NATIONAL CLIMATE CHANGE ACTION PLAN

REPUBLIC OF KENYA

Annex A: Current and future international climate finance architecture: implications for Kenya's financing mechanism

Report prepared for Government of Kenya

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The 2011 research phase consists of 8 tasks associated with the three key themes of the project

Task 1: survey of current and future sources of international climate finance

Task 2: survey of donor action in climate change in Kenya

Task 3: survey of Kenyan government action in and related to climate change

Task 4: identifying priority spending items for the financing mechanism

Task 5: assessment of international best practice in national climate financing mechanisms

Design of climate finance mechanism

Task 6: Analysis of Kenyan carbon finance landscape

Task 7: Analysis of international carbon market developments

Improving Kenya's access to carbon markets

Task 8: Analysis of Kenya's investment climate

Recommendations on low–carbon investment climate

Key findings

1. In the current climate finance architecture, the strongest candidates for resourcing a Kenyan mechanism are **direct bilateral support from government donors** (possibly supplemented by domestic resources) and the **small number of international climate funds that allow for 'direct access'** e.g. Adaptation Fund.

2. Although they could be combined, they have **different design and governance implications**. It will need to be decided whether the financing mechanism should just channel resources or also implement projects. Before the direct access modality can be used, the body will need to have a track record of project implementation.

3. Most other current sources of climate finance, especially those committed to explicit climate funds, are unlikely to resource a fund where disbursement of funds and implementation of projects are delegated to a national level. However, as these represent the bulk of current flows, it will be **important for any Kenyan financing mechanism to be able to work alongside these 'vertical' funds**.

4. Developments such as the Green Climate Fund and the Africa Green Fund might increase the resources that could flow through a Kenyan financing mechanism. **Developing a financing mechanism to access money in the current architecture should give Kenya a head start if these new institutions emerge.**

5. 96% of current climate finance goes towards mitigation. Given Kenya's needs, **its financing mechanism may wish to focus on adaptation**.

