Managing environmental & social risks to achieve bankability for renewable energy projects in Africa

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Abstract

Interest in and support for renewable energy projects to address the energy supply gap in Africa continues to grow. Opportunities for investors within this space are plenty but come with unique challenges that require careful evaluation of ESG risks early in the project lifecycle. A key component to a successful project is making sure that is it 'bankable' from an ESG perspective, making it attractive to lenders and investors. The focus of this paper is specifically on how to address ESG risks to ensure that renewable energy projects in Africa are 'bankable' from the start of the project through to the construction and operation of the project.

Introduction

With energy demands continuing to increase across Africa, interest in power projects, particularly renewables, remains high with international developers and investors. Despite Environmental, Social and Governance (ESG) risks being addressed much earlier on in the project life-cycle than ever before, ESG risks often delay and, in some cases, derail financing of projects. To successfully navigate this process and secure funds, it is essential that projects demonstrate from an ESG perspective that they are 'bankable'.

A project is considered 'bankable' when its ESG risks are well understood and when effective measures and structures are in place to mitigate and/or manage these risks to an acceptable level for financiers.

The Environmental and Social Impact Assessment (ESIA) is typically the first step developers take in demonstrating how they have identified and will be managing ESG risks. However, it is at this stage that many projects fail because of the assumption that the ESIA needed by regulators to secure a permit through the national process will be largely sufficient to meet lender needs. Apart from this, in many cases the ESIA is initiated too late in the site selection or design process, often its importance is not fully understood (it might be considered as a mere formal requirement) and thus it is less effective in addressing ESG risks appropriately.

This position paper explores what 'bankable' is from an ESG risk perspective, shows that these risks are also associated with the renewable energy sector in Africa, and discusses some proactive approaches to addressing ESG risks in a way that allows a project to be 'bankable' and compete against the many other power projects in Africa for financing.

Bankable projects

A project is considered bankable if lenders are willing to finance it. In the language of environmental and social consultants, the bankability of a project is not only determined by its technical and financial features but also from its environmental and social performance. Nowadays, it is getting more and more common that when applying for financing from international financing institutions, export credit agencies and commercial banks, companies are required to undergo an environmental and social due diligence in parallel to or following the assessment of other aspects (for example, of economic, financial or legal nature). The purpose of the due diligence is to identify and evaluate potential environmental and social impacts generated by the project and theits compliance against applicable international and national laws and standards. The main international standards that usually apply for projects developed in Africa are:

- International Finance Corporation (IFC) Performance Standards on Environmental and Social Sustainability (2012);
- Equator Principles (2013);
- European Bank for Reconstruction and Development (EBRD) Performance Requirements (2014);
- European Investment Bank (EIB) Environmental and Social Standards (2014); and
- African Development Bank (AfDB) Operational Safeguards (2014).

The purpose of the due diligence is to prevent project developers and financial institutions from being exposed to the following three types of risks arising from their client's potential environmental and social issues:

- credit risk: when a client is unable to repay loan on account of environmental and social issues;
- liability risk: when a financial institution faces legal complications, fees, and/or fines in rectifying environmental and social damage by virtue of taking possession of collateral;
- reputational risk: when the negative aspects of a project harm a financial institution's image — in the media, with the public, with the business and financial communities, and even with its own staff.

The correct implementation of these standards together with best practices have shown that this can assist project developers and financiers in reducing liability and reputational risks as well as economic risks caused by work stoppages resulting from social problems or environmental accidents.

Are ESG risks real for renewable energy projects?

Environmental and social impacts and risks are generally recognized as being relevant to the extractive industry as well as for the development of infrastructure, with only minor relevance to renewable energy developments. Initial perceptions are often that renewables have a significant positive environmental impact through the reduction of greenhouse gas emissions and thus there is no requirement to 'manage' environmental and social risks. This perception is misplaced as all renewable energy developments have some negative impacts that need to be mitigated, while several of the benefits can be enhanced. These impacts are experienced locally through the construction and operation of the power plant and associated infrastructure, and impact both ecological and social aspects of the surrounding local environment. Ignoring these impacts, or potential risks, can have dire consequences for the project.

Research in the extractive industry undertaken by ERM (see Figures 1 and 2), clearly shows that environmental and social risks can directly impact the implementation of a project meaning they have the potential to cause delays, subsequent project overspending and potential reputational risks to developers. Is this the case for the renewable energy sector in Africa?

