


















**Ministry of Foreign Affairs – (Department for Sustainable Growth and Employment, BVB)**

**Meeting in the Council for Development Policy 13 November 2019**

Agenda item 2

- |   |  |
|---|--|
| <b>1. Overall purpose</b>                       | For discussion and recommendation to the Minister    |
| <b>2. Title:</b>                                | Commitment to IFU for investment in the water sector |
| <b>3. Presentation for Programme Committee:</b> | 26 September 2019                                    |

# Commitment to IFU for investment in the water sector

<p><b>Key results:</b> This commitment to Climate Investor 2 (CI2) through IFU will promote responsible and sustainable blended finance for water and sanitation investment solutions that can be replicated and scaled in support of the achievement of SDG 6. CI2 will contribute to several other SDGs including good health, climate action, affordable and clean energy, and sustainable cities and communities.</p> <p>The principal outcomes of CI2 include: Number of people benefiting from improved wellbeing from improved water and sanitation; volume of private finance mobilised; reduced or avoided greenhouse gas emission; amount of urban and industrial water supply per day; amount safely urban and industrial wastewater treated per day, reduced losses of drinking water per day.</p> <p><b>Justification for support:</b></p> <ul style="list-style-type: none"> <li>• <i>Inadequate investments in effective and sustainable water infrastructure and systems are fundamental constraints that hamper social and economic development and promote the risk of instability and inequality in developing countries.</i></li> <li>• <i>The challenges of increasing water and sanitation investments in developing countries are so explicit that it calls for an international effort with joint participation of donors, DFIs and investors.</i></li> <li>• <i>CI2 has an innovative investment fund structure which will allow it to promote responsible and sustainable commercial water and sanitation solutions that can be replicated and scaled.</i></li> </ul> <p><b>Major risks and challenges:</b></p> <ul style="list-style-type: none"> <li>• <i>Political and/ or financial instability in specific countries where CI2 has invested. CI2 will apply a number of risk mitigation measures, including a broad geographical investment portfolio.</i></li> <li>• <i>Reputational risks due to e.g. the social dimension of possible expensive water and sanitation services in very poor communities. It is important that blended finance is only used in water sub-sectors that are suitable for this type of finance. The projects must not result in human rights violation or negative effects on poor or vulnerable stakeholders, e.g. higher prices.</i></li> <li>• <i>Inadequate interest among donors, DFIs and private investors to provide the required capital. However, donors and DFIs have increased focus on the water sector, CI2 has an appropriate fund structure, and the fund manager has a proven track record.</i></li> </ul>	<b>File No.</b>	2019-18118						
	<b>Country</b>	DC						
	<b>Responsible Unit</b>	BVB						
	<b>Sector</b>	Water and sanitation						
	<b>Partner</b>	Climate Investor 2 through IFU						
		<i>DKK mill.</i>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>Tot.</b>
	<b>Commitment</b>		50					50
	<b>Projected ann. disb.</b>		50					50
	<b>Duration</b>	2020-2022						
	<b>Previous grants</b>	Capital contribution: DKK 300 million in 2017; DKK 100 million in 2018; DKK 200 million in October 2019						
	<b>Finance Act code</b>	§06.38.01.11						
	<b>Head of unit</b>	Ole Thonke						
	<b>Desk officer</b>	Jørn Olesen						
	<b>Financial officer</b>	Marie Gro Svendstrup						
<b>Relevant SDGs</b>								
 No Poverty		 No Hunger		 Good Health, Wellbeing		 Quality Education		
 Gender Equality		 Clean Water, Sanitation		 Affordable Clean Energy		 Decent Jobs, Econ. Growth		
 Industry, Innovation, Infrastructure		 Reduced Inequalities		 Sustainable Cities, Communities		 Responsible Consumption & Production		
 Climate Action		 Life below Water		 Life on Land		 Peace & Justice, strong Inst.		
 Partnerships for Goals								

## Strategic objectives:

The overall objective is to contribute to improved access to safe drinking water, improved effective wastewater treatment and effective use of water resources in developing countries through an innovative blended finance initiative that can promote and scale responsible and sustainable commercial water and sanitation investment solutions.

## Justification for choice of partner:

The challenges of improving the water sector in developing countries in terms of project development, construction and operation are so requiring that it calls for an international effort with participation of donors, DFIs and private investors. The newly launched Climate Investor 2 (CI2) initiative, which focuses on the water sector, appears to be an appropriate and powerful PPP response to these requirements. CI2 is based on a well-tested institutional setup, and an experienced fund manager with the required capacity, experience and network. An active IFU participation in CI2 can be an effective gate to strengthen IFU's and the Danish water sector's engagement in water sector investments in developing countries.

