# INNOVATIVE SOLUTIONS TO CLIMATE FINANCE: BLENDED FINANCE FOR PRIVATE SECTOR PROJECTS

Blended Climate Finance
IFC Climate Business
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# BLENDED FINANCE IS ONE OF IFC'S OFFERINGS TO LEVERAGE PRIVATE SECTOR INVESTMENTS IN CLIMATE

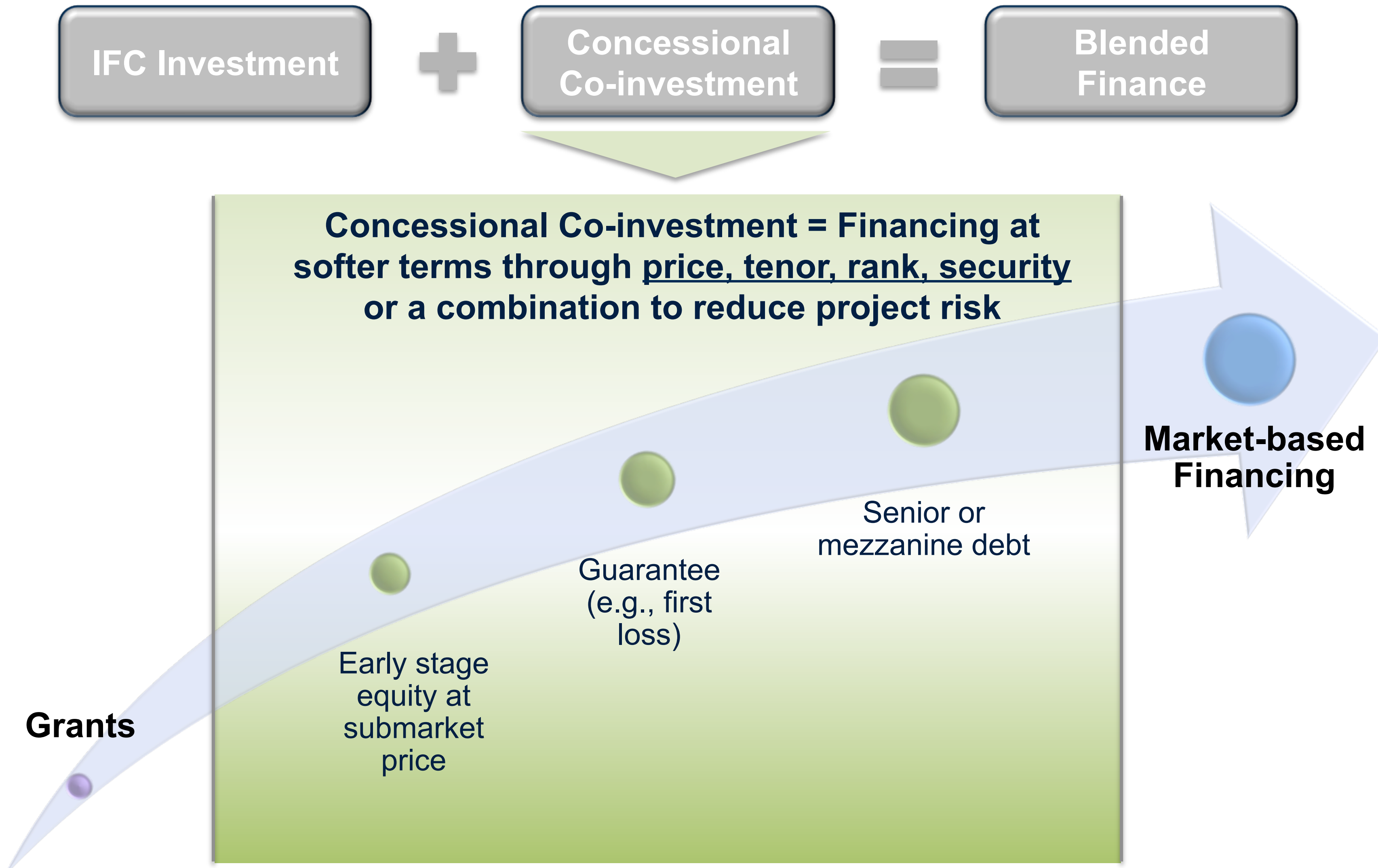
IFC leverages the power of the private sector to advance innovative and viable climate solutions for emerging markets by offering:

