**September 2019**

# Finland-IFC Blended Finance for Climate Program

## *- Catalyzing Climate Finance, Accelerating Climate Solutions -*


*Girls on their way to school near the Trishuli River Basin, passing the forthcoming Upper Trishuli-1 run-of-river hydropower project site that will provide renewable energy to future generations in nearby areas. The project will also increase other development activities in remote and hard-to-reach areas in the region with additional benefits to affected local communities such as livelihood opportunities, schools, hospitals and free electricity. Support from the* Finland-IFC Blended Finance for Climate Program *is instrumental in making the project a reality.* Photo © Mohammad Shahnewaz Khan/IFC.

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*The Finland-IFC Blended Finance for Climate Program was established in October 2017 to* ***catalyze innovative investments*** *and* ***unlock private financing into climate-smart projects*** *in developing countries,* ***creating markets and opportunities*** *to the private sector in places that banks and other investors have traditionally deemed 'too risky'.*

*Blending concessional funds from the Program helps* ***mitigate the uncertainties and risks*** *that deter investors from entering frontier markets,* ***rebalance risk-reward profiles*** *of early movers and* ***unlocks investments for high-impact climate projects*** *for mitigation and adaptation activities.*

## KEY FEATURES

**Size of the fund:** €114 million

**Duration:** 25 years, including a 5-year active investment period

**Priority sectors:** Renewable energy; Energy efficiency in buildings; Agriculture, forestry and land-use; Water, wastewater, and sanitation; Meteorology; Food security; Sustainable forestry

**Geographies:** Global, targeting the funds to projects in Least Developed Countries, Other Low-Income Countries, and Lower Middle-Income Countries and Territories

**Instruments:** Equity, senior debt, mezzanine debt, and guarantees

## Role and Value of IFC and Blended Finance

For more than six decades, IFC has been a leader in private sector development — working with multinational, regional, and local companies to accelerate growth and lift people out of poverty while promoting global competitiveness and global standards. IFC's **'global reach' is one of IFC's strongest competitive advantages**, demonstrated not only through geographical coverage, but also through IFC's capacity and ability to **create and then transfer successful solutions and experience from one region to another**.

As an example, IFC started unlocking private investment in solar power in emerging markets through the Scaling Solar program in Zambia and in other African countries, which is now being transferred to the Europe and Central Asia (ECA) region. Another example is the Cities initiative, which started by first experimenting in the ECA region (e.g. Turkey, Kazakhstan, Ukraine) and which is now being expanded and adapted to Asia and Latin America and Caribbean regions. IFC is thus positioned to **deliver solutions and impact at scale** and across sectors and regions.

IFC's new strategic framework – IFC 3.0 – is a concrete response to the challenge of converting "Billions to Trillions" by **deploying new tools and amplifying development impact**. Blended Finance[1] plays a **critical role in IFC's efforts to create new markets** by demonstrating their commercial viability, and to **leverage scarce ODA resources** to crowd-in and **mobilize vastly more private capital** for developing countries.

[1] For purposes of this note, as adopted by the DFI Working Group on Blended Concessional Finance for Private Sector Projects, the definition of blended concessional finance or blended finance refers to: *Combining concessional finance from donors or third parties alongside DFIs' normal own account finance and/or commercial finance from other investors, to develop private sector markets, address the Sustainable Development Goals (SDGs), and mobilize private resources.*

## *Multiplying the Development Impact of ODA Contributions*

The investment needed to achieve the Sustainable Development Goals (SDGs) by 2030 is far beyond the reach of public sector contributions. Participation from the private sector is essential to transform **billions of ODA into trillions of private sector capital flows**. However, many emerging markets, particularly among the poorest countries, are considered **too risky by private sector investors**. Constraints such as lack of transparency, inadequate investment climate or regulatory framework, poor infrastructure or a lack of access to skills and finance remain key obstacles to private sector engagement. Blended Finance is a critical tool to bring private sector investment, by **mitigating risk, opening doors for new projects**, and **securing critical investments** that would not happen otherwise. Blended Finance provides targeted financing solutions that help overcome financing barriers, move deals over the finish line, and boost IFC's development impact by **enabling high-impact projects** that would not otherwise materialize.

