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STRENGTHENING CONFIDENCE IN FINANCING LOCAL CLIMATE-RESPONSIVE PROJECTS

Scaling up funding and financing instruments for local and regional governments (LRGs) is essential for ensuring that they can pay their fair share in financing climate-responsive projects and driving forward the achievement of the Sustainable Development Goals (SDGs). It is particularly relevant for SDG 13 "Climate Action" and SDG 11 "Sustainable Cities and Communities." The GCH advocates the importance of a multilevel governance approach, policy coherence, and inclusive financial systems to overcome the significant financing gap that currently hinders the realization of our common goals.

This paper highlights the need for localizing finance through strengthened cooperation between national and local governments, private sector actors, and international financial institutions (IFIs). Multilevel and multilateral cooperation is of high importance to effectively connect the global sustainability agenda and its local implementation. It advocates for greater private sector engagement and the mobilization of resources from multilateral development banks (MDBs) to support local climate-responsive projects. Several financing instruments, such as catalytic financing, guarantee funds, blended financing, and public-private partnerships, are identified as effective tools for de-risking investment in local climate projects and improving the creditworthiness of LRGs, ensuring that no place is left behind.

To achieve the SDGs, it is also essential that LRGs are included in the policy-making process from the outset. This inclusion ensures that global policies are actionable on the ground, while also building trust and attracting the investments needed for climate-resilient sustainable development. One of the key challenges identified is the lack of policy coherence between different levels of government – global, national, regional, and local – which undermines the effectiveness of global SDG frameworks when implemented locally.

The GCH calls for a more inclusive and effective international financial system accommodating LRGs that supports their capacity to finance climate-responsive projects and contribute to sustainable development at the local level. The policy paper highlights various innovative financing instruments that can help unlock resources for these projects, enhance financial management capacities at the local level, and strengthen the involvement of LRGs in both national and international policy-making processes.

It is a call to action for international organizations, including IFIs and MDBs, national governments, and private investors to join forces in scaling up financing and enabling LRGs to take the lead in achieving the SDGs. Its recommendations serve as building blocks for creating a more effective and equitable global financial system for sustainable development.

Towards a more inclusive and effective international financial system accommodating local and regional governments

The United Nations (UN) SDG Summit of 2023 made it clear that attaining the Sustainable Development Goals (SDGs) will require the unlocking of local solutions to address global challenges. The Summit "marked the beginning of a new phase of accelerated progress towards the Sustainable Development Goals with high-level political guidance on transformative and accelerated actions leading up to 2030." [1]

The UN Summit of the Future of 2024 adopted as its main outcome the 'Pact for the Future' where States recognized that efforts must involve local authorities. They requested the UN Secretary-General to provide recommendations on "how engagement with local and regional authorities could advance the 2030 Agenda, particularly the localization of the Sustainable Development Goals."[2]

Political commitments are only one piece of the puzzle. The more strategic involvement of Local and Regional Governments (LRGs) in advancing the SDGs through localization and implementing relevant policies at the local level cannot be achieved without adequate financing. To ensure local action yields real added value, necessary funding needs to be channeled effectively towards impactful projects. Unfortunately, several challenges remain to be overcome. It requires the strengthening of the different dimensions of SDG localization: local planning; urban policy development; and institutional capacity building. It also calls for the adaptation of the state-centered international financial system, which lacks the very framework for financing the localization of SDGs.

This paper aims to dive into the multilevel governance approach to localize SDGs, specifically looking at the elements of financing and policy coherence for the effective delivery of SDG 13 'Climate Action', which is very much linked to SDG11 'Sustainable Cities and Communities'. The paper presents the current challenges of financing at local level and explains briefly four funding and financing instruments which – if scaled up – could facilitate significantly the delivery of local sustainable development projects.

1 www.un.org/en/conferences/SDGSummit2023

2 www.un.org/sites/un2.un.org/files/sotf-pact_for_the_future_adopted.pdf

Current institutional challenges

Coherence of policies across governance levels and localization of finance for sustainable development are essential to work towards the realization of the 2030 Agenda. However, significant gaps exist, which jeopardize the policy efforts to achieve the SDGs. The funding gap for achieving the SDGs as planned reaches or even exceeds $4 trillion – following different estimations. Evidence shows that the amount, efficiency and selected SDG-focus of financing are all key to reaching the desired result. The way investment projects are identified (i.e. sustainable urban development, climate resilience, just energy transition, etc.), prioritized and designed have an important impact on their outcomes and therefore on their effectiveness on the ground.