Contents

1. The current climate finance architecture and implications for Kenya’s financing mechanism

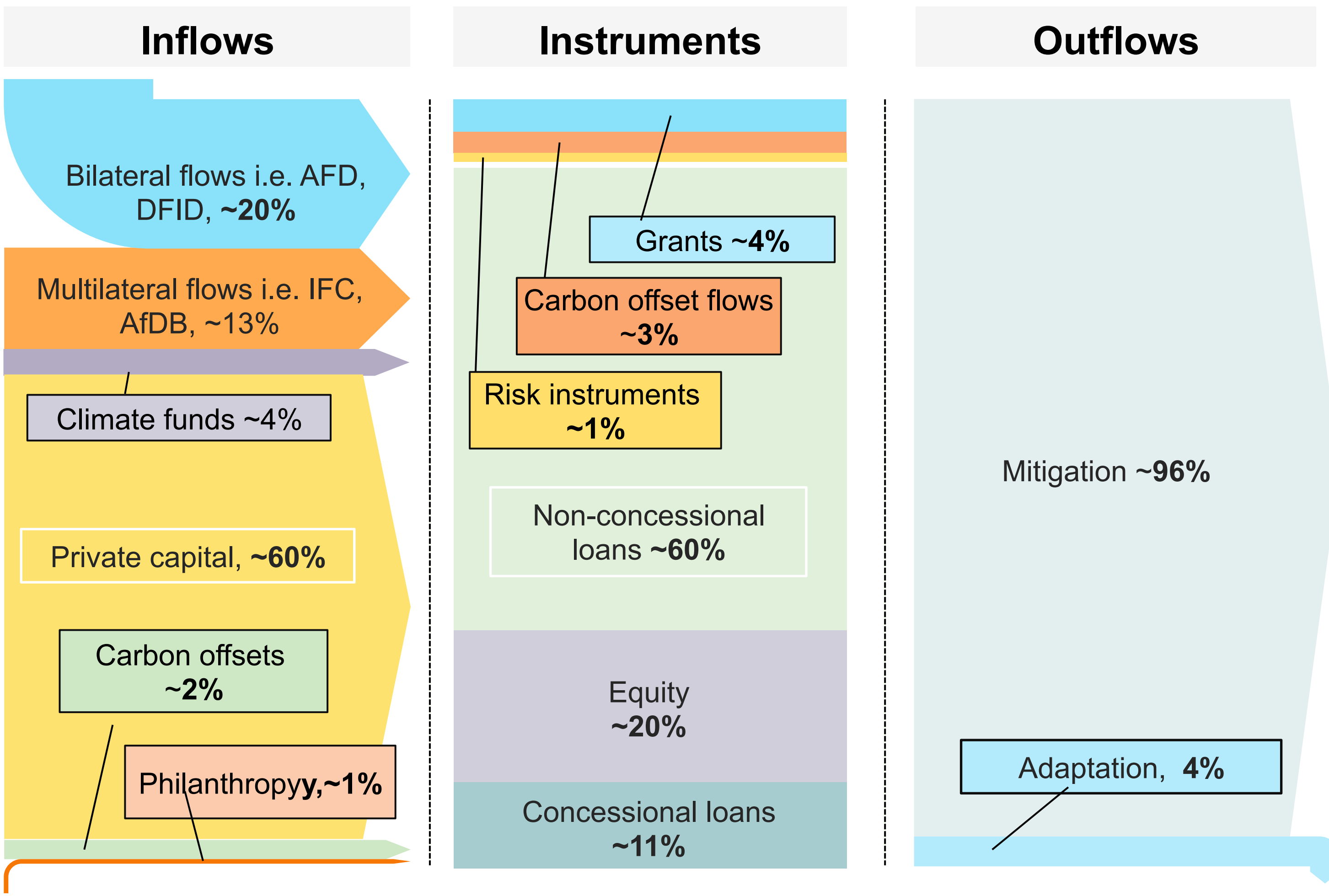
— the overall climate finance landscape

— entry points for Kenya’s climate finance mechanism

2. Possible future changes in the climate finance architecture and implications

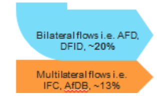
The current climate finance architecture is dominated by private capital investing in mitigation projects

Figure 1. **Average disbursements of different forms of climate finance, 2009-10**



Note: see Annex slide for more information

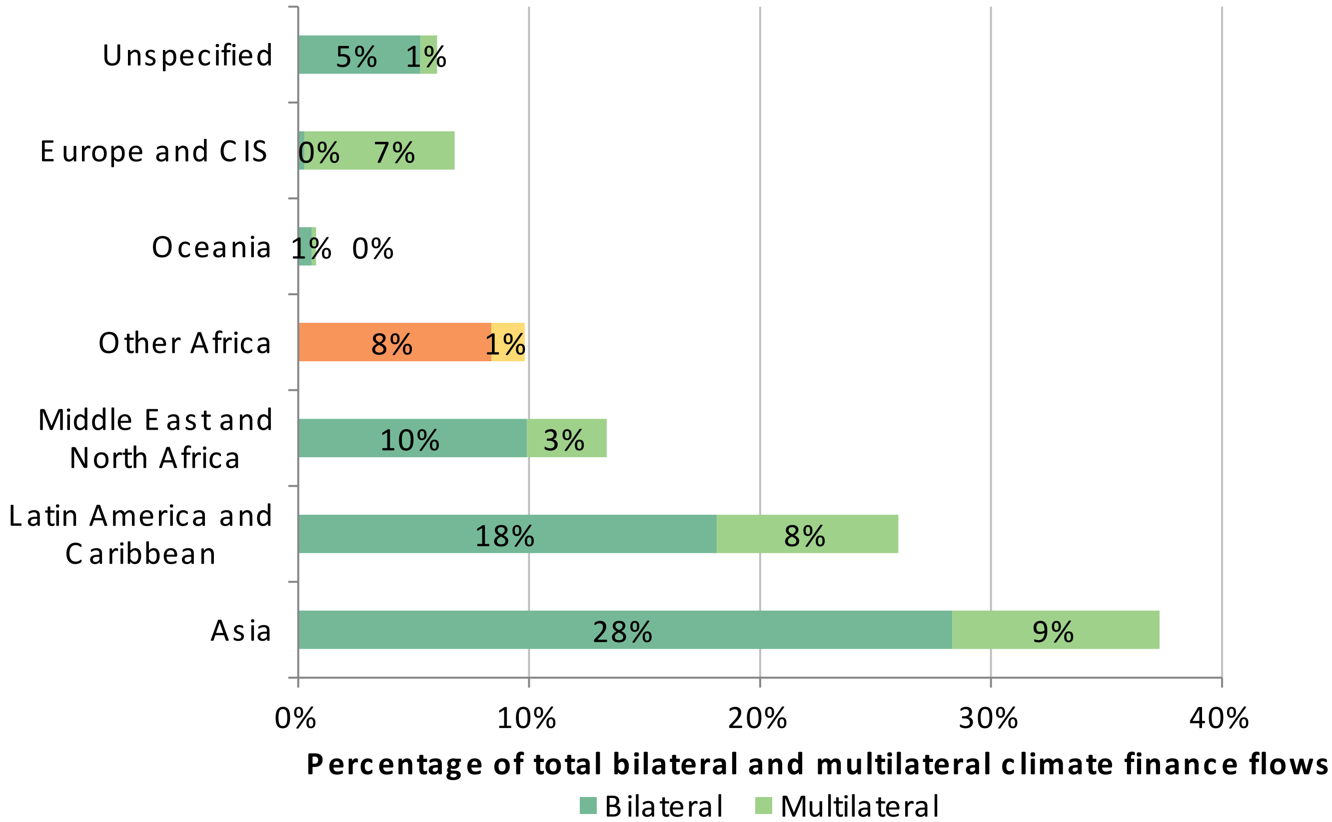
Source: CPI (2011) adapted by Vivid Economics



