

EVALUATION OF FMO'S RENEWABLE ENERGY PROJECTS IN FRAGILE AND CONFLICT-AFFECTED STATES

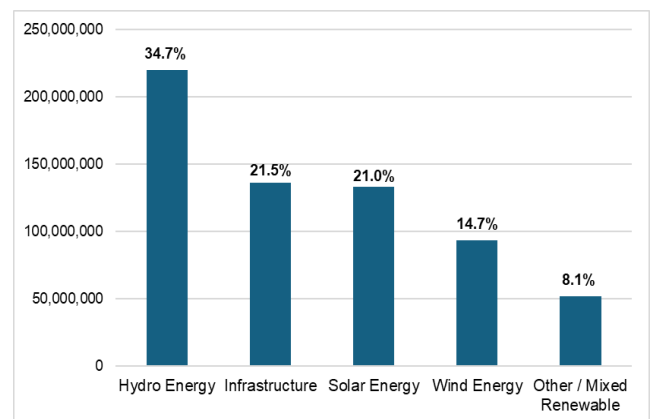
INTRODUCTION

FMO's strategic ambitions for 2030 include the objective to "invest more in LDCs and develop a Proof of Concept for successfully investing in Fragile and Conflict-affected States (FCS)". In this context, FMO has been exploring if and how to refine its approach for investing in FCS. FMO also committed to invest in the Renewable Energy (RE) sector, to contribute to the transition to low-carbon economies, while simultaneously widening access to energy. These strategic ambitions are anchored in FMO's commitment to the Sustainable Development Goals (SDGs), particularly 10 and 13.

FMO's RE investments are intended to enhance access to reliable and affordable energy, support inclusive economic growth, and mitigate climate change. Moreover, access to energy is key for peace and development, with energy poverty and fragility mutually reinforcing each other: More than three-quarters of the world's 800 million people without access to electricity live in FCS. At the same time, investing in FCS comes with higher financial, political, and operational risks, which require a carefully calibrated and holistic approach. FMO is therefore strengthening and harmonizing its investment framework for these settings, ensuring that projects are both impactful and resilient while safeguarding financial sustainability.

FMO so far, has built up a track record of investing in RE in FCS in Africa, Asia, Eastern Europe and Latin America. For direct RE investments in LDC/FCS FMO uses funds from its own balance sheet (FMO-A), in combination with government-funded vehicles. The total committed portfolio covered in this evaluation includes 39 customers across 15 countries, with a total value of about EUR 633 million, between 2012 and 2023. Investments where FMO-A is the sole participant dominate in terms of investment value, representing almost 60% of the portfolio (around EUR 370 million). FMO invests across most types of RE power plants (Hydro, Solar, Wind and others), and in transmission and distribution (T&D) infrastructure.

Total committed portfolio per type of RE project (EUR)



KEY CONCEPTS

Fragile and Conflict-affected Settings (FCS): FMO relies on the annual World Bank list of FCS which comprises countries with high levels of institutional and social fragility and countries affected by violent conflict.

Conflict sensitivity refers to the ability of organizations such as FMO to understand the context in which they operate and to act with awareness of how their activities interact with that context to minimize negative impacts and maximize positive contributions within fragile, unstable, or conflict environments. Conflict sensitivity is also relevant for areas experiencing social tensions, political instability, or historical inequalities and is relevant across all sectors, development, humanitarian aid, climate finance, governance, and private investment, especially if these interventions in some way touch upon issues of power or resources.

Do-No-Harm (DNH) is a broader ethical principle that guides how international engagements in conflict settings are conducted. DNH emphasises that external interventions should aim to limit or prevent any form of harm to the communities in which the intervention is conducted, and includes protection of beneficiaries, transparency, etc. It is normative and focuses on limiting or preventing harm, especially to avoid exacerbating conflict. Conflict sensitivity is a component of operationalising DNH, focused on analysis and adapting, especially focused on avoiding harm and negative consequences related to conflict.

When looking at FMO's total portfolio of investments in RE, 23,4% is in FCS. While this share is considerable, it should be noted that many of these investments were made in countries that were not classified as fragile or conflict affected at the time the investment was made. Some countries moved on and off the FCS list. When considering that Georgia, Ukraine and Armenia were not classified as FCS at the time of the investment, FMO's share of RE investments in FCS would be over 50% smaller.



THE STUDY

This evaluation, undertaken by Ecorys NL, covered the period from 2012 to 2023, encompassing both debt and equity instruments in on- and off-grid RE projects in FCS, and was commissioned to inform the ongoing work undertaken by FMO to refine its investment approach in FCS in line with the strategy 2030. Specifically, the evaluation:

- Identified lessons learned from investments in on- and off-grid RE projects in FCS.
- Compared the expected financial returns and development impacts with the actual achievements.
- Assessed the adequacy of FMO's internal procedures for such investments. This includes focusing on Do-No-Harm principles, conflict sensitivity, gender issues, and risk mitigation measures, and exploring ways to improve these procedures.

