Exploring Innovative Mechanisms for Financing Smart Cities: Innovations from the health sector

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Innovative mechanisms: Definition

* **Innovative financing mechanisms, in general, must provide for the following:**
  - Sustainability
  - Predictability
  - Transparency
  - Leverage
  - Partnerships

* **Models that:**
  - Can maximize impact and potentially generate returns for investors;
  - Engage a new tier of investor in terms of both financial capacity and risk appetite for financial products across asset classes;
  - Diversify financing to reduce risk.

Innovative mechanisms

* Advance Market Commitments (AMC): Fund structure designed to catalyse investments, from a mixture of government/ public funding with a possibility of other sources of funding – Private, Foundations, CSR.
* Revolving Fund: Multi-sourced, diversified capital structure.
* Bond/ Loan structure using capital markets to finance, with government/ public sector commitments backing the borrowing.
* Private partners including suppliers JVs and upstream integration.
* Social Impact Bonds: PPP Structures with risks being transferred to private investors/ capital markets/ individuals. Returns driven and impact investment.
* Social Impact Funds: Private Fund structure with a public and private investor base, possibility of leverage from development banks/ loans. Returns and revenue driven.
* Islamic Financing/ CSR: Corporate sector funding, unlocked often using public sector incentives.
* New donors, Bilateral Funding and Philanthropy +++++++++

Advanced Market Commission (AMC)

Defined: A promise or agreement to take some future action. For example, a promise by a buyer to purchase goods at a price set beforehand is an advance commitment. By removing two important uncertainties – price and demand – from the equation, the mechanism is being hailed by many as the holy grail of spurring development growth.

Structure: A

Fund, financed by the government and other health organisations where monies would be earmarked for specific Target Projects (TPs).

Evidence: The pneumococcal vaccine related AMC is a prime example of a successful use of such a mechanism. In the pilot AMC, donors committed funds to guarantee the price of vaccines once they have been developed.

Points to consider: Volume and pooling, Pre-Qualification, Joint Fund, Leveraging using development banking borrowing (as lower risk), Stimulated Demand and Increased Supply for Revenue generation.

Complementary forces need: *to an AMC are critical for creating the enabling environment necessary for its success (e.g. GAVI's Accelerated Vaccine Introduction initiative, WHO recommendations, GAVI co-financing policy, GAVI's operational partners)*, Non revenue driven, Specific use of funds.

Catalytic Smart City Fund - PPP

Defined: A Revolving PPP Fund designed to provide the 1st layer of risk in order to attract other forms of investment and lending, along the lines of a social impact Fund.

Structure: The aim of the Fund will be to create a transparent, well governed, project catalysing, financing facility that can attract funding from various financing sources that are not sovereign guaranteed.

Evidence: There are several Funds in discussion such as the one being suggested. The creation of such a Fund could have a first mover advantage, be highly innovative (attracting new sources of financing). Local Health Investment Fund is a smaller prototype of this ideology, as is the power of nutrition.

Points to consider:

- Well structured fund able to attract international/ domestic finance sources.
- Strict eligibility criteria for projects based on prioritised need, volumes and a diversified portfolio.
- Commercial rationale for projects to attract private sector.
- Well designed and ready 'Anchor Projects' that can seek funding from the Facility to demonstrate success.
- Eco-system in terms of HR institutions, NRAs, Policies, Management, plus infrastructure, incentives.

Catalytic Smart City Fund (CSCF)

Leveraged & Diversified Capital Structure

- Matching funds
- Trade and Aid funds
- Phlianthrophy

Leverage Finance
- Development/ Commercial Bank
- Social Impact/ Pension Funds
- Bond/ Corporate Investors

Seed Funding
- Governments
- Organisations – Foundations
- PE Funds (GHIF)
- Fatigued/ New Donors

Non-returns Based Funding

Loans

Repayable from Sales, Take-out Financing

Seed-funding

Shareholding

Catalytic Smart City Fund (CSCF)
Independent, Bankruptcy-Remote, Special-Purpose Trust

Equity

Management PPP & Investment

Fund Management Company (PPP)
- **Professional Fund Manager**
- **Governments (Finance Ministries)**

Investment & Advisory Committee (PPP)
- **Governments (Finance Ministries)**
  - **Industry**
  - **Stakeholders**
  - **UNEP, UNECE, UNIDO**

Shareholdings

Investments

DIVERSIFIED INVESTMENTS IN SMART CITY PROJECTS

Domestic/ Regional Health Bond Programmes

Defined: Using as a basis the IFFIm model of securitised bonds, there is much discussion if adapted models could be created at the regional or national level to fund other development such as in smart cities. Borrowings from the capital markets regionally/ eurobonds potentially to fund manufacturing.

Structure: A securitised regional bond programme, that could be securitised using the guarantees of governments in the EAC, and over-collateralised using the future income flow from revenues or other income models. The bonds would be long term, issued in the local market, with financing raised in the local capital markets.

