Financing Climate Adaptation and Mitigation Activities via a Liability Management Operation

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History of Debt for Development Swaps

- **Emerged during Latin American debt crisis of the 1980s**
  - US cancelled $875 million of debt to 7 LA countries
- **Two types:**
  - Commercial or Private: involving debt owed to banks
  - Bi-lateral: involving debt owed to governments

Seychelles Debt Conversion & Commitments

Deal summary

- Create a permanent funding source for local conservation & adaptation to climate change through **$22 M of sovereign debt restructuring**, via the Paris Club
- Blend grants & impact capital to purchase & restructure foreign debt into a domestic obligation to invest in conservation & adaptation.
- Deal results in upwards of $8 M to fund activities (over 20 years) and $6.6 M endowment capitalized for conservation

Government's Conservation/Policy Commitments

- 30% of waters in protected areas (400,000 Sq. Km)
- 15% of waters in no take fish replenishment zones (200,000 Sq. Km)
- Adopt recently completed Marine Spatial Plan to guide updating of Coastal zone management/fisheries/marine policies

Belize Blue Bond & Debt Restructuring

1. Blue Bonds Issuance: **$363 M**

2. Purchase of Existing Debt: **$554 M** (45% discount to FV)

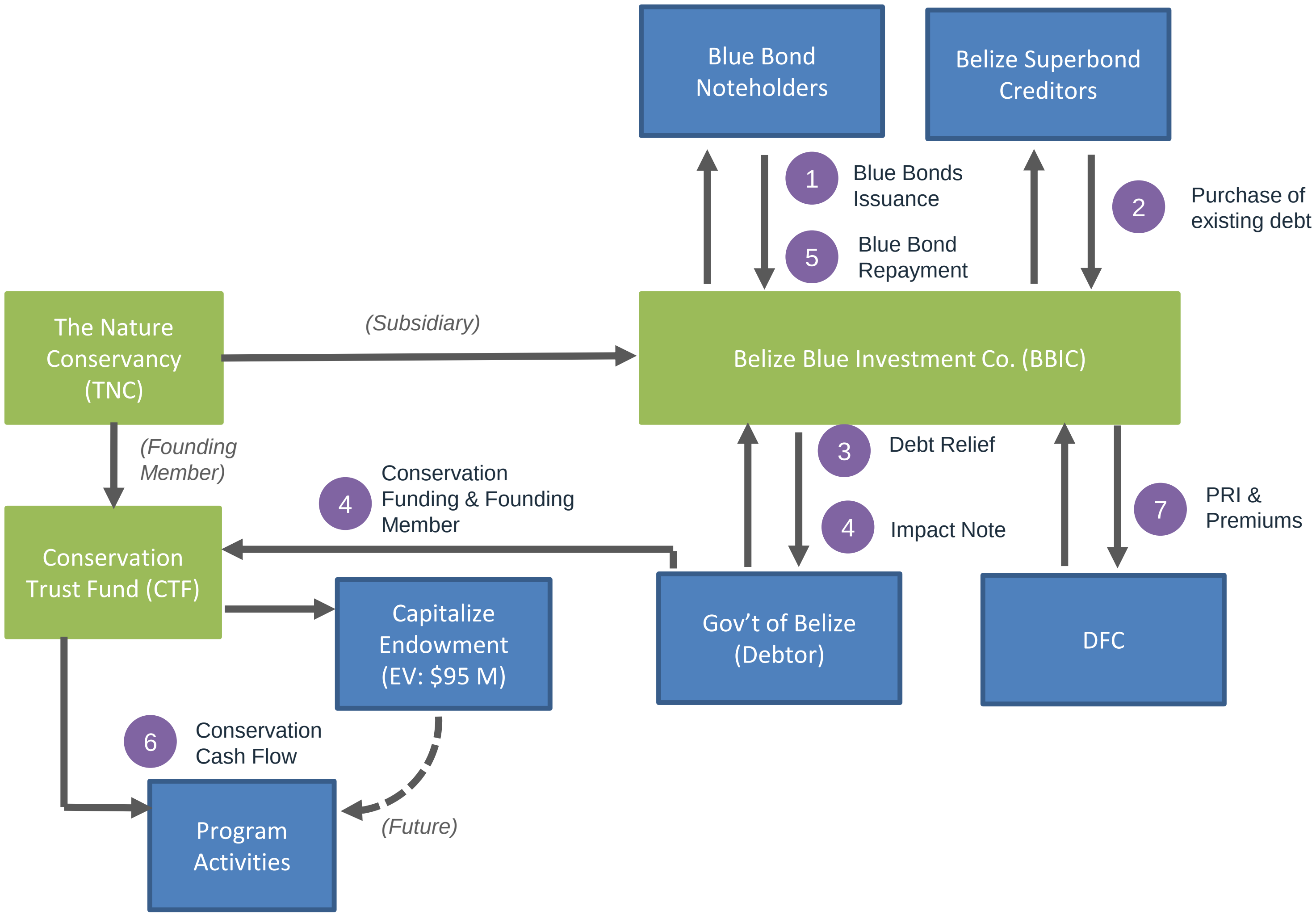
3. Debt/Interest Savings to GoB:
   - **$200 M** savings via interest rate reduction & debt write off

