

GCF insight: Co-financing

GCF insight seeks to understand what's working - and what's not working - in Green Climate Fund (GCF) project development. The surveys and reports spotlight the most topical GCF issues. This fifth edition explores challenges associated with co-financing of GCF projects.

Spotlight on co-financing

At the 15th UNFCCC COP in Copenhagen in 2009, developed countries pledged to provide USD 100 billion per year by 2020 in climate finance. The Green Climate Fund was envisioned as the main vehicle for meeting this pledge, and it has established itself as one of the key institutions in international climate finance. But the reality is that even higher volumes are likely needed to shift global economic development to more sustainable pathways. This is why the GCF aims to lever additional money for the projects it funds.

The Fund requires accredited entities to secure up-front co-financing - that is, funding from sources other than the GCF - for their projects to achieve that. This poses at least two questions every entity working with the GCF must consider. What sources for funding count toward co-financing? What co-financing level - relative to the overall project volume - is adequate? The answers to these questions also depend on what purpose co-financing should serve in GCF project development.

Drawing on a survey of GCF stakeholders conducted for this report, this edition of *GCF insight* examines the different ways in which organisations perceive co-financing and how they deal with the challenges associated with it. The report also offers suggestions on the way forward.

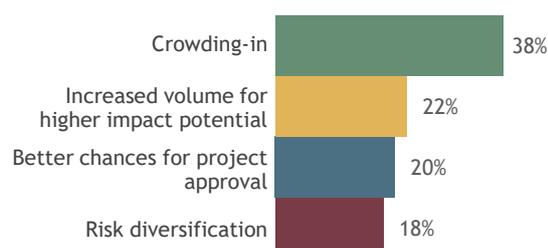
Key findings

- The GCF and its stakeholders have diverging views regarding co-financing.
- Crowding-in, that is, stimulating long-term investments beyond GCF money and up-front commitments, is the benefit of co-financing most commonly mentioned by stakeholders.
- Challenges related to co-financing are diverse and depend on the type of stakeholder: NDAs are uncertain about expected co-financing levels; International Financial Institutions (IFIs) struggle to ensure additionality; other entities find it difficult to secure up-front letters of commitment.
- Many stakeholders do not know what co-financing levels the GCF expects, and of those who do, most think the expectations are too high.
- Stakeholder views about desirable sources of co-financing vary depending on their type: NDAs prefer public finance from *planned* programmes; IFIs prefer new and additional money; and other entities prefer public finance from *ongoing* programmes.

Survey overview

- 152 respondents
- Conducted 9-19 March 2017

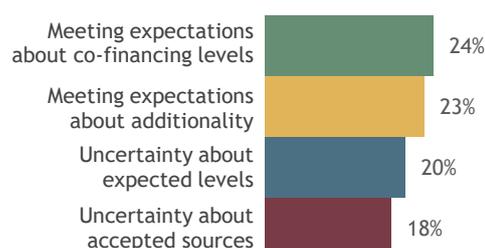
Benefits and challenges of co-financing



Top-4 most important benefits of obtaining co-financing for GCF projects

GCF Board decisions imply that the Fund considers drawing lessons from other institutions' experiences and increased volume of funding to be the key purposes of co-financing. *“Particularly in the early stages of operations, this might be a way of scaling up quickly and capitalizing on and learning from the knowledge and experience of [co-financing] institutions.”* (GCF/B.12/32)

The survey conducted for this report revealed that the GCF's stakeholders do not completely agree with this notion. Only 22% of respondents believe that increased volume for higher impact potential is the most important benefit of project co-financing. Crowding-in is prioritised more often: 38% say that attracting additional long-term investments *beyond* up-front commitments is the key benefit. In addition, meeting the GCF's expectations for a higher chance of getting the project approved (20% of respondents) and risk diversification among involved organisations by broadening the funding base (18%) were also mentioned. The latter aspect is of particular importance to International Financial Institutions (40% of



Top-4 biggest challenges regarding co-financing

IFI respondents indicated broadening the funding base as a priority).

