

Private Sector Consultation to Support the Work of the Transitional Committee for the design of the Green Climate Fund

International Finance Roundtable

4 August 2011, Chatham House, London.

This summary reflects issues raised at a roundtable of experienced finance practitioners with an interest or direct involvement in developing country markets. It seeks to contribute to the Transitional Committee's consultation with the private sector on the Green Climate Fund, and will also contribute to UNEP Finance Initiative's submission process.

A majority of participants were mainly senior project or asset financiers ('kit in the ground') with extensive experience in infrastructure/energy (including energy efficiency) and renewable energy (RE) from across the finance sector: from international banks at global or EMEA (Europe, Middle East and Africa) level; specialised equity funds; international project development, VC and institutional investor advisors plus two key public finance entities working with the private sector.

The roundtable was organised by the Renewable Energy Finance Project at Chatham House, which has worked with RE finance practitioners on policy-related issues for the last 7-years, collaboratively with UNEP's Finance Initiative (UNEPFI).

This summary reflects the actual points raised by financiers (and through subsequent comments). A majority of participants do not attend UN level meetings, and as such was a first engagement, and in some cases awareness of, the Green Climate Fund (GCF).

Starting points, based on the TC Private Sector consultation questions¹:

- Current market context
- Key issues of market failure – what tiers of problem/risk (emerging markets) should be focused on
- What range of instruments (& priority) would open up greatest opportunities for private finance, including reference to the efficacy of other public/finance mechanisms.

Submission

Key Points

1. Market context
2. Market opportunity & approach
3. Characterisation of issues
4. Using public finance efficiently: objectives and design principles
5. Getting the design right: build on existing expertise
6. Operational: some approaches/priorities

Annex I Principles for attracting capital

Participants & Contact information

¹ The private sector consultation questions were not dealt with consecutively, but rather grouped into the three broad areas, as above, and emphasis placed on hearing how financiers characterise the issues.

KEY POINTS

- There is steadily rising investment into, and interest in, renewable energy/energy efficiency (key sectors for delivering GHG mitigation) in developing countries; however there remains significant variation in where money is going.
- The overall challenge is not a shortage of capital per se. The main barrier to investment remains the need for conditions that can facilitate the emergence of bankable projects on the ground (the right risk/reward profile) and a larger pipeline that will attract pools of capital at scale. This highlights the importance of the policy conditions on the ground.
- Financiers would frame the issue at the heart of the consultation as how to 'invest' the \$100 billion to get the best return possible for governments, in terms of the public policy outcomes governments are seeking. The importance of being able to leverage private finance can be seen in that context.
- Clarify the objectives more precisely: the structure of the Fund, and the pools of capital it seeks to leverage, should flow from this.
- Agreement on a set of principles that guide the structure and operation of the Fund, and reflect factors that will facilitate capital deployment into and within developing countries including, importantly, domestic finance institutions.
- Recognise the 'levels of generality' problem: at the international level this is about mobilising \$100 billion and its efficient transmission down to execution level, where a different set of details matter (policy and enabling environments).
- Three principle areas for the Fund to work: subsidies to execution level (via national policy for example), risk mitigation tools; and tools that facilitate greater finance capacity. These need aligned including at the international/national interface, to avoid gaps and to ensure monies are efficiently used.
- In design, capitalise on existing experience and institutions; engage with private financiers practitioners to ensure policymakers understand where public finance tools and products are working well; an accurate identification of gaps in finance availability; and the efficiency of design options for private finance.
- Retain the ability to have a level of risk appetite in the structure to foster some experimentation with new tools, without losing pace.

DISCUSSION

In the achievement of international and national public policy goals, the use of public sources of finance can assist in creating conditions that attract private capital. Doing so effectively and efficiently was the focus of the discussion.

1. Market Context

Current economic and policy conditions are affecting perception of risk, and impacting capital allocations from in this area (RE) internationally. Relevant financial market trends may be useful to monitor in the context of identifying longer-term factors impacting sources of finance (the initial bullet points below look at what is

happening in international banking markets from those sitting in Europe, and reports from some specialist funds) and may be useful background for GCF targets effort to fill 'gaps'.

