



CTI PFAN Background Paper on Adaptation

Executive Summary



Authors: Thaven Naidoo, Kemal Vaz & Lynne Byaba

CTI PFAN – Background Paper on Adaptation Executive Summary

This Executive Summary summarises the CTI PFAN Background Paper on Adaptation, which is conceived as an introduction to adaptation to climate change (adaptation) in relation to private sector financing. The paper constitutes the first step of a programme of work engaged by CTI PFAN, which aims to explore a methodology for facilitating private sector investment and finance in adaptation related projects in developing countries, based on the CTI PFAN model, which is already operating successfully to raise investment and financing for technology transfer projects in the sphere of Mitigation. Further steps in the process will include a series of workshops to engage stakeholders and, if determined to be appropriate, a pilot programme to support the development and financing of commercially viable adaptation projects. The ultimate objective of this process is to determine whether a CTI PFAN network and project development activity can be established that is dedicated to connecting private sector investment and financing to adaptation related projects.

The geographic focus of this study and any initial activity will be Sub-Saharan Africa (SSA). SSA is considered particularly vulnerable to climate change (see Annex VIII) and as such rich in adaptation investment opportunities (especially in the agri-business sector). The region is also expected to be particularly challenging, having a generally low starting adaptive capacity and a high incidence of Least Developed Countries. Also, a large proportion of recent and current multi-lateral and bi-lateral financing is being targeted towards Africa (see Section 4), which should make it easier to leverage off existing activities and lessons learned. However, the process is flexible and will remain open to projects, activities, participants and learning inputs from other regions and countries, especially those which have demonstrated success and can provide guidance and assistance in further developing the model. Assuming the approach works in SSA, it will be available for replication and scaling-up globally.

It is generally accepted that developing countries will experience some of the worst impacts of climate change while being among the least responsible for the causes and the least capable of dealing with the effects. Adaptation to climate change remains a major challenge for many, if not all, developing countries. It is now generally accepted that even the most stringent mitigation efforts would not avoid further impacts of climate change in the next few decades. This makes adaptation essential, particularly in addressing near and medium term impacts. Notwithstanding this, mitigation and adaptation are seen as interdependent, non-competing, and equally vital strategies for dealing organically with climate change. Adaptation needs to be integrated into good development practice so that development and adaptation actions become mutually reinforcing.

While estimates of the financing requirement vary greatly (the lowest range from USD 4 billion to USD 400 billion of incremental spending per year, depending on the time horizon and the relative pessimism of the climate model used – see section 4) it is clear that the adaptation challenge is dauntingly large (and will probably get bigger). Given the constraints on the availability of public sector financing, private sector financing will be required to play a role in addressing many of these challenges. Given the scope and areas of adaptation related measures, it remains less clear how private sector funds can be

effectively mobilised and channeled. Although daunting, the volume of financing required could be manageable by the private sector if appropriate mechanisms and channels were available. This is where the CTI PFAN adaptation activity may contribute to a solution.

It is anticipated that few areas of adaptation will generate sufficient financial returns to mobilize traditional, fully commercial private finance and may therefore require additional public resources. This in turn means that investment is most likely to reach only the subset of developing countries in which investment risks are generally considered sufficiently low. It is therefore all the more important to identify those areas where private sector finance can play a role and focus efforts on them accordingly.

Comprehensive and accurate risk analysis is instrumental to private sector investor and financier buy-in. The ability to understand and analyse risk in a transparent and coherent fashion, reduce, manage and / or share it where possible, and put a commensurate value on it is key to the investment decision. In other words, the ability to earn a commensurate commercial return for the risk engaged. An important conclusion of this paper is that, from an investor's standpoint, the analysis and treatment of adaptation related project risks can be expected to be broadly the same as for other project categories and investment activities. These risks require dedicated attention to improve the information, coordination and response options available and significant effort needs to be dedicated to understanding and evaluating the specific risk dynamics arising from "typical" adaptation related projects in the identified target sectors in order to gradually increase tolerance thresholds and thereby reduce transaction and specific risk weighting costs. Dedicated programs that focus on climate change risks and adaptation may be necessary where risks and impacts lie beyond the scope and vision of ongoing development activities.

