Document:	EB 2021/133/R.25
Agenda:	16(a)
Date:	13 August 2021
Distribution:	Public
Original:	English

E

IFAD
Investing in rural people

Utilization of Resources under the IFAD Regular Grants Programme for the Implementation of the IFAD Climate Facility

Note to Executive Board representatives

Focal points:

Technical questions:

Jyotsna Puri
Director
Environment, Climate, Gender and Social Inclusion Division
Tel.: +393316235485
e-mail: j.puri@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra
Chief
Institutional Governance and Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

Executive Board — 133rd Session
Rome, 13-16 September 2021

For: **Approval**

Contents

Annexes

Recommendation for approval

The Executive Board is invited to approve the commitment of US$10 million from the regular grants programme for the Eleventh Replenishment of IFAD's Resources to resource and operationalize the IFAD Climate Facility.

I. Background and rationale

1. Natural resource degradation and climate change are threatening the viability of small-scale farmers, fishers, forest users and rural producers across the globe. Records from the World Meteorological Organization (WMO) show that 2020 was among the top three warmest years on record with an average global temperature of 1.2°C above pre-industrial (1850-1900) levels.[1] The increasing frequency and intensity of extreme climate events is leading to large-scale biophysical, social and economic losses, as well as losses of human lives. In rural settings, access to fertile land and usable water is becoming increasingly difficult for many small-scale farmers as competition for diminishing resources grows. Rural poor people are increasingly vulnerable, and their incomes and quality of life are in decline. An estimated 720 million to 811 million people went hungry in 2020, significantly more than in 2019.[2] Climate variability and weather extremes are major drivers of food insecurity, hunger and malnutrition. Under current climate projections, the food insecurity crisis will intensify and the second Sustainable Development Goal (SDG 2) of zero hunger and associated 2030 targets will not be met.

2. In response to this growing threat, governments are increasing their climate commitments and are enhancing their nationally determined contributions under the Paris Agreement. There is increasing country-led demand for investments in climate adaptation and mitigation – a trend that is expected to grow. Since 21 to 37 per cent of all greenhouse gas emissions are caused by food systems and small-scale farmers (<2ha) account for 84 per cent of farms globally, producing approximately 35 per cent of the world's food, investment in climate-resilient agriculture is essential.[3]

3. Targeted investments in small-scale agricultural systems can have a disproportionately large positive impact on the fight against climate change. Small-scale farmers are highly dependent on their land and ecosystems to maintain their livelihoods, and are stewards of natural resources. Investments in sustainable and climate-sensitive interventions in the sector will enhance climate resilience and sustainability as well as productivity and profitability.[4] Indeed, as cited by United Nations Secretary-General António Guterres,[5] every dollar invested in climate resilience has a rate of return that outstrips investments in humanitarian efforts by a ratio of 1 to 6.[6] Investments in climate resilience generally have a high cost-benefit ratio.

[1] WMO, "2020 was one of three warmest years on record", Press Release Number: 14012021, (January 2021), https://public.wmo.int/en/media/press-release/2020-was-one-of-three-warmest-years-record.
[2] Food and Agriculture Organization of the United Nations (FAO), IFAD, United Nations Children's Fund, World Food Programme and World Health Organization, 2021. The State of Food Security and Nutrition in the World 2021. Transforming food systems for food security, improved nutrition and affordable healthy diets for all. Rome, FAO. https://doi.org/10.4060/cb4474en.
[3] Lowder, S. K., Sánchez, M. V., & Bertini, R. (2021). Which farms feed the world and has farmland become more concentrated?. World Development, 142, 105455. https://www.sciencedirect.com/science/article/pii/S0305750X2100067X#b0065.
[4] K Swiderska, A Argumedo, Y Song, A Rastogi, N Gurung and C Wekesa, SDG2: Achieving Food Security, Sustainability and Resilience Using Genetic Diversity and Indigenous Knowledge (2018). http://pubs.iied.org/17410IIED/.
[5] https://www.un.org/press/en/2019/sgsm19807.doc.htm.
[6] https://www.fema.gov/sites/default/files/2020-07/fema_ms2_interim_report_2017.pdf.

4. The Global Action Plan for the United Nations Decade of Family Farming 2019-2028[7] reflects this need to engage small-scale farmers in the fight against climate change. Pillar 6 of the plan directly addresses the need to improve sustainable food systems by tackling the climate issue and enabling small-scale farmers to become critical agents of change, contributing to SDGs 2, 12, 13, 14 and 15. Consequently, there are growing country-level pressures to focus climate adaptation and mitigation interventions on small-scale agriculture.