For contributing partners, such as Finland, Blended Finance also offers an **opportunity to re-invest** financial reflows from the investments under the Finland-IFC Blended Finance for Climate Program, **multiplying the development impact** that donors can achieve with their ODA contributions.

## *Delivering Leverage and Additionality*

From fiscal years 2010-2019, IFC deployed $1.2 billion in blended concessional resources across many sectors and themes supporting 212 projects, mobilizing $4.1 billion in IFC's own resources and an additional $5.5 billion from other private sources. For **each $1 contributed** as concessional resources by our partners, IFC blended finance investments **leveraged more than $9 additional dollars to finance critical projects** that paved the way for private sector engagement in some of the most challenging markets in the world.

Beyond leverage, IFC's blended climate finance projects continue to demonstrate robust development impacts. As part of IFC 3.0, IFC is looking to systemically assess development impact across its entire portfolio by implementing the new "AIMM" (*Anticipated Impact Measurement and Monitoring*) system that enables IFC to assess and measure the expected development impact of projects while they are still being developed. This approach allows IFC to set **ambitious yet achievable targets**, select **projects with the greatest potential for development impact** and financial sustainability, and **optimize project design**.

The AIMM system enables IFC to assess an intervention's **project-level outcomes** as well as its **systemic effects on the overall market**. It also looks at how a project affects stakeholders and examines the broader effects on the economy and society.

## *Key Lessons Learned: Experience, Principles, and Partnerships Matter*

IFC has been operating in the blended finance investment space for more than **a decade** and, in recent years, has been **leading and actively participating in many of the key discussions on definition and data harmonization of blended finance** for development. For example, IFC has chaired the working group of development finance institutions (DFIs) on the use of blended concessional finance for private sector projects resulting in 2017 in a *DFI Enhanced Principles* report on the **principles and guidelines that aim to maximize impact and minimize potential distortions through the use of concessional resources**.

In 2018 the DFI Working Group on Blended Concessional Finance for Private Sector Projects released an updated report providing extensive data on **how blended concessional finance is used** by DFIs and **how to promote the effective and efficient use** of blended concessional finance for private sector projects.

From many years of experience in blended finance, IFC has learned some key lessons. These include:

- ***Leverage and crowding-in matter***: Blended finance has proven to be a powerful tool and effective element for crowding-in private investment;
- ***Principled approach matters***: IFC uses a disciplined and targeted approach when it comes to blending concessional donor funds with its own commercial funds by applying the five Blended Finance Principles: (1) Rationale for Using Concessionality, (2) Crowding-in and Minimum Concessionality, (3) Commercial Sustainability, (4) Reinforcing Markets, and (5) Promoting High Standards;
- ***Market demonstration and sector sustainability matter***: Public institutional expertise and emerging-market knowledge are essential to identify and structure projects that can demonstrate market and sector sustainability;
- ***Risk/return allocation matters***: Successful deployment of blended finance requires a well-crafted risk/return allocation for innovative investments and strong governance so that leverage and development objectives are met;
- ***Partnerships matter***: Blended finance solutions capitalize on partnerships among a multitude of development and private sector partners, foremost on the vision and risk appetite of partners willing to be part of creating solutions for the most challenging markets in developing world through concessional capital contributions.

## Climate-Smart Business – the Economic Growth Story of Today and Tomorrow

Global markets for climate-smart businesses and technologies have grown to $1 trillion annually. This growth is expected to accelerate, delivering **environmental and social benefits while creating value for investors**. An IFC report[2], based on the national climate-change commitments and underlying policies of 21 emerging-market economies – **representing 48% of global emissions** – showed that **21 emerging market economies alone hold $23 trillion in climate-smart investment opportunities** through 2030. A subsequent report[3] found that cities alone hold $29.4 trillion in climate-smart investment opportunities through 2030. These reports also identified sectors in each region where the potential for investment is greatest with the following highlights:

- *Sub-Saharan Africa*: Clean energy presents a $783 billion investment opportunity in Côte d'Ivoire, Kenya, Nigeria, and South Africa;
- *Middle East and North Africa*: Egypt, Jordan, and Morocco can unlock $146 billion in investments for green buildings, transport, and waste;
- *South Asia*: By developing climate resilient infrastructure, India and Bangladesh can unlock $2.5 trillion in investment opportunities;
- *East Asia and the Pacific*: Green buildings in China, Indonesia, the Philippines, and Vietnam show a climate-smart investment potential of $16 trillion;
- *Latin America and the Caribbean*: Investment opportunities for sustainable transportation in Argentina, Brazil, Colombia, and Mexico exceed $2.6 trillion;
- *Eastern Europe*: Russia, Serbia, Turkey, and Ukraine hold $665 billion in energy efficiency and green building investment opportunities.

