Second Africa Adaptation Initiative South South Exchange Program

April 5 & 6 2023

SUSTAINABLE SOLUTIONS FOR AFRICA SSA

Day I

Learning from financing Adaptation in Africa

- Finance and related instruments for adaptation finance in Africa
  - Review of Africa's Public Expenditure on Adaptation (APEA)
  - Studies on needs-based finance and climate access

Addressing the scarcity of climate finance

- Beyond grants and loans, the need for financial innovation to scale up adaptation resources
  - Understanding the concessional and grant elements associated with climate investments and how their understanding can help diversify the use of various financial instruments
  - Deeping NDA capacity and understanding of the diversified roles of various instruments

Potential of equity and guarantee as financial instruments

- Getting familiar with Equity and guarantee instruments through cases studies
  - The Infrastructure climate resilient fund
  - The Green Guarantee company
  - The AAI proposed multi country sovereign guarantee

Learning from financing Adaptation in Africa

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Adaptation remains TOP priority for Africa

The warning

Pace and scale of climate action are insufficient to tackle climate change

Fairness is one of the solutions

- Those who contributed the least to climate change are often the most vulnerable to its impacts.
- Millions exposed to acute food insecurity, reduced water security.
- Biggest impacts in parts of Africa, Asia, Central/South America, LDCs, Small Islands, Arctic.
- People in highly vulnerable areas up to 15x more likely to die in floods, droughts, storms (compared to those in in most resilient areas)

Water scarcity and food production

Health and wellbeing

Cities, settlements and infrastructure

Ecosystem structure, species range shifts and changes in timing

ipcc

APEA (First presentation)

Studies on needs-based finance and climate access

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Key findings

The State of Climate Finance in Africa: Climate Finance Needs of African Countries