- In Europe and the US economic conditions are impacting banking markets, leading to higher bank funding costs, increased caution and a sense of 'battening down the hatches'.
- This follows a period of RE policy uncertainty and instability (review/change). The implementation of retrospective changes to PV tariffs in Spain has been particularly damaging to confidence in government policy internationally in the RE sector, and has increased caution across finance providers particularly as economic conditions continue to worsen.
- Specialised funds also report much greater caution from institutional investors (internationally) towards RE investment, linked to the above. This includes reductions in allocations to alternative asset classes and potentially an increased need for geographic diversification within portfolios.
- The impact of financial regulation such as Basel III (and Insolvency 2 for the insurance industry) may impact the appetite for holding long-term debt by banks but so far this remains a concern for the future rather than of immediate significance.
- Those engaged in emissions trading projects, have seen carbon prices drop precipitously and with that volatility comes additional strains on some types of project and their valuations.
- At international level, there is 'a complete lack of confidence' that Governments are taking climate change seriously, following Copenhagen. International climate-drivers are not visible in policy at domestic level in a majority of countries. Financiers familiar with the UNFCCC process perceive a weakening of government intention (a shift from firm targets to 'pledges') leading to wait and see approach, or 'betting on non-achievement'.

Policy-driven markets such as renewables, driven by a range of factors as well as climate (e.g. basic energy supply and demand factors, energy security considerations), and as such have their own dynamics and debates at national level, adding to an often complex picture for financiers.

Financiers and their credit or investment committees will have to feel comfortable that Governments are serious, and a robust commercial case is there: risks can be assessed and managed and returns are there for the given level of risk, compared to other opportunities. This will vary depending on the type of finance: venture capital, private equity/funds, bank debt, institutional investors and sovereign wealth funds.

2. Market Opportunity & Approach

All of the financiers at the roundtable have existing investments, or a direct interest, in RE in developing countries. While RE is clearly not the only sector for the Transitional Committee/Green Climate Fund, it is illustrative of some of the dynamics arising in market segments that will be central to tackling climate change. The detail is relevant as context for the design stage of the Fund.

One equity fund differentiated current developing country market characteristics as:

- Large volume, tight terms such as China, India, Brazil that have a large number of opportunities or projects but relatively low returns. These might attract investors that are looking for long-term yield, or strategic players that are building

capacity in those countries, including international utilities. In this category the problem is not access to capital.

- More risky markets with lower volume. These will attract the interest of specialised funds that can take some risk (and, under the right conditions, project finance banks). This includes individual countries in North Africa, North and South Asia as well as SE Asia, South America, and interest in eastern Europe are now starting to move ‘further and further east’.

Volume is linked to whether there is legislation in place, whether targets are high enough to drive multiple projects, whether there is a support mechanism that makes it attractive, and whether there are the relevant human capacity/skills.

The risky markets may involve greater political risk, execution risk (parties with adequate skills), and counterparty risk alongside technical risks. However, these countries can still attract interest where policy and policy supports are pitched to enable commercial returns; low volume is linked to lower targets.

One fund describes the clean energy sector in Africa as a nascent, relatively early stage market (other points in Box 3. below). Capital is out there for investment in energy, but investors with the risk appetite for the earlier stage opportunities need to be found, otherwise it is difficult. Properly functioning feed-in-tariffs are not seen in Africa, although viable projects do exist without them – however, again, this is a matter of finding the right ones.

Investment statistics back up input from financiers: there is now a substantive rise overall in investment in developing countries. China, India and Brazil are leading this, and are all in the top ten ranked countries internationally for new RE investment in 2010. China had the highest level of new RE investment globally in 2010².

Among developing country regions, Africa experienced the highest growth in RE investment (a five-fold increase) albeit from a low baseline. The majority of investment occurred in Egypt and Kenya³.

Box 1. A project developer’s view

For utility-scale wind project development, a range filters are used to select market-entry. Country assessment would include:

- Country size/scale of market;
- renewable energy resource (e.g. solar, wind);
- energy demand context;
- does the situation lend itself to economies of scale, e.g. cross border turbine procurement, contracting, financing etc, re the wider opportunity;
- the local business environment and culture: can business get done within firm’s business time horizon;
- the state of policy development, design and stability, a factor in both developed and developing countries at present.

Being able to work closely with a local developer is central to the equation.

Another financiers identifies independent, scalable power producers and distributed energy solutions as interesting markets (including the biomass gasification sector

² ‘Global Trends in Renewable Energy Investment 2011’ UNEP, Bloomberg New Energy Finance, 7July 11.