## Summary:

According to the UN an estimated 2.1 billion people lack access to safe and readily available water, and more than 4 billion people lack access to sanitation compatible with SDG 6 on water and sanitation. Inadequate water and sanitation systems at all levels in developing countries have great negative impact on social and economic development. The inadequate water and sanitation investments in developing countries are two sided: a) International development assistance and public authorities in developing countries have inadequate resources and b) the private sector is not ready to invest in water infrastructure and systems in developing countries due to a perceived unattractive risk-return balance. It is therefore necessary to develop new blended finance solutions that can catalyse the mobilisation of private capital.

## Budget:

Capital contribution to CI2 through IFU	DKK 50.0 million
<b>Total</b>	<b>DKK 50.0 million</b>

**Project Document**  
**Commitment to IFU for investment in**  
**the water sector**  
October 2019

## Cover page

- Countries: All DAC countries, but with a strong focus on Low Income Countries and North and West Africa including Sahel
- Project title: Climate Investor 2
- Start-End-Date: 2020 and up to 2037
- Budget: DKK 50 million – capital contribution to IFU for investment in Climate Investor 2 (CI2)
- Oversight: CI2 will be implemented by Climate Fund Managers (CFM), which is jointly owned the Dutch Development Bank (FMO) and Sanlam Infra Works, a South African infrastructure investment company. The investment decisions of CI2 will be managed by investment committees with representatives from the investors and independent experts. The investors will comprise donors, Development Finance Institutions (DFI) and private institutional investors.
- Main features: According to the UN an estimated 2.1 billion people lack access to safe and readily available water, and more than 4 billion people lack access to sanitation compatible with the SDG 6 on water and sanitation. Inadequate water and sanitation systems at all levels in developing countries have great negative impact on social and economic development. There is an urgent need to increase investments in the water sector.
- The inadequate water and sanitation investment level is two sided: a) International development assistance and public authorities in developing countries have inadequate resources, and b) the private sector is not ready to invest due to a perceived unattractive risk-return balance.
- The challenges of improving the water sector in developing countries in terms of project development, construction and operation are so explicit that it calls for an international effort with participation of donors, DFIs and investors. The newly launched CI2 initiative, which focuses on the water sector, appears to be an appropriate and powerful Public Private Partnership (PPP) response to these requirements. CI2 has the potential to promote the development of suitable business models, promote the development of bankable projects, and substantially scale up the mobilisation of private finance for responsible and sustainable water investments. CI2 can also be an useful entry for IFU and Danish water sector stakeholders to gain experience about market and investment opportunities within the water sector.
- It is also obvious that blended finance solutions should not be applied for complex water infrastructure investments, which may have negative effects on poor and vulnerable stakeholders. It is important, that water projects ensure inclusive access to clean water and sanitation as a human right

# Table of Content

- Table of Content** ..... 2
- Abbreviations ..... 3
- 1. **CONTEXT**..... 4
  - 1.1 **Background** ..... 4
  - 1.2 **Preliminary blended finance experiences of importance for CI2** ..... 5
- 2. **PROJECT PRESENTATION** ..... 6
  - 2.1 **Theory of change** ..... 6
  - 2.2 **Objectives** ..... 7
  - 2.4 **Strategic considerations** ..... 8
- 4. **INSTITUTIONAL AND FINANCIAL FRAMEWORK** .....12
  - 4.1 **Institutional setup and operation** .....12
  - 3.2 **Resources and staffing** .....13
  - 3.3 **Financial management and exit** .....13
  - 3.4 **Reporting** .....13
- 4. **RISKS** .....14
  - Annex 1: **Context analysis** .....15
  - Annex 2: **Partners** .....19
  - Annex 3: **CI2 - Preliminary results framework of engagement** .....20
  - Annex 4: **Governance of Dutch Fund for Climate and Development** .....21
  - Annex 5: **Preliminary Risk Management Matrix** .....22
  - Annex 6: **Process Action Plan – Commitment to IFU for investment in Climate Investor 2** .....25
  - Annex 7: **Signed Quality Assurance Checklist** .....26

## Abbreviations

CI2	Climate Investor Two
CFM	Climate Fund Managers (Fund manager of CI2)
Danida	Danish International Development Assistance
DIM	Development Impact Model
DFI	Development Finance Institution
DKK	Danish Kroner
EAC	Export Credit Agency
ESG	Environmental, Social and Governance
EUR	Euro
FMO	Dutch Development Bank
LDC	Least Developed Countries
LIC	Low Income Countries
LMIC	Lower Middle Income Countries
MFA	Ministry of Foreign Affairs of Denmark
NGO	Non-Government Organisation
ODA	Overseas Development Assistance
PPP	Public Private Partnership
SDG	Sustainable Development Goals
SNV	The Netherlands Development Organisation
UMIC	Upper Middle income Countries
UN	United Nations
USD	United State Dollar
WWF-NL	World Wildlife Fund of the Netherlands

