



Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Appraisal Stage | Date Prepared/Updated: 08-Feb-2018 | Report No.: 123392



BASIC INFORMATION

A. Basic Project Data

Country Kenya	Project ID P162422	Parent Project ID (if any)	Project Name KenGen Guarantee Project (P162422)
Region AFRICA	Estimated Appraisal Date N/A	Estimated Board Date Mar 20, 2018	Practice Area (Lead) Energy & Extractives
Lending Instrument Investment Project Financing	Borrower(s) Government of Kenya	Implementing Agency KenGen	

Financing (in USD Million)

Financing Source	Amount
Commercial Financing	300.00
International Development Association (IDA Guarantee)	180.00
Total Project Cost	180.00

Environmental Assessment Category

C – No EA required

Concept Review Decision

Track II-The review did authorize the preparation to continue

Have the Safeguards oversight and clearance functions been transferred to the Practice Manager? (Will not be disclosed)

No

Other Decision (as needed)

B. Introduction and Context

Country Context

Kenya aims to achieve middle income country status by 2030. Kenya, a country of 48 million people located across the equator in Africa’s east coast, is one of the largest and most vibrant economies in Sub-Saharan Africa. In stark contrast to the slump in economic growth observed across the region, growth in Kenya has been projected to reach 4.9 percent in 2017, placing Kenya as one of the fastest growing economies in the area. Kenya’s robust growth performance was supported by a stable macroeconomic environment, lower oil prices and improvements in the steady easing of certain supply-side constraints due to earlier public investments. The Gross National Income per capita in Kenya has reached US\$1380 in 2016, rapidly converging towards the regional average of US\$ 1505 and on



the right path to achieve the upper middle-income status in accordance with the aspirations of Vision 2030.

With headwinds subsiding, economic growth is projected to rebound over the medium term. The Kenyan economy faced multiple headwinds in 2017. A drought in the earlier half of the year, the ongoing slowdown in private sector credit growth, and a prolonged election cycle weakened private sector demand. Nonetheless, reflecting the relatively diverse economic structure, these headwinds were partially mitigated by the recovery in tourism, better rains in the second half of the year, still low global oil prices. With headwinds subsiding, economic growth is projected to rebound over the medium term, reaching about 5.8 percent in 2019.

Fiscal consolidation remains a challenge. The fiscal deficit is projected to rise in 2017 primarily because of an increase in development spending, in the backdrop of slower revenue growth and therefore of the expected slower economic growth. This rise in the fiscal deficit reflects the difficulty the Government of Kenya (GoK) faces in creating the necessary fiscal space through reductions in the share of recurrent spending, and expansion of the revenue base to carry out the ambitious public investment drive without straining public finances. There is a need, thus, to consolidate Kenya's fiscal stance in order not to jeopardize its hard-earned macroeconomic stability.

The newly elected government presented a medium-term plan (2018-22) dependent on provision of adequate, affordable, and reliable electricity supply. The medium-term plan is centered on four pillars- universal healthcare, affordable housing, food security, and manufacturing, all of which are dependent on provision of adequate, affordable, and reliable electricity supply. In particular, GoK targets to lower the cost of construction, improve accessibility to affordable mortgages, encourage large scale agriculture, and create an enabling environment for manufacturing for creating jobs particularly for the young population. In order to increase competitiveness of Kenya's manufacturing, a 50 percent reduction in electricity tariff during the off-peak hours was introduced recently taking advantage of the surplus capacity of power generation that the country currently enjoys.

Sectoral and Institutional Context

Kenya's vibrant power sector has emerged from successive waves of sector reforms since the early 1990s. GoK has successfully separated policy and regulatory functions from commercial activities, unbundled generation from transmission and distribution activities, introduced cost reflective tariffs and attracted private capital through the liberalization of generation activities while retaining majority ownership of the largest power utilities in the country – the Kenya Power Lighting Company (KPLC) and Kenya Electricity Generating Company Limited (KenGen). The sector is regulated by a single sector regulator, the Energy Regulatory Commission, with a mandate for technical and economic regulation of petroleum, electricity and renewable energy and an Energy Tribunal is in charge of solving sector disputes.

