

Sri Lanka: Renewable Energy for Rural Economic Development Project

OPERATING GUIDELINES

Part 1. Credit and Grant Arrangements

Measure	Arrangement/Entity
1. Loan Amount and Financing Sources	<ul style="list-style-type: none"> ▪ Total estimated project cost: US\$ 133.7 million; comprising IDA: US\$ 75.0 million, GEF: US\$ 8.0 million and others US\$ 50.7 million. ▪ US\$ 10.0 million from IDA has been earmarked for off grid projects and will be reviewed at mid-term evaluation.
2. Borrower	Democratic Socialist Republic of Sri Lanka
3. Executing Agency	DFCC Bank/Administrative Unit (AU)
4. Estimated Commitment Period	Four and one half years for grid connected and five years for off-grid projects after Credit Effectiveness
Interest Rates	
5. Service Charge to Government of Sri Lanka (GOSL)	Standard Service Charge levied by the International Development Association (IDA)
6. Interest Rate to Participating Credit Institutions (PCIs)	<ul style="list-style-type: none"> ▪ Average Weighted Deposit Rate (AWDR), which is the weighted average of the interest rates paid to depositors by all commercial banks on interest-bearing term deposits, as issued weekly by the Central Bank of Sri Lanka, or another appropriate rate to be determined during project implementation by GOSL in consultation with IDA. ▪ Rate subject to revision (both new and existing loans) every six months.
7. Interest Rate from PCIs to Final Borrowers	To be determined by PCIs in agreement with their clients.
Maturity Structure of Credit and Subloans	
8. IDA to GOSL	Standard IDA terms with 40 years maturity.
9. GOSL to PCIs	Amortization based on an aggregate of withdrawals for individual subloans, repayable in 20 equal semi-annual instalments, payment commencing sixty-six months after the date on which the PCI made the first withdrawal.
10. Subloans	<ul style="list-style-type: none"> ▪ Maximum ten years, including maximum two-year grace. ▪ Maximum maturity not to exceed useful economic life of equipment financed.
11. Applicant Eligibility Criteria	Any private enterprise, NGO, co-operative or individual operating in Sri Lanka is potentially eligible, subject to PCIs' creditworthiness assessment.
12. Eligible Subprojects (refer Part 2 of Operating Guidelines for PCI eligibility)	<ul style="list-style-type: none"> ▪ Private investment proposals for: (i) grid-connected renewable energy power projects (with capacity not more than about 10MW); (ii) off-grid village based renewable energy power projects; (iii) solar home systems; (iv) other renewable energy investments and (v) energy efficiency, conservation and demand side management (DSM) investments. ▪ Funds cannot be used for financing or acquisition of existing assets (including land) or refinancing of existing debts or accrued interest.
13. Maximum Amount of Refinancing	Maximum of US\$ 8.0 million for any one subproject, or single borrower exposure limit of concerned PCI, whichever is lower.
14. Portion of Subloan Refinanced	Maximum of 80 percent of PCI total subloan amount for a specific subproject.