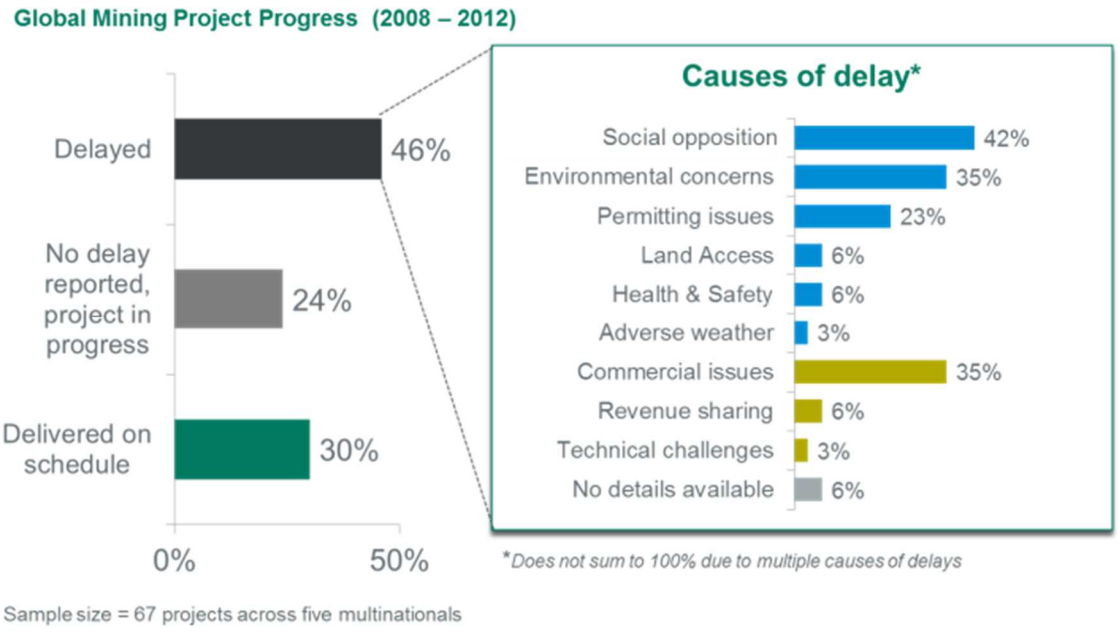

Fig. 1 - Global mining project progress 2008 - 2012, ERM

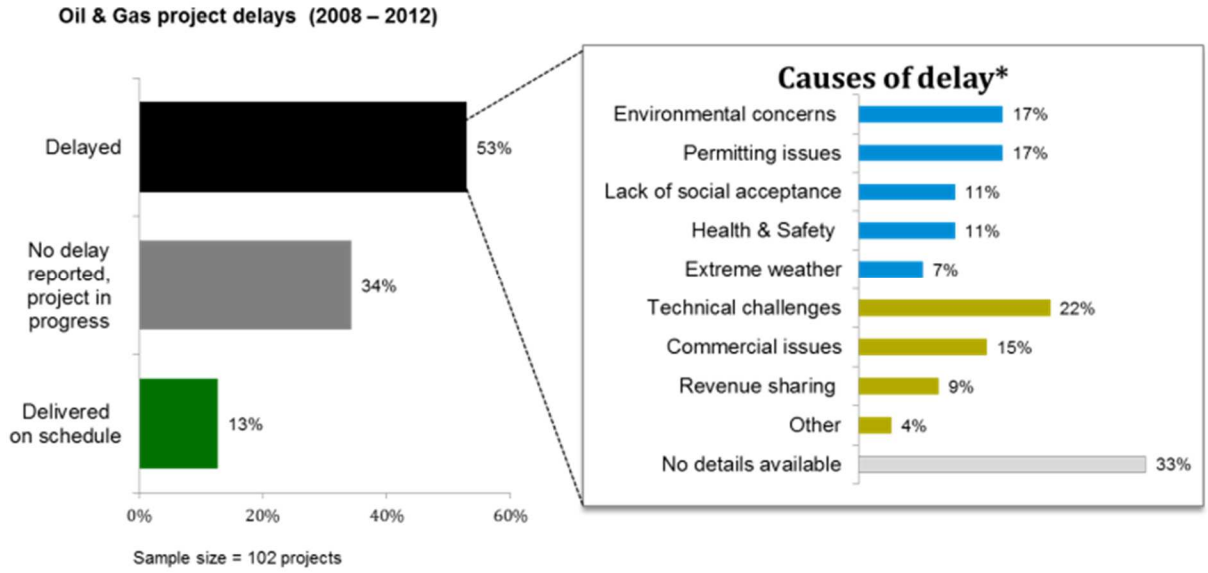

Fig. 2 - Oil and gas project delays 2008 – 2012, ERM

To answer this question, one only needs to consider two major renewable energy projects in East Africa that have been profoundly impacted by environmental and social risks. The first is the Kinangop Wind Project, which was ultimately abandoned on 25 February 2016. KWP Ltd and its shareholders announced that the project would not be completed due to civil disturbances over a 21-month period in the local area of the project resulting in delays that led to a depletion of funds, as well as court cases and community hostilities. Another renewable project in East Africa, this

Power type	Most common high risk ESG issues
Thermal	• Air quality • Physical and/or economic resettlement for land owners and land users • Project induced labour influx • Noise
Wind	• Biodiversity (in particular birds and bats) • Noise and visual • Physical and/or economic resettlement for land owners and land users
Solar PV	• Physical and/or economic resettlement for land owners and land users • Waste management (disposal of waste panels)
Hydro	• Physical and/or economic resettlement for land owners and land users • Project induced labour influx • Biodiversity (from the dam and inundation area) • Environmental flow and fisheries
Associated infrastruc-ture	• Physical and/or economic resettlement for land owners and land users • Biodiversity

one deemed a success, has not been immune to similar challenges. Whilst the Lake Turkana Wind Power Project is expected to inject 310MW from its 365 turbines into the national grid, the project has been held back for 6 months now by a controversy surrounding the completion of a 400KV, 428 km line from its fields at Loyangalani to Suswa.

These are just two recent examples where social risks have either totally stopped the project or resulted in significant delays. There are other examples where ecological issues have been the primary risk. For a renewable energy project to be considered bankable, ESG risks will need to be carefully identified and proactively managed throughout the project life-cycle.

The importance of acting early

Acting early is the key to success when it comes to managing ESG risks and impacts in order to secure international finance for projects and ensure their smooth implementation. There are a number of actions project developers should take from an ESG perspective to make financing as easy and fast as possible, including:

