Backgrounder

Urban; Climate change

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Residents in Sujat Nagar slum in Dhaka, Bangladesh.
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Enabling city resilience bonds

Bonds can bridge the resilience finance gap in cities

Urbanisation is today's defining global demographic trend. Five years ago, for the first time, most of the world's population became urban. Between 1950 and 2018, the share of population living in urban areas almost doubled. Asia's population is now 50% urban and Africa's is 43%. Low-income countries are urbanising at 4% every year, middle-income countries at 2.1% and high-income countries at 0.7% (World Bank, 2023). By 2030, six out of every ten people on Earth will be town and city dwellers.

Cities are on the frontlines of climate risk

A disproportionate number of the world's urban centres are located along coasts and rivers — locations highly exposed to climate change and disasters. In the three decades between 2000 and 2030, the size of the urban area worldwide exposed to flood and drought will have increased by 250% (Güneralp, Güneralp & Liu, 2015). These hazards pose a major challenge to cities in all countries, but cities in the global South will experience the greatest impacts. Most large cities will experience at least a 1.5 degree temperature rise this century (Revi et al., 2014).

Globally, one third of all urban residents live in informal settlements, which are characterised by a high degree of vulnerability and low adaptive capacity. Informal settlement dwellers have inadequate access to healthcare, emergency services, policing, rule of law, protective infrastructure, and healthy and safe housing, and they commonly experience disasters caused by extreme weather (Revi et al., 2014). Hundreds of millions of urban residents lack the financial resources to bounce back from climate-induced shocks and stresses.

KEY TERMS

- **Green bond:** an instrument that raises financing from capital markets to fund initiatives that deliver a positive environmental benefit
- **City bond:** a financial instrument employed by city governments, municipal corporations and associated bodies to raise debt for public investment
- **Urban resilience:** the ability of cities to anticipate, absorb and adapt to complex, cascading and concomitant shocks and stresses from climate and disasters.

VITAL STATISTICS

- Today 55% of the world's population live in urban areas; this will rise to 60% by 2030
- One third of the world's urban population live in informal settlements facing acute climate risks
- Cities receive only 11% of multilateral climate funds and a mere 3–5% of total climate adaptation finance
- Close to US$1 trillion has been raised through green bonds in more than 50 countries worldwide.

WHY IT IS IMPORTANT

For the first time in history, more people worldwide live in towns and cities than in rural areas. Urban areas, owing to their location, demographics and governance contexts, 'concentrate' climate risk. However, international climate finance has largely overlooked cities' needs,

Contact and feedback: **Aditya Bahadur** *aditya.bahadur@iied.org* @iied www.facebook.com/theIIED

Rapid and unplanned urbanisation is occurring in areas highly exposed to climate change. By 2050, according to one estimate, 800 million people will live in cities where sea levels could rise by more than half a metre (C40 Cities, 2018).

Climate finance gaps in cities are immense

It is often thought that cities are well resourced, but the reality is very different. Only 11% of multilateral climate funds go to cities, and urban climate adaptation finance represents a mere 3–5% of total adaptation finance flows (Barnard, 2015; Richmond, Upadhyaya & Pastor, 2021).

Estimates of the cost of making urban infrastructure resilient to climate change across the world vary from US$0.4 trillion to US$1.1 trillion of additional investment per annum (Alexander et al., 2019). For cities in the global South, there is growing evidence that access to finance from international climate funds is too difficult and slow and that conditionalities are too high.

City resilience bonds can help fill the gap

In the context of rapid urbanisation, extreme climate risk in cities and major deficits in finance, there is a growing need for innovative mechanisms to finance urban climate resilience in the global South. This is where city resilience bonds can make a large difference. Through these bonds, a city government or agency can raise money from capital debt markets for investment in building resilience.

Cities in the global North have employed this instrument to deal with a range of issues. For instance, the US Federal Reserve pledged to buy up to US$500 billion in municipal bonds to finance COVID-19 response and recovery.

Despite this precedent, very few cities in the global South have employed this mechanism to manage risk or increase their funding sources. This is particularly startling because in many developing countries with massive urban populations (such as Bangladesh and India) there are no major administrative or legal barriers preventing cities from issuing bonds. Creditworthiness is often cited as the reason cities do not issue these bonds, but research reveals that many cities that are home to vast numbers of at-risk people are creditworthy. For example, a review of 94 cities in India deemed 59% of them to have 'investment grade' ratings (Press Information Bureau, 2017).

The lack of uptake of this financing instrument is also surprising given the success of 'green' or sustainability-linked bonds. Such bonds have been used extensively at the national level and by front-runner cities such as Helsingborg in Sweden and Johannesburg in South Africa. These bonds are proving to be an extremely effective financing tool, raising almost US$1 trillion in more than 50 countries, including in the global South. India, for instance, issued a US$1 billion sovereign green bond in 2023 that was oversubscribed four times (Climate Bonds Initiative, 2023).

Looking ahead

The time is right to embrace city bonds as a significant, tried and tested instrument of sustainable finance through which to tackle climate change in cities and urban areas, and that puts city governments in the lead on investment decision making. To ensure uptake, there is a need to identify and meet critical capacity gaps within city governments; for example, to strengthen fiscal protocols, enhance accountability mechanisms and build investment planning capability. There is also a need to develop approaches to manage fiscal risk such as risk pooling and strengthening financial performance to improve creditworthiness. Crucially, issues of equity need to be front and centre: durable step changes in urban resilience are possible only when investments incorporate the needs of the most vulnerable urban dwellers, especially people living in informal settlements.

Knowledge Products

The International Institute for Environment and Development (IIED) promotes sustainable development, linking local priorities to global challenges. We support some of the world's most vulnerable people to strengthen their voice in decision making.

leading to an urgent requirement for innovative and local mechanisms to generate finance for urban resilience. City resilience bonds are one such mechanism, with significant promise to make a difference.

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IIED Third Floor, 235 High Holborn, London WC1V 7DN, UK
T: +44 (0)20 3463 7399 | www.iied.org