Other Measures	
15. Responsibility of Administrative Unit (AU)	<ul style="list-style-type: none"> ▪ Process disbursement requests for loans approved by PCIs under their Free Limit and process disbursement requests for loans above PCIs' Free Limit approved by IDA. Process disbursement requests for GEF grant co-financing. Free Limit for subloans is US\$ 1.0 million. ▪ With respect to subloans and GEF grant cofinancing, maintain disbursement records and accounts of each PCI, keep supporting disbursement documents, and keep bank accounts relating to disbursement. Maintain Project Accounts. ▪ Appoint independent auditors to continuously verify data entry by solar companies and perform systems reviews in respect of cofinancing grant disbursement requests made to the AU. ▪ Inform IDA from time to time regarding the progress of the Project, provide regular reports on the progress of the Project, and assist IDA and GEF supervision and/or evaluation missions. ▪ Maintain RERED Credit Programme related statistical records. ▪ Monitor timely submission by PCIs to AU of subproject progress reports and estimates of credit and grant withdrawals for the next two quarters. ▪ Submit quarterly Financial Monitoring Reports (FMRs) on the Project and other reports as required by GOSL, IDA and GEF. ▪ Perform project support activities including facilitating barrier removal with stakeholders, procurement of consultant services, award of contracts, and monitoring of Technical Assistance assignments. ▪ Perform other tasks and functions as are necessary to achieve the objectives of the Project.
16. Loan Approval Procedures (if not previously satisfied under ESD Project)	<p>The following are subject to approval by IDA: (i) the first two subloan proposals, irrespective of size, presented by each PCI, (ii) subloan proposals above the free limit, (iii) each PCI's first solar home systems subloan proposal, (iv) each subproject developer's first solar home systems subloan proposal, (v) each PCI's first grid-connected hydro, wind and biomass proposal and (vi) each PCI's first village based hydro, wind and biomass proposal.</p>
17. Environmental/Social Assessment Requirements	<p>In accordance with national standards and procedures as mentioned in the Environment and Social Assessment Framework prior review by IDA is required for: (i) all biomass projects; (ii) mini hydro projects >5MW; (iii) wind projects >10MW; (iv) all projects involving land acquisition and/or resettlement. Also, the first two EAs of mini hydro power, biomass, and wind power projects require prior review.</p>
18. Subloan Documentation Requirements to be furnished for Approval of Refinancing	<ul style="list-style-type: none"> ▪ Subloans involving refinancing below the Free Limit: (i) PCI confirmation of assessment of creditworthiness of subborrower including description of business(es); (ii) description of project and confirmation of compliance with IDA procurement requirements and adequate due diligence in appraisal; (iii) list of goods and services to be financed; (iv) project costs and financing; (v) PCI confirmation that terms and conditions of subloans include adequate insurance of subproject assets; (vi) timetable for implementation; (vii) evidence of full compliance with the Environmental and Social Assessment Framework; (viii) financial and justification of the subproject; (ix) economic and social benefits in the case of off-grid community based subprojects and (x) any other information as agreed between IDA and AU. ▪ Additional information for refinancing above the Free Limit: Appraisal report of the project, which will additionally include: (i) cash flow projections of subborrower and subproject and (ii) assessment of technical and commercial feasibility.

19. Procurement Procedures	<ul style="list-style-type: none"> ▪ For Part A of the Project - Credit Component: Bid packages over US\$2.0 million for goods contracts, over US\$3.0 million for works contracts and over US\$5.0 million for turnkey contracts are subject to International Competitive Bidding (ICB) requirements. For lesser amounts use established commercial practices acceptable to IDA. ▪ For Part B of the Project - Technical Assistance: Goods contracts (i) over US\$200,000 are subject to ICB; (ii) between US\$25,000 and US\$200,000 subject to NCB; and (iii) goods and works contracts less than US\$25,000 subject to local/international shopping with a minimum of three quotations. ▪ Consulting service contracts for firms (i) above US\$100,000 QCBS shall be used; and (ii) less than US\$100,000 CQ shall be used. Consultancy service contracts for individuals shall be as per paragraphs 5.1 - 5.3 of Guidelines for Selection and Employment of Consultants. ▪ For Parts B and C of the Project: Contracts for goods over US\$200,000 and the first two contracts each year regardless of value require prior review of IDA.
20. Disbursement Procedures	<ul style="list-style-type: none"> ▪ Eligibility of expenditures: (i) below prior procurement review limits would be ascertained by AU and disbursements of expenditures for all subloans would be made on the basis of PCIs' submission of full documentation; (ii) above the prior review limits, AU to submit reimbursement applications to IDA for review/approval. Documentation evidencing expenditures to be kept by AU in respect of grid-connected subprojects and with PCIs in the case of off-grid subprojects, for external audits and for review by World Bank missions. ▪ Reimbursement available for project-related expenditures made within 120 days prior to World Bank/AU receipt of subloan/subproject proposals together with corresponding subproject documentation. The 120-day limit will be relaxed until September 30, 2002 for ESD eligible claims for which no re-financing and grants were available under the ESD Project. These subprojects will be subject to and paid on RERED Project terms. ▪ AU would have the authority to notify the Central Bank of Sri Lanka (CBSL) to make payments from the Special Accounts and would be responsible for keeping track of these Accounts.
21. Audit Requirements	<ul style="list-style-type: none"> ▪ Annual external audit of Special Accounts, and separate opinion on FMR. ▪ Annual external audit of PCIs' financial statements and its compliance with the Eligibility Criteria.
22. Exchange Risk	GOSL would bear all foreign exchange risk.
23. Assessment of Compliance with Prudential Regulations by PCIs	The Supervision Department of CBSL or other relevant regulatory agencies would confirm that PCIs conform with prudential regulations, taking into account the Eligibility Criteria for each PCI. For PCIs not under CBSL supervision, evaluator to be hired by AU and report to IDA.
Grant Arrangements	Off-grid village based hydro, wind, biomass systems & Off-grid household based solar, wind systems
24. Basis and Amount of GEF Grant Cofinancing	<p><i>Off-grid, non-solar sub-projects:</i> US\$400 per kW installed, up to a maximum of US\$20,000 per subproject.</p> <p><i>Off-grid solar:</i> First 1½ years (up to 30 Jun 04): 10 to < 20Wp = US\$40; 20 to 60Wp = US\$70; Next 2 years (up to 30 Jun 06): 10 to < 20Wp = US\$40; 20 to 40Wp = US\$70; Next ½ year (up to 31 Dec 06): 10 to < 20Wp = US\$40; 20 to 40Wp = US\$40 Next 1 year (up to 31 Dec 07): 10 to < 20Wp = US\$40.</p> <p>Limited to one subgrant per household and per system. Upgrades shall not qualify for grants.</p>

