



GREEN
CLIMATE
FUND

Level of Concessional Terms for the Public Sector

GCF/B.10/06

22 June 2015

Meeting of the Board

6–9 July 2015

Songdo, Republic of Korea

Provisional Agenda item 17*

* The agenda item number will be determined when the final sequence of items in the provisional agenda is confirmed by the Co-Chairs.

Recommended action by the Board

It is recommended that the Board:

- (a) Take note of the information presented in document GCF/B.10/06 *Level of Concessional Terms for the Public Sector*; and
- (b) Adopt the draft decision presented in Annex I to this document.

Table of Contents

I.	Introduction	1
II.	Links to the Governing Instrument and previous decisions	1
III.	Guidance from the Board and the Risk Management Committee	2
IV.	Practices of other institutions	3
V.	General principles relating to the deployment of the Fund's concessionality	6
	5.1 Current barriers to financing	6
	5.2 Leveraging the Fund's concessionality	7
	5.3 Options for the deployment of the Fund's concessionality for public sector projects	13
VI.	Recommendations and next steps	15
	Annex I: Draft decision of the Board	16
	Annex II: Consolidated country list	17

Level of Concessional Terms for the Public Sector

I. Introduction

1. At its fifth meeting, the Board of the Green Climate Fund (the Fund) adopted a set of guiding principles and factors for determining terms of financial instruments, as outlined in Annex III to decision B.05/07. These guiding principles and factors constitute a foundation of the financial terms and conditions of the Fund's instruments.
2. At its ninth meeting, the Board adopted the financial terms and conditions of the Fund's instruments (decision B.09/04).
3. It was decided that the Fund will use grants and two types of concessional loans to the public sector following the principles and factors set out in Annex III to decision B.05/07. Two types of concessional loans were adopted: high concessionality and low concessionality (decision B.09/04, Annex II).
4. The Board furthermore decided to consider a proposal at its tenth meeting regarding the cases in which the high level concessional terms and the low level concessional terms in the table 2 of Annex II to decision B.09/04 for public sector proposal would apply.
5. The purpose of this document is to outline options for the cases in which various levels of concessionality will apply for the public sector, taking into consideration guidance received from the Risk Management Committee and the Board at its ninth meeting.
6. This document has links to document GCF/B.10/Inf.10 *Brief guideline on the application of the case-by-case provisions in the financial terms and conditions of the Fund's instruments*.

II. Links to the Governing Instrument and previous decisions

7. The Fund was designated as an operating entity of the financial mechanism under Article 11 of the United Nations Framework Convention on Climate Change and will be accountable to and function under the guidance of the Conference of the Parties (COP) with the purpose of making a significant and ambitious contribution to the global efforts towards attaining the goals set by the international community to combat climate change.¹
8. As stated in the Governing Instrument, the Fund will play a key role in channelling new, additional, adequate and predictable financial resources to developing countries and will catalyse climate finance, both public and private, at the international and national levels.²
9. These financial resources will be provided in the form of grants and concessional lending, and through other modalities, instruments or facilities as may be approved by the Board. Financing will be tailored to cover the identifiable additional costs of the investment necessary to make the project viable.³ At its eighth meeting, the Board decided that the Fund will work through accredited implementing entities and intermediaries, who may deploy the resources in approved projects and programmes by using financial instruments, focusing on grants, concessional loans, equity, and guarantees.⁴
10. At its fifth meeting, the Board adopted, for the initial operationalization of the Fund, the principles and factors for the terms and conditions of grants and concessional loans, as contained in Annex III to decision B.05/07. These guiding principles and factors constitute a

¹ Governing Instrument, paragraphs 1 and 4.

² Governing Instrument, paragraph 3.

³ Governing Instrument, paragraph 54.

⁴ Decision B.08/12.

foundation of the Fund's financial terms and conditions. All decisions subsequently taken on financial terms and conditions are building upon this existing decision.

11. Two of the Fund's key principles are to tailor grant elements to incremental cost or the risk premium required to make the investment viable, and to seek the right level of concessionality, so as not to displace investments that would otherwise have occurred.

12. At its ninth meeting, the Board decided that the financial terms and conditions for non-grant instruments to the public sector, other than concessional loans, will be established on a case-by-case basis. The Board also decided that all non-grant instruments extended to the private sector shall be determined on a case-by-case basis, taking into consideration Annex III to decision B.05/07 and Chapter III in Annex XIV to decision B.07/06.⁵

13. The Fund will receive financial inputs from developed country Parties to the Convention. The Fund may also receive financial inputs from a variety of other sources, public and private, including alternative sources.⁶ The financial risk policies as contained in Annex XI to decision B.07/05 ensure that the average concessionality level of outgoing loans will be less than the average concessionality level of incoming contributions with a sufficient margin to cover credit risk.

