

**Approval by Mail: SREP Nepal: Rural Electrification Through Renewable Energy (ADB)—
Response from MDB**

Request from UK for clarification and confirmation

Thank you for the request for approval by mail for USD 11.2 million in SREP grant funding for the project proposal entitled Nepal: Rural Electrification Through Renewable Energy submitted by the Government of Nepal and the Asian Development Bank (ADB).

We appreciated the opportunity to discuss with the ADB leads on the project last week and were reassured that our areas of concern had been taken into account in the project design. We are content to approve the project, however, we would appreciate written confirmation and clarification on the following points from the Government of Nepal and the ADB for the record:

- It would be useful to set out in more detail the Nepal Renewable Energy Policy as it affects the mini-hydro and solar/wind projects – particularly the percentages of subsidy, loans and community contribution applicable. We were reassured to hear that a degree of competition will be applied in the allocation of the subsidy component and we would appreciate further details of how this would be applied.

The current Renewable Energy Subsidy Policy¹ stipulates that the subsidy percentage is decided subject to RE technology, location of subprojects, number of household to be electrified etc. The Policy has long term goal of replacing subsidy with credit and supports long term credit at an affordable interest rate be made available for investment in the field of renewable energy through proper institutional arrangement. Some support for enterprises using renewable energy is also provided to promote productive use of energy. There is also an additional subsidy for those households with single woman, backward, disaster victim, conflict affected, poor and endangered ethnic group as identified by the Government of Nepal. The Government of Nepal has also issued the Subsidy Delivery Mechanism and undertakes regular review of the Policy and delivery mechanism and adjusts the subsidy level and other arrangements as needed.

The subprojects of AEPC's off-grid component are to be developed on sector loan and demand driven approach. The selection criteria include willingness to contribute by communities in accordance with current Renewable Energy Subsidy Policy. When AEPC selects the subprojects to be eligible for fund by this project, the percentages of subsidy as well as community contribution will be one factor to be considered. The goal will be to use limited public sector funding to mobilize more private/community participation and extend the support to more beneficiaries.

- Further to the above point, we note that the proportions of subsidy expected on the solar and wind projects in particular are relatively high, and in addition to the competition for subsidy resources, we would also suggest that an emphasis is placed in that competition and in learning/evaluation on business models which have the potential to scale at lower levels of subsidy once demonstration effects have been achieved.

¹ The Policy is available from AEPC's website:
http://www.aepc.gov.np/docs/resource/rescenter/20130818060043_RE%20Subsidy%20Policy%202013%20-%20English.pdf

Agreed. As mentioned in above, the subprojects are to be developed on sector loan and demand driven approach. There are 3 sample subprojects for mini-grid based solar and/or solar/wind systems that have been evaluated during project processing, and implementation of the 3 sample subprojects will be started soon. The potential to scale at lower level of subsidy will be tested during implementation of the sample subprojects. If the result is feasible, the lower level of subsidy will be followed in the implementation of subsequent subprojects.

- We did not find the leverage assumptions clear between the original IP and this project, and the leverage assumption is much lower for this component (even on a component by component basis) than foreseen in the IP. We would appreciate a written confirmation of the changes in assumptions and design which have led to this reduction.

The line-item allocations in the original IP are indicative. The project design has evolved and the ADF allocation has been reduced taking into account the on-going NRREP and capacity of AEPC.

Piloting of the \$ 5mil credit line through the proposed intervention will be later extended to CREF (when operational) and hence has a very high leveraging factor in the form of attracting credit financing (which cannot be quantified at this stage). Further it is not fair to assume same high leveraging factors in all sub-components of the IP. At the time of IP preparation, it was always expected that grid connected mini-hydro power will have a leveraging factor much higher than others while the off-grid components were expected to have less leveraging given the nature of these projects.

In addition, given the different payment period, i.e. 32 years (8 years grace period + 24 years payback period) for the \$5 mil credit from AEPC to ADB through government, and maximum 8 years for the subloans of the credit from developers or user communities to AEPC through commercial banks, the \$ 5mil credit can be revolved several times before it gets paid back to ADB. Even the \$5mil credit is revolved only once, around \$24.4 additional fund will be leveraged as subsidy from government and contributions from communities or developer. Thus, the leverage factor of 3.36:1 will be achieved if we consider the \$5mil credit will be revolved only once which is a conservative assumption. The cost estimates, output and outcome did not include the effects of credit revolving to be conservative.

- The potential of this SREP support to 1) act as a scaling-up and shift to a more commercial basis of the existing mini-hydro debt fund, and 2) to act as a pilot for the proposed Central Renewable Energy Fund - are key factors in the argument for transformation in this project. We would appreciate if you could set out a bit more clearly the positioning, co-ordination and expected outcomes of this SREP support with respect to existing funds, and expected future funds.

The expected Central Renewable Energy Fund (CREF) will have two windows to handle subsidy and credit for renewable energy sector. The credit window of CREF is more than \$50 mil which is much larger than the credit line of proposed SREP. AEPC will be the executive agency for oversight CREF. Given the larger size of CREF, a Handling Bank instead of AEPC will be responsible for managing and administering the credit window of CREF, including channeling of lending/refinancing funds to and from Prequalified Partner Banks. A number of Prequalified Partner Banks will be responsible for the on-lending of CREF funds to eligible projects in the renewable energy sector. The CREF is being established under NRREP. ADB is fully involved in the establishment of CREF. The lessons learned during implementation of SREP including the \$5 mil credit line will help improve the structure and mechanism of proposed CREF.

The \$5 mil credit line from ADF loan is developed based on the existing mini-hydro debt fund (MHDF) mechanism (Euro 0.5 million grant from GIZ). The due diligences on financial, financial management and integrity risks of the two commercial banks have been conducted, and track

records of the two banks to onlend MHDF to micro hydro projects have been evaluated. AEPC is the executive agency to implement SREP. With supports of consultants, AEPC will manage the \$ 5mil credit line, which will be onlent to the two commercial banks and further onlent to user communities/developers for development of mini hydro subprojects. The project thus does help to pilot test the credit line through the proposed interventions which will then later be extended to CREF (when operational) and can attract more financing.