PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA2482

Project Name	Kabeli-A Hydro Electric Project (P122406)
Region	SOUTH ASIA
Country	Nepal
Sector(s)	Other Renewable Energy (100%)
Theme(s)	Infrastructure services for private sector development (100%)
Lending Instrument	Specific Investment Loan
Project ID	P122406
Borrower(s)	Kabeli Energy Limited
Implementing Agency	
Environmental Category	A-Full Assessment
Date PID Prepared/Updated	27-Oct-2013
Date PID Approved/Disclosed	15-Oct-2013, 28-Oct-2013
Estimated Date of Appraisal Completion	18-Oct-2013
Estimated Date of Board Approval	23-Dec-2013
Decision	

I. Project Context

Country Context

Nepal is a land-locked country. Of its 26.5 million people, 24.8 percent live on less than US$1.25 per day, and 82 percent live in rural areas. Nepal has a per capita income of US$735. Despite a decade-long armed insurgency and protracted political transition, Nepal has made exemplary progress in poverty reduction and human development. Poverty is much more severe in rural areas (27 percent of the population) compared to urban areas (15 percent) and particularly severe in mountainous areas (42 percent). Nepal attained the first Millennium Development Goal, to halve extreme poverty, ahead of time. In 2011 Nepal ranked 157 in the world in the Human Development Index. In addition, Nepal has achieved gender parity in education and sharp reductions in infant and maternal mortality.

In the process of transition from conflict to peace, a constituent assembly (CA) was established to issue a new constitution by May 2012 but reached the end of its mandate without agreeing a constitution. After almost a year, the four largest political parties in March 2013 agreed to establish a technocratic interim administration mandated to undertake elections for a new CA; the election date has since been set for November 19, 2013.

Economic growth is projected to reach 3.6% in FY13, significantly below the 4.8% achieved on

average over 2008-2012. This slowdown has resulted from reduced public spending, particularly for infrastructure; low levels of private investment, due to power outages, labor issues, policy inconsistency, and political uncertainty; strong linkages to and slow growth in the Indian economy; as well as a disappointing monsoon and depressed agricultural growth.

Sectoral and institutional Context

As per national census published in 2013, about 75 percent of the population in Nepal has access to electricity (grid and off-grid), with a significant disparity between urban (90 percent) and rural Nepal (30 percent). Individual consumption remains very low at about 70 kWh per capita, even for urban Nepal, compared to 733 kWh for India and 2,600 kWh for China. While the country is endowed with huge hydropower potential relative to the size of the population, about 84,000 MW theoretically and 43,000 MW economically exploitable, the installed hydropower generation capacity as of July 2013 is merely 746 MW, of which 704 MW is grid-connected.

Most of the hydropower plants are of run-of-river type and thus the available generating capacity is low during dry seasons when the system demand is high. This deficit of electricity has resulted in load shedding up to 18 hours a day in 2012 and is a fundamental obstacle to economic and human development.

Nepal Electricity Authority (NEA), a vertically integrated power utility, is in net loss in electricity services and heavily indebted. NEA's financial position has deteriorated sharply in recent years, as the result of high system losses (26.4 percent) and high costs and the insufficient increases in retail tariffs, among other factors. Under the prevailing conditions, NEA is neither able to generate financing required to invest in generation, transmission and distribution infrastructures nor serve its debts.

The country suffers from chronic under investment in the power sector. Since 2002, almost no transmission line has been built and only 92 MW added to the system. Given the poor financial performance of the public sector, large scale private investments in hydropower development are expected.

While successive governments in Nepal have expressed firm commitment in attracting private sector investments in hydropower, financial and implementation constraints have limited Government's ability to provide the common infrastructure (roads and transmission corridors) needed to foster hydropower development. The rationale for public development of such infrastructure is compelling as they generally bring high economic returns but are not financial viable for individual projects to bear the costs. In addition, slow progress was made in policy and procedures development for risk sharing mechanism, procedural streamlining, regulatory improvements and structural reforms. In some parts of the country, disputes on land and law-and-order problems also disrupt and discourage investments.

Rationale for Bank Involvement

The proposed Project is consistent with GON's strategy to deal with the current crisis in the energy sector and to attract private investments in hydropower generation in Nepal. It is consistent with the goals of the first pillar of the joint IDA/IFC Interim Strategy Note (ISN, FY12-13), "Enhancing Connectivity and Productivity for Growth" and is included in the ISN. The ISN stressed the

importance of alleviating infrastructure bottlenecks in energy and other infrastructure sectors. The prepared project is also aligned with the priorities of the new country partnership strategy, currently under preparation.

Without IDA financing and the CCCP loan at concessional terms, the project return will not be able to attract the expected private investment. The project is the first hydropower project bid out to private developer in 2008 based on the lowest tariff proposal. The project return on equity becomes marginal given the project cost escalation over the past five years. If successful, the project will demonstrate the viability of future hydro power projects through proper public private financing arrangement and attract investors and financiers to the country and the sector.

This proposed project is in line with IFC's strategic priority on climate change. It also meets the core principles that guide IFC's approach to deploying concessional finance as articulated in the Board Paper "IFC's Approach to Blending Concessional Funds" (IFC/SecM2012-0009).

