

## PROPOSAL FOR FINAL CONSIDERATION

### Project Fact Sheet

REGIONAL AFRICA - African Guarantee Fund (AGF) Green Guarantee Facility (GGF)	
<b>Partner Agency</b>	African Guarantee Fund (AGF)
<b>Executing Agency</b>	AGF
<b>Sector</b>	Financial Sector Intermediaries, Private Sector CRS Code: 24030
<b>Region</b>	Africa (piloted in Kenya, Zambia, Cote d'Ivoire and Ghana)
<b>Budget</b> - NDF - Partner Agency - Other Funders	<b>EUR 7,600,000 (USD 8,230,000)<sup>1</sup></b> EUR 7,600,000 (USD 8,230,000) Operations and management (not factored above) Existing share capital of USD 80,500,000 (not factored above)
<b>Project Period</b>	7 year lock-in period with option for phased exit thereafter
<b>Mode of Finance</b>	Equity (EUR 6 million), Grant (EUR 1.6 million)
<b>Previous Support to Region</b>	Credits: EUR 295.5 million; SDR 134.6 million Grants: EUR 106.6 million
<b>Rio Markers</b>	Mitigation: 2 = principal objective (TBC) Adaptation: 2 = principal objective (TBC)
<b>Gender Marker</b>	1 = significant objective
<b>Climate Screening Satisfied</b>	Yes (TBC)
<b>Processing Schedule</b>	Pipeline - Nov 2015 Final - Mar 2016 Signature - Apr 2016 Disbursement Effective - June 2016

<sup>1</sup> Exchange rate 1 EUR = 1.097 USD

## **PROJECT SUMMARY**

**NDF Finance:** EUR 7.6 million

**Project Period:** 7 year lock-in period with option for phased exit thereafter

**Partner Agency:** African Guarantee Fund (AGF)

**Implementing Agency:** AGF

### **Objective**

The African Guarantee Fund (AGF) Green Guarantee Facility (GGF or Facility) will establish a climate-focused guarantee product available to small and medium-sized enterprises (SMEs) in Africa. It picks up on momentum from the 2015 Paris Climate Agreement and introduces a specialized green finance instrument designed to unlock finance for SMEs investing in low carbon, green growth and climate resilient development.

The Facility brings together the NDF mandate to finance climate change adaptation and mitigation with the proven AGF business model for improving access to finance for SMEs and will be managed and administered by AGF.

In the first 3 years of the Facility life, NDF's equity subscription is expected to be fully committed, unlocking up to EUR 36 million, or approximately USD 40 million, in private commercial capital for green growth and achieving a 6:1 leverage ratio of NDF resources.

The Facility will target SME investments in sustainable energy, cleaner production, climate-smart agriculture and natural resource management and green services leading to improvements in overall sustainability of African economies and growth in green jobs, income and quality of life for low income communities across the continent.

### **Financing**

Total NDF financing is EUR 7.6 million consisting of EUR 6 million in equity finance and EUR 1.6 million in grant finance.

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## **ABBREVIATIONS**

<b>AECID</b>	Spanish Agency for International Development Cooperation
<b>AFD</b>	French Development Agency
<b>AfDB</b>	African Development Bank
<b>AGF</b>	African Guarantee Fund
<b>APP</b>	Africa Progress Panel
<b>CDTF</b>	Capacity Development Trust Fund
<b>CSAF</b>	Climate-smart Agriculture Fund for Latin America and the Caribbean
<b>DAC</b>	Development Cooperation Directorate
<b>EEGF</b>	Energy Efficiency Technical Assistance and Guarantee Fund
<b>GGF</b>	Green Guarantee Facility
<b>GHG</b>	Greenhouse gas
<b>IDB</b>	Inter-American Development Bank
<b>IFC</b>	International Finance Corporation
<b>IMF</b>	International Monetary Fund
<b>LPG</b>	Loan Portfolio Guarantee
<b>NDF</b>	Nordic Development Fund
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>SUNREF</b>	Sustainable Use of Natural Resources and Energy Finance
<b>UNEP</b>	United Nations Environment Programme

## **1. INTRODUCTION AND PROJECT BACKGROUND**

This proposal seeks final approval from the NDF Board for total financing of EUR 7.6 million in equity and grant finance to support establishment of the African Guarantee Fund (AGF) Green Guarantee Facility (GGF or Facility).

GGF will provide a climate-focused guarantee product available to small and medium sized enterprises (SMEs) in Africa. It will be managed and administered by AGF with the aim to catalyse commercial bank lending to SMEs investing in green growth and climate resilient development.

The concept for GGF stems from discussions between NDF and AGF dating back to 2014 and builds on NDF's growing green finance and private sector portfolio. NDF and AGF signed an MOU in May 2015 emphasizing cooperation in select areas including development of green financing instruments. Continued discussions between the two institutions led to preparation of a pipeline proposal and approval by the NDF Board in November 2015.

AGF is a non-bank, financial institution established to promote access to finance for SMEs in Africa through provision of partial loan repayment guarantees to commercial banks on loans to SMEs. It is owned jointly by the Governments of Denmark, Spain and France and the African Development Bank (AfDB) and was officially launched in 2011 with share capital of USD 50 million. This was increased to USD 66.5 million with an additional capital injection by Denmark in 2014 and again to USD 80.5 million when the French Development Agency (AFD) joined the list of AGF shareholders in December 2015.

