

## Annual Review

<b>Title:</b> UK Climate Investments (UKCI)		
<b>Programme Value:</b> £200m		<b>Review Date:</b> November 2017
<b>Start Date:</b> June 2015	<b>End Date:</b> November 2018	[ <a href="https://aidstream.org/files/documents/UKCI-business-case-2018-01-15-20180308030342.pdf">https://aidstream.org/files/documents/UKCI-business-case-2018-01-15-20180308030342.pdf</a> ]

### Summary of Programme Performance

Year	June 2015 - Nov 2016	Dec 2016 - Nov 2017	Dec 2017 - Nov 2018
Programme Score	B	B	
Risk Rating	Major	Major	

## A: INTRODUCTION AND CONTEXT

### Outline of the programme

UK Climate Investments (UKCI) is a joint venture between the Green Investment Group (GIG), part of Macquarie (formerly the UK Green Investment Bank, part of Her Majesty's Government) and the Department for Business, Energy and Industrial Strategy (BEIS).

UK Climate Investments Limited Liability Partnership (LLP) has been mandated to invest in a pilot phase (2015-2018) up to £200 million from BEIS's portion of UK International Climate Finance (ICF) in low carbon projects in emerging markets.

### Summary of progress and lessons learnt since last review

This is the second review of the pilot and covers progress between December 2016 and November 2017. The overall score given to the pilot for the second review is a B, below expectations. There has been considerable debate over the grading of this project, and a full consideration was given as to whether this review should be graded C. However, BEIS has agreed that the programme should be rated B for a second time because while results have been below expectations, there have been mitigating circumstances, both within the pilot itself (including privatisation) and in the real-world economy.

In the first review BEIS considered a range of factors which affected progress including: a potentially too narrow/ limiting mandate; lack of resources and relevant experience in the target geographies, and macroeconomic factors. In addition, BEIS discussed the significant impact of the privatisation of the Green Investment Bank (GIB) on the pilot, particularly the ability to recruit and build the team up to the envisaged capacity. For recommendations from this review and an update on progress please see Annex A.

At the end of the first review, it was expected that the privatisation would complete around January 2017, which would allow the new owner to recruit a full team and work with BEIS to address factors affecting their ability to complete investments. However, the sale did not complete until August 2017, followed by a change in Managing Director in October. This undoubtedly had an impact on performance and the ability of both sides of the LLP to implement the necessary changes which were highlighted in the first review, in time to see a change in performance.

The expectations at the start of the pilot, on which the logframe is based, do not consider these unforeseen issues. However, despite the impact of the privatisation and transition, the UKCI

management continued to project that a number of investments would complete in this period and this level of activity has not been delivered. Although BEIS consider that the 5/6 cumulative investments foreseen at the end of the second year was probably not realistic due to lack of progress in year one, BEIS and UKCI's expectations in December 2016 were that there would be more investments at the point of this review.

Nonetheless, since the acquisition of the GIB by Macquarie (where it has become the Green Investment Group) and the management of the pilot being assumed by Macquarie Infrastructure and Real Assets (MIRA), there have been early indications of positive progress. One deal was completed (Project Bolt, a 60GW solar project in Maharashtra, India) and there continues to be a pipeline of potential investments, signs of an open and constructive working relationship between both sides of the LLP and attempts to bring resourcing up to the appropriate levels. A new Managing Director (MD) was appointed in October 2017 and the team are demonstrating a willingness to understand and deliver the mandate according to BEIS's original intentions.

Given the uncertainty and changes previously described, BEIS considers that although there are concerns about UKCI's ability to deliver the objectives, there has not been a lot of opportunity to see UKCI working under 'business as usual' conditions. Evidence from other ICF investments suggests that the set-up period for funds similar to this one can be longer than imagined at fund inception, while the rate at which investments are made can increase in the later years.

The initial investment period of the pilot is due to end in November 2018 - this can be extended by up to two one-year periods by mutual agreement. It will be necessary to decide on the future of the pilot in the first half of 2018. This Annual Review, as well as progress against the business plan set out by the new Managing Director in November 2017 and the interim independent evaluation, will be the evidence base informing the decision about whether to end the pilot after three and a half years, to extend and test the mandate further or potentially expand the remit to test new markets, sectors or instruments.

## **Recommendations (including those brought forward from last year)**

### **1. Improving performance - deployment of funds**

The biggest risk to the pilot is the inability to deploy funds into equity investments (see Section C - Output 1). Upon privatisation the investment criteria in the mandate were adjusted. One key change was to expand the target geographies in Africa to include all of sub-Saharan Africa - particularly due to the lack of opportunities due to the regulatory and investment environments in the existing geographies, especially South Africa and East Africa (the original target geographies).

As outlined in the previous review - BEIS agreed an action plan with Macquarie as the new owners post-privatisation, with a focus on improving the resourcing, management and implementing the changes outlined above and were close to finalising ways to allow the use of shareholder loans at the end of this review.

Before the next review BEIS and UKCI need to consider whether changes to the mandate are appropriate to increase the deployment of funds in line with BEIS original objectives.

Action	Deadline	Lead	Status
Consider mandate changes of waivers highlighted by the UKCI investment team to improve deployment of funds.	Q3 2018	BEIS project leads, UKCI investment team, UKCI Board.	<b>Ongoing.</b>
Ensure UKCI investment team is built and maintained up to capacity and with the right level of experience and the right leadership and access to in-country expertise.	Ongoing	UKCI Managing Director.	<b>Ongoing:</b> Macquarie have brought in junior resource in a matrix system to assist the India and Africa Vice Presidents (VPs) in modelling and transacting existing deals. They have also sought to recruit more senior team members. This has not been as prompt as BEIS would have hoped and resource at the point of this review is still below expectations. BEIS maintains concerns about the ability to originate and bring through deals to early stages of the Investment Committee while also focussing on closing advanced deals - which can be a time intensive process.

## 2. Governance - Investment Committee

Upon privatisation, the Investment Committee (IC) was reconstituted by the new owner (BEIS retains its current role and membership), with a smaller committee. BEIS wanted to encourage the assessment of specific projects in the context of the wider portfolio the programme is looking to build, ensuring there is a good mix of deals of different sizes and technologies and geographies, encouraging the team to not focus only on commercial aspects in order to test the concept. BEIS also wanted to expand on the level of debate taking place at the IC as this would further help the learning process for BEIS and the UKCI team. Definite improvements have been made in the IC process under the new management and with a smaller committee.

In terms of developing market experience, BEIS has not elected to appoint an independent member (a recommendation of the last review) with developing market experience as there has been a changeover of the BEIS member – the new appointee has significant Africa experience. The BEIS IC member is also shadowed by another BEIS commercial advisor with significant Africa experience.

Action	Deadline	Lead	Status
Agree with MIRA a new process for the IC. If agreed, commence necessary recruitment of independent member.	December 2017.	UKCI management.	<b>Complete:</b> The Investment Committee papers have also been streamlined to make the process more efficient and the necessary information, particularly on the development aspects, clearer for BEIS.

## 3. Promotion of UK Climate Investments

One of the original aims of the pilot was to bring more visibility to UK Climate Finance as opposed to the level of visibility being achieved investing through multilateral development banks.

Macquarie and Lightsource, the partner company for UKCI's first investment (Project Bolt), issued a commercial press release which had been developed in consultation with BEIS.

It served as a test case and BEIS and Macquarie are working together to agree a joint communications strategy to ensure that UKCI's activities reach an appropriate audience to help both origination of new deals (i.e. attracting potential new partners) and to deliver 'demonstration effects' (whereby commercial developers and investors can see the opportunity and profitability of such investments to attract additional private capital into these markets).

Action	Deadline	Lead	
Set up a workshop to agree communications strategy.	Q1 2018	BEIS project team, ICF comms team, UKCI comms team.	<b>Ongoing:</b> Communications has been discussed at Board meetings and approaches trialled with the initial investment which was received positively.