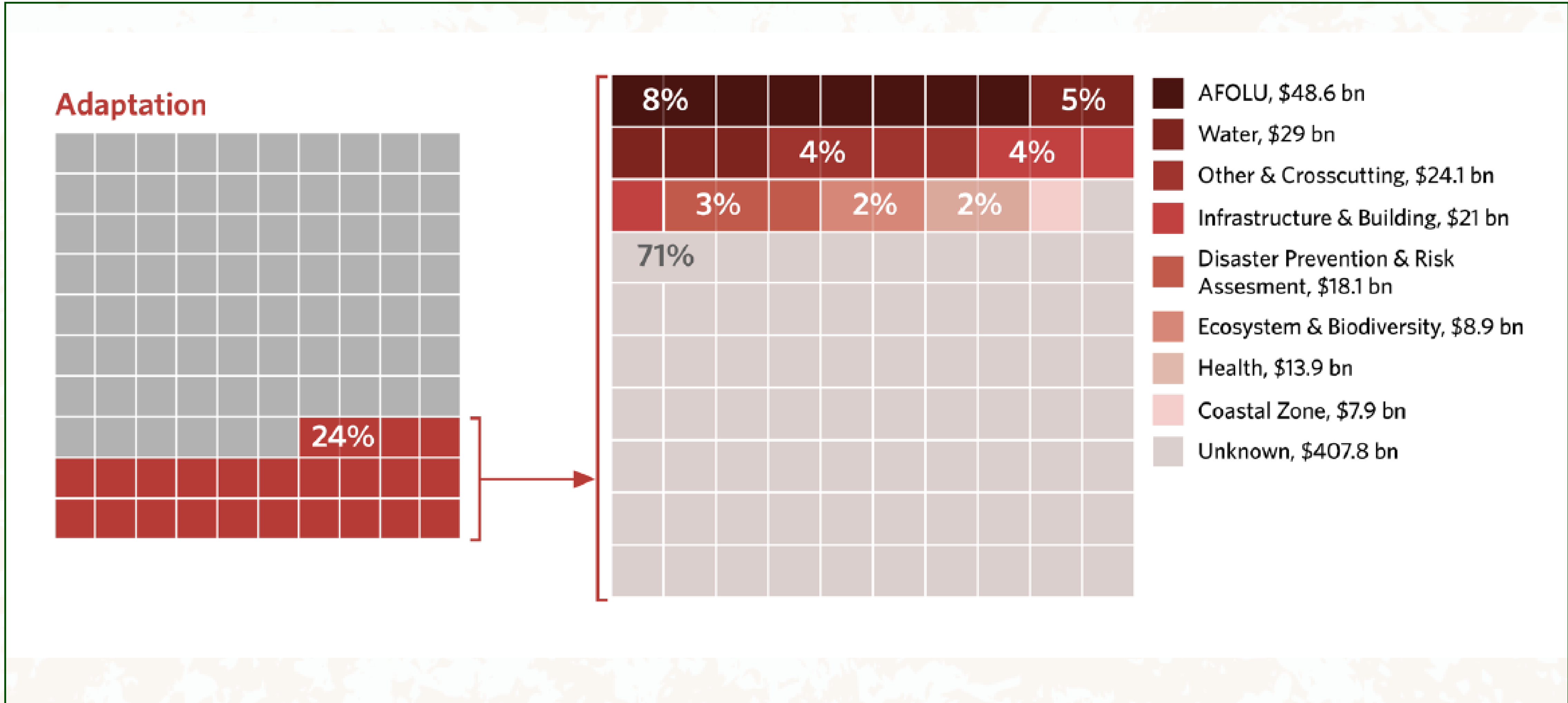
June 2022

Landscape of Climate Finance in Africa

September 2022

- Published by Climate Policy Initiative (CPI), show that Africa's USD 2.5 trillion of climate finance needed between 2020 and 2030 requires, on average, USD 250 billion each year. Total annual climate finance flows in Africa for 2020, domestic and international, were only USD 30 billion (CPI forthcoming), about 12% of the amount needed2.
- The landscape of climate finance in Africa shows that mitigation accounted for 49% (USD 14.6 billion) of climate finance flows in Africa, followed by 39% (USD 11.4 billion) towards adaptation, and 12% (USD 3.5 billion) to dual benefits

Climate finance adaptation needs per sector



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Climate finance adaptation needs per sub region

USD billion

300
250
200
150
100
50
0

Unknown
Water
Infrastructure & building
Health
Ecosystem and biodiversity
Coastal Zone
Disaster prevention & risk assesment
Other and Crosscutting
AFOLU

34.6
271.6
69.3
43.1
156.5

Western Africa	
Mauritania	35%
Mali	26%
Senegal	10%
Ghana	10%
Cote d'Ivoire	6%
Others	12%

Southern Africa	
Namibia	100%

Central Africa	
Cameroon	50%
DRC	35%
Chad	10%
Congo	4%
CAR	1%
Others	1%

Northern Africa	
Morocco	86%
Tunisia	14%

Eastern Africa	
Somalia	76%
Eritrea	7%
South Sudan	7%
Seychelles	6%
Burundi	2%
Others	1%

Addressing the scarcity (but also) quality of climate adaptation finance in Africa

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State of play

- Loans and grants are the two primary instruments for adaptation finance in Africa
- The World Economic Forum reported that adaptation finance leads to more debt as more adaptation related finance was provided as loans (57%) than as grants (42%).
- Only two sectors, agriculture and water supply & sanitation, received half of the adaptation-related funding

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Understanding concessional finance for climate action

- Concessional finance : below market rate finance provided by major financial institutions
    - Concessional finance is a type of financing provided at below-market interest rates to developing countries for projects considered high-impact and respond to globally significant development challenges such as climate change mitigation and resilience.
    - The degree of concessionality of public finance can be measured by its grant element.
    - This type of financing is important because it provides specialized financial support for projects that would otherwise not be able to go ahead without it.
- Not a single mechanism or type of financial support but a range of below market rate products used to accelerate climate and development objectives.

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Assessing the grant elements in financial structuring

Financial Instrument	Description	Concessionality Features
Grants	Non-repayable funds	Include a 100% grant element
Concessional Loans	Provided at below-market interest rates and have longer repayment periods than commercial loans	The grant element is defined as the difference between the loan's nominal value (face value) and the sum of the discounted future debt-service payments to be made by the borrower (present value), expressed as a percentage of the loan's face value.
Guarantees	Provide a guarantee to lenders that they will receive payment if the borrower defaults on their loan	Can provide a first loss guarantee whereby a third party compensates lenders if the borrower defaults to crowd in private sector investors. (1)
Equity Investments	Investors purchase shares in a company or a dedicated investment vehicle and become part owners of that company	One of the most common archetype of concessional finance, include first-loss equity, investment-stage grants, and equity that bears risk at below-market financial returns to mobilize private sector investment. (2)

1. A first loss guarantee is a form of credit enhancement in which an investor has additional recourse to a third party for a stated percentage of any obligation or a percentage of any losses. It can also come in the form of a property insurance policy that provides only partial insurance.
2. Investment-stage grants are a type of concessional equity that provides funding to startups in their early stages of development1. They are typically provided by venture capitalists or angel investors who are willing to take a risk on a new business idea.