Sub-Saharan Africa receives around 9% of climate finance disbursed by bilateral and multilateral agencies

Bilateral flows are especially important in Africa

Figure 2. **In Africa, bilateral climate finance flows exceed multilateral flows by a ratio of 8:1**



Note: Other flows of finance excluded due to lack of information

Source: CPI (2011) adapted by Vivid Economics

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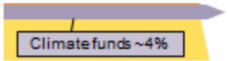
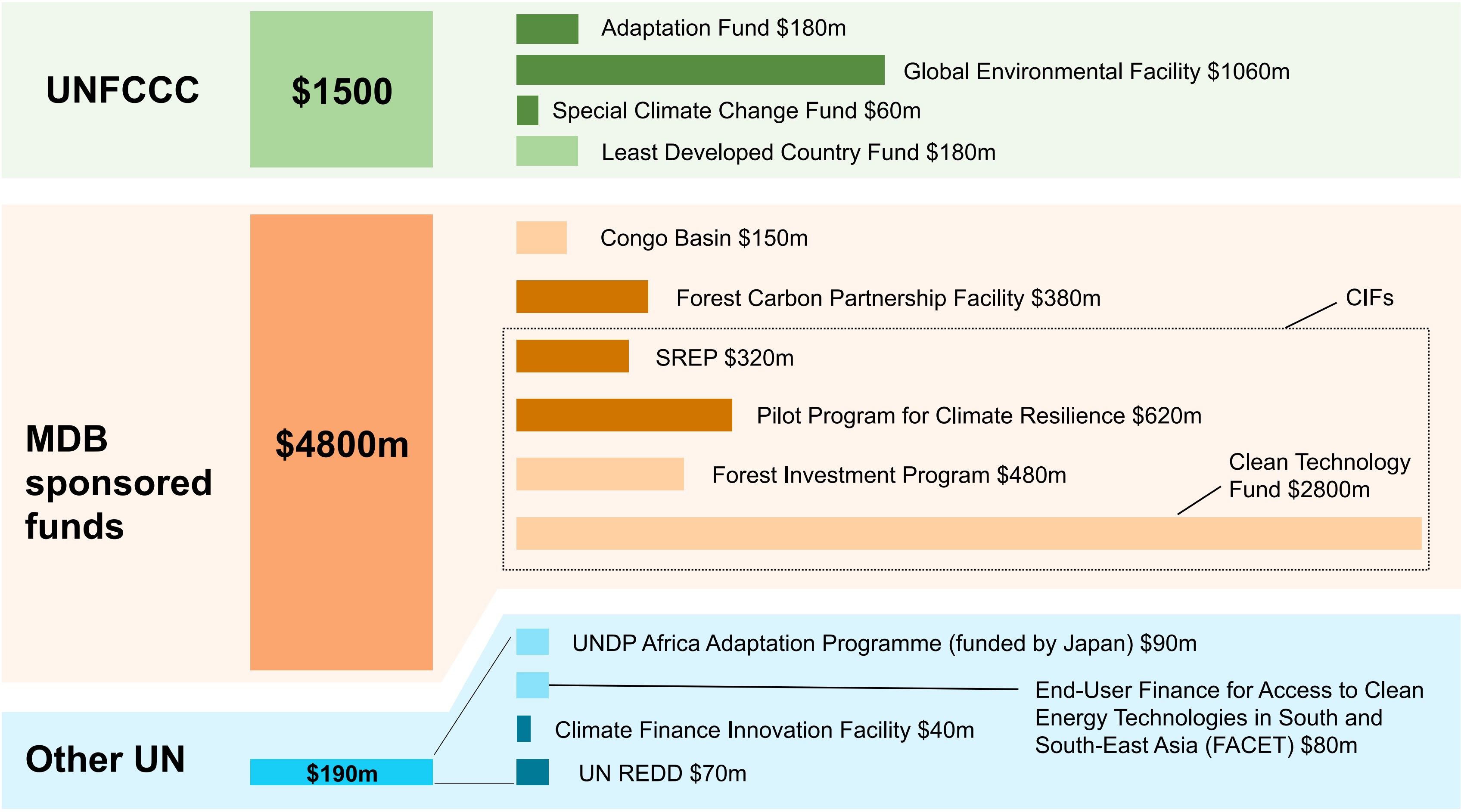


