

Paper 2: The Climate Finance Equation in Africa

Summary of Key Messages



African private sector finance accounts for 12% of the continent's climate funding

It is heavily concentrated in renewable energy for mitigation transition

The need for adaptation funding is acute

Innovations are underway to drive up private sector adaptation funding in Africa

Climate funds remain inaccessible, but are shifting emphasis and developing new instruments

Blended finance, green bonds and green loans offer huge potential, with many 'firsts in Africa' since 2022

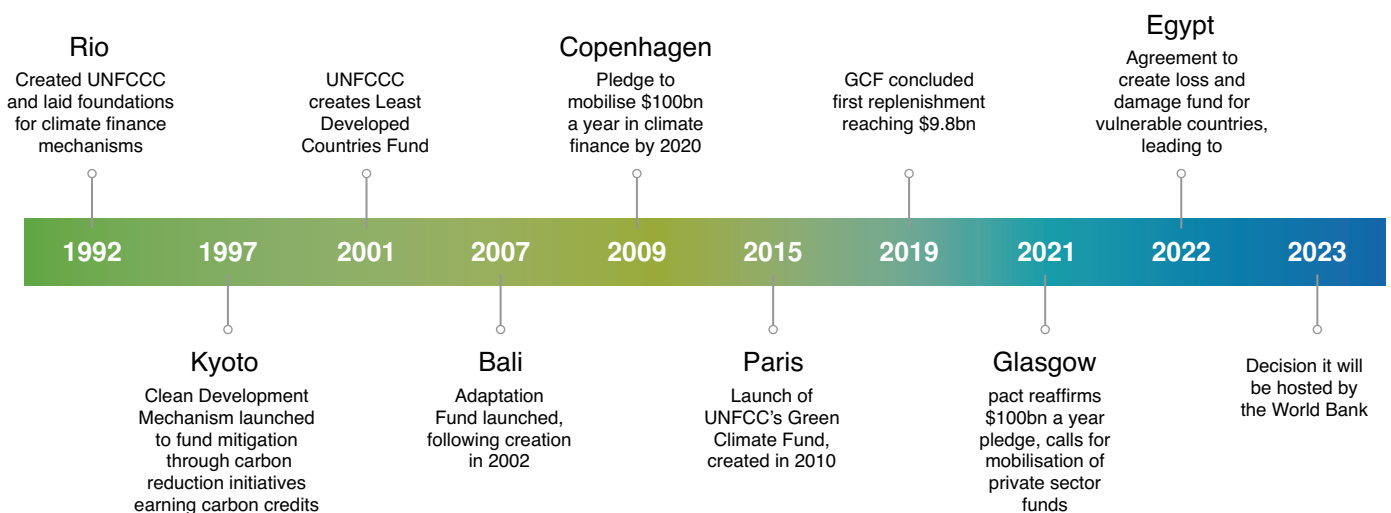
Tracking climate finance flows in Africa is still facing a significant challenge due to gaps in data availability.



Defining climate Finance

The rise and pace of climate change in the last 55 years has triggered a global mobilisation of capital, to slow down and reverse the deterioration. More recently, calls have ballooned for funds to finance human adaptation to the rising heat, water scarcity, and erratic weather, and to re-engineer our civilisations to better survive and recover from natural disasters.

The evolution of climate finance



Yet, even as finance is rallied, the world remains on a steep learning curve in mapping the impacts of climate change, most starkly in Africa, which is presenting as the hardest hit continent. Data is scarce, frameworks are under development, and old instruments are floundering on new risk equations and uncharted needs.

Climate finance remains in its infancy, even as it channels over a trillion dollars a year in the race to beat the changes underway. Its primary focus remains climate mitigation, in the serving of increasingly vigorous targets for achieving Net Zero carbon emissions. Our white papers deal with the, as yet smaller, but also life-critical matter of equipping Africans to survive and thrive as climate change undermines their food, water, health and infrastructure.

In this area of climate adaptation finance, there is not yet a prevailing taxonomy. Most of the current climate adaptation flows fall under two broad pillars of resilience and conservation. Resilience covers any development intervention achieving the creation of new livelihoods or improved wellbeing, on the basis that development is necessary for populations to be able to 'cope' or 'adapt' to climate changes.

Conservation, meanwhile, places a heavy emphasis on public goods, across public lands, oceans and reforestation, with a strong crossover, particularly in reforestation, into carbon mitigation.

This approach is drawing increasing controversy over how much of this funding is genuinely related to climate change, or delivering climate-related benefits - in a debate that also encompasses the quality of carbon accounting in mitigation finance.

Climate Capital

World Bank

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Hundreds of World Bank climate projects have no direct connection to climate, research finds

Examination of more than 2,500 programmes over two decades reveals lack of evidence of benefits

For the purposes of our series, we are defining climate adaptation finance as funding that enhances the protection, survival, recovery and benefits from direct climate impacts, across erratic weather patterns, increased heat and water scarcity, and natural disasters.



Climate Finance in Africa

As climate change has accelerated, becoming suddenly more visible in its global impact, the pressure to increase the flow of climate finance has grown. This has delivered a sharp rise in the last three years. But flows into Africa remain different in their character and distribution than elsewhere.

Globally, climate commitments reached \$1.3 trillion a year in 2021-2022, topping \$1 trillion for the first time. Of these, 90% were for clean energy in China, the US, Japan and India, reducing the global share of adaptation finance from 7% in 2019 - 2020 to 5% in 2021 - 2022.

In Africa, flows have been much more geared towards adaptation, which accounted for 39% of flows in 2019 - 2020, and 20% of the world's tracked adaptation finance commitments of \$63bn in 2021 - 2022.

This share, however, reflects the breadth of definition of adaptation finance across development spending, with the tracked data tilted towards OECD-recorded donor funding, where data is complete, versus the data from national governments, which is partial, and from private sector tracking, which is patchy.

Nonetheless, the sum remains far below the amounts donors have pledged, and even further from the continent's estimated needs: causing a swing in attention towards accelerating private investments.