³ As above.

within that, given the resource availability (primary and secondary e.g. industrial waste). These are of interest due to:

- Demand, i.e. low country electrification levels
- Captive audience, e.g. mines, hospitals, etc.
- Offers a low cost, reliable alternative, e.g. vs. diesel back-up generators
- Projects can be replicated and then aggregated
- Preference for 'low-touch' from government required.

Another financier described all low carbon markets as 'in a sense, emerging markets for financiers': newer technologies, different risks, different delivery systems e.g. planning for variable power, less track record, and so on, as well as carbon markets which many asset or infrastructure financiers are less familiar with⁴.

Three risk categories are identified:

- normal risks/business risk;
- low carbon market risks - renewable energy and utility/energy policy more broadly, including RE tariff or revenue support within that; carbon markets;
- general business/enabling environment - even in industrialised countries there can be the need for a public finance intervention to foster market creation and attract more pools of capital into the sector. This needs focused to meet real gaps, and therefore based on a strong evidence-base.

As has been stated by financiers, using public finance tools to tackle policy-related risks that are better dealt with through policy solutions (e.g. improved planning, grid availability or regulatory issues) is likely to be more expensive and will not necessarily lead to underlying conditions for scale.

3. Characterisation of Issues

Not a finance problem per se: finance is not lacking globally per se, pools of funds are available and currently allocated in areas that financiers feel comfortable with, and reflect the risk exposure they can take. This indicates it is not only a function of capital availability but also the appetite of investors to invest in what may be a more nascent, early stage market. The more immediate issue is seen as the creation of a bankable projects i.e. those with the right risk/reward characteristics, and potential for a pipeline/ scale. This requires the wider policy and market conditions to be in place, as these have a central bearing on the project economics, alongside strong sponsors/ project developers.

Domestic financial institutions are not seen to be lacking funds either but, in general, have less (or zero) experience/expertise for understanding and managing the range of risk issues involved in these newer markets; as well as the expertise/experience, potentially, for smaller deals which results in less ability to participate in the range of financing the sector needs. Domestic financial partners are seen as having a central role in enabling international financial institutions to operate on the ground in developing countries.

⁴ In previous work with financiers on RE investment issues in developing country markets, carbon revenue was seen as 'icing on the cake' for those working at RE/energy project level (i.e. project financiers as opposed to CDM or climate project developers who were deliberately developing renewables projects with a carbon revenue stream). 'Scaling up renewable energy in developing countries: finance and investment perspectives', Chatham House, April 2010. http://www.chathamhouse.org.uk/research/eedp/current_projects/renewable_energy_finance_policy/

International institutions can take significant comfort from the presence of local investors who may have a greater understanding and appreciation of “local” risks. It can also help from a cultural aspect (as an example, many projects in Islamic countries may use a mix of Islamic and conventional funding sources to provide additional liquidity and meet local expectations).

Policy conditions: it is noted that developing countries already use tools such as market incentives for the development of national power and infrastructure projects, including in increasingly renewable energy. These generally provide a level of stimulus to incentivise the private sector in areas such as construction, operations and maintenance (O&M) and finance.

Policy characteristics: financiers consistently emphasise the importance of predictable, stable, transparent policy environment as a critical element in providing a framework, on the ground, that will positively impact the risk/reward ratio at project level.

Significant work has now been done on barriers/policy including with, and by, private financiers, describing the need for an ‘investment grade’ policy package. This means ensuring all the policy pieces are in place relevant to a completing a deal; or that policy that has the characteristics of TLC - ‘transparency, longevity and certainty’⁵. Getting the detail right is crucial: for projects this may involve lining up planning and land access, grid availability and access terms, incentive mechanism and design; ability to sell power e.g. through power purchase agreements (PPAs) to a creditworthy party as well as the broader utility or energy policy context. These elements can impact on project economics and are a central part of the creation of bankable projects.

Pipeline & Scale: ‘everyone wants a pipeline’: large capital providers want large opportunities – visibility on a pipeline or portfolio of projects makes a country or sector more attractive and this kind of scale potential takes away some of the coordination risk, and some of the technology risk at individual project level. China is described as ‘a massive test-bed’ for scaling RE, with important lessons that can be learned by other developing countries.

