LKA

TRANSACTIONS & ENGAGEMENTS

Independent Hedging Advisory Across South Africa's Renewable Energy Programme

From REIPPPP Round 1 to Round 6

Independent Treasury, Hedging & Capital Markets Adviser

EXECUTIVE SUMMARY

South Africa's Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) transformed the country's power sector and created a new market for the financing of utility-scale renewable energy.

Lionel Kruger's involvement dates to the programme's inception in 2011. Since then, he has advised on the successful financing and hedging of **16 renewable-energy projects across Bid Windows 1, 2, 4, 5 and 6**, spanning wind, solar PV and hydro.

The work has evolved alongside the market itself: from establishing hedge strategies for the first generation of projects, through financial-close execution and portfolio financings, to more sophisticated interest-rate and foreign-exchange structures, post-financial-close hedge management and refinancing.

A consistent feature has been **independent sponsor and investor-side advice**, providing transparency over bank pricing and helping ensure that hedging supports the underlying economics and financing requirements of each project.

THE CHALLENGE

Renewable-energy project finance creates multiple, interconnected financial-market risks.

Projects typically combine long-dated floating-rate debt with substantial foreign-currency equipment costs, while lenders impose minimum hedging requirements as a condition of financing. The timing of financial close can also move materially, exposing projects to market movements before hedges can be executed.

The challenge is therefore broader than selecting a derivative.

Sponsors and investors need to determine:

- how much interest-rate and FX exposure should be hedged;
- when hedging should take place;
- how lender requirements interact with project economics;
- whether conventional swaps, options or other structures provide the appropriate protection;
- whether bank pricing, credit charges and execution margins are reasonable;
- how hedges should be managed after financial close; and
- how existing positions should be dealt with during refinancing.

LKA's ROLE

Across successive REIPPPP mandates, Lionel has provided independent advice covering:

Hedge strategy
Determining appropriate interest-rate and FX hedge structures and ratios, taking account of project economics, lender requirements and sponsor risk appetite.

Independent benchmarking
Assessing market rates, execution margins, credit charges and other components of hedge pricing independently of the financing banks.

Financial-close preparation
Coordinating and participating in dry-run pricing exercises ahead of execution.

Hedge execution
Supporting sponsors and investors during live execution and independently verifying the economics agreed with hedge counterparties.

Documentation
Reviewing the commercial implications of hedge provisions within financing and derivative documentation, including breakage arrangements.

Post-financial-close management
Monitoring existing hedges, assessing annual hedge requirements and benchmarking subsequent hedge rolls and top-ups.

Refinancing
Assessing the treatment, restructuring or termination of existing derivatives when project debt is refinanced.

Experience Across REIPPPP

The First Round

Lionel was appointed on his first REIPPPP mandate in **2011**, at the inception of the programme.

Completed Round 1 engagements subsequently included **Umoya, Metrowind, Cookhouse and Kathu**.

These early projects required sponsors and investors to establish approaches to hedging within what was itself a new financing market.

On Metrowind, for example, the work extended from pre-financial-close hedge strategy through execution and into development of the longer-term hedge strategy after financial close. Advice considered lender minimum hedge requirements alongside the effect of interest rates and inflation assumptions on project economics and debt-service metrics.

The financial-close process included independent scrutiny of bank pricing across the underlying market rate, execution costs and credit charges rather than simply accepting an all-in swap rate.

Expanding Across the Programme

In **Round 2**, Lionel advised Kakamas Hydro Electric Power on hedge execution, including independent benchmarking of interest-rate and foreign-exchange hedging.

The advisory model continued to develop as projects and financing structures became larger and more sophisticated.

Rather than treating hedge execution as an isolated financial-market transaction, the approach was to consider the hedge as part of the overall project financing — balancing lender requirements, sponsor objectives, project economics and prevailing market conditions.

Project Cricket — Portfolio Hedging at Scale

A significant Round 4 mandate was **Project Cricket**, a portfolio of six solar PV projects held within Old Mutual's IDEAS Fund.

The portfolio comprised approximately **457 MWDC** of generation capacity. Four projects were financed by Absa and two by Nedbank.

Lionel was originally approached for the mandate while operating independently. Following his subsequent move to JCRA, the original commercial terms of his proposal were retained and he ultimately advised on the hedging of all six projects through their financial closes in 2018.

Project Cricket also illustrates the use of derivatives beyond conventional fixed-rate swaps.

