THE ROLE OF TRANSITION FINANCE FOR CLIMATE MITIGATION

A JUST CLIMATE TRANSACTION FOR SOUTH AFRICA

21 April 2020
THERE IS GLOBAL AGREEMENT THAT DEVELOPED COUNTRIES WILL ASSIST DEVELOPING COUNTRIES TO FINANCE CLIMATE CHANGE MITIGATION

- Given the global concern about the climate crisis:
- The Paris Agreement (Art.9.) stipulates developed countries are to:
  - provide financial assistance, and
  - lead the mobilisation of finance from a wide variety of sources to support developing countries to mitigate and adapt to climate change.
- It sets a collective goal of USD$100bn in climate finance assistance per year by 2020 (to be revised upwards in 2025)
- This is largely concessionary finance, whose efficacy is assessed according to $/tCO2e mitigated
LATTERLY, THE NEED FOR ‘TRANSITION FINANCE’ MODELS AS CATEGORY OF MITIGATION-RELATED CLIMATE FINANCE HAS EMERGED

• For instance, divestment can happen much faster than power systems can be reconfigured to clean energy
  – Even for most aggressive renewable rollout scenarios
• Existing generation (often coal-based) is required for power system adequacy during (even an accelerated) transition
  – Capital is required to keep this required capacity going. Under indiscriminate divestment, who will fund this?
  – Mitigation of transition related negative economic, employment and social impacts also has to be funded.
• For a transition to be just, incumbents cannot just be pushed to collapse. This will trigger significant negative economic and social impacts. Transition support is required.
• In many countries renewable energy is now bankable and does not need concessionary climate finance, but these transition requirements need climate funding support.
WITHIN CLIMATE FINANCE THERE IS NO CATEGORY YET FOR TRANSITION FINANCE

Source: CPI: Global Climate Finance Landscape 2019
EXAMPLE\textsuperscript{1}: THE TRANSITION PERIOD IN A SOUTH AFRICANPOWER SYSTEM SCENARIO COMPATIBLE WITH < 2°

1: Based on modelling undertaken by the SA CSIR for the Climate Ambitions project funded by Agora (forthcoming). This scenario emits ~2GT less CO\textsubscript{2} than the current IRP plan.
CONTEXTUALISING THE RE BUILD IN THIS SA TRANSITION EXAMPLE

Source: BP Statistical Review of World Energy; CSIR
DESPITE A GLOBALLY SIGNIFICANT REBUILD OUT, COAL GENERATION IS UNAVOIDABLE IN SA FOR A TRANSITION PERIOD

Generation of this energy requires ongoing financing.
ONGOING FINANCING OF LEGACY ASSETS IS THEREFORE AN OPERATIONAL REQUIREMENT IN AN ACCELERATED TRANSITION

These amounts must be refinanced to remain solvent

Available Cash flow for debt service
INDISCRIMINATE DIVESTMENT OF SYSTEMICALLY CRITICAL LEGACY ASSETS IN TRANSITION COULD CAUSE LARGE ECONOMIC DAMAGE

If divestment makes this refinancing unavailable utility fails immediately or becomes a burden to the state.
TRANSITION FINANCE IS NEEDED IN SECTORS HEAVILY RELIANT ON CARBON INTENSIVE LEGACY ASSETS

Divestment Pressure

Transition Finance

Green Finance

Divestment from fossil fuel infrastructure / economies

Investment in green infrastructure / economies

2020
SUPPORT FOR THE TRANSITION PATHWAYS OF LEGACY CARBON INTENSIVE SECTORS IS IN LINE WITH THE PARIS AGREEMENT’S PROVISIONS ON CLIMATE FINANCE

• Article 2: ‘This Agreement, in enhancing the implementation of the Convention, including its objective aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by:
  
c) making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development’.

• Article 9: Stipulates developed countries are to:
  
  • ‘provide financial assistance, and
  
  • lead the mobilisation of finance from a wide variety of sources to support developing countries to mitigate and adapt to climate change’
A TRANSITION FINANCE MODEL FOR THE SOUTH AFRICAN POWER SECTOR:

THE JUST TRANSITION TRANSACTION
SOUTH AFRICA’S ECONOMY IS DOMINATED BY CARBON INTENSIVE LEGACY ASSETS COUPLED WITH HIGH LEVELS OF UNEMPLOYMENT AND INEQUALITY

