (DFIs), and private and institutional investors. SEFA was also catalytic in establishing the Facility for Energy Inclusion (FEI). FEI is expected to mobilize up to USD 500 million debt financing for small-scale renewables from concessional and commercial financiers.[9]

3. RATIONALE

3.1. **SEFA needs to adapt to a new renewable energy landscape, given transformation in the market both globally and in many African states since SEFA's establishment in 2011.** New business models have emerged, some variable renewable energy sources have become mainstream, private sector participation is more active, and financing for medium sized projects is more widely available. Governments are also changing their approaches to sourcing new renewable energy capacity and connections through tenders and auctions. However, projects continue to stall because of a lack of readiness, high risk in early stage development, and viability gaps. New technologies such as battery storage are now available to help manage the variability of renewable energy, but deployment in Africa is still lagging behind. Thus, there is an urgent need for more risk capital and concessional project financing to stimulate investments in new technologies and businesses, optimize project economics to ensure financial sustainability and catalyze additional private investments into the sector.

3.2. **SEFA needs more instruments beyond TA to fulfil its mandate of maturing early stage markets and advancing renewable energy projects to fruition.** Whist SEFA is currently one of the largest multi-donor trust funds administered by AfDB and is comparable in capitalization to existing special funds in the AfDB, it has to date only deployed TA grants and, in one exceptional case, provided equity to one project.[10] Under the current arrangement, SEFA is unable to sufficiently address market gaps identified in early stage energy project development, especially for new technologies and business models like GMGs.

[8] AfDB approved the equity investments from SEFA under an exemption to the Trust Fund Policy.
[9] FEI off-grid achieved first close in August 2018 while first close of FEI on-grid is expected in Q3 2019.
[10] Under the Bank's Proposal for the Technical Cooperation Fund Reform ("Trust Fund Policy"), the Bank's technical cooperation funds are limited to technical assistance and capacity building through the use of grants. The Board of Directors, at the establishment of SEFA, exceptionally approved SEFA's equity component on pilot basis.

3.3. With the proposed SEFA Special Fund arrangement under Article 8 of the Agreement Establishing the African Development Bank (the "Bank Agreement"), SEFA would enjoy more customization and flexibility in terms of instruments to deploy. When SEFA becomes a Special Fund, it would have two financing windows for its operations – TA and concessional investment windows. The TA window will focus on addressing readiness of projects and developing programs to achieve needed scale in the energy sector. The concessional investment window, on the other hand, will leverage commercial financing, and support projects through the most risky implementation phases[11] and/or reshape technology and financing costs to improve commercial viability. Thus, restructuring SEFA into a special fund is expected to increase its impact and capacity to provide more flexible and diverse financing instruments as well as steer co-financing arrangements at concessional rate between the AfDB and willing and interested co-financiers.

4. PROGRAMMATIC THEMES AND FINANCING WINDOWS

4.1. **SEFA will focus on, amongst other evolving interests**, **three thematic areas of intervention to scale-up investments in early stage markets as follows:**

- **Green mini-grids.** SEFA will continue to support the scale-up of GMG investments as one of the main avenues for providing electricity access to underserved populations in rural areas. In this regard, SEFA will continue to provide enabling environment support, focusing increasingly on programmatic approaches at country level, complemented by concessional investments to mitigate key project risks and address commercial viability gaps, including through results-based financing. The MDP will be scaled up to be able to continue to respond to developers and policy makers needs along-side AfDB and SEFA supported country GMG programs.

- **Green baseload.** SEFA will support the scale up of renewable energy to displace or reduce the use of fossil fuel generation including from coal. The program will support the deployment of renewable sources of energy by providing (i) TA for power system optimization, integrated resource planning and project preparation; (ii) concessional to buy-down technology and financing costs and mitigate risks, so as to reduce the tariffs to comparable levels to fossil-fuel alternatives; and (iii) capacity-building in new technologies, including battery storage. The program will complement other climate and commercial funds in the renewable energy space and create new pipeline opportunities. SEFA will support technologies that have the potential to displace fossil fuels.

[11] Once a project is "ready", the riskiest phases of project implementation include the period before financial close through the construction phase up until cash flow is proven.

- **Energy Efficiency.** SEFA will enable energy efficiency investments thereby contributing to optimizing generation capacity requirements and energy intensity of African countries. Specifically, it will contribute to removing market barriers, support project preparation for energy services companies and assist financial intermediaries to open up or expand thematic business lines. SEFA will also support fuel-switching, including clean cooking, and demand-side energy efficiency targeting public and private beneficiaries along with residential consumers. Instruments under SEFA's concessional investment window will be deployed to support the implementation of projects during the riskiest phases, with the intention of later leveraging finance from AfDB's investment operations.