Though dedicated climate funds comprise only a small amount of climate finance, there is considerable fragmentation (1/2)

Figure 3. **Dedicated climate funds can be divided into 5 main categories (1/2)**



Note: values relate to total fund sizes (less committed funds) so differ from annual flows in previous slide. Darker shading represents funds with greater relevance to Kenya

Source: Vivid Economics based on climate funds update and others

Though dedicated climate funds comprise only a small of climate financing activity, there is considerable complexity (2/2)

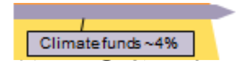
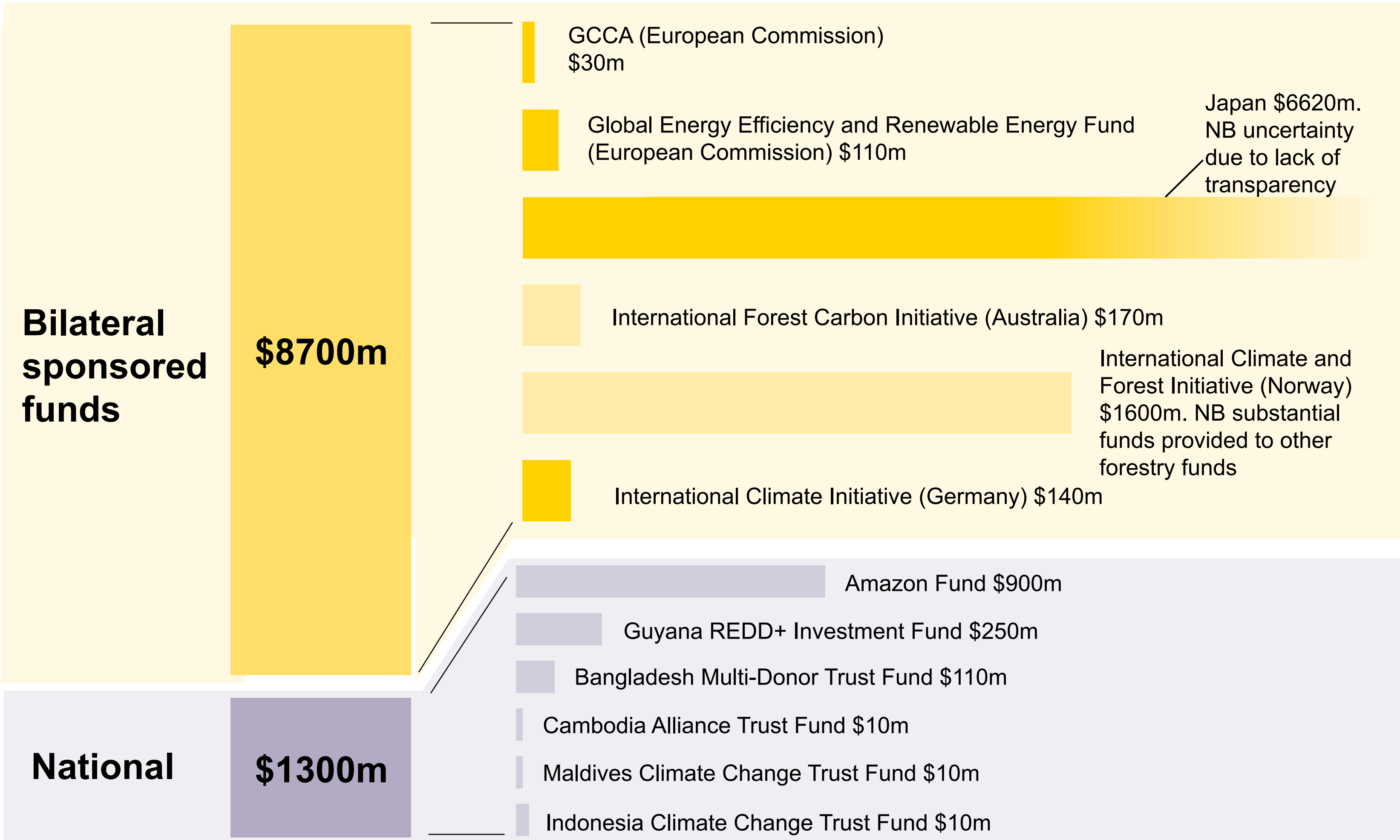


