



© Ravin Rau/Unsplash

# 01

# OVERVIEW

**Cities are both a cause and a victim of climate change and have important reasons for addressing it.** While achieving the goals of the Paris Climate Agreement rests on many factors, much depends on what happens in cities. Cities account for 55 percent of the world's population and 80 percent of global gross domestic product (GDP). Their rapid and often haphazard growth has been a driver of climate change. Today, cities account for 70 percent of the world's greenhouse gas (GHG) emissions. They face unmanageable air pollution, traffic congestion, and waste accumulation. Their energy demands are increasing along with their vulnerability to disasters and climate shocks such as heat stress, flooding, and health emergencies. These challenges put increasing pressure on critical urban infrastructure and services, city livability, and business continuity and can impact city competitiveness in the future if not addressed today.

**By becoming climate-smart, cities can avoid locking-in to high-emissions and vulnerable pathways while enhancing future attractiveness and competitiveness.** As the world's population becomes increasingly urban, it is critical that cities invest in physical infrastructure and natural capital solutions that will enable them to reduce their emissions and increase their resilience to climate change and other shocks and stresses. A climate-smart city minimizes environmental damage, reduces air pollution and GHG emissions, and maximizes opportunities to enhance urban resilience, thereby improving the natural environment and overall livability and appeal of the city. Efforts to address climate change in urban areas through investments to enhance air quality, the circular economy, green buildings, green spaces as well as compact, optimal densification and urban form, add to quality of life which in turn attracts talent and businesses and increases the competitive edge of a city. Green investments can also help lower the cost of living and help attract or retain talent in urban centers.

**The private sector has an important role to play and its perception of climate investment is changing, particularly in cities.** The investment potential of climate-smart urban infrastructure is substantial. Some \$29.4 trillion in opportunities exist in developing countries alone across six urban sectors that reduce emissions: renewable energy, public transportation, climate-smart water, electric vehicles, and green buildings (IFC 2017). Climate resilience also presents significant private investment opportunities as climate change becomes an increasingly powerful macroeconomic trend impacting the real economy. As the climate change crisis gets bigger, better understood by markets, and better priced, so will the value, importance and return of companies and assets that are intrinsically resilient or provide resilience solutions. According to a recent survey of the world's biggest companies, climate adaptation products and solutions could result in \$236 billion in increased revenue (GCA 2019).

**Despite the investment potential, cities face unique challenges in accessing finance to fill the climate-smart investment gap.** The global need for urban infrastructure investment is estimated at \$4.5 trillion to \$5.4 trillion per year, with current levels of financing only reaching \$2.5 to \$3 trillion annually (CCFLA 2015). Infrastructure needs are particularly acute in rapidly growing cities in Africa and South Asia. Many of the barriers cities face in attracting private investment are rooted in their limited control over broader enabling environmental conditions, such as national policies and regulations, as well as limited institutional capacity to plan and design climate-aligned investment opportunities for the private sector (C40 and ODI 2019). Globally, cities vary widely in their ability to borrow money. Only 5 percent of the 500 largest cities in developing countries have a credit rating on international capital markets and only 20 percent have a credit rating in local markets (World Bank 2018). In addition, 56 percent of countries forbid any kind of borrowing by local governments, excluding them from issuing bonds, and only 16 percent grant any taxation authority to local governments.



**Private investors face their own challenges investing in urban climate projects.** The risks associated with emerging markets and developing countries are still present in cities. These include political risks, such as breach of contract, currency convertibility and expropriation of assets, and macroeconomic risks, such as currency fluctuation and inflation. At the urban level, investors are often less familiar with municipal governments and their financial conditions and finding a pipeline of sufficient size and quality can be difficult.

**Significantly more must be done to support cities and subnational governments in their efforts to achieve low carbon, resilient development.** There is no single solution to overcoming the complex, multifaceted barriers that cities face in financing climate change projects, particularly given the need for large, complex, cross-sectoral investments. Turning main sources of GHGs in urban areas into opportunities for green growth and creating livable cities requires integrated systems approaches and coordination with national government agencies. The scale and complexity of the investment needed will require enhanced technical capacity of people and systems in local municipal markets, national governments, and the private sector. This report outlines a number of innovative financing approaches and instruments that can increase critical climate investment in cities and help uphold the global commitment to keep global warming to less than 1.5°C.

**The objective of this report is to explore innovative financing instruments and approaches for catalyzing private sector financing to fill the climate-smart investment gap in cities.** The report reviews the existing literature, highlights key barriers in scaling-up private investment in climate-smart urban infrastructure, and showcases innovative financial de-risking instruments and other financial instruments for private sector financing for low carbon, resilient urban investments. The first chapter of the report introduces the topic and the second presents the challenges and the opportunities of urban climate investments. The third chapter discusses climate-smart cities and types of urban mitigation and resilience investments. The fourth chapter reviews and provides a framework to examine the interconnected layers of investment barriers specific to private investment, city financing, and climate-smart projects. Considering these risks allows investors and other stakeholders to better understand the complex web of challenges to expanding investment in urban climate projects and how they build on one another. Chapter five presents 10 case studies of innovative financing approaches to address some of these barriers and mobilize private sector finance for low carbon, resilient urban development. Finally, the conclusion in chapter six offers some key findings and considerations for the wider community of practice.