- **Project and corporate finance** for climate-smart projects, including debt and equity, with long-term horizon
- **Advisory services** and technical assistance for companies to build capacity and help develop markets
- **Green bonds** to bolster financing for climate-related investments
- **Blended finance** for some high-impact, first-mover climate projects, with support from donors

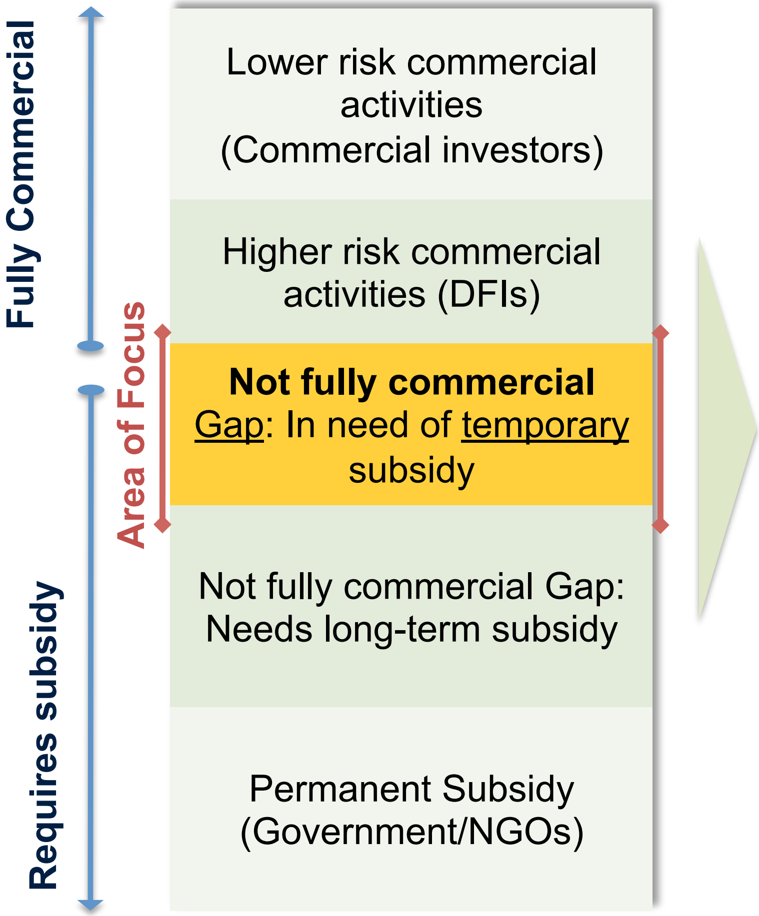
Since 2005, IFC invested over **US$13 billion** in long-term financing

In FY15, **22 percent** of IFC's long term financing was climate-smart, exceeding its target of 20 percent. IFC invested **US$2.3 billion** in 103 projects in 31 countries