[2] *Climate Investment Opportunities in Emerging Markets*, IFC, November 2016.
[3] *Climate Investment Opportunities in Cities*, IFC, January 2018.

IFC's Climate Business **creates markets by investing directly in climate-smart sectors, developing new de-risking and aggregation mechanisms – many times through blended finance solutions**, and engaging public and private sector stakeholders through international forums and working groups.

**Through blended finance, IFC can de-risk private sector** investments and **leverage public sector resources** multiple times in these challenging markets, promoting an opening of key sectors to private participation and creating a significant impact on development in these regions.

## Progress Update of the Finland-IFC Blended Finance for Climate Program

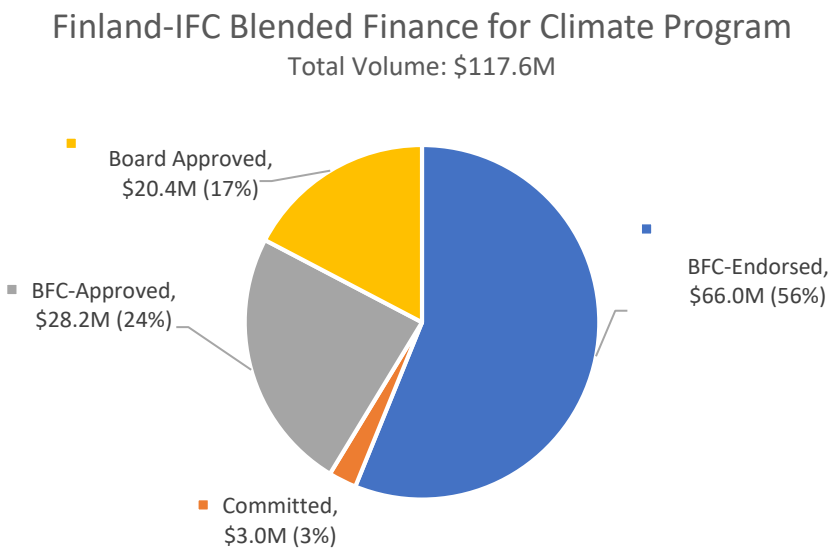
Since the establishment of the Program, the pipeline of the Finland-IFC Blended Finance for Climate Program is demonstrating both **strong demand for first-of-their-kind, innovative climate projects** in some of the world's least developed countries and the **critical value-add** of the Program.

### *Current Pipeline – A Reflection of Strong Demand for De-Risking Innovative Climate Solutions*

As end of fiscal year 2019 (June 30, 2019), the Program portfolio and pipeline highlights include:

- With one project already committed, two projects being approved by the Board, and additional projects approved by the Blended Finance Committee or the Blended Finance Director, approximately **44% of programmed funds** are currently allocated to the "**downstream" pipeline**;
- With an additional six projects being concept endorsed, **around 56% of programmed funds** are currently in the "**midstream" project pipeline**;
- As an indication of the strong interest and demand towards the Program, the **available funds under the Program are now nearly fully allocated to projects and project concepts** with approximately 3% of contributed funds available for new programming;
- The Program is thus entering to an "over-programming" phase following the pipeline management measures, i.e. when Program funds are allocated to endorsed projects, projects can still be presented to the BFC but will seek an endorsement subject to funding availability[4];
- Several additional high-impact projects are currently in the "upstream" pipeline seeking endorsements subject to funding availability.

[4] Funds will become "available" with pipeline fluctuations, which occur when an endorsed or approved project is put on hold or does not proceed to commitment.