25. Trigger for Release of Grant Cofinancing	<p><i>Off-grid village based systems:</i> Certification by a Chartered Engineer that system is complete, complies with specifications and is operational.</p> <p><i>Off-grid household based solar:</i> Presentation of detailed schedules in read-only soft copy format of REREDP compliant SHS installed along with grant disbursement request. The solar company will also forward to AU a declaration confirming that the schedules exactly match the information given in the Customer Acceptance Receipts (CARs) and that the original CARs will be available for inspection by authorized personnel.</p> <p><i>Household based wind:</i> Presentation of Customer Acceptance Receipt(s) evidencing installation and confirmation of eligibility.</p>
26. Grant Cofinancing Reservation Period after Commitment	One year, beginning on the date of subloan approval (and annual anniversary dates if applicable).
27. Project Preparation Grant Amount	Up to 95 percent of Preparation Costs subject to a maximum of US\$ 6,000 plus, in the case of village based systems, an incentive of up to US\$ 2,000 for demonstrated success in achieving economic benefit targets agreed to between the consultant and AU during sub-project preparation.
28. Project Preparation Grant Eligible Expenses	Fees of an independent consultant directly attributable to subproject preparation. Only expenses incurred after April 30, 2002 would be eligible. Each subproject developer would be eligible for only one grant.
29. Trigger for Project Preparation Grant Release	<p><i>Off-grid, non-solar subprojects:</i></p> <ul style="list-style-type: none"> ▪ On presentation of eligible expenses and submission of grant disbursement request: (i) 50 percent of grant amount (subject to a maximum of US\$ 3,000) to be released on approval of subloan by PCI or any other lending institution acceptable to AU; (ii) 30 percent of grant amount (subject to a maximum of US\$ 1,800) to be released on successful installation verification; and (iii) 20 percent (subject to a maximum of US\$ 1,200) to be released after six months of successful operations following the installation verification of subproject. ▪ In addition, the incentive payment of up to US\$ 2,000 to be released against an independent verification that confirms that the economic benefits as per agreed project outcomes indicated by the consultant have been created.
30. Renewable Energy Technical Assistance: where the Industry as a Whole is the Beneficiary	<ul style="list-style-type: none"> ▪ Stakeholder will prepare TOR as needed in consultation with AU, stakeholder groups and IDA. A TOR will be endorsed by at least five key stakeholders acceptable to AU/IDA, or ratified by a recognized industry association. AU will contract consultants and oversee the technical assistance efforts. Payments to be based on agreed deliverables. ▪ The AU will approve activities up to US\$ 100,000. Applications for more than US\$ 100,000 need a no-objection from IDA.
31. Renewable Energy Technical Assistance: where an Organization is the Primary Beneficiary	<ul style="list-style-type: none"> ▪ Stakeholder will prepare TOR. The AU - with support of independent technical expertise if required - will approve the activities up to US\$ 100,000. Applications for more than US\$100,000 need a no-objection from IDA. The AU will contract consultants and oversee technical assistance efforts. ▪ Activities will be cost-shared with a substantial portion (not less than 25 percent) borne by the stakeholder. Payments to be based on achievement of agreed deliverables.
32. Off-Grid Project Supervision Fee to PCIs	US\$ 1,000 per subproject, only for off-grid village based sub-projects.
33. Trigger for Release of Off-Grid Project Supervision Fee	Certification by a Chartered Engineer that system is complete, complies with specifications, and is operational.