Respondents were also asked to name their biggest challenge regarding co-financing. At first glance, none of the answers stands out as particularly pressing. Respondents are concerned about securing co-financing that satisfies the GCF's expectations both in terms of volume (24%) and additionality beyond existing programmes (23%). Moreover, there is a degree of uncertainty about the expectations regarding both quantity (what co-financing level is required; 20%) and quality (what counts as co-financing; 18%). A closer look, however, reveals that each type of stakeholder organisation has its own particular challenges to deal with. International Financial Institutions (IFIs) find it particularly difficult to ensure additionality (47%), NDAs have trouble understanding what co-financing levels are expected (35%), and accredited entities, excluding IFIs, may struggle to secure up-front letters of commitment (27%).

Levels of co-financing: More clarity needed

An examination of the Green Climate Fund's existing portfolio finds an average co-financing level, that is, the ratio of co-funding to the total volume of a project, of 43%. However, co-funding levels vary significantly depending on the project (standard deviation: 27%). For mitigation projects, the average co-financing levels are clearly higher (average level: 65%) than for adaptation projects (average level: 30%). Cross-cutting projects appropriately lie in between at 43%.

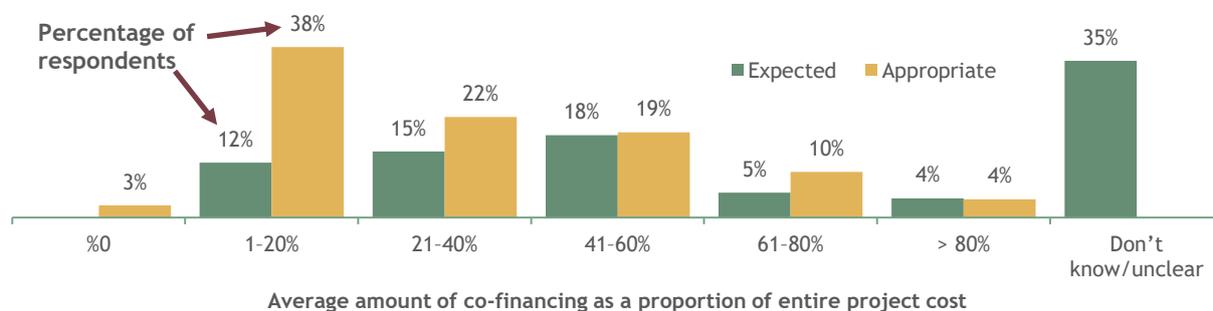
There is a disconnect between the current co-financing levels of GCF projects and what stakeholders would aim for. The majority of respondents (62%) consider co-financing levels below 40% to be appropriate for GCF mitigation projects (81% consider below 60% appropriate). *“Co-financing amount should [be] low as much [as] possible”*, one respondent emphasised.

The Fund's stakeholders realise, however, that the GCF expects higher co-financing levels than they would deem appropriate, as

can be seen in the chart below. Overall, only 7% of respondents estimate the GCF's expectations to be lower than their own desired level. Correspondingly, respondents urge the GCF to allow more flexibility in co-financing levels. Projects in particularly vulnerable countries should be "*exempted from co-finance requirements when applying for GCF*", respondents proposed. There are concerns that rigid co-financing requirements could act as an exclusionary mechanism: "*Requirement for third party funds will further narrow number of countries able to apply and secure funds. Co finance should be aspired not required.*" Respondents also emphasised that the GCF's

financial contribution to a project should add value beyond increased volume: "*GCF must accept to take more risk than the co-investors in the project.*"

Importantly, 35% of respondents find themselves unable to estimate the GCF's co-financing requirements at all. In other words, virtually all respondents either do not know what co-financing levels the GCF expects or they think the expectations are too high. This demonstrates the need for the GCF to communicate its expectations more clearly. As one respondent stressed, "*[c]o-financing should be clearly and precisely determined in % for both mitigation and adaptation to avoid doubts or confusion*".



Respondents' estimates of average co-financing level expected by the GCF for mitigation projects (green) versus their understanding of appropriate levels (yellow)

Sources for co-financing: More flexibility desired

What happens when entities fail to secure enough co-funding to satisfy the GCF's expectations? When prompted about this, most respondents (54%) said seeking additional funding from institutions that are capable of committing co-financing upfront is a likely solution. The problem with this option is that those institutions are usually established players in climate and development finance. Relying too much on them could jeopardise the GCF's ambition to fund climate action beyond business-as-usual.