<b>Currency</b>	
1 EUR	DKK 7.50
1 EUR	USD 1.11
1 USD	DKK 6.75

## 1. CONTEXT

### 1.1 Background

According to the UN an estimated 2.1 billion people lack access to safe and readily available water at home, and more than 4 billion people lack access to sanitation compatible with the SDG 6 on water and sanitation. The very majority of all wastewater in developing countries is discharged without any treatment. Safe water, effective sanitation and hygiene are critical for households, business communities and societies. Inadequate water and sanitation systems have a great negative impact on social and economic development. Poor water, sanitation and hygiene lead, according to the World Bank, to about 675,000 premature deaths annually, and estimated annual losses of up to 7% of GDP in some developing countries<sup>1</sup>. Climate changes is an additional factor significantly aggravating access to water and sanitation in many developing countries, and the worrying effects that climate changes may have on water and sanitation systems in rural and urban areas in developing countries is only now attracting attention. The World Bank has further indicated that water related losses in agriculture, health, income and property within some decades could lead to sustained negative growth in some regions.

According to World Bank and other international organisations the present value of the additional investments needed until 2030 to achieve SDG 6 for all is approximately USD 1.7 trillion. This amount is about three times the current investment levels. In addition, this estimate represents according to other international sources only a fraction of the water agenda, and the related financing needs<sup>2</sup>. Closing the financing gap for water and sanitation is obviously critical to achieving universal, sustainable, and equitable access to water and sanitation as well as ensuring stability and social and economic development.

In 2016 Official Development Assistance (ODA) to water and sanitation investments constituted about USD 8.6 billion, only a tiny part of the financing needs. Considering the constraints on national and international public finance, including ODA, and the substantial water and sanitation investment needs, efforts to leveraging capital mobilisation from other sources of finance, in particular international and domestic commercial finance with different risk appetite, are highly needed.

The water sector is very broad, and blended finance is only an appropriate modality in parts of the sector. This could be the case when blended finance at the same time can provide better water and wastewater solutions and reduction of greenhouse gas emission, without negatively effecting stakeholders and services. Possible examples include: a) climate smart water supply and wastewater treatment for industrial areas, which can ensure essential and efficient infrastructure for the promotion of economic activities and job creation, and at the same time reduce pollution through efficient wastewater treatment, reduce emission of greenhouse gases through the use of renewable energy supply and efficient pumping technology, and reduce water losses (non-revenue water) through better pipeline systems; b) desalination infrastructure for urban areas with insufficient water resources where the desalination plant can ensure stable water supply, protect overexploited groundwater resources and avoid negative climate effects through the use of renewable energy and energy efficient pumping systems.

It is also obvious that blended finance solutions should not be applied for complex water infrastructure investments, where risk of human rights violations or negative effects on the poor

---

<sup>1</sup> World Bank: Water overview, 2018.

<sup>2</sup> OECD: Financing water. Investing in sustainable growth, 2018. Projections based on new indicators of safely managed drinking water and sanitation services defined by WHO/UNICEF.

and vulnerable cannot be satisfactorily addressed through livelihood analyses, safeguards and project design. It is important, that water investments ensure inclusive access to clean water and sanitation as a human right. According to the former UN special rapporteur on the right to safe drinking water and sanitation, water can have a price as long as people are not excluded. This is in parallel with other human rights, e.g. the right to food and health.

The inadequate water and sanitation investment level is two sided: a) International development assistance and public authorities in developing countries have inadequate resources, and b) the private sector is not ready to invest in the development, construction and operation of water and sanitation infrastructures and systems in developing countries due to a perceived unattractive risk-return balance. The challenges for private investors include a number of factors: a) water infrastructure is typically capital intensive requiring high initial investments followed by a very long pay-back period; b) it often takes a long time to prepare and construct water infrastructure projects leading to considerable investment uncertainties; c) water services are often under-priced resulting in poor return or cost recovery on the investments; d) challenges to generate a satisfactory mix of public and private benefits; e) inadequate private investor knowledge about the water sector and the potential investment opportunities and business models; f) inadequate project development capacity and experience; and g) a challenging business environment in most developing countries.

The challenges of improving the water sector in developing countries in terms of project development, construction and operation call for international efforts with participation of governments, donors, DFIs and investors. The CI2 initiative, which focuses on the water sector, appears to be an innovative response leveraging private sector contribution. CI2 aim for a targeted capital of USD 500 – 1,000 million of which at least 50 percent is expected be provided by private investors (rf. Section 3 and 4). Additional public and private capital will be mobilised in relation to the specific investment projects. CI2 can also be a useful entry for IFU and Danish water sector stakeholders to gain experience with market and investment opportunities in the water sector.