Methodology and approach

Data collection and analysis included interviews and workshops, a peer review of practices from other Development Finance Institutions (DFIs); three country (case) studies in Armenia, Burkina-Faso, and Nigeria, and desk-based review activities such as documentary and quantitative (portfolio) data analysis. In particular, the country (case) studies involved field work with customers and other stakeholders such as communities, other investors, civil society organisations and the Dutch Embassies.

FINDINGS

#1 Additionality: Strong evidence was found for additionality of FMO's RE investments, particularly financial additionality, in FCS, given the high perceived risks levels and the need for long return periods.

#2 Risks and Challenges: Investing in renewable energy (RE) in FCS presents both (potential) opportunities and significant challenges. Fragile contexts are marked by complex regulatory environments, underdeveloped energy markets and off-takers, volatile currencies, and recurring security concerns. Moreover, the evaluators assumed that without careful design, RE investments can risk exacerbating existing tensions or altering local dynamics in ways that may unintentionally contribute to conflict. However, in discussions with key informants, RE projects in FCS were perceived to present lower risks in comparison to alternative investment opportunities in FCS (for example, agribusiness projects). This is largely due to low electrification rates in FCS, coupled with often strong local demand for energy infrastructure, which is typically prioritised by national governments, and which reduces the offtake risk for FMO.

#3 Credit Risk: Despite the elevated risk profile, the proportion of RE debt investments in FCS that experience default events (on either interest or principal repayments) was found to be comparable to those in non- or less fragile markets. This is surprising given the challenges of investing in such countries. Often, collaboration between DFIs (pipeline sharing and co-investing, for example) enables investors to adopt a portfolio approach and spread their risks and achieve mutually beneficial outcomes.

#4 Development Outcomes: Development results beyond output level (e.g. Megawatts of solar power generated), such as access to energy, is hard to substantiate. For instance, electricity generated and delivered to the grid by an FMO-financed RE project is difficult to trace to specific end-beneficiaries. Hence, data is often modelled and not empirically assessed. Case study research, nevertheless, provided evidence of direct employment creation, and for off-grid solutions, examples of positive impact on livelihood opportunities. Such examples include the provision of cell phone charging services or cooling drinks following from access to solar power. In the case of energy generation, this link cannot be evidenced due to limited information on energy access and increased reliability of the grid.

#5 Community Engagement: In those cases where energy generation doesn't directly benefit local communities (because they are not yet connected to the grid and the project doesn't foresee that connection either), RE investments may negatively impact the context. The lack of such a benefit could lead to resentment from the local communities living close to the energy infrastructure.

Regular interaction with the local communities and a well-functioning grievance mechanism are key to addressing (potential) resentment from local communities. The evaluation found that FMO clients engage in community outreach and provide public goods for the benefit of local communities, such as health centres, solar power (e.g. streetlights) and boreholes, often in the absence of the government. Such measures are often labelled as corporate social responsibility measures and follow continuous consultations with the communities during which their concerns and demands are considered.

#6 FMO'S Approach towards FCS: This evaluation was commissioned to inform the ongoing work undertaken by FMO to refine its approach to investing in FCS. There is a growing understanding within FMO of the need to be conflict sensitive and ensure that investments are designed and implemented in a conflict sensitive manner. Currently, FMO's Human Rights Toolkit already offers some support for identifying conflict-related risks. The targeted Contextual Risk Assessment we are developing and piloting will allow for further granularity and strengthen our ability to proactively identify and anticipate on conflict sensitive risks in our investment process. Furthermore, conflict-sensitive investing will require a monitoring element for assessing countries at risk of becoming an FCS.

Drivers of success and failure

Based on discussions with FMO and staff from peer DFIs, **several enabling factors emerged as critical to the success of RE investments in FCS.** These include the experience and local knowledge of project developers, a supportive regulatory environment, a reliable off-taker (for on-grid investments), good community relations, as well as on-the-ground presence. Collaboration with other investors and the use of concessional finance were also found to have helped to manage risks and strengthen a project's viability.

CONCLUSIONS AND LESSONS LEARNED

WHAT WE LEARNED?

FMO has a sizeable portfolio of about EUR 633 million of RE investments in FCS, of which the majority is financed through its own balance sheet.

FMO is highly additional when investing in RE in FCS.

The financial risks of RE debt investments in FCS are comparable to those in non- or less fragile markets.

There is some evidence of positive development impact of RE investments on the ground, for example in terms of employment creation and livelihood opportunities.

Community engagement is key for mitigating contextual risks.

There is a growing understanding within FMO of the need to be conflict sensitive and the development of the Targeted Contextual Risk Assessment is an important step towards bringing this into practice.

