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Interrelated policy matters on incremental cost and full cost, concessionality, and co-financing

Summary

This document is a consolidated paper covering three interlinked policy matters on incremental cost and full cost, concessionality, and co-financing. The document is divided into three parts discussing definitions, principles, linkages and approaches to addressing the issues related to these policy matters.

The three parts are titled as follows:

Part 1: Incremental cost and full cost methodologies;

Part 2: Options for further guidance on concessionality; and

Part 3: Policy on co-financing.

Table of Contents

Part 1: Incremental cost and full cost methodologies	2
Part 2: Options for further guidance on concessionality	6
Part 3: Policy on co-financing	10
Annex I: Draft decision of the Board	13
Annex II: Methodologies for incremental cost and full cost calculations	14
Annex III: Policy on concessionality	17
Annex IV: Policy on co-financing	20
Annex V: Illustrative examples of how incremental cost might be considered in the context of a small subset of hypothetical GCF project types	25
Annex VI: Review of practices in other funds on incremental cost	27
Annex VII: Comparative analysis of existing approaches and methodologies on co-financing	31
Annex VIII: Comparative analysis of co-financing data from GCF and comparable funds	36
Annex IX: Portfolio analysis of co-financing	39

Introduction

1. This document is a consolidated paper covering three interlinked policy matters on incremental cost and full cost, concessionality, and co-financing. The document is divided into three parts titled as follows:
 - (a) Part 1: Incremental cost and full cost methodologies;
 - (b) Part 2: Options for further guidance on concessionality; and
 - (c) Part 3: Policy on co-financing.
2. Each part is consistently structured discussing definitions, principles, linkages and an approach for each policy matter.

Part 1: Incremental cost and full cost methodologies

I. Background

1. The Governing Instrument for the GCF, paragraph 35, states that GCF “will finance agreed full and agreed incremental costs for activities to enable and support enhanced action on adaptation, mitigation (including REDD-plus), technology development and transfer, capacity-building and the preparation of national reports by developing countries”.
2. By decision B.11/11, paragraph (j)(vi), the Board decided to review the proposal approval process with a view to, inter alia, strengthening project/programme eligibility criteria, including categories of incremental cost eligible for funding. In paragraph (k) of the same decision, the Board requested the Secretariat to submit a final report on the review at the thirteenth meeting of the Board.
3. By decision B.17/10, paragraph (c)(i), the Board requested the Secretariat to prepare, under the guidance of the Co-Chairs, a proposal to be discussed at the nineteenth meeting of the Board for “the development and application of an incremental cost calculation methodology and/or alternative methodologies, as appropriate”.
4. By decision B.19/06, paragraph (a), the Board noted the linkages between incremental cost and concessionality and the policy gaps identified in decision B.11/11. In paragraph (d) of the same decision, the Board requested the Secretariat to develop an integrated approach to resolve these interrelated issues for the Board’s consideration at its twentieth meeting.
5. A description of a recommended approach that allows GCF to develop a methodology over time while learning from the experiences of accredited entities is contained in annex II.

II. Definitions

2.1 General definition of full costs and incremental costs

6. In economics and cost accounting, incremental cost refers to the additional expenses incurred with respect to a baseline to produce a new output or an equivalent output in a different manner.¹ In the context of climate change, the incremental costs are the additional expenses incurred with respect to a baseline to produce a new output or an equivalent output in a manner that results in climate impact. The full cost equals the baseline cost plus the incremental cost.
7. As part of the discussion to elaborate Article 11 of the United Nations Framework Convention on Climate Change (UNFCCC) on the Financial Mechanism, the interim UNFCCC secretariat in 1994 prepared a technical note which stated “Incremental costs will be defined vis-à-vis a baseline situation, which could be not to implement a measure at all, or to implement it in a manner that does not aim at achieving the objective of the Convention. The incremental cost will be the difference between the cost of the baseline activity (which may be zero) and that of the actually implemented measure.”²

¹ This concept is different from marginal cost, which refers to the change in total costs associated with producing an additional unit of output.

² *Approaches to the Determination of Agreed Full Incremental Costs*. A/AC.237/50/Add.1. 1994. Intergovernmental Negotiating Committee for a Framework Convention on Climate Change. Ninth session.

8. The UNFCCC technical note also included the following key observations, which continue to be relevant:
- (a) Baselines, or baseline scenarios, which are essential for defining incremental costs, are necessarily hypothetical; defining them constitutes a major issue in the determination of incremental costs and is inevitably a matter for negotiation among the parties concerned. There will be a need to apply rules of economic, environmental, technical and financial reasonableness in defining baselines;
 - (b) Incremental costs are very sensitive to proposed measures and the baseline. In cases where the latter is specific to the country situation, this may complicate any attempt to codify standard incremental costs on the basis of an indicative list of measures;
 - (c) The determination of incremental costs would be facilitated by the development of model projects, corresponding to the substitution of typical baseline activities by typical alternatives;
 - (d) The use of net versus gross incremental costs may lead to different funding levels. If net costs are used, any local economic benefits from the project would be subtracted and therefore the amount of incremental costs would be reduced; and
 - (e) The fact that the alternative project is economic or has important local benefits does not guarantee that the additional funds required will be available domestically or from external – public or private – sources.

2.2 Defining the baseline project and baseline costs

9. The identification of a baseline project is essential to establish the baseline cost. In some cases, the baseline project, often known as the business as usual scenario, can be relatively easy to determine and cost. For example, a project retrofitting an existing power plant to reduce its consumption of fossil fuels and/or its generation of emissions would have as its reference or baseline case the known cost associated with its continuing operation. The incremental cost could therefore be calculated as the capital cost of the investment necessary to undertake the retrofit, plus or minus the change in operational and maintenance cost resulting from the conversion. Although there may be exceptions, the determination of incremental costs generally is more likely to be simpler in mitigation activities, and their related global climate benefits are also more likely to be easier to identify and quantify.

10. On the other hand, incremental cost of an adaptation project may be necessary to distinguish costs related to climate change from those intended for development. For example, expanding a water supply system in a drought-prone area may have elements of development and adaptation. An assessment of incremental costs is likely to require an analysis of the degree to which drought frequency or severity is increasing as a result of climate change. Such an analysis might be difficult to undertake in a precise quantitative manner.

11. Annex V presents some additional examples of the different types of projects that GCF may consider and how the issue of incremental costs would arise in each case. These examples illustrate that the calculation of incremental costs is likely to need to be different in the adaptation and mitigation contexts.

III. Guiding principles

3.1 Proposed principles for GCF

12. A review of practices in the Multilateral Fund, the Global Environment Facility (GEF), the clean development mechanism (CDM), the Adaptation Fund and the Climate Investment Funds (CIFs) is included in annex VI. Four main principles can be derived from this review:
- (a) **Incrementality is a key tool to assess climate rationale.** The use of incremental costs and the need to compare the proposed intervention with a baseline case may provide a clear and transparent framework to more directly link the proposed activities with climate change;
 - (b) **Quantitative approaches should be applied to mitigation activities when sufficient data are available.** Both the Multilateral Fund and the CDM have developed approaches to define the baseline and counterfactual case and use them to quantify the incremental costs of the supported interventions in the case of mitigation activities;
 - (c) **Qualitative approaches connected to a strong project logic may be used for adaptation activities or activities lacking sufficient data for a quantitative approach.** None of the funds has done comparable quantitative work in the area of adaptation. Instead, the work of GEF, including its adaptation work through the Least Developed Countries Fund and the Special Climate Change Fund, has used a qualitative approach whereby an incremental reasoning is applied in the process of project design to ensure that GEF funding is focused on the incremental activities necessary to generate global benefits. In the adaptation context, a qualitative determination of incremental cost can be incorporated into the project logic or theory of change. However, it is likely to be less precise, as it would involve agreement on the degree to which the adaptation intervention is needed as a result of climate change; and
 - (d) **Funding for full costs may be justified under certain circumstances.** The Multilateral Fund, GEF, the Adaptation Fund and CIFs provide full (not only incremental) support for a host of supporting activities, including capacity-building, barrier-removing activities and pilot projects designed to demonstrate new technologies.

3.2 The challenge of constructing baseline scenarios

13. In many countries, the data required to construct realistic baseline scenarios do not exist because of the cost and time needed to collect quality data. Partners in vulnerable countries, particularly small island developing states, may have difficulty constructing baseline scenarios owing to the imminent and increasing effects of climate change on their societies. Some accredited entities (AEs), particularly direct access entities in such countries, may not currently have the analytical capacity to develop a quantitative estimate of incremental costs. Thus, while a quantitative approach would present advantages in terms of a more transparent and objective assessment of projects, these data challenges illustrate that a quantitative approach may not be immediately feasible in certain contexts.

3.3 Differences in methodologies used by accredited entities

14. Many AEs already have their own methodology for estimating incremental costs, including some quantitative methodologies. This could present a challenge for GCF to maintain consistency in incremental cost calculations across projects. However, it could present an opportunity for GCF to learn from the experience of the AEs in applying various methodologies.

15. If GCF were to try to enforce a consistent standard in all projects, some AEs may resist the change, especially in blended finance projects. In those cases, a more qualitative approach may be easier to apply and avoid discrepancies between the methodologies of the AE and GCF.

16. Developing a detailed quantitative approach to incremental costs would potentially facilitate a more rules-driven framework and ensure greater consistency of project assessments in the long run. It should, however, be experience-based and developed over time, and with a view to maintaining a focus on the overall mandate of GCF.

3.4 Options for agreed full and agreed incremental costs

17. GCF will need to develop criteria to help distinguish between project activities eligible for funding on a full cost basis instead of an incremental cost basis. However, these criteria need to be experience-based and developed over time, as the theoretical background is less developed than that of incremental costs. In the short term, such decisions can be made on a case-by-case basis, taking into account the objectives of the project, the GCF investment criteria and the qualitative or quantitative description of the baseline scenario provided by the AE.

IV. Linkages to other ongoing policy initiatives

18. The final approach to incremental cost calculation and full cost determination should consider and inform prior policy decisions and ongoing initiatives under the integrated policy approach (GCF/B.20/19), including, but not limited to, concessionality, co-financing and investment criteria indicators. It should also be developed in coordination with the mapping of elements related to project or programme eligibility and selection criteria discussed in document GCF/B.20/Inf.13.

19. The areas proposed to be supported under full cost should not be the same as those under the GCF Readiness and Preparatory Support Programme, where activities deemed eligible include: enabling the national designated authority or focal point to engage with stakeholders, including fostering private sector engagement; developing strategic frameworks; enabling and supporting national institutions; and supporting the development of initial pipelines of programme and project proposals.

20. Any application of incremental cost methodologies or full cost criteria should be tailored to fit within the existing programme framework objectives of specific initiatives for direct access entities, such as enhanced direct access and the simplified approval process, so as not to undermine their effectiveness.

V. Approach

21. The Secretariat proposes a phased approach to learn from experience in applying full cost and incremental cost principles. The approach consists of a first phase focusing on learning and capacity-building for GCF stakeholders. Subsequent phases will include a review and evaluation of the incremental and full cost methodologies.

22. Because of the interlinkages among principles and policies, the Secretariat recommends that a policy be developed according to the approach contained in annex II consistent with the principles in this paper and the related policies, including on concessionality and co-financing.

