



Department
of Energy &
Climate Change

Business Case for UK Green Investment Bank international pilot

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1. Executive Summary

1.1 Approval sought

- a) Approval to set-up an international climate finance delivery vehicle with the Green Investment Bank (GIB), **investing up to £200 million** from the International Climate Fund (ICF) in renewable energy and energy efficiency projects in developing countries over a three year pilot.

Set-up would then be subject to:

- Conclusion of commercial negotiations with the GIB; securing a value for money deal for DECC
- The assurance of action plan review by the Major Project's Authority (9-10 March).
- HMT approval – based on a) Treasury Approvals Panel (13 March) and b) Approval by Chief Secretary to the Treasury (CST) (as the funding goes beyond this spending review)

Subject to these approvals, we should be in a position to sign legal documentation (or Heads of Terms as a fall back) ahead of purdah, which would fit with Ministers' ambitions.

- b) **Approval for £2 million to procure a third party to conduct an independent evaluation of the international pilot.** Given the innovative nature of the Pilot, establishing a new climate finance delivery vehicle, it is vital we learn from the Pilot both to assess whether to scale-up and to inform the effective deployment of UK climate finance more broadly.

Approvals to date

April 2014 - Business case approval to provide £75,000 to the GIB to scope a potential international pilot.

October 2014 – DECC **Investment Committee consideration** of a draft business case and agreement to proceed with the development of the preferred option – a pilot with the GIB, which would involve incurring costs to develop the pilot. Subsequent agreement to:

- Single Tender Action (STA) to pay the GIB's set up costs
- Business case to recruit external legal advisors
- Business case to pay for a Market Economy Operator report

1.2 Introduction

The global investment challenge

There is an urgent need to scale-up low-carbon investment to keep the world on a 2 degree pathway. Around two thirds of the low carbon energy investment needed from 2014-2040 will be in developing countries, however, the International Energy Agency (IEA) estimates that it needs to rise from around \$400bn in 2013 to around \$1.5trillion pa in 2040 (well beyond the \$900bn likely under the IEA's current policies scenario).

It is also clear that this scale of investment could never come from public sources alone; the vast bulk of the investment needed in developing countries will need to come from the private sector. However, there is a financing gap. There are many reasons for this gap: low carbon energy is often capital intensive compared to fossil fuels, not 'business as usual' for investors and regulators, and

relies on a particularly supportive regulatory environment. Investments that combine low carbon and developing countries are also perceived as high risk by most investors.

Therefore, it is vital that we use scarce public resources to address these barriers and demonstrate that low carbon investment is sustainable and profitable. The purpose of the UK's mitigation finance is above all to demonstrate that transformation is possible, replicable at scale and commercially viable whilst simultaneously contributing to economic growth.

The UK's £3.87bn ICF was established in recognition of the urgent need for developing countries to mitigate and adapt to climate change. The ICF is all Official Development Assistance (ODA) and DECC has £1.329bn to invest between 2011 and 2016. Through the ICF, we want to:

- change facts on the ground by delivering results that demonstrate that low carbon development is feasible and desirable;
- **improve the international climate architecture** and finance system to increase the scale, efficiency and value for money of climate spend; and
- **pioneer innovation to test out new approaches** to delivering climate finance that have the potential to achieve bigger and better results in the future.

To achieve this, the ICF has a strong focus on **scaling up private sector investment** in line with meeting the UNFCCC goal of mobilising \$100bn per year by 2020 from public and private sources.

The ICF challenge

DECC's current ICF business model has allowed us to meet challenging spend targets and strategic objectives by channelling funds largely through multilaterals and to a lesser extent by investing in bilateral projects. While these two approaches have significant advantages and are likely to remain important for the ICF going forward (including through the Green Climate Fund), there are gaps that could be usefully addressed to improve further the overall effectiveness of UK climate finance.

We face the following challenges:

- To date, there has been insufficient focus on **private sector leverage** in multilateral channels, and their ability to work nimbly with the private sector is limited, including to deploy a range of financial instruments (beyond concessional finance, which can risk crowding out private investors).
- The UK has a **high burden share** in funds like the CIFs compared with donors like France and Germany who channel money through their own development banks. And there is (decreasing) appetite from the DECC Investment Committee and Ministers to continue to over-rely on these channels.
- **Poor UK visibility**: blending finance with other donors and delivering it through international channels means recipient countries are generally unclear of the UK's role. We could get greater visibility and negotiating capital in the UNFCCC with a visible UK-branded channel.
- Bilateral projects allow us to select innovative projects with a strong private sector focus and transformational potential (CP3, GCPF, GET FiT, GAP). However, these are **time consuming and challenging to identify, develop and manage**.

There are a number of internal drivers for this project as well. Should (as is expected) more money be made available for climate finance in the next spending review, constraints on the DECC ICF team will increase. In particular, government is not resourced to generate new projects nor would it be appropriate to make individual investments directly with the private sector; hence our current reliance on using trusted delivery channels.

We also recognise that our governance and approvals process is comparatively slow to the timescales that private sector investors typically work to. This is corroborated by a recent review of the ICF conducted by the Independent Commission for Aid Impact (ICAI) who noted:

“Private sector people who were interviewed for this review stressed the need for the ICF to work through a more nimble set of financial channels, so that it can respond within the tight timelines on which private investors need access to capital.”

In conclusion, there is a need for the ICF portfolio to be flexible and diverse and not over-reliant on MDBs. This is corroborated by the ICAI review¹ which found:

“There is now scope for the ICF to use a wider range of delivery partners, including civil society and the private sector.” (2014:14)

Given our currently limited in-house capacity to develop and implement bilateral projects, there is a case for complementing existing channels with a dedicated vehicle that can invest in projects that mobilise private investment, being nimble and responsive to opportunities, where the UK role is clearly recognised. Such a vehicle would draw on financial and commercial expertise to better inform investments and contribute to building a sustainable business model for the delivery of DECC’s international climate finance, complementing the existing multilateral and bilateral portfolio. It will also support the mobilisation of private finance towards the \$100 billion goal. This is why in 2013, DECC Ministers set out their ambitions for a dedicated UK climate finance delivery vehicle.

Aims & Objectives

The aim of this project is to pilot a new approach to investing UK climate finance. The objectives for this project are as follows:

- a. to identify and deliver projects that **scale up private climate finance** flows to low carbon development and address the particular gaps in the international climate finance architecture (in particular through transformative investments that have a demonstration effect, build a successful track record and prove commerciality of low carbon investments to the broader market);
- b. to achieve better value for money by enhancing climate and development benefits through **more effectively and nimbly interacting with the private sector**, while using less administrative and financial resource compared to the rest of the ICF low carbon development portfolio; and
- c. to increase the **visibility of UK climate finance** compared to the rest of the ICF low carbon development portfolio.

1.3 Options Assessed

We assess a number of delivery options against these objectives. One potential solution, **recruiting in the right level of expertise**, has been considered but has been ruled out given that DECC is not resourced to trade directly in financial markets. Other options involving **strengthening our partnerships with other countries’ development finance institutions** or setting up a **dedicated trust fund with an MDB**; were judged to do little to improve the climate finance architecture, or offer a more nimble, private-sector facing delivery option, nor would they improve

the visibility of UK climate finance. The option to set up an **entirely new institution from scratch** was considered too costly, risky and time-consuming.

We analysed the option to **procure a private fund manager** to invest the ICF funds. However, it was considered that it would be difficult to design investment criteria and financial incentives that worked against this inherent profit maximisation of a purely-private organisation to deliver the kind of investments that lead to transformational change. A solely 'for profit' organisation would therefore be unlikely to 'plug the gaps' left by current commercial activity, i.e. market-leading / pioneer investments, or deliver on energy efficiency projects (commercially less attractive at present). They would inevitably pursue 'low hanging fruit' i.e. business as usual low-carbon investments that would not be additional and could crowd out other private sector actors. It is not certain that this could lead to a long-term delivery option for UK climate finance as DECC would have no control or influence over the future strategic direction of the firm.

We conclude that the option to **extend the remit of an existing delivery vehicle** is the best option. We commissioned an independent study (by Vivid Economics) into options for UK delivery vehicles which has informed this business case. It suggested three options, CDC, the Private Infrastructure Development Group (PIDG), and the GIB. Our analysis, based on this study, concludes that neither CDC nor PIDG are appropriate for DECC investment at this stage. This is because the institutions and DFID (as sole shareholder of CDC and UK shareholder of PIDG) are not currently able to pursue this option as there is a lack of strategic fit at present. While flagging the potential advantages of the GIB option, Vivid Economics recognised that this was an **innovative proposal** and therefore recommended an initial £200m pilot with the GIB for 2-3 years. GIB is taken forward as the preferred delivery vehicle in this business case.

Preferred Option

There is a strong case for investing through the Green Investment Bank.

Private Sector focus: The GIB is a market-facing institution with a proven ability and to leverage private investment (their current private leverage ratio is 1:3). The GIB has also demonstrated it can interact quickly and nimbly with the private sector: in just over two years of operation GIB has invested in 43 projects, committed over £2bn of capital, which will deliver around £6bn of new infrastructure investment. The GIB invests on commercial terms and has to date focused on equity investments.

Climate impact: The GIB was institutionally designed to deliver green policy objectives, and has a **double bottom line** to be 'green and profitable'. The GIB's investment criteria and process ensure that their investments achieve 'maximum green impact' by assessing them against their 5 'Green Purposes' (reduce greenhouse gas emissions, increase natural resource efficiency, protect the natural environment, enhance biodiversity and promote environmental sustainability), which are well-aligned with our ICF KPIs, including transformational change. The GIB has a **strong track record** of low carbon investment in the UK.

UK visibility: GIB already has a strong international reputation. As a wholly owned UK institution, which is known to be linked to the British Government, GIB would be able to deliver strong visibility for UK climate finance.

Strategic alignment: The Pilot aligns with the GIB's future strategic direction; they want to demonstrate their capabilities to an international market and attract private capital. The pilot is designed to be scalable should it prove a success, and therefore has the potential to improve the climate finance 'architecture' and provide an alternative delivery vehicle for UK climate finance².

² See GIB PB 1.2 'Strategic Case' for further detail on GIB's potential to enhance ICF business model

We also expect the pilot to deliver **strong value for money for DECC**. Modelling the indicative portfolio suggests that the pilot will offer a benefit cost ratio of 1: 15.9, with an attributed Net Present Value of £3bn.

The pilot will deliver £3bn worth of results for the UK:

- 31.9 Mt CO₂e saved in developing countries;
- 3160 jobs created in developing countries; and
- Private sector leverage of 1:2.02

We consider the combination needed in a delivery body to achieve this project's strategic objectives is currently found in the Green Investment Bank. This includes the ability to combine private sector expertise and low-carbon investment capability with institutional policy objectives that are aligned with DECC's; the ability to establish strong governance arrangements and accountability to HMG; the potential for long-term strategic alignment; a strong UK identity and co-benefits to UK PLC. In addition, strong senior management support and a good track record for delivering value for money investments and proven ability to deliver transformative investments supports the case for the Green Investment Bank as a trusted and effective delivery partner for this pilot.

Challenges and Risks

However, we have identified a number of challenges associated with the Pilot.

- The GIB has no international experience of investing development finance.
- Despite their strong 'green' credentials, there is a risk that they will deliver investments that are less transformation than we aim for (i.e. market leading, pioneer investments which ensure strong additionality).
- The GIB has performed less strongly on energy efficiency, and due to the tension between ODA concessionality requirements for loans and the commercial focus of the pilot, we are concerned they may not be able to deliver on their business plan in terms of energy efficiency.
- Risk of future strategic misalignment: under current plans, the GIB also wants to attract private capital into the bank; we want to ensure the Pilot would continue to operate as envisaged under these circumstances.
- Risk of reputational damage to DECC given public concern over fee and profit share arrangements.

We have designed the pilot to address these challenges, where possible

Ensuring delivery of **high quality ODA and boosting development expertise:**

- GIB has identified staff with development expertise and experience to recruit as Investment Directors.
- We will use the FCO and DFID network of posts to help establish in-country contacts and networks.
- Comprehensive, independent market analysis has been carried out to inform the GIB's business plan.

- DECC and DFID are confident investments in the business plan are ODA eligible, and will continue to support the GIB to ensure they fulfil their mandate to only make ODA eligible investments.

Ensuring **transformational change**:

- As well as requiring that investments meet the GIB's Green Purposes, we will include the requirement to meet transformational change criteria in **the legally-binding investment mandate**.
- We have agreed a **business plan** with the GIB which outlines the countries, sectors and financial instruments which the GIB will focus on for the Pilot. DECC, DIFD and DFID and FCO Posts, as well as external experts, have fed into the business plan, and it is backed up by comprehensive independent market analysis. We have therefore been able to influence the business plan so that it will achieve strong climate and development outcomes, and has transformational potential.
- We propose that the GIB's existing additionality test be applied to an international context. This prevents crowding out of other investors or lenders.

Ensuring **strong governance and oversight** by DECC:

- DECC will maintain power of decisive influence over both strategic objectives and significant decisions to encourage high ambition regarding transformational change through representation on the Board and Investment Committee.
- Strong management arrangements (see below).

Ensuring **future strategic alignment**

- ShEx have reassured that the plans to attract private capital into the GIB envisage a continuing public arm of the bank, where the pilot would sit. DECC will influence this through representation on the cross-Whitehall steering group on the future of the GIB.

Incentivising strong performance

- Given the risks outlined above and that this is a new direction for the GIB, and the possibility of a changing policy or political landscape, it is considered prudent to test this approach through a time-limited pilot.
- The pilot structure will **incentivise the GIB** to deliver against DECC's strategic objectives. There is the potential for the pilot to be scaled up to deliver a significant portion of UK climate finance. We know that the GIB are interested in a long-term role in the delivery of UK climate finance as they are looking to expand their work in an international context and also to demonstrate that their business model works outside a UK context.
- We will procure an **independent evaluation** of the pilot. The evaluation will assess whether the pilot has the potential to achieve transformational change. There will also be a **Gate 5 review by the Major Projects Authority** to determine the success of the Pilot. The pilot will only be expanded and scaled-up if the project is deemed to be a success.

Protecting DECC's reputation and ensuring a strong commercial deal

Management and administration costs (and financial returns to the UK) have been benchmarked and we will ensure that the GIB's fees compare favourably with other ICF delivery channels. Staff will continue to be bound by GIB's remuneration policy, which we are comfortable with (their salary ranges have to be within the lowest quartile compared to the market). Furthermore, the fees paid to GIB will need to conform with HMT's Managing Public Money guidelines. Finally, we have procured

an independent Market Economy Operator report to ensure that the GIB's fees are on or below market rates.

The GIB will be able to keep a **share of the profits**³ that the investments will generate on top of the management fee⁴ that DECC pays them to cover the costs of running the operation. For GIB and ShEx it is key to run the pilot on commercial terms for a broader demonstration effect of the GIB's capabilities in the international context.

From an overall commercial/policy perspective, a profit sharing concept aligns the manager (GIB) with DECC's investment objective of demonstrating transformation by investing in profitable projects, and crowding in private capital. This also relates to a key part of the ICF strategy - to make the low-carbon transition, public money has to be employed strategically to leverage more private capital. These arrangements are therefore already tested in some of the other ICF's private finance projects.

It is important to emphasise that the profit share under discussion is at the corporate level only. We have explicitly agreed that individual staff profit share (common for commercial private equity funds) will not be part of the deal, especially as profits will be generated from invested aid money.

Commercial negotiations are ongoing. Outstanding issues for discussion are focused around what fees and profit share the GIB will earn over the pilot life, and the lifetime of the fund. We will negotiate to ensure a strong commercial deal that provides value for money for DECC.

Pilot Structure

The Pilot is designed to test an approach. £200 million has been determined as the appropriate amount to test the GIB's ability to invest climate finance. It will enable the GIB to fund around 8-12 projects in a number of countries (at least two to test the approach, but not too many so that the transformational impact is diluted or costs become too high), sectors (energy efficiency and renewable energy) and technologies (at least 2). Three years is considered an appropriate time to allow the establishment of project pipeline, the build-up of networks and for initial results to be collected and benefits realised.

In terms of structuring this in practice, we have identified a subsidiary/joint venture (JV) as the option that works best to navigate across our policy, commercial and legal objectives, including:

- ensuring the pilot **does not distract the GIB** from its domestic agenda (additional funding, separate subsidiary and dedicated staff), is aligned with its future strategy and future-proofs DECC's interests in case of changes in GIB ownership;
- ensuring the **right balance of control vs. distance/flexibility for DECC**: A deal structure that allows DECC oversight and the ability to steer the strategic direction (by setting the investment mandate in the legal documentation, agreeing the business plan and ensuring robust monitoring and reporting requirements) but does not micro manage individual investment decisions;
- ensuring management fee and profit share arrangement conforms to HMT **Managing Public Money** Guidance, as well as offering good **VFM** for DECC/HMG and being acceptable to BIS / ShEx / GIB;
- ensuring the assets are **consolidated on DECC's balance sheet; and**

³ The profit share is a share in the profits should the investments be a success, with a hurdle rate that is kept for DECC to reprogram to other ODA projects.

⁴ The management fee is a pass-through up to a fixed cap (expressed as % of committed funds during investment period, and a lower % of capital committed to projects after investment period)

- designing a **legal structure** that protects DECC in terms of liability, affords the necessary control.

Management and governance

Comprehensive governance arrangements are in place to ensure effective senior level and operational management of the project and to support rigorous reporting.

The project has been classified a 'major project' and subject to the Major Project Authority's (MPA) review process and reporting for the Government Major Project Portfolio (GMPP). In their assurance of action plan review, the Major Projects Authority made a number of recommendations regarding strengthening our project governance arrangements, increasing the resource assigned to the existing project team, and enhancing commercial input to the project. As a result we have significantly increased resource devoted to this project from the policy and commercial teams, including at senior level (The SRO Director of ICC and the Commercial Director). We have also created a Project Board of senior officials from across the department (legal, finance, procurement, commercial and the Chief Economist) that has met regularly to discuss and take key decisions on the project design which has informed this business case. Furthermore, an established cross-Whitehall steering group ensures appropriate input into the project from interested departments. During the Pilot phase, the Project Board will continue to meet to discuss the development of the Pilot, especially to inform DECC's interactions with the GIB and position on the Board. The cross-Whitehall steering group will also continue during implementation.

The project also follows an established ICF governance process with a cross-Whitehall Director General (DG) Level ICF Board responsible for endorsement of all ICF expenditure and oversight of project implementation. This project will be managed along with DECC's existing portfolio of ICF investments. This is led by the ICF Programme Management Office (PMO) in the International Climate Fund team.

At a project level, there is an established project team (see Section 6.2.3) who meet regularly with a GIB project team to review the project plan. During project implementation, these meetings will continue to take place on a weekly basis, eventually moving to monthly meetings as the project establishes itself. On a day to day basis, there are strong communication channels with the GIB (including regular phone calls and meetings).

Timing and next steps

Following approval of this business case and legal documentation by Ministers, we will work with the GIB to establish the joint vehicle quickly.

Key Milestones

Launch of the pilot
Appoint contractor for independent evaluation
Capital deployed - Year 1 (est. £29.7m)
Capital deployed - Year 2 (est. £59.5m)
Capital deployed - Year 3 (est. £89.2m)
Gate 5 review
Preliminary evidence
Pilot end
Evaluation report finalised

Timing

April 2015
Oct 2015
by Dec 2015
by Dec 2016
by Dec 2017
Jan 2018
March 2018
April 2018
August 2018

2. Strategic Case

2.1 Purpose

2.1.1 *The global challenge*

The IPCC's Fifth Assessment Science Report⁵ concluded that warming of the climate system is unequivocal. In the absence of significant global emission reductions it is extremely likely that climate change will continue over the decades and centuries to come. Dangerous climate change is expected to have disproportionate impacts on developing countries. There is strong evidence to suggest that climate change will:

- **Disrupt economic development in the short run** through increases in the frequency of natural disasters such as storms, floods and droughts⁶.
- **Slow down economic development in the long run** by slowing down economic growth. This finding holds particularly strongly for low income countries, which are often more exposed to climate extremes, have high dependency on agriculture, and have high numbers of vulnerable people⁷.
- **Have disproportionately large impacts on poor people** in developing countries, who often have limited livelihood opportunities and are unable to cope with the impacts of natural disasters and changes in the climate⁸.
- **Have disproportionately large impacts on women and girls**, who may be less able to cope in disasters because of cultural norms, and who may have lower socioeconomic status in society with poor access to productive assets⁹. Women's mortality from climate-related disasters is higher than men's; various manifestations of climate change, such as drought, add more to women's domestic burdens than to men's; and as women tend to rely more on natural resources for their livelihood, the decline in land and biomass productivity affects women more than men, especially in rural areas, and exacerbates their poverty.

In addition to this, market failures and barriers to action prevent people from adapting to climate change and investing in low carbon technologies.

In particular, the IPCC report demonstrated that in order to mitigate GHG emissions to below 2 degrees relative to pre-industrial levels and to remove the risk that societies are 'locked-in' to high emissions pathways **international cooperation and large scale changes to energy systems and investment patterns are required now**.

This report concludes around two thirds of this investment needed from 2014-2040 will be in developing countries. The IEA estimates that financing levels need to rise from around \$400bn in 2013 to around \$1.5trillion pa in 2040 (well beyond the \$900bn likely under the IEA's current policies scenario).

⁵ <http://www.ipcc.ch/report/ar5/wg1/>

⁶ IPCC (2012) Special Report on Managing the Risks of Extreme Events (SREX) and Disasters to Advance Climate Change Adaptation; Tarazona, M et al (2014) Understanding the Patterns of Climate-Resilient Development: A Literature Review, Oxford Policy Management Report Commissioned by DFID, July 2014

⁷ IPCC (2014) IPCC Working Group II AR5 Summary for Policymakers; Climate Change 2014: Impacts, Adaptation and Vulnerability, IPCC March 2014; Vivid Economics (2010) *Promoting Economic Growth when the Climate is Changing* (DFID, 2010); Tarazona (2014)

⁸ SREX (2012), IPCC (2014)

⁹ Bradshaw and Fordham (2013) *Women, Girls And Disasters A Review For DFID*, Department For International Development, August 2013 Neumayer, E., and Plümper, T., 2007, 'The Gendered Nature of Natural Disasters: The Impact of Catastrophic Events on the Gender Gap in Life Expectancy', *Annals of the Association of American Geographers*, vol. 97, no.3, pp. 551-566

It is clear that the scale of the UK's public finance – or even all developed countries' public finance - is not remotely enough to finance the transition needed. The vast bulk of the investment needed will need to be financed by the private sector.

Private sector investment is flowing and in many geographies and situations, renewables are increasingly cost competitive or even cheaper than fossil fuels, and the costs are continuing to fall. **But there is a financing gap.** There are many reasons for this gap: low carbon energy is often capital intensive compared to fossil fuels, unfamiliar to investors and regulators, and relies on the right regulatory environment being in place. Investors are also unfamiliar with some developing countries and perceive a high risk of working there. DECC commissioned a study by Vivid Economics¹⁰, which highlighted the gap relating to the **limited role of the private sector** in climate investment in developing countries compared to developed countries. At present, the available data suggests that the private sector may only account for around 57 per cent of climate investment in developing countries, compared with around 88 per cent in developed countries.

Many of the UK's International Climate Fund's interventions seek to address issues around such factors as upfront costs, unfamiliarity with the technologies and the overpricing of risk in order to demonstrate that low carbon solutions can be cost-effective. The purpose of the UK's mitigation finance is above all to demonstrate that transformation is possible, replicable at scale and commercially viable whilst simultaneously contributing to economic growth. The acid test is above all that we influence mainstream private investment decisions across the whole economy.

2.1.2 The International Climate Fund

Developed countries have committed in the UNFCCC to mobilise \$100 billion per year of public and private climate finance by 2020. This finance is an essential political precondition for securing agreement to a global deal on climate to achieve the 2 degree goal. It is important that this money flows, and is seen to do so. The UK is committed to playing its part and is recognised as a world leader on climate finance.

The International Climate Fund (ICF) was established in response to this. The ICF was allocated £3.87bn over 5 years (2010 – 2016), split between DFID, DECC and Defra¹¹.

The ICF meets the UK's International Climate Finance commitments and contributes to the global \$100 billion goal. The ICF is all Official Development Assistance (ODA), and therefore also contributes to the UK Government's 0.7% (of GNI) aid commitment.

Climate change and Overseas Development Assistance

The main objective for overseas development is the “**economic development and welfare of developing countries**”¹². Furthermore, the UK's International Development Act notes that ODA spend must ‘have regard... to reducing inequality between persons of different gender.’

There is clear evidence that tackling climate change will support economic development and improved welfare in developing countries. The recently published High Level Panel report on Post-2015 Development called for the new post-2015 goals to leave no one behind. It sets out the ambition that after 2015 we should move from reducing to ending extreme poverty, in all its forms, ensuring that no person is denied basic economic opportunities and human rights. Securing lasting development benefits for 8 billion people by 2030 will face many challenges and the High Level

¹⁰ Delivery options for the International Climate Fund (Vivid Economics, 2014) can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/318874/delivery_options_icf.pdf

¹¹ Of this allocation, DECC have £1.329bn, the resultant amount is shared between DFID and DEFRA.

¹² <https://www.gov.uk/government/publications/official-development-assistance/official-development-assistance>

Panel noted that, '**above all, climate change, will determine whether or not we can deliver on our [post 2015] ambitions**'.

Low carbon development is about harnessing opportunities that can promote economic growth and slow the pace of climate change. Market failures and barriers to action prevent people from adapting to climate change and investing in low carbon technologies. There is therefore a strong rationale for public intervention to **create an enabling environment to encourage private investment in low carbon technologies**.

ICF objectives

Responding to the challenges of tackling climate change, while at the same time boosting economic development and welfare in developing countries, the Government has determined a number of strategic objectives for the International Climate Fund. Through the ICF, we want to:

- **Change facts on the ground**, by delivering results that demonstrate that low carbon climate resilient development is feasible and desirable.
- **Improve the international climate architecture and finance system**, to increase the scale, efficiency and value for money of climate spend.
- **Pioneer innovation to test out new approaches** to delivering climate finance that have the potential to achieve bigger and better results in the future.

To do this we will:

- **Strengthen the evidence base** and generate knowledge about which approaches to deploying climate finance work best.
- **Mainstream climate change** into UK official development assistance, EU development assistance and Multilateral Development Bank (MDB) lending.
- **Strengthen UK relationships with key countries**, including those with rising emissions potential and those showing strong political leadership in international negotiations.
- **Drive change through the private sector** by building new partnerships and create a tipping point for technologies to commercial scale and viability, in order to ramp up low carbon investment.

2.1.2 ICF's Current Delivery Model

To date, the ICF's delivery model has seen finance channelled through multilateral funds (where UK finance is blended with single or multiple other donors e.g. the Climate Investment Funds) or invested in bilateral projects (targeted programmes co-developed with one, or a few, other donors).

The latest results collection exercise indicates that this approach has been successful. Data collected through the key performance indicators (KPIs) shows that between April 2011 and March 2014 the ICF has:

- Supported over 3.2 million people to cope with the effects of climate change;
- Improved access to clean energy for almost 550,000 people;
- Created over 15,000 new jobs;
- Helped reduce or avoid 1.4 million tonnes of Greenhouse Gas Emissions; and
- Mobilised almost £800 million of public finance (from other donors, multilateral development banks and development finance institutions) and £113 million of private finance for climate change purposes.

However, our own analysis, backed up by a recent review of the ICF conducted by the Independent Commission for Aid Impact (ICAI)¹³, recognises that there are some challenges with our current delivery model, particularly in relation to effectively scaling up private finance.

Multilateral funds

There is a strong case for continuing with the use of multilaterals, which we are doing through a significant contribution to the Green Climate Fund (GCF), because combining donor funds can leverage impact at scale and improve coordination leading to greater efficiency. Multilaterals are also experienced in the delivery of climate finance or are being designed specifically to fulfil this role, in the case of the GCF. However, there are also some downsides to over-reliance on the multilaterals:

- 1) To date, there has been insufficient focus on private sector leverage in multilateral channels, and their ability to work nimbly with the private sector is limited. They are improving in this respect (partly as a result of our lobbying), but the consensus-based governance processes can make approvals processes too slow for the private sector. It can also lead to the 'lowest common denominator effect' which limits the appetite for the higher risk/reward projects and constrains the type of financial instruments which can be used (e.g. preference for grants or debt, not equity).
- 2) The UK has a high burden share in funds like the CIFs compared with donors like France and Germany who channel money through their own development banks. And there is (decreasing) appetite from the DECC Investment Committee and Ministers to continue to over-rely on these channels.
- 3) The visibility challenge: blending finance with other donors and delivering it through international channels means recipient countries are generally unaware of the UK's role. We could get greater visibility and negotiating capital in the UNFCCC with a visible UK-branded channel.

Bilateral projects

With the ICF bilateral projects, it has been possible to select innovative projects with a strong private sector focus and transformational potential (CP3, GCPF, GET FiT, GAP). However, these are **time consuming and challenging to identify, develop and manage**.

In addition, we lack sufficient investment and commercial in-house expertise to make individual investments directly with the private sector or generate new projects, so it makes strategic sense for us to use existing vehicles to operate in the market on our behalf. In doing so, we limit our ability to diversify. One potential solution, recruiting in the right level of expertise, has been considered but has been ruled out given that the (relatively) low rates and inflexibility of civil service pay are unlikely to attract the necessary talent and experience (and direct investments into firms and projects by DECC would still not likely be possible or appropriate).

We also recognise that our governance and approvals process is comparatively slow to the timescales that private sector investors typically work to. This is corroborated by a recent review of the ICF conducted by the Independent Commission for Aid Impact (ICAI) which noted:

“Private sector people who were interviewed for this review stressed the need for the ICF to work through a more nimble set of financial channels, so that it can respond within the tight timelines on which private investors need access to capital.”

Financial Instruments

¹³ ¹³ The ICAI report, 'The UK's International Climate Fund (2014)' can be found at:

<http://icai.independent.gov.uk/wp-content/uploads/2014/12/ICAI-Report-International-Climate-Fund.pdf>

In order to interact effectively with the private sector, a range of financial instruments will be necessary and appropriate in different contexts. The UK Government, and donor projects focussing on private finance, already utilise a range of financial instruments, including providing targeted public project finance (Public Infrastructure Development Group and Climate Investment Funds), debt (US Government Overseas Private Investment Corporation - OPIC and Multi-lateral Development Banks - MDBs), guarantees (OPIC, World Bank), support for carbon credits or by supporting improvements to the investment climate (via feed-in tariffs or other investment incentives). In addition, DECC has recently invested in two private equity clean energy funds – the IFC Catalyst Fund and the Asia Climate Partners.

However, overall, existing ICF delivery vehicles predominantly focus on providing debt finance^[1]. Specifically for this project, which aims to create a demonstration effect by proving the commercial viability of low-carbon investments (i.e. investing on market terms in market-leading projects), the strong focus on concessional debt finance in many development institutions is misaligned. In 2010 DFID held meetings with the P8 pension fund investors, OPIC which showed that there was more need to stimulate and participate in equity. The Vivid Economics study into delivery options for the ICF points to evidence to suggest merit in extending the range of financial instruments provided by public climate finance actors to include more use of, for example, guarantees and equity capital, that mitigate specific risks faced by providers of private finance.

In practice, equity is one piece of a jigsaw to get a project to financial close. There are big players such as the MDBs as well international banks who – given their scale - are very active in the debt market. Equity allows strategic and targeted use of public funds by providing (often-lacking) risk capital and sending the right signals to the private market whereby relatively small equity injections can leverage significant amounts of debt finance. Equity capital is the cornerstone form of capital for any private business, especially in the construction phase where projects require risk capital to support planning and development. Without equity capital, other forms of capital (such as debt, asset finance, insurance, trade finance and guarantees) cannot be accessed. For smaller companies and projects at an earlier stage of development and in developing countries sources accessing listed equities is not feasible. This risk-bearing cushion of equity is particularly important in developing countries. For example, in developed markets, banks are often willing to finance wind farms with a debt-equity ratio of 90:10 (nine parts debt finance to one part equity). In developing countries the comparable figure is often far lower; in some other countries a debt-equity ratio of 70:30 is the norm. Another important point is that debt is to some degree passive whereas equity is pro-active and succeeds by identifying and growing the best new projects, companies and technologies within a market segment.

We would like to explore the potential of an alternative delivery vehicle which could make direct investments into projects, predominantly equity investments, as complimentary to our existing vehicles.

In conclusion, there is a need for the ICF portfolio to be flexible and diverse and not over-reliant on MDBs. This is corroborated by the ICAI review¹⁴ which recommended:

“There is now scope for the ICF to use a wider range of delivery partners, including civil society and the private sector...“The ICF should develop a more differentiated strategy for working with the private sector, focussed on the particular conditions and approaches required to attract different forms of private capital.” (2014: 1)

^[1] Venugopal, S., Srivastava, A., Polycarp, C., & Taylor, E. (2012). Public financing instruments to leverage private capital for climate-relevant investment: focus on multilateral agencies. *World Resources Institute Working Paper*, (December).

Given our limited in-house capacity to develop and implement bilateral projects, there is a case for investing in a dedicated vehicle that can invest in projects that mobilise private investment, being nimble and responsive to opportunities, where the UK role is clearly recognised. Such a vehicle would draw on financial and commercial expertise to better inform investments and build a sustainable business model for the delivery of DECC's international climate finance and more effectively mobilise private finance towards the \$100 billion goal. It would complement our existing multilateral and bilateral channels, including by focusing on equity investments at the project level.

2.2 Aims and outcomes

2.2.1 Objectives

This project will trial a new, complementary approach to deliver UK climate finance that will enable the DECC ICF portfolio to **deliver on its transformational objectives for best value for money**.

This will be achieved through delivery against the following objectives:

1. To identify and deliver projects that **scale up private climate finance** flows to low carbon development and address the particular gaps in the international climate finance architecture, in particular through transformative investments that have a demonstration effect, build a successful track record and prove commerciality of low carbon investments to the broader market;
2. To achieve better value for money by enhancing climate and development benefits through **more effectively and nimbly interacting with the private sector**, while using less administrative and financial resource compared to the rest of the ICF low carbon development portfolio; and
3. To increase the **visibility of UK climate finance** compared to the rest of the ICF low carbon development portfolio.

2.2.2 Outcomes for DECC

This project will contribute towards:

- One of DECC's key objectives to drive ambitious action on climate change at home and abroad. This is delivered in part through DECC's International Climate Change Strategy, by supporting action on the ground through financing ambitious low carbon projects in developing countries. In addition, the project is expected to give UK climate finance greater visibility, which will help the UK to make progress in the international negotiations due to increased political leverage with developing countries.
- The ICF strategic objectives, in particular, through demonstrating that climate change offers real opportunities to drive innovation and new ideas for action, and to create new partnerships with the private sector. In addition, the project will help the UK to improve the international climate finance architecture by diversifying delivery channels, through the establishment of a high quality, complementary vehicle.
- The ICF Low carbon development Strategy, in particular, through achieving greater private sector investment in low carbon infrastructure and service delivery, to increase rates of deployment of technologies that are further along the innovation chain, or where abatement costs are relatively low.