14. The Fund will strive to maximize the impact of its funding for adaptation and mitigation⁷, and its programmes and projects, as well as other activities, funded by the Fund will be regularly monitored for impact, efficiency and effectiveness in line with rules and procedures established by the Board.⁸

15. The Fund will also seek to catalyse additional public and private finance through its activities at the national and international levels.⁹

16. Finally, the Board will steer the Fund's operations so that they evolve with the Fund's scale and maturity and will exercise flexibility to allow the Fund to evolve over time and become the main global fund for climate change finance.¹⁰

III. Guidance from the Board and the Risk Management Committee

17. At the ninth Board meeting, as part of the discussions under agenda item 11 on Financial Terms and Conditions of the Fund's instruments, the Board and the Risk Management Committee gave guidance on how concessionality should be applied for the public sector.

18. The Risk Management Committee recommended that there be an explicit list of vulnerable countries, and recommended that the Fund could provide highly concessional resources to Least Developed Countries (LDCs), Small Island Developing States (SIDS) and Low-Income Economies (LIEs), as contained in Annex II to this document.

19. While this did not lead to a decision, a number of Board members supported this approach and expressed the view that highly concessional financing should be allocated for those facing the greatest difficulties in terms of accessing finance. It was highlighted that the level of income and indebtedness of countries is a significant factor when providing concessionality, as well as the vulnerability of SIDS to climate change.

⁵ Decision B.09/04.

⁶ Governing Instrument, paragraphs 29 and 30.

⁷ Governing Instrument, paragraph 3.

⁸ Governing Instrument, paragraph 57.

⁹ Governing Instrument, paragraph 54.

¹⁰ Governing Instrument, paragraph 32.

20. However, there were concerns from some Board members that for various reasons, including income and vulnerability, certain countries outside of this sub-group may not always be able to implement climate change activities without sufficient levels of concessionality for these activities.

21. Decision B.09/04 further states that the Board will review the financial terms and conditions of the Fund's instruments on an annual basis.

IV. Practices of other institutions

22. Table 1 outlines the practices of other relevant institutions in providing concessional finance. Other institutions base their level of concessionality on one of two main factors:

- (a) Income level of the recipient country; or
- (b) Project needs.

Table 1: Practices of other institutions

	Method	Grants	High concessionality loans	Low concessionality loans
Global Environment Facility (GEF)^a	By country.	Country-based allocation formula.	LCDs and SIDS.	Other recipients.
Clean Technology Fund (CTF)^b	On the basis of an analysis of each project in terms of its financial internal rate of return without CTF co-financing.	Small grants provided for investment planning and project preparation. Exceptionally, grants could also be considered for project components with very high additional costs. Grants will be determined on a case-by-case basis.	For projects with: (a) Negative rates of return; and (b) Rates of return below normal market threshold.	For projects with: (a) Rates of return near normal market threshold, but below risk premium for project type, technology or country; and (b) Rates of return near normal market threshold, but acceleration in deploying the low carbon technology will have high opportunity costs.
Scaling Up Renewable Energy in Low Income Countries Program (SREP)^c	Pilot programme in 27 low-income countries. By project and debt distress of recipient country.	Small grants provided for investment planning and project preparation. Grants provided for debt distressed countries and if project does not generate sufficient revenue.	For low-income countries that are not debt distressed and if project generates sufficient revenue.	n/a
Forest Investment Program (FIP)^d	Pilot programme in 8 low-income countries. Project based.	Small grants provided for investment planning and project preparation. For projects in low-income countries with: (a) Negative rates of return; or (b) Rates of return below normal market threshold.	For projects in low-income countries: (a) With rates of return near normal market threshold, but below risk premium for project type, technology or country; or (b) With rates of return near or above normal market threshold, but where intensified forestry investment will have higher opportunity costs.	n/a

	Method	Grants	High concessionality loans	Low concessionality loans
Pilot Program on Climate Resilience (PPCR)^e	Pilot programme in 18 low-income countries. By debt distress of recipient country.	Grants provided for debt distressed countries.	For low-income countries that are not debt distressed.	n/a
Adaptation Fund	By country, project and programme.	Resource allocation cap per eligible host country, project and programme with a view to ensuring equitable distribution.	n/a	n/a
International Development Association (IDA)	By income and debt distress of recipient country.	Countries with a high risk of debt distress ('red-light countries') receive 100 per cent of their allocation in the form of grants and those with a moderate risk of debt distress ('yellow-light countries') receive 50 per cent in the form of grants.	Countries with a gross national income (GNI) per capita below a certain level.	Blend terms / less concessional terms apply to countries with GNI per capita above a threshold. An exception to the GNI per capita operational cut-off for IDA eligibility has been made for some small island economies on the basis of their vulnerability.

