Communiqué
from

Creating the Climate *for* Change
Sustainable Energy Finance
Bonn, Germany, 1-2 June 2004

On 1-2 June 2004, the Sustainable Energy Finance event "Creating the Climate for Change" brought together 260 members of the finance community, government officials and project developers from 37 countries in Bonn as part of the International Conference for Renewable Energies. Work sessions were held on the following topics: risk management, venture capital, consumer lending and microfinance, export credit, carbon, infrastructure, and SME finance, as well as public-private partnerships. Each session produced specific recommendations for unlocking investment in sustainable energy, which have been summarised in this communiqué to be submitted to the International Conference for Renewable Energies. The views expressed are a synthesis of views and opinions presented during the work sessions and should not in any way be attributed to any one participant, the sponsoring governments or organizations.

A global transition to a sustainable energy mix based on renewable energy (RE) and energy efficiency (EE) has a significant potential to mitigate climate change, address regional and local environmental concerns, reduce poverty, and prevent future resource conflicts. The challenge is to provide the right policy frameworks and financial instruments that will enable RE and EE to achieve their market potential and move from the margins of energy supply to the mainstream.

The introduction of RE and EE is hampered in part because economies of scale have yet to be achieved for most technologies, but also due to the high transaction costs of first-time investments that create barriers to entry, and energy markets that fail to "price in" environmental and social externalities.[1] These barriers help status quo energy technologies that impose external costs on society and impede cleaner and more sustainable energy sector development. The result is market distortion, environmental destruction, and loss of natural capital.

To shift to a sustainable energy future based on RE and improved EE, concrete actions are thus required from both policymakers and the finance sector.

Steps to be taken by governments, international institutions, and financiers:

1. Many countries and organisations have formulated targets for the uptake of RE, but achieving set goals requires a coordinated and credible process for delivery. Strength, clarity, and stability

[1] Fossil fuel subsidies are also a problem in many markets as they make conventional energy costs artificially low, which disguises real costs, and conversely make it harder for RE and EE to become commercially competitive.

are decisive characteristics of the **policy framework** that attracts capital to renewable energy: that framework must be specific enough to improve the bankability of projects and provide conditions for steady market growth in the renewables sector[2].

2. **Venture Capital** (VC) can play a crucial role in the spectrum of financing solutions needed to promote innovative RE and EE technologies. VC is particularly relevant to helping emerging technologies bridge the *Valley of Death*, the funding gap between laboratory research and fully commercial business activities. The best way to increase mainstream VC flows into this sector is by creating enabling policy frameworks that help investors generate real-world returns.

- *Recommendation 1 – Governments can help to get the message out to the mainstream financial community by highlighting examples of high performing investments and disseminating market data and case studies about commercial activity and returns.*
- *Recommendation 2 – Governments can help create a high-quality investment pipeline of new companies by funding R&D, assisting with business plan development and co-funding costly patent applications.*

3. In developing countries, **small and medium-sized enterprises** (SME) are key to delivering clean energy, but the services and capital needed to increase the number of energy SMEs is lacking. International financial institutions and donors, local financial institutions, and government agencies need to work together to establish resources and innovations adapted to the financing needs of the energy SME.

- *Recommendation 1 – Financial innovations are needed to provide entrepreneurs with access to risk capital and to fill the widening gap between traditional debt and equity now available in the market. This can take the form of seed, growth, or mezzanine finance.*
- *Recommendation 2 – Government agencies and donors must recognize that energy SME development requires their long-term commitment to build local SME capacity and specialized service and capital providers.*

4. The bulk of the **infrastructure finance** provided to mid to large-scale RE and EE projects is usually in the form of corporate or project-financed debt. Besides equity investment from strategic partners, more and more finance is provided by the capital markets. However, all types of investment require certain conditions.

- *Recommendation 1 – To attract mid-to-long-term financing, governments need to create a stable regulatory environment ensuring predictability as well as compatibility regarding the REC and carbon markets.*
- *Recommendation 2 – By financing pilot projects, governments can play a crucial role in demonstrating the commercial viability of RE technologies.*

5. **Carbon finance** can catalyze RE and EE investment by providing a high-quality, hard-currency revenue stream to projects that reduce greenhouse gas emissions. But at current prices, carbon revenues alone are insufficient to render most economically-viable projects bankable.