The sector operates under a single buyer system and key parastatals operate on commercial principles. KPLC preserves the role of transmission and distribution system operator as well as the role of market operator. KPLC signs standard Power Purchase Agreements (PPAs) with all the generation companies, including KenGen, which are further approved by ERC, to govern their relationship. KenGen is the largest generation company in Kenya with 70 percent of the market share, in terms of installed capacity. Both KPLC and KenGen have reasonable governance structures, instruments and practices. The two companies trade their shares in the Nairobi Stock Exchange and comply with information disclosure requirements – ensuring public availability of audited financial statements. The two have private sector representation on their Board of Directors. Generally, both companies are managed on commercial basis and are able to raise funds directly from Development Financial Institutions (DFIs), and to some extent commercial banks and capital markets. The other agencies in the supply value chain which are wholly owned by GoK



are the Kenya Electricity Transmission Company Limited (KETRACO), that develops new transmission assets; the Geothermal Development Company Limited (GDC) whose mandate is to de-risk geothermal development by undertaking upfront steam-field development works; and the Rural Electrification Authority (REA) that, together with KPLC, implement rural electrification activities.

Over the last two decades Kenya's power sector has continuously been thriving to reform its energy sector and improve efficiency of its utilities with the objective to open its sector to increased private investments and commercial financing, thereby trying to optimize the use of scarce public resources. Realizing huge investment needs in the sector, and inability to meet all the financing needs through public sector funding, the GoK, with World Bank support, in fact has been pioneering the approach to increased commercial financing participation, we today refer to as Maximizing Finance for Development. Starting with the Bank's Energy Sector Reform and Power Development Project in 1997 (P001344), whose aim was to create an enabling environment for the private investments, followed by Kenya Private Sector Power Generation Support Project (P122671) approved in 2012, where US\$166 of IDA guarantee were able to mobilize US\$623 million of total investments, out of which \$357 million were from private investments and commercial lenders; and more recently, Kenya Electricity Modernization Project (P120014) approved in 2015, which was able to attract US\$500 million of long-term commercial debt financing (through IDA guarantee support of US\$200 million) used to restructure KPLC's existing debt, thus generating significant savings – first such example in Sub-Saharan Africa. Key results of this approach have been: (a) significant amount of private sector investment in generation segment in 30 percent of the total installed generation capacity; (b) two well managed dominant publicly listed companies.

Kenya boasts of a continuously evolving low carbon, affordable and diverse energy mix. Traditionally, Kenya relied on thermal and hydropower energy to meet its electricity demand. However, strong dependence on hydropower left the country exposed to hydrology risks that significantly affected the sector during drought periods. By increasing the share of geothermal in the energy mix, Kenya was able to: i) cope with an increasing peak demand; ii) provide enough reserve margin to maintain regular electricity services even during severe drought periods; and iii) reduce generation costs – by displacing expensive thermal generation. On June 2017, renewable energy accounted for 65 percent of total installed capacity (approx. 1,500 MW) and 78 percent of total electricity generation (approx. 7.9 TWh); geothermal became the largest electricity source in Kenya with 44 percent of the electricity generated over the past fiscal year, and is rapidly matching thermal and hydropower sources in terms of installed capacity. The end users are currently reaping the benefits from the recent geothermal development. The reduction in overall electricity generation costs has been transferred to the consumers through a reduction in the end-user tariffs, with average reductions of 22 percent for domestic consumers and 25 percent for commercial and industrial consumers.

Kenya is a leader in geothermal generation. Development of geothermal resources since early-1970s has propelled Kenya as a leader in the geothermal sector. At the end of 2016, Kenya, with 640 MW of installed capacity in geothermal, occupied the 9th place worldwide in total geothermal installed capacity. KenGen, with 524 MW of installed capacity, is the largest developer of geothermal power in Africa. The World Bank (under Kenya Electricity Expansion Project – KEEP [P103037]), along with other donors, supported the installation of 280 MW of geothermal capacity in Olkaria I and IV which were commissioned between September 2014 and January 2015.

