FINANCING
GERES, UCLG

Background

1- Rapidly growing needs at the global level are not being adequately met

The phenomenon of rapid urbanization at global level, combined with the impacts of climate change and the challenges associated with the achievement of the Sustainable Development Goals (SDGs), have created an important deficit between the needs and the actual amounts invested in infrastructures and public facilities[1]. Simultaneously, local authorities need to cope with these challenges, yet are the ones who are facing severe budget constraints and dependencies to other levels of governance. Whereas local authorities need to make e.g. their infrastructure resilient and buildings energy efficient, they have too little financial access to implement the necessary measures. According to a number of studies, the amounts currently dedicated to these investments should be doubled over the next 15 to 20 years. This deficit is particularly significant in terms of the additional costs of climate change. Taking this parameter into account, dedicated amounts should be tripled[2], and include a shift from environmentally harmful investments to investments consistent with the fight against climate change.

Even though an important share of these investments will need to be made in urban areas, significant efforts must also be made in urban and peri-urban areas, which are in the front line in sustainable forest management, and whose resilience has a direct impact on living conditions in cities.

2- A large part of these climate-related investments will be made at the local scale

In line with the powers that are devolved to them, local authorities are taking on increasing responsibility for strategic social, economical and environmental investments. In OECD countries, they provide, on average, 70% of public investments. However, in many developing countries, decentralization processes are not mature enough to finance ambitious investment schemes necessary to meet the challenges they face. In most cases, local governments have responsibility for sectors related to climate change adaptation, such as water and sanitation, disaster risk management or urban development regulations, but they do not have the necessary financial resources to make the necessary long-term investments in these areas. Yet, investments in mitigation and, even more, in adaptation, not only provide low-cost solutions to climate-change, but can also stimulate local economies through a more efficient use of natural resources, ensuring sustainable access to energy, generating jobs and increasing household revenues. Local authorities are able to make the investments revolve for the long-term sustainable development objectives and thus keeping the resources within local communities. When finding appropriate support for launching financing schemes, the local authorities can act as catalysts for unlocking the potential of its citizens (soft loan schemes, green bonds, cooperative models) and private sector (EPC facilities,...)

Furthermore, local authorities can tackle the financing needs of both adaptation and mitigation measures holistically in order to become self-sustaining in obtaining the different policy objectives. This means, more profitable investments such as energy efficiency in the public building or lighting stock can balance the less bankable projects in, for example, drought communication systems and water retention/dams.

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[1] According to the Report of the Intergovernmental Committee of Experts in preparation for the IIIrd International Conference on Financing for Development, global needs in investments are estimated at 5 to 7 trillion dollars annually, corresponding approximately to twice the amounts currently dedicated.

[2] According to the International Energy Agency, around 359 billions dollars are invested annually to cope with the consequences and challenges of climate change, whereas the needs are estimated a 1 trillion dollars per year between 2012 and 2050.

Funding opportunities exist from public (international donors, multilateral and bilateral banking institutions) and private stakeholders (banking sector, companies and households), but they remain inadequate to meet investment needs. For instance, there is over-liquidity in the commercial banking sector in Africa, due to a lack of bankable projects and guarantees for investors. Yet, these resources are not adequately directed towards territorial investments. Whereas African cities' economic importance approaches 51 billion dollars, they have an investment capacity estimated at barely 8.7 billion dollars. In general, technical assistance is needed for local authorities to move from a grant mentality to a financial instrument mentality. Local authorities have many potential projects but they are not yet investment-ready. They need more capacities to carry out the feasibility studies and business modelling. If we are serious about tapping into the local potential, the local authorities should be supported in bridging the gap between their local climate and energy plans and adequate financing solutions.