^a See <http://www.thegef.org/gef/sites/thegef.org/files/documents/16_EN_GEF%20C%2047%2006_GEF-6_Non-Grant_Instrument_Pilot_and_Updated_Policy_for_Non-Grant_Instruments.pdf>.

^b See <http://www.climateinvestmentfunds.org/cif/sites/climateinvestmentfunds.org/files/CTF_Financing_Products_Terms_Public_Sector_Nov2013_0.pdf>.

^c See <http://www.climateinvestmentfunds.org/cif/sites/climateinvestmentfunds.org/files/SREP_Financing_Modalities_final.pdf> and <http://www.climateinvestmentfunds.org/cif/Scaling_Up_Renewable_Energy_Program_in_Low_Income_Countries>.

^d See <http://www.climateinvestmentfunds.org/cif/sites/climateinvestmentfunds.org/files/FIP_Investment_Criteria_and_Financing_Modalities_final.pdf> and <http://www.climateinvestmentfunds.org/cif/Forest_Investment_Program>.

^e See <http://www.climateinvestmentfunds.org/cif/sites/climateinvestmentfunds.org/files/PPCR_Financing_Modalities_final.pdf> and <<http://www.climateinvestmentfunds.org/cif/node/4>>.

^f See <<https://www.adaptation-fund.org/sites/default/files/OPG%20amended%20in%20October%202014%20final.pdf>>.

^g See <<http://www.worldbank.org/ida/articles-agreement/IDA-terms-Apr-15.pdf>>.

V. General principles relating to the deployment of the Fund's concessionality

23. The purpose of the Fund is to make a significant and ambitious contribution to the global efforts towards attaining the goals set by the international community to combat climate change.¹¹ In order to best achieve this objective, the financing made available to the Fund by its contributors is concessional in nature, i.e. below the cost of market-based financing, and takes the form of grants, capital and concessional loans.¹² The issue is how best to deploy the Fund's scarce concessionality to meet its stated purpose, and maximize the impact of its funding.

5.1 Current barriers to financing

24. General principles for the deployment of the Fund's concessionality need to take into account current barriers to financing. Current financing gaps severely hamper the implementation of mitigation and adaptation efforts of developing countries. It is estimated that developing countries need to mobilize and invest up to US\$ 2.5 trillion per annum in essential infrastructure to support their social and economic development. In addition, in order to achieve the paradigm shift to make those investments systematically low-emission and climate-resilient, an incremental estimated US\$ 450 billion per annum should be mobilized and invested. The current debt and equity investments made by developed economies in developing economies are at US\$ 1.2 trillion per annum. This is larger than the incremental annual climate financing needed for mainstreaming low-emission and climate-resilient investments. However, funding is not currently flowing to climate investments.

25. This is partly because, in many instances, low-emission and climate-resilient investments face a number of hurdles compared to "brown" or business-as-usual (BAU) investments, including:

- (a) **Higher upfront costs:** There is often a need for much higher upfront capital expenditure (CAPEX) for many low-emission and climate-resilient projects even though operational expenditure (OPEX) relating to resources may be lower over the lifetime of the project. For example, the CAPEX associated with hydropower plants is much greater than for a heavy fuel oil power plant, even though the OPEX is lower. This is a binding constraint in many developing countries where access to finance (even for the public sector) is scarce. The Fund's appetite to take both the country risk and project risk is highly useful, as it brings a new large financier to the table, and enables the transition from BAU to green investments;
- (b) **Need for longer-term finance:** There is often a need for a much longer repayment period of investment for low-emission and climate-resilient projects because the recovery period of investment is longer than in a "brown" project. This is a binding constraint in many developing countries where access to long-term finance (even for the public sector) is scarce. The Fund's willingness to offer long-term funding at 20 and 40 years is highly useful in enabling green investments to take place;
- (c) **Lower returns:** There is often the need for a return premium because certain green projects are less profitable (lower internal rate of return [IRR]) than "brown" projects. This is a binding constraint everywhere because investors, even public sector decision-makers, will seek projects with a higher IRR, which will often be a BAU project. The Fund's willingness to earn "less than fully risk-adjusted returns" and to offer below-

¹¹ Governing Instrument, Paragraph 1.

¹² The level of concessionality of grants, capital and concessional loans can be compared by converting their face amounts into grant equivalent. See decision B.08/13, Annex XXI

market interest rates is highly useful as it can tip the balance in favour of green public projects; and

- (d) **Unwillingness to invest in new technologies:** There is often the need for "technology pioneering" financiers. Often lenders are unwilling to be the first to fund a project that uses a technology that has not yet been deployed in a given country, even with public sector borrowers. The Fund's willingness to provide financing for such "inaugural" projects and take on new technology risk can catalyse the use of new and transformative technologies and open up the possibility of replication by other financiers.