Figure 3. **Dedicated climate funds can be divided into 5 main categories (2/2)**



Note: values relate to total fund sizes (less committed funds) so differ from annual flows in previous slide. Darker shading represents funds with greater relevance to Kenya

Source: Vivid Economics based on climate funds update and others

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Within this landscape, there are two ‘entry points’ for any Kenyan financing mechanism to acquire resources

1. a ‘**national recipient fund**’ that bilateral donors decide to resource rather than (or as well as) other climate funds or their bilateral programmes
   - e.g. Indonesia Climate Change Trust Fund has received, in total, around $18.5m direct from UK, Australia and Sweden
   - bilateral climate finance flows are more significant than multilateral flows in Africa
2. applying to climate funds that allow ‘**direct access**’ by ‘national implementing entities’
   - e.g. the Adaptation Fund has accredited the Senegalese body ‘Centre de Suivi Ecologique’ (a public institution operating under the Environment Ministry) as a vehicle can apply for and implement adaptation projects in Senegal
   - similar relationship between national bodies and MDBs could also develop

these are not mutually exclusive but have different design/governance implications

- a national recipient fund could just channel resources while NIEs also require project implementation capacity
- with a national recipient fund all decisions made ‘in-country’ whereas under ‘direct access’ NIE’s choose which projects/programmes should apply for funding, and implement successful projects, but funding decisions are external

Only a few dedicated climate funds currently provide opportunity for direct access

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Fund types		Opportunities for direct access	Score
UNFCCC	$1500m	Opportunities with AF and possibly GEF. NIE's have had difficulties receiving accreditation	
MDBs	$4800m	Historically, limited opportunities with implementation undertaken by the relevant MDB associated with the fund or project (CIFs), although these must be integrated into country strategy. However, greater access in, for instance, Congo Basin	
Other UN	$190m	Historically, limited opportunities with implementation undertaken by UN body	
Bilateral	$8700m	Varies by fund but typically bilateral funds will have their own implementing entities i.e. Germany's International Climate Initiative primarily using GTZ and KfW. By contrast GCCA has a preference for providing direct budget support	
National	$1300m	By definition, implementation undertaken by national bodies	

The Adaptation Fund sets specific requirements for NIEs around financial management, institutional capacity and transparency

Table 1. **The AF requires NIEs to meet criteria around three competencies**

Competency required	Specific capability
Financial management and integrity	Accurately and regularly record transactions and balances
	Manage and disburse funds efficiently and with safeguards
	Produce forward looking financial statements
	Legal status to contract with AF and third parties
Institutional capacity	Transparent procurement procedures
	Ability to undertake monitoring and evaluation
	Ability to identify, develop and appraise projects
	Competence to manage or oversee project/programme execution
Transparency, self-investigative powers and anti-corruption measures	Competence to deal with financial mismanagement

To date, 5 NIEs have been accredited, 3 of which are in Africa

Meeting the accreditation standards has been a challenge for many institutions

Three African NIEs are:

