Overview of Climate Finance in Asset Recycling

Full Description

Defining climate finance

Climate finance broadly refers to resources, from public and private sources, mobilized to facilitate, materialize, or expand activities that support climate change mitigation actions and adaptation efforts. According to the United Nations Framework Convention on Climate Change (UNFCCC), “climate finance refers to local, national or transnational financing—drawn from public, private and alternative sources of financing—that seeks to support mitigation and adaptation actions that will address climate change.”

Climate change mitigation refers to actions that seek to reduce or avoid the release of greenhouse gas (GHG) emissions, or to increase the capacity of carbon sinks, thereby helping slow the pace of global warming. Adaptation refers to efforts to enhance or improve the resilience of infrastructure, communities, economies, and ecosystems, and adjust to both the current adverse effects of climate change and the predicted future impacts.

Landscape for climate finance

According to the Global Landscape of Climate Finance 2021 report from the Climate Policy Initiative (CPI), total climate finance reached USD 632 billion in 2019/2020.[1] The public sector accounted for 51% (USD 321 billion) of all 2019/2020 tracked climate finance. Development Finance Institutions (DFIs)[2] continued to provide most of the public finance, at 68% (USD 219 billion) of all public contributions. State-owned financial institutions and governments contributed nearly all the remainder, accounting for 14% (USD 45 billion) and 12% (USD 38 billion) of all public flows, respectively.

Private finance from private sector actors (including corporations, commercial financial institutions, households, and non-profit and philanthropic organizations), accounted for the remaining USD 310 billion, with commercial financial institutions and corporations together contributing almost 80% (USD 248 billion) of this amount. Households comprised the third largest share of private climate finance, with annual consumer spending on electric vehicles reaching USD 25 billion in 2019/2020.

Most climate finance, 61% (USD 384 billion) of global tracked investments, was raised as debt (i.e., via debt instruments including bank loans and bond issuances). Market-rate debt accounted for 88% (USD 337 billion) of this total, while 12% (USD 47 billion) was raised as low-cost or concessional debt. Almost 100% of concessional and low-cost project debt was provided by public institutions. Equity investments accounted for 33% (USD 206 billion) of total climate finance. Grants accounted for 6% (USD 36 billion) of all climate finance in 2019/2020, with governments as the main source of grant funding.

Renewable energy accounted for 57% (USD 324 billion) of all finance for mitigation activities, with solar photovoltaic and onshore and offshore wind accounting for over 91% of this amount. Renewable energy projects were primarily financed privately (USD 222 billion), reflecting the sector’s growing commercial viability, with an additional USD 101 billion coming from public sources.

Adaptation finance reached USD 46 billion in 2019/2020, reflecting a 53% increase compared to USD 30 billion in 2017/2018. The public sector provided nearly all tracked adaptation financing, with adaptation finance accounting for 14% of total public sector climate finance.

Most climate finance flowed domestically, with about 76% (USD 479 billion) of all tracked climate finance raised and spent within the same country. International flows reached USD 153 billion (24%), driven mainly

by increased investment by DFIs. Regionally, East Asia and Pacific, Western Europe, and North America accounted for 75% (USD 474 billion) of global climate investments, with East Asia and Pacific comprising almost half (USD 292 billion) of all tracked investments. Approximately 81% (USD 237 billion) of this amount was concentrated in China. Most climate investment in more economically advanced regions, namely Western Europe, United States, Canada, and Oceania, came from private sources, while other regions primarily relied on public sources.

Advantages and barriers to accessing climate finance

Key advantages of climate finance include expanding the pool of available financing for climate-related projects and opportunities to leverage risk sharing mechanisms to increase viability at the project level. This includes access to dedicated funds (international and in some cases national), multilateral and bilateral development institutions, and strategic private investors (such as pension funds), as well as non-governmental and philanthropic organizations that are committed to investing in climate mitigation and adaptation efforts. In addition, for some activities or interventions, more favourable funding and financing instruments, such as, grants, seed funding, and concessional loans, may be available.

Government resources alone cannot provide the amount of finance needed for the climate transition, making unlocking private sector capital fundamental to achieving transformational and long-term impacts across all economies. Climate finance can play a catalytic role in mobilizing private investments in mitigation and adaptation activities and aligning public and private investment incentives. The combination of traditional investments with innovative financing instruments is increasingly gaining traction, with larger climate finance sources expecting to leverage more private investments alongside public finance.

The private sector is also exposed to various climate-related risks that may prompt action and investment. These risks range from economy-wide risks to entire sectors or industries, to company- and asset-specific risks. Adverse impacts can be direct, including damage to infrastructure and disruption of production processes, and indirect, through disruption to supply chains and changes in regulations, product demand, and business reputation. Climate finance accelerates investments that reduce vulnerability to these risks.

At the same time, seeking climate finance requires additional time and expense, both to prepare a climate finance proposal on the front end and then monitor and report on results on the back end. The level of effort can be substantial, particularly if the climate impacts are difficult to quantify and evaluate. It also tends to increase overall transaction costs, as time and resources must be devoted to identifying and applying to an appropriate climate financier, including obtaining any required certifications and/or accreditations. Accessing climate finance can be a complex process, in some cases involving multiple layers of governance and institutional arrangements (at the domestic and/or international level), public and private actors and institutions, and an array of financial instruments that may be mobilized to deliver the funds.

Climate change mitigation and adaptation projects may have different financial characteristics and face distinctive financing challenges. Some common barriers to accessing climate finance include:

- The time and cost associated with understanding the specific requirements and criteria of climate investors and submitting specific project proposals and supporting technical documents that satisfy investor criteria.
- The time and cost associated with gathering and processing climate-related data and information (for example, weather data covering wind, sun radiation, and precipitation; information on the nature, likelihood, and intensity of meteorological and hydrological implications of climate change).
- Uncertainty over, or unfamiliarity with, the use of new technologies, new project types, and innovative transaction structures.
- Uncertainty over methodological issues for evaluating climate-related benefits, for example how to calculate energy savings from investments in energy efficiency.

- Absence of domestic enabling conditions for climate finance, for example the availability of reliable third-party verifiers and legal frameworks for defining and certifying green financing instruments and projects.
- Absence of, or insufficient, carbon pricing schemes or feed in tariffs that would level the playing field with more emissions-intensive alternatives.
- Immature or underdeveloped financial markets.
- Political and regulatory risks.
- Macroeconomic volatility (fluctuations in exchange rate, inflation, interest rates, etc.).

There are, however, dedicated funding sources and Project Preparation Facilities that support institutions that lack adequate in-house capacity to access climate finance. These funds support the project development process (for example, by providing funding to procure third-party specialists/consultants to complete necessary studies) and related activities, including technical assistance and capacity building, preparation of climate finance proposals, and improving the enabling conditions set by the government for the effective deployment of climate finance.

Footnote 1: All figures cited herein related to the flow of climate finance are as per CPI's Global Landscape of Climate Finance 2021: Climate Policy Initiative. 2021.

Footnote 2: As used herein, a DFI, also referred to as a development bank or development finance company, broadly refers to a specialized financial institution that provides risk capital for economic development projects, often on a non-commercial basis. A DFI is usually majority owned by governments and may be bilateral, for example Germany's KfW Bankengruppe, or multilateral, for example the Asian Development Bank.

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