26. The Fund's ability to supply additional, new long-term public sector loans (even at 20 years) is extremely valuable in enabling the transition from BAU to green investment and can help overcome the barriers to investment that have so far prevented significant flows of finance to green activities.

5.2 Leveraging the Fund's concessionality

27. In 2014, the Intergovernmental Panel on Climate Change (IPCC) estimated that average incremental investment needed in key mitigation sectors would be around US\$ 350 billion per annum until 2029 and that addressing adaptation would require incremental financing of around US\$ 70-100 billion per annum by 2050. Given these high financing requirements, it is very important that the Fund's US\$ 10.2 billion of pledged resources over a four-year period are used efficiently and in a way that maximizes their impact. In particular, the Fund must deploy the concessionality it receives from contributors (in the form of grants and the grant element of capital, and of concessional loans paid in by contributors) in a manner that maximizes total financing channelled to climate-related projects and programmes.

28. The Board has decided that concessional resources received by the Fund can be deployed under a wide array of financial instruments including grants, concessional loans, equity and guarantees, as defined in decision B.08/12.

29. It was decided under the policies and procedures for the initial allocation of Fund resources that all allocation parameters should be determined in grant equivalents (decision B.06/06). This decision was further elaborated under the Fund's investment policies which state that funding received and extended by the Fund will be accounted for in grant-equivalent terms based on a standard methodology, to be developed by the Fund based on best international practices, to provide an accurate comparison of funding amounts between financial instruments (Annex XIV to decision B.07/06). Such a methodology was adopted by the Board under the policies for contributions (Annexes XIX and XXI, decision B.08/13).

30. These policies have implications on the amount of funding that could be allocated to each country. In fact a country can access more resources from the Fund if it chooses an instrument with a lower grant element. This is because instruments with a lower grant element provide greater concessionality leverage as described in the next section.

31. In accordance with the guiding principles and factors for determining terms of financial instruments (Annex III to decision B.05/07), grant elements should be tailored to incremental cost or the risk premium required to make the investment viable, or to cover specific activities such as technical assistance. It is therefore important to ensure that the Fund's scarce grant resources are used in an efficient and effective manner.

32. Many developing countries have a need for infrastructure, energy generation and other investments that will help advance their socio-economic development. In many cases, these investments would take place with or without the Fund's involvement. The role of the Fund is to enable countries to make the transition from brown investments to green investments, and to cover the incremental cost of making these projects viable. As many of these projects would

have taken place even in the absence of the Fund's involvement, and will provide significant socio-economic benefits to the country, the Fund should provide the appropriate amount of concessionality to green the investments.

33. The incremental cost can oftentimes be the incremental capital expenditure needed upfront in a green project. As mentioned previously, in many cases, green investments can have greater upfront costs than brown alternatives, even if they have lower operational costs. Therefore the Fund should aim to provide the right amount of concessionality to cover these incremental costs.

34. Furthermore, as the Fund has limited resources, deploying these resources in a manner that generates reflows from successful projects and programmes will extend the use of its funding. This approach is in favour of continued and growing access to the Fund by the countries most in need of the Fund's resources, as it will prevent the Fund's resources from becoming completely depleted and ensure that the Fund will be able to grow over time as it gets replenished and to meet its mandate to promote the paradigm shift towards low-emission and climate-resilient development pathways.

35. This is particularly important as many of the countries most in need have fewer options in accessing resources from institutions like the Fund. It is therefore imperative that the Fund ensures that it has resources available for these countries.

5.2.1 Concessionality leverage

36. Concessional resources deployed by the Fund are able, through astute deployment of their grant element, to leverage other non-concessional sources of funding and thus increase the overall volume of funding for climate-related investments.

37. **The concessionality leverage ratio** can be defined as the amount of **additional** financing that the Fund can deploy for a given amount of grant element deployed. Concessionality leverage will occur through three mechanisms:

- (a) **Type of instrument:** This ratio measures the amount of additional financing provided by the Fund itself for the project or programme, for a given amount of grant element;
- (b) **Reflows:** Over the longer term, reflows to the Fund resulting from the loans it makes can be redeployed to finance new projects and programmes. This will extend the Fund's impact for the same amount of grant element deployed; and
- (c) **Third party leverage:** Crowding in other public and private financiers into a given project or programme alongside the Fund's share of overall financing.

38. Overall, the Fund's climate impact will be maximized when it is able to achieve maximum leverage of its concessionality, i.e. through the instrument it deploys for any given project and, over the longer term, through reflows to the Fund, and the amount of third party financing it manages to mobilize.

