

Executive Summary

THE FUND

The World Bank has created a new fund to provide carbon finance to small-scale projects in least developed countries (LDCs) and poorer areas of all developing countries. The Community Development Carbon Fund (CDCF or the “Fund”) will link small-scale projects seeking carbon finance with companies, governments, foundations and NGOs seeking to improve the livelihoods of local communities and obtain verified emission reductions (ERs).

Contributors to the Fund (the “Participants”) support projects that measurably benefit the poor and receive “Development + Carbon” ERs (ERs with the added value of development benefits) that have the potential to be recognized under emerging global, national and regional programs.

The Fund is a public-private initiative established as a trust fund, similar to the Prototype Carbon Fund (PCF), and is administered by the World Bank. The target size for the Fund is US\$100 million. Governments and companies from Canada, Europe and Japan have already subscribed to the CDCF. The minimum contribution is provisionally set at US\$2.5 million for private sector and US\$5 million for public sector Participants.

An Advisory Group of outside experts, co-convened with the International Emissions Trading Association (IETA), provides guidance to the World Bank in ensuring the Fund’s environmental and social objectives are met. In parallel with the Fund, the World Bank is also mobilizing resources from donors to support technical assistance and project preparation.

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RATIONALE

Many small-scale projects, such as mini- and micro-hydro, wind energy, small municipal and agricultural waste projects, energy efficient appliances, clean transport and agro-forestry projects offset or sequester greenhouse gases. Least developed countries, in particular the poorer communities of all developing countries where small-scale projects tend to be located, are at a disadvantage when competing for carbon finance and they are likely to be bypassed by carbon investors.

Concern over this market bias has led the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) to find ways to reduce the transaction costs of small-scale CDM projects by simplifying methodologies and procedures. It is in this context that the World Bank has developed the Fund, in line with its role as Trustee for the PCF and its responsibility to help its client countries advance the goals of the UNFCCC.

Carbon assets similar to those to be generated by the Fund are reported to be commanding a premium in the market. By working through local intermediaries such as financial institutions, micro-credit organizations and NGOs, and by streamlining small-scale project procedures compatible with on-going UNFCCC efforts, the Fund seeks to lower the transactions cost and risks of developing small-scale projects.

FUND BENEFITS TO PARTICIPANTS

All Participants

- All Participants receive high value “Development + Carbon” assets with measurable sustainable development benefits, and may use the ERs to meet their regulatory or voluntary compliance requirements. They would be able to demonstrate support for sustainable development, diversify their ER portfolios and learn about creating, and bundling carbon assets.

Private Sector & Corporate

- Companies advance their sustainable development and corporate responsibility agendas, help meet voluntary or mandatory carbon compliance targets, learn about carbon market instruments and gain competitive advantage.
- Emissions brokers receive a credible supply of high quality emission reductions for their retail businesses for socially responsible buyers or for investments in green energy.

Public Sector and Public Interest

- National, state and local governments, foundations and NGO Participants can leverage private investment in cleaner technologies, demonstrate support for action to mitigate climate change and improved environmental management, and support sustainable development in impoverished regions in developing countries.

FUND BENEFITS TO HOST COUNTRIES AND COMMUNITIES

Financial Resources

- The fund directs public and private sector carbon finance to small-scale projects in least developed countries (LDCs) and poorer areas of all developing countries.

Technology

- Host countries and communities are able to implement sustainable technologies and create opportunities to reduce poverty.

Implementation Capacity

- Local communities and organizations build financial intermediation capacity to bundle small transactions to lower market entry barriers and costs.

PROJECT PROPOSAL EXAMPLES

Energy services

- Micro-hydro developed by an NGO provides electricity for small community agricultural cooperatives.

Electricity from agricultural waste

- Power plant uses waste rice husks as fuel.

Renewable energy

- Utility uses wind turbines to provide energy services to unserved customers.