The ICF uses three main ways to disburse climate finance:

1. Channelling investments through multilateral funds, most significantly to the Green Climate Fund in coming years (subject to value for money considerations);
2. Continuing to directly manage ICF projects where DECC can add most value or which do not fit with the above two channels, primarily through existing delivery partners (e.g. Multilateral Development Banks), focussed primarily on Technical Assistance, public sector and policy-driven or politically important projects (such as the Global Innovation Lab for Climate Finance), and innovative / risky projects; and
3. **And additionally, through a UK climate finance delivery vehicle, focussed specifically on mobilising the private sector and targeting the gaps in the current architecture.**

This business case focuses on the last of these, i.e. how we can design this climate finance delivery vehicle to complement an existing set of activity.

The case for investing through the Green Investment Bank

The appraisal case (Section 3) examines the options for a UK delivery vehicle (public and private) assessing them fully against strategic objectives and critical success criteria. The appraisal case concludes that GIB best meets DECC's ICF and Departmental objectives and a pilot with a new international arm of GIB is therefore the preferred option put forward in this business case.

The Green Investment Bank will deliver against the project's strategic objectives:

1. Improved climate finance architecture.

The GIB is a market-facing institution with a proven ability to interact nimbly with the private sector; The Vivid Economics study praised GIB's commercial acumen and "fleetness of foot" (Vivid Economics, 2014:7). The GIB invests on commercial terms and has deployed a variety of financial instruments, though focusing on equity. In just over two years of operation GIB has invested in 43 projects, committed over £2bn of capital, which will deliver around £6bn of new infrastructure investment. The GIB has proven its ability to leverage private investment, a key objective of this project (their current private leverage ratio is 1:3).

As an operationally independent vehicle the GIB could have a broader demonstration effect to the private sector; market players are more responsive to the GIB acting in a market-oriented manner than investment decisions perceived to be policy/politically driven. This would help demonstrate to the market the commerciality of low-carbon investments.

However, the GIB is wholly owned by government, and was institutionally designed to deliver green policy objectives (it's objective is to be 'green and profitable'); as distinct from private investors who would focus on profit maximisation. There is an established relationship with HMG through the Shareholder Executive.

The GIB therefore operates across the public and private spheres: publically-funded with clear policy objectives and accountability, but set-up with clear commercial structures, staff and incentive structures.

The pilot aligns with the GIB's future strategic direction; they want to demonstrate their capabilities to an international market. Indeed, the GIB are interested in the Green Climate Fund and the potential role of implementing entities (which could enhance the global climate finance architecture). Furthermore it aligns with the GIB's current plans to attract private capital.

The pilot is designed to be scalable should it prove a success, and therefore has the potential to improve the climate finance ‘architecture’ and provide an alternative delivery vehicle for UK climate finance¹⁵.

2. Stronger climate and development benefits

Unlike purely commercial operations, the GIB is **institutionally designed** to deliver public policy objectives (green investments) and this is built into its investment processes. And unlike existing development finance institutions, it is entirely focused on low carbon investment

- The GIB has a **double bottom line** to be green and profitable
- The GIB’s investment criteria and process ensure that its investments achieve ‘maximum green impact’ by assessing them against their **5 ‘Green Purposes’** (reduce greenhouse gas emissions, increase natural resource efficiency, protect the natural environment, enhance biodiversity and promote environmental sustainability), which are well-aligned with our ICF KPIs including transformational change (see annex 7.18).
- The GIB has market leading assessment, monitoring and reporting practices against Green Purposes.
- The GIB has an **additionality test** written into its Shareholder Framework- this prevents crowding out of other investors or lenders. It also ensures the GIB will mobilise (‘crowd in’) private investors.
- **Strong track record** - Its domestic portfolio shows its potential to make market-leading, transformational investments. We have concluded that the GIB has a unique capability and appetite to invest in transformational projects and already has a strong track record in the UK.

This is supported by results: in just over two years of operation the GIB has invested in 43 projects, committed over £2bn of capital, which will deliver around £6bn of new infrastructure investment. They have an estimated average annual production of 13,527 GWh; estimated annual average reduction in energy demand of 47,017 MWh; estimated average annual reduction of 3,716kt CO₂e of Greenhouse gas(GHG) emissions; and estimated total lifetime remaining GHG emissions reduction of 61,597kt CO₂e.

3. Improve the visibility of UK climate finance

GIB already has a strong international reputation and considers itself to be a ‘thought leader’ when it comes to making and measuring green investments. Delegates from other countries visit GIB to discuss their business model and some have raised their intention to set up an equivalent bank. GIB’s strong links with the City of London would create opportunities for UK private investors overseas. As a wholly owned UK institution, which is known to be linked to the British Government, GIB would be able to deliver strong visibility for UK climate finance.

Conclusion: Due to its institutional objective to deliver ‘green and profitable’ investments, its investment policies and processes designed to deliver this, and its market-leading assessment, monitoring, reporting practices, GIB has a proven its potential in the UK market to deliver climate benefits, in line with our ICF objectives, including mobilising private investment and transformational change.

¹⁵ See GIB PB 1.2 ‘Strategic Case’ for further detail on GIB’s potential to enhance ICF business model

The GIB has shown potential, but how do we ensure the pilot delivers high ambition?

It is vital that the GIB performs well and adapts its business model to an international development context, especially to deliver the ICF objective of ‘transformational change’. This means more than making profitable investments, that deliver carbon emissions reductions, we want the GIB to affect broader transformation of the market; to contribute to building a sustainable market for low carbon investment in developing countries:

1. Demonstration effect: signalling attractiveness of low-carbon investments by making pioneering, market-leading and profitable investments, in projects with developmental and carbon benefits; whilst avoiding crowding out other private investors profitable investment. This will in turn lead to increased investment (private climate finance) into needed areas.
2. Improved climate finance architecture: GIB will transform the UK’s main mechanisms for delivering UK investments in climate finance; particularly by increased and more effective engagement with the private sector and increased visibility of UK climate finance (leading to improved outcomes in UNFCCC negotiations).

Addressing the knowledge gap.

However, the GIB has no international experience of investing development finance. To address this knowledge gap:

- GIB has identified staff with development expertise and experience to recruit as Investment Directors.
- We will use the FCO and DFID network of posts to help establish in-country contacts and networks.
- Comprehensive, independent market analysis has been carried out to inform the GIB’s business plan.

Ensuring ODA eligibility

In line with our existing ICF portfolio, and as described above, the GIB’s investments will have a positive development impact as investments in energy and private sector development are important conditions for economic growth and poverty reduction¹⁶. Furthermore, renewable energy and energy efficiency are crucial to decouple economic growth from increases in greenhouse emissions – which is essential to mitigate climate change which would hit the poorest earliest and hardest. In the short/medium term, the pilot’s investments will contribute to poverty reduction by boosting economic/human development (including through job creation), through enabling increased installed capacity of cost-effective energy supplies, making energy savings through efficiencies, improving countries’ balance of payments position, as well as the transformation of the market place for low-carbon investment.

The GIB pilot will only invest in ODA eligible, ICF priority countries.

The current business plan for the pilot envisages largely equity investments, which the OECD classifies as ODA when spent on development projects in developing countries. Debt or quasi equity investments (e.g. mezzanine financing) are more complex from the perspective of OECD DAC rules and guidance, requiring in certain circumstances a degree of concessionality with which GIB would have to comply. Although the onus will be on GIB to ensure ODA eligibility, DECC /

¹⁶ There is significant evidence that enabling economic growth has a strong positive link with poverty alleviation when appropriately implemented (Dollar & Kraay 2000, ‘Growth is good for the poor’)

DFID will give guidance to the GIB on ODA eligibility of investments through the governance and management structures outlined in the management case.

Gender impact

In line with the gender equality provisions in the International Development Act 2002, we have considered whether and how the pilot is likely to impact on gender inequality in developing countries.

At a high-level, as outlined above, there is evidence that **climate change will have disproportionately large impacts on women and girls**. In addition, improved energy access and security will impact on social development, including gender. Thus the clean energy projects that will be funded through this pilot will contribute to improved outcomes for women and girls.

However, it is important to note that the objectives of this project are to leverage private investment at scale; which will necessarily focus on larger-scale, on-grid energy projects. This should help **improve energy access overall**, although it might be expected to make less of an impact on women and girls than smaller-scale energy interventions (aimed at households) or off-grid projects. In terms of power relations between men and women, there is no evidence that this intervention will change fundamental dynamics. The risk of unintended consequences regarding gender inequality is considered low.

Given the objective to prove a successful, commercial investment model, we expect the GIB to interact with investors, project developers, and the construction industry; currently male-dominated professions in developing countries. We will therefore **monitor the impact of the pilot on gender** by measuring job creation disaggregated by gender throughout the pilot. We will use this evidence collected over the pilot to assess gender impact and inform our development of future scale-up options (post pilot). This could also help inform the development of other ICF interventions; providing evidence of the impact on gender of large scale energy interventions and informing our consideration of how to reduce gender inequality.

At this present time, given the objectives of the pilot to achieve climate and development benefits by building a sustainable market for low-carbon development, focusing on leveraging private investment at scale, we do not consider it appropriate to change the focus of the vehicle to interventions specifically aimed at boosting energy access for women and girls (which is addressed by other UK ODA energy projects). Over the course of the Pilot, we will work with the gender experts in DFID to **consider further whether there are any options for addressing gender inequality through this vehicle** should the Pilot be continued and scaled-up. We will **include the GIB** in this discussion, and encourage them to consider their own priorities, procedures and business plan could and how it could contribute further to reducing gender inequality.

The monitoring and evaluation of both job creation and (for the evaluation) broader development benefits will provide information about the impact on gender inequality. In addition, **we will evaluate gender impact** specifically as part of the evaluation. We will also ensure our evaluation methodology is not biased by gender (see Evaluation Section 6.3 and Evaluation draft Terms of Reference Annex 7.5).

The Pilot has been designed to achieve maximum impact for the ICF

We have designed the pilot and legal structure to maximise climate, development and transformational potential and to adapt the GIB business model to an international development context.

1. Investment Mandate

The legally-binding Investment Mandate will set out DECC's requirements for investments. As well as requiring that investments meet the GIB's Green Purposes, we will include the requirement to meet transformational change criteria.

The legal agreements will also set out the reporting requirements against ICF Key Performance Indicators (see Management Case).

The Investment Mandate will require that all investments are ODA eligible.

2. Business Plan

We have agreed a business plan with the GIB before committing to the pilot. This Business Plan outlines the countries, sectors and financial instruments which the GIB will focus on for the Pilot. DECC, DIFD and DFID and FCO Posts, as well as external experts, have fed into the business plan, and it is backed up by comprehensive independent market analysis. We have therefore been able to influence the business plan so that it will achieve strong climate and development outcomes, and has transformational potential. 'Transformation' necessitates pioneering, market-leading and profitable investments but the focus will vary according to the country context and stage of market development of the sector and technology. Even though not strictly legally-binding, the business plan can be annexed to the legal documentation and is a strong expression of strategic intent from GIB against which success will be judged.

3. Maintaining GIB additionality test in an international context

We propose that the GIB's existing additionality test be applied to an international context. This is intended to prevent GIB from crowding out other investors or lenders.

4. Governance arrangements

We have structured the Pilot to ensure the right balance of flexibility and control.

Flexibility: allowing GIB the flexibility and independence to use their investment experience and expertise to make the investment decisions and respond to conditions on the ground. Also because DECC does not have sufficient in-house expertise to make investment decisions; we want to test the GIB capabilities and investment process through this pilot; we want the GIB pilot to demonstrate to the market the commerciality of low-carbon investments - and market players are more responsive to the GIB acting in a market-oriented manner than investment decisions perceived to be politically driven.

Control: However, DECC should maintain power to contribute effectively to both strategic objectives and significant decisions to encourage high ambition regarding transformational change. In practice this means that DECC together with GIB sets the investment mandate in the legal documentation, agrees the business plan as well as ensures robust reporting requirements - and the investment committee makes individual investment decisions within that pre-agreed framework.

Therefore, DECC will be represented on the Board of the vehicle (having a casting vote), as well as have an observer and DECC appointed representative on the Investment Committee; this will ensure strong governance and oversight of the Pilot. There will be strong management arrangements between the DECC project team and the GIB team, to monitor progress and ensure the Pilot is delivering against its mandate and the requirements in the logframe, as well as maximising learning for DECC.

The governance and management arrangements are further outlined in the Management Case.

5. Pilot structure and evaluation

The pilot structure is necessary to **test an approach**. £200 million has been determined as the appropriate amount to test the GIB's ability to invest climate finance against a number of countries (at least two, but not too many so that the transformational impact is diluted), sectors (energy efficiency and renewable energy) and technologies (at least two). £200m will enable us to make around 8-12 investments which will give us a good indication of performance across technologies and countries. This is important because our ultimate objective is to identify a future delivery vehicle for UK climate finance, which needs to operate across countries, sectors and technologies). Three years is considered an appropriate time to allow the establishment of project pipeline, the build-up of networks and for initial results to be collected and benefits realised.

The pilot structure will **incentivise the GIB** to deliver against DECC's strategic objectives. There is the potential for the pilot to be scaled up to deliver a significant portion of UK climate finance. We know that the GIB are interested in a long-term role in the delivery of UK climate finance as they are looking to expand their work in an international context and also to demonstrate that their business model works outside a UK context.

We will procure an **independent evaluation** of the pilot. The evaluation will assess whether the pilot has the potential to achieve transformational change. There will also be a **Gate 5 review by the Major Projects Authority** to determine the success of the pilot. The pilot may be expanded and scaled-up if the project is deemed to be a success, especially with regards to transformational change, by the independent evaluation and the MPA. However, it may not be expanded even if it is a success: a decision will need to be made at the based on the range of evidence of the performance of the pilot, as well as on the financial and political considerations of the time.

Conclusion:

We consider that, at the current time, the combination needed in a delivery body to achieve our strategic objectives are most optimally found in the GIB. This includes the ability to combine private sector expertise and low-carbon investment capability with institutional policy objectives that are aligned with DECC's; the ability to establish strong governance arrangements and accountability to HMG; the potential for long-term strategic alignment; a strong UK identity and co-benefits to UK PLC. In addition, strong senior management support and a good track record for delivering value for money investments and proven ability to deliver transformative investments supports the case for the Green Investment Bank as a trusted and effective delivery partner for this pilot.

2.1.1 Scope

Given the results of the options appraisal (annex 7.2), the detailed analysis of the gaps within UK climate finance funding, and the on the ground upwards assessment of where changes needed to be catalysed in technology and country terms, the scope of the project pilot has been designed as follows:

Table 11 - Pilot scope

Scope

An international pilot with GIB to invest up to £200m of ICF resources over a three year period.

All investments will be ODA eligible and consistent with the International Development Act 2002.

All investments will support low carbon development, targeting both renewable energy generation and energy efficiency.

Investments will target ODA eligible developing countries with stronger enabling environments and high emission abatement potential (essentially progressive middle income countries).

Investments will target the gaps identified in terms of:

- mobilising additional private sector investment,
- using a range of financial instruments¹⁷,
- supporting energy efficiency investments,
- small and medium sized projects

All investments will be returnable capital investments rather than financial grant aid.

An independent assessment of the pilot to see if it has achieved the desired benefits identified in this

Rationale

£200m was chosen as the appropriate amount to enable GIB to support 8-12 projects ranging between investments of £10m - £50m. This would allow the GIB to test a number of technologies and sectors, providing sufficient evidence to be able to evaluate the pilot. 3 years is considered an appropriate time to allow the establishment of project pipeline, the build up of networks, make investments and start to judge the commercial viability without constraining choice in the long term. Also to collect sufficient data for the formative evaluation.

The ICF currently only has ODA budget available for this pilot.

Reflecting the ICF team's mitigation objectives and GIB's energy efficiency and renewable energy expertise in the UK.

Reflecting GIB's current lack of international presence, DECC's mitigation objectives and the requirement for strong regulatory frameworks for low carbon infrastructure investments.

Also reflecting the objective to build a demonstration effect, successful track record and prove commerciality of low carbon investments to the broader market (thereby necessitating activity in more mature markets that support private investment).

Vivid Economics study suggested that GIB was well placed to address these particular gaps, with their domestic portfolio leveraging private finance at a ratio of 1:3; using a range of financial instruments; investing in several energy efficiency projects; and with a typical deal size of £50, given the greater challenge we expect this to be 10-30m internationally.

Political decision to make ODA investments in MICs returnable capital or technical assistance.

Policy objective to prove model to broader market / demonstration effect; deals must be made on commercial terms.

Provide evidence for course corrections and to determine whether and how to scale up the pilot in

¹⁷ Including equity, mezzanine finance, and senior debt
V1.1

Business Case (the terms of reference can be found at annex 7.5) future.

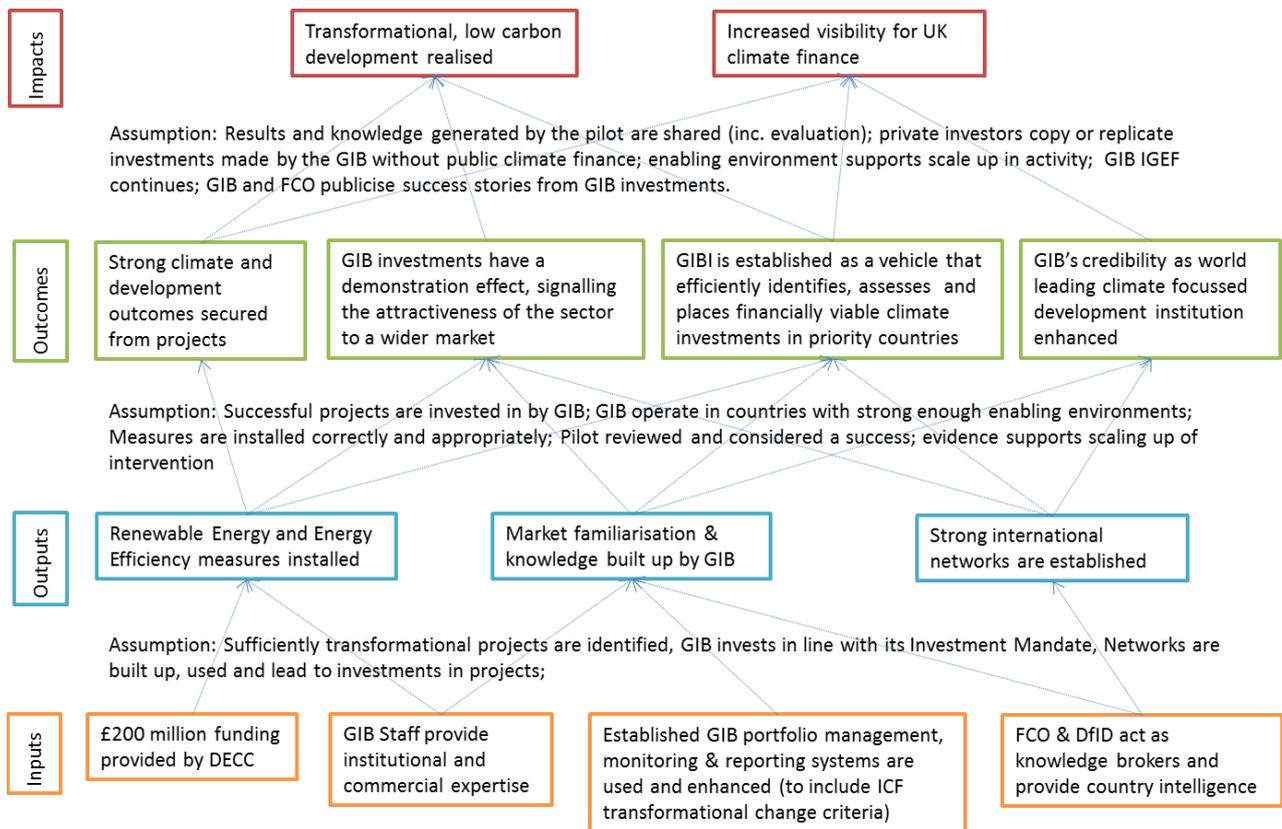
In the longer term, the results of this pilot will be used to inform a decision on establishing a dedicated UK climate finance delivery vehicle. Should this be the case, it would be the subject of another Business Case in 2018.

Pages 6-14 of GIB’s business plan, attached at annex 7.4, explain the project scope and investment strategy in further detail.

2.1.2 Theory of Change

A project Theory of Change (or logic map) is set out below, which details how the inputs from the project will lead towards the desired outcomes and impacts for the project. These will be measured through the project’s logical framework which is set out in annex 6.8.

Figure 1 – Theory of Change



2.2.3 Benefits being sought

Table 2 lists the main benefits being sought for each stakeholder group, aligned as appropriate with objectives:

Table 2 - Main Benefits

Objectives of project	Main benefits by stakeholder group / customer
<p>Scale up of private climate finance flows and address particular gaps to low carbon development</p>	<p><i>UK Government</i> - Lower proportion of public climate finance will be needed in the future if private climate finance flows can be mobilised more effectively. This project will aim to achieve greater levels of private sector leverage than our current low carbon development portfolio and to help create and support new markets or fix market failures where private finance currently does not play a significant role.</p> <p><i>Private investors (national and international)</i> - Increased low carbon investment opportunities and improved investment environment in developing countries attracts new flows of capital.</p> <p><i>Developing country project developers</i> - Increased access to alternative sources of finance and/or risk mitigation instruments leads to lower costs/higher returns for project developers.</p> <p><i>Developing country recipients</i> - Reduced costs of energy-related services (e.g. lower energy bills) as a result of lower financing costs. Boosting economic growth.</p>
<p>Achieve better value for money</p>	<p><i>UK Government</i> - Improved environmental and development benefits, (including reduced greenhouse gas emissions, increased energy efficiency, and improved energy security). To measure this, cost-effectiveness indicators can be used, for example, the cost per reducing a ton of carbon through the ICF's current low-carbon development portfolio is £6.5.</p> <p><i>UK Government</i> - Improved terms negotiated for the UK on climate finance. As a proxy, the CTF is expecting an average annual return of 1.25% on MDB approved CTF private sector projects¹⁸;</p> <p><i>UK Government</i> - More potential investment opportunities (in terms of geography, sector, type of instrument) by reaching out to a wider range of partners (including the private sector) to develop new and innovative approaches.</p> <p><i>Recipient governments</i> – Increased ability to take on / meet more ambitious mitigation commitments</p> <p><i>Developing country consumers</i> – Improved social and environmental conditions as a result of project implementation, including employment opportunities, reduced energy prices, and greater security of supply.</p> <p><i>Private investors</i> – Demonstrate the commercial viability of making low carbon investments in developing countries by securing market rate returns.</p> <p><i>Project developers / financiers</i> – Reduce the potential for over-subsidisation of the private sector through using highly concessional public climate finance.</p>

¹⁸ This is based on 28 MDB approved CTF private sector projects.

<p>Increase the visibility of UK climate finance</p>	<p><i>UK Government</i> –Helps rebut claims that public finance is not flowing and demonstrate that the UK is delivering its climate finance commitments. Helpful for interactions by FCO, DECC and DFID with developing country governments where the UK is investing funds through pilot schemes as UK aid in these projects has greater visibility. This should make a positive impact in international negotiations.</p>
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Inter-Dependencies, Assumptions & Constraints

This section sets out the high level internal and external factors upon which successful delivery of the project benefits are dependent. There are also a number of further assumptions which are set out in the Theory of Change (Figure 1). These detail our assumptions from moving between project inputs to desired project outcomes and impacts and are not repeated here.

Inter-dependencies

The project has the following inter-dependencies. These are linked to GIB’s wider ambitions to continue its current activities, as well as attract private sector investment:

- GIB continues to be an integral part of the UK’s climate finance architecture.
- Any form of private capitalisation of GIB’s is structured in a way that allows us to continue with the pilot and retain sufficient control (i.e. does not prompt termination of Pilot).

Assumptions

In addition to the inter-dependencies above, the project has the following high level assumptions:

- GIB continues to operate successfully within a UK context while expanding successfully into international investments.
- The UK maintains our climate finance commitments.
- There is no fundamental shift in strategic objectives for climate finance from 2014-2018 which would impair the investment choice of GIB.
- Results can be demonstrated in the time period to inform longer term decisions (including tracking the early signs of transformational change).
- GIB can attract and retain the resources necessary to deliver this work and support it at senior level.

Constraints

The project has the following high level constraints:

- All investments have to be ODA eligible as DECC’s existing ICF allocation is 100% ODA.
- All investments have to be consistent with the International Development Act 2002 under which DECC derives its Spending Powers for the ICF.
- Reflows from some ODA investments will count as negative ODA (in the case of the pilot, this is likely to be the returns from any eventual sale of assets) which will increase the requirements on HMG to invest ODA in future years.
- There will be no additional HMG headcount to manage the Pilot and this will be managed under existing staff resources.
- It must be consistent with the ICF Strategic objectives

Table 3 - High level potential risks

Risks	Mitigation
<p>Policy risks:</p> <ol style="list-style-type: none"> GIB is distracted from its core UK focus and its brand as a commercial investor is diluted The pilot may be stopped prematurely / delayed The project does not align with the GIB's future plans The project could result in a more fragmented climate finance architecture 	<ol style="list-style-type: none"> Work undertaken by GIB on the delivery of the pilot is covered from the ICF budget to avoid a possible diversion of funds. Management fee will ensure full recovery of costs. GIB will receive a profit share from successful investments. GIB will invest on commercial terms i.e. specifically demonstrating to the market that low-carbon investments are commercially viable whereby GIB has the chance to prove itself as a successful actor for profitable investments in more challenging environments (fit with future strategic objectives). Ensure the investments under the pilot are not on GIB's balance sheet. Exit strategy in place (see section 4.4.2). Engage with BIS/ShEx to assess the likelihood of plans to attract private capital and link up to any DECC representation (likely to be Strategy/Commercial) formal engagement in the ShEx proposed policy forum/steering group . Ensure the legal agreements protect DECC's policy and vfm objectives for the life of the pilot and vehicle. Despite the benefits of diversity of climate finance vehicles, there are risks of fragmentation and lack of coherence. However, as it would be acting on commercial terms, we envisage there will not be competition with other development finance institutions, though the additionality test will help ensure this. Furthermore, there is the possibility with future role as implementing entity for multilateral funds such as the Green Climate Fund; in this way the GIB would be complementary.
<p>Design risks:</p> <ol style="list-style-type: none"> Project overestimates the expected benefits GIB does not originate or execute value for money investments 	<ol style="list-style-type: none"> Monte Carlo analysis conducted on the example portfolio to improve the confidence in the expected benefits under a wide range of different scenarios. Economic modelling includes a range of additionality assumptions to stress test financial model. Economic modelling includes assumptions about rebound effects for energy efficiency projects. Strong relationship established with DfID/FCO through ICF Board and X-Whitehall Steering Group to ensure UK visibility is maximised through the project. GIB recruit a team with the right international / development expertise and are drawing on key personnel with relevant expertise in establishing the pilot. Strong focus on DECC / ICF objectives in legal documents. DECC influence on strategic direction through Board and Intelligent Client Function. Clear success criteria. Evaluation focussed around achieving transformational change and private sector mobilisation.
<p>Operational risks</p> <ol style="list-style-type: none"> GIB does not invest in line with its investment 	<ol style="list-style-type: none"> DECC has recruited expert external legal advisers to draft the investment mandate and legal agreement. Seek wide range of input to

3. Economic Case

3.1 Long list of options

In assessing the best route to achieving the strategic objectives set out above, a long list of delivery options has been considered. The long list of options is considered below, with the full analysis attached at Annex 7.2. These options have been assessed against the project's objectives and some critical success factors. Figure 2 summarises the analysis.

1. Do nothing

In this case we would continue to use our in house resource to pursue investments through multilaterals, pushing for increased private sector processes where possible (e.g. the Dedicated Private Sector Program (DPSP) in the Clean Technology Fund (CTF)).

- The 'do nothing' option, effectively the counterfactual, continues to deliver value for money for UK climate finance. However, reliance on existing channels and limited in-house supply side capacity bounds the ICF team's ability to address some of the key weaknesses in the international climate finance architecture. This project aims to achieve objectives which are not currently possible through existing channels (i.e. working more nimbly with the private sector, to more effectively mobilise private investment); the value for money of the 'do nothing' option decreases in light of the project's specific objectives. Without additional staffing, continuation of the existing model will also result in an increasing, cumulative burden on the ICF team and specialist services (DECC legal, finance and analysts), whose support is essential, due to the need to manage a growing portfolio of existing projects in addition to developing new investments. This would likely result in less bilateral and/or innovative private sector programmes and increased reliance on multilaterals, which could result in the UK having a disproportionate burden share in these channels. This option also continues to deliver weak visibility for UK climate finance which is key especially with regard to the upcoming UNFCCC negotiations in Paris where we aim to agree an ambitious deal.

2. Increase commercial in house resource

This option would involve recruiting up to 4 additional private sector advisors who would be based in the DECC ICF team. These advisors would draw on wider corporate services and specialist support. This would give us greater ability to develop and pursue more private sector focussed projects than we currently have the capacity or expertise to undertake. To note, in this option we would still need to work through existing multilateral and bilateral channels.

- Given the current reliance on MDBs and DFIs, the 'in house' option only slightly improves the ICF team's ability to develop strong, value for money proposals. In fact, it may result in the status quo being maintained (given the growing management burden of existing portfolio). However, this is at a higher cost and delivers only a marginal improvement against the strategic objectives in comparison to the 'do nothing' option.

3. Strengthen partnerships with other countries development finance institutions

This option would involve strengthening our partnerships with countries that have their own development finance institutions, such as Germany (KfW) or the Netherlands (FMO). Germany's KfW Development Bank has been used as an illustrative example.

- Experience working through other DFIs, like KfW, has demonstrated their ability to deliver value for money climate finance, with strong climate impacts. However, UK climate finance

visibility is lessened under this option and our ability to influence spend in line with our strategic objectives might be limited. This option, relying on existing vehicles already delivering climate finance, would have little impact on the existing climate finance architecture.

4. Set up a dedicated trust fund with an MDB

The Canadian government have a trust fund with the IFC whose objectives are 'to address market barriers that prevent the faster, more wide-spread or more long-term sustainable adoption of low carbon technologies and / or business models that address climate change'¹⁹. To note, IFC invest Canada's climate finance on an arm's length basis (i.e. not 'normal' for a trust fund relationship). We could look to pursue something similar.

- Managing a project through an MDB trust would offer less influence to spend in line with our strategic objectives and do nothing to alter the challenges identified in the strategic case with existing delivery channels (insufficient focus on private sector leverage and the challenge to interact nimbly and efficiently with the private sector). Experience from Canada's climate fund with IFC shows that projects do not have a 'transformational' focus and mainly leverage IFC's own balance sheet. This option would increase our reliance on MDBs.

5. Set up a new delivery vehicle from scratch

In this case we would set up a completely new vehicle from scratch, whose core and sole mandate would be to deliver this project's objectives.

- Setting up a delivery vehicle from scratch is risky, costly, resource-intensive, potentially duplicative and would probably require primary legislation to be set up. With no track-record, a new institution could also take a long time to deliver results on the ground.

6. Procure a private fund manager to invest UK climate finance

This would involve an open EU-wide procurement process to recruit a private fund manager to invest a portion of UK climate finance in target sectors and countries.

- Procuring a private fund manager could offer value for money (generating competition for the role), and ensuring experienced private sector investors would invest on behalf of DECC, with less burdensome investment processes. However, it would be difficult to design a tender specification and subsequent investment criteria and financial incentives that worked against the inherent profit maximisation of a purely-private organisation to deliver the kind of investments that lead to transformational change. A 'for profit' organisation would therefore be unlikely to 'plug the gaps' left by current commercial activity, and would inevitably pursue 'low hanging fruit' i.e. business as usual low-carbon investments that would not necessarily be additional and could crowd out other private capital. In addition, there is no certainty this could offer a long-term delivery vehicle for UK climate finance, as HMG would have limited insight into, and no influence over, the future strategic direction of the entity. It is doubtful whether this option would improve the visibility of UK climate finance significantly. We would not be able to restrict the recruitment exercise to UK-only firms and a private fund manager is not associated with public finance. However, we could name and brand the fund in a way that ensured it was clearly delivering UK climate finance.

¹⁹ Canada's Climate Change Fund – IFC update presentation 2014

7. Extend the remit of an existing UK vehicle

In this scenario we would assess whether there were any existing UK vehicles that have the institutional capacities to deliver climate finance on behalf of the ICF in line with the project objectives.

- Expanding the remit of an existing UK vehicle could potentially deliver effectively against all of the project’s objectives, including the ability to scale-up and establish a sustainable, scalable model to deliver UK climate finance, increasing the skills and capacity to originate and manage investments which will mobilise private investment.

3.1.1 Analysis of options

Figure 2 - Analysis of options - long list

	Do nothing	In house	Strengthen partnerships	MDB trust	Set up from scratch	Recruit Private Fund Manager	Extend remit of existing
Project objectives:							
1. Improved climate finance architecture							
2. Stronger climate and development benefits							
3. Improved visibility for UK climate finance							
Critical Success Factors:							
VFM							
Strategic Fit							
Potential achievability							
Risk profile							
Potential cost							
Supply side capacity							
Alignment with regulatory agenda							
Timing							
Summary/Score	37	35	43	39	33	39	49

	Low	Medium	High
Score per box	1	3	5

The analysis therefore shows that the preferred way forward is to extend the remit of a suitable existing UK vehicle. The institutions identified as potential vehicles for UK climate finance (informed by the Vivid Economic Study – see below) were the CDC, Private Infrastructure Development Group and the Green Investment Bank.

However, there are still risks. In particular, that extending the remit of an existing institution bears the risk of distractions from its original core mandate, and success would depend on the degree of fit between the institution's mandate and experience and those of the ICF.

3.2 Short List of options

3.2.1 Future options for delivery of International Climate Finance – Study

To provide more analysis on possible options, in 2013 the ICF team commissioned an independent study to look at whether there might be more effective and efficient ways to deliver ICF funding. The study considered whether there could be a role for a new or existing UK institution to move into the international climate finance space, that could fill gaps in provision (e.g. effective channels for mobilising private climate investment) and possibly also provide an opportunity to build upon the UK's expertise and comparative advantage.

A team led by Vivid Economics prepared a report²⁰ based on desk research and stakeholder consultation that considered a range of options and identified potential delivery vehicles that the ICF might choose to deploy resources through, following consideration of:

1. The current weaknesses, deficiencies or gaps in the current international climate finance architecture;
2. Whether the delivery options have the institutional capacities required to deliver climate finance effectively; and
3. Whether the options would deliver strong climate and development benefits, increasing the visibility of UK climate finance.

The study shortlisted three delivery options that could respond to **different gaps** identified based on the institutional capacities of these institutions and concluded that these were feasible delivery vehicles that could be pursued to achieve this project's objectives²¹. These options were not mutually exclusive and included:

1. Providing resources to Infracore Africa (part of the Private Infrastructure Development Group (PIDG)) to support early stage project development activities in sub-Saharan African;
2. Using CDC's relationships with its portfolio companies to offer energy audits and finance for energy efficiency opportunities;
3. Undertaking a pilot scheme with the UK Green Investment Bank (GIB) to deploy ICF resources in middle income countries with a view to increasing private sector investment in developing countries.