5. Despite this widespread demand by countries for climate mitigation and adaptation action, IFAD finds that only 1.7 per cent of international climate finance flows target small-scale agriculture.[8] There is a clear and manifest need for increased climate finance to low-income countries (LICs) and lower-middle-income countries (LMICs) to meet the demands of enhanced national commitments and needs in the rural sector.

II. IFAD's enhanced climate ambition

6. In 2019, IFAD updated its Strategy and Action Plan on Environment and Climate Change 2019-2025[9] to reflect its growing ambition to address the mounting threat posed by climate change. The current approach builds on the substantial progress made in the programme of loans and grants (PoLG) in integrating environment and climate change into investments and programmes. In addition to updating its Social, Environmental and Climate Assessment Procedures and mainstreaming commitments, IFAD has increased its targets for climate finance within the PoLG. Over the Twelfth Replenishment of IFAD's Resources (IFAD12) period, 40 per cent of the PoLG is expected to be climate-focused (increasing from 25 per cent in IFAD11) and 90 per cent of all projects are expected to achieve an environment and climate rating at completion of at least four (out of six).[10] This reflects the importance of environment and climate as a key mainstreaming theme and emphasizes a significant increase in IFAD's commitment to combating climate change and reducing its negative impact on small-scale farming systems.

7. In keeping with IFAD's overall climate finance ambition, the Environment, Climate, Gender and Social Inclusion Division has increased its engagement with multilateral climate finance donors, notably the Green Climate Fund (GCF), the world's largest multilateral funder of climate investments in developing countries. As a GCF-accredited entity, IFAD has access to loan resources for climate activities in excess of US$250 million. This is far greater than the typical small and grant-focused adaptation-specific resources provided by other donors to date. It also opens the door to supporting innovative green and low-emissions climate-resilient financing mechanisms that can support large-scale national and regional climate interventions with the potential to bring about a paradigm shift. With this access, and in response to the significant country demands for climate finance, IFAD has developed an ambitious pipeline of client-driven projects targeting GCF resources, currently totalling US$1.5 billion to 2.0 billion.[11] Operationalizing this pipeline will increase climate finance flows directly to governments and national partners and also increase their capacities to manage climate-focused projects through IFAD technical assistance during their design and implementation, while contributing to nationally determined contributions and increasing country capacities in the long run.

[7] http://www.fao.org/3/ca4672en/ca4672en.pdf.
[8] https://www.ifad.org/en/web/knowledge/-/publication/examining-the-climate-finance-gap-for-small-scale-agriculture.
[9] https://www.ifad.org/en/-/ifad-strategy-and-action-plan-on-environment-and-climate-change-2019-2025.
[10] https://webapps.ifad.org/members/repl/12/02/docs/IFAD12-2-R-3-Rev-2-Tracked.pdf?attach=1.
[11] This figure does not include cofinancing from IFAD or other donors and contributors.

III. IFAD's climate finance experience

8. IFAD's previous experience has shown that designing GCF projects is costly, up to US$400,000 more per project, for reasons outlined below. Unlike other multilateral donors, GCF does not provide resources for project preparation, nor does it allow management fees to be used to cover design costs.[12] The additional project preparation costs far exceed the resources available under the administrative budget to cover project development.

9. Overall, the design and supervision of climate finance projects funded by supplementary funds, although essential to meeting IFAD's strategic targets and ambitions, bring a heavy burden. As a highly competitive donor, GCF requires different standards of technical and fiduciary inputs and due diligence. It also has a five-tiered review system that culminates in review by an independent technical advisory panel. During this review process, IFAD is expected to provide detailed climate, environmental and social impact assessments, analysis of historical climate trends and other variables at very high resolutions, economic and financial analyses (including costing of non-market goods in many cases) and due diligence of executing entities. These differ from IFAD's current standard requirements and practices, and have required the recruitment of expensive and highly technical consultancy services. GCF investments typically take between 20 and 24 months to go from idea to approval by the GCF Board. In addition to project design and supervision, setting up verification systems and tracking investment impact also implies additional costs. Further, the efficient and effective supervision and implementation of climate finance portfolios requires the use of specialized methodologies and IT systems that IFAD currently does not have in-house and has been outsourcing as needed, which is expensive. Additional costs (i.e. over and above regular PoLG costs) relate to portfolio management, legal fees, data management, maintaining donor relations and continual evaluation and updating of fiduciary standards.