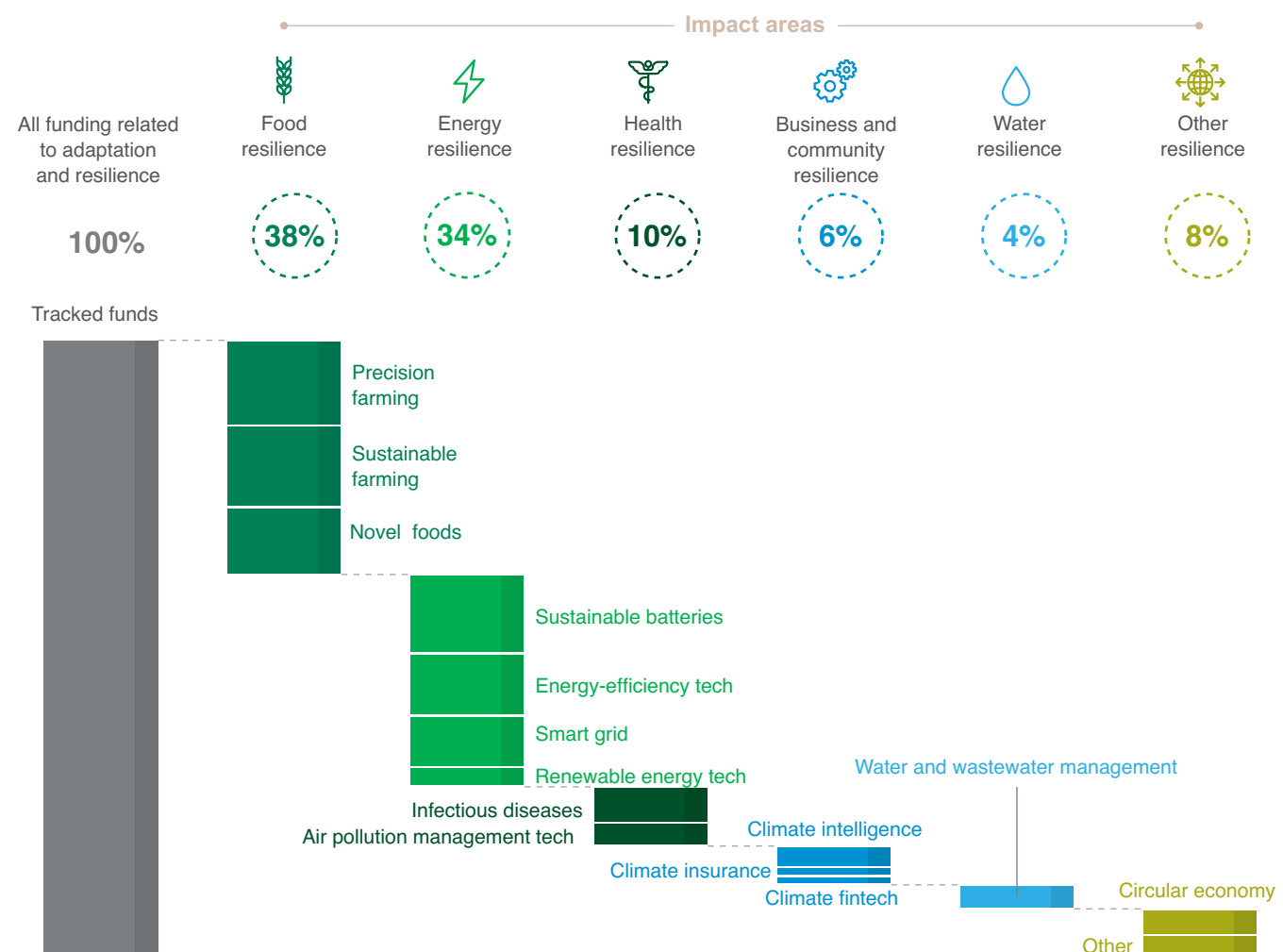
Tracked private sector flows currently provide 12% of SubSaharan Africa's overall climate finance, but only 3% of its adaptation finance, meaning that the sector is leaning much more heavily towards mitigation spending than the other sources of climate finance in Africa.

This represents a notable inversion of need and demand, with Africa contributing 3.9 % of the world's carbon emissions, but home to 17 of the 20 countries most vulnerable to climate change, and already suffering severe impacts, with over 110 million people affected by weather, climate and water-related hazards in Africa in 2022, at a cost of over \$8.5 billion.

The private sector is also investing differently within adaptation finance in Africa. Globally, the highest proportion of tracked private-sector adaptation funds, at 38%, is going into food production, followed by 34% into energy, and 10% into health.



Figure: Global private sector investments in adaptation, by sector Source. From Risk to Reward, compiled from PitchBook Data

