Carbon Payments for Development (CP4D)

A Facility to incentivize private investments into countries' NDC targets and development objectives

UNDP Zambia

Accelerating NDC implementation and a green recovery from the COVID-19 crisis

The Carbon Payments for Development Facility (CP4D, "the Facility") draws on decades of UNDP experience using carbon finance to stimulate investments for emission reductions and sustainable development impacts. The design of the Facility is the result of research on global investment in climate action under the UNDP NDC Support Programme. The Facility is in line with the Paris Agreement, particularly Article 6.1, which highlights how voluntary cooperation in the implementation of NDCs will allow for higher ambition. The Facility is also in line with Article 9, which highlights the need to increase climate finance volumes.

The Facility seeks to create value by addressing existing development challenges, with the following priorities:

- **Use climate finance to drive a green recovery from the COVID-19 crisis while advancing the Paris Agreement goals.** The Facility focuses on rewarding additional MOs and measurable SDG impacts, not on trading carbon offsets. It will use the established knowledge of carbon markets for PBPs for MOs and, in addition, will track and reward results in terms of employment, income generation, gender equality, improving health indicators and other SDG impacts.
- **Ensure net reduction in emissions through additionality.** The Facility's PBP incentive will act as a de-risking tool in sectors/markets not yet fully mature for investment projects. Even if paid ex-post, the guaranteed payment upon performance essentially acts as a market accelerator.
- **Complement UNDP's climate work.** Through stimulating private investment in conditional NDC activities, the Facility will help implement the new generation of more ambitious NDCs that countries are currently developing. This backs up UNDP's Climate Promise and its work on long-term strategies for decarbonization.
- **Deliver results through a lean operational structure.** By working with reputable RPs the Facility will (a) leverage capacity to develop strong project bases and (b) reduce the administrative burden, costs and financial risks for UNDP.
- **Target developing countries with high conditional NDC targets and stated interest in market mechanisms.** The Facility has a global scope but will target countries with the highest conditional NDC targets and that have stated the value of private sector participation and/or carbon finance in their NDCs.
- **Generate funding for climate adaptation and resilience building.** The Facility is structured to allocate some funds to host country governments to enhance funding for National Adaptation Plan processes and implementation. The SOP will automatically be diverted from the PBPs the RPs receive from the Facility to the government.


