

THE ROLE OF TRANSITION FINANCE FOR CLIMATE MITIGATION

A JUST CLIMATE TRANSACTION
FOR SOUTH AFRICA

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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
- Given the urgency of the climate crisis, the mitigation portion of this financing should include a consideration of the \$/tCO₂e it achieves

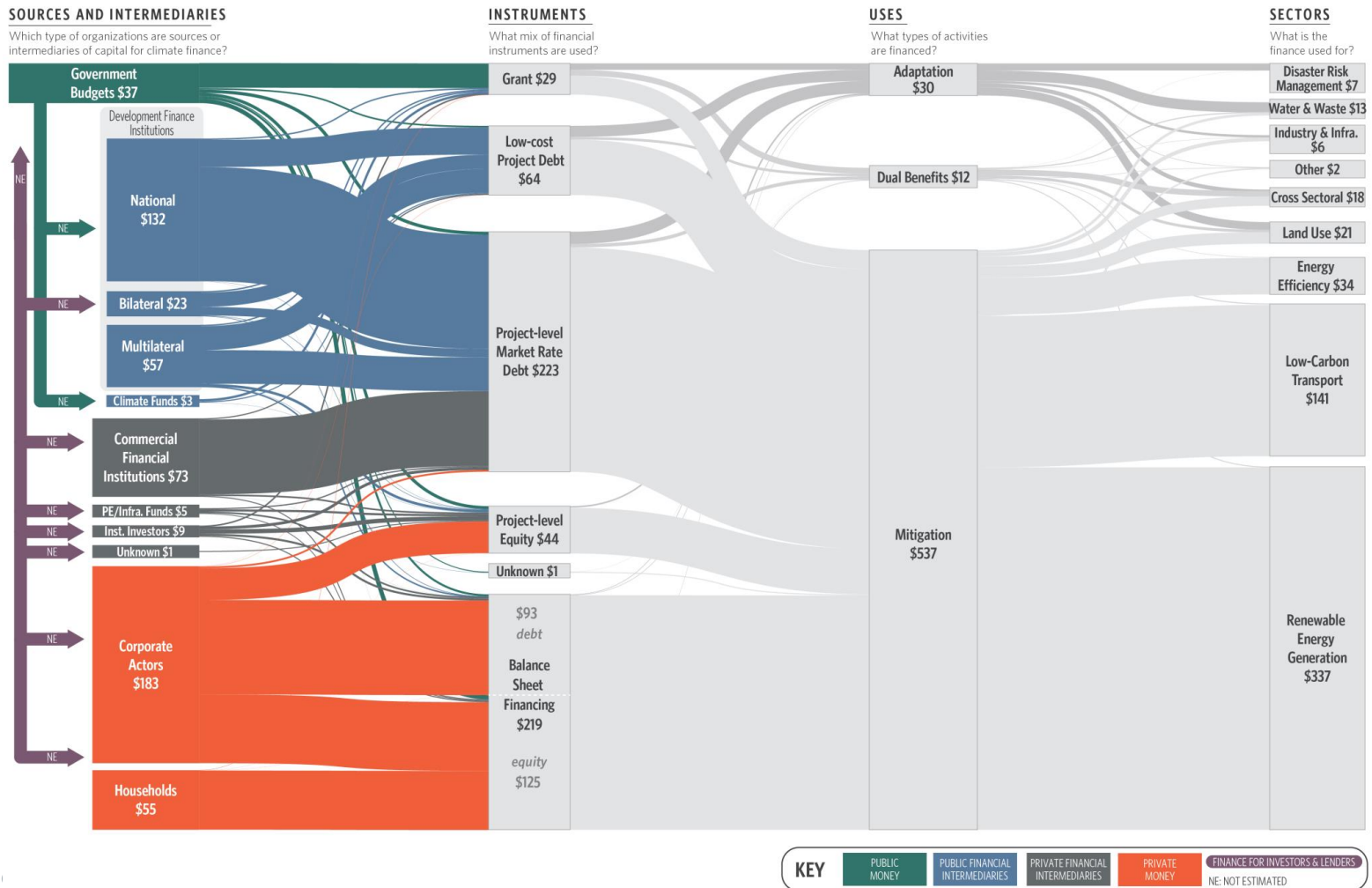


LATTERLY, THE NEED FOR 'TRANSITION FINANCE' MODELS AS CATEGORY OF MITIGATION-RELATED CLIMATE FINANCE HAS EMERGED

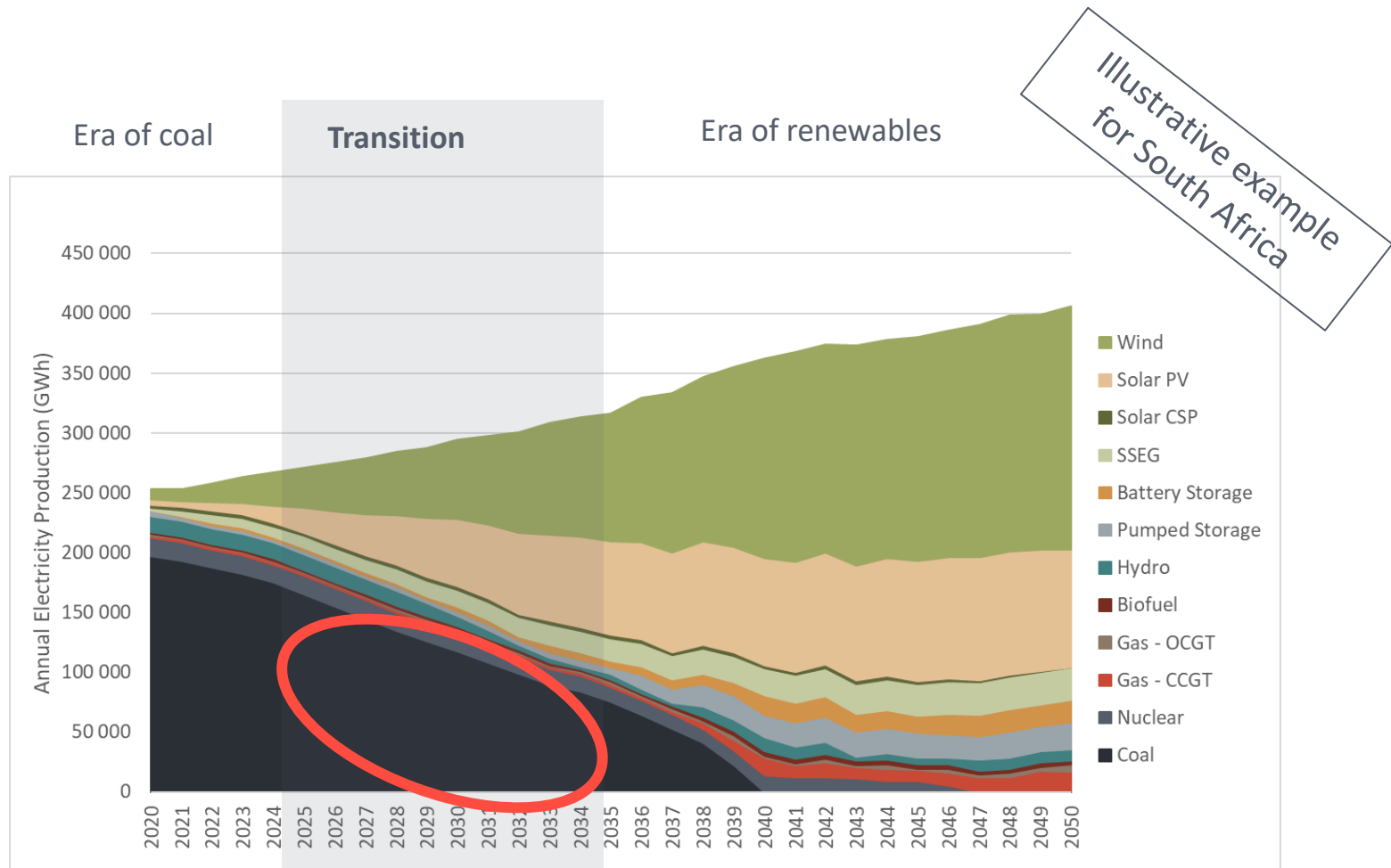
- Divestment can happen much faster than power systems can be reconfigured to clean energy
 - Even for coal phase down / renewable rollout scenarios that are aligned with the Paris Agreement objectives
- Existing generation (often coal-based) is required for power system adequacy during transition
 - Capital is required to keep the necessary coal capacity going. Under indiscriminate divestment, who will fund this?
 - Mitigation of transition related negative economic, employment and social impacts requires funding
 - But only under the condition of remaining on a Paris-aligned transition path
- 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.



