BRIEFING

Key issues in climate finance in Nigeria

This note presents an overview of the landscape of climate finance in Nigeria and identifies some key barriers to access to climate finance. It is intended to inform State Governments and support their evolving thinking and activities on accessing climate finance. The note

- First outlines the global climate finance landscape, and then
- Focuses on issues affecting Nigeria's access to climate finance, before
- Concluding with some guidance for States.

The Global Climate Finance Landscape

There's 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 all 'climate-aligned' finance that does not have an explicit climate mandate, but contributes to green growth or climate resilient development.

Global climate finance reached $1.3 trillion a year in 2021/2022

The Global Landscape for Climate Finance 2023 (GLCF-2023) reports that in 2021/2022, global climate finance reached an average of $1.3 trillion annually, representing a substantial increase compared to $653 billion in 2019/2020. This growth was primarily driven by the increase in mitigation finance, particularly in renewable energy and transport sectors. Private actors provided 49% of total climate finance, while public sources accounted for the remaining 51%.

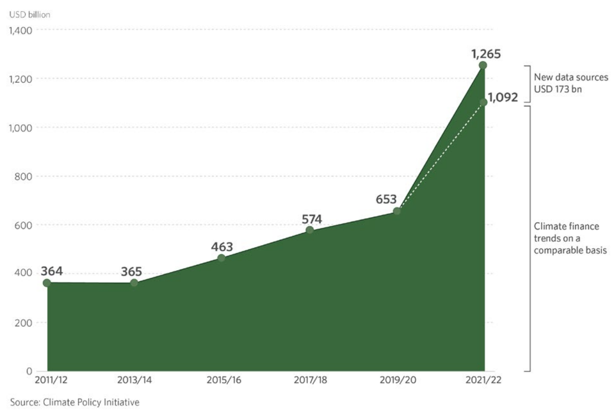

Figure 1: Global Annual Climate Finance Flows

While there has been significant progress, global climate finance still falls short of the estimated $8-9 trillion per annum needed annually by 2030 to keep global temperature rise below 1.5 degrees Celsius.

Global climate finance remains relatively small compared to global defence spending, which exceeds $2 trillion annually. It is also significantly less than the estimated $10 trillion spent on COVID-19 pandemic relief measures.

Mitigation finance accounted for the majority of climate finance, with 44% allocated to energy and 29% to transport. Adaptation finance reached an all-time high of $63 billion but remains far below the estimated $212 billion needed annually for developing countries alone.

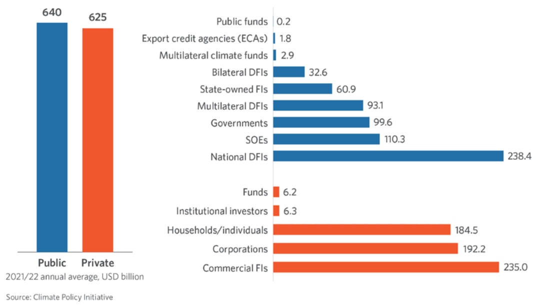

Figure 2: Sources of public and private climate finance (USD bn)

China received the largest share of climate finance, followed by the US, Europe, Brazil, and India. However, flows to developing countries – who are expected to be most impacted – were inadequate, with low-income countries receiving only 3% of the total finance.

While progress has been made in increasing climate finance, substantial gaps remain in meeting the necessary levels to mitigate and adapt to climate change effectively. Addressing these gaps will requires increased funding commitments, a reshaping of international and local financial ecosystems, targeted allocation to vulnerable countries, and a shift towards increased private sector mobilization.

Very little global climate finance reaches Nigeria

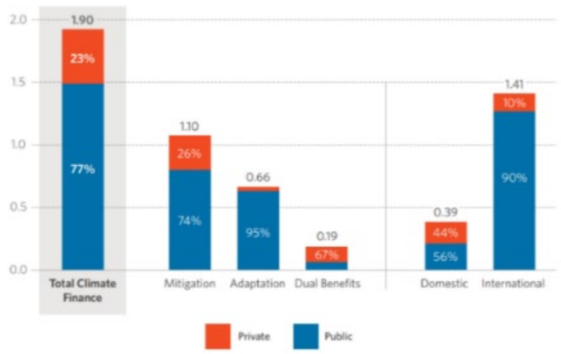

Figure 3: Climate finance breakdown by sources, and domestic-international split (USD bn)

The Landscape for Climate Finance in Nigeria 2022 (LCFN-2022) reports that in 2019/2020, climate finance in Nigeria reached $1.9 billion, which fell short of the $17.7 billion needed annually to meet Nigeria's Nationally Determined Contribution (NDC)[1].

Notably, over 75% of this $1.9 billion was provided via debt (mainly concessional debt) rather than grant or equity financing options. The majority (56%) of climate finance went towards mitigation efforts, while adaptation received only 34%. Public actors provided the vast majority (77%, $1.5bn) of climate finance.

Domestic climate finance is relatively small but 44% was from private investment, which is an encouraging trend to build upon.