10. In summary, for IFAD to deliver on its ambitions for increased leverage from GCF and other financiers in the climate space, that can in turn complement its PoLG and meet country needs, it must ramp up its operational and technical capacities and put new systems in place.

IV. Financing IFAD's Climate Facility

11. Against this backdrop, and in response to increasing demands and expectations for climate adaptation and mitigation finance from Member States, Management has established the IFAD Climate Facility (ICF). The overall objectives of the ICF are:

    a. **Objective 1:** Increase resources that enable IFAD to design and implement high-quality, sustainable and robust climate finance projects (and at the same time build IFAD's leadership and credibility in climate finance internationally, regionally and nationally, including in connection with the United Nations Framework Convention on Climate Change);

    b. **Objective 2:** Enhance IFAD's institutional capacities to increase the impact of IFAD/GCF investments, and contribute to the development of national capacities for managing climate-resilient investments; and

    c. **Objective 3:** Enhance IFAD's climate-related technical capacities, tools and management systems.

12. The ICF will be funded from the IFAD11 regular grant programme and managed as a distinct facility. The ICF will follow existing processes established for the Rural

[12] https://www.greenclimate.fund/document/general-principles-and-indicative-list-eligible-costs-covered-under-gcf-fees-and-project.

Poor Stimulus Facility and the Private Sector Financing Programme, so as not to set up new reporting channels.[13] The ICF differs from these facilities in that resources will not be channelled to finance specific projects but will be used mainly to build and enhance IFAD's capacities to leverage additional climate finance, primarily for LICs and LMICs.

13. With the establishment of the ICF, IFAD will be better placed to: (i) implement its increased supplementary climate finance portfolio going forward;[14] and (ii) make concrete progress in closing the large gap in climate finance to benefit small-scale agriculture in developing countries. It is important to note that establishing facilities or financial mechanisms specific to climate finance is standard practice across other multilateral development agencies (see annex II).

V. Use of facility resources

14. Taking into consideration existing capacities and the required institutional development (staffing, training, consultants, IT, results, audit, legal, financial reporting systems, etc.), IFAD expects to submit between 20 and 25 projects to GCF during the period 2022-2027. Realizing this pipeline will help leverage IFAD's PoLG with the potential for an additional US$1.5 billion to US$2.0 billion in GCF financing, while accounting for approximately 20 per cent of IFAD's total programme of work. Investing US$10 million in IFAD11 grant resources will therefore leverage significant GCF resources, in alignment with the guidance that grant resources should be instrumental to leveraging additional funds for climate change adaptation from GCF and other sources (strategic guidance note for IFAD grants 2019-2021).

15. In light of the above, the Executive Board is requested to approve the commitment of US$10 million from the IFAD11 allocation for the regular grants programme to resource and operationalize the ICF. These funds will be covered by a segregated budget line item and used as outlined in annex I. In addition to covering IFAD's supplementary climate finance ambitions for the period 2022-2027, this will provide the required lead and preparation time to meet IFAD12 commitments as well as those reflected in IFAD's Environment and Climate Change Strategy 2019-2025. At the end of this period, an evaluation of the ICF will be conducted for consideration of the next phase.[15]

[13] The ICF will be ring-fenced for accounting, reporting and budgeting purposes with financial reporting in an appendix to the consolidated financial statements, which are subject to annual audit by IFAD's external auditor and presented to the Executive Board annually.
[14] Synergies will be created with IFAD's own PoLG and lessons learned will strengthen IFAD's overall programme of work related to climate.
[15] It is worth noting that GCF limits the use of GCF fees to supervision and project-specific implementation costs incurred by an accredited entity. Though not currently under consideration by the GCF, if in future it were to revise its policy to include design activities, IFAD Management will update the Executive Board accordingly in a timely manner with a view to addressing potential implications regarding the ICF.

Estimated budget to cover IFAD's climate finance costs

1. This annex presents the estimated budget to cover IFAD's climate finance costs according to a detailed costing exercise undertaken in early 2021.