## **1.2 Preliminary blended finance experiences of importance for CI2**

Public-Private-Partnership (PPP) arrangements can be useful tools to facilitate the development of relevant business models and financing instruments to mobilise private capital, technology and knowhow for financing and operation of water investment projects in developing countries. This model is well established in more mature sectors and markets which are close to be commercially viable, e.g. renewable energy and parts of the transport sector. Blended finance can also play an important role within parts of the water sector provided that a number of challenges are addressed.

Preliminary OECD data shows that official development assistance has mobilised USD 2.1 billion from the private sector for water and sanitation projects in developing countries from 2012-17<sup>3</sup>. This is still a tiny part of the total mobilised private capital of USD 157.2 billion for blended finance investments during the same period.

Blended finance cannot compensate for a challenging enabling environment, but need to be accompanied by efforts to promote a conducive policy environment similar to policy developments that have been achieved within renewable energy. However, subsectors likely to benefit from blended finance in the short to medium term include industrial water supply and industrial wastewater treatment, urban water supply and wastewater treatment, desalination etc.

---

<sup>3</sup> OECD: Making blended finance work for water and sanitation, Unlocking commercial finance for SDG 6, 2019



Some blended finance and business models are emerging but have still not reached scale. The public sector is likely to continue to play a significant role in most water and sanitation subsectors, due to the strategic importance of water and the related infrastructure, but the involvement of commercial investors cannot only contribute with financing but also with improved know-how and management capacity.

CI2 is the successor of Climate Investor One (CI1), which came into full operation in 2018 with a capital of EUR 850 million. The objective of CI1 is to create a sustainable positive impact on the environment and communities of developing countries through the financing of development, construction and operation of renewable energy projects in developing countries<sup>4</sup>.

The implementation of CI1 is so far progressing according to plans both in terms of project development and commitment of funds for the implementation of the investments. About one third of the funds will be committed by the end of 2019. Some of the main lessons learned include: a) funds should be available as soon as the fund is established in order to avoid a slow start-up of activities.; b) it is important that all funds can be pooled since earmarked finance from donors or DFIs complicates preparation, approval and not least the waterfall processes; c) it is important to have physical presence in regions/countries with good market knowledge and ability to work closely with local stakeholders; d) in addition to support to financing of investments it is also important to be able to provide support to Technical Assistance (TA) and Environmental, Social and Governance (ESG) to local project managers; e) active and transparent cooperation with civil society organisations through regular information meetings is very useful; f) it is easier and faster to work with equity only, compared with a mix of equity and loans which complicates the due diligence processes that participating banks need to undertake. A positive experience is also, that the project development activities may be self-financing despite their natural higher risk (ref. section 3.1).

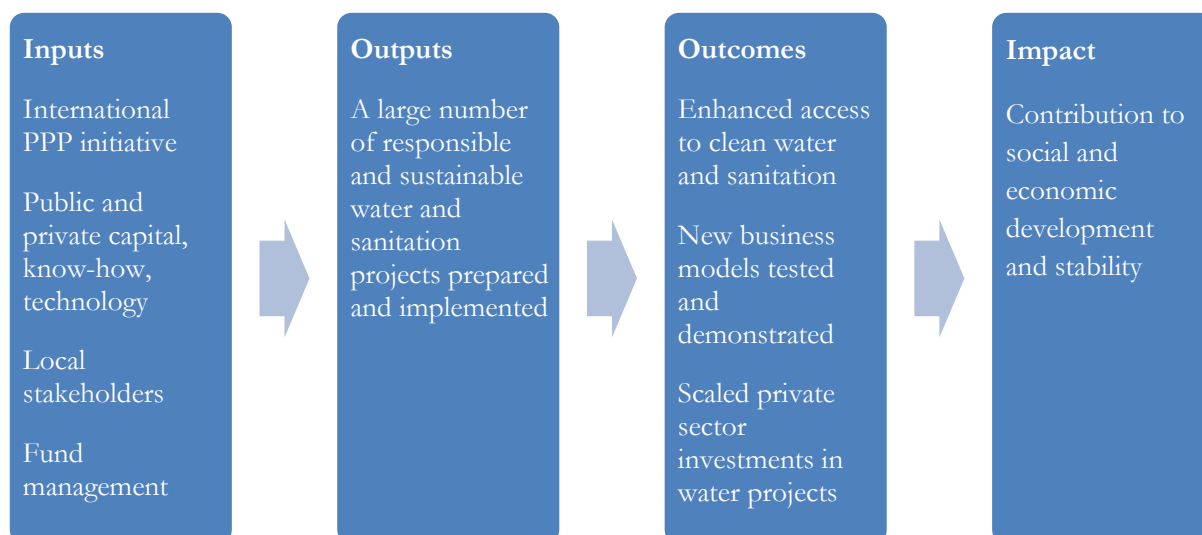
## 2. PROJECT PRESENTATION

### 2.1 Theory of change

A very large part of the population in developing countries have no or inadequate access to safe water and sanitation. Inadequate water and sanitation systems at all levels in developing countries have a great negative impact on social and economic development, stability and quality of life. The requirements to address these challenges are very demanding in terms of financing, technical capacity, governance and management, and that calls for a strong international and innovative PPP vehicle that can develop projects, test and demonstrate approaches and prepare markets for private stakeholders. **If** a group of committed donors, DFI and private investors can establish and operate a powerful and innovative PPP water investment vehicle, **then** it will be possible to contribute to an important breakthrough in project development and investments in the water and sanitation sector in developing countries.