Since its launch, AGF has grown its operations to 35 countries in Africa, transacted more than \$200 million in signed guarantees and established a widely-recognized brand and business model. In 2013, it was named Best SME Finance Company in Africa by the International Finance Magazine and Best Financial Institution for Financial Inclusion in Africa at the annual African Bankers' Awards. It is currently partnered with more than 60 banks, and its commitments have enabled access to finance for more than 800 SMEs.

GGF will build on the AGF business model by establishing a new green product as part of the AGF product basket. The proposed NDF equity subscription will provide capital for partial guarantees on loans for green growth investments by SMEs. NDF will also provide a parallel grant to the AGF Capacity Development Trust Fund (CDTF) to support product rollout with technical assistance targeting partner banks, beneficiary SMEs and AGF.

## **2. RELEVANCE AND RATIONALE**

### **2.1. Project Relevance**

SMEs play a critical role in African economies today and are expected to play an even larger role in the future. They are vehicles for innovation and entrepreneurship in local economies and widely cited as key drivers for job creation, economic growth and poverty reduction. The International Finance Corporation (IFC) reports that SMEs account for up to 90% of all

businesses in Sub-Saharan economies.<sup>2</sup> According to the AfDB, SMEs “are the lifeblood of Africa’s economy” and responsible for close to 60% of all employment.<sup>3</sup>

Rapid growth in the SME sector is also viewed as the best option for absorbing projected increase in the labour pool among youth demographics. The International Monetary Fund observes that “over the next 20 years, sub-Saharan Africa will become the main source of new entrants in to the global labour force.”<sup>4</sup> SMEs may represent the only viable segment of the economy capable of growing at a pace to match and absorb the growth in jobs demand.

However, SMEs face major constraints to growth. Financial inclusion is one critical constraint. SMEs in Africa have historically been underserved by the financial sector. The same AfDB study cited above reports that “only 29% of formal SMEs have access to a loan” and observes that without financing, SMEs are unable to grow.

Access to reliable and efficient energy is another key constraint. The penetration and consistency of national electricity grids in many African economies is notoriously poor, and, in many cases, failing even to keep up with population growth. According to a 2015 report by the Africa Progress Panel, “installed grid-based capacity [in Sub-Saharan Africa] is less than the capacity in South Korea where the population is only 5% of Sub-Saharan Africa.”<sup>5</sup>

At the same time, improvements in availability and pricing for clean, renewable and distributed energy technologies together with developments in energy efficiency, cleaner production standards and climate resilient agricultural technologies are opening up viable green growth and climate resilient alternatives for SMEs in Africa in many sectors. According to the APP report cited above, “a ‘triple win’ is within the region’s grasp, as renewable technologies create opportunities to increase agricultural productivity, improve resilience to climate change, and contribute to long-term reductions in carbon emissions.”

Finance, however, remains a binding constraint, and lack of information both at banks and SMEs is creating a missed opportunity. For banks, SME borrowers targeting green growth represent an untapped and fast growing new lending market. For SMEs, tapping green growth technologies and solutions is an important strategy for reducing energy and production costs, diversifying away from dependence on unreliable grid infrastructure and costly back-up generators and improving resilience to a changing climate, not to mention, building a strong climate-friendly brand.

GGF introduces a specialized green finance product specifically designed to address this opportunity gap and picks up on momentum from the 2015 Paris Climate Agreement by targeting investments in a “low carbon, resilient and sustainable future.”<sup>6</sup>

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<sup>2</sup> See [www.ifc.org](http://www.ifc.org). Sub-Saharan Africa SME Initiatives.

<sup>3</sup> See Financial Inclusion in Africa. AfDB, 2013.

<sup>4</sup> See Regional Economic Outlook. IMF, 2015.

<sup>5</sup> See Power, People, Planet. Africa Progress Panel, 2015.

<sup>6</sup> See <http://newsroom.unfccc.int/unfccc-newsroom/finale-cop21/>

## **2.2. Relevance to NDF's Mandate and Strategy**

The GGF proposal is a case study for alignment with the new NDF Strategy. NDF has been a driver behind the creation of the Facility and will continue to play an active supporting role during implementation. The Facility reflects the core of the NDF Mission and strongly captures several of the underlying Strategic Focal Areas.

### **NDF Mission**

The focus of GGF is on leveraging climate finance to stimulate green growth and poverty reduction in Africa. It brings together the NDF mandate to finance climate change adaptation and mitigation with the proven AGF business model for improving access to finance for SMEs. GGF also builds directly on a foundation of Nordic added value. Denmark is the largest AGF shareholder and has been involved since the earliest design and formulation discussions. More recent support from Sweden in 2014 in the form of a USD 50 million re-guarantee agreement reinforces the Nordic-AGF partnership and highlights the strength of the underlying AGF business model.

### **Catalytic Role and Leverage**

There is a strong case for leverage of NDF finance built into the GGF proposal. The AGF Board of Directors has approved a 3:1 leveraging of base capital. This enables an NDF equity subscription of EUR 6 million to mobilize up to EUR 18 million or its USD equivalent in green guarantee commitments to banks. AGF commitments, in turn, are structured as partial loan guarantees covering up to half of total loan size. This means that AGF guarantees mobilize commercial lending to SMEs at a rate of two times the commitment volume. Combine these two figures and NDF funds are expected to catalyse at least six times their value in private sector lending to SMEs. Added to this is the fact that guarantee commitments work on a revolving basis. A 6:1 leverage ratio is merely the baseline target. Over time, the cumulative leverage result for NDF resources is expected to be much greater as old guarantees expire and new ones are issued.