Although the final composition of the project pipeline can still change – as some projects can still drop while some others will enter the pipeline from the more upstream stage – the fast pipeline development and demand is evidence of the **vast need for de-risking tools to support innovative climate projects**: around 97% of Program funds are supporting pipeline projects in just over one and a half years (out of the five year investment period).

The set of investments and projects in the current pipeline is also **geographically diverse**, with downstream projects in Africa and South Asia, and midstream projects in Africa, Southeast Asia, Europe and Central Asia, Middle East and North Africa, along with some global projects.

In terms of instruments, the portfolio and tentative pipeline of the Program represent a **well-varied investment composition**: the investments in the portfolio and downstream pipeline include early-stage risk capital, equity investment, and senior debt. As of the end of fiscal year2019, the planned instruments in the midstream pipeline include equity, subordinated debt, senior debt, and guarantees. This diversification of instruments allows a balanced portfolio in terms of risk and reward with equity, guarantees and subordinated debt generally carrying higher risk than senior debt. However, from a pricing and potential returns perspective, it is the non-senior debt instruments that usually fare better.

## *Collaboration and Business Development Opportunities for Finnish Companies*

A key element of the *Finland-IFC Blended Finance for Climate Program* is to strengthen collaboration opportunities between IFC and Finnish stakeholders. These activities include e.g. increasing IFC's visibility locally and accrue awareness among Finnish private sector actors on business development opportunities in emerging and frontier markets; enhancing the know-how among Finnish private sector and sector-specific industries of procurement opportunities in IFC and World Bank Group projects; and building knowledge among Finnish stakeholders of business opportunities and financing potential especially in the Program sectors. The Program is on a promising track to deliver also on these objectives and activities, which thus far have led to one signed Memorandum of Understanding and other on-going discussions with Finnish companies on projects that can be supported by IFC financing.

## Looking Forward: Significant Expected Demand Growth in New and Innovative Climate Sectors

In the short and medium term there is a **significant expected growth in demand for blended finance for new climate sectors and innovative solutions**, including e.g. waste management, floating solar, battery storage, offshore wind, transport, etc. Therefore, the range of application of concessional funds needs to remain broad – or even expanded – to account for the growing demand in emerging climate areas.

- The infrastructure sector is expected to continue shifting rapidly as a result of **next generation technologies**, such as battery storage & hydrogen, and the **effects of geography** (e.g. off-grid areas) – all of which require at least at the beginning increasing amounts of blended finance to mitigate risks and unlock investments. In addition, there will be a growing need for 'upstream strategies' and **upstream project development** where individual projects lead the way toward more holistic sector reforms.

- Forward-looking strategic themes in the manufacturing, agribusiness, and services sectors include **climate-smart projects that are scalable and cut across value chains**, such as cold-chain refrigeration, food-loss reduction, packaging, circular economy, etc. In Sub-Saharan Africa, **programmatic approaches in climate-smart agribusiness** include themes such as AgTech, transport, value-chains, non-bank financial institutions for farmers, etc.

- Financial sector operations are facing a growing need for **performance-based incentives to scale climate lending**, combined with funding mobilized by IFC from market resources and blended finance resources in the form of loans that would also include risk-sharing elements on a case by case basis.

- Mitigation and adaptation projects addressing **forced displacement and climate migration** and projects limiting the severity of **health impacts** resulting from climate change will be growing areas in the near future.

In short: There is an ongoing need for **flexible approaches** with a diverse array of instruments and with **high-risk tolerance** to help de-risk projects across different sectors to create or accelerate sustainable markets.

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CONTACT INFORMATION:

Kruskaia Sierra-Escalante
Senior Manager, Blended Finance
International Finance Corporation
2121 Pennsylvania Avenue NW
Washington, DC 20433
www.ifc.org

Jussi Tapio Lehmusvaara
Operations Officer
International Finance Corporation
2121 Pennsylvania Avenue NW
Washington, DC 20433
www.ifc.org

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# *Snapshots of Board Approved Projects in Finland's Current Portfolio*

## *GAIA WIND POWER PLATFORM IN AFRICA*

*Current Situation and Development Barrier*

- Uptake of wind energy in Africa is limited because of high development costs associated with land acquisition, low government capacity to establish the enabling environment for first-of-a kind IPPs, high off-taker risks, limited availability of long-term financing, and lack of private investors willing to invest early stage development capital.
- Currently only a few wind projects in Africa are reaching the stage where they are suitable for project financing.
- As a consequence, wind resources are significantly underutilized in Africa, with less than 1% of global installed wind capacity (as of end 2017).

