



Financial Solutions: Partial Risk Guarantee

Finance, Economics & Urban Development Department
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November 2003

World Bank provides IBRD Enclave Guarantee to Cross-Border Southern Africa Regional Gas Project

The World Bank provided its first enclave partial risk guarantee (PRG) for Mozambique in support of the **Southern Africa Regional Gas Project** (the Project or SARG). The project met the requirement for an enclave project, as an exported-oriented, commercial project expected to generate foreign-exchange outside of Mozambique, an IDA-only country. This is also the first guarantee applied to a cross-border transaction and denominated in South African Rand. The success of the transaction is expected to promote other regional private sector infrastructure investments in Africa.

Background

Natural gas was first discovered in Mozambique in 1956 in the Temane field, followed by the discovery in 1961 of the Pande field. The gas fields are located in the Inhambane province in central Mozambique. By 1970, the potential for Mozambican gas in Southern Africa was becoming apparent. However, years of regional conflict, civil war and political turmoil in both South Africa and Mozambique prevented the gas from being utilized for the benefit of the region. The return of political stability in the 1990's and the focus on peace and development in Mozambique allowed the private sector to refocus on developing the gas potential in Mozambique.

The World Bank support for the Mozambique gas sector began in 1994 when IDA credit was provided to support: (i) Pande gas field delineation to prove the adequacy of reserves for commercialization; (ii) negotiation of agreements for commercialization of Pande/Temane gas field with investors; and (iii) initiation of the process of strengthening Mozambique's gas sector institutions to enable them to pay a substantial role in future gas operations. Work on this ambitious project commenced in earnest in 1996, when Sasol acquired the exploration and development rights to the Temane and Pande fields from Arco and Enron respectively.

Project Overview

The Southern Africa Regional Gas Project is a Mozambique-South Africa natural gas development and pipeline project. The project comprises of two individual but fully integrated sub-projects. Firstly, the development of the Pande and Temane gas fields in Mozambique and the construction of a central processing facility, together the "upstream project", and secondly, the construction of the 865km pipeline to transport the gas to Sasol's Secunda plant in Mpumalanga, South Africa, the "pipeline project." The gas fields at Temane and Pande have a proven reserve capacity of 2.6 trillion cubic feet (tcf). The proven reserves are sufficient to supply the pipeline for a minimum of 25 years from first gas.

The second component of the upstream project is the central processing facility. Here, gas from the fields is cleaned and compressed before delivery to the inlet flange of the pipeline. The central processing facility is situated approximately 600 km north of Maputo. The gas is then transported along an 865km route through a 660mm high-pressure steel transmission pipeline to Sasol's petrochemical complex at Secunda. The gas pipeline is buried at depth of 1 meter and has an initial uncompressed capacity of 120 MGJ per annum. The pipeline however has been designed to allow gas flow to be doubled with the installation of mid-and quarter point compression. A length of 531 km of the gas pipeline is located in Mozambique and 334km is located in South Africa.

The Mozambican gas is imported to South Africa by Sasol, the Project's private sponsor to: (i) replace the hydrogen-rich gas produced from coal by natural gas; (ii) convert Sasol's Sasolburg chemical complex from coal to gas as feedstock for chemical production; and (iii) modification of Sasol's synthetic fuel plant in Secunda to augment coal-based growth in the production of petroleum and petrochemicals.

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Contractual Framework

The Project is implemented under a series of contractual agreements between Government of Mozambique (GoM), Government of South Africa, ENH (Empresa Nacional de Hidrocarbonetos de Moçambique), Sasol Limited and its subsidiaries. These agreements include the Petroleum Production Agreement (PPA), the Pipeline Agreement (PA), the Joint Operation Agreement (JOA), the Gas Sales Agreement (GSA) and the Gas Transportation Agreement (GTA).

Petroleum Production Agreement. Under the PPA, GoM grants to SPT (Sasol Petroleum Temane Limitada) and CMH (Companhia Mocambicana de Hidrocarbonetos) the exclusive rights for the development, production and disposition of the reserves located in “the Petroleum Production Area” in the Pande and Temane Field Reservoirs for a period of at least 30 years.

Pipeline Agreement. Under the PA, GoM authorizes ROMPCO (Republic of Mozambique Pipeline Investments Company) to construct, own and operate the gas pipeline and related infrastructure and equipment to transport natural gas for a period of at least 30 years.