The hedge structure incorporated **long-dated, deeply out-of-the-money JIBAR call options**, providing protection against significant adverse interest-rate movements while allowing the projects to retain participation in rates below the option strike.

The structure reflected an important principle of independent hedge advice: **the objective is not necessarily to maximise the amount of fixed-rate protection, but to find a structure appropriate to the project's economics, financing requirements and risk tolerance.**

Round 4 experience also included **Roggeveld**, continuing an important Building Energy advisory relationship that subsequently developed into further mandates with Red Rocket.

Continuing Through Rounds 5 and 6

The Red Rocket relationship continued into **REIPPPP Round 5**, when LKA was formally appointed on **Brandvallei, Rietkloof and Wolf**.

The three-project mandate covered approximately **R6.4 billion of senior debt**, with Absa and Standard Bank providing financing and substantial foreign-currency exposure arising from imported equipment.

LKA's scope encompassed interest-rate and FX strategy, independent pricing, hedge-document review, market monitoring, dry runs and financial-close execution.

The mandate also considered **deal-contingent hedging**, including the potential use of international banks to provide protection against adverse interest-rate and FX movements ahead of financial close while recognising the contingent nature of the projects.

In **Round 6**, the relationship continued with **Virginia**, where the hedge strategy encompassed both construction-period FX and interest-rate exposure and post-completion interest-rate risk.

Beyond Financial Close

LKA's REIPPPP experience has not been confined to initial project financing.

On **Lesedi and Letsatsi**, Lionel was brought in by Old Mutual after the original financial closes to advise on the projects' ongoing interest-rate hedging requirements.

The financing arrangements required hedge coverage to be reset periodically to predetermined percentages. LKA independently assessed the reasonableness of bank pricing for the required hedge top-ups and rolls, with the relationship continuing through **2022**.

This illustrates an often-overlooked aspect of project hedging: financial risk management continues throughout the life of the financing rather than ending when the initial derivatives are executed.

COMMERCIAL OUTCOME

Across these engagements, independent hedge advice has provided sponsors and investors with:

Pricing transparency
Independent assessment of lender and hedge-counterparty pricing.

Strategic challenge
An alternative perspective on structures proposed by financing banks.

Execution discipline
Dry runs, coordinated execution processes and independent verification of final hedge economics.

Structural flexibility
Consideration of swaps, options, deal-contingent hedging and other structures rather than adopting a single standard approach.

Lifecycle support
Advice extending from bid and pre-financial-close strategy through execution, operations and refinancing.

LKA PERSPECTIVE

REIPPPP has changed substantially since its first procurement round, but the underlying principle of independent hedge advice has remained remarkably consistent.

The financing bank is both lender and, frequently, derivative counterparty. Its objectives are therefore not necessarily identical to those of the sponsor or equity investor.

Independent advice provides a separate market perspective.

The appropriate hedge is also not necessarily the structure that eliminates the greatest amount of market risk. Project economics, lender requirements, flexibility, credit costs, breakage exposure and the ability to participate in favourable market movements all need to be considered.

The use of deeply out-of-the-money JIBAR calls on Project Cricket is one example: the derivative was designed around the project's required protection rather than defaulting automatically to a conventional long-dated fixed-rate swap.

Key Takeaways

REIPPPP experience from inception
Advisory involvement dating to 2011.

16 successfully completed project mandates
Across Bid Windows 1, 2, 4, 5 and 6.

Wind, solar PV and hydro
Experience across different renewable technologies and financing structures.

Strategy through execution
Independent advice encompassing hedge design, bank benchmarking, dry runs, documentation and financial-close execution.

Beyond financial close
Ongoing hedge management and refinancing advice.

Long-standing client relationships
Repeat appointments from infrastructure investors, sponsors and developers across successive projects and procurement rounds.

About Lionel Kruger & Associates

Lionel Kruger & Associates provides independent treasury, project finance and capital markets advisory services across infrastructure, energy, mining and industrial sectors.

LKA advises sponsors, investors and borrowers independently of financing banks and derivative counterparties, with particular expertise in interest-rate, foreign-exchange and commodity risk management.

Career Note: This engagement was undertaken by Lionel Kruger prior to the establishment of Lionel Kruger & Associates Limited. It forms part of his personal professional advisory track record, which continues through the firm's current infrastructure, treasury and capital markets advisory engagements.