#### 4. Aligning expectations and understanding of transformational change and poverty reduction

The first review flagged the challenge of developing a joint understanding of the concept of transformational change, in addition to poverty alleviation, and how these could be operationalised in UKCI's investment process. Part of this was to do with the different risk appetites of BEIS and the Green Investment Bank. In this last year both parties have worked together to improve the understanding of these mandate requirements. This has included developing a joint risk matrix and process for demonstrating the poverty alleviation potential of investments in the Investment Committee, so that BEIS could be satisfied that the portfolio would meet the requirement of furthering economic and social development in these geographies.

Action	Deadline	Lead	
Agree and implement a joint risk appetite and management process.	Q1 2018	BEIS project team, UKCI team and Board.	<b>First draft complete:</b> This is an ongoing process that requires testing and refining.

#### 5. The external evaluation - capturing and embedding experience from the pilot

Due to the delay in completing investments, the independent evaluation has not been able to progress as originally envisaged. BEIS has agreed with the independent evaluator, Ipsos MORI, how to get the most out of this activity in terms of testing the transformational potential of the pilot despite limited investment activities.

Ipsos MORI will also be helping to inform the decision about whether to extend the pilot by measuring the effectiveness of UKCI processes, analysing the markets in the target geographies and mapping other donor climate finance activities similar in scope to assess the effectiveness of the UKCI model.

Action	Deadline	Lead	
Agree new scope for evaluation contract.	Q2 2017 (depending on rate of disbursement).	BEIS Project Manager, Ipsos MORI.	<b>Complete:</b> Actioned Q1 2018.

#### 6. Logframe

The first Annual Review process revealed some potential weaknesses with the current logframe. Given the privatisation only completed in August 2017, BEIS decided not to substantially adjust the logframe before this second review as a change in expectations and assumptions would require buy-in from the new owner. The privatisation took longer than expected, meaning that an update before August 2017 was not possible. However, as suggested in the previous review, 'expected' as well as actual emission reductions and installed capacity have been added in order to capture the climate mitigation potential of UKCI's activities during the relevant assessment period (if only actual results were reported, there would have been no results to discuss until after the end of the pilot due to the time-lag between investment and delivering these benefits).

Action	Deadline	Lead	
Discussion of logframe output/outcome indicators, possibly including interim indicators and lessons learned, methodology for cost of capital and milestones.	Q2/3 2018	BEIS Project Manager, BEIS analysts, Ipsos MORI, GIB analysts.	<b>Near completion:</b> BEIS has discussed changes to the logframe to capture and incentivise UKCI outputs and this will be agreed as part of the Board discussion on monitoring and reporting in Q3/Q4 2018.

## B: PERFORMANCE AND CONCLUSIONS

### Annual outcome assessment

The vision of success is for UKCI to have invested in a diverse portfolio of projects, which demonstrate transformational impact and is additional i.e. would not have happened without the intervention of UK Climate Investments. At the point of this review, there has been one investment. BEIS's assessment is that, as it stands, the UKCI investment team will have difficulty disbursing all the funds within the initial investment period. BEIS expects to revise down its overall expectation for disbursement of funds in the final year the LLP, unless the pilot is extended further.

Initial discussions with the new management indicated that they were hoping to disburse £100m by November 2018, with £75m in four projects by April 2018 (including project Bolt). It is still possible that even with a smaller portfolio there will be a diversity of projects that could have transformational impacts. If the pilot is extended (there is the possibility of up to two one-year extensions in the LLP Agreement) there will be a greater chance of committing the full funding and realising the expected results. However, given the management fees are a percentage of total funding rather than funds invested, it could mean that the project has lower value for money than envisaged in the Business Case. If the £200m assigned to the UK is not committed, it will be made available to invest in other ICF projects. Four outcomes are being tracked for this investment:

#### **Outcome One** – *Strong climate outcomes*

If the full allocation is not disbursed into a portfolio of investments, climate outcomes in absolute terms for the pilot are likely to be lower than originally modelled as fewer investments will be made.

#### **Outcome Two** – *Strong development outcomes are secured from the project: total number of direct jobs created by UKCI projects*

As above, lower disbursement of UKCI's allocation and a smaller portfolio of investments could result

in a lower number of jobs created than the number originally modelled.

**Outcome Three** – *Decreased cost of capital, reduced cost of capital to similar projects*

This outcome was included in September 2015 as a result of the updates to the logframe and revised theory of change. However, BEIS has yet to agree a methodology as it is challenging to attribute any reduction in the overall cost of capital in these markets to specifically UKCI investments. This will be discussed by BEIS, MIRA and Ipsos MORI (the evaluation provider) before the next Annual Review and may be considered instead as part of the assessment of transformational change.

**Outcome Four** – *UK Climate Investments pilot improves risk perception, demonstrates feasibility/return of renewable energy (RE)/energy efficiency (EE) investments (return on investment of portfolio, speed of implementation)*

Despite the delays, BEIS expects UK Climate Investments to pursue deals that provide a strong rate of return (in the logframe the target is constant at a 10% return on investment).

In terms of speed of implementation (the time taken between finding an opportunity to invest and completion), BEIS expected to see the time between deal origination and execution to decrease over the course of the investment period as the team built up experience and networks. This has been slower than expected, which could be the result of macroeconomic factors in the target geographies, for example in South Africa, as well as a lack of capacity in the investment team and a lack of in-country presence. There were many projects that fell away or became dormant for some time. In the second year, the speed of implementation improved for the completed investment faster than expected.

**Overall output score and description**

**The overall output score for the pilot is a B**

Output 1 - *Pilot improves risk perception, demonstrates feasibility/return of RE/EE investments*

Weighting 50%

Score: C

The pilot has made one investment against a target of 6 (cumulative – over first and second review period) and has mobilised £32.6m of private and public finance to date.

Output 2 - *Strong international network established (for both deal origination and effective dissemination)*

Weighting 20%

Score: A.

The pilot has showed high levels of activity in terms of meetings to originate deals, and promotion of the vehicle, and increased interest in the pilot via the website.

Output 3 - *Renewable energy and energy efficiency measures are installed [Expected and Actual]*

Weighting 30%

Score: B

Renewable energy capacity for the value of the completed investment was higher than expected though in aggregate, lower than if more investments had been made. This is below expectations.

For further information on these outputs plus supporting evidence please see Section C.

There have also been activities beyond those captured by the logframe. These includes ongoing work between BEIS and Macquarie to align expectations, reach a shared understanding of objectives and ensure lessons learned are being captured. There has also been an active pipeline of projects, many which fell away during due diligence (as can be expected in these markets and geographies). There is a summary of the progress not reflected in the output scorings in Section D.

### **Has the logframe been updated since the last review?**

This is the second review of the pilot - the logframe has seen one change since the last review.

#### Outputs

- 'Renewable energy and energy efficiency measures are installed' has been expanded to include 'expected' and 'actual' to align with ICF Key Performance Indicators (KPIs) which measure actual measures installed.

#### Milestones

- Although the expected results in the first year were not achieved, expected results for the second year were not revised down. This is because at the point of the review, the investment team were at the point of closing a deal and had a strong pipeline of investments to develop over the subsequent 12 months. It was also anticipated that privatisation would complete in early 2017, enabling the pilot to start operating at the pace expected.

#### Weightings

- Output 3 '*Renewable energy and energy efficiency measures are installed*' was updated in the revised logframe to include 'expected' results in addition to 'actual' results. In year one, BEIS did not expect any actual results against this output due to the time-lag between making an investment and increased capacity or energy savings due to construction times. Therefore, it was not considered appropriate to assign this output any weighting for the first review as, even if UKCI had made investments, no results would have been achieved in this area. Greater weighting has now been given to this set of outputs as it is now possible to score the portfolio against these indicators.

Although effort has been made to capture the poverty alleviation potential of investments in Investment Committee papers, the development outcomes in the logframe, which focuses on jobs created and supported, has not been updated to include any further indicators. As it is not 100% clear what additional poverty reduction benefits can be quantitatively measured (beyond clean energy capacity and emissions displaced which are a core part of all ICF projects). Last year BEIS did not think there would be any off-grid projects increasing energy access, however it is still possible there will be projects with these benefits in the portfolio.

Specific actions to update the logframe from the last review can be found in Annex B.