In this context there are particular gaps identified:

- public finance: sub-\$10 million, even sub-\$20 million finance for projects in developing countries; deals at this size are generally too small individually for external financiers due to due diligence costs
- country level: how to aggregate or line-up different elements particularly across policy framework, finance capacity in newer technologies and markets, and confidence in the broader business environment.

The national policy environment will be a key element in the perception of scale of opportunity (are the underlying growth drivers for a sector reflected in policy and regulatory environment)⁶.

⁵ Clearly articulated by private financiers in two papers ‘Scaling up renewable energy in developing countries: a financiers perspective’; and in ‘Unlocking Finance for clean energy: the need for ‘investment grade’ policy’. Deutsche Bank has outlined this through its ‘TLC’ descriptive for policy – Transparency, Longevity and Certainty, and there was an earlier ‘loud, long and legal’ descriptive from renewables financiers in 2004 into the German government’s international renewable energy conference. These highlight the importance of understanding detail on the ground – right across the range of elements that affect the ability to execute a project. Chatham House RE Finance Project http://www.chathamhouse.org.uk/research/eedp/current_projects/renewable_energy_finance_policy/.

⁶ Clearly articulated by financiers recently in ‘Investing in Renewable Energy in the MENA Region: Financier Perspectives’, Working Paper, June 2011, Chatham House.

Non-financial aspects – project development and risk capital: the non-financial aspects of infrastructure build-out are central to creating conditions for strong domestic delivery, as well as offering a broader range of opportunities for supply chain businesses and employment. This includes: project development at utility-scale and smaller-scale local distributed projects; EPC (engineering, procurement, construction) services; equipment research and development (e.g. for national/regional specific conditions); local manufacturing if market size is sufficient, which may reduce currency exposure for projects; plus delivery infrastructure: grid, street networks (and potentially roads to enable installation etc). These factors also imply human capacity and experience.

Relevant for the timing of public policy delivery, early attention to fostering project development is highlighted, noting that 4-6 years is a fairly standard timeframe to get through project process (if not longer). Attracting strong project developers means fostering entrepreneurs and facilitating the entry of risk capital.

4. Using public finance efficiently: objectives and design principles

To leveraging private capital: it will be necessary to map out the segments of the finance sector that the GC fund/s are trying to attract to meet objectives, and understand characteristics of those segments.

The core issue for financiers, thinking this through from a government point of view, is not what to do with \$100 billion of capital, in terms of how to deploy it, but rather what governments want to get for this, how do governments want to invest it to get the best public policy return? Or put another way – a shift in attention from an input process (money in) to an output focus (what do government's want to achieve).

Clarify objectives: defining the policy objectives (or ‘government returns’) for the fund as precisely as possible for the GCF Board, and in terms that are relevant for an operating financial entity, will help to structure the fund, in that gaps can be identified and options that can attract the most relevant pools of capital.

This will feed through to its core products and activities, key areas such as the appropriate distribution mechanism or mechanisms for monies, and the level of centralisation or decentralisation of decision-making.

Note that GHG emissions reduction (mitigation), for many financiers, is essentially a calculation on top of actual investments, and in turn raises eligibility criteria for accessing monies (and potential complexity). At the roundtable financiers asked:

- what will be eligible, what is the fund intended to foster on the ground: clean energy (100%) or ‘cleaner’ (and what does the latter mean in practice)?
- will eligibility be defined at international level or national level?

These questions raise what might be described as the ‘tonnes versus transformation’ issue: is this about short-term emissions reductions or longer-term infrastructure/transformation e.g. of the energy sector? Investment in underlying infrastructure (e.g. transmission grids) may not produce near-term emissions reductions, but may be central to enabling a scaling up of renewable energy and energy efficiency. Keeping things as straightforward as possible will be important.

A further question is whether the Fund will incorporate a sustainable development policy, or broader ESG (environmental, social, governance) factors.

Focus & ‘Levels of Generality’

In terms of the GCF resolution, one financier identifies a ‘levels of generality challenge’:

- at the highest level of generality - how to mobilise ‘\$100 billion of something into something’;
- at the execution level (delivery on the ground) - how to originate, underwrite and execute projects in a way which is measurable and can be aggregated to create impact;
 - recognition that developing countries are not a homogenous group, a ‘one size fits all’ approach is unlikely to work given very different starting points.