39. The achievable concessionality leverage ratio depends on the type and concessionality of the instrument that is being provided.

Concessionality Leverage Ratio	
(Example)	
The concessionality leverage ratio is defined as the amount of additional financing that the Fund can deploy for a given amount of grant element deployed.	
Concessionality leverage can occur because of the type of instrument deployed (grant or loan) and its degree of concessionality; from reflows of loans; and from third party financiers.	
For example, the concessionality leverage before reflows for a concessional loan with a grant element of 66 per cent is as follows:	
<u>For a loan of US\$ 100:</u>	
– Grant element = US\$ 66	
– Non-grant element = (US\$ 100-US\$ 66) = US\$ 34	
– Concessionality Leverage = Non-grant element / Grant element	
– = 34/66 = 52 per cent	
Therefore, for a concessional loan with a grant element of 66 per cent, US\$ 1 of grant element provides US\$ 0.52 of additional financing.	

Table 2: Concessionality leverage ratio of grants and concessional loans¹³

Type of leverage	Grant	High concessionality loan (grant element = 66 per cent)	Low concessionality loan (grant element = 32 per cent)
Instrument leverage*	US\$ 0 additional financing per US\$ 1 of grant element	US\$ 0.52 additional financing per US\$ 1 of grant element	US\$ 2.13 additional financing per US\$ 1 of grant element
Reflow leverage**	US\$ 0 additional financing per US\$ 1 of grant element	At least US\$ 1 additional financing per US\$ 1 of grant element	At least US\$ 1 additional financing per US\$ 1 of grant element
Total Fund level leverage	US\$ 0 additional financing per US\$ 1 of grant element	At least US\$ 1.52 additional financing per US\$ 1 of grant element	At least US\$ 3.13 additional financing per US\$ 1 of grant element
Third party leverage	Depends on project financial structure and third party financiers		

* Corresponds to ratio of non-grant element financing to grant element financing of the Fund's contribution to the project.

** If reflows are reutilized just once (i.e. redeployed the second time around as grants), the concessionality leverage will be 100 per cent. In practice, they may be re-used more than once and the ratio will be higher, particularly for the 20-year loans.

40. Table 2 shows that the concessionality leverage ratio of the Fund is maximized by using low concessionality loans, where each dollar of grant element mobilizes US\$ 2.13 of non-grant financing and at least US\$ 1 of reflows. For high concessionality loans, one dollar of grant element mobilizes US\$ 0.52 of non-grant financing and at least US\$ 1 of reflows. For pure grants with no repayment contingency, US\$ 1 of grant element mobilizes US\$ 0 of non-grant financing at the Fund level, as there is neither leverage though the instrument nor reflow leverage. For pure grants, in essence, the grant amount goes out once to finance the project without any additional financing attached, and does not return to the Fund to finance

¹³ The grant element is estimated using the joint International Monetary Fund – World Bank parameters, applied using the Fund's financial terms and conditions of its instruments.

additional projects. Grants may, therefore, be less efficient than concessional loans in deploying the Fund's scarce concessional resources as they do not generate instrument or reflow leverage.

41. However, all three instruments, including grants, have the potential to mobilize third party financing from other institutions. The amount of third party financing leveraged depends on the project financial structure and third party financiers and is therefore not quantified in Table 2.

5.2.2 Limits to concessional leverage

42. There are, however, limits to how much the Fund can leverage its grant element. The terms that the Fund's different instruments offer have to be economically and financially feasible for the project or programme, for the country or for the vulnerable community. Limits to concessional leverage will be guided by:

- (a) The nature of the project or programme being financed (in particular, whether or not the project or programme is revenue-generating);
- (b) The income level of the recipient country (in particular, whether the country is highly indebted or low-income); or
- (c) By the vulnerable local community benefiting from the investment (in particular, whether the project targets the most vulnerable communities in the country or region).

43. The purpose of this document is to present options to the Board in the setting of guidelines for the use of grants, high level concessional loans and low level concessional loans for the public sector, taking into account the benefits of concessional leverage and the limits of such leverage as outlined above.

5.2.3 General principles applying to the concessional nature of public sector projects or programmes

44. Based on the above concepts of leverage and limits thereof, four broad concepts might be considered by the Board in setting policies relative to the deployment of grants, high level concessional loans and low level concessional loans for the public sector.¹⁴

45. These principles are guided by the Fund's investment framework and are as follows:

- (a) **Principle 1: Maximize concessional leverage.** One of the key guiding principles and factors for determining the terms of the Fund's financial instruments is the leveraging of other financing, including public and private financing (Annex III, decision B.05/07). All else being equal, a financial product or financing structure that maximizes leverage of the Fund's concessional resources (i.e. the grant element) will be preferred, as this will enhance the Fund's attainment of its stated purpose.

