Asia LEDS Partnership NDC Finance
Community of Practice

Summary report of Online Session 1 on ‘Introduction to Blended Capital and Green Bonds’, August 21, 2018

The second online session of the Nationally Determined Contributions (NDC) Finance Community of Practice (CoP) was held on August 21, 2018 and was attended by more than 35 participants.

The session focused on providing introductory background of green bonds market and blended capital to accelerate the capital and investment in green projects. The discussion was fruitful and experts from different countries shared their insights and comments.

Introduction to NDC Finance CoP — Anandhan, ALP

The Asia LEDS Partnership (ALP) is a regional platform under the LEDS Global Partnership, comprised of over 885 members from public, private, and non-governmental sectors that are designing, promoting and implementing LEDS in Asia. The main objectives of the ALP are (1) to facilitate coordination among stakeholders on low emission development, (2) to identify and disseminate tools and best practices, (3) to foster capacity building of practitioners on low emission development and green growth, and (4) to catalyze leaders of change and to raise awareness about the benefits of low emission development strategies.

The priority topics of ALP during the year of 2018-2019 are (1) grid-scale renewable energy, (2) clean mobility, (3) multi-level governance, and (4) NDC finance. The purpose of establishing CoP is to facilitate knowledge and information exchange. CoP is a group learning arena in which people share and learn from each other.

Financial institutions and banks have put effort on clean energy and other climate actions, but apparently, the effort is still not enough to meet the NDCs. Such fact shows that the need to accelerate the capital investment, and to strengthen the link between the public and private sectors. The NDC finance CoP is created to address the needs and to support members of ALP to develop policies and actions. NDC Finance CoP firstly focuses on two financial mechanisms: Green bonds and blended capital.

Introduction to ‘Green bonds’—Bridget Boulle, Climate Bonds initiative

Green bonds are debt securities issued by financial/non-financial or public entities in which the proceeds will completely finance green projects and assets. Green bonds are similar to regular vanilla bonds but with the specific ‘green feature’. Green bonds can be the critical tool to bridge global financial markets with climate mitigation and adaptation solutions. On the one hand, in the global financial market, investors are seeking for opportunities to increase climate investments; on the other hand, to keep the temperature rise below two degrees, all sectors need USD 93 trillion investment. Green bonds could direct capital to the green/climate market.
The green bonds market has been growing rapidly since 2007 in which the World Bank and European Investment Bank issued the first green bond. Not only the amount of issuance but also the issuers have changed dramatically since then. In the year 2017, over 1500 green bonds were issued in 38 countries by 253 different issuers. Different from the period of 2007-2013 in which the issuers were mainly development banks, during 2014-2017 the issuers are more diverse, including financial/non-financial corporate, local government, and country sovereign.

Renewable energy and green buildings dominate the allocation of proceeds in the year 2017, while transport and water issuance are on the rise. The issuance on industrial energy efficiency and information and communications technology has been under discussion, but not much to be issued.

Similar to any innovative financial tools, the rules of the game is important for investors and the financial market. In Asia, several countries have introduced guidelines, such as ASEAN Green Bond Standards, Japan Green Bond Guidelines, and India SEBI Guidelines and so on. Guidelines support the growth of green bonds as guidelines provides information for investors and project managers; for instance, the green bond issuance in China grows after the introduction of regulations.

Green bonds are featured to the investment on green projects. The most critical question in the discussion regarding green bonds is: what are the criteria of ‘green’? Aligning with the Green Bond Principles and the Green Loan Principles, standards and criteria are introduced. Such standards and criteria may be set on the basis of sectors. Climate Bond Initiative develops easy-to-use criteria to assist investors and project managers. For instance, a solar thermal project has gas-fired backup accounting for 30% cannot be considered as a green project, as long as the backup is below 15% of energy generation. The standards and criteria can also be set for a specific region, such as ASEAN Green Bond Standards.

**Discussion on ‘Green bonds’**

- **What do governments have to be involved in green bonds market?**
  Governments do not ‘have to be’ involved, but they can be a good catalyst for some markets. In large and active bond markets, the need for governments is much less. Governments would play the role of providing useful information—such as standards, regulations, and guidance—to enhance the transparency of the market. In developing green bond markets, governments could provide liquidity to the market. There are some examples in Australia and the United States. Local governments issuing sub-sovereign bonds would provide a spotlight to investors. Regarding the demand, governments could be the one to back-up high-risk projects which attract some investors but not all issuers have the ability to issue.