Electricity access is one of the key priorities in Kenya's power sector. KPLC is driving one of the most successful electrification programs in Sub-Saharan Africa that connected about 1.1 million new consumers annually in the last three years on an average, and presently has about 6.2 million consumers. The GoK has adopted the Last Mile Connectivity Program (LMCP) to densify the existing electricity network and, so far, has mobilized close to US\$700 million in donor resources (including the World Bank-financed Kenya Electricity Modernization Project [KEMP – P120014]) to support the program. Under the flagship slum electrification program (supported by the recently closed



Kenya Electricity Expansion Project and Global Partnership for Output Based Aid), GoK has been able to address the affordability barriers of people living in high-density informal settlements by providing targeted subsidies for connections through an innovative output-based mechanism.

The development of new generation capacity is underpinned by the Least Cost Power Development Plan. The “Least Cost Power Development Plan” (LCPDP) prepared by the GoK for the period of 2015 through 2035 (and approved in October 2016) confirmed that geothermal power generation is the least cost alternative to supply Kenya’s base load power component. According to the LCPDP, electricity consumption is forecasted to grow in the long term by 7.3 or 9.6 percent per year under the reference growth scenario and vision scenario, respectively. Peak demand is expected to increase to 10,200 MW under the vision scenario and 6,700 MW under the reference growth scenario by 2035, of which the share of geothermal is expected to be 3,600 MW and 2,850 MW, respectively.

National Geothermal Strategy recommends the central role of KenGen and stronger role of private sector as financier and partner in geothermal development. The GoK is finalizing the preparation of a National Geothermal Strategy. This strategy has been able to identify the means to develop nearly 2,200MW of new geothermal capacity by 2035 and meet the Vision Scenario target of the LCPDP. The Strategy confirms the central role KenGen and GDC on the future expansion of geothermal capacity in Kenya. In addition, strengths the role of KenGen’s to create partnerships with the private sector to crowd in private capital into ring fenced projects on a competitive basis. Furthermore, the strategy addresses a number of weaknesses in social safeguards, providing an accurate analysis of these issues and defining a specific action plan to overcome them. The National Geothermal Strategy is expected to be adopted in early 2018.

Kenya features an active donor community with multilateral and bilateral financiers who have consistently contributed to the development of the power sector, particularly on the generation sector, where geothermal resources are a key contributor to the environmental sustainability of the sector, mirroring the heightened momentum driven by the GoK. Power Africa supported KenGen in the design and implementation of the “Good-to-Great (G2G) Transformation Strategy. The strategy promotes the transition from the existing KenGen structure, traditionally financed by the donor community towards a structure in which KenGen is able to attract private capital to the development of generation assets, supporting the financial sustainability of KenGen. Also, KenGen is receiving support from Power Africa as part of the “Community Engagement Program” – an exchange program with New Zealand to learn from harmonious relationship between geothermal development and the indigenous Maori community. The main objective of the KenGen-New Zealand Exchange program under Power Africa Initiative is to create a mutually beneficial relationships and partnerships with stakeholders with a view of building sustainable business in line with KenGen G2G strategy. It is aimed at learning and adapting best practice in community engagement and establishing internal partnerships based on the lessons learnt from New Zealand geothermal companies that work in areas occupied by the indigenous Maori community. Also, Power Africa recently published a “*Guide to Community Engagement for Power Projects in Kenya*” with the objective of guidance to developers on country specific laws, customs and institutions related to power projects in the country.

The donor community is committed to support KenGen in its path towards full commercial viability; and while KenGen’s investment pipeline shows that most of the projects are expected to be financed by donors, developing partners are also supporting KenGen in its efforts to attract private capital. This activity is complemented by the Technical Assistance (TA) for financial advisory work to support development of KenGen’s Investment and Financing strategy developed by the World Bank, with PPIAF funds; this TA focuses on enhancing the decision process by providing detailed financial impact of new generation project on KenGen financial performance. In addition, KenGen is currently receiving World Bank support from the Kenya Infrastructure Finance / PPP Project (P121019), the objective of this project is to increase private investment in Kenya infrastructure market across sectors.

The proposed IDA Guarantee will leverage up to \$300 million of commercial finance. The proposed project supports KenGen’s debt restructuring by providing a US\$180 million IDA Guarantee that will backstop KenGen’s debt payment



obligation, thereby enhancing KenGen’s credit quality and enabling it to raise up to US\$300 million of new commercial debt with lower interest rates and longer tenors than those currently available to it. The immediate result of KenGen’s debt restructuring will be a significant reduction of the Company’s overall financing costs with the respective liquidity benefits and the rescheduling and extension of the amortization periods.