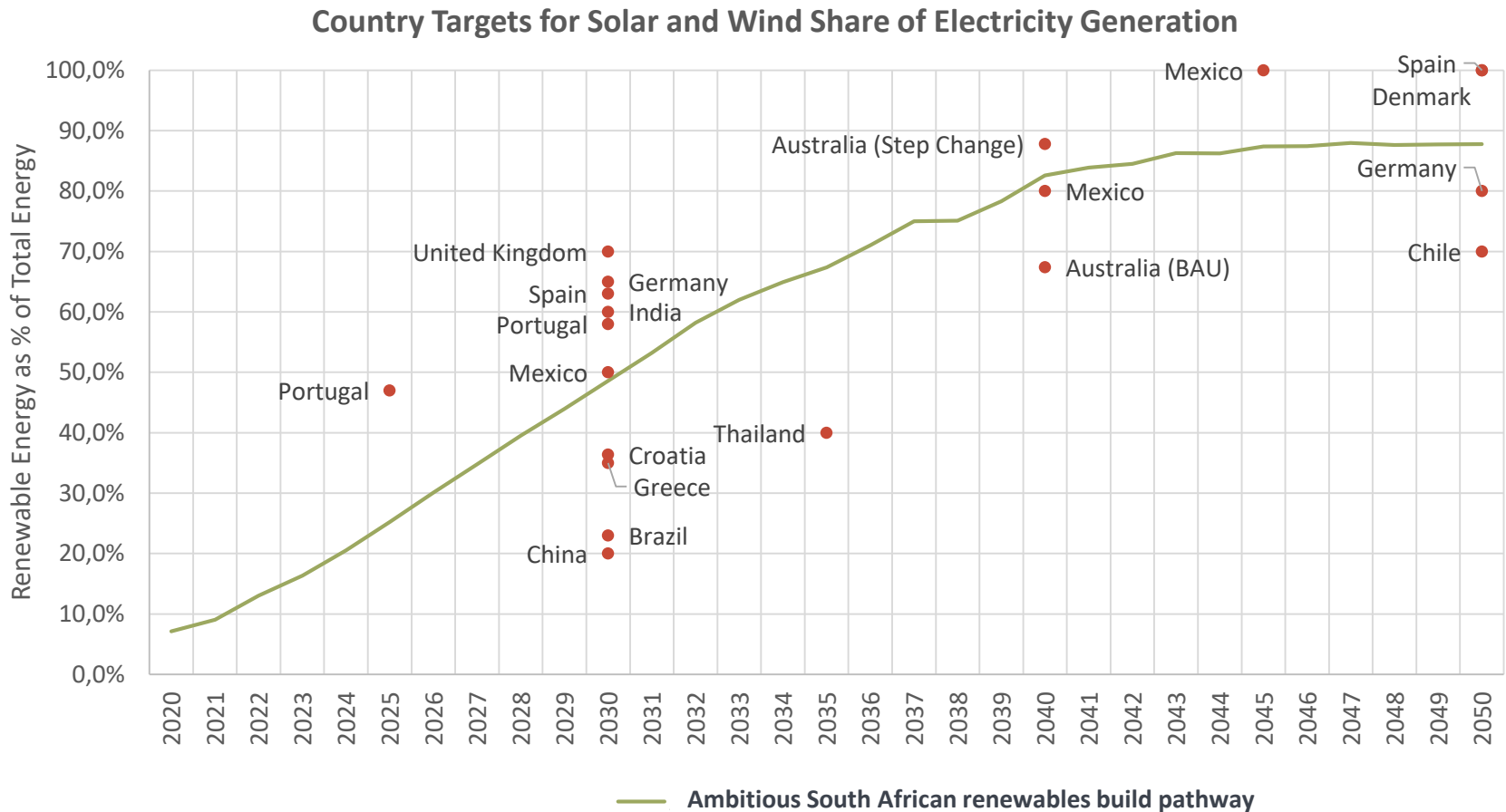
WITHIN CLIMATE FINANCE THERE IS NO CATEGORY YET FOR TRANSITION FINANCE



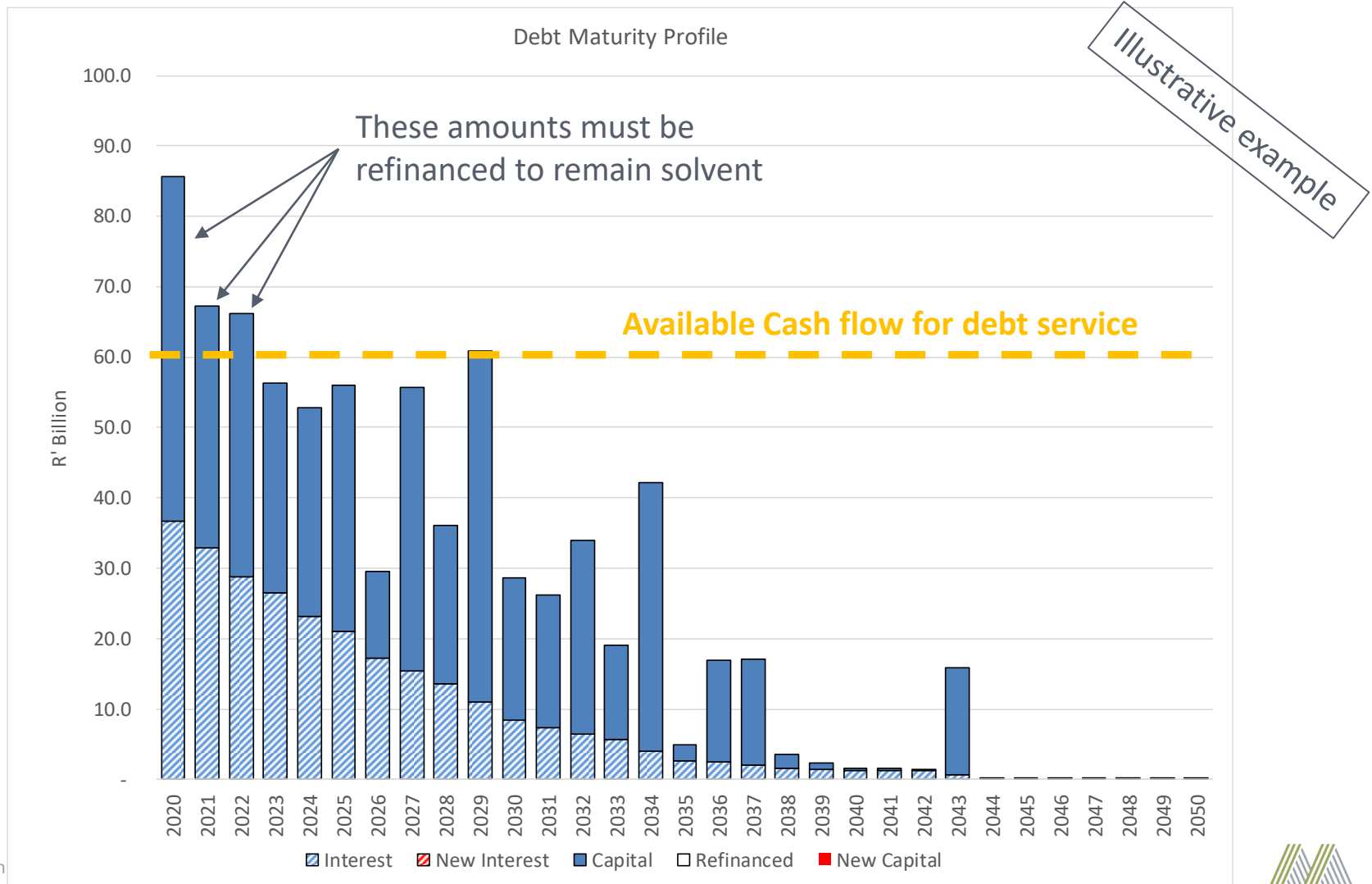
GENERATION OF (DECLINING) COAL ELECTRICITY STILL NEEDS FINANCING THROUGH THE TRANSITION