Part 2: Options for further guidance on concessionality

I. Background

1. The Governing Instrument for the GCF, paragraph 54, states “The Fund will provide financing in the form of grants and concessional lending, and through other modalities, instruments or facilities as may be approved by the Board.”
2. The initial investment framework adopted by the Board at its seventh meeting under decision B.07/06 states:

“The Fund will provide the minimum concessional funding (i.e. a grant-equivalent subsidy element) necessary to make a project or programme viable. Concessional funding is understood as funding with below-market terms and conditions. Consistent with the Governing Instrument, the minimum amount of concessional funding needed can be up to and including the full cost of the project or programme.”
3. At its ninth meeting, the Board by decision B.09/04 adopted the financial terms and conditions for the financial instruments of GCF, which described the concessional financial instruments available to the public and private sectors.
4. At its seventeenth meeting, the Board in decision B.17/10, paragraph (c), requested the Secretariat to develop a proposal for its consideration at its nineteenth meeting, taking into account best practices from other multilateral funds and other approaches, to address, among other issues, “options for further guidance on concessionality, building on related work”. In decision B.17/06, the Board instructed the Secretariat to ensure that the financial terms and conditions proposed in concept notes and funding proposals for concessional loan products meet the principle of minimum amount of concessionality, among others, and apply the financial terms and conditions set out in decision B.09/04 (annex II to document GCF/B.09/23) in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein.
5. At its nineteenth meeting, the Board considered document GCF/B.19/12/Rev01, titled “Concessionality: potential approaches for further guidance”. In decision B.19/06, paragraph (d), the Board requested the Secretariat to develop an integrated approach to resolve interrelated policy matters for consideration at its twentieth meeting, including “policies on the review of the financial terms and conditions of GCF instruments and concessionality, incremental costs, full costs, and co-financing”.
6. The purpose of this paper is to outline guiding principles and propose an approach to developing a policy on concessionality that is consistent with the financial terms and conditions of GCF and with the GCF investment criteria for public and private sector operations.
7. A description of a recommended policy on concessionality is provided in annex III with the understanding that such a policy will be implemented over time to learn from experiences.

II. Definition

8. In decision B.07/06, the Board defined concessional funding as funding with below-market terms and conditions. Similarly, the International Monetary Fund (IMF) defines concessional lending as “loans that are extended on terms substantially more generous than market loans. The concessionality is achieved either through interest rates below those

available on the market or by grace periods, or a combination of these. Concessional loans typically have long grace periods.”³

9. Concessionalism can also be defined as a measure of the level of benefit provided to a borrower when compared with financing available at full market rates. Concessionalism aims at lowering the cost of borrowing or minimizing the risk in a transaction for the borrower.

10. GCF offers concessionalism in order to facilitate a high-impact climate response initiative that would otherwise not take place. In many countries, a paradigm shift towards low-emission and climate-resilient development pathways cannot be achieved through existing market mechanisms. Although reducing greenhouse gas emissions and increasing climate resilience have economic benefits for the public, these benefits are often underpriced in public and private investment decisions, leading to suboptimal outcomes. To circumvent these market failures, GCF provides concessional financing to align the financial incentives with the economic benefits, leading to low-emission and climate-resilient investments.

11. The level of concessionalism provided by GCF will be the minimum amount necessary to make a proposal viable, as assessed on a case-by-case basis, and help achieve the climate impact and paradigm shift objectives of GCF, as stated in the investment criteria: “demonstration that the proposed financial structure provides the least concessionalism needed to make the proposal viable”.

12. Concessionalism can be extended to interventions of both the public and the private sector, in several ways:

- (a) As a non-reimbursable grant, that is, 100 per cent concessionalism;
- (b) As minimum concessionalism, typically to revenue (cash) generating private sector clients or established sub-sovereign clients with revenue generating operations (e.g. utilities); terms can vary and can include below-market rates, as well as longer tenors and grace periods;
- (c) In debt funding proposals, a concessional loan can have different seniorities (senior, *pari passu*, subordinated) and may have a heavily discounted loan with generally longer tenors and grace periods before first repayment, as well as facilitation of more flexible terms; and
- (d) In equity, concessionalism can be extended as first loss shares in junior positions in tiered funds or can be the “anchor” portion of the fund that de-risks the investment and thus catalyses further equity participation, with preferred equity returns for the private sector to move the flow of financing to climate finance sectors.

III. Guiding principles

13. As outlined in the guiding principles and factors for determining terms of financial instruments (annex III to decision B.05/07), GCF will seek the right level of concessionalism, so as not to displace investments that would otherwise have occurred, including for private sector investment, and will avoid crowding out commercial financing.

14. The below-mentioned guiding principles are also guided by the research and conclusions of the consultants’ assignment on the “Review of financial terms and conditions of the GCF’s financial instrument”.

³ IMF. 2003. *External Debt Statistics: Guide for Compilers and Users*. Appendix III, Glossary. Washington DC.: IMF. Available at <<https://www.imf.org/en/Publications/Manuals-Guides/Issues/2016/12/30/External-Debt-Statistics-Guide-for-Compilers-and-Users-15621>>.

15. GCF will base the degree of concessionality on the nature of each funding proposal as a function of three key variables: the proposal's strengths in delivering climate impact, paradigm shift potential and potential for reflows, as assessed through the rating given on the basis of the investment framework of the GCF. The case for greater concessionality is clear in proposals that are assessed to have greater climate impact and paradigm shift potential.

16. For projects with potential for financial reflows, the level of concessionality should be lower, all else being equal, because the gap between economic benefits and financial incentives is smaller. Based on these three considerations, the following **primary principles** are recommended for concessionality:

- (a) Concessionality for **private sector projects** will be determined on a case-by-case basis according to the needs of the project and the above-mentioned variables;
- (b) Concessionality for **public sector projects with reflows** will be determined according to the needs of the project and the above-mentioned three key variables within the boundaries imposed by the financial terms and conditions of GCF. The terms and conditions are to be updated regularly, and future revisions could consider greater flexibility, similar to the private sector approach, in line with the principles outlined in this paper; and
- (c) Concessionality for **public sector projects with no reflows** will be determined by the current financial terms and conditions.

17. **Secondary principles** for private sector (primarily) operations and public sector funding proposals with reflows:

- (a) Extend the minimum level of concessionality needed for the project or programme to take place, thus avoiding any market disruptions by **crowding out** private sector investors in the climate space;
- (b) Ensure that GCF intervention is mostly a catalyst for further co-financing, **crowding in** investors; this is the case of acting as "anchor" capital in equity structures or in risk mitigation;
- (c) Ensure the **sustainability of the intervention beyond first concessionality**, whichever the financing instrument used. This includes dedicated capacity-building and knowledge transfer in full concessionality instruments; or ensure 'graduation' or movement towards partial or full commercial viability, in the case of concessional loans;
- (d) Structure the concessional product in such a way that it dedicates GCF resources to mitigation and adaptation measures that **address the root cause of market failures** and work towards the removal of barriers to pro-climate investments, thereby bringing market transformation towards low-emission and climate resiliency; and
- (e) Ensure that the GCF concessional tranche is central to **upholding higher standards** in the development of funding proposals throughout the entire cycle, for example by including key consideration as defined in the investment criteria of GCF.

18. **Guidelines for implementation:** consistent with the GCF mandate and recognised principles in blended finance, the choice of financial instrument to be used and the pricing applied are based on the following assessments:

- (a) The existence and availability of other climate finance products and the elements or areas they address;
- (b) Whether the project would occur without concessional resources, thus ensuring GCF additionality;

- (c) Evidence (e.g. market studies; technical, risk or financial assessments) to inform decisions on the size and type of concessionality alongside the objective of that concessionality, that is, to remove barriers related to affordability;
- (d) A financial analysis that estimates whether a project generates sufficient reflows to be sustainable;
- (e) The capacity of the borrower to repay; and
- (f) An economic analysis that estimates both the financial and non-financial benefits of the project (e.g. reduced greenhouse gas emissions), especially for projects without reflows.

IV. Linkages to other ongoing policy initiatives

19. This paper is part of a series of operational policies presented to the Board at its twentieth meeting. The policy overview and interlinkages between the papers are presented in document GCF/B.20/18 titled “An integrated approach to addressing policy gaps to ensure climate impact: an overview of policies related to the consideration of funding proposals”.

20. The estimation of agreed full costs and agreed incremental costs due to climate change is relevant for the concessionality policy, as it helps determine which costs are eligible for GCF concessional financing. This is consistent with paragraph 54 of the Governing Instrument, which states “Financing will be tailored to cover the identifiable additional costs of the investment necessary to make the project viable.”

21. The concessionality policy is linked to the co-financing policy, because GCF concessional financing may be blended or applied in parallel with concessional or market-rate financing from other parties, affecting the overall concessionality and financial viability of the project. Changes to the way co-financing is defined, monitored and reported could have an impact on the need for GCF concessional financing.

22. The principles used to determine levels of concessionality have a direct impact on the financial terms and conditions of the GCF financial instruments, as they are the tools by which these principles will be made operational. The review of financial terms and conditions as presented in document GCF/B.20/Inf.12 produced several recommendations that have yet to be addressed and could be further considered as part of this approach.

23. Any concessionality policy should be tailored to fit within the programme framework of specific initiatives for direct access entities, such as enhanced direct access and the simplified approval process, so as not to undermine their effectiveness.

V. Approach

24. The Secretariat proposes a phased approach in the implementation of the policy on concessionality. The first phase of the approach will focus on learning and capacity-building for GCF stakeholders and the subsequent phases include a review and evaluation.

25. The Secretariat intends to report on its experience with assessing projects following the report on progress of implementation according to concessionality principles as part of the periodic review of financial terms and conditions of GCF.

26. Because of the interlinkages among principles and policies, the Secretariat recommends that the policy on concessionality be adopted as contained in annex III consistent with the related policies in this paper through a phased learning approach.

Part 3: Policy on co-financing

I. Background

1. At its seventeenth meeting, the Board requested the Secretariat, under the guidance of the Co-Chairs, to develop a proposal for the Board's consideration at its nineteenth meeting, taking into account best practices from other multilateral funds and other approaches, to address some issues including a policy on co-financing (decision B.17/10, paragraph (c)).
2. Following this, in decision B.19/06, paragraph (d), the Board requested the Secretariat to develop an integrated approach to resolve interrelated issues for its consideration at its twentieth meeting, including "policies on the review of the financial terms and conditions of GCF instruments and concessionality, incremental costs, full costs, and co-financing".
3. The policy on co-financing also fits into the operational framework on complementarity and coherence (decision B.17/04), wherein co-financing is emphasized at Board-level discussions on fund-to-fund arrangements to maximize impact and at the activity level for greater complementarity with main multilateral funds in the climate finance architecture.
4. GCF currently requires accredited entities (AEs) in their funding proposals to report on "Co-financing, leveraging and mobilized long-term investments" (E.6.2) and "Expected volume of finance to be leveraged by the proposed project/programmes and because of the Fund's financing, disaggregated by public and private sources" (E.6.5). The responses to these requests currently form the ex-ante estimation of co-finance and leveraged finance.
5. As part of the criterion "Efficiency and effectiveness" in the GCF investment framework, the following indicative assessment factors are included: (i) expected volume of finance to be leveraged by the proposed project/programmes, disaggregated by public and private sources; (ii) co-financing ratio; and (iii) potential to catalyse private and public sector investment, assessed in the context of performance on performance industry best practices.
6. However, the lack of a clear definition of what constitutes co-finance or leveraged finance can lead to inconsistencies across funding proposals. This paper provides clarity in definitions and presents guiding principles to calculate, track and report co-finance, thereby providing clarity to both countries and AEs as they prepare funding proposals.
7. A description of a recommended policy on co-financing is provided in annex IV with the understanding that such a policy will be implemented over time to learn from experiences.

II. Definitions

8. As relevant terms have not formally been defined by the United Nations Framework Convention on Climate Change, GCF proposes the following main definitions that take into account the specifics of the work and mandate of GCF:
 - (a) **Co-finance** (also referred to as **additional finance, primary co-finance, or direct co-finance**) includes all financial resources – which can be private or public – from third parties that flow directly into the project/programme alongside the financing provided by GCF. There is a causal link between GCF resources and third party's resources;
 - (b) **Indirect co-finance** (also referred to as **secondary co-finance, or second/third tier finance**) includes all financial resources – which can be private or public – by third parties that indirectly flow downstream into projects/programmes supported by GCF. A causal link needs to be proven between GCF resources and third party's resources, meaning that the GCF acts as a catalyst for this secondary co-finance;

- (c) **Leveraged finance** (sometimes also referred to as **mobilized finance** or **catalysed finance**) is all financial resources from third parties that flow into the intervention that can reasonably be assumed to have been the result of financing provided by GCF. Leveraged finance equals direct co-finance plus indirect co-finance. Leveraged finance requires a causal role between GCF and third-party financiers. In other words, the additional financial resources would not have been applied in the absence of GCF participation. Ideally, this causal role needs to be proven, but may also be assumed because of the pivotal role of GCF, such as the role of anchor investor, financier of the riskiest tranche or provider of guarantees. These resources can be public or private. In the case of an equal partnership in catalysing additional financing (e.g. by another anchor investor alongside GCF or an investor with the same financing terms), the amount will be calculated on a volume-basis and pro-rated;
- (d) **Public finance** is all financial resources other than the GCF resources that flow into projects/programmes from the public sector or entities that are more than 50 per cent owned by the public sector;
- (e) **Private finance** is all financial resources that flow into projects/programmes from entities that are more than 50 per cent owned by private shareholders; and
- (f) **Parallel finance** defines the resources that are flowing alongside GCF resources to a project, but that are earmarked for other outcomes, which may be consistent with general mitigation and adaptation solutions but are not part of the GCF funding proposals, and as such are not tracked as GCF impacts.