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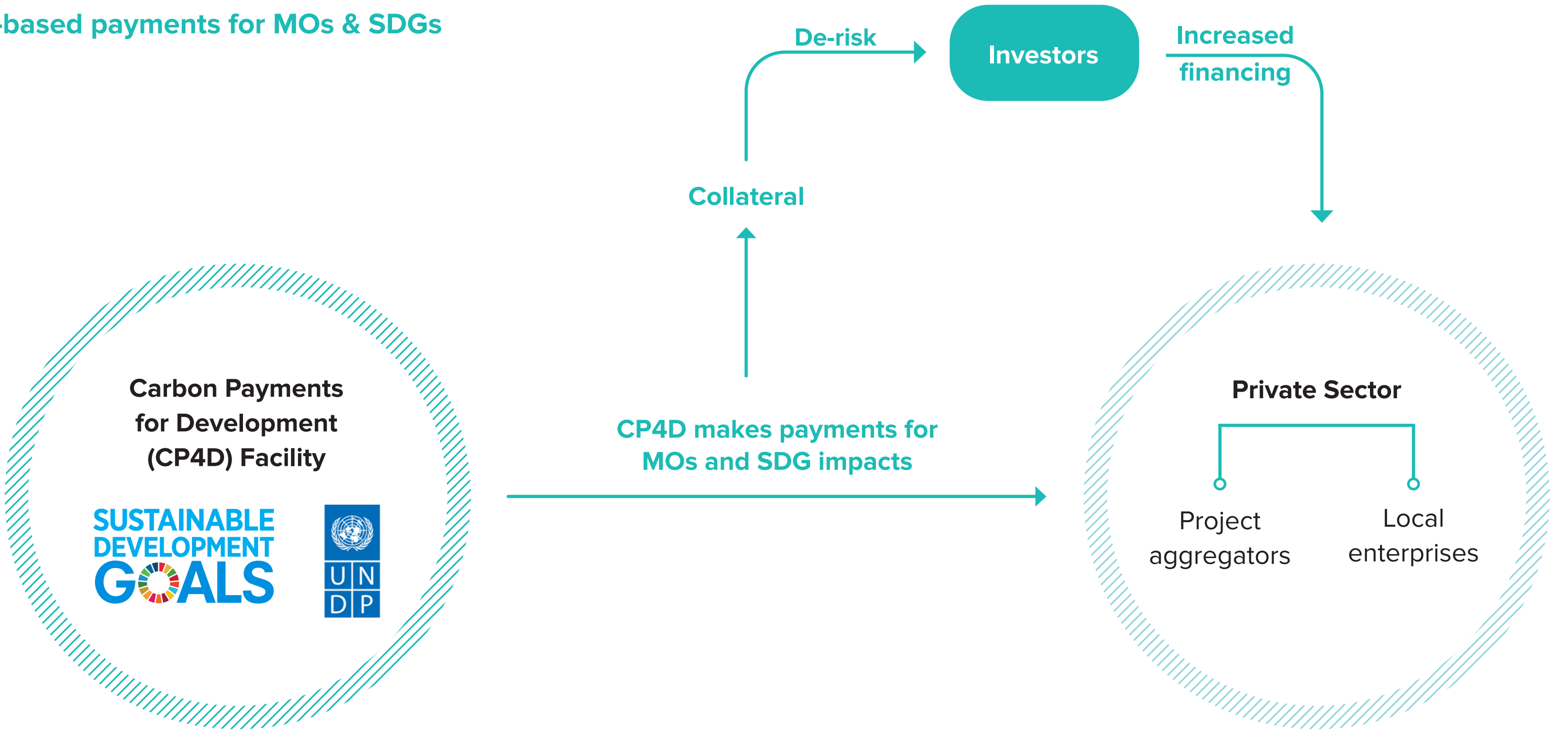
Facility concept

The purpose of the Facility is to incentivize private sector investment to implement projects that address conditional Nationally Determined Contributions (NDCs) and contribute to the Sustainable Development Goals (SDGs). The Facility specifically targets green job creation to drive an equitable recovery from the COVID-19 crisis. It will achieve this by operating a performance-based payment (PBP) scheme, using grant finance to make payments for verified mitigation outcomes (MOs) and SDG impacts. The Facility will therefore activate the de-risking function of public finance to attract private sector entrepreneurship and finance and mobilise businesses to contribute to their countries' conditional NDCs and development objectives.

The Facility's eight-year lifespan is carefully balanced between two conflicting priorities: (1) disbursing payments quickly, which is critical to achieving climate and economic recovery goals; and (2) ensuring that the PBP scheme lasts long enough to provide sufficient incentive to stimulate private sector engagement and project implementation. A PBP scheme that involves five years of annual payments per project is already at the shorter end of the range, but the comparatively generous prices for MOs and SDG impacts compensate for this.

The MOs and SDG impacts targeted by the projects will be defined ex-ante through existing methodologies, and a price for these expected results will then be agreed. Donors participating in the Facility will thus be able to support developing countries achieve their NDCs, while also harnessing the co-benefits that climate projects offer through multiple SDGs (beyond SDG13).