3- Investments needs in local and regional areas are difficult to estimate

Many local authorities are already **planning strategies with ambitious environmental goals**. Besides its major impacts on the resilience of cities and territories, this strategic planning has many advantages, such as providing a whole scale of operational plans for actions, and multiannual investment programmes. This process directly contributes to streamlining public purchasing, and to designing bankable projects, which constitute necessary prerequisites to attract funding and direct it towards the energy and ecology transition. Besides, a better prioritisation, rationalization and operation of infrastructures would enable to make significant economies on the invested amounts[3].
The decision to invest in low-carbon resilient infrastructures is influenced by political priorities and **regulatory frameworks** established by local and national institutions. Creating an enabling environment for private investments therefore implies dealing with the overall governance, legislation, data information and methodologies, in order to guide investment choices and, at the same time, to meet the SDGs with respect for human rights.
Experience has shown that one of the most important reasons for investors and financial intermediaries to select projects are their stable and secured environments. This means that measures in the framework of long-term and integrated plans are safer investment choices and therefore preferred. One European example is the multitude of Sustainable Energy Action Plans of the Covenant of Mayors initiative that embodies an integrated and long-term approach and therefore a secured policy context. The ELENA facility of the European Investment Bank (EIB) has been used by several CoM signatories and coordinators, and can finance up to 90% of the eligible costs in order to prepare and implement investment programmes. This experience should be replicated and adapted to other contexts and smaller-scale investment sizes (the EIB threshold is 30 million).
In Northern and Southern countries, the dialogue between various local and regional stakeholders – state and local authorities, civil society, private sector – through urban planning and programming, is key to enable each of them to get involved in the project implementation phase in a climate of confidence and trust necessary to attract funding.
In this regard, Territorial Climate and Energy Packages (which will become compulsory for local governments in France starting 2020), NAMAs (with a more sectorial approach) or the review of the climate-consistency of existing urban development plans, all constitute powerful instruments, in particular when they are based on adequate public guarantees provided by the national or international levels.

4- A large number of local and regional governments have limited access to financial resources

a) Incomplete decentralization processes generate irregular and inadequate structural funds

[3] According to a study by McKinsey, 1 trillion dollars could be saved per year – See *Infrastructure productivity: How to save $1 trillion a year, McKinsey Global Institute.*

Even though a large amount of wealth is produced within their jurisdiction, local authorities in many developing countries have a very limited fiscal autonomy and a few instruments at their disposal to capture part of the land and economic added value produced. The strengthening of local governments' financial health, management and financial engineering capacities, are the basis on which long-term financing can be mobilized, either as loans, private investment or climate finance.
Therefore, central governments have a crucial role to play in leading the reforms necessary to strengthen local investment. Meeting the challenges of climate-change entails, in the first place, **strengthening fiscal decentralization** through institutional and legal reforms, which the state can leverage, to provide greater autonomy to local authorities. This autonomy should relate to the mobilization of endogenous resources (local taxation, land valuation, use fees, …) but also to the implementation of equalization and incentive mechanisms (transfers) enabling local and regional authorities to carry out the tasks devolved to them.

b) Shortcomings in capacities and information available at the local level to develop and implement the mechanisms and instruments necessary to secure investment.

Besides local governments' enhanced mobilization of their own resources, additional funds must be raised to leverage investments, in particular for large-scale projects (transportation, energy/ energy efficiency, etc.), with low profitability, long payback periods (up to more than 20 years) and high risks.

To this end, central governments, in some cases with the support of international donors, have an important role to play in order to facilitate local and regional access to external long-term resources well fitted to local needs. The instruments to be developed and improved can take many forms, depending on local contexts: strengthening of national or regional investment banks, soft loan schemes and revolving operating funds, cooperative models, incentive mechanisms towards banking and commercial institutions, structuring of existing facilitation mechanisms for local governments (with regard to local governments meeting international standards, in general determined by rating agencies), third party financing schemes for energy efficiency, etc.

With regard to private investment, many local governments have already undertaken successful measures to attract such types of financing by using one of the various forms of public-private partnerships, either directly, through the intermediary of an existing specialized financing institution, or through the creation of Special Purpose Vehicles (SPV). Such formulas are only dedicated to productive infrastructures, in a secure setting, and require an analysis in terms of risk/ profitability. The association of several local governments together, either on an ad-hoc basis or permanently, can also contribute to creating an enabling environment. This enables local governments to reach a critical threshold of investments needs and thereby reduce the transaction costs for potential investors.