## C: DETAILED OUTPUT SCORING

<b>Output Title</b>	Private and public investment mobilised directly by UK Climate Investments funding		
Output number per LF	1	<b>Output Score</b>	<b>C</b>
Risk rating:	Major	Impact weighting (%):	50%
Risk revised since last Annual Review?	No	Impact weighting % revised since last AR?	Changed from 65%

<b>Indicators</b>	<b>30-month milestone</b>	<b>30 month achieved</b>
1.1 Cumulative number of investments and capital invested by the fund	6	1
1.2 Volume of public finance mobilised for climate change purposes as a result of portfolio (ICF KPI 11)	42.1 (£m)	0
1.3 Volume of private finance mobilised for climate change purposes as a result of portfolio (ICF KPI 12) [cumulative]	218.2 (£m)	32.6 (£m)
1.4 Number of private and public sector investors across portfolio	6	2

### Key points

- One investment was completed, Project Bolt, a solar partnership with UK company Lightsource, mobilising £32.6m of private finance.
- Another project, Project Sigma, was signed off by the Investment Committee and expected to complete early on in this period but subsequently did not complete due to a number of complications outlined below.
- In total, eight deals were considered at Investment Committee. Six did not progress beyond structure (red/amber) stage and have either been ruled out or are on hold.
- Given that the pilot has completed only one investment, the likelihood of achieving the original target of 8-12 investments is reduced, which will be reflected in the logframe target for the third review.
- Private finance mobilised and the number of investors brought in on a per deal basis was higher than expected but on aggregate below expectations and therefore the programme gets a C for this output.
- The risk rating for this output is Major (risk of not being achieved).

### Progress against milestones

#### Output Indicator 1.1

The Investment Committee considered seven new projects during this period and progressed one from the previous period. Only two progressed to the final stage of the Investment Committee, and three to the penultimate 'structure' stage (one of these did not progress any further and the other two are still being considered).

In the first 18 months, 12 projects were considered but an increase in activity and the conversion rate

of project concepts to deals signed was expected as networks had been built up, processes established, and market and execution experience developed in the previous period. Although this second period was shorter, the relative number of projects considered was lower. This may have been affected by the privatisation which was live throughout this year, both creating uncertainty for the UKCI team as well as for potential partners.

**Table 1 - Projects considered by Investment Committee**

<b>Investment Committee</b>	<b>Preview Stage</b> (White/Red)	<b>Structure Stage</b> (Red/Amber)	<b>Pre-Final/Final Stage</b> (Amber/Green)
December 2016	Cricket (South Africa, Solar)		Project Sigma India, Solar)
January 2017			Sigma
March 2017	Bolt (India, Solar)		Sigma
June 2017	Pangolin (Rwanda, Mini Hydro)		
July 2017	Sirius (Nigeria, Energy Efficiency) Cheetah (Kenya, Namibia, Nigeria, Solar)		Bolt
August 2017		Cheetah	Bolt
October 2017	Biryani (Solar Biomass) Lakeside (India, Yieldco Wind)		Bolt (update)

### **Factors limiting progress**

In the last review, an analysis was provided of why progress had been less than expected. Factors included design issues (the investment team considers the mandate to be quite narrow as the deal requirements do not quite match up with market opportunities), delivery issues (particularly the privatisation and lack of staff resources) and contextual issues (i.e. macroeconomic conditions in the target countries). BEIS consider these issues to have persisted in this second review period – particularly as the privatisation took nine months longer than expected. Economic issues in the target African geographies continue to affect deals. An update on the issues delaying in progress is provided below.

#### **1. Design elements**

**Geographies:** During the design of the pilot, BEIS and GIB considered a wide list of target geographies based on a country analysis by KPMG - before settling on the three regions: India, East Africa and South Africa. At the time it was believed these three regions/countries presented the most favourable characteristics to meet the pilot’s objective of transformation within the context of commercial investment (for more on how the markets in these geographies have changed see the external factors below).

At the set-up phase, GIB was confident as to how quickly investments could be made in these geographies. However, during this period, macroeconomic changes and additional investment challenges meant that the limited country selection made investment more challenging. In South Africa, political and economic challenges served to stall the Renewable Energy Investment IPP

Procurement Programme (REIPPP) meaning that new Independent Power Producer (IPP) projects were not signed. Also, the difficulty of achieving financial close on larger power projects in Kenya and Tanzania became more apparent, something that perhaps could have been picked up earlier in the process. In the previous Annual Review, BEIS recommended expanding the target geographies to include all of sub-Saharan Africa which were on UKCI's tier two list. In this time, the investment team have considered projects in Namibia and Nigeria – the latter being a very large potential market with low levels of energy access and reliability, including in urban areas.<sup>1</sup>

In the previous Annual Review, GIB's lack of market experience in the target geographies was identified as hindering progress (due to lack of understanding of the challenges leading to high expectations). Although the Vice Presidents both had previous experience, in general the team continued to lack the resourcing expected including further market experts. A lack of physical presence on the ground is also considered to be a major disadvantage. In the latter part of the year the team were able to take advantage of MIRA's India office, however there is no permanent resource based in country. Had the GIB team showed greater understanding that their relative lack of experience and in country presence would mean slower progress, targets would have been made more realistic and therefore the pilot would be scoring higher.

**Financial Instruments:** UKCI's mandate requires that the vehicle invests using equity or 'equity like' instruments, to comply with UK Overseas Development Assistance Rules whilst also retaining the required commercial imperative of investing "at market rate". This limits the structures that UKCI can use to invest and therefore limits the universe of potential investment opportunities. The UKCI investment team considers that the inability to make shareholder loans in projects has made UKCI's offer more expensive overall and that has made investing much more challenging. The UKCI team asked BEIS to explore options to allow UKCI to be able to use shareholder loans which should considerably ease their ability to transact deals - a solution achieving this has been identified and is in the process of being implemented.

**Ticket size:** Particularly in the case of India, the UKCI investment team considers the £30 million maximum size per investment an increasingly limiting factor. The investment team's analysis suggested that in India there are more opportunities with these larger companies and platforms. This is potentially a question of strategy - if UKCI want to target large-scale solar then the ticket size may need to be larger. There is a demand for these types of investments, but they are considered to be less transformational when invested in at scale and do not align fully with UKCI's objectives. At this stage of the pilot, BEIS expects that there may still be more transformational deals out there which will tend to be smaller and work within the £30m limit. If a sufficiently transformational deal was brought to the Investment Committee above this cap, the Board may issue a waiver.

**Deal structuring:** The UK Climate Investments mandate implies a restriction on being exposed to pre-financial close development cost risk which means that complex financial structures are developed to accommodate the developer to avoid that exposure. BEIS recognises the feedback from the UKCI investment team and market about there being a need for intervention at development stage and is considering allowing such deals (by providing a waiver at Board level) or considering this model in a future formulation of UKCI, noting that other ICF programmes provide this type of finance already.

## 2. Delivery factors

**Resourcing:** Since the beginning of the pilot the UKCI team has been under resourced and below the level of experience that was set out in the agreed original business plan. This has meant that often senior team members are analysing data and writing papers (which should usually be the role of junior team members) rather than originating and transacting deals (as envisaged in the team

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<sup>1</sup> <https://www.se4all-africa.org/seforall-in-africa/country-data/nigeria/>

structure in the UK Climate Investments Business Case). This continued to be the case into the end of the second and the beginning of the third year. This is partly due to the delays in completing the GIB sale (until September 2017), which meant a long period where it was not possible to recruit due to uncertainty.

BEIS is conscious that if the team is under resourced the geographic leads have to focus on finalising deals to meet the investment targets of the pilot, however this can be at the detriment to the wider pipeline and ensuring there is a steady flow of new projects reaching the latter stages of the IC process.

Post privatisation, BEIS emphasised to the new owners that this needed to be addressed urgently. However, progress has been slower than desired. Although the final Board meeting of 2017 (just after the end of this reporting period) posted positive progress, there have been a number of challenges in recruiting new full-time team members. MIRA has drawn on its matrix resource structure for junior resource with a number of new staff working on the deals. However, it is important to bring in new senior full-time investment leads in order to meet the resource plans in the original Business Case.