### **Support for Innovation and Support for Private Sector Development**

The Facility directly supports climate-related innovation in the private sector. In many African economies, and indeed globally, SMEs are already leading the way in developing, piloting and disseminating renewable energy and energy efficiency technologies as well as climate-smart practices in agriculture and natural resource management. GGF will mobilize additional finance to sustain and scale up this trend.

### **Piloting of Interventions with a High Risk Level**

GGF is a pilot case on several levels. For NDF, it represents a pilot of a non-grant facility with a new partner. It positions NDF in the role of climate finance innovator and signals an institutional willingness to explore initiatives with a higher risk and reward profile.

The Facility also represents a form of regional piloting for NDF carrying some uncertainty on outcomes. There are good examples of successful green guarantee products covering other

geographies<sup>7</sup>, including several in Latin America that have been co-financed jointly by NDF together with the Inter-American Development Bank (IDB), but GGF represents the first NDF experience with a guarantee product in the Africa region.

For AGF, the Facility marks the pilot of a sector based approach and the Fund's first exploration of a green finance instrument. At the level of participating banks, the Facility will serve as a pilot for an instrument specifically aimed at mitigating high-risk and building comfort around transactions in a relatively newly defined segment of the SME market.

For many of the individual SMEs qualifying for green guarantees, the process of planning and implementing green investments will, in practical terms, mean changes to normal business operations in order to pilot new green technologies and processes.

### 3. THE PROPOSED PROJECT

#### 3.1. Objectives

The overall objective for GGF is to promote sustainable, green growth and climate resilient development in African economies.

The specific objectives are to establish a green guarantee product aligned with the NDF climate mandate and catalyse commercial bank lending to SME investments in activities that satisfy criteria for climate change adaptation or mitigation.

#### 3.2. Project Activities

NDF support to AGF will cover two principal activities, both fully aligned and integrated with AGF existing core business as illustrated in the Figure below.

AGF Existing Core Business	New Business Under GGF
<b>Partial loan repayment guarantees to unlock commercial financing for SMEs</b>	<b>Partial loan repayment guarantees to unlock commercial financing for SMEs investing in green growth</b>
<b>Technical assistance to strengthen SME financing capacity at partner banks</b>	<b>Technical assistance to 1) strengthen green financing capacity at partner banks and AGF; 2) support roll-out and absorption of the green guarantee product in target markets; and 3) support monitoring of green guarantee results and impact.</b>

NDF financing will be packaged in two instruments. Capital to finance green guarantee commitments under the GGF will be structured as an equity subscription to AGF in the amount of EUR 6 million. Funds for technical assistance support will be in the form of a grant to the CDTF in the amount of EUR 1.6 million. Terms of financing will also secure an active NDF role in defining eligibility criteria for GGF and providing other input and support during implementation.

<sup>7</sup> See Guarantees for Green Markets: Potential and Challenges. IDB, 2014.

## Green Guarantee Facility and Eligibility Criteria

AGF has a proven business model, a strong team in place and an established platform reaching a growing number of partner banks and countries. GGF will leverage these assets as it introduces a climate-focused product to the AGF product basket. The purpose is to bring a complementary product which embraces the NDF climate mission and adds to the overall strength and relevance of the AGF brand. It is a win-win for both sides.

The primary product available to selected banks under GGF will be a loan portfolio guarantee (LPG). LPGs are a standard product for AGF and structured to streamline the mobilization of credit to SMEs. The LPG product provides a guarantee against losses on a portfolio of loans held by the participating bank. In line with existing operations, AGF will also have the flexibility to transact individual green guarantees with partner banks on a one-off basis.

SME activities financed by the underlying loans will satisfy specific eligibility criteria for the green guarantee. These criteria pair the existing AGF criteria with NDF climate criteria. The result is a guarantee product which targets a specific green segment of the SME market.<sup>8</sup>

Guiding principles for GGF eligibility criteria are that they should be reasonably broad to attract additional shareholder interest and allow for flexibility and innovation in local markets but sufficiently targeted to meet the climate objectives driving NDF equity subscription and ensure that green guarantees reach SMEs in the intended market segment.

GGF will rely on a framework of core eligibility criteria for green guarantee commitments, reflecting criteria from both AGF and NDF, together with a positive, activity-based classification for eligible activities.<sup>9</sup> This framework is presented in the Figure below.

### Core Eligibility Criteria

SME activities covered by green guarantee commitments must satisfy:

- |  |     |  |
|--|-----|--|
| 1) Existing AGF guidelines and criteria; | AND | 2) Commonly accepted definitions <sup>10</sup> and classifications for climate change adaptation and mitigation. |
|--|-----|--|



### Activity-based Classification for Climate Eligibility

- |   |
|---|
| ⇒ Sustainable Energy  |
| ⇒ Cleaner Production  |
| ⇒ Climate-smart Agriculture and Natural Resource Management |
| ⇒ Green Services  |

<sup>8</sup> See United Nations Environment Programme (UNEP) working definition for Green Economy.

<sup>9</sup> See 2014 Joint Report on Multilateral Development Banks' Climate Finance.

<sup>10</sup> See OECD DAC Handbook on Climate Markers which defines *climate change adaptation* as any activity which contributes to reducing vulnerability of human or natural systems to climate change or climate related risks and *climate change mitigation* as any activity which contributes to reducing or limiting GHG emissions or enhancing GHG sequestration.

