UKNiAF

United Kingdom Nigeria Infrastructure Advisory Facility

Climate Finance in Nigeria: An introduction

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What's this about?

This brief is a primer on climate finance – it aims to help readers navigate the climate finance landscape and quickly focus on the aspects that are most relevant to Nigeria. It is not comprehensive and is complemented by other reading. This paper introduces relevant sources of climate finance in Nigeria, the barriers faced in accessing them and examples of entry points for those seeking to tap into these sources (the Climate Finance Navigator provides further depth).

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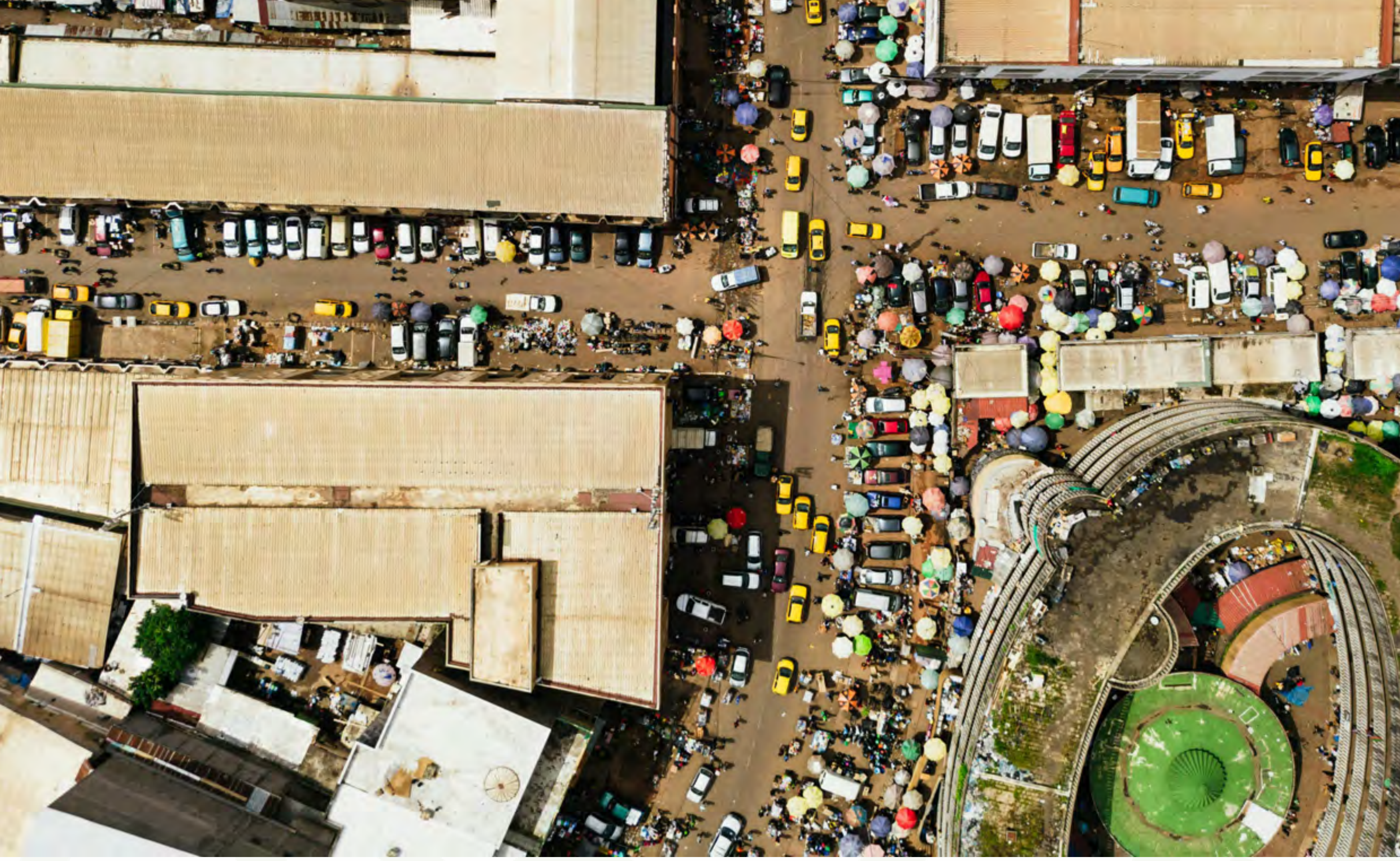

Financing development priorities through climate finance

While the most populous and economically significant country in Africa, Nigeria faces a perpetual shortfall in investment. Climate finance can play an important role towards closing the gap, driving positive environmental and social impact while unlocking new opportunities for attracting investment and innovation to Nigeria and improving resilience to the many climate-related risks that it faces.