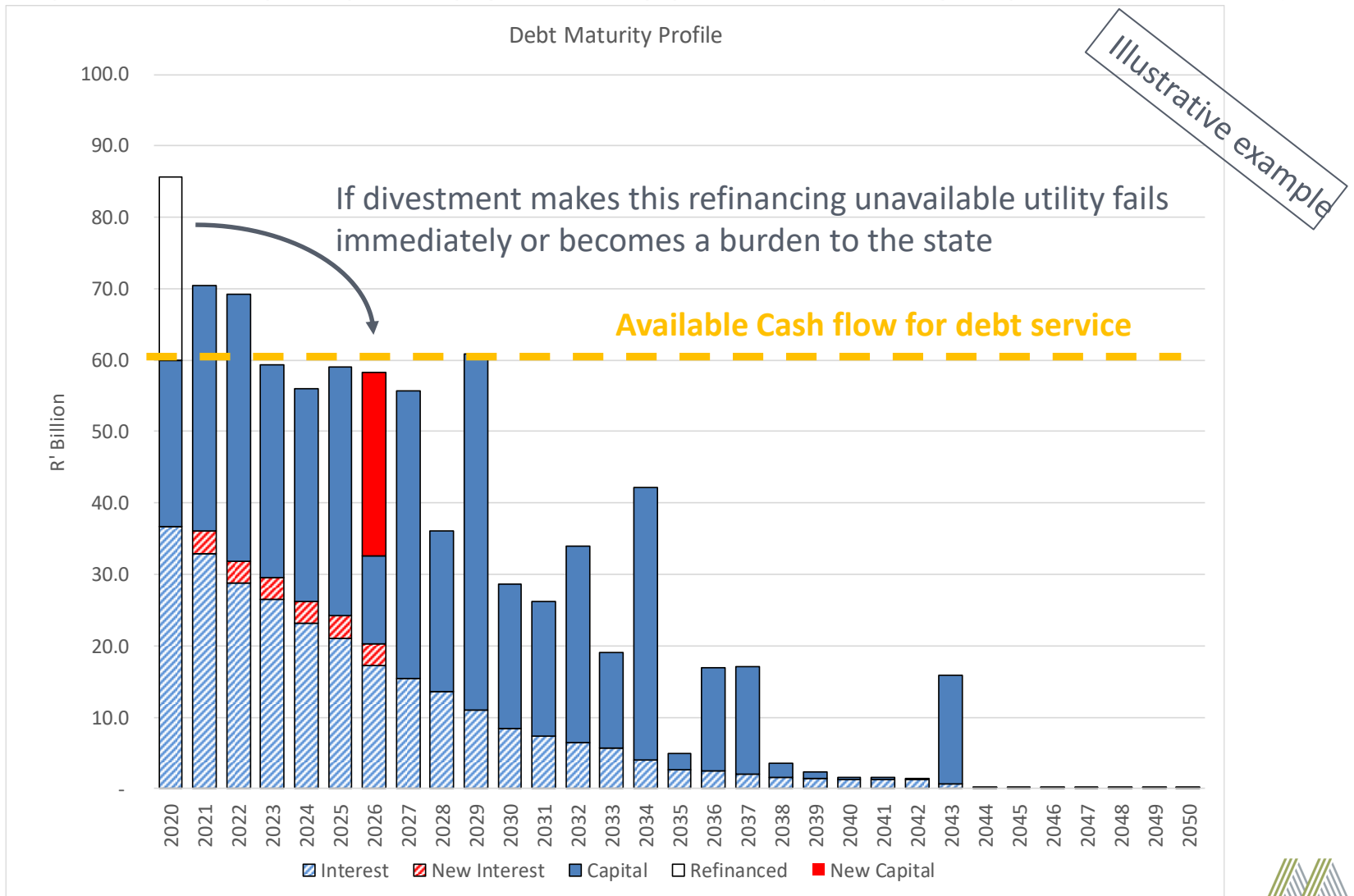
THIS SOUTH AFRICAN GENERATION PROFILE REQUIRES A RENEWABLES ROLLOUT IN STEP WITH GLOBAL TARGETS



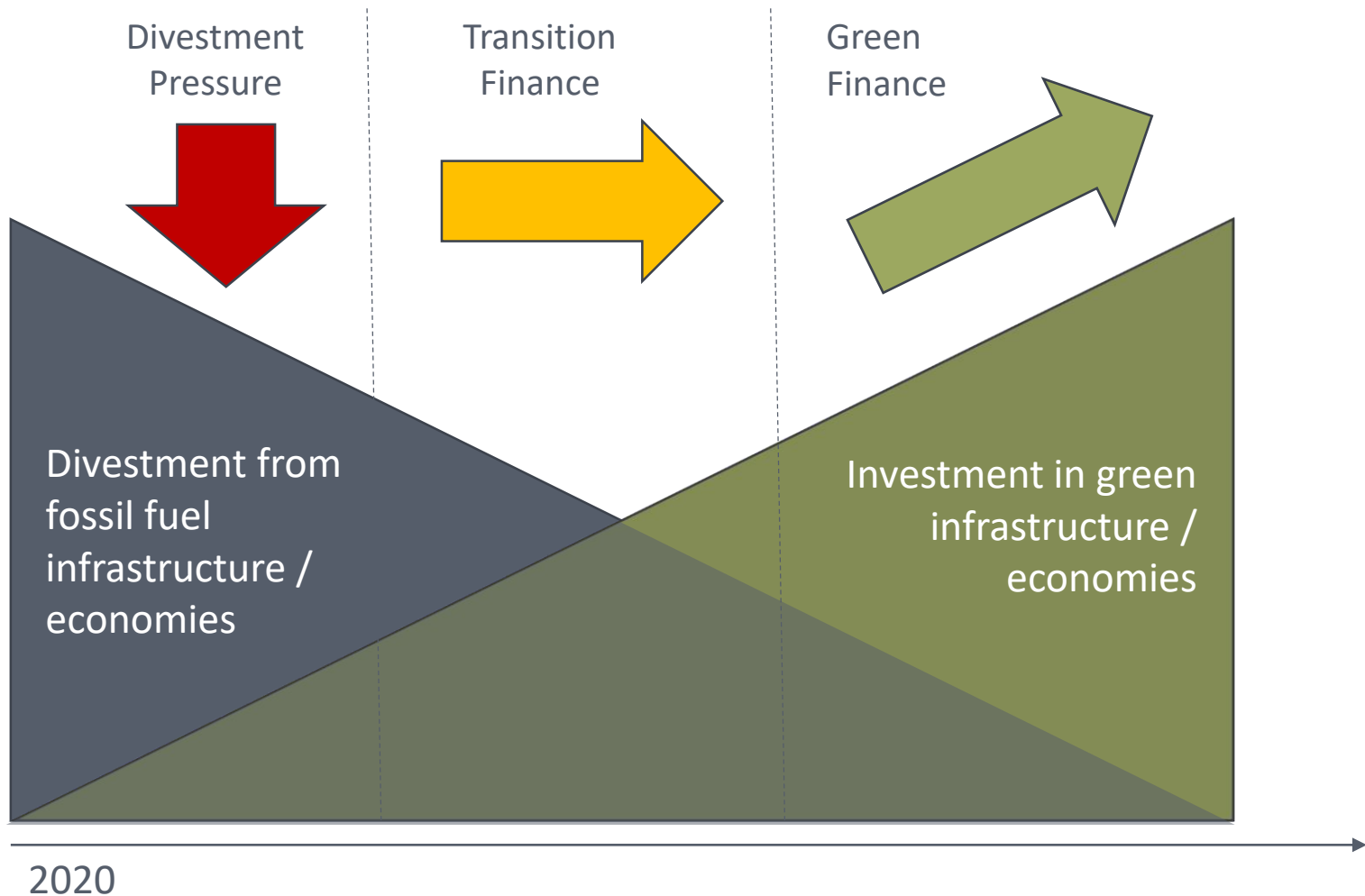
ONGOING FINANCING OF LEGACY ASSETS IS THEREFORE AN OPERATIONAL REQUIREMENT IN AN ACCELERATED TRANSITION