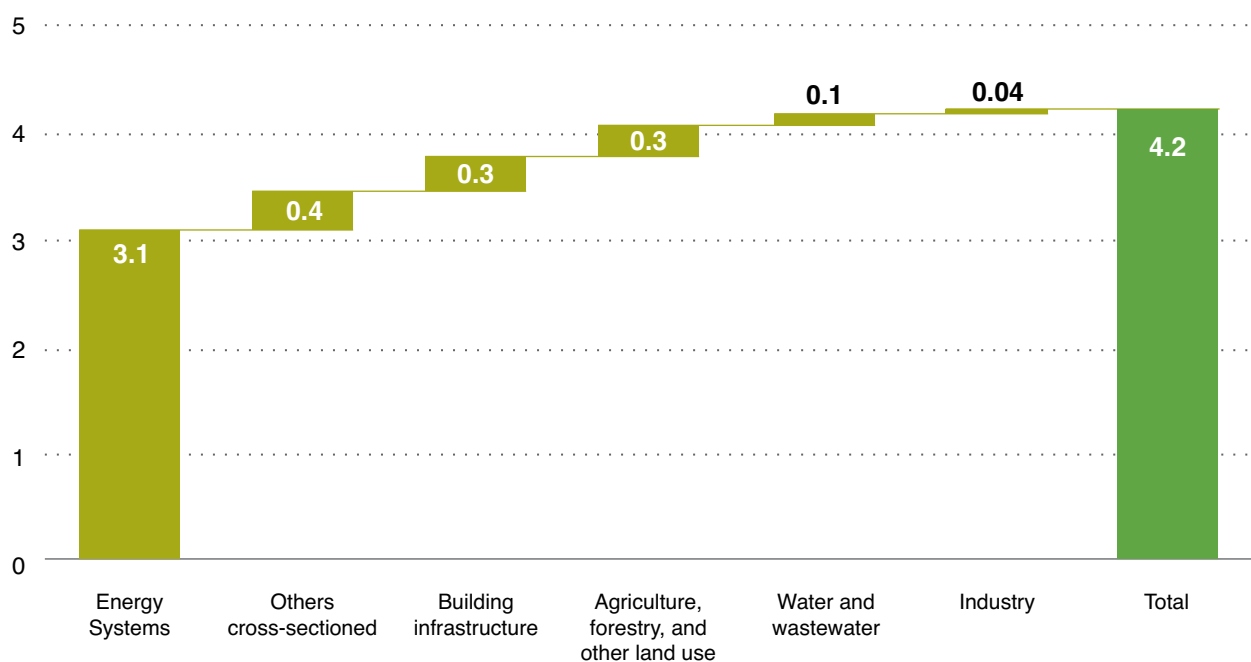


In Africa, of the \$4.2 billion of total private climate finance, only 7 percent, or \$0.3 billion went into food, where ratios of mitigation versus adaptation for all African flows, and of food spending within global private adaptation finance, would have delivered twice that inflow.

Figure: Sectoral breakdown of private climate finance across Africa, average 2019-2020



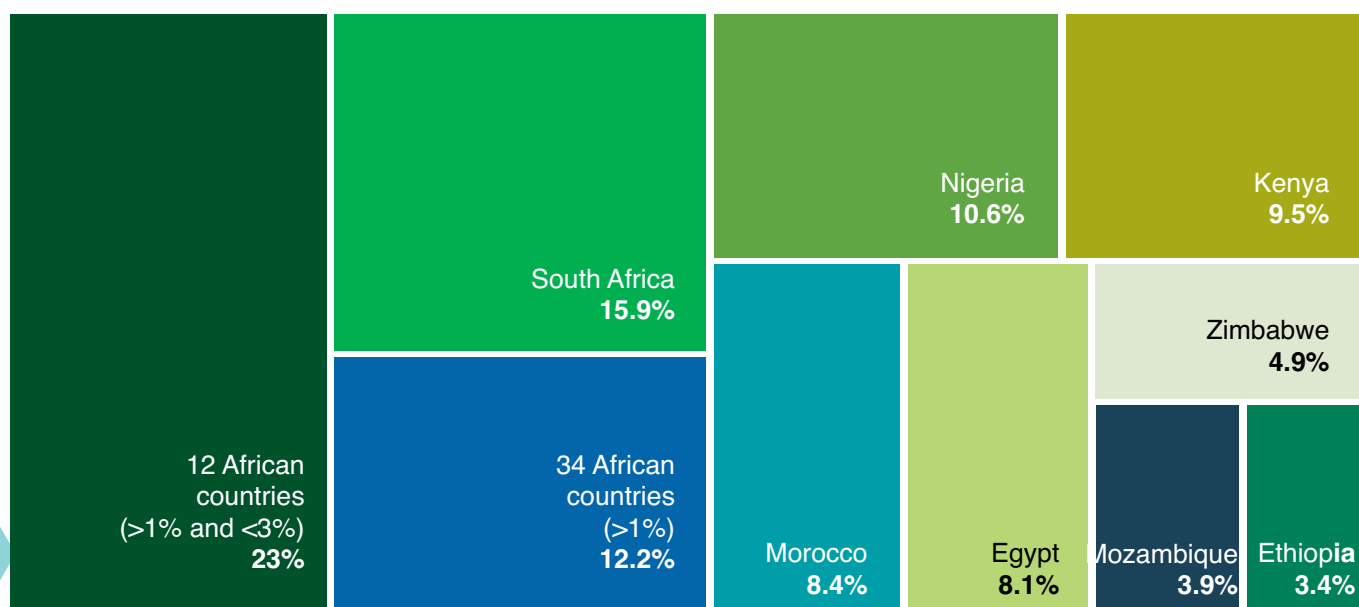
\$ billions



With food security now acutely impacted in subSaharan Africa, this shift of emphasis has been driven by issues of market sophistication and assessments of risk.

Over 56% of Africa's private climate finance inflows in 2019/2020 (56.2 percent) went to Egypt, Kenya, Morocco, Nigeria, and South Africa, which, as the African Development Bank observes, are "the continent's largest economies with more developed financial markets".

Figure: Distribution of private climate finance across Africa, average 2019-2020 African Development Bank



The World Bank further cites research pointing to three barriers for private sector investors, as:

- 01 A lack of data on climate impacts and for investment decision-making.
- 02 A lack of clarity on where private investment is needed.
- 03 The perception that returns on investment are low.

In addition to these obstacles, investors cite elevated risk.

These perceptions have, further, seen more than half, at 53% of the adaptation finance commitments to Africa, in 2021 - 2022, delivered as loans, with corporate funding providing the bulk of equity-based funding.

Overall, private equity, venture capital, and infrastructure funds provided less than 1% of private climate finance flows into Africa in 2019 - 2020, compared with 5% by commercial banks, 10% by institutional investors, 21% by commercial financial institutions, and 39% by companies.

It is against this backdrop, and in light of the urgency of catalysing private investment flows, that there are now extensive moves to develop new and more creative funds, financial instruments and markets to stimulate greater private sector investment in Africa's adaptation.

