Climate change is having a profound impact on agricultural value chains across ACP countries, with smallholder farmers feeling the worst of the pain. Changing weather patterns pose a new threat to already precarious livelihoods and are rendering many traditional agricultural practices ineffective. But while climate-smart finance has become a fashionable topic, only a tiny proportion of funding is directed towards agriculture. Without more investment, feeding the world will become ever harder, warns Margarita Astralaga, director of Environment, Climate Division at the International Fund for Agricultural Development (IFAD).

While no corner of the world is immune to climate change, regions in most need of smart solutions include Africa’s Sahel, where more frequent and longer droughts are disrupting the planting calendar. “Farmers don’t know when to plant corn, when to plant cassava, because they cannot predict what is going to happen next,” notes Astralaga. Farmers on small Pacific islands – many of which are already isolated in terms of external markets or supply chains – face shrinking fresh water resources while rising sea levels threaten to consume arable land.

**Blended finance**

In a recent CTA discussion paper, *A Business Case for Engaging the Private Sector in Climate-smart Solutions for Smallholder Farmers*, the authors emphasise the need to harness financial, technological and intellectual capital in the private sector to complement public sector-driven climate actions, as a new dimension in the delivery of sustainable climate-smart solutions at scale. “Climate finance through a blend of grant, commercial and quasi-commercial financing instruments has the potential to unlock resources from the private sector towards promoting climate-smart agriculture (CSA) at scale,” says Oluyede Ajayi, CTA’s Senior Agriculture and Climate Change Programme Coordinator.

Blended finance – where public and private funds are combined in a common investment scheme or deal – has proven one of the most successful ways of funding CSA, states Astralaga. Many blended finance schemes include a grant component from a government body, development or philanthropic organisation which, when mixed with funds from a commercial lender, reduces the interest that borrowers have to pay. Some blended schemes include a guarantee that lenders will receive back a proportion of the loan funds should the borrower fail to repay. This reduces the risk that financial institutions take, encouraging them to offer more or bigger loans to borrowers or sectors that they perceive as high risk, or to offer them more favourable terms such as interest-free periods or favourable repayment schedules.

The grant component of many blended finance schemes can persuade governments, organisations or firms in countries that are not directly responsible for climate change – and are therefore loath to pay for its consequences – that borrowing to alleviate its effects might still be in their best interest. Once they experience the benefits of climate-smart investments in agriculture or other sectors, they tend to be more open to borrowing in the future, via blended finance schemes or even pure commercial loans, says Astralaga. Others are resigned to having to make...
climate-smart investments but simply cannot afford a loan unless interest rates are reduced. “In many countries, the only way they would take a loan is if we have a grant component. That’s a fact,” she affirms.

In 2012, IFAD launched its flagship Adaptation for Smallholder Agriculture Programme (ASAP). The programme, which channels climate and environmental finance to smallholder farmers, helped persuade reluctant ministries of agriculture – many of whom initially argued that environmental issues were outside their remit – that the potential losses if they failed to invest in climate-change adaptation were greater than the costs of borrowing, Astralaga explains. Investments funded so far through ASAP include everything from improved meteorological data and early warning systems to solar energy, biogas and making rural roads that are essential for getting crops to market less vulnerable to flooding.

Six years later, “the change is just incredible,” with many governments now seeking second loans. IFAD’s first ASAP project in Nicaragua, for example, included a large grant, but it is now taking a second full loan to fund climate-adaptation activities, she says. In Bolivia, a number of indigenous communities are applying for loans after they saw the benefits enjoyed by other indigenous communities that have implemented IFAD-facilitated climate resilience projects.

**Pomeroon**

Agricultural projects that demonstrate resilience to climate change – either from the outset or following targeted adaptation – can represent a better financial risk to private-sector lenders, while helping development banks, donors and an increasing number of private investors achieve their sustainability goals.

Climate resilience was a key consideration – from both a financial risk and sustainability perspective – for investors who participated in a €2.6 million fundraiser by Pomeroon Trading for a major rehabilitation of the 280 ha Stoll Estate in Guyana, says co-founder Duncan Turnbull.

