Final Report

Evaluation of the Dutch Fund for Climate and Development's project origination approach

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Disclaimer

This evaluation covers the period from the start of the Dutch Fund for Climate and Development until the time of research, which ended October 2021. The views expressed in this report are those of the evaluators. They do not represent those of the Dutch Fund for Climate and Development partners, the Dutch Ministry of Foreign Affairs or of any of the individuals and organisations referred to in the report.

Executive Summary

The Dutch Fund for Climate and Development (DFCD) has been established with an ambitious mandate to identify, originate and finance business solutions for climate resilience in developing countries. It was established in 2019, with €160 million of funding available from the Dutch Ministry of Foreign Affairs (MoFA), and is managed by a consortium of four organisations: Climate Fund Managers (CFM), Netherlands Development Organisation (SNV), Worldwide Fund for Nature Netherlands (WWF-NL), and the Dutch Entrepreneurial Development Bank (FMO), which is the lead partner.

Itad was commissioned by FMO, on behalf of DFCD, to deliver a formative evaluation of the Fund, focusing in particular on its approach to originating climate resilient bankable projects. The purpose of this evaluation is to provide lessons about DFCD implementation to date and, from these, identify opportunities for improvement of the Fund and recommendations for future funds.

The evaluation draws on data from an in-depth desk review of key documentation, interviews with Consortium staff, three case studies exploring 10 investments in detail, telephone interviews with 20 clients and discussions with peer organisations taking a landscape approach to climate finance.

DFCD structure

DFCD is structured around three facilities; the DFCD Origination Facility provides grants and technical assistance (TA) to source and develop investment proposals for the FMO-managed DFCD Land Use Facility and the CFM-managed DFCD Water Facility.

The DFCD Origination Facility has three phases: SNV and WWF-NL support sponsors through initial discussions in the Discover phase, development of bankable business cases in the Structure phase and preparing full business cases in the Develop phase.

The **key features** of the Fund are:

- To catalyse at least €500 million in private finance, up to €1 billion over the lifetime of DFCD, and that at least 50%, but preferably 65%, of total aggregate funding commitments goes towards adaptation projects.
- That no less than 25% of total aggregate funding commitments goes to least developed countries (LDCs).
- That no less than 25% of total aggregate funding commitments goes to NL-priority countries.
- That investments will be between €1 million and €10 million, with flexibility if provided for grants to be less than €1 million. The maximum exposure per transaction will be 15% of total commitments.

The Fund has adopted a landscape approach to help develop an interlinked pipeline of bankable projects with synergistic and maximized impact for inclusive climate resilience.

DFCD progress

It is too soon to tell whether overall investment is on track to meet its targets, but it is clear that the DFCD Origination Facility has made good progress in identifying and supporting potentially bankable projects, despite the challenges of Covid-19.

The DFCD Origination Facility is intended to put forward 35 projects for financing through DFCD's two Investment Facilities by 2023. Currently 19 projects are in the Develop phase of the DFCD Origination Facility, but none have yet been put forward to the Investment Facilities. Some of these projects would not have been pursued, and would not have the potential to become bankable, without the work of the

DFCD Origination Facility. Consequently, if these projects are successful in securing investment following their graduation from the DFCD Origination Facility there will be a high degree of additionality.

In addition to the projects in the DFCD Origination Facility, four projects have received direct investment from the DFCD Land Use Facility and seven projects are being supported by the DFCD Water Facility's Development Fund in preparation for a potential investment by its Construction Equity Fund. Both FMO and CFM have identified projects that are being supported by the Origination Facility to develop their business case.

The Consortium has achieved this progress despite the challenges presented by Covid-19. They have adapted their approaches, particularly to project origination, due diligence and TA. Staffing and skills within SNV and WWF were initially a constraint in originating bankable projects but this has been addressed by recruiting staff with investment expertise.

The Consortium partners all monitor their own progress towards DFCD's goals and their specific targets. They report that although the pace of investment is slower than was initially envisaged, each Consortium partner expects to commit most of its capital before the end of 2023. However, there is no single report which covers progress of the Fund as a whole towards its targets and it is not simple to aggregate the existing data to assess whether DFCD as a whole is on track to meet those targets. In addition, the consortium does not track the overall numbers of cancelled projects as some are cancelled following an initial assessment and are not included in the pipeline managed on Monday.com.