Perform early screening of potential high-risk E&S issues. This could be in the form of a 'red flags assessment' or an early-stage due diligence. The table below illustrates the most common high-risk ESG issues for various power projects (note: this is not an exhaustive list, as different projects will have different sensitivities). It is important to integrate the consideration of potential environmental and social impacts into early site selection and design decisions so that impacts can be avoided or minimized where feasible. International best practice should be applied where applicable at the design phase (e.g. compliance with the World Bank EHS Guidelines). It is also important to note that international finance standards require developers to demonstrate in the ESIA how environmental and social considerations

have been included in the alternatives selection process (e.g. routing, siting, and technology selection).

Engage early with potential lenders and government stakeholders. This dialogue helps avoid unwanted surprises and is important to reassure lending institutions throughout the process that ESG risks are being robustly managed. This can also be an opportunity to discuss and agree on realistic mitigation measures where meeting specific international standards may not be that straight forward. Liaising with governmental stakeholders early is advised to discuss key differences between national requirements and lender requirements and to agree on an approach to bridge these gaps. There are a number of areas that often show key differences between these requirements, including the extent and nature of stakeholder engagement and compensation measures when dealing with physical or economic resettlement.

Identify and engage early with key stakeholders. Stakeholder engagement is a key aspect for all bankable projects. Beyond the fact that it is a requirement of all international standards and often of some national environmental legislation, its actual implementation from the early phase of project development allows the project to gain the social license to operate and prevent the outbreak of protests. The identification of project stakeholders should start ideally at the beginning of the project design phase and, specifically for renewable energy projects, before the identification of the site. Project stakeholders are various individuals, groups or communities who:

- will be affected or are likely to be affected, positively or negatively, and directly or indirectly by the project ('Project Affected Parties'), particularly those directly and adversely affected by project activities, including those who are disadvantaged or vulnerable; or
- may have an interest in the project and/or the ability to influence its outcomes, either positively or negatively ('other influential/interested groups').