INDISCRIMINATE DIVESTMENT OF SYSTEMICALLY CRITICAL LEGACY ASSETS IN TRANSITION COULD CAUSE LARGE ECONOMIC DAMAGE



TRANSITION FINANCE IS NEEDED IN SECTORS HEAVILY RELIANT ON CARBON INTENSIVE LEGACY ASSETS



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

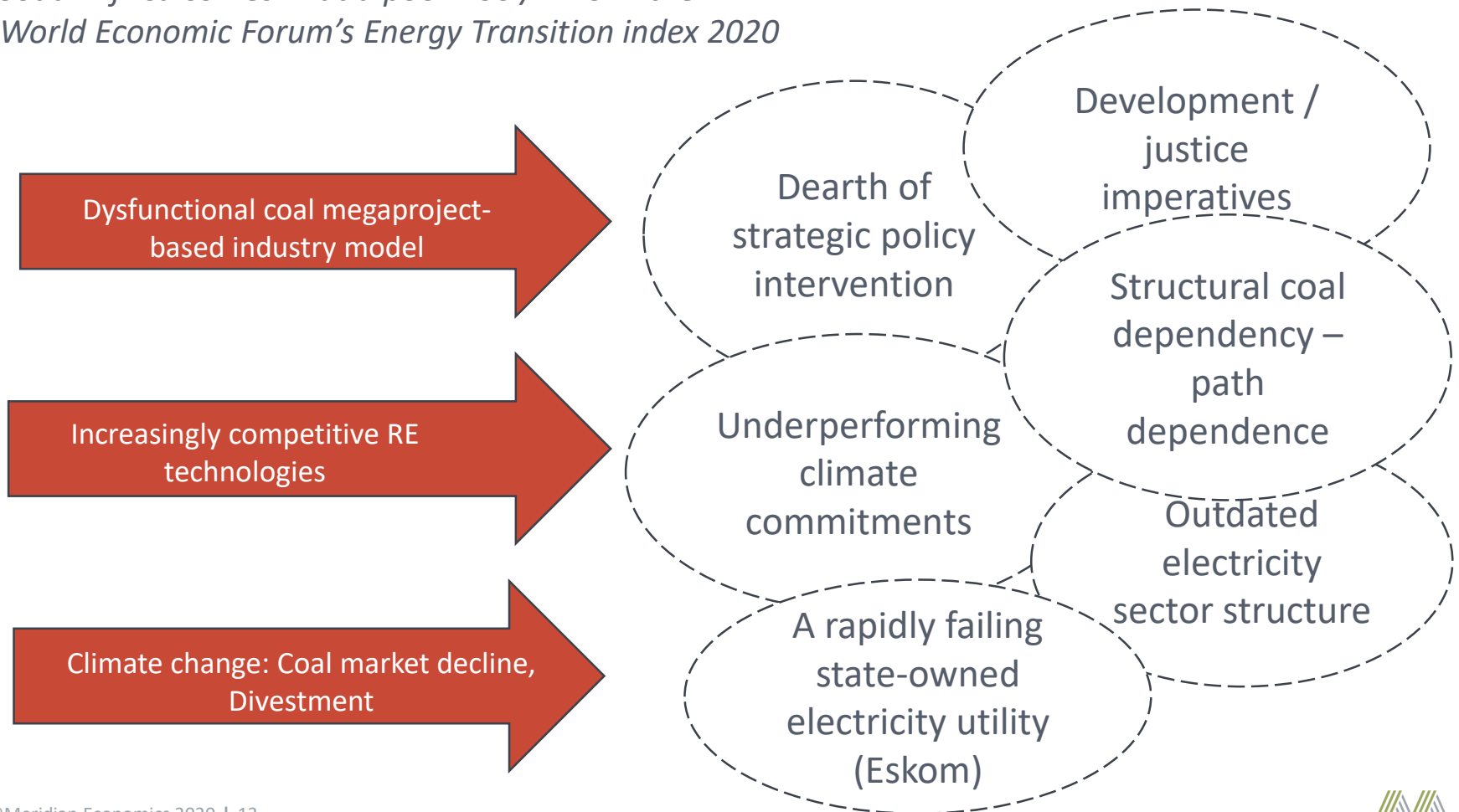
THE CONTEXT: AN ECONOMY DOMINATED BY CARBON INTENSIVE LEGACY ASSETS COUPLED WITH HIGH LEVELS OF UNEMPLOYMENT AND INEQUALITY

- 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



SOUTH AFRICA'S POWER SECTOR TRANSITION: HEADING FOR A PERFECT STORM

*South Africa comes in at a poor 106 / 115 in the
World Economic Forum's Energy Transition index 2020*