Joint Operation Agreement. Under the JOA, CMH and SPT have agreed to sell natural gas jointly on terms set out in the Gas Sales Agreement and, if jointly produced, to sell condensate jointly on terms to be negotiated in good faith between them.

Gas Sales Agreement. The GSA regulates the commercial relationship between the Sellers, SPT and CMH, and the Buyer, Sasol Gas Limited, a Sasol Limited subsidiary. The supply period shall be at least 25 years. The GSA guarantees a revenue stream for the Sellers through a take or pay obligation of the Buyer set at 80% of the annual contract volume ramping up to 120 MGJ/a over four years.

Gas Transportation Agreement. The GTA secures revenue stream for ROMPCO through a ship or pay set at 80% of contract volume ramping up to 120 MGJ/a over four years. The GTA period is set for 25 years.

Under the Project contractual arrangements (see Figure 1), Sasol Limited is the primary sponsor of the Project from gas field development to the end user sales in South Africa. Sasol Limited (through its subsidiary SPT) is one of the sellers (jointly with CMH, a subsidiary of ENH), the operator of the upstream (fields and CPF) for both the parties, the transporter (through its subsidiary ROMPCO¹), the operator of the pipeline (through Sasol Gas) and the buyer (through Sasol Gas). Given Sasol Limited’s extensive involvement in the project, the

¹ The Governments of South Africa and Mozambique have options to purchase shares in ROMPCO.

company provides corporate support for the financing with a carve-out for Mozambique political risks which are largely assumed by others project participants.

Project Cost and Financing

The financing involves three tranches lead by the Standard Bank of South Africa, Development Bank of Southern Africa (DBSA) and European Investment Bank (EIB) (see Figure 2). The financing is further split between the upstream project and the downstream cross-border pipeline company. All tranches of debt share the 12-year tenor, with the potential for a two-year extension. Due to weather constraints for pipeline construction, the need for the gas at the Sasol plant, and the complexity of the transaction, Sasol financed the construction via bridge loans while long-term financing were arranged. The natural gas project reached financial close on its 12-year R3.692 billion debt package on March 15th 2004 while first gas arrived in Secunda on February 23rd.

The financing structure is a hybrid of a corporate loan and project financing. In terms of the structure, Sasol provides full debt service support to the two project companies. This support takes the form of a debt service support agreement in terms of which Sasol stands behind the repayment obligations of the project companies. In essence, the lending is a full recourse corporate loan with Sasol assuming all project related risks. Mozambican political risk, however, is a risk over which Sasol has no control. As such, this risk is carved out of the Sasol debt service support to the lenders. The risk is assumed by the lenders and in the case of the commercial lender, political risk coverage providers.

The first tranche of the debt was led and underwritten by the Standard Bank of South Africa representing R1.46bn of commercial debt. An amount of R1.05 billion was advanced to ROMPCO and an amount of R410m was advanced to SPT. The political risk coverage was provided by the World Bank through the enclave partial risk guarantee, MIGA (partially reinsured by Sace of Italy and EFIC of Australia) and Export Credit Insurance Corporation of South Africa (ECIC). The Standard Bank tranche is based on Sasol corporate credit for commercial risks. The Mozambican political risks have been carved out from Sasol corporate support and are covered by political risk coverage providers. The political risk coverage on the SCMB commercial tranche is split as follows:

- (i) ECIC, the South Africa export credit agency, is guaranteeing R 80m of the upstream and R350 m of the downstream.
- (ii) MIGA is covering R190m of the upstream and R630m of the downstream. Of the downstream MIGA guarantee, R310m is being reinsured,

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on an even split of R 155m each by SACE of Italy and EFIC of Australia.

- (iii) The World Bank partial risk guarantee covers R140m of the upstream and R70m of the downstream.

The second tranche of the debt is R1.47bn from developing financial institutions. The second tranche receives the same Sasol debt service support as first tranche of commercial debt. However, the lenders are assuming Mozambican political risks on their own account. The participants of this second tranche are DBSA with R300 for the upstream and R350 m for the downstream, the African Development Bank with R350m for the upstream and R200 m for the downstream and R270 m-equivalent, split equally between Proparco of France, DEG of Germany and FMO of the Netherlands– all for the upstream.

The third tranche is provided by the European Investment Bank for the downstream project. The EIB tranche comprises of two separate sub-tranches of R381 m each. Under one sub-tranche, EIB received a full Sasol guarantee, where Sasol in effect is assuming all project risks including Mozambican political risk. While for the other sub-tranche, EIB assumes the Mozambican political risk with recourse to Sasol via the debt service support agreement for the commercial risks.