Project proponents should identify the different stakeholder groups to outline a continuous public information, consultation and communication strategy. This strategy is generally known as Stakeholder Engagement Strategy or Plan (depending on the project development phase). At first, proponents should undertake a detailed stakeholder identification analysis that specifies and enumerates which groups are most affected by the project, how, and to what degree. The proponent will map the key components, as follows:

- project activities, both on site and the surrounding area, that may result in local environmental or social impacts;
- impact zones (e.g. labor standards and employment, land use and acquisition, soil/air/water pollution, etc.) for each component; and
- directly affected, indirectly affected, and vulnerable groups in the impacted zones.

Following the preliminary stakeholder mapping, based on field surveys and desktop study, the proponent should verify this analysis through direct consultation with stakeholders or credible and trustworthy representatives. The project's stakeholder engagement strategy should be based on meaningful and culturally appropriate interaction and good faith dialogue with

interested parties. It should be commensurate with project impacts and development phase.

When starting stakeholder engagement at the early stages of project development, developers have the possibility, among others, to reach an agreement for a suitable location which minimizes social impacts and maximizes benefits, and to disclose correct and reliable information on the project which can prevent the spreading of false beliefs and expectations (in particular regarding employment). Engaging early will help the project to develop trustful relationship with local communities and authorities and identify, from the very beginning, local needs that could be addressed through a sustainable community investment strategy.

Identifying from the very beginning opportunities that can create additional value to affected communities. Bankability is achieved more rapidly when a careful assessment of the local and business context is performed in the earliest stage of the project. This allows a deeper understanding of the local communities that the business will be operating in and, subsequently, an effective management of ESG risks and opportunities. The screening of opportunities that can create additional value to the local community pushes the company to be proactive and meaningfully engage with local stakeholders as international standards require. This approach reduces the risk of poor ESG performance and of subsequent delay in achieving bankability status. For this reason, a number of project proponents have developed in recent years a thorough and strategic approach to the management of ESG risks, by developing a cross-functional coordination at the company level and by focusing corporate policies on external aspects such as local hiring/procurement policies and community investment programs.

For renewable energy projects, the local hiring aspect is an issue that must be handled carefully to meet local expectations and possibly maximize the contribution of available local workforce. This is particularly important for renewable energy projects, as the number of available jobs in the construction and operation phases is lower than envisioned by local communities and generally largely based on skilled workers. In this regard, investment in capacity building or *ad hoc* community investment programs can successfully contribute to maximize local opportunities and, ultimately, contribute to a positive reputation at local and national level. A successful ESG management strategy focused on local and business context should be developed around achieving the following targets:

- target local people categories that might contribute in the most effective way to building the project's 'social license to operate';
- build capacities at local level that are recognized as beneficial in the Project context (either with direct and indirect impacts); and
- depending on project size and characteristics, consider a variety of capacity-building options to ensure diversification of the local workforce and supply chain.

The importance of social issues

People are seldom straightforward and this means that measuring social impacts is often

complex, making the full understanding and management of social risks prior to financial close a real challenge. This is exacerbated by the fact that social impacts are often excluded from consideration in many of the national ESIA processes in Africa. As a result, unless a project proactively incorporates international finance requirements early in the process, as previously advocated, significant additional work on the assessment of social impacts is often needed to supplement a national ESIA. To further raise the stakes, as illustrated in the table above, social issues can often present some of the highest ESG risks to a project (e.g. physical and economic resettlement, and community conflict associated with physical environmental changes to air quality, noise emissions and water supply). Social issues can make or break a development; on one hand, they can stop a project dead in its tracks, and on the other hand, good social management can de-risk a project and generate value in the eyes of potential investors.

Below are several ways in which project developers can de-risk projects for social issues and avoid related delays in financing:

Work to build trust with local communities at the outset. Good stakeholder engagement should start early, as explained in the former sections. Once trust with stakeholders is lost, it is difficult to regain. It should be noted that social impact assessments need to include the community's consideration of perceived impacts, since these can often pose a very real social risk to projects. The only way to identify these risks is by engaging stakeholders early in the impact assessment process.