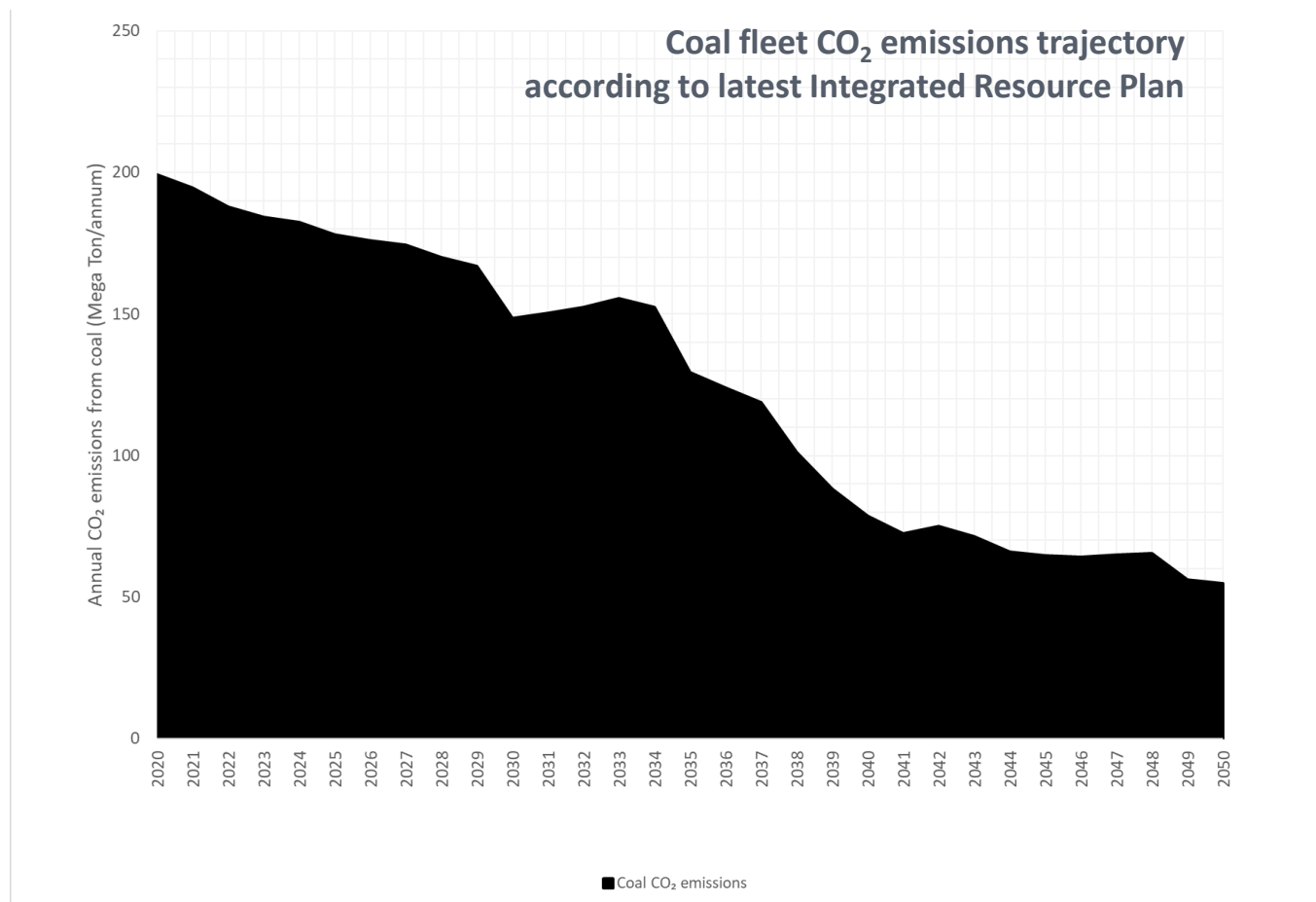


THE JUST TRANSITION CLIMATE FINANCE TRANSACTION IN A NUTSHELL

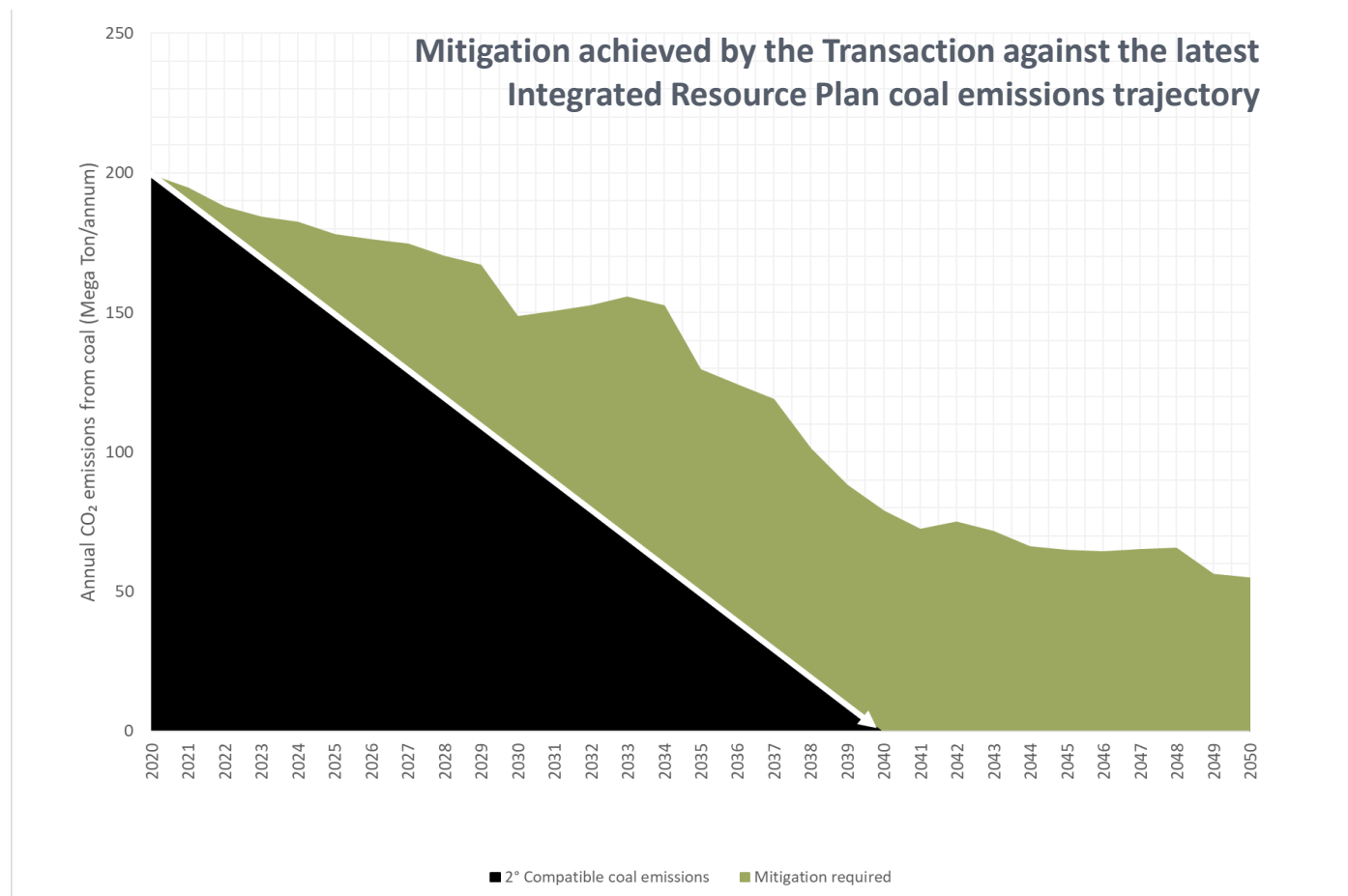
- A multilateral **climate finance transaction framework** with **DFI, climate finance** and a larger amount of **private sector green finance** in a blended structure
- Creates a **large (~\$12Bn) long term (~20yr) debt facility** to refinance Eskom, conditional on measurable progress with substantial **additional** mitigation and social action, subject to credible remedies.
- Consists of **three legs**:
 - A** The South African Government and Eskom will commit to **delivering substantial, additional CO₂ reductions** over and above the current policy trajectory; In return:
 - B** Eskom's **access to its traditional debt funding sources** (DFIs, MDBs, capital markets, banks, etc.) **will be restored** within this framework; while
 - C** Affected **labour and communities will benefit** from a Just Transition programme backed by the net proceeds from the transaction, **embedded in a large green economic recovery industrialisation programme** for Mpumalanga province and beyond.