Table 1
Climate finance costs (2022-2027)[16]
(Millions of United States dollars)

Cost category	*Total*
Required funding	
Design costs	9.5
Portfolio-level activities and one-off costs	3.0
Subtotal (1)	**12.5**
Secured funding[17]	
Vote by correspondence approval to cover designs in 2021	1.2
GCF Project Preparation Facility resources	1.3
Subtotal (2)	**2.5**
Totals	
Total required (1)	12.5
Total secured (2)	2.5
Total financing gap (1) – (2)	**10**

2. The ICF will target primary cost categories associated with the development and management of IFAD's supplementary climate finance portfolio: first and foremost, additional project design costs; followed by corporate services, portfolio-level activities and one-off costs. Expenditures covered by the ICF will include those that are not eligible to be covered by GCF fees. Costs covered by the ICF include:

   (i) **Direct costs:** incurred only for, and directly attributed to, the project design activities identified as additional. Eligible direct cost expenditures can be grouped into two categories:

      (a) **Consultancies:** studies, technical assistance and other advisory services carried out for GCF designs or corporate services by international and/or national consultants. These also include doing greenhouse gas projections, developing clear climate rationales (including non-market values in economic and financial analyses, stakeholder consultations and vulnerability analyses and preparing climate risk assessments), preparing financial feasibility assessments of new markets and ensuring anti-money laundering and countering the financing of terrorism due diligence. It may also include design costs for other supplementary funds such as the Global Environment Facility (GEF) and the Adaptation Fund (AF) when not covered by agency fees.

      (b) **Salaries and allowances:** hiring additional staff to perform GCF project design, GCF portfolio management or corporate services related to the GCF or ICF and providing for additional costs relating to other

[16] The budget presented does not include costs that are eligible to be covered under the GCF fee policy. Costs presented in table 1 are specific to the additional costs incurred by IFAD for supplementary finance pipeline development and portfolio-level management that cannot be recouped from GCF fees or financed from IFAD administrative budgets. The use of these resources is therefore complementary to the use of GCF management fees and covers those costs that are not recoverable from GCF.

[17] The secured financing represented here accounts for resources already secured outside of the ICF to date. It is worth noting here that GCF Project Preparation Facility funds are meant for direct access entities; however, in the case of the Inclusive Green Financing initiative an exception was made for IFAD due to high political pressure to advance quickly on the programme to align with the French Great Green Wall Accelerator.

agencies such as AF and GEF that may not be covered and are additional to PoLG costs.[18]

(ii) **Indirect costs:** additional costs related to administrative services, office expenses and utilities required for ICF implementation and management. These include costs related to financial policy reviews, auditing accounts for agency requirements, separate financial management and legal requirements and reporting.

[18] Although direct costs are predominantly related to consultant services for design and one-off costs related to design, a small number of staff positions will be funded by the ICF to ensure that IFAD is building and retaining capacity in-house in the long term. GCF engagement is highly competitive and consultant-based institutional approaches are subject to high turnover and consequent uncertainty and variability in quality, which as a long-term strategy is not conducive to IFAD being impactful and efficient in the climate finance space.

Summary of practices of other institutions

1. Other accredited agencies have built their portfolios from a mixed use of supplementary fees (AF and GEF), their own resources and mobilizing additional technical assistance. The Asian Development Bank, for instance, has mobilized technical assistance to support GCF project design from its own climate change fund (from shares of proceeds from loan repayments to the Bank), its own special technical assistance fund and other donors such as the Nordic Development Fund. The United Nations Development Programme (UNDP) has drawn on its GEF and AF fee-funded expertise to enhance the quality of GCF project designs, in addition to mobilizing additional donor support through its regional offices. The World Wildlife Fund gained approval from its Board for three full-time core-funded GCF experts. The Food and Agriculture Organization of the United Nations (FAO) has reportedly invested core resources in the start-up of its GCF portfolio.

2. All organizations have pre-invested in dedicated GCF staff across expertise areas:

   - **FAO:** The GCF unit at headquarters is composed of 13 people: four staff, including a lead D-1, P-3, P-1 and one General Service, and nine consultants, split across four regions. The GEF team at headquarters is separate and led by another D-1.

   - **UNDP:** GCF, GEF and AF projects are managed by the same team, led by a D-1, supported by three P-6 positions specializing in adaptation, mitigation and forestry, as well as one legal counsel, two safeguards officers, one communication officer, one finance officer, and four to five administrative and support staff members. In addition, each regional hub has one regional environment team lead (D-1), and around 10 regional technical advisers (P-4/P-5 levels) per region. Each country office has its own environmental and climate officer dedicated to these funds (P-3/P-4 equivalent).