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FINANCING SUSTAINABLE PROJECTS AND ACTIVITIES

Innovative schemes based on public-private partnerships

EXECUTIVE SUMMARY

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Jorge Fernández Gómez

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Executive summary

The sustainable transition requires devoting, over the coming decades, large volumes of capital to investments in infrastructure, equipment, technologies, digitalization, knowledge, etc., in all sectors of the economy and in all countries.

On a global scale, the costs of investing in climate change mitigation and adaptation projects could amount to between 6% and 8% of global GDP over several decades. However, the financial system is not providing an effective response to this major challenge and traditional financing frameworks are failing to channel sufficient capital funds towards the sustainable transition. This is leading to a significant "green finance gap".

This is due, on the one hand, to limited public resources at the different layers of government and, on the other hand, to practical issues such as the difficulty of directing capital and private financing funds to projects involving immature technologies or solutions that are not yet commercially proven, legal and regulatory frameworks that are still under development, an insufficient alignment of private interests with net positive environmental and social impacts or the long payback periods for many investments.

In order to respond to the challenge of sustainable finance, new financing schemes are being developed based on novel forms of public-private collaboration that involve the participation of multiple actors, new business models and innovative financing strategies and instruments.

Among these innovative financing solutions and tools, we can highlight "smart" public financing schemes (e.g., with conditionality clauses), advanced financial engineering schemes, novel risk-sharing schemes between public and private entities, innovative revenue, payment and financing formulas (e.g., "as a service"), citizen financing structures (e.g., crowdfunding or crowdlending), nature-based and market-oriented solutions, sustainable funds, and solidarity or philanthropic contribution schemes (e.g., private sponsorship and financing of spaces, assets or services).

The new public-private partnership schemes offer a very promising tool for generating the private capital flows needed to finance sustainable projects with net positive social and environmental impacts.

Innovative public-private partnership (PPP) schemes include traditional PPP (3P) schemes specifically oriented to sustainable activities and the more novel 4P schemes, with the participation of foundations and other third sector entities, in addition to traditional public and private agents. These schemes are particularly appropriate for sustainable projects because of their flexibility, their ability to simultaneously leverage the strengths of the different types of agents (public, private and third sector entities) and their greater efficiency in aligning the financing needs of project developers with the preferences of private investors (banks, investment funds, etc.).

The review of cases shows that the adoption of 3P and 4P collaboration schemes can boost the flow of new sources of private capital to sustainable projects, and several lessons can be highlighted:

- *There is no single model:* existing collaboration experiences are very diverse and tailored and adapted to the objectives pursued, the economic, legal and regulatory context, the culture of the actors involved, the type of projects, etc.

- *Simple or complex governance:* collaboration agreements can be based on simple investment financing or leasing contracts for new infrastructure or on complex governance systems involving multiple stakeholders.
- *Leading role of the public sector:* public institutions acting as leaders, catalysts, patient financiers, promoters of major initiatives, guarantee providers, etc., play an essential role in launching and developing new financing schemes.
- *Importance of demand:* there is a growing demand for financing funds from project developers, but the mechanisms for identifying and evaluating their risks, costs and benefits must be improved.
- *Broad typology of new investors:* investors with heterogeneous profiles could provide capital under very diverse formulas in the new collaboration schemes (e.g., SMEs, citizens, family offices, business angels, associations, foundations, etc.).
- *Wide variety of financing structures:* the new financing schemes can be simple (grants, simple loans) or innovative, incorporating sophisticated financial tools and structures (e.g. mezzanine financing and other financial engineering solutions), "smart" or contingent financing clauses, lease back formulae, recoverable subsidies... and their use depends on each specific case.
- *Need for new skills and knowledge:* it is essential to develop skills in areas relevant to the promotion of PPP schemes (sustainability, financial, legal and contractual aspects, etc.) in order to promote new financing schemes.
- *An adequate legal and regulatory framework:* it is necessary to develop stable frameworks to foster investments in sustainability, which requires holistic strategies to boost the supply and demand for financing, generate relevant data and information, favor the implementation of market mechanisms and the deployment of new business models.

PPP collaboration schemes can be successfully scaled up to a supra-local or regional level, as the Greater Manchester experience shows.