The activity-based classification list is intended as a practical, “front-line” tool to guide AGF and partner banks in making a judgment as to whether a prospective SME borrower is eligible for a green guarantee. It is organized into four broad categories. Each category positively defines a sub-list of eligible investments. A borrower must be able to “check” at least one of the boxes on the list to be eligible for consideration. See Annex 2 for the full list.<sup>11</sup> On a case-by-case basis, AGF will also have the flexibility to look at opportunities that satisfy the core eligibility guidelines but do not easily fall into any of the proposed categories.

AGF will have responsibility for ensuring activities match these eligibility criteria. Detailed operational guidelines on verifying eligibility will be developed by AGF with support from NDF grant funding during the beginning of the implementation period. Guidelines will be incorporated into AGF operational manuals and packaged as practical guidance tools for partner banks.

### **Technical Assistance (TA)**

The second component of NDF financing consists of grant support for capacity building and technical assistance. This will be placed with the CDTF, administered by AGF, and will support technical assistance and training targeting AGF, participating banks and SME borrowers. It is intended to facilitate start-up and market entry for GGF through capacity building investments in people, systems and information at all three levels.

The TA component builds on the core AGF operating model which utilizes CDTF resources to build internal capacity at participating banks to conduct due diligence, appraisal and approval of underlying loans. This component also draws inspiration from the successful EcoMicro model for capacity building at micro finance institutions, co-financed by NDF and the IDB in Latin America, as well as the AFD financed facility Sustainable Use of Natural Resources and Energy Finance (SUNREF) as implemented in Kenya.

TA support will be structured as a series of discrete capacity development events and inputs during the rollout phase of the Facility together with a rolling technical advisory facility available for call-down for the purpose of validating specific loan transactions.

Specific areas of TA support will include:

- Delivering specialized green product training and capacity development to AGF team and providing back up support to AGF Green Guarantee Focal Point for refining and validating GGF eligibility mapping;
- Supporting development of marketing tools, market analysis, talking points and eligibility manual for use with partner banks;
- Delivering specialized green product training and capacity development to partner banks on eligibility criteria and green growth lending opportunities;

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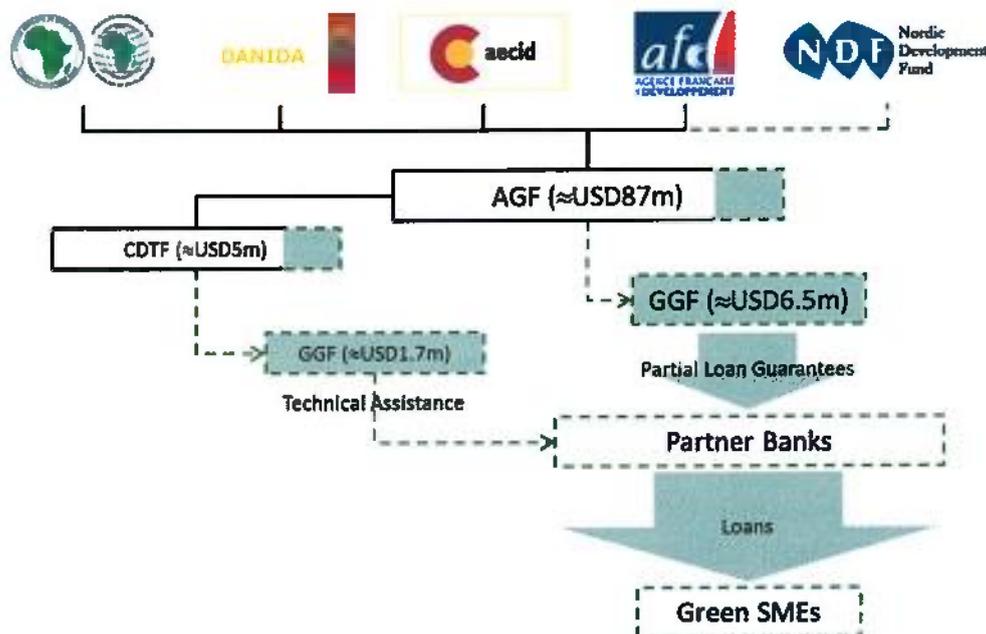
<sup>11</sup> Reference sources include OECD DAC Rio marker typology; 2011 Joint MDB Report on Mitigation Finance; 2015 Common Principles for Climate Mitigation Finance Tracking; and the 2015 International Development Finance Club (IDFC) Green Finance Mapping Report.

- Providing a pool of technical advisory expertise to AGF and partner banks available on call-down for assessing and validating eligibility and, on case-by-case basis, providing support on structuring and technology selection to SME clients; and
- Providing technical opinions to validate green guarantee eligibility of underlying transactions.

NDF capacity development resources will also be used to finance a flagship study on results and impact of GGF in Year 3. This study will look in detail at the impact and results of select borrower case studies with a particular focus on impact of the Facility on poverty and employment, women, and youth as well as key climate finance indicators.

### 3.3. Cost Estimates and Financing Plan

The total NDF commitment will amount to EUR 7.6 million comprising EUR 6 million in equity subscription and EUR 1.6 million in grant finance. NDF subscription capital will be pooled with existing AGF shareholder capital and raise the current capital base to approximately USD 87 million. NDF will join the group of shareholders as a Class C shareholder, carrying first loss risk together with Denmark and Spain, and obtain a full voting seat on the AGF Board of Directors. Share class determination reflects discussions with AGF and current shareholders and accommodates risk to the overall portfolio deriving from GGF concentration in a single sector. The terms of NDF's shareholder subscription will commit AGF to allocating at least the equivalent of NDF share capital to green guarantee commitments. This structure is depicted in the Figure below.