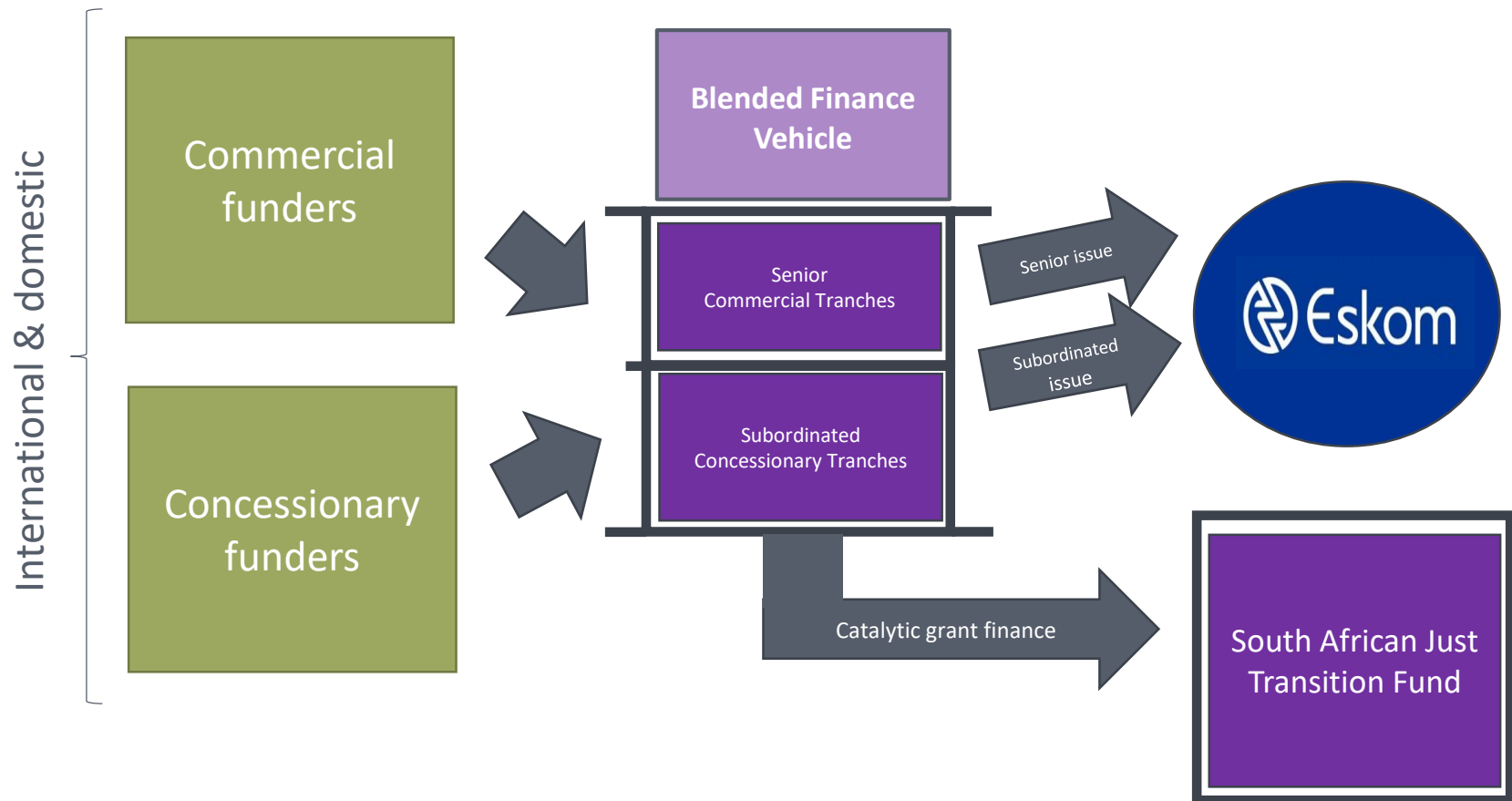
CO₂ MITIGATION: EMISSIONS TRAJECTORY WITHOUT TRANSACTION



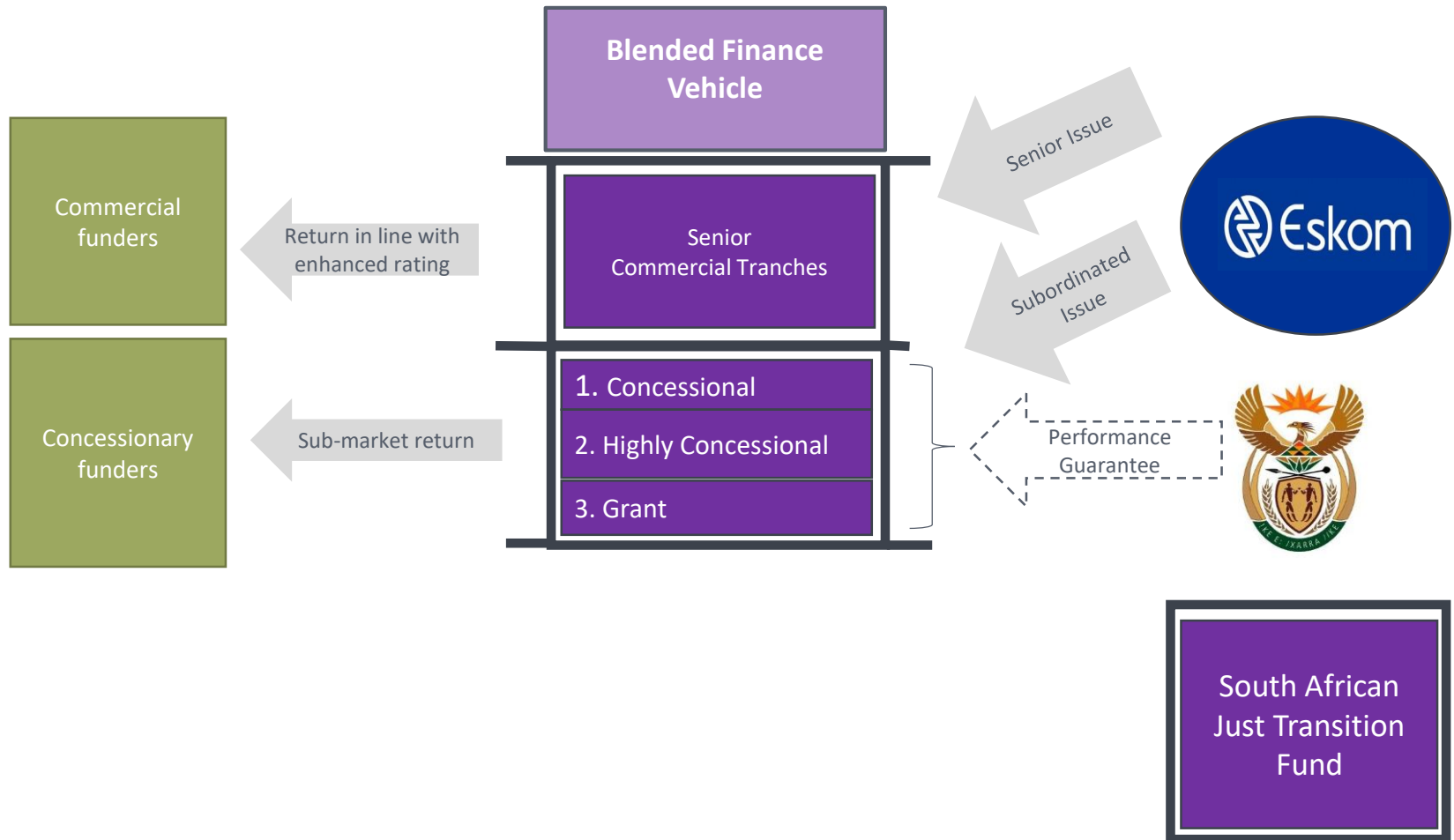
CO₂ MITIGATION: CARBON TRAJECTORY WITH TRANSACTION



JTCT: HIGH LEVEL FINANCIAL FLOWS



JTCT: DEBT SERVICE FLOWS



A CLIMATE TRANSACTION UNLOCKS THE POLITICAL AND INSTITUTIONAL IMPASSE PREVENTING TRANSITION

Through providing:

- An **Organising vision** for South Africa's just energy transition
- **Transition financing** to rapidly decrease coal power and enable Eskom to pivot to a grid management utility
- **Policy certainty** required to crowd in a massive, independently funded RE industrialisation and economic recovery programme
- **Substantial decarbonisation** (>1GT) at low \$/tCO₂e

The South African situation offers a huge opportunity to demonstrate a **high-impact and globally relevant transition finance model** which catalyses an inclusive transition and green economic recovery

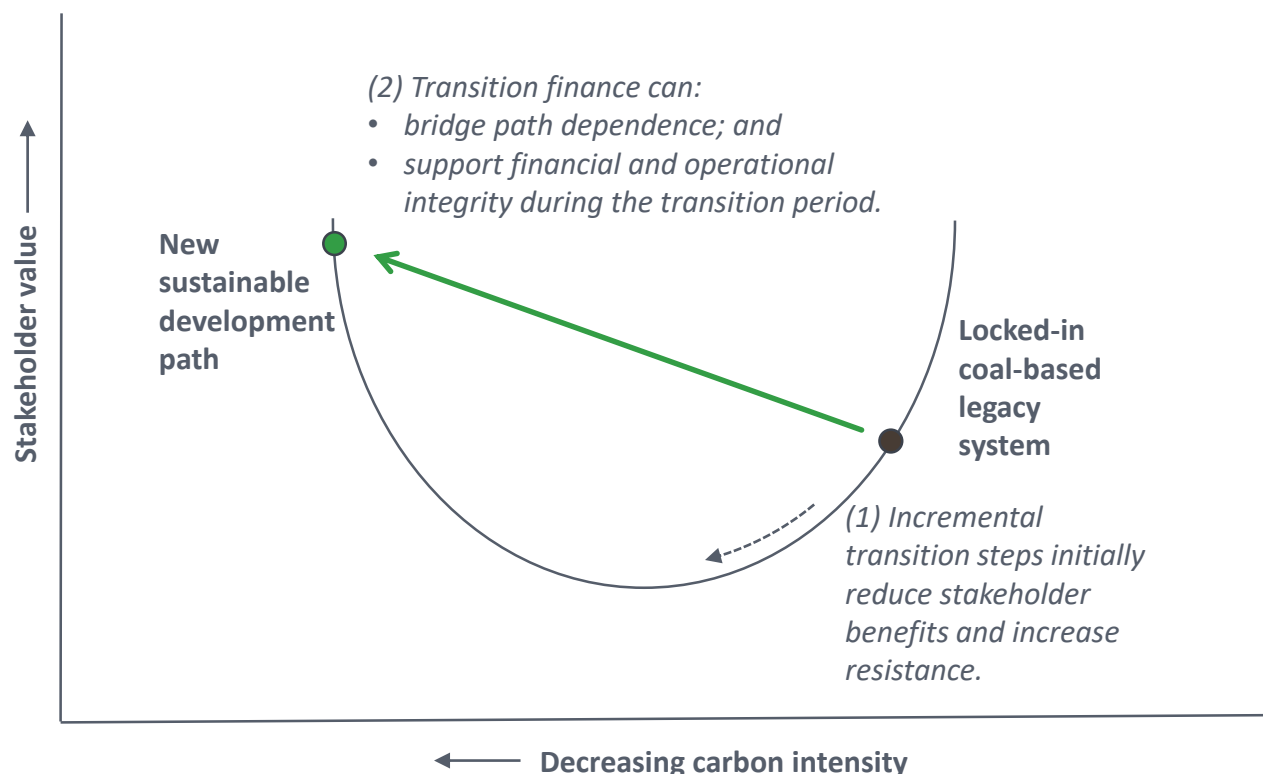


THE TRANSACTION ENSURES SOUTH AFRICA'S ECONOMIC POST-COVID RECOVERY IS GREEN

- COVID has severely weakened SA economy, national fiscus is strained – further limiting capacity to deal with Eskom's debt and operational costs
- SA Government has allocated \$29.9 Bn for social and economic response to COVID
 - With an emphasis on modernising and reforming network industries including energy; and stimulating inclusive and sustainable growth
 - Includes IMF \$4.3 Bn loan
- SA Department of Trade, Industry and Competition (DTIC) has signalled need for “tectonic shifts” towards greener industries to provide new opportunities for enterprise development and job creation.
- **The ambitious decarbonization of SA power sector locked in by the Transaction enables a massive green industrialization recovery without additional strain on the national fiscus.**
- **The immediate RE build programme also constitutes the shortest route to restoring adequate electricity supplies to power a recovering economy.**



