Private Sector Views on the Green Climate Fund and International Climate Finance from Latin America and the Caribbean

I. Background

The Green Climate Fund (GCF) Transitional Committee members have expressed interest in receiving feedback from the private sector on how to best mobilize and leverage private capital to achieve the scale and funding predictability necessary to meet the goals of the Green Climate Fund.

Following this request, the Inter-American Development Bank (IADB) has conducted a web-based survey among private companies in Latin America and Caribbean (LAC) requesting views on how to obtain this leverage, also on the basis of the experience to date with the Global Environment facility, Climate Investment Funds, and other bilateral and multilateral funds. The survey has been sent to 300 companies, and about 25 have responded with specific feedbacks that are summarized below.

An additional consultation has been conducted by the IADB during the Sixth Latin America and Caribbean Carbon Forum (San Jose, Costa Rica, September 27-29, 2011).

This report summarizes the main inputs received through the web-based survey and the consultation that took place in Costa Rica.

II. Barriers to private investment and opportunities for the Green Climate Fund

Because cleaner technologies generally have higher initial capital costs (but lower long-term operating costs) than traditional alternatives, access to affordable, long-term finance is essential to level the playing field. In addition, many renewable energy and energy efficiency projects, particularly in smaller LAC countries, are unable to attract private sector investment due to real or perceived technology, market, regulatory policy, currency, or political risks. Some of these risks, such as currency or political risk, can be hedged, though at a cost. A "green finance gap" exists, because even when private sector finance is available, the risks can result in high equity and collateral requirements and/or debt risk premiums that dramatically increase costs, making many projects uneconomical. In order to mobilize the $100B+ per year promised in the Copenhagen Accord, the GCF needs to assume some of the risks to private sector investors.

III. Mechanisms the Green Climate Fund should use to obtain private sector leverage

A. Concessional loans

Until there is a substantial increase in the price of releasing greenhouse gas emissions and facilitated access to the carbon markets, the burden of paying the premiums for renewable energy will continue to fall on developing country governments and consumers. Due to the high initial capital investments required for renewable technologies, lower cost debt can dramatically reduce the levelized cost of energy, i.e. in an anecdotal case, a concessional tranche of 50% of the debt for a solar plant in Chile could reduce the price of power by over 20%. Such cost reductions are essential in order for renewables to compete with fossil fuel and large hydropower alternatives in the LAC region. Concessional loans and/or guarantees can also be used to support smaller projects and reach consumers directly, i.e. a GCF loan or guarantee to a utility can be used to help residential consumers finance the purchase of energy efficiency equipment. Banks can also be intermediaries for "greenlines" of climate lending, but the GCF should ensure that the final interest rate is as concessional as possible in onlending and guarantee programs.

B. Credit, Performance and Regulatory Guarantees

The GCF should be able to provide guarantees to assume resource, regulatory, off-taker credit, or perceived technology risks that prevent private sector investment at affordable rates. For example, a performance guarantee could reduce the risk that a renewable resource is lower than expected or of construction cost overruns or technology under-performance. Credit guarantees can cover the risk of a contracted power off taker or fuel purchaser going out of business. Both performance and credit guarantees can be valuable for financing energy efficiency investments through Energy Service Company performance contracts. Regulatory guarantees can insure against the loss of supportive tax credits or feed-in-tariffs provided by a host country government or utility.

Sample quotes from LAC companies on the GCF

"Liquidity isn't the problem, the problem is the need for capital or other coverage mechanisms that mitigate the risks"

"Guarantees without a doubt are the most effective financial mechanism"

"The ESCO market has companies with strong technical capabilities but they need guarantees"

"There is a gap in growth capital finance - medium sized companies who need $500K-$2M"

"Small and medium enterprises have scarce access to credit"

"The GCF needs to cover at least 70% of the risk, this percent of risk coverage will enable low cost access to finance"

"There is a lack of long term finance"

"The ideal paths are through venture capital, or risk capital for companies that are starting projects with few guarantees"

C. Equity and mezzanine debt

High risk, first loss capital is needed for many large-scale climate change mitigation projects, such as geothermal plants, for new technologies, and for the growth of companies that provide clean technology products and services. The GCF should have some funding to provide equity, subordinated or mezzanine debt, and act as a fund of funds for developing country clean technology private equity funds, particularly those that focus on SMEs.

D. Grants for private sector project identification and feasibility studies

Concessional finance can make climate change projects economical, enabling the private sector to go beyond business as usual. However, particularly for energy efficiency, agriculture and forestry greenhouse gas emissions reductions, the private sector may not be aware of the opportunities for profitable investment. The Green Climate Fund should also have some grant funding available to the private sector for project identification and feasibility analysis in order to demonstrate the financial viability of the projects.

IV. Engagement and access to the Green Climate Fund

The private sector lending arms of the Multilateral Development Banks (MDBs) have typically provided private companies access to international funds. In this arrangement the MDBs provide deal sourcing, financial transaction structuring and fund management as well as leverage from their capital, while the international funds assume key risks that the MDBs alone cannot. This may continue to be the most effective access mechanism for the GCF, but the GCF should also evaluate the feasibility of allowing companies to apply for GCF products through a direct window for private sector engagement.

Transaction costs are a well known hurdle to successful public-private partnership risk sharing programs such as those proposed under the GCF. Whether direct window or through the private sector lending arms of the MDBs, the GCF needs to ensure access is facilitated, private sector transaction costs are minimized, and decisions are made rapidly, within the time horizons of private sector projects. The GCF needs to consider the different phases in project finance and engage early in the development of the concession with the public sector or regulatory authority. For instance, in tenders for large-scale renewable energy project development, private sector bidders need to know whether and what type of support the GCF will provide early in process, i.e. a

concessional loan, non-controlling equity stake, or an established premium on production. The private sector recognizes that GCF funds should be used only where they are necessary and additional based on the principle of minimum concessionality. However, in order to reduce transaction costs and facilitate the approval process, the GCF should consider establishing criteria and sectoral standards for project qualification rather than requiring project level additionality analyses.