Similarly to the challenge of sustainable development itself, financing the activities to face this challenge cannot be provided by states alone. A multistakeholder approach is needed – taking into consideration the specificities of the different institutional and private actors. "Policy coherence aligns governmental strategies, while finance serves as the lifeblood of SDG implementation, requiring targeted resources for sustained impact. Together, they provide the necessary frameworks, resources, and coordination mechanisms to navigate the intricate landscape of sustainable development and transform aspirations into tangible, positive outcomes."[3]

> To build an effective multilateral system – especially for SDG localization financing – a multilevel multistakeholder approach is needed and LRGs need to be involved in the process from the beginning.

Most countries fail to recognize the need for better policy coherence across the different levels of governments for sustainable development as a fundamental tool for achieving the SDGs. Although some have decided to include in the implementation and revision process of their National Sustainable Development Strategy, a dedicated dialogue on multilevel policy coherence. LRGs must also find a way to be better involved in the process both at the national and international levels. It requires increased understanding of how to more efficiently leverage existing finance and attract additional finance to achieve the SDGs at the local level.

3 https://sdgs.un.org/events/addressing-policy-coherence-and-finance-gaps-pursuit-sdg-localization-and-multilevel

Perception versus reality of local financing

Financing sustainable development efforts directly at the local level, especially climate-related projects, is considered a challenging and risky business. However, the European Investment Bank (EIB) determined that from 1994 to 2022, subnational borrowers had a lower default rate (2.2 percent) on average than private borrowers (3.6 percent).[4] Nevertheless, today's international financial architecture is state-centered, and only 44 percent of the world's countries allow subnational borrowing.

In places where national laws allow subnational government borrowing, they usually require cities to secure a sovereign guarantee on any debt transaction. However, securing a sovereign guarantee can be a burdensome process, resulting in untenably long delays.[5] Also, a national government can withhold or deny a sovereign guarantee because it has differing priorities than a given city regarding infrastructure development plans.

The challenge is not any smaller but different when the national government supports local financing. The World Bank Group's book '*Municipal Finances: A Handbook for Local Governments*' already noted in 2017 that "when responsibilities are transferred from central to local governments, it is often not accompanied with an adequate transfer of resources. Local government needs to improve its skills -- and quickly -- in areas such as expenditure control, increasing local revenue, raising external funds responsibly, achieving creditworthiness, and adopting good borrowing practices."[6]

Through inclusive multilateral cooperation the international community should be able "to bridge the gap between SDG visioning and the reality of on-the-ground implementation. In doing so, it addresses the tensions between a global sustainability agenda and the unique local conditions in which the agenda must be implemented."[7] To build an effective multilateral system – especially for SDG localization financing – LRGs need to be involved in the process from the beginning. On the one hand, it would make sure that global decisions are implementable on the ground, and on the other, it would also increase the willingness of LRGs who are closest to the population to efficiently implement them.

4 European Investment Bank., 2023. Default statistics: private and sub sovereign lending 1994 2022. Vol. 1. Publications Office, LU.

5 Some initiatives seek to facilitate access to guarantees for local financing. For instance, the UN Capital Development Fund and the European Union are conducting discussions on launching a Guarantee Facility for Sustainable Cities. The French Development Agency launched CITYRIZ, a guarantee fund dedicated specifically to cities' sustainable infrastructure projects.

6 www.worldbank.org/en/events/2017/10/03/localizing-the-implementation-of-the-sustainable-development-goals

7 www.undp.org/sites/g/files/zskgke326/files/2024-03/undp-dfs-institutionalizing-sdg-localizing-in-multi-level-governance-settings-lessons-from-india.pdf

Cities are where the climate battle will largely be won or lost

As UN Secretary-General António Guterres put it: "The choices that will be made on urban infrastructure in the coming decades – on urban planning, energy efficiency, power generation and transport – will have a decisive influence on the emissions curve. Indeed, cities are where the climate battle will largely be won or lost."[8] LRGs are natural and increasingly inescapable allies in this battle since SDG13 'Climate Action' is very much linked to SDG11 'Sustainable Cities and Communities'. Without their will, climate change effects cannot be mitigated and without their capacity to do so, local development will not be climate resilient, nor sustainable – hence global efforts will be in vain.