Consortium partners reported that it is hard to identify bankable projects in LDCs, as businesses tended to be smaller and were less likely to have the track record or scale of opportunity that would make the project bankable. They are not currently confident that they will meet the target of 25% of investment in LDCs, and are taking steps to address this challenge by, for example, exploring how they could invest in smaller opportunities.

Half of the sponsor representatives that we interviewed live in the country where the project is located, and fewer than half come from that country. Only three of the 34 sponsor representatives we interviewed were female. This may reflect a focus on sponsors that have an established track record and are able to bring in capital, technology, technical expertise, and/or market access opportunities who may be disproportionately based in more developed countries. However, the Consortium members recognise that, although characteristics of sponsor respresentatives is not one of the selection criteria for projects, there would be benefits from more diversity in their sponsors.

The DFCD Origination Facility in practice

The Consortium has developed successful approaches to identify potential sponsors and the DFCD Origination Facility is bringing forward financially additional projects that would not otherwise have been developed. The Consortium has adapted their approaches building on their early experience of delivering the DFCD Origination Facility and responding to the challenges of Covid-19.

SNV and WWF-NL have used a range of approaches to identify potential sponsors. Their experience led them to decide that open calls for proposals were unlikely to be an effective way of generating potentially bankable projects. They have:

- Built on the long experience and networks of their local offices to reach out to organisations in sectors and locations of interest.
- Extended their networks by recruiting staff with banking and investment expertise in developing countries.
- Collaborated with partners such as Dutch embassies with connections with businesses in developing countries who could introduce opportunities.

- Established the Scalable Climate Solutions Challenge, which has identified three potentially bankable projects which were announced at the 2021 United Nations Climate Change Conference (COP26).

None of the sponsors that had been approached by SNV or WWF-NL with a project idea had approached other funders, and in some cases, sponsors reported that they would not have been able to access corporate funds to investigate the idea and so were reliant on the DFCD Origination Facility to assess its viability. This suggests that the DFCD Origination Facility is bringing forward financially additional projects that would not otherwise have been developed.

Sponsors saw the DFCD Origination Facility as helping them to develop their projects and to better understand the climate and environmental and social (E&S) impacts. They also expected the Facility to reduce the risk associated with the project and build evidence that would make it easier to raise capital for the next phase of their development.

Consortium partners reported that, as anticipated in the Bid Book, it was easier to identify potential projects for the DFCD Land Use Facility than it was for the Water Facility. The ticket size requirements and targets for return on investment and revolvability are seen as challenging, particularly in LDCs, and the Consortium is working to find solutions that address this challenge.

Around a quarter of sponsors reported that DFCD's processes were slow and complex. This may be unavoidable and there is anecdotal evidence that the processes of other funds are also slow. However, there may also be opportunities to manage applicants' expectations of the time and effort involved in applying to the Fund. Most applicants were satisfied with DFCD's processes and there is no evidence that DFCD's processes result in projects that could be bankable being rejected or deter applications from sponsors of potentially bankable projects.

The landscape approach

The landscape approach offers rapid operational benefits of relationship building, information and resource sharing and understanding and reduction of financial and reputational risks of investments; as well as potential for longer-term benefits of climate adaptation, ecosystem resilience and participation of vulnerable groups. However, due to the multi-faceted, large-scale and long-term nature of the approach, it can be challenging and time-consuming to implement.

The landscape approach supports the DFCD Consortium to originate synergistic projects that can maximise the DFCD's resilience impact within each landscape. Several projects have been engaged in DFCD's priority landscapes. Identified synergies between these projects have the potential to boost landscape-level resilience in the longer term.

The approach is delivered in two different ways: as a stakeholder-centric approach in priority landscapes; and as a project-centric, rapid landscape study, outside of priority landscapes. This enables the approach to be applied appropriately to the context of DFCD's particular activities. Landscape considerations are integrated in project assessment by CFM and FMO where they have identified projects directly.

Although rapid landscape studies are not able to provide the same depth of understanding as the stakeholder-centric approach, they allow for consideration and integration of core landscape issues as relevant to a particular investment, without delaying the DFCD's origination and investment progress.

DFCD's model of combining the landscape approach with private sector finance offers potential to meet DFCD's longer-term socioeconomic commitments by working with companies to ensure projects are investable and self-sustaining, to secure longer-term private sector finance for businesses that build climate resilience.