The city of Manchester and its surroundings (Greater Manchester) are pioneering the implementation of new forms of collaboration to promote and finance projects related to environmental sustainability and aligned with business and industrial development. For the last decade or so, they have been developing a far-reaching, grand 4P collaboration scheme based on the management of different financing funds within the Greater Manchester Environment Fund (GMEF), a strategic public-private initiative. The GMEF acts as a meeting point for diverse entities and channels financing funds towards specific projects of various kinds with environmental impact and aligned with Greater Manchester's environmental strategy.

The case of Greater Manchester is of special interest for the Basque Country because it implements an innovative and large-scale regional (supra-municipal) 4P collaboration scheme oriented towards financing multiple projects related to sustainable transition. In general, this case highlights the importance of having a stable and robust political leadership, with a clear vision and strategy, supporting the development of a new financing and governance ecosystem in existing PPP institutions, using large strategic projects as catalysts for change, and fostering collaboration between actors to attract funding from external sources (e.g. central governments or the European Union).

A set of recommendations (for public institutions, private entities, etc.) aimed at boosting innovative green finance schemes in the Basque Country is proposed.

1. *Creation of an expert advisory committee on green financing*

An independent advisory committee of finance experts can help institutions set priorities consistent with the Basque Country's sustainable development strategy and lay the groundwork for a robust and effective sustainable finance strategy.

2. *Development of a Basque sustainable financing strategy*

This strategy, which should be aligned with other strategies underway in the territory, should boost the sustainable finance market, strengthen financing institutions and structures, develop rules and regulations that favor private investments in projects with environmental impact (e.g., related to the circular economy, carbon capture, biodiversity, etc.), enhance training and specific skills in environmental sustainability and green finance, and promote innovation in financial tools and products.

3. *Identification of areas of opportunity to develop the Basque green finance ecosystem*

Taking into account the different competitiveness and territorial development strategies in the Basque Country and each of the Historical Territories and the strengths in terms of natural capital and business fabric in the primary sector, industry or services, a map can be developed to identify the major areas of interest in different environmental fields (e.g., potential carbon sinks, natural spaces requiring regeneration, circular economy, waste management...). The ultimate goal should be to identify strategic projects towards which public-private financing funds can be channeled.

4. *Elaboration of a map of relevant entities in the green financing ecosystem*

The recently created BasqueFIK cluster can serve as a forum and meeting point for a wide range of existing entities that could be interested in actively participating in a sustainable project financing ecosystem.

5. *Assessment of the possibility of developing a public-private governance and financing model in the Basque Country*

Among the elements in the Basque Country that may help to foster the implementation at territorial scale of financing models such as the Greater Manchester model, we can highlight (i) the transformational leadership of the institutions and public entities in the different layers of government; (ii) the fundraising and management capacity of the Basque Government and the Provincial Councils; (iii) a tradition of multi-agent and public-private collaboration; (iv) the ecosystem of knowledge, technology and innovation entities; (v) the experience in financing deep transformations of the Basque economy and the existence of some relevant institutions in the financing sector (Elkargi, Basque Institute of Finance, financing vehicles in public companies, etc.); (vi) the experience of the Basque Government in the issuance of sustainable bonds.

6. *Launching a specialized forum of agents and initiatives to generate social capital, specialized knowledge, and greater information and awareness*

This forum can have different objectives (strengthen agent networks, explore potential project financing opportunities, attract financing, disseminate information, raise awareness among individuals and companies, etc.). Some examples of this type of initiatives would be a "Green Finance Summit", a "Green Investment Day", roadshows throughout the territory, green finance guides, etc.

7. *Generation of specific skills in highly specialized areas that strengthen the green finance ecosystem in the Basque Country*

This can be carried out through programs that generate transversal skills, including: (i) specialization in advanced green finance (in universities, vocational training or non-regulated vehicles) and in legal aspects related to public-private partnership schemes, etc.; (ii) environmental sustainability assessment methodologies and other general concepts related to sustainability; (iii) new business models focused on environmental sustainability, circular economy, valorization of natural resources (e.g., habitat banking, carbon offsets, recovery and management of natural spaces, etc.); (iv) training of persons and companies on responsible production and consumption, environmental impacts, etc.

8. *Provision by public institutions (Basque Government, etc.) of technical support services to project developers or potential investors*

The creation of a "Sustainable Financing Office", for instance, or a technical support structure (offering evaluation services, analysis, information...) in a public company or department of the Basque Government or associated to another relevant public institution can facilitate the decision making process regarding the development of sustainable projects and private investments in these.

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