- **Infrastructure Development**: Many of Nigeria's infrastructure needs are aligned with climate change, such as renewable energy installations, climate-smart agriculture projects, and resilient transportation systems. Climate Finance can therefore help Nigeria enhance its energy security, improve agricultural productivity, and promote sustainable urbanisation.

- **Job Creation**: Nigeria needs to develop alternate sources of revenue and economic growth. Climate finance investments create new employment opportunities across various sectors including renewable energy, sustainable agriculture and ecosystem restoration. Nigeria has a large "green" jobs potential, creating further opportunity for entrepreneurship and skills development, particularly in rural areas where climate-related activities are often concentrated. By targeting green growth, rather than a narrowed carbonisation lens, climate finance can help Nigeria diversify its economy and create jobs.

- **Energy Access & Affordability**: Nigeria needs to continue to develop its energy systems to widen and deepen energy access. Climate finance facilitates the expansion of access to clean and affordable energy sources, in particular solar power. Improved access to energy stimulates economic productivity, which in turn powers small and medium-sized enterprises (SMEs) and enhances the quality of life for communities, particularly in rural and underserved areas.

- **Climate Resilience & Risk Reduction**: Investing in climate resilience measures, such as flood defences, drought-resistant crops and early warning systems helps Nigeria adapt to the impacts of climate change and reduce vulnerability to extreme weather events.

- **Attracting Investment and Fostering Innovation**: Climate finance leverages domestic and international investment in climate-smart projects and technologies, stimulating innovation and entrepreneurship in Nigeria's economy.

- **Global Market Opportunities**: Embracing climate finance opportunities positions Nigeria to participate in the growing market for sustainable goods and services. By investing in low-carbon technologies, green infrastructure and climate-smart solutions, Nigerian companies can first and foremost better serve its large, domestic market and ultimately enhance its competitiveness in global markets.

In summary, by leveraging climate finance effectively, Nigeria can unlock new opportunities for sustainable economic growth and advance the country's development agenda, and in doing so address pressing climate change challenges.

What is Climate Finance?

There is no universal definition of climate finance, and the term is often used interchangeably to refer to different things. For the purposes of this brief, we consider climate finance as any financing for credible climate action. This includes activities such as renewable energy projects, energy efficiency improvements, reforestation efforts, climate-friendly infrastructure development, and initiatives to enhance resilience to climate impacts, aimed at mitigating or adapting to climate change.

The goal of climate finance is to mobilise resources to support actions that contribute to green growth or climate resilient development. It is important to note that this includes flows of finance that deliver climate change outcomes but may not have an explicit climate mandate. This are often referred to as 'climate-aligned' finance.

Climate finance can take various forms (instruments), including grants, concessional loans, equity investments, guarantees, lines of credit, carbon market finance and green bonds. These are provided by a wide range of actors in the finance system, including, governments, investors, asset owners, individuals, philanthropic and non-governmental organisations.

- **Loans:** Loans must be repaid at the end of their term and attract interest payments. Concessional loans are those that have longer repayment terms or lower interest rates than the market rate. National or international development finance institutions (DFI) typically enhance investments through concessional loans. Private sector lenders typically provide non-concessional loans at market rates.

- **Equity:** Equity is where the investor takes a stake in the company or projects.

- **Bonds:** Bonds are fixed-income financial instruments that offer investors a stated return on their capital. Climate or green bonds are linked to climate change solutions – with a commitment to use the proceeds to finance or refinance climate projects.