4.2. **The resources of the SEFA Special Fund will be deployed through two financing windows (figure 2): the technical assistance window and the concessional investment window.**

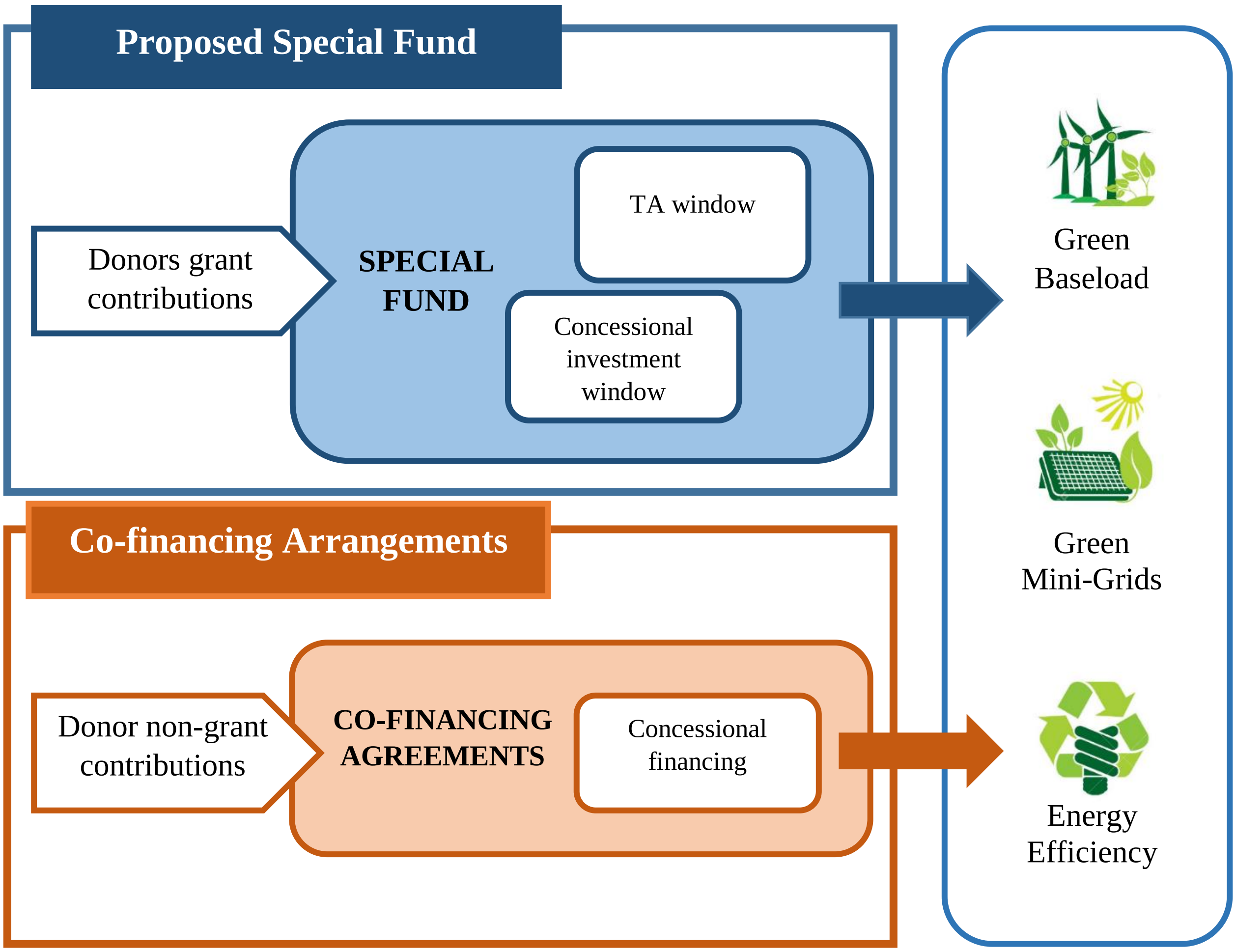
- The **technical assistance window** will provide support through grants and reimbursable grants for project preparation and enabling environment, but with an increased focus on activities that will directly unlock investments. Enabling environment activities, therefore, will have a stronger focus on downstream activities, such as, the design and structuring of procurement schemes to assist national authorities in contracting new generation capacity.