— Center for Ecological Monitoring (Senegal),

— National Environment Fund (Benin), and

— National Institute for Biodiversity (South Africa)

as of September 2010, less than 15% of submissions for accreditation had been forwarded for review

to date, the challenges with getting accreditation have included difficulties in providing supporting documentation and evidence on fiduciary standards particularly

— institutional capacity, especially capacity to undertake project appraisal, monitoring and evaluation

— transparency, self-investigative powers and anti-corruption measures

GEF-5 will include a pilot project to attract national agencies

under GEF-5 (2010-2014) a pilot project will be launched with the aim to accredit 10 new GEF Project Agencies

of these agencies, at least 5 will be national institutions,

two stages of accreditation: first stage of accreditation will require body to be scored against six criteria (see following 2 slides)

The GEF applies stringent criteria and it is unlikely that a new body such as a National Climate Fund could prove compliance with the standards

if the new Fund wishes to serve as implementing body itself and expects to apply for GEF Project Agency status at a later time, it can use current criteria to set out a strategy that would lead to adherence by the time the application is made

The GEF has set stringent criteria for new agencies (1 of 3)

Criterion	Questions for applicant	Scoring			
		4	3	2	1
Relevance to the GEF	How is the agency's mission relevant to the GEF? In what GEF focal areas/ issue areas is the agency engaged? What experience has the agency in implementing/ executing relevant projects?	Mission/ areas of work align with GEF's missions, agency engaged in at least two GEF focal areas and in operation for at least 8 years with more than 5 projects funded by major organisations.	As for 4 but only engaged in one focal area	Low alignment with GEF missions; only some areas of relevance. In operation for at least 3 years but completed less than 5 projects funded by international organisation	Agency has hardly any experience relevant to the GEF; in operation for less than 3 years and less than 3 projects funded by other organisations.
Environ-mental or climate change adaptation results	What are the clear, quantified outcomes that the agency achieved through its projects? What outcome ratings were given to the agency's projects in the terminal evaluation reports or equivalent? If such evaluation ratings are not available, what are the implementation ratings for the projects?	Consistent achievement of satisfactory outcomes in projects, with up to 5 examples of projects that have achieved strong results in relevant areas. Consistent good independent evaluations	Moderately satisfactory outcomes with 3-5 examples of projects with strong results in relevant areas. Independent evaluations generally moderately satisfactory	Less than moderately satisfactory achievement on relevant projects with only 1-2 projects with strong results. Independent evaluations at least moderately satisfactory	Generally unsatisfactory project outcomes, bad independent evaluations

The GEF has set stringent criteria for new agencies (2 of 3)

Criterion	Questions for applicant	Scoring			
		4	3	2	1
Scale of engagement	Average project size over last five years? Size of largest project and evaluation rating on this project? What multilateral or bilateral agencies has the agency received funding from the past five years, and for what projects?	Experience in engage in regular GEF full-size projects. Successful completion of of at least 3 projects for multi/bilateral orgs and of projects >USD10mn, adequate paid staff to work at this scale	Experience in in medium-sized GEF projects. Document 2 projects funded by multi/bilateral orgs. Successful completion of projects with total financing of >USD1.8mn, adequate paid staff	Low capacity to engage with GEF. Successful completion of 1 project for multi/ bilateral org, but only projects worth <USD1.8mn, no adequate staff	Weak capacity to engage with GEF, no documentation of successful project for multi/ bilateral org, no projects >USD1mn, no adequate staff
Capacity to leverage co-financing	Average amount of financing that the agency has leveraged/raised? From which sources? What percentage of these resources that came from the agency's own budgetary resources?	Average amount of financing raised for its projects to date equals to four times amount of GEF grants for its first GEF project. Able to commit own resources, limited dependence on GEF	As in 4, but average finance raised for its projects to date equals three times GEF grants for first project	Average finance raised to date equals two times GEF grants for first project. Difficulty committing own resources, not many other sources beyond GEF	Average finance raised to date equals GEF grant expected for first project. Weak capacity for committing resources, may become heavily reliant on GEF

The GEF has set stringent criteria for new agencies (3 of 3)