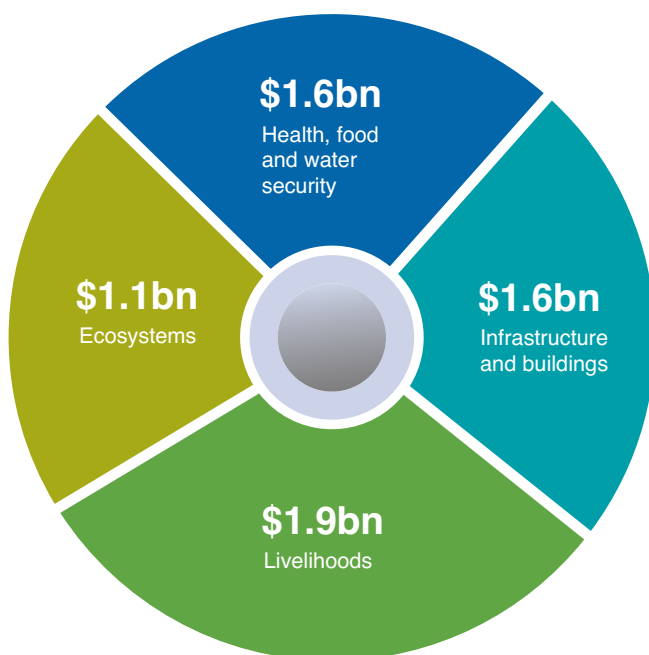


The Climate Funds

The first generation of climate finance was driven by the global climate funds launched from 2001, and offering grants and concessional debt. These funds are evolving, and will be launching a plan at COP 29 in Baku in November 2024 to work jointly to engage the private sector and increase adaptation finance. They have flagged that this new approach will include moves to facilitate blended finance, explore risk mitigation, and develop innovative financial instruments.

Currently, of the world's leading funds, only the Green Climate Fund (GCF) provides substantial adaptation funding, at \$13.9bn for 253 projects by end-2023 and with \$12.8bn for disbursement by 2027. The GCF is also one of the only funds offering direct access to impact investors and NGOs for programme or project funding. It is running a large backlog of applications, but successful accreditations have led to the creation of funds such as the \$56m co-funded Acumen Resilient Agriculture Fund, which is active in Africa.

Figure: Sectoral split of adaptation funding by the GCF, 2023



Total:
\$6.2bn

Mitigation - 205 projects
\$7.7bn



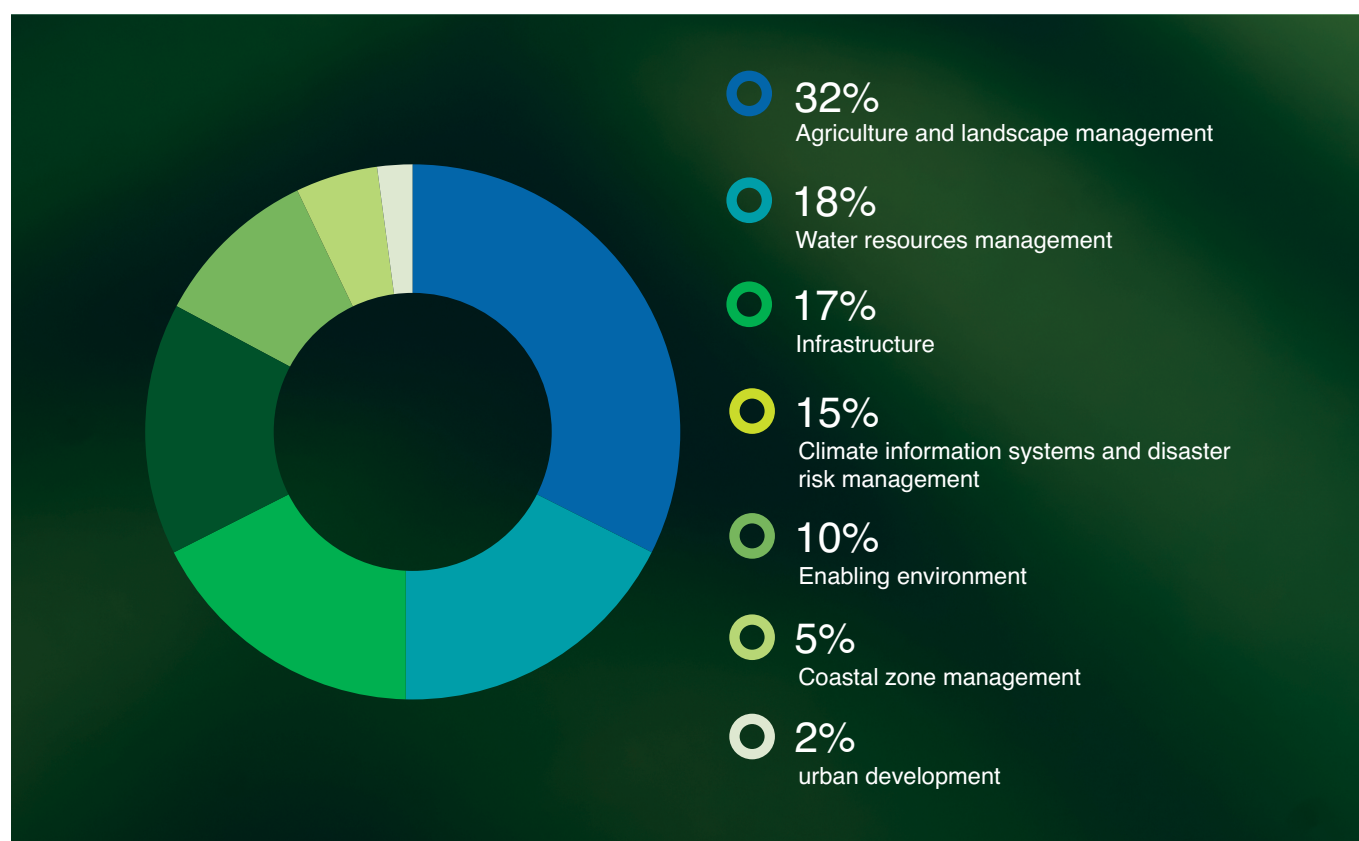
Other funds include the Global Environment Facility (GEF), which is the largest multilateral environmental fund, administered by the World Bank, but allocates over 90 percent of its funds to mitigation. By 2024, it had provided \$2.1bn, or 8.75% of its funds, for adaptation, through the Least Developed Countries Fund (LDCF), and the Special Climate Change Fund (SCCF).