Figure 1. Performance-based payments for MOs & SDGs
Source: Own creation



Facility objectives and targets

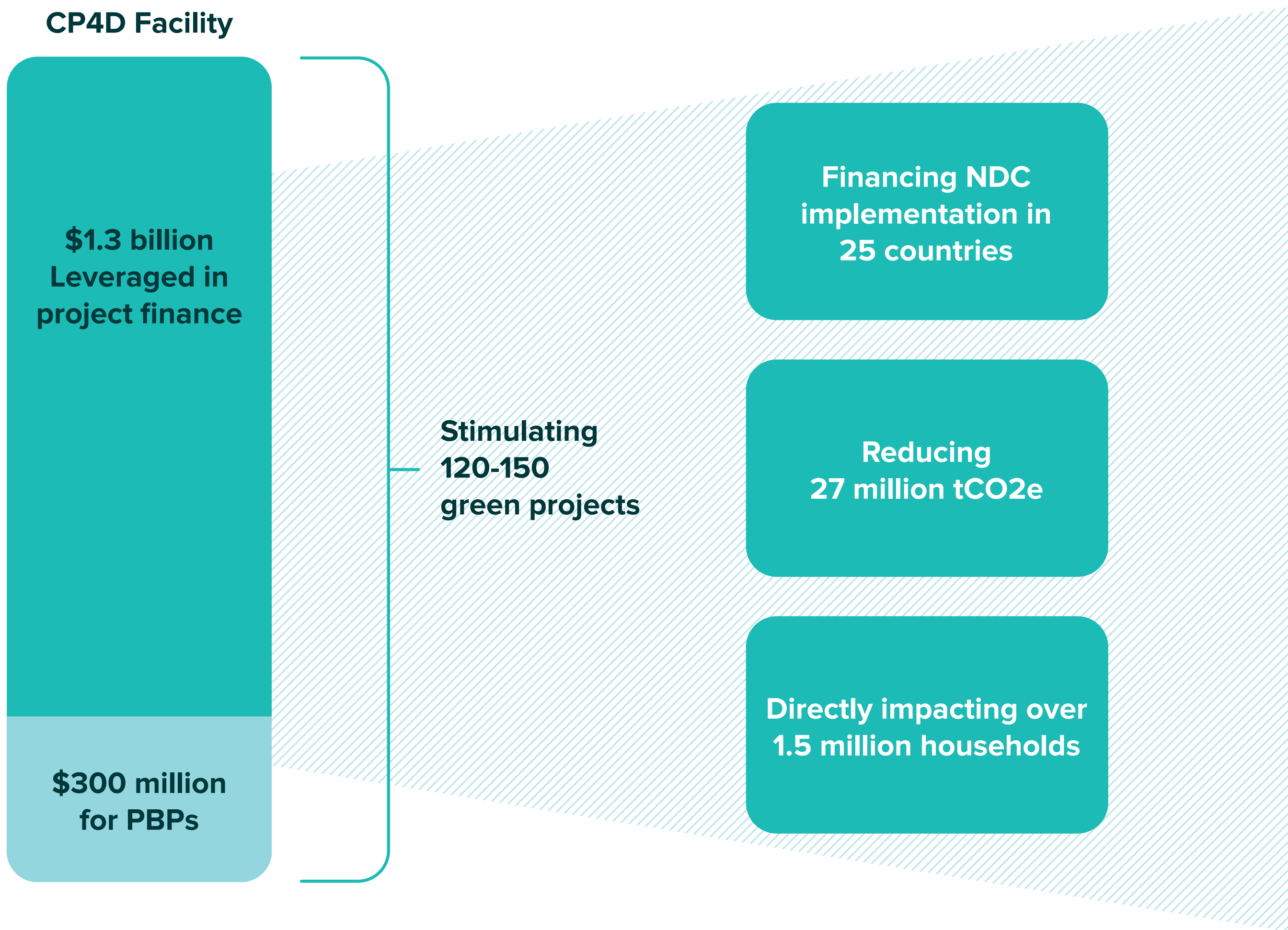
By engaging partners across the value chain—from donors to local project developers—over five years, the Facility will reduce emissions by 35 million tCO_2e and achieve a private sector investment leverage factor between 1:4 and 1:6 [1]. With a target of raising US$300 million for the PBPs, the Facility will support 120-150 projects in countries that have the highest and most ambitious conditional NDC targets stating the value of private sector participation and/or carbon finance in their NDCs.