4. Debt Exchange (New Gov't Debt Structure):
   - **$363 M** Impact Note, 19 years, 10-year grace, 9 years amortized, step up interest rate 3%-6% over 4 years
   - Conservation Agreement, 20 years

5. Repayment of Blue Bonds

6. Conservation Cash Flow (over 20 years):
   - **$84 M** for on-the-ground activities
   - endowment funding with ending value of **$95 M**

7. Political Risk Insurance (DFC)



Benefits to Government of Belize

- **Savings of US$200 million** via debt write off and interest reduction;
  - Additionally, avoided **US$58 million** of principal reinstatement due to SuperBond default
  - Debt tenor extended by 6.5 years
  - Post restructuring, S&P upgraded Belize's credit rating from Selective Default to B-
- **Provide annual funding of approx. US$4.2 million,** over 20 years, for marine conservation activities in Belize (managed by a Conservation Trust Fund (CTF), created under US law)
- **Capitalize an endowment with an ending value of US$95 million,** after 20 years
- **Parametric Insurance coverage equal to one semi-annual payment of Impact Note** in case of hurricane or major rain event
- Government entities eligible to apply for funding from debt conversion proceeds, managed by the CTF

Conservation Commitments by Gov’t of Belize

- Increase in Biodiversity Protection Zones from 15.9% to 30% of ocean area by 2026—half in high protection areas (Replenishment Zones) and half in medium protection areas (Multi-use Zones)
- Completion of a Marine Spatial Plan by 2026 (initiated in 2022)
- Protection of the public lands within the Belize Barrier Reef Reserve System, a UNESCO World Heritage Site, as mangrove reserves
- Revision and implementation of Belize’s Integrated Coastal Zone Management Plan to include marine and coastal biodiversity offsets
- Application for three formally designated marine protected areas as International Union for Conservation of Nature (IUCN) Green List