Identified advantages of the Landscape Approach have potential to benefit the DFCD in its endeavours; as well as project sponsors and investors, in terms of building their understanding of the landscape context and reducing investment risk; and local stakeholders, in terms of maximising the alignment of investment with local priorities and needs. The challenges primarily affect DFCD and sponsors, who sometimes perceive the landscape approach as detracting attention from business development activities and slowing progress.

Peer organisations[8] provided some lessons from their experience of working with landscape approaches. They specified that the Consortium partners could strengthen the depth of their landscape assessments, focusing on key values and drawing further on stakeholder engagement, including with local communities and government. In alignment with the DFCD's approach, peers agreed that a landscape approach should use a blended finance model, and have an associated pipeline of projects. Further, peers advised that skilled and knowledgeable staff on the ground are crucial to delivering the approach, and that capacity building for implementing parties is crucial. In the context of the long-term nature of landscape approaches, DFCD is in the early stages of implementation, yet is responding to many of these lessons already, particularly through the stakeholder-centric approach.

Environmental and social impact

All four Consortium organisations have committed to addressing climate change, environmental degradation and social inclusion, which are key aspects of bankability for DFCD projects. All projects, including those directly identified by CFM and FMO, undergo rigorous E&S assessments, and a Rio Marker score of 2 for either climate change adaptation or mitigation is mandatory for each project.

There is a recognition across MoFA and the DFCD Consortium that E&S risks are high when aiming to deliver climate solutions that are also bankable, and particularly in developing countries where companies often do not have their own E&S managers. Despite each partner aligning with the IFC performance standards, CFM interviewees noted differing expectations between the DFCD Origination Facility and DFCD Water Facility in terms of the extent to which a project should be de-risked through its E&S standards in order to be considered for investment. Insights suggest that there is room for further increasing the alignment and understanding of E&S requirements between partners to ensure that DFCD Origination Facility projects are able to overcome the associated hurdles to securing investment, and thereby support a smoother transition of projects between facilities.

The ability of a project to build climate resilience is a key aspect of bankability for DFCD projects and a core aim for the DFCD. Alongside the Rio Marker for climate assessment, a project's climate resilience potential is understood through the landscape approach, impact indicators, and the institutional expertise of the Consortium partners. There is potential for DFCD Consortium partners to combine these different tools and approaches to articulate the intended climate resilience impacts of the projects more clearly.

DFCD sets out to gain insight into impacts on vulnerable groups and to respond to these insights within project design. The landscape approach is used to identify climate risks in a particular landscape and to consider how these are likely to affect local stakeholders. In DFCD's priority landscapes, such an understanding is then fed into project identification and design. For all projects, consortium partners apply E&S processes to understand the impacts of a given project on vulnerable groups. Sponsors also support the consideration and consultation of vulnerable groups.

For most DFCD projects, it is currently too early in the process to gain insight into how the consideration of local communities through the different phases of origination has led to changes in project design to ensure the projects meet the needs of vulnerable groups, including women and children. This is expected to happen as a result of activities in the Develop phase.

SNV and WWF-NL provide TA in the DFCD Origination Facility, together with consultants, where sponsors' needs are outside the expertise of the partners. This is valued by sponsors, who note that their engagement with the DFCD has positively influenced their projects.

[8] Including from CDC, Earth Security (previous employee), the International Union for Conservation of Nature (IUCN), the Sustainable Trade Initiative (IDH) and the Landscape Finance Lab.

The DFCD Consortium

The DFCD Consortium brings together a powerful combination of skills and experience, in particular SNV and WWF bring local presence and expertise which complements the investment expertise of FMO and CFM. Collaboration and cooperation between the partners have improved through working together, although some reservations remain.

The composition of the Consortium – comprising a Development Finance Institution (FMO), an Alternative Investment Manager (CFM), a conservation non-governmental organisation (NGO: WWF-NL) and a development organisation (SNV) – appears to be innovative and unique.

The Consortium partners recognise that collaboration between them has improved as they have learned more about each others' strengths; cooperation has increased and relationships have been formed. However, some within CFM remain sceptical of the value added by the DFCD Origination Facility in regard to identifying commercial opportunities for the Water Facility's Construction Equity Fund.

