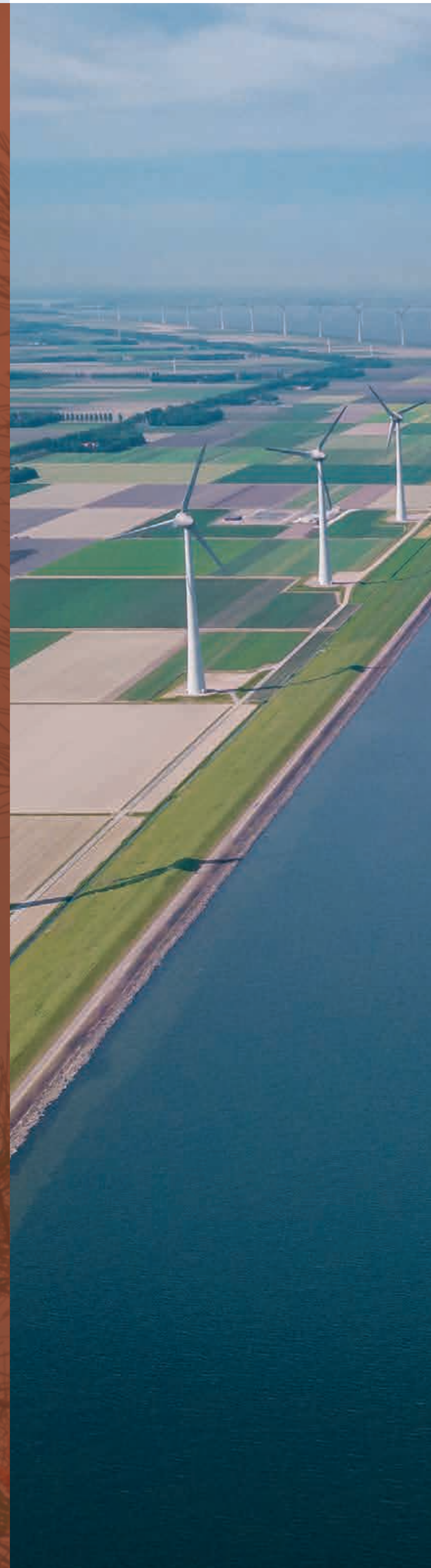
INVEST4CLIMATE
KNOWLEDGE SERIES

United Nations Development Programme

THE ECOSYSTEM OF PRIVATE INVESTMENT IN CLIMATE ACTION

TABLE OF CONTENTS



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Objective ... 2
Abbreviations ... 2

01 | Introduction ... **4**

02 | The Role of Private Investment in Climate Action ... **8**
- Scale of Global Capital Markets and Alternate Investments ... 9
- Climate-aligned Investment Opportunities ... 10

03 | Financial Instruments and Common Investment Modalities ... **14**
- Debt ... 14
- Equity ... 16
- Mezzanine Financing ... 20

04 | Private Capital Providers ... **22**
- Asset Owners ... 24
- Asset Managers ... 27
- Hybrid Providers ... 29

05 | Blended Finance ... **32**
- Capital Providers ... 34
- Blended Finance Instruments ... 35
- Transactions ... 37
- Blended Finance Trends for Climate Projects ... 42

06 | Market Facilitators ... **44**
- Information Providers ... 44
- Enabling Environment ... 50
- Investment and Pipeline Facilitators ... 54

References ... 60
Appendix 1: Invest4Climate ... 63
Appendix 2: Glossary of Terms Used in Figure 13 ... 64

Objective

This report is part of the Invest4Climate Knowledge Series. The Invest4Climate platform, a World Bank Group–United Nations Development Programme (UNDP) partnership, was designed to mobilize, coordinate, and deliver the financing needed to close the climate financing gap and help countries transition to a low carbon, resilient future that supports jobs and growth. The Invest4Climate Knowledge Series provides targeted reports on expanding private investment in climate action through financial innovation and collaborative partnerships.

Abbreviations

AMC	Asset Management Company
AUM	Assets Under Management
CCRI	Coalition for Climate Resilient Investment
CFLI	Climate Finance Leadership Initiative
CIC	Climate Innovative Centre
CIG	Closing the Investment Gap
DFI	Development Finance Institution
DFID	Department for International Development (U.K.)
ESG	Environmental, Social and Governance
ETF	Exchange-Traded Fund
GEF	Global Environment Facility
GIC	Global Investor Coalition on Climate Change
GP	General Partner
GISD	Global Investors for Sustainable Development Alliance
HNW/ UHNW	High Net Worth/ Ultra-High Net Worth
IDF	Insurance Development Forum
IFC	International Finance Corporation
IPCC	Intergovernmental Panel on Climate Change
IPO	Initial Public Offering
LP	Limited Partner
MDB	Multilateral Development Bank
NDC	Nationally Determined Contribution
NGO	Non-governmental Organization
OECD	Organization for Economic Cooperation and Development
PE	Private Equity
PPA	Power Purchase Agreement
REIT	Real Estate Investment Trust
SDG	Sustainable Development Goal
SME	Small Medium Enterprise
SWF	Sovereign Wealth Fund
TCFD	Task Force on Climate-related Financial Disclosures
UN	United Nations
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
VC	Venture Capital