Example Liability Management Operation

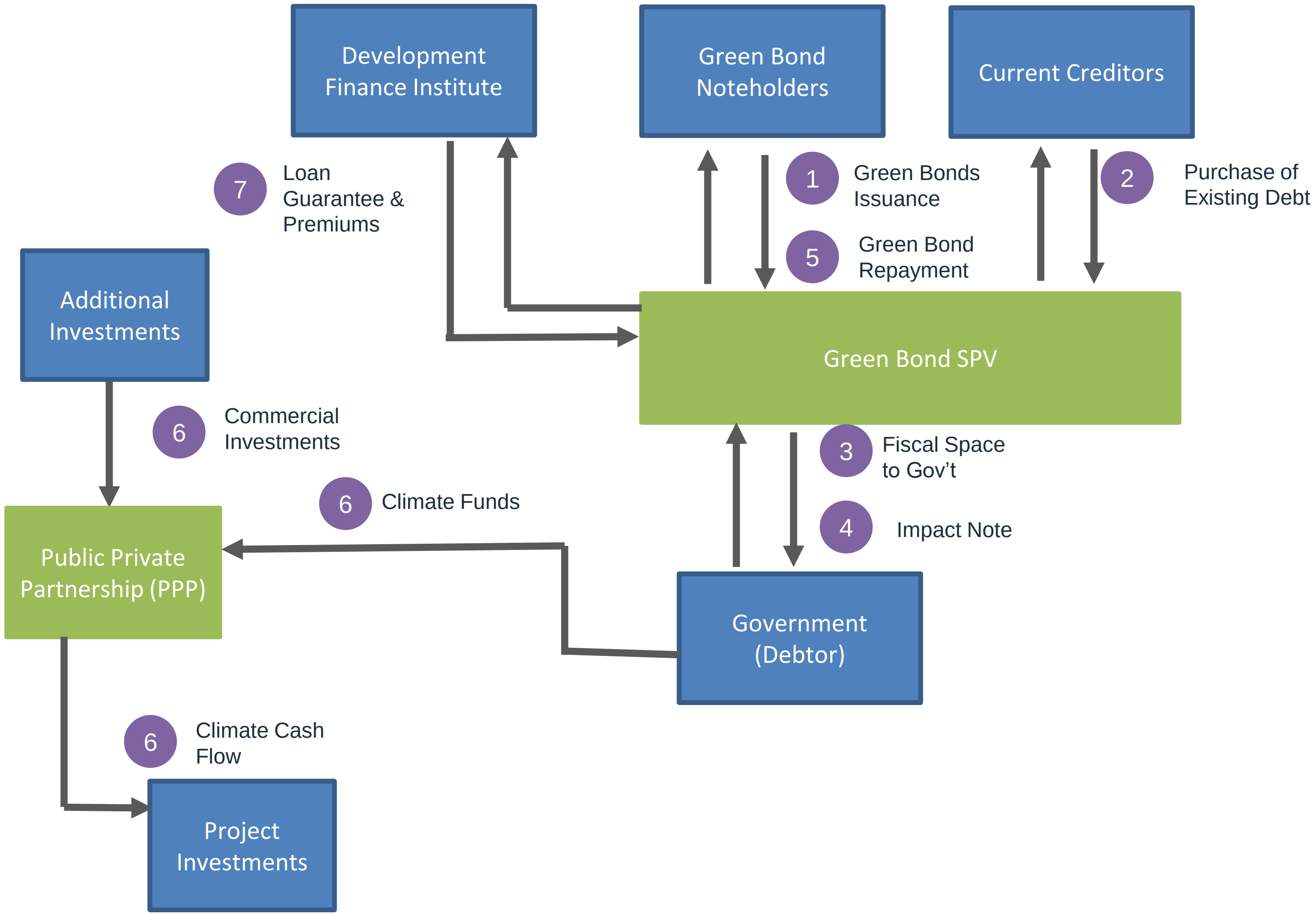
- **Current Situation**
  – US$200 million of domestically and externally held Notes, Loans, and Overdraft Lines with average maturity of approx. 5 years, average interest rate of 7%, and annual servicing cost of approx. US$48.8 million

Post Liability Management Operation

- US$200 million Impact Note with 20-year maturity, 5-year interest only grace period, 15 years amortized, 5.85% interest rate, and annual service cost of US$11.7 million in the first five years – creating US$37.1 million of fiscal space annually over the first five years, equal to approx. 10% of estimated government revenue (2022)