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Fit for purpose of diverse instruments

Financial Instrument	Features	Fit	Unfit
Grants	Most concessional and more desirable but might not fit all types of climate investments or actors	For activities that have no financial reflows For start ups	For a requiring a large amount of capital or that are focused on later-stage development

Then other types of instruments are more relevant

Equity financing and concessional loans are two different ways of raising capital for a business or project.

- Equity financing involves selling shares of ownership in a company to investors in exchange for capital.
- Concessional loans, on the other hand, are loans that are offered at below-market interest rates.

Concessional loans

More relevant when the project

- requires a large amount of capital
- can services its debt.
- cannot generate sufficient returns to attract private investors.
- is focused on delivering social or environmental benefits rather than financial returns.

Concessional loans are often used by governments and international organizations to provide funding for development projects in developing countries.

- Being increasingly used for climate change
- Mitigation projects have greater repayment potential
- Adaptation lower, hence loans for adaptation raise the question of quality – Debt for adaptation ? Can make sense if adaptation solutions have potential for repayment (true for very specific sectors)

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Concessional guarantee

- Guarantees are essentially a form of insurance that protects investors against losses in case a project fails. Concessional loans, on the other hand, are loans that are offered at below-market interest rates.
- In general, guarantees can be more relevant than concessional loans in climate finance when investors are hesitant to invest in a project due to concerns about its viability or when there is a lack of available financing.
- Guarantees can help to reduce the risk associated with investing in a project and can make it more attractive to investors.

Potential of equity and guarantee as financial instruments for Adaptation

Equity

Advantages	Disadvantages
Investors are entitled to get a dividend from the profit remaining after paying the preference shares and debts	There is dividend uncertainty
Equity shares provide investors with capital gains, limited liability, control, claim over income and assets, right shares, bonus shares, liquidity etc	Equity shares can be high risk and fluctuate in market price
	Investors have limited control over the company and have a residual claim

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Guarantees

Advantages	Disadvantages
Guarantees can improve the risk profile of an already attractive deal	Guarantees can be expensive
Guarantees can be used as a tool to mitigate against loan loss	Guarantees can be difficult to obtain if the borrower has poor credit or insufficient collateral
	If a borrower defaults on a loan, the guarantor may be required to pay back the entire amount of the loan

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Mobilisation factor

- The mobilization ratio of equity and guarantee varies depending on the type of guarantee and the context in which it is used.
- For example, Bank Guarantees are an effective instrument for mobilizing commercial financing for development purposes.
- On average, a portfolio of debt and equity averaged a 4:1 mobilization ratio.
- Guarantees have a much higher mobilization effect with literature indicating a mobilization ratio ranging from 10:1 to 24:1.

Cases studies

Infrastructure Climate Resilient Fund (ICRF)

Investment strategy

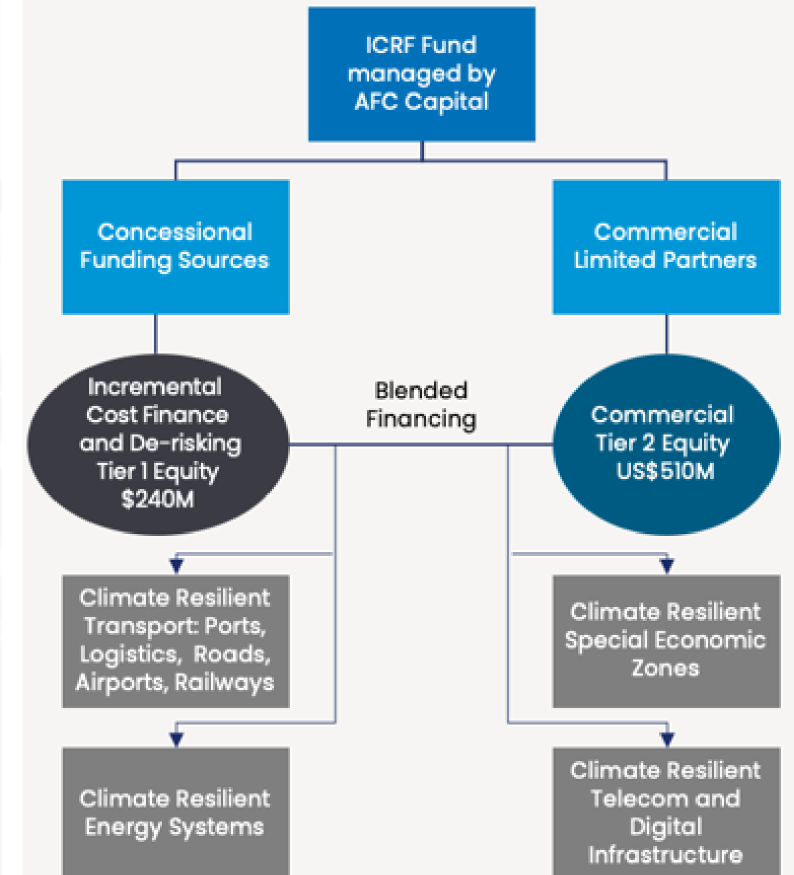
The fund will focus on investments in climate-resilient infrastructure assets, which are planned, built, and operated in a way that anticipates, prepares for, and adapts to changing climate conditions. Resilient assets can withstand, respond, and recover rapidly from disruptions caused by climate change conditions, and improve access of vulnerable people to infrastructure services.