GEF also runs the Challenge Program for Adaptation Innovation, open to direct private sector proposals, which is providing up to \$20m as grants of \$1m to \$2m in its third round from 2024.

The Adaptation Fund provides funding only through national implementing entities, of \$1bn by 2023, including 49 projects in Africa. But it also funds a \$20m Adaptation Fund Climate Innovation Accelerator (AFCIA) in partnership with the UNDP, UNEP and the Climate Technology Centre and Network, awarding the first \$2.2m of innovation grants in 2022 for 21 projects.

A further leading fund is the Climate Investment Funds (CIF). It is strongly focussed on mitigation, but has a Pilot Programme for Climate Resilience accessible through multilateral development banks. Around 30% of its funding is to Africa, and includes some private-sector climate resilience solutions.

Figure: CIF Pilot Programme for Climate Resilience distribution of funds by sector, 2023



The core challenges in relation to the climate funds are the lack of direct access, complexity of accreditation, and insufficient funds.

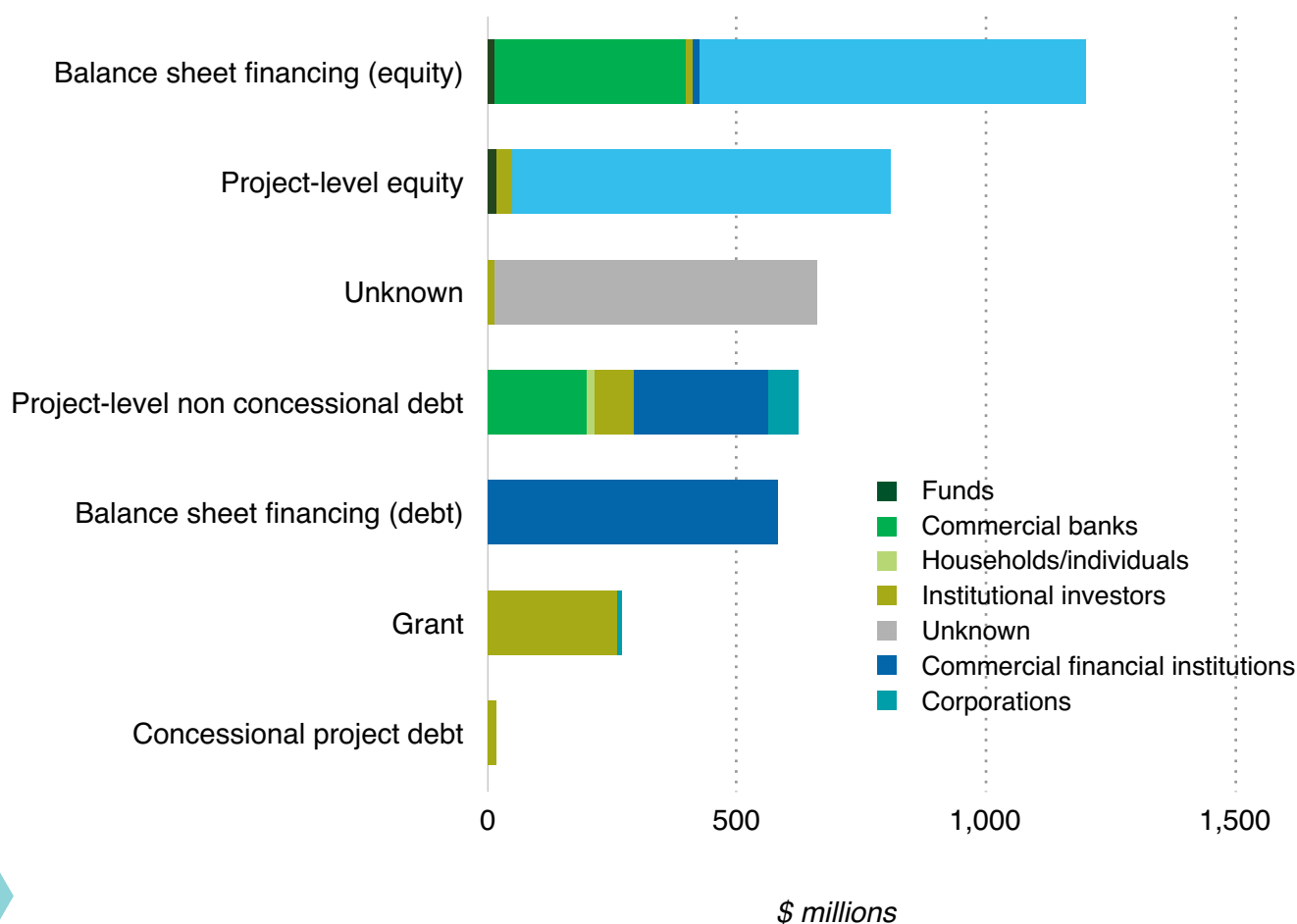
However, since 2021, several private equity/ venture capital funds have been successful in launching adaptation funds that have been funded in part by the Climate Funds and are now active in Africa, including the Lightman Group, Catalyst, Acumen, and Mazarine Ventures. Funds have also opened, such as TECA Ventures for Climate Resilience, run by BFA Global and FSD Africa.

Instruments in Africa

The shape of the climate funds and their engagement levels with predominantly multilateral institutions have directly influenced the current spread of private climate finance.

With the exception of corporate and household investments in adaptation, private-sector financing is being delivered primarily as debt by commercial financial institutions, and grants by institutional investors, with private funds playing very little role in the market.

Figure: Private climate financing by instruments and sources , 2020



Private sector equity investments and public public partnerships are far less common in African climate finance than elsewhere in the world, although investment trusts have been mooted as a novel pathway to substantial increases in equity funding.

