PRE READING

Securing external financing is crucial for accelerating urban climate action. This guide outlines how to identify projects that appeal to external financiers and the essential steps for project preparation. In Module 5 Focus Session 1 of the NetZeroCities Online Capacity Building we will delve further into this concept.

1. Identifying Projects Attractive to External Financiers

External financiers, including private investors, look for specific characteristics and assurances in climate projects such as:

Clear Alignment with Climate Goals: Investors are increasingly aware of climate change risks and opportunities. Projects that clearly demonstrate their contribution to climate objectives, such as emissions reduction, are more appealing.

- Regulatory Alignment & Credibility: Projects that demonstrate clear regulatory alignment such as with the EU Taxonomy for environmental sustainability and broader EU strategic initiatives (e.g., European Green Deal, InvestEU) signals strong credibility to potential investors.
- Financial Viability and Returns: Projects must demonstrate a clear path to financial reward with a competitive risk-return profile, proving their financial soundness and viability through thorough assessment of cash flows, revenue generation potential, and overall financial sustainability.
- Revenue Generation Potential: Projects that can generate their own revenue streams are inherently more attractive, as this directly contributes to self-financing capacity and investor returns.
- Project Scale and Bundling: Individual small projects may not meet the minimum investment thresholds of larger institutional investors due to high per-project transaction costs. Cities can overcome this by aggregating smaller, similar projects into a larger portfolio to reach the necessary scale.

In addition, when evaluating public sector projects, investors also look for:

- Creditworthiness of the Municipality: For loans and bonds, a municipality's creditworthiness is often a critical factor. A higher credit rating can lead to more available finance at lower interest rates. One solution is incorporating project financing where instead of relying on the balance sheet of the municipalities, the project financier looks to the project itself to be financially viable and produce secure cashflows to repay debt and equity. Selecting the right business model with the right mix of revenue is key to a project's viability.
- Internal Capacity and Expertise: The municipality's internal capacity to prepare, execute and manage the project, is a significant consideration for financiers. Having skilled technical expertise can be a key advantage. *The NetZero Cities consortium provide technical assistance and financing expertise to support the municipalities from project preparation to financing.*
- Strategic Planning and Policy Signals: Long-term targets and policies that signal a clear direction for climate action provide confidence to lenders and investors for long-term urban infrastructure

investments. *The NetZero Cities consortium assisted Mission Cities to develop such plans and policies including Climate City Contracts and Climate City Action Plan earning them Mission City Labels.*

2. The Importance of Project Preparation

Thorough project preparation is paramount to ensure projects can attract external financing. This involves defining the project, assessing its viability, and presenting it professionally.

<u>Defining Financing Needs:</u> Utilize tools like the Finance Guidance Tool to clarify your city's specific financing needs and identify appropriate funding options. This tool uses a questionnaire to match project types with suitable funding mechanisms (e.g., grants, commercial loans, private equity, public-private partnerships).

<u>Developing an Investment Plan:</u> Cities should develop a long-term financial strategy, often part of a broader Climate City Contract, to achieve climate neutrality. This plan mobilizes public resources and outlines how to attract private capital. *Completed by all EU Mission label Cities.*

<u>Designing a Project Concept:</u> This initial step of project preparation involves developing the project concept and articulating it in a **Concept Note**. It's crucial to understand potential **revenue streams** from the outset, as this forms the core of the business case and signals financial viability to external private financiers. *The NetZeroCities Climate City Capital Hub can provide a sense check and support Cities in drafting sound Concept Notes and Business Models.*

<u>Feasibility Studies and Financial Modelling:</u> Establishing the financial and technical feasibility of projects is essential. Financial modelling helps assess the economic viability and potential impact of climate projects, providing insights into their financial implications. *Resources like the NetZeroCities Climate City Capital Hub provide technical assistance support in preparing investment projects including financial modelling, and the scoping and reviewing feasibility studies.*

<u>Refining Proposals and Documentation:</u> Project proposals need to be well-structured and comprehensive. Key documents and data should be prepared in advance to showcase the project's readiness and potential. *The NetZeroCities Climate City Capital Hub can assist cities in refining their proposals and preparing key documents/data for funding.*

<u>"Investment-Ready" Projects:</u> The goal of project preparation is to make projects "investment-ready." This includes understanding the project's financial structure, addressing potential risks, and clearly articulating its benefits and alignment with investor criteria. *The NetZeroCities Climate City Capital Hub has the technical assistance and financing expertise to support the project preparation.*

<u>Project Aggregation:</u> For smaller projects, bundling them together can create a larger, more attractive investment opportunity that meets the minimum thresholds of institutional investors and helps overcome high transaction costs. *EU Mission label cities are also looking to bundle projects.*

Glossary

- **Blended Finance:** A financing approach where concessional finance (e.g., grants or very low-interest loans) from public or philanthropic sources is strategically combined with commercial or market-rate finance from other public banks, or private investors
- **Capacity Building:** The process of developing and strengthening the skills, abilities, and resources of individuals, organizations, or institutions. In the NetZeroCities context this means providing technical assistance, training, and advisory support to project promoters and partners to

enhance their ability to prepare, implement, and manage projects effectively, thereby improving project quality and ability to be financed.