• Structural energy-economic coal path dependency developed over 100 years, the ‘Mineral-Energy-Complex’
• 77% of SA’s greenhouse gas emissions are from energy; ~40-45% from electricity
• 86% of electricity is from coal fired power stations
• Eskom generates 95% of SA’s electricity – a regulated state owned monopoly
• Coal is SA’s second highest export earner
• Sasol generates 1/3 of SA’s liquid fuel requirements from coal
• SA has one of the highest inequality levels in the world (Gini 0.67)
• 29% official unemployment
• 50% of SA’s citizens are classified poor
INTERSECTING DOMESTIC PROBLEM COMPLEXES COME UNDER FURTHER TRANSITION-RELATED EXTERNAL PRESSURE

Climate change: Coal market decline, Divestment

Increasingly competitive RE technologies

Development / justice imperatives

Structural coal dependency

Underperforming climate commitments

Outdated electricity sector structure

A rapidly failing electricity utility (Eskom)
LEAVING SA WORST PREPARED GLOBALLY FOR THE ENERGY TRANSITION

According to World Economic Forum Energy Transition index 2019 results
TRANSITION FINANCE IS REQUIRED TO UNLOCK AN ACCELERATED TRANSITION BY OVERCOMING ECONOMIC, SOCIAL AND POLITICAL PATH DEPENDENCE.

(1) An incremental transition initially involves a reduction in stakeholder benefits, which creates broad based resistance.

(2) Transition finance supporting a bridge to a more rapid, sustained transition is required to overcome change resistant path dependence.

Transition finance is required to unlock an accelerated transition by: (a) supporting substantial measures to overcome economic, social and political path dependence; (b) while protecting system integrity during the intervening period.
WHAT CREATES THE TRANSITION FINANCE OPPORTUNITY FOR THE SA POWER SECTOR?

• The global commitment to climate finance under the UNFCCC sets a collective goal of **USD$100bn in climate finance assistance** per year by 2020 (to be revised upwards in 2025)
• This is largely **concessionary finance, whose efficacy is assessed according to $/tCO2e mitigated**
• The SA power sector is able to offer **additional CO2e savings at low cost**
• Real **political and institutional barriers** are preventing power sector decarbonisation
• Transition financing is **conditional upon a clear political commitment to sector decarbonisation including market reform**, and creates the space for a massive RE ramp-up and green industrialisation programme
<table>
<thead>
<tr>
<th>What are the specific SA Power sector problems that transition finance could respond to?</th>
<th>How could a transition finance model solve these problems?</th>
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<td>As a <strong>coal-based utility</strong>, Eskom will increasingly be <strong>unable to raise finance</strong> from DFIs, the bond market and (ultimately) banks.</td>
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<td>SA coal workers and communities will be severely affected by the transition and only limited financing is available to provide a <strong>Just Transition</strong>.</td>
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<td>SA has committed to increase the ambition of its <strong>NDC</strong> in 2020, and power sector decarbonisation will need to play a central role in doing so.</td>
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THE CONCEPT: A ‘JUST TRANSITION’ CLIMATE FINANCE TRANSACTION

• The foundation is an international government and DFI climate finance transaction that crowds in a larger amount of private sector finance in a blended structure.
• Creates a large (~$11Bn) long term (~20yr) debt facility to refinance the national utility Eskom, conditional on additional mitigation and social action, with credible remedies.
• This ‘Just Transition Transaction’ consists of three legs:
  1) The South African Government and Eskom will commit to delivering additional, measurable CO₂ reductions over and above the current policy trajectory; In return:
  2) Eskom’s access to its traditional debt funding sources (DFIs, MDBs, capital markets, banks, etc.) will be restored; while
  3) Affected labour and communities will benefit from a Just Transition programme backed by the net proceeds from the transaction, and the crowding in of new energy projects and other infrastructure in Mpumalanga and beyond.
PROGRESS TO DATE

- Conceptualised by SA think tank, Meridian Economics in 2018
- Promoted by the Presidential Eskom Sustainability Task Team
- Announced by President in UN Climate Summit Statement, Sept 2019
- Socialised broadly in SA (Government, Finance, Labour, Business, NGOs, etc.)
- Socialised internationally with serious interest by DFI community and key counterparty Govts
LEG 1: GREENHOUSE GAS MITIGATION

1) The South African Government and Eskom will commit to delivering additional, measurable CO₂ reductions over and above the current policy trajectory; In return:

2) Eskom’s access to its traditional funding sources (DFIs, capital markets, banks, etc.) will be restored; while

3) Affected labour and communities will benefit from a Just Transition programme backed by the net proceeds from the transaction, and the crowding in of new energy projects and other infrastructure in Mpumalanga and beyond.
CARBON TRAJECTORY WITHOUT TRANSACTION