²⁰ The Vivid Economics report 'Delivery Options for the International Climate Fund' at: can be found at: http://www.vivideconomics.com/uploads/reports/delivery-options-for-the-international-climate-fund/delivery_options_icf.pdf

²¹ Vivid Economics found that beyond these options, there would appear to be few other organisations that would be likely to score well against the project's objectives. In particular, few other UK-based organisations also have experience in financing climate and development goals in conjunction with private investors. Another potential option might have been The Carbon Trust, although it has a wide mandate of which only one aspect relates to financing low-carbon technologies.

We now assess these three options in detail.

3.2.2 Shortlist appraisal

A. Private Infrastructure Development Group (PIDG)

The Private Infrastructure Development Group is a multi-donor organisation funded by and under the governance of nine development agencies. The UK is the largest contributor to PIDG and most of its subsidiary companies are based in the UK. Its mission is to mobilise private sector investment to assist developing countries in providing infrastructure vital to boosting their economic growth, and combating poverty. There are a number of companies operating under the PIDG umbrella including Infraco Africa; a company that manages project developers providing early-stage project development capital and expertise in Africa.

This option suggests providing resources to Infraco Africa (part of the PIDG) to support low-carbon project development activities. £10m - £30m of resources would be required to support one investment team over a three year period.

B. CDC

CDC is a Development Finance Institution (DFI) wholly owned by the Department for International Development. It seeks to achieve DFID's economic developmental goals through investment in the private sector within developing countries.

The Vivid report identified that we could use CDC's relationships with its portfolio companies to offer energy audits and finance for energy efficiency opportunities. The provision of energy audits would be at a cost of £100,000 to £150,000 per audit. If successful, potential financing opportunities could form the basis of up to £7.5m to £10.5m in financing demand, of which half could be provided by the ICF.

C. Green Investment Bank (GIB)

The UK Green Investment Bank was set up as a public limited company in 2012, wholly owned by the UK Department for Business, Innovation and Skills. Its mission is 'to accelerate the UK's transition to a green economy and to create an enduring institution, operating independently of Government'. GIB has a strong focus on engaging the private sector and has become a core part of the UK's low carbon finance architecture.

As an operationally independent vehicle the GIB could have a broader demonstration effect to the private sector; market players are more responsive to the GIB acting in a market-oriented manner than investment decisions perceived to be policy/politically driven. This would help demonstrate to the market the commerciality of low-carbon investments.

The Vivid report proposed we could undertake a pilot scheme with the UK Green Investment Bank to deploy £200m of ICF resources with a view to increasing private sector low carbon investment in developing countries.

Assessment

It should be emphasised that these options are not mutually exclusive and could be pursued in parallel if the necessary resources were available and if the institutions in question, and shareholders, were willing.

The analysis in Figure 3 below considers these three options against those criteria used to assess the long list:

Figure 3 - Analysis of options - short list

	GIB	CDC	PIDG
Project objectives:			
1. Improved climate finance architecture	<p>As a market facing institution, it is expected that GIB's ability to liaise effectively with development finance institutions and private sector financiers would generate high quality projects for investment. The Vivid Economics study suggested that GIB's commercial accumen and 'fleetness of foot' would enable them to work effectively with the private sector.</p> <p>GIB have demonstrably deployed a variety of financial instruments, though largely focusing on equity, their current private leverage ratio is 1:3. But, unlike a private sector organisation, the GIB has 'green' policy objectives built into its institutional design; market-leading systems and processes to ensure its 'green principles' are upheld in all its investment decisions and stringent environmental and social safeguards</p> <p>The GIB therefore operates across the <u>public and private spheres</u>: publically-funded with clear policy objectives and accountability, but set up with clear commercial structures, staff and incentive structures.</p> <p>In the UK, GIB is mandated to make investments in low carbon energy and energy efficiency and they have developed the institutional capacities to develop and appraise these types of projects.</p> <p>As an operationally independent vehicle the GIB could have a broader demonstration effect to the private sector; market players are more responsive to the GIB acting in a market-oriented manner than investment decisions perceived to be policy/politically driven. This would help demonstrate to</p>	<p>CDC is a cost-effective body, with strong historical financial performance, low operating costs and a good record on leveraging co-finance. CDC have consistently earned good financial returns, generating £250m profit in 2012.</p> <p>Under their previous model (while operating only as a fund of funds between 2008-2010), CDC's private leverage ratio was 1:3.5</p> <p>Following CDC's recent restructure to focus on development in the hardest countries, there was little appetite for additional strategic re-direction towards low-carbon in DFID and CDC, constraining their ability – in the current timescale - to improve the climate finance architecture.</p>	<p>The PIDG generally, and Infraco Africa specifically, appears to deliver well against its mandate on delivering private sector investment: the PIDG Annual Report implies that Infraco Africa has achieved a private sector leverage rate of almost 1:14.</p> <p>To help address the gap in low-carbon early stage project development, the ICF could provide resources to Infraco Africa, to fund a dedicated developer team focussing on low-carbon project development in Africa. This proposal marries a well-established gap in the climate finance architecture (early stage project development) with an organisation (PIDG) that has capacities in this area and that is widely considered to be an effective delivery vehicle with a good track record of delivering high-quality ODA.</p>

	<p>the market the commerciality of low-carbon investments.</p>		
<p>2. Stronger climate and development benefits</p>	<p>GIB's double bottom line of both green and commercial returns would enable them to achieve strong climate results. In just over two years of operation GIB have invested in 43 projects, committed over £2bn of capital, which will deliver around £6bn of new infrastructure investment. They have an estimated average annual production of 13,527 GWh; estimated annual average reduction in energy demand of 47,017 MWh; estimated average annual reduction of 3,716kt CO₂e of GhG emissions; and estimated total lifetime remaining GhG emissions reduction of 61,597kt CO₂e.</p> <p>The GIB's existing investment processes (see annex 7.3) ensure that projects meet their 'green purposes', which map well against ICF KPIs.</p> <p>Their domestic portfolio shows their potential to make market-leading, transformational investments.</p> <p>As an institution, GIB has no development expertise, or experience investing ODA, therefore additional personnel would need to be recruited to this end. However, some of the existing staff have international investment expertise.</p>	<p>CDC is focused on lower-income countries, whereas the biggest climate mitigation potential is in middle-income countries . Although CDC is developing expertise in some low-carbon investments, especially renewables, there has been limited climate focus within CDC. However, recently CDC has been developing a power team that intends to explore opportunities for direct financing of energy infrastructure projects In addition, CDC's Code of Responsible Investment and its Coal Policy – which rules out financing coal-fired power stations – do require it to pay attention to climate issues and, in particular, consider the emissions impact of its investments during its due diligence. However, at present, the country focus is not aligned with our objectives and the CDC incentives are designed for a focuson investments that create jobs. CDC does not currently count the carbon output of its investments.</p> <p>This implies that CDC would be able to deliver strong development results, but is unlikely to deliver as strong climate benefits.</p>	<p>Its focus on Sub-Saharan Africa indicates a strong potential to deliver development benefits, as corroborated by DFID's Multilateral Aid Review of PIDG as a whole which identifies its 'critical role in supporting growth' and its well-targeted assistance to poorer states.</p> <p>However, only a small portion of PIDG's business is focussed on renewable energy project development and there is no energy efficiency focus.</p> <p>Potential climate benefits (in terms of GHG emissions reduced) would be more limited in less industrialised countries.</p>

<p>3. Improved visibility for UK climate finance</p>	<p>GIB already has a strong international reputation and consider themselves to be 'thought leaders' when it comes to making and measuring green investments. Delegates from other countries visit GIB to discuss their business model (e.g. Indonesia and Mexico) and India and China have recently raised their intention to set up an equivalent bank. GIB's strong links with the City of London would create opportunities for UK private investors overseas. As a wholly owned UK institution, which is known to be linked to the British Government, GIB would be able to deliver strong visibility for UK climate finance.</p>	<p>CDC's staff are based in London and as a well established, UK based institution, owned by HMG, CDC could deliver greater visibility for UK climate finance than we achieve through multilateral architecture.</p>	<p>While the PIDG is a multilateral vehicle and hence may not deliver as much visibility to the UK's climate finance flows as other options, stakeholders confirm that the UK is considered an influential donor within the PIDG. Infraco Africa is currently headquartered in the UK and has close links to the climate finance expertise within the City of London.</p>
<p>Critical Success Factors: eg</p>			
<p>VFM</p>	<p>GIB has had a good first two years of performance with over £1.9bn committed, once built investments are expected to generate a return of over 8% (note, this is in a UK context). GIB's direct and operating costs for 2013-14 were within budget at £20.7m. The institution has a strong results culture and there is confidence in senior leadership teams. The strong focus on working with private investors has led to a reported leverage of 1:3.</p>	<p>CDC has excellent financial performance from fund investments (9% profit in 2012 and outperformed emerging market equity indicators in previous years). Operating costs of 0.6% net value and a strong record of leveraging co-finance; from Sept 08 to Sept 10 leverage was 1:3.5.</p> <p>Given CDC's limited track record for making green investments, it is not clear that they would be able to deliver climate impact, reducing the potential value for money per £ invested.</p>	<p>PIDG received a strong evaluation in DFID MAR: 'good delivery against challenging objectives, its strong results focus is enhanced by incentives for management'</p> <p>PIDG overall costs are 1.9% of total donor commitments</p> <p>Strong at leveraging private investment: 11 PIDG projects that reached financial close in 2012 expected to mobilise an additional USD 3.9bn investment from domestic and international private sources.</p>
<p>Strategic Fit</p>	<p>GIB would allow ICF finance to be used for targeted work with the private sector and a specific private mobilisation focus. It would allow ICF to be more nimble and response to private investors and would invest directly into projects on our behalf. GIB may be able to become accredited to become an implementing entity under the GCF. It would enhance the sustainability of the ICF business model.</p>	<p>CDC is unlikely to be a strong candidate to deliver a significant quantity of ICF resources in the short-term. Pursuing low-carbon investment through funds (CDC's main investment strategy until 2010) seems unlikely to generate sufficient deal-flow, while making direct investments according to their climate benefit would not currently reflect CDC's comparative expertise. Channelling a large quantity of ICF finance through CDC would also require additional restructuring, for which there is currently</p>	<p>An investment into a dedicated low-carbon team of developers through Infraco Africa is likely to leverage a significant amount of private finance. However, a dedicated low carbon team may be at the expense of PIDG being able to achieve its core development aims. This could also limit the climate mainstreaming that Infraco Africa is already doing through low-carbon investments in its general infrastructure business.</p> <p>Furthermore DFID, as shareholder, would need to push</p>

		little appetite (in CDC or DFID). The recent establishment of the 'power team' focusing on energy infrastructure makes it unlikely that CDC would want to divert further resource towards low carbon. In addition, the country focus is not aligned.	this agenda and there is no appetite at present.
Potential achievability	<p>GIB do not currently make investments overseas. However they have identified existing personnel who have international investment experience and have identified individuals with strong development experience to act as Fund Directors. GIB could also be mandated (through an investment mandate) and incentivised to retain focus to ensure that the agreed project objectives are achieved. Their investment processes might be further enhanced to ensure they deliver transformational investments.</p> <p>GIB consider that taking on a role with ICF could demonstrate their capabilities to an international market and attract inward investment to their UK operations. There is support from the project at CEO level and the BIS Shareholder Executive are content to support the pilot. They are keen to take on the role.</p>	<p>CDC has only recently moved into direct investment. Interviews with the organisation have confirmed that, while they are already acting as a lead investor on equity deals, they are unlikely to act as a lead investor in relation to debt transactions over the next few years. Furthermore, although there is emerging renewables experience in CDC, the direct investment team built over the last two years has been primarily selected to provide expertise in sectors that will support its strategic objectives around job creation, not emissions reductions. In particular, most direct investment deals in the short-term are expected to be operating businesses, rather than the infrastructure deals typical of renewables investment. As a result, suggesting that CDC develops a strong focus on emission reduction investment opportunities in the short-term would not optimally reflect the current skills and expertise of the organisation.</p> <p>There is currently little appetite to pursue this in CDC or DFID. The next opportunity for DFID to discuss CDC's future strategy will be in 2017-18, CDC is currently implementing their five year strategy agreed in 2011-12.</p>	<p>In order to ear-mark funds for low-carbon development, DECC would need the agreement of DFID but also the eight other members who commit funds to the vehicle. All members would need to agree that the dedicated pursuit of low carbon activities is a strategic priority for Infraco Africa. PIDG will only look to grow in areas that are aligned with their strategic framework. As PIDG is a DFID led institution with a strong focus on development, the countries of focus are unlikely to be aligned with DECC's priority countries for ICF, which are generally rapidly industrialising countries that have the biggest opportunities for GHG emission reductions. DFID would need to push this agenda and there is no appetite at present.</p> <p>PIDG has also received a significant amount of finance since 2011 (over £700m from DFID) and has been criticised in a recent NAO report for the Trust not disbursing £27m since 2011, therefore PIDG could face challenges if it tries to grow any further.</p>
Risk profile	<p>GIB as an institution currently has no track record of making international investments, and has no presence on-the-ground in developing countries; GIB has no experience of investing ODA.</p> <p>GIB may foster less national ownership than other investments made by the ICF</p> <p>As a commercial institution, it could potentially be challenging to incentivise GIB to make market-leading, pioneering transformational investments. However, the GIB is wholly owned by UK government, and was institutionally designed to</p>	<p>There is little appetite within CDC for further structural changes, given the significant refocus that has taken place since 2009. The current long term strategy of CDC is to have investment flows of £500m per year by 2018, with approximately half provided by funds and half provided by direct investment. ICF capital could therefore significantly increase total investment flows and, given the change in focus, would necessitate further changes in resourcing and institutional structure. Such changes could compromise CDC from its recently agreed core mission of promoting job creation in the</p>	<p>Infraco Africa's focus is on early stage project development which is intrinsically a high risk activity. This, of course, explains why the gap is present in the first place and increases the likelihood that the deployment of public funds will be additional. However, it does mean that the returns on ICF investment – both financial and climate/development related – are uncertain and only likely to be realised over the medium-term. For instance, to date, Infraco Africa has brought eight projects to partial equity or financial close over the period since 2004.</p> <p>Although an important gap identified by Vivid, early</p>

	<p>deliver green policy objectives (it's objective is to be 'green and profitable'); as distinct from private investors who would focus on profit maximisation. There is also an established relationship with HMG through the Shareholder Executive. The GIB therefore operates across the public and private spheres: publically-funded with clear policy objectives and accountability, but set up with clear commercial structures, staff and incentive structures. We therefore think it can be mandated to deliver transformative investments.</p> <p>GIB's brand as a for-profit investor may be diluted by taking on a remit to invest ODA. However, they have a strong communications team and will be making investments on profitable terms.</p> <p>There are plans to attract private capital into the GIB; we would have to ensure a continued future alignment with the project objectives in the event of any partial privatisation.</p>	<p>hardest countries and business environments.</p> <p>There is currently little appetite to pursue this in DFID. DFID's priorities for lower income countries over the middle income countries (major emitters) would likely take precedence.</p>	<p>stage, higher risk projects are less well aligned with the objective for this project to achieve transformation through a demonstration affect; i.e. market-leading investments which prove the commerciality of low carbon investment in developing countries</p> <p>In addition, as mentioned above, a dedicated low-carbon team could be at the expense of a team prioritising strong development benefits.</p>
<p>Supply side capacity</p>	<p>GIB have strong portfolio and risk management , green appraisal and commercial procedures in place which give confidence that they will be able to make investments on behalf of the ICF.</p> <p>They have market-leading investment assessment as well as monitoring and reporting procedures against their green purposes.</p> <p>They have identified staff with international experience to recruit as Fund Directors.</p> <p>One area that they have identified that DECC and DFID's assistance will be required is to understand the ODA eligibility of projects. This requirement could be written into any agreement between DECC and GIB and would be fairly straightforward to achieve. Open lines of communication and a strong governance structure would ensure the GIB received support and advice on ODA eligibility from DECC and DFID.</p>	<p>Vivid economics suggested that the ICF may be able to leverage CDC's existing client relationships to develop a pipeline of energy efficiency opportunities that the ICF could finance. This could pave the way for more substantial low-carbon engagement with the ICF team in future.</p>	<p>The PIDG is not a dedicated climate finance delivery vehicle but has already made a significant number of investments in low-carbon projects.</p> <p>Infraco Africa has experience in one of the key gaps identified, early stage project development. Infraco have recently recruited a new developer team to manage £10m over the next three years. They could potentially perform the same recruitment exercise for a dedicated low carbon team.</p> <p>As a multilateral institution, it is unlikely that the other donors will want the PIDG to take on a role looking after the private sector investments that the DECC ICF team has already made.</p>

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Potential cost	This would be determined based on the exact role and function that GIB undertake and subject to negotiations. Vivid economics suggested that a comparison could be drawn with CDC's recently established direct equity team which has 14 direct staff plus a further 4 support staff at a total cost, including allocated overhead, of £3m a year which it expects will provide it with the capacity to make 5-7 direct deals a year as a co-investor. Admin costs to the organisation would be on top of this. This is comparable with the proposed cap of 2% of committed capital by GIB, ie. up to £4m a year.	Assuming that CDC are involved in five to seven direct investment deals per year, the total cost of providing energy audits would likely be below £150,000 and could form the basis for up to £7.5m in demand for finance from public and private sources, potentially split 50:50 between public and private finance.	Administrative costs of Infraco Africa, are an ongoing basis, relatively modest. Data provided by Infraco Africa suggests that its administrative costs are on an ongoing basis around 2 per cent of disbursed donor contributions (shareholder equity).
Summary/Score	Preferred	Discounted	Discounted

3.3 Preferred way forward

CDC is discounted as a vehicle for investing DECC ICF at present given their limited climate experience, non-aligned country focus and the timeframe given that the next opportunity for DFID to discuss CDC's future strategy will be in 2017-18.

PIDG is also discounted for investing additional DECC ICF in the near term. As a multilateral vehicle all donors would need to agree to pursue low-carbon development activities but during this analysis it was not considered an appropriate focus at present by DFID, and there is likely to be no appetite from other donors to channel funds in this way. This option also delivers less visibility for UK climate finance and the country focus is only weakly aligned with the DECC ICF priority countries.

The analysis in Figure 3 shows that the vehicle with the strongest fit to deliver the project's objectives is GIB given its potential to deliver strong climate results and ability to engage with the private sector. This option is however not without risks, as discussed below in this appraisal and in the management case, section 5.7. For that reason a time-limited pilot is recommended, to test the GIB's ability to deliver transformative investments of UK ODA. The pilot structure would also incentivise high performance.

A number of different working arrangements for a project with GIB have next been assessed.

3.4 Short list of options for working with the GIB

Option 1: Do minimum. Leverage some of GIB's commercial and green expertise to help the ICF team originate and appraise projects by seconding some GIB staff to the ICF team. Projects are still approved and implemented through the ICF's governance and portfolio management processes and procedures. This option is similar to 'Option 2' in the long-list: 'Increase in house commercial resource'.

Option 2: Pursue a time-limited pilot with GIB; the GIB would establish a subsidiary 'GIB International', and DECC and GIB would set up an investment vehicle ('Newco'), to allow GIB international to manage and invest £200 million ICF funds over 3 years.

Option 3: Provide £200m capital to GIB so that it can make investments from its own balance sheet. To note this would require amending legislation and GIB's core mandate to explicitly allow it to invest internationally.

3.4.1 Qualitative benefits appraisal

Figure 4 describes some of the qualitative benefits that would be derived from the three short-listed options above.

Figure 4 - Qualitative benefits

Objectives	Narrative of qualitative benefits derived	Score (1-5)
Option 1 – do minimum. Total Score: 5/15		
1. Improved climate finance architecture	<p>Seconding staff members with experience and expertise in areas where key gaps were highlighted (e.g. energy efficiency) would improve the ICF's team to develop and appraise these sorts of investments. In addition, their commercial expertise would enable us to develop more private sector proposals. However, we would still be reliant on our existing DFI delivery channels and constrained in operating nimbly or directly with the private sector. As with increasing in-house expertise, this option would remove the advantages of using an operationally independent vehicle which would have a broader demonstration effect to the private sector - we want the pilot to demonstrate to the market the commerciality of low-carbon investments - and market players are more responsive to the GIB acting in a market-oriented manner than investment decisions perceived to be policy/politically driven. It would also contradict the objective of establishing a sustainable, scalable model to deliver UK climate finance. The ability to scale up post the pilot is a key objective for this project.</p>	2
2. Stronger climate and development benefits	<p>Increased commercial and 'green' appraisal expertise would allow us to develop proposals with a strong climate focus at the lowest level of concessionality, potentially improving value for money per £ of ICF. This could also improve our ability to interact with the private sector and better understand how to maximise private sector leverage. It is unlikely that existing GIB staff would significantly improve the development benefits of projects as this is not their area of expertise.</p> <p>Under this option, the ICF team would not be able to use GIB's wider internal processes and procedures for detailed project due diligence, risk, commercial appraisal and portfolio management. Instead, the ICF team's processes would be further stretched, reducing our oversight ability to ensure that strong climate and development benefits are being delivered by the investments.</p>	2
3. Improved visibility for UK climate finance	<p>The ICF team would still rely on MDBs / DFIs to implement projects therefore it is likely that there would be no improved visibility in comparison to our business as usual case.</p>	1
Option 2 – pilot project. Total Score: 13/15		
1. Improved climate finance architecture	<p>As an institution that is mandated to make both green and commercial returns, GIB is geared up to operate commercially and therefore will develop proposals that will have a strong private sector focus. The GIB's existing investment processes ensure that projects meet their 'green purposes'. The financial tools that GIB would plan to deploy are equity and mezzanine products. The Vivid economics study shows that the use of these is limited within climate finance therefore this would fill one of the gaps.</p> <p>In addition, as GIB are mandated to make energy efficiency investments in the UK, they have a significant body of in house technical expertise to perform due diligence and appraise these projects. This will allow them to pursue investments that fill the energy efficiency gap.</p> <p>Under the arrangements, DECC and GIB would agree to an investment mandate. DECC could use this to ensure that GIB is sufficiently mandated to fill the gaps in the climate finance architecture.</p>	4
2. Stronger climate and development benefits	<p>GIB's domestic portfolio shows their potential to make market-leading, transformational investments. GIB is institutionally designed to deliver public policy objectives (green investments) and this is built into its investment processes. The GIB's investment criteria and process ensure that their investments achieve 'maximum green impact' by assessing them against their 5 'Green Purposes' (reduce greenhouse gas emissions, increase natural resource efficiency, protect the natural environment, enhance biodiversity and promote environmental sustainability), which are well-aligned with our ICF KPIs including transformational change. The GIB has market leading assessment, monitoring and reporting practices against Green Purposes. The GIB has an additionality test written into their Shareholder Framework, which prevents crowding out of other investors or lenders. We could design the Pilot to</p>	4

	<p>incorporate appropriate parts of GIB’s investment policy and processes; securing these in the legal agreements including the investment mandate.</p> <p>Furthermore, we could improve the climate and development benefits for an international pilot by enhancing the GIB’s existing processes and policies:</p> <ul style="list-style-type: none"> • include the requirement to meet transformational change criteria in the investment mandate. • reporting requirements against ICF Key Performance Indicators • require that all investments are ODA eligible. <p>Furthermore we would agree a Business Plan for the Pilot, which outlined the countries, sectors and financial instruments which the GIB will focus on to achieve strong climate and development outcomes, and ensure transformational potential.</p> <p>The Pilot structure would incentivise the GIB to deliver against DECC’s climate and development objectives. £200 million has been determined as the appropriate amount to test the GIB’s ability to invest climate finance against a number of countries (at least two, but not too many so that the transformational impact is diluted), sectors (energy efficiency and renewable energy) and technologies (at least 2), This is important because our ultimate objective is to identify a future delivery vehicle for UK climate finance, which needs to operate across countries, sectors and technologies. There is the potential for the pilot to be scaled up to deliver a significant portion of UK climate finance. We know that the GIB are interested in a long-term role in the delivery of UK climate finance as they are looking to expand their work in an international context and also to demonstrate that their business model works outside a UK context.</p> <p>However, it is important to note that, as an institution, the GIB has no track record in international development or delivering ODA. However, GIB would recruit a team of staff who have international development expertise to ensure that strong development benefits are achieved from projects. GIB have adopted the Equator principles²² and are compliant with IFC Standards.</p>	
3. Improved visibility for UK climate finance	<p>As a unique institution, wholly owned by HMG, with a good track record in the UK and a growing international reputation, GIB will deliver strong visibility for UK climate finance.</p> <p>Throughout the pilot, the DECC ICF team could also ensure that GIB and the FCO and DFID office network are well connected, to make the most of opportunities to gain visibility.</p>	5
Option 3 –Extend GIB’s balance sheet. Total Score: 11/15		
1. Improved climate finance architecture	<p>See option 2.</p> <p>However, the difference being we could not mandate the GIB to deliver ‘transformational’ investments.</p>	4
2. Stronger climate and development benefits	<p>Under this arrangement, the funds would sit on GIB’s balance sheet.</p> <p>There would therefore be the climate and development benefits of their existing successful processes and policies as described above. However, there would not be the option to enhance these processes to focus on transformational change. Given their remit to be seen as a commercial actors , taking the assets and therefore also the risks on their balance sheet, may influence them to have a lower appetite for investment risk and so pursue low/medium-impact projects in order not to endanger the performance of the GIB portfolio. In addition, we would have less influence over the strategic direction of the fund as we would not be able to establish governance arrangements or take an active role eg through Board representation. We would have no influence over possible changes to GIB policies and processes or remuneration, thereby potentially impacting the climate, development and vfm for the ICF.</p> <p>There would be the same potential risks and mitigants regarding lack of development experience as described in option 2. The lack of track record and less control under this option might make it riskier in the short term.</p> <p>It would also need to be consistent with European Commission State Aid rules.</p>	2

²² GIB adopted the Equator Principles in December 2013, more information on the Equator Principles can be found at: <http://equator-principles.com/>

	Given these challenges, this might offer a longer term option, but is unlikely to be achievable in the short term.	
3. Improved visibility for UK climate finance	See option 2, no change.	5

3.4.2 Risk appraisal

The ratings used in the following appraisal are from the DECC Risk Management Framework scale: very low = 1-2, low = 3-6, medium = 4-10, high = 10-16, very high = 20-25.

Figure 5 - Risk appraisal

Risk description	Do minimum	Pilot	Extend GIB's balance sheet
Risk of forex and default risk to the UK	Low – 1 DECC will need to manage the risk of potential losses from its own balance sheet. Assets will be regularly valued, but given that it will be unlikely that hedging instruments will make economic sense, we would have to deal with a certain degree of forex risks.	Low – 4 DECC will need to manage the risk of potential losses from its own balance sheet. Assets will be regularly valued, but given that it will be unlikely that hedging instruments will make economic sense, we would have to deal with a certain degree of forex risks.	Very low – 1 No risk to DECC as potential losses would accrue to GIB's balance sheet. However, this will affect GIB's appetite for higher impact, pioneering projects.
GIB is distracted from its UK mandate and its brand as a commercial investor is diluted	Very low – 1 Seconding GIB staff to DECC will only marginally reduce GIB's ability to deliver against its UK mandate.	Low – 4 By taking on a remit to deliver development assistance, GIB's brand as a commercial investor may be diluted. However, GIB would invest on commercial terms i.e specifically demonstrating to the market that low-carbon investments are commercially viable whereby GIB has the chance to prove itself as a successful actors for profitable investments in more challenging environments. Arrangement to be structured so that no resources would be diverted by GIB from UK operations. GIB believes that international activities are in line with its strategic direction, in particular to prove its business model of being green and profitable to international investors.	Very High – 20 This option would likely require GIB to notify the European Commission which could be a lengthy process. GIB do not want to proceed in this way. So early on in GIB's life, it may also confuse UK stakeholders, including Parliament, if their core remit is changed. With the funds on GIB's balance sheet, the institution is more at risk.
GIB invests DECC ODA in projects that are not ODA eligible	Very low – 1 Projects would go through ICF governance processes and therefore would not be approved if not ODA eligible.	Low – 4 The JV would be legally mandated to make only ODA eligible investments and governance arrangements will be in place to ensure this is the case.	Low – 4 (see left)

		<p>The JV will seek additional expertise from DECC and DFID when this is not clear. This will be particularly important given the ongoing ODA modernisation process.</p> <p>We are satisfied that the business plan focuses on only-ODA eligible investments.</p>	
DECC miss ODA targets	<p>Low – 3</p> <p>DECC will be able to manage the ODA portfolio as it currently does. Additional GIB staff may enable DECC to work with its current delivery partners to deliver more, higher quality, ODA investments.</p>	<p>Medium – 7</p> <p>DECC may be unable to manage ODA under/over spend as it has diminished control over when the £200m is invested. ODA will only count as spent once invested and there is the risk that investments could fail. Strong forecasting will help to mitigate this risk.</p> <p>We could investigate designating the GIB as an ODA eligible institution in the medium – longer term (once the pilot is up and running).</p>	<p>Medium – 9</p> <p>As the funds reside on GIB's balance sheet, once agreements have been signed with GIB, DECC will have minimal directly active control over when investments are made. ODA will only count as spent once invested and there is the risk that investments could fail. Forecasting will help to mitigate this.</p> <p>We could investigate designating the GIB as an ODA eligible institution in the medium – longer term (once the pilot is up and running).</p>
HMT do not approve any spending commitment beyond the current SR	<p>Very low – 1</p> <p>Funds do not have to be committed up front.</p>	<p>Low – 5</p> <p>HMT are reassured that the funds would come from the UK's 0.7% ODA commitment which is now enshrined in law.</p>	<p>Medium – 9</p> <p>HMT are reassured that the funds would come from the UK's 0.7% ODA commitment which is now enshrined in law.</p> <p>However, HMT might see risk to GIB's existing operations.</p>
Total Score	9	37	63

3.4.3 Preferred option

Figure 6 - Preferred option

Results	Do minimum	Pilot	Extend GIB's balance sheet
Qualitative benefits appraisal: <i>(Higher number = greater benefit)</i>	5	13	11

Results	Do minimum	Pilot	Extend GIB's balance sheet
Risk appraisal: <i>(Higher number = greater risk)</i>	9	37	63

Results	Do minimum	Pilot	Extend GIB's balance sheet

Overall ranking	Discounted (Low benefit)	Preferred	Discounted (High risk)
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On the basis of the qualitative benefits and risk appraisal above, the preferred option is to pursue the pilot through establishing a special investment vehicle with the GIB. This is because the option to extend GIB's balance sheet delivers similar benefits but with much higher risk and the do minimum option is without much risk, but also delivers very few benefits. A value for money appraisal of the pilot is next assessed below.

However, given the risks outlined above and that this is a new direction for the GIB, and the possibility of a changing policy or political landscape, it is considered prudent to test this approach through a time-limited pilot, with strong governance arrangements in place and a legal mandate to deliver against our ICF objectives.

3.5 VFM appraisal

The approach used to assess value for money is in line with DFID's 3E's approach which looks at economy, efficiency, effectiveness and cost-effectiveness.

- **Economy:** Are we or our agents buying inputs of the appropriate quality at the right price?
- **Efficiency:** How well do we or our agents convert inputs into outputs?
- **Effectiveness:** How well are the outputs from an intervention achieving the desired outcomes?
- **Cost-effectiveness:** How much impact does an intervention achieve relative to the inputs that we or our agents invest in it?

Economy

The pilot will be run by a team of international development experts. The Managing Director and one Investment Director have already been identified. This team will draw on GIB's support services as shown in Figure 7 below. The remuneration policy for the UK GIB plc will also apply in the international arm and will be based on achievement of both personal and business objectives. We will enshrine the current remuneration policy in the legal documentation so that it cannot be changed without DECC's consent. There will be a specific restriction on any individual carry arrangements (i.e. staff participating in the profit share from asset performance) now and in the future.

–It is expected that the UKCI team structure will comprise of a Managing Director, three investment directors, with three associates working to them and an office manager. This is in addition to support services including legal and HR provided by the GIB.

Before the details of the commercial deal have been fully determined it is not possible to make an exact judgement as to the economy of the pilot, however a comparison of costs against some of the ICF's other investments and non-HMG investments will be made to determine an acceptable range within which the pilot would be viewed as economical. It should be noted that this comparison is crude as ICF's existing investments have varying objectives, are structured in different ways, and deliver outputs through different means.

Hurdle and remuneration in other funds:

We will also look not only at the management fees, but also, the hurdle rates and carry received in other funds. SJ Berwin and the Asian Development Bank conducted some benchmarking analysis using data from Prequin into the fees associated with a number of infrastructure funds, to inform the arrangements that were agreed for CP3 (hence most of the data is on Asia focused funds).

For the pilot, GIB's management fee will be a percentage of committed capital (£200m). The details of which will be determined through the commercial negotiations.

The nature of the investments that GIB will make needs to be considered when determining the appropriate management and performance fee arrangements.

The data above shows that funds which make the majority of their investments directly into projects (rather than into sub-funds) require higher management fees to cover the higher costs associated with conducting project-level / company due diligence and ongoing monitoring and time invested in asset management. Based on discussions so far, GIB expect all of their investments to be direct investments in projects, and are planning to conduct extensive project-level due-diligence given the risks associated with low carbon development projects in developing countries and the impact potential fraudulent activity / health and safety incidents could have (not least on GIB's reputation, and hence their core business in the UK).

The other factors to consider are the size and geographic spread of the aforementioned funds. In order to prove the business model, we require GIB to operate in at least two countries across two different sectors (as opposed to the Asia focused funds above) which adds to costs. Furthermore the pilot will be capitalised with £200 million, therefore where larger funds benefits from economies of scale, GIB's management fee will be a percentage of a smaller amount. If the pilot was scaled-up in future, it is reasonable to expect that the percentage management fee could come down.

Market Economy Operator (MEO) Report

A MEO report produced by an independent third party will provide additional assurance that the pilot is being delivered on appropriately commercial terms.

Managing Public Money (MPM)

The Pilot aligns with 'Managing Public Money' (MPM) guidelines regarding fees and profit share. The arrangement is in the public interest as view it as necessary for the more effective deployment of UK climate finance, and as offering value for money for DECC and HMG.

Efficiency

In total, in just over two years of operation the GIB has invested in 7 UK funds and 43 projects, committed over £2.0bn of capital, which will deliver around £6.0bn of new infrastructure investment. Once built, these projects will generate a return of over 8%, provide renewable power to 3.1m homes, support over 3,500 construction and operational jobs and deliver savings of 3.7m tonnes of CO₂e per year. All of this has been achieved with annualised operating costs at c.£25m per annum.

This impressive, results-oriented track record is one which we will aim to replicate through the international pilot, but there will be differences: GIB is not yet established internationally; the due diligence required to make investments in developing countries is likely to be more costly than in the UK; and regulatory uncertainty, even in middle-income developing countries, may impact the risk-return profile. We will also ensure that the investment process

takes into account the ICF transformational change criteria. Taking account of this, the investment process that has been used successfully to deliver GIB's UK investments will be applied and enhanced for the pilot and will be tested throughout as part of the evaluation discussed in Section 5.6.2.