---

<sup>4</sup> The target is to finance 30 renewable energy projects with a total capacity of 1,700 MW, which are expected to generate more than 10,000 decent jobs throughout the construction and operational phases. CI1 is financed by a number of donors, DFIs and private investors. The donors include Ministry of Foreign Affairs of the Netherlands, European Commission, Nordic Development Fund and the Green Climate Fund. The DFIs include FMO (the Netherlands), Swedfund, FinDev Canada, and the African Development Bank. The private investors include a number of European pension funds, foundations and banks.



## 2.2 Objectives

Development objective: Contribute to improved access to safe drinking water; improved effective wastewater treatment and effective use of water resources in developing countries in support of the achievement of SDG 6.

Immediate objective:

1. CI2 operational as an innovative international blended finance vehicle for the promotion of responsible and sustainable commercial water and sanitation investment solutions that can be scaled to accelerate progress towards achievement of SDG 6.
2. Strengthened IFU and the Danish water sector's experience and opportunity to engage in an increased number of water infrastructure projects in developing countries

In addition to SDG 6 it is envisaged that CI2 will contribute to several other water related SDGs including: SDG 3 (Good health), SDG 5 (Gender equality), SDG 7 (Renewable energy), SDG 9 (Innovation and infrastructure), SDG 11 (Sustainable cities and communities), SDG 13 (Climate action), SDG 14 (Life below water) and SDG 17 (Partnerships for goals). CI2 will report on a number of climate related impact indicators including a) total number of people benefiting from improved wellbeing, economic prospects and livelihood; b) volume of private finance mobilised for climate change action, c) reduced or avoided greenhouse gas emissions and d) share of renewable energy in total energy mix. Specific targets for the various indicators will only be prepared at a later stage, when the size of the fund is finally known and the pipeline of investment projects further developed. The outcome indicators include: Amount of urban water supply per day, amount of urban wastewater safely treated per day, amount of industrial wastewater safely treated per day, reduced losses of drinking water (non-revenue water) per day. The outcome indicators will be linked to the SDG impact indicators. CI2 will use the Rio Marker framework for Climate Mitigation and Climate Adaptation, and all CI2 financed projects must be designated as either a climate mitigation or a climate adaptation project.

CI2 will also contribute to enable implementation of new financial models and agreements similar to the PPA arrangements that over the last decade have made a breakthrough for renewable energy in developing countries and transformed the market for such technologies. Annex 3 provides further details about the results framework.

## 2.3 Justification

*Relevance:* The engagement is fully in line with Danish and international development policy priorities. Inadequate investments in effective and sustainable water infrastructure and systems

are fundamental constraints that hamper social and economic development and promote the risk of instability, inequality and forced displacements. There are good reasons to believe that a strong and innovative PPP arrangement comprising strong governance, new business and financing models etc. can catalyse the mobilisation of private capital, technology and know-how and prepare markets for commercial investors. Similar developments have been achieved in other infrastructure sub-sectors including telecommunication, transport and renewable energy. However, it will require a comprehensive effort which can best be achieved through an international initiative, where IFU can be an investment partner and hereby build network and experience, and get access to investment opportunities together with Danish and international investors and stakeholders.

CI2 should be seen as an early water investment mover that with a comprehensive start capital and new approaches and business models, will develop water sector investment and demonstrate market opportunities that can attract private investors. CI2 is envisaged to operate in difficult settings and markets with a broad range of public and private stakeholders in urban, semi-urban and rural areas in developing countries.

*Impact and additionality:* Sustainable water infrastructure investments at scale will first of all contribute to economic and social development and stability, sustainable use of water resources and protection of the environment, improved quality of life and gender equality.

CI2 will through its catalytic role underpin the acceleration and scaling of water infrastructure investments. CI2 is expected to demonstrate how new solutions and approaches can turn risky and challenging markets into commercial business opportunities. Gradually this will bring the private sector and commercial finance on board; create new experiences and relations; and hopefully an appetite for replication and scaling of projects on a commercial basis that meets the huge needs for water infrastructure investments in developing countries.