In the first 3 years of the Facility life, NDF's equity subscription is expected to be fully committed, thereby unlocking up to EUR 36 million or approximately USD 40 million in private commercial capital for green growth and climate resilient development, and representing a 6:1 leverage ratio of NDF resources as cited above. Preliminary baseline projections for resulting greenhouse gas (GHG) reductions derived from underlying SME activities are estimated at 5,500 tons of CO<sub>2</sub> equivalent per year.

In parallel to the equity subscription, NDF grant funds will be used to support, facilitate and validate realization of GGF's financial and climate targets. The following table provides an indicative cost breakdown of grant resources in USD.

<b>Grant Activity</b>	<b>Cost (USD)</b>
Training, capacity development and support to AGF	100,000
Training and capacity development to select partner banks	600,000
Technical advisory support to AGF, partner banks and SME clients for validating eligibility	800,000
Green Guarantee Results and Impact Study	200,000
<b>Total</b>	<b>1,700,000</b>

### **3.4. Nordic Interest**

As discussed earlier in the document, a strong Nordic-AGF partnership is already in place with support from both Denmark and Sweden. The NDF commitment will complement both of these existing arrangements and underscore the strong Nordic interest in seeing AGF continue to grow its portfolio and reach. It should also be noted that NDF's Nordic Climate Facility (NCF) portfolio constitutes a pool of potential clients and beneficiaries for GGF, and NDF will publicize this opportunity accordingly.

### **3.5. NDF's Added Value and Comparative Advantage**

GGF stems directly from discussions begun between NDF and AGF in 2014. NDF input in design and formulation has driven the process at every stage, and NDF will continue to have an active supporting role during implementation, providing input in selection of partner banks and Terms of Reference for TA support. The project is also a direct follow on to NDF's growing green finance portfolio in Latin America, including, EcoMicro 1 and 2, GREENPYME 1 and 2, the Energy Efficiency Technical Assistance and Guarantee Fund (EEGF), the Climate-smart Agriculture Fund for Latin America and the Caribbean (CSAF) and PROADAPT, an ongoing initiative which identifies and pilots viable climate-related business models and climate resilience strategies for MSMEs.

## **4. IMPLEMENTATION ARRANGEMENTS**

### **4.1. Technical Aspects**

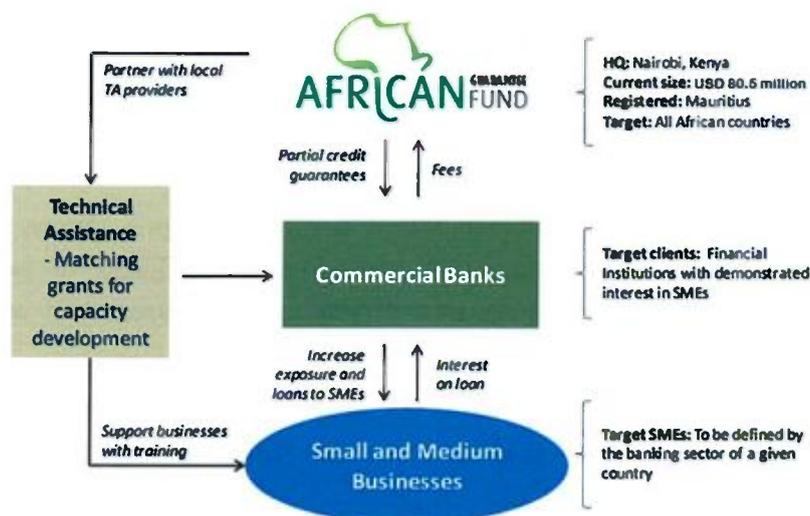
The green guarantee product will function exactly as other risk insurance products in the AGF basket. NDF capital will be pooled with the rest of the shareholder capital, thereby sharing risk between the standard products and the green product so that all benefit from the same leveraging ratios and risk tolerance.

The green product will be a commercial product marketed to commercial banks. It will enable banks to offload a portion of the risk of doing business with green SMEs. Each guarantee transacted will generate an origination fee plus commitment and utilization fees. In return, AGF will guarantee partial repayment of loan principal in the event of non-repayment by the SME client.

AGF will apply the same terms and ceilings to green commitments that it applies to the rest

of its portfolio. This entails a maximum tenor of 8 years on individual guarantees and 10 years on LPGs. The maximum ceiling for commitments on single guarantees is USD 1 million or 25% of the AGF commitment in the case of an LPG. The ceiling for commitments to a single LPG is USD 5 million.

The figure below illustrates the AGF core business and revenue model.



### Role of Pilot Countries

Kenya, Zambia, Cote d'Ivoire and Ghana are targeted as pilot countries for the Facility. AGF will focus its capacity development funding together with initial marketing and business development efforts in these four markets. This selection seeks to achieve a balance between geography, NDF partner countries and the strengths of the existing AGF country portfolio.

The intent in establishing pilot countries is to achieve a balance between spreading limited resources too thinly in the early life of the Facility and working on an exclusive basis in a narrow group of countries. AGF will target capacity development resources toward a select group of partner banks in the four pilot markets, thereby achieving a minimum concentration of resources and results. At the same time, AGF will retain management flexibility to develop green guarantee commitments in all African countries, thereby ensuring flexibility to adapt to fast paced, dynamic developments in climate technology, finance and demand.