"Harnessing sufficient financing for development will be critical for meeting the Sustainable Development Goals, yet private financing remains undertapped and fragmented."[9] Given the financing gaps in implementing the SDGs, more involvement from the private sector is essential. However, it requires businesses to seek returns on their investments while taking into consideration social, environmental, and financial aspects too. Broader engagement and support from International Financing Institutions (IFIs) is also needed.

In addition to national guarantee programs, many IFIs and multilateral development banks (MDBs) – including the World Bank, the African Development Bank, the Asian Development Bank, the Development Bank for Latin-America and the Caribbean, and the Inter-American Development Bank – have guarantee programs to support development at the global and regional levels. However, climate-oriented guarantee funds have only recently emerged. Moreover, locally focused guarantee funds for LRGs are in development or recently put in operation but no guarantees for this purpose had yet been deployed in 2024.

The work by the Global Commission of the Sustainable Development Solutions Network (SDSN) is considered as a prime example of inclusive multilateralism in action. Led by the mayors of Paris and Rio de Janeiro, it tackles a challenge LRGs face systematically and offers a solution to be carried out by the State-led international financial system. To help improve the climate finance landscape for cities, the Commission makes actionable recommendations for how cities can obtain more and better financing for projects that contribute to achieving the SDGs. It works for creating avenues for bringing in private capital, including philanthropies, in local projects with public interest. It recommends supporting cities to create and attract more finance to integrated portfolios of projects that deliver on SDG goals across climate adaptation and mitigation.

8 https://unfccc.int/news/guterres-urban-infrastructure-choices-will-have-decisive-influence-on-theemissions-curve
9 www.undp.org/sites/g/files/zskgke326/files/2024-03/undp-dfs-institutionalizing-sdg-localizing-in-multi-level-governance-settings-lessons-from-india.pdf

De-risk the capital flow for urban climate-responsive projects

There are different types of climate finance instruments available for LRGs. They can be classified as nonrepayable (funding) instruments and repayable (financing) instruments. The two can be used separately or in a complementary manner. "For simplicity, all instruments that do not create future repayment obligations (for example, intergovernmental fiscal transfers and grants to LGs, own-source revenues, and operating surpluses) can be considered nonrepayable, or funding, instruments, while all instruments that create future repayment obligations (for example, commercial debts, such as loans and municipal bonds and equity or PPPs) are, naturally, repayable, or financing, instruments."[10]