- The **concessional investment window** will provide catalytic risk capital and viability gap financing by deploying investment grants (including results-based financing grants), unior equity, and concessional debt. Concessional investments from SEFA will in most cases be "blended" with commercially-priced investments from other sources, including but not limited to AfDB's ordinary capital resources.

4.3. **SEFA may also mobilize concessional financing through separate co-financing arrangements (figure 2) to finance SEFA-related project pipeline.** The concessional financing will not be commingled with the resources of the SEFA Special Fund, but will be governed by separate agreements between the co-financier and AfDB. In addition, such resources will not mix with those of the SEFA Special Fund at the related project level, unless the financing is provided on same terms and/or further to explicit authorization by the SEFA Special Fund's donors.

4.4. **SEFA will also have a special focus on fragile countries including in support of the AfDB's Desert-to-Power Initiative,** which aims to transform the Sahel/Sahara region by developing and implementing on-grid and off-grid solar projects through project preparation, improved regulatory environment and capacity building for public authorities, and concessional finance instruments to unlock private sector participation.

Figure 2: SEFA programmatic areas and financing windows[12]



[12] Under the TA window, SEFA will deploy grants and reimbursable grants (including innovative finance instruments such as results-based finance) for project preparation and enabling environment purposes. Under the concessional investment window, SEFA will provide grants, reimbursable grants, concessional debt and equity instruments that will leverage commercial financing and support projects through the riskiest implementation phases.

5. GOVERNANCE FRAMEWORK AND ADMINISTRATION

Governance Arrangements

5.1. **Legal Arrangements.** The SEFA Special Fund will be a special fund under Article 8 of the Bank Agreement and accordingly will not enjoy separate legal status. All grant contributions from donors to the SEFA Special Fund will be made to the AfDB, as the administrator and trustee of the SEFA Special Fund. The SEFA Special Fund will be established pursuant to a legal instrument, to which donors will join by providing (i) an instrument of participation and (ii) an instrument of commitment. Any remaining and uncommitted grants previously made to the SEFA as a multi-donor trust fund as well as reflows from the operations of the SEFA multi-donor trust fund will be rolled into the SEFA Special Fund by virtue of the legal instrument.

5.2. **Governance**. The SEFA Special Fund's governance structure and approval processes would build on the existing SEFA structure. In line with other special funds, the SEFA Special Fund will have a detailed governance section in its Operational Procedures. The primary oversight body for the SEFA Special Fund will be the Governing Council (GC). Some investment decisions will require the approval of the AfDB's Board of Directors (BoD), in line with AfDB policies and procedures. The SEFA Special Fund will have a Technical Review Committee (TRC) which will review all SEFA-related projects and make recommendations for approval by the relevant approval authority. The SEFA Technical Unit will administer SEFA on a day-to-day basis. Further details on the role of these governance bodies is provided in section 5.6 below.

5.3. **Approval Process.** The initial technical screening and eligibility verification will be managed by the SEFA Technical Unit independently from AfDB operations.[13] Final appraisal reports for all SEFA transactions will be presented to the TRC, which may (i) reject, (ii) provide a conditional recommendation for approval by the approving authority, or (iii) provide an unconditional recommendation for approval by the approving authority. SEFA concessional investments may also benefit from being reviewed in the manner as linked non-concessional investments by the AfDB, which will go through standard AfDB appraisal and approval processes.[14]

5.4. **Approval Thresholds.** Approval thresholds are dependent upon the instrument and amount under consideration. For TA window operations, relevant activities will be approved as follows: less than or equal to USD 1 million grants will be approved by the Vice President of Energy, Climate and Green Growth Complex (PEVP); grants of over the equivalent of USD 1 million will be cleared by the GC on a non-objection basis, and submitted for approval by the BoD in accordance with AfDB's rules and procedures. For concessional investment window operations, the GC will review and recommend for approval all transactions on a non- objection basis. The BoD will have ultimate approval authority over all concessional investments, in line with institutional policies governing such instruments.

[13] Such independence is required to manage conflicts of interest at initial stages but does not preclude collaboration on the content of proposals to ensure alignment with parallel financing provided by the AfDB, where applicable.
[14] This could include, for example, review by Country Team where a SEFA transaction is included.

5.5. **Co-financing Arrangements.** AfDB may negotiate and sign separate co-financing arrangements. The nature of the co-financing arrangements will dictate review and approval requirements in line with AfDB's policies and procedures.[15] When possible, the co-financing arrangements between the AfDB and the co-financier should delegate project due diligence, procurement aspects, and administration to the SEFA Technical Unit and AfDB teams. Applicable administrative and other fees will be negotiated between AfDB and the co-financier – fair sharing between the SEFA Special Fund and external co-financing for origination and supervision expenses will be the guiding principle for negotiating fees, noting that there may be variations depending on the degree of delegation to the AfDB.