The additionality of CI2 is likely to be high. CI2 will ensure the development, implementation and operation of water projects that would otherwise not be implemented or implemented in a less ambitious way. At the same time it is a clear ambition at project level to raise the bar in terms of using good practices and governance e.g. on transparency, public participation, user involvement, holistic planning and decision making, energy efficiency, social, environmental and gender aspects, and creation of decent jobs.

*Effectiveness, efficiency and sustainability:* CI2 is based on a well-tested institutional setup, and an experienced fund manager, Climate Fund Managers (CFM), with the required capacity, experience and networks. The CFM has for the last few years managed CI1 with a total capital EUR 850 million, and the required systems and procedures for an efficient management are already in place. The investment in CI2 is expected to be an effective use of limited Danish funds in terms of promoting sustainable water investments and to strengthen the involvement of Danish stakeholders in the water sector in developing countries.

CI2 will have a strong focus on sustainability and is already applying sustainability policies and procedures in line with international best practice. Specific sustainability policies and procedures for water investments will be prepared and adopted.

## **2.4 Strategic considerations**

*Environmental, Social and Governance (ESG) framework:* The CFM has adopted an ambitious Responsible Investment Code which applies to all funds and project companies in which CFM invest. The funds and project companies are requested to implement a management system that effectively complies with the Code and addresses environmental and social risks and opportunities. All contractors and sub-contractors working for, or on behalf of the fund

manager, should either adopt the Code or present policies and procedures meeting the requirements set out in the Code. The Code emphasizes commitment to meet all legal requirements as well as the Equator Principles, the IFC performance standards, ILO core labour standards and UN Guiding Principles on Business and Human Rights. The Code further provides an operational framework and emphasizes that developers, contractors, and project companies should have adequate management and monitoring systems in place. The Code provides detailed guidance on how to prepare environmental and social impact assessments, adequate content of safeguards, due diligence assessments etc., and it outlines expectations for quarterly and annual reporting from business partners. An anonymously grievance mechanism is also available with clear procedure for managing any incoming grievance.

*Need of strong international PPP vehicle:* CI2 appears to be a strong PPP investment vehicle to address some of the water infrastructure challenges in developing countries. Water infrastructure projects are capital intensive with a challenging risk return balance, and therefore they require comprehensive public and private capital in the form of grants, concessional capital, loan and equity in order to ensure adequate financing and implementation. It may take 5-10 years, or even more, to prepare and implement large water infrastructure projects, and that requires solid capacity. CI2 is structured with a targeted closing capital of USD 500 - 1,000 million and several risk classes for the investors.

*Legal and financial structure:* Unclear roles and mandates, inadequate incentives and potential overlap and gaps characterize the institutional backdrop for many water infrastructure projects. The capacity and measures to go into a dialogue with relevant institutions and user groups, and openly discuss possible ways forward and develop innovative and viable institutional solutions, will be crucial. CI2 is established as a private and commercial investment vehicle to ensure optimal opportunities to explore markets opportunities in an efficient, effective and flexible manner. A private institutional structure is of paramount importance to ensure that the company effectively can mobilise private capital and specialised skills according to needs.

*Partners and stakeholders:* It will be crucial for CI2 to establish strong relations with the stakeholders in the eco-system of the specific water investments. The stakeholders may include: public organisations including national and local water authorities, city municipalities, water utilities, user groups incl. women, NGOs, suppliers, service providers, and public and private investors. Close dialogue with user groups concerning their needs and priorities is essential in the design of water infrastructure investments. Grant funding for stakeholder analyses, user dialogue and capacity building will be available for these purposes. CFM applies an environmental and social management system outlining how to undertake stakeholder mapping and engagement. The CFM further expects to attach a community development project to each investment. Community projects will engage local stakeholders and will include project specific indicators to measure the impact of community development activities linked to the water infrastructure investment. An example is a near-shore wind energy project in an Asian country where the linked community project contributes to the protection and reestablishment of the local mangrove forest.

*Fast establishment of the PPP vehicle:* It can be a very long and complicated process to establish a large PPP investment vehicle, but CI2 can be operational relatively fast. CI2 is already legally and managerial established, and it is expected to be fully operational by the end of 2020. Denmark can therefore relatively quickly become an active partner, whereas it could easily take several years to establish a similar new vehicle from the ground. The CFM has already identified a substantial pipeline of potential water investment projects. Development of the first two water investment projects is expected to be initiated already by the end of 2019. These two projects may include a

combined industrial wastewater and bio-energy project in Asia, and a combined desalination and solar energy project for an urban area with insufficient water resources in Southern Africa.

*Need of an experienced fund manager:* An experienced fund manager with the required financial, technical and managerial capacity is crucial for a successful outcome of CI2, and there are only few fund managers with the required sectoral and regional experience in the market. CI2 will be managed by the same fund manager as for CI1. The fund manager has a strong international experience with climate investments in developing countries, and the current 50 professional staff is planned to be complemented with an additional 15-20 water and investment staff. Climate Fund Managers (fund manager) is based in the Netherlands and it has regional offices in Africa and Asia.

