

**Green Finance Investment Case:** INVESTIGATE THE FINANCIAL CONSTRAINTS TO INVESTMENT IN THE GREEN ECONOMY AND PROPOSE MEASURES TO ADDRESS THE BARRIERS, WITH PARTICULAR REFERENCE TO A PROVINCIAL-BASED GREEN FUND AND GREEN FINANCE SUPPORT FACILITY

The Western Cape's 2013 *Green is Smart, Green Economy Strategy Framework* outlines the Province's intent to become a regional hub for the global green economy. "Finance" is one of five "enablers" in *Green is Smart*, but finance is not always available for desirable projects and is not always enabling. Inadequate per capita income and low population densities already make the financing of South African infrastructure difficult, and the perceived technology and novelty risks associated with the green economy further confound the finance case relative to "more pressing needs" such as housing and maintenance of existing infrastructure.

The need in the Western Cape, then, is for a planned and progressive transition towards an economy that is more productive, more competitive and less environmentally damaging. This will only prove socially and politically tenable if green economy efforts simultaneously address these pressing social needs: housing, job creation and social inclusion. It is in the marshalling of financial resources towards these conjoined socio-ecological priorities that the Provincial Government has a critical role to play.

The focus of the Green Finance Investment Case was on the Western Cape's "financial ecosystem" that is the combination of fiscal resources, private investments, savings, loans, risk reduction facilities and regulations that collectively constitute the broad financial sector. In keeping with the Western Cape Green Economy Strategy Framework's intention of being "private sector driven" but "public sector enabled", the study paid particular attention to the complementarity between fiscal resources, regulation and the mobilisation of private sector finance. Thus, the strategic aim of this study was to identify opportunities through which the Provincial Government in the Western Cape might secure international and domestic finance in support of the long-term benefits of a provincial green economy. To this end, the research involved three components:

1. A review of the existing financial landscape, as it pertains to the green economy, and the identification of finance gaps;
2. An evaluation of the merits of a "provincial green fund"; and

3. Exploration of alternative opportunities to enhance financial flows to the provincial green economy, including a "finance facility".

## **Key Findings**

The study reviewed the potential for a Provincial Green Fund to address existing finance gaps and assist the Western Cape economy's transition to a green economy. Gaps and failures in the financial landscape were identified as follows:

- Mainstream investors operate within very narrow mandates and are poorly equipped to identify entrepreneurs or to analyse the risks associated with their business proposals.
- The country does not have an established venture philanthropist, venture capital or "ethical banking" sector.
- Local DFIs have not been good at isolating a section of financial market need that is distinct from that serviced by commercial banks and have not crowded-in private sector finance to the projects that they initiate.
- University research units absorb early phase funding from donors and corporate foundations, but have not yet created significant partnerships with the private sector or contributed to significant commercial opportunities.

Collectively, these gaps truncate the market for finance and, with the significant exception of the REIPPP process, green economy opportunities have not yet presented investors and financiers with a compelling case.

The interviews conducted with specialists and financiers revealed equity investors with unallocated funds, the DBSA Green Fund with unallocated grants, mainstream fund managers frustrated that they are not presented with green economy investment options and green technology companies and green entrepreneurs lamenting the absence of markets for their products and services. The research did not, however, at any stage uncover green economy companies with markets for their goods and services that were unable to attract finance.

The study found that there are at least four aspects of the financial landscape that warrant public sector attention:

- Disconnect between green entrepreneurs, markets for green goods and services and funds;

- “Crowding-in” of private sector resources;
- Redressing the mis-alignment between investment and known risks; and
- Ensuring inclusivity and access to finance by poor communities.

Through the research it became clear that it was too soon to set up a green fund which would address these gaps. Not only is a fund unlikely to attract the requisite private sector capital, but funds are expensive to administer. Without effective demand for green economy goods and services, a Provincial Green Fund is likely to elicit professional grant applicants and not necessarily projects with a reasonable chance of honouring financial obligations and contributing to a prosperous green economy.

### **Recommendations**

Rather than a green fund, then, the proposal advanced by the study is for the formation of a “Green Finance Support Facility” which would be best located outside of government, perhaps in one of the Western Cape’s Sector Development Agencies or Special Purpose Vehicles. The facility should consist of an expert team, with experience of public and private finance, which is mandated to negotiate and structure financing partnerships that unlock the Province’s green economy potential. Where the Western Cape Government can create a portfolio of viable new green economy projects in the housing, education, healthcare, energy, water and agriculture sectors, this will prove attractive to private sector investors that are under pressure to diversify their portfolios and demonstrate a commitment to environmental, social and governance (ESG) projects.

The Western Cape government should apply the full extent of the province’s fiscal, regulatory, land holding and convening influence to incentivise the type of green economy projects that will attract finance. Ways in which it might do this include:

- Fiscal influence: Collaborate with local governments to make a portion of the provincial housing budget available to private sector financiers capable of leveraging this budget to provide “lower-gap houses”. In exchange for access to the human settlements fiscus, private sector financiers would be made to compete in terms of the number of suitably priced houses financed and the green economy credentials of those houses.

- Land-owning influence: By rationing the supply of electricity, sanitation and solid waste services as a condition of releasing land owned by the province, this would incentivise developers to include off-grid energy, sanitation and waste solutions in their development proposals and favour developers that were able to finance and deliver these innovations.
- Regulatory influence: The Province transfers considerable budget to schools and clinics annually. It is possible to structure financial packages that leverage the fiscal transfer to allow these institutions to access private sector finance for technologies such as solar water heaters, heat pumps, grey water systems and composting facilities that reduce electricity, water and resource expenditure.
- Convening influence: in enabling partnerships between insurers, government programmes aimed at reducing fire, flood and water contamination and the farmers and other businesses that are exposed to these risks. Structuring these partnerships so as to ensure they tackle the systemic origins of risk in a cost-effective manner will require collaboration and public sector oversight.

The case for a fund may yet emerge, in the interim, the Western Cape Government's is advised to focus its finance efforts on the green economy's key financial constraint, namely creating the type of demand that will allow green economy projects to capture the attention of private sector financiers and enable these projects to honour their commitments to these financial institutions.

With this in mind, funding has been made available to set up a Green Finance Support Facility which will:

- Create an enabling platform that will connect investors and financiers and support the development of financial structures and transactions;
- Develop a strong relational network of financiers, funds and incentives that directly or indirectly support green investment;
- Support projects of the Green Economy Working Group where financial access and structuring are critical to the successful roll-out of such projects; and
- Facilitate green finance opportunities for the GreenCape's WISP project by creating linkages between financiers and entrepreneurs.

*This executive summary was developed utilising the “Green Finance Investment Case Final Report” prepared by Econologic. If you would like the full report please contact us via [110Green@westerncape.gov.za](mailto:110Green@westerncape.gov.za)*