5.6. **Governance Bodies:**

- **AfDB Board of Directors.** The BoD provides general oversight through review and approval of SEFA Special Fund's operations subject to pre-determined thresholds defined in the Operational Procedures. All concessional finance operations will be subject to BoD approval.

- **Governing Council.** The GC, comprising SEFA donors and AfDB representatives, shall provide general oversight and strategic guidance for SEFA operations. The GC will establish the overall strategy and priorities of SEFA and approve the SEFA Technical Unit's work program and budget accordingly.

- **Technical Review Committee.** The TRC comprises representatives from Policy, Legal, Procurement, Financial Management Financial Control, Private Sector and Resource Mobilization and Partnerships departments of the Bank and other relevant sector teams, as the case may be.[16] The representative of the Resource Mobilization and Partnerships Department (FIRM) shall chair the TRC. The TRC shall review all funding proposals and ensure that they are (i) technically and financially sound, (ii) fully aligned with the the SEFA Special Fund and the AfDB's strategic priorities and policies and (iii) compliant with applicable AfDB and SEFA Special Fund rules and procedures. The TRC shall recommend projects for final approval by the relevant approving authority.

5.7. **Administrative Bodies**

- **SEFA Technical Unit.** The Technical Unit will be the delivery and administrative unit responsible for screening requests, implementing, reporting, monitoring and evaluating the overall portfolio activities. It comprises technical experts with project management, energy, and finance backgrounds. A coordinator will be responsible for managing the day-to-day operations of the SEFA Technical Unit. The Technical Unit will work alongside

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[15] Such review may include presentation to and approval by the AfDB's Standing Committee on Partnerships (SCP) and coordination with the Syndications & Co-Financing Department (FIST), as dictated by the nature of the co-financing arrangement.

[16] This shall include AfDB's blended finance lead and colleagues from risk and treasury departments as appropriate

AfDB energy operations teams that manage some of the SEFA Special Fund's funded projects. The SEFA Special Fund's projects will generally have an AfDB "sponsor" leading on the implementation of the project to ensure ownership and facilitate subsequent AfDB financing for the project. The Technical Unit will also manage and supervise the MDP and associated helpdesks as part of the GMG program.

- **The Renewable Energy Department (PERN).** PERN is the department hosting the SEFA Technical Unit, under the PEVP. PERN management will provide overall managerial guidance and oversight of day-to-day activities of the SEFA Special Fund under the guidance of the Vice President of the PEVP.

- **AfDB Support Ecosystem.** The SEFA Special Fund will rely on back-office support, risk management and fiduciary processes of AfDB, as well as overall fiduciary oversight by FIRM. The Syndications, Co-financing and Client Solutions Department (FIST) will be involved in the implementation of co-financing activities. Accounting, disbursement, procurement and quality assurance support will be provided by the relevant AfDB departments. The related cost of such services shall be borne through the administrative fee.

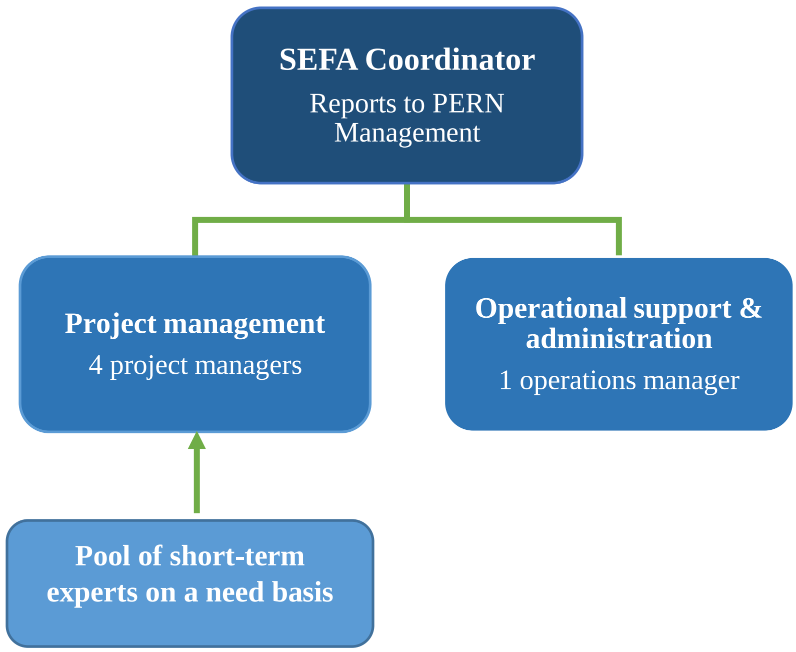
5.8. **Operational Procedures.** SEFA's governance, operations and financial practices will be defined in detail in comprehensive Operational Procedures. This document will be approved by the BoD subsequent to the GC's review and approval. The GC may periodically revise the Operational Procedures in consultation with the SEFA Technical Unit. Such amendments to the Operational Procedures will be decided by a consensus of the GC and will be circulated to the BoD for information.