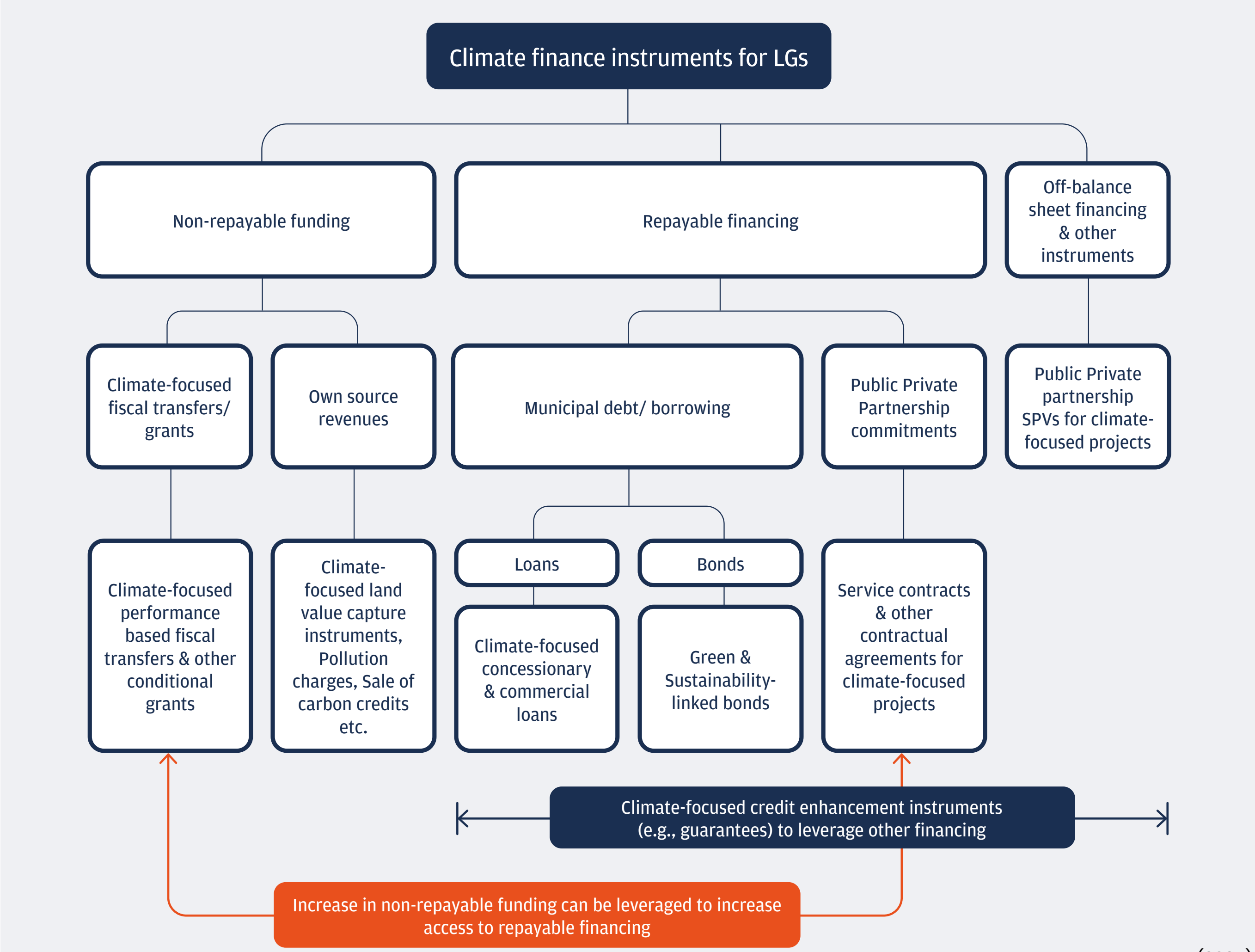
Building trust is a key component of strengthening investor confidence in local climate-responsive projects. Several initiatives involving LRGs aim to advance this agenda. Some aim at providing seed or catalytic finance, others are offering guarantees for lenders. Based on research, the capital mobilization ratio of guarantees is 6-25 times higher than that of loans or equities, making this instrument highly effective for crowding in investments for climate-related projects.[11] Seeking cooperation and revitalizing global partnerships (SDG 17) can mobilize resources and help implement commitments.

Credit guarantees incentivize lenders to provide debt to borrowers that have a high degree of perceived risk by transferring part or all the loan recovery risk to a guarantor. Credit guarantee programs are an important tool for derisking borrowing for entities like cities that may lack creditworthiness and have insufficient collateral revenue sources. By this we can make sure that no low-resource cities are left behind.

To illustrate different avenues of action – without the attempt to be exhaustive – we present below some of the valuable examples of funding or financing instruments which, if scaled up, can contribute to advancing adequate financing of climate-related SDG localization:

- Catalytic financing enables the launch of bankable projects for sustainable development by bridging the financial gap between the need for developing sustainable infrastructure and the risks investors are willing to take
- Guarantee funds for local projects provide an incentive for potential lenders to work with LRGs that lack a history of creditworthiness or have limited administrative capacity.
- Public-Private Partnerships, especially in financing infrastructure development, are central in implementing the SDGs, since governments are increasingly turning to the private sector as an alternative additional source of funding.
- Financing of the localization of SDGs, especially concerning climate-responsive projects, can profit from blended financing instruments. The international community recognizes its importance for building trust around development projects.

10 Local Governments Climate Finance Instruments, World Bank Group – UNCDF (2024)
11 https://urbansdgfinance.org/static/documents/20241101-gcgf-paper.pdf



Source: WB – UNCDF (2024)

Each of these instruments – as well as several others – might be analyzed in more detail. Our goal is not so much to present all their specificities but to offer the international community inspiration to chart new avenues which lead us to more efficient local financing for climate-responsive and sustainable development. By doing so, we can unlock local solutions to address together the global challenges.

Providing Catalytic Financing

One of the approaches is to transform sustainable infrastructure financing with an integrated value-chain designed to scale up bankable projects in critical sectors for sustainable development. Given the significant gap between the need for developing sustainable infrastructure and the risks investors are willing to take, it enables project financing where the public and private sectors come together as the catalysts of change.

