

Leverage in IFC's Climate-Related Investments (2005-2013)



SUMMARY

Development banks – whether global, regional or national, or multilateral, bilateral, or domestic – can play an important role in financing climate-related investment and in leveraging significant resources from the private sector to do so. This report presents an analysis of the International Finance Corporation's (IFC) climate finance experience over a nine-year period from July 2004 to June 2013, and provides insights on trends in the nature of the activities that have been financed, as well as the leverage and mobilization achieved.

Why this paper? Climate change is now acknowledged to be one of the greatest challenges facing our planet. The recent World Bank publication, *Turn Down the Heat: Why a 4° C Warmer World Must be Avoided*, describes well the perils that face our planet if we continue on our current emissions trajectories.¹ Climate change could erode or reverse the gains that the world has made in economic development. Action to move growth trajectories to lower-carbon pathways is urgently needed, and massive investment in mitigation and adaptation will be required. It is also widely acknowledged that this investment will need to come predominantly from the private sector. However, the private sector is reluctant to invest where the returns are not commensurate with risks, be they real or

perceived. The public sector has a large role to play in creating an appropriate enabling environment conducive to investment in general, and low-carbon activities in particular.²

This paper demonstrates that significant private finance can be mobilized for climate-related investment. It attempts to glean lessons from IFC's extensive experience in financing such investment; these insights could inform the deliberations currently taking place in the design of international climate finance mechanisms.

Starting from a relatively modest level in 2005, when IFC began tracking its climate-related activities (21 projects amounting to IFC investment of \$211.7 million, or 4% of IFC's own account commitments), IFC's activities have grown in volume as well as in the breadth of sectors involved, to reach 14% of total own account³ commitments in 2013. This review encompasses 562 investments undertaken over the 2005-2013⁴ period in a variety of sectors, using the full panoply of IFC financial structures and instruments.

The analysis points to a number of interesting observations and insights:

¹ See wrlld.bg/mBkXD

² See IFC (2011). *Climate Finance: Engaging the Private Sector* available at www.ifc.org/Report-ClimateFinance

³ Investments that are carried on IFC's balance sheet; does not include monies mobilized through third parties.

⁴ IFC's fiscal year runs from July 1 to June 30.

There is great potential in leveraging private sector climate-related investment through multilateral development banks (MDBs). As IFC's experience shows, one dollar of IFC climate-related investment brings in close to 3 additional dollars from other investors on average; and that one dollar of IFC investment has itself been leveraged on the strength of IFC's shareholder capital. All MDBs follow a similar funding model, and would likely have similar leveraging potential.

Average leverage ratios, while useful, mask significant variations across project types. A nuanced picture of leveraging potential emerges when the underlying activities are broken down into "like" categories. Even within a relatively homogeneous category, such as renewable power generation, there are variations depending on technology and market characteristics. The private sector does not behave in a homogeneous fashion.

A simple leverage ratio calculation does not always tell the full story. Because of the way IFC accounts for investments, the leverage that will actually be achieved on the ground is not always captured. This is particularly the case for indirect investments, as through financial intermediaries (FIs). Direct investment financing better captures the actual investment that takes place. Neither case captures the broader multiplier effects of investment on income and economic development.

Greater leverage is achieved with well-established technologies. Where technologies are well established and understood by the market, it is easier to attract other financiers to participate in the investment plan. Where there are technical issues associated with a technology, as in solar thermal electric technology (concentrated solar power – CSP), or where the activities financed have not yet entered the mainstream, as in some types of energy efficiency (EE), leverage ratios are lower.

Leverage ratios are often higher for larger projects. Big, capital-intensive projects tend to attract more financiers, as individual lenders run up against exposure limits. Large projects can also absorb the higher transaction costs

associated with multiple lenders and complex project finance structures.

Lower leverage activities may still fulfill important market development roles. In some cases, leverage appears to be low because of the conventions underlying project accounting for that type of activity (as in FI activity, for example). In other cases, the underlying technology may be less well understood by the market, and a critical mass of activity may not yet have been attained for market demonstration purposes, leading to limited co-financing interest on the part of other investors. IFC can play an important role in financing such activities, so as to bring them up the curve and create greater market awareness and acceptance.

Climate-related investment follows underlying market trends. The growth in IFC's climate-related business, particularly for renewable energy (RE), reflects underlying market trends in the RE business, which has seen significant growth in many of IFC's markets. IFC has been ready and able to support such growth, but the supply of capital, while undoubtedly critical, is not necessarily the defining element in the growth of such activity.

Climate-related investment needs a conducive underlying investment environment. Most of the activities that IFC has undertaken to date have not involved explicit subsidies. This means that their creditworthiness derives from the prevailing business environment, policy and regulatory regimes in the countries involved. In the absence of such conditions, such investments will simply not take place – or will require additional risk mitigation measures.

Active "selling" of climate-related activities can help. In some cases, climate-related opportunities may not be immediately obvious to a client. This is particularly the case in some EE improvements. In such cases, the difference between their adoption or not is the advice and technical expertise that can be brought to bear in a given project. IFC's in-house technical experts (engineers and environmental specialists) are key to such

active client engagement, particularly in the context of IFC's Performance Standards⁵ which requires clients to consider resource efficiency possibilities.

Climate finance is often a portion of the overall financing. In many cases, the climate-related portion could be tangential to the main investment being pursued, yet there may well be opportunities to reduce the project's emissions footprint through captive renewable energy (RE) or EE measures. Such components may be a small part of the project overall, but they should not be discounted for their impact or demonstration value. Here again, active client engagement by IFC's technical staff is key.

Blended finance can nudge investment into promising, but as yet commercially unproven areas. Often, being a first-mover entails risks that make it difficult for a client to complete a financing plan on acceptable terms. The perceived risk may be too high even for a development finance institution like IFC. A small amount of concessional finance used to address such risks can act as a catalyst and mobilize the necessary financing.

What gets measured gets managed. It is only when IFC made a public commitment to grow its RE and EE activities⁶ that a tracking system was put in place; it is only when such investments began to be tracked and targets set that staff realized that there were several climate-related opportunities in the business that could, with a little extra effort, be materialized. IFC's commitment to grow its climate-related business has given a boost to such endeavors.

Advisory services and capacity building are essential components of some activities.

This paper has not examined Advisory Services (AS) and the role that it has played in supporting IFC's climate-related activities. The brief description of AS programs provided shows that some technical assistance and capacity building activities are essential building blocks for certain types of climate-related investment.

Leverage is an important “bang for buck” measure, but not the only one.

Leverage shows how much money was mobilized on the back of a public dollar, but it does not capture the impact of that money in terms of GHG reductions, or employment creation, or any number of other co-benefits on health and local pollution or other objectives that a country may wish to pursue. These should be areas for further work for IFC and others.

This paper is a part of a series of publications underpinning a report to the G20 Development Working Group on “Mobilizing Public and Private Funds for Inclusive Green Growth Investment in Developing Countries.”

The full version of this paper and the aforementioned report are available online at www.ifc.org/climatebusiness.

⁵ www.ifc.org/performancestandards

⁶ In Bonn in 2005.

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