The company has developed a seedling nursery at Stoll where it conducts extensive testing of seed nuts from across Guyana, to ensure the ones planted on the estate are of the best genetic stock and grow into trees with a better yield than typically seen across the country. As well as planting 50,000 trees that could sequester as much as 24,000 t of carbon equivalent, Pomeroon has developed a sophisticated water management system and is piloting inter-cropping with the aim of introducing cash crops such as nuts, citrus fruits or ‘superfoods’ like moringa that are new to Guyana.

While sustainability was not the top criterion for the institutional investors who provided around 25% of the funds, it was a big concern for the high-net worth private investors that contributed about 40% and was a core mandate for the development fund institutions that provided the remainder.
Incentives

Lenders are increasingly offering staggered incentives such as better terms or reduced interest rates to agribusiness borrowers as they achieve climate-related milestones, such as implementing more resilient irrigation systems. However, it is difficult to accurately measure the impact of climate-smart interventions and even harder for commercial banks to assess the extent to which such actions will reduce the financial risk that lenders are exposed to, and improve a borrower’s ability to repay a loan. The sustainability of such financing structures is therefore uncertain, argues Bogaard. FMO prefers instead to support clients with capacity development, for example by paying 50% of the cost of consultants hired to help farmers and project developers improve their climate resilience.

“Climate finance through a blend of grant, commercial and quasi-commercial financing instruments has the potential to unlock resources from the private sector towards promoting CSA at scale”

One recent project in which FMO has participated saw Africa Improved Foods (AIF) – a Rwandan producer of nutritious complementary foods to combat malnutrition (see Spore article, Rwandan Farmers Reduce losses with Nutritious Grains: https://tinyurl.com/ybjncjhm) – set up rural maize collection centres in 2017. It did this in an effort to combat the growing problem of farmers’ crops being rejected by buyers because they contained aflatoxin-producing fungi – a problem that is expected to become a “silver bullet” that every development bank strives for, he adds.

Incentives are by issuing green bonds or green loans that can be used for climate-smart investments for bigger projects to benefit smallholders surrounding it.
clients, Bogaard adds. Typically, however, development banks focus on climate mitigation investments, for example forestry projects that will sequester carbon. For projects with long ramp-up periods – such as agroforestry, where it can take 5 years for production and revenue to start – banks must be prepared to forgo interest payments initially, perhaps in return for profit-sharing later on, states Bogaard.

Development bank provision of long-term or mezzanine finance – a mix of debt and equity financing that gives the lender the right to take an equity stake in a borrower if it defaults – can be vital here.

Innovation

There remains a need for more innovative financing solutions for CSA. To this end, IFAD has started exploring opportunities for crowd-sourcing as an alternative to traditional finance, as well as ways in which it could facilitate access to climate and commodity hedging, and help microfinance institutions measure and price climate risks.

Risk remains a key concern for both governments and financial institutions, with microfinance organisations in particular often uncertain about what interest rates they should charge when lending to smallholders to reflect climate-related risks and the extent to which they are reduced by any adaptation or mitigation initiatives. Lenders “need feedback so that they can design their own products based on the information we can provide them on climate risks,” Astralaga says. IFAD hopes to be able to launch a product or service related to this in early 2019.

Risk is also front of mind for DBJ, which is keen to support the scaling up of weather-related crop insurance in Jamaica. So far, Jamaica International Insurance Co (JIIC) has experimented with weather-related insurance, but has struggled to offer premiums that are considered affordable. Galbraith notes. In 2013, JIIC teamed up with the Caribbean Catastrophe Risk Insurance Facility, which sells storm and earthquake coverage to governments, to pilot a livelihood protection policy to protect individuals’ income following severe wind or rain events (see Spore article, Innovative Insurance for Minimising Climate Risk: https://tinyurl.com/y8qd5sbw).

Innovations like this in risk management will encourage financial institutions to offer more agri-finance, adds Galbraith. And as the financing tools available for climate-smart agriculture projects in general become more sophisticated, investments in sustainable agriculture should finally gain pace.