BEIS considers that the level of staff resourcing is generally lower than in similar funds, particularly in relation to the admin/management fee. BEIS believes that the pilot would benefit from a project manager to make sure all relevant processes take place on time and an analyst to lead on monitoring and reporting. Despite some team members having been involved from the start of the pilot, there is not a clear understanding of reporting requirements or shared understanding of methodologies between BEIS and UKCI. Several members of the team left during the privatisation process, which was unrelated to UKCI performance, but has affected the ability to build pipeline and progress deals.

The UKCI investment team has reported that working with new entrants to the market meant that processes could take longer than usual, in particular when applying high European standards. An objective of UKCI is to bring in new international developers and investors and to raise standards (which will also help bring in more new entrants). However, some stakeholders in the market feel that, in some cases, UKCI needs to be more comfortable with local ways of doing business.

**Due Diligence:** UKCI undertakes a professional and detailed due diligence approach for its UK investments and applies the same level of rigour to the UKCI investment process. A strong level of due diligence is vital to ensuring strong value for money for UKCI. However, it also means that it has slowed the deal process as well as being a transaction cost burden on the potential investments, which has effectively made UKCI capital more expensive (as generally deal costs are charged back to the company to be invested in). There tends to be a higher level of uncertainty in emerging markets where the investor needs to take a view without full information and consider this as part of the risk/return trade-off. In certain cases, UKCI has had to abort deals due to concerns raised during due diligence that were considered too great a risk to proceed. External stakeholders have commented in interviews with the external evaluation partner that in some cases UKCI may be too exacting, although BEIS supports strong Health, Safety and Environment (HSE) and Environmental, Social and Governance (ESG) standards.

**Finding the right deals/risk appetite:** BEIS, the UKCI Investment Team, and GIB spent significant time and effort in the first 18 months discussing the balance between additionality (that other private sector investors will not be crowded out by our investment), the ability of investments to transform markets and the commercial viability of projects. Halfway through the first year BEIS raised concerns about the visibility of the transformational aspects in the deals. As discussions progressed, misalignments in risk appetite between BEIS and GIB became clear and it also became apparent that GIB's preference was to try and replicate its UK business model by trying to partner with large-scale project developers operating in the target geographies which BEIS considers to be excluding more transformational deals and reduced the additionality case.

**Management/Governance:** In the previous review, it was assessed that the senior management of the GIB did not fully grasp BEIS's ambitions for risk appetite or transformational change and that our concerns raised at the Board about the way the pilot was progressing were not fully reflected in working practices (in terms of the types of deals being brought forward or the way transformational change was reflected in the papers).

There has been a clear improvement under Macquarie who have been responsive to BEIS requests and objectives.

It was also BEIS's view that the GIB senior management team, as a whole, did not have sufficient experience of emerging market investments. It therefore took some time for the management to build up this experience, some of which was lost with the privatisation. MIRA does have stronger experience in emerging market investments, especially in India where they have a large presence.

In the last Annual Review, BEIS identified a tendency at Investment Committees for these meetings to be overly choreographed which limited debate. Since the privatisation there has been a considerable improvement in the way this process is run with genuine discussions and opportunity for challenge.

### 3. External factors

**The sale of the GIB** had two significant impacts on UK Climate Investments: 1) it has absorbed significant resources on both the GIB and BEIS side that arguably could have been spent on the delivery of the pilot; and 2) created a huge amount of uncertainty exacerbating issues around staff management, retention and recruitment. As the privatisation did not complete until August 2017, this issue persisted for most of this reporting period and had a detrimental effect on delivery of the pilot.

**Macroeconomic factors** have impacted potential investments in the target geographies and potentially the deal flow available to UK Climate Investments. Again, this is outside the control of UKCI and BEIS.

Annex C contains a summary of specific regional challenges and recommendations.

### Progress against milestones (continued)

#### **Output Indicator 1.2**

The amount of public finance mobilised is lower than modelled due to the lack of deals. It must be noted however that mobilising public finance is not an aim of the project. It is included here as it is one of the generic performance indicators of the ICF.

#### **Output Indicator 1.3**

The amount of private finance mobilised is lower than modelled due to the lack of deals in years one and two.

The expectation for the first 18 months was that the pilot would make three investments, and that the resulting mobilisation of public and private finance would then follow in the second period. On this basis, BEIS did not expect any mobilisation in year two as there were no investments made in the first 18 months. However, as in the case of Project Bolt, there were funds invested directly alongside UKCI's investment (both debt and equity) which can be reported during this period.

The private finance mobilised by Project Bolt was in fact higher than the leverage rate envisaged in the Business Case of £2.5 mobilised for every £1 of ODA invested. For commercial reasons the exact

amount invested alongside Lightsource in project Bolt is not disclosed, however it is less than the amount of private finance leveraged divided by 2.5.

#### Output Indicator 1.4

As with finance mobilised, the number of investors overall is lower than expected, due to the lack of deals completed in the first 18 months. However, as project Bolt mobilised both equity and debt investors into the deal, two investors have been reported for this deal, which is higher than expected. It had been assumed that one new investor would be engaged per deal.

#### Recommendations

- 1) Resourcing: BEIS recommend UKCI management establish a full-strength team including, where possible, resource on the ground. UKCI management should ensure that there is sufficient origination and progression of deals even when advanced deals are being negotiated.
- 2) Shareholder loans: BEIS and UKCI management should finalise the agreement for allowing UKCI to be classified differently under ODA reporting purposes and the UKCI investment team should start using shareholder loans where appropriate to structure investments. BEIS and Ipsos MORI should assess and evaluate what impact this makes in the delivery of longer-term results.
- 3) Development stage risk: BEIS and UKCI management should explore whether, during the remainder of the current investment period, it would be appropriate to waive the relevant part of the mandate and invest in deals at development stage. At this stage, projects have the potential to be more additional and in certain markets there is a greater need. Both organisations will need to consider other ICF programmes such as the Renewable Energy Performance Platform (REPP) which provide this type of finance.
- 4) Other mandate changes: BEIS to consider other changes to the mandate recommended by the investment team.

<b>Output Title</b>	Strong international network established for both deal origination and effective dissemination		
Output number per LF	2	<b>Output Score</b>	<b>A</b>
Risk Rating:	Minor	Impact weighting (%):	20%
Risk revised since last Annual Review?	No	Impact weighting revised since last AR?	No

Indicators	2016- 2017 milestone	2016-2017 achieved
<b>2.1</b> Number of people accessing information from GIB's website on the international pilot aggregated by geography	7,790 (18 month) = 5193 (annual) + 10% (519) = 5712	74,114
<b>2.2</b> Number of meetings with stakeholders in project origination (potential) project investors, project developers	300	204 [to note that some data was lost with the departure of the Managing Director, so this number could be higher]
<b>2.3</b> Number of meetings with stakeholders promoting UKCI and GIB overseas	12	12

## **Key points**

- Deal origination and dissemination is in line with expectations at this point in the pilot.
- BEIS expected website hits per year to increase due to increased awareness of and interest in the pilot - which has been the case.
- UK Climate Investments has performed as expected in terms of deal origination – the investment teams considered a wide range of projects in the target geographies even though this activity did not result in completed transactions in that year or a sufficiently strong pipeline which is considered able to meet the original expected results by the end of the pilot (for the reasons described in Output 1).
- Both the wider GIB/GIG staff and the UKCI team have been active in events, conferences and networking opportunities to promote UKCI alongside the GIB/GIG.
- Project Bolt - the investment with Lightsource BP was accompanied by a low-key press release targeting commercial audiences.
- Going forward UKCI, in partnership with BEIS, should consider if more activity is required around promoting individual deals to achieve a ‘demonstration effect’.

## **Progress against milestones**

### **Output Indicator 2.1**

The BEIS ICF team did not set a milestone for the first reporting year as it was considered too early to identify an ‘appropriate’ number of hits that would demonstrate adequate evidence of promoting the pilot. In the first 18 months there were 7,790 individual website hits on the UKCI pages of the GIB website. In the subsequent 12 months there were 74,114 individual hits. This means that the rate of visitors visiting the website has increased over time, as would be expected.

However, as discussed in the previous review, the website could be improved by explicitly making the link to UK Climate Finance and therefore meet the desired outcome of increasing visibility of UK climate finance. The website should contain the most up to date information including team contact details and updates on deals completed.