Standardised rules could be created for e.g. power purchase agreements (PPA) on the ground or for support mechanisms such as feed-in tariffs (FITs). However, PPAs themselves are described as ‘radically different’ in different geographies, even at sub-national or provincial/para-statal level. At project level a more detailed risk assessment will still need to take place across all the factors that might impact the project’s ability to become operational with a secure revenue stream. Project developers and domestic financiers will have to have capacity to do this.

To attract greater private capital, the basic risk-return model will need to prove-out on the ground, and with that track record and prospect of a deal pipeline (likely to be driven more by policy environment).

Between setting high-level policy objectives for the \$100 billion, to delivering to those that actually originate, underwrite, execute and asset manage on the ground, an efficient transmission or distribution mechanism(s) has to be in place; and it will have to be understandable what is eligible, what scale and over what timeframe.

For private financiers, engaging with public institutions adds another dimension ‘that can’t necessarily be controlled’ (in general, more variables mean it is harder to get a deal through – with respect to expectations of timing and other factors). This is a key element to ‘get right’ (or as right as possible). It will be essential to get direct private finance feedback on what works well, to increase the efficiency of distribution.

Box 2. Transmission - the green car analogy

An analogy is that of: “how to get from the engine through the transmission to the wheels, so that the vehicle is actually moving somewhere. Part of the reason for the language difficulty is that at one level entities are using the gasoline, but aren’t necessarily thinking about the overall vehicle efficiency, or getting to the final destination.”

Through this analogy the role of the GCF is essentially to facilitate transmission, and to secure the greatest efficiency in the use of public monies. While public and private vehicles might look very different, the GCF public-private mix will be a new hybrid.

At project level, there is an assembly line of pieces required to make projects work – policy, money, timing, capacity on the ground. Aligning those - as far as possible - will help avoid unintended lumpiness or ‘black holes’ that will slow implementation.

There is a diversity of ways to ‘invest’ or deploy \$100bn of ‘something that might be called capital’ (e.g. grant, equity, debt).

In that context, three approaches were characterised:

- subsidy - monies delivered to national governments for simulating conditions to meet, for example, national infrastructure needs, this might be through support mechanisms and incentives designed to bring in domestic or international investment;
- provision of risk mitigation tools through, for example, multilaterals (public finance institutions e.g. development banks); and
- use of capital to stimulate and leverage private capital for a specified objective. This may be through deepening the capacity of private capital markets, through for example, some form of public equity fund; or increasing in-country finance capacity (particularly emphasised for sub-utility scale projects that will be less attractive to international project financiers).

Mobilising private capital efficiently is one tool in the context of others: e.g. grant funding for least developed countries (LDCs) or technical assistance for domestic finance institutions.

Efficiency of the package: ensuring that these three elements line-up with the policy and regulatory environment will be important.

Strategic context & Principles:

The structure should be guided by

- setting out the principles that mobilise private capital (debt and equity) to enable public policy goals to be met, noting that principles will need to be able to be ‘tailored’ from international down to national or even sub-national relevance (see Annex 1);
- reflect the difference between developed and developing countries: the focus has to be to make developing countries attractive in the context of being competitive with other opportunities;
- developing countries themselves are not homogenous, and different capital needs will be assessed and reflected in products and operations of the Fund;
- where possible using existing frameworks: to facilitate the scale-up that enables pension funds and sovereign wealth funds to come in.

The balance of the three broad areas of finance intervention described above (subsidy, risk mitigation, enabling greater financial capacity) within the GCF should be guided by its objectives and timing; and needs on the ground (identifying and prioritizing what is required for execution). The nature of how the GCF selects and monitors its portfolio will also be important, noting options raised below, linked to the existing MRV infrastructure.

The difference of need between developing countries, e.g. emerging economies and least developed countries (LDCs) was recognised, and indicated in the market context section above. Liquidity and capital availability may not be a central issue for markets that are already achieving some scale, but it is clearly an issue for the latter. Both require the ability to attract and enable investment (bankable projects with reliable cash flows on the ground, stronger participation and capacity/experience in domestic financial institutions).

5. Getting the design right: build on existing expertise

Capacity: policy-makers should use the capacities at their disposal - existing expertise in their own public finance institutions (including those working with private financiers, including export credit agencies and domestic development banks) in the context of feedback on GCF functions and design principles being considered.

