Climate Action in Financial Institutions

PRINCIPLES FOR MAINSTREAMING CLIMATE ACTION

DBSA's innovative blending financing mechanism to catalyze small scale renewable energy market in South Africa

Institution	Principle	Related Work Stream(s)		
DBSA	PRINCIPLE 3: PROMOTE Climate Smart Objectives	CITY-LEVEL CLIMATE SMART APPROACHES AND FINANCIAL INSTRUMENTS	MAPPING REPORTING INITIATIVES AND UNDERSTANDING IMPLEMENTATION CHALLENGES	CLIMATE RISKS: APPROACHES, TOOLS, METHODOLOGIES

Publication date: 2017

Date Policy/Tool Established	Additional Capacity Required (e.g., staff, resources, other)	How Established?
2014: DBSA established a Debt Facility to finance and catalyze the small scale renewable energy (RE) market under the South African (SA) government's Independent Power Producer Programme (IPP).	• Implementation of the funding mechanism is well aligned with DBSA's core mandate. Each transaction is processed in line with established internal procedures and utilizes existing DBSA staff resources. • Following a recent organizational restructuring process, a newly established Climate Finance unit will provide more focused climate change expertise, work with the GEF and IIPSA to ensure deal processing and reporting requirements are met.	In line with DBSA mandate on financing energy infrastructure, a strategic decision was taken at board level to provide financing resources that would help catalyze the small scale renewable energy sector in South Africa. DBSA as an agency of the Global Environmental Facility (GEF), further mobilized equity funding for the small scale projects. Through the GEF, an equity fund was established. As the Secretariat of the Infrastructure Investment Programme for South Africa (IIPSA), the Bank also facilitated formulation of an interest rate subsidy accessible to all DFIs that will finance projects under the small IPP programme.

Monitoring, reporting tools	How Established?
Established DBSA processes will be followed including the environmental and social safeguards standards appraisal guidelines. These align with GEF monitoring and evaluation processes. DBSA's Operations and Evaluation unit will provide services in line with existing policies. DBSA continuously improves its evaluation tools such as the Development Results Templates (DRTs) to incorporate specific indicators aligned to global good practice such as the GEF global environment benefits (GEBs).	DBSA receives RE projects that have reached preferred bidder status from the South Africa IPP Office and assesses them through its already existing structures and procedures. The IIPSA steering committee approves the interest rate subsidy for projects. DBSA manages GEF capitalized equity fund and advances funding to projects.

Key Lessons
• It is crucial for the DFIs to align their strategic priorities to national policies in this case, the SA National Development Plan 2030, the Integrated Resource Plan (IRP) 2030 and SA's Nationally Determined Contribution (NDC). • It is essential for DFIs to support governments in implementation and realization of national policy and established targets in building a low carbon and resilient transition process thus creating an enabling environment that opens up new technologies particularly in both the small and large scale RE market, as is the case in South Africa. • Initiatives that incorporate the climate change phenomenon into a country's strategic priorities such as an energy mix benefit from early senior leadership buy-in at all stakeholder levels. • DBSA's partnerships with other climate financing mechanisms such as GEF and IIPSA funding were crucial in establishing innovative blended resources, particularly for risky markets**.**

Introduction

DBSA with its partners developed a financing mechanism aimed to address barriers to accessing financial resources by small and medium enterprises in the renewable energy sector. The mechanism aims to catalyze the small scale renewable energy market, creating jobs, improving the South African economy and averting the emission of greenhouse gases (GHGs).

DBSA provides sustainable infrastructure project preparation, finance and implementation support, working closely with selected African markets to improve the quality of life of people, accelerating the sustainable reduction of poverty and inequity and promoting broad-based economic growth and regional economic integration.

The DBSA together with other financial institutions (FIs) recently financed the successful large renewable energy projects under the Renewable Energy Independent Power Producer Procurement Programme (REIPPP). The large and small scale REIPPP projects are well aligned with the Government of South Africa's policies such as the Integrated Resource Plan (IRP) which is a blueprint for the energy mix in the period up to 2030. It targets 17,000 MW of renewable energy. The Small Projects Independent Power Producer Programme (SP-IPPP) was designed with the objective to contribute to at least 400MW of the total RE target. Renewable energy financing is also clearly defined in the country's NDC.