### **Output Indicator 2.2**

The reporting against this milestone shows significant activity in deal origination which is a necessary step towards building a strong pipeline.

UKCI management provided a long list of the projects the investment team identified as potential opportunities pre-screened against the investment criteria in the first 18 months, which amounted to over 200 projects. This however did not include meetings from the departing Managing Director who left 10 months into the period. Although this data was not captured, it can be seen from the previous year and the first two months of activity by the new MD that this target was met comfortably.

It is standard commercial practice to expect large amounts of origination activity to not directly translate into a high number of deals coming through the Investment Committee. The main reasons for origination not leading to a high number of actual deals for UKCI include:

- A large number of potential projects did not fit the mandate in terms of country, the type of finance requested and the scale of investment (as the UKCI mandate requires that it is a minority investor).
- In some cases, the UKCI investment team assessed that the developers were too early in their fundraising process and asked them to return later.
- Several projects, including those that were previewed at the Investment Committee, did not meet GIB’s required standards.

## Output Indicator 2.3

Annex C documents the events that the UKCI investment team participated in during the second review period. The team reported that, in the vast majority of cases, this participation led to follow up discussions and new leads on deals.

In the logframe, it was envisaged that these events would consist of UKCI having a platform to make the wider investment community aware of the types of opportunities available in these countries, to demonstrate the commercial viability of these investments and to attract new investors. The target was therefore set at a relatively low number.

Although somewhat different in nature, the types of events in which UKCI representatives participated are considered appropriate for this stage of the pilot and are therefore included in the results.

For Project Bolt, Lightsource BP put out a commercial press release at the time to trade publications aimed at raising awareness of the investment in the developer and investment community, which received positive pick-up (as assessed by MIRA's communications team).

Once more investments have been made, BEIS expects an increase in the promotion of the pilot (particularly overseas) to showcase its achievements and the impact of UK Climate Finance. A key objective of the Business Case is to receive credit in international negotiations and demonstrate mobilisation of private capital (towards the "\$100billion/year by 2020" goal).

<b>Output Title</b>	Renewable energy and energy efficiency power <u>potential</u> (expected results based on investments completed in portfolio)		
Output number per LF	3a	<b>Output Score</b>	B
Risk Rating:	Major	Impact weighting (%):	30%
Risk revised since last AR?	This is the first time this has been captured in the logframe.	Impact weighting revised since last AR?	Not previously weighted

Indicators	2016- 2017 milestone	2016-2017 achieved
Level of installed capacity of clean energy as a result of (cumulative) UKCI investments (MW).	182.5 MW [expected lifetime results 365MW pro rated for 4 out of 8 deals, omitting 2 as they are Energy Efficiency].	60 MW
Electricity demand reduction (MWh) resulting from (cumulative) UKCI investments.	26.92m MWh	0

## Key Points

- This indicator covers what would *be expected* in terms of installed capacity and electricity demand reduction over the lifetime of the projects resulting from current renewable or energy efficiency investments in the portfolio (where some may or may not be constructed at the time of investment.)
- The milestones were calculated on a pro-rata basis from the lifetime expected results (i.e. six of around ten investments were expected to have taken place with a total 182.5 MW and demand reduction of 26,921,699 MW hours (as two out of the six expected investments in the model were assumed to be energy efficiency investments).

- While there was only one investment instead of six (cumulatively) (and in this sense results were substantially below expectations), the results expected from the successful investment are proportionately greater than predicted (in terms of MW/£). The expected installed capacity from project Bolt is 60 MW (DC), larger than the capacity expected from a similar renewable energy investment in the model portfolio (taking the milestone which includes four renewable energy projects and dividing by 4 which is an average of 45.76 MW). The programme has therefore scored a B for this output as, while performance overall is below expectations, there have been positive signs of good potential results in terms of renewable capacity. It must be noted that mobilising private finance is more of a focus than achieving scale for each project.
- In terms of the make-up of the portfolio, BEIS used a model based on assumptions about the likely portfolio which assumed two energy efficiency projects in the first year to 18 months. The UKCI investment team have considered relatively few energy efficiency projects vis-à-vis renewables in their pipeline, mostly due to the difficulty in finding suitable projects that met the mandate and the time that would be needed to structure and complete them. Both partners feel that energy efficiency projects will take place later in the investment cycle once the team has more experience completing renewable projects in these geographies which are relatively less complex. As discussed, BEIS will update their assumptions in the model regarding the likely portfolio for the next review.

<b>Output Title</b>	Renewable energy and energy efficiency measures are installed ( <u>actual operational</u> )		
Output number per LF	3b	<b>Output Score</b>	<b>N/A</b>
Risk Rating:	Major	Impact weighting (%):	0
Risk revised since last AR?	N/A	Impact weighting revised since last AR?	Not previously weighted

<b>Indicator(s)</b>	<b>30-month Milestone</b>	<b>30 month Achieved</b>
Level of installed capacity of clean energy as a result of UKCI investments (MW)(ICF KPI 7)	45.6	0
Electricity demand reduction (MWh) resulting from the UKCI investments (ICF KPI 16)	4.09	0

## Key Points

- These outputs measure *actual* renewable energy capacity and electricity demand reduction achieved by ICF projects in each year (rather than *expected*).
- In the first and second reporting period BEIS did not expect to see any results in the target geographies, as it was assumed there would be a two-year lag due to construction between making an investment and having new clean energy capacity installed or a reduction in demand. These outputs are therefore not weighted.
- Although there was one investment, the construction was not complete by the end of November 2017 so is not included in these results.
- However, as found through experience thus far, the lag between investment and construction is likely to vary, and in most cases will be less than the two years assumed in the model. In the case of project Bolt, construction would take place less than six-months after completion.
- Also, the assumptions in the Business Case model that 2/3 investments in the first 18 months would be energy efficiency investments were not correct or realistic as they are typically harder to structure.
- In the next Annual Review, it will be possible to measure and discuss actual installed capacity as a result of project Bolt or further investments where there is a short lag between completion and construction.

## **D: Progress not captured by the outputs**

### Privatisation

- During the earlier part of the privatisation period, significant staff resources from BEIS (project, commercial and legal teams) were diverted to the renegotiation of the LLP Agreement to ensure it was fit for purpose under new ownership including any future change of ownership post sale.
- Following the privatisation of the GIB, BEIS and existing UKCI staff held a number of meetings and workshops with Macquarie to ensure the new owner understood BEIS objectives, constraints and processes. This led to an improvement in management processes and quality of discussions at the Board and Investment Committee meetings.
- Following the change of UKCI Managing Director, BEIS and UKCI staff put similar effort into bringing the MD up to speed on the requirements of the pilot (in addition to BEIS ensuring their skills and capability matched the responsibilities of the role).

### Governance

- Board: Three Board meetings were held during this reporting period. Key issues discussed included finance, risk, strategy, the project pipeline and resourcing.
- As discussed in the output sections, BEIS commercial advisers worked with colleagues across the ICF, BEIS finance and in DFID to determine a solution that would allow UKCI to be able to use shareholder loans in its investment.

### Lessons learned

- A workshop was hosted by Ipsos MORI in July 2017 to capture lessons from the first two years in transacting deals and target geographies, and to inform the strategy and deal execution under new management. The UKCI investment team's experience of working in India was shared with the ICF team and wider climate and energy colleagues.

## **E: VALUE FOR MONEY & FINANCIAL PERFORMANCE**

The approach used to assess value for money (VfM) is in line with DFID's 4E approach which looks at economy, efficiency, effectiveness and equity.