*Important platform for IFU and Danish stakeholders:* CI2 can be an important platform for IFU, and Danish investors, equipment suppliers, utility and knowledge companies, who want to pursue promising future market opportunities within water infrastructure investments in developing countries. The Danish water sector has a lot to offer, but it is still relatively small and fragmented when it comes to development and investment in complex and integrated water infrastructure projects in developing countries. An active Danish participation in CI2 can be a low cost effective gate to strengthen Denmark's activity in the sector through investment opportunities, knowledge sharing, and networks paving the way for future market penetrations.

*Types of investment projects:* The water sector is very broad and comprises a number of sub-sectors including water resources management, bulk water supply, storage, sanitation, wastewater treatment, flood protection etc. CI2 will invest in projects generating sustainable development outcomes for citizens, industry and society, and a satisfactory return to the investors and only in greenfield projects. Typical investment opportunities include industrial water supply and wastewater treatment, bulk water supply<sup>5</sup>, urban water supply, urban wastewater treatment, and environmental services. An important part of the investment approach is to find solutions that can optimise operation. This can e.g. be done through: a) higher energy efficiency by means of modern technology for pumping and waste water treatment etc. (electricity constitutes typically 40 – 60% of the operation costs in water infrastructure projects); b) efficient re-use of water and waste after wastewater treatment (e.g. re-use of waste for bioenergy and fertilizer); and c) investment in complementary renewable energy facilities to ensure cost effective energy supply. The expected average size of the investment projects is USD 25 – 75 million depending on the mix of the project portfolio.

*Geographical scope:* CI2 can invest in all DAC countries. CI2 will invest at least 25 percent of the fund's capital in Low Income Countries (LIC). It is further stated, that at least 25 percent of the capital will be invested in North and West African counties incl. the Sahel, which mainly comprise low-income and fragile states. The remaining funds will be invested in Lower Middle Income Countries (LMIC) and some Upper Middle Income Countries (UMIC).

*Financial products and services:* CI2 will have access to both public grant resources and concessional capital as well as private capital, and it will therefore be able to provide a range of financial and non-financial services including technical assistance for feasibility studies and capacity building, concessional and ordinary loans, equity and guarantees. CI2 may also be able to establish cooperation agreements with one or several Export Credit Agencies (ECA).

---

<sup>5</sup> International organisations define bulk water supply as: The production of water to be distributed to various end-users including drinking water supply. Bulk water supply may be produced from abstraction of surface or groundwater or through non-conventional sources, such as desalination or wastewater reuse.

*Return:* The return on the CI2 investments is expected to be in the range of 8-10 percent for the commercial investors, sufficient to attract private investors due to the various risk mitigation mechanisms that the fund is able to apply. Donors that are taking higher risk through investment in the Tier 1 of the Construction Fund (rf. section 3 and 4) can expect a return of 2-4 percent.

*Leverage:* A key purpose of blended finance is to use donor funds as leverage for the mobilisation of private capital, technology and know-how. The private capital mobilisation will occur at two levels, respectively at the level of CI2 and at the level of the specific investment projects. A target for the leverage factor has not been defined, but the leverage factor will be measured. The fact that the water sector is unknown frontier to most private investors implies a lower leverage factor than more mature blended finance markets, such as renewable energy.

**3. BUDGET**

CI2 will have a targeted capital of USD 500-1,000 million. Of that USD 150-250 million is expected to be committed from donors, and the remaining from DFIs and private investors.

The Dutch Government has committed EUR 75 million (ODA) to CI2, of which EUR 25 million is intended to be allocated to the Development Fund and EUR 50 million to the Tier 1 of the Construction Equity Fund (rf. figure in section 4). The EC has committed EUR 20 million, which is expected to be allocated to the Development Fund and the Tier 1 of the Construction Fund. Additional donors and DFIs has shown interest to join the initiative.

The MFA commitment of DKK 50 million (EUR 6.7 million) will be allocated through IFU which will invest the funds in the Development Fund and the Tier 1 level of the Construction Fund. The specific distribution will be negotiated with the fund manager during the preparation process, but it is envisaged that at least one third will be allocated to the Development Fund and the remaining amount to the Tier 1 level of the Construction Equity Fund. It is further expected that IFU will invest a substantial amount of own funds in the Tier 2 of the Construction Equity Fund, but that is awaiting final board decision within the next months. If the IFU board against expectation does not approve an additional IFU commitment, then the MFA commitment will not be disbursed to IFU for investment in CI2, but reallocated for other development policy purposes. It is important that IFU participates as an active investor with own resources.