III. Guiding principles

9. The following general principles should guide the application and determination of an appropriate level of co-financing to funding proposals submitted for GCF consideration and approval:

- (a) **Project proposals should seek to incorporate appropriate levels of co-financing to maximize the impact of GCF resources.** The level of co-finance should be at the maximum level appropriate based on each project's individual characteristics;
- (b) **While maximizing co-financing is desirable, GCF should avoid using co-financing metrics as stand-alone targets.** Doing so may be counterproductive, as it may disincentivize financing funding proposals with strong climate rationale and high paradigm shift potential, but inherently low prospects for co-financing. Rather, co-financing should be considered as one appraisal item among many in the investment framework;
- (c) **Where GCF funding is covering the incremental costs of a project, the non-climate related costs should be provided by co-financing.** In the case where a project is only eligible to the agreed incremental costs, the co-financing should complement GCF resources and be proportionate and adequate to at least cover the non-climate related components of the project. The approach for determining incremental costs and full costs is proposed in the previous section; and
- (d) GCF should ascertain that **financial resources of third parties that are tracked by GCF as co-finance or leveraged finance are consistent with the objectives of GCF;** and

- (e) **The methodology should be based on the basic financial instruments of GCF.** These instruments consist of grants, (concessional) loans, guarantees and equity investments. A step-by-step illustration of this methodology is included in annex IV. The methodology is not applicable to policy interventions (e.g. capacity-building support on regulatory issues).

IV. Linkages to other ongoing policy initiatives

10. This paper is part of a series of operational policies presented to the Board at its twentieth meeting. The policy overview and interlinkages between the papers are presented within the document GCF/B.20/18 titled “An integrated approach to addressing policy gaps to ensure climate impact: an overview of policies related to the consideration of funding proposals”.
11. The estimation of agreed full costs and agreed incremental costs due to climate change is relevant for the co-financing policy, as it helps determine which costs are eligible for GCF financing and which ones should be covered through co-financing by GCF partners.
12. The concessionality policy is linked to the co-financing policy, because GCF concessional financing may be blended or applied in parallel with concessional or market-rate financing from other parties, affecting the overall concessionality and financial viability of the project. Changes to the way co-financing is defined, monitored and reported could have an impact on the need for GCF concessional financing.
13. Any co-financing policy should be tailored to fit within the programme framework of specific initiatives for direct access entities, such as enhanced direct access and the simplified approval process, so as not to undermine their effectiveness.

V. Approach

14. The Secretariat proposes that the implementation of the policy on co-financing be aligned to the approach for incremental cost and full cost methodologies, which is based on a gradual learning process to accommodate the needs of GCF stakeholders, including national designated authorities and AEs. The approach also includes a review and evaluation of the policy after an agreed interval.
15. The Secretariat recommends that the Board adopt the proposed policy provided in annex IV, to be implemented through a phased approach consistent with related policies including on concessionality and on incremental and full cost calculation methodologies.

Annex I: Draft decision of the Board

The Board, having noted document GCF/B.20/19 titled “Interrelated policy matters on incremental cost and full cost, concessionality, and co-financing”,

- (a) Notes the linkages between incremental cost and full cost, concessionality, and co-financing;
- (b) Adopts the following methodologies and policies:
 - (i) The methodologies for incremental cost and full cost calculations set out in annex II;
 - (ii) Policy on concessionality based on the principles and definitions set out in annex III; and
 - (iii) Policy on co-financing based on the principles and definitions set out in annex IV;
- (c) Notes that the above-mentioned methodologies and policies are to be implemented through a phased approach to enable GCF to implement changes gradually, learn from experience and improve the methodologies and policies as necessary;
- (d) Requests the Secretariat to update the templates for concept notes and funding proposals to reflect the policies and other matters related to the integrated approach to address policy gaps adopted at the twentieth meeting of the Board, with a view to making these available by the twenty-first meeting of the Board;
- (e) Also requests the Secretariat to design and implement a capacity-building programme, as part of the readiness and preparatory support programme, to support accredited entities, particularly direct access accredited entities, to enable them to implement the incremental cost and full cost methodologies, the policy on concessionality and the policy on co-financing;
- (f) Recommends that the Secretariat review the methodologies for incremental cost and full cost calculations, the policy on concessionality and the policy on co-financing one year after implementation;
- (g) Decides to conduct an evaluation of the implementation of the methodologies for incremental cost and full cost calculations, the policy on concessionality and the policy on co-financing three years after implementation; and
- (h) Notes that the methodologies and policies referred to in paragraph (b) shall not apply to funding proposals which are in Stage 4 to Stage 7 of the project/programme activity cycle on the date on which the modified funding proposal template referred to in paragraph (d) above is made available.

Annex II: Methodologies for incremental and full cost calculations

1. Objectives

1. The purpose of this paper is to outline guiding principles and present an approach to developing methodologies for incremental cost and full cost calculations that seek to achieve the following objectives:

- (a) Further facilitating the application of the GCF investment framework, particularly with respect to the effectiveness and efficiency criterion to ensure that GCF funding targets the full costs or incremental costs of climate-related activities as appropriate to the project;
- (b) Facilitating Secretariat and independent Technical Advisory Panel review and Board decision-making by providing a detailed assessment of the components of a proposed project that are directly related to climate change adaptation and mitigation as opposed to other co-benefits such as economic development; and
- (c) Guiding national designated authorities (NDAs)/focal points and accredited entities (AEs) in articulating climate change considerations in funding proposals.

2. Based on the review of approaches taken by other funds and the GCF objective of promoting the paradigm shift towards low-emission and climate-resilient development pathways using a broad set of climate change adaptation and mitigation projects, the Secretariat will implement a phased approach to incremental and full costs, enabling GCF to make changes gradually, learn from experience and improve the methodologies as necessary.

3. This process will require coordination with related policies on concessionality and co-financing, among others. It will also require the Secretariat to elaborate tools for assessing projects according to the principles adopted by the Board and a robust programme of capacity-building among AEs and NDAs where necessary.

2. Guiding principles

4. Based on a review of practices of other funds, GCF will develop methodologies based on the following principles:

- (a) **Incrementality is a key tool to assess climate rationale.** The use of incremental costs and the need to compare the proposed intervention with a baseline case may provide a clear and transparent framework to more directly link the proposed activities with climate change;
- (b) **Quantitative approaches should be applied to mitigation activities when sufficient data are available.** Both the Multilateral Fund and the clean development mechanism have developed approaches to define the baseline and counterfactual case and use them to quantify the incremental costs of the supported interventions in the case of mitigation activities;
- (c) **Qualitative approaches connected to a strong project logic may be used for adaptation activities or activities lacking sufficient data for a quantitative approach.** None of the funds has done comparable quantitative work in the area of adaptation. Instead, the work of GEF, including its adaptation work through the Least Developed Countries Fund and the Special Climate Change Fund, has used a qualitative approach whereby an incremental reasoning is applied in the process of project design to ensure that GEF funding is focused on the incremental activities necessary to generate

global benefits. In the adaptation context, a qualitative determination of incremental cost can be incorporated into the project logic or theory of change. However, it is likely to be less precise, as it would involve agreement on the degree to which the adaptation intervention is needed as a result of climate change; and

- (d) **Funding for full costs may be justified under certain circumstances.** The Multilateral Fund, GEF, the Adaptation Fund and CIFs provide full (not only incremental) support for a host of supporting activities, including capacity-building, barrier-removing activities and pilot projects designed to demonstrate new technologies.

3. First phase

5. The first phase will last one year and focus on learning. The Secretariat will request AEs to explain which project activities are being proposed based on incremental cost reasoning and which are based on full cost reasoning. When explaining the choice of incremental or full cost, each entity should use the method it believes best demonstrates full cost and incremental cost. For some proposals, especially mitigation projects, this might be a full quantitative estimate of the costs of the proposed project compared with the costs of a baseline alternative project. For other proposals, particularly adaptation projects, this might be a narrative description of the proposed project's logic framework that links each investment to climate change and describes the baseline project that would prevail in the absence of climate change considerations. This approach will enable GCF to learn about the methods used by various AEs, the quantity and quality of information available to NDAs and AEs to make these assessments and the general capacity among AEs to do so.

6. As GCF can fund "agreed full and agreed incremental costs", achieving such agreement requires AEs to include in each funding proposal the following aspects because it is essential to differentiate between the full and the incremental costs:

- (a) **A comparison between the proposed project as well as a description of the baseline project, clearly identifying those project components and associated costs that are directly related to climate change.** The comparison of the baseline and the project proposal should clearly identify accruing savings, separately;¹
- (b) **An explanation of how the proposed incremental investments will achieve mitigation or adaptation results or reduce barriers to climate change-related activities; and**
- (c) **An estimate of the fraction of the costs of each of the components of the funding proposal that are related to those incremental investments.** For proposals where data are available, this would imply both a detailed costing of the baseline scenario and a detailed estimate of the incremental costs. For other proposals, this would imply a more qualitative description and estimate of the degree to which the proposed intervention is necessary as a result of climate change versus historically observed conditions.

7. As part of this phase, the Secretariat will undertake parallel activities to discuss incremental and full cost principles with AEs, learn about their challenges in applying the principles outlined in this approach, and build capacity among them. These activities will be

¹ Theoretically, all the benefits arising from the baseline project would be part of the full set of co-benefits from the project. The incremental investment would add other co-benefits or could in fact decrease them (e.g. increasing the resilience to climate change of a road may lead to new design characteristics with higher environmental and social impact risks).

conducted through the Readiness and Preparatory Support Programme, regional structured dialogues and strategic partnerships.

8. To supplement this learning process, the Secretariat will also undertake a detailed internal review of incremental cost reasoning in the existing GCF portfolio to document the approaches used.

4. Subsequent phases

9. One year after the adoption of this approach, the Secretariat will review the experience with applying incremental and full cost principles and report to the Board with lessons learned and recommended improvements to the methodology. The report will assess the various methods used by AEs to estimate incremental and full costs and identify tools or techniques that can be used to improve and standardize the estimates. It also will examine any gaps in data or capacity to apply the methodology and propose a strategy for closing these gaps.

10. The assessment and improvement of the methodology could become an iterative process and repeated at regular intervals as directed by the Board. At an agreed interval, an independent evaluation of the methodologies can be undertaken.

5. Next steps necessary for implementation

11. Implementation of this approach would require the Secretariat to adjust the existing concept note and funding proposal templates to enable them to distinguish between incremental costs and full costs. Owing to the multiple integrated and interrelated policies that are currently under consideration, it is proposed that all modifications to the template occur simultaneously. The twenty-first meeting of the Board would be the earliest this could happen, in which case these changes would appear in funding proposals considered by the Board at its twenty-second meeting.

12. In addition to changes in the templates, the Secretariat, as part of its support to NDAs/focal points and dialogue with AEs, would prepare a technical note and carry out a series of training sessions to ensure that proposals are consistent with the new principles discussed above. At the same time, the Secretariat should initiate discussions with the AEs with a view to evaluating different proposals for the standardization of methodologies and the development of an indicative list of agreed incremental costs.