### **Key cost drivers and performance**

The key cost drivers for UK Climate Investments are the equity capital investments, remuneration to GIB and the due diligence costs which are set out in the Business Case and the previous Annual Review:

- Equity capital investment: The novel application of Official Development Assistance (ODA) in commercial investments means that the UK may realise more than its initial investment (which includes associated due diligence costs). The timescale for this is expected to be in the long term.
- Remuneration to GIG and the evaluators: Costs are driven primarily by the remuneration paid to GIG for the services it provides to UK Climate Investments, including the services of the dedicated UKCI team, MIRA senior level and junior support, legal and financial management, green advisory services and investment activities. Generally, asset managers are remunerated through a fixed annual fee (in UKCI's case the 'priority return') and in addition a share of the profits from the investment after the return of capital to the investor (as relevant). Due diligence costs: in the Business Case it was envisaged that due diligence costs would form part of the priority return.
- There is a contract with a specialist monitoring and evaluation (M&E) provider. A consortium, led by Ipsos MORI including Mott MacDonald, SQ Consult and Ernst and Young, were contracted following a competitive procurement process in December 2015 to evaluate the programme from 2016-2019. This contract has been on pause for some of the period and some of the activities scaled down to reflect the lower number of investments.

### **VfM performance compared to the original VfM proposition in the Business Case**

The original VfM proposition in the Business Case was based on GIB's expected ability to invest effectively and deliver results. The expectations at the start of the pilot was that they would make six investments during the first two years of the pilot (extended to two and a half years due to the privatisation) and 10 investments by the end of the third year. This period has been extended by six months and the milestones in the logframe were adjusted accordingly.

Expectations are that UK Climate Investments will not commit the entirety of the fund during this initial 3 ½ year investment period, which as noted earlier in the review, can be extended by mutual agreement.

The new Managing Director of UKCI produced a business plan at the end of this period which projected that £100m would be committed by November 2018, on about six projects. If this is the case and the pilot ends in November 2018, it would mean potentially lower VfM for the fees vis-a-vis the portfolio of investments delivered.

### **Economy**

The annual 'priority return payments' which are in line with similar commercial funds would to-date appear less economic than envisaged in the Business Case when compared to the staffing levels and the level of investments that have been made. In addition, there has been a six-month extension agreed as part of the privatisation so BEIS will pay an extra six months of priority return. However, this is not a straight forward pro rata calculation, as the priority return is also supporting the

development of a pipeline, network of contacts, wider GIG support team and brand. Results are expected to be backloaded towards the end of the pilot, based on the understanding of commercial funds.

Sufficient staffing has been flagged consistently by BEIS members of the UKCI Board, though it is not possible to compare directly with the Business Case as resource has been drawn in ad hoc from other parts of GIB and is starting to be deployed via a matrix system under Macquarie which is their normal business practice. Since coming under management of MIRA, there has been a perceived improvement in their understanding of the mandate, investment activities and level of staffing.

The previous Annual Review also highlighted that the level of BEIS resource expended on the project has been higher than anticipated. This is partly due to the complexity of the project, its legal and financial arrangements (some of which were unforeseen) and the sale of GIB which meant significant resource required to perform due diligence of the new owner and renegotiate new terms with the bidder (which has been exacerbated by several delays to the overall sale). BEIS staff committed significant time to initiate new Macquarie managers and team members into BEIS and ICF processes and the requirements of managing ODA spend, transparency, reporting etc. BEIS ICF resource requirements have been higher than was originally anticipated. However, as discussed earlier in the review, there has been an improvement in the level of service during the last two months under the new management.

#### Efficiency

The outputs in terms of number of origination meetings has been as expected, and therefore received an 'A'. Due diligence and time spent by the investment team progressing deals, analysts in UKCI and the Investment Committee in assessing deals has been significant and has yielded a lot of knowledge for the BEIS ICF team and is not captured by the logframe. This will be considered for the next Annual Review. BEIS has seen an improvement in the Investment Committee process under new management which will be assessed more fully in the next review.

In terms of the fee structure, BEIS think that UKCI is adequately incentivised to transact and complete deals in order to realise returns and therefore should allocate appropriate resource to the project. In addition, impact and sustainable investment is a growing segment, a business opportunity and holds positive reputational value for Macquarie.

The speed of implementation is expected to improve with more deals to be completed the longer the team are in place.

#### Effectiveness

Overall, until the investments are made, it is too early to say whether the benefits expected to result from these investments will be delivered and therefore whether it is the right model to affect transformational change in these markets. The Business Case is predicated on the ability to unlock flows of private capital that transforms markets, something GIB had a strong track record of in the UK. It remains to be seen whether a partner with less experience of investing in these developing markets will be able to bring the same ability to these more complex environments.

So far, one of the investments made is likely to perform well in terms of greenhouse gas (GHG) impacts, and returns, and although there has been some promotion of the benefits of the investment structure and outputs, it won't be possible until the evaluation activities to assess how great a 'demonstration' effect this has achieved.

## Equity

Equity has been added as a measure of VfM since the Business Case was written. However, throughout the project BEIS has put a strong emphasis on individual projects explicitly demonstrating how they would have benefits to the poor. It is challenging in the sphere of private equity investment into mostly on-grid projects to see the direct impacts on the poor. However, in general UKCI, through mobilising investment into renewables and displacing new fossil fuel capacity, contributes to wider benefits in terms of mitigating climate change and local air pollution.

UKCI investment papers outline where each project may score highly against relevant sustainable development goals (SDGs). The investment team ensure it works with reputable partners, who meet ESG and Equator principle guidelines in their investments and work with the local communities in which facilities are based. In the case of project Bolt, the company has very high standards (as verified in person by members of the ICF team) and has delivered benefits to the local community including jobs.

### **Assessment of whether the programme continues to represent value for money**

Given the market challenges and change in assumptions about the likely portfolio of investments, BEIS analysts will remodel the expected results in 2018 to determine whether the lifetime results will be impacted by a different portfolio and assess how that effects the VfM case.

It seems likely that UKCI may not disburse the full fund, and therefore may represent lower VfM than envisaged in terms of monetised benefits. While some aspects of VfM have been assessed here, and underperformance has been identified, it is too early to say on others. Considering other ICF programmes tend to see an increase in the pace of delivery over the longer term, more time could allow the pilot to realise the benefits envisaged in addition to other non-monetised benefits including greater UK visibility, transformational change and lessons for the ICF in devising future programmes.

### **E: Quality of financial management**

The quality of financial management for UK Climate Investments has been acceptable. The legal agreements for the LLP set out the financial management requirements.

The UKCI finance team have been proactive in clarifying their understanding of BEIS requirements. In some cases, providing the information that is needed in the required format has not taken place automatically and required prompting.

The accounting for the LLP is carried out by the GIB finance department. This responsibility will transfer to MIRA finance department from September 2017.

The audited accounts of the LLP were submitted on time following the end of the financial year.

Date of last narrative financial report	June 2017
Date of last audited annual statement	June 2017

## **F: RISK**

### **Overall risk rating: Major**

BEIS considers there still to be major risks to the delivery of this programme. However, there are potentially considerable benefits to be gained from the programme now that the initial setup phase is complete, and a new delivery agent is in place.

### **Overview of programme risk**

In the Business Case the following were identified as key risks to the programme, which continue to be major delivery risks to the programme and in some cases have materialised (and therefore have become 'issues' as discussed in the outputs section):

- As an institution, GIB had no international experience of investing development finance.
- Despite their strong 'green' credentials, there was a risk that they deliver investments that were less transformational than BEIS is targeting i.e. market leading, pioneer investments which ensure strong additionality.
- GIB did not have a strong track record in energy efficiency in its investments in the UK which could have affected its ability to make this type of investment through UK Climate Investments. Due to the tension between ODA concessionality requirements for loans and the commercial focus of the pilot, there were concerns that they might not be able to deliver the energy efficiency aspects of their business plan.
- There was a risk of future strategic misalignment. At the time the project was approved, GIB wanted to attract private capital into the bank, while BEIS's priority was to ensure the pilot would continue to operate as envisaged under such circumstances.
- There was a risk of reputational damage to BEIS and wider UK Government given public concern over fee and profit share arrangements.

BEIS has dedicated significant additional staff resources to the pilot to proactively manage the relationship with UKCI senior management and the investment team.

The risks are managed by:

- Weekly meetings with the UK Climate Investments team to keep abreast of changes to the pilot and the progress of the investment team;
- Engagement with the UK Climate Investment Board through quarterly Board meetings and ad-hoc discussions to address issues including risk appetite and transformational change;
- Utilising a project Board of senior BEIS expert advisors, commercial, financial, procurement, economists and legal, to provide advice on progress and improvement to the pilot;
- Developing a joint risk matrix with UKCI in line with MIRA central processes and reviewing it at least quarterly at Board level (any change in risk will be automatically flagged by internal MIRA processes).