34. Off-Grid Project Supervision Fee Eligibility Period	Subloan refinance application received by the AU after 30 April 2002 and up to six months prior to date of Project close.
35. Verification of Village Based and Household Based Systems	<ul style="list-style-type: none"> ▪ AU will prepare TORs (in consultation with IDA) for design verification, installation verification and spot checks to ensure installation compliance. ▪ AU will maintain a list of qualified consultants for the above and release grant funds for PCI to contract consultants ▪ AU will follow-up on design and installation irregularities and seek remedial action. If the remedial action is unsuccessful and suspension from the Credit Program is required, the AU will notify all PCIs. ▪ AU will verify SHS data furnished by solar companies for completeness, technical compliance and duplication before releasing cofinancing grant.
36. Off-grid Consumer Protection Facility	AU will prepare TOR for Consumer Education and Protection Facility (in consultation with IDA). GEF grant will cover the costs of maintaining and publicizing the facility, which will investigate consumer complaints and seek appropriate solutions.
37. GOSL Provisions	PCIs to ensure that the terms and conditions of subloans provide for (i) GOSL and IDA to inspect subprojects (Investment Projects) including goods, works, sites and construction. This includes inspection of both physical assets and relevant documentation; (ii) GOSL to suspend or terminate access by the Investment Enterprise to the Credit Line, Subgrants, Preparation grants and/or Technical Assistance for failing to comply with the Operating Guidelines.

Part 2. Eligibility Criteria for Participating Credit Institutions

Participating credit institutions (PCIs) shall satisfy the criteria given in section (A) below, as well as those identified for specific classes of institutions as applicable.

A. For all Participating Credit Institutions

In order to become eligible to participate in the Renewable Energy for Rural Economic Development (RERED) Credit Program and to maintain their eligibility, credit institutions must be privately owned and controlled, and meet the following criteria:

- (a) The International Development Association (IDA) should receive a satisfactory statement approved by the Board of Directors of the institutions outlining:
 - A proposal as to how they would plan to utilize the credit facility, how they would get internally organized to market the RERED scheme, evaluate the subproject proposals and manage subsequent follow-up monitoring and loan recoveries
 - Name of the senior officer who will be in charge of RERED credit operation and key team staff;
 - Lending institutions which are not PCIs under the Energy Services Delivery (ESD) Project should submit the institution's business strategy and operating policies, and
 - Details of their existing term lending programs and portfolio management scheme, if any.
- (b) Except as IDA shall otherwise agree, a profitable operation for at least two full years of operation preceding its application for participation, attested to by unqualified audit reports from independent private auditors acceptable to IDA.
- (c) A majority of the share capital of the PCI should be held by private sector

- (d) The PCI should furnish to IDA, a certificate from the external auditors within 90 days of the date of audited financial statement, that the financial performance of the PCI concerned is in conformity with the applicable financial criteria outlined below. The PCI shall physically forward this certificate to the World Bank's office in Colombo who will receive it on behalf of IDA.
- (e) After fulfilling the eligibility criteria, the PCI shall continue to meet the eligibility criteria aforementioned to the satisfaction of GOSL and IDA, which will monitor the PCI's compliance therewith semiannually. If the PCI fails at any time to satisfy the above specified criteria the GOSL and IDA reserve the right to suspend subloan authorizations under the RERED Project until the PCI has taken specific steps to address its problems in a manner acceptable to GOSL and IDA.