- **The green bonds are not equivalent to climate investment, aren’t they?**
  Green bonds start very much on the climate-based projects, such as energy efficiency and renewable energy. They are also other kinds of projects included. Climate investment bonds – deal with climate related investments – involves different sectors as they relate to climate is the criteria to find and not gree criteria. This is one of the way to find. Climate bond certified
There are different definitions of green bond over the climate. Climate Bonds Initiative, as a non-profit organization facilitating green bonds market development, focuses more on climate-based projects and providing relevant certification.

- **Would there be some examples of the green bonds and off-grid solutions?**
  If here ‘off-grid solutions’ means small solar projects, then bonds play a less crucial role in these small projects. The characteristics of bonds and the market require large projects to attract investors. Though there are retail bonds in the UK and Australia targeting on rooftop solar projects, the market screws towards large infrastructure projects.

**Introduction to ‘Blended capital’—Alexia Kelly, LEDS GP Finance Working Group**

‘Blended capital’ is the use of public or philanthropic capital to attract private sector investment. When private sectors consider investment, they make a decision based on the balance between risk and reward. In order to mobilize private sectors’ investment to NDC and climate-related projects, there is a need to adjust the risk and return. Blended capital can address the risk/return mismatch. It is not an innovative concept, but it has been popular within these two years. In Asia, there are increasing blended finance initiatives on clean energy projects.

Blended finance is a structuring approach that allows different types of capital invest alongside each other while each achieving their own objectives. Blended capital structures can be observed across a broad range of transaction types, including funds, facilities, bonds, notes and so on.

Two cases are taken as examples to explain the role of blended capital in facilitating NDC and LED. One is the Micro-grid Investment Accelerator (hereafter MIA). Micro-grid developers in Africa and India have the potential to grow but they have difficulties to attain capital. MIA provides investment products including mezzanine finance instruments to meet the needs of micro-grid developers and to attract different private sectors’ capital. The structure includes grants, concessionary capital, and impact investment. Many large corporations get involved in MIA. For instance, Facebook provided seed funding in the beginning. The other case is the cKers Finance in India. The existing institutions fail to provide debt at absorbable rates to SMEs on energy efficiency projects, as these institutions are not familiar with energy efficiency and lack the capacity to assess the credit models. The cKers provides a variety of debt products. Among them, the Sustainable Energy Bonds is the most innovative one.

There are six tips to be noticed before designing a blended capital facility, including:

1. **Understand the problem:** As the blended capital is not the one-fits-all solution, it is necessary to talk to the market and to better understand the problem which is to be solved.

2. **Innovate incrementally:** The concept of blended capital is still in the growing phase so that it may not be appropriate to ask investors to invest in a whole new product.

3. **Plan to fund the design process:** The design process likely takes longer time than expected so that it is important to plan funding for the process.
(4) Building flexibility to everything: The blended capital needs to adapt with the market.

(5) Find an anchor/lead investor: As private sectors are always eager to know who get involved in, it is crucial to have lead investors. Ideally, it could be one private sector and one philanthropic/public sector.

(6) Start small: Usually it starts quite small, around 5 million dollars.

Discussion on ‘Blended capital’

- **In the blended capital scheme, is it more like PPP investment?**
  Yes. The purpose of blended financing scheme is to identify where and which we could bring private sectors in, so that the PPP aspect is important. The objective of blending capital scheme is to bring private sector come to the commercial phase.

- **In Vietnam the blended capital scheme is through PPP. Most of the PPP projects focus on transportation, roads, and construction, but not many about green and climate projects. How to promote and persuade private sectors to invest more on green projects?**
  PPP has been applied in transportation and construction projects for decades. It is worthy to take a close look and to think about how to apply some effective elements to green and climate projects. We do need to find a way that the traditional capital market is comfortable with so that we could just push a bit to direct the investment to green projects.

- **In India, there are a lot of opportunities. Is there any centralized data center or source of information that show which investors are willing to commit to which sectors and which types of projects and in which countries?**
  Such kind of source of information is not existing yet. It is quite demanding to create the data center. It would be good to ask regional offices which are familiar with the region and provide information that we could explore.
Expert Q & A | Bridget Boulle, Market & Data Services, Climate Bonds initiative

1. Smaller private RE players in the Philippines want to raise a revolving debt facility to be able to bridge developmental capital gaps to finance RE projects. Can green bonds be raised for this? How do they start and which parties (bank, etc.) will be involved?
   In principle, yes (although without further detail, I can't comment on the attractiveness to investors). As a start, an underwriting bank could be engaged to understand investor appetite and deal structure.