*Critical Value-Add of the Finland-IFC Blended Finance for Climate Program*

- The Blended Finance co-investment from the Finland Program will provide additional risk capital not available at this moment for early stage development of wind projects in Africa.
- Catalyzing the development of wind power projects in Africa with a pipeline of more than twenty potential projects in nine countries in North, West and East Africa, representing a pipeline under development of more than 3 gigawatts.
- If the initial development work is successful, this investment will crowd in new investors both during the development phase and at financial close of the underlying wind projects.

*Expected Impact of the Project*

- Increased power generation capacity in several African countries that face access and reliability constraints.
- New generation capacity from local resources helps power systems to better respond to energy supply shocks.
- Lower carbon footprints of the power generation systems.
- Development of the wind energy potential in Africa through the establishment of a pipeline of bankable projects, necessary to mobilize private investors and commercial financing.

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# *UPPER TRISHULI 1 HYDROPOWER PROJECT IN NEPAL*

*Current Situation and Development Barrier*

- Nepal is abundantly endowed with hydropower resources that can both meet the domestic electricity needs and enable it to become an important player in regional power markets.
- However, the energy sector has not been able to attract the significant investment that is needed, especially from foreign sources, for large transformational projects.
- Nepal currently imports both power and fossil fuels to supply the generation needed to provide reliable power for industry and commerce – making it difficult for Nepal to become a competitive economy.

*Critical Value-Add of the Finland-IFC Blended Finance for Climate Program*

- The sustained multi-party effort, including the Finland Program, is critical to help the project company and government to agree on internationally bankable set of project agreements and ultimately to develop a replicable, environmentally sound, and financially sustainable project.
- The support by the Finland Program will be instrumental in making the project a reality.

*Expected Impact of the Project*

- The Upper Trishuli 1 Hydropower project is breaking new ground in many ways. It represents one of the largest foreign direct investments in Nepal to date and, when completed, will increase Nepal's domestic power supply by one third compared to 2018 generation levels, helping to meet the country's significant and growing demand for electricity.
- The project supports the development of a key greenfield 216 megawatt run-of-the-river hydropower project north of Kathmandu. It is also expected to help reduce greenhouse gas emissions by expanding renewable energy capacity to help avoid increased reliance on fossil fuel-based generation.
- The expected major demonstration effect of this joint effort at the project and sector level is crucial for Nepal to replicate UT1's contractual structure and tariff framework to attract significant capital and expertise.

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# *SCALING SOLAR IN SENEGAL*

*Current Situation and Development Barrier*

- Diversifying from imported heavy fuel oil (HFO) and diesel for power generation is central to Senegal's power sector development strategy.
- Over-reliance on imported HFO has introduced structural vulnerabilities into the power sector that derive from exposure to oil price volatility, high average generation costs, high end-user tariffs that still fail to fully cover costs, and reliance on government subsidies.

*Critical Value-Add of the Finland-IFC Blended Finance for Climate Program*

- The Finland Program, through the WBG Scaling Solar Program, will help Senegal realize the objectives of the Strategic Electricity Generation Master Plan by allowing the deployment of solar PV capacity.
- The Finland Program will add critical value by supporting the Scaling Solar Program in creating viable markets for solar PV power plants in Senegal, enabling the government and utilities to procure such plants transparently and at the lowest possible cost.

*Expected Impact of the Project*

- The project is expected to improve reliability of supply and reducing the average cost of generation. The investment adds 79 MW of power generation capacity to the electricity grid, sourced at competitive tariffs.
- The additional capacity substitutes costly thermal capacity based on imported fuels and emergency plants.
- Displacement of current and future thermal power generation by solar PV would result in reduced carbon emissions and pollution and contribute to climate change mitigation.
- By supporting the first IPPs procured under the Scaling Solar framework, the Project demonstrates a competitive replicable model to scale solar PV in Senegal that also contributes to establishing a low tariff benchmark.