These aspects will be further addressed through the test cases investigated at the Exploratory Workshop and, if warranted, through the Pilot. As with the main CTI PFAN programme an intimate understanding of risk appetites of different investors and their return criteria, together with their constitutional limitations and requirements (ie target investment amounts, maximum and minimum maturity periods, regulatory requirements and limitations, exit criteria etc) will be key to successfully structuring projects for investment and mobilizing financing for them.

Against this background, it is likely that innovative risk allocation models and public – private blending mechanisms will need to be developed to leverage the use of public resources by private funding. Public Private Partnerships (PPP) and variants thereof can be expected to play an important role in creating these mechanisms and models.

While PPP models show great potential for mobilising financing for adaptation related projects, even more so than for other financing models, they require combination of the enabling environment and incentives to achieve the necessary alignment of interests across the involved parties and sectors. Private sector funding requires that strong, stable, transparent, coherent and credible long-term national policies are in place and backed up by appropriate enacted regulation (commercial, legal, environmental, energy and other sectoral) and incentives (which can be of a fiscal, regulatory or commercial nature) and market governance structures (i.e. in agribusiness, commodity exchanges, intermediary institutions, or associations of small producers). Climate change is an issue that no government can address in isolation, and will depend on organizations, businesses and

communities across Africa accepting responsibility and acting in an integrated and concerted way to prepare for a changing climate.

There is a need for a radical awareness change and significant capacity building efforts within the private sector to help investors, financiers and potential entrepreneurs understand, realise and exploit the opportunities provided by adaptation in the same way as they have since done in some mitigation areas, specifically for example clean and renewable energy which, in the meantime, has developed into a mainstream investment activity in many countries. A parallel capacity building effort continues to be required in the public sector to embed adaptation thinking and approaches in all development activities.

It is anticipated that CTI PFAN can contribute to this transformation, principally by identifying and supporting the further development of those projects and activities which offer the most potential for private sector investment. Bottom up demonstration and real life implementation of adaptation measures using private capital can be expected to establish the investment community's acceptance that adaptation represents real investment and commercial opportunity and to build and reinforce the capacity to understand and manage the related risks, such that, over time, private sector financing of some adaptation related activities becomes mainstream.

Against this background, the paper identifies a number of adaptation related areas where the private sector may be expected to play an important and increasing investment and financing role; these include

- Agriculture (agri-business & agri-processing)
- Water & Sanitation
- Energy & Energy Access
- Tourism

These sectors were selected based on their vulnerability to climate change and their perceived potential to generate and support opportunities for private sector financing approaches, including

- availability of fungible assets;
- the provision of services for which there is a ready market demand and capacity to pay (albeit at low levels);
- the generation of cash revenues which may be used to service investment and financing;
- the existence of un-serviced markets for basic infrastructure and utilities;

In addition, a number of cross cutting issues and coping mechanisms appear to provide frameworks which will help focus project identification and development activity. The coping mechanisms include principally micro-finance and micro-insurance which often facilitate the packaging and delivery of adaptation Products and Services (resilient crop varieties and other agricultural inputs, solar lighting kits for the rural poor, etc) and which are delivered through innovative business models, targeted specifically at the rural poor in areas of high vulnerability. A further cross cutting issue is urban development (which for example is driven by the accelerating urbanisation of many SSA countries) and which encompasses development sectors such as transport, waste, energy, water and other infrastructure as well as buildings (energy efficiency and green construction methods)

which can also be expected to present opportunities for private investment. Each of these areas is dealt with in more detail in sections 6 and 7 of the paper.

It is proposed that these identified sectors and areas are targeted through a regional approach to leverage and exploit geographical and geo-political drivers, thereby potentially accelerating the outreach and impact of the programme and optimising the deployment of resources. Further refinement of this approach is intended through the work engaged by the envisaged workshops, the case studies and a possible pilot programme.

Following the distribution and review of this paper the next step in the development process will be to analyse, discuss test and refine the above findings through the planned workshops, project case studies and, to the extent appropriate, a pilot programme. Anybody wishing to participate in this process through the proposal of projects to be used as case studies or wishing to attend the workshops should register their interest with Thaven Naidoo, CTI PFAN Africa Adaptation Coordinator (adaptation@cti-pfan.net).