



IFC Facilities to Purchase Carbon Credits

The International Finance Corporation (IFC), the private sector investment arm of the World Bank Group, is a global investor and advisor committed to developing a sustainable private sector in emerging markets. Given IFC's experience with projects in developing countries, IFC is well positioned to assist project sponsors with participation in the rapidly growing market for 'carbon credits'.

IFC's Carbon Finance Facilities

What are the Facilities? The Facilities are arrangements under which IFC will purchase carbon credits for the benefit of the Government of the Netherlands under the international emission reduction transfer rules of the Kyoto Protocol. IFC presently has about \$80 million under management in two facilities to purchase credits: (i) the IFC-Netherlands Carbon Facility (INCaF) operating under the rules of the Clean Development Mechanism (CDM); and (ii) the Netherlands European Carbon Facility (NECaF) operating under the rules of the Joint Implementation (JI) mechanism and managed jointly with IBRD. Payments for carbon credits purchased will be made to eligible projects in emerging markets and will provide them with additional revenue.

What are 'Carbon Credits'? Carbon credits are greenhouse gas (GHG) emission reductions that are created when a project reduces or avoids the emissions of GHGs, such as carbon dioxide or methane, relative to what would have been emitted under a 'business as usual' scenario. For example, a new wind power plant that displaces existing or expected coal-fired power generation would create a significant amount of credits, as would a project at a landfill that captures and utilizes some or all of the methane that previously escaped into the air. In contrast, a wind power project that offsets hydropower would not generate credits as the baseline itself has no GHG emissions.

Eligible Projects

What types of projects are potentially eligible? IFC has a particular interest in projects of the following types:

- ▶ renewable energy projects (e.g., biomass, wind, geothermal) that displace use of fossil fuels;
- ▶ energy efficiency projects, supply side or demand side, that reduce consumption of fossil fuels;
- ▶ recovery and utilization of methane from, for example, waste landfills and coal mines;
- ▶ switching from fuels with greater to lesser GHG intensity (e.g., from coal to natural gas);
- ▶ recovery and utilization or destruction of industrial gases that are potent GHGs (HFC, N₂O, PFCs, SF₆); and
- ▶ in Europe only, certain projects to plant trees or other biomass to sequester carbon on lands that have not been forested since 1989 or later.

Please also see additional selection criteria below.

Carbon Contract

What type of funding will be provided? If a project is approved, IFC will make periodic payments (e.g., annually), on behalf of the relevant Facility, to the project company upon certification and transfer of the legal title for the actual credits. Partial advance payments for credits to be generated in the future *may be* considered, but only under exceptional circumstances.

The Government of the Netherlands will use the purchased credits to meet its GHG reduction obligations under the Kyoto Protocol. The credits will be purchased and paid for regardless of whether or not the Kyoto Protocol is in force.

What are the key terms in a carbon contract? A contract to purchase carbon credits will specify:

- ▶ the *volume* of GHG emissions that are expected to be reduced, measured in metric tonnes of carbon dioxide equivalent (CO₂ equivalent);
- ▶ the *price* agreed per tonne of CO₂ equivalent; and
- ▶ the *period* over which credits will be purchased and payments made. All credits contracted for must be generated before the end of 2012.

Other terms and conditions will also be negotiated and agreed by IFC and the project company.

Can this contract be used to facilitate conventional financing? The contract will specify a series of cash flows to be paid to the company on delivery of certified credits over a period of time. Conventional providers of financing may choose to consider these additional cash flows when evaluating the capacity of the company to repay debt and/or provide a return on equity. IFC may consider lending against this forward stream of revenues for projects that are also financed by IFC.

How long will it take to negotiate a contract? A quick initial assessment will determine IFC's potential interest in a project. The time required for IFC to evaluate, negotiate and finalize a contract is expected to be about 6 months. However, the need to interact with several other parties, e.g., to validate the project design with an independent auditor and to receive host-country approval (please see below), is likely to lengthen the total time needed for IFC to process a project to about 6-8 months. Any delays in external processes and approvals could further extend the timeline, as could delays in reaching financial closure on the project itself.

Project Selection Criteria

What are the main project selection criteria? In addition to the project preferences noted above, there are a number of selection criteria including, but not limited, to:

- ▶ **Location:** Projects must be located in an emerging market country that has either ratified the Kyoto Protocol or is in the process of doing so. A list of eligible countries is available on request.
- ▶ **Likely Project Closing:** Projects must be likely to reach financial closing in the short term.
- ▶ **Amount of Credits:** Projects must generate a minimum number of credits through to 2012. As this requirement varies by facility, please contact IFC for more information.
- ▶ **IFC and non-IFC Investments:** While IFC's preference is to purchase credits from projects that are also financed by IFC, it will also consider projects that are not IFC-financed. For projects not financed by IFC, projects should have well-established sponsors with access to confirmed sources of conventional financing. Such projects will also require additional due diligence on project fundamentals.
- ▶ **Environmental and Social Impact:** All projects, whether financed by IFC or not, must comply with IFC's Environmental and Social Policies and Guidelines. Projects that have large-scale adverse environmental or social impacts will not be considered.
- ▶ **Host Country Approval:** The government of the host country will have to approve the project under the CDM or JI mechanism of the Kyoto Protocol. IFC can support the application of the project company to the government for such approval. The host country will also need to have ratified, or initiated domestic procedures to ratify, the Kyoto Protocol.

- ▶ **Independent Verifications:** The initial design of the project will need to be validated by an independent auditor, as required under the Kyoto Protocol. In addition, the credits generated by a project must be verified and certified periodically by auditors.

Working with IFC

What are the benefits of working with IFC's Carbon Facilities? The facilities, managed by IFC's Carbon Finance Unit, could provide projects with a future stream of income that may otherwise not be available. In addition to this direct financial benefit for companies, host countries will gain access to efficient, clean technologies at a lower cost and will achieve more environmentally sustainable economic growth.

Why work with IFC? IFC is the largest multilateral source of loan and equity financing for private sector projects in the developing world. In the year ending June 2004, IFC committed \$4.75 billion of investments for its own account in more than 215 projects in developing countries around the world. IFC also has a dedicated Carbon Finance Unit to assist project sponsors to access the market for carbon credits, as well as contribute to the development of an important new market for environmental services.



Contact Information

For further details or information on the IFC's carbon finance facilities, visit www.ifc.org/carbonfinance, e-mail carbonfinance@ifc.org or write to:
Program Manager
Carbon Finance Unit
Environmental Finance Group
International Finance Corporation
2121 Pennsylvania Avenue, NW
Washington, DC 20433 U.S.A.
Telephone: 202 473-4194

