Project Finance and Incentives

Clay Brick Association Regional Meeting
Midrand
16 February 2017
Agenda

• Background to Cova
• Energy Efficiency Finance Guideline
• Key Findings from Interviews
• Incentive value chain
• The missing middle
• Project finance available
• Incentives available
• Case Study Examples
Background to Cova

• We are an advisory consulting firm specialising in Government Grants and Incentives.
• We also advise on matters related to green finance, as well as carbon and energy policies and strategies.
• We are a SANAS Accredited Measurement and Verification Inspection Body (EEMV0007)
• Cova has secured over R1 billion in after tax grants and incentives (R5 billion before tax) for clients in the last three years.
Energy Efficiency Finance Guideline

- Interviews with Brick Makers to understand barriers to access finance or incentives for energy efficiency projects
- Develop business case examples using Energy Efficiency Projects proposed in the Energy Efficiency Guidelines
- Develop guidelines of available options as well as indicative list of all options available for all energy efficiency projects listed in Energy Efficiency Guidelines

Key Findings from Interviews

- Brick makers are on the whole continuing to invest in their operations.
- Primary investment drivers appear to be the need to improve efficiency and address bottlenecks within operation.
- Energy efficiency appears amongst the drivers, but isn’t a primary concern.
- Investments are almost universally made from brick maker’s own financial resources as and when cash becomes available.
- Businesses typically assess different projects on a payback basis, but are not necessarily able to develop business cases.
- Brick makers are struggling to access bank finance due to risk concerns, and the way that banks assess affordability and projects.
- Financing is typically limited to asset based on certain pieces of machinery.
Key Findings from Interviews

- Brick makers are not accessing grants or incentives due to both lack of ability, and structural barriers
- As a consequence, the market is unable to contemplate any large scale investment
- Finance is a barrier to the implementation of energy efficiency projects
- All interviewees see the need for some form of intervention, including demystifying the Carbon Tax
The Business Cycle

**Enterprise Development**
- APDP
- NIPP
- S12I
- MCEP 2
- CIP/MIG
- SEZ
- SPP
- EIP
- BI

**Competitiveness**
- NIPP
- BBSDP
- MCEP 2
- S12L - energy
- Carbon Credits and S12K
- DSM/IDM
- Green Fund
- Jobs Fund
- BI

**Export**
- EMIA
- SEZ
- CPFSP
- NIPP
- Drawbacks

**R&D**
- S11D
- SPII
- Thrip
- PII
- Innovation Fund
- Green Fund
The Missing Middle

- Grants and Incentives are typically available for either large projects or corporations or for small business
- Lack of grants and incentives for middle sized projects and companies
- Larger focus on black business
• Typically through asset-based or non-asset based option through financial institutions

• It is important to consider banks that have been given credit lines expressly for energy efficiency offering preferential products for energy efficiency projects

• Typically most energy efficiency projects above a certain capital investment can apply for finance – often easier to link it to asset-based finance options
SUNREF Phase II / AFD Finance

- Continuation of Sunref Phase 1 – interest rate, longer payback, matching cashflows
- Supposed to be focussed on smaller sized projects – project limit €15 million
- Technologies include renewable energy technologies, emission reduction projects, and energy efficiency projects
- Total Credit Line Available €120 million
- Currently – IDC agreement has been signed, other partner bank will be Nedbank
- IDC is used to dealing with larger projects and larger corporates and typically follow the evaluation criteria of the IDC
- If the investment value of the project is not large enough for banks – it would be possible to group projects OR have a large supplier apply for loan to finance group of smaller projects
- Also provide assistance on technical expertise and regulatory issues
- Can apply and submit projects to the Technical Assistance Facility based at SANEDI
IDC Funding Energy Efficiency and Small-Scale Renewables

- Roof top solar PV
- Biomass/Biogas
- Lighting
- Solar Water Heaters & Commercial Water Heating
- Refrigeration
- Variable speed drives, Energy efficient plant and machinery, Other
## IDC Financing Options

<table>
<thead>
<tr>
<th>Characteristic (Feature)</th>
<th>Limited Recourse Project Finance</th>
<th>Hybrid (Financing of a Project)</th>
<th>Corporate Finance (Balance Sheet)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core business</td>
<td>Outsourced to specialised power company – Sponsor/SPV</td>
<td>Combination of host operating, but may outsource</td>
<td>Create new capacity in possible non-core activity, but may be “tail-of-the-dog”</td>
</tr>
<tr>
<td>Capital availability</td>
<td>Developer/ Sponsor raises and provides</td>
<td>Can be linked to project and may not have corporate guarantee, or limited</td>
<td>All capital from cash reserves or corporate borrowing, and guarantee repayment from other business</td>
</tr>
<tr>
<td>Cost of debt</td>
<td>Depends on structure and security of project cashflows</td>
<td>Depends on host &amp; offtakers guarantees (security) as well as cashflows</td>
<td>Depends on balance sheet strength (&amp; security) (\text{Generally lower})</td>
</tr>
<tr>
<td>Debt term</td>
<td>Aligned to project cashflows eg. 10 years</td>
<td>Combination, so can look at project and/or host ability to repay debt</td>
<td>Depends on balance sheet strength and ability to pay debt</td>
</tr>
<tr>
<td>Balance sheet impact</td>
<td>On Sponsor’s/SPV balance sheet</td>
<td>Can be ringfenced as project cashflows</td>
<td>On own balance sheet</td>
</tr>
</tbody>
</table>
Finance can also be offered through corporate development funds, typically targeting SMMEs – an example of this is Massmart Supplier Development Fund.

In 2014, Massmart funded five different brick making companies: R19 139 591 in approved grants, R8 332 046 in finance.