Criterion	Questions for applicant	Scoring			
		4	3	2	1
Institutional efficiency	Evidence on efficiency particularly with regard to controlling administrative costs and improving the efficiency of the agency's project cycle What are the agency's total administrative costs and total program funding? Time to bring a project from concept development to approval	Well developed system for improving efficiency, benchmarking performance, and basing decisions on evidence. Admin costs 10-15% of program costs. 18 months between project concept and agency approval	System with clear indicators for measuring efficiency, started to track performance, decisions based on evidence, Admin costs 15-20% of program costs, 20 months between project concept and agency approval	Only started or weak performance measurement. Efficiency improvements needed, admin costs 20-25%, 22 months between project concept and agency approval	No information available on, or substandard, admin efficiency, admin costs more than 25% of program costs, 24 months between project concept to agency approval
Networks and contracts	What organizations and experts does it co-operate with on the implementation of environmental projects? Provision of resources to other organizations to execute a project under its supervision? How have collaborations with other organizations contributed to improvements in project quality?	Wide network of collaborators and experts, >3 examples of successful projects in which it commissioned an executing agency, 5-10 examples of collaborations with other partners	As in 4, but with 1 example of successful project with executing agency and at least 5 examples of collaboration	Experience in collaborating but not very extensive network. No supervision of executing partners and only 3-5 examples of collaboration	Only few collaborations and no deep network, only participated in project execution, <4 collaborations, interested in building network

Some additional criteria/considerations apply for national institutions

Additional criteria for national institutions	Project Experience: Does the agency implement and/or execute projects in their countries as a core part of their business? (Normally, national institutions primarily engaged in policy formulation will not be eligible for accreditation as GEF Project Agencies.)
	Type of Project: Has the agency implemented a similar type of activity previously?
	Enhancement of Country Ownership: Will accepting the agency help the GEF enhance country ownership? How will implementation of GEF projects by the agency help ensure that GEF funding is better aligned with country priorities for the generation of global environmental benefits, including as contained in country strategies?

Three implications of the current climate finance landscape for Kenya's financing mechanism

1. any financing mechanism will not be the only channel for climate finance to flow into Kenya

— flows through dedicated climate funds represent only ~3% of climate investment with 97% of flows coming from private sector, bilateral and MDB activities which are likely to persist in the short term regardless of a Kenyan financing mechanism

— Kenya does not want to displace these activities but complement and work in conjunction with them

2. there are two main entry points where Kenya's financing mechanism could attract resources

— direct bilateral contributions from specific donors possibly supplemented by domestic sources

— through the small number of climate funds that allow direct access, but these will require an existing track record in implementing projects

— aside from this, most of the existing climate funds are not suitable for resourcing Kenya's climate change mechanism as they have existing mechanisms

3. given the bias in the current architecture towards mitigation, there may be a case for Kenya's financing mechanism prioritising adaptation

Contents

The Green Climate Fund (GCF)… evolving to become 'the main global fund for climate change finance' ?

Cancun Agreements decided to establish the GCF

may both increase size and consolidate current climate finance structure

- — WB CIFs have an explicit sunset clause linked to the establishment of GCF
- — could also subsume some of existing GEF funds
- — in longer term, some donors may prefer to place funds through GCF than bilateral funds

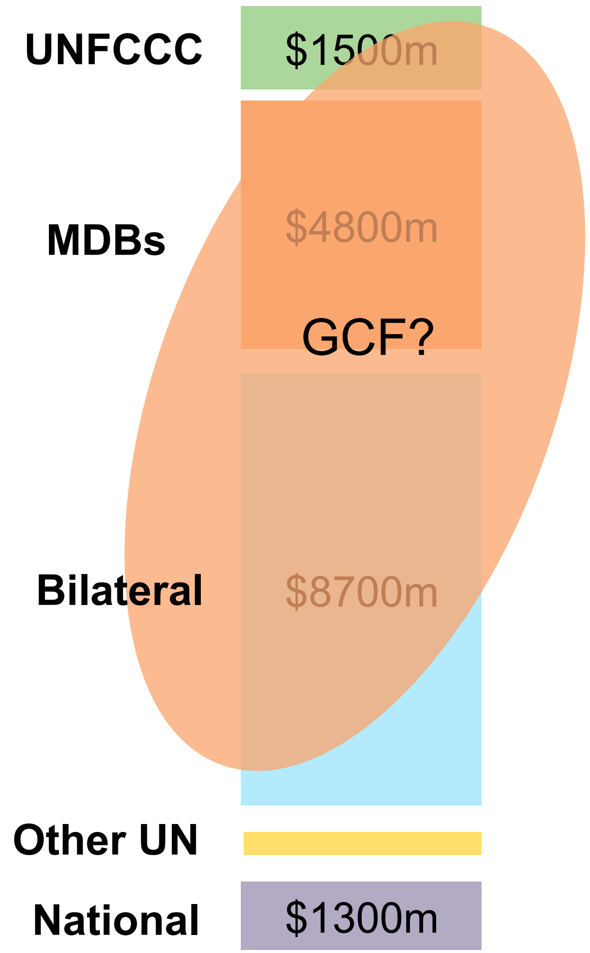
Transitional Committee released its report on GCF design to COP17 on 18th October