Participants in the Fund

Potential Participants wishing to join the Fund, which has been operational since July 2003, are invited to sign a non-binding Confidentially Agreement to indicate their interest in learning about the Fund's design and operational features. They will be given access to a password-protected website containing the CDCF Information Memorandum, Participation Agreement and Promissory Notes.

Concept Note

RATIONALE

The Community Development Carbon Fund (CDCF) links small-scale projects with a growing niche market demand for verified emission reductions (ERs) that have the additional attribute of contributing to measurable sustainable development benefits.¹ The ERs generated by small-scale projects in the CDCF portfolio have a well defined sustainable development component intended to benefit local communities. There is already some evidence that carbon assets similar to those generated by the CDCF are attracting a premium in the carbon market.²

Project proposals received by the Prototype Carbon Fund (PCF) and input received from host countries, NGOs and project developers suggests that there are many small-scale projects seeking carbon finance. Examples include mini-hydro, wind energy, small municipal and agricultural waste projects (with methane emissions), energy efficiency, clean transport, and agro-forestry projects eligible under the Kyoto Protocol.

Carbon finance, for the most part, is not reaching these small-scale projects. Least developed countries, and poorer communities in all developing countries where small-scale projects tend to be located, are at a disadvantage when competing for carbon finance. Evidence from the PCF³ experience, the Pilot Phase of Activities Implemented Jointly (AIJ)⁴ and other programs indicate

that the lion's share of global carbon finance slated for CDM will likely go to a few, large developing countries with large projects for the following reasons:

- transaction costs per ton of ERs for small-scale projects are higher than for large projects; and,
- investment conditions in many small developing countries and poorer communities are unfavorable or risky.

OBJECTIVES OF THE CDCF

- Reach communities not presently benefiting from development through carbon finance.
- Generate high value ERs with significant sustainable development attributes that will be potentially creditable against the obligations of Annex B Parties to the Kyoto Protocol as well as other emerging mandatory and voluntary greenhouse gas markets.
- Offer relevant information and support to the UNFCCC Parties as they streamline procedures for small-scale projects and projects in least developed countries.

BENEFITS TO PARTICIPANTS

Socially responsible businesses, governments, municipalities, emissions brokers, banks, foundations and NGOs will accrue the following benefits:

- ER portfolio diversification and risk management through a large portfolio of small-scale projects in several countries to meet obligations under emerging carbon management regimes.
- Knowledge about creating differentiated, potentially premium products for a growing socially responsible market.
- For companies, a concrete and visible contribution to their sustainable development and corporate responsibility agendas.
- For emissions brokers and traders, a supply of high value, high quality emission reductions for socially responsible corporate and retail buyers.
- For governments, (1) leverage private investment in cleaner technologies and improved environmental management to benefit a greater number of developing countries than would otherwise occur; (2) demonstrate their resolve to support sustainable development and equitably manage greenhouse gas emissions.

BENEFITS TO HOST COUNTRIES AND COMMUNITIES

Countries and communities hosting CDCF projects benefit from cleaner technologies and sustainable natural resource management practices. Specifically, the CDCF will:

- Open up access to and distribute the benefits of carbon finance to small-scale projects in least developed countries and poorer areas of all developing countries.
- Help build the market for high-quality ERs⁵ through projects that reduce poverty and improve basic services for local communities.
- Encourage local community entrepreneurs, SMEs and NGOs to implement sustainable energy and agro-forestry projects.
- Build intermediation capacity to bundle small transactions and use financial innovation to lower market entry barriers and costs.
- Build local capacity to benefit from carbon finance and to attract investment.

FUND CRITERIA AND QUALITY ASSURANCE

CDCF projects comply with all relevant CDM procedures in order to be potentially Kyoto Protocol-eligible.

The project portfolio is being developed with the intention that over the lifetime of the Fund:

- Preference is given to small-scale projects that are compatible with the definition of “small-scale CDM project activities” as defined by the UNFCCC;⁶
- No more than 10 percent of the Fund capital may be committed to projects located in the same country;
- A minimum of 25 percent of the Fund’s assets will be invested in least developed countries and poorer areas of all developing countries;⁷
- CDCF projects will measurably improve the quality of life of local communities.