Administration

5.9. **Staffing and Human Resources (Figure 3).** The SEFA Special Fund will strengthen its team to ensure effective implementation given its increased scale and breadth of activities. The PEVP operational departments will also provide technical support, who may act as team-lead or co-team lead for the SEFA Special Fund's concessional investments blended with AfDB ordinary resources. The coordinator of the SEFA Special Fund, who shall oversee the SEFA Technical Unit, will be an AfDB staff member, as is currently the case under the SEFA multi-donor fund. Five full-time project staff will be hired for the SEFA Special Fund and be funded from the SEFA Special Fund's budget for support services. These positions are critical for the continuity and stability of SEFA Special Fund's operations, contrary to the current arrangement which relies exclusively on long-term consultants. Short-term consultants will be deployed on a needs-basis.[17] The Staffing structure of the SEFA Special Fund may be reviewed and adjusted from time to time.

[17] The short-term consultants will be recruited on a 6 month or 1-year (renewable) basis. This may include a procurement expert to address implementation challenges and support the origination teams.

Figure 3: Staffing of SEFA



5.10. **Administration Fees.** AfDB will charge a minimum standard administrative fee of 5% of the total amount of the contribution to the SEFA Special Fund to defray general costs and the services provided by the AfDB ecosystem. A direct support services budget will also be reviewed and approved on an annual basis by the GC, based on recommendations from the SEFA Technical Unit.

Financial Management Considerations

5.11. **Reimbursable Grants.** The SEFA Special Fund will follow the emerging practice of other trust funds including AfDB-hosted facilities that have already considered the introduction of reimbursable grants in their operational guidelines, including the African Water Facility (AWF), the African Legal Support Facility (ALSF) and the African Development Fund (ADF) Project Preparation Facility mechanism.[18] In practice, this instrument is a zero interest cash advance where a verifiable trigger induces either repayment of the amount advanced or write-down/write-off. In practice, these transactions may be structured as a mezzanine or convertible loan/debt[19] instrument with zero or near-zero interest rates. This instrument will target primarily projects of a commercial nature for sharing project development and/or construction risk through structures that function

[18] As stipulated in its operational procedures document, the AWF may provide reimbursable grants to its beneficiaries after consultation with its Governing Council and with the approval of the BoD. In the case of ALSF, it may extend TA to a beneficiary in the form of a recoverable grant and the beneficiary has to include the reimbursement obligation in the relevant transaction documents. In the event of an agreed milestone, the grant can be converted into a loan.
[19] As defined in the AfDB's Guidelines for Quasi-Equity Instruments (Subordinated, Mezzanine and Convertible Debt), 2013.

like equity, thereby enabling the developer to pursue commercial debt with a relatively stronger balance sheet. Exact terms, legal structures and loan system integration will be implemented on the basis of the SEFA Special Fund's approval process. SEFA Special Fund will continue to provide grants for TA to public sector entities and exceptionally to private sector projects where a clear and compelling case is established.

5.12. **Re-deployment of Reflows.** The SEFA Special Fund will administer, manage and report on the reflows from concessional investments, including loans, equity and reimbursable grants deployed from its resources. Reflows will flow back into the SEFA Special Fund and may be re-deployed for new projects. If the SEFA Special Fund ceases to exist prior to receiving reflows from its concessional investments, the SEFA Special Fund's account would continue to be managed under the SEFA Special Fund enabling legal instrument and operational procedures document, and would be deployed for purposes that the GC and AfDB may agree at such time.

5.13. **Accounting and Financial Reporting.** Concessional investments will add complexity in managing SEFA Special Fund's resources envelope compared to the grants-based current operations. SEFA has managed a portfolio of grants using the existing AfDB's Trust Fund Management System and an equity investment using the AfDB's Equity Portfolio Management Platform, both running on the SAP platform. These are handled separately by a dedicated back-office team and consolidated quarterly in SEFA's financial statements. The same approach will be used to track new concessional investments under the SEFA Special Fund.