Costs will also be controlled. As discussed above, we intend for the GIB's management fee to be capped as a percentage of committed capital (£200m). In addition, to incentivise GIB to keep costs down and operate as efficiently as possible, we intend for the target hurdle rate to be calculated on profits net of management costs.

Effectiveness

This section provides an indicative assessment of the value for money of investing £200m in the pilot over 3 years in terms of effectiveness. The underlying modelling for the pilot is designed to model a range of investments in different countries and technologies and allows the user to vary key assumptions to carry out scenario and sensitivity testing. It is driven by an indicative portfolio of projects to be invested in, and produces expected outputs in terms of tCO₂e saved, MW installed, leverage achieved, and cost metrics such as cost per tonne of CO₂e and Net Present Value (NPV). The model has undergone the standard ICF QA process and has also been subject to external²³ review, in keeping with DECC Modelling Integrity Team guidance, and is considered fit for purpose. The economic appraisal, at Annex -, gives more information on the modelling and an assessment of the strength of the evidence of each element of the modelling. Overall the evidence is assessed as moderate given the exact project portfolio is not known at this time but the input data²⁴ is, on average, reliable.

This section discusses the modelling based on an updated project portfolio informed by market analysis undertaken by KPMG for GIB. DECC objectives in terms of country and technology coverage are taken into account, including general energy efficiency measures. At the time of writing, the Heads of Terms (HoT) and draft Investment Mandate (IM) has not yet been fully finalised, therefore the modelling contains some of the conditions laid out in the draft legal documents prepared ahead of the last Investment Committee meeting in October 2014. Where possible, input assumptions to the model have also been drawn from these documents. This analysis will be updated once these documents are finalised in order to monitor the impact on expected results and sense check expected results included in the GIB logframe. The current project portfolio reflects a snapshot of an illustrative range of projects given the available information at the time the analysis was carried out. Sensitivity analysis has been carried out to test the results are robust to varying key inputs such as the carbon price and additionality.

The model constrains the fund to invest at least 20% of the portfolio finance in energy efficiency projects, no more than 30% of the portfolio finance in one region, and no more than 25% in any one project. The country constraint has been updated to allow a maximum of 30% (rather than 20%) to be invested in any one country to reflect the progression in selecting the most feasible countries to invest in during the pilot.

Modelling the indicative portfolio suggests that the pilot represents good value for money in effectiveness terms. The headline indicators, presented in Figure 9 below, used to assess the effectiveness of the pilot are cost per tonne, amount of carbon saved, cost per MW and Mwh, and leverage of other finance. The model also produces a Benefit cost ratio (BCR) and is able to give an indication of the jobs created by the pilot.

²³ QA was undertaken by Operational Researcher working in DECC, but external to International Climate Change Directorate.

²⁴ For example, the Renewable Energy technology cost per MW installed is based on World Economic Outlook data carried out by IEA (2013).

DECC will provide the GIB with £200m in financing to cover project investments and administrative costs (6.3%²⁵). The monetised benefits²⁶ associated with this investment amount to £3,170m using the indicative modelled portfolio, a benefit cost ratio of 1: 15.9, with an attributed NPV of £3bn. This suggests that there is a strong value for money rationale for the project.

Figure 9 - UK attributed results

UK Attributed Results	
UK Share of Results	100%
Carbon	
Carbon Saved (MTCO2e)	31.9
Carbon Valuation (m)	£ 1,580
Jobs Created	
Jobs Created	3160
Economic Data	
Total Benefits (m)	£ 3,170
Net Present Value (m)	£ 2,990
Benefit Cost Ratio	15.9
Unit Costs	
Cost Per Tonne (£/CO2e)	£ 5.65
Cost Per MW Installed (£/MW)	£ 495,000
Leverage	
Public Leverage	0.39
Private Leverage	2.02
Overall Leverage	2.4

As GIB is set up specifically as a vehicle for UK climate finance and to invest in projects that without UK money would not be undertaken then it is reasonable to assume that the UK can claim 100% of the project benefits. The total leverage of other finance is £1:£2.4, of which 84% is private finance²⁷. However, this is heavily dependent upon the size of the projects invested into and the type of technology. Achieving total leverage of 2.4 is considered relatively cautious given GIB's expectations based on their market analysis (range of 4 – 6.7 leverage ratio depending on country and technology) and the current ICF portfolio. The

²⁶ Including carbon, energy saved and resource value.

²⁷ Total leverage is endogenously determined by the model, however public and private shares are exogenous to the model.

range of expected total finance leveraged (i.e. public and private finance mobilised), based on the current DECC ICF portfolio is between £1:£0.2 and £1:£10²⁸.

The **cost per tonne** of the indicative portfolio is £5.65/tCO₂e. This compares favourably to the currently approved DECC ICF portfolio expected attributed cost per tonne range of £4 - £16²⁹ (spend weighted average attributed cost per tonne of £6.4^[1]), and thus suggests that the GIB provides good value for money compared to the wider ICF portfolio. Equally the attributed cost per MW installed is approximately £495,000, this is well within the expected range of unit costs and suggests on these measures the pilot represents good value for money. The modelled portfolio contains many of the most cost effective, near commercial, renewable energy sources such as wind and solar power at scale, therefore unsurprisingly produces a relatively low cost per tonne. However, given the transformational objectives that the GIB will be working towards, the actual portfolio could well report a higher cost per tonne if more innovative and novel projects are included in the investment portfolio. It is expected that a limited number of investments may fail to return the capital, this is common in private equity investments. Currently the GIB have a very good record at 0% failure rate, other ICF projects have an expectation of 11% failure rate. This model assumes therefore 10% failure rate. Projects are also not all assumed to be additional, in this case we assume that 50% are fully additional, which is considered cautious, but in line with ICF best practice.

The failure rate and additionality associated with project are key to determining the vfm. These both reduce the expected benefits from the project by a set percentage and therefore lend themselves to breakeven analysis. Increasing the failure rate to above 93% or the project additionality to around 4% are the points at which the investment fails to return a net positive benefit to society³⁰.

The carbon price has a significant impact on the NPV of the project, returning around 50% of the monetised benefits. Central DECC/DFID ICF carbon prices are used in the main scenario here. When the lower carbon values are used a BCR of 11.9 is returned³¹, using the higher carbon prices a BCR of 19.7 is returned.

Modelling Evidence Assessment

The modelling is based on data and information from a range of sources. The technical annex provides detail on each individual element of the modelling and the associated evidence rating. Overall the evidence used in this modelling is considered moderate. A lot of the underlying data used is reasonably strong however the model is highly dependent on the investment portfolio and this is perhaps the weakest area in terms of reflecting what will actually happen in the investment. We have tried to be conservative in our assumptions were appropriate.

²⁸ Partnership for Market Readiness, a capacity building project that is not focused on leveraging additional finance represents the lower end of the range, while Global Climate Partnership Fund, a structured fund providing risk cushion to leverage in private investment for energy efficiency and renewable energy project in developing countries is the top project. Based on the current portfolio of the projects that report on leverage, the ICF is expected to leverage at least £4 for every £1 of ICF funding from private and public resources.

²⁹ The CTF, a large multilateral fund delivered through MDBs, represents the bottom end of this range. The top end of the range relates to the Green Africa Power fund that aims to stimulate private sector investment in renewable energy generation in Africa.

^[1] To note: ICF project Vfm indicators and expected results need to be considered in the context of each project and may have differing key objectives and non-monetised benefits. Therefore, they cannot be directly compared, figures included here to illustrate ICF portfolio context.

³⁰ I.e. the point at which the UK attributed BCR is equal to one.

³¹ ICF uses different carbon prices to model projects in 2014 compared to 2013, using the old central values the BCR of the IGIB is 13.43. Which carbon prices are assumed makes a significant difference to the valuation of the carbon savings. In 2020 (2015 prices) the central carbon price is 57.1, the low is 28.5, the high is 84.9, and the central price from the 2013 methodology is 30.8.

4. Commercial Case

4.1 Commercial Strategy

As set out above, the preferred option is a time-limited international pilot with GIB where DECC retains ownership of the assets. In terms of structuring this in practice, we have identified a **subsidiary/joint venture (JV) as the option that works best to navigate across our policy, commercial and legal objectives**, which are:

(a) Policy/commercial

- Ensuring investments are **ODA eligible** and compliant with the International Development Act
- Ensuring the pilot **does not distract the GIB** from its domestic agenda (additional funding, separate subsidiary and dedicated staff), is aligned with its future strategy and future-proofs DECC's interests in case of changes in GIB ownership
- Ensuring the pilot will deliver **transformational** investments in line with ICF objectives, i.e. building a sustainable market for investment by proving commercial viability of low-carbon investments, rather than simply buying-down emissions reductions
- Ensuring the **right balance of control vs. distance/flexibility for DECC**: A deal structure that allows DECC oversight and the ability to steer the strategic direction (by setting the investment mandate in the legal documentation, agreeing the business plan and ensuring robust monitoring and reporting requirements) and to have influence over significant decisions but does not micro manage individual investment decisions
- Ensuring management fee and profit share arrangement conforms to HMT **Managing Public Money** Guidance, as well as offering good **VFM** for DECC/HMG and being acceptable to BIS / ShEx / GIB
- Ensuring the assets are **consolidated on DECC's balance sheet**

(b) Legal

Designing a legal structure that protects DECC in terms of liability

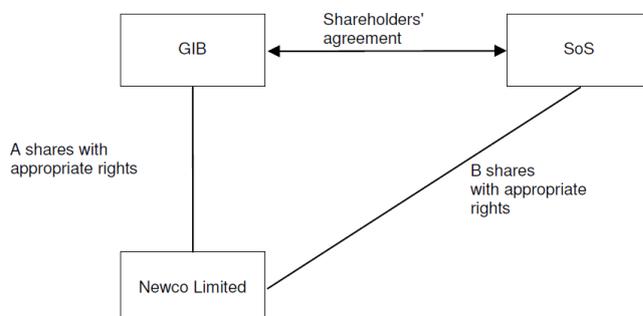
4.1.2 Delivery approach

The proposed delivery approach for the pilot will involve two separate exercises:

1. the creation of a joint venture (JV) company established by DECC and GIB (or a wholly owned subsidiary of GIB); and
2. an open procurement exercise to conduct an independent evaluation of the pilot with a budget of up to £2 million.

Joint venture structure

Our current working assumption is a shareholder loan of up to £200 million by DECC to a joint venture company (“Newco”) established by DECC and a wholly owned subsidiary of GIB (GIB International (GIBI)). An indicative diagram of the structure can be found below:



DECC and GIB (or a wholly-owned subsidiary, GIBI) would subscribe for share capital in NewCo. The DECC subscription is likely to be for a nominal amount in cash, with the GIB subscription paid for as consideration for services provided³². The key documents would set out, inter alia, the policy framework for making the investments, corporate governance arrangements including rights to appoint directors and certain reserved voting rights for DECC, economic rights as well as reporting/information rights for DECC. Detail on the structure as currently envisaged is below, noting that certain details may change through the course of the negotiations with GIB. The key commercial principles outlined will be maintained regardless of the ultimate details of the structure.

DECC’s class of shares will carry the following rights:

- Majority voting rights on any resolutions of the Company, save for certain Reserved Matters which will require mutual consent;
- The right to appoint directors to the Board of the Company;
- Rights to appoint an observer to the Investment Committee, and appoint a member of the Investment Committee, with a right to veto other members; and
- Rights to receive dividends.

GIBI’s class of shares which it will subscribe for in consideration of agreeing to make certain individuals and resources available to the Company) will carry the following rights:

- The right to vote on any resolutions of the Company, save for certain Reserved Matters which will require mutual consent;
- The right to appoint directors to the Company;
- The right to nominate the majority of the members of the Investment Committee, responsible for the investment decisions; and
- Rights to receive dividends.

GIBI’s shares will not be transferable without the consent of DECC.

The Investment Committee will be required to comply with the Investment Mandate. The Board will have overall responsibility for the strategic governance of the Company (except on

³² Both equity subscription amounts are nominal (DECC’s is cash, GIB’s is services).

reserved matters) and have the power to object to any investment decisions on the grounds it does not comply with the investment mandate (or potentially the business plan). The Board will form an Investment Committee, the majority of the members will be nominated and appointed by GIB and appointed by the Board. The Investment Committee will have delegated responsibility from the Board for analysing, sourcing, identifying, structuring, negotiating and transacting investments to be made by the Company. DECC will have the right to appoint an independent member as well as a DECC observer to the Investment Committee. The Investment Committee will report regularly to the Board on its activities and on investments that passed approval and are in the pipeline.

There will be certain reserved matters that can only be undertaken with the consent of both DECC and GIB. These most notably include:

- Changes to the articles of association or any other constitutional documents;
- Changes to the rights attaching to any shares or other interests in the Company;
- Change in the scope of the business or the investment mandate; and
- Any change to the remuneration policy of the Company (which shall adopt the remuneration policy of GIB at the time of contract signature). There is also a restriction that no individual may participate in the distribution of profits of the Company.

Profit sharing

GIB will be able to keep a share of the profits³³ that the investments will generate on top of the management fee³⁴ that DECC pays them to cover the costs of running the operation. For GIB and ShEx it is key to run the pilot on commercial terms for a broader demonstration effect of the GIB's capabilities in the international context.

From an overall commercial/policy perspective, a profit sharing concept aligns the manager (GIB) with DECC's investment objective of demonstrating transformation by investing in profitable projects, and crowding in private capital. GIB domestically has the 'double bottom line' of being 'green and profitable', so profit is part of their strategy to show to the wider market that investments in 'green' are commercially attractive. This also relates to a key part of the ICF strategy - to make the low-carbon transition, public money has to be employed strategically to leverage more private capital. These arrangements are therefore already tested in some of the other ICF private finance projects. Having no profit share to the GIB would not necessarily provide better value for money for DECC as from a commercial perspective, a profit share for the GIB is essential to ensure that the pilot remains important to the overall GIB strategy and to get the best people on board (commercial actors tend to favour ventures where they can show they have generated a profit for the company).

It is important to emphasise that the profit share under discussion is at the corporate level only. We have explicitly discussed with GIB (and they have agreed) that individual staff profit share (common for commercial private equity funds) will not be part of the deal, especially as profits will be generated from invested aid money. Staff will continue to be bound by GIB's remuneration policy, which we are comfortable with (their salary ranges have to be within the lowest quartile compared to the market).

There is a strong policy argument that innovative finance instruments (in addition to more 'traditional' grants for specific purposes) are key to move forward the low-carbon transition –

³³ The profit share is a share in the profits should the investments be a success, with a hurdle rate that is kept for DECC to reprogram to other ODA projects.

³⁴ The management fee is a pass-through up to a fixed cap (expressed as % of committed funds during investment period, and a lower % of capital committed to projects after investment period)

i.e. instruments that mobilise private capital by signalling through profitability to the market that this is an attractive and sustainable area for investment. Sharing the profit with GIB (who will receive a modest share) is justified given that, in terms of generating a demonstration effect, market players are likely to perceive the performance of a commercial actor with interest.

The management fee and profit share arrangement is in line with HMT Managing Public Money' (MPM) guidelines and is clearly in the wider public interest.

Delivery approach for the independent evaluation

The delivery approach proposed for the independent evaluation of the international pilot will involve an OJEU open procurement exercise. The anticipated contract value for the Evaluation is up to a maximum of £2 million. The timescales for this procurement exercise are set out in the project plan at annex 7.9.

1.1.2 Delivery approach considerations

Classification

In light of the proposed creation of this new legal entity, we worked with the Cabinet Office Public Sector Reform Team and HMT Classification team to check they were content with the proposed legal structure and ownership.

Financial Conduct Authority (FCA)

For GIB's existing UK investments, it is subject to a "group exemption" from the FCA regulations for "Collective Investment Schemes" as it is wholly owned by BIS. GIB will test the JV structure with the FCA which bears the risk that the start of the actual operations of the pilot might be delayed until the GIB gets FCA approval. We will deal with this in the legal documentation by making our commitment conditional on the GIB getting FCA approval for the pilot.

1.1.3 Ownership of Assets & Accounting Treatment

Assets acquired by the JV will be accounted for as part of DECC's consolidated financial accounts. The assets will be mostly in the form of equity investments, with the potential for mezzanine finance. Our investment will be re-valued by NewCo on an annual basis based on the underlying assets held. For valuation purposes, the accounting standard used will be IAS 39 Financial Instruments: Recognition and Measurement as adapted by FReM (Financial Reporting Manual) for public sector bodies. DECC and GIB Finance (with advice from Ernst and Young) are confident that we could make a case for control for DECC consolidation based on setting the investment mandate, certain reserved matters for DECC, DECC providing the capital funding, and GIB receiving less than 25% of the profits.

1.1.4 Commercial deliverability

Pipeline development

A key challenge with any new vehicle is the ability to originate a robust project pipeline. Domestically, GIB has a strong track record of origination, investing £1.4bn of capital from a standing start in 2012. However this has been beneath its notional investment targets on its original £3.8bn allocation. In particular, it has found it more challenging to make energy efficiency investments, a key target sector for the Pilot. To ensure a robust pipeline, the following steps will be taken:

- *Allow flexibility in the Investment Mandate* - Development of the investment strategy has been deliberately broad with the minimum of sectoral and geographic restrictions that still meet DECC requirements, allowing GIB to identify deals without being too prescriptive.
- *Recruiting an investment team with relevant contacts and experience* - GIB has already identified a small team of experts to develop the pilot, with relevant experience and contacts. This team will lead the recruitment of the remainder of the investment team during the pre-launch phase and at the beginning of the pilot. They will be specifically targeting people with relevant experience.
- *Increasing their profile internationally* - Once there is agreement to the Pilot, GIB will work to increase their profile with international investors and project developers through participating in relevant conferences and events, including leveraging our existing DfID / FCO networks.

Maintaining Commercial Tension

DECC policy and Commercial have secured value for money from the GIB in a number of ways:

- Learning from independent reviews of similar UK ODA vehicles (e.g. Private Infrastructure Development Group³⁵ and CDC PLC³⁶) by the NAO. Key findings and how these will be addressed in the GIB international pilot are set out at section 6.7.
- Benchmarking both management fees and profit sharing arrangements against competitively tendered fund management roles in other ICF projects (e.g. IFC Catalyst Fund, CP3 Asia, Global Climate Partnership Fund) and GIB's offshore wind fund. While it is challenging to establish exact comparators between funds given different fund strategies and size, the costs appear broadly consistent as discussed in section 3.5.
- Capitalising on existing GIB systems and procedures (e.g. Investment Committee format, Portfolio Management system, Dashboard reporting, assessment of Green Impacts, etc.) to align processes where possible and achieve efficiency gains.
- Ensuring GIB contract out and competitively tender functions that can be delivered more cost effectively by other organisations (e.g. detailed company and individual professional investigations by WorldCheck, enhanced due diligence of initial investments).

Aligning incentives

There are a number of ways in which GIB International (and GIB) will have aligned incentives with DECC. These include:

- Incorporating a profit share arrangement; and paying performance fees to GIB and not directly to staff.
- Termination clauses in the legal documentation to both protect DECC's position and ensure GIB share our Pilot objectives.
- Ensuring that GIB is clear on our success criteria for the Pilot (which will be used to assess whether we continue to use GIB in the future) and these success criteria are

³⁵ <http://www.nao.org.uk/wp-content/uploads/2014/07/Oversight-of-the-private-infrastructure-development-group-summary.pdf>

³⁶ <http://www.nao.org.uk/wp-content/uploads/2011/03/NAO-work-on-DFIDs-oversight-of-CDC-and-a-summary-of-CDCs-investment-approach.pdf>

built into our on-going performance management (see logical framework in annex 6.8).

- Ensuring our appetite for financial, legal / compliance and reputational risk is consistent with one another (see slide 45 of GIB's draft business plan).

In addition to the legal documentation that DECC will have in place for the JV, while GIB remains "operationally independent", HMG retains significant influence over the GIB parent company and its subsidiaries activities for as long as it remains the sole shareholder. HMG has the right to appoint both the Chairman and the Senior Independent Director on GIB's Board. In addition, HMG has a representative on the GIB Board. The Shareholder Executive carries out the GIB sponsorship role on behalf of HMG. This high level influence is secondary to the specific protections agreed contractually and will not be relied on, but provides additional comfort.

Under current plans, the GIB will look to attract private capital in the medium term. We are engaging with both ShEx and GIB on this basis as their project to attract private capital progresses.

Managing conflicts of interest

In order to mitigate against conflicts of interest, there will be an appropriate mechanism incorporated in the legal documentation. Failure to disclose a conflict of interest could lead ultimately to termination of the contract.

4.2 Potential for risk transfer

The key risks in making investments fall into three main categories:

1. **Financial:** For example, returns on investment being less than anticipated.
2. **Legal:** Broadly split into known risks (poor negotiation of contractual arrangements) and unknown (for example, fraud).
3. **Operational:** Covers risks associated with running both the management function and the underlying assets themselves (third party liability, fraud, commodity price exposure, counterparty credit risk)

It is not practical to transfer the majority of financial and legal risks – though the limited liability company at the heart of the JV provides protection here. DECC's best on-going protection is through diligence in setting up and monitoring the management of investments. However there are important ways in which DECC can transfer and mitigate operational risk in this Pilot project, through insurances and appropriate indemnities.

4.2.1 Risk transfer through insurance

Opportunities to mitigate operational risk through insurance arise at two levels in this Pilot:

There will be insurance policies in place at the level of the underlying investments / portfolio companies. As part of the GIB team's due diligence, they will undertake insurance due diligence at the level of each investment. This insurance due diligence would include:

- Checking there is adequate and appropriate insurance in place prior to investment (e.g. third party liability, employer's liability, directors' liability, asset, MIGA insurance) in terms of type, coverage, restrictions, additional insured endorsements, etc.
- Ensuring that there were covenants in investment agreements to specify / enforce adequate insurance requirements during the life of the investment;
- Validating insurance requirements (as required) as part of the on-going Portfolio Management process.

There are a full suite of corporate insurance policies in place for the GIB, including professional indemnity and Directors and Officers liability insurance. The GIB's insurance adviser is considering whether any updates are required to the existing suite of policies for international operations.

Within our contractual agreement with the GIB International, we will require that they include provisions for insurance requirements on individual investments, additional insured status, and certificates of insurance.

4.3 Risk transfer through indemnification

Opportunities to transfer risk through indemnification arise at two levels in this Pilot:

- There will be indemnity clauses in contractual agreements at the level of underlying investments. The GIB International will negotiate these indemnifications and risk will be borne by the party best able to manage risks associated with the investment.
- There will also be liability / indemnity clauses in our agreement with the GIB Fund Manager. These will be agreed upfront in the Heads of Terms.

4.4 Plans for managing contracts

4.4.1 Getting the legal arrangement right

To prepare the international pilot, DECC, with the support of specialist external legal advice, has worked with the GIB to prepare the Heads of Terms. The Heads of Terms are a non-binding document³⁷ which set out how the pilot will operate, as well as the various responsibilities, conditions, and requirements on either party. The Heads of Terms or final arrangement include, *inter alia*, details of the:

- How funds are to be invested by GIB International;
- Fee mechanisms, including profit share arrangements;
- Performance management arrangements, communication routes, escalation procedures, change control procedures, dispute resolution and other governance arrangements; and
- Exit strategy and termination events.

The finalised Heads of Terms will be a key input into full-length and legally-binding agreements with the GIB International. It is intended that this intermediate step will help to reduce legal costs associated with negotiating the final documentation.

4.4.2 Exit strategy

DECC interests need to be protected – both in terms of investments and operations that comply with UK and international laws as well as deliver against the investment mandate and objectives for the project. That is why appropriate termination clauses need to be in place in the legal documentation. These clauses need to specify the reasons for timing, reasons and consequences for termination.

Possible timings

Termination needs to be considered with regard to looking **at the three year pilot phase** (i.e. the time where GIB draws down capital from DECC to make investments), **the end of the pilot phase** (i.e. when all capital should be invested) and **the life of the fund** (i.e. the

³⁷ Save in a number of limited respects – in particular, an obligation to pay the agreed establishment costs whether or not the Pilot proceeds and to pay management costs that have already incurred in the event of a successful legal challenge.

time after the pilot where GIB manages and subsequently exits the investments and receives management fees as well as any profit shares).

At the **end of three year pilot, there will be no automatic extension**, i.e. no commitment of new capital if certain conditions are met. DECC needs to have the full discretion to consider any new funding for the joint venture. GIB will also have the opportunity to consider whether they would like to invest new capital for DECC.

It is important to note that the assets acquired during the three year phase (and any additional ones if a decision is made extend operations by new capital) will **continue to be managed by GIBI during the life of the fund unless the agreement is terminated**.

Reasons for termination

Reasons to terminate the agreement would follow a **'for cause'** or **'without cause'** distinction with appropriate dispute resolution mechanisms*. The grounds on which GIBI is removed as a fund manager impact on the length and extent to which GIBI receives management fees and profit shares.

Currently we envisage that GIB can be removed **'for cause'** for the following reasons:

- *a material or persistent breach of any provision of the Shareholders' Agreement which has not been remedied in a pre-specified time period*
- *a material or persistent breach of the investment mandate, in particular with respect to any reputational damage to DECC or not making ODA compliant investments and which has not been remedied in a pre-specified timeframe*
- *fraud, wilful misconduct, bad faith or negligence or a material breach of laws by GIBI or any investment committee members*
- *any act of fraud by or a criminal conviction of GIBI or (i) any fraud by or a criminal conviction of a member of the Investment Team in connection with his or her business activities of GIB or the joint venture, or (ii) that has a materially adverse impact on the joint venture or (iii) that would have a materially harmful effect on DECC's reputation*
- *any steps towards liquidation or disposal of GIBI's shareholding in breach of the shareholders agreement is undertaken*

'Without cause' reasons could include for example:

- Failure to meet transformational criteria. Given that transformation is no hard concept and requires some subjective assessment, making this 'for cause' would make the arrangement not predictable for the GIB.
- Decision to terminate at a break juncture

Summary of outcomes at the end of the pilot

At the end of the pilot, DECC will take into account inter alia the results of the independent evaluation, the MPA review, an assessment by officials based on the reporting at that date as well as any changes in political and financial conditions. GIB will also have the opportunity to consider whether they would like to invest new capital for DECC. The following scenarios can arise:

- (a) **The pilot is considered a success and political conditions allow scaling up.** The JV is scaled up; further climate finance is invested in the joint venture; the potential for the GIBI or GIB to take on a management role of existing ICF projects is explored. Pilot investments are, over time, either a) held with dividends reinvested as additional capital into the Fund, or b) divested and returned to DECC to invest elsewhere. (=

Continuation of asset management vehicle and commitment of further investment capital)

- (b) **The pilot is considered a success but other (political) conditions prevent scaling up or the pilot is not considered a success.** The GIB continues to play a management role for existing pilot investments within the fund life. Capital is not called back, but no further ICF capital is invested in the joint venture. (= Continuation of asset management vehicle, no additional investment capital)
- (c) **The pilot is not considered a success or political conditions prevent scaling up and there are doubts about GIB.** The GIB does not continue to play a management role. DECC makes arrangements with a 3rd party to manage the existing pilot investments or manages the assets in the public sector (DECC, ShEx, CDC). (= Effective termination of asset management function (by calling GIB's shares in the vehicle) and procurement of alternative asset manager).

We also intend to 'break junctures' at pre-defined times after the end of the pilot phase, i.e. predictable times where DECC can reassess GIB's performance and make a decision about continuation.

Termination options during the pilot phase

During the pilot phase, termination would only be possible 'for cause' (see above). If no cause is present, DECC will not be able to terminate the pilot until the conclusion of the pilot period, at which point there will be an opportunity to pursue a 'without cause' removal.

Both parties could, of course, bilaterally negotiate an early finish to the pilot at any point (this applies during the fund life also), if there was a shared view that it was advantageous to do so.

Termination options after the pilot phase (during the fund life)

After the pilot phase, termination would be possible 'for cause' at any time. Opportunities for a 'without cause' removal will arise at the 'break junctures' from the conclusion of the pilot phase.

Implications of termination (replacement of manager)

To terminate GIB as manager of the assets, DECC would exercise a call option on GIB's shares in the joint venture. The assets themselves are on DECC's balance sheet, so termination only refers to transferring their management obligations.

In any scenario where GIB is being terminated as manager, it will be necessary for DECC to procure a replacement asset manager. Therefore we will negotiate into the agreements an option for a notice period, during which period GIB will continue to act as asset manager. The cost implications for the two options (for / without cause) are different; the key principles are:

- Without cause – GIB provides asset management services for the notice period at the terms agreed; continues to receive a percentage of profit share for investments made during its period as manager
- For cause – GIB provides asset management services for up to for the notice period ; not entitled to receive future profit share

These principles are played out in the summary table of the implications of various scenarios below.

Figure 10: Implications of termination

Timing	Management fee	Profit share	New investments	Management of existing assets
End of pilot phase: No new investment capital, but continuation of asset management for the fund life, i.e. joint venture continues	Continues for the fund life	Continues for the fund life	No new investments	GIB continues as manager of the existing assets
End of pilot phase: No new investment capital, termination of asset management ('without cause')	Continues until new manager appointed	GIBI entitled to a percentage of profit share for those investments made under their management	No new investments	Existing assets are taken over by a 3rd party Fund Manager or manages the assets in the public sector
Terminated 'for cause' during pilot phase	Services provided at cost until new manager appointed	GIBI not entitled to any profit share	Incoming manager could make new investments during the pilot (time permitting)	Existing assets are taken over by a 3rd party Fund Manager or manages the assets in the public sector (e.g. DECC, ShEx, CDC).
Terminated 'without cause' after pilot phase	Continues until new manager appointed	GIBI entitled to a percentage of profit share for those investments made under their management	No new investments	Existing assets are taken over by a 3rd party Fund Manager or manages the assets in the public sector
Terminated 'for cause' after pilot phase	Services provided at cost until new manager appointed	GIBI not entitled to any profit share	No new investments	Existing assets are taken over by a 3rd party Fund Manager or manages the assets in the public sector

With regard to potential implications for the pilot operations and the assets under management during the fund life from plans to attract private capital, DECC discretion over what happens to the operations in these is key for the legal documentation. Furthermore, the legal documentation will make sure that GIB's current remuneration policy is enshrined for people working on GIB and cannot be changed without DECC's consent. There will be also a specific clause that there will not be any profit share arrangements for individuals now or in the future.

4.4.3 Delivery management and contract administration

As set out in the management case (section 6.2), this project will follow established ICF procedures for performance managing delivery partners and be delivered by an experienced HMG Project Team working closely with the dedicated GIB investment team. During the set-up phase, DECC staff in the Project Team sit within the International Climate Fund team in the International Climate Change Directorate with assistance from Legal, Commercial and Finance Directorates. During implementation, it is proposed that the advisory role from Commercial should be further enhanced to enable joint ICC/Commercial project ownership and management.

There will be regular formal meetings (on a weekly basis, eventually moving to a monthly occurrence as the project establishes itself) between NewCo and the Project Manager / Project Advisor as well as agreed project level reporting requirements.

This will allow the HMG Project team to monitor the project on an on-going basis and complete monthly project reporting on the financial profile, key risks and milestones to the ICF Programme Management Office.

The project will also complete more detailed performance assessments through Six Monthly (in the first year) and Annual Reviews. As part of these reviews, the Pilot will be assessed against the project's logical framework (see annex 6.8) which sets out project outputs and outcomes together with associated milestones and targets against ICF key performance indicators. These reviews are conducted with the delivery partner to maintain a shared sense of purpose and a clear focus on objectives and to promote continual improvement.

Project Steering Group meetings will be held every six months based around the six monthly and Annual Reviews, and more frequently as required. This will ensure that wider stakeholders within Government (e.g. HMT, FCO, etc) are kept informed of progress and can feed in.

4.4.4 Contract documentation and record keeping

All records relating to contract management will be saved on DECC Shares. This includes:

- Risk assessments (including versions of risk registers and risk potential assessments);
- Project plan (including versions)
- All substantive communications with GIB Fund Manager
- Evidence of insurance, indemnities, deeds and / or licences required under the contract
- Records of briefings of stakeholder and / or management team members
- Records of minutes, meetings, and discussions relating to the contract
- Records of payments
- Records of performance monitoring (through ICF Programme Management Tool) and performance assessments (through Six Monthly, Annual Reviews and Project Completion Reports), including discussions, feedback, and evidence of any non-compliance or under / non performance

- Variations to the contract
- Records of any disputes and related discussions and negotiations
- Records of any assistance or expert advice received

5. Financial Case

5.1 Financial resources & budgets

The total budget for the Pilot would be up to £202m over 3 years. This covers £200 million for pilot operations plus up to £2 million for an independent evaluation at the end of the pilot. Based on draft fund management models, we envisage that the £200 million portion would be largely capital with the remainder being programme budget which will be used to cover the management fees and transaction costs (maximum 2% of committed capital per year, i.e. £12 million over the pilot phase) incurred by GIB in delivering the Pilot.

In addition to the Pilot, we have already agreed across three separate business cases³⁸ to spend £458,080 programme budget on 'pre-launch' activities that have been necessary to advise our approach and provide the necessary information to this business case. These were procured and covered:

- External legal advice (specialist commercial lawyers) from Slaughter and May to negotiate the heads of terms and the final legal documentation.
- Set-up costs for the GIB where key outputs were the preparation of the draft heads of terms as well as preparing the draft business plan.
- Comprehensive market analysis on target countries conducted by KPMG to further inform GIB Business Plan and ensure that planned investments are in line with the objectives of the project and enable the ICF portfolio to deliver on its transformational objectives.
- Commit GIB staff time to setting up the pilot.
- Market Economy Operator Report to analyse whether the arrangements with GIB are on market terms.

Potentially there will be a need to increase that set-up budget to cover the following from the programme budget (to fall in the 16/16 financial year):

- Setting up GIB International as a company limited by shares
- Additional legal costs

The reason for covering the GIB's costs to set up the fund is that we are required to maintain a clear separation between the GIB's existing allocation (which is clearly ring-fenced for UK activities) and anything we do on the international pilot. All activity by the GIB to develop the international pilot has been new and additional money from the IC, thereby no diverting capital from its domestic resources.

The first year of the Pilot will use funding from DECC's £329m ICF allocation for 2015/16. The remaining years of the Pilot (up to 2017/18) form part of the new Spending Review period and therefore require agreement from HMT that will allow DECC to commit spending in the new SR when base lines have not yet been agreed.

The indicative cost profile for the project (excluding VAT) as detailed in the draft financial model is set out below; this is still subject to negotiation. If in the (likely) event that the fund manager will need to be covered for VAT, DECC will need to source an additional 20% budget cover for the management fee, this budget cover would be available from the 15/16 budget envelope through a set aside next year resource swap for this additional 20%.

Beyond the life of the Pilot, we have modelled a continuing active investment approach (see section **Error! Reference source not found.**) on the basis that the Pilot is a success.

³⁸ Approved on 8th December 2014, 30th December 2014 and 14th January 2015

However if we decide that the pilot has been no or only a partial success, we have the option to continue using GIB (or an alternative fund manager) to play a Portfolio Management role for our investments until these are divested.