FMO has a sizeable portfolio of RE investments in FCS, based on the FCS/fragility classification over the period 2012-2023. However, less fragile countries account for a large proportion of the RE FCS portfolio, while the most fragile contexts are less represented. Moreover, a relatively large proportion of the RE investments in FCS were made at a time when these countries were not classified as FCS. Changing fragility requires proactive monitoring of country developments. In addition, the dynamic nature of the FCS classification makes any new FMO requirements for investing in FCS, such as additional risk assessments, and potential efforts to steer on FCS investments, challenging.

The development impact of RE investments in FCS cannot always be retrieved, due to limited evidence on increasing access to energy and the extent to which targets and assumptions are being met. The developmental impact of RE generation and/or T&D can be assumed to be extensive but is not always clear ex-post. FMO data collected, and

case study research provide evidence for job creation as well as some evidence of direct impact on livelihoods, with examples of local businesses becoming able to provide affordable services to community members via improved access to energy, but these are yet to lead to any measurable increases in community prosperity.

Although the impacts of conflicts have not yet materialized in FMO's investments in the countries studied in-depth for this evaluation (Armenia, Burkina-Faso, and Nigeria), current approaches do not fully ensure conflict sensitivity. This presents a risk to FMO's RE investments in FCS, which could be better mitigated. The evaluation did not identify any clear examples in the three country case studies (Armenia, Burkina Faso, and Nigeria) where conflict sensitivity issues or risks led to a negative impact on the context or conflict dynamics. This outcome may be attributed, in part, to strong community outreach and engagement by FMO's investees, along with other risk mitigation approaches as part of FMO's current investment management approach.

There is a growing understanding within FMO of the need to be conflict sensitive and ensure that investments are designed and implemented in a conflict-sensitive manner, but the necessary tools to do so require further development.

FMO's investment policies, procedures, and processes are considered highly professional and rigorous, but they were not explicitly designed with conflict sensitivity in mind.

Current approaches for project design lack structured pro-active identification and monitoring of conflict sensitivity issues, meaning risks can remain unidentified until a situation evolves beyond a mitigatable scale. Thus, from both a responsible business perspective and from a risk management perspective, there is a need for more systematic integration of conflict sensitivity and DNH considerations into FMO's RE investment processes in FCS.

The first steps have been taken, making use of a Human Rights Toolkit together with a Targeted Contextual Risk Assessment as key requirements for FCS investments. Because these are not yet fully institutionalized, they result in different applications across teams/investments. Furthermore, compared to peer DFIs, FMO lacks a 'boots on the ground' presence, which is widely regarded as valuable for gaining a deeper contextual understanding.

RECOMMENDATIONS

Based on the findings and conclusions, the evaluation brought forward a set of recommendations. One recommendation focused on adapting FMO's internal organization to the needs presented by investing in RE in FCS, such as on-collaborating more with stakeholders, aligning targets as well as redefining roles and responsibilities. The other recommendations are:

- 1. Increase (non-financial) risk-awareness when investing in FCS by undertaking Targeted Contextual Risk Assessments and integrating context information into FMO's existing systems and processes.** FMO's ongoing work in developing the approach for contextual risk assessments at country level is a first step in ensuring availability of up-to-date relevant contextual information. Specifically, FMO should ensure that: i) Conflict sensitivity is integrated into existing systems and processes. This includes further integrating conflict risk awareness within existing E&S risk classification and risk mitigation, and having contextual risk feature in ongoing dialogue and knowledge sharing between FMO and customers; ii) Conflict sensitivity risk identification is a continuous effort, taking place from investment decision, to monitoring, to exit, and not just at investment decision.
- 2. Include a conflict-sensitivity lens when making clear arrangements with clients on community engagement.** This would require clients to consider contextual factors when interacting with relevant communities to minimize negative impacts and maximize positive contributions within fragile, unstable, or conflict environments. A conflict-sensitivity lens can be more explicitly integrated in efforts that FMO already undertakes: Proactive and inclusive approaches to community engagement clearly supports mitigation of (conflict) risks due to community grievances. This would be the responsibility of FMO clients but required by FMO.
- 3. Provide technical assistance to support customers in identifying conflict risks, including engagement with communities.** More attention should be given to supporting clients in proactively identifying (conflict sensitivity) risks, how to develop and record effective mitigation measures, and how to continuously monitor situations.

KEY STEPS TO IMPROVE IN THE FUTURE?

1. Increase (non-financial) risk-awareness when investing in FCS by undertaking Targeted Contextual Risk Assessments and integrating context information into FMO's existing systems and processes.
2. Include a conflict-sensitivity lens when making clear arrangements with clients on community engagement. This would require clients to consider contextual factors when interacting with relevant communities to minimize negative impacts and maximize positive contributions within fragile, unstable, or conflict environments.
3. Provide technical assistance to support customers in identifying conflict risks, including engagement with communities.

FURTHER INFORMATION

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