This implies that, all else being equal, the deployment of concessional loans will be preferred to grants as the former leverages more direct financing and generates reflows; and deployment of low level concessional loans will be preferred to high level concessional loans. In particular, grants, being a potentially less efficient way for the Fund to deploy its scarce concessional resources, will be used sparingly and on a case-by-case basis to maximize their impact.¹⁵

¹⁴ These principles build upon the Guiding principles and factors of determining the terms of the Fund's financial instruments (decision B.05/07, Annex III).

¹⁵ To ensure the full amount of the grant goes directly to the intended beneficiary, rather than financing transaction costs, for example, the Board may consider reserving pure grants, such as for technical assistance, to be deployed only through direct access mechanisms, as defined by paragraph 47 of the Governing Instrument.

- (b) **Principle 2: Financial Sustainability.** A second key guiding principle and factor for determining the terms of the Fund's financial instruments is the promotion of long-term financial sustainability. In certain cases, projects and programmes that do not generate revenues may not be financially sustainable if the Fund were to offer an insufficient level of concessionality. Therefore, all things being equal, projects or programmes that are non- or low-revenue generating (i.e. they do not generate enough revenue to meet repayment obligations) could receive a higher level of concessionality than projects or programmes that generate enough revenue to meet repayment obligations;
- (c) **Principle 3: National Income Level and Sovereign Indebtedness.** A third key guiding principle and factor for determining the terms of the Fund's financial instruments is the consideration of the levels of income and indebtedness of the recipient so as not to exacerbate excessive indebtedness (Annex III, decision B.05/07). Projects or programmes located in low-income countries or in countries with a higher debt burden could therefore receive a higher level of concessionality than projects or programmes located in other countries. In all cases, the Fund's will provide resources with the level of concessionality necessary not only to ensure the financial viability of the specific project or programme, but to ensure consistency with the recipient country's debt sustainability framework.
- (d) **Principle 4: Vulnerable community.** There are no current guiding principles or factors relating to the vulnerability of the beneficiary community. However, given that the Fund can provide resources to projects and programmes at the sub-national level, it may be necessary to assess the final recipient community when determining concessionality. There is a strong relationship between income level and vulnerability to climate change. All things being equal, the lower the income of a community, the lower their savings, and therefore the lower their ability to cope with adverse events. In other words, vulnerability to climate change is exacerbated when a community's income level is low, as they do not have the means to undertake climate change activities if they do not receive sufficient levels of concessionality from the Fund, and may not be able to repay a loan. Projects or programmes that benefit lower income or marginalized communities and social groups (e.g. the poorest, women, etc.) could therefore have a higher level of concessionality than those benefiting the general population in the country. The vulnerability of a community will be determined on a case-by-case basis taking into account the Fund's investment framework (decision B.07/06).

46. The Fund will be supporting a very wide range of country circumstances (middle income, low-income, debt-distressed, SIDS, etc.) and project types, with widely differing incremental costs or risks. In particular, the Fund's broad-brush approach with two concessional loan types does not allow specific country situations to be taken into account, notably how to target LIEs, which are defined as those with a Gross National Income per capita of US\$ 1,045 or less in 2013. Such economies are mostly a subset of LDCs which have the lowest per capita income and are therefore the most vulnerable.

47. In order to better tailor the level of concessionality of the Fund's loans to these wide-ranging country circumstances, the Board may consider in some circumstances the deployment of a 50/50 mix of low concessionality and high concessionality loans (50/50 of the face value of outgoing amounts). Such a mix can offer approximately 49 per cent in grant element.

48. Examples of how these principles could be applied in determining the level of concessionality of the Fund's public sector financing are outlined in Table 3.