5.2 Budget arrangements & business planning

5.2.1 Budget Availability

As set out above, the first year of Pilot is budgeted for. Funding will be drawn from our £329m ICF allocation for 2015/16. Budget for the remaining years of the Pilot will require agreement from HMT at the Treasury Approvals Panel and subsequently HMT Ministers. We have already discussed this budgetary issue with the DECC Spending Team and have agreed that they will review this request as part of considering the full Business Case following consideration by DECC's Investment Committee. This is set out in our project plan (see Annex 6.9).

5.2.2 Additional Expertise / Capabilities

In addition to core civil servant competencies, there are some specific expertise / capabilities required to ensure effective management and oversight of the pilot and the GIB as the implementing entity. These are:

- **Fund Management expertise** – Based on conversations with the DfID CDC team, we believe that fund management expertise will be important to help us act as an “intelligent client” of NewCo. Commercial expertise will continue to be crucial in the implementation phase and it expected that ownership of the project will be shared between commercial and policy teams. In addition, it may also be desirable to include Commercial staff in the governance positions (eg. on the board of the JV vehicle) though this is yet to be determined.
- **Shareholder expertise** – We will use BIS' 100% shareholding in GIB to support our oversight and management role for the Pilot. As set out in the management case, Shareholder Executive representatives already play a sponsorship role for GIB, and the GIBI form part of this on-going sponsorship role.
- **Financial accounting** – The investments held within NewCo will be re-valued on a semi-annual basis with particular emphasis for both the Supplementary Estimate and End of Year accounts time periods. While these valuations will be in line with effective accounting standards applicable at the time adapted for government reporting (currently IAS 28, IAS 39, IFRS9 and IFRS 13), the project team will need to rely on a DECC financial accountant with relevant expertise – particularly in the situation where there is some impairment / default associated with investments.

5.2.3 Supplementary Consultancy requirements

There will be two sources of supplementary consultancy:

- **Due diligence and appraisal of specific investments** - Where the GIB Fund Manager does not have the requisite expertise or local knowledge to appraise specific investments and companies, they will procure (through an open procurement process) consultancy resource to support specific investments. In the event of a successful transaction, such consultancy fees will be capitalised into the project SPV. Where transactions fail these will be paid by the JV in addition to the management fees, and an estimate of these ‘abort fees’ (c. £250k each year) has been included in the resource budget shown in the table above. This is similar to the model that the CDC use when making investments in-country.
- **Independent Evaluation of the Pilot** - The HMG project team will run an open procurement exercise to procure some evaluation specialists to conduct an

independent evaluation of the Pilot in the final year of the pilot period. We estimate that this will cost up to £2 million, and will come from the ICF's future budget (i.e. 18/19). This will be procured through an open procurement exercise. Draft Terms of Reference for the Independent Evaluation are attached (see section 6.3) and a timeline for procuring these specialists is included in the project plan.

5.2.4 Financing mechanism / arrangements

In order to deliver the £200m Pilot budget effectively and transparently so that there is a clear audit trail of funds invested, loans repaid, interest earned, dividend income received and management fees we will:

- Establish a dedicated DECC Government Banking Service (GBS) account for the Pilot. DECC has already set up dedicated bank accounts for the CRC (Carbon Reduction Commitment) which are owned by DECC but managed by a third party. These separate dedicated accounts allow for the accounting of this scheme to be done efficiently so that CRC money flows do not get mixed into DECC's main Fund account. The additional benefit of this approach is that the UK government's monies remain within the Exchequer Pyramid until the very last moment when the overseas transaction flow takes place. This means that taxpayers' money continues to work for the UK taxpayer as effectively as possible.
- Give NewCo access to manage the account on behalf of DECC – This would allow the company to make investments directly and drawdown funds to cover administration costs. Funds would only be transferred to this GBS account following a written request with no less than 10 working days' notice. However we will already be aware with as much notice as possible in advance due to regular cash forecasting compliance that will be expected from GIB.
- Require NewCo to specify in the drawdown request the amount that will be used to make investments or pay fund expenses and/or organizational expenses. In the case of a drawdown request seeking contributions to fund an investment, the relevant Drawdown Notice has to include a description of such Investment (incl. any co-investors) as well as a confirmation that all the necessary approvals from the Investment Committee are in place.
- Require NewCo to revalue our investments every 6 months and in particular in time for Supplementary timetable. This will allow us to assess whether there are likely to be any impairments / defaults from the investments made under the Pilot for DECC's Supplementary Estimate. DECC Finance will then be able to secure budget cover (resource AME) from HMT for any impairments / defaults. If the value of the investments increases, this does not create any challenges for DECC.
- Require NewCo to revalue our investments as of 31 March by the third week in April. DECC Finance will then use this valuation for our End of Year accounts.

There will be a number of further financial reporting requirements that will ensure DECC finance, policy and HMT can keep track of spend, as well as risk reporting. This will contribute to our overall assessment of the success of the pilot and therefore the ability to achieve transformational change. In addition, the reporting requirements below will provide evidence of the impact of the project and therefore allow DECC to assess likelihood of delivering transformational change. To note, these reporting requirements have not been agreed with GIB and are subject to change.

Figure 12 – Reporting requirements

Frequency	Report	Description
Quarterly	Quarterly financial and performance report	<p>Within [15] working days following the end of each fiscal quarter of each Fiscal Year, a report which shall contain (i) unaudited financial statements (management accounts), including profit & loss, cashflows and balance sheet (ii) an update on the JV's existing portfolio, investment pipeline and divested investments and (iii) descriptive investment information with respect to each Portfolio Investment including notes on cash-burn, debt and valuation. (iv) financial model for the whole fund (yield, profit, IRR, fees)</p> <p>Commentary for each project investment: the name of such investment, the address of the headquarters of investment, a brief description of such investment, the percentage of shares of such investment held by GIBI and held by the GIBI together with any Parallel Funds or Alternative Investment Vehicles, (change in) co-investors for KYC reasons, any major developments with the projects. We also need to have the right to see the financial modelling of every project (although does not have to be part of the reporting)</p>
Annual	Annual financial and performance report	<p>Within [25-30] working days following the end of each Fiscal Year, an audited set of financial statements including balance sheet, profit and loss and cash flows of the JV as of the end of such Fiscal Year and statements of operations, an update on the JV's existing portfolio, investment pipeline and divested investments, a valuation of each investment, and a statement of cash flows of the JV for such Fiscal Year, accompanied by an audited report from an internationally recognized independent public accounting firm, incl. a confirmation that, during the previous Fiscal Year, the allocations, distributions and fees related to the JV were, in the auditor's opinion, made correctly and in accordance with the terms of the JV Agreement.</p> <p>Commentary for each project investment: the name of such investment, the address of the headquarters of investment, a brief description of such investment, the percentage of shares of such investment held by GIBI and held by the GIBI together with any Parallel Funds or Alternative Investment Vehicles, (change in) co-investors for 'know your client; reasons, any major developments with the projects. We also need to have the right to see the financial modelling of every project (although does not have to be part of the reporting)</p> <p>If any investment has been liquidated or disposed of during such Accounting Period, the amount distributed to GIBI in respect of such liquidation or disposal</p> <p>A confirmation that the manager has complied with its obligations in terms of Environmental, Social and Governance (ESG) standards and corruption, anti-money laundering and</p>

		combating of financing terrorism policies
Semi-annual	Six Month Review	Mini-review which identifies any key issues in the project. A shorter/simpler version of Annual Review
Semi-Annual	Central ICF Results collection	Part of central results collection exercise across the ICF in March and September every year. (Including results against transformational change KPI)
Annual	ODA Return	Detailed breakdown of individual investments (and administration costs) together with the appropriate classification codes for ODA. Qualitative description of arguments why investments are ODA-eligible.
Annual	Annual Review	Measures the pilot against the logical framework / theory of change and project success criteria.

Foreign exchange rate hedging

The ICF would like to encourage investments in local currency, which gives rise to a level of FX performance risk. The use of a hedging facility, in certain circumstances, can mitigate FX performance risk but comes also potentially with downsides. They can be costly and only partially effective and generally only 'hard' currencies (including GBP, EUR and USD) have sufficiently liquid markets to make hedging an attractive VFM proposition. In addition, the use of a hedging facility may not be appropriate for a fund of this size and GIB may not have the capability to execute hedging arrangements.

The use of hedging instruments can also give rise to losses (or gains) at the project level (even if unrealised) on a market-to-market revaluation of the value of the hedging instrument. Initial guidance at this stage is that such losses would either be taken to reserves until realised, or be taken to AME budgets. While it is thought unlikely that hedging instruments would endanger RDEL budgets, it is critical to involve Finance in discussions around any FX policy agreed with GIB. HMT also need to be involved as hedging instruments are treated as novel and contentious by Treasury. DECC would therefore have to run past Treasury the use of hedging instrument and their budgetary impact.

We will ask GIB to lay out their recommended structure of the hedging instruments so that DECC can assess the costs of the approach versus the risk mitigation attained, and consider whether assessment of portfolio results takes account of FX variations.

5.2.5 Managing overspends / underspends

Overspends and underspends could arise if:

- Forecast investments are larger or smaller than anticipated in each year;
- Management costs are higher or lower than anticipated
- The Fund Manager is making loans and the instalments are linked to milestones that slip.

The ICF team deal with similar challenges in our wider ICF portfolio every year as part of meeting our annual calendar year ODA targets. We manage this risk by ensuring accurate monthly forecasting and RAG rate investments based on the risk of slippage to the next calendar year. The GIB Fund Manager will be required to do the same.

To mitigate the risk of underspend, the ICF team over-programmes in line with the RAG rating for investments on the basis that some of these projects will not complete during the calendar year period.

5.3 Financial risk

The main financial risks for this project together with the mitigating actions are set out below:

Figure 7 - Financial risk

Risk Description	Mitigating Actions
Default / impairment of investments made under the Pilot lead to DECC reporting a loss in our financial accounts and risk DECC's accounts being qualified.	<ul style="list-style-type: none"> • Ensure GIB as Fund Manager values assets as close to Supplementary Estimate as possible so we have a good idea what our End of Year exposure is • Seek sufficient resource AME budget cover from HMT for any impairment when realising i.e. selling equity investments or default on loans.
Not having sufficient RDEL budget cover for exchange losses when foreign currency monetary asset receipts (loans and mezzanine finance) are converted to sterling leading to DECC's financial accounts being qualified	<ul style="list-style-type: none"> • Seek HMT agreement to RDEL budget cover for realised currency losses
Successful pilot divestments lead to more negative ODA than our original investments which has to be continually reinvested in future years to meet future ODA targets.	<ul style="list-style-type: none"> • Ensure accurate forecasting about expected proceeds from sales of investments so that these can be incorporated within annual investment targets. • Encourage GIB as Fund Manager to reinvest sale proceeds within the calendar year.
Pilot investments are subject to fraudulent activities resulting in financial loss	<ul style="list-style-type: none"> • The GIB team will operate with same level of risk analysis as GIB and offshore wind fund with a dedicated legal, risk and compliance manager. The GIB team will conduct Know Your Customer (KYC) due diligence (alongside financial, legal, operational & technical, insurance due diligence, and environmental & sustainability) on all pilot investments. • The staff GIB is intending to recruit for working in GIBI have a track record of working in public development finance institutions (Stephen West, the intended MD of the fund, has a

long history working in CDC / Actis) and are accustomed to dealing with situations of corruption within a government funding context.

- Ensure GIB understand and apply Managing Public Money guidance in managing GIBI.
- An initial internal sense check on the deal and people involved will be conducted by the dedicated compliance manager. As the deal progresses, the GIBI team will identify the key parties involved in the transaction and run third party background checks (i.e. standard check from WorldCheck). As an extra layer of compliance, the Fund Manager will perform a detailed due diligence on key counterparties (i.e. external verification through PWC) for its initial deals to ensure comfort in new jurisdictions. If any flags are raised, further investigation may be required prior to final approval of the investment to make sure there are no additional risks.

Management Case

Overview and key short and long term milestones: High level plan

1. The Management Case sets out how the pilot will be structured and managed to ensure it delivers against its objectives. It covers plans for managing the pilot with GIB, internally within DECC and also our responsibilities across Whitehall. Additionally it covers how we intend to evaluate the project and our options for remedying situations and possibly exiting the arrangement should that be deemed necessary.
2. A project plan has been established and agreed between DECC and GIB. It will be owned by DECC and kept updated and used to map progress throughout the pilot. A selection of the critical high level actions and milestones associated with establishing and implementing the international pilot are captured in the table below for information.

Figure 8 - Milestones

Milestone	Completion Date	Detail
Sign legal agreement	March 2015	This would be DECC and the GIB Fund Manager signing the legal agreements to establish the joint venture
Six Month Review	Sept 15	This is a high level assessment of progress led by the HMG project team with input from the GIB Fund Manager. The report is made publicly available.
Finalise independent evaluation design	By March 16	We will procure a two stage evaluation: <ol style="list-style-type: none"> 1. Evaluation at the conclusions of the Pilot (outputs, governance and management processes) 2. Impact evaluation (of performance of specific projects) <p>To note, due to the need to for an early baselining period, the evaluation should be designed, with the designated evaluation contractor, within year 1 of implementation.</p>
First Project Annual Review	March 16	This is an in-depth review of the projects, based on established DFID best practice, which focuses in particular on how the project is performing against the project's theory of change and key performance indicators. The report is made publicly available.
Six Month Review	Sept 16 (ongoing)	Six month reviews are required in the first year of a project's life and when deemed necessary thereafter. Given the significance of the project and the short length of the pilot there is a good case for continuing with six month reviews for this project. A final decision though on this would rest with the project board.
Second Project Annual Review	March 17	As above
Pilot End	Mar 18	The pilot phase for the project concludes. Funds allocated to the pilot have been invested.
Independent / Evaluation finalised (Formative)	July 2018	A 'formative' evaluation to assess the GIB international pilot against project success. This evaluation will build on evidence and monitoring collected throughout the pilot and including against the project's Logical Framework. To note

evaluation)

this will be too early to report against outcomes and impacts, so will instead focus on:

- Outputs (see Theory of Change and Logical Framework)
- Success Criteria (see below)
- Management and design of the Pilot, including the governance, selection criteria for projects and GIB processes.

Project Completion Review	Aug 18	This is an established DfID procedure and is similar to an Annual Review.
Gate 5 Review	August 2018	This Review confirms that the benefits set out in the Business Case are being achieved and that the operational service (or facility) is running smoothly.
SRO Decision Point	August 2018	This SRO decision point would establish whether to scale up the Pilot or not. This judgement will draw on the the Gateway Review, Independent evaluation and annual reviews.
Impact Evaluation Report	Tbd (post 2020)	Focusing on specific GIB investments / projects and their delivery against the outcomes and impacts outlined in the Pilot's Theory of Change and logical framework (an early baselining period will occur during Pilot)

Under this plan there would be a 'gap' between the conclusion of the Pilot and a decision on whether to scale – up, however, the assets would continue to be managed by GIB during this period (see below).

It is important to note that even if a decision is made not to scale up the pilot, any assets acquired during the pilot phase would continue to be managed by GIBI for the agreed 'fund life' period, unless a decision is made to terminate the joint venture. Further details on termination and exit strategies are in section 4.4.2.

5.4 Stakeholder management and communications

There are a large number of stakeholders involved in the successful delivery of this project both within and outside the UK Government. However the most important stakeholders for the project based on our stakeholder mapping are GIB, BIS/ShEx, HMT, DFID and CO and they have been engaged formally via the Steering Group and informally throughout the business case development. The Steering Group will continue to operate through the pilot period and the broader engagement strategy and communications plan (see annex 7.14) for the project will be updated regularly by the DECC Project Team and reviewed by the Steering Group. Additional regular meetings with BIS/Shex will be established to enable coordination and consistent engagement with GIB across their domestic and international portfolios. More information on the expectations of other departments for the project are set out below:

Figure 9 - Stakeholder management

Stakeholder	Expectations
BIS/ShEx	<p>Pilot does not distract GIB from its existing UK mandate; Pilot does not dilute commercial brand of GIB; and Pilot helps to build GIB brand internationally attracting inward investment into the UK</p> <p>Pilot also aligns with current thinking on future strategic direction of the GIB; to attract private capital</p>
HMT	<p>Approach to Pilot offers strong Value for Money, arrangements conform with managing public money guidance; and Pilot does not make it more difficult to attract private capital into the GIB in the longer term</p>
GIB	<p>Pilot helps to build GIB's commercial brand internationally and develop new networks; Pilot helps diversify GIB's reliance on BIS for future funding; Pilot helps GIB to learn lessons from international investments which could be replicated in UK or vice versa; Pilot contributes to any efforts to attract private capital</p>
DfID	<p>Pilot delivers useful evidence to inform strategic development of aid financing framework; Pilot maintains UK's reputation for high quality ODA; GIB/DECC keep abreast of ODA modernisation process; Pilot investments align with strategy on development capital (given middle income country focus) and achieve strong development outcomes</p>
CO	<p>DECC manages the project in line with the requirements for a 'major project'; including quarterly returns to the Cabinet Office, and regular Assurance of Action reviews</p> <p>Work with CO (and through them ONS) to ensure appropriate classification of vehicle.</p>

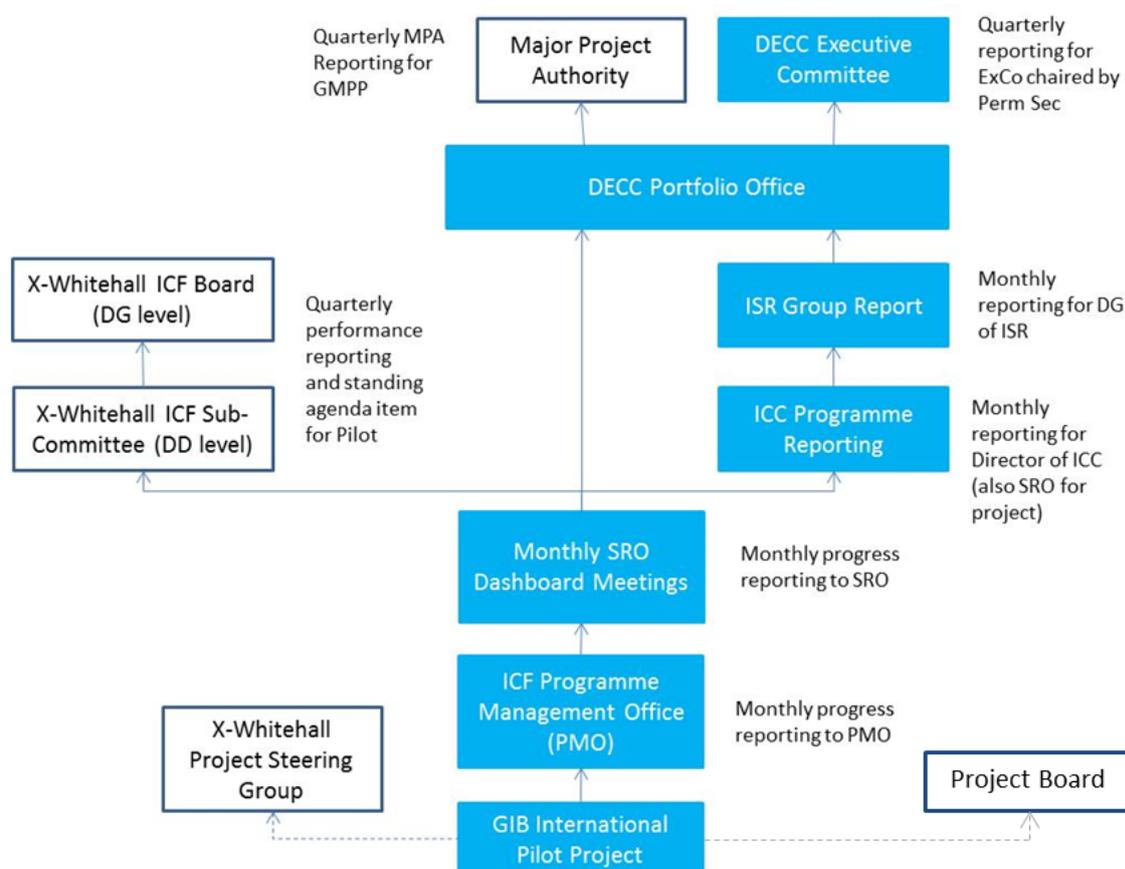
5.5 Project or programme governance

5.5.1 Governance arrangements

HMG Governance

Comprehensive governance arrangements are in place to ensure effective senior level and operational management of the project and to support rigorous reporting. The diagram below sets out the how the governance structure for the project will work together with lines of reporting, authority and accountability. This is explained further below.

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Senior Level HMG Governance

Senior Level Governance is provided across Whitehall and internally to DECC. First, as an ICF project, it follows an established ICF governance process with a cross Whitehall Director General (DG) Level ICF Board responsible for endorsement of all ICF expenditure and oversight of project implementation. The ICF Board meets approximately quarterly and is supported by a Deputy Director (DD) level Sub-Committee and Secretariat. This project has been endorsed by the ICF Board (as set out in Assurance & approvals below) and will be a standing agenda item for the Board going forward.

Second, within DECC, a Project Board of senior officials from across the department (legal, finance, procurement, commercial and the Chief Economist) has been set up to meet regularly and discuss and take key decisions on the project design. See Annex 7.23 for list of Project Board members and Terms of Reference. During the Pilot phase, the Project Board would continue to meet to discuss the development of the Pilot, especially to inform DECC's interactions with the GIB and position on the Board. We envisage the Project Board would continue to meet quarterly and during implementation we will invite ShEx and DFID to attend the Project Board meetings.

Operational Level HMG Governance.

As mentioned, there is already a cross Whitehall operational level process that supports the ICF Board and which collects and reviews information on all ICF investments. Within DECC, this project will be managed along with DECC's existing portfolio of ICF investments. This is led by the ICF Programme Management Office (PMO) in the International Climate Fund team. In addition, at a project level, there is an established project team (see Section 6.2.3)

who meet regularly with a GIB project team to review the project plan. During project implementation, these meetings will continue to take place on a weekly basis, eventually moving to nearer to a monthly occurrence as the project establishes itself. On a day to day basis, there are strong communication channels with the GIB (including regular phone calls and meetings) and the ICF envisages that this will continue

Reporting Processes

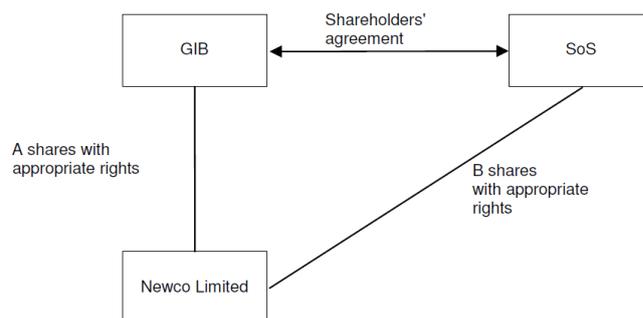
Progress on the GIB pilot will be highly visible across Whitehall and within DECC as a result of the multiple reporting channels that it feeds into. These include:

- Standard X-Whitehall performance management requirements for all ICF projects including monthly progress, financial and risk reporting, annual reviews and project completion reports.
- DECC reporting requirements. These include a monthly Dashboard meeting with the Senior Reporting Officer (SRO) to ensure continuing oversight of the ICF portfolio; monthly International Climate Change (ICC) Directorate Programme reporting (which in turn feeds into the International Security & Resilience (ISR) Group report for the DG and are used for monthly challenge sessions with Directors (including the SRO); and inclusion in the DECC Portfolio Office’s quarterly report on projects for the DECC Executive Committee chaired by the Permanent Secretary.
- Major Project Authority’s (MPA) Government Major Project Portfolio (GMPP) reporting. Given its categorisation as a ‘major project’, the pilot will be included in quarterly returns to the Cabinet Office, managed via the DECC Portfolio Office.
- ShEx quarterly review of each business in the GIB portfolio and a monthly risk register update for the ShEx Executive Committee. The pilot will be included in these reports.

As mentioned already, in addition to these processes, other government departments will be updated and consulted as part of the HMG Steering Group chaired by the Deputy Director.

5.5.2 Project Governance

As described in the Commercial Case, section 4, to implement the pilot, GIB and DECC will establish a company (NewCo) which will undertake and manage investments and both DECC and GIB would subscribe for share capital to establish Newco as shown below.



The governance arrangements are defined by the share structure and key documents will set out the policy framework for making the investments, retained voting rights for DECC, rights to appoint directors, economic rights as well as reporting/information rights for DECC..

The two main governance bodies for the project will be the Board and the Investment Committee.

The Board

The Board will have overall responsibility for the strategic governance of the Company and will include representation from both DECC and GIB. The final composition of the Board (including the majority) needs to reflect legal and accounting considerations, as well as CO advice on what is appropriate regarding ONS (Office for National Statistics) classification. Advice is still outstanding on these issues and should it turn out that DECC does not hold a majority on the Board, measures will need to exist elsewhere to give DECC sufficient degree of assurance and control. The Board will form an Investment Committee, the majority of the members will be nominated and appointed by GIB and appointed by the Board.

The Investment Committee

Investment committee members will be largely nominated by GIB and, as mentioned, appointed by the Board. DECC will retain a veto over individual appointments. It will comprise of key individuals from across the GIB organisation with relevant expertise³⁹ (i.e. Executive Director, Group Operations Director, Chief Risk Officer, General Counsel, Head of Investment Banking, Managing Director of Energy Efficiency, and the Managing Director of Newco). In addition, DECC will have the right to appoint an independent member as well as a DECC observer. The latter will not have voting rights but will be essential to help understand and learn lessons from the pilot.

The Investment Committee will have delegated responsibility from the Board for analysing, sourcing, identifying, structuring, negotiating and transacting the investments to be made by the Company. All investments will be subject to a four stage investment process based on the GIB's current investment model overseen by a GIB corporate level (parent company) Investment Committee. The Investment Committee for the pilot will meanwhile report regularly to the Board on its activities and on those investments it has approved or anticipates approving. More details on how this subsidiary/joint venture works are found in the Commercial Case.

5.5.3 Project or programme organisation – team members and roles

This project will be delivered by an experienced HMG Project Team working closely with the dedicated GIB investment team. During the set-up phase, DECC staff in the Project Team sit within the International Climate Fund team in the International Climate Change Directorate with assistance from Legal, Commercial and Finance Directorates. During implementation, it is proposed that the advisory role from Commercial should be further enhanced to enable joint ICC/Commercial project ownership and management. BIS staff in the Project Team sit in the Green Investment Bank team in the Shareholder Executive.

The project team has been significantly increased in recent months to match better skills and resources to a project of this scale. Its composition is listed below. The ICF team as a whole operates flexibly with additional resources being able to be brought on board relatively quickly if needed. Likewise the level of resourcing will be kept under review as the pilot settles into implementation and it is expected that less resource will be needed by mid to late 2015.

³⁹ <http://www.greeninvestmentbank.com/team/>

5.5.4 Assurance & approvals

The GIB is an ICF project and as such it follows an established cross Whitehall approvals process which was endorsed by the recent independent ICAI report of the ICF. The two stage process covers:

- ICF project concept proposals (akin to Outline Business Cases), which are endorsed by the x-Whitehall ICF Board, following review by a Technical Panel as part of a competitive bidding process. The concept proposal for this project was endorsed by the ICF Board in January 2014; and,
- Following endorsement, a full Business Case is prepared for each project (and quality assured by experts within DECC, across relevant Departments and with external experts) which is then subject to the respective spending Department's own approvals arrangements.

The project has been added to the Major Project Authority's (MPA) Government Major Projects Portfolio (GMPP). This requires quarterly reporting to the Cabinet Office. Throughout the pilot the Major Project Authority will continue to review the progress with a final review following the independent evaluation is complete in 2017.

Finally, Parliament have been notified that that we are working with the GIB to explore options for an international pilot. A further written ministerial statement is planned alongside any announcement.

5.6 Performance, Evaluation and Benefits Evidence

The international team will draw on GIB's central functions for performance management. The Green Team is responsible for all GIB's engagement on green issues and they lead the sustainability element of GIB's work. They have responsibility for issues including stakeholder engagement, policy development, transaction due diligence, and using our green focus to originate new transactions. The Green Team will allocate dedicated services to the pilot and the project management team (PIM) will advise and support on portfolio management and reporting. As part of DECC's agreement with GIB, GIB will be mandated to report on the financial and performance data outlined below. See financial case (section 5.2.4) for full table, the below focuses on performance data.

Figure 18 – Additional reporting requirements

Frequency	Report	Description
Monthly	Spend and returns profile Costs incurred P&L	See table in financial case
Monthly	RAG rating for slippage	Project by project risk of slippage for commitment / deployment into next calendar year
Quarterly	Quarterly financial and performance report	See detail in financial case, also communications plan in annex 7.14.
Semi-annual for first year and thereafter as needed	Six Month Review	Mini-review that which identifies any key issues in the project. A shorter/simpler version of Annual Review which is published.
Semi- annual	Central ICF Results collection	Part of central results collection exercise across the ICF in March and September every year. It includes results against transformational change KPI and all results pass through a rigorous QA process. The intention is that results should be published annually.

Semi -Annual	Portfolio Valuation	
Annual	Annual financial and performance report	Further detail in financial case. This includes a confirmation that the manager has complied with its obligations in terms of ESG standards and corruption, anti-money laundering and combating of financing terrorism policies
Annual	ODA Return	Detailed breakdown of individual investments (and administration costs) together with the appropriate classification codes for ODA. Qualitative description of arguments why investments are ODA-eligible
Annual	Annual Review	An in-depth review of the projects, based on established DFID best practice, which focuses in particular on how the project is performing against the project's theory of change and key performance indicators. The report is made publicly available.

Success criteria

There are a number of different ways in which the project will be measured/assessed, including at an impact, outcome level and output level (in line with the Theory of Change and Logframe). It is important to note that, whilst success for the GIB may also be commercially successful investments with associated profit share, this is not essential for DECC if we learn more about how to use out finance effectively. Similarly, a commercially profitable project may be viewed as less successful through a transformational lens if those investments do not change the wider low carbon landscape (in line with the overarching impact the pilot seeks to achieve: transformational, low-carbon development and increased visibility for UK climate finance). Finally, the pilot could be successful in all aspects, but not continued because of a range of factors (political, financial etc) which are relevant at the time. The success of the Pilot and decision on whether to scale up will take into consideration:

- Independent evaluation of a) outputs and management / governance and b) outcomes and impact
- Annual Reviews (GIB to complete, with support / input from DECC project team).
- Gate 5 review.
- Broader political priorities and financial context

However, during the Pilot, it is vital that the GIB understand what 'success' means for DECC; as transformational change is more complex than simply achieving a successful commercial outcome, or emissions reductions. Therefore, in addition to the Key Performance Indicators outlined in the logframe and agreed with the GIB, we have agreed the following success criteria with the GIB (which align with the ICF and non-ICF KPIs in the logframe):

Pilot Success Criteria:

- The GIB has invested the full £200 million at the end of the three year pilot period
- The GIB has invested in at least 2 target countries, across two sectors (renewable energy and energy efficiency); including at least two renewable energy technologies⁴⁰
- GIB's investments are likely to lead to transformational change: investments which a) mobilise private investors at the project level and b) have a

⁴⁰ This will allow us to test the approach as recommended by Vivid, but without 'diluting' the impact of increasing the costs of the pilot.

demonstration effect; signalling to wider market the attractiveness of low-carbon investments

- Strong climate and development outcomes are secured from projects⁴¹ (mostly expected rather than actual given the long lead time it needs for investments to translate results):

- Climate: Pioneering, market-leading Renewable energy and energy efficiency measures are installed; measured by GHG emissions reductions; Level of installed clean energy capacity; electricity demand reduction

Development: enhancing economic growth in developing countries (measured by jobs created)

Improved UK visibility: GIB's credibility as a world leading climate institution which delivers commercial and developmental benefits is enhanced by the GIB building strong local/international networks (investor/financial community, project developers, policymakers/regulators) as well as credible market familiarisation and knowledge (interest from DFIs, private sector, DFID, ministries from other countries)

- Investments conform to rigorous social, safety and environmental standards

As set out in detail in the logframe (Annex 7.8), the pilot aims to achieve the following:

Key Performance Indicators (KPIs)

NewCo will monitor investments and report on a set of KPIs that have been agreed between DECC and GIB. There will be two levels of reporting: GIB fund level and project level investment reporting (see figure 12 in Financial Case).

Fund level reporting

The logframe for the Pilot level indicators has been agreed with the GIB. GIB will collect data to allow DECC to monitor the pilot throughout its implementation (see above for timing of data collection, in line with ICF results collection and review processes). These are set out in the project's logical framework attached at Annex 7.8⁴² and are linked to the project's Theory of Change. The logical framework describes who will be responsible for collecting evidence, the method of evidence collection and baseline measurements that results will be assessed against the milestones and targets for the indicators will be agreed between DECC and the GIB in the early stage of the Pilot.

Project level reporting

As part of the investment process for each investment, NewCo will need to consider the case for investment against their 5 Green Purposes (which map well to our ICF objectives expressed measured through KPIs): reduce greenhouse gas emissions, increase natural resource efficiency, protect the natural environment, enhance biodiversity and promote environmental sustainability. In addition, NewCo will need to assess the project against the ICF Transformational Change criteria (see below). The case for investment will then be considered by the Investment Committee and the board, where DECC will be represented. See Financial Case for outline of project-level reporting requirements, figure 12.

ICF KPIs:

The Project will also contribute to the following ICF KPIs:

⁴¹ These are ICF Key Performance Indicators; we will also monitor performance against other KPI's outlined in the table in section 3 but these are the most significant for the pilot

⁴² This is an excel file which has been provided alongside the business case

- Extent to which NewCo intervention is likely to have a transformational impact.(see below)
- Number of people with improved access to clean energy as a result of NewCo investment in the project
- Number of direct jobs created as a result of as a result of NewCo investment in the project
- Change in Greenhouse Gas (GHG) emissions as a result of NewCo investment in the project
- Volume of public finance mobilised for climate change purposes as a result of NewCo investment in the project
- Volume of private finance mobilised for climate change purposes as a result of NewCo investment in the project
- Electricity demand reduction (energy efficiency MWh) resulting from the NewCo project
- Level of installed capacity of clean energy as a result of NewCo investment in the project (MW)
- Number of low carbon technologies supported (units installed) through NewCo investment in the project

Transformational Change

Our objective is for the GIB pilot to be transformational by:

1. Demonstration effect: signalling to wider market the attractiveness of low-carbon investments by making pioneering, market-leading and profitable investments, in projects with developmental and carbon benefits whilst avoiding crowding out other private investors profitable investment. This will in turn lead to increased investment (private climate finance) into needed areas.
2. Improved climate finance architecture: GIB will transform the UK's main mechanisms for delivering UK investments in climate finance; particularly by increased and more effective engagement with the private sector and increased visibility of UK climate finance (leading to improved outcomes in UNFCCC negotiations).

These two aspects of transformational change will be ensured by:

Demonstration effect:

1. Investment criteria

The GIB's existing investment criteria and process ensure that their investments achieve 'maximum green impact' by assessing them against their 5 'Green Purposes' (reduce greenhouse gas emissions, increase natural resource efficiency, protect the natural environment, enhance biodiversity and promote environmental sustainability), which are well-aligned with our ICF KPIs (see annex 7.18). We will enhance this existing process by including the requirement in the investment mandate that investments must meet the ICF transformational change criteria (outlined in annex 7.19). Mandating this requirement in the investment mandate means that NewCo will be legally required to take into account transformational potential as part of its investment process. GIB will be responsible for developing the methodology in consultation with DECC.