Sponsors generally saw the benefits of the Consortium approach and valued the environmental, social and investment expertise brought by the partners. We recognise that the partners bring expertise in other areas, but these were not mentioned by sponsors.

SNV and WWF-NL have improved their understanding of CFM and FMO's bankability requirements since the start of DFCD. WWF-NL and SNV have employed staff with experience in finance, which has assisted in this. However, respondents from CFM expressed reservations about how well their requirements were understood.

The DFCD Investment Facilities

The DFCD Origination Facility is intended to support potentially bankable projects to make a convincing case for funding by the DFCD Investment Facilities or others. It is too soon to know whether the DFCD Origination Facility is likely to be successful in doing so.

As intended in the Bid Book, the two Investment Facilities have different investment criteria and require different rates of return on their investments, and it was expected that the Water Facility would identify fewer projects than the DFCD Land Use Facility. For example, projects supported by the DFCD Water Facility were envisioned to have larger ticket sizes and more commercial rates of return, although CFM is also able to use its Development Fund to assist higher risk projects to prepare for investment by their Construction Equity Fund. The DFCD Land Use Facility can finance smaller projects and has more concessional return targets, they can also support very large projects by taking a sub-ordinated tranche that will catalyse more commercial funding. At this stage both the Investment Facilities are confident that they will be able to finance all the projects that complete the Origination Facility.

SNV and WWF-NL find it more challenging to identify projects that are suitable for the DFCD Water Facility than for the DFCD Land Use Facility because there are limited readily available opportunities in LDCs and the NL-priority countries that can provide the scale and the rate of return required to receive funding from CFM's Construction Equity Fund.

The landscape approach supports bankability by confirming the E&S impact, reducing risk and, where complementary investments are found, providing scale.

Key conclusions

DFCD progress

1. The DFCD Origination Facility has proved successful in identifying and supporting potentially bankable projects that would not otherwise have been pursued. This is likely to generate additional investment to address climate change in developing countries.

2. Although it is too soon to be fully confident, the DFCD Origination Facility is making good progress towards meeting their aims. The consortium report on progress on investment commitments to the Advisory Board and in the 2022 Annual Plan. However, DFCD's routine monitoring information does not enable a full assessment of whether DFCD's investment targets are realistic in the timescale allocated for the Fund.

Landscape approach

3. The landscape approach is innovative and ambitious. It helps to ensure a focus on sustainable development, and the approach supports DFCD in meeting its business goals of investing in climate resilient projects along with DFCD socio-ecological goals. The DFCD Origination Facility partners appear to value the landscape approach – or elements of the landscape approach – more than Investment Facility partners and it forms a more integral part of their implementation actvities.
4. The landscape approach has not as yet involved significant engagement of intended multi-stakeholders, but DFCD Origination Facility partners are scoping and planning engagement with existing multi-stakeholder platforms across priority landscapes in Vietnam, Zambia, Uganda and Kenya, among others. Engagement with these platforms will enhance efforts with vulnerable communities, governments and others in the landscape. In priority landscapes, current ways of applying the landscape approach to address the broader governance context could be strengthened to provide further detail on the social and political context of the landscape. Engagement with multi-stakeholder platforms will support this.

Environmental and social impact

5. All Consortium partners have committed to addressing climate change, environmental degradation and social inclusion, which are key aspects of bankability for DFCD projects. Each partner aligns with the IFC performance standards and, while the DFCD Origination Facility partners initially applied their own approach, they are now more purposefully aligning, tailoring and sharing their approaches.
6. There are differing perspectives among the consortium on the E&S expectations for a project at the end of the DFCD Origination Facility and the start of its engagement with an Investment Facility. Further alignment through increased collaboration and discussion on partner E&S activities and expectations could support a smooth graduation process.
7. While E&S processes offer rigour in understanding broader impacts of projects on vulnerable groups, the articulation and documentation by Consortium partners and/or project Sponsors, of how projects will directly benefit vulnerable groups (i.e. *how* a project builds resilience for *who*) could be strengthened. Project level ToCs that draw together insights from the landscape approach, impact indicators, and the institutional expertise of the Consortium partners would be useful in this regard; as would a narrative complementing indicator 6B: *'# of beneficiaries reached; vulnerable groups/beneficiaries benefitting from improved (climate resilient) well-being, economic prospects, livelihoods',* that explains how resilience is built.