Annex III: Policy on concessionality

1. Objectives

1. The purpose of this paper is to define principles that underpin a policy on concessionality for GCF funding proposals that seeks to achieve the following objectives:
 - (a) To provide guidance to ensure consistency in the application of principles underpinning concessionality and the selection of the GCF financial instruments. This guidance can facilitate the work of national designated authorities (NDAs) and accredited entities (AEs) in developing funding proposals by having a clearer blue-print on the criteria to be used in linking the GCF financial instruments and their terms and conditions to specific activities in funding proposals;
 - (b) To facilitate the assessment of funding proposals with respect to principles and performance parameters previously agreed by the Board, such as maximizing leverage of GCF funding and avoiding crowding out private sector investments; and
 - (c) More generally, to facilitate the work of the Secretariat and the independent Technical Advisory Panel in assessing funding proposals, particularly with respect to the efficiency and effectiveness investment criterion, which underpins the review of the level of concessionality requested in funding proposals.
2. This process will require coordination with related policies on incremental cost, co-financing and financial terms and conditions, among others. It will also require the Secretariat to elaborate tools for assessing projects according to the principles adopted by the Board and a robust programme of capacity-building among AEs and NDAs where necessary. As such, the policy is to be developed through a phased approach, enabling GCF to implement the changes gradually, learn from experience and improve the policy as necessary.

2. Guiding principles

3. As outlined in the guiding principles and factors for determining terms of financial instruments (annex III to decision B.05/07), GCF will seek the right level of concessionality, so as not to displace investments that would otherwise have occurred, including for private sector investment, and will avoid crowding out commercial financing.
4. GCF will base the degree of concessionality on the nature of each funding proposal, as a function of three key variables: the proposal's strengths in delivering climate impact, paradigm shift potential and potential for reflows. The case for greater concessionality is clear in proposals that are assessed to have greater climate impact and paradigm shift potential. For projects with the potential for financial reflows, the level of concessionality should be lower, all else being equal, because the gap between economic benefits and financial incentives is smaller.
5. Based on these three considerations, the **primary principles** for concessionality are:
 - (a) Concessionality for **private sector projects** will be determined on a **case-by-case basis** according to the needs of the project and the above-mentioned three key variables (i.e. the proposal's strengths in delivering climate impact, paradigm shift potential and potential for reflows, as assessed through the rating given on the basis of the investment framework of the GCF);
 - (b) Concessionality for **public sector projects with reflows** will be determined according to the needs of the project and the above-mentioned three key variables within the boundaries imposed by the financial terms and conditions of GCF. The terms and

conditions are to be updated regularly, and future revisions could consider greater flexibility, similar to the private sector approach, in line with the principles outlined in this paper; and

- (c) Concessionality for **public sector projects with no reflows** will be determined by the current financial terms and conditions.
6. **Secondary principles** for private sector (primarily) operations and public sector funding proposals with reflows:
- (a) Extend the minimum level of concessionality needed for the project or programme to take place, thus avoiding any market disruptions by **crowding out** private sector investors in the climate space, or by creating unjustified subsidies;
- (b) Ensure that GCF intervention is mostly a catalyst for further co-financing, thus **crowding in** investors; this is the case of acting as ‘anchor’ capital in equity structures or in risk mitigation;
- (c) Ensure the **sustainability of the intervention beyond first concessionality**, whichever the financing instrument used. This includes dedicated capacity-building and knowledge transfer in full concessionality instruments; or ensure “graduation” or movement towards partial or full commercial viability, in the case of concessional loans;
- (d) Structure the concessional product in such a way that it dedicates GCF resources to mitigation and adaptation measures that **address the root cause of market failures** and work towards the removal of barriers to pro-climate investments, thereby bringing market transformation towards low-emission and climate resiliency; and
- (e) Ensure that the GCF concessional tranche is central to **upholding higher standards** in the development of funding proposals throughout the entire cycle, for example by including key considerations as defined in the investment criteria of GCF.
7. **Guidelines for implementation:** consistent with the GCF mandate and recognized principles in blended finance, the choice of financial instrument to be used and the pricing applied are based on the following assessments:
- (a) Existence and availability of other climate finance products and what they address;
- (b) Whether the project would occur without concessional resources, thus ensuring GCF additionality;
- (c) Evidence (e.g. market studies; technical, risk or financial assessments) to inform decisions on the size and type of concessionality alongside the objective of that concessionality, that is, to remove barriers related to affordability;
- (d) A financial analysis that estimates whether a project generates sufficient reflows to be sustainable;
- (e) The capacity of the borrower to repay; and
- (f) An economic analysis that estimates both the financial and non-financial benefits of the project (e.g. reduced greenhouse gas emissions), especially for projects without reflows.

3. First phase

8. The first phase will focus on learning and capacity-building that will support the implementation of the policy on concessionality. For background information, the Secretariat will review a sample of projects from the approved portfolio and the information used to assess concessionality in each one, including economic and financial analyses and other materials

submitted by AEs. The review will analyse how well these projects adhere to the primary, secondary and tertiary principles described in section 2 of annex III, with a view to assessing the practicality of the principles in the GCF context.

9. During this phase, the Secretariat will seek to apply the principles to funding proposals. The primary focus of this application will be to uncover any issues or challenges in applying concessionality principles in the GCF context. GCF will continue to rely on the minimum standards of the AEs in assessing concessionality for funding decisions. As part of this learning process, the Secretariat will document any problems that arise from interlinked issues of concessionality, incremental cost, co-financing and financial terms and conditions.

10. The Secretariat will undertake parallel activities to discuss these concessionality principles with AEs, and learn about their challenges in assessing the need for concessionality. The Secretariat will survey the tools and methods used by AEs, including the applicable standards for economic analysis and financial analysis. GCF will review the relevant academic literature. As needed, the Secretariat will engage in activities to build capacity among AEs to conduct these assessments. These activities will be conducted through the Readiness and Preparatory Support Programme, regional structured dialogues and strategic partnerships.

11. Based on this information, the Secretariat will develop internal tools to help assess the need for concessionality, including technical guidelines for economic analysis and financial analyses.

4. Subsequent phases

12. One year after adoption of this policy the Secretariat will report to the Board on its experience of the first phase in assessing concessionality and applying the principles. The report will include lessons learned and recommended policy improvements. It also will examine any gaps in data or capacity to apply the methodology and propose a strategy for closing these gaps. Special attention will be given to the linkages between concessionality and other policy issues, such as incremental cost, full cost and co-financing. The results of this review will be aligned to the next review of the financial terms and conditions of GCF.

13. The assessment and improvement of the concessionality policy could become an iterative process repeated at regular intervals in coordination with reviews of the financial terms and conditions of GCF as directed by the Board. At an agreed interval, an independent evaluation of the policy can be undertaken.

5. Next steps necessary for implementation

14. The implementation of this approach would require the Secretariat to adjust the existing concept note and funding proposal templates to signal to AEs which information is needed to undertake the assessments described above. Owing to the multiple integrated and interrelated policies that are currently under consideration, it is proposed that all modifications to the template occur simultaneously. The twenty-first meeting of the Board would be the earliest this could happen, in which case these changes would appear in funding proposals considered by the Board at its twenty-second meeting.

15. In addition to changes in the templates, the Secretariat, as part of its support to NDAs/focal points and dialogue with AEs, would prepare a technical note and carry out a series of training sessions to ensure that proposals are consistent with the new principles discussed above.

Annex IV: Policy on co-financing

1. Objectives

1. The primary objective of this policy is to present the general principles and approaches for determining co-financing (direct, primary) applicable to all GCF-funded activities, as well as approaches to monitor, track and evaluate the mobilization of additional resources (i.e. direct and indirect leveraged finance) to maximize the impact of GCF interventions in developing countries. All co-finance and leveraged finance refers to finance.
2. It also provides clarity by defining key terms so that comparisons can be made and reporting can be consistent across all types of projects. The policy also proposes key guiding principles that can support the co-financing and leverage finance in the specific context of the mandate of GCF. The Secretariat will support focal points, national designated authorities (NDAs), accredited entities (AEs) and all relevant stakeholders in adopting this approach.
3. The Secretariat will implement the current policy and will ensure that the following actions are carried out:
 - (a) Review all funding proposals for consistency with the requirements of this policy and other interrelated policies;
 - (b) Provide the relevant documentation to support stakeholders in the calculations and reporting of co-finance and leveraged finance;
 - (c) Maintain a funding proposal database or registry to record all co-financing data during all the stages of the GCF project cycle;
 - (d) Engage in discussions with recipient countries and AEs in opportunities to improve the level of co-financing in the project and report annually on the efforts undertaken as well as challenges faced by partners; and
 - (e) Monitor, evaluate and report to the Board, including on the progress achieved in improving the levels of co-financing over time both at the project and the portfolio level.
4. In the implementation of this policy, the Secretariat will avoid imposing a minimum threshold and/or specific co-financing sources as part of the individual project or funding proposal assessment process, cognizant that co-financing may not always be achievable or relevant.
5. For reporting purposes at the portfolio level, where possible, the policy will be applied retroactively. This is to ensure consistency in definitions, their application and data generation across the GCF portfolio.

2. Applicability

6. Co-financing is encouraged for all GCF funding proposals as a means to maximize the opportunity for strategic partnerships towards achievement of the highest possible impact and ambition in accordance with the GCF mandate and the Paris Agreement.

7. The co-financing policy is applicable to all funding proposals. Its application should be consistent with other related policies as part of the integrated policy approach for approval of GCF funding proposals.
8. Co-financing is desirable for all GCF funding channels, including the Readiness and Preparatory Support Programme and the Project Preparation Facility.

3. Guiding principles

9. The general principles that GCF stakeholders should abide by in determining the appropriate level of co-financing to funding proposals are as follows:
 - (a) **Project proposals should seek to incorporate appropriate levels of co-financing to maximize the impact of GCF resources.** Co-financing plays a critical role in ensuring country ownership by supporting more effectively the translation of national priorities into action. It also supports greater climate impact, including through knowledge transfer and the consideration of best practices in climate finance. Co-finance maximizes the opportunities for partnerships by bringing more resources alongside GCF financing. Potential sources of co-financing to be encouraged by the GCF include additional resources from national governments, AEs, other partners' agencies and private sector actors. However, establishing the right level of co-finance is dependent on project characteristics and determined on a case-by-case basis;
 - (b) **While maximizing co-financing is desirable, GCF should avoid using co-financing metrics as stand-alone targets.** Maximizing climate mitigation and adaptation results does not necessarily equal minimizing or optimizing spending on climate mitigation and adaptation. Co-finance and leverage ratios should therefore not become stand-alone targets. High levels of co-finance and leveraged finance may not always be achievable or relevant. Using it as a stand-alone target may be counterproductive, as doing so may disincentivize financing projects/programmes with strong climate rationale and high paradigm shift potential. Rather, co-financing should be considered as one appraisal item among many in the investment framework;
 - (c) **Where GCF funding is covering the incremental costs of a project, the non-climate related costs should be provided by co-financing.** GCF policies on incremental costs and full costs provide the guiding principles for defining funding eligibility as agreed incremental costs or agreed full costs. In the case where a project is only eligible to the "agreed incremental costs", the co-financing should complement GCF resources and be proportionate and adequate to at least cover the non-climate related components of the project;
 - (d) GCF should ascertain that **financial resources of third parties that are tracked by GCF as co-finance or leveraged finance are consistent with the objectives of GCF;** and
 - (e) **The methodology should be based on the basic financial instruments of GCF.** These instruments consist of grants, (concessional) loans, guarantees and equity investments. The methodology is not applicable to policy interventions (e.g. capacity-building support on regulatory issues).

4. Definitions

10. The following definitions should be adhered to when reporting co-financing and leveraged financing to GCF:
- (a) **Co-finance** (also referred to as **additional finance, primary co-finance, or direct co-finance**) includes all financial resources – which can be private or public – from third parties that flow directly into the project/programme alongside the financing provided by GCF. There is a causal link between GCF resources and third party's resources;
 - (b) **Indirect co-finance** (also referred to as **secondary co-finance, or second/third tier finance**) is all financial resources – which can be private or public – by third parties that indirectly flow downstream into projects/programmes supported by GCF. A causal link needs to be proven between GCF resources and third party's resources, meaning that GCF acts as a catalyst for this secondary co-finance;
 - (c) **Leveraged finance** (sometimes also referred to as **mobilized finance or catalysed finance**) is all financial resources from third parties that flow into the intervention that can reasonably be assumed to have been the result of financing provided by GCF. Leveraged finance equals direct co-finance plus indirect co-finance. Leveraged finance requires a causal role between GCF and third-party financiers. In other words, the additional financial resources would not have been applied in the absence of GCF participation. Ideally, this causal role needs to be proven, but may also be assumed because of the pivotal role of GCF, such as the role of anchor investor, financier of the riskiest tranche or provider of guarantees. These resources can be public or private. In the case of an equal partnership in catalysing additional financing (e.g. by another anchor investor alongside GCF or an investor with the same financing terms), the amount will be calculated on a volume-based pro rata calculation.;
 - (d) **Public finance** is all financial resources other than GCF resources that flow into projects/programmes from the public sector or entities that are more than 50 per cent owned by the public sector;
 - (e) **Private finance** is all financial resources that flow into projects/programmes from entities that are more than 50 per cent owned by private shareholders; and
 - (f) **Parallel finance** defines the resources that are flowing alongside GCF resources to a project, but that are earmarked for other outcomes, which may be consistent with general mitigation and adaptation solutions but are not part of the GCF funding proposals, and as such are not tracked as GCF impacts.