2. Business Plan

We have negotiated a business plan for the Pilot with the GIB which outlines the countries, sectors and financial instruments where GIBI will invest. The GIB procured comprehensive, independent market analysis to inform this business plan; demonstrating the opportunities for transformative investments. We have ensured input into the business plan from the DECC Project Board, the ICF team, DFID, FCO posts and external reviewers. Even though not strictly legally-binding, the business plan can be annexed to the legal documentation and is a strong expression of strategic intent from GIB.

3. Additionality test

The GIB has an additionality test written into their Shareholder Framework order which they use to assess their potential investments prior to committing capital. The test has two elements, a) Mobilisation: A positive commitment to “seek to operate alongside other market participants so as to introduce and mobilise additional investment that contributes to the Green Impact” and b) Insufficient availability of alternative market finance: A negative restriction to prevent GIB investing in projects that have sufficient access to capital investment. This prevents crowding out of other investors or lenders. We will ensure the GIB’s existing additionality test be applied to an international context.

Improved climate finance architecture:

4. Pilot Structure

The pilot structure will incentivise the GIB to deliver against DECC’s strategic objectives. Ultimately, we want to identify a future delivery vehicle for UK climate finance; there is the potential for the pilot to be scaled up to deliver a significant portion of UK climate finance. We know that the GIB are interested in a long-term role in the delivery of UK climate finance as they are looking to expand their work in an international context and also to demonstrate that their business model works outside a UK context.

5.6.2 Evaluation

Given the pilot nature of this project, evaluation is crucial for learning, accountability, and to assess success.

Evaluation approach

An independent evaluation of the pilot will be tendered once the pilot is up and running. It is DECC Policy that the M&E Plan and terms of reference will be finalised within six months of Business Case approval. A draft Terms of Reference for the evaluation is attached at annex 6.3. In short the evaluation will include:

- i) A baseline of key project outcomes within a year of Business Case approval;
- ii) a formative evaluation to report by August 2018;
- iii) an impact evaluation, date to be determined and dependent on the results of the pilot.

As the pilot is scheduled to end in March 2018, the evaluation team will aim to provide a final formative evaluation report by August 2018. It will assess the pilot and will be used as evidence to assess whether DECC should provide additional funds to GIB so that they can take on a longer term role investing international climate finance.

In addition to a formative evaluation in 2018, the GIB pilot investments will also undertake an impact evaluation at a later date (e.g. 5 years after project implementation) to determine whether outcomes and impact were achieved at a project level. This will occur in the

situation b or c of the exit strategy (see section 1.6.2 below), e.g. in the case where the GIB pilot investment vehicle function is terminated, but asset management continues of existing investments. In the case of exit strategy a being chosen, e.g. the GIB asset management and investment vehicle function is extended, the evaluation plan will be reviewed within six months of that decision to ensure the most effective impact evaluation plan can be designed.

Evaluation objectives

A formative evaluation will be designed to assess the effectiveness of its inputs and activities as outlined in the theory of change, including if (and why/why not):

- The shareholder agreement and the investment mandate are being followed, are still aligned with the project's objectives and have resulted in any unintended impacts, both positive and negative;
- The strengths, limitations and constraints of the team that has been established in NewCo to run the pilot and how this affects delivery including if any changes would be beneficial for scaling up the pilot;
- The incentive framework is ensuring that NewCo is investing in line with the Theory of Change, including whether elements of the framework have led to perverse incentives;
- Appropriate mitigating actions are in place and have been put into action to manage risk⁴³;
- Review the methodology for reporting KPI15 – transformational change.
- The project has an impacted on gender (where feasible at formative evaluation stage)

In addition, the evaluation will scope out the design for a robust impact evaluation which will attempt to attribute climate and development results (outcomes). The first step of this will be to conduct a baseline early on in project implementation. Key questions for the impact evaluation to consider include:

- Assess and attribute results (as far as possible), capturing factors independent of the project that may impact the results;
- The pilot has the potential to achieve transformational change;
- There are any external factors that are impacting NewCo's ability to deliver outputs, what these are and how they are impacting NewCo. The evaluation should unpick the theory of change by analysing whether / how /and why / why haven't achieved outputs led to expected outcomes and impacts;
- The pilot is delivering value for money including whether funds are being used economically, efficiently and effectively to deliver the intended benefits in terms of the expected climate and development benefits and anticipated financial costs / reflows to the UK.
- The pilot has impacted on gender

The log-frame and theory of change will act as reference points to guide the evaluation. The evaluation should also generate learning that can be applied more widely to the international climate finance landscape.

Evaluation management and funding

⁴³ Including risks to the delivery of GIB's UK objectives

The evaluation will be commissioned by the DECC ICF team. Direct users of the evaluation findings will be GIB and UK government including DECC, DFID, FCO, BIS and Treasury. The funds for the evaluation will come from the DECC ICF budget.

Evaluation dissemination plan

For the evaluation, a dissemination and engagement plan will be developed as part of the evaluation design. As required by DECC policy, the evaluation will be published on DECC's .gov.uk website. The evaluation team will be asked to summarise the results for different audiences and stakeholders, as appropriate and as laid out in the evaluation inception report. We envisage this would include UK stakeholders, including climate finance stakeholders in the Capital Markets Climate Initiative; international stakeholders, for example at UNFCCC, Major Economies Forum or Global Innovation Lab meetings.

Lessons Learned

However, in advance of any evaluation findings, given the Pilot is innovative and targeted on mobilising private investment (a shared global objective) it will be important that DECC share lessons and insights learnt from the management and monitoring of this Pilot – in DECC, DFID, and also external stakeholders (private investors) and international partners, donors and multilateral entities. The DECC Project Manager will be responsible for sharing lessons learned as part of broader ICF outreach and engagement. Furthermore, the GIB will be active in promoting investment success, as outlined in the communications and press requirements in the Logframe.

5.7 Risk management

Risks are managed in line with the standard DECC Risk Management Framework. Risks have been managed throughout the development of the Pilot, and are recorded on the DECC Standard Risk Register, which can be found at annex 7.16 The risk register is updated on a regular basis and is owned by the Project Manager(s) and Commercial Advisor. To ensure oversight and escalation of project level risks, the risk register is incorporated into the ICF Programme Management Tool and is also reviewed by the GIB Project Board. Project risks are also managed by GIB.

Table 3 in the strategic case sets out some of the **high level potential risks** associated with the project and what we are doing to mitigate them. All key mitigating actions listed on the Risk Register are incorporated in the Project Plan and resources assigned to complete these actions within the required timescales. Further detail on risk management can be found in the following documents:

- ICF Risk Appetite Statement (section **Error! Reference source not found..3**)
- Risk Potential Assessment (section **Error! Reference source not found..1**).

This project is using the ICF Board's risk appetite statement to guide the target and management of project risks. The full statement is set out in section **Error! Reference source not found..** In summary, the ICF has a:

- moderate / high appetite for both the risk that the expected benefits are not realised following the investment (i.e. investment risk) and the risk of loss when investing in a country caused by changes in a country's political structure or policies (i.e. political risk).
- a moderate appetite for the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events (i.e. operational risk).

- a low appetite for the risk of financial loss or exposure from poor financial management, fraud / corruption, and insufficient funding (i.e. financial risk); the risk of loss caused by claims, including litigation and regulatory action, or defective documents (i.e. legal / compliance risk); the risk of loss of confidence and trust from the UK Government (i.e. reputational risk); and the risk that information leads to inadequate decision-making or causes a breach of privacy (i.e. information risk).

This risk appetite has been shared with the GIB to inform the risk appetite of the international pilot. Given the risks and mitigation actions outlined above, the pilot is in line with the ICF's risk appetite.

6. Annexes

6.1 Accounting Officer Issues

Possible Accounting Officer issues and how they are being handled

Issue	Applicable business case section (give paragraph numbers)	Other sources of evidence and/or further plans to mitigate identified issues	Status, e.g. - Fully addressed - Plans in place to address - Not addressed
<i>Regularity & propriety*, including fraud & misuse of public funds</i>	<p>Section 5.5.4 - Assurance and Approvals</p> <p>Section 5.5.1 - Governance arrangements</p> <p>Section Error! Reference source not found. - Delivery approach</p> <p>Section 7.9 - Key short and long term milestones</p> <p>Section 5.3 – Financial risk</p>	<p>DECC Spending Team from HMT are represented on project steering group</p> <p>Draft IGEF Business Plan (section Error! Reference source not found.)</p> <p>Legal Note (section 7.6)</p> <p>Legal Note (section 7.6)</p> <p>Draft IGEF Business Plan (section Error! Reference source not found.)</p>	<p>- Plans in place for HMT approval as project is over DECC's delegated approval limit and would involve financial commitments beyond current spending review (i.e. 2015/16).</p> <p>- ICF, Departmental and project governance arrangements set out</p> <p>- Consideration of proposed delivery approach of international pilot by DECC and BIS legal as well as DECC and BIS State Aid teams, in terms of:</p> <ul style="list-style-type: none"> o the legal position for GIB to pursue the pilot under its existing Articles of Association (rather than following an amendment to their Articles), o the procurement position of a direct investment in IGEF vis-à-vis an open procurement o plans in place to check the State Aid position. <p>- Plans in place for Parliamentary handling through tabling a second Written Ministerial Statement</p> <p>- Plans in place to minimise the risk of financial loss / fraud associated with pilot investments.</p>
<i>Selection & appraisal of projects & good quality PPM techniques</i>	<p>Section 3.1 – Long list of options</p> <p>Section 5.5.4 – Assurance & Approvals</p>		<p>- Considered a wide range of options to achieve the project objectives from in-house delivery to establishing a wholly new UK climate finance delivery vehicle</p> <p>- MPA Project Validation Review and Gate 3 review conducted. Plans in place for Gate 4 and Gate 5 reviews at appropriate points during the pilot.</p>
<i>Financial affordability & sustainability</i>	<p>Section 3 – Economic Case</p> <p>Section 5 – Financial Case</p>		<p>- Plans in place as preferred option is a pilot so this avoids longer term commitments. However we still need to consider low cost exit strategy in the event the pilot is not successful.</p> <p>- Sufficient budget available for 2014/15 and 2015/16 from DECC's ICF allocation. Plans in place for HMT approval as project is over DECC's delegated approval limit and would involve financial commitments beyond current spending review (i.e. 2015/16).</p>

<p><i>Value for money</i></p>	<p>Section 3.5 – VfM Appraisal of Preferred Option</p> <p>Section Error! Reference source not found. – Maintaining commercial tension</p> <p>Section Error! Reference source not found. – Aligning incentives</p>		<ul style="list-style-type: none"> - Consider the value for money of preferred option assessed in terms of economy, efficiency and effectiveness (and compared this against other ICF investments where possible) - Considered how commercial tension can be maintained in the absence of open procurement - Plans in place to align incentives between GIBI and DECC to maximise value for money, however still working to finalise incentive structure. 									
<p><i>Management of opportunity & risk</i></p>	<p>Section 3.3.2 – High level risks</p> <p>Section 3.4.2 – Risk appraisal of shortlisted options</p> <p>Section Error! Reference source not found. – Potential for risk transfer</p> <p>Section 6.4 – Risk Mgmt</p>	<p>Project risk register (annex 7.16)</p> <p>Draft Business Plan (annex 7.4)</p>	<ul style="list-style-type: none"> - Top project risks identified and mitigating actions established. - Considered whether the preferred option is the right balance of risk and reward - Considered of opportunities for risk transfer from DECC to the GIB and the underlying investments - Risk appetites shared and compared for between DECC and the GIB which show a good alignment. 									
<p><i>Learning from experience</i></p>	<p>Section 2.1 – Purpose</p> <p>Section 6.7 – Lessons learnt from similar UK vehicles</p> <p>Section 6.1 – Stakeholder mgmt.</p> <p>Section 6.2 – Governance</p>	<p>Vivid Economics Study</p> <p>Vivid Economics Study</p> <p>Stakeholder Engagement Strategy and Comms Plan (section 7.14)</p>	<ul style="list-style-type: none"> - Considered how the project will help us to enhance the ICF's current business model in terms of the way in which we invest our climate finance. - Considered issues / criticisms of other UK aid delivery organisations to help identify risks and pitfalls. - Stakeholder management strategy in place and project steering group established to ensure relevant input from other parts of HMG into project design (e.g. BIS / ShEx, DfID) - Plans in place to use a similar governance structure to the GIB domestically for the project and rely on existing reporting channels where possible. 									
<p><i>Accurate financial information</i></p>	<p>Section Error! Reference source not found. – Plans for Managing Contracts</p> <p>Section 5 – Financial Case</p> <table border="1" data-bbox="350 1650 1587 1856"> <thead> <tr> <th>Frequency</th> <th>Report</th> <th>Description</th> </tr> </thead> <tbody> <tr> <td>Monthly</td> <td>Spend and returns profile Costs incurred P&L</td> <td>See table in financial case</td> </tr> <tr> <td>Monthly</td> <td>RAG rating for slippage</td> <td>Project by project risk of slippage for commitment / deployment into next calendar year</td> </tr> </tbody> </table>	Frequency	Report	Description	Monthly	Spend and returns profile Costs incurred P&L	See table in financial case	Monthly	RAG rating for slippage	Project by project risk of slippage for commitment / deployment into next calendar year		<ul style="list-style-type: none"> - Plans in place to manage performance and ensure good record-keeping - Plans in place to allow clear transparent accounting that shows how funds are used and reflow to DECC. - Plans in place for financial and performance reporting.
Frequency	Report	Description										
Monthly	Spend and returns profile Costs incurred P&L	See table in financial case										
Monthly	RAG rating for slippage	Project by project risk of slippage for commitment / deployment into next calendar year										

	Quarterly	Quarterly financial and performance report	See detail in financial case, also communications plan in annex 7.14.		
	Semi-annual for first year and thereafter as needed	Six Month Review	Mini-review that which identifies any key issues in the project. A shorter/simpler version of Annual Review which is published.		
	Semi- annual	Central ICF Results collection	Part of central results collection exercise across the ICF in March and September every year. It includes results against transformational change KPI and all results pass through a rigorous QA process. The intention is that results should be published annually.		
	Semi -Annual	Portfolio Valuation			
	Annual	Annual financial and performance report	Further detail in financial case. This includes a confirmation that the manager has complied with its obligations in terms of ESG standards and corruption, anti-money laundering and combating of financing terrorism policies		
	Annual	ODA Return	Detailed breakdown of individual investments (and administration costs) together with the appropriate classification codes for ODA. Qualitative description of arguments why investments are ODA-eligible		
	Annual	Annual Review	An in-depth review of the projects, based on established DFID best practice, which focuses in particular on how the project is performing against the project's theory of change and key performance indicators. The report is made publicly available.		

SRO statement on Accounting Officer Issues

As the SRO, I confirm that all Accounting Officer issues have been identified as far as reasonably practicable and that they have been fully addressed or plans are in place to address them consistent with the maturity of the programme/project.

Signature:

Date:

6.2 Options Appraisal

	Do nothing	Increase in-house resource	Strengthen partnerships	MDB Trust	Set up from scratch	Recruit a private fund manager	Extend the remit of an existing UK vehicle
Description	For the purposes of this analysis, the 'do nothing' option is our counterfactual. In this case we would continue to use our in house resource to pursue investments through multilaterals, pushing for increased private sector processes where possible (e.g. DPSP in CTF). There would be fairly limited capacity to take on any new, particularly innovative private finance, bilateral projects.	This option would involve recruiting up to 4 additional private sector advisors who would be based in the DECC ICF team. These advisors would draw on wider corporate services and specialist support. This would give us greater ability to develop and pursue more private sector focussed projects than we currently have the capacity or expertise to undertake.	This option would involve strengthening our partnerships with countries that have their own development finance institutions, such as Germany. KfW has been used as an illustrative example.	The Canadian government have a trust fund set up with the IFC whose objectives are to address market barriers that prevent the faster, more wide-spread or more long-term sustainable adoption of low carbon technologies and / or business models that address climate change. Their target sectors are RE, EE, forestry and sustainable agri-business, climate risk and adaptation. We could look to pursue something similar.	Setting up a vehicle from scratch would incur the highest political buy in, highest costs and longest time to implement.	We could recruit a private investor with commercial expertise and experience to ensure profitable investments; we would attempt to find an actor with low carbon and/or development expertise	This option would involve extending the remit of an existing institution that is deemed to have the institutional capacities to be able to invest climate finance on behalf of the ICF.
Objectives:							
1.Improved climate finance architecture by: a. Scaling up private finance b. Targeting gaps	Despite some notable strengths, the Vivid Economics report identified a number of gaps and weaknesses inherent in the international climate finance landscape, which reduce the overall effectiveness of UK climate finance. In the 'do nothing' scenario, this is particularly prevalent when it comes to mobilising private sector co-financing.	Private sector experts may be able to strengthen the overall ICF portfolio by developing more innovative programs , that are more focussed on scaling up private finance. However, this could be limited as it is likely that projects would still need to be implemented through MDBs.	The ICF already has a strong relationship with KfW and implement many projects with them (e.g. EERI, GET FIT). KfW's status as an institution that can deliver high quality climate finance is not in doubt. In 2013, 30% of KfW development bank's new projects were to renewable energy and energy efficiency. 28% of their climate mitigation projects were for energy efficiency (one of the key gaps found)**. This suggests that the DECC ICF team could leverage their existing relationship with KfW and use their strong institutional capacities to push them to focus even more on the gaps in the climate finance architecture.	Private leverage achieved through the fund is 1:1.9. However, the trust has mainly leveraged IFC's own balance sheet. A number of energy efficiency projects have been implemented by the fund and the IFC claim to have done some 'first of a kind', but on the whole, projects are large scale renewable infrastructure. 4/10 projects have been implemented in the middle east. The Trust Fund is covered by an Administration Arrangement which sets out what IFC can do in terms of financial instruments. IFC can deploy senior debt, guarantees and mezzanine debt as well as local currency lending. There is a cap on the amount of mezzanine finance that they can deploy. All of the investments to date have been senior loans with one	DECC would have complete control over the vehicle as there would be no existing institutional barriers to operate within, therefore the focus on increasing private finance and targeting the gaps could be easily mandated. That said, an institution with absolutely no track record may find it hard to partner with the private sector and do difficult/technical deals, particularly in developing countries.	A private fund manager would have the experience, expertise and 'fleetness of foot' (streamlined processes) to invest alongside private investors and would therefore likely mobilise private finance. It might be challenging to find a private investor already active in ICF priority countries in renewable energy and energy efficiency projects, or broader networks (in DFID or local administrations) as we have identified insufficient private investment as a gap. However, they might be able to recruit staff with the necessary expertise (i.e. of a development context). They would have the capability to deploy a range of financial instruments. Would be able to invest directly into projects. Uncertainty this could lead to a long-term delivery option for UK climate finance; DECC	Different institutions will have different capacities dependant on their existing mandate. It is unlikely that an existing institution is set up with the institutional capacities to address all of the gaps in the international climate finance landscape. However, there are a number of institutions, e.g. the Green Investment Bank (GIB), CDC and the Private Infrastructure Development Group (PIDG), who already have a strong private sector focus, whose mandate could be potentially extended and who have existing institutional capacities to target some of the gaps.

			KfW also express the importance of the private sector but and have their own impact fund 'DEG' to support this end.	guarantee. A limited amount of local currency has been used. It is not clear why a wider range of financial instruments haven't been used although it may be that low awareness initially about the fund and what it can do.		would have no control or influence over the future strategic direction of the firm.	
2. Secure stronger climate and development benefits	<p>The currently approved DECC ICF portfolio has an expected attributed cost per tonne range of £4 - £16, and a spend weighted average attributed cost per tonne of £6.4^[1].</p> <p>The range of expected total finance leveraged (i.e. public and private finance mobilised), based on the current DECC ICF portfolio is between £1:£0.2 and £1:£10. Based on the current portfolio of the projects that report on leverage, the ICF is expected to leverage at least £4 for every £1 of ICF funding from private and public resources. Only two of the ICF's investments report on expected jobs created.</p>	<p>There is a risk that we wouldn't be able to recruit private advisors who have the right level of skills or expertise on climate finance / ODA, undermining our ability to strengthen these objectives. However, with enhanced commercial expertise we might be able to deliver greater benefits for a lower cost.</p>	<p>In 2013, KfW development bank committed EUR1.53bn to climate mitigation projects. The expected carbon savings from this portfolio is 9.3mt Co2 per year (it is not clear how those carbon savings have been calculated and whether they have been correctly attributed). Of this portfolio, 28% of investments were made to Energy Efficiency projects.</p> <p>KfW have a strong delivery architecture with offices in a number of countries where there is no DFID presence.</p>	<p>In 2013, eight investments were committed for a total of \$53.6m. These programs expect to reduce annual GHG emissions by ~94,000 metric tons. As development finance institutions, MDBs are likely to have a good focus on achieving strong development results.</p>	<p>The institution would need to recruit personnel with relevant climate, development and banking expertise - perhaps previous experience in MDBs. This would be expensive.</p>	<p>Concern that profitability would take precedence over climate and development impacts. It would be difficult to design investment criteria and financial incentives that worked against this inherent profit maximisation of a purely-private organisation to deliver the kind of investments that lead to transformational change. A 'for profit' organisation would therefore be unlikely to 'plug the gaps' left by current commercial activity, i.e. market-leading / pioneer investments, or deliver on energy efficiency projects (commercially less attractive at present). They would inevitably pursue 'low hanging fruit' i.e. business as usual low-carbon investments that would not be additional and could crowd out other private sector actors. Concern that there might not be stringent social and environmental safeguards in place. Concern that a private entity would be willing or able to fulfil the detailed reporting requirements against ICF KPIs. Unlikely to be able to fulfil additionality requirements.</p>	<p>This would need to be assessed on a case by case basis and would depend on the institutions' current capacity to deliver strong climate and development benefits.</p>

^[1] To note: ICF project VFM indicators and expected results need to be considered in the context of each project and may have differing key objectives and non-monetised benefits. Therefore, they cannot be directly compared, figures included here to illustrate ICF portfolio context.

<p>3. Improve visibility of UK climate finance</p>	<p>Continued reliance on multilateral channels means that the UK would continue to receive limited visibility for its international climate finance spend.</p>	<p>Reliance on multilateral channels means that the UK would continue to receive limited visibility for its international climate finance spend.</p>	<p>There would be increased visibility for UK climate finance through a bilateral project with KfW than an investment into a multi-donor fund. However, as KfW will be developing deals and have people on the ground, it is likely that most of the visibility would accrue to Germany.</p> <p>The NAMA Facility has excelled as KfW (and GIZ) proactively market it (e.g. co-sponsoring side events at UNFCCC conferences, sending representatives to other workshops, etc) but the reason that the NAMA Facility is so visible may be down to its unique nature.</p>	<p>[REDACTED]</p>	<p>A dedicated vehicle to deliver climate finance, set up and wholly owned by HMG would deliver strong visibility for UK climate finance.</p> <p>With no brand / existing track record, reputation will take time to establish.</p>	<p>We would not be able to restrict the recruitment exercise to UK-only firms. However, we could ask that the Fund be branded in such a way that it was recognisable as UK finance. However, a private fund manager is not associated with public finance or the UK Government so even with branding this might not increase UK visibility significantly.</p>	<p>By using a UK institution that has a track record, reputation and existing network, the visibility of UK climate finance is likely to be improved, in particular if the institution is wholly owned by the UK government.</p>
<p>Critical Success Factors:</p>							
<p>VFM</p>	<p>This option would continue to be affordable in the short term as it within DECC's budget profile. The lifetime costs associated with all of our current investments are considered to be Value for Money. However, we don't have any evidence to assess whether in future we could achieve the same results with less concessional finance.</p>	<p>This option is likely to lead to better value for money as we could use commercial expertise to push for minimum levels of concessionality whilst improving our climate and development benefits.</p>	<p>The ERI program is being implemented with KfW, with funds on a parri passu basis. DECC's £29.7m in the revolving fund is expected to grow to £34m by the time it is returned in 2029.</p>	<p>Canada do not expect to get all of their money back from their investment into the fund.</p>	<p>This option will be very expensive and resource intensive to establish and there are likely to be significant "sunk costs". It is also likely that a new institution would need to establish duplicative systems and processes that are readily available elsewhere.</p>	<p>A competitive EU-wide tender process would ensure good vfm, however given concerns about the ability to meet our objectives (especially achieving transformational change) this would be decreased. An experienced fund manager would likely ensure a profitable portfolio with good returns for DECC. There would be establishment costs for the set-up of a new fund vehicle; DECC as investor would likely have to pay for parts of the costs.</p>	<p>This option is likely to be more efficient, as existing institutional processes and capacities can be built on.</p> <p>Extending the remit of a UK vehicle to operate in the international climate finance space would also increase competition, improving value for money.</p> <p>NAO reports for CDC and PIDG show that these institutions deliver good impacts and financial returns. GIB has had a good first two years of performance with over £1.4bn committed, once built investments are expected to generate a return of over 8%. GIB's direct and operating costs for 2013-14 were within budget at £20.7m. The strong focus on working with private investors has led to a</p>

reported leverage of 1:3.

<p>Strategic fit (with existing and future climate finance architecture e.g. GCF)</p>	<p>In the short term, the GCF's private sector focus looks limited (although it is still early days), therefore, a private sector focus through our bilateral work should be pursued.</p>	<p>Additional in-house commercial expertise may help us to push for ambitious private sector activity in the CIFs / GCF. However, as in the short term, the GCF's private sector focus looks limited, therefore, a private sector focus through our bilateral work should be pursued.</p>	<p>KfW's model is to partner with the host countries' state development bank*** therefore there could be limitations to the level of private leverage expected through a new dedicated program with KfW.</p>	<p>There is potential to fragment the climate finance architecture by creating another investment fund, very similar to Canada's.</p>	<p>This would need to be carefully considered in the context of the review of development finance institutions that is currently ongoing and led by DFID. Reports from the expert group have noted that tackling global goods (e.g. climate change) are particular and have to be considered as such.</p>	<p>This option is not certain to offer a long-term delivery vehicle. This would therefore mean that the climate finance architecture would not be fragmented, but nor would it be improved.</p>	<p>Extending the remit of an existing private-sector oriented delivery vehicle is unlikely to fragment the existing climate finance architecture and where wholly or partly-owned by UK government, we will have more ability to ensure that their activities are in line with existing and future international climate finance architecture.</p>
<p>Potential achievability: - Ability to influence - Absorptive capacity</p>	<p>Most of our existing investments are through large multi-donor trust funds (e.g. the Climate Investment Funds) e.g. 46% of our current spend is to the Clean Technology Fund (CTF). As a large contributor to the fund (with ~27% burden share) and very active donor in the committee, we have reasonable influence over the fund. There are however limitations with using MDBs to develop pipeline as evidence has suggested that our 'transformational' ambition is not always central to their investments.</p> <p>Over programming decisions have been taken in the CTF (30%) but the pipeline has not slipped in line with these expectations, therefore there is considerable absorptive capacity. In addition, 14 new countries have received finance to develop investment plans in SREP. Therefore there is an investment gap of around \$600,000m. Although SREP countries are not wholly aligned with DECC ICF's strategic focus.</p>	<p>KfW's model of originating projects through countries own development banks indicates that most opportunities will be driven by the public sector. This could limit the absorptive capacity and influence over the types of projects pursued (e.g. projects with a strong private sector focus).</p> <p>However, experience for the ERI program has shown that without DECC and DFID's money, the program could not go ahead, therefore HMG have had strong influence on program design.</p>	<p>Initially disbursement was very slow. However the pipeline is more healthy now and lots more funding was approved in 2012 and 2013.</p>	<p>This is the least achievable option given the cost, time to implement and political will required.</p> <p>However, once up and running, DECC would have absolute ability to influence.</p> <p>Absorptive capacity is likely to take time to ramp up as the new institution develops a track record and identifies pipeline.</p>	<p>DECC would not be able to influence or control the strategic direction or institutional objectives of the private firm.</p> <p>Absorptive capacity would depend on the winning bidder; though commercial entities likely to be able to ramp up and realign the business model relatively quickly.</p>	<p>Influencing existing institutions, especially institutions that are not wholly owned by DECC or even HMG is difficult and requires the buy in from the Shareholders and institution itself.</p> <p>However, there are two vehicles GIB and CDC that are wholly owned by HMG, and therefore with ability to influence.</p> <p>If these activities are new to the delivery vehicle then the absorptive capacity is unlikely to be very strong from the outset. However, with networks and existing commercial expertise, deal origination and absorptive capacity should be possible in the medium term (6-12 months).</p>	

<p>Risk profile</p>	<p>Continuing to "do nothing" means that we are less able to diversify risks across our ICF low carbon development portfolio. There is also a risk that we continue to support medium-risk-return projects that do not offer the transformational potential that we are seeking from our portfolio. Through some of our existing investments we have experienced delivery partners whose appetite for impact risk is not aligned with ours.</p> <p>There is also a risk that if we pursue new bilateral projects, without the commercial expertise required to perform the appropriate scrutiny and due diligence on them, then we may be at risk of not securing best value for money, or leaving our Accounting Officer open to risks</p>	<p>Additional in-house commercial expertise may help us to improve value for money, however, as in this scenario, we will still largely rely on the MDBs for pipeline, there is a risk that we will not be able to pursue many more innovative, transformational projects.</p> <p>There is also a risk that DECC's offer will not be sufficient to attract private sector advisors with the correct skills or expertise, undermining our ability to deliver new projects.</p> <p>In addition, more projects will stretch our program management systems, potentially weakening overall program management oversight. We would likely have to increase our legal and financial resources to maintain high quality of business case development, decision making and ensure robust legal and financial arrangements are in place for new projects.</p>	<p>KfW have a strong presence on the ground and established networks in developing countries, reducing country and counterparty risk.</p> <p>Channelling increasing amounts of ICF through the same delivery partner does not enable us to diversify our risk profile (in terms of implementing entity).</p> <p>KfW haven't always shown through our previous operations with them that they have an appetite to take on the type of risks necessary to deliver transformational change.</p> <p>DECC's investment with KfW would need to be managed by the ICF's limited portfolio management systems.</p>	<p>Regarding transformational change, Canada said that not every investment is ground breaking although IFC do try to sell the innovative nature of projects where they can. It's not clear yet to what degree projects will be replicated without donor finance as a result.</p> <p>Key weaknesses:</p> <ul style="list-style-type: none"> - The extent to which the investments were innovative / transformational in terms of the types of financial instruments used and the types of investments supported; - The returns that Canada expected to get on the funds; - The greater challenge in getting visibility as it is not a Canadian institution 	<p>There would be significant "sunk costs" and the institution would be unproven and therefore not immediately effective from the outset.</p>	<p>Potential reputational risk for DECC given lack of control or influence over processes or activities, or the focus of investments beyond the ICF funds (e.g. if an energy investor also invested in high carbon energy). Reputational and financial risks include: risk to reputation for delivering high quality ODA, risk to reputation as world-leaders on climate change mitigation, risk to reputation due to excessive salaries or bonuses, risk that environmental or social standards poor; inadequate control would make it difficult to ensure against corruption.</p>	<p>There is a risk that by diversifying the activities of an existing institution to deliver this project's objectives, it will be distracted and less able to deliver it's existing mandate.</p> <p>However, it would be possible to set up an existing vehicle in a way that the risk appetite would be aligned with the ICF's.</p>
<p>Potential cost</p>	<p>In early 2014, it was estimated that the admin budget to run the DECC ICF team was around £1m per year.</p> <p>On top of this are the costs that we pay to our delivery partners to invest ICF on our behalf. For example, our investment to the CIFs is layered with additional costs.</p> <p>In addition to this, MDBs charge a flat fee for project implementation and additional costs to support country programming. For the CTF projects that have been</p>	<p>In addition to the costs outlined in the 'do nothing' scenario (see left), it is anticipated that the cost for this option over two years would be approximately £750,000. This includes 4 private sector advisors (G6 salary, pay enhancement, and pension) for 2 years (£74,000 per annum per person) as well as staff overheads (£20,000 per annum per person) for central corporate functions (i.e. accommodation, IT, Finance, HR, Internal Audit, Knowledge Management, L&D, procurement). This cost does not include</p>	<p>The cost being charged to DECC and DFID for implementing the ERI program is £1.77m (total investment of £36.8m).</p> <p>The anticipated cost for the implementation of a \$900m Geothermal proposal from KfW is EUR 8m.</p>	<p>In terms of administrative fees, these are a flat % of the overall amount. Apparently this is CAN\$ 17m of the \$300m that the fund has to invest over the lifetime of the fund. This works out at around \$680,000 per year. However all the actual investments have to be done by the end of next year so the Commitment period is over 5 years. However it's likely that this administrative cost will go up, given the World Bank is trying to follow a full cost recovery approach on Trust Funds now. The IFC have a</p>	<p>This option is likely to be expensive and resource intensive to establish. There is no budget available for this option at present and a specific budget would have to be identified and secured to make this option feasible.</p> <p>McKinsey estimated that the set up costs associated with the UK Green Investment Bank were £11m.</p>	<p>We would likely pay higher rates for financial services; which would likely include individual carry arrangements in addition to the management fee and profit share for the institution.</p>	<p>CDC have recently established a direct equity team with 14 direct staff plus a further 4 support staff at a total cost, including allocated overhead, of £3m a year which it expects will provide it with the capacity to make 5-7 direct deals a year as a co-investor.</p> <p>This is broadly comparable to the size and number of investments that we would expect to be delivered through this project.</p>

	<p>approved so far (funding decision of \$3.3bn), this stands at \$16m.</p>	<p>additional legal or economist resource which would increase the cost by another £100,000 - £140,000.</p>		<p>blended finance team of three or four people although it wasn't clear how much time it took for them to manage the Canadian funding as opposed to other climate finance donor funds.</p> <p>In terms of staff resources to manage the Fund, one staff member estimates that she spends about 10% of her time on this although she does engage others (Environment colleagues, etc) when necessary.</p>			
<p>Supply side capacity:</p> <p>- Appropriate expertise (inc. for ODA eligible investments)</p> <p>- For long-term pipeline management</p>	<p>No change. One of the key drivers to implement this project is the lack of commercial and private sector expertise in the ICF team.</p> <p>The level of organisational churn also causes difficulties for long term pipeline management.</p>	<p>This option would improve our capacity to appraise and deliver more commercial, private-sector focussed projects. These experts could also ensure improved management of the current private sector project portfolio. However, it is likely that the majority of these projects would still be routed through the MDBs and it is not clear whether DECC's offer will be enough to attract the type of commercial expertise required.</p> <p>In addition, the posts won't have access to wider private sector systems and processes for investment appraisal and due diligence.</p>	<p>KfW have a credible and strong history of making ODA eligible investments and clearly have the appropriate expertise to do this. KfW also have strong technical capability to deliver low carbon investments.</p> <p>On an ongoing basis, it is unlikely that there would be much appetite to give KfW a mandate to look after the ICF's new and existing investments on an ongoing basis.</p>	<p>One key advantage would be that funds could be scored as ODA as soon as they are committed. MDBs already have on the ground presence for project origination.</p> <p>It would not be possible to ask the MDB to manage all of DECC ICF's private sector portfolio.</p>	<p>The delivery vehicle could be set up in such a way that ICF funds could be transferred to the vehicle to invest and manage itself. This would significantly reduce transaction costs for the ICF team while delivering similar levels of climate and development benefits to the pilot. In addition, the delivery vehicle would be able to recycle any interest / returns which could be used to secure greater benefits.</p> <p>There would be significant potential to establish a high quality ODA institution that would be able to deploy climate finance effectively. Systems and processes could be designed so they were 'fit for purpose' from the start and staff could be recruited on the basis of relevant expertise. This is likely to lead to good quality projects and investments.</p>	<p>Would have appropriate commercial expertise. Unlikely to have experience investing ODA. Could not hand over management of ICF existing portfolio to an investment firm.</p>	<p>In this instance we could leverage the in house expertise of the institution, including commercial, risk and PM. Their expertise would also enable decisions about exiting investments to be made.</p> <p>Where wholly owned by HMG there may also be some appetite to manage DECC's existing ICF investments.</p>

Alignment with regulatory agenda	No change	No change	No change	No change	It is likely that parliamentary approval and therefore a legislative process would be required to set up this institution from scratch.	No change	It depends on the organisation's existing legislative permissions. A regulatory amendment could take up to 12 months to implement.
Timing	No change	This would require the recruitment of a number of private sector experts. Once recruited, developing and securing approval to private sector projects through the ICF governance process takes at least 18 months. This will impact when results can actually be delivered	ICF governance processes take at least 18 months to go through.	ICF governance processes indicate that this would take around 18 months to set up and get agreement to	Establishing a new delivery vehicle would also be complex with greater uncertainties impacting on the timeline. As a result, the delivery vehicle is unlikely to begin identifying and investing in projects for at least 2 years.	A private firm would be able to recruit the necessary staff quickly so the pilot could begin within 6 months	Extending the remit of an existing vehicle could take between 6-12 months.
Summary/Score							

*https://www.climateinvestmentfunds.org/cif/sites/climateinvestmentfunds.org/files/FY15_business_plan_and_budget...pdf

**<https://www.kfw-entwicklungsbank.de/PDF/Entwicklungsfinanzierung/Umwelt-und-Klima/Zahlen-Daten-Studien/KfW-Klimafinanzierung-in-Zahlen/Commitments-for-Environment-and-Climate-2013.pdf>

6.3 GIB's Existing Investment Processes

Green Investment Bank

MAXIMISING GREEN IMPACT...

