DESIGNING NAMAS TO CATALYZE BANKABLE LOW-CARBON INVESTMENTS

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Introduction

With the historic Paris Agreement in place, Nationally Determined Contributions (NDCs), together with the availability of new sources of climate finance, including the Green Climate Fund (GCF), lay the groundwork for ambitious, country-driven climate action. Achieving NDC goals will require substantial investments in support of low-carbon, climate-resilient infrastructure and most of those investments will come from the private sector.[1]

The challenge going forward will be to turn NDCs into transformational action on the ground in ways that can catalyze private sector investments. Nationally Appropriate Mitigation Actions (NAMAs) are one concept for implementing NDCs that can be used to leverage domestic or international public support to mobilize private investment at scale. In doing so, NAMAs can help realign global capital flows in support of low-carbon, climate-resilient development in line with the purpose of the Paris Agreement.

Private sector actors will invest in projects to the extent that their anticipated return on investment is commensurate with the perceived risks of the project. In the context of the developing world, because many low-carbon technologies are relatively new market entrants, they may have higher costs, greater real or perceived risks, or face additional barriers relative to the existing technologies. Therefore, to attract investors to these technologies, policymakers must put in place the frameworks that make low-carbon investments competitive with carbon-intensive, business-as-usual alternatives.

NAMAs in the post-Paris context

NAMAs refer to climate mitigation actions of developing countries in the context of sustainable development. Prior to the 2015 Paris Agreement, NAMAs also represented formal submissions to the UNFCCC by developing countries declaring their intent to mitigate emissions. While NDCs have now replaced NAMAs as developing countries' commitments to climate mitigation, NAMAs are still an important tool to implement NDCs. Whereas NDCs represent the broader national climate "goal or vision," NAMAs represent one means of achieving these aims. Because the term NAMA is still helpful in promoting a comprehensive approach to developing climate mitigation programs, in this paper, we use "NAMA" as a general term to represent sector-wide mitigation programs undertaken at a national level by developing countries to reduce emissions in the context of sustainable development.

This policy brief looks at how to develop NAMAs in the form of policy and financial frameworks that make low-carbon projects bankable. This entails combining policy reforms and targeted interventions that address investment barriers and risks, as well as the development of a pipeline of low-carbon investments.

[1] According to the Climate Policy Initiative, private sector investment amounted to USD 243 billion, or 62% of global climate finance captured by their 2014 *Global Landscape of Climate Finance*. See http://climatepolicyinitiative.org/wp-content/uploads/2015/11/Global-Landscape-of-Climate-Finance-2015.pdf

How can NAMAs promote project bankability?

Projects, not NAMAs, may or may not be bankable, i.e., something that a bank or financier is willing to finance. NAMAs should create the conditions or frameworks that attract the private sector—both enterprises and households—to invest profitably in low-carbon projects and products.

Three main dimensions need to be addressed by a NAMA to help create favorable conditions for low-carbon investment:

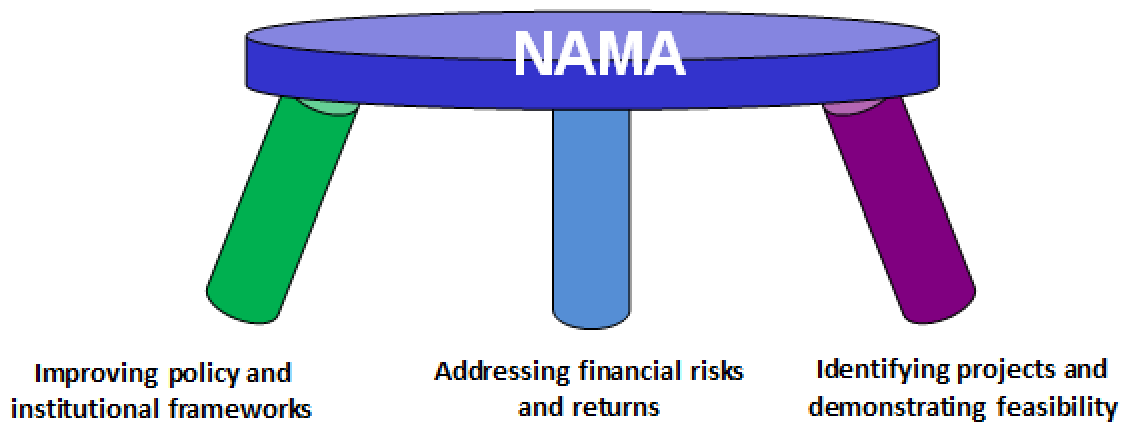
1. **Improving policy and institutional frameworks**, including through policy mandates, regulations that level the playing field for low-carbon investment, and/or the development or strengthening of institutional arrangements for policy planning and implementation;
2. **Addressing financial risks and returns,** including through financial mechanisms and interventions that lower real and perceived risks and/or improve returns sufficiently to mobilize low-carbon investment; and
3. **Identifying projects and demonstrating feasibility,** including the development of an initial project or set of projects, and the identification of a larger project pipeline.