Carbon emissions from Eskom coal fleet per latest government plan

Annual CO₂ emissions from coal (Mega Ton/annum)

Coal CO₂ emissions (MT)
CARBON TRAJECTORY WITH TRANSACTION

Mitigation required against emissions consequent from latest government plan

Mitigation required 2°C compatible coal emissions
LEG 2: ESKOM CAN RETURN TO THE MARKETS

1) The South African Government and Eskom will commit to delivering additional, measurable CO₂ reductions over and above the current policy trajectory; In return:

2) **Eskom’s access to its traditional funding sources (DFIs, capital markets, banks, etc.) will be restored**; while

3) Affected labour and communities will benefit from a Just Transition programme backed by the net proceeds from the transaction, and the crowding in of new energy projects and other infrastructure in Mpumalanga and beyond.
HIGH LEVEL FINANCIAL FLOWS

Commercial funders

Concessionary funders

Blended Finance Vehicle

Senior Commercial Tranches

Subordinated Concessionary Tranches

Catalytic grant finance

South African Just Transition Fund
DEBT SERVICE FLOWS

Commercial funders

Return in line with enhanced rating

Concessionary funders

Sub-market return

Blended Finance Vehicle

Senior Commercial Tranches

1. Concessional
2. Highly Concessional
3. Grant

Senior Issue

Subordinated Issue

Performance Guarantee

South African Just Transition Fund

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LEG 3: CATALYTIC FUNDING FOR A JT PROGRAMME

1) The South African Government and Eskom will commit to delivering additional, measurable CO\textsubscript{2} reductions over and above the current policy trajectory; In return:

2) Eskom’s access to its traditional funding sources (DFIs, capital markets, banks, etc.) will be restored; while

3) **Affected labour and communities will benefit from a Just Transition programme backed by the net proceeds from the transaction, and the crowding in of new energy projects and other infrastructure in Mpumalanga and beyond.**
THE JT FUND CATALYSES FINANCING FOR MPUMALANGA FOCUSED JUST TRANSITION
The Just Transition Fund: Catalytic financing for the Mpumalanga Just Transition

2020

- **Grant**
- Patient capital
- Concessionary loans
- Seed funding
- Incubation finance
- Etc.

2030....

- **Packages for coal workers**
- **Transition management:** Process, strategizing, co-ordination, research, strategy development, communications.
- **Education** (green citizenship orientation) and upskilling

**RE based socio-economic acceleration programme:**

- REDZ
  - Upstream RE manufacturing
  - Utility scale RE
  - Embedded RE

- **Mine Rehabilitation**
  - Embedded RE

- **Infrastructure**
  - (RE, transport, water)

- **Agri / agro-processing and industry**

- **Tourism**

**Co-funding:**
- Eskom, coal companies
- DFIs
- Local and Provincial Government; DFIs, TVETs
- Mining rehabilitation funds
- Department budgets – DST, Provincial, EPWP, other
- Venture capital
- Commercial

**Etc.**
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<td>As a <strong>coal-based utility</strong>, Eskom will increasingly be <strong>unable to raise finance</strong> from DFIs, the bond market and (ultimately) banks.</td>
<td>The Transaction situates Eskom as the <strong>‘transition pivot’</strong> in a green framework committing SA to accelerated decarbonisation. Restores access to normal DFI, bond market, bank and other institutional finance.</td>
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<td>Government’s capacity to provide <strong>sovereign guarantees</strong> is highly constrained</td>
<td>Subordination of the concessionary finance in the <strong>blended structure</strong> provides the security required for senior commercial debt.</td>
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<td><strong>Eskom’s coal costs</strong> have soared in recent years.</td>
<td>A <strong>large least cost power investment programme</strong> will displace the most expensive primary energy first.</td>
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<td>Eskom faces large <strong>capex requirements</strong> to repair its 2 newest coal plants, refurbish older stations and implement environmental retrofits.</td>
<td>Much of <strong>this expenditure can be avoided</strong> with an accelerated IPP renewables programme.</td>
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<td>SA coal workers and communities will be severely affected by the transition and only limited financing is available to provide a <strong>Just Transition</strong>.</td>
<td>A <strong>SA Just Transition Fund</strong> is capitalised with proceeds from the climate transaction. Other funding can then be crowded in.</td>
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<td>SA has committed to increase the ambition of its <strong>NDC</strong> in 2020, and power sector decarbonisation will need to play a central role in doing so.</td>
<td><strong>Finance is conditional</strong> upon the electricity sector meeting predetermined emissions constraints in line with a more ambitious SA NDC.</td>
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