Tools & Transparency: public and private financiers need to work with policymakers together to assess where financial products/tools are already in place and working effectively (in the context of efficient transmission above). One view is that ‘the wheel does not need re-invented’ in terms of risk mitigation tools as these are either already in place, or ‘blueprints’ are available.

The existing public finance landscape needs outlined and assessed in more detail and more comprehensively, with private financiers’ direct involvement, to find out what genuinely works on the ground.

In a plea for the fund to be lined-up with existing public finance entities and fully transparent, one financer described an RE project in a North African country: “I can’t even count the number of MDBs, bi-laterals that want to fund that project – this means it takes ages. It’s hard to foresee from which structure and what we really get for this”. The GCF should avoid being another one of many MDBs.

Pace and Experimentation: there is a plea for speeding up the pace of development of instruments and opportunities, including experimental approaches around new options. This means governments putting in some risk capital, and being prepared for some level of failure: otherwise, financiers fear that over-caution means ‘these kind of developments will be glacial’, and governments will be seen as expecting private players to take the risk. The issue was also raised of whether MDB’s – as large investors in this space, are also sufficiently incentivized to take risks.

In this context a ‘challenge fund’ approach might be useful:

- define conditions that financiers need to deliver certain public objectives;
- establish which government or entity is prepared to try that;
- provide capital for that objective.

By definition this will end up being selective (countries, or a region) however it may be possible to have various regional or bi-lateral efforts in this vein that could kick-start broader application – e.g. a smaller groups of countries, at the right scale, that go to execution. The latter is essential for creating some track record of using new financial tools.

Specific approaches for finance capacity building, set in the context of the UNFCCC,:

- Sending real signals to financial actors on the ground – an underwriting mechanism for emissions reductions, building on MRV structure is an option;
- Results-based approach building on the existing MRV infrastructure, ultimately a subsidy mechanism (linked to a national strategy)⁷.

⁷ Climate Change Capital has a briefing on this underwriting mechanism (www.c-c-capital.com)

Box 3. On the Ground

Bankable projects: one Fund manager reports that he is struggling to finance any power projects at all, with very few bankable projects in conventional thermal generation or renewables (with what are described as the ‘additional issues’ for renewables – cost, grid access and new technology risk). It is possible to find bankable projects in single individual countries, but despite need for new power capacity in several countries, basic issues, including delays to electricity sector reform plans, is making things much harder.

As above, the clean energy sector in Africa is described as a nascent, relatively early-stage market, and investors are needed with the risk appetite for the earlier stage opportunities.

Domestic finance: another financier, with considerable experience in Africa, cautions against simply trying to provide exactly the kind of risk mitigation required by financiers in industrialised countries, as this will produce ‘an endless set of delays’.

“In 2002, we could have been saying same about India as some African countries, but in 2002 a policy framework was brought in for renewable energy that catalysed much greater domestic finance sector interest.” This was seen as pivotal for opening up the market to greater scale and involvement of external finance.

A view was that African private sector probably would look for the provisions for domestic financial entities – getting African private finance institutions involved in the design of fund would be important in that context.

Aggregation and scale: a financier active in north and south Asia indicates that governments are ‘interested and listening’, albeit at different stages of engagement. “What is missing the is the know-how on aggregating the different elements to produce scaled opportunity, a pipeline.”

Due diligence support? One suggestion is a mechanism that helps defray the high transaction costs associated with African based due diligence

6. Operational: some approaches/priorities

- Enabling ‘start up’ i.e. starting deployment of Funds with smaller coalitions of the willing to create execution track record, as above.
- Work with the range of public finance entities that are already out there, including those working with the private sector, but line these up carefully with delivery to avoid over-complexity. There are different views, but there is general agreement on things that work:
 - guarantee structures can work, the ‘blueprints’ described above (opt-in to some level of best practice in this regard to avoid any moral hazard issues);
 - retain the ability to have a level of risk appetite in the structure so that innovation and experimentation are fostered;

- policy approaches at national and regional level that work (FITs or other support mechanisms embedded in a broader power or utility policy framework for example, to ensure projects are bankable).
- There is a clear opportunity to use GCF structure to leverage private finance, and this needs to be embedded appropriately across the GCF, depending on its structure. If governments accept that the appropriate starting point is how their money can be ‘invested’ effectively to deliver public policy outcomes (whether through grant provision; amended mandates to their own and multilateral development banks, many of whom work with private financiers, or through a specific set of tools aimed at facilitating larger pools of private capital) then any ‘private sector’ window for the fund, would need understood clearly in that context.