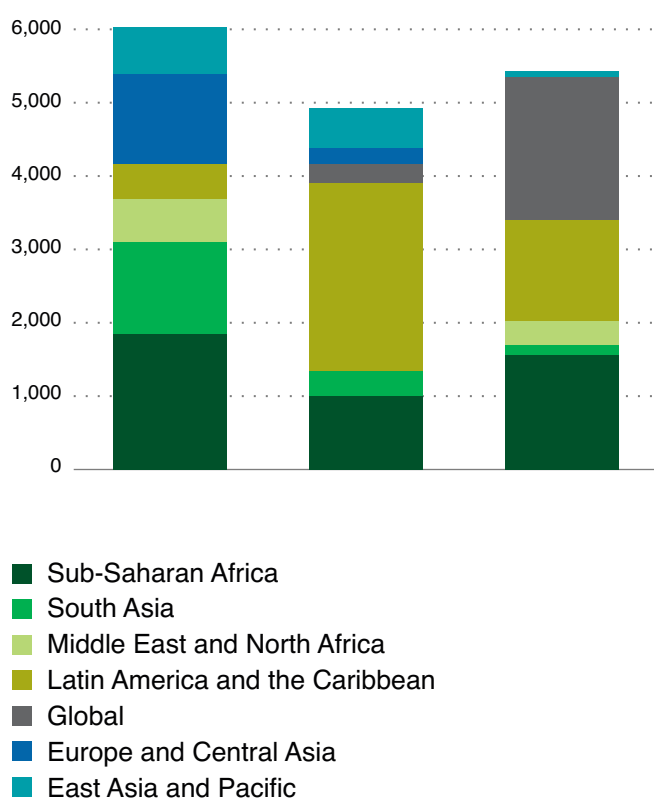
The big shift in equity investments is, instead, coming through catalytic, blended finance, which is drawing concessional debt into private sector investments; while debt tools are expanding directly through the launch of green, climate and social bonds.



Blended Finance

Blended finance, pooling capital from philanthropic donor sources with private capital to reduce private-sector risk, has failed to achieve a steady growth trajectory in Africa, or globally, but it has expanded considerably in Latin America, and is now the subject of vigorous fund and donor attention.

Figure: Climate blended finance by region, 2019-2021



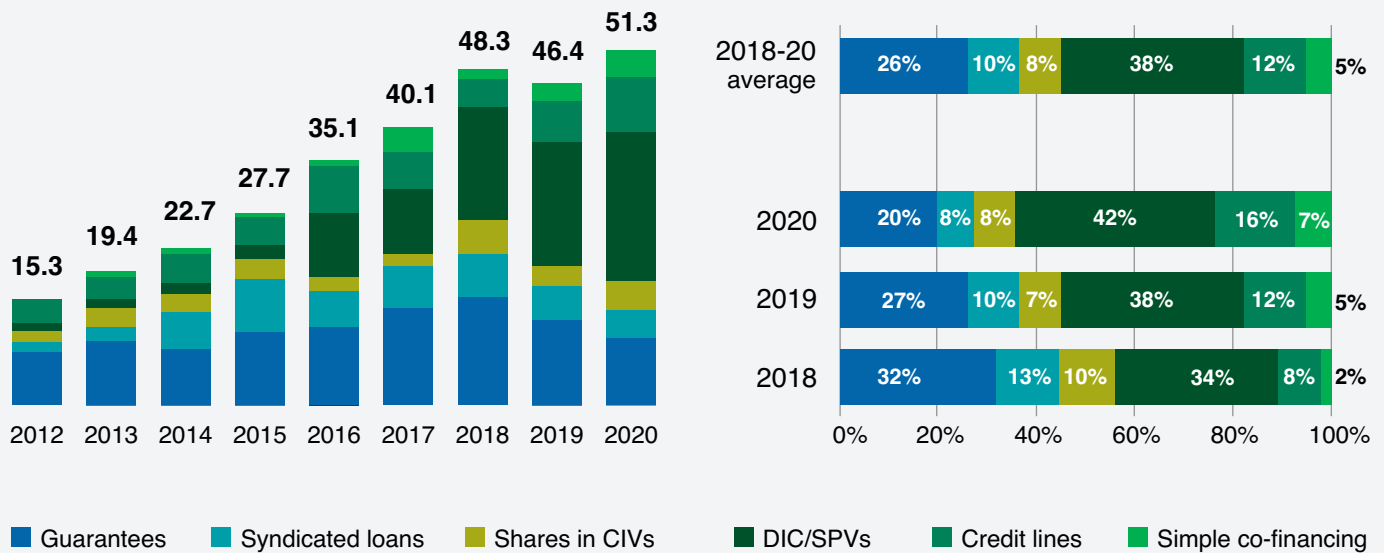
We will look in more detail at derisking tools in the white paper on capital mobilisation and de-risking, but the main elements of blended finance include:



The balance between these elements has been shifting, with a recent analysis of blended finance by the European Investment Bank suggesting far greater flows than the AfDB analysis, topping \$50 billion globally by 2020, but shifting away from guarantees and towards direct investments in companies, and credit lines.

Figure: Mobilised private finance by leveraging mechanism, USD billion

2018-20 average
USD 48.6 billion



Green Bonds

The Green, Social, and Sustainable (GSS) bond market is now growing rapidly globally, and delivering a series of firsts in Africa, in the midst of strong institutional support. It is still inhibited by market constraints, with the United Nations Economic Commission for Africa reporting that “While Africa has 23% of official climate finance, it has less than 1% of global green bond issuances and is paying more than twice more than similarly rated peers to access markets”.

But early issuers are reporting significant successes. Up until 2020, there had been only two sovereign green bonds in the continent, from Seychelles and Nigeria. But Egypt’s oversubscribed 2020 \$750 million Green Eurobond has since seen it issue two further bonds in four issues in 2022 and 2023, each for around \$500 million, in Yen and Renminbi drawing in Japanese and Chinese investors.