Another key issue is the security that will be provided to investors from the banking or the private sector. In many developing countries, guarantee mechanisms should then be developed, at the national or regional scales (e.g. regional development banks), to enable local governments to access these resources while, at the same time, strengthening their fiscal management capacities.

In June 2015, CDC Climat research, in partnership with AFD, published a **mapping of the types of initiatives available for the financing of urban adaptation to climate change**, offering additional options to more conventional sources of funding. Based on the review of 27 main initiatives, the report shows a strong prevalence of initiatives supporting soft adaptation measures (strategy planning, capacity building, project design, technical assistance, etc). These are in a position to help support the development of a coherent portfolio of bankable projects. The mapping also reveals that local intermediaries (regional and local banks, national development funds, etc.) play a significant role in financing urban adaptation to climate change. Several key factor of success for the cities' access to these sources of funding are also identified, among which liaising with international development stakeholders (such as multilateral and bilateral donors) at the local level, and the identification of various co-benefits and synergies between the economic, environmental and climate impacts.

c) A global climate-finance offer with a limited access for local and regional governments

It must be noted that local governments have very limited access to climate-finance global mechanisms due to information asymmetries and complicated financial engineering necessary for the implementation of programs.

However, many global climate funds and related mechanisms are open to local governments4. For instance, the Green Fund allows for the accreditation of local governments as intermediaries, subject to acceptance by designated national authorities and to compliance with established governance and fiduciary standards.

To enhance this participation of local and regional governments in the solidarity effort in favour of the most vulnerable cities, and as part of decentralized cooperation, the City of Paris and the Île-de-France Region are experimenting an innovative joint-initiative aiming to create a specific green fund for mitigation and adaptation, dedicated to cities and local governments in developing countries, for them to borrow directly for financing green projects.

Crowdfunfing : The Haut des Ailes Park (France)

The Haut des Ailes wind park has developed over 2 years along an original “crowdfunding” approach. Part of the park’s capital is opened to inhabitants of the area, through a simplified joint stock company (SAS) involving GDF SUEZ and 98 local shareholders, contributing to up to 1.2 million euros (with a remuneration of 7% over 12 years) of the 29 million total investments. First of its kind, this model is based on the concrete commitment of residents and enhanced cooperation conducive to greater acceptability. During the development of the park in 2008, this previous successful experimentation of local ownership has been renewed. This time it allowed 79 new local shareholders to invest in the park, for a down payment of 760 000 euros. Since the park is operating, it has enabled the creation at the local level of seven jobs dedicated to informing the general public about wind energy and renewable energy. 5

Commitments of Local and Regional Stakeholders

⇨ **Develop an integrated, inclusive, gender-sensitive and systemic territorial approach to guide the decision-making process in including climate-related issues.**

The consistency of projects, and thereby their funding, require that they form part of a global planning strategy that mobilize local and subnational governance bodies, as well as all other stakeholders operating in this area: the private sector, citizens, civil society… To be effective, the fight against climate change must take a long-term approach, with responsibilities shared between all stakeholders involved in urban and financial planning strategies. The success of local and regional climate-energy plans demonstrates the benefits of this systemic approach, and of making climate projects more consistent for investors. Our first commitment, in the North as much as in the South, is

4 Green Fund, Adaptation Fund, Global Environment Facility, Fonds d’adaptation, GEF, Local Climate Adaptative Living Facility - LoCAL

5 http://www.gdfsuez.com/journalistes/communiques-de-presse/premier-parc-eolien-participatif/

to drive this approach at the global level, by bringing together all the actors involved, and integrating social and economic challenges. This will enable us to propose mitigation and adaptation objectives well fitted to local and regional specificities in order to meet the challenges.