Annex 1

PRINCIPLES FOR ATTRACTING CAPITAL

This list of principles for attracting capital below were structured around a consideration of national policy, nevertheless they are also relevant for the GCF. Good design can reduce policy-linked risk, and therefore make specific finance interventions more effective (rather than using public finance to compensate).

The set of principles outlined below is based on a submission by the Low Carbon Finance Group to the UK's 'Electricity Market Reform' in March 2011 – this is a group of mainstream finance practitioners from across the finance sector.

- Price stability and predictability, including
 - Long-term revenue certainty and visibility
 - Bankable markets and structures
 - Inflation-linked revenues
- A level playing field for all market participants, including
 - A power purchase obligation with a creditworthy counter party
 - Fair, reasonable, and equal balancing charges for utility and non-utility generators
- Simplicity and transparency

There are additional measures of interest to both Government and financiers:

- Affordability (important to Government, consumers and financiers in the context of overall stability of the policy environment)
- "0-60" speed, a measure of how long it takes financiers to become comfortable with the new regime and to commit to investments (important to Government for delivering public policy goals)
- Consideration of potential unintended consequences

Long-term Revenue Certainty and Visibility: Both debt and equity financiers strongly favour regulatory support mechanisms that provide long-term electricity price stability and visibility. It is central to creating bankable projects that will attract the longest term and lowest price capital. The longer, and more stable and visible, prices are, the lower the cost of capital, and the more likely banks and pension funds will invest and commit increasing allocations of capital.

Bankability: This refers to the willingness of banks to lend to projects. It is determined not only by the 'overall package' of factors, but also familiarity. Both debt and equity tend to favour policies and systems that they know and have been proven to deliver, not new and untried systems.

Inflation Linkage: Most of the pension and other institutional investors that Governments seeks to attract to the sector have long-term liabilities (pensions, annuities, insurance companies) that are linked to inflation. Therefore, they are increasingly seeking investments that are linked to inflation. Thus, a system that includes inflation linkage will attract more of this class of investors and will ensure higher allocations.

Purchase Obligation: As critical as price is a market for the power sold, price stability without an assured market or purchaser exposes independents (and their investors) to revenue risk there may be no buyer. If there is a possibility that a developer faces this uncertainty after a project's Capital Costs are fixed, it will be impossible to invest.

Level Playing Field: ensuring that incumbent utilities do not have pricing advantages that undermine investment from new entrants.

Simplicity: This refers to lower barriers to entry for new investors in terms of ease of understanding of the regime and becoming comfortable with the asset class. A track record in other markets helps, as it is easier to explain to credit committees and pension fund trustees, who are the ultimate decision makers about the investment of funds.

Transparency: Whatever support system is chosen, it should have clearly defined policy goals and have a transparent mechanism for review and change. It must be seen as sustainable beyond the short-term (for example a parliamentary cycle). To retain confidence in the support mechanism, and for it to be an effective and continuing driver for investment, there has to be transparency regarding the rules under which it will operate. Any proposed changes must be consistent with the original objectives, where possible scheduled from the outset, and provide for suitable grandfathering.

Affordability: We understand Governments have concerns in wanting to ensure sufficient capital inflows without interested parties making returns that are considered 'too high'. Unless the system is affordable across the medium to long term, there is a high risk of amendment or change, which undermines market stability.

0-60 Speed: '0-60mph' can be defined as the speed of getting comfortable with the new system in the marketplace, reducing the time period of delay/hiatus. This adds greater confidence for government in the timing of investment and ability to meet public policy goals.

Unintended Consequences: Anticipating where possible, is important for market stability.

PARTICIPANTS

Individuals from the following institutions participated, or contributed comments.
Please note that this summary does not reflect the view of any individual or individual institution specifically.

Allianz
Ariya Capital
BNP Paribas
BNP Paribas Clean Energy Partners (fund)
Climate Change Capital
Conduit Ventures
Credit Agricole
DEG
Earth Capital Partners
Emerging Africa Infrastructure Fund
HSBC
Mainstream Renewable Power
OPIC
Paradigm Change CP
Sustainable Development Capital Ltd
Standard Chartered
Private Infrastructure Development Group (Advisor)

UNEP Finance Initiative
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