5. Reporting requirements

5.1. Accredited entities

11. Timing: the ex-ante estimation of co-finance and leveraged finance takes place at the start of the project or programme. The tracking of actual co-finance and leveraged finance takes place annually over the project/programme duration. Amounts will be tracked annually as well as cumulatively. At project/programme completion an assessment will be made of the extent to which the actual co-finance and leveraged finance amounts live up to estimations (expressed as a percentage of actual co-finance and leveraged finance amounts vis-à-vis estimated amounts).

12. Data source: the main source for ex ante estimation of co-finance and leveraged finance is the funding proposal submitted to GCF by the AE. The estimation should be backed up by a solid explanation and methodology, notably in cases of expected indirect co-finance downstream. The main source for tracking actual co-finance and

leveraged finance is the reported data that will be included in the annual performance reports submitted to GCF by the AEs.

13. Methodology: to determine co-finance and leveraged finance, the following steps need to be undertaken by the AE:
 - (a) Identify the GCF financing to the funding proposal;
 - (b) Identify the total financial resources from third parties that flow into the project/programme alongside the financing provided by GCF. Distinguish between public and private entities. This is the **direct co-financing** amount (also referred to as co-finance, additional or primary co-finance);
 - (c) Identify the financial resources by third parties that flow directly in the project/programme further downstream that are funded by the project/programme supported by GCF. Where available, this can be backed up by documentation, but this will primarily rely on the expert judgment of the task managers, taking into account the pivotal role of GCF (e.g. anchor investor, financier of the riskiest tranche,² or provider of guarantees). In the case of an equal partnership in catalysing additional financing (e.g. by another anchor investor alongside GCF or an investor with the same financing terms), the amount will be calculated on a volume-based pro rata calculation. This is the **indirect co-financing** amount attributable to the GCF (also referred to as secondary or second/ third tier finance);
 - (d) Add (b) and (c). This is the total additional investment or **leveraged financing** amount.
 - (e) Divide (b) by (a). This is the **co-financing ratio**;³
 - (f) Divide (d) by (a). This is the **leveraged financing ratio**.
14. The specialist or task manager from the Secretariat who is responsible for the project/programme is expected to assess the plausibility of the co-finance and leveraged finance estimates and underlying assumptions, notably in cases of expected indirect co-finance downstream.
15. During the project implementation and at project closure, GCF accredited entities will report on materialized co-financing according to source and type to the Secretariat. This will include resources secured or mobilized during project implementation that are in addition to the co-financing confirmed at the time of Board approval. All such financing will count as materialized co-financing in monitoring and evaluation documents.

5.2. Secretariat

16. GCF will provide annual reporting on co-finance and leveraged finance to the Board and the general public. The report will include:

² The risk level of different instruments from least to highest risk is: loans, concessional loans, equity, guarantees, and reimbursable grants, grants.

³ It is expressed as a ratio where 1 represents the unit provided by GCF (e.g. 1:4 or 1:6.7).

- (a) The total co-financing and leveraged financing at the GCF level, including corresponding ratios; and
- (b) The total co-financing and leveraged financing at the individual project/programme level, including corresponding ratios.

17. Reporting will take place based on the estimated amounts provided in the funding proposals. Once a project/programme is financed by GCF, the actual annually reported co-financing figures will also be reported, subject to data availability.

18. In reporting, the Secretariat will break down co-financing and leveraged financing amounts by private or public, and by type of instrument. This will further inform GCF as well as the climate finance community on the effective design of the climate policy and associated financial instruments in such a way as to mobilize further public and, in particular, private finance.

19. In reporting, the Secretariat will visualize results as much as possible to facilitate understanding. GCF will also transparently provide explanations on the methodology, assumptions and challenges encountered. This may be included in the reporting itself or through clear referrals to other GCF documents.

20. GCF methodology strikes a balance between alignment with international guidance and the main approaches by partners (AEs) and peers, as well as practical limitations and current practices to date. The GCF methodology makes reference to guidance of the OECD, MDBs, GEF, and the CIFs, as detailed in annex VII of document GCF/B.20/19 titled “Interrelated policy matters on incremental cost and full cost, concessionality, and co-financing”.

21. The Secretariat will monitor overall portfolio co-financing and leveraged financing that materialized as reported by the AE and will report to the Board on levels of co-financing and leveraged financing through the annual portfolio review or other such reports as the Board may determine.

6. Next steps necessary for implementation

22. The implementation of this policy would be aligned with the approach for incremental cost and full cost methodologies, which is based on a gradual learning process to accommodate the needs of GCF stakeholders, including NDAs and AEs.

23. Implementation of this approach would require the Secretariat to adjust the existing concept note and funding proposal templates to enable them to distinguish between the different definitions of co-financing, leveraged financing and so on. Owing to the multiple integrated and interrelated policies that are currently under consideration, it is proposed that all modifications to the template occur simultaneously. The twenty-first meeting of the Board would be the earliest this could happen, in which case these changes would appear in funding proposals considered by the Board at its twenty-second meeting.

24. In addition to changes in the templates, the Secretariat, as part of its support to NDAs/focal points and dialogue with AEs, would prepare a technical note and carry out a series of training sessions to ensure that proposals are consistent with the new principles and definitions discussed above. At the same time, the Secretariat should initiate discussions with the AEs with a view to evaluating different proposals.

25. The assessment and improvement of the policy could become an iterative process and repeated at regular intervals as directed by the Board. At an agreed interval, an independent evaluation of the policy could be undertaken.

Annex V: Illustrative examples of how incremental cost might be considered in the context of a small subset of hypothetical GCF project types

Case 1 project proposal: construction of a greenfield solar energy plant and transmission and distribution infrastructure to serve an area currently without electrification. Counterfactual in the absence of GCF support: expansion of the generation capacity of an existing coal plant in the adjacent region and construction of transmission and distribution infrastructure. The net incremental costs of a related GCF project would be the difference in capital investments and operating costs between the solar plant and the counterfactual. In such a case, including operating costs could take into account and net out the expected savings generated by the lower operating costs that the solar plant would have.

Case 2 project proposal: retrofit of existing small and medium-sized enterprises production processes for higher energy efficiency. In addition to the capital investments required, operating costs initially increase owing to the need to train personnel and calibrate new equipment. Counterfactual in the absence of GCF support: no capital investments in retrofitting and continuation of existing operating costs (i.e. business as usual). The net incremental cost of a related GCF project would be the capital investments of the proposed project plus the difference in operating costs. Such operating costs may be initially higher for the project than for the existing baseline.

Case 3 project proposal: expansion of port facilities with increased resilience to climate change using construction standards consistent with the expected intensity of weather events due to climate change. Counterfactual in the absence of GCF support: equivalent expansion (i.e. infrastructure necessary to handle a similar amount of tonnage) with resilience standards consistent with an increasing intensity of weather events. The net incremental costs of a related project could consider the additional capital investments required to build to the enhanced standards and the degree to which those standards were required as a result of climate change (versus historically observed weather). A variation of this example would be one in which the proposed project generates additional co-benefits – if, for example, as a result of the enhanced infrastructure to increase resilience the port can handle larger ships than it could otherwise, and such ships generate additional economic benefits. Those additional benefits could be subtracted when calculating the net incremental costs.

Case 4 project proposal: enhanced livelihoods and resilience of agricultural communities in semi-arid regions. Counterfactual: project generating similar improvements in livelihoods with interventions consistent with historical weather patterns and addressing the long-term path of soil degradation without considering future changes due to climate change. In this case, as well as in case 3 above, an additional element of complexity is the need to estimate and reach agreement on the degree to which the proposed intervention is needed because of climate change.

Case 5 project proposal: strengthening hydrometeorological services and development of a multi-hazard early warning system. Counterfactual in the absence of GCF support: continued operation of existing hydrometeorological systems. While an effort could be made to distinguish between programme elements that are necessary because of climate change and those that are not, the periodic nature of natural disasters means such a determination could be problematic. Given the new technology and technical capacities, it may be more appropriate to finance the project on the basis of full costs.

Case 6 project proposal: integration of climate mitigation and adaptation needs into national development plans. Such an investment facilitates new governance approaches that may be transformational, which would be appropriate for financing of full costs.

Case 7 project proposal: restoration of mangrove forests in coastal areas, which delivers protection from waves and storm surges, carbon sequestration and other ecological benefits. Most of these benefits are public goods for which no market exists. In the absence of the project, the baseline scenario would be continued deterioration of these forests and increasing costs to society. Because the costs of a baseline project would be zero, the project would be funded on the basis of both incremental and full costs.

Annex VI: Review of practices in other funds on incremental cost

1. Multilateral Fund for the Implementation of the Montreal Protocol

Mandate and role of incremental costs

1. The Multilateral Fund for the Implementation of the Montreal Protocol (Multilateral Fund) is the financial mechanism that supports developing countries in complying with their obligations under the Montreal Protocol to phase out the use of ozone-depleting substances (ODS) and reduce their use of high global warming potential hydrofluorocarbons (HFCs).

2. As agreed in the Montreal Protocol and its amendments, the Multilateral Fund provides funding to cover only the incremental costs incurred in converting from ODS to more environmentally friendly alternatives. In that regard, funding is approved for the net agreed incremental cost associated with the difference between a proponent's baseline scenario and the converted project. Costs compensated for are those included in a list of categories of agreed incremental costs incurred to convert to non-ODS/non-HFC technologies. This general rule has been refined over a period of years to consider such factors as technology upgrades and economies of scale.

Principles and use of an indicative list of categories of incremental costs¹

3. The indicative list of incremental cost categories is applied to proposals under several principles. It calls for the incremental cost to be assessed based on the most cost-effective and efficient option available to achieve the reductions. In addition, it calls for both savings and benefits to be considered when calculating incremental costs. This latter point is particularly important, as, if the benefit generated to the project's sponsor exceeds its cost, the project is not eligible for Multilateral Fund support. The indicative list covers three types of activities – those that seek to (i) facilitate the supply of ODS substitutes; (ii) eliminate the use of ODS as an intermediate good in manufacturing; and (iii) eliminate the end use of ODS. For each one of these areas, an indicative list of cost categories eligible for compensation is defined. For example, with respect to the supply of ODS substitutes, there is a list of 11 categories of incremental costs eligible for funding that includes capital investments, operational costs, training and research. In practice, it is up to the Executive Committee of the Multilateral Fund to decide how to apply the list, and to determine whether and to what extent costs not on the list should be eligible. For example, agreed costs for capacity-building are not on the indicative list – yet they have been fully supported by the Multilateral Fund.

Calculation of incremental cost and approval process

4. Over time the Multilateral Fund gained significant experience in estimating incremental costs for many of the conversions it supports. This enabled it to define a range of cost-effectiveness thresholds for incremental costs for specific types of activities based on the cost of the tonnes of ODS reduced. Additional experience also enabled the Multilateral Fund to modify those allowable costs further to take into consideration such factors as economies of scale for smaller projects and lower consuming countries. The Multilateral Fund secretariat verifies the consistency of these calculations as well as the eligibility of expenditures as per the indicative list of categories of incremental costs during the process of funding a proposal review. One final important factor related to the Multilateral Fund's focus: the Multilateral Fund generally pays for the net incremental capital and operational cost of converting an existing facility from the

¹ This discussion is based on the Multilateral Fund *Policies, Procedures, Guidelines and Criteria (as at April 2017)*.

use of an ODS or HFC towards the use of a non-ODS or non-HFC. This payment for global benefits is virtually always in the form of a grant. The Multilateral Fund does not pay, for example, for the incremental cost of expanding an existing facility to use a non-ODS or non-HFC technology or building a new greenfield plant that will use a non-ODS or non-HFC technology.