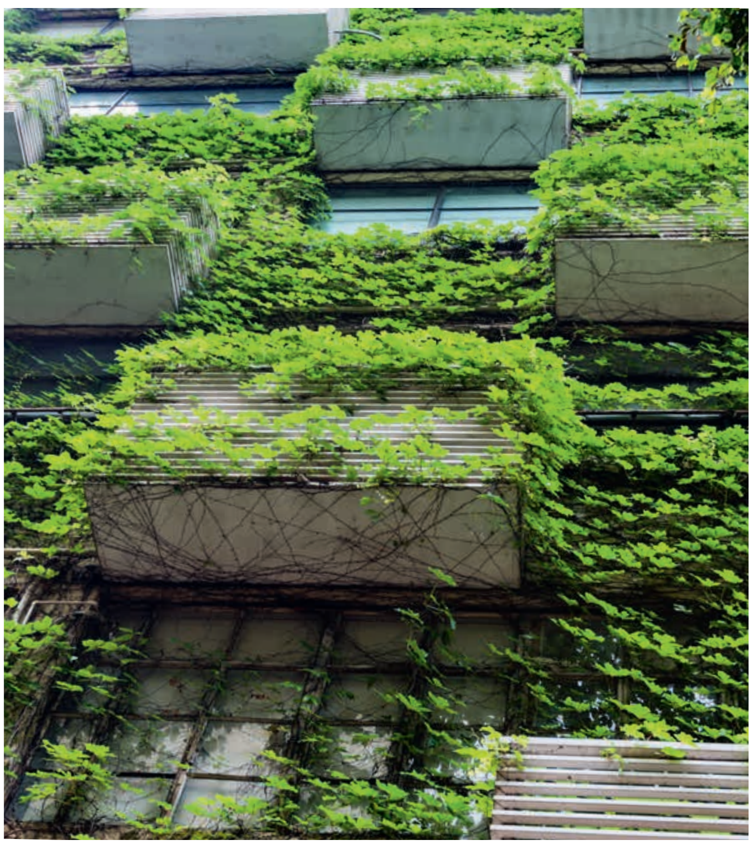
Note: All dollar ($) amounts are U.S. dollars unless otherwise indicated.

01

INTRODUCTION

01 | Introduction

Achieving the goals of the Paris Agreement requires mobilizing substantial amounts of public and private capital swiftly and at scale. In 2019, the Climate Policy Initiative estimated total climate finance flows during 2017-2018 to be $579 billion annually, which falls well below what is needed to limit global temperature rise to 1.5°C (Buchner et al, 2019). The Intergovernmental Panel on Climate Change (IPCC) report suggests that investments between $1.6 trillion to $3.8 trillion are needed every year from now until 2050 for supply-side energy alone (IPCC 2018) while the handful of Nationally Determined Contributions (NDCs)[1] with financial needs assessments anticipate annual investment requirements between $3.5 trillion and $4.4 trillion in order to meet their emissions reduction targets. By any measure, we are far away from meeting the scale and pace of the investment needed to transition to a low-emission and climate-resilient future.



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In 2017-2018, public climate finance averaged $253 billion annually, a small fraction of what is required to meet global climate finance goals (Buchner et al, 2019). To close the multi-trillion climate investment gap, more private capital is needed. However, as the leading provider of concessional capital, public finance has an important role to play in crowding-in private investment and expertise for climate action, particularly in developing countries where investors face complex risks and less familiarity with local policies and regulations.

Concessional capital can make climate-aligned investments more attractive to private investors who seek commercial returns by filling critical gaps in the capital stack[2] such as absorbing more risk, accepting lower returns and being more patient than commercial capital (Nakhooda 2013). Blending public and private finance into climate-aligned investment opportunities enables finite concessional resources to de-risk and crowd-in commercial capital while offering a pathway to generating long-term, sustainable investment models.

However, the ecosystem of private finance is complex. There are many sources of private capital, each with unique risk and return expectations, that work with and through a variety of intermediaries, resulting in a web of investment modalities and financial instruments through which capital is deployed. Tracking private climate finance flows is also more challenging than tracking public flows; as examples, difficulties may arise when distinguishing

1 NDCs are country-led plans to reduce national greenhouse gas emissions and adapt to the impacts of climate change based on Article 4 of the Paris Agreement (UNFCCC). See https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement/nationally-determined-contributions-ndcs

2 The capital stack represents all types of capital in an investment, with the most-risky positions represented toward the top of a stack that naturally seeks higher returns, than those further down the stack.

the origin of private finance, encountering confidentiality clauses related to private sector data, and facing a lack of data collection systems (UNFCCC 2018). As a result of this complexity, the landscape of private investment, and the ways in which the private sector considers the threats and opportunities presented by climate change, is often less well understood by development experts, policymakers and other stakeholders responsible for financing climate action.

The sources of private capital represent the largest pool of capital that can be engaged and mobilized for climate action. But they are less well represented and understood than sources of public capital in climate finance resources guides. In addition to investment, private financiers can also bring a very diverse range of industry expertise, financial acumen, and new technologies that can reduce costs, improve efficiencies, and drive innovation in the fight against climate change.

This resource guide presents an entry point to be used by development and policy professionals to better understand the broad private investment ecosystem and the market facilitators that impact and enable climate-aligned investment, including how they interact with public actors.

Section 1 considers the macro-level investment criteria of different types of private investors and how this impacts the flow of capital to climate-aligned investments, especially those in developing countries. The section then considers the financial instruments investors use and the trade-offs along risk, return, liquidity, and other investment considerations. Finally, the section outlines the sources of investable capital, covering those who “own” financial assets (asset owners), and also those with fiduciary responsibilities to invest financial assets on behalf of others (asset managers).

Section 2 illustrates how private and public capital can interact through blended finance, a financial structuring approach that leverages catalytic capital to crowd-in multiples of private capital.

Section 3 considers the market facilitators who influence capital flows and consequently the private climate finance and investment ecosystem. It is this wide ecosystem of financial actors, based on their investment objectives and risk appetite, that ultimately determines what gets financed and how much this financing costs.