Focus Group Discussion: Developing a green finance facility to catalyse private investment

27 October 2020

Background

The OECD Clean Energy Finance and Investment Mobilisation (CEFIM) Programme aims to support Indonesia in strengthening its policy frameworks to accelerate investment in clean energy. This focus group discussion (FGD) was one in a series of virtual events that are part of the OECD Clean Energy Finance and Investment Review of Indonesia. The FGDs call upon Indonesian and international experiences in topical areas, which will help produce insights and provide recommendations on the enabling conditions to mobilise clean energy finance and investment in Indonesia.

This FGD considered the unique role that a green finance facility or green bank can play in how a green facility or green bank to de-risk projects and thereby help to lower financing costs and facilitate greater participation of commercial banks and other investors. The discussion looked at the current status of financing options for clean energy projects in Indonesia as well as experiences and lessons learned from other countries in setting up dedicated vehicles and institutions for clean energy finance.

Summary of Discussions

To meet the country's NDC, Indonesia will need to mobilise approximately USD 220 billion (MoF) of investments by 2030 in the clean energy and sustainable transport sectors. Both domestic and international public and private sources of finance will be needed to meet these goals. Indonesia has a variety of public finance options available to support climate finance through a number of different public institutions such as PTSMI, BPDLH (the Environment Fund Management Agency) and IIGF. Each of these institutions have different operational structures and mandates and could play an important role in helping to leverage private investments for clean energy. PTSMI and IIGF have already supported clean energy projects, while the BPDLH is still currently evaluating the possibility of financing clean energy projects.

A variety of international public and private sources of finance are also active in Indonesia's clean energy sector, including the Green Climate Fund (GCF), Multilateral Development Banks such as the World Bank and the Asian Development Bank, various philanthropic actors, international commercial banks and foreign project developers. BPDLH, the SDG One Indonesia Fund managed by PTSMI, GCF and the Climate Investor One fund (supported by FMO, the Dutch development bank) were highlighted as important financing vehicles to channel international climate finance with a goal of attracting private investors. With limited state budget, the government of Indonesia is looking to how these funds can be used strategically to mobilise private finance. The biggest challenge Indonesia faces is the development of a scalable pipeline of bankable clean energy projects. Additional technical assistance is needed to support project development.

To mobilise finance from the private sector, the government of Indonesia has been working closely with the financial sector to develop sustainable finance products within the banking, capital market and non-bank financial institutions. Phase I (2015-2019) of OJK's Sustainable Finance Roadmap focused on

increasing awareness amongst financial service institutions on the importance of sustainable finance and provided comprehensive regulatory frameworks and guidelines. Phase II (2020-2024) will focus on building the sustainable finance ecosystem by strengthening the implementation of ESG risks and supporting innovation and development of financial services and products that can help the country achieve its sustainable development goals (SDG) and the Paris Agreement.

A number of challenges were highlighted on the difficulties faced by financial institutions in financing renewable energy projects. These included a lack of familiarity with renewable projects among financiers and insufficient information; high perceived risks; lack of suitable financing instruments and funds; and limited green finance to support corporate sourcing of renewables[1]. To overcome these challenges the government of Indonesia will evaluate additional incentives to support investments; improve availability of data and information by implementing monitoring and reporting protocols; support capacity building among financial institutions staff and develop innovative finance schemes to help attract investors and corporations.

A green finance facility or green bank can play an important role in overcoming barriers to raising commercial finance for clean energy projects by using public funds to crowd in private finance. The green bank model (or green finance facility) is designed to address market constraints in finance for climate investments. It uses concessional funding to blend public funds with private capital to build investor confidence and help lower financing costs for new technologies that offer climate mitigation or adaptation solutions. It typically establishes products for repeatable financing of a target market and its objective is to mobilise finance from domestic finance institutions.

The experiences of Australia, Mongolia and South Africa in setting up a dedicated green finance facility or green bank highlighted a variety of different models that can be used to help catalyse private investments in clean energy and crowd in private capital for projects that would not otherwise be financed by the market. These examples showed how limited public funds can be used to pull in private capital and expand clean energy markets. Different blended finance models are available to de-risk projects and help the banking sector gain experience and confidence in financing clean energy projects. These include partial risk guarantees, subordinated debt, tenure extensions and other de-risking instruments. Such facilities have played an important role in providing local currency debt for projects which are not able to access affordable finance.

Financial instruments used by countries include the provision of debt and equity finance, investing in green bonds, investment and creation of funds to co-deliver projects, concessional finance, on-lending facilities, credit enhancement via first loss or subordinated funding and tenor extension, reimbursable grants to help smaller project developers meet collateral requirements and green mortgages. The use of grants and concessional finance varied across countries but all highlighted the need to ensure that such measures were focused on projects with high social and/or environmental impact or with significant demonstration capacity and replicability to develop scalable project pipelines. Tools to evaluate the environmental and social impact of projects are also an important element, in the case of South Africa's Climate Finance Facility a high impact committee was establish to help evaluate project impacts.

In the case of both Mongolia and South Africa, the GCF is playing an important role in capitalising the facility or institution as well as providing technical assistance in its development. Various capitalisation models were used, e.g., a completely public funded model; a mix of state budget and GCF; and a mix of state budget, GCF and consortium of private banks. The decision to create a new institution or house a

[1] A focused group discussion on Corporate Sourcing of Renewables was held on 13 October.

facility inside an existing institution depended on whether a suitable existing institution already exists with appropriate governance structure and operational mandate.

Experts highlighted the importance of understanding the market needs for such a facility to better tailor the design of financial instruments. The involvement of the local finance sector in identifying market gaps and the importance of transparency and clear operational mandates was also stressed. Independence from the government and political interference in the funds operation was also cited as important elements. Strong technical capacity of staff and experience in financing clean energy or climate solutions was also seen as an important prerequisite for success. While all agreed that it was key for countries to develop project pipelines ready to be supported by a green finance facility, the involvement of green finance institutions in developing project pipelines varied across countries with some focusing on financing and leaving project pipeline development to the market or other government institutions.

Conclusions and recommendations

- The creation of a green finance facility should be informed by a detailed market assessment of financing needs and challenges faced by project developers and domestic finance institutions. This will allow the facility to create suitable financing instruments that meet the needs of the market and help identify sector requirements.
- The staffing of a dedicated green finance facility requires expertise in project evaluation and ideally experience evaluating energy efficiency, renewable energy projects and other climate related sectors such as water and waste management. International collaboration to support training and capacity building should be considered.
- A green finance facility should focus funding towards commercial or near commercial projects that have a strong demonstration impact or potential for replicability to help build investor confidence and develop knowledge and expertise among local financiers. Finance should focus on additionality and pulling in commercial finance which would otherwise not have funded a project. Operational independence from the government can protect against political uncertainty that often comes with changes in government. Such independence can be achieved through the legal frameworks set up in the creation of the facility or institution.
- To help prove concepts and demonstrate viability of projects, such a facility should start with easy wins in more mature sectors, for example solar and wind projects that are already competitive in many countries but lack sufficient experience in Indonesia.
- Where grants or concessional funding is used, such projects should have significant social impacts, and benefits of low interest rates should be passed on directly to the project developer.
- Once a sector has reached maturity, the facility should phase out financing such projects and shift funding towards other promising sectors that are not able to access commercial funding.