- **Insurance:** Insurance instruments pay out if a particular risk materialises. For example: weather-linked insurance, contingent credit and loans, and multi-country risk facilities. The FCDO supported Financial Services Development Africa (FSD Africa) programme is providing valuable support to the Federal Government of Nigeria in accessing such insurance products.

- **Grants:** Grants are normally provided for non-revenue generating activities, such as knowledge management programmes, capacity building programmes, ongoing activities that do not generate financial return, and technical and costing plans, among other projects. Grants generally come from foundations, DFI, or development partners.

- **Guarantees:** A guarantee is an undertaking by a third party (guarantor) to fulfil the obligations of a borrower to a lender, in the event of non-performance or default by the borrower. Guarantees with full risk coverage will typically incorporate all commercial and political risks, whilst guarantees with partial risk coverage will incorporate either commercial or political risks.

- **Debt Swaps:** Debt for climate and environment swaps offer debt relief in exchange for commitments to invest in climate action.

The Global Climate Finance Landscape

The global volume of climate finance is on the rise, currently standing at a significant USD 1.3 trillion annually. The landscape of global climate finance is marked by a pronounced emphasis on mitigation strategies, with most mitigation funding allocated towards project-level market-rate debt. While grants and concessional financing do play an important role, they constitute a smaller portion of the overall finance pool. Notably, investments have primarily been directed towards "hard" infrastructure sectors. Climate finance data from 2021 to 2022 reported by the Climate Policy Initiative (CPI 2023), illustrated in Figure 1 show:

- the vast majority of climate finance went into mitigation activities, adaptation (not to mention loss and damage) activities are severely underfinanced;
- the financial instrument chosen to deploy the highest volume of finance was project-level market-rate debt, followed by balance sheet financing, and thirdly, equity; and,
- the energy and transport sectors received the most financing at USD 515 billion and USD 336 billion respectively.

The growth in climate finance is neither sufficient nor consistent across sector or regions, since climate finance tends to be geographically concentrated as developed economies continue to mobilise most of the climate finance, primarily from private sources. The long-term need for climate finance of around USD 10 trillion per annum is several orders of magnitude larger than the currently available volume. International initiatives to significantly upscale the level of climate finance, such as the Glasgow Financial Alliance for Net Zero (GFANZ) announced at COP26 in Glasgow, have struggled to deliver. Similarly, initiatives to prepare support packages for individual emerging economies, such as South Africa, have not yet materialised, which puts renewed focus on the ongoing international climate change negotiations to agree a global quantified financial goal.