While the bidding rounds for the large REIPPP have been very successful, the small scale programme had not taken off. Even though financial markets have proven to be effective in the funding of the large projects on a limited-recourse basis, there has been a lack of financing for similar but small-scale projects. Small scale renewable energy project developers face a myriad of constraints and financial barriers to participation in the industry due to issues such as poor financial records and the nature of the size of projects being unattractive to financiers.

To address these challenges, the DBSA board made a decision to facilitate the participation of the small scale project developers in the REIPP programme, catalyzing the market. To implement the Board decision, the Bank allocated its own funding and mobilized additional resources from two strategic international partners, the GEF and European Union (EU). The DBSA is an accredited agency of the GEF and acts as the Secretariat of the EU funded Infrastructure Investment Programme for Southern Africa (IIPSA). The SP-IPPP is also well aligned to the objectives of both partners.

Development and Design

In line with its developmental mandate, DBSA established a balance sheet debt facility for its participation in the SP-IPPP. Working with its partners, the GEF and the EU through IIPSA, the Bank further established an equity fund and an interest rate subsidy capitalised by these institutions respectively to provide funding to the SP-IPPP. Each project will be financed through the DBSA debt facility and the Bank will receive an allocated interest rate subsidy whilst the GEF fund will provide the proportional equity. This funding mechanism currently with a total value of over USD 160 million, of which 90% is DBSA's resources, will provide finance to an estimated twenty (20) small scale RE projects each with a capacity of 5MW.

The DBSA, following the GEF project funding eligibility criteria, developed an equity fund proposal which was approved by the GEF Council in 2017. It further engaged with its partners to agree on an interest rate subsidy from IIPSA that would be accessible to all DFIs that would participate in the SP-IPPP.

Without this finance mechanism, the renewable energy industry would be at increased risk of domination by large scale international companies, with the exclusion of local businesses, sustaining economic inequality and resulting in failure to meet climate mitigation targets both from the DBSA and national perspective.

Implementation

DBSA receives RE projects that have reached preferred bidder status from the South Africa IPP office calls for proposals and opens up preferred projects to FIs. The DBSA assesses projects through its already existing structures and procedures. The IIPSA steering committee approves the interest rate subsidy for projects. DBSA manages GEF capitalized equity fund and advances funding to projects. The DBSA utilizes its internal resources to appraise projects and its newly established Climate Finance unit provides specific climate expertise and ensures alignment with funding and reporting requirements of the partner funding institutions.

Experience and Impact

- The SP-IPPP facility will result in the installation of about 100MW reducing approx. 40 tCO2e, (including both direct and indirect emissions) over the 20 year lifespan of each of the 5MW solar PV projects. Emissions reduction achieved through this funding mechanism will contribute towards South Africa's target of reducing its GHG emissions by 34% below Business as Usual (BAU) before 2020 and by 42% BAU by 2025.
- The facility will enhance skills transfer and capabilities. It will help build competence of small project developers and open opportunities for local businesses to participate in large scale projects in the future. The mechanism unlocks the participation of commercial banks in the SP-IPP programme projects by developing a proven model for financing small scale RE projects. Participating SMEs will have a track record of project implementation and investment in the sector. This will help reduce risks and increase bankability of future projects, thus catalyzing the market.
- Renewable energy is an important sector fostering and sustaining the growth and competiveness of the South African economy and the programme will contribute towards ensuring the security of supply of more affordable energy.

Next Steps

In mainstreaming climate in its day-to-day core business, DBSA is currently finalizing its Climate Finance Strategy and has reorganized itself and established two new sections, the Structured Products and Climate Finance Units dedicated towards managing its climate change financing activities and improving its products and services in this regard.

To mainstream climate change whilst playing its developmental role, DBSA seeks to continue taking strides towards creating and adopting new and innovative solutions for financing low carbon and climate resilient infrastructure. DBSA will further commit its own funds, maintain its partnerships and mobilise additional funding and contribute towards achievement of the full 17000 MW national RE target, in particular the 400MW demarcated for SP-IPPP. The goal is to play a role in improving the quality of life of people, reduction of poverty and inequity, growing the RE market including small scale initiatives and contribute towards carbon emissions reduction targets.

Knowledge Sharing

Several DFIs that participate in the REIPPP, particularly in the small projects are already taking and sharing lessons from this funding model. It is also an innovative approach that may be improved in the future, drawing the attention of commercial banks and adopted nationally.