The proposed IDA Guarantee would enable KenGen to significantly leverage IDA resources. The application of a US\$180 million IDA Guarantee to mobilize up to US\$300 million of commercial debt results in a leverage ratio of 1.6 times which is not only substantial but also fully reflective of IDA’s and the WBG strategies for optimization of resources and mobilization of private capital. The project has largely benefited from the lessons learned from a similar support provided to KPLC in 2016, where it helped refinance US\$500 million of its existing commercial debt, with much better terms, resulting in significant savings and improvement in KPLC’s financial position. The market appetite to respond to such IDA supported project was very strong, resulting in oversubscription by the commercial banks.

Relationship to CPF

The proposed project is aligned with the Country Partnership Strategy (CPS - FY14-20), whose overarching goal is sustainable reduction in poverty and increased shared prosperity. Aligned both with Kenya’s Vision 2030 and its Medium-Term Plan, the strategy highlights three domains of engagement:

- Competitiveness and sustainability – growth to eradicate poverty;
- Protection and potential – human resource development for shared prosperity;
- Building consistency and equity – delivering a devolution dividend.

The project will directly contribute to domain 1 by supporting an enabling environment to scale-up least cost renewable generation capacity – vital for reducing the operating costs of industries and enhancing the productive incomes of households.

The proposed project also adheres to the objectives set in World Bank’s Energy Sector Directions Paper - specifically on ‘create an enabling environment’. The World Bank is dedicated to helping countries promote market solutions and increase leverage of financial resources. This support can be in the form of strengthening regulatory and contractual frameworks; enhancing the financial sustainability and creditworthiness of utilities; and using guarantees where appropriate to improve credit standing and mitigate risks for private sector.

By building from the long-term experience in the development of innovative products to optimize the use of concessional resources, promote the judicious use of scarce public funds and crowd-in commercial capital across the power sector in Kenya, the proposed project supports the implementation of Maximizing Finance for Development (MFD, the “Cascade”) approach laid out in the World Bank’s Development Committee paper. The objective of the Cascade is to mobilize commercial finance, enabled by upstream reforms where necessary to address market failures and other constraints to private sector investment at the country and sector level, including the provision of guarantees and risk-sharing instruments to mitigate sectoral risks.

C. Proposed Development Objective(s)

The proposed development objective is to enhance KenGen’s ability to attract long-term private capital for the sustainable development of renewable energy.

Key Results (From PCN)

PDO level indicator:



- Amount of Private Capital Mobilized
- KenGen Debt Service Coverage Ratio
- KenGen Current Ratio

Intermediate level indicators:

- Disclosure of Anti-bribery and Corruption Policy on KenGen’s webpage
- Disclosure of Board Charter and Policies on KenGen’s webpage and Annual Reports
- Disclosure of Sustainability Goals and Strategy on KenGen’s webpage
- Disclosure of Community Engagement Policy on KenGen’s webpage

D. Concept Description

Project Components

The proposed project is composed of an IDA Guarantee of \$180 million, that will support KenGen in raising up to \$300 million in long-term commercial financing. This new commercial financing will be used to restructure/refinance an expensive portion of KenGen’s existing commercial loans.

The proposed IDA Guarantee will accomplish this by enhancing KenGen’s credit quality and enable the company to raise new commercial debt with a lower interest rates and longer tenors than what is currently available to it. KenGen’s existing commercial debt has interest rates ranging between seven and eight percent for tenors of six to twelve years. IDA guaranteed new commercial debt is expected to reduce interest rates, and extend the tenor to at least fifteen years, thus generating direct financial savings that will support enhancing KenGen’s short-term cash flows.

E. Implementation

Institutional and Implementation Arrangements

KenGen Finance Department will be responsible for the overall implementation, coordination, and monitoring of the project. The Finance Department is managed by the Finance & Information, Communication and Technology (ICT) Director supported by three managers, Finance Manager, Corporate Finance Manager and ICT Manager, each one of them with their subsequent reports. The Figure below presents the organogram of the Finance Department.

