Public-Private Partnership Stories

Indonesia: Central Java IPP


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The demand for electricity in Indonesia has grown quickly in the last decade. Facing greater consumption by industry, increasing residential demand, and a push to bring electricity to rural areas, the government aims to dramatically expand power generation and transmission capacity. In 2005, it designated a proposed new coal-fired power plant in Central Java as a top priority and moved to implement new regulations to attract private investment. IFC was transaction advisor in this project, which will use the cleanest commercial coal-fired generation technology available.

A consortium consisting of J-Power, Itochu Corporation and Adaro Power won the bid for a 25-year contract to build, own, operate and transfer the new facility, which will use ultra-super critical technology. The project includes a 2,000 MW power plant and transmission facilities which are expected to improve access to electricity to 7.5 million people and mobilize $3.5 billion in investment. The project was the first to be implemented under the country's new PPP and guarantee regulations, laying the groundwork for future private infrastructure projects. The agreement was signed in October 2011. The plant is expected to start operations in 2016.

This series provides an overview of public-private partnership stories in various infrastructure sectors, where IFC was the lead advisor.

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The project was implemented with the financial support of DevCo, a multi-donor facility affiliated with the Private Infrastructure Development Group. DevCo provides critical financial support for important infrastructure transactions in the poorest countries, helping boost economic growth and combat poverty. DevCo is funded by the UK's Department for International Development (DFID), the Austrian Development Agency, the Dutch Ministry of Foreign Affairs, the Swedish International Development Agency, and IFC.

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BACKGROUND

Indonesia's economic recovery following Asian financial crisis in 1997 led to a large increase in the demand for power, both for industrial and residential use. In 2005, demand for electricity was expected to grow by over eight percent per year. The government of Indonesia estimated that $31.4 billion in investments would be required to meet the country's power needs by 2013.

In response, the government sought to dramatically increase power generation capacity in the country, in part by encouraging private sector investment. But issues with risk allocation and government support to backstop the single offtaker's payment obligations resulted in very few financial closings. Furthermore, PLN, the state-owned energy corporation responsible for most of the country's power generation, transmission and distribution, had suffered financial difficulties in the Asian currency crisis of the late 1990s and had been unable to make payments to independent power producers (IPPs).

In 2005, the government organized the Indonesia Infrastructure Summit to encourage the use of public-private partnerships (PPPs) in infrastructure, and identified the Central Java IPP, a proposed 2,000MW greenfield coal-fired power plant, as one of ten model infrastructure projects.

IFC'S ROLE

IFC provided advice to the PLN to structure and implement a PPP to find a private-sector investor through a transparent, competitive tender process in a difficult business environment. IFC's input included the following:

- Thorough technical, legal, environmental and financial due diligence to identify key transaction issues;
- Coordinating with and supporting the government on developing a risk management and guarantee frameworks for the power sector;
- Preparing and supporting negotiations for the power purchase agreement (PPA) and related agreements to efficiently allocate risk;
- Addressing technical issues, which included supercritical and ultra-supercritical technology, system planning and stability and environmental standards;
- Working with key stakeholders to revise PPP and guarantee legislation;
- Supporting the bidding process through closing.

As a neutral broker, IFC worked with key stakeholders, including the PLN, the National Development Planning Agency (BAPPENAS), the Ministry of Finance, and the newly-established Indonesia Infrastructure Guarantee Fund (IIGF) and qualified potential investors to structure a bankable transaction.

TRANSACTION STRUCTURE

IFC recommended structuring the transaction as a 25-year build, own, operate and transfer (BOOT) project. Under this arrangement, at the end of the contract period, the operator will transfer the plant to PLN, which will run it for the remainder of its useful life (a minimum of 40 years). IFC also proposed a risk allocation structure in the PPA to maximize bankability of the IPP while minimizing the risks to PLN.

Since the government sets retail electricity tariffs and PLN receives state subsidies, a guarantee scheme was required to manage offtaker payment risk for the IPP. The government introduced a new guarantee scheme with participation from the IIGF and supported by revised regulations.

IIGF and the government, acting through the Ministry of Finance, provided a guarantee to the project to cover payment defaults and termination payments under required buyout scenarios. This was executed through a single guarantee agreement supported by recourse agreements to provide for reimbursement by PLN for claims made under the guarantee.

BIDDING

Interest in the project was strong, with about 30 firms expressing interest and [15] requesting pre-qualification documents. Seven consortia were pre-qualified based on their technical and financial strength.

Of these, four consortia—Itochu (Japan), J-Power (Japan), Shenhua (China), and Guangdong Yudean (China) —submitted bids in April 2011. The winner, a consortium between J-Power, Itochu Corporation and Indonesia's Adaro Power, was the lowest bidder for the price of electricity among those who met administrative and technical criteria. The consortium was awarded the project in June 2011.

The project agreements, including the PPA and the Guarantee Agreement for the Central Java IPP project, were signed in October 2011.

EXPECTED POST-TENDER RESULTS

- The project will bring improved electricity services to 7.5 million people in Java, the most densely populated island in Indonesia.
- Upon financial close, the investment will mobilize $3.5 billion in foreign direct investment (both debt and equity).
- The project contributes to the Indonesian government's policy to rapidly expand power generating and transmission capacity.
- The guarantee mechanism and revised PPP regulations will pave the way for future PPPs in infrastructure in Indonesia, bringing much-needed investment to the sector.

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