In further firsts, in 2021, Benin launched Africa’s first SDG bond, raising EUR 500 million in 2021, and Standard Bank of South Africa launched an \$8.7m social bond the same year. In the same year, advisers for the regional development bank Banque Ouest Africaine de Développement (BOAD), reported that the bank’s first-ever sustainability bond led to the “best coupon (2.75%) and Reoffer Spread (MS +300 bps) conditions ever achieved by the bank in the international market.”

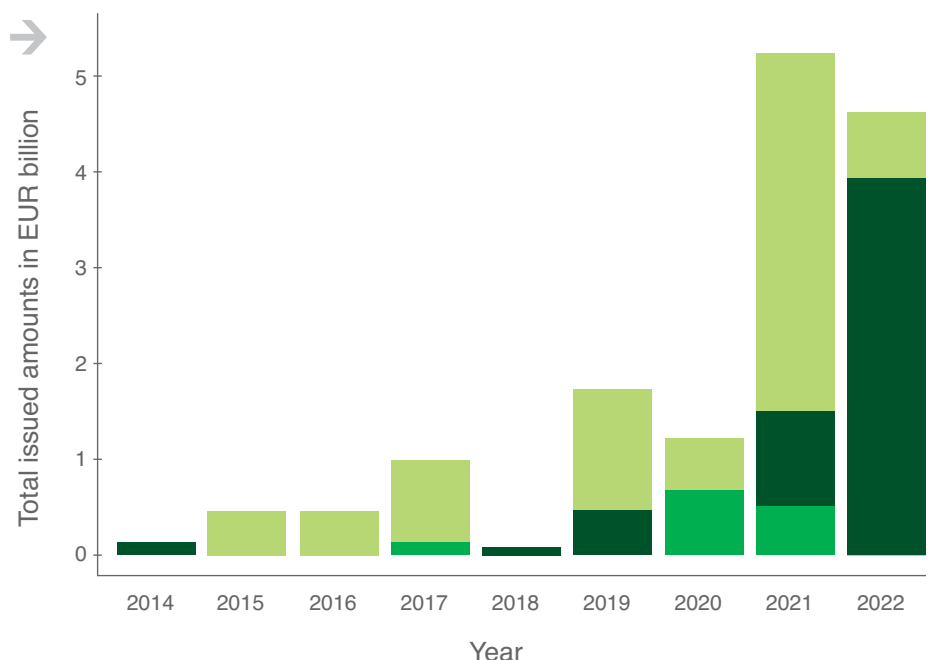
Overall, financial institutions have been taking the lead in the surge in GSS issues in Africa. But, the position remains small, with sub-Saharan Africa still only accounting for 0.7% of the global labelled bond market in 2022.

Figure:

Mobilised private finance
by leveraging mechanism,
USD billion

Issue Type

- Corporates
- Financial Institutions
- Public Sector



The trajectory of corporate and municipal bonds in Africa has been similar, with very few issued from 2014 to 2020. There has been some subsequent acceleration, particularly in South Africa, but a “patchy and small-scale” deal flow for local currency bonds in Africa up until the end of 2022.

The draw of a wide investor base, spanning institutional and retail investors, and sovereign wealth funds, is driving innovation, however, as well as moves to incentivise GSS investments through tax breaks to investors.

This is now spawning early project bonds, with the Global innovation Lab for Climate Finance citing the social bond, the InvestHER Climate Resilience Bond, raised to empower women-led adaptation-focused agri-SMEs in Uganda, as a 2024 top idea.

Last year (2023), also saw a novel \$500m blue bond issue from Gabon, as a debt-for-nature swap, covering existing debt on more favourable terms and using the \$163m funds saved to fund marine conservation projects. It follows from several development debt swaps that covered climate elements, in Cameroon (2006). Seychelles (2015), and DRC (2019), and has raised hopes of a much larger flow ahead, facilitated through development finance credit guarantees or risk insurance.

The continent has also seen the first moves towards green securitisation, with SunKing and Citi closing a \$130 million securitisation in mid-2023 to finance off-grid solar in Kenya.

The growth in green loans has been more rapid, but remains constrained by knowhow and standards, with a 2021 survey finding 70% of banks in sub-Saharan Africa saw green finance as an attractive lending opportunity, but only around 10% had launched green finance products.

Figure:

Green finance opportunities and products (% of Surveyed African banks)