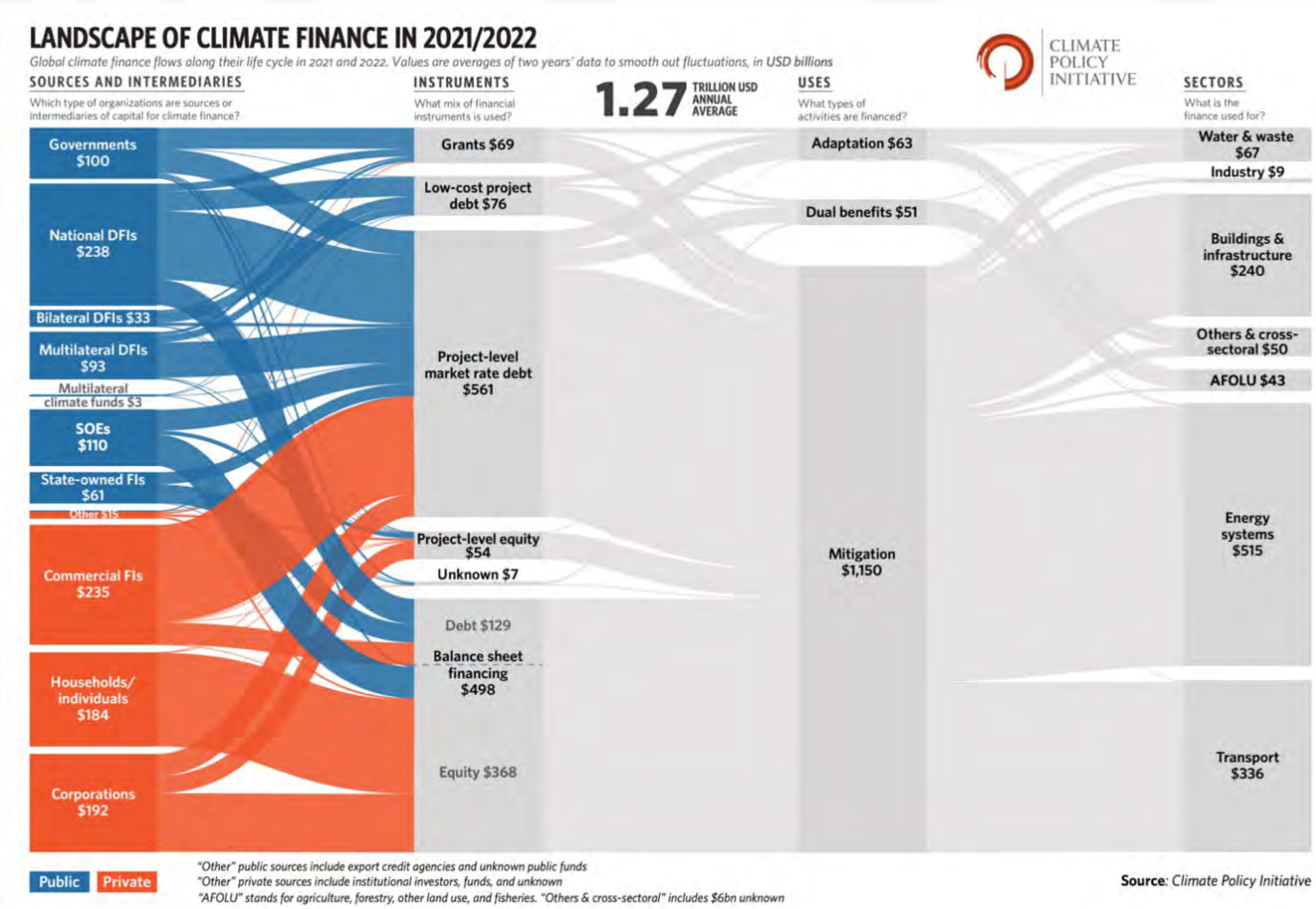

Figure 1: Landscape of Climate Finance in 2021/2022 by the Climate Policy Initiative

The Climate Finance Landscape in Nigeria

Despite the substantial volume of global climate finance available, Nigeria receives only a fraction of this funding, totalling about USD 1.9 billion in 2019/2020. Of the total USD 1.9 billion, adaptation finance accounted for USD 663 million, while mitigation finance amounted to USD 1.1 billion, with an additional USD 186 million allocated for dual-benefits finance. In line with global trends, adaptation finance in Nigeria requires substantial scaling up to align with the country's economic development ambitions and its Nationally Determined Contributions (NDC) adaptation goals. This is especially critical given Nigeria's status as one of the world's most vulnerable countries to the impacts of climate change (Verisk Maplecroft, 2017).

Nigerian climate finance is predominantly debt-based, accounting for over 75% of funding, with a primary focus on mitigation efforts, although there is a greater emphasis on adaptation compared to the global average. While advocating for low-carbon and climate-resilient development offers substantial long-term economic benefits for Nigeria, winning the public debate on its urgency and gaining widespread support from all stakeholders is essential for success.

Sources of Climate Finance

There are broadly 4 groups of climate finance sources:

- Domestic public finance.
- International public finance.
- Domestic private finance.
- International private finance.

All these sources face the same challenges as any other investment operating in Nigeria. In 2024, the macro-economic environment in Nigeria remains challenging. Domestic public finances are likely to remain dampened, inflation and currency challenges remain major concerns for international investors (World Bank, 2023). However, there are some specific characteristics and barriers, as well as entry points, that are highlighted below.