Another option frequently mentioned (40%) was to request the GCF to reduce the required level of co-financing. Some respondents also considered the possibility of window-dressing project proposals, in the form of including or strengthening adaptation components to lower co-financing requirements (21%) or

redirecting funding from other existing or planned programmes (20%). The latter would of course come at the expense of the additionality of co-funding.

One way to avoid this problem of entities skirting around co-financing requirements would be for the GCF to relax the requirements for new and additional co-financing. There is a range of possible sources for co-financing, both private and public. While there is quite some variation with regard to which sources respondents prefer, certain types of GCF stakeholder organisations have clear favourites, as can be seen in the chart below. NDAs emphasise public finance drawing on *planned* programmes (36%). Accredited entities (excluding IFIs), on the other hand, prioritise public finance drawing on *already ongoing* programmes (33%). Accredited IFIs prefer new and additional public money

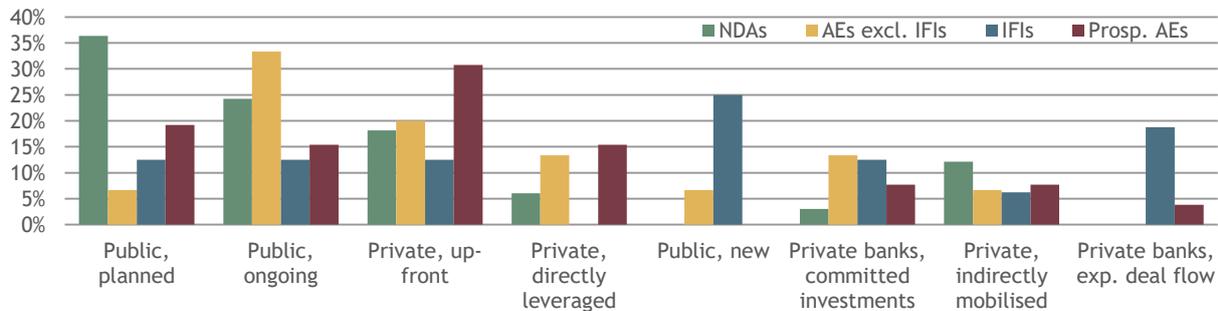
(25%). Finally, many entities wishing to become accredited have a preference for private investments committed up-front (31%).

Beyond these more conventional sources of up-front co-financing, however, further investments that are directly or indirectly leveraged by the project could also be considered as co-financing. After all, long-term crowding-in is most commonly seen as the key benefit of co-financing. Asked directly about what sources are acceptable, many respondents would not be opposed to funding unlocked during project implementation (40%) or indirectly mobilised after successful project implementation to count as co-financing (31%).

In fact, the GCF already allows for that kind of flexibility to some extent, be it only as a

second-best option. Specifically, “for projects/programmes that may not leverage a significant level of up-front co-financing, the accredited entity may instead demonstrate a significant level of indirect or long-term investment mobilized as a result of the proposed activities” (GCF Concept Note User’s Guide).

Respondents indicated that more explicit and easily accessible information on what counts as co-financing and what levels are expected under what conditions would resolve many of the problems. In addition, if the GCF would adopt a broader definition of what counts towards co-funding (for example relaxing the requirement for new and additional co-financing), stakeholders would not have to be as concerned about high co-financing levels.



Preferences for sources of co-financing by organisation type, ranked by total number of mentions

About this survey and report

This survey is an initiative of E Co, emerging from work we are doing to develop low-carbon, climate resilient projects. E Co’s team of consultants designed and administered the survey and prepared this report. E Co. has conducted this research independently, and is not affiliated with the GCF, the GCF Secretariat or donors. The views expressed in this report are those of the authors and do not represent those of the GCF.

About E Co.

We are a UK-based consulting company with a long-track record in low-carbon, climate-resilient project formulation. We believe that the GCF can make a substantial and lasting change in the world, and we’re doing all we can to help it do that. As a consulting company we are leading the way, and we are happy to share the lessons with the GCF community to make all GCF projects better. We would love to hear your thoughts on this edition of GCF insight. Please get in touch by email or phone.

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