Meeting of the CTF Trust Fund Committee

Washington D.C. (Virtual)

Thursday, June 24, 2021

CTF RISK REPORT

SUMMARY

CLIMATE INVESTMENT FUNDS
1818 H Street NW
Washington, D.C. 20433 USA
T: +1 (202) 458-1801
climateinvestmentfunds.org

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PROPOSED DECISION

The CTF Trust Fund Committee reviewed the document, CTF/TFC.26/4, *CTF Risk Report*, and welcomes the progress that has been made in advancing the work of CTF.

The Trust Fund Committee requests the CIF Administrative Unit to continue to identify, assess, monitor and report the key risk exposures to the program.

1 Introduction

1. Inherent risks in the global economy remain high as the COVID-19 pandemic (the pandemic) continues to evolve, albeit the outlook is more benign compared to six months ago. The positive outlook is on the back of multiple COVID-19 vaccines that have been noted to be effective, and this provides a path for the global economy to begin to recover and rebuild.
2. All CIF programs continue to face heightened credit, market and operational risks due to the impacts of the pandemic. More specifically, the CIF Administrative Unit has observed numerous impacts of the pandemic on project implementation and financial strength CIF recipients. The outlook on operational risks impacting projects remains negative in the short-term as travel restrictions and supply chain disruptions continue to hamper the progress of some projects. These, however, are expected to abate over the next 24 months.
3. The consensus among credit rating agencies now is that the credit cycle may have bottomed, and defaults are expected to decrease in 2021. The view reflects the anticipated re-opening of the global economy as vaccine rollouts accelerate across the world. However, although the CIF Administrative Unit does not believe that the current heightened levels of expected defaults and losses which have resulted from the pandemic will increase further, they will likely persist for several years into the medium term and, in some cases, long term.
4. This report presents assessments of the more significant risk exposures facing the Clean Technology Fund (CTF).

1.1 Risk Exposure Summary

5. Data as of June 30, 2020, was used to flag projects for implementation risk and compare them with projects flagged in the previous CTF Risk Report (which used data as of December 31, 2019 for implementation risk). Certain projects use more updated information, as indicated in the report. Data as of March 31, 2021 was used to assess other risks and compare them with risk assessments in the previous CTF Risk Report (which used data as of September 30, 2020 for those risk assessments).
6. The following matrix summarizes CTF's key risk exposures.

Summary Risk Matrix - CTF			
Risk	**Likelihood**	**Severity**	**Risk Score**
Implementation Risk	Likely	Moderate	High
Currency Risk	Possible	Minimal	Low
Credit Risk	Likely	Moderate	High
Resource Availability Risk	Possible	Severe	High

7. Implementation risk for CTF remains **High** largely due to the outlook on operational risks associated with the impacts of the pandemic. As of June 30, 2020, five out of 113 projects representing USD 224 million (four percent) of program funding have been flagged for implementation risk. The program's implementation risk score has been **High** for the past six reporting cycles. The pandemic has affected three of the projects which are flagged for this risk.

8. During the reporting period the GBP appreciated against the USD by seven percent, causing the value of CTF's GBP 200 million promissory notes to increase in value by USD 18 million resulting in an unrealized gain of USD 14 million associated with these notes. Thus, the program's exposure to this risk remains **Low**. It should be noted, however, that if these notes remain unencashed for a prolonged period, they will be exposed to greater fluctuations in foreign exchange rates. The program's currency risk score has been **Low** for the current and prior two reporting cycles but had been **High** for the preceding four reporting cycles.

9. Credit risk exposure for CTF has increased and remains **High**. The impacts of the pandemic, have increased expected losses associated with CTF. However, the number of loans experiencing payment defaults decreased significantly during the reporting period as one defaulting loan representing USD 16 million, and another representing USD 15 million which had been in deferral, being cured with all interest payments and principal repayments now current. As of March 31, 2021, three loans were reported to be experiencing payment defaults (two representing EUR 8 million and one representing USD 12 million). Additionally, a EUR 16 million defaulted loan was sold in 2019. Three additional loans, although not yet experiencing payment defaults, are experiencing significant challenges and are highly likely to experience payment defaults imminently. The program's credit risk score has been **High** for the last six reporting cycles.

10. Resource availability risk remains **High**, however, the shortfall in available resources decreased from USD 703 million to USD 434 million.