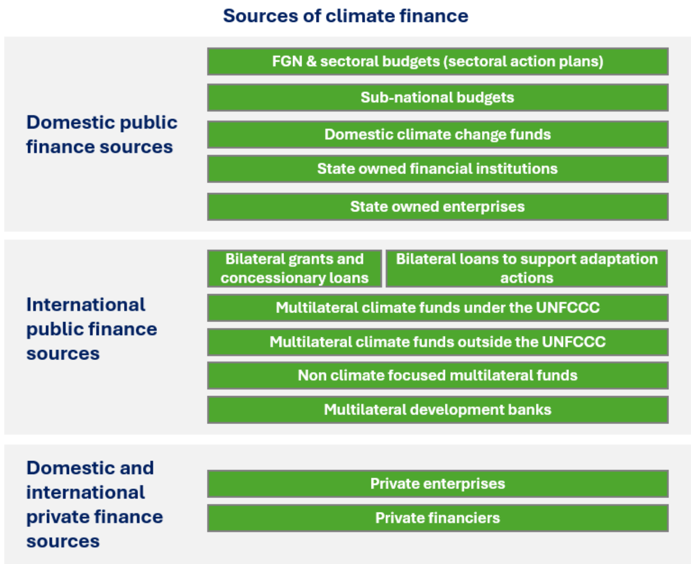

Figure 2: Sources of climate finance and their deployment through the development and implementation phase of a project or investment opportunity.

1. Domestic public finance

Financial resources allocated by Federal Government of Nigeria. This is typically sourced from government revenues, including taxes, fees, and levies, as well as dedicated climate funds and appropriations allocated through national budgets.

Key challenges and barriers

- **Competing priorities** – the government faces competing priorities when allocating public funds, including social welfare, infrastructure development, and economic growth. Balancing these priorities can be challenging, particularly at a time when the government has limited financial resources and many pressing socio-economic needs..
- **Limited budgetary allocations** – the government's limited budgetary allocations for climate action had hindered the implementation of essential projects, initiatives and climate adaptation measures over the years.
- **Limited institutional capacity** – Insufficient technical expertise, human resources, knowledge and monitoring management systems hinder effective planning, coordination, and reporting of climate-related expenditures at the Ministries of Environment, Budget and Planning and the Debt Management Office (DMO).

- **Lack of long-term planning** – Inadequate long-term planning for climate finance can result in ad-hoc and fragmented investments that fail to achieve meaningful impact. The absence of comprehensive strategies and frameworks for climate financing are real issues due to inadequate long-term planning for climate financing that has led to inefficiencies, missed opportunities, and suboptimal resource allocation.
- **Inadequate policy & regulatory framework** – The absence of supportive policy and transparent regulatory frameworks may have deterred private sector investment in climate-related projects and initiatives. Uncertain regulatory environments, inconsistent policies, and lack of incentives for climate-friendly investments can undermine the effectiveness of domestic climate public finance.
- **Data & information gaps** – Inadequate data and information on climate finance flows, project outcomes, and impact assessments pose challenges for effective decision-making and transparency and accountability. There is no effective mechanism to tag or report on the use of domestic climate public finance in Nigeria either at the State or Federal level.

Entry points

- **Federal and State budget allocation** – Federal and State governments allocate finance on an annual cycle, based on the investment submissions from Federal and State Agencies. Securing budget from these sources requires engaging with the relevant MDA.
- **Sovereign Green Bond** – Nigeria has issued 2 sovereign green bonds and is currently developing a third. The current sovereign bond is allocated through the budget process. The allocation of proceeds and selection of projects happens based on the federal budget allocations. Accessing this source requires securing allocation through the annual budget process.
- **State-owned financial institutions** – The Development Bank of Nigeria (DBN), Bank of Industry (BOI) and Nigeria Sovereign Investment Authority (NSIA) have various funds for developmental investments in Nigeria. NSIA recently launched CarbonVista for investing in carbon market projects.
- **National Climate Change Fund** – The Climate Change Act 2021 provides for the creation of the Climate Change Fund (CCF). This is currently under development.

2. International public finance

This involves financial resources provided or mobilised by international entities, such as multilateral development banks (MDBs), donor countries (ODA), and international organisations, to support climate change mitigation and adaptation efforts in developing countries. International public climate finance primarily originates from contributions made by industrialised countries, MDBs (e.g., World Bank Group (WBG), African Development Bank (AfDB)), and international climate funds (e.g., Green Climate Fund (GCF), Global Environment Facility (GEF)). This finance can be part of the United Nations Framework Convention on Climate Change (UNFCCC) commitments made by industrialised countries to developing countries, or outside of it.