The pilot structure is expected to be phased out over time as capacity development funds are drawn down, AGF builds its internal capacity and comfort with the product and guarantees gradually expire and roll over into new commitments with new partners in new markets.

### Roll-out

The rollout in the 4 pilot countries will entail a series of information and outreach events during the second half of 2016. These will be timed to coincide with the launch in each market of a competitive Call-for-Proposals to serve the purpose of identifying and selecting partner banks with demonstrated commitment to investing in building green lending capacity and a long term portfolio of green loans.

AGF will structure the process to fully complement its existing methodology for identifying and selecting partners looking at demonstrated interest in expanding services to SMEs,

geographical reach, and overall fit with the AGF portfolio strategy. The Calls-for-Proposals will be publicized openly and through AGFs existing network of partner banks.

AGF will lead the process and retain control over final selection of partners. NDF will provide input on design and participate in evaluation of the climate related aspects of the proposals. NDF will also have an opportunity to support country level information events.

The outcome of the Call-for-Proposals process will be a selection of between one and three partner bank(s) in each pilot country to manage and administer a green LPG facility. In parallel, AGF will plan and tailor a package of capacity development and training inputs to facilitate effective utilization of green guarantees.

Roles during the commitment period will follow normal AGF procedures, fully leveraging the AGF business model, procedures and methodology in place. Banks will be responsible for approving individual loans according to normal banking procedures. AGF will adhere to its normal supervision and risk management protocols.

AGF will also be responsible for supervision and monitoring of GGF eligibility criteria. AGF will utilize the technical advisory facility to validate eligibility of individual transactions. This can be achieved by distance review or on-site verification depending on the structure, technologies being considered and quality of available documentation.

#### **4.2. Institutional Aspects and Project Organization**

A Side Letter adjoined to the NDF shareholder agreement with AGF will set the terms for NDF's contribution and establish the guidelines for establishing and administering GGF.

AGF will be the executing agency and NDF will obtain a voting seat on the AGF Board of Directors. This position will enable NDF to have a long term view on the whole of AGF operations and promote an effective integration of the green product with other aspects of the portfolio. This setup is also well-matched to the uncertainties inherent in piloting new facilities and creates a "living" framework for supervision that makes it feasible to look at needed changes in Facility design on a rolling basis.

AGF will add one staff on a permanent basis to serve as Green Guarantee Focal Point and coordinate and lead the rollout, marketing and placement of the green guarantee. This person will provide a first line of response to address climate eligibility and structuring questions during the course of implementation and be responsible for having primary relationships with participating banks as well as relevant in-country industry and SME associations.

The Green Guarantee Focal Point will also supervise and coordinate inputs from capacity development and technical advisory service providers. Costs associated with GGF administration, salary of the Green Guarantee Focal Point and other normal operational expenses related to implementation of the Facility will be covered on a sustainable basis and in line with existing AGF operations by revenues from Treasury placement of the NDF equity subscription and origination fees derived from green guarantees.

#### **4.3. Procurement and Contract Structure**

AGF will have final decision authority on selection of partner banks in line with existing

AGF partner selection and risk management policies and guidelines. NDF will support the selection process by evaluating and commenting on green growth strategies outlined by prospective partner banks in response to the Calls-for-Proposals. Guarantee agreements between AGF and partner banks will be structured according to standard AGF procedure.

Procurement of capacity development and technical assistance service providers will follow established private sector procurement methods outlined in the AGF Finance and Accounting Policies and Procedures Manual and be in compliance with procurement principles for MDB engagements with private sector operations.<sup>12</sup> AGF will determine whether to structure capacity development and technical assistance support as a single contract or multiple contracts on the basis of market outreach and analysis during implementation. NDF will provide input to the Terms of Reference for service providers and advertise relevant opportunities on its website.

#### **4.4. Risk Analysis**

GGF is an example of NDF playing a central role in project origination for a pilot initiative without the direct involvement of a traditional MDB partner. This entails certain risks which are less prominent in more traditional NDF transactions.

##### **Institutional and Reputational Risk**

The presence of four recognized donor partners, including one of NDF's own shareholders and one of NDF's traditional MDB co-financing partners, anchoring the AGF capital base and governance framework provides strong assurance on AGF credibility. The timing of successive shareholder contributions provides additional assurance. Denmark conducted a performance review in 2013 and 2014 in the process of preparing a 2nd capital injection. AFD followed with its own assessment in 2015 in the course of approving its subscription.

NDF due diligence of AGF also resulted in a green light for cooperation. AGF has a clear organization and governance framework. It has a competent and committed management team together with robust operational, financial, risk and treasury procedures in place and well documented in operational manuals and policies.

##### **Technical Risk**

GGF will introduce a new product to the AGF product basket and therefore an element of risk in terms of technical capacity to deploy the new product as well as technical capacity for the market to absorb the new product.

On the delivery side, this risk is deemed largely mitigated by the AGF track record and the structure of the new product which heavily leverages the existing AGF operational model and strong brand with partner banks. Further mitigation on technical risk related to the unique climate aspects of the product comes from the addition of a Green Guarantee Focal Point to the permanent AGF staff and the inclusion of grant funding to smooth and facilitate the process of learning and market absorption.

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<sup>12</sup> See Procurement Principles Applicable to Private Sector Transactions: Guidance for MDBs

There are also downstream technical risks at the level of partner banks and SMEs. The green guarantee requires buy-in and commitment of partner banks to build capacity and green lending portfolios. It also depends on the capacity of individual loan officers to articulate and sell the green guarantee product in discussions with SME clients. This is addressed through targeted capacity development and technical assistance.

