Financing the transition to Net Zero: Investment Confidence for Governments

Role of Govt

Ecosystem of capital providers

Economy-wide climate actions
Climate Finance – what is it?

Observe three tiers in the debate (interlinked but separated)

• **Top-down**: re-wiring overall financial sector
  – critically important but won’t in itself deliver a climate outcome

• **Bottom-up**: securing capital for climate solutions
  – Sector-level outcomes ‘real economy’
  – Sustainable Infra / energy
  – Adaptation/resilience

• **UNFCCC Political climate finance**
  – $100 billion & public finance linked to UNFCCC process
  – GCF/specific institutions plus linked issues – equity & SDGs
### Barriers and solutions: mobilizing private capital

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<th>Barriers</th>
<th>Blackrock</th>
<th>EBRD</th>
<th>ASIAN</th>
<th>ABNAMRO</th>
<th>Allianz</th>
<th>Bank of America</th>
<th>BNP Paribas</th>
<th>Average</th>
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<td>1 Unfavourable and uncertain regulations and policies</td>
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<td>2 Lack of transparent project pipelines</td>
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<td>3 Lack of viable funding models and</td>
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From Amal-Lee Amin’s slides: No 1 Barrier ‘Unfavourable and uncertain regulation and policies’

- Policymakers don’t necessarily understand how investment works
- Direct experience of bringing finance practitioners into policy design: ‘investment grade’ policy (2009, see references)
- Design for objectives + “Pick and system and stick to it”
  - policy and regulatory detail: “devil in detail”
  - risk profile of ‘project’ (across the package of factors that impact that)
  - revenue visibility a key factor
- Low Carbon Finance Group – what it means in practice – examples EMR (Electricity Market Reform) and RenovAR (Argentina)
Key moment

• Strong appetite for infra: ~ 90% of institutional investors – planning to maintain or increase allocations to infra (2019 Survey)

• Energy transition: “no exaggeration to call [it]...the biggest global investment opportunity of the century” [PEI 2018]

• Investors look to LT: are assumptions robust across 30 year assets?
  – Supply and demand
  – Disruption as tech / business models in period of rapid change
  – Cost & revenue assumptions
  – Society and also investor – changing expectations (ESG, ‘impact’)
  – add in Covid-19

• Government’s also looking LT – net Zero; infra build out; econ/SD
Finance - policy integration 1: EMR

• **Illustrative risk** issues impacting overall project economics/bankability:
  – Route to market factors;
  – Counterparty risk in the CfD contract,
  – ‘Refi gain share’ (capped upside, but unlimited downside);
  – Auction design / future auction rounds and budget

• Contract length: finance model to illustrate & assumptions book.
• ‘0-60’ – how fast players adapt (explainable to credit/inv committees)
• Goes without saying? Clear goals, depoliticised decision-making

Institutional
• Emergence of Commercial team in DECC: in-house capacity
• Systematic engagement with investors, transparent?
• Market monitoring, feedback and data
• The intersect with ‘green finance’ – clarification

Current area of work – structures/tools to embed investment factors into decision-making systematically
Finance - policy integration 2: RenovAR

- 2016 – 2019 Govt contracts awarded for 6.5GW of new RE capacity
- Key: overcoming political and financial barriers

Government led ~ package
- Auction process – brought in market experienced players to help design
- Legal framework (legislation passed 2015) and ambitious target
- + ‘RenovAR’ financial mechanism aim to attract international bidders and investors
- Complementary power sector policies: including LT bankable PPAs (with clear rules for passing costs on), grid allocation plan to avoid capacity constraints and curtailment, fiscal incentives
- Nested set of guarantees and funding, including national ‘FODER’ (liquidity and guarantee fund) and WB partial project guarantees.

IFC: ‘holistic approach that creates a pipeline of infrastructure projects’

References available.
Economics / Finance

Economic Impact Assessment: different from investor/risk issues
~ Investment Impact Assessment?

Example: UK onshore wind: WACC – merchant vs fixed PPA cost of capital implications - global asset management firm (numbers @ April 2019 – illustrative only)

* Merchant
25pc debt @ 4pc cost of debt
75pc equity @ 10-12pc equity

* Fixed PPA (backed by government)
75pc debt @ 3pc debt
25pc equity @ 8-10pc equity

* Merchant price premium is £10-15 / MWh i.e. a purely merchant project would need prices £10-15/MWh higher than a contracted asset to earn the same equity return.

From the investor's financing models as the difference they would need to see in their development pipeline for each revenue structure to be investible.
Aiming for: ‘Investment confidence’ for policymakers

- Government/decision-makers are confident that capital will flow to meet objectives
  - Avoids ‘delivery risk’

- ‘Devil in detail’ + sector transition: complex and dynamic
  - Getting to right resolution of detail for both sides
  - Policy and regulatory design decisions need to be ‘investment grade’
  - ‘Subsidy free’ is not policy free

- Practical steps for doing this ~ next slide

2016 input to EU policymaking ref ‘investability’ of national energy and climate plans.
Integrating finance/investment into policy – practical steps

1. Clarify assumptions
   - Is policy designed to attract private capital (overall or within sector-specific plans)?
   - Range of approaches, national local context
   - Are any particular sources of capital are intended to respond?

2. Test assumptions
   - Investment Assessment
     - Involve range of capital providers and investors
     - Are policies consistent across the economy
     - Identify gaps that need public finance tools.

3. Monitoring sectoral policies
   - Structured template
   - Assess ‘delivery risk’
   - Does decision-making support an agile response?
Observations to BIEE in 2012

• Finance and investment – getting clear on what we are solving for
• Injecting greater precision where policy debate intends to be operational
• Set of interface issues –
  o Finance/policymakers – e.g. Low Carbon Finance Group aims to get accurate, non-political input to policymakers from finance practitioners on attracting capital.
  o Economics/policy – what does it tell us and what doesn’t it tell us?
  o Energy scenarios – getting underneath ‘low carbon’
  o Human learning curve - how many people produced the same generic report last year?
2020 Investment confidence critical

- Key moment: capital, climate, people, technology
- Investment grade ‘policy’ ~ right resolution of detail on all sides (national or local) to ‘land’ that capital where it’s needed ~ whether called ‘climate finance’ or not
- Policy (role of government) integrated approach essential including public finance (note investor DD, risk profile)
- Processes that help speed things up: get basics right, enable more agility in the face of transition, depoliticise
- Expertise pooling – this is ‘gearbox’ work
Factual overview of the finance sector – a reference guide for non-financiers.

2020 ~ IRR numbers will have changed and energy debate has moved at pace since 2015/16 re business models.

Free download from Bloomberg New Energy Finance: http://about.bnef.com/white-papers/finance-guide-policy-makers/

“As the world focuses on implementing the Paris Agreement, attracting scaled-up investment to climate solutions will be critical.

For those of us who do not come from the finance world but need to understand it better – this Guide provides an excellent foundation to the key aspects of who does what and why in finance. It has become a favourite reference for me.”

Christiana Figueres
Thank you! References & contact

Early Papers via Chatham House


Current work on ‘Investment Confidence’ for governments, integrating investment into energy and climate-related policymaking.

Kirsty Hamilton
Former Policy Head, Low Carbon Finance Group
Associate Fellow, Chatham House
Co-lead, Energy Transition Investment (UKERC)
khamilton@chathamhouse.org