The Enclave Partial Risk Guarantee

Mozambique is an IDA-only country and hence eligible for financing under concessionary terms. The partial risk guarantees extended to this project, however, is backed by the IBRD resources because the transaction met the requirements for an enclave project as all the revenue will be generated in Rand, the project company receives revenue outside of Mozambique and makes debt service payments from accounts outside of Mozambique. The use of IBRD resources to back the enclave guarantee would preserve for Mozambique the concessionary financing from the IDA window.

IBRD as a guarantor provided not only direct enhancement but also comfort to the other financing agencies for a project with complex web of contractual arrangements with GoM. The Bank guarantee was the only instrument in the financing package which was backed by an Indemnity Agreement with the GoM under which Mozambique counter guarantees IBRD for any payments made under the IBRD Guarantee. This direct linkage between the Bank and GoM would facilitate Bank engagement to forestall a political risk related default.

The PRGs provided risk coverage for commercial financings led by SCMB: R140 m for SPT and R70 m for ROMPCO. The Bank exposure is capped at US\$20 m and US\$10 m for SPT and ROMPCO respectively. The PRGs would cover debt service defaults resulting from a breach by the GOM of specified obligations as set forth in

the PPA and the PA, respectively. The PRGs cover:

(i) changes in law in Mozambique including the petroleum law and regulations that would have the effect of making the Project agreements (i.e., PPA and PA) unenforceable or having material adverse effect;

(ii) failure by GoM to expeditiously award licenses, permits, approvals, company registration, expatriate permits, land use rights necessary to finance, develop and transport gas; to enforce licenses terms (length of period, renewal terms), exclusivity terms, stabilization clauses, free access to pipeline corridor, environmental accords, appointment of management committee members, regulatory authority approval, and to abide by land use and access rights;

(iii) expropriation; and

(iv) (currency transferability relating to repatriation of funds that maybe located in Mozambique

Given the risk coverage for SPT and ROMPCO relates to government obligations under different agreements, there are two separate guarantee agreements with the commercial lenders defining the scope of the IBRD's risk coverage and the trigger mechanisms of the guarantee. There are two separate Project Agreements between the Bank, SPT and ROMPCO respectively and Sasol Limited as the corporate parent. Under the Project Agreements, the companies covenant that they comply with World Bank environmental guidelines and other applicable requirements. In parallel, IBRD and Mozambique concluded the Indemnity Agreement backstopping the Bank's exposure under the Project Agreements.

Benefits of the Guarantee

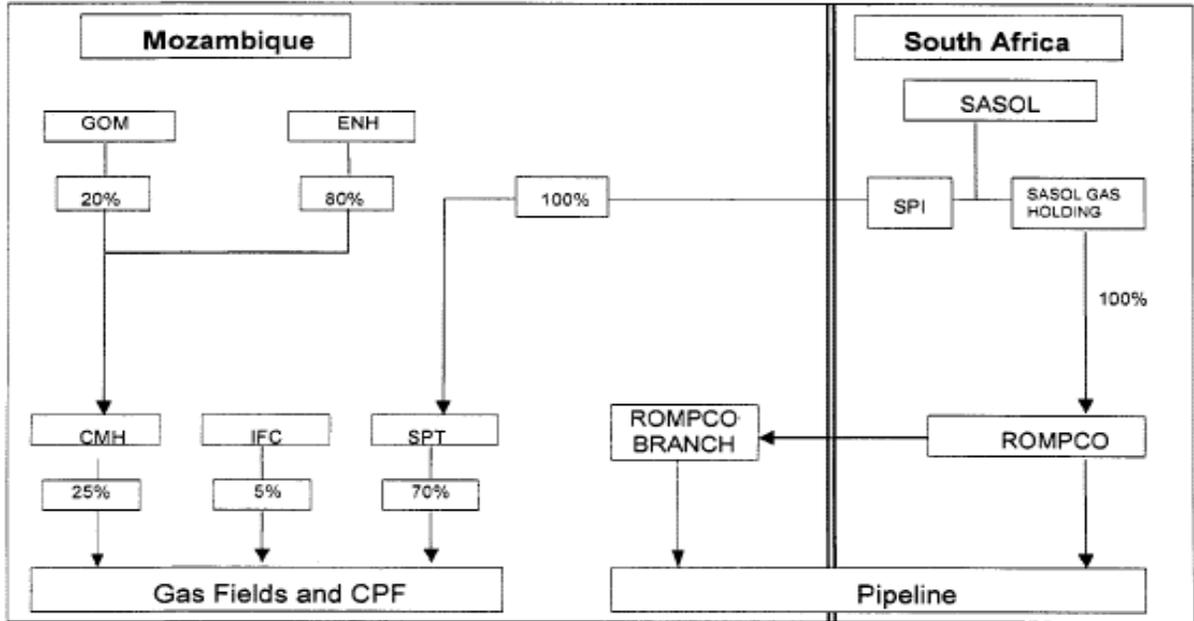
- The IBRD guarantees helped Mozambique in realizing its gas potential by mobilizing private financing to supplement the official financing that assumed Mozambique political risks.
- The transaction provided Mozambique with equity participation in the gas fields, central processing facility and pipeline and with royalty and tax payments.
- The guarantees' involvement in transaction provided environmental and resettlement review of complex project that benefited the other project participants.
- The enclave guarantee used IBRD balance sheet and did not use IDA concessionary lending to Mozambique