While in principle all three dimensions need to be considered to drive low-carbon investments, a NAMA need not address all three dimensions if one or two of the conditions are already in place. For example, in a country with a robust policy framework for renewable energy investment, the NAMA may only need to address financial barriers such as the cost and terms of financing. Moreover, these dimensions are not necessarily independent of each other—for example, a robust policy framework can itself lower financial risks or increase returns. The specific context of the NAMA and the barriers to private sector investment must therefore be well understood in order to define interventions. These barriers can be related to financial conditions, as well as non-financial barriers including regulation, market structure, knowledge and technical issues.

The NAMA design should ensure long-term financial sustainability, and for NAMAs supported by international climate finance, the continuation of proposed activities when this funding ends. In some cases, it may take some time before low-carbon markets can grow naturally without some degree of concessional support. However, NAMAs should have a clear strategy for the catalytic use of international climate finance that allows for the gradual phase-out of concessional support. As markets mature, national public sector finance may move in or support may become altogether unnecessary to secure continuous engagement of national and international private sector capital.[2]

[2] Climate & Development Knowledge Network. The Green Climate Fund: Options for Mobilizing the Private Sector. December 2011.

Figure 1 – Three elements of NAMAs that can make climate-friendly investments bankable



Considerations and challenges to building “the three legs of the stool”

Improving policy and institutional frameworks

Domestic policy and institutional frameworks are important to create the demand for low-carbon technology and infrastructure investments. Policies can encourage low-carbon investment through measures that price carbon (e.g., a cap-and-trade program or carbon tax), include economic instruments (e.g., a feed-in tariff or tax incentive), or mandate different practices (e.g., building codes). In other instances, policies can be used to overcome barriers to private sector investment, for example, through changes to government procedures that lower transaction costs for private investors, or through government procurement that demonstrates the technical and financial viability of a domestic low carbon investment. In addition, removal of any existing pricing structures and regulation that may disadvantage low-carbon technologies can help level the playing field with conventional alternatives (e.g. removing fossil fuel subsidies).

To promote investment, domestic policies should be designed to afford the private sector the following:

- *Transparency*: Policies should be easily understood.
- *Certainty*: Policies should provide a clear and long-term signal over the investment timeframe and avoid retroactive changes.
- *Economic viability*: Policy incentives should lead to economically viable investments.

A key challenge in NAMA development to date has been to anchor NAMAs in the broader domestic political and sustainable development agenda and, in particular, sectoral policy planning. While NAMA development has been largely driven by ministries of environment, engaging ministries of finance, planning, and relevant sectoral ministries is essential to secure political and budgetary support for the implementation of NAMA policies and planned measures. Ministries of environment, and their advisers, must secure such engagement of the national sectoral and finance ministries from the very outset of the NAMA development process in order to ensure effective implementation as integral parts of national policy. This in turn can send a signal of high-level political commitment that can encourage private sector investment.

Addressing financial risks and returns

Many low-carbon projects face lower returns and higher risks—real or perceived—than business as usual, high-carbon alternatives. A number of financial mechanisms can be designed to reduce risk and/or boost investment returns to help unlock private sector investment. For example, performance or loan guarantees can improve access to finance by increasing credit worthiness in cases where there is real or perceived credit risk or a lack of familiarity with a low-carbon technology. Concessional loans, including loans with lower interest rates, or longer tenors and/or grace periods than market rate financing, can lower investment costs and risks. Aggregation and securitization tools can be used to address high transaction costs and increase returns for small-scale investments. These tools are not designed to make "bad projects" financially viable. Rather, they are designed to mitigate or remove certain risks to investors and lenders, and/or improve returns by lowering the cost of finance.

In some cases, it may be appropriate to use policy tools to address risks and create the right market conditions for investment, including feed-in-tariffs, rebates, and competitive tender processes that can address high investment costs and risks. It is therefore desirable to coordinate policy instruments and financial interventions so that the approaches complement one another and avoid duplication of effort or counteractive effects.

In the development of a NAMA, financing mechanisms or other interventions aimed at lowering financial risk and/or improving returns must be considered from the beginning, and incorporate a clear understanding of the requirements of those institutions that are intended to participate in the financing of implementation.

Identifying projects and demonstrating feasibility

Identifying and demonstrating the feasibility of projects can help ensure that NAMA polices and financial mechanisms will successfully overcome the barriers that the private sector faces and result in action on the ground. In addition, demonstrating an investment is technically and economically sound can give confidence to financiers and banks that may not be familiar with certain technologies or mitigation options, and are therefore more likely to view these as risky or unattractive investments.

In some cases, demonstrating feasibility will involve developing one or more investments for near-term implementation. In the design of a waste sector NAMA, for example, developing an initial set of projects may be important to showcase the technical and economic soundness of municipal waste treatment technologies at specific sites and inform wider replication in other cities. For NAMAs that target the implementation of many small-scale projects—for example, distributed renewable energy such as rooftop solar—it may be more appropriate to characterize the broader project pipeline to show market potential and the scale of the investment opportunity. In cases where small projects may not meet the minimum size of investments required by investors, it may also be important to identify a way to aggregate projects.