II. Proposed Development Objectives

The project development objective is to increase hydropower generation capacity of NEA grid through public private investment.

III. Project Description

Component Name

Kabeli-A Hydroelectric Project (KAHEP) Component (USD 102.08 million)

Comments (optional)

The KAHEP Component will support construction of the proposed project. This component will be implemented by the project company KEL.

Component Name

Ministry of Energy (MOE) Component (USD 2.0 million)

Comments (optional)

Support MOE to: (i) supervise KAHEP to ensure compliance with the PDA, EMP and SAP; (ii) technical, environmental and social safeguards capacity building; and (iii) cover incremental operating cost.

Component Name

The Investment Board of Nepal (IBN) Component (US$4.0 million)

Comments (optional)

Support IBN to: (i) review and supervise large sized hydropower projects; (ii) technical, environmental and social safeguards capacity building; and (iii) cover incremental operating cost.

IV. Financing *(in USD Million)*

Total Project Cost:	108.08	Total Bank Financing:	46.00
Financing Gap:	0.00		

For Loans/Credits/Others	**Amount**
BORROWER/RECIPIENT	22.96
International Development Association (IDA)	40.00
IDA Grant	6.00

International Finance Corporation (IFC)	38.12
Local Sources of Borrowing Country	1.00
Total	108.08

V. Implementation

As the owner/operator of the proposed project, KEL is responsible for implementation of the KAHEP Component. The Department of Electricity Development (DOED) of MOE will be responsible for executing the MOE Component. The HIDCL will facilitate the on-lending of the IDA funds to KEL.

Institutional and Implementation Arrangements

Legal Arrangement. GON and IDA will enter into a Financing Agreement based on standard IDA loan terms. The Financing Agreement will define the obligations of DOED in implementing the MOE Component. GON will enter into a HIDCL Subsidiary Agreement with HIDCL which will detail the arrangement for flow of funds and relevant terms and conditions under which GON will provide funds to HIDCL for on-lending to KEL. HIDCL and KEL will enter into a KEL Subsidiary Agreement. The key terms and conditions for KEL subsidiary agreement have already agreed and approved through a cabinet decision. The terms and condition of HIDCL subsidiary agreement will be same as KEL subsidiary agreement. HIDCL would not assume any kind of risk while lending IDA funds to KEL. It is confirmed from the Ministry of Finance (MOF) that HIDCL will received fees from GON for managing IDA funds. The fee will be based on resource requirement for HIDCL to manage such funds. IDA and KEL will conclude a Project Agreement to define the key obligations of KEL in implementing the KAHEP Component.

KAHEP Component. KEL was established with majority-owned by BPC (Nepal) – 51%, together with Gurans Energy Limited (Nepal) – 44% and Asia Pacific Tech. Co. Ltd. (China) – 5%. It is solely for the purpose of developing, building and operating the KAHEP, which was awarded by the GON to KEL under a 35-year concession through a PDA signed on January31, 2010.

KEL is responsible for all aspects of project implementation, including design, hiring contractors and consultants and managing contract execution; implementation of the EMP and SAP; communications with PAPs and civil society; payment of contractors and financial management; monitoring, reporting and evaluation etc.. KEL has established teams for technical, procurement, financing, safeguard and administrative work during the project preparation stage and will hire a site-based Project Team responsible for day-to-day management of the project construction, with support by staff at headquarters of KEL in Kathmandu. The site team will include a Project Manager, Senior Engineers, a Public Relations Officer and assistants, a Corporate Social Responsibility Officer, a Social and Environment Manager, Environmental Officer(s) and a Livelihoods Officer(s). The supportive staffs at headquarters in Kathmandu will include contract officers, procurement officer(s), a chartered accountant and assistants. Major contractors for surface civil works, underground works and supply and installation of equipment will be selected by KEL through international competitive bidding. KEL will hire an Owner's Engineer consisting of an international firm and the local engineering firm that has conducted the detailed project design, to supervise the project execution. A POE for implementation stage will also be engaged to advice on critical technical, environmental and social issues.

MOE Component. The DOED under MOE will implement this component related to the technical assistance and associated operating cost. The Secretary of Energy will have general oversight over the implementation of the component on behalf of the Ministry.

IBN Component. The IBN under the Prime Minister Office of GON will implement this component related to the capacity building and associated operating cost. The Board of IBN, chaired by the Prime Minister and consisting of representatives from different ministries, will have general oversight over the implementation of the component on behalf of the GON.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	×	
Natural Habitats OP/BP 4.04	×	
Forests OP/BP 4.36	×	
Pest Management OP 4.09		×
Physical Cultural Resources OP/BP 4.11	×	
Indigenous Peoples OP/BP 4.10	×	
Involuntary Resettlement OP/BP 4.12	×	
Safety of Dams OP/BP 4.37	×	
Projects on International Waterways OP/BP 7.50	×	
Projects in Disputed Areas OP/BP 7.60		×

Comments (optional)

VII. Contact point

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Implementing Agencies

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