5.14. **Co-financing Agreements**. External co-financing will be governed by separate co-financing agreements. These will follow the AfDB's existing templates and will be deployed on their own terms and conditions. The SEFA Special Fund and AfDB will not bear any default or other direct risks arising from these co-financing arrangements.[20]

5.15. **Support Services.** The SEFA Special Fund's budget for support services will be funded from contributions to the SEFA Special Fund. A work plan and associated budget to finance direct costs associated with the SEFA Special Fund's operations will be approved by the GC on an annual basis. Direct costs could include, among other things, SEFA Special Fund's project staff, consultancy services, origination missions, project missions, meetings, conferences and audits.

5.16. **Audits.** AfDB's external auditor will undertake audits of SEFA's financial statements on an annual basis, duly supervised by the Financial Control Department of AfDB. Project sponsors benefitting from SEFA Special Fund's concessional investment window will be required to submit annual audited financial statements to the SEFA Technical Unit for the term of the financing.

[20] For avoidance of doubt, no co-financing agreement will be structured in a way that requires the special fund to bear the risk of default.

6. MONITORING AND EVALUATION ARRANGEMENTS

6.1. **SEFA has an established monitoring and reporting system and will continue to monitor and track project performance**. Project completion reports are required for all SEFA projects. These completion reports are used to evaluate the relevance, efficiency, and effectiveness of SEFA support. SEFA beneficiaries are required to submit annual reports and audit reports until the implementation of the activities financed are finalized.

6.2. **The SEFA Special Fund will incorporate the key recommendations from the internal audit carried out for the period January 2015 to December 2017.** This audit highlighted some areas that require strengthening, namely on portfolio management, grant effectiveness and archiving. Key actions will focus on project readiness at approval (to reduce start-up, signature and procurement delays), upgraded portfolio management system functionalities, portfolio management support and ensuring stronger Bank staff involvement and accountability in project implementation.

6.3. **The SEFA Technical Unit will provide annual and semi-annual reports to the GC.** The SEFA Technical Unit will report on the overall portfolio with reference to the SEFA Special Fund's results measurement framework contained in the Operational Procedures, and highlight the risks and mitigation measures for the portfolio. All reporting will be divided into the two financing windows, and across the three areas of intervention.

6.4. **A mid-term evaluation will be commissioned within 5 years of commencement of SEFA as a Special Fund**. The objective is to assess progress towards impact and outcomes, value for money, efficiency and effectiveness of deployment of SEFA Special Fund's resources, adequacy of SEFA Special Fund's portfolio and risk management protocols, and provide recommendations for the SEFA Special Fund. These evaluations will additionally provide recommendations for use of reflows and potential exit options.

7. RESOURCE MOBILIZATION AND FINANCIAL CONTRIBUTIONS

7.1. **The ambition is to raise up to USD 500 million in both direct SEFA Special Fund grant contributions and separate co-financing contributions managed by the SEFA Special Fund**. Such grant and concessional resources are expected to be complementary to the ongoing ADF-15 replenishment and the General Capital Increase VII. Donor resources earmarked for the SEFA Special Fund derive predominantly from budgets committed to climate finance and dedicated SDG7 resource envelopes. Non-grant resources to be provided through co-financing arrangements are bilateral concessional loans and risk mitigation instruments, some of which already exist, and therefore do not compete with ADF-15 replenishment and the General Capital Increase VII. The SEFA Special Fund's resource mobilization effort is expected to take place over the life of the SEFA Special Fund, with a strong push in the first two years of operation. This volume of capitalization will enable the SEFA Special Fund to deploy instruments at scale under a blended finance approach.

7.2. **The initial estimated donor contributions to the SEFA Special Fund amount to USD 88.5 million, of which USD 24 million are firm and USD 64.5 million are at different stages of processing for approval.** To date the United Kingdom and Norway have approved the equivalent USD 20 million and USD 4 million, respectively, for the replenishment of SEFA under the SEFA Special Fund. Additional contributions of approximately USD 64.5 million are expected to be approved in 2019 by Denmark (USD 45 million), Norway (USD 6 million), Sweden (USD 4 million), Spain (USD 4.5 million) and the United States (USD 5 million), respectively. Dialogue is on-going with Germany, Italy, Switzerland, Spain, UK, the Nordic Development Fund and others regarding additional contributions.