Further downstream, there is risk at the level of SMEs and market demand for the product. SMEs are unlikely to use the product without a clear understanding of the financial value and savings derived from investments in green growth and climate resilience. Information, technical assistance support and capacity development funding will be the key tools in addressing perceptions and building demand.

Information seminars during the roll-out period will look to change perceptions among banks and SMEs and establish the rationale for green growth and climate relevant investments in starkly financial and economic terms pointing to direct savings, efficiency gains and productivity increases that can improve returns for SMEs.

### **Social and Environmental Risk**

AGF guidelines restrict guarantees on activities which may result in adverse social or environmental impact. This is reinforced during AGF due diligence on prospective bank partners with a rigorous risk assessment looking specifically at issues of capacity and compliance with AGF guidelines. AGF conducts regular monitoring to ensure compliance and safeguard against this class of risk.

### **Exit Risk**

Shareholder subscription in AGF is, by definition, a long term ownership stake without a prescribed closing date. This is aligned with NDF interest to support AGF in establishing a long lasting and sustainable green guarantee window. It does, however, create a risk to NDF in terms of exit options.

There have not been any exits by shareholders up to this date. There are, however, several exit scenarios available to all shareholders, including NDF, following an agreed lock-in period of 7 years. In all cases, it is understood that the exit should not impair AGF capacity to execute its core business. Possible exit scenarios include:

- AGF executes a phased buy back of NDF shares following expiration of the lock-in period and provided there are sufficient reserves on hand;
- AGF executes a partial buy back following expiration of the lock-in period and converts the remaining shares to quasi-equity to be repaid as debt; and
- NDF shares are purchased by another investor, following expiration of the lock-in period and subject to approval by AGF.

### **Sustainability and Results Risk**

The AGF model is built to ensure long term sustainability. A core role of AGF Treasury Management is to secure availability of liquidity to cover operating expenses, staff costs and business development. This is based on revenues derived from returns on placement of capital in stable interest bearing securities and origination fees from placement of guarantees.

GGF will operate with the same sustainability model. AGF analysis has established that additional costs incurred by AGF for administration of the green guarantee product will be fully covered by revenue generation from the NDF equity subscription.

At the level of climate results and impact, the explicit pilot aspect of the Facility together with the private sector focus generates some ex-ante uncertainty regarding the underlying SME demand and specific mix of adaptation and mitigation activities to be supported with green guarantees. Figures from the OECD DAC suggest that most private sector climate finance targets climate mitigation.<sup>13</sup> On the other hand, NDF experience in the PROADAPT project points to a growing set of viable business models on the adaptation side. Referencing this uncertainty, this proposal attaches a to-be-confirmed (TBC) notation to its core Rio marker and climate screening scores. A strong emphasis on measuring results during implementation will enable regular assessment of the accuracy of initial projections.

#### **4.5. Monitoring and Evaluation**

Monitoring and reporting on GGF results will be integrated with the existing AGF monitoring and reporting framework to promote consistency with existing AGF procedures. The framework for M&E is provided in Annex 1. NDF will receive regular reports from AGF consistent with its rights as a shareholder and seated member of the Board of Directors.

In addition to normal reporting under this framework, a select set of climate finance indicators will be monitored with support from the GGF technical advisory facility. Partner banks will report on guarantee and lending volumes according to the categories listed in the Green Guarantee Eligibility Classification tool in Annex 2, and NDF will have opportunities to participate in select supervision visits by AGF to banks participating in the GGF window.

A flagship results and impact study will be commissioned in Year 3 and financed from the NDF grant allocation to the CDTF. This will be a detailed ex-post analysis of results and impact of the facility to provide a technical analysis of impact on GHG emissions under the mitigation category and look at longer term results of specific SME case studies on poverty reduction and sustainable employment for women and youth.

It is noted that AGF is in the process of developing and refining its M&E systems and reporting framework. NDF will have an ongoing opportunity to impact the quality and detail of results monitoring from its permanent position on the AGF Board. This seat can be used to promote enhanced focus on priority issues including gender and the environment.

## **5. ECONOMIC AND SOCIAL ASPECTS**

### **5.1. Economic Justification**

AGF receives fees for its services and operates on a commercially viable basis. Its clients are commercial banks doing business with SMEs. AGF reported an increase in income in its 2014 Annual Report from USD 1.98 million in 2013 to USD 5.38 million in 2014, of which

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<sup>13</sup> See Development Cooperation and Private Sector Engagement Scoping Paper. DAC Network on Environment and Development Cooperation, March 2016.

69% was derived from fees on guarantees. This is against total expenses of USD 6.34 million in 2014. Preliminary indications from 2015 suggest AGF achieved a modest net positive return for the year.

## **5.2. Environmental and Social Aspects**

Sound environmental and inclusive growth is at the heart of what GGF strives to achieve. It will build on and extend AGF's track record of enabling access to finance for more than 800 small, growing companies across 35 countries.

Growth at the level of SMEs can shift the horizon of opportunity for entire communities in low income settings. The impact of jobs and reliable income on households can have transformational impact on the quality of life for all. The AGF business model also extends its reach and impact to very small businesses with as few as 5 people which many other institutions classify as micro enterprises.

NDF will also leverage its permanent position on the AGF Board of Directors to advocate for specific gender related improvements in impact from core operations including promoting access to finance for women-owned companies in all capacity building programming with partner banks.