2. The Global Environment Facility

Mandate and role of incremental costs

5. The Global Environment Facility (GEF) is one of the entities of the financial mechanisms supporting five major environmental conventions, including the United Nations Framework Convention on Climate Change. The instrument for the establishment of GEF states that it provides “new and additional grant and concessional funding to meet the agreed incremental costs of measures to achieve agreed global environmental benefits”.² In this case, GEF provides resources to cover the difference in costs between a baseline project that would provide only national benefits and one that would provide global ones. The GEF website explains this concept as follows: “for example, choosing solar energy technology over coal or diesel fuel meets the same national development goal (power generation), but is more costly. GEF grants cover the difference or ‘increment’ between a less costly, more polluting option and a costlier, more environmentally friendly option.”³

Use of incremental cost

6. In 2006, the GEF Evaluation Office conducted a review of the application of incremental cost assessments in the project approval process and found that while the incremental cost concept underpinned the design of GEF projects, there was substantial confusion among stakeholders regarding interpretation of this concept. In particular, there was no consensus as to whether incremental costs were meant to be a specific quantitative measure or a more qualitative form of reasoning used during project design to separate the “incremental” aspects of the project seeking to provide global benefits. As a result of this review, a new set of guidelines on incremental costs, currently in use, was approved by the GEF Council in 2007. These guidelines focus efforts on a more qualitative approach underpinned by five steps geared towards requiring incremental reasoning as part of project design: (i) determination of the environmental problem, threat or barrier, and the baseline scenario (i.e. what would happen in the absence of the GEF intervention?); (ii) identification of the global environmental benefit (i.e. the incremental benefit that GEF is enabling); (iii) development of the result framework of the project describing both the baseline and the incremental activities to achieve the global benefits; (iv) provision of the incremental reasoning; and (v) negotiation of the role of co-financing. In fact, the vast majority of the projects funded under GEF provide grants to cover the incremental cost of the global benefit. The remainder is meant to be covered by co-financiers with whatever instrument they negotiate with the project partner.

3. Clean development mechanism

Mandate and role of baselines methodologies

7. The clean development mechanism (CDM), established under the Kyoto Protocol, allows emission reduction projects in developing countries to earn certified emission reductions. To establish eligibility, projects must show the amount of emission reductions

² GEF. 2015. *Instrument for the Establishment of the Restructured Global Environment Facility*. Article 1.

³ Available at <<https://www.thegef.org/documents/incremental-costs>>.

achieved when compared with a baseline, such as a reference baseline project. This baseline is established using CDM methodologies that should be based on (i) existing actual or historical emissions, as applicable; or (ii) emissions from a technology that represents an economically attractive course of action, taking into account barriers to investment; or (iii) the average emissions of similar project activities undertaken in the previous five years, in similar social, economic, environmental and technological circumstances, and whose performance is among the top 20 per cent of their category. Following these principles, CDM has reviewed and approved close to 200 methodologies as of its most recent update of the *CDM Methodology Booklet* in November 2016. The appropriate methodology is selected based on the project's sector (e.g. energy, manufacturing, construction, transport) and applied technology (e.g. biomass, grid electricity, off-grid electricity, renewable thermal energy).

Incorporation into project proposal

8. Project proponents use one of the approved methodologies to estimate the emissions generated by the counterfactual project and to monitor the expected reduced emissions from the proposed project. Proponents can use alternative methodologies, particularly when these are needed to adapt to national circumstances, provided that they are submitted for technical review by CDM. These methodologies can also be used to define standardized baselines for specific countries (e.g. cookstoves in Senegal).

4. The Adaptation Fund

Mandate and role of incremental costs

9. The Adaptation Fund, established under the Kyoto Protocol, finances projects and programmes that help vulnerable communities in developing countries adapt to climate change. Initiatives are based on country needs, views and priorities. Through its financing of concrete adaptation projects and programmes, the Adaptation Fund has gained experience and expertise in applying “climate change adaptation reasoning” to projects, such as vulnerability criteria used to prioritize projects. The Adaptation Fund relies on the definitions of “incremental” and “transformational” adaptation developed by the Intergovernmental Panel on Climate Change (IPCC). According to these definitions, incremental adaptation involves adjustments to maintain the essence and integrity of existing systems and functions. However, climate change may reach a scale that exceeds the capacity of human actors and/or natural systems to adapt through incremental adjustments, which would require a transformational adaptation response to avoid further adverse outcomes. Both the Adaptation Fund and the IPCC Fifth Assessment Report note that transformational adaptation is a relatively new concept in the adaptation literature, and it lacks clear operational definitions to differentiate it from incremental costs.

Use of incremental and transformational adaptation⁴

10. Given the unclear definition of transformational adaptation, the Adaptation Fund identified some examples of outputs with potentially transformative characteristics: introduction of new technologies or practices to a region or system, new structures of systems of governance and shifts in location or nature of activities. Even within this framework, additional criteria were used to better define each characteristic and its transformative potential. A review of Adaptation Fund projects/programmes identified a potentially transformative output in 18 of the 21 projects/programmes analysed. The review mentioned

⁴ Adaptation Fund, 2015. *Analysis of Climate Change Adaptation Reasoning in Project and Programme Proposals Approved by the Board*. AFB/PPRC. 17/5, 10 December 2015.

two common examples of outputs with transformative potential: the development of planning and policy mechanisms that integrate climate risk assessments and adaptation measures, and the strengthening of technical and human capacities necessary to develop such mechanisms.

5. Climate Investment Funds

Mandate and role of incremental costs

11. The Climate Investment Funds (CIFs) have two main funds: the Clean Technology Fund (CTF) and the Strategic Climate Fund (SCF). SCF has three programmes: the Forest Investment Program (FIP), the Pilot Program for Climate Resilience (PPCR) and the Program for Scaling Up Renewable Energy in Low Income Countries (SREP). The relevance and treatment of incremental costs vary according to the mission of each one of them:
- (a) **CTF:** CTF provides resources to scale up low-carbon technologies with significant potential for long-term greenhouse gas emission savings. While the CTF Governance Framework does not explicitly refer to incremental cost criteria, it states that “CTF financing will provide a grant element tailored to cover the identifiable additional costs of the investment necessary to make the project viable.”⁵ Further guidance prepared as part of the CTF private sector operation guidelines states “Financial support through the CTF should be targeted at global benefits of the projects and proportional to incremental costs of their achievement.”⁶ Consistent with this approach, project proponents identify in their proposals the incremental costs of the proposed activities;
 - (b) **FIP:** FIP provides funding to address the drivers of deforestation and forest degradation both within and outside the forest sector to support forests and development and address climate change challenges. Given the nature of its mandate, FIP can support the full costs of projects and therefore an explicit assessment of incremental costs is not required;
 - (c) **PPCR:** PPCR supports climate change adaptation and resilience-building by funding activities to pilot and demonstrate ways to integrate climate risk and resilience into core development planning, while complementing other ongoing activities. While PPCR does not explicitly focus its financing on incremental activities, its focus on supporting pilot activities makes this issue less important. The additionality of PPCR lies in contributing to demonstrating the viability of certain adaptation activities and therefore in this process it may support the full costs of activities; and
 - (d) **SREP:** SREP supports the demonstration in low-income countries of the economic, social and environmental viability of renewable energy. In developing its financial instruments, SREP has emphasized the need to focus resources to address the “incremental risks” associated with renewable energy projects as opposed to the usual technical and financial risks that other baseline projects may have and which could be mitigated through other mechanisms.

⁵ *Governance Framework for the Clean Technology Fund*. 2008.

⁶ *CTF Private Sector Operations Guidelines*. 2012.

Annex VII: Comparative analysis of existing approaches and methodologies on co-financing

1. The United Nations Framework Convention on Climate Change (UNFCCC) calls upon Parties and organizations serving in the capacity of observers to actively track the catalytic effect of public interventions. At the seventeenth session of the Conference of the Parties, held in Durban, South Africa, in 2011, Parties were called upon to (i) report on private financial flows leveraged by bilateral climate finance; and (ii) report on policies and measures that promote the scaling up of private finance in mitigation and adaptation activities. The work of several UNFCCC subsidiaries and constituted bodies under the Convention, including the Standing Committee on Finance,⁷ as well as of the Subsidiary Body for Technological and Scientific Advice⁸ provided significant insights to understand approaches to account for co-financing from both public and private sector entities in climate finance.
2. These important workstreams have benefited from technical inputs from expert organizations, such as the Organisation for Economic Co-operation and Development (OECD), and have been built on experiences and learning from collaborative efforts made by multilateral development banks (MDBs) to report jointly on their climate finance figures in developing countries on an annual basis, with a clear explanation of the joint methodologies in the global efforts to improve the transparency of climate finance, including through effective and efficient tracking of climate finance flows from both private sector and publicly owned MDBs. The methodological contributions from OECD and MDBs, supported by think tanks and civil society organizations, have been instrumental in the development of approaches to estimate and track co-finance and leveraged finance.
3. There is no single, harmonized approach that covers all types of interventions and financial instruments to track co-finance and leveraged finance. OECD, a group of accredited entities and other multilateral climate funds all have their own approaches, driven by their own realities, stakeholders' demand, reporting requirements and data, or document availability.
4. The table below shows the different methodological choices made on key decision points according to the framework provided by OECD.

⁷ Including the 2014, 2016 and ongoing 2018 biennial assessment and overview of climate finance flows, the measurement, reporting and verification of support beyond the biennial assessment and overview of climate finance flows, as well as the 2017 Standing Committee on Finance forum on "Mobilizing finance for climate-resilient infrastructure".

⁸ The work on methodologies for the reporting of financial information by Parties included in Annex I to the Convention, as well as on modalities for the accounting of financial resources provided and mobilized through public interventions in accordance with Article 9, paragraph 7, of the Paris Agreement.

	Year adopted	Main term used	Capital source	Boundaries	Causality	Point of measurement	Reporting period
Organisation for Economic Co-operation and Development (OECD)							
OECD Development Assistance Committee Methodologies^a	2017	Mobilized finance	Private	Direct	Differs per instrument	Differs per instrument	Annually
OECD Research Collaborative^b	2015	Mobilized finance	Private & Public	Direct & Indirect	Suggests proven if possible	Commitment, disbursed if possible	Not mentioned
Multilateral development banks (MDBs)							
MDBs Private Investment Mobilization^c	2017	Mobilized finance	Private	Direct & Indirect	Proven causality (documents)	Commitment	Annually
MDBs Climate Co-Finance^d	2015	Co-finance	Private & Public	Direct	Blanket causality	Not mentioned	Annually
Multilateral climate funds							
Global Environment Facility Co-Finance Policy^e	2014	Co-finance	Private & Public	Not mentioned	Not mentioned	Not mentioned	Project inception, annually & closure
GCF Co-Financing and Leveraged Financing Methodology	2018	Co-finance & Leveraged finance	Private & Public	Direct & Indirect	Based on assessment	Commitment, disbursed if possible	Project inception, annually & closure

^a OECD Development Assistance Committee. 2017. *Methodologies to Measure Amounts Mobilised from the Private Sector*. Available at < <http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/OECD-DAC-Methodologies-to-measure-amounts-mobilised-from-the-private-sector-by-official-development-finance-interventions-2016.pdf>>.

^b Jachnik R, Caruso R and Srivastava A. 2015. *Estimating Mobilised Private Climate Finance: Methodological Approaches, Options and Trade-offs*. OECD Environment Working Papers, No. 83. Available at < https://www.oecd-ilibrary.org/environment/estimating-mobilised-private-climate-finance_5js4x001rqf8-en>. It should be noted that the Research Collaborative provides guidance on the development of a methodology rather than providing a single approach.