### **Changes to the risk profile of the pilot**

#### **The sale of GIB**

A considerable change to the overall risk context since the design of the pilot was the sale of GIB. The legal and strategic risks of new ownership are considered here. Other risks were quickly established to be low or straightforwardly mitigated.

The legal and strategic risks have been mitigated by:

- Conducting necessary due diligence of the bidders and assurances provided by the new owner.

- Agreeing changes to the pilot's legal agreement in the first few months of the second year of the pilot to provide assurances under new ownership. Key changes included providing further controls on future changes to terms, ensuring UK Government visibility through maintaining UKCI and UK Government branding, and continuing management and governance of the pilot in line with BEIS accounting and propriety objectives. BEIS ensures that it will continue to have sufficient oversight of the pilot in line with the Government's 'Managing Public Money' framework.
- Concerns about the new owner not delivering in line with BEIS sustainability objectives have been allayed due to positive experiences in the first few months of operation.
- The risk of links to UK Government and fund branding being diluted continue to be monitored.

### **Macroeconomic risks**

The risk that policy and regulatory changes in target geographies may undermine investments made under the pilot in the selected countries is a concern.

Since the market assessment was undertaken in early 2015, economies in Africa have slowed down considerably. The UKCI team have actively adapted to these circumstances. However, there are ongoing challenges, for example, limited investments can be made in South Africa until Round 4 of the REIPPP closes.

To mitigate this risk, BEIS agreed to expand the target geographies to include all of sub-Saharan Africa to enhance the range of potential investment opportunities. BEIS also has Investment Committee members with increased developing market experience which is expected to help the team make informed decisions when operating in these environments.

### **Remaining risks**

A joint BEIS / UKCI risk matrix was developed, firstly with the GIB risk team and subsequently the MIRA risk team. Risk management processes have significantly improved under MIRA with more controls in place and a more sophisticated internal system.

### **Outstanding actions from risk assessment**

The remaining actions are:

- Agree a strategy with UKCI team for the remainder of the investment period to ensure strategic alignment and shared risk appetite and most transformational deals are targeted.

## **G: COMMERCIAL CONSIDERATIONS**

### **Delivery against planned timeframe**

The programme is currently not delivering against the expected timeframe.

The difference between expected and actual results is a consequence of optimism bias, design issues, and issues with the UK Climate Investments and GIB management processes. In addition, the sale of GIB was not foreseen when the Business Case was produced.

The pilot has only recently completed its first investment and has two further investments expected to complete in the first half of 2018. In general, there has been a backloading of investment towards the end of the investment period and a lower rate of disbursement than expected.

To account for the GIB sale process, the length of the investment period has been extended by six months (until the end of 2018) making the investment period three and half years instead of three

years. There remains an option of extending the investment period (and commitment period correspondingly) by one or two years with the agreement of both sides of the LLP.

### **Performance of partnership**

As discussed in the risk section, BEIS's risk appetite differed from that of the delivery partner before privatisation. BEIS has worked closely with the new owners and consider there to have been an improvement in processes and alignment of strategic objectives.

### **Asset monitoring and control**

As of the end of this reporting period, there is one asset under management by the LLP. BEIS receives regular updates on the asset from the UKCI investment team, specifically when discussing the risk framework.

## **H: MONITORING & EVALUATION**

### **Evidence and evaluation**

The evidence compiled to assess progress in this Annual Review consisted of:

- Ipsos MORI Phase one scoping report
- Board papers
- Investment Committee papers
- Google data analytics of UKCI website visits
- UKCI investment team records
- Discussions with BEIS project and commercial teams and UKCI investment team

### **Summary of evaluation progress and plans**

In early 2016, Ipsos MORI in partnership with Mott MacDonald, Ernst & Young and SQ Consult, were contracted to evaluate the UK Climate Investments pilot following a competitive tendering process.

The consortium will take a theory-based evaluation approach which utilises contribution analysis and employs varied data sources to triangulate findings. They will utilise a real-time approach, sharing feedback on findings as they emerge to help improve delivery.

As part of the inception activities, the consortium facilitated a workshop between BEIS and GIB in April 2016 which included a visioning exercise of what success of the pilot would look like in 2018. As a result of the discussions, Ipsos MORI undertook a revision of the Theory of Change. This was agreed by both parts of the LLP in September 2016. The logframe was consequently revised between May and September 2016 to ensure it was in line with the updated theory of change.

Due to the lack of investments and possible case studies, the evaluation activities were rescoped to in late 2017 to focus on preliminary results and the effectiveness of the process. An interim report is planned to inform decisions over the future of the pilot.

### **Monitoring progress throughout the review period**

Other than the annual reporting against the milestones in the logframe, the pilot does not currently have a formal plan for more granular monitoring arrangements. This is due to the fact BEIS is closely involved in the day to day investment process, giving clear oversight over investment size, type, finance mobilised etc. The UKCI team have regularly provided a list of origination meetings demonstrate the types of deals they are targeting.

As discussed in the section on Output 2, regular discussions have not been held regarding promotion activities. This could benefit from more regular monitoring and lessons learned once more investments have been made.

At the outcome level, BEIS maintains clear oversight of Outcome 4 (rate of return and speed of implementation) through the Investment Committee process. A time-lag is between completing investments and seeing results for the outcomes concerning climate, jobs and cost of capital. Once delivering, these results will be collected annually.

### KPI 15 Rating

There is currently a methodology for transformational impact at both the individual project (investment) level and the pilot level (below). The assessment of current progress for the pilot as a whole during year one is based on the following scoring:

0	Transformation judged unlikely
1	No evidence yet available - too soon to revise assessment in Business Case
2	Some early evidence suggests transformation likely
3	Tentative evidence of change – transformation judged likely
4	Clear evidence of change - transformation judged very likely

The current assessment is that the pilot scores ‘1’ as there is insufficient evidence available due to the lack of investments. The slow start to the programme means that evidence of transformation is emerging more slowly. Further assessment of the transformational change criteria is found below.

### Evidence and evaluation

The external evaluation provider will be assessing how UKCI affects transformational change by collecting and analysing data at the project level. The Investment Committee papers contain an assessment of the potential for progress against these indicators.

Each investment will be assessed against the criteria below to give an overall assessment of transformational change potential for the project. The final three are mandatory requirements for every project.

- *Political will and local ownership:* need for the change is agreed locally and the process is locally owned. For widespread changes, notably changes to the patterns of development, this will require high level political buy-in and broader support from across society;
- *Capacity and capability can be increased:* countries and communities have the capacities and capabilities necessary to bring the change about;
- *Innovation:* innovative technologies are piloted, with the potential to demonstrate new ways of doing things, which could lead to wider and sustained change;
- *Evidence of effectiveness is shared:* approaches which have proved successful in one location are made widely available and lessons on their usefulness are credible and shared widely;
- *Leverage:* create incentives for others to act;
- *Replicable:* the costs of climate action are reduced to the point that acting on climate is a sensible decision for commercial firms and private individuals. These cost reductions may need to be steep enough to overcome behavioural inertia;

- *At scale*: interventions (such as national, sectoral or regional programmes) that have sufficient reach to achieve institutional and policy reform, or drive down costs of technology deployment
- *Sustainable*: change is likely to be sustained once ICF support ends.

Following the completion of the first investment project, the evaluation provider will baseline the data for this project by visiting the project site and interviewing relevant stakeholders. They will visit the project at a later date to assess changes. Bolt is expected to be replicable, sustainable, to leverage others and to build capacity and evidence of effectiveness.

Delays to the pilot and privatisation of GIB have meant that the Ipsos MORI led consortium has not been able to deliver the work plan on the timeframe originally envisaged. BEIS has therefore agreed with Ipsos MORI to rationalise the plans for the external evaluation, including fewer site visits.