ICRF will focus climate resilient infrastructure investments in AFC traditional infrastructure core sectors including:

i. Transport infrastructure: Ports & Logistics, Road & Bridges, Airports, Railways.
ii. Renewable energy generation, transition, and distribution.
iii. Economic Zones and Industrial Parks.
iv. Telecommunication and Digital Infrastructure.

ICRF will blend commercial and concessional equity capital to deliver bankable climate resilient infrastructure projects. Concessional capital (Tier 1 Class) will be mobilized from the Green Climate Funds (GCF) to integrate climate resilient and de-risk the participation of commercial institutional investors (Tier 2 Class).

This innovative capital structure will de-risk the participation of institutional investors. The concessional equity tranche will be subordinated to the commercial equity tranche, and therefore provide a first loss risk protection to institutional investors such as pension funds, insurance companies, and sovereign wealth funds in Africa and globally.



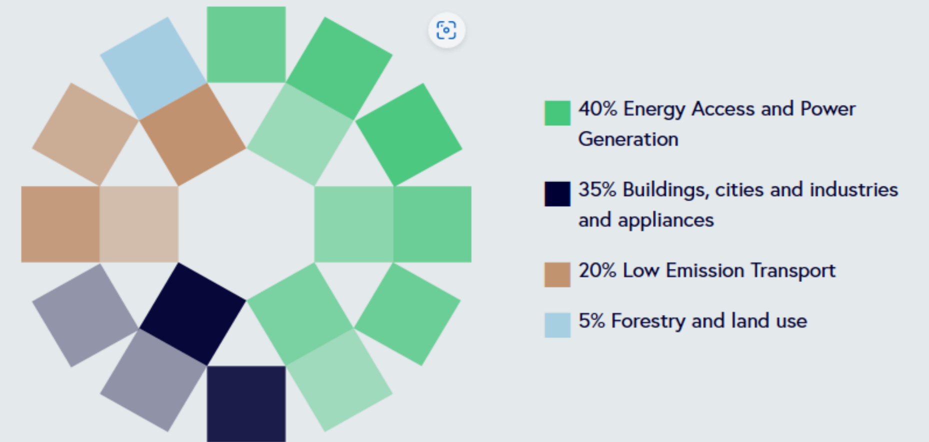
GCC

THE GREEN GUARANTEE COMPANY BY THE NUMBERS

MOBILISE
6 BILLION USD
OF LOANS
AND BONDS

PROVIDE GUARANTEES
OF UP TO
200 MILLION USD
PER TRANSACTION

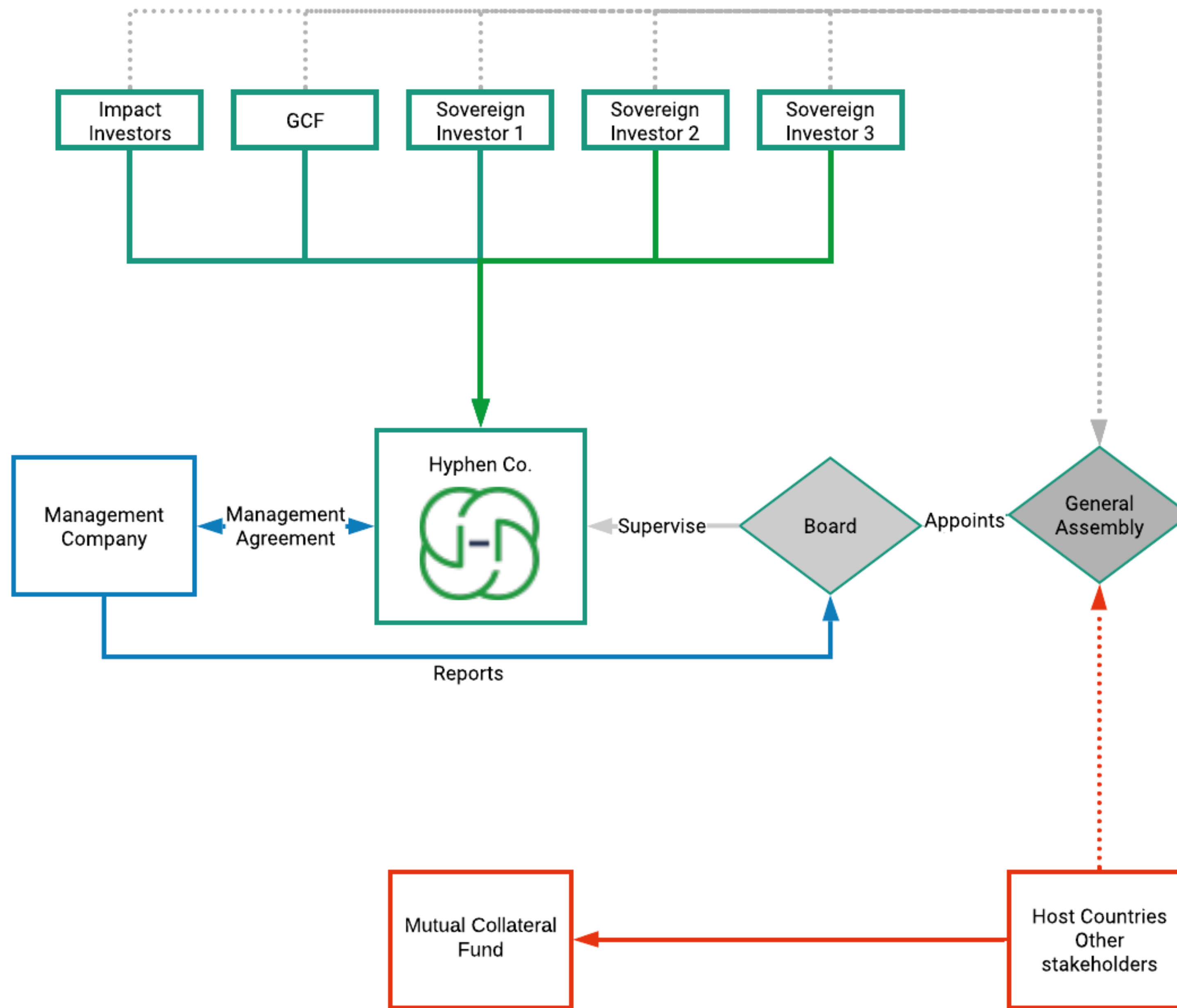
TARGET CAPITAL OF
600 MILLION USD



The design

AAI proposed guarantee : Hyphen