B. For Commercial Banks and Licensed Specialised Banks

Commercial banks and licensed specialised banks may extend sub-loans to all eligible subprojects listed in paragraph 12, Part 1 of the Operating Guidelines.

Compliance with Ministry of Finance and Planning/Central Bank of Sri Lanka guidelines on prudential regulations, capital adequacy, classification of risk assets, provisioning, single borrower exposure limit, sector exposure limits, and disclosure and reporting requirements.

A confirmation from external auditors acceptable to IDA that, at the date of its application for participation and subsequently at the end of its financial year, the credit institution met the following financial criteria, ratio requirements and exposure limits calculated in accordance with IDA standard guidelines:

- (a) A minimum total cash collection ratio of principal and interest of 80 percent on term loan portfolio calculated on a rolling twelve-month basis;
- (b) A minimum total cash collection ratio of principal only of 80 percent on term loan portfolio calculated on a rolling twelve-month basis;
- (c) A minimum after tax profit equivalent to 9 percent p.a. on average shareholders' funds;
- (d) A minimum debt service cover ratio of 1.25 times (only for Licensed Specialized Banks and similar institutions);
- (e) A maximum portfolio infection rate of 20 percent;
- (f) A maximum debt equity ratio of 8:1;
- (g) Compliance with minimum capital adequacy ratios for tier-1 and tier-2 as required by prevailing Central Bank of Sri Lanka (CBSL) guidelines;
- (h) Credit exposure (loans and leases) to one party or any one group of companies must not exceed 30 percent of the PCI's total capital funds (shareholders' funds);
- (i) Credit exposure (loans and leases) to any one sector, as defined in the UN Standard Classification of Economic Activities, must not exceed 30 percent of PCI's total credit portfolio.

C. For Merchant Banks and Leasing Companies

Merchant banks and leasing companies may extend sub-loans only to off-grid village based renewable energy power projects, solar home systems and energy efficiency, conservation and demand side management (DSM) investments listed in paragraph 12, Part 1 of the Operating Guidelines.

A confirmation from external auditors acceptable to IDA that, at the date of its application for participation and subsequently at the end of its financial year, the credit institution met the following financial criteria, ratio requirements and exposure limits calculated in accordance with IDA standard guidelines:

- (a) A minimum total cash collection ratio of principal and interest of 80 percent on the lease and loan portfolio calculated on a rolling twelve month basis;

- (b) The value of non-performing leases and loans less cumulative provisions shall not at any time exceed 30 percent of the shareholders' funds of the company;
- (c) A minimum after tax profit equivalent to 9 percent p.a. on average shareholders' funds;
- (d) A maximum debt equity ratio of 8:1;
- (e) Compliance with the minimum risk weighted capital adequacy ratio in accordance with measures prescribed by the Central Bank of Sri Lanka or the Basel Committee on Banking Supervision appointed by the Bank of International Settlements (BIS);
- (f) Credit exposure (leases and loans) to any one party or to any one group of companies should not exceed:
 - 15 percent of the PCI's total lease rentals receivable, and
 - 25 percent of the shareholders' funds.
- (g) Credit exposure (leases and loans) to any one sector, as defined in the UN Standard Classification of Economic Activities, must not exceed 30 percent of the PCI's total credit portfolio;
- (h) Lease receivables at fixed interest rates which are financed by loans at variable interest rates shall not at any time exceed 50 percent of the shareholders' funds;

Compliance with pertinent laws and regulations regarding capital adequacy, classification of assets, non-accrual of interest and provisioning, exposure limits, etc.

In the absence of relevant regulatory framework, merchant banks or leasing companies that wish to participate in the Credit Program should adopt and comply with their own financial policies acceptable to IDA, which might be tighter than the eligibility requirements listed in paragraph (4) above. A confirmation from external auditors acceptable to IDA that, at the date of its application for participation and subsequently at the end of its each financial year, the credit institution is in full compliance with its own financial policies. Any changes in financial policies of these institutions would be subject to prior review and approval by IDA.