# WHAT IS BLENDED FINANCE AT IFC?



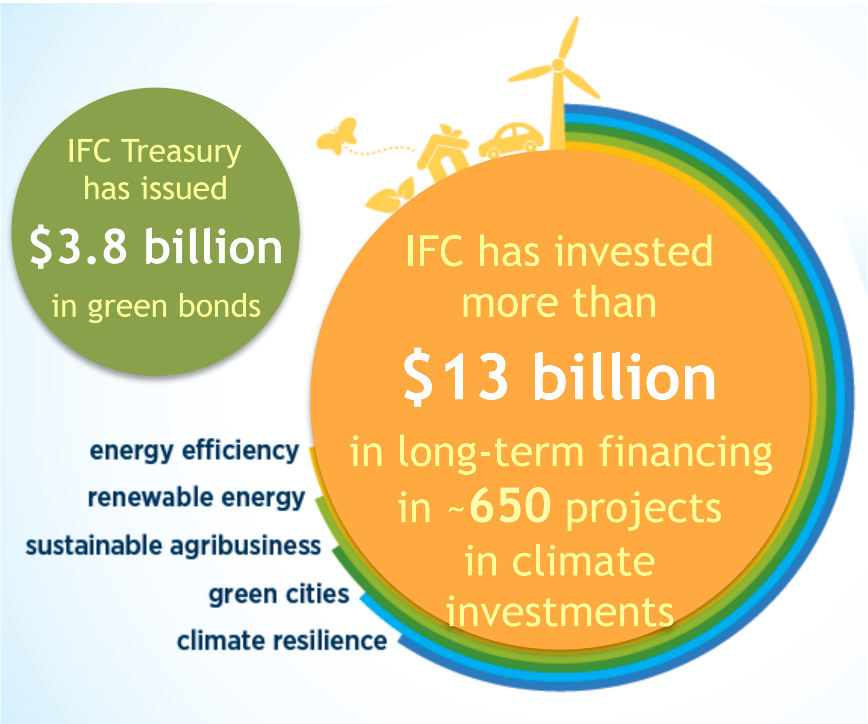
# WHY/WHEN DOES IFC BLEND CONCESSIONAL FUNDS?



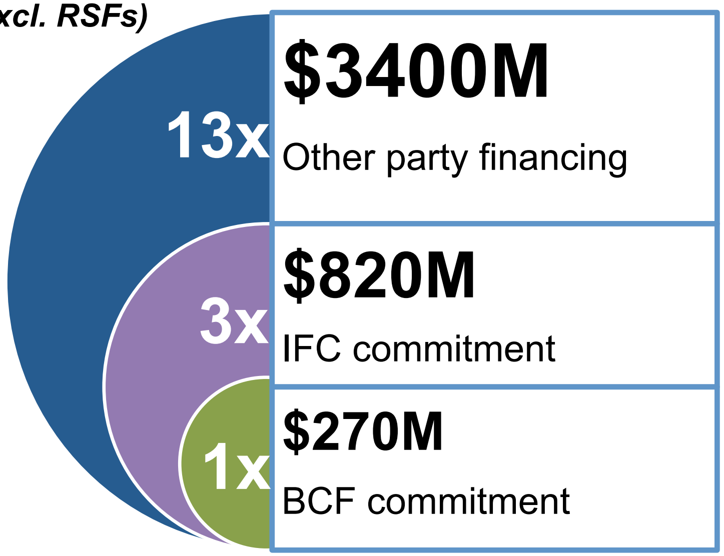

- When a project is not commercially viable due to **high perceived or real risks** and/or **costs**
  - Blended finance can help "fill the temporary gap" in the market and accelerate/catalyze private sector investments
  - In sectors/markets that can become **commercially viable** over time
- High-impact projects that would not have happened otherwise

***Concessional funds can take higher risk and/or lower returns than IFC to enable high-impact/transformational projects***

# CLIMATE FINANCE AND BLENDED CLIMATE FINANCE AT IFC




***Leverage of BCF Commitments: FY10-FY15 (excl. RSFs)***



# PRINCIPLES FOR DEPLOYING BLENDED FINANCE

**IFC's Principles for Deploying Blended Finance**

1. **Moves Beyond IFC Additionality:** Only supports transactions where a subsidy is needed
2. **Avoids Market Distortion/Seeks Minimum Concessionality:** Provide minimal subsidy to make the project happen, with minimal market distortion
3. **Leads to Sustainability:** should not be applied where long term subsidies are required; limited in time; couple with advisory services (as needed) to broaden impact and achieve market transformation
4. **Good Governance:** Conflicts of interest addressed by Blended Finance Committee, a sub-committee of IFC's Senior Management, and a dedicated separate investment team