## ANNEX A: Recommendations from the previous Annual Review and progress

Action	Deadline	Lead	Comment
<b>Resourcing</b> - BEIS recommends UKCI management build up a full-strength team including, where possible, resource on the ground. There should be sufficient origination and progression of deals even when advanced deals are being negotiated.	Q2 2018	MIRA management	MIRA have hired two new team members [as of May 2018] and actively use the India office however should consider options for having more formal resources on the ground.
<b>Shareholder loans</b> - BEIS and UKCI should finalise the agreement for UKCI to be classified as a PPP and the UKCI investment team should start using shareholder loans where appropriate to structure investments. BEIS and Ipsos MORI should assess and evaluate what impact this makes in the delivery of results.	Q1 2018	BEIS and MIRA	Completed  Ongoing
<b>Development stage risk</b> - BEIS and UKCI should explore whether, during the remainder of the current investment period, it would be appropriate to waive the relevant part of the mandate and invest in deals at development stage where they could be more additional and where in certain markets there is a greater need.	Q2 2018	BEIS and MIRA	Due for discussion July 2018 to be agreed at the September 2018 Board.
BEIS to consider changes to the mandate recommended by the UKCI investment team.	Q2 2018	BEIS	Due for discussion June 2018 to be agreed at the September 2018 Board.
<b>Reporting</b> - BEIS to agree new milestones with UKCI and revise assumptions of the model based on actual information on the likely size and shape of the portfolio. BEIS to also consider whether to include additional indicators in the logframe and whether to instigate more regular reporting requirements.	August 2018	BEIS	In discussion. New model to be finalised by August 2018 and any changes to the logframe made by September 2018.
<b>Extension/ Fees</b> - If the pilot is extended, consider appropriate fee structure to ensure appropriate VfM for UK Government and to align incentive structures.	Q2 2018 (post extension decision)	BEIS	To be agreed as part of the extension discussion by July 2018.

## ANNEX B: Updates to the logframe

Action	Deadline	Lead	Status
A methodology for the new outcome in the revised logframe – <i>'Reduction to cost of capital'</i> - does not yet have an agreed methodology. BEIS intends to have a workshop to agree how this will be measured and attributed in relevant markets.	3 months prior to next review	GIB Green Team, BEIS Analysts, BEIS Project Lead.	Ongoing Following the change in ownership and management this has not been a top priority, however will be explored during this final year to test market outcomes of any future investments.
With <i>'Number of people with improved energy access'</i> removed as an outcome, BEIS should consider whether to include additional indicators that capture the development and poverty reduction effects of the pilot.	3 months prior to next review	GIB Green Team, BEIS Analysts, BEIS Project Lead	Ongoing As some off grid solar projects came to Investment Committee in late 2017, it will be necessary to consider how to capture these results.
Having only 'actual' installed capacity and demand reduction instead of expected means there are results to discuss in the early years. BEIS should consider including both expected and actual.	3 months prior to next review	GIB Green Team, BEIS Analysts, BEIS Project Lead	Completed
BEIS should consider how the logframe could be used to capture the lessons learning process in a more systematic fashion. This could help embed and record lesson learning. The BEIS project and Compass (ICF wide monitoring and evaluation) teams should consider how to operationalise this idea in the second reporting period.	3 months prior to next review	GIB Green Team, BEIS Analysts, BEIS Project Lead.	Ongoing This requirement has been communicated to the UKCI investment team who have made an effort to capture experiences to date to share with BEIS and beyond. This will be added to next Annual Review logframe.  Ipsos MORI was on contractual pause for most of this reporting period due to the delayed activities.
BEIS and the UKCI team should agree realistic milestones post-privatisation.	Once the new owners are in place.	BEIS Project Team, UKCI Management and Investment Team.	Completed 'Business plan' discussions have been held with the new owners about their aims for the pilot which generally accept that it is not practicable to

			disburse the remaining funds in the remaining time left in the investment period. However, an exact number of investments and £ disbursed has yet to be agreed. This will be agreed before the next review.
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## **ANNEX C: OUTPUT 1 - Specific regional challenges**

### **India**

#### **Policy:**

- Heavy on utility scale solar (which BEIS considers not to be the most additional type of project to focus on) and rooftop solar by Indian government. However, the latter is more challenging (nascent fragmented market, project implementation difficulties etc.)
- Stagnation in wind installations by IPPs due to transition from feed-in tariffs to reverse auction process.
- Lack of auctions in early 2017 left huge pent up demand and intense competition for utility scale solar in late 2017 driving tariffs to record lows – particularly in federal agency auctions where land and grid connections are provided.
- Due diligence of asset uncovered numerous issues (e.g. Chroma and Hallway including HSE, poor build quality and permitting issues, management weaknesses) even though asset valuations continue to be aggressive.
- UKCI's £30m cap and other requirements are significant deterrents for India's leading IPPs where scale is key
- Risk profile of niche businesses (e.g. Biryani) not acceptable for UKCI- i.e. where business models have failed or proved unsustainable.
- Increasing popularity of mezzanine finance as dilution becomes an important consideration for current investors- something which UKCI does not offer.

### **Africa**

#### **Policy:**

- Focus towards decentralized systems and off-grid solutions by a number of governments in sub-Saharan Africa (e.g. Nigeria, Tanzania, Rwanda) which are riskier types of investments compared to infrastructure.

#### **Market:**

- Delays in renewable energy tenders primarily due to lack of hard currency reserves (e.g. Nigeria, Ethiopia).
- Success of the Scaling Solar Programme in some countries (e.g. Zambia, Senegal) set unrealistic expectations around tariffs across the continent and reluctance by African governments to continue with existing Feed-in-Tariff regimes (e.g. Kenya).
- Further delay in REIPPPP due to political instability in South Africa; similar outlook in Kenya (key markets for RE to date).
- General scarcity of renewable energy deals coming to fruition across the continent due to technical (grid), financial (hard currency reserves, capacity to provide guarantees) and investor risk appetite constraints.

#### **Mandate:**

- UKCI's investment period (3-4 years) is very aggressive in the context of project development timelines in Africa.
- Caps with respect to other ODA providers (both UK and non-UK-based) limit the pipeline to more established jurisdictions where it is often harder to achieve additionality.
- Rigidity of the available funding instruments poses significant structuring challenges (e.g. Black Economic Empowerment preference shares).

**Lessons:**

- Being able to 'follow the market' (Access to Energy, Private PPAs) together with flexibility around funding instruments key features for successful deployment.
- Being able to take local foreign exchange risk is a key differentiator for UKCI as well as the 25-year holding period.
- Achieving pipeline fruition requires patient capital (i.e. longer investment period) and higher risk appetite compared to other regions such as Asia and Latin America.

## ANNEX D: Events to promote UKCI during 2016-2017

<b>Date</b>	<b>Event</b>	<b>Audience</b>	<b>Comments</b> e.g. did this lead to any discussions about deals/ enquiries etc.
27 Feb 2017	Market Open Ceremony with Indian Finance Minister, Arun Jaitley – London	Investors, advisers and renewable energy stakeholders in India.	Various introductions
9 March 2017	MNRE Secretary Roundtable – London	Investors, advisers and renewable energy stakeholders in India.	Various introductions
20 March 2017	Pitch@Palace (invitation by Duke of York) – UK	N/A	
6 April 2017	Industry Roundtable with Greg Clarke – New Delhi	Investors, advisers and renewable energy stakeholders in India.	Various introductions
7 April 2017	Green ratings training for Indian Stakeholders – New Delhi	Investors, advisers and renewable energy stakeholders in India	Various introductions
12 May 2017	SEBI Seminar London	Investors, advisers and renewable energy stakeholders in India.	Various introductions
13 July 2017	Roundtable Luncheon London – “Developing the India UK Green Finance Partnership”	Investors, advisers and renewable energy stakeholders in India	Various introductions
11 September 2017	Climate Finance Accelerator workshop	Investors, advisers and renewable energy stakeholders in Africa	Various introductions
15 September 2017	Climate Finance Accelerator workshop	Investors, advisers and renewable energy stakeholders in Africa	Various introductions
31 October 2017	Trinity Seminar Series	N/A	Various Introductions
2 November 2017	GIG Stakeholder Event	Investors, advisers and renewable energy	Various introductions

		stakeholders in India, Africa and elsewhere	
6 November 2017	UK GFT Investor Roundtable	Various investors	Various introduction