Currently, the Finance team is in the process of procuring a commercial bank that will act as mandated lead arranger (MLA), and facilitate the origination of new US\$300 million loan facility that will be used to refinance KenGen’s existing expensive commercial loans. KenGen has issued a request for proposal (RfP) and invited local and international commercial banks to bid. The selection process (ongoing) will include reviewing the offers and using the financial model prepared by KenGen’s financial advisor to determine the financial impact of each of the proposals.

KenGen is also in the process of procuring external legal counsel to support the company in negotiating the final loan agreement. This is a critical component as this agreement will be the single largest commercial loan agreement the company will sign and set a precedent for future agreements.

The implementation of the guarantee will include the drafting of the Guarantee Agreement which will be between



The World Bank and the selected MLA (the beneficiary). It is likely that the provision of the Guarantee Agreement will be included in the loan agreement; the Project Agreement signed between the World Bank and KenGen; and the Indemnity Agreement between National Treasury and the World Bank.

F. Project location and Salient physical characteristics relevant to the safeguard analysis (if known)

The proposed project is a financial refinancing transaction -replacing existing commercial loans of shorter tenor and higher interest rates with commercial loans of longer tenor and lower interest rates – thus generating savings for the company. This is a corporate debt restructuring operation.

G. Environmental and Social Safeguards Specialists on the Team

Kimberly Vilar, Edward Felix Dwumfour

SAFEGUARDS POLICIES THAT MIGHT APPLY

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	No	
Natural Habitats OP/BP 4.04	No	
Forests OP/BP 4.36	No	
Pest Management OP 4.09	No	
Physical Cultural Resources OP/BP 4.11	No	
Indigenous Peoples OP/BP 4.10	No	
Involuntary Resettlement OP/BP 4.12	No	
Safety of Dams OP/BP 4.37	No	
Projects on International Waterways OP/BP 7.50	No	
Projects in Disputed Areas OP/BP 7.60	No	

KEY SAFEGUARD POLICY ISSUES AND THEIR MANAGEMENT

A. Summary of Key Safeguard Issues

- Describe any safeguard issues and impacts associated with the proposed project. Identify and describe any potential large scale, significant and/or irreversible impacts:
Not applicable
- Describe any potential indirect and/or long term impacts due to anticipated future activities in the project area:
Not applicable
- Describe any project alternatives (if relevant) considered to help avoid or minimize adverse impacts.
Not applicable
- Describe measures taken by the borrower to address safeguard policy issues. Provide an assessment of borrower capacity to plan and implement the measures described.

Safeguard practices have been an integral component of business planning in KenGen for decades. Environmental



management in KenGen has been certified by the ISO14001:2008 standards and are guided by its Environmental Policy Statement, which is also aligned with its vision and mission statements. KenGen’s environmental policy statement commits the organization to compliance with applicable laws and regulations, prevention of pollution, continuous improvement and accountability to the internal and external stakeholders and the public at large. In compliance with local legislation, annual environmental audits are submitted to the National Environmental Management Authority (NEMA) and Energy Regulatory Commission (ERC).

The safeguards unit in the KenGen consists of three (3) major departments: Environment & Clean Development Mechanism (CDM); Corporate & Community Affairs; and Quality & Safety under the division of Regulatory & Corporate Affairs. During the life cycle of a project involving environmental or social impacts, each department is in charge of determining the management measures required to minimize the environmental and social impact of a project. KenGen has a team of about forty (40) multi-disciplinary staff handling safety, environment and social safeguards comprising of environmentalists & liaison officers, safety engineers and technicians.

5. Identify the key stakeholders and describe the mechanisms for consultation and disclosure on safeguard policies, with an emphasis on potentially affected people.

Not applicable

B. Disclosure Requirements (N.B. The sections below appear only if corresponding safeguard policy is triggered)

C. Compliance Monitoring Indicators at the Corporate Level (to be filled in when the ISDS is finalized by the project decision meeting) (N.B. The sections below appear only if corresponding safeguard policy is triggered)

CONTACT POINT

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APPROVAL

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Approved By

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Country Director:	Trichur K. Balakrishnan	February 11, 2018 1:04 PM