- **Cash Flows:** The movement of money into and out of a project or business over a specific period. Positive cash flow indicates that cash inflows exceed outflows, crucial for covering obligations and enabling further investment. Investors assess a project's cash flow to evaluate its financial health and capacity to repay debt or generate returns.
- **Concept Note:** A brief outline of a proposed project, summarizing its objectives, scope, methodology, expected outcomes, and preliminary budget. A concept note serves as an initial articulation of a project idea used to gauge interest and alignment form other parties.
- **Creditworthiness:** An assessment of a borrower's ability and willingness to meet their financial obligations.
- **De-risking:** The process of reducing or mitigating the perceived risks associated with an investment or project, often to make it more attractive to private investors.
- **Due Diligence:** The comprehensive investigation or appraisal of a potential investment or project to confirm all relevant facts and financial information, and to identify any potential risks. It is critical part of project appraisal process, covering financial, economic, environmental, social, technical, and legal aspects.
- **Economic Viability:** The assessment of whether a project generates benefits that outweigh its costs from a societal or macroeconomic perspective, often considering wider externalities (e.g., environmental benefits, job creation) beyond direct financial returns
- **Feasibility Studies**: An analysis conducted to determine if a proposed project is practically possible and viable. This involves a comprehensive assessment of a project's technical, economic, environmental, social, and financial aspects to determine its probability of success and suitability for financing.
- **Financial / Investor Returns**: The monetary benefits or gains an investor expects to receive from an investment, typically expressed as a percentage of the initial investment over a period
- **Financial Grants:** Non-repayable funds provided by an entity, often public bodies or foundations, to support specific projects or activities that align with their objectives.
- **Financial Modelling:** The process of creating a mathematical representation of a project's financial performance. It is a projection of costs, revenue streams, funding requirements, and various financial metrics (e.g., Internal Rate of Return, Net Present Value) to assess a project's financial viability, sustainability, and capacity to repay debt or generate returns for investors.
- **Financial Structure:** The composition of a project's or company's financing, detailing the mix of debt (e.g., loans, bonds), equity (e.g., shares, owner's capital), and other funding sources.
- **Financial Structuring:** The process of arranging the different sources and types of finance (e.g., debt, equity, grants, guarantees) to fund a project or entity. For the EIB, this involves designing an optimal financial package that balances risk and return for all parties, often blending EIB's own financing with that of other public and private co-financiers to make projects bankable.
- **Portfolio (Project Portfolio):** A collection of diverse projects or investments managed collectively by an organization or financial institution.
- **Private Capital:** An umbrella term for investment from non-public sources, typically through funds, in assets not available on public markets. This encompasses various asset classes including private equity, venture capital, private debt, real estate, and infrastructure.
- **Private Equity:** A type of private capital investment in companies that are not publicly traded on a stock exchange.
- **Project Aggregation**: The process of combining multiple smaller, often similar, projects into a larger investment package or programme.

- **Project Preparation:** The comprehensive set of activities undertaken to develop a project from its initial concept to a fully structured and ready-to-implement stage.
- **Technical Assistance (TA):** Non-financial support provided to help project promoters develop and implement projects. TA can include feasibility studies, environmental impact assessments, financial structuring advice, and capacity building to ensure projects are well-prepared and meet eligibility criteria.
- **Transaction Costs:** Costs incurred in making an economic exchange or financial transaction, beyond the price of the good or service itself. In the context of large-scale project finance, these can include legal fees, due diligence costs, and administrative expenses

Mission City

[Link to Case Study]

Group on the NZC portal

[Link to group in the portal]

Related projects and resources

- Related Project 01
- Related Project 02

Useful Links

1. Finance Guidance Tool - NetZeroCities.app
2. Module 5 - Spotlight session 1: Preparing a pipeline of projects for external financing - NetZeroCities Portal
3. Climate City Capital Hub - NetZeroCities
4. Climate City Contracts - NetZeroCities Portal
5. Climate-neutral City Contract Concept - NetZeroCities
6. Capital idea: How the Climate City Capital Hub aims to make the difference for cities' climate neutrality goals - NetZeroCities