2 Update on the Impacts of the COVID-19 Pandemic

11. CIF recipient countries continue to struggle due to the ongoing global and local economic challenges posed by the pandemic, and this is also impacting projects currently under implementation as well as projects in the CIF's programs' pipelines.

12. Developing countries including some CIF recipients, were already heavily indebted coming into the pandemic and face acute fiscal and monetary constraints to buffering their real economies from the adverse effects of travel restrictions, lock downs and social distancing measures put in place to limit the pandemic. Additionally, the risk of governments in developing countries recalibrating their budgetary priorities away from funding climate-related projects as they focus on addressing the effects of the pandemic on their economies and fiscal sustainability remains high.

13. All CIF programs continue to face heightened credit, market and operational risks due to the impacts of the pandemic. More specifically, the CIF Administrative Unit has observed numerous impacts of the pandemic on CIF projects' implementation, and CIF recipients' financial strength.

   - **Delays in project implementation:** Travel restrictions and lockdowns continue to impede the ability of consultants to get to project locations, workers to perform the necessary works to implement projects, and stakeholders to engage. Supply chain disruptions are delaying or preventing the procurement of essential equipment and supplies. Much of the time, only certain aspects of a project are delayed without causing an extension in the overall implementation timeline, however, in many cases, extensions of up to 24 months and/or project restructurings are required. In rare cases (so far) projects have been cancelled altogether. Target dates for funding approvals have also been extended. For reflow-generating projects, these factors in turn delay disbursements and the timing within which reflows from these projects will be realized.

- **<u>Economic impacts:</u>** The pandemic has depressed economic activity in most countries globally, with magnified effects in certain countries which are dependent on more vulnerable industries (e.g. travel and tourism). This has substantially weakened the fiscal strength of many countries, damaged the financial strength of many of CIF private sector recipients and industries, and created great financial uncertainty.

  Credit rating agencies have downgraded many of CIF's publicly rated recipients, citing the pandemic as a contributing factor. Consequently, for CIF public sector loan recipients, the expected losses implied by their credit ratings has increased. However, given CIF's experience to date with public sector borrowers (i.e. no defaults have been reported on CIF's public sector loans despite the fact that several of CIF's borrowers have defaulted on obligations to various bondholders) the CIF Administrative Unit believes that these credit rating downgrades are less of a concern than the risk of public sector funding recipients focusing their resources and efforts away from climate-related priorities in order to deal with the fallout from the pandemic in other areas.

  Additionally, the economic uncertainty resulting from the pandemic has had a chilling effect on the appetite for green finance in the private sector. Financial Intermediaries are reporting sharp declines or even a complete cessation of green finance lending for mitigation finance, including renewable energy and energy efficiency due to the current economic uncertainties attributed to the pandemic. Some projects involving power purchase agreements (PPA) with privates from retail or tourism sectors or public utilities are suffering from delays in construction, with various private investors deciding to retain cash rather than approve investments. Such projects are also experiencing payment delays via PPAs due to the economic slowdowns.

14. Additional potential impacts include:

    i. Increased demand for more concessionality by MDBs and funding recipients for pipeline projects, including requests to convert non-grant financing instruments into grants; and

    ii. Altered timing of repayments from loan recipients due to loan restructurings to allow for longer grace periods and maturities.

15. On the brighter side, vaccines have now been developed and are being distributed and administered to combat the pandemic. The CIF Administrative Unit anticipates that some of the impacts on project implementation will abate as COVID-19 vaccines become more widely available. Implementation delays due to travel restrictions, lockdowns and supply chain disruptions should decline. However, the rollout of vaccine distribution and administration has been very slow in most developing countries, and, for this reason,

although the CIF Administrative Unit expects these implementation delays to improve, they will likely persist for at least the next 24 months.

16. In the meantime, improvements will depend on the frequency, duration and severity of pandemic surges in recipient countries, as well as vaccines' efficacy against newer strains of the virus as these strains continue to evolve.
17. The CIF Administrative Unit expects the economic impacts and impacts on the credit quality and financial strength of funding recipients to persist for longer. In the past, individual public sector recipients have had to refocus their budgetary priorities away from climate-related initiatives in response to more localized natural disasters. The pandemic has been global in nature, and the CIF Administrative Unit believes there is a risk of more widespread budgetary recalibrations to address the impacts. The decline in private sector appetite for green finance is likely to persist well beyond the next 24 months.