



Aurora

Q4 2021

MILESTONE BASED FUNDING FOR OFF-GRID ENERGY IN NIGERIA

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INTRODUCTION

In 2019, the International Monetary Fund (IMF) identified that a lack of access to reliable electricity costs Nigeria an estimated US\$29 billion a year. The inability of the government to provide reliable power supply has further amplified the need for off-grid systems and other clean alternatives.

The subject of finance is crucial to the achievement of Nigeria's electrification targets. According to the International Energy Agency, distributed renewable energy solutions, like small-scale solar systems and mini-grids, are the least-expensive way to provide power to more than half of the world's off-grid population. Through the Nigeria Electrification Project (NEP), Mini-Grid Acceleration Scheme and other programmes in the country, funding is available to stimulate the sector. The World Bank, the African Development Bank and Nigeria's Rural Electrification Authority have made major commitments to improving electricity access via a US\$550 million fund for the NEP. For the Solar Hybrid Mini-grids component of this program, the funds available are US\$150 million out of a total of US\$350 million dedicated to the program.

Despite the grants available, the Nigerian off-grid energy sector is yet to scale at the projected levels. Here are some of the reasons why:

1. The nature of some of the available grant facilities in the country requires developers to obtain prior debt or equity financing for project development/construction. Unfortunately, local commercial funders such as banks and other financial institutions are not still abreast with the sector's needs to lend at catalytic scale.
2. Higher perceived risk and the low debt profile of the sector results in higher costs of capital characterized by prohibitive interest rates and unrealistic loan tenures (compared with projected receivables) and higher equity requirements, which in the first place is difficult to procure these days.
3. Since the launch of the NEP, very few developers in the space have achieved financial close to deploy projects at scale. This is still largely due to the fact that investors are still exercising great caution in funding such large-scale projects.

Perhaps, it is time for grantors (including the NEP) to consider a slightly different structure to some of the grant funding available? The NEP currently operates a Result Based Funding structure. Perhaps a Milestone Based Funding should be considered instead especially for the smaller companies in the space. Let us consider the two funding approaches for a better appreciation of this perspective.

WHAT IS A RESULT-BASED FUNDING?

Results-based financing (RBF) is a mechanism whereby a donor disburses funds to a recipient once a pre-agreed set of results has been achieved. This approach involves three key principles:

1. Payments are made only after the results have been achieved;
2. The recipient may independently choose how to achieve these results; and
3. Independent verification of results is the trigger for disbursement. RBF is therefore fundamentally different from more traditional approaches in development where funding is provided in advance to finance inputs and activities. Results-based financing has gained increasing recognition as a valuable instrument for donors and development partners, enabling them to de-risk commercial investment and incentivize the engagement of companies offering solutions in hard-to-reach markets. The key feature of RBF is payment upon delivery, with financing contingent upon the success of the business or initiative: That means the companies that receive the financing are expected to take the full risk until results are achieved. In the energy sector, RBF payments are only made after the successful verification of energy access being delivered by participating companies.

From the foregoing, development assistance under an RBF model is provided in response to verified results (for instance, the number of households provided with a working electricity connection), rather than providing funding up-front for inputs (for instance, delivery of electricity meters, wires and poles). This implies, as we mentioned above, that to access the grants, companies will need to raise 100% of the debt/equity upfront, construct the projects and then claim the grants 3-months post-completion. The challenge of raising the requisite capital is a daunting task for many companies that could prove abortive.



WHAT IS MILESTONE-BASED APPROACH

A Payment-for-Milestones or milestone-based approach re-imagines government support of private-sector innovation, tying funds to the achievement specific hardware, technical, and/or financial milestones. In these milestone-based projects, applicants identify and describe expected milestones. These milestones are tied to awards – when a company reaches a milestone, they receive the money. If they do not reach a milestone, they do not receive the funding.

By dividing projects into discrete phases via milestones, progress indicators can be readily identified and funding can be matched to project success. Further, such approaches can be more attractive for venture and institutional capital, building a foundation for later rapid commercialization.

Milestones-based funding of demonstration projects for new energy technologies is an effective, and in many instances preferable, alternative to conventional cost reimbursement models. This gives the companies the option of either using the first disbursement as “equity” to access debt to complete projects, or it helps get projects underway immediately until a milestone is attained to trigger another disbursement till the end of the project.

With milestone funding, the parties agree that an initial tranche of financing will be followed by a subsequent tranche based on the company achieving (or not achieving) some milestone. By awarding funding to a company when they achieve specific commercial milestones, this model incentivizes more rapid innovation and can provide offramps for federal funding for unsuccessful projects.



CONCLUSION

In conclusion, it is our recommendation that a milestone-based approach be adopted by the NEP and other grantors to potentially increase commercially viable participation in the off-grid energy space.

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