For example, the Catalytic Finance Foundation in Geneva is dedicated to developing solutions to enable sustainable infrastructure investments.[12] Through the development of catalytic finance solutions, it helps to unlock capital and improve the feasibility of local projects for climate-change related sustainable development. By collaborating with investors and donors, the Foundation offers end-to-end solutions, addressing every stage of project development — from identification and due diligence to operation and reporting. This comprehensive strategy ensures that impactful projects not only emerge but thrive on a large scale.

12 www.catalyticfinance.org

Recognizing the urgent need for sustainable capital flows, the Catalytic Finance Foundation emphasizes a pragmatic approach to overcome the limitations of current capital markets. Their catalytic financing solutions aim to unlock significant investment in sustainable infrastructure, bridging the gap between market challenges and sustainability goals.

Guarantee Funds for local projects

A guarantee fund is situated between the potential lenders and recipient LRGs. For lenders, guarantees provide an incentive to work with LRGs that lack a history of creditworthiness or have limited administrative capacity. For LRGs, guarantees contribute to raising their credit ratings, and lowering the cost of borrowing, therefore providing access to a broader pool of investments.

The SDSN Global Commission for Urban SDG Finance proposes, for example, the Green Cities Guarantee Fund (GCGF) dedicated to de-risk and increase the flow of public and private capital for subnational climate-responsive projects. The GCGF aims to fill the gap of current efforts ranging from The Green Guarantee Company[13] to the World Bank's Multilateral Investment Guarantee Agency. The Sustainable Markets Initiative's (SMI) Blended Finance Task Force[14] deepens the argument that the GCGF could have the potential to increase MDBs capital mobilization ratios dramatically, especially for private investment.

The GCGF could provide an alternative to sovereign guarantees, and address risk perceptions that limit city borrowing. Urban climate finance could be taken on by such borrowers as local governments, municipal utilities, PPPs, and also private sector entities. It is also necessary to advise mayors and city leaders how they can successfully get access to additional financial resources through the Fund.

The GCGF could help expand the base of investors for emerging market cities through increasing access to the global bond market. "In addition to supporting standard international bond issuances, the GCGF could gear efforts to Green, Social, or Sustainable (GSS) bonds, that today constitute a USD 1 trillion business."[15] If Public Private Partnerships at the municipal level are new to a potential investors or creditors, the GCGF could create or partner with a project preparation facility and strengthen mutual trust to launch an urban infrastructure project, such as water management systems, waste collection and recycling, and transit line development.

Public Private Partnerships

Governments are increasingly turning to the private sector as an alternative additional source of funding to meet the funding gap, but also for gaining know-how and innovation. However, private firms and investors remain cautious about accepting major risks beyond their control.

The value of capitalizing on private sector financing for the SDGs was recognized in the UN Addis Ababa Action Agenda of the Third International Conference on Financing for Development in 2015. Translating it to the local level, however, remains a challenge. Among the relevant initiatives, the World Economic Forum and UN-Habitat established the Global Partnership for Local Investment to advance investments in local communities through public-private partnerships to contribute to sustainable development.

13 The Green Guarantee Company is the first specialist guarantor for emerging market climate adaptation and mitigation projects: https://greenguarantee.co

14 SMI BFTF helps mobilize finance at scale and promote innovation to drive industry, create value and support sustainable solutions: www.sustainable-markets.org/taskforces/blended-finance-task-force

15 IFC/Amundi, Emerging Market Green Bonds, 2024 www.ifc.org/content/dam/ifc/doc/2024/emerging-market-green-bonds-2023.pdf

Around the world there are already thousands of municipal public-private partnerships (PPPs) that rely on the private sector for delivery of public services, such as: water and sanitation; waste to energy; social housing; urban mobility; sport facilities; and cultural projects. There is a need to harness the power of a new generation of SDG-driven and climate resilient PPPs that deliver value for future generations.

As the UNECE Guidelines on green and sustainable procurement of PPPs for the SDGs put it, "PPPs are long-term contracting mechanisms through which governments engage the private sector to deliver public infrastructure and services. These contracts often include long-term risk allocation, private funding and financing, and, in some cases, private ownership or control over public assets."[16] When well-prepared and well-managed, PPPs can catalyze the strategic deployment of private capital to bridging financing gaps at the local level. PPPs are central to leveraging private sector expertise, capital, and transformative innovation to build infrastructure that advances climate action and accelerates progress on the SDGs.