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"The Governments of South Africa and Mozambique together with Sasol have demonstrated what can be achieved in SADC when governments and the private sector cooperate. Cross border infrastructure projects such as this one goes a long way towards the provision of much needed infrastructure."

Ms. Phumzile Mlambo-Ngcuka, South African Minister of Minerals and Energy

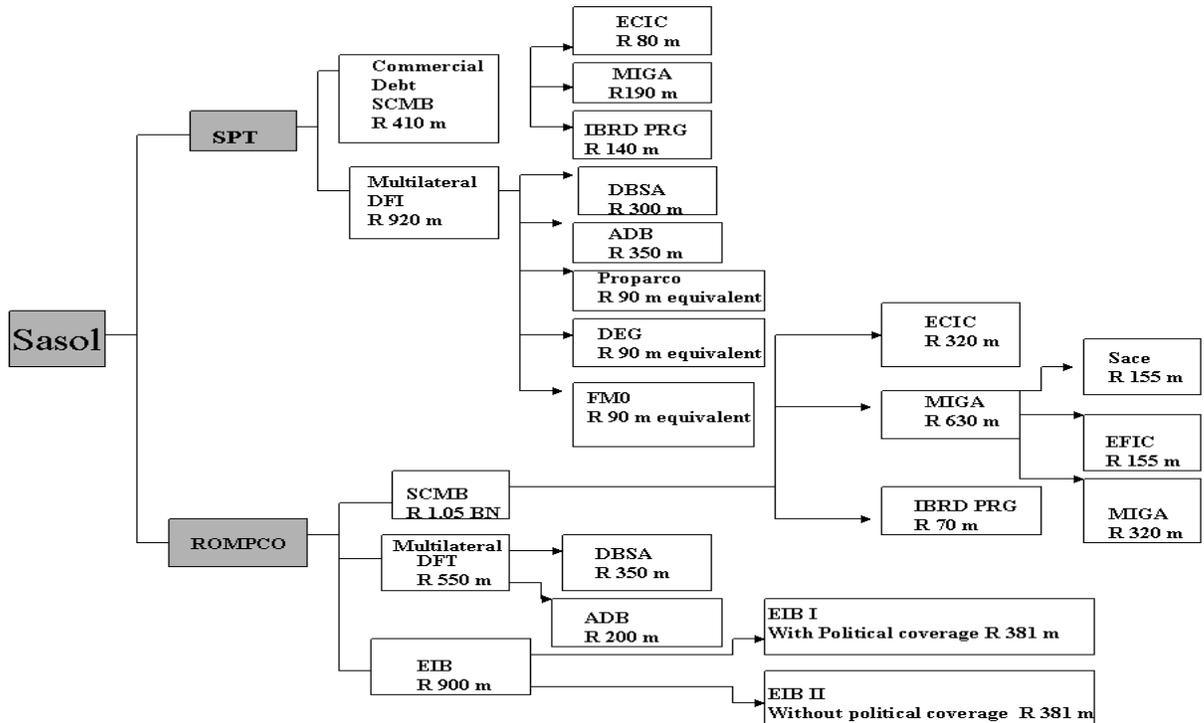
FIGURE 1 – Project Ownership and Implementation Structure²



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Mr. Alec Erwin, South African Minister of Trade and Industry

FIGURE 2 –Financing Plan



For more information on the World Bank Guarantee program please visit our web site www.worldbank.org/guarantees or contact: Upali Perera at (202) 458-2801, by email at uperera@worldbank.org

² At the time of World Bank Board in November 2003