Energy Service Companies offer finance through energy performance contract agreements.

Original Equipment Suppliers may offer finance through financial institutions they bank.
Grant and Incentive Options

- Grants programmes generally require high capital investment and high levels of black ownership
- The current grant programmes that are currently available (more applicable to brick makers)
  - The Black Industrialist Scheme
    - Minimum 51% Black Ownership
    - Capital Investment Minimum R30 million
  - Critical Infrastructure Programme
    - Must invest in infrastructure supporting a manufacturing investment
    - Minimum Level 4 B-BBEE status – recently waived – just compliant
    - Cost Sharing Grant
  - Manufacturing Competitiveness Enhancement Programme MCEP)
    - WC - Finance Option available for now – 4% blended, Level
    - Expect a MCEP grant programme to re-open - underspent
• A tax incentive is a tax allowance or a deduction on your taxable income. Company must be tax paying / profitable to benefit

• **Section 12L: Energy Efficiency Tax Incentive**
• 12L applies up to years of assessment ending before 1 January 2020. This means that your project must be implemented by December 2018. Extension?
• The rate has been increased to 95 cents per kilowatt-hour effective from 1 March 2015. Previously 45c per kilowatt-hour for project implemented after November 2013.
• Incentive is administered by SANEDI, High costs to access as it requires SANAS accredited M&V body and high data accuracy
• SANEDI are currently working on a M & V “Lite” option, could be very useful for smaller projects

### Grant and Incentive Options

<table>
<thead>
<tr>
<th>After Tax Benefit</th>
<th>Fuel</th>
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<tbody>
<tr>
<td>R 0,27 /kWh</td>
<td>Electricity</td>
</tr>
<tr>
<td>R 1,85 /kg</td>
<td>Coal</td>
</tr>
<tr>
<td>R 2,82 /litre</td>
<td>Diesel</td>
</tr>
<tr>
<td>R 2,67 /m³</td>
<td>Natural Gas</td>
</tr>
<tr>
<td>R 2,04 /litre</td>
<td>LPG</td>
</tr>
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</table>
Section 12I: Capital Infrastructure Incentive for Manufacturing

Incentive on the Capital Investment of a Manufacturing Project

Minimum capital investment R30 mill (brownfields) and R50 mill (greenfields)

Section 12I was brought into effect in July 2010 with a sunset clause of 31 December 2015, which was extended to 31 December 2017.

The budget allocation for the additional allowance benefit was R20 billion.

To date, approximately R20 billion Additional Investment Allowance as been allocated to about 80 approved projects

Waiting list – projects withdraw
Grant and Incentive Options

- **Section 12I: Capital Infrastructure Incentive for Manufacturing**

- Incentive on the Capital Investment of a Manufacturing Project

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**Grant and Incentive Options**

- **Research and Development**
  - Incentive options available for R&D include Section 11D (tax allowance) and the Support Programme for Industrial Innovation (Grant Programme)
  - Typically for brick makers, this would include for example running a pilot project to test a new type of kiln

- **Carbon Offsets**
  - It is possible to obtain carbon credits for project which reduce carbon emissions
  - It is expected that through the implementation of the Carbon Tax in 2018 and the promulgation of the Carbon Offset Regulations
Business Case Examples

- Project Eligible for Section 12L Allowance – Installation of Vertical Shaft Brick Kiln
- Section 12L Tax Benefit Calculation

<table>
<thead>
<tr>
<th></th>
<th>Clamp Kiln</th>
<th>VSBK</th>
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<tbody>
<tr>
<td>Production</td>
<td>101 000 tonnes</td>
<td>120 000 tonnes</td>
</tr>
<tr>
<td>Energy</td>
<td>2.44 MJ / kg</td>
<td>0.84 MJ / kg</td>
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<tr>
<td>Energy Saving</td>
<td>53 267 093 kWh</td>
<td></td>
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<tr>
<td>Section 12L Benefit</td>
<td>R 50 603 738</td>
<td></td>
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<tr>
<td>(before Tax)</td>
<td></td>
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<tr>
<td>Section 12L Benefit</td>
<td>R 14 169 047</td>
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<tr>
<td>(after Tax)</td>
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## Business Case Examples

### Example of matching the project with the criteria of potential options

#### Project Details

<table>
<thead>
<tr>
<th>Kiln type</th>
<th>Energy Saving Opportunity</th>
<th>Ease of Implementation</th>
<th>Capex (Rand)</th>
<th>Energy Savings (kWh/annum)</th>
<th>CO₂ Saving (t/yr)</th>
<th>Payback (Years)</th>
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<tbody>
<tr>
<td>Fixed &amp; Clamp</td>
<td>Replace Current Clamp Kiln with Fixed Kiln Type (e.g. VSBK, Zig-Zag, TVA or Tunnel kiln etc.)</td>
<td>Difficult</td>
<td>R18 000 000</td>
<td>70 000 056</td>
<td>24 700</td>
<td>2.30</td>
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#### Kiln Type

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<th>Kiln Type</th>
<th>Energy Saving Opportunity</th>
<th>Capex (Rand)</th>
<th>Energy Savings (kWh/yr)</th>
<th>Finance</th>
<th>Grants</th>
<th>Tax Incentives</th>
<th>R&amp;D</th>
<th>Carbon Offsets</th>
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<tr>
<td>Clamp</td>
<td>Replacement of Clamp Kiln with a Fixed Kiln</td>
<td>18 000 000</td>
<td>70 000 560</td>
<td>Asset Based</td>
<td>Non-asset</td>
<td>Development</td>
<td>OEM</td>
<td>ESC</td>
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## Contact Us

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