TRANSITION FINANCE IS REQUIRED TO UNLOCK AN ACCELERATED TRANSITION BY OVERCOMING PATH DEPENDENCE



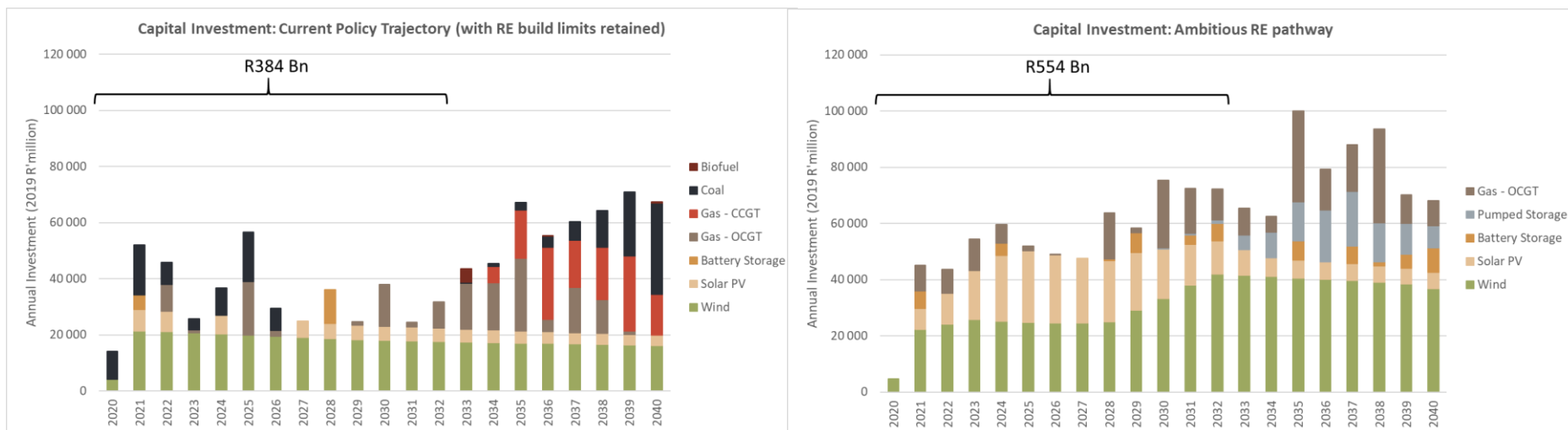
Transition finance is required to unlock an accelerated transition by:

- a) supporting substantial measures to overcome economic, social and political path dependence ;
- b) while protecting system integrity during the intervening period.

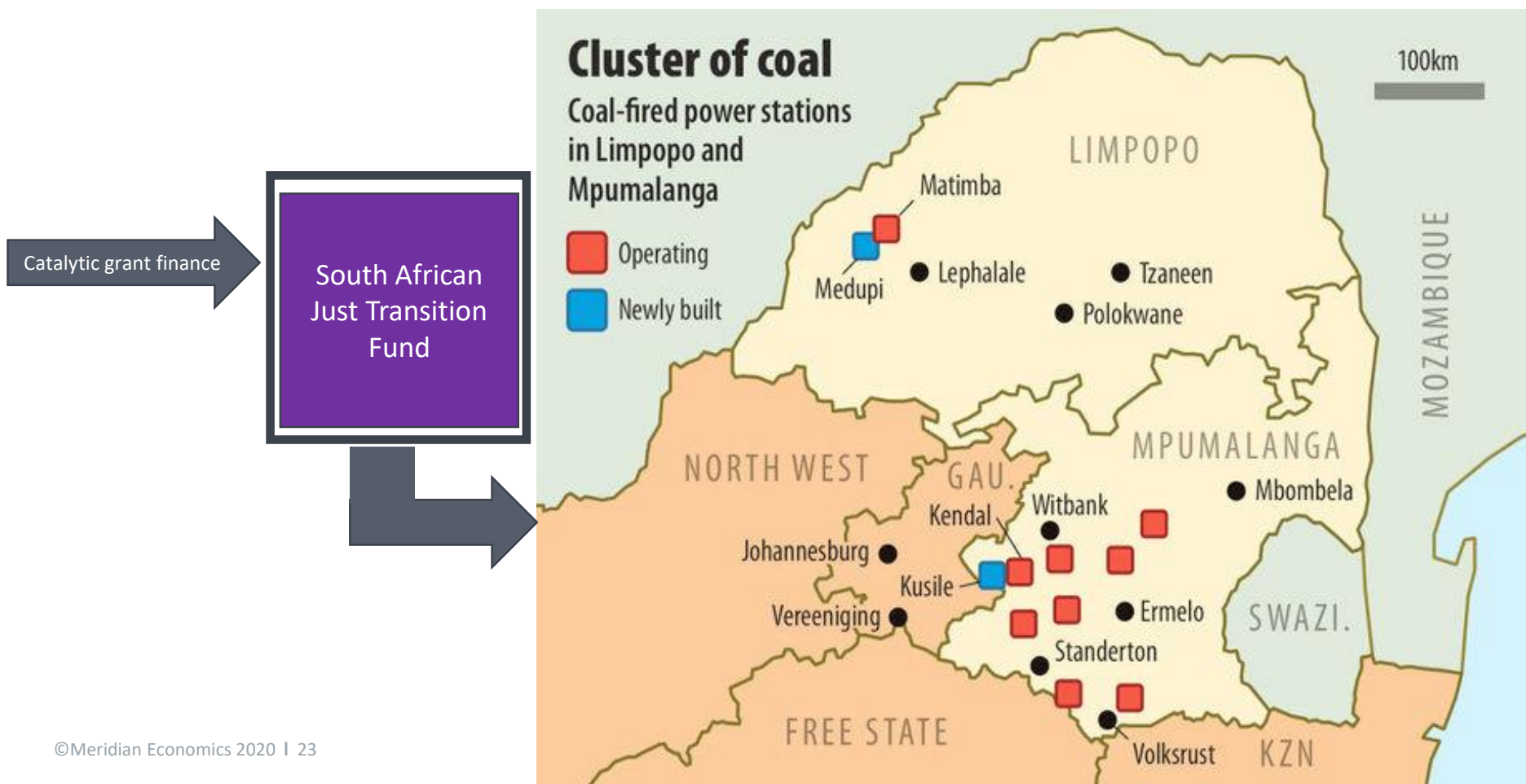


THE TRANSACTION TRIGGERS A SUSTAINED ENERGY SECTOR CAPITAL INVESTMENT PLAN FOR SOUTH AFRICA

- Over the next 10 years alone, ambitious RE pathways locked in by the Transaction could crowd in around **R200Bn capital investments** beyond those required for the IRP2019
- Such a programme creates the opportunity for **value chain localisation, reindustrialisation, and large-scale job creation** in manufacturing, associated services, construction, operations and maintenance
- Positioning SA as a green investment location will likely **increase access to green financing across the economy** as the international decarbonisation agenda accelerates