Chile Renewable Energy Self-Supply NAMA: Incorporating the Three Legs of the Stool

In Chile, the NAMA Facility supports a NAMA which aims to reduce greenhouse gas emissions by fostering renewable energy systems in small and medium-sized businesses. Thus it will contribute to increased energy security, improved quality of energy services at lower costs, and the creation of new job opportunities. The NAMA incorporates the three legs of the stool to effectively support low-carbon private sector projects as follows:

- **Improving policy and institutional frameworks:** While some decentralized renewable energy systems will generate energy for use on-site only, in many cases, the ability to connect and sell excess energy to the grid can improve the economics of such systems, thereby encouraging greater investment. The NAMA incorporates national regulations to improve grid access by allowing businesses to use the same point of connection to both receive electricity and feed it back into the grid. Net metering regulations introduced in 2014 establish the technical and legal parameters for the interconnection standards and rate reimbursement.

- **Addressing financial risks and returns:** To counter the lack of experience among project investors and financial institutions in financing these energy systems, and therefore greater perceived risk, the NAMA establishes a credit guarantee fund to support lending by local financial institutions for these projects. The NAMA also provides investment grants to set up these systems, and for training and advisory services to improve the financial sector's understanding of such systems.

- **Identifying projects and demonstrating feasibility:** The NAMA provides co-financing for feasibility studies to encourage the development of a portfolio of small-scale renewable energy systems. To address a lack of awareness, capacities and experience among local users as well as service and technology providers in developing and financing small-scale renewable projects, the NAMA supports trainings, workshops and a technical support "help desk".

Recommendations and next steps

As countries look to operationalize their NDCs, NAMAs that can catalyze private sector investment in low-carbon technologies can accelerate progress toward achieving countries' climate and sustainable development goals. Early action to develop and implement robust NAMAs will be important to establish the frameworks and conditions that will underpin long-term transformation of economic sectors and financial systems. The following are general recommendations for developing country policymakers and organizations, as well as funding agencies, on how to support the development of NAMAs that encompass all three legs of the stool to promote bankable low-carbon investments.

Recommendations for developing countries and organizations seeking to develop NAMAs

Countries and organizations seeking to develop NAMAs should work to structure policies and financing interventions to target the most important barriers to investment and create favorable economic conditions for low-carbon investment. This will likely require a comprehensive assessment of the barriers to investment in the target sector in order to identify appropriate interventions, understanding that these barriers can be both financial (e.g., repayment risks) and non-financial (e.g., lack of policy certainty). In the latter case, simply securing additional financial resources is not necessarily the solution. Such an assessment will require actively engaging with private sector actors on the policy frameworks and de-risking measures needed to enable investment, as well as with policymakers to identify policy actions that create demand for low-carbon investment and address existing policy and regulatory barriers. Most importantly, engaging with ministries of finance, planning, and relevant sectoral ministries is critical to ensure that the NAMA is an integral part of national and sector policy.

Recommendations for funding institutions

While all climate finance entities have their own criteria for proposal evaluation and funding, many sources, including the GCF and the NAMA Facility, share the goal of using climate funds to help transform economic sectors and redirect public and private capital toward low-carbon, climate-resilient development. An important part of achieving this transformation is for climate funding to be used catalytically in a way that diminishes or eliminates the need for donor support over time. For example, the GCF has six overarching criteria to evaluate proposals for funding on a competitive basis. Those criteria include two which relate most directly to the question of how the proposed activity will drive long-term, low-carbon investment in the target sector: *paradigm shift*, which includes the contribution to regulatory and policy frameworks and creation of an enabling environment, and *efficiency and effectiveness*, which includes the potential to mobilize additional investments and long-run financial and economic viability.[3] The three legs of the stool can provide a useful framework to evaluate proposals against funding criteria and assess their potential to achieve this long-term transformation.

Developing transformational NAMAs is a multi-year process that involves different stages, including capacity building and stakeholder engagement, analysis of technical, policy and financing options, regulatory and policy reform, and project development work. Securing funding to support the different phases of NAMA development can be challenging. Donors and financiers can support the development of transformational NAMAs by providing multi-staged funding to advance NAMAs through the various stages of development. For instance, early-stage funding can support the identification of key stakeholders and champions, initial scoping, and development of project concepts, while later-stage funding can support policy and financial mechanisms design, as well as pipeline development.

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[3] See http://www.greenclimate.fund/documents/20182/239759/Investment_Criteria.pdf/771ca88e-6cf2-469d-98e8-78be2b980940.

Concluding thoughts

Many developing countries and donor institutions are pursuing the development and funding of NAMAs as part of their strategy to support NDC implementation. NAMAs that work to improve policy and institutional frameworks, address financial risks and returns, and identify projects and demonstrate feasibility can achieve lasting impacts and long term change. Such NAMAs can play an important role in achieving NDCs. In addition, by creating the conditions to catalyze private sector low-carbon investment, they can mobilize resources at scale, contributing to achieving countries' sustainable development goals, as well as larger global efforts to realign financial flows towards low-carbon and sustainable economic development.

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