Through focusing on the countries that have requested for significant international support for NDC implementation, through their high conditional NDCs, the projects will be impact underserved communities and directly benefit over 1.5 million households and, indirectly, up to 5 million households through gender-sensitive and green job creation. The majority of the projects will range between $5 million and $40 million in size, in a wide range of priority sectors, such as clean cooking, biogas, waste management, energy access, safe drinking water, climate-smart agriculture and urban electric mobility.

Based on its size ($300 million) and the anticipated leverage factor (~1:5) the Facility could leverage approximately $1.5 billion of private sector finance for low-carbon economic recovery from COVID-19. It would help create jobs in green, “shovel-ready” projects that would deliver SDG impacts and MOs that contribute to NDC implementation.

1 ‘The Green Investment Report: The ways and means to unlock private finance for green growth,’ WEF (2019) **https://www.weforum.org/reports/green-investment-report-ways-and-means-unlock-private-finance-green-growth**

Figure 2. CP4D sizing & ambition
Source: Own creation



CP4D's alignment with UNDP corporate priorities

Three core factors shaped the creation and design of this Facility:

1. **The need to accelerate NDC implementation and achieve the Paris Agreement goals.** The initiative is aligned with the ethos of Next Generation UNDP and supports UNDP's Climate Promise to contribute to enhancing 100 NDCs in the developing world, launched in September 2019. To increase the ambition of the second generation of NDCs, and transition to carbon neutrality by 2050, cannot be achieved without private sector engagement across the board. Public finance has always played a vital catalytic role in scaling-up technologies and bringing in private sector investors. The CP4D is part of this process.
2. **Need to drive a green and equitable recovery from COVID-19.** In a world that was already struggling with growing inequalities and a climate crisis, COVID-19 has further exposed vulnerabilities and is disproportionately affecting the most disadvantaged in our societies. The CP4D can play a pivotal role in UNDP's offer to support this recovery phase. It proposes to quickly inject $300 million into developing country markets, leveraging four times that in private investment. Research indicates that public finance injections during economic downturns can generate multipliers of 1.5 to 2.0 and, in the long run, as high as 2.5 to 3.0[2]. The Facility provides an opportunity to have deep, compounded impacts in countries and communities that need job creation now more than ever. Furthermore, the CP4D is targeting technologies and sectors that have been were listed in the top five most effective stimulus policies in a recent analysis of 700 such policies. These are: (a) clean physical infrastructure investment; (b) increased energy efficiency; and (c) natural capital investment for ecosystem resilience and regeneration, such as climate-smart agriculture.
3. **UNDP's track record in bringing projects online and delivering results.** UNDP has had success designing programmes and projects using similar PBP instruments to deliver both MOs and SDG impacts. All of these initiatives use financial instruments to incentivise private sector investment. This empowers private sector to address national climate commitments and ensures there is always a leverage factor for each dollar committed by donors. UNDP's MDG Carbon initiative[3] and its support to mobilise finance for Ghana's National Clean Energy Access Programme[4] are two key examples.

2 Oxford Smith School of Enterprise and the Environment, Working paper, 'Will COVID-19 fiscal recovery packages accelerate or retard progress on climate change?', p. 5 (4 May 2020). Retrieved from **https://www.smithschool.ox.ac.uk/publications/wpapers/workingpaper20-02.pdf?stream=top**

3 United Nations Development Programme, 'Positive Impact Report MDG Carbon,' (8 April 2016). Retrieved from **https://www.undp.org/content/undp/en/home/librarypage/environment-energy/mdg-carbon/positive-impact-report-mdg-carbon.html**

4 **https://www.international.klik.ch/en/Activities-and-impact/Mitigation-activities.287.html**

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How will the Facility operate and deliver MOs and SDG impacts?