D. For Micro Finance Institutions

Micro finance institutions may extend sub-loans only to off-grid village based renewable energy power projects and solar home systems listed in paragraph 12, Part 1 of the Operating Guidelines.

A confirmation from external auditors acceptable to IDA that, at the date of its application for participation and subsequently at the end of its each financial year, the micro finance institution met the following financial criteria, ratio requirements and exposure limits calculated in accordance with IDA standard guidelines:

- (a) Minimum loan collection ratio of 92 percent
- (b) At least 10,000 borrowers with strong expansion potential
- (c) At least Rs100 million in Accumulated Fund (including foreign grants)
- (d) Maximum debt/accumulated fund ratio of 3.5 times
- (e) Minimum liquidity ratio (liquid assets to deposits) of 20 percent
- (f) Minimum current ratio of 1.5 times
- (g) Minimum capital adequacy ratio of 20 percent
- (h) Minimum debt service cover ratio of 1.25 times
- (i) Minimum rate of return on capital of 2 percent

A five-year successful track record, substantiated by written confirmation by external auditors acceptable to IDA, of running a successful micro-credit programme is also required.

In the absence of relevant regulatory framework, micro finance institutions that wish to participate in the Credit Program should adopt and comply with their own financial policies acceptable to IDA, which might be tighter than the eligibility requirements listed in paragraph (4) above. A confirmation from external auditors acceptable to IDA that, at the date of its application for participation and subsequently at the end of its each financial year, the credit

institution is in full compliance with its own financial policies. Any changes in financial policies of these institutions would be subject to prior review and approval by IDA.

E. For registered Finance Companies

These criteria shall apply to any registered finance company coming under the purview of the Finance Companies Act No. 78 of 1988 and subsequent amendments made from time to time.

Registered finance companies may extend sub-loans only to off-grid village based renewable energy power projects, solar home systems and energy efficiency, conservation and demand side management investments listed in paragraph 12, Part 1 of the RERED Operating Guidelines.

A confirmation from external auditors acceptable to IDA that, at the date of its application for participation and subsequently at the end of its financial year, the credit institution met the following financial criteria, ratio requirements and exposure limits calculated in accordance with IDA standard guidelines:

- (a) A minimum total cash collection ratio of principal and interest of 80 percent on the lease and loan portfolio calculated on a rolling twelve month basis;
- (b) A maximum net non-performing asset ratio of 15 percent, computed using the definition of Central Bank of Sri Lanka (CBSL) for classification with any specific provisions netted off in both the numerator and denominator of the ratio;
- (c) The value of non-performing leases and loans less cumulative provisions shall not at any time exceed 30 percent of the shareholders' funds of the company;
- (d) A minimum after tax profit equivalent to 9 percent p.a. on average shareholders' funds;
- (e) A maximum debt to equity ratio of 8:1;
- (f) Compliance with minimum capital adequacy ratios for tier-1 and tier-2 as required by prevailing guidelines of CBSL or the Basel Committee on Banking Supervision;
- (g) Credit exposure (loans and leases) should not exceed:
 - 15 percent of the PCI's total loan and lease rentals receivable for a single party or a group of corporate or unincorporated borrowers
 - 10 percent of the PCI's capital funds for a single party, and
 - 15 percent of the PCI's capital funds for a group of corporate or unincorporated borrowers
- (h) Credit exposure (loans and leases) to any one sector, as defined in the UN Standard Classification of Economic Activities, must not exceed 30 percent of the PCI's total credit portfolio;
- (i) Proportion of liquid assets to deposits received to be a minimum 15 percent, as defined in the CBSL Directions and Section 46 of the Finance Companies Act No. 78 of 1988.
- (j) Corporate governance measures: (i) The Board of Directors to include at least one independent non-executive director, and (ii) The company to have an Audit Committee, headed by a non-executive director.

Registered finance companies that wish to participate in the Credit Program should also adopt and comply with all directions and rules issued under the Finance Companies Act No. 78 of 1988 which may be more stringent than the eligibility requirements listed above. A confirmation from external auditors acceptable to IDA that, at the date of its application for participation and subsequently at the end of its each financial year, the credit institution is in full compliance with the aforesaid directions and rules shall be furnished.