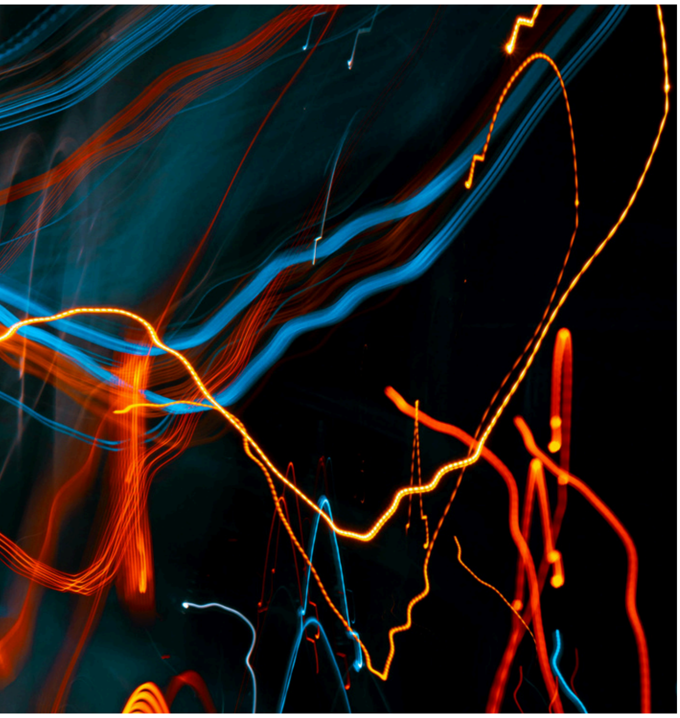

ZAMBIA'S ENERGY SECTOR:

ENERGY SERIES

Reimagining Bankability: Zambia's Response to the Energy Crisis

(This is the first article in our series on Zambia's energy sector.)

Just two years ago, Zambia's energy sector faced one of its most significant challenges in recent history. A severe drought exposed the vulnerabilities of a power system heavily dependent on hydropower generation, resulting in widespread load shedding and growing concerns regarding the country's ability to meet future energy demand. The crisis also brought renewed attention to a longstanding issue within Zambia's power sector: bankability.

The central concern for investors and lenders was the creditworthiness of the primary off taker within the Zambian market. Project revenues were largely dependent on a single buyer model, resulting in financiers placing significant emphasis on payment security arrangements and the availability of government backed support mechanisms.

This challenge was further exacerbated by Zambi"s sovereign debt restructuring programme. As part of the broader fiscal reforms being implemented under the IMF supported programme, the Government's ability to provide sovereign guarantees and assume additional contingent liabilities became increasingly constrained. Consequently, many of the traditional credit enhancement mechanisms relied upon by lenders to mitigate utility payment risk were either unavailable or significantly more difficult to procure, creating additional hurdles to achieving financial close for new power projects.

However, the energy crisis appears to have accelerated a fundamental shift in how the market approaches bankability.

A New Approach to Bankability

In order to address the hurdles of achieving bankability, there appears to have been a gradual diversification of the market and the emergence of alternative pathways to bankability.

One of the most significant developments has been the increasing willingness of large industrial consumers, particularly mining companies, to procure power outside traditional supply arrangements. Faced with growing energy requirements and concerns regarding supply reliability, many mines and industrial users have become active participants in the power market. Corporate power purchase agreements, bilateral supply arrangements and private generation solutions are becoming increasingly common.

From a lender’s perspective, this creates new opportunities. Many mining companies possess strong balance sheets and international credit profiles that compare favourably with traditional utility offtakers. The availability of alternative offtakers broadens the pool of potential buyers and improves the overall risk profile of projects.

Implementation of open access reforms

The introduction of frameworks that permit third party access to transmission infrastructure has created greater flexibility within the market. Independent power producers are increasingly able to explore opportunities to supply power directly to eligible customers while utilising existing transmission networks.

While challenges remain regarding wheeling arrangements, transmission capacity and cost allocation, the broader direction of travel is clear. Zambia is moving towards a more diversified and competitive electricity market where power can flow to the customers that need it most.

Emergence of energy traders

Energy traders have assisted in sourcing power from regional markets, managing supply portfolios, aggregating demand and providing commercial solutions during periods of generation shortfall. Their participation has helped bridge the gap between buyers and sellers, particularly during times of market stress.

Importantly, traders have introduced additional liquidity into the market. Rather than relying exclusively on a single utility or a limited pool of buyers, generators increasingly have access to multiple routes to market. This diversification reduces concentration risk and provides greater confidence to investors evaluating project revenues.

The growing sophistication of regional electricity trading is also strengthening the role of the Southern African Power Pool, enabling Zambia to participate more actively in regional energy markets and benefit from cross border power flows.

It should be noted that notwithstanding the above highlighted solutions, Zambia has not completely solved its bankability challenges. Utility reform remains important. Continued investment in transmission infrastructure will be necessary to support future growth. Cost reflective tariffs, payment security mechanisms and regulatory certainty remain critical considerations for investors and lenders.

Nevertheless, Zambia's response to the energy crisis demonstrates that bankability is not solely determined by the financial position of a national utility but rather, has shown that there are numerous other models that can be adopted to achieve bankable projects within the country.

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