Barriers and Challenges for Climate Finance in Nigeria

Climate finance in Nigeria remains small compared to its potential and Nigeria's finance needs. Nigeria's wider investment barriers and macro-economic factors are a major determinant of

[1] NDCs reflect country's efforts to reduce national emissions and adapt to the impacts of climate change.

investment and finance flows. In addition there are key barriers and challenges in scaling up climate finance.

1. Lack of bankable projects

The Climate Finance Accelerator concluded that most of the components for a well-functioning climate finance supply chain are already in place in Nigeria – but that these components aren't engaging productively – resulting in a lack of a credible and bankable pipeline.

A project is 'bankable' when its risk-return profile meets investors' criteria and can secure financing for implementation. The exact definition differs depending on source, but key criteria for bankability include:

- the probability of meeting the project's financial, environmental, and social goals
- sufficient estimated cash flows to cover costs and produce returns that meet investor expectations,
- whether the project will be implemented by a creditworthy entity
- confidence that regulatory, economic, social and environmental factors are not likely to prevent the project from being completed.

There are many 'raw' projects in Nigeria, often with high ambition and innovation – however, these fail to progress through to the primary finance stage because they are not seen as bankable by investors. Projects tend to lack clear financial models/plans and the necessary feasibility/project documentation to give investors sufficient confidence that they will succeed. Project promoters need a wide range of financial and non-financial support to bring projects and schemes to market – but there are key gaps in the skills required to bring together the necessary financial and non-financial support for market readiness (Ian Callaghan Associates, 2019).

There is a relatively strong pipeline in power, but not a clear set of investment priorities beyond that. There are several disparate initiatives and plans (e.g. NDC, ETP, CFA, InfraCorp).

2. Lack of familiarity of working with private sector investors

The Federal Government of Nigeria's (FGN) approach to addressing infrastructure gaps over the last two decades has been to fund capital projects through a combination of government financed budgetary allocations, and external and domestic debts. However, with rising debt and underperforming revenue, FGN has recognised that project finance through debt is not sustainable and the updated National Integrated Infrastructure Master Plan (NIIMP, 2020 – 2043) targets a 56% contribution from the private sector to the USD$2.3 trillion of investment required.

<u>Growing private sector investment to this level requires a much deeper understanding of drivers and interests of private actors.</u> Project proponents are generally familiar with public financing (whether from the Budget or from development partners), but will increasingly have to engage more with the private sector. This group of investors are very different from typical public sources. State Governments and agencies need to better understand how investors approach and manage risk; and how to engage with them to win confidence and trust. For example, private investors frequently cite

the lack of available project-level information and a lack of awareness of climate-aligned investment opportunities; the absence of strategic programmes of investment (rather than a list of projects); projects tend to be too small for major investors, but too big for retail investors.

3. Complex financing structures are 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 sort of blended financial structure is complex and more difficult to develop, 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). Some of the factors that need to be considered when structuring deals that blend different sources from different investors with different risk appetites and profiles include:

- **Alignment of investment objectives**: Different investors have different investment objectives, such as maximising financial return, achieving social impact, or mitigating environmental risks. Aligning these objectives can be complex and time-consuming.
- **Risk appetite and tolerance:** Different investors have different risk appetites and tolerance levels. Concessional capital providers may be willing to take on more risk than commercial investors, which can lead to differences in the financing terms and conditions.
- **Due diligence and reporting requirements:** Different investors may have different due diligence and reporting requirements. This can add to the complexity and cost of structuring and managing deals.
- **Currency and exchange rate risk:** Blended finance deals often involve multiple currencies, which can introduce currency and exchange rate risk. Managing this risk can add to the complexity of the deal structure.
- **Alignment of exit strategies:** Different investors have different exit strategies. This can lead to challenges in structuring the deal to ensure that all investors can achieve desired outcomes.

4. International public climate funds have high barriers to entry...

Accessing international public climate funds (e.g. Green Climate Fund or Adaptation Fund) is complex and costly. Recipients need accreditation – which is a burdensome process with stringent fiduciary requirements. Accreditation requires certain policies to be in place (e.g. Gender and Social Inclusion)

– these can take a long time to develop and implement, even if they already exist. Accreditation is also costly – in the order of $50k – and re-accreditation is required every five years. The means that Nigeria currently does not have a GCF Accredited Entity (AE) or Adaptation Fund National Implementing Entity (NIE) – DBN and NSIA are currently undergoing GCF accreditation, but this will take several years. As a result, currently accessing these funds means working through multilateral banks and international financial institutions like the World Bank and UNDP. This often comes at the cost of national ownership and control, with programmes being driven by development partner agendas.

The complex climate finance architecture makes it particularly difficult for State Governments to access funding. In recognition of this, the Subnational Climate Fund (SCF) was established, part financed by GCF. This is a particularly promising development for States in Nigeria, although wider macro-economic challenges remain major obstacles to investment

...although reforms are underway.