2. How do you translate how green bonds are issued in developed countries to developing countries like Bhutan?
   Issuing green bonds in small developing countries can be challenging (especially if there is little bond market activity) but it is certainly possible and there are many precedents. Bond markets tend to start with highly-rated sovereign issuance and then broaden to corporate and lower rated bonds – this has happened in developed markets and developing markets. This has been the case in many developing countries – e.g. Fiji (sovereign bond), Nigeria (sovereign bond), South Africa (city bond), Argentina (local government) and Lithuania (sovereign). There have also been a few cases where green bond issuance has been supported by multilateral development banks – e.g. in the Philippines where AP Renewable issued a green bond to finance geothermal energy and this was bought by the ADB. There have been a few other examples of this.

4. Can the presenter circulate the SGP green bond grant scheme document to the group?

5. Hi, question from South Pole is that how can the municipalities use green bond to support low carbon city action? Any good examples from this region that you can recommend
   City and local government bonds have been issued by cities all around the world to support climate projects but the legal power for a city to issue bonds is not the same in all countries – in some countries, it is possible but in other counties it is not.

7. What would be minimum size for green issuance?
   There is no minimum size – it depends on the currency, the issuer and the appetite for investors. The average size is approximately USD130m but there have been many deals around USD10m. These include Brazil’s PEC Energia for BRL48m (USD14m), Vietnam’s People’s Committee of Ba Ria Vung Tau Province (VND80bn – USD4m), Enel (Brazil) BRL22m (USD7m) and Hero Future Energies in India USD44m. It is very rare to see a deal that is less than USD5m in size but there even very small deals are possible.

8. What kind of checks or due diligence takes place to decide whether a project is fit for green bonds?
There are many: The main method is that an issuer gets an external review or certification – this can be done by the Climate Bonds Initiative or other organisation that gives either certification or an opinion that the projects are green. Most organisations use the “Green Bond Principles” as a starting point for assessing whether the bond is green along with some additional details. Definitions of green are not fully consistent at the moment but international efforts being undertaken to harmonise definitions. The Climate Bonds Initiative also supplies to data to indices around the world, this data has been checked that the bonds meet basic green principles (although they are not fully certified by the climate bonds initiative.) Every year, about 10% of bonds issued are excluded from this list because either: 1) there is not enough public information to assess greenness, 2) the bond does not meet basic green principles, 3) not 100% of bond proceeds are going towards green projects.

Expert Q & A | Alexia Kelly, Co-Chair LEDS GP Finance Working Group

1. Are there any examples of blended financed projects scaling up and seeking other forms of finance as they mature? Or is it something that is becoming big in its own universe implying that the pipeline of projects for blended finance is an ever increasing one? Some examples?

An excellent resource for examples in the blended finance space is the Convergence Platform. This platform has blended finance case studies/examples from various sectors.

2. Could you give us a sense of the extent of acceleration that blended finance model has been able to achieve? How actively is the blended finance community joining forces with more mainstream financing models?

The concept of blended finance and putting it into practice are becoming more widely known, though putting it into practice has been a bit slower. Our experience in the climate space has been that more and more of the key players are becoming familiar and open to the idea but have some internal hoops to jump through due to funding historically being ring-fenced for specific activities and outcomes.

In terms of joining forces with more mainstream models - mainstream models for the clean energy finance space hasn't been scaled or achieved the levels of success that we desperately need it to, which is the reason behind designing innovative blended finance models - we need new ways / models to bring the various investors in the space together in a way that can leverage and scale funds.

3. I am interested to know how different issuers can pay investors interests through ‘green projects’. While governments may have tax income, how about other issuers? Ideally projects are generating returns from whatever service they provide (mobility, electricity, clean water, etc.) sufficient to cover operation of the program and returns to investors. Blended capital becomes useful when the costs of installing and operating the project exceed the revenues generated from whatever service is being provided.

4. Are there any examples of philanthropic agency or development agency providing loss guarantee?
Many different development organizations provide different types of first loss capital or guarantees. The Packard Foundation and USAID have provided first loss capital for different funds or projects.

Discussion on next steps of the NDC Finance CoP

The NDC Finance CoP encourages all participants to share the topics which they want to explore more. In Q4 2018 there will be an in-person workshop in India. The NDC Finance CoP also encourage the participants to actively participate and share their thoughts.

Access further details and materials from the session:

Presentation

For any feedback or queries please contact:

alpsecretariat@iclei.org