The DFCD consortium

8. The expertise that each of the Consortium partners brings to DFCD adds considerable value in identifying, supporting, evaluating and investing in projects to address climate change and development.
9. The Consortium members bring different perspectives and have successfully overcome a lot of the challenges of working together. They have established good communications, particularly between FMO, SNV and WWF-NL. CFM has been less engaged with the Consortium and some within CFM

remain sceptical of the value added by the DFCD Origination Facility in regard to identifying commercial opportunities for the Water Facility’s Construction Equity Fund.

DFCD Investment facilities

10. The different investment criteria applied by the two Investment Facilities mean that water projects are required to offer a much larger ticket size and rate of return than land use projects to secure funding.
11. Both facilities require larger ticket sizes than projects in LDCs can easily absorb, and the Consortium recognises that new approaches may be required there. The Consortium is investigating opportunities to invest in projects with smaller ticket sizes.
12. It would be possible to improve the clarity with which bankability is communicated within the Consortium or to potential investees. Improved communications will help to ensure that the DFCD Origination Facility can meet the needs of the Investment Facilities effectively.

Recommendations

Following the initial presentation of findings from this evaluation, the Consortium partners met to consider their response. This resulted in their agreement on a set of recommendations, which have been included in DFCD’s annual plan for 2022. The evaluation team have made some additional recommendations.

Priority recommendations from the evaluation team are as follows:

- The Consortium produces a quarterly forecast of the actual capital commitments to date and the predicted capital commitments together with the date those commitments are expected to be made. The commitments should be analysed by adaptation focus, LDC and NL-priority country. All partners should contribute to this forecast in a consistent format. One parther should be responsible for co-ordinating this process.
- The Consortium should monitor the characteristics of the leadership teams of project sponsors and consider steps it could take to increase the number of projects from businesses led by women and people resident in the countries where the projects will be implemented.
- CFM considers whether there would be benefits from regular engagement with project origination staff in SNV and WWF-NL to help them to identify and shape potentially bankable opportunities for the Water Fund at an early stage.
- The DFCD Origination Facility monitors service levels (e.g. the time taken to respond to communications or to complete specific tasks) and the time taken by projects to progress through each phase of the DFCD Origination Facility. This evidence should be reviewed after 3–6 months to identify opportunities to improve efficiencies and speed up progress.
- Consortium partners collaborate to align their E&S processes to ensure that DFCD Origination Facility partners meet the minimum requirements of investment facilities at the point of graduation. This includes identifying differences between partner expectations of the extent to which aspects of E&S requirements are examined and fulfilled; and clarifying how those will be fulfilled during the origination process.
- The DFCD Origination Facility formalise process of consultation of representatives of the relevant Investment Facilities on opportunities that are included in the pipeline to obtain their view of bankability for all opportunities.
- Representatives of SNV and WWF are invited to join the Investment Committees for the Land Use Fund and the Water Fund.

In addition, we draw on learning from this evaluation to make some recommendations for future FMO funds:

- By providing support to projects to build their business cases, the origination facility approach engages opportunities that otherwise would not have been available to the Fund. It seems likely that additional finance will be mobilised by the Investment Facilities as a result. Future FMO funds should consider offering support for sponsors to structure and develop business cases.
- The DFCD Consortium has brought in skills and contacts that would not have been available in a traditional structure. SNV and WWF's embedded local networks have been particularly valuable along with their environmental and social expertise. Future FMO funds should consider ways in which they can obtain similar benefits either by partnering and/or by recruiting skills. We would also recommend that our above recommendations relating to the composition of investment committees and consultation between partners are adopted.
- DFCD has offered a range of financial products with different risk appetites and tenors. This has enabled them to mobilise private finance and to meet the needs of different sponsors. However, allocating specific products for water and land use projects has potential to be limiting and we recommend that future FMO funds should offer all products for all eligible purposes and the type of funding should not differ between sectors.
- Future FMO funds should consider how to meet the need for smaller ticket funding, particularly in LDCs. They should also consider whether they can provide a structure where projects graduate to funding with lower levels of concessionality as they progress towards commercial viability.
- If future FMO funds adopt the landscape approach they should consider how to align financial structures to that approach. For example, a structure where projects are funded on an individual basis may need to be adapted to finance multiple connected projects in a landscape.