The complexity of accessing international public climate funds (e.g. Green Climate Fund or Adaptation Fund) has been recognised and some reforms are underway. A recent UNDP report (What GCF do we want for the Pacific? July 2023) proposed reforms to the GCF, highlighting the disadvantages faced by sub-sovereigns and smaller entities and advocating for further facilitating access by sub-sovereigns:

- **Simplify Accreditation and Support:** Extend re-accreditation timelines and offer flexibility for state projects.
- **Improve Guidance and Frameworks:** Modify due diligence assessments and reporting processes to reflect local capabilities, reduce turnaround times for Financiers' feedback.
- **Increase Literacy and Engagement:** Establish where possible local/ regional presence or offices.
- **Build Capacity and Enhance Support:** Provide technical assistance, facilitate peer-learning programs, and focus on long-term capacity building to strengthen understanding of Financiers' processes.
- **Enhance Project Funding:** Review allocation options to ensure funding prioritizes vulnerable regions, use vulnerability indices, and conduct periodic stocktaking of GCF funds benefits.
- **Increase Local Currency Financing Options:** Commission studies to understand the costs of doing business locally, provide guidance on allowable costs for capacity support, and facilitate legal arrangements for local currency financing.

Key messages for States

The specific context and need for Climate Finance will vary from State to State, so any actions will need to be tailored to and owned by the State. However, some potential strategies to consider are set out below.

Focus on quality project pipeline

Good capital flows to good projects – so a focus on bankable projects could be a good way to attract climate finance. Potential strategies include:

- **Understand the preferences and expectations of foreign private investors.** Engage with potential investors to better understand their risk appetite, risk profile and perceptions. Matching projects to sources, target the most relevant and take time to understand what bankability means to those sources. Investors are typically looking for projects that are financially viable, have a clear environmental and social impact, and are supported by a stable policy environment.

- **Prioritise and concentrate on a small number of key projects.** By a small number of flagship projects, resources can be used more effectively to unblock barriers and make progress. As individual projects develop, they can help identify systemic challenges that can inform policy changes.

- **Learn what works from peers.** Look for examples (positive and negative) of efforts to secure climate finance in other States. Where appropriate, standardise approaches and develop best practices.

- **Get beyond the technical.** Bankability of projects is not just about technical feasibility studies. Focus on financial viability and look to give investors confidence that financial management, governance arrangements and delivery capability are sufficiently robust to assure quality delivery.

Strengthen the investment climate

Investment Promotion Agencies can play a role in clearly communicating priorities, profiling key investment opportunities, and matching proponents with investors.

- **Communicate State strategic priorities and approaches clearly** Investors need to understand the context that potential investment opportunities exist within – and have confidence that there is likely to be long term support. Projects need to be integrated with state political priorities and reflect the needs of local communities. These priorities need to be credible and realistic. The plan should be developed in consultation with the private sector and other stakeholders. This includes engaging with civil society organisations and community groups to ensure that climate finance projects are aligned with local needs and priorities.

- **Promote targeted capacity building** State officials need to be able to understand and evaluate climate investment opportunities. The state should provide training and technical assistance to help officials develop the necessary skills. States can also assist with the promotion of programmes to build the capacity of domestic investors to identify and evaluate climate investment opportunities.

- **Provide targeted incentives** States can offer financial incentives, such as tax breaks or grants, to encourage private sector investment in climate projects.

- **Create a supportive policy environment** Review and revise state regulations and policies to ensure they are supportive of climate finance investments. States can adopt policies that support climate-friendly investment, such as green building codes and renewable energy targets.

- **Promote the state's investment opportunities to potential investors** Proactively engage with private sector actors to promote climate finance opportunities. This can be done through marketing campaigns, trade shows, and other events such as investment forums and matchmaking events to connect project developers with potential investors.

Leverage partnerships and support

Look for support across the wide landscape of development partners.

- **Establish partnerships with domestic financial institutions** States can partner with banks and other financial institutions to provide loans and other financing mechanisms for climate projects.

- **Develop partnerships with international organisations** The state should partner with international organizations to access technical assistance and financial resources. These partnerships can help the state attract foreign private-sector investment.

- **Grow dialogues with development partners** Engaging with banks, funds and development partners in open dialogue – even if they don't directly lead to financial flows. By ensuring that conversations are not just about specific financing opportunities, State officials and project proponents can get a better understanding of their perspectives and priorities.

Further reading

#	Reference	Link
[1]	Global Landscape of Climate Finance 2023	https://www.climatepolicyinitiative.org/wp-content/uploads/2023/11/Global-Landscape-of-Climate-Finance-2023.pdf
[2]	IDFC Green Finance Mapping 2023	https://www.climatepolicyinitiative.org/wp-content/uploads/2023/11/IDFC-Green-Finance-Mapping-Report-2023.pdf
[3]	Landscape for Climate Finance in Nigeria 2022	https://www.climatepolicyinitiative.org/wp-content/uploads/2022/10/Landscape-of-Climate-Finance-in-Nigeria.pdf
[4]	"What GCF do we want in the Pacific? Practical recommendations for reform and capacity support."	https://www.undp.org/sites/g/files/zskgke326/files/2023-11/undp-pacific-gcf-recommendations-2023.pdf