Fund resources support a range of technologies such as renewable energy technologies, energy efficiency improvements, improved waste management and agro-forestry activities eligible under the CDM.⁸

Basic project selection and review criteria that ensure compliance with Fund objectives have been established in consultation with an Advisory Group of development, climate policy, and corporate social responsibility leaders and specialists. Consultations with Participants have led to further refining portfolio design, project criteria and quality assurance processes.

Quality is also enhanced by the application of World Bank Safeguard Policies; professional fund management by the World Bank; guidance from Participants and the Host Country Committee, and review of Fund operations by the Advisory Group. The PCF experience will be particularly valuable in ensuring quality in CDCF operations.

COSTS AND INDICATIVE PRICES

Small-scale projects may generate ERs at a somewhat higher cost per ton than ERs from larger CDM projects. Not only are the transactions costs higher when spread over small-scale projects, but least developed countries and poorer areas of all developing countries have higher risks associated with them, raising the cost of capital for such projects.

The CDCF aims to keep prices in the range of \$7/tCO₂e across the Fund’s portfolio. To achieve this outcome, contracted prices in the Emission Reductions Purchase Agreement (ERPA) are expected to be in the range of \$3-\$6/tCO₂e.

The CDCF fund management team will strive to narrow the differential between large and small-scale projects by

- placing carbon finance through local financial and NGO intermediaries;
- streamlining and standardizing procedures such as baseline studies, certification, and verification and using umbrella agreements with host countries;

- bundling projects and using financial innovation, where possible; and
- mobilizing substantial resources from donors to buy down project preparation and technical assistance costs (see below).

The UNFCCC has adopted measures designed to reduce the transaction costs of small-scale projects and projects in least developed countries (LDCs). Projects in LDCs are exempt from paying a share of their proceeds to an adaptation fund established under the Kyoto Protocol (two percent of the CERs issued for a CDM project activity). The CDCF takes advantage of such benefits.

STRUCTURE, SIZE, AND TERM OF THE FUND

The CDCF is a multi-donor Trust Fund administered by the World Bank with Participants from both public and the private sector. Participants acquire a *pro rata* share of emission reductions from purchase agreements signed with host countries or project sponsors.

The CDCF's initial target capitalization level is US\$100 million, and operations have began in July 2003 when the threshold of US\$30 million was achieved.

The minimum contribution to participate in the CDCF is set at US\$2.5 million for private sector Participants and US\$5 million for governments. Over and above the minimum contribution, Participants may buy additional

shares in multiples of US\$100,000. Participant commitments will be in the form of promissory notes drawn down as needed over the life of the Fund.⁹

Fund management has 3 years in which to place the Fund capital in projects, 14 years to acquire and manage ERs from projects, and 1 year to close the Fund and distribute its assets.

FUND MANAGEMENT

The World Bank, as Trustee, oversees the Fund's management and appoints a Fund Manager and a Fund Management Unit. This unit is part of the World Bank's carbon finance team and draws on the World Bank's experience with carbon finance, in particular the PCF.

A Participants' Committee provides general advice to the Fund Manager on issues regarding the operations of the Fund.

PARALLEL RESOURCES

Fund management is mobilizing resources from donors (governments and foundations) and from Participants for parallel project preparation and technical assistance. These resources will support project identification and preparation, capacity building (e.g., of intermediaries), and other technical assistance. Participants will be

encouraged to transfer their contributions up-front or significantly advance their payment in order to generate investment income to support Fund-related technical assistance.

ADVISORY GROUP

Along with the International Emissions Trading Association (IETA),¹⁰ the World Bank has co-convened an Advisory Group comprised of internationally recognized sustainable development leaders and specialists. Advisory Group members will have public or private sector experience in promoting sustainable development, and act in their individual capacity.