- Project Hyphen is a proposal for founding a new public private partnership (PPP) aiming to create an innovative multi-sovereign backed guarantee mechanism , Hyphen Co., that will solve in a catalytic manner the main barrier to the scaling up of private investment in climate/infrastructure PPPs in EDCs: the chronic cash shortage of LTOs and the lack of sovereign guarantees.
- The Guarantees would be issued by a new public private partnership vehicle, Hyphen Co.
- Hyphen Co. would initially benefit of a capitalisation, in cash and sovereign guarantees, from developed countries and multilateral institutions with a view to opening up to philanthropic and private investors as fast as possible to unlock a double catalytic effect. There are proven and successful cases of guarantee funds or mechanisms backed by sovereigns or sub-national sovereign entities from developed countries, for example, the Swedish International Development Cooperation Agency (SIDA), GuarantCo, and the Africa Guarantee Fund.
- Hyphen Co. can effectively leverage on catalytic capital such as the Green Climate Fund (GCF).
- Hyphen Co. could also experiment new forms of capitalisation, such as debt for climate swaps.
- Hyphen Co. could be structured in an innovative way, building on the very innovative experiences of the Sustainable Infrastructure Foundation, GuarantCo or TCX for instance, and be developed as an open environment to enhance multi-stakeholder cooperation.
- Hyphen would benefit from a very strong, multi-stakeholder governance and would be managed independently by a management company.



Africa Finance Corporation

Thanks