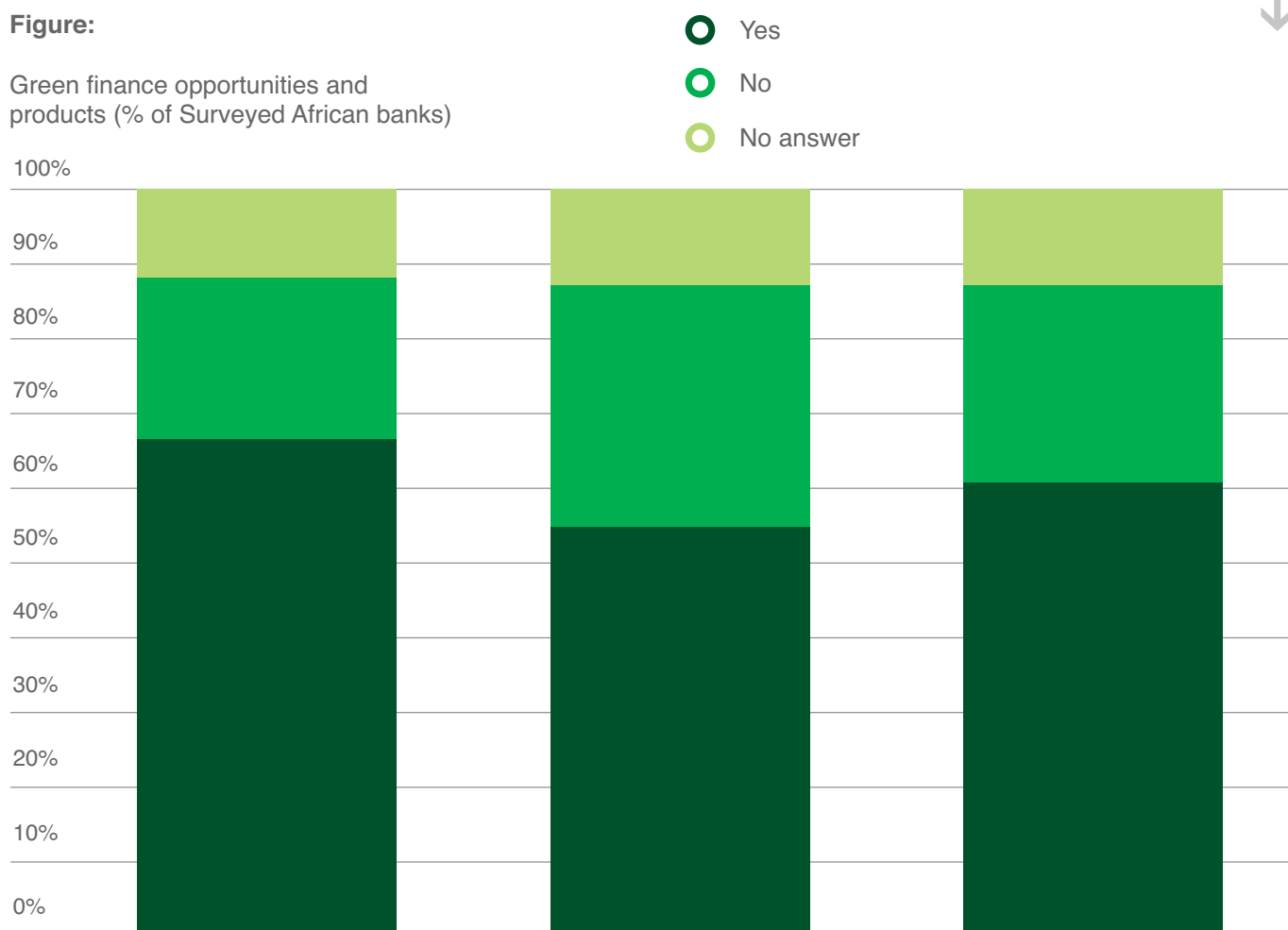
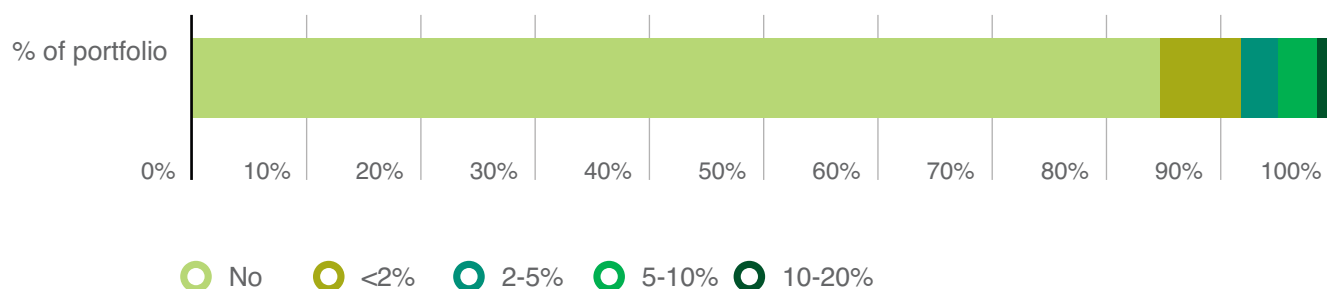


Figure: Products tailored to green finance opportunities

Innovation is also underway in green loans, however, with the launch in 2021 of Africa's first certified green loan, complying with Green Loan Principles, by IFC to Absa Bank Ltd for \$150 million.

The AfDB has, further, launched an African Green Bank Initiative, announced at COP 27, to accelerate the development of green financing through the continent's banking system.

There is, additionally, an ongoing conversation about opening an equivalent in adaptation to mitigation's carbon market. Some units have been launched, such as the AfDB's Adaptation Benefit Mechanism. But none of these are yet tradeable, as they do not satisfy any reciprocal need, such as carbon offset in the carbon market. There is interest in this concept as a pathway to future finance, but no sight yet of a market model.



Key Points for Climate Investors

01 The barriers to adaptation finance in Africa are breaking down

Sources are multiplying, access to established large funds is improving, and markets are rapidly evolving to enable the use of new instruments.

02 Investor appetite is strong

Oversubscriptions and coupon evidence in the last two years have demonstrated a strong institutional appetite for adaptation instruments.

03 Derisking for the private sector has emerged as a key focus for funds and institutions

Blended finance has been on an uneven trajectory, but the upcoming allocations and new fund structures are certain to move blended finance into consistent growth.

GSS bonds have emerged as viable and powerful instruments in all forms. The GSS bond market is accessible at all levels, from sovereign and debt-to-nature to corporate and project, with early adopters demonstrating strong uptake at all tiers, across green, social, sustainable and blue bonds.

04 Further innovations are possible, especially in equity investments

Opportunities exist, for which investor appetite is also apparent, for rapid innovation into green securitisation, as well as shifts towards equity investments through green convertible, perpetual, mezzanine and Sukuk bonds.



The White Paper Series

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The African Venture Philanthropy Alliance (AVPA) Climate Finance Unit seeks to enable the mobilization and deployment of impact capital for climate action across Africa. This publication is part of the Africa Climate Investing Series on Adaptation Finance which seeks to accelerate the development of a vigorous and sustainable private sector in adaptation in Africa through the development of key knowledge assets.

The series addresses climate impacts, private-sector financing needs, current and emerging financial flows and instruments, including novel emerging markets, sectoral case studies, and innovative policy frameworks. AVPA would specifically like to thank the African Development Bank (AfDB) through the Fund for African Private Sector Assistance (FAPA) and the Lemelson Foundation for providing the financial support that has made this series a reality.

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