Our investment strategy targets maximum 'green impact'. To achieve that we have committed to market leading green assessment, monitoring and reporting practices..

We define 'green impact' through five measures – our 'green purposes'

	Reduce greenhouse gas emissions 	Increase natural resource efficiency 	Protect the natural environment 	Enhance biodiversity 	Promote environmental sustainability 
EXAMPLE	Investing in offshore wind to replace fossil fuel power generation	Replacing old street lighting with energy efficient LEDs	Diverting waste from landfill through recycling and energy from waste plants	Developing sustainable biomass procurement	Create a positive demonstration effect in the market that mobilises others
MEASURE	<ul style="list-style-type: none"> CO₂e avoided Renewable electricity generated 	<ul style="list-style-type: none"> Materials consumption avoided Energy demand reduced 	<ul style="list-style-type: none"> Waste to landfill avoided 		<ul style="list-style-type: none"> Capital mobilised

We ensure 'green impact' throughout the project lifecycle:



We are committed to continuous improvement and open engagement

Adoption of best practice: Equator Principles & United Nations Principles for Responsible Investment.

6.4 GIB Business Plan

(see attached separately)

6.5 Project Evaluation Terms of Reference (ToR)

International Green Energy Facility (IGEF): Draft Evaluation Terms of Reference

1. Introduction

The International Climate Fund (ICF) was established in recognition that developing countries will need support (technical and financial) to adopt low carbon development pathways in line with the 2 degree goal. Thus, the ICF has a number of strategic objectives to achieve with the £3.87bn of Official Development Assistance (ODA) that it has been allocated to spend on climate related projects in developing countries from 2010 – 2015⁴⁴. These include, scaling up private finance and improving the climate finance architecture, by targeting the ‘gap’.

The UK Green Investment Bank (GIB) has a very successful track record of mobilising private investment into the UK’s green infrastructure and economy. In [insert approval date], DECC agreed to a £200m pilot project with GIB to test whether their commercial and green discipline could benefit the deployment of climate finance to mitigation projects in a selection of developing countries.

2. Impact and objectives

The pilot aims to deliver the following objectives:

- a) Increase the ICF team’s ability to identify and deliver projects that scale up private climate finance flows to low carbon development and address the particular gaps in the international climate finance architecture through the pilot scheme;
- b) Achieve better Value for Money through the pilot scheme by enhancing climate and development benefits while using less administrative and financial resource compared to the rest of the ICF low carbon development portfolio; and
- c) Increase the visibility of UK climate finance compared to the rest of the ICF low carbon development portfolio.

It is expected that these will be achieved through the outputs and outcomes, shown in the pilot’s theory of change.

3. Purpose of the Evaluation

Given the pilot nature of this project, evaluation is crucial for learning, accountability, course correction and to assess success. There will be two evaluations: a formative evaluation to be completed after the pilot phase (evaluating outputs and management/governance) and an impact evaluation at least 5 years after the project inception.

The formative evaluation will be conducted by August 2018, after the pilot implementation. It will assess the pilot and will be used as evidence to assess whether DECC should provide additional funds to or extend the legislative remit of GIB so that they can take on a longer term role investing international climate finance.

⁴⁴ Of this allocation, DECC have £1.329bn, the resultant amount is shared between DFID and DEFRA.

The impact evaluation will be conducted at least 5 years after the project inception, and will be used to inform the UK's approach to climate finance (as well as any continuing role for the GIB, if relevant).

4. Recipient

The evaluations will be commissioned by the DECC ICF team. Direct users of the evaluations findings will be GIB and UK government including DECC, DFID, FCO, BIS and Treasury. The evaluation will also generate learning that can be applied more widely to the international climate finance landscape.

5. Overall Evaluation Approach

This Terms of Reference sets out the scope of work, requirements and reporting procedures for the supplier that will be contracted to carry out the mid and full evaluations of the IGEF. The evaluation approach should be guided by the Development Assistance Committee (DAC) Quality Standards for Development Evaluation which DECC adheres to.

The evaluation will have a focus on learning and will enable HMG to assess whether the pilot can be classed as good development finance and has delivered against the pilot's objectives.

6. Objectives

The evaluations will be designed to assess if (and why/why not):

- The agreement and the investment mandate are being followed, are still aligned with the project's objectives and have resulted in any unintended impacts, both positive and negative;
- The strengths, limitations and constraints of the team that has been established in GIB to run the pilot and how this affects delivery including if any changes would be beneficial for scaling up the pilot;
- Assess and attribute results (as far as possible), capturing factors independent of the project that may impact the results;
- The incentive framework is ensuring that GIB is investing in line with the Theory of Change, including whether elements of the framework have led to perverse incentives;
- The pilot has the potential to achieve transformational change;
- Appropriate mitigating actions are in place and have been put into action to manage risk⁴⁵;
- There are any external factors that are impacting GIB's ability to deliver outputs, what these are and how they are impacting GIB. The evaluation should unpick the theory of change by analysing whether / how /and why / why haven't achieved outputs led to expected outcomes and impacts;
- The pilot is delivering value for money including whether funds are being used economically, efficiently and effectively to deliver the intended benefits in terms of the

⁴⁵ Including risks to the delivery of GIB's UK objectives

expected climate and development benefits and anticipated financial costs / reflows to the UK.

- The pilot has impacted on gender inequality.

The Logical Framework and Theory of Change will be used as reference points to guide the evaluations. The formative evaluation will focus on outputs and governance / management and the impact evaluation will focus on outcomes and impacts.

7. Governance of the Evaluation

The DECC Project Manager will oversee the evaluation. However the Supplier will report directly to the Deputy Project Manager who will manage day-to-day issues, emerging findings, contracts and the Terms of Reference. The DECC evaluation adviser will provide support as necessary.

A Reference Group will also be established during the inception phase. This will draw on membership from the project Steering Group and will consist of key stakeholders including DECC, BIS, DFID, FCO and Treasury, as well as representatives from GIB. The Reference Group will also include the DECC evaluation adviser who will provide advice on the robustness of the on-going approach and methods being used. The Reference Group will meet regularly throughout the evaluation.

Peer review and quality assurance will be provided by the DECC evaluation adviser, support from an impact development evaluation specialist, and SEQAS. At a minimum, the following outputs will be subject to peer review:

- This Terms of reference
- Inception report, including detailed approach and methodology to be used for the evaluation
- Interim and final evaluation report.

8. Scope of the Evaluation

In terms of scope, the work will include:

- Evaluation design (Formative and Impact evaluations).
- Evaluation (reporting for Formative Evaluation at end of Pilot 3 years, baselining for the Impact Evaluation during Pilot with reporting at least after 5 years of project implementation)

As part of the evaluation design, we would expect the Contractor to appraise the robustness of the current baselines in the project log-frame and assess whether further data collection is required to improve these.

It is anticipated that the evaluation will assess case studies in a sample (if not all) of GIB's locations and types of financial intervention. The contractor will use monitoring and reporting information provided by GIB to support interviews and fieldwork.

9. Constraints and challenges

- The pilot is time limited, therefore a strong project management discipline will be required to deliver outputs on time;

- Investment must be in line with the International Development Act 2002 legislation and Official Development Assistance (ODA) rules;
- Given the nature of the investments that GIB is likely to make, it may not be possible to assess actual results from realised projects on the ground within the pilot length;
- Given the wide geographical scope, the counterfactual for some of the expected outcomes and impacts may be challenging to clearly determine.

10. Evaluation Questions (to be developed in-depth by project team and M and E lead)

The broad analytical framework for the evaluation is outlined below. It follows the structure of the Organisation of Economic Co-operation (OECD) Development Assistance Committee (DAC) “Principles for Evaluation of Development Assistance”.

During the inception phase, based on stakeholder feedback, this list may be modified.

As part of the tender, bidders will be expected to give an indication of the methodologies that they will employ to answer each of the questions. This should form part of the proposed overall evaluation approach.

To note, only limited results will be available for the Formative Evaluation (focusing on outputs and governance/management of the Pilot) and a later Impact Evaluation will attribute impacts to GIB.

IMPACT

The positive and negative changes produced by a development intervention, directly or indirectly, intended or unintended. This involves the main impacts and effects resulting from the activity on the local social, economic, environmental and other development indicators. The examination should be concerned with both intended and unintended results and must also include the positive and negative impact of external factors, such as changes in terms of trade and financial conditions. When evaluating the impact of a programme or a project, it is useful to consider the following questions:

- What has happened as a result of the pilot?
- What real difference has the activity made to the beneficiaries?
- How many people have been affected?
- Does it appear that these results will eventually have a transformational impact?
- Have the projects achieved greater visibility for UK climate finance? What method will be used to assess this and how will the counterfactual be measured?
- Has the pilot addressed the gaps in the international climate finance architecture that the research suggested it could potentially target?
- Do the achieved outputs lead to expected outcomes and impacts as outlined in the theory of change and how, why / why not? Is this to do with project design or GIB’s delivery capability?
- Has the pilot impacted on gender inequality?

RELEVANCE

The extent to which the aid activity is suited to the priorities and policies of the target group, recipient and donor. In evaluating the relevance of a programme or a project, it is useful to consider the following questions:

- To what extent are the objectives of the pilot still valid?

- Are the activities and outputs of the pilot consistent with the overall goal and the attainment of its objectives?
- Are the activities and outputs of the pilot consistent with the intended impacts and effects?
- Is the investment mandate and incentive structure fit for purpose and delivering the objectives of the program?
- Is GIB delivering against their double bottom line of both green and commercial returns?

EFFECTIVENESS

A measure of the extent to which an aid activity attains its objectives. In evaluating the effectiveness of a programme or a project, it is useful to consider the following questions:

- To what extent were the objectives achieved / are likely to be achieved?
- What were the major factors influencing the achievement or non-achievement of the objectives?
- Are there any unintended consequences, both positive and negative, from project design?
- Does the incentive framework encourage behavior that will ensure the project's objectives are met?
- Are strong climate and development benefits expected to be achieved from the pilot?

EFFICIENCY

Efficiency measures the outputs -- qualitative and quantitative -- in relation to the inputs. It is an economic term which signifies that the aid uses the least costly resources possible in order to achieve the desired results. This generally requires comparing alternative approaches to achieving the same outputs, to see whether the most efficient process has been adopted. When evaluating the efficiency of a programme or a project, it is useful to consider the following questions:

- Were activities cost-efficient in terms of delivering the desired results?
- Were outputs and outcomes achieved on time?
- Was the pilot implemented in the most efficient way compared to alternatives? The alternative options from the business case appraisal should be used to guide this analysis.
- Are the financial tools that have been deployed additional?
- Have there been any significant, costly delays? Could these have been avoided by any realistic alternatives?

SUSTAINABILITY

Sustainability is concerned with measuring whether the benefits of an activity are likely to continue after donor funding has been withdrawn. Projects need to be environmentally as well as financially sustainable. When evaluating the sustainability of a programme or a project, it is useful to consider the following questions:

- Is there evidence to suggest that the benefits of the pilot will continue after donor funding ceases?
- What were the major factors which influenced the achievement or non-achievement of sustainability of the pilot?

- Have investments demonstrated commercial viability of investments in low carbon development in target countries? Are business models replicable?
- Has GIB's international credibility been enhanced?
- Will the jobs created, skills and capacities built through the pilot be sustained?
- Is environmental and social best-practice being upheld by GIB?
- Is the pilot conducive to the attainment of GIB's UK activities?

11. Recommendations

The evaluation reports should contain a set of relevant recommendations. These need to explain clearly what needs to be done, where, when and by whom.

The rationale and evidence for each of the recommendations should be presented clearly. Recommendations should be ranked in priority order. Recommendations will provide answers to the following:

Should we scale up the pilot? If so, what amendments to the structure and design should be made? Including:

1. What can be done to maximise the intended outcomes and impacts from the pilot?
2. What further steps can be taken to improve project implementation and value for money?
3. Can any action be taken to correct perverse incentives / negative unintended impacts (if the evaluation finds any)?
4. What further steps can be taken to maximise learning from the pilot?
5. Is there any action that we should (and can) take to influence external factors which would limit the success of future ICF funding to GIB?
6. If DECC's strategic objectives have changed by 2018, how should the pilot be amended?
7. What can be done to reduce gender inequality through this intervention?

12. Evaluation Methodology

[NB this methodology focuses on the Formative Evaluation. The method for the Impact Evaluation will be determined at a later date]

The short time frame available for the formative evaluation means that findings will mainly be determined through existing literature, data that has already been captured, interviews and observation. The analytical approach to the literature review and data capture should be robust. The impact evaluation will conduct more in depth research on the impact of individual investments.

A combination of both qualitative and quantitative methodologies should be used including an analytical approach that can assess the pilot against a robust counterfactual.

Bids should propose well-articulated and rigorous methodologies, including a formal evaluation framework, structured to provide reliable answers to all of the questions. The methodology proposed should use established, objective research methods e.g. semi-structured interviews following an agreed guide, conducted by qualified social research interviewers.

The proposed methodology should show how evidence will be triangulated to ensure that assessments are credible and the recommendations are grounded in evidence.

The proposed methodology should ensure that perspectives/views are not biased by gender. e.g. ensure survey methods don't only talk to 1 individual per household.

At a minimum, it is expected that the evaluation will comprise of:

- A desk review of strategic documents including the business case, Heads of Terms, Investment Mandate and policy/procedural documents;
- Interviews with in-country beneficiaries, the project team, GIB senior management and government stakeholders;
- A detailed evaluation of investments made and financial tools employed by the pilot and their success at leveraging private finance;
- A review of resource use within GIB - is this in line with expectations, or has it encroached on core UK activities?
- An analysis of press monitoring to assess whether the pilot is getting UK visibility and in what context: as a commercial investor or distributor of ODA.

Interviews can be iterative but the rationale for which stakeholders to talk to and the questions to ask should be very clear.

13. Existing Information

DECC will collect information for program management purposes from GIB. On a quarterly basis GIB will provide an assessment of the pilot pipeline, actual investments made, ICF KPIs achieved against target and background narrative on investments.

GIB will also collect press data and an investor attitude survey.

A project logical framework (based on the Theory of Change) will be provided that will detail baselines and expected milestones.

14. Deliverables and timeframe

The timing of the evaluation will be critical, as the purpose of the evaluation is to provide feedback to enable course corrections, as well as inform a subsequent decision about whether to scale up the pilot if there is clear evidence that it has been a success.

A rough expectation of deliverables has been included below but counter proposals in bids will be considered.

[To note, this timeframe focuses on the Formative Evaluation. The deliverables and timeframe for the Impact Evaluation will be determined at a later date]

Milestone activities	Date	Who
Legal agreement between DECC and GIB signed	March 15	DECC & GIB
Agree ToRs for Evaluation	July 15	DECC/HMG Steering Group (SG) & GIB, SEQAS, DECC M and E advisor
Tender for evaluation (OJEU process)	July 15 – October 15	DECC
Appoint contractor	November 15	DECC

Inception report presented	March 16	Contractor to RG
Inception report agreed	May 16	DECC, SG, SEQAS
Baselining for Impact Evaluation	tbc	Contractor
Data collection	June 16 – March 18	Contractor
Preliminary results presentation	March 18	Contractor
Draft evaluation presented	April 18	Contractor to SG, SEQAS consulted
Formative Evaluation report finalised	August 18	DECC
Impact Evaluation report finalised	Tbd 2020 or later	DECC

The deliverables will be subject to quality assurance by the reference group and SEQAS and are expected to meet DAC quality standards for evaluation.

a) Inception report

The evaluation inception phase is expected to run for the first three months of the evaluation contract. During this phase, the contractor will work closely with DECC and the reference group. The inception report will contain an agreed:

- Set of evaluation questions and methodology
- Monitoring and evaluation framework, including how the evaluation will build on existing data sources
- Assessment of the probable credibility of identified data sets
- A detailed proposal for primary data collection
- A review of the main risks and challenges for the evaluation and how these will be managed
- Discussion on how ethical standards will be applied
- Plan for managing any conflicts of interest
- Detailed work-plan.

This should be presented in draft form, taking on board feedback from stakeholders and QA.

b) Summative evaluation report

The summative evaluation report should contain:

- A detailed analysis of findings
- Recommendations for scale-up

This should be presented in draft form, taking on board feedback from stakeholders and QA.

c) Raw data

All raw data collected as part of the evaluation should be provided, aggregated and anonymised where appropriate.

d) Presentations to the reference group

At least three presentations will be made to the reference group; these will be presentations of the draft inception and final report.

15. Abilities and expertise to deliver this evaluation

The supplier should have the following minimum competencies between team members:

- Strong experience of and knowledge in public and private sector climate-related development programs;
- Deep understanding of the international climate finance landscape and ability to think strategically;
- Commercial experience, understanding of market failures and tools used to correct these;
- Demonstrable experience in leading, designing and conducting real time evaluations, employing quantitative and qualitative data collection methods, beneficiary monitoring, desk reviews, interviews and fieldwork;
- Strong research and analytical skills, including qualified social research interviewers and analysts with the ability to triangulate complex qualitative and quantitative data;
- Proven track record in conducting cost-effective and VfM evaluations, delivered on time;
- Excellent stakeholder management, negotiation, communication and drafting skills;
- Experience of logical frameworks and theories of change;
- Demonstrable ability to communicate findings and disseminate lessons learned to a wider audience.

A designated team leader should co-ordinate and monitor operational performance and continually report to DECC as required.

DECC will accept proposals from consortiums.

16. Logistics and duty of care

Logistics and procedures

1.1 The Supplier will be responsible for their logistical arrangements including in-country transport, office space, translation and other logistical support. The Supplier will also be required to cover the duty of care (see below for more details) for all members of the evaluation team. All relevant expenses should be covered by the evaluation contract budget.

1.2 The Supplier will be provided with the information detailed under 'existing information sources'. DECC will facilitate contacts for the Supplier with other stakeholders and provide support where appropriate.

11. Duty of Care (DoC)

1.3 The Supplier is responsible for the safety and well-being of their Personnel and Third Parties affected by their activities under this Contract, including appropriate security

arrangements. They will also be responsible for the provision of suitable security arrangements for their domestic and business property.

- DECC will share available information with the Supplier on security status and developments in-country where appropriate. DECC will provide the following:
- A copy of the DECC visitor notes (and a further copy each time these are updated), which the Supplier may use to brief their Personnel on arrival.

1.4 The Supplier is responsible for ensuring appropriate safety and security briefings for all of their Personnel working under this Contract and ensuring that their Personnel register and receive briefing as outlined above. Travel advice is also available on the FCO website and the Supplier must ensure they (and their Personnel) are up to date with the latest position.

1.5 Tenderers must develop their Tender on the basis of being fully responsible for Duty of Care in line with the details provided above. They must confirm in their Tender that:

- They fully accept responsibility for Security and Duty of Care.
- They understand the potential risks and have the knowledge and experience to develop an effective risk plan.
- They have the capability to manage their Duty of Care responsibilities throughout the life of the contract.

1.6 Acceptance of responsibility must be supported with evidence of capability (no more than 2) A4 pages and DECC reserves the right to clarify any aspect of this evidence. In providing evidence, Bidders should consider the following questions:

- a) Have you completed an initial assessment of potential risks that demonstrates your knowledge and understanding, and are you satisfied that you understand the risk management implications (not solely relying on information provided by DECC)?
- b) Have you prepared an outline plan that you consider appropriate to manage these risks at this stage (or will you do so if you are awarded the contract) and are you confident/comfortable that you can implement this effectively?
- c) Have you ensured or will you ensure that your staff are appropriately trained (including specialist training where required) before they are deployed and will you ensure that on-going training is provided where necessary?
- d) Have you an appropriate mechanism in place to monitor risk on a live / on-going basis (or will you put one in place if you are awarded the contract)?
- e) Have you ensured or will you ensure that your staff are provided with and have access to suitable equipment and will you ensure that this is reviewed and provided on an on-going basis?
- f) Have you appropriate systems in place to manage an emergency / incident if one arises?

1.7 Further information on Duty of Care is provided in the Supplier Instructions

17. Reporting and contracting arrangements

This contract will be advertised following the OJEU procurement procedures and will last for a maximum of three years.

The DECC project lead and the evaluation team leader will establish regular meetings to monitor progress, performance and respond to issues arising. Milestone payments will be

made upon receipt of the final inception reports and the final evaluation reports at each of the stages.

18. Budget

Credit will be given to bids that demonstrate how they will deliver exceptional value for money for the UK tax payer.

19. Annex

The Logical Framework and Theory of Change will be annexed to the ToR

6.7 Lessons learnt from similar UK vehicles

This section captures relevant findings from NAO reviews of two DFID funded vehicles – the Private Infrastructure Development Group Trust and CDC Capital Partners PLC:

- *Overestimation of the rate at which pipeline of proposed deals are converted into actual investments by Actis* – We will only transfer funds to the Green Investment Bank for quarterly invoices in arrears and for any investments following a minimum of 5 days' notice period. If investments take longer to close than anticipated, this risk is at least in part mitigated as any funds will sit in a DECC GBS account which is part of the HMG Exchequer pyramid so the UK taxpayer continues to benefit from these monies until there is an overseas/ODA transaction flow.
- *No policies or incentives to drive the efficient use of cash in CDC so that it did not hold large cash balances* – Any cash repayments will be paid into a DECC GBS account which is part of the HMG pyramid so the UK continues to earn interest. We will give the GIB [up to 1 year] to reinvest any reflows / returns, otherwise these reflows / returns will be reprogrammed elsewhere.
- *Insufficient staffing in DfID led to lapses in HMG governance oversight* – The project team for the international pilot comprises of 1.5 FTE in set up and 0.8 FTE through implementation. There will also be additional support from the Shareholder Executive who play an existing oversight role of the Green Investment Bank.
- *Insufficient scrutiny of reporting from investments to enable aggregated, validated information at a portfolio level* – The Green Investment Bank has established processes and systems in place for reporting against their “green purposes”. This reporting is quality assured by Deloitte. The GIB will report on the performance of each of their individual project investments so aggregated, validated information can be reported at portfolio level. This approach will be replicated for ICF reporting.
- *Inability to demonstrate development impact of investments* – The GIB already requires reporting from their investments and includes covenants to this effect within legal agreements (covenants) with investee companies. The GIB will incorporate requirements for reporting on ICF KPIs under the international pilot.
- *No systematic evidence about the extent to which investments mobilise additional investment in recipient countries* – As part of the logical framework for the international pilot, we have included indicators to assess to what extent the ICF is being catalytic in mobilising additional investment.
- *Remuneration arrangements led to extraordinary levels of pay* – The salaries for the GIB project team have been benchmarked against other GIB salaries and compared against a recent market assessment of remuneration within the sector commissioned by DECC. The performance fee for the pilot has been benchmarked against similar ICF investments; as well as some wider market analysis by the Asian Development Bank using Prequin data, and a separate assessment by SJ Berwin.
- *Incentive structure and business model has limited range of financial instruments deployed beyond equity* – The GIB has a good track record in place already in terms of being able to deploy a wider range of financial instruments. In addition, one of the success criteria against which the pilot will be assessed is the extent to which it has been able to deploy a range of financial instruments.
- *Lack of evidence to support size of allocation to PIDG* – The rationale to justify the level of expenditure for the GIB international pilot was set out in the Vivid Economics study and tested in the full Business Case. The central premise was that the GIB needed to

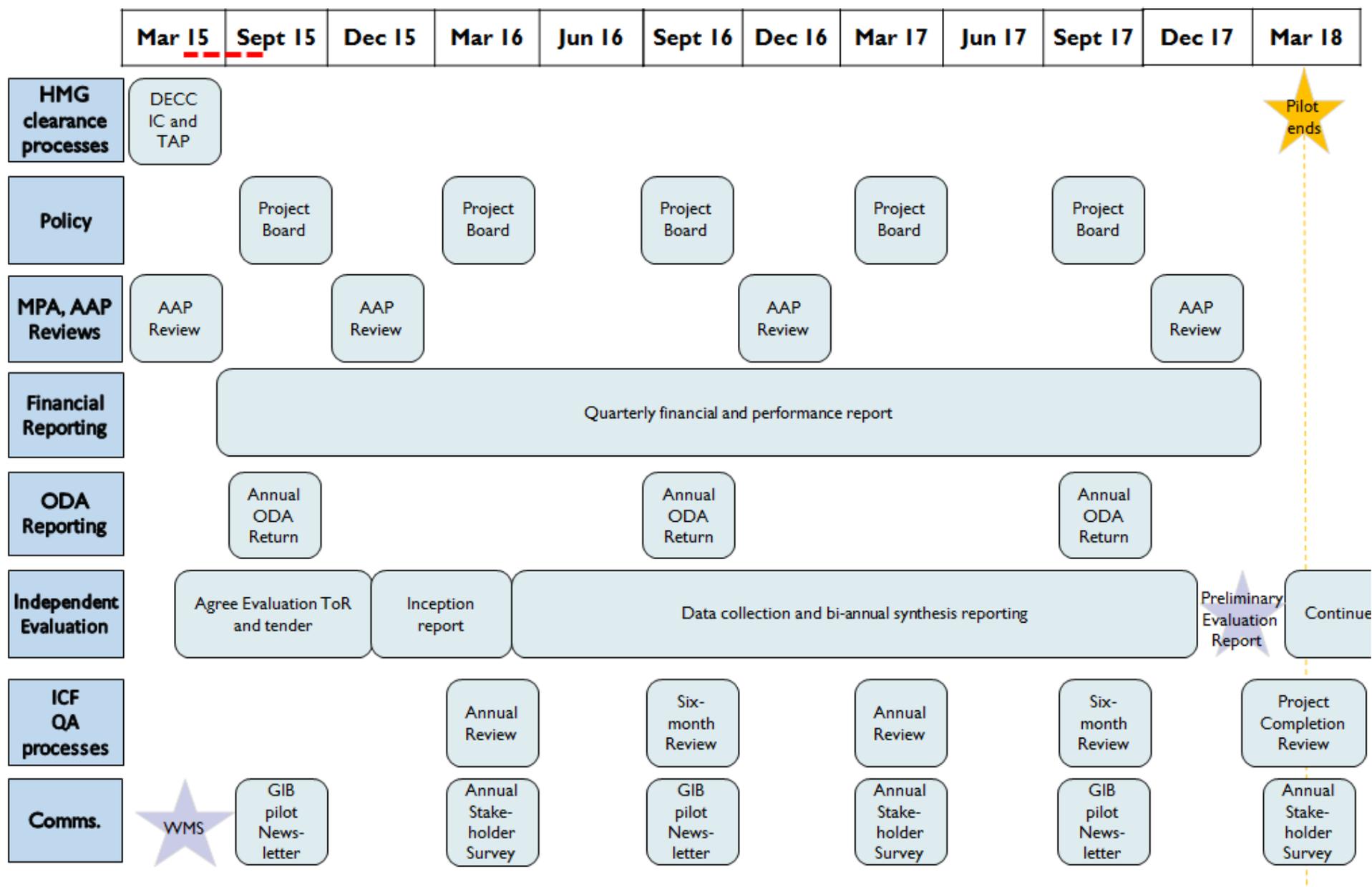
demonstrate a sufficient number of investments to assess whether they could be effective.

- *DfID have not ensured sufficient monitoring or transparency of PIDG administrative costs (e.g. travel policy)* – The GIB already has a travel policy in place agreed with HMG and agreed rules on gifts and hospitality. All administrative costs will be charged to DECC on a quarterly basis in arrears. The sponsorship team will scrutinise these invoices as part of open book accounting.
- *DFID has not yet achieved effective communication and coordination between PIDG and DFID country teams* – FCO embassies and DFID country offices will be key parts of the delivery chain for the pilot project. The GIB will use them to help gather local intelligence as well as to publicise UK investments made through the GIB.

6.8 Project Logical Framework (Benefit Management Strategy)

(See attached separately)

6.9 Project Plan



Milestone activities	Date	Who
MPA AAP Review	Oct 14	X-Whitehall
Investment Committee	Oct 14	DECC
Project Board	Nov 14	DECC
MPA AAP Review	Nov 14	X-Whitehall
Project Board	Dec 14	DECC
Ministerial steer	Jan 15	DECC / BIS
Project Board	Feb 15	DECC / DfID
Project Board	Feb 15	DECC
Investment Committee	Mar 15	DECC
MPA AAP review	Mar 15	X-Whitehall
TAP	Mar 15	DECC & HMT
Ministerial clearance	Mar 15	DECC
HoT signed	Mar 15	DECC & GIB
Legal agreement signed	Mar/April 15	DECC & GIB
WMS	Mar 15	BIS/DECC/DfID
Agree evaluation ToR	June 15	Reference Group (RG) & GIB
Tender	July 15 – Oct 15	DECC

Appoint contractor	Nov 15	DECC
Inception report presented	Jan 16	Contractor to RG
Inception report agreed	Mar 16	DECC, RG, SEQAS
Data collection	Mar 16 – Mar 17	Contractor
Draft evaluation presented	April 17	Contractor to RG, SEQAS consulted
MPA Gate 5 Review	Jan 18	X-Whitehall
Preliminary results presented	Mar 18	Contractor
Project/Programme End Date	Mar 18	DECC/ GIB
Evaluation report finalised	Aug 18	Contractor

6.14 Stakeholder Engagement Strategy & Communications Plan

6.14.1 Stakeholder Identification

There are a large number of stakeholders involved in the successful delivery of this project both within and outside the UK Government. A number of these stakeholders are involved in directly supporting the delivery chain.

In identifying our stakeholders we have considered:

What do we want to do?

- Why are we interested in this issue/policy (what's the problem)?
- What do we want to achieve?
- What boundaries or parameters limit what can be done?
- What is the timescale (what would be nice and what's the bottom line)?

Why do we want to work with others?

- What do we want to achieve by working with others (and why might they want to work with us)?
- What can or can't be influenced by our work with others?
- What types of engagement might be appropriate?

Who do we need to involve?

- What are the kinds or categories of stakeholders relevant to this work?
- What is our long list of stakeholders?
- How will we refine our stakeholder list?
- What are the interests of each of the stakeholders and how might they want to be engaged with (e.g. consulted, involved, partnered, etc)?

The table below captures the high level stakeholders and their expectations of the project:

Stakeholders	Expectations
BIS / ShEx	<ul style="list-style-type: none">• Pilot does not distract GIB from its existing UK mandate• Pilot does not dilute commercial brand of GIB• Pilot helps to build GIB brand internationally attracting inward investment in the UK
HMT	<ul style="list-style-type: none">• Approach to pilot offers strong Value for Money for the ICF

	<ul style="list-style-type: none"> • The pilot does not reduce the wider-economic value of GIB • Pilot does not make it more difficult to privatise GIB in longer term • GIB is the correct option based on a robust options analysis
DfID	<ul style="list-style-type: none"> • Pilot delivers useful evidence to inform strategic development financing framework • Pilot maintains UK's reputation for high quality ODA • Pilot investments minimise concessionality (given middle income country focus) but still achieve strong development outcomes
GIB	<ul style="list-style-type: none"> • Pilot helps to build GIB's brand internationally and develop new networks • Pilot helps diversify GIB's reliance on BIS for future funding • Pilot helps GIB to learn lessons from international investments which could be replicated in UK or vice versa
FCO	<ul style="list-style-type: none"> • Pilot gives FCO climate change officers opportunity to promote UK climate finance investments more easily • Pilot helps raise profile of GIB internationally as policy solution to crowd in private sector investment to green infrastructure • Pilot will tap FCO network for knowledge and government contacts on potential investments in recipient countries
Co-investors	<ul style="list-style-type: none"> • GIB pilot investments raise interest amongst other private sector co-investors that are familiar with their work
Sub-Funds	<ul style="list-style-type: none"> • GIB pilot investments raise interest amongst other private sector co-investors that are familiar with their work
Investee companies / projects	<ul style="list-style-type: none"> • GIB pilot investments attract private sector capital from the UK and elsewhere

Beneficiaries	<ul style="list-style-type: none"> • GIB pilot investments are longer term and more patient • Pilot investments lead to improved security of supply and jobs created
UK general public	<ul style="list-style-type: none"> • Pilot investments minimise concessionality (given middle income country focus) but still achieve strong development outcomes
Recipient country governments	<ul style="list-style-type: none"> • Pilot investments help recipient country governments to achieve national climate change plans and targets • Pilot investments deliver strong development benefits for the country
Multilateral Development Banks (MDBs)	<ul style="list-style-type: none"> • GIB as potential partner / co-investor • GIB as potential competitor
Bilateral Development Finance Institutions (DFIs)	<ul style="list-style-type: none"> • GIB as potential partner / co-investor • GIB as potential competitor

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6.14.2 Phases

Our next step was to consider the phases of the project, and who it was appropriate/necessary to engage with at each stage. We have identified the important stages of the project, what we are trying to achieve, what needs to be done, and who needs to be engaged in the table below:

Phase – what specifically are we trying to achieve?	What needs to be done in this phase?	Who should be involved?	Current Status
Build evidence base	<ul style="list-style-type: none"> • Commission study • Expert input • Steering groups • External expert QA review • Draft documents shared and feedback taken on board • Publish the report 	DECC, DFID, HMT, FCO, ShEx	Completed
Secure Finance	<ul style="list-style-type: none"> • Concept note approved • Update on concept note • Develop business case • Business case signed off 	Business case QA'd and externally reviewed by experts to give it legitimacy	Business case has been developed and QA'ed. Awaiting final sign off.
Ensure that the process does not get tied up / slowed down by work being undertaken to look at a UK development bank in 2014	<ul style="list-style-type: none"> • Liaise with relevant team in DFID 	DFID	There has been extensive engagement with DfID
Work at official level to ensure that the officials can put up clear and informed advice to their investment committees and ministers when it comes to decision making	<ul style="list-style-type: none"> • Hold a project kick off meeting – clarifying roles, responsibilities and points of contact. • Hold weekly project catch-ups • Hold meetings with key senior representatives and experts to test direction of travel • Project Steering Group – to ensure wider stakeholder buy-in on the project from key government departments. 	ShEx, DFID, Treasury, DECC, GIB	<p>We have liaised closely with relevant stakeholders to ensure they remained informed.</p> <p>We have established regular project boards and X-WH steering group meetings to maintain buy in.</p> <p>We engage with senior representatives as necessary.</p>
Maintain good working relationship with GIB.	<ul style="list-style-type: none"> • Established project team will meet regularly with a GIB project team to review the project plan. 	DECC, GIB	We have engaged on at least a weekly basis with GIB counterparts to ensure objectives and processes remained aligned.