8. RISKS AND MITIGATION MEASURES

8.1. **As a special fund deploying concessional finance, the SEFA Special Fund will strengthen its risk management procedures to minimize portfolio losses and market distortions.**[21] The following key risks and mitigation measures for the SEFA Special Fund have been identified:

- **Default risk –**The risk of defaults for concessional investments provided by the SEFA Special Fund will be borne by SEFA Special Fund alone. The SEFA Special Fund will manage this risk through a stringent due diligence process and with support from the Bank's credit risk team. Additionally, the SEFA Special Fund will define allocation limits as it relates to first loss positions, portfolio distribution, concentration (geographic/single beneficiary/single obligor) and other parameters. However, given the catalytic nature of the SEFA Special Fund's concessional investments, the risk of default is expected to be above the levels faced by other debt and equity investors, even with mitigation measures in place. At no time will the SEFA Special Fund's outstanding commitments exceed cash in hand (i.e. there will be no financial leveraging of the SEFA Special Fund's resources beyond straight cash value). The risk of default under co-financing arrangements managed by AfDB/the SEFA Special Fund will be borne by the co-financing provider alone and with no recourse to the grant contributions to the SEFA Special Fund.

- **Conflict of interest**. While the SEFA Special Fund will benefit from being embedded within an AfDB operational department, this also creates possible conflicts of interest for deployment of blended finance that need to be managed to avoid market distortions and reputational risks. SEFA's concessional investment window will be subject to the principles for blended finance and the forthcoming AfDB Group Approach on Blended Finance, which stipulate a level of independence within project teams and decision making bodies managing blended concessional finance operations. The proposed governance structure clearly establishes the required independence, by designating a TRC chair from outside the PEVP and requiring a GC review and non-objection for all concessional finance operations prior to BoD approval.

[21] DFI Working Group on Blended Concessional Finance for Private Sector Projects (2017).

- **Selecting proposals aligned to the SEFA Special Fund's objectives and priorities.** SEFA has established an independent screening process with a track record of selecting project proposals that are aligned to the SEFA objectives and priorities. Initial screening takes place according to pre-determined criteria, and subsequently SEFA undertakes a due diligence process for proceeding with proposals alongside an investment officer or energy expert. Additionally, funding requests for the SEFA Special Fund will be cleared for pipeline by a committee composed of Directors/Managers from the PEVP. Finally, SEFA leverages the AfDB checks and balances between operational and fiduciary departments for the approval process, and the TRC composition includes many departments specifically dealing with AfDB fiduciary standards, including legal, financial control, procurement and strategy.

- **SEFA staffing and continuity of operations.** SEFA has largely operated with consultants, which is a key risk for the continuity of operations as the one-year term of the contracts do not synchronize with the multi-year duration of the projects. The SEFA Special Fund will move towards full-time long-term (multi-year) contracts (i.e. project staff) for key positions. Short-term consultants will continue to be deployed to meet specific capacity and skills constraints, namely around specific technologies, business models or geographies.

- **Corruption risks**. All the SEFA Special Fund's projects will be subject to AfDB's Whistle Blowing and Complaints Handling Policy. Where firms or individuals commit any breach of the policy, including corrupt, fraudulent, collusive, coercive and obstructive practices, the AfDB imposes relevant sanctions regulated in the AfDB's Sanctions Procedures. Adherence to AfDB's policies is duly reflected in the contracts with consultants and agreements with clients. Project sponsors benefitting from the concessional investment window will be required to submit annual audited financial statements for the term of the support.

9. TIMEFRAME AND DURATION

9.1. **Transitioning of the legacy SEFA Portfolio.** SEFA's legacy project portfolio will transition into the SEFA Special Fund and continue implementation in a "business as usual" manner. The equity investment in AREF is expected to start generating reflows to the SEFA account through the "divestment" period starting in 2020 and ending in 2024. Overall, any unspent amounts and reflows from the SEFA multi-donor fund should be made available for new commitments under the SEFA Special Fund. The detailed modalities will be defined in the Operational Procedures. The existing AfDB account for SEFA funds will remain active and ready to accommodate new contributions. SEFA's Operational Procedures will be updated to incorporate the peculiarities of the special fund regime and undergo the relevant approval process. When approved, the Operational Procedure will continue to apply to all existing and new projects to be generated by the SEFA Special Fund.

9.2. **Duration of the Initiative**. The SEFA Special Fund will commence operations as of the effective date stated in its legal instrument and initiate new programs under its areas of intervention and financing windows. The tentative effective date is expected in the fourth quarter of 2019. The SEFA Special Fund will have a duration of 10 years, which can be extended with GC approval to enable SEFA to continue to operate and deliver on its mandate.