Key challenges and barriers

Nigeria has accessed a very small amount of international public climate finance to date and continues to face significant challenges in accessing international funds, listed below.

- **Complex application & approval process** – Nigeria encounters high barriers to accessing international climate finance, including stringent eligibility criteria, complex application processes, and limited capacity to meet requirements set by MDBs and global climate funds. DBN continues to face challenges in meeting the accreditation criteria of the GCF. Previously, the Bank of Industry failed to get accredited to the Adaptation Fund (AF) despite undertaking a lengthy process.

- **Mediated access through MDBs** – Access to international climate finance is often mediated through MDBs, requiring partnership or approval of national accredited entities. The Clean Technology Fund (CTF) as an example, will typically channel its funds through the WBG or the AfDB. Nigeria does not currently have an Accredited Entity to the major funds such as the GCF and AF making it difficult to access much needed funds.

- **Small ticket size** – International climate finance sources typically require large-scale investments in public projects (in the order of $10s of millions), which makes it challenging for smaller projects and initiatives to access funding. This requirement limits the scope of eligible projects and tend to overlook grassroots opportunities and community-based initiatives.

- **Duplication & overlap** – Fragmentation and overlap among different international climate finance sources contribute to duplication of efforts, inefficiencies, and gaps in coverage, thus hindering the effective utilisation of available funds.

- **Conditionality & policy priorities** – International climate finance comes with conditionality attached, requiring the implementation of specific policies or reforms. In the case of Nigeria that concerns, for example, the envisioned expansion of gas infrastructure as part of the Energy Transition Plan (ETP).

- **Governance & accountability** – International public climate finance operates within a framework of international agreements, conventions, and institutions that set guidelines and standards for transparency, accountability, and effectiveness in climate finance delivery. Despite the implementation of programmes such as the Nigerian Green Bonds Market Development Program, limited knowledge of these standards in key agencies continues to be an issue in accessing finance.

Entry points

• **Green Climate Fund** – This is one of the biggest international climate funds, proposals need to be developed with an Accredited Entity – in Nigeria, this means international agencies like UNDP or the World Bank. As noted above, DBN and NSIA are currently seeking accreditation. There are two specific areas of the GCF that are of relevance in Nigeria:

- o **Sub-National Climate Fund (SCF)** – this is a privately managed equity fund and Technical Assistance (TA) facility for investments at a sub-national level, and;
- o **Private Sector Facility** – for private sector projects and investments.

• **Adaptation Fund Climate Innovation Accelerator** – this offers small grants up to $250,000 against 7 themes. It has regular calls for proposals.

• **NDC Partnership** – This is a group of development partners who provide support to access climate finance. The relationship is managed through the National Council on Climate Change (NCCC).

3. Domestic private finance

This pertains to financing of activities within a specific country or region, targeted at mitigating and adapting to climate change impacts within national boundaries. The funds stem from domestic institutions, such as private investors, commercial banks and domestic institutional investors.

Key challenges and barriers

Whilst there is growing appetite from domestic private sector players to invest with a climate lens, there remain significant barriers to doing so, some of which are:

• **Limited awareness of eligible investment opportunities** – Many stakeholders lack an awareness of eligible climate-related projects and financing mechanisms, which impedes the identification of viable projects and hampers investment flows into climate adaptation, resilience and mitigation.

• **High cost of commercial capital** – Projects often face exorbitant borrowing costs due to elevated interest rates and risk premium in Nigeria's commercial lending market. The high costs of capital undermine the financial feasibility of climate projects and diminishes investor interests in climate resilience and mitigation initiatives.

• **Limited bankable projects** – Nigeria suffers from a dearth of bankable climate projects that meet the criteria for investment. The lack of a robust pipeline of viable projects stifles investment opportunities and constrains the scalability of climate adaption and mitigation efforts across the country.