^c African Development Bank, Asian Development Bank, Asian Infrastructure Investment Bank, European Bank for Reconstruction and Development, European Investment Bank, Islamic Corporation for the Development of the Private Sector, Islamic Development Bank, World Bank Group, New Development Bank. 2017. *Methodology for Private Investment Mobilization. Reference Guide*. Available at < <http://documents.worldbank.org/curated/en/495061492543870701/pdf/114403-PUBLIC-PrivInvestMob-Ref-Guide-Aug-14-2017.pdf>>. For an example of reporting see African Development Bank, Asian Development Bank, Asian Infrastructure Investment Bank, European Bank for Reconstruction and Development, European Investment Bank, Islamic Corporation for the Development of the Private Sector, Islamic Development Bank, World Bank Group, New Development Bank. 2017. *Mobilization of Private Finance by Development Banks*. Available at < http://www.eib.org/attachments/mdb_joint_report_mobilization_2016_en.pdf>.

^d African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Islamic Development Bank, World Bank Group. 2015. *Tracking Climate Co-Financing: Approach Proposed by MDBs*. Available at <http://www.eib.org/attachments/documents/mdb_tracking_climate_cofinance_en.pdf>. For an example of results reporting see African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Islamic Development Bank, World Bank Group. 2017. *2016 Joint Report on Multilateral Development Banks' Climate Finance*.

^e Global Environment Facility (GEF). 2014. *Co-Financing Policy*. Available at < https://www.thegef.org/sites/default/files/council-meeting-documents/GEF.C.46.09_Co-Financing_Policy_May_6_2014_1.pdf>. For an example of results reporting see GEF Independent Evaluation Office. 2017. *Project Performance and Progress to Impact 2017*. Available at < <http://www.gefio.org/sites/default/files/ieo/evaluations/files/project-accomplishments-2017.pdf>>.

5. The OECD Development Assistance Committee has developed proposed methodologies for calculating amounts of mobilized finance from the private sector. These methodologies are tailored per instrument (guarantees, syndicated loans and shares in collective investment vehicles, credit lines and direct investment). The methodologies are perceived as robust and precise, but also rather complex to apply in practice. The methodologies are described by OECD as “ongoing work”, and characterized by “causality assumptions and attribution techniques that balance accuracy with practicality”.¹
6. Two years earlier, a consortium of six MDBs started joint reporting on the co-finance of their climate investments according to the climate co-finance (CCF) approach.² The main differentiating characteristic is that CCF does not imply a causal relationship as to who catalysed whom in an investment, but rather measures the amount of co-financing that has been invested alongside contributions made by MDBs. However, the MDBs mentioned that the use of private co-financing data is based on “best available evidence of mobilization” of private finance by public finance in the absence of consistent evidence. The CCF document therefore acknowledges that “private co-financing may not always equate to mobilization”.
7. The Global Environment Facility (GEF) first introduced a co-financing policy in 2002,³ which was updated in 2014. The policy states that a full-sized project must provide confirmed co-financing amounts prior to being considered for Chief Executive Officer endorsement, and medium-sized projects must provide indicative co-financing. During project implementation and at project closure GEF partner agencies must report on materialized co-financing according to source and type. The GEF policy does not distinguish between direct and indirect co-finance, and does not include any guidance on causality.
8. The following definitions and references support the main decision points of the GCF methodology:
- (a) Main term: GCF tracks both co-finance and leveraged finance to ensure alignment with current practices and collected data to date, and to ensure alignment with the other climate funds such as GEF and international financial institutions;
 - (b) Capital source: GCF tracks both public and private flows of additional financing to be in line with most approaches, and because GCF actively cooperates with both public and private financing partners;
 - (c) Boundaries: GCF distinguishes between direct and indirect financing flows to adequately track and map where in the investment value chain co-finance takes place. This enables GCF to transparently explain and show why some projects generate higher co-financing and leveraged finance amounts and ratios than others;
 - (d) Causality: GCF includes an assessment of the causal role, by determining the financing that can reasonably be assumed to have been catalysed by the financing provided by GCF. Through this endeavour, the GCF will gain better insights into its role as a catalyst of climate finance.;

¹ See for instance OECD. 2017. *Private Finance for Climate Action: Estimating the Effects of Public Interventions*. p.3 Available at < <http://www.oecd.org/env/researchcollaborative/WEB%20private-finance-for-climate-action-policy-perspectives.pdf>>.

² This was a broadening of the scope of their reporting on climate change adaptation and mitigation projects, which they had performed on an annual basis since 2011.

³ Global Environment Facility. 2002. *Co-Financing Policy*. Available at < https://www.thegef.org/sites/default/files/council-meeting-documents/C.20.6_5.pdf>.

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- (e) Point of measurement: GCF tracks committed financing flows by default, but disbursed flows where applicable (e.g. usually not applicable in the case of guarantees) and available. This ensures that GCF tracks actual financing flows, but retains the flexibility to fall back to committed amounts where disbursed amounts are not applicable, or where data collection is not feasible (e.g. exact disbursed co-finance amounts to a project invested by a climate fund that is invested by a fund-of-fund to which GCF provided financing); and
- (f) Reporting: GCF tracks and may report on co-finance and leveraged finance at project inception (through the funding proposal), during the monitoring phase (through annual performance reports) and at project completion/closure. This is in line with the approach of GCF's main peer multilateral climate fund. It provides insights into annual progress, as well as the extent to which projects lived up to initial expectations (where applicable).

Annex VIII: Comparative analysis of co-financing data from GCF and comparable funds

1.1 GCF Co-financing ratios

Table 1: Summary: Co-financing ratios (data up to the nineteenth meeting of the Board)

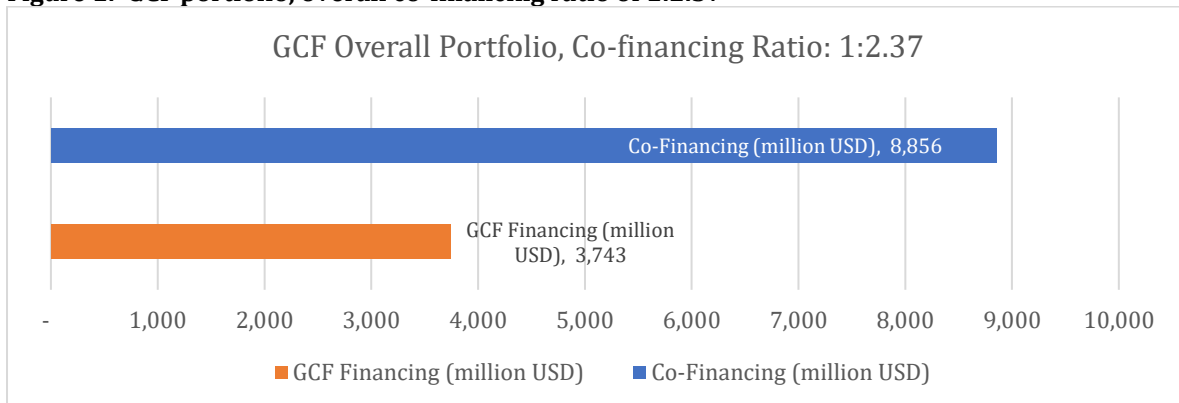
Sector	Portfolio	Median	Max	Min
Public	1.94	0.70	12.05	0.00
Private	3.00	2.72	7.39	0.30
Overall	2.37	1.04	12.05	0.00

Table 2: Co-financing data by theme (data up to the nineteenth meeting of the Board)

Theme	Share of co-financing	Portfolio co-financing ratio
Adaptation	19%	1.57
Mitigation	55%	3.02
Cross-cutting	26%	2.18
Grand total	100%	2.37

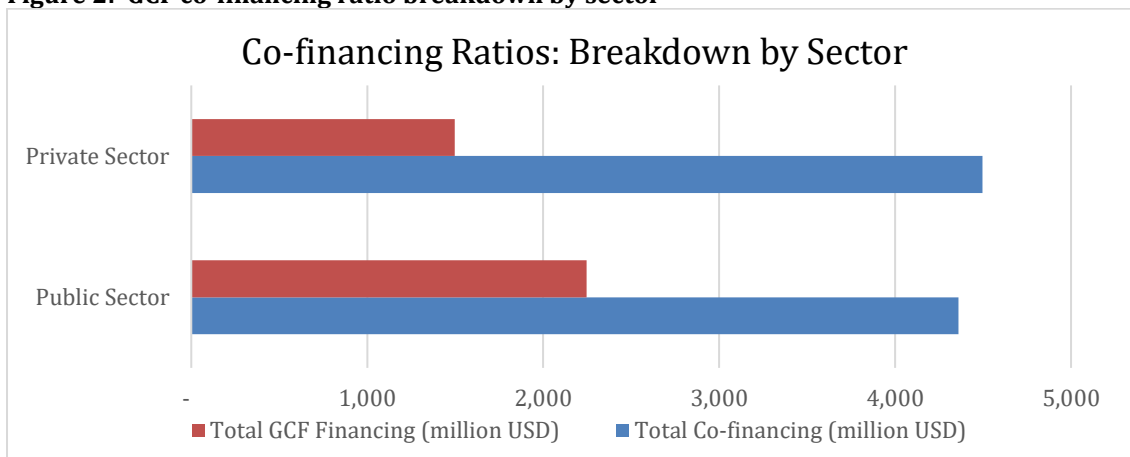
1. Table 1 and figure 1 indicate that the co-financing ratio of the overall GCF portfolio is 1:2.37. For all approved projects, the co-financing amount totals USD 8,856 million for GCF total financing of USD 3,743 million.

Figure 1: GCF portfolio, overall co-financing ratio of 1:2.37



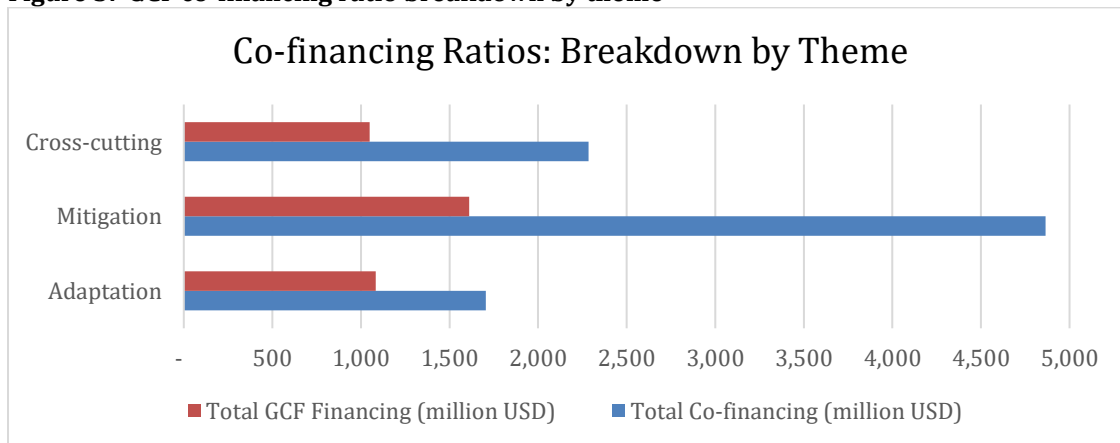
2. Sector wise, public sector projects have an overall co-financing ratio of 1:1.94, while that of private sector projects is 1:3.00, as indicated in figure 2.

Figure 2: GCF co-financing ratio breakdown by sector



3. In addition, the co-financing ratios of the three themes are adaptation (1:1.57), mitigation (1:3.02) and cross-cutting (1:2.18).

Figure 3: GCF co-financing ratio breakdown by theme



1.2 Comparison with other funds

4. Table 3 compares the portfolio co-financing ratios of major climate funds.

Table 3: Comparison: co-financing ratios

	GCF (up to B.19)	Global Environment Facility^a	Climate Investment Funds^b
Portfolio	2.37	6.6 ^c	5.95
Median	1.04	3.4	-

^a Global Environment Facility replenishment periods 4 and 5 only; source: GEF/C.46/09

^b Source: Climate Investment Funds. CIF Learning: Assessing “Leverage” in the Climate Investment Funds.

^c The Global Environment Facility’s portfolio co-financing ratio for the climate change focal area is 12.2.

5. In terms of co-financing policy, the Global Environment Facility (GEF) requires co-financing for all GEF full-size projects, medium-size projects and GEF programmatic approaches. It is important to note that for GEF, co-financing is a longstanding practice that is an integral part of its operations to mobilize additional resources, increase country ownership, create stronger partnerships on the ground and ensure that GEF supports only the incremental costs of a project.