Governance – once established the Pilot will be subject to four governance processes; established ICF project processes, project level measures, MPA reporting; and ShEx processes

At DECC level:

- Quarterly project board.

At ICF level:

- Quarterly ICF board meeting
- Quarterly ICF sub-committee meeting
- Six monthly annual reviews, monthly progress, financial and risk reporting, and project completion reports. These are used to contribute to; ICC directorate programme reporting, ISR group reporting for the Director General and, quarterly reports from the DECC Portfolio Office to the Executive Committee.

MPA reporting;

- Regular reviews

ShEx governance processes:

- Quarterly review of each business case in the GIB portfolio
- Monthly risk register update for ShEx ExCo.

DECC, DFID

Arrangements have been made to ensure that governance is effective while not overly onerous.

DECC, GIB, MPA

ShEx, GIB

6.14.3 Communication Methods

As set out in the communications plan, the GIB and the Project Team intend to disseminate information and handle feedback about the pilot in the following ways:

Communication Method	Target Stakeholders	Feedback
Steering Group meetings	Relevant HMG contacts; GIB	Project team to action feedback directly
Six Monthly / Annual GIB pilot Newsletter	Relevant HMG contacts; potential co-investors; MDBs; DFIs	Opportunity for stakeholders to contact GIB / DECC to ask for additional details about pilot
Quarterly internal reporting prepared by GIB Fund Manager	Relevant HMG contacts	Project Team to coordinate feedback received from relevant HMT contacts and to discuss this at steering group meetings
Joint DECC / GIB Press Releases on financial close / project construction	Recipient country governments; potential co-investors; MDBs; DFIs; potential investee companies; potential sub-funds; UK general public	Opportunity for stakeholders to contact GIB / DECC to ask for additional details about pilot
Case study on Gov.uk	Recipient country governments; potential co-investors; MDBs; DFIs; potential investee companies; potential sub-funds;	Opportunity for stakeholders to contact DECC to ask for additional details about pilot

	UK general public	
Webpages on GIB website	Recipient country governments; potential co-investors; MDBs; DFIs; potential investee companies; potential sub-funds; UK general public	Opportunity for stakeholders to contact GIB to ask for additional details about pilot
Annual Stakeholder Surveys	Recipient country governments; potential co-investors; MDBs; DFIs; potential investee companies; potential sub-funds;	Semi-structure online questionnaires to illicit feedback from key stakeholders which will be used to inform annual review and independent assessment

6.14.4 Updating the stakeholder engagement plan

Our stakeholder engagement plan will be maintained and updated throughout the pilot. We will use the methods outlined below to commission feedback from our key stakeholders which we will use to tailor our engagement methods in the appropriate ways.

Method	Frequency	Target Stakeholders
Annual Reviews	Yearly	Relevant HMG contacts
Steering group meetings	Six monthly	Relevant HMG contacts; GIB
Stakeholder Surveys	Yearly	Recipient country governments; potential co-investors; MDBs; DFIs; potential investee companies; potential sub-funds;

6.16 Risk

6.16.1 Risk Potential Assessment

6.16.2 Risk Register

(attached separately)

6.16.3 ICF Risk Appetite Statement

“Risk is an inherent part of the ICF. Climate finance is a relatively new area of expenditure. The evidence base to inform investment decisions is of variable quality, and the results chains to demonstrate impact and value for money are still relatively weak. As a result, it is important that we are clear about our appetite for risk and have robust procedures in place for minimising our exposure wherever possible.

The ICF Board has a medium / high risk appetite for investment risk and political risk where projects have the potential to deliver sustainable and transformative change, providing that risks can be managed appropriately. We will carry out rigorous economic and political appraisal to understand and manage these risks. This is consistent with the strategic ambitions of the ICF and acknowledges the political climate of countries in which we will invest and the rate of failure inherent in these types of project.

The ICF Board has a medium risk appetite for operational risk. We will develop robust management and governance arrangements, carry out regular monitoring and reviews to manage these risks.

The ICF Board has a medium / low risk appetite for reputational risk recognising the potential for UK public criticism on international climate spend while positively communicating our expenditure internationally through climate negotiations and wider international fora.

The ICF Board has a low risk appetite for financial risk, information risk and legal / compliance risk. We will not invest in organisations where fraud is suspected. HMG procedures on protecting sensitive information must be adhered to by programme and project staff. We will comply with UK legislation and in-country law where this does not conflict. This is consistent with corporate statements on minimising the risk of financial loss, protecting personal safety and the need to meet accounting officer responsibilities. Significant effort will be made to avoid these risks through the project lifecycle and appropriate skills and resource will be apportioned accordingly.

The Board’s risk appetite will be reviewed formally on an annual basis and will be updated more frequently as required.”

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6.17 MPA Recommendations

Gateway 3 review - October 2014

Ref	Recommendation	Criticality	Action and resource
1.	<p><u>Governance Arrangements</u></p> <p>We recommend that the SRO:</p> <ul style="list-style-type: none"> Reviews the current governance arrangements and assures himself that roles and responsibilities are clearly documented and there is sufficient external scrutiny of the project to support him in the decision making processes. 	Medium	<ul style="list-style-type: none"> Revised governance structure now in place. Project board established with SRO and senior figures from legal, finance, commercial and DECC economics. The Project Board will meet at least monthly during the set-up phase to take decisions and drive the project forward, feeding into the Investment Committee and to Ministers. The existing cross-Whitehall Steering Group will feed into the project. Project Board Governance, including the Terms of Reference, were signed off at first meeting on 19 November 2014.
2.	<p>We recommend that the SRO:</p> <ul style="list-style-type: none"> Reprioritises his workload to dedicate sufficient time to provide oversight of the Project and to fully execute his responsibilities as SRO. 	Urgent	<ul style="list-style-type: none"> SRO has invested significant time in the project including regular review meetings with the team since the Gateway Review. SRO has also increased engagement with others on the project outside the team including commercial, and legal directors, key BIS & the Shareholder Executive and DFID counterparts and GIB senior management, and Chairing the cross-Whitehall Steering Group. SRO anticipates that going forward work on the GIB, including more frequent Project Boards, will result in the SRO dedicating significantly more of his time on overseeing this project.
3.	<p><u>Business Case and Options Evaluation</u></p> <p>We recommend that the Project Team:</p> <ul style="list-style-type: none"> Revisit the Full Business Case to ensure that the appraisal of long-list options incorporates all of the evidence available to indicate reasons for options not to have been included in the short-list evaluation. 	Low	<ul style="list-style-type: none"> Amendments are currently being made to the business case to ensure that all of the evidence has been included in the long-list options table and is clearly and appropriately referenced in the business case itself. In response to the Investment Committee's conclusions, the team has prepared a stronger narrative on why a Pilot with the GIB is the best option. This was tested and agreed at the first Project Board on 19 November 2014. The business case will remain a working document in the coming weeks, and will be updated at regular intervals to reflect progress in component parts of the project (i.e. including the Exit Model for the Fund).
	<p><u>Project Team Capability and Capacity</u></p>		<ul style="list-style-type: none"> The Commercial Director will now be leading negotiations with GIB, and dedicated 1 FTE commercial expert to the Pilot. He is receiving frequent briefings

4.	<p>We recommend that the Chair of the DECC Investment Committee:</p> <ul style="list-style-type: none"> Establishes an empowered senior level negotiation team (led by the department's Commercial Director directly supported by the SRO and Chief Economist and internal / external professional support) to conduct and complete negotiations of the Heads of Terms with GIB by end of Dec 2014 and the associated contract by end of Jan 2015. 	Critical	<p>from his commercial team on the project.</p> <ul style="list-style-type: none"> Additionally we are working closely with member of the Project Board (including the SRO, Head of Commercial, Head of Procurement and Chief Economist, to discuss agree our position on negotiations and the project. Stronger governance and increased resources are supporting an accelerated timetable leading to an announcement ahead of Purdah. This is still ambitious though and in light of this, both the Project Board and team have considered fall-back options should negotiations not proceed as quickly as anticipated.
5.	<p>We recommend that the SRO:</p> <ul style="list-style-type: none"> Immediately ensures that there is sufficient resources made available within the Project Team to complete all remaining key tasks up to the closure of the GIB agreement in order to increase the current pace of the Project and secure the agreed overall timescales for delivery. 	High	<ul style="list-style-type: none"> The existing Project Team's other non-GIB responsibilities have been reallocated within the ICF team leaving them to focus 80% of their time on the project. The Project Team has also increased significantly in size with the Project team now consisting of Sam Balch (0.8 FTE, leading on <i>inter alia</i>, legal, State Aid, procurement, ShEx/BIS), Julia Ellis (0.8 FTE, leading on transformational change, commercial (MEO), Cabinet Office), Kam Roopra (P/T PPM), Rob Gould (P/T procurement and PPM), Hannah Rollason (P/T admin support, stakeholder engagement), with two full-time HEOs to join from 1 December onwards. Additionally, we have received additional support from other parts of DECC including legal and commercial.
6.	<p>We recommend that the SRO in conjunction with the Commercial Director:</p> <ul style="list-style-type: none"> Ensures that a dedicated Intelligent Client Function is designed and resourced in order to manage DECCs on-going business relationship with GIB, before contractual agreement is made. 	High	<ul style="list-style-type: none"> The Project Board will meet monthly to take decisions where authority has been delegated, and ensure that the project meets the proposed specification and that the concerns of the Investment Committee and Ministers are dealt with. The team has been allocated additional commercial resource (now 1 FTE) which will help support the Intelligent Client Function. On-going oversight of the project will be maintained by the Project Board (who will meet at least quarterly once the project is up and running).
	<p><u>Benefits Realisation - How success of the pilot will be demonstrated</u></p> <p>We recommend that the SRO:</p> <ul style="list-style-type: none"> Develops a clear set of critical success factors for the Project that will be used to demonstrate the success of the pilot. Determines what flexibilities exist within DECC's objectives for the ICF 		<ul style="list-style-type: none"> Our revised business case set out that we would use our Annual Review scoring process (linked to the projects logical framework) to assess whether the pilot has been a success. We will continue to fine tune our logical framework to make sure project success can be measured effectively at key stages of the project. Our SRO and Chief Economist held a senior meeting on the 20 November for GIB to present their assessment of how they could integrate our requirements (including transformational change) into GIB's existing process. Further work is required to agree a common position on this. On 19th November, our first Project Board agreed that DECC would cover the costs of the comprehensive market analysis. Subject to the requisite procurement

7.	<p>schemes and pilot, in order to secure agreement with GIB.</p> <ul style="list-style-type: none"> Urgently tasks GIB to complete a business plan which incorporates a comprehensive market analysis that identifies the specific target countries for the pilot projects to be developed and the likely segments they will come from. 	Critical	<p>approvals, GIB can begin this work.</p>
8.	<p><u>Legal and Procurement Risks</u></p> <p>We recommend that the DECC Investment Committee:</p> <ul style="list-style-type: none"> Assures itself that the currently identified legal, state aid and procurement risks (and potential delays that could occur if the arise) are acceptable to DECC and can be signed off by the Accounting Officer with reference to the Minister as required. 	High	<ul style="list-style-type: none"> Comprehensive paper on procurement, vires and State Aid risks prepared and discussed with Project Board (see Document GIB/PB/1/4). There was appetite from the Project Board to test further the willingness of GIB / ShEx to amend the GIB's Articles given the impact this would have on reducing the procurement risk. The Project Board's preferred approach, and alternatives (e.g. taking not amending GIB Articles and taking a larger risk on will be shared with the Accounting Officer and subsequently Ministers in a submission in w/c 24 November and w/c 1 December respectively.
9.	<p>We recommend that the Project Team:</p> <ul style="list-style-type: none"> Examines the outputs from the Project Validation Review workshop and where appropriate makes any additions to the existing risks and issues log. 	Medium	<ul style="list-style-type: none"> Detailed work on the key legal risks has progressed significantly (see bullets in section 8 above and Document GIB/PB/1/4). Detailed work has also begun to identify key issues in each project work stream. A project team workshop has been scheduled for w/c 1 DEC to deep dive into project risks and issues.
10.	<p><u>Exit Strategy Options and Planning</u></p> <p>We recommend that the Project Team:</p> <ul style="list-style-type: none"> Develops a clear exit strategy for the end of the pilot. This will need to consider a range of scenarios (closure, transfer, expansion etc.) and the possibility that GIB will have changed its status within government. Confirms the elements that need to be incorporated into any commercial agreement and Heads of Terms. Incorporates any associated estimates of costs and impacts in the Full Business Case. 		<ul style="list-style-type: none"> Commercial have identified in table form which elements need to be incorporated within the Heads of Terms. Bullets 1&2 have yet to be progressed significantly. A workshop will be held with Commercial, Legal and Policy to discuss exit strategy options in more detail; and economists will update the cost benefit analysis in light of the commercial agreement, will inform discussions on the HoT, and will be incorporated into the business case.

		High	
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AAP review November 2014

	Recommendations / Review Team's Commentary	Status	Action and resource
1	<p><u>Review Governance Arrangements</u></p> <p>A Project Board (PB) including the SRO and senior DECC figures from legal, finance, commercial and economics has been established and had its first monthly meeting on 19th November. The PB will take decisions and drive the project forward, feeding into the Investment Committee and to Ministers. The review team find that it is too early to tell if this is effective or enduring.</p>	Complete	<p>There was comments that the project board was too DECC-heavy and DfID have been invited and participated in recent project board discussions.</p> <p>There has also been a X-Whitehall Steering Group meeting with DfID, Treasury, BIS/ShEx and Cabinet Office. This has been constructive for disseminating a clear narrative across departments and seeking views on cross-Whitehall matters.</p>

2	<p><u>Increase SRO Availability</u></p> <p>The SRO has invested more time through regular reviews with the project team and will continue to chair PBs. He has increased engagement with senior DECC and external stakeholders in BIS, ShEx, DFID and GIB, despite this being his busiest time of the year due to international negotiations. The review team heard that many anticipated this increased level of support to continue.</p>	Complete	<p>SRO meets weekly with the project team for an update and discussion.</p> <p>SRO has chaired monthly projects boards and stays highly engaged in the project. He has also kept engagement high with senior officials within DECC and across Whitehall.</p>
3	<p><u>Establish a Negotiation Team</u></p> <p>The DECC Commercial Director will lead the negotiations, and has now dedicated commercial expertise for this. Other senior officials on the Project Board are also involved in agreeing the DECC negotiating position and timeline.</p>	Complete	<p>The negotiations team meets with GIB regularly and are still in the process of agreeing the Heads of Terms.</p> <p>The DECC Commercial Director has fortnightly meetings with the GIB CEO Shaun Kingsbury, and regular catch-ups with the negotiations team.</p>
4	<p><u>Resource the Project Team</u></p> <p>Project Team capacity and capability has increased significantly over the last few weeks and will have a compliment of nearly 10 staff by early December, covering key skill sets including legal, State Aid, procurement and commercial, transformational change, PPM and stakeholder engagement). The team have also received support from other parts of DECC including legal and commercial.</p>	Complete	<p>The project team has successfully been resourced up with the policy team, negotiations team and legal team meeting weekly for project updates.</p> <p>There is daily contact between all members.</p>

5	<p><u>Evidence for Options Evaluation</u></p> <p>The review team heard that the FBC was being amended to ensure that all of the evidence has been included in the long-list options table. The project team has also prepared a stronger narrative (tested and agreed at the first PB) on why a pilot with the GIB is the best option. Work continues on developing the FBC in readiness for HMT approval expected around March 2015.</p>	Ongoing	<p>The FBC reflects the full options evaluation.</p> <p>This is reflected in the strategic case, economic case and annex 7.2.</p>
6	<p><u>Intelligent Customer Function</u></p> <p>Although DECC have recognised the need to design and resource a dedicated Intelligent Client Function, the review team heard that to date the commercial work has rightly focussed on preparing for the negotiations. Currently, the negotiation team manages oversight of the relationship with GIB, and there is no plan yet established for ongoing management of the relationship post contract signature.</p>	Ongoing	<p>The Intelligent Client Function is discussed in the FBC under the project governance (section 6.2).</p>
7	<p><u>Articulate How Success Will Be Demonstrated</u></p> <p>The review team heard differing views (as might be expected at this stage of the negotiations) about GIB's ability to integrate DECCs requirements into their existing business model and to demonstrate 'transformational change'. DECC are also fine tuning their projects logical framework to ensure that success can be measured effectively at key stages of the project.</p>	Ongoing	<p>The criteria for monitoring and demonstrating transformational change have been developed and will be built into the investment mandate.</p> <p>The success criteria is articulated in the FBC section 6.3 and 7.11.</p>

8	<p><u>Determine Departmental Appetite for Risk</u></p> <p>The Review Team heard differing views about the level of legal, state aid and procurement risks. This is closely aligned with the decision about what can be achieved by Purdah and further advice (particularly the willingness of GIB and ShEx to amend GIB's Articles given the impact this would have on reducing the procurement risk) was being prepared for ministers.</p>	Ongoing	<p>There is departmental consensus on the appropriate structure for the project and the level of risk that carries. This has been shared with GIB and ShEx who agree are aligned with DECC's views.</p> <p>There is also consensus that the Articles do not need to be amended.</p>
9	<p><u>Update Risk Log following PVR</u></p> <p>Work on the key legal risks has progressed significantly and the project team have also begun to identify key issues within each project work stream. These will be reviewed at a project team workshop on risks and issues scheduled for December.</p>	Ongoing	<p>The risk log has been updated and reviewed in the workshop.</p> <p>The latest version is attached to the FBC.</p>
10	<p><u>Develop an Exit Strategy</u></p> <p>Commercial, Legal and Policy are due to attend a workshop to discuss Exit Strategy options in more detail, after which the associated estimates of costs and impacts will be incorporated in the FBC.</p>	Ongoing	<p>Commercial, Legal and Policy attended a workshop where exit strategies were discussed. This has been translated into an agreed position and shared with the external commercial legal advisers. This is incorporated in the FBC and will be translated into the HoT and final legal agreement.</p>

6.18 ICF KPIs

ICF KPI 5: Number of direct jobs created as a result of ICF support

ICF KPI 6: Net Change in Greenhouse Gas Emissions (tCO₂e) – tonnes of GHG emissions reduced or avoided

ICF KPI 7: Level of installed capacity (MW) of clean energy generated as a result of ICF support

ICF KPI 9: Number of low carbon technologies supported (absolute number of units installed) through ICF support

ICF KPI 11: Volume of public finance mobilised for climate change purposes as a result of ICF funding

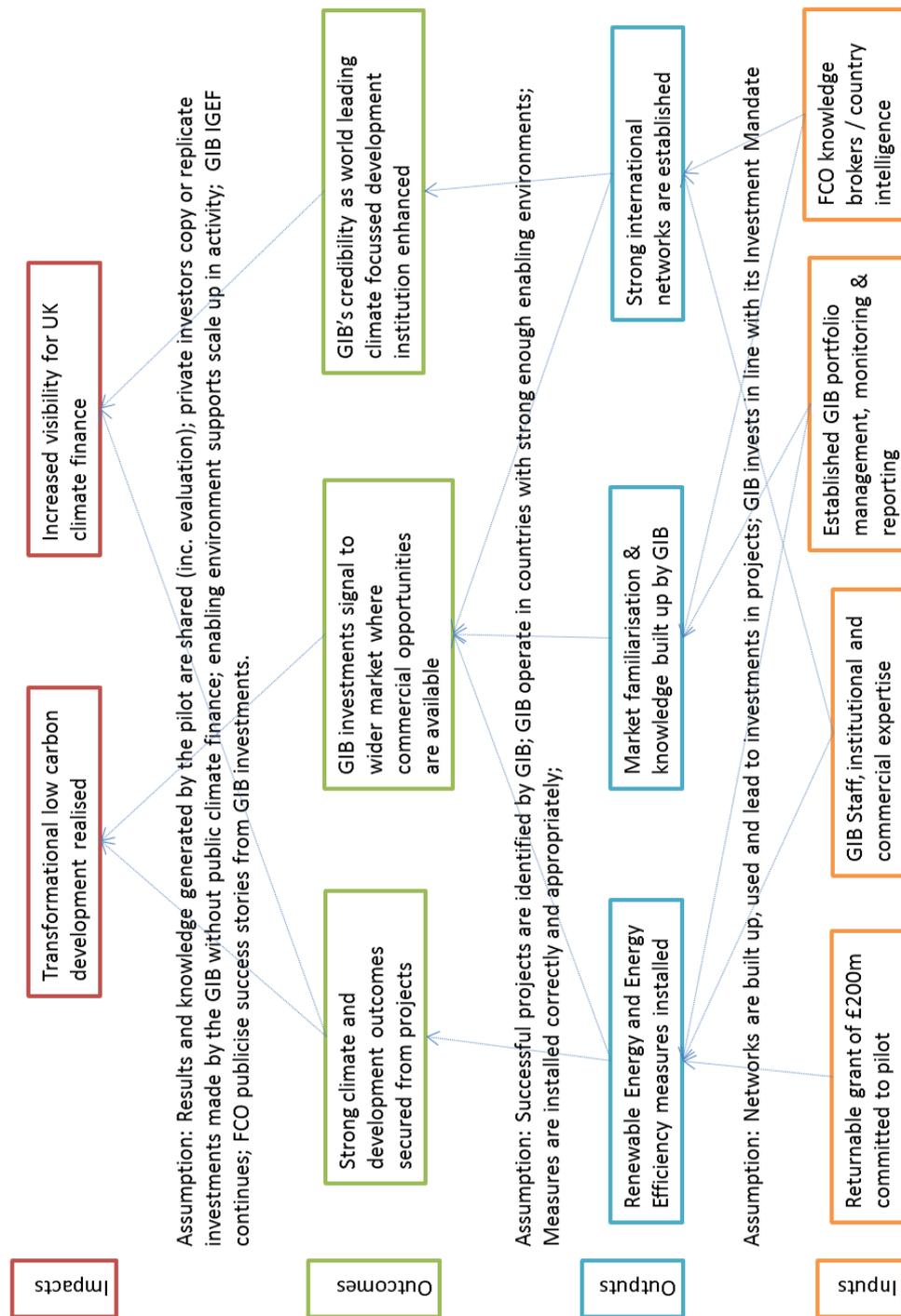
ICF KPI 12: Volume of private finance mobilised for climate change purposes as a result of ICF funding

ICF KPI 15: Extent to which ICF intervention is likely to have a transformational impact

6.19 ICF Transformational Change Criteria

All GIBI investments must be:	
Sustainable: AND	The project / investment has the potential to be financially sustainable if DECC exits
Replicable: AND	The project / investment has the potential to be copied by others in either the same country, region or more widely
Incentivise other investors: AND	GIB's investment attracts private sector co-finance within a project and/ or The project / investment has the potential to lead to material reductions in overall project costs (including reductions in costs of capital) within a country context
All GIBI investments must also meet [one or two – to be negotiated] of the following criteria:	
At scale:	Investment supports a step change in the sector within a country context (e.g. first utility scale solar project)
Increased capacity and capability:	The project / investment has the potential to build capacity / capability in other institutions / organisation (both public or private) to replicate the activity.
Political will and local ownership:	The project / investment has the potential to strengthen political buy-in and public support for the activity and/or The project aligns with country strategies and/or uses the national systems (planning or financial management systems)
Innovative:	'First of a kind' investments within a country context – sector and/or technology and/or financing mechanism

6.20 Project theory of change / logic map



6.21 Evidence

6.21.1 Identification of evidence gaps and weaknesses

Our understanding of the problem is underpinned by:

- The ICF team's experience of delivering international climate finance over the last four years
- Vivid Economics' gap analysis

Evidence underpinning of choice of proposed solution is:

- Industry sounding and conversations with other governments and potential delivery partners
- Vivid Economics' proposed options
- GIB's Business Plan
- Value for money assessment including benchmarking exercise and Monte Carlo Analysis

Research proposed to support the design and delivery of the policy:

- Vivid Economics' study
- External legal advice on contract documents
- Mid-term and full-term pilot evaluation for course corrections and to assess success

6.21.2 Evidence Planning

Evidence deliverable	Workstream lead	Estimated cost (£)	Human resource required	Start Date	Due date	Key milestones
Evaluation	BEIS project team	£250k	0.1 FTE	April 15	Nov 17	Mid-term report at May 16

6.21.3 DECC Experts

Experts engaged so far:

- DECC Commercial, Analysts, Finance, Legal and Evaluation
- The Terms of Reference for the evaluation have been submitted to DFID's expert advisor panel: SEQAS.

6.22 Economic Appraisal

Technical Modelling Annex

UK Government contribution

1. For modelling and assessment purposes it is assumed that, on behalf of the UK government ICF, the Green Investment Bank will invest £200m less costs of administration and operation costs. The modelling assumes that this is committed in 2015⁴⁶ but spent over 3 years. The investment profile in the Economic Model will differ from GIB's financial model, this is due to differences in the number of projects included in GIBs pre-prepared template, and DECCs economic modelling, which includes 10 investments to be undertaken over the lifetime of the project. The number of projects has no impact on the financial modelling as it is assumed that the returns are equal. The crucial element is how much money is invested each year; this is consistent between GIBs initial financial modelling and the economic modelling for the Business Case, but will need to be checked and updated when GIB have finalised their financial modelling once the legal terms of the pilot have been agreed. The table below shows the investment profile in the economic model.

Figure 10 - Investment Profile in the economic model

Economic Modelling		
Year of investment	Amount invested	Number of Projects
2015	£60m	3
2016	£54.36m	3
2017	£73.08m	4

Modelled Portfolio

2. The portfolio used for the data quoted as the central numbers in the updated business case was informed by market analysis undertaken by KPMG for GIB. DECC objectives in terms of country and technology coverage are taken into account, including general energy efficiency measures. The final Heads of Terms (HoT) and draft Investment Mandate (IM) has not yet been finalised, therefore the modelling contains some of the conditions laid out in the draft legal documents prepared ahead of the last Investment Committee meeting in October 2014. Exogenously determined assumptions have also been drawn from these documents where possible. This analysis will be updated once these documents are finalised in order to monitor the impact on expected results and sense check expected results included in the GIB logframe. The current project portfolio reflects a snapshot of an illustrative range of projects given the available information at the time the analysis was carried out and may change with further detailed analysis, due diligence and timing. The portfolio includes 40% Solar, 30% wind, 20% energy efficiency and 10% biomass across four countries shortlisted as viable investment options in GIB market analysis.

⁴⁶ 2015 is the price base year. The model assumes that the UK commits the money in 2015 and therefore the cost to the UK is occurred in this year.

Figure 11 - Technologies and countries in the investment portfolio

Technology	Country
Wind	South Africa, India, Mexico
Solar	South Africa, India, Kenya, Mexico
Biomass Power Plant	Kenya
Energy Efficiency	South Africa, India

3. The model is bound by certain conditions: the fund must invest at least 20% of the portfolio finance in energy efficiency projects, no more than 30% of the portfolio finance in one region, no more than 25% in any one project, and a maximum of 30% to be invested in any one country. The model is conditioned to ensure these criteria are met, although it should be noted that the Heads of Terms and Investment Mandate are still under negotiation, and therefore these conditions are subject to change.

Administration costs

4. GIB administration costs are determined exogenously to the economic model and are based on initial GIB draft financial modelling of the investment portfolio. This assumption will be updated once negotiations have concluded.

Public Finance

5. The model assumes that the remaining project finance required for a project to go ahead is raised within a year of the GIB investment being committed. The central assumption is that public finance in renewable energy projects makes up 20% of the residual investment required. Renewable energy projects public finance is lower because it is expected that the GIB will invest in near commercial renewables which tend to require less public support. Previous experience on implemented ICF projects has shown this to be the case and we make a strong assumptions, therefore we rate this as weak to moderate. Benefits are attributed on the basis of the contribution that the UK Government makes to each project. Private finance leveraged is attributed to the UK Government on the same basis as the benefits.

Private Finance

6. As with public finance, private finance is assumed to be raised within one year of the GIB investment. It is assumed that the public finance is just at a sufficient level to encourage the remaining required investment in each project to be made by the private sector. The central assumption is the reverse of the public finance assumptions; private finance accounts for 80% of the residual investment in renewables and 100% of the residual investment in energy efficiency projects. As this is purely a modelling assumption based on estimates from previous experience we rate this evidence as weak to moderate.

Renewable Energy

7. The model has a range of possible renewable energy investments that can be made. These include Biomass, Wind, Solar and Geothermal. Data on cost per megawatt installed, capacity factors and construction time is from the World Economic Outlook modelling done by the IEA in 2013. Plant lifetimes are from the DECC levelised cost calculator and the degradation, downtime and transmission losses are estimated from previous ICF projects and experience⁴⁷. The WEO is

⁴⁷ See GAP company financial modelling.

widely used and quoted data, however actual costs will vary by country (as well as region in as in the WEO data) and by situation. The remaining data is weaker evidenced than the WEO, although still evidenced. Therefore we score this evidence as moderate to strong⁴⁸.

8. The cost of renewable energy investments are modelled using the cost per megawatt as in the WEO data by the total number of megawatts installed plus legal, financing and other fees of 9%⁴⁹. The output of the investments is modelled by calculating the Mwh produced at maximum output adjusted for capacity factor and then adjusted down for downtime, losses and year-on-year degradation. The plant size is user defined⁵⁰ and it is assumed additional finance made up by a mix of public and private investment.

Energy Efficiency

9. The model relies on a user defined leverage ratio to calculate the total investment in each energy efficiency project. It then takes data from a range of sources on the cost per Mwh saved to calculate the total Mwh from the IGIB investment, adjusted for the relevant rebound factor. The cost per Mwh is identified from a range of sources including evidence from the Clean Technology Fund (CTF), evidence also gathered from projects by KFW, IFC and internal DECC projects. This data covers industrial, non-domestic and domestic energy efficiency measures. The rebound factor is evidenced from the recent DECC/DFID study. This study showed rebound factors 0-20% for industrial and 10–30% for residential energy efficiency measures. The evidence used for the energy efficiency analysis, whilst limited in quality, is the best available and based on current projects however is still context specific and therefore rated as moderate.

Jobs

10. The data used to calculate the number of jobs created or supported on the project is taken from an Ecofys Study that was produced for DfID, this data provides the approximate jobs required in the construction and O&M of the energy resource by MW installed. Whilst this is the best available data disaggregated by renewable energy type it is primarily focused on only a limited number of regions, mostly OECD and South Africa, and does not take into account the differences between these regions. This data does not suggest whether these jobs are additional or temporary. Therefore the evidence rating for this data is weak to moderate; the best available information but has known deficiencies. Due to a lack of data no valuation is attributed to jobs and therefore does not affect the BCR of the project.

Failure Rate

11. Within equity investments it is likely that some investments within the portfolio will fall below the hurdle rate, or fail entirely. Discussions with the GIB suggest that 10% failure rate may be expected in this case, so far the GIB has had a zero failure rate and therefore this is used for the central case. The failure rate is determined by expert opinion and actual project experience of the CIFs and private investor funds, but we do not know exactly what the failure rate will be, as such we rate this as moderate.

Benefit Valuation

12. The model accounts for a number of the benefits from the projects funded by the IGEF programme; social benefit of carbon saved from producing the energy in a carbon intensive manner, welfare benefit of the previously unmet demand, the welfare benefit of future unmet demand and the benefit of saving the carbon based resources.

13. The amount of carbon abated or reduced by the intervention is valued using the DIFD/DECC ICF carbon prices. Central prices are used for the portfolio modelling here and sensitivity analysis⁵¹. The amount of carbon saved is based on the operating and build margin

⁴⁸ See modelling for full references on assumptions and input variables.

⁴⁹ Is standard assumption in similar ICF projects that invest directly into projects.

⁵⁰ Assumptions have been sense checked against GIB market analysis and ICF experience (i.e. CTF experience in countries included in portfolio).

⁵¹ Carbon prices used for sensitivity analysis are low, central and high DFID/DECC ICF prices and the central DECC traded carbon price.

carbon factors as defined by DECC/DFID guidance. The counterfactual assumes that 50% of the renewable power generated helps meet current or future unmet demand. This carries significant welfare benefits in terms of access to energy, however does not have an associated carbon saving. The welfare benefits are valued at the projected future energy prices supplied by Enerdata, weighted by relative consumption for the relevant region or country. It is assumed that the remaining energy generated displaces future and current generating capacity equally. This carries a carbon and resource benefit. The resource benefit is valued at 80% in line with DECC/DFID guidance of the weighted energy price.

14. Benefits valuation uses a range of data and overall the evidence used to calculate the monetary value of benefits is rated as moderate. The price projections are used widely in DECC analysis and modelled on the international energy system. We consider this moderate to strong. The grid emission factors are internationally recognised and therefore thought to be strong. However, resource valuation is an estimate only, as are the estimates associated with the displacement of current and future energy production.

Discount rates

15. In line with appraisal guidelines a 3.5% discount rate is applied to global public goods; in this case the carbon benefits accruing from the project. All other costs and benefits are discounted at a developing country discount rate of 10%, this is because we do not know exactly where the fund will invest and therefore cannot use country specific discount factors.

Additionality

16. A key assumption is the impact of the level of additionality, this is the amount of activity that would have happened without the UK finance. The IGEF mandate is to only invest in projects which are additional, in other words those project that would not have happened without GIB money. It is however unlikely that all projects will fall into the category and therefore a conservative assumption of 50% of investments are non-additional is assumed, this is consistent with the assumptions for CTF. There is no way of directly verifying this ex-ante as such the evidence on the additionality is considered moderate-weak, however it is similar to the assumptions used in similar private sector based ICF projects and agreements with delivery partners.