Example Liability Management Operation

1. Green Bonds Issuance: **US$200 M**
2. Purchase of Existing Debt: **US$200 M**
3. Fiscal Space to Gov't:
   - **US$37 M** over first 5 years via extension of maturity of debt
4. Debt Exchange (New Gov't Debt Structure):
   - **US$200 M** Impact Note, 5.85% (TBC), 20 years, 5-year grace period, 15 years amortized
5. Repayment of Green Bonds
6. Climate Cash Flow (over 18 years):
   - **US$150 M** for carbon neutrality investments from GOAB
   - **US$150 M** of additional commercial investments (equity and/or debt)
7. Loan Guarantee (DFI)



Parties and Roles to the Transaction

- **Government**: would need to agree on the terms of the liability management operation and climate commitments.
- **Project Proponent**: will execute the transaction with gov’t, DFI and a commercial bank; set up and manage the PPP/CTF; serve as the agent representative of the SPV; and is responsible for achieving the climate commitments via the PPP/CTF.
- **SPV:** orphan entity that issues the Green Bonds and conducts the debt exchange with the government and creditors.
- **Commercial Bank**: will arrange the issuance of Green Bond and support the Gov’t in sourcing the commercial debt for the LMO (including advising on and implementing any liability management that may be required).
- **DFI**: will provide the political risk insurance policy or loan guarantee on the Impact Note.

Catastrophic Coverage

- Parametrically triggered insurance that pays out if specific event occurs (Cat. 3 hurricane, large rain event for example)
- Catastrophic insurance (Cat. 3 and above, specific amount of rain):
  - 2-3 year coverage (rolled over as needed); parametrically triggered
- SPV required to purchase coverage of one semi-annual payment of the Impact Note which will offset the government’s payment, freeing up cash for hurricane/rain event recovery

Activities funded by the Transaction

- Climate Adaptation and Mitigation activities as identified by the government.

Benefits to Government

- Creation of at least US$185 million in fiscal space for investments and/or debt relief in the country, via extending maturity of restructured debt (over 20 years, with a 5-year grace period, at 5.85%:
  - Provide annual fiscal space of approx. US$37 million, over the first five years of the liability management operation.
  - With the government pledging US$150 million over 18 years to a PPP (or CTF) to fund climate adaptation and mitigation activities, the PPP will commit to raising an additional funding over 18 years from other sources to match the government's commitment.
- US$6 million of parametric insurance for the first five years and US$10 million for the last 15 years (equal to one semi-annual payment on the restructured debt) included in the impact note created via the debt restructuring payable to the government in the case of a hurricane hitting the country.

Enabling Conditions

- **To finalize negotiations**:
  - Willing Government
    - Climate Commitments finalized
  - Willing Seller (Creditor)
  - Financing in place
- **To close**:
  - PPP/CTF created and operational
  - Legal agreements finalized

Indicative Steps

1. Draft concept shared with government, and government indicates interest in the liability management operation: July 2022
2. Draft Term Sheet for proposed liability management operation: August 2022
3. Government approval of Term Sheet: September 2022
4. Development Finance Institute (DFI) approval to provide loan guarantee: October 2022 – February 2023
5. Draft and finalize liability management operation legal documents, based on term sheet: October 2022 – February 2023
6. PPP (or CTF) legally created and operational: March 2023
7. Green Bond SPV and the government sign legal documents: March 2023
8. Commercial Bank underwrites US$200 million Green Bond to finance liability management operation: March 2023
9. Government and Commercial Bank (if needed) initiates liability management operation w/ creditors: March 2023
10. SPV and government exchange debt purchased: March 2023

Lessons Learned

- Patience
- Scale matters
- Ministry of Finance key
- High Level commitments helpful
- Concept very well received by countries, public and private donors, impact investors, etc.
- Possible to raise loan capital directly from capital markets
- Possible to de-risk deal for sovereign and climate (hurricane/major rain event) risk
- Broad stakeholder consensus necessary