9.3. **Exceptional Provisions for SEFA Special Fund**

9.3.1 **Exit option.** Traditionally, under the AfDB's special funds, withdrawal provisions were not provided as it was envisaged that the donors will remain with the special fund until the termination date. SEFA donors have requested that specific withdrawal provisions be included in the Instrument, where a donor may withdraw from the SEFA Special Fund by written notice to AfDB and the withdrawal shall become effective six (6) months after the communicated date of receipt of the notice by AfDB to the participant. The participant shall, however, remain liable for the payment of any portion of the amount of its commitment based on which the SEFA Special Fund has made commitments to recipients. Further to the withdrawal, AfDB shall return to the donor its pro-rata share of uncommitted funds, unless AfDB and the donor agree for the use of the pro rata share otherwise. It must however be noted that where withdrawal(s) from the SEFA Special Fund is of such significance that the resources remaining in the account of the SEFA Special Fund would be insufficient to continue its operations, such event would be treated as an early termination of the SEFA Special Fund.

9.3.2 **Consensus approval for changes to the Operational Procedures:** The donors through the GC originally approve the Operational Procedures. Customarily, any subsequent modifications thereto have been by a simple majority of the GC and the AfDB. However, the SEFA Special Fund's donors have requested the AfDB to deviate from the standard practice by requiring the consensus of the GC on all amendments of the Operational Procedures.

9.3.3 **Consensus approval for changes to the legal instrument:** The legal instrument is originally approved by the donors through the GC. Customarily, any subsequent modifications thereto have been by a simple majority of the GC and the AfDB. However, the SEFA Special Fund's donors have requested the AfDB to deviate from the standard practice by requiring the consensus of the GC on all amendments of the Instrument. Any such modification would subsequently also need to be approved by the BoD and reported to the Board of Governors at its next annual meetings.

9.3.4 **Sanctionable Practices:** The SEFA Special Fund donors have requested that the AfDB includes specific language on Sanctionable Practices wherein the AfDB determines to conduct investigation further to credible and material allegations of sanctionable practices in relation to activities financed by the SEFA Special Fund. This will be the first time such sanctions language will appear in a special fund approved by the Board of Governors.

9.3.5 **Verification:** The SEFA Special Fund donors have requested to be able to review or evaluate activities financed by the SEFA Special Fund at any time up to the termination or closure of the SEFA Special Fund, whichever is earlier. The AfDB is required to agree on the scope and conduct of such review or evaluation, including providing all relevant information within the limits of the AfDB's applicable policies and procedures. All associated costs, including any costs incurred by the AfDB, in such verification shall be borne by donor(s) in question. However, any such review or evaluation will not replace or constitute a financial, compliance or other audit of the SEFA Special Fund.

The mid-term evaluation of the activities of the SEFA Special Fund will provide recommendations for future management, use of reflows and more detailed exit options.

10. CONCLUSION AND RECOMMENDATIONS

10.1. In 2018, a donor-commissioned review of the SEFA multi-donor fund included feedback from the market confirming the need for concessional finance instruments to unlock renewable energy investments in Africa, in particular given the inadequacy of facilities providing such support in Africa. The SEFA Special Fund's ambition is to significantly increase the funding pool and deploy a mix of concessional financing instruments alongside its technical assistance tools. This will enable AfDB to continue to provide blended finance solutions to its clients – leveraging a decade long experience with external facilities – that has for example enabled large-scale concentrated solar power investments in Morocco as well as geothermal development and investments in Kenya. In addition, SEFA's experience with the Africa Renewable Energy Fund and Facility for Energy Inclusion as well as its track-record and institutional know-how provide a solid base for SEFA's.

10.2. The proposed changes will sustain SEFA's key role in paving the way for private sector participation in nascent renewable energy markets, thereby supporting AfDB's mandate to light up and power Africa as well as achieving SDG7. SEFA is uniquely positioned vis-à-vis other global facilities that will be strengthened pursuant to this scale-up. The SEFA Special Fund's unique position include: (i) higher risk-taking appetite, early stage engagement, developing pipeline for financiers; (ii) focus on sustainable energy technologies and first-of-a-kind private sector projects; (iii) exclusive mandate for the African region, prioritizing low income and transition countries; and (iv) ability to leverage AfDB's operational pipeline to the extent possible.

10.3. **In view of the foregoing considerations, the Board of Directors is invited to consider the proposal for the conversion of the SEFA multi-donor fund to a special Fund pursuant to Article 8 of the Bank Agreement**, and recommend it for the approval of the Board of Governors by 30 September 2019 or such date that the Board of Directors may direct.