**IFC pool of multilateral and bi-lateral concessional funds for climate**

CIF Climate Investment Funds

Canada Climate Change Program

gef Global Environment Facility

***IFC's Blended Finance has a track record of being a disciplined investor with strong governance***

# Lessons of Experience

# RELEVANCE OF CROWDING IN PRIVATE SECTOR ACTIVITIES

Increasingly **recognized** over time

**~5%** of GEF funding for private sector

**~30%** of CIF funding for private sector

**"Substantive allocation"** of GCF under a separate Private Sector Facility

**Bilateral allocations** to MDBs (e.g., Canada's facilities with IFC, IDB and ADB)

**Flexibility** (country, technology/sector) can help follow investment opportunities in the private sector

Private Sector can be leveraged through both direct and indirect MDB interventions or "direct access" mechanisms through national entities

# RELEVANCE OF MDB/IFI CO-FINANCING

**Aligns interest** of all parties over the life of the project

**Balances innovation** with financial discipline, which allows scaling-up

**Helps to manage transaction costs** for contributors

# RELEVANCE OF UNDERSTANDING PRIVATE SECTOR TIMELINES AND REQUIREMENTS

Iterative multi-donor facility processes typically do not match private sector decision timeline

Delegated Authority to the implementing entity helps:

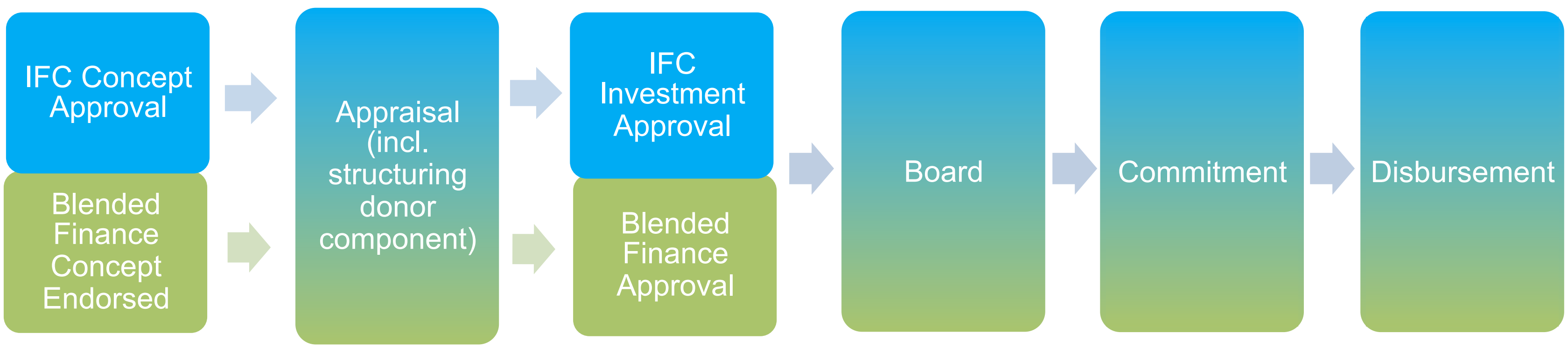
- **Align timeline** of funding decisions to project cycle
- Provide **flexibility to react and respond faster** to changes in project and market conditions

Key to successful engagement by implementing entities

- Well articulated risk appetite
- Clear eligibility criteria
- Established Principles & Governance framework to manage potential conflicts of interest

# GOVERNANCE FOR BLENDED FINANCE TRANSACTIONS

***Strong institutional governance to manage conflicts of interests takes a disciplined investment approach, in line with stated risk-reward of the Contributor***