## **6. CONCLUSION**

Under the proposed Facility, NDF financing will support establishment of a climate-focused guarantee product targeting SMEs in Africa. It will be managed and administered by AGF with the aim to unlock commercial lending to SMEs investing in green growth and climate resilient development. AGF has demonstrated the reach and impact of guarantees to improve financial inclusion for SMEs in Africa. This proposal will leverage that business model to enhance the focus on green SMEs investing in renewable energy and energy efficiency, cleaner and more resource-efficient production, climate smart agriculture, fisheries and forestry and green services. This is a pilot initiative aimed at proving the effectiveness of green guarantee products and attracting additional capital to extend the product reach in every country where AGF is active.

## **7. RECOMMENDATION**

***The Board approved financing of up to EUR 7.6 million to the project C88 - REGIONAL AFRICA - African Guarantee Fund (AGF) Green Guarantee Facility (GGF).***

Helsinki, 16 March 2016



Pasi Hellman

Managing Director



Charles Wetherill

Country Program Manager

## Annex 1 - Project Results Matrix

The Table below presents key indicators for measuring AGF results. Indicators specific to GGF are highlighted in bold.

M&E Level	Main Indicator	Specific Indicators	Source	Frequency
Impact	Lasting effect on the landscape of financial markets and products	1. Average tenor of loans to SMEs in countries where AGF operates	AGF Surveys	3 year intervals
		2. Average cost of loans to SMEs in countries where AGF operates	AGF Surveys	3 year intervals
		3. Collateral requirements in countries where AGF operates	AGF Surveys	3 year intervals
		4. Share of loans to SMEs in countries where AGF operates	AGF Surveys	3 year intervals
		5. Local capital raised in countries where AGF operates	AGF Surveys	3 year intervals
		<b>6. Reductions in GHG emissions by SMEs supported under AGF green guarantees</b>	<b>GGF TA</b>	<b>Ex ante and 3 year follow up</b>
Outcome	Growth of SMEs benefiting from AGF facilities	1. Incremental revenue created by SMEs benefiting from AGF facilities	Partner banks AGF Surveys	Quarterly Annually
		2. Number of jobs supported by SMEs under AGF guarantees	Partner banks AGF Surveys	Quarterly Annually
		• No. of jobs supported for women by sector	AGF Surveys	Annually
		• No. of jobs supported for youth by sector	AGF Surveys	Annually
Outcome	Growth in SME led green investments	<b>3. Increase in kWh of renewable energy capacity supported by SMEs under AGF green guarantees</b>	<b>GGF TA reporting</b>	<b>Ex ante and 3 year follow up</b>
		<b>4. Net energy savings from energy efficiency investments supported by SMEs under AGF green guarantees</b>	<b>GGF TA reporting</b>	<b>Ex ante and 3 year follow up</b>

M&E Level	Main Indicator	Specific Indicators	Source	Frequency
Output	Increased financing available to SMEs	1. Number of partner banks benefiting from AGF facilities	AGF Surveys	Quarterly
		2. Volume of loans disbursed to SMEs by PFI's benefiting from AGF facilities by sector	Partner banks	Semi-annually
		<ul style="list-style-type: none"> <li>Loans disbursed to women-owned SMEs</li> <li>Loans disbursed to women-owned SMEs</li> </ul>	Partner banks	Annually
		3. Breakdown of SME loan portfolio by sector	Partner banks	Annually
		4. Number of SMEs benefiting from AGF facilities by sector	Partner banks	Semi-annually
		<ul style="list-style-type: none"> <li>No. of women-owned SMEs</li> <li>No. of youth-owned SMEs</li> </ul>	Partner banks	Annually
		5. Volume of loans disbursed under AGF green guarantees disaggregated for adaptation and mitigation	Partner banks	Annually
		6. Number of partner banks benefiting from capacity development initiatives	AGF CD reporting	Quarterly
		7. Number of bank staff trained	AGF CD reporting	Quarterly
		8. Number of SMEs by sector benefiting from capacity development initiatives	GGF TA reporting	Quarterly
		<ul style="list-style-type: none"> <li>No. of women-owned SMEs</li> <li>No. of youth-owned SMEs</li> </ul>	Partner banks	Annually
		9. Number of loans issued under AGF GGF	Partner banks	Annually
Inputs	Volume of guarantees issued	1. Loan Guarantees by sector	GGF TA reporting	Quarterly
		2. Value of grant commitments for capacity development and technical advisory support	AGF	Quarterly
Inputs	Capacity development and technical advisory support to AGF partners	1. Loan Guarantees by sector	AGF	Quarterly
		2. Value of grant commitments for capacity development and technical advisory support	AGF	Quarterly

## **Annex 2 - Green Guarantee Eligibility Classification**

### **Sustainable Energy**

- Renewable energy
- Energy efficiency
- Sustainable transport

### **Cleaner Production**

- Cleaner materials, technologies, systems and practices in product value chains
- Waste and wastewater management
- Waste and material recovery and re-use
- Recycling

### **Climate-Smart Agriculture and Natural Resource Management**

- Climate-smart agriculture
- Sustainable forestry and fisheries
- Organic waste management
- Water protection, conservation and management
- Protection of vulnerable ecosystem resources

### **Green Services**

- Climate finance
- Climate-related ICT
- Climate change training, education and consulting services
- Natural disaster prevention, preparedness and response
- Sustainable tourism
- Other climate-related service sectors