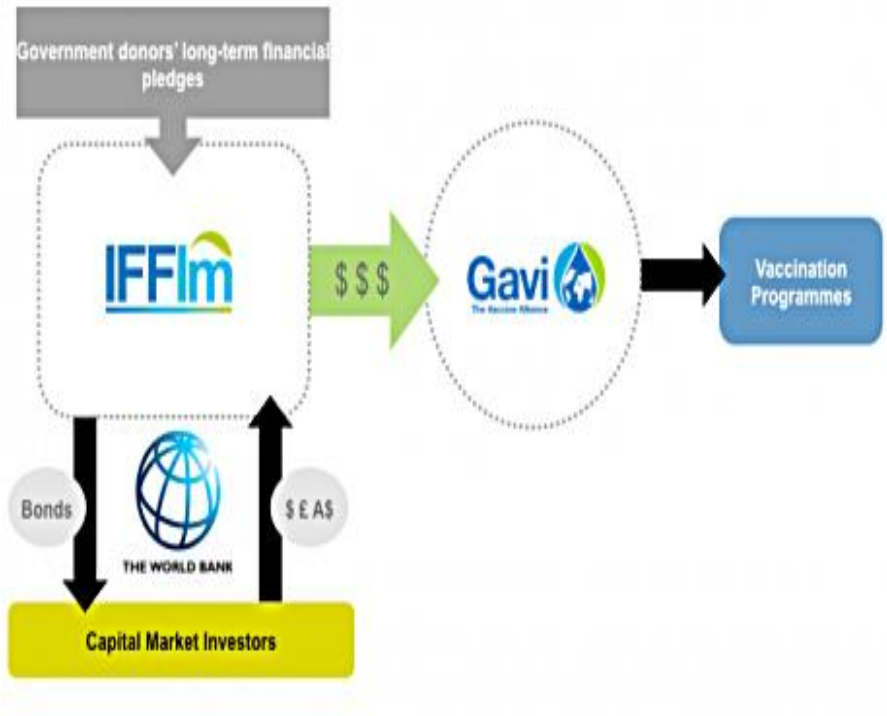
Evidence: The IFFIm platform, Social Impact Bond Initiatives including bilateral bonds.

Points to consider:

- Securitisation Law unutilised thus far and the depth of domestic and regional capital markets.
- Capital Market appetite and knowledge of risks/ understanding.
- Projections in terms of timing for the project and returns scenarios.
- Size of the borrowing? Capital Markets needs.
- Rating issues and international debt issues.

IFFIm Bond Structure

- Rapidly accelerate the availability and predictability of funds for immunisation.
- Uses international capital markets to raise funding for the purchase of vaccines, by securitising (using as collateral) financial commitments from highly rated governments.
- Uses long-term legal commitments from donor governments to issue 'vaccine bonds' in the capital markets (up to 20 years), raising funds (borrowings) immediately available for GAVI programmes, thereby creating the "predictability" that is necessary for long-term budget and planning decisions for programmes.
- Refinanced USD 6.5bn backed by legal commitments from the governments.
- The 3rd international conference in Addis Ababa in 2015 for financing and development has also backed this mechanism for wider applicability.



Viability Gap Funding

Defined: VGF is effectively a fund set-up by government(s) to supplement returns into a specific priority industry. It serves as a feature to attract further private sector funding.

Structure: No specific structure needed but a corpus fund would be created by the governments typically and earmarked to bridge the GAP between economically justified projects that fall short of financial viability.

Evidence: Several of these exist in the world of infrastructure though not necessarily in health. Solid waste management project in Kampala, Uganda; Highway projects in India, Vietnam Hydropower, Cambodia Renewable Energy.

Issues to Consider:

- Usually limited amount of funding (uptil 20% of the entire project).
- Favorable Terms and Return Profile.
- VGF grants are only disbursed after investors have committed equity to the project, thereby putting their money at risk for a project they believe to be viable.

Achieving a Blended Mechanism

One could envisage a production line style of financing, with:

* **Multilateral Loan:** An anchor project platform could seek a multilateral bank loan to allow a mixture of projects to be financed ('Core' and 'Related').
* **PDA:** A Project Design Advance from the governments/ foundations is envisaged to prepare initial projects and set up a project platform.
* **The first loan tranche:** Could be for a core projects as identified by experts – which could theoretically use 100% multilateral financing – a PPP arrangement could then mean that the private contractor need not finance any capex and have a revenue model backed by the project platform with assurance to pay possible revenue gaps. Viability GAP funding could also be investigated by governments where the manufacturing will take place.
* **Other loan tranches:** Multilateral funds through later tranches can also be capped at 20-30% of a project to allow for financing from other sources (private sector)– this allows the impact of such funds to be much bigger and catalytic for private and commercial sources.
* **Non-Sovereign Loan:** Some of the underlying manufacturing projects may be developed for bankability.

Linking Funding to the Funded

In general, any platform to finance manufacturing must try to include initiatives to tap financing from:

* The people that get the most benefit from the services being build – the populace – individual investments from conduits and bonds at the senior level debt lending.
* Businesses that stand to benefit from the development – through indirect effects on health and better standard of living.
* Businesses that are benefitting from the city.
* Allow leveraging of government and public sector equity and budget allocations.
* Allow development and commercial banks to contribute in areas and stages of knowledge and risk acceptance.

Thank you

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