The CP4D has a lean operational structure and streamlined approval process that will reduce transaction costs and fast-track implementation. This will be achieved by collaborating with Responsible Parties (RPs) that have track records of successfully managing portfolios of projects that deliver MOs and SDG impacts in the Facility's target countries. The RPs will then be responsible for providing eligible projects to the CP4D and overseeing the delivery of MOs and SDG impacts, in exchange for the PBPs.

There are a number of key operational steps and processes the Facility will undertake in order to achieve its goals of stimulating and achieving large volumes of MOs and SDG impacts in a short time frame. Figure 3 illustrates where these processes fit into the Facility's eight-year lifespan.

1. **Selection of RPs.** Through market research UNDP has identified around 20 entities who could be eligible to pre-qualify as RPs to the CP4D. An open tender will be created and the CP4D will select all entities that meet the eligibility criteria. Key criteria revolve around track record of managing portfolios of projects that deliver MOs and SDG impacts in UNDP's target countries and regions.
2. **Selection of Independent Assessors (IAs).** The inherent nature of PBP scheme requires an independent verification of results. To verify the results achieved by the RP's underlying projects, IAs will be hired and contracted by the CP4D to conduct verifications of the annual reports the RPs are obligated to produce. UNDP's Country Offices (COs) will in turn be responsible for validating the SDG impacts achieved by the project, through UNDP's Climate Action Impact Tool.[5]
3. **Project approval and project finance.** All RPs that pass the pre-qualification criteria will be eligible to submit projects to the CP4D. The CP4D will assess their eligibility and if eligible, approve the projects. If eligible projects need additional project finance, the CP4D will engage its Finance Partners who will consider financing the project through their own due diligence approaches
4. **Implementation, verification of results and payments.** Once financed the PBP agreements will be signed between the RPs and the CP4D and the projects will be implemented. Each year the RPs will submit reports on their results, and once validated, the CP4D will make an annual payment for these results at the pre-agreed price.

Figure 3 Facility key processes timeline
Source: Own creation

Year 1	Year 2	Year 3	Year 4 - 8
• IAs and RPs selected • Project submission window opens for two years • First projects submitted and approved • Fundraising continues	• Projects submitted and approved • First tranche of annual ex-post payments made • Fundraising continues • Project submission window closes at end of Year 2	• Projects window closed • Annual verifications and payments taking place • CP4D team works with RPs and FPs so all projects are financed and implemented by end of Year 3 • Fundraising stops at end Year 3 before final PBPAs signed	• By end of Year 4, all projects to be delivering verified results in order to benefit from the five annual payments that cease after Year 8 • Monitoring, reporting, communication activities take place • Project evaluation commences in Year 7

The size of this Facility ($300 million) can only address a fraction of the market and carbon projects that exist in the developing world. However, the type of projects and markets the Facility is targeting are on the periphery; underfinanced and underdeveloped. This Facility will leverage UNDP's Country Office presence and its wide ranging and deep network of expertise in implementing development projects, to bring job creation and income growth into these countries; contributing to the achievement of Paris Agreement goals and an economic recovery from COVID-19.

The CP4D has had detailed discussions with donors and finance institutions about funding and partnering with the Facility, respectively. The sustainable energy financiers, bettervest[6] and Trine[7], as well as the Development Bank of Southern Africa (DBSA)[8] and United Nations Capital Development Fund (UNCDF)[9] are all confirmed as Finance Partners to the Facility. The expectation is to launch the Facility in 2021.

5 Climate Action Impact Tool **https://climateimpact.undp.org/#!/**

6 bettervest **https://www.bettervest.com/**
7 Trine **https://trine.com/**
8 Development Bank of Southern Africa **https://www.dbsa.org/EN/Pages/default.aspx**
9 United Nations Capital Development Fund (UNCDF) **https://www.uncdf.org/**

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