

## **Agenda item 4.1.(b)**

Paragraph 20 of the annotated agenda

# TOOL27: Investment analysis

**CDM EB 112**

Glasgow, United Kingdom of Great Britain and Northern Ireland, 26 to 29 October 2021



## Procedural background

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- At EB85, the Board requested the Methodologies Panel (MP) to revise the tool on a yearly basis to update the default values for the cost of equity based on the latest available data.
- Since then, the MP has worked on annually revising the default values based on the agreed approach.
- At MP86 the Panel assessed the updated values and agreed to launch a call for public inputs and recommend the Board to approve the revised methodological tool.
- A call for public inputs for the methodological tool was conducted between 05/10/2021 and 19/10/2021. No comments were received.



## Purpose

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The purpose of the proposed revision is to update the default values for the cost of equity based on the latest available data.



## Key issues and proposed solutions (1)

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Key parameters for deriving default values:

**B:** risk premium for the host country (estimated using Moody's rating).

**C1:** risk free rate of return (based on annualized real return on US government bonds. A value of 4.1 % is used);

**C2:** equity risk premium (based on the long-term historical returns on equity in the US market relative to the return of bonds. A value of 4.4 % is used).

$$\text{Default value} = B + (C1 + C2)$$



## Key issues and proposed solutions (2)

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- For the risk premium for the host country (B), NYU-Stern presents values for most countries. (Latest update is July 2021).
  - 23 countries don't have available data to calculate B (Moody's rating).
  - Most of these countries don't have CDM projects (e.g. Bhutan, Burundi);
  - From those countries with CDM projects (e.g. Nepal), most are not using the "Cost of equity" benchmark.
- In previous years, a model was used to calculate the B values for these countries based on predictive Mean Matching method with macroeconomic data from the World Bank;
  - The World Bank revised its data reporting platform; the model is to be updated/tested accordingly (requiring 2 working weeks);
  - In case the Board agrees to do so, the Panel would propose to use data from the IMF instead of World Bank.



## Recommendations to the Board

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- The MP recommends the Board to approve the proposed revision to “TOOL27: Investment Analysis” with the updated values for those countries with available data.
- Provide any further guidance on work to be undertaken in calculating the ROE for the 23 countries.