- *Recommendation 1 – Governments should find innovative approaches for ODA and carbon finance to be used in a complementary and additional way. This will help develop bankable projects by bridging the investment gap and lowering perceived risks.*

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[2] An effective policy framework must be 'loud, long, and legal': Loud – the signal to the market, through incentive structures or other means, needs to be 'loud' and clear to attract capital into the sector; Long – rules and incentives need to be stable and sustained for a duration that reflects the financing horizons of the projects; Legal – a legally-established regulatory framework based around binding targets or implementation mechanisms is needed to provide the basis for long-life capital-intensive investments. (*excerpted from the Finance Sector Statement on Renewable Energy submitted to the International Conference for Renewable Energies through the Multi Stakeholder Dialogue)*

- *Recommendation 2 – Governments can reduce risk and transaction costs by clarifying the status of Certified Emission Reductions and Emission Reduction Units beyond 2012, the national processes for project approval and the baseline methodologies.*

6. An integral element of deal structuring is **financial risk management**. However, there are currently constraints on the availability of such instruments, which relate to factors such as the lack of data, and the limited willingness and capacity of insurance sector and capital markets to respond.

- *Recommendation 1 – The public sector should support activities to improve availability of data to be used for private sector actuarial studies to develop new underwriting/rating methodologies.*
- *Recommendation 2 – Public-private partnerships can be usefully focused on the development and re-adaptation of financial risk management instruments that aggregate and securitize risks.*

7. **Export Credit Agencies** (ECAs), by supporting exports of sustainable energy products and services to developing countries, can play an important role in helping meet growing energy needs in a sustainable manner. Yet, to date ECAs have had little experience with RE support.

- *Recommendation 1 – Governments should consider a special Renewable Energy Sector Understanding to supplement the Arrangement on Officially Supported Export Credit, allowing longer and more flexible repayment terms, and higher local content.*
- *Recommendation 2 – ECAs should individually develop products and processes to address current barriers to RE projects: for example, project bundling, special products and hand-holding services tailored to SMEs, and new risk management tools to assess the carbon risk of all projects.*

8. **Consumer lending and microfinance** is often needed to finance energy services in order to increase consumers' purchasing power, especially in developing countries. Unlocking access to loans for consumers will be essential in engaging the private sector and improving the investment climate for rural energy services. In considering the role of microfinance for RE, it is necessary that RE projects generate an income for their clients.

- *Recommendation 1 – Government agencies and donors can contribute to developing domestic credit markets in developing countries by offering capacity building and risk mitigation/sharing facilities for microfinance institutions, energy service providers and consumers.*
- *Recommendation 2 – Scaling up of microfinance approaches and models requires supportive fiscal and banking policies.*

9. Coordinated, joint initiatives by the public and private sectors are important vehicles for leveraging the resources necessary to develop sustainable energy services, particularly for the nearly 2 billion people who currently lack access to modern energy. Successful **public-private partnerships** use public-sector resources to attract private capital for sustainable energy services through innovative risk-sharing arrangements.

- *Recommendation 1 – The public sector should work with financial institutions and other key stakeholders to identify and nurture investment opportunities, providing targeted subsidies to build the capital and human capacity that will attract private investment to sustainable energy services.*
- *Recommendation 2 – Successful partnerships are dynamic, and require a long-term commitment from all parties. Working partnerships should be formed early in each initiative*

in order to maximize the policy support from governments, as well as the engagement of local financial institutions, initially and over the longer term.

10. **Local governments,** with their purchasing and regulatory power, significantly influence energy demand and use. They should provide financial incentives to stimulate voluntary investments in RE and EE and offer innovative financing. National governments should support local governments in their efforts to promote RE and EE.

To ensure the success of RE and EE projects, it is necessary that appropriate financial instruments are available along the entire finance continuum from project development to construction and commercial operation. The above recommendations provide some of the concrete actions needed to close gaps in this continuum and to provide the private sector with the incentive and confidence to invest at a scale commensurate to meeting government targets.

Bonn, 2 June 2004