⇨ **Encourage and participate to regional or global platforms for capacity-building and collaborative action through peer-to-peer exchanges**

The creation of an enabling environment for investment is highly dependent on the national regulatory framework, but local governments also have a role to play. As leaders of territorial development, they coordinate multi-actor dialogue, ensure transparency and management efficiency, and undertake their own initiatives to attract funding.
The creation of a global platform bringing together initiatives and experiences that are led at local or national levels would enable local elected officials and technicians to debate these practices, build on successful models, and potentially undertake training.
This platform should guide its visitors also to technical assistance facilities that can support them in the processes of better defining their projects and increasing their readiness for investments.

⇨ **Commit to create and enabling environment in order to mobilize and use local resources for climate action, in liaise with respective capacities of each territory**

This refers to the earmarking of decentralized cooperation funds to environmental goals: most bilateral development banks or multilateral funds include a climate dimension in order to bring development financing into line with the fight against climate change. However, this tends to be less the case for decentralized cooperation financers, which are often less well equipped to assess the environmental impact of the projects funded.
Contradictory financing strategies should come to an end: no public guarantees for unsustainable investments.

⇨ **Urgently assess the feasibility of a climate fund for local and regional governments, taking into account different local and territorial circumstances and on-going initiatives**

Prefeasibility studies must be undertaken towards the possible creation of a Green Fund directly lending to local and regional governments, and abounded by local authorities themselves and/or innovative financing mechanisms. Besides, to face the challenges of rapid urbanization and massive financing needs of infrastructure projects, this fund should be conditioned to other criteria than climate-compatible criteria (SDGs and developmental criteria).

⇨ **Encourage cooperation, grouping and solidarity between territories, in particular between rural and urban territories, and target climate change in funding provding through decentralized cooperation**

Recommendations for National Governments

⇨ **Mobilize sufficient resources to enable local and regional governments to face the climate-change challenge, including grants for adaptation for the most vulnerable and poor people and territories.**

- Provide sufficient funding, at preferential rates, through central banks, international donors and development banks, to boost climate-related investment.

- Study the possibility of recording energy and climate investments (with high returns on investment) differently within the calculation of local governments' debt ratio.

⇨ **Support local and regional governments in identifying, structuring and planning investment needs in order to cope with climate change.**

- Support capacity-building for the preparation, management and formulation of projects, in particular through budgetary aid and technical assistance, in order to ensure a crosscutting approach to climate-related issues in regional policies.
- Promote and support the implementation of global regional strategies, strategic planning instruments and required investments (e.g. Energy and Climate Change Package PCET).
- Support the implementation of regional emissions accounting systems, enabling to strengthen access to climate finance.

⇨ **Create enabling environments for long-term investment, enhance mobilization of local resources and ease access to external financing resources for long-term and sustainable investment**

- In terms of decentralization, ensure that fiscal decentralization frameworks enable local governments to undertake long-term investments (e.g. though stable and predictable subsidies, increased fiscal capacity, competencies for the management of productive infrastructures, etc.). This requires central governments to recognize the role played by local and regional governments in the fight against climate change. Such commitments can, for instance, appear within national contributions without appeal.
- Adapt regulatory and legal frameworks to local investments as necessary, in particular regarding subnational governments' creditworthiness.

⇨ **Support and promote well-fitted financial instruments that enable local governments to access existing resources**

- Create the necessary conditions for financial intermediation (relying on already-established specialized financing institutions or on the creation of SPVs) at the international, regional and national scales, to guide existing financial resources towards local investments in line with territorial needs.
- Whenever possible, support local governments' access to financial markets: develop further existing guarantee mechanisms (USAID) and create the necessary leverage.
- When the above recommendation cannot be followed due to local contexts and capacities, support the most vulnerable to strengthen their resilience through granted public aid, e.g. Green Fund.
- Support the development of a platform matching investment opportunities in local and regional territories (offer), and solutions, as showcased through inspiring experiences of financing basic services and infrastructures well fitted to climate-change and low-carbon emissions.