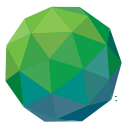
6. Co-financing is optional for GEF enabling activities. GEF also encourages a minimum co-financing of 1:6 at the portfolio level. Specifically, GEF deems that an across-the-board requirement for minimum co-financing thresholds can create disincentives for undertaking projects where there is high potential for achieving global environmental benefits but prospects for co-financing are low. This is true for projects that take on higher levels of risk and can often be the case for technical assistance projects and projects seeking to support policy reform.

7. The GEF has a more inclusive definition of co-finance that also accounts for in-kind as well as leveraged and parallel finance. Alongside the provision of grants, which can be small vis-à-vis the entire investment size, this can support the generation of higher ratios (as compared with GCF ratios).

8. On the other hand, co-financing is not formally required at the Climate Investment Funds; however, in concessional lending operations the aspiration has been for proposals to achieve a 1:4 ratio. Even in the absence of formal co-financing requirements, the Climate Investment Funds operational policies put strong emphasis on “facilitating the mobilization of co-financing. The CIF aims at leveraging financing not only from the MDBs themselves, but also from other development actors, including UN agencies and bilateral development agencies, and the private sector, thereby demonstrating the potential of scaled-up, blended development financing.”

Annex IX: Portfolio analysis of co-financing

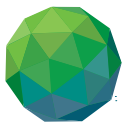
Project Name	Sector	Theme	GCF Financing (million USD)	Co-Financing (million USD)	Total Financing (million USD)	Co-financing Ratio
Building the Resilience of Wetlands in the Province of Datem del Maraón, Peru	Public	Cross-cutting	6.24	2.87	9.11	0.46
Saving Lives and Protecting Agriculture based Livelihoods in Malawi: Scaling up the use of Modernized Climate information and Early Warning Systems	Public	Adaptation	12.30	3.97	16.27	0.32
Increasing the resilience of ecosystems and communities through the restoration of the productive bases of salinized lands	Public	Adaptation	7.61	0.55	8.16	0.07
Climate Resilient Infrastructure Mainstreaming (CRIM)	Public	Adaptation	40.00	40.00	80.00	1.00
KawiSafi Ventures Fund	Private	Cross-cutting	25.00	85.00	110.00	3.40
Energy Efficiency Green Bond Programme in Latin America and the Caribbean	Private	Mitigation	22.00	162.50	184.50	7.39
Supporting vulnerable communities in Maldives to manage climate change-induced water shortages	Public	Adaptation	23.64	4.59	28.23	0.19
Fiji Urban Water Supply and Wastewater Management Project	Public	Adaptation	31.04	374.10	405.14	12.05
Energy Savings Insurance (ESI) for private energy efficiency investments by Small and Medium-Sized Enterprises (SMEs)	Public	Mitigation	21.70	20.00	41.70	0.92
De-Risking and Scaling-up Investment in Energy Efficient Building Retrofits	Public	Mitigation	20.00	9.82	29.82	0.49
Large-scale Ecosystem-based Adaptation in The Gambia: developing a climate-resilient, natural resource-based economy	Public	Adaptation	20.55	4.97	25.52	0.24
Africa Hydromet Program – Strengthening Climate	Public	Adaptation	22.75	4.50	27.25	0.20



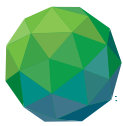
Resilience in Sub-Saharan Africa: Mali Country Project						
Improving the resilience of vulnerable coastal communities to climate change related impacts in Viet Nam	Public	Cross-cutting	29.52	11.01	40.53	0.37
Climate Adaptation and Mitigation Program For the Aral Sea Basin (CAMP4ASB)	Public	Adaptation	19.00	49.78	68.78	2.62
Tuvalu Coastal Adaptation Project (TCAP)	Public	Adaptation	36.01	2.86	38.87	0.08
Strengthening the resilience of smallholder farmers in the Dry Zone to climate variability and extreme events through an integrated approach to water management	Public	Adaptation	38.08	14.00	52.08	0.37
Climate action and solar energy development programme in the Tarapacá Region in Chile	Private	Mitigation	49.00	216.00	265.00	4.41
Scaling-up of Glacial Lake Outburst Flood (GLOF) risk reduction in Northern Pakistan	Public	Adaptation	36.96	0.50	37.46	0.01
Priming financial and land use planning instruments to reduce emissions from deforestation	Public	Mitigation	41.17	42.84	84.01	1.04
Sustainable Energy Facility for the Eastern Caribbean	Public	Mitigation	80.00	110.47	190.47	1.38
Senegal Integrated Urban Flood Management Project	Public	Adaptation	18.52	69.14	87.65	3.73
Development of organiculture orchards in degraded environment (DARED)	Public	Cross-cutting	39.29	9.90	49.19	0.25
Climate Resilient Agriculture in three of the Vulnerable Extreme northern crop growing regions (CRAVE)	Public	Adaptation	9.50	0.50	10.00	0.05
Empower to Adapt: Creating Climate-Change Resilient Livelihoods through Community-Based Natural Resource Management (CBNRM) in Namibia	Public	Adaptation	10.00	-	10.00	0.00

GCF-EBRD Sustainable Energy Financing Facilities	Private	Cross-cutting	378.00	1,007.00	1,385.00	2.66
Sustainable Landscapes in Eastern Madagascar	Private	Cross-cutting	53.50	16.30	69.80	0.30
Universal Green Energy Access Programme (UGEAP)	Private	Mitigation	80.00	221.60	301.60	2.77
MSME Business Loan Program for GHG Emission Reduction	Private	Mitigation	20.00	40.00	60.00	2.00
Catalyzing private investment in sustainable energy in Argentina – Part 1	Private	Mitigation	133.00	520.00	653.00	3.91
Accelerating the transformational shift to a low-carbon economy in the Republic of Mauritius	Public	Mitigation	28.21	163.18	191.39	5.78
Building Resilient Communities, Wetland Ecosystems and Associated Catchments in Uganda	Public	Adaptation	24.14	20.12	44.26	0.83
Climate Information Services for Resilient Development Planning in Vanuatu (Van-CIS-RDP)	Public	Adaptation	22.95	3.68	26.64	0.16
Pacific Islands Renewable Energy Investment Program	Public	Cross-cutting	17.00	9.00	26.00	0.53
Integrated Flood Management to Enhance Climate Resilience of the Vaisigano River Catchment in Samoa	Public	Adaptation	57.72	8.00	65.72	0.14
Geeref Next	Private	Mitigation	265.00	500.00	765.00	1.89
GCF-EBRD Egypt Renewable Energy Financing Framework	Private	Mitigation	154.70	852.30	1,007.00	5.51
Tajikistan: Scaling Up Hydropower Sector Climate Resilience	Public	Cross-cutting	50.00	83.00	133.00	1.66
Simiyu Climate Resilient Development Programme	Public	Adaptation	126.79	50.25	177.04	0.40
Irrigation development and adaptation of irrigated agriculture to climate change in semi-arid Morocco	Public	Adaptation	24.69	69.14	93.83	2.80
The Saïss Water Conservation Project	Public	Adaptation	39.47	215.68	255.15	5.46

Tina River Hydropower Development Project	Public	Cross-cutting	86.00	147.98	233.98	1.72
Ground Water Recharge and Solar Micro Irrigation to Ensure Food Security and Enhance Resilience in Vulnerable Tribal Areas of Odisha	Public	Adaptation	34.36	131.94	166.30	3.84
Renewable Energy Program #1 - Solar	Private	Mitigation	8.65	8.91	17.56	1.03
GCF-EBRD Kazakhstan Renewables Framework	Private	Mitigation	110.00	447.00	557.00	4.06
Low Emissions and Climate Resilient Agriculture Risk Sharing Facility	Private	Cross-cutting	20.00	138.00	158.00	6.90
Building the climate resilience of food insecure smallholder farmers through integrated management of climate risk (R4)	Public	Adaptation	9.98	-	9.98	0.00
Bhutan for life	Public	Cross-cutting	26.56	91.70	118.26	3.45
Scaling-up Investment in Low-Carbon Public Buildings	Public	Mitigation	17.35	105.22	122.57	6.07
Sustainable and Climate Resilient Connectivity for Nauru	Public	Cross-cutting	26.91	38.29	65.20	1.42
Enhancing climate change adaptation in the North coast and Nile Delta Regions in Egypt	Public	Adaptation	31.39	73.81	105.19	2.35
Implementation Project of the Integral Management Plan of the Lujan River Basin	Public	Adaptation	58.53	256.82	315.35	4.39
Scaling up climate resilient water management practices for vulnerable communities in La Mojana	Public	Adaptation	38.50	78.72	117.21	2.04
Responding to the increasing risk of drought: building gender-responsive resilience of the most vulnerable communities	Public	Adaptation	45.00	4.96	49.96	0.11
Climate Resilient Water Sector in Grenada (G-CREWS)-	Public	Adaptation	43.57	8.35	51.92	0.19
Water Sector Resilience Nexus for Sustainability in	Public	Cross-cutting	27.61	17.60	45.21	0.64



Barbados (WSRN S-Barbados)						
Integrated physical adaptation and community resilience through an enhanced direct access pilot in the public, private, and civil society sectors of three Eastern Caribbean small island developing states	Public	Adaptation	20.00	-	20.00	0.00
Poverty, Reforestation, Energy and Climate Change Project (PROEZA)	Public	Cross-cutting	25.06	65.20	90.26	2.60
Promoting private sector investments in energy efficiency in the industrial sector and in Paraguay	Public	Mitigation	23.00	20.00	43.00	0.87
Promoting risk mitigation instruments and finance for renewable energy and energy efficiency investments	Public	Mitigation	103.00	60.85	163.85	0.59
Financial Instruments for Brazil Energy Efficient Cities (FinBRAZEEC)	Public	Mitigation	195.00	1,111.00	1,306.00	5.70
Pacific Resilience Project Phase II for RMI	Public	Adaptation	25.00	19.13	44.13	0.77
Building climate resilience of vulnerable and food insecure communities through capacity strengthening and livelihood diversification in mountainous regions of Tajikistan	Public	Adaptation	9.27	0.70	9.97	0.08
Scaling-up Multi-Hazard Early Warning System and the Use of Climate Information in Georgia	Public	Adaptation	27.05	43.24	70.29	1.60
Enhancing adaptive capacities of coastal communities, especially women, to cope with climate change induced salinity	Public	Adaptation	24.98	8.00	32.98	0.32
Global Clean Cooking Program – Bangladesh	Public	Cross-cutting	20.00	62.17	82.17	3.11
Scaling Up Energy Efficiency for Industrial Enterprises in Vietnam	Public	Mitigation	86.30	1.70	88.00	0.02
Strengthening climate resilience of agricultural livelihoods in Agro-	Public	Adaptation	32.00	105.27	137.27	3.29



Ecological Regions I and II in Zambia						
Strengthening Climate Resilience of Rural Communities in Northern Rwanda	Public	Cross-cutting	32.79	0.36	33.15	0.01
Africa Hydromet Program – Strengthening Climate Resilience in Sub-Saharan Africa: Burkina Faso Country Project	Public	Adaptation	22.50	2.50	25.00	0.11
Institutional Development of the State Agency for Hydrometeorology of Tajikistan	Public	Adaptation	5.00	5.00	10.00	1.00
Climate-Friendly Agribusiness Value Chains Sector Project	Public	Cross-cutting	40.00	101.39	141.39	2.53
Ulaanbaatar Green Affordable Housing and Resilient Urban Renewal Project (AHURP)	Public	Cross-cutting	145.00	399.01	544.01	2.75
Acumen Resilient Agriculture Fund (ARAF)	Private	Adaptation	26.00	30.00	56.00	1.15
Zambia Renewable Energy Financing Framework	Private	Mitigation	52.50	101.50	154.00	1.93
Line of Credit for Solar rooftop segment for commercial, industrial and residential housing sectors	Private	Mitigation	100.00	150.00	250.00	1.50
Improving rangeland and ecosystem management practices of smallholder farmers under conditions of climate change in Sesfontein, Fransfontein, and Warmquelle areas of the Republic of Namibia	Public	Adaptation	9.30	0.70	10.00	0.08
		Total	3,743	8,856	12,599	2.37