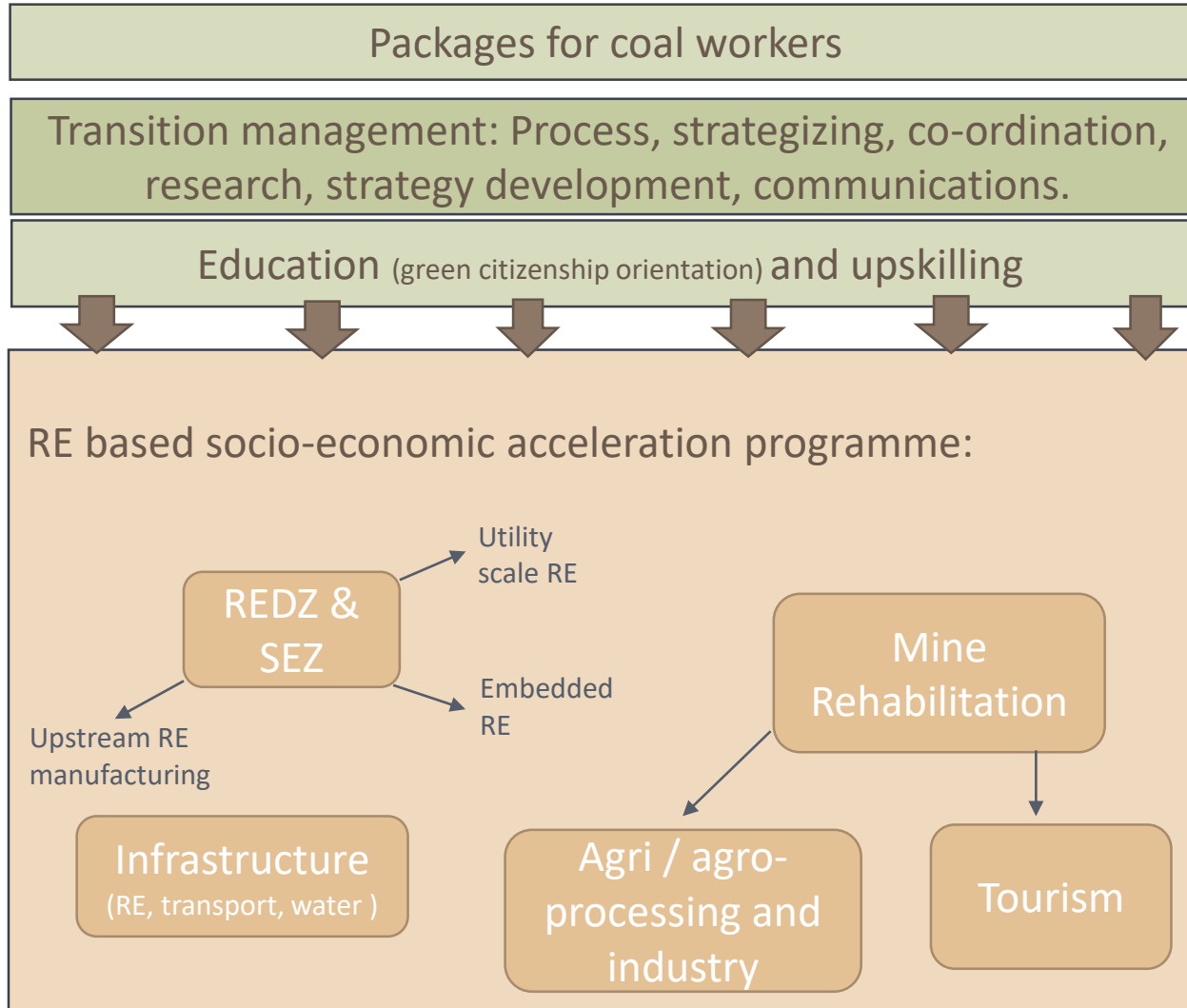


THE JT FUND CATALYSES FINANCING FOR MPUMALANGA FOCUSED JUST TRANSITION



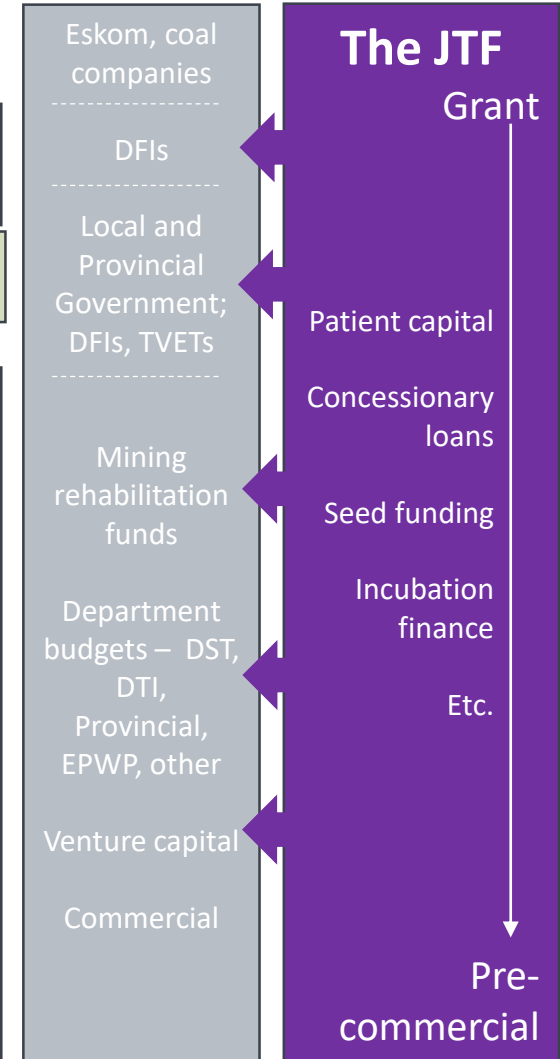
THE JUST TRANSITION FUND: CATALYTIC FINANCING FOR THE MPUMALANGA JUST TRANSITION

1. A Just Transition in Mpumalanga will involve public and commercial projects and programmes in various sectors to transition coal workers, enable economic and social development and attract investment to the region



2. Different sources of finance are available depending on the type of project

3. The JTF provides grant finance, catalysing other financing sources.



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**
- The SA power sector is able to offer additional CO2e savings at low cost, representing **highly efficient use of international climate finance**
- 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
- **Post-Covid, the co-benefits of such a green recovery programme are unequivocal**



What are the specific SA Power sector problems that transition finance could respond to?

Whilst essential to a post-Covid economic recovery, **there is no coherent enabling vision for the SA power sector going forward.**

As a **coal-based utility**, Eskom will increasingly be **unable to raise finance** from DFIs, the bond market and (ultimately) banks.

Government's capacity to provide **sovereign guarantees** is highly constrained

Eskom's **coal costs** have soared in recent years.

Eskom faces large **capex requirements** to repair its 2 newest coal plants, refurbish older stations and implement environmental retrofits.

SA coal workers and communities will be severely affected by the transition and only limited financing is available to provide a **Just Transition**.

SA has committed to increase the ambition of its **NDC** in 2020, and power sector decarbonisation will need to play a role in doing so.

How does Just Transition Transaction solve these problems?

Through decarbonisation milestones, **the Transaction provides this vision.**

The Transaction situates Eskom as the **'transition pivot'** in a green framework committing SA to accelerated decarbonisation. Restores access to normal DFI, bond market, bank and other institutional finance.

Subordination of the concessionary finance in the **blended structure** provides the security required for senior commercial debt.

A large least cost power investment programme will displace the most expensive primary energy first.

Much of **this expenditure can be avoided** with an accelerated IPP renewables programme.

A SA Just Transition Fund is capitalised with proceeds from the climate transaction. Other funding can then be crowded in.

Finance is conditional upon the electricity sector meeting predetermined emissions constraints in line with a more ambitious SA NDC

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
<http://www.dirco.gov.za/docs/speeches/2019/cram0923.htm>
- Socialised broadly in SA (Government, Finance, Labour, Business, NGOs, etc.)
- Socialised internationally with serious interest by DFI community and key counterparty Govts
- Announced by Eskom CEO as a central part of the utility's turn-around strategy <https://www.engineeringnews.co.za/article/eskom-sets-up-just-energy-transition-office-as-it-mulls-repurposing-options-for-power-stations-2020-06-25>



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