Table 3: Examples of projects and programmes and concessionality

Principle	Reason for principle	Example of grants	Example of high concessionality loans	Example of 50/50 mix high/low concessionality loans	Example of low concessionality loans
Principle 1: Maximize concessionality leverage	Extending the Fund's reach and attainment of its mission	Early-stage investment in project development to bring project to bankability	To fill specific project funding gaps	To fill specific project funding gaps	To fill specific project funding gaps
Principle 2: Existence or not of revenue stream	Difficult if not impossible to identify potential source of reflows from non-revenue generating activities	Direct access adaptation project that does not generate revenue stream and improves the livelihood of a particularly vulnerable community	Cross-cutting adaptation and mitigation project (e.g. agroforestry) that generates a limited revenue stream	Mitigation project that finances investment in renewable energy generating capacity in a low-income economy (LIE)	Mitigation project that finances investment in renewable energy generating capacity for a commercially-run public utility, for example, creating clearly identifiable income from electricity sales
Principle 3: Income and indebtedness levels of sovereign	Avoiding the creation of unsustainable debt burdens, particularly in low-income countries	On a case-by-case basis for particularly debt distressed countries	Project located in LIEs	Countries in intermediate situations between high vulnerability and middle income	Project located in middle income country with healthy macro-economic outlook
Principle 4: Vulnerability of community	Avoiding negative impacts on vulnerable communities or groups that are more vulnerable than the general population	Direct access adaptation project that does not generate revenue stream and targets highly vulnerable communities, e.g. social safety net to enhance the resilience of poor households in the Sahel	Project targeting a relatively vulnerable community, e.g. increasing the resilience of coastal fishing communities with possible co-development spin-offs (e.g. tourism)	Project with benefits spread broadly across the entire economy or global community, e.g. increasing the resilience of the infrastructure in a low-income highly indebted country	Project with benefits spread broadly across the entire economy or global community, e.g. increasing the resilience of infrastructure in a middle income country

49. Options for the application of these four principles will be outlined in the following section of the document for the Board's consideration.

5.3 Options for the deployment of the Fund's concessionality for public sector projects

50. This section outlines a number of options for consideration of the Board on how to apply the principles outlined above in order to determine the appropriate level of concessionality for the Fund's financing of public sector projects.

51. Options for how the Fund could deploy concessionality are outlined in Table 4.

Table 4: Options on concessionality for public sector projects

Options	Grants (100 per cent grant element)	High level concessional loans (66 per cent grant element)	50/50 mix high/low concessionality loans (49 per cent grant element)	Low level concessional loans (32 per cent grant element)
Option 1: Project based	<ul style="list-style-type: none"> For projects/programmes that are non-revenue generating, and delivered through direct access*** Small grants for technical assistance 	<ul style="list-style-type: none"> Projects/programmes that are revenue-generating, with low economic viability** 	n/a	<ul style="list-style-type: none"> Projects/programmes that are revenue-generating, with good economic viability
Option 2: Project and income level based*	<ul style="list-style-type: none"> For projects/programmes that are non-revenue generating, in Low-Income Economies (LIEs)*, and delivered through direct access*** Small grants for technical assistance 	<ul style="list-style-type: none"> All projects/programmes in LIEs Non-revenue-generating projects/programmes in other countries 	<ul style="list-style-type: none"> Revenue generating projects in other Least Developed Countries (LDCs) and Small Island Developing States (SIDS) countries with low economic viability 	<ul style="list-style-type: none"> Revenue generating projects /programmes in all other countries
Option 3: Project, income level and vulnerability based	<ul style="list-style-type: none"> For projects/ programmes that are non-revenue generating, in LIEs, targeting vulnerable communities, and delivered through direct access*** Small grants for technical assistance 	<ul style="list-style-type: none"> All projects/programmes in LIEs Non-revenue-generating projects/programmes that are targeting vulnerable communities, in all other countries 	<ul style="list-style-type: none"> Revenue generating projects in other LDC and SIDS countries with low economic viability Revenue-generating projects with low economic viability that are targeting vulnerable communities, in all other countries 	<ul style="list-style-type: none"> Revenue generating projects/programmes in all other countries

* Low-Income Economies are defined by the World Bank as those with a Gross National Income per capita of US\$ 1,045 or less in 2013. They are mostly a subset of LDCs with the lowest per capita income.

** Low economic viability: rate of return of five per cent and below.

*** Exceptions may be allowed on a case-by-case basis for small countries that may not be able to access the Fund's resources through the direct access modality.

52. In order to allow further tailoring of concessionality to the specific requirements of the country and the project/programme, the same project could receive funding from more than one instrument.

53. Depending on the option chosen, accredited entities (AEs) need to articulate how the instrument was chosen. For example, if Option 3 were chosen and if an AEs were seeking grant financing, the project would need to fulfil four conditions:

- (a) Is the project non-revenue generating? = Yes
- (b) Is the project located in a low-income economy? = Yes
- (c) Is the project targeting a vulnerable community compared to the average national, regional or global community? = Yes
- (d) Is the project to be managed by a direct access AEs? = Yes

54. This will not guarantee approval by the Board but will improve the project's chances. The project or programme would still be assessed in accordance with the Fund's investment framework in line with the proposal approval process, and the Board would have the ultimate decision on whether or not to fund the project.

55. In all cases, the AEs will be responsible for providing due diligence on the proposed project or programme and for justifying the concessionality requested using technical, economic and financial analysis that demonstrates the need for the instrument proposed.