• **Risk-averse lending policies** – Financial institutions in Nigeria tend to adopt risk-averse lending policies, particularly for long-term projects with uncertain returns. This cautious approach to lending restricts access to finance for climate initiatives and impedes the expansion of climate action efforts. For example, both BOI and DBN, request 100% cover in near-liquid assets from commercial banks for loan on-lent to project sponsors.

Entry points

• **Commercial banks** – such as Access Bank or Sterling Bank who both have funds for climate-aligned investments.

• **Fund Managers** – Including Chapel Hill Denham and All On, who manage various local funds on behalf of investors.

• **Infracredit** – Government backed company that provides long-term local currency infrastructure finance through local currency guarantees.

• **Corporate green bond** – Four green bonds have been issued by private companies, which has helped establish clear frameworks for corporate issuance.

4. International private finance

This refers to climate financial flows that cross international borders. The objectives of international climate finance often focus on supporting developing countries in their efforts to mitigate and adapt to climate change, as well as promoting sustainable development and achieving global climate goals like those outlined in the Paris Agreement.

International private climate finance may originate from a variety of sources, including international organisations, (the non-concessional arm of) DFIs and MDBs. Some of the institutions offering commercial investments in Africa are the IFC, the DFC, as well as several European DFIs, such as the European Investment Bank (EIB), KfW, BII (formerly CDC), DEG, FMO, Proparco, Swedfund, and Norfund.

Key challenges and barriers

All the challenges facing domestic private finance apply to international public finance, as the main financing instruments deployed (e.g. debt, equity, guarantees) operate through domestic private finance institutions. In addition, it's worth noting the following:

- **Foreign exchange & inflation risk** – Nigeria's volatile exchange rates and high inflation rates, especially in recent times, pose significant risks to international investors. Currency fluctuations and inflation have eroded the value of investment and inflate project costs, thus discouraging investors from allocating capital to long-term climate projects.

- **Scale & accessibility** – International climate finance tends to involve larger-scale investments, given its global scope and the need to address systemic climate challenges.

- **Policy & regulatory framework** – International climate finance often operates within a framework of international agreements, conventions, and protocols, which set guidelines and principles for climate finance governance and accountability. Nigeria, with a government dependent on revenue and forex from the oil and gas sector, the requirement to align with international criteria and standards on decarbonization makes accessing international climate finance more challenging.

Entry points

- **Alterra Transformation** – Alterra is a USD 30 billion catalytic climate investment fund that includes a Alterra Transformation, a USD 5 billion window for risk mitigation capital.

Complex financing structures are often needed to share risk

Climate-aligned investments are risky because projects are often novel or unproven from a financing perspective. Public and concessional sources have a larger appetite for this sort of risk – but lack the scale of capital required, so are unable to fully fund major projects. The private sector has the capital but lacks the risk appetite and wants a clearer return. By structuring an investment to engage both types of investors, a project can become more financeable overall. For example, public finance can take on more of the early stage risk, or a discrete portion of the project could be isolated for private financing – which can make an investment more attractive to a private investor.

This is referred to as blended finance – structuring these investments is complex and more difficult to develop, However, investors typically prefer entering projects that are already viable, rather than to engage in complex financial arrangements. So project promoters need a wide range of financial and non-financial support to develop viable financing structures to bring projects and schemes to market. However, there are key gaps in skilled transaction intermediation in Nigeria – firms that can bring together the necessary support for market readiness and help broker deals between multiple, diverse actors (Ian Callaghan Associates, 2019).

InfraCredit's Clean Energy Funding Programme (CEFP) is an example that seeks to aggregate, de-risk and unlock domestic institutional investments to support eligible clean energy projects. It blends public sector, pension funds, donor-funds and DFI concessionary capital (through PIDG, UKNIAF, and others) to catalyse private sector financing.

Conclusion

Over the years, proponents seeking funding for investment opportunities they deem climate and or environmentally friendly have experienced a number of challenges accessing climate finance, some of which have been discussed above. Addressing these barriers requires concerted efforts from government agencies, financial institutions, civil society organisations and international partners to strengthen institutional capacity, streamline application processes, enhance policy frameworks, and promote private sector engagement.

By leveraging climate finance effectively, Nigeria can unlock new opportunities for sustainable economic growth and advance the country's development agenda, and in doing so address pressing climate change challenges.