- — unable to reach consensus but press comments suggest cautious optimism for COP17

optimistic timetable for implementation would be:

- — detailed design issues being worked out in 2012 for endorsement at COP18
- — donors start pledges in 2013
- — disbursement from 2014

Figure 4. **The GCF could simplify the current structure of climate funds**



Source: Vivid Economics

What might the Green Climate Fund imply for a Kenyan financing mechanism

any Kenyan financing mechanism might be able to access resources from the GCF using the same two modalities as described above

1. GCF provides project by project support to projects undertaken by ‘NIEs’

— same direct access model as used in Adaptation Fund

— receiving accreditation will be a key challenge

2. GCF provides support to national funds

— report of the Transition Committee appears to leave this option open

— *The Board will consider additional modalities that further enhance direct access, **including through funding entities*** [emphasis added] *with a view of enhancing country ownership of projects and programme*s

— accreditation will still be crucial and challenging

if Kenya can develop a financing mechanism that effectively taps resources in the current climate finance landscape then this may remain robust to the GCF

Transitional Committee report also identifies urgent needs for adaptation in Africa

The AfDB is also developing an Africa Green Fund

Framework Document shows design echoes many features of the proposed GCF

— principle of direct access with accredited 'national implementing entities' able to approach fund for projects/programmes

— priority for the AfGF: one of its four objectives is *'Strengthen national institutions and support the use of country systems to ensure a sustained yearly increase in the number of African countries that have the capacity for direct access to the Fund'*

— unclear whether the AfGF would be able to resource a national climate fund (which would require delegating project-by-project funding decisions)

— AfGF recognises adaptation as priority spending area for Africa

relationship between this and GCF still under review/development

— possible that the resources under this fund may be better targeted at Kenya's priority investment needs

— and if the GCF fails then it could become an attractive vehicle for donors to meet their Copenhagen Accord commitments

— and hence an important source of resources for Kenya

A financial mechanism design that is 'fit-for-purpose' in the current climate finance landscape can be robust to the future

Notwithstanding the uncertainties ahead

to recap, the two most likely sources of finance for a financial mechanism at present are

— direct bilateral contributions from specific donors possibly supplemented by domestic sources

— (possibly) supplemented through the small number of climate funds that allow direct access

designing a financial mechanism that can attract these resources should be robust to future changes in the climate finance landscape

— if initiatives such as the GCF/AfGF fail to emerge then these sources will continue to be Kenya's best bet

  — although, in this instance, most climate finance resources will simply bypass a Kenyan financing mechanism

— if initiatives such as the GCF/AfGF emerge then the standards, procedures and principles in place to attract these resources initially will still be the right procedures to attract resources from these alternative sources

  — with there being more resources available for Kenya's financing mechanism to tap

Next steps

1. Research progress in to EAC Adaptation Fund
2. Discussions with GEF on progress on direct access.

Annex: further details on the climate finance landscape flows

analysis based heavily on CPI (2011) *'The Landscape of Climate Finance'*

— so far as data allows, this reports annual disbursements through different channels

— data is a combination of 2009 and 2010

— often when there are different sources, values represent mid-points between two estimates i.e. for private finance, 'Green' FDI from UNCTAD is estimated at USD 37.0 billion while BNEF estimate USD 72.2 billion invested in renewable energy projects. Analysis is based on midpoint of these values (USD 55 billion)

adjustments to the analysis presented by CPI

we use the gross totals for disbursement through climate funds and net these flows out from bilateral/multilateral flows to avoid double-counting

while CPI use a point estimate for bilateral flows, we use a range with the low end taken from analysis of the OECD CRS database. Our high end corresponds with the CPI point estimate

these changes mean that our estimates for climate finance flows are USD~90 billion rather than USD~ 97 billion from CPI

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