VI. Recommendations and next steps

56. The Board may wish to consider the three options above. In particular, Option 3 considers most of the concerns that were raised at the ninth Board meeting.

57. Furthermore, the Board may wish to note the rendezvous clause that was adopted at its ninth meeting, where the Board decided to review the financial terms and conditions of the Fund's instruments on an annual basis (paragraph (h), decision B.09/04).

58. The Board may wish to adopt the decision as contained in Annex I.

Annex I: Draft decision of the Board

The Board, having reviewed document GCF/B.10/06 *Level of Concessional Terms for the Public Sector*:

- (a) Adopts the following approach for the concessional funding to public sector projects and programmes:
 - (i) Grants may be awarded on a case-by-case basis to projects and programmes that [*insert option selected by the Board*];
 - (ii) High level concessional loans may be awarded to projects and programmes that [*insert option selected by the Board*];
 - (iii) A mix of high level concessional loans and low level concessional loans (50/50 mix of face value) may be awarded to projects and programmes that [*insert option selected by the Board*]; and
 - (iv) Low level concessional loans may be awarded in all other cases.
- (b) Decides that the terms of the Fund's public sector funding must be consistent with the countries' debt sustainability framework;
- (c) Requests the Secretariat to analyse and propose exceptions to paragraph (a) above that the Board may wish to consider; and
- (d) Notes the decision to review the financial terms and conditions of the Fund's instruments on an annual basis in paragraph (h) of decision B.09/04.

Annex II: Consolidated country list

Table 1: Consolidated list of Least Developed Countries, Small Island Developing States and Low-Income Economies¹

Afghanistan (LDC, LIE)	Maldives (SIDS)
Angola (LDC)	Mali (LDC, LIE)
Antigua and Barbuda (SIDS)	Marshall Islands (SIDS)
Bahamas (SIDS)	Mauritania (LDC)
Bangladesh (LDC, LIE)	Mauritius (SIDS)
Barbados (SIDS)	Micronesia (Federated States of) (SIDS)
Belize (SIDS)	Mozambique (LDC, LIE)
Benin (LDC, LIE)	Myanmar (LDC, LIE)
Bhutan (LDC)	Nauru (SIDS)
Burkina Faso (LDC, LIE)	Nepal (LDC, LIE)
Burundi (LDC, LIE)	Niger (LDC, LIE)
Cambodia (LDC, LIE)	Niue (SIDS)
Cabo Verde (SIDS)	Palau (SIDS)
Central African Republic (LDC, LIE))	Papua New Guinea (SIDS)
Chad (LDC, LIE)	Rwanda (LDC, LIE)
Comoros (SIDS, LDC, LIE)	Saint Kitts and Nevis (SIDS)
Cook Islands (SIDS)	Saint Lucia (SIDS)
Cuba (SIDS)	Samoa (SIDS)
Democratic Republic of the Congo (LDC, LIE)	Sao Tome and Principe (SIDS, LDC)
Djibouti (LDC)	Senegal (LDC)
Dominica (SIDS)	Seychelles (SIDS)
Dominican Republic (SIDS)	Sierra Leone (LDC, LIE)
Equatorial Guinea (LDC)	Solomon Islands (SIDS, LDC)
Eritrea (LDC, LIE)	Somalia (LDC, LIE)
Ethiopia (LDC, LIE)	South Sudan (LDC)
Fiji (SIDS)	Sudan (LDC)
Gambia (LDC, LIE)	Suriname (SIDS)
Grenada (SIDS)	Tajikistan (LIE)
Guinea (LDC, LIE)	Timor-Leste (SIDS, LDC)
Guinea Bissau (SIDS, LDC, LIE)	Togo (LDC, LIE)
Guyana (SIDS)	Tonga (SIDS)
Haiti (SIDS, LDC, LIE)	Trinidad and Tobago (SIDS)
Jamaica (SIDS)	Tuvalu (SIDS, LDC)
Kenya (LIE)	Uganda (LDC, LIE)
Kiribati (SIDS, LDC)	United Republic of Tanzania (LDC, LIE)
Lao People's Democratic Republic (LDC)	Vanuatu (SIDS, LDC)
Lesotho (LDC)	Yemen (LDC)
Liberia (LDC, LIE)	Zambia (LDC)
Madagascar (LDC, LIE)	Zimbabwe (LIE)
Malawi (LDC, LIE)	

¹ Low-Income Economies are defined by the World Bank as those with a Gross National Income per capita of US\$ 1,045 or less in 2013.

Sources:

- LDC - http://unfccc.int/cooperation_and_support/lcd/items/3097.php.
- SIDS - <https://sustainabledevelopment.un.org/index.php?menu=1520>.
- LIE - http://data.worldbank.org/about/country-and-lending-groups#Low_income.