During the design stage of the Fund, the Advisory Group has helped the Bank establish quality criteria, market the concept to potential Participants, and design efficient screening tools for projects.

Following the launch of the Fund and during its implementation, the role of the Advisory Group is to advise management on the directions of the Fund, including adjustments to the project selection criteria and community benefits..

The Advisory Group provides advice on overall portfolio development in terms of types of projects and distribution of projects among countries, regions and technologies.

PARTICIPATING IN THE FUND

The CDCF became operational in July 2003, when the Organizational Meeting and first Annual Meeting of the Participants was held in Washington, D.C. The meeting was attended by Canadian, European, and Japanese Participants, both from the public and private sectors, representing approximately US\$30 million in fund value.

The target size of the Fund is US\$100 million. Potential participants wishing to join the Fund are invited to sign a non-binding Confidentiality Agreement. They will be provided with access to a password-protected website containing the CDCF Information Memorandum, outlining further information on the CDCF (including risks) as well as the Participation Agreement and Promissory Notes. For further information on the CDCF go to www.communitycarbonfund.org or www.carbonfinance.org

ANNEX

- ¹ The CDCF concept emerged from informal discussions with a wide range of stakeholders including the United Nations Climate Change Secretariat, IETA, individuals from host countries, industrial companies and banks, carbon brokers, NGOs, and government agencies.
- ² The World Bank's carbon finance team regularly consults with carbon market makers, brokers, traders and companies purchasing ERs to receive updated market and price information.
- ³ See Prototype Carbon Fund, Occasional Papers Series Number 1, October 2, 2000.
- ⁴ About 60 percent of the total AIJ portfolio was in the industrializing economies of Eastern Europe; in comparison, only one project was completed in Africa.
- ⁵ These are ERs with a high social and local development component, and hence, it is our intention that in some practical way they are branded as such ("Development + Carbon" or "Carbon with a Human Face")
- ⁶ These, as defined in paragraph 6, subparagraph (c) of decision 17/CP.7 on modalities and procedures for a CDM are:
 - a) "Renewable energy project activities with a maximum output capacity equivalent of up to 15 megawatts (or appropriate equivalent);
 - b) Energy efficiency improvement project activities which reduce energy consumption, on the supply and/or demand side, by up to the equivalent of 15 gigawatthours per year;
 - c) Other project activities that both reduce anthropogenic emissions by sources and directly emit less than 15 kilotonnes of carbon dioxide equivalent annually."
- ⁷ These are defined as countries eligible to borrow from the World Bank's International Development Assistance (IDA), "IDA blend" countries with a population of less than 75 million, or, countries designated as LDCs by the United Nations.
- ⁸ Following any specific post-Marrakech guidance to be provided by the UNFCCC Parties on eligibility and requirements of CDM afforestation and reforestation projects.
- ⁹ Participants are encouraged to transfer their contributions upfront or to advance their contributions in order to allow the Trustee to use any interest accrued to support research, capacity building and training activities.
- ¹⁰ IETA played an important role in developing the fund concept and the Bank and IETA have agreed to continue their collaboration during the design phase of the Fund. Co-managing the Advisory Group on aspects of design is representative of this collaboration.

The material contained in this document is intended only to provide a summary of the current state of the IBRD's newly established Fund and does not constitute an offer to sell, or an invitation by or on behalf of the Fund to purchase an interest in the Fund. The document does not represent an obligation of, nor the final position of the World Bank, and should not be relied upon for the purposes of making any decision regarding possible contributions to the new Fund. There are legal and other risks involved in participating in the Fund, including potential conflicts of interest. Entities considering making financial contribution to the Fund should consult their own legal and financial advisors on the risks and other considerations of an involvement in the Fund. The statements made in this document are current as of 17 September 2003, unless stated otherwise. The World Bank has no obligation to update the document - updates will occur at the sole discretion of the World Bank and will not necessarily be advised.