- Separate  senior-level Approval Body (Blended Finance Committee)
- Separate team to structure donor funded investments
- Separate donor-funded portfolio monitoring and reporting

# STRUCTURING TO ENSURE "MINIMUM CONCESSIONALITY"

- "Minimum Concessionality" to avoid market distortion
    - "Concessionality" goes beyond pricing (instrument, ranking, etc.)
    - Helps maximize leverage of private sector and align incentives with other project financiers

- When possible, structure subsidies linked to demonstrated higher costs, clear utilization of funds, or achievement of milestones in projects with financial intermediaries
    - For example, ex-post interest rate reduction when targets are reached

# Structuring concessional funds

# TO UNLOCK PRIVATE FINANCING THROUGH FINANCIAL INTERMEDIARIES

Blended finance to support financial intermediaries to build a successful track record with a new asset class

- Advantages:
  - Greater reach to smaller companies which cannot be targeted with direct investments
  - Higher leverage of private sector funding vis-à-vis direct investments
- Success factors:
  - Committed management team
  - Advisory services to build capacity

### Credit Lines

- **Interest rate discount** to incentivize banks to develop new lines of business and compensate for the extra costs

### Risk Sharing Facilities

- **First loss guarantees** to encourage liquid banks to lend to small climate-smart projects

### Private Equity Funds

- **Lower expected returns** (e.g., capped returns) to support the growth of private equity and venture capital funds in climate sectors without affecting the returns of commercial limited partners

# TO ENABLE RENEWABLE ENERGY INVESTMENTS

## Typical barriers for first movers

- High transaction costs; first mover challenges
- Untested regulatory environments; lack of track record of PPAs
- Limited ability to raise financing (due to country and/or off-taker risk)

### Senior debt

- **Interest rate discount**: reduce end-user electricity tariffs; help rebalance risk-reward for sponsor
- **Structural subordination** (rear-ended repayment; longer tenor and/or grace): "blended" tenor sufficiently long to meet the minimum debt service coverage ratios and equity returns
- **Deferral** mechanism: mitigate specific project risks (e.g., low spot energy prices) for a limited time period

### Subordinated debt

- Strengthen the project equity profile and encourage commercial lenders to provide senior debt

### Seed/risk capital

- Cover development cost in riskier environments

# Case Study

# CASE STUDY: RENEWABLE ENERGY INFRASTRUCTURE INVESTMENT

**INVESTOR:** Climate Finance Bank (CFB)

**SPONSOR:** XYZ Solar

**THE PROJECT**:

- A utility-scale, greenfield concentrated solar power (CSP) plant with storage in a developing country
- The area contains strong solar resources, and the sponsor has secured all necessary licenses and approvals
- The project has secured an off-take agreement/PPA with a large utility at a price that makes the project viable
- The project is expected to cost $300 million. Debt financing will constitute 70% of project investment
- CFB is expected to provide financing in the form of senior and subordinated debt at commercial rates

**WHY BLENDED FINANCE?**

- The project faces significant technology risks, as there is no operating track record for this new technology at a large scale
- Also, due to the capital intensive nature of the technology, the tariff under the PPA is quite high, and there is little flexibility to negotiate key provisions of the PPA
- These factors, combined with the non-recourse, project finance deal structure, have made investors hesitant to get involved in the project, and therefore concessional financing is required to move the project over the finish line.

**How would you structure the concessional funds to enable this project?**

Option 1.) Provide a senior loan at a lower interest rate

Option 2.) Provide a subordinated loan at a lower interest rate

Option 3.) Provide both a senior and a subordinated loan. How would you price them?

# DISCUSSION POINTS / CONCLUSION

1) What are the leading emission sectors in your country?
2) Do you see opportunities for private sector investments that could support low emissions development in those sectors?
3) Which barriers limit those private sector investments?
4) How do you see blended finance playing a role in supporting those investments?

# THANK YOU AND QUESTIONS

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