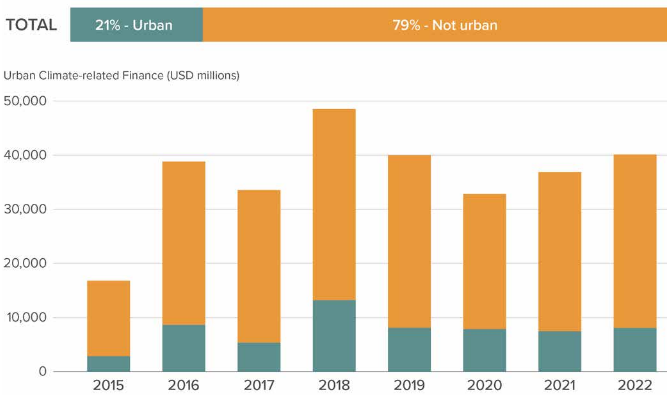
Blended financing instruments

Multilateral Development Banks have a high potential to mobilize more public and private capital into urban climate projects. In their recent New Delhi Declaration, G20 Leaders noted that the 21st century requires an international development finance system that is fit for purpose, putting MDBs at the center of solutions to global challenges. There are expectations that MDBs will become the banks of global or regional public goods, such as climate-change resilient infrastructure development.

MDBs often provide non-repayable grants as part of a broader financing package. They are supposed to play a role in building trust and bridging the knowledge gap between private investors and local green projects by providing financial support and technical assistance where capital deployment capabilities are limited. Given the significant shortfall in funding for green projects in general, several MDBs announced at climate COP28 their commitment to provide over $180 billion in climate finance.

In the Marrakesh statement, "the leaders of 10 Multilateral Development Banks (MDBs) announced joint steps to work more effectively as a system and increase the impact and scale of their work to tackle urgent development challenges."[17] While it includes boosting joint action on climate change, strengthening country-level collaboration and co-financing, catalyzing private-sector mobilization, it still lacks the local context.

Urban Share of MDB's Climate-related Finance (2015-2022)



Source: Cities Climate Finance Leadership Alliance/Climate Policy Initiative analysis

16 https://unece.org/sites/default/files/2024-11/ECE_CECI_WP_PPP_2024_05-en.pdf
17 www.worldbank.org/en/news/statement/2023/10/13/statement-of-the-heads-of-multilateral-development-banks-group-strengthening-our-collaboration-for-greater-impact

Conclusion and recommendations

A lot of efforts are still needed to properly fund the localization of SDGs. Slowly, relevant tools are strengthened, and new ideas have appeared to facilitate the investment in sustainable projects at the local level. These need to be scaled up rapidly if we want to overcome the challenges facing the 2030 Agenda.

Supporting climate-responsive and sustainable development at the local level is key to achieving the SDGs, especially SDG11 and SDG13. Financing the activities advancing climate-responsive and sustainable development is a challenge states cannot face alone. A multistakeholder approach is needed – with local and regional governments and private actors in its center.

At the UN Summit of the Future, States committed to strengthen the engagement of local and regional authorities in localizing SDGs. Through inclusive multilateral cooperation the international community might be able to bridge the gap between the ideal pursuit of the SDG and the reality of implementation on the ground.

Building trust is a key component of strengthening investor confidence in local climate-responsive projects, and several initiatives involving LRGs aim to advance this agenda. Some aim at providing seed or catalytic finance, others are offering guarantees for lenders, others promote mission-oriented PPPs.

In places where national laws allow subnational government borrowing, they usually require cities to secure a sovereign guarantee which is not a reliable way for cities to access needed capital. To overcome this constraint, credit guarantees incentivize lenders to provide debt to borrowers that have a high degree of perceived risk, such as cities.

Our recommendations

The Global Cities Hub recommends exploring the different options of advancing the investment in urban mitigation and adaptation infrastructure and services by:

- Promoting public-private partnerships structured at the municipal level for climate-related urban infrastructure projects;
- Developing credit guarantee programs for de-risking borrowing for entities like cities and regions that may lack creditworthiness and have insufficient collateral;
- Making urban climate finance a key component of MDB reform agendas, by integrating urban content into country platforms through multilevel coordination;
- Strengthening the principle of inclusive multilateralism within the international financial architecture, incorporating the needs of LRGs.

> “Indeed, cities are where the climate battle will largely be won or lost.”

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