It is essential to understand any potential impacts on people's livelihoods since these can pose a high ESG risk and will require a significant amount of management. If land take is required for the development, the following should be considered:

- who are the current land owners and how will they be impacted?
- is land ownership clearly documented? Note that in many parts of Africa this may not be the case (e.g. community/tribal ownership of land).
- are there any other users of the land who are dependent on the land to support their livelihoods? Note that this can include informal or even illegal use of the land.
- any compensation will need to be in line with international finance standards (e.g. IFC's Performance Standard 5), so it is important to understand how the national compensation process may differ. Note that there may be a requirement to 'top-up' national compensation.
- if the land has been allocated to the project by the government, this does not automatically mean that any government-led resettlement meets international requirements.

Determine if the project has the potential to affect any indigenous peoples. If this is a possibility, the stakeholder engagement process, and indeed the social impact assessment, will trigger additional requirements under the IFC's Performance Standards (IFC Performance Standard 7) and will introduce an added layer of complexity. Potential impacts on indigenous peoples also pose an increased reputational risk and NGOs are likely to focus their attention on the

project. Engaging with indigenous peoples requires a deep understanding of their culture and livelihoods and must be led by appropriately qualified individuals that are known and trusted by the affected communities.

Don't underestimate the capacity or influence of local NGOs. NGOs have access to project information, permits and licenses and can be adept at identifying non-compliance. They can place considerable pressure on project developers, thereby increasing the risk of reputational damage. Additionally, with the increased role of social media in society, international NGOs often back local NGOs as part of targeted campaigns. This means that small, local NGOs often receive guidance and resources from larger, international NGOs. Additionally, potential local ESG issues are more likely to be communicated to an international audience, thereby increasing the reputational risks both for a developer and their financiers.

Appoint the right Community Liaison Officer (CLO). This is a key decision in helping to manage local project risks effectively. A local individual with knowledge of international standards/protocols and hands-on experience in stakeholder engagement is ideal for this role.

Ensure that a robust Environmental Social Management System (ESMS) will be in place for construction and operation. From a social perspective, it is essential that this system also includes procedures and resources to manage social impacts, any labor working condition issues and community grievances on an on-going basis for the life of the project.

The importance of full project commitment to implementing ESG mitigation and enhancement measures

Experience has shown that in order to manage ESG risks throughout the project life-cycle, a company needs to commit to the appropriate level of human resources to implement the necessary risk mitigation measures during both the construction and operational phases of the project. Showing this commitment prior to the start of construction has become more important to project lenders and financiers, as they require proof of qualified staff and appropriate organizational management systems to ensure implementation.

Two common situations have been observed in bankable projects, especially in small to medium scale projects, such as renewable energy projects:

- a full set of environmental and social documents is prepared in compliance with international standards (usually with the support of external experts) but they remain a mere formal exercise without actual implementation. Site procedures and practice remain those generally applied by the developer on all sites and no personnel with specific environmental and social skills are deployed; and
- project developers appoint specialists within their staff responsible for the due diligence/compliance monitoring phase (specifically as company interface with lenders) as an additional task in addition to their normal workload without giving them the right tools, support and

authority to set up a project-specific environmental and social management system.

An effective environmental and social management system aimed at mitigating environmental and social risks should be endorsed by the project's management team and become an integral part of the company procedures and day-to-day business operations. This implies that a dedicated organizational structure with adequate skills, resources, agreed upon strategy as well as a good monitoring system is necessary to ensure good environmental and social implementation and performance.

Related infrastructure

The installation of supporting infrastructure needed for a power development is something that is often overlooked when conducting a national ESIA. Common examples include transmission lines, substations, access roads and pipelines. If these are essential to the project and would not exist without the project, they are considered 'associated facilities' and need to be considered as part of the scope for the international ESIA, even if they are not directly funded by the project.

Conclusion

Using the appropriate mechanisms to integrate ESG risks into the project life-cycle will allow project developers to help de-risk their projects, making them 'bankable' from an ESG perspective. This will increase the likelihood of securing international financing and receiving the funds more quickly. From previous forums that address power in Africa, it is evident that there is plenty of money for investment; however, there are not enough 'bankable' projects. With so many power projects in Africa competing to secure financing, managing ESG risks properly can make the difference between a successful development and one that never gets off the ground.