**Budget for the Danish Contribution to CI2**

	DKK million	DKK million
<i>Utilisation of MFA commitment</i>		
Funds to IFU for investment in CI2	50	
Total	50	
<i>Expected IFU investment in CI2</i>		
Development Fund		15
Tier 1 of Construction Fund		35
IFU own funds – tier 2 of Construction Fund – to be determined		
Total		50 + IFU

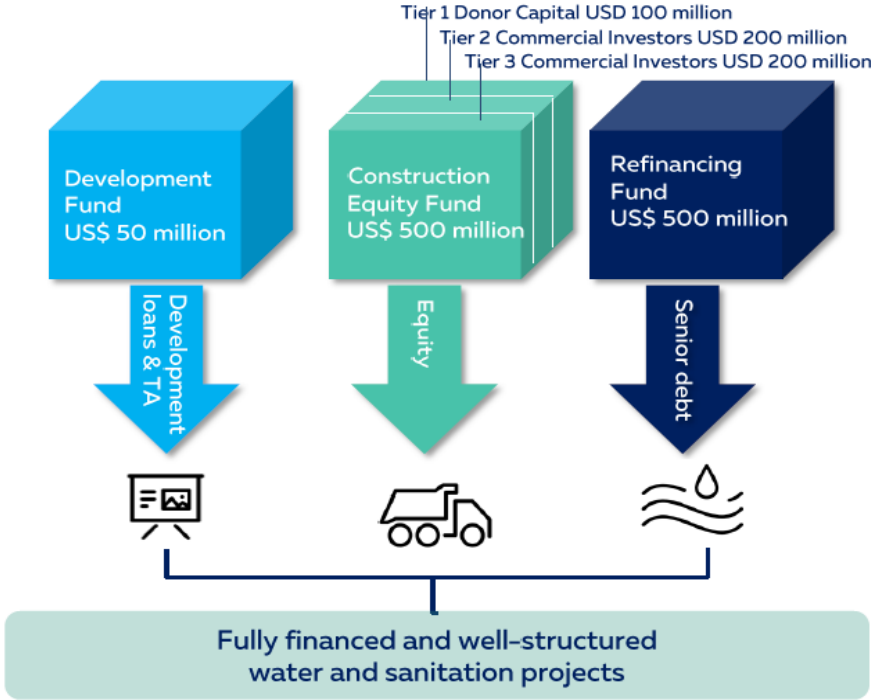
IFU also intends to facilitate CI2 contacts to Danish pension funds for them to explore opportunities for direct investments in the Construction Fund.

**4. INSTITUTIONAL AND FINANCIAL FRAMEWORK**

**4.1 Institutional setup and operation**

CI2 is a Dutch initiative established through the Dutch Fund for Climate and Development (DFCD)<sup>6</sup>. CI2 is financed and managed by an international group of public and private investors. The CFM, which has been contracted to manage CI2, is jointly owned by the Dutch Development Bank (FMO), and Sanlam InfraWorks, a South African infrastructure investment company. The vision of CFM is to structure and operate financing facilities for climate change mitigation and adaptation sectors including energy, water and sustainable cities.

CI2 is structured in the following three interrelated funds with specific purpose and risk profile, ref. below:



- a Development Fund with the purpose to identify and develop responsible and sustainable water infrastructure investment projects. This is a risky and resource requiring process where a significant percentage of the identified project pipeline may fail to materialise. The Development Fund will therefore be financed with donor funds to cover development costs, TA and capacity building in relation to stakeholders etc. However, it is envisaged that Development Fund will be able to maintain the capital, as it will receive a mark-up of 50 percent of the development costs for all successfully developed projects

<sup>6</sup> DFCD is structured in three separate but operational linked facilities respectively a Water Facility (CI2) managed by CMF, an Origination Facility managed by the NGOs SNV and WWF-NL, and a Land Use Facility managed by FMO. Although the interaction between the three DFCD facilities is relatively loose, it is quite innovative that a DFI, a private sector investment manager, a conservation NGO and a development NGO work together on a fund of this size. DFCD will screen all projects at an early stage during project preparation. The Origination facility can provide project proposals to the Water and Land Use Facilities. However, it is expected that CFM, will identify and select the very majority of the water project proposals to be developed.

that are transferred to the Construction Equity Fund. The Development Fund is envisaged to be fully operational within a few months.

- a Construction Equity Fund with the purpose to invest in the construction of developed investable projects. The construction phase of water infrastructure is also a relatively risky process, due to the size and complexity of the projects which can result in considerable cost overrun, delays or other unforeseen challenges. The Construction Fund is therefore structured with three financing risk classes, respectively: Tier 1 financed with donor capital assuming most risk and includes a first loss cover risk mitigation mechanism; Tier 2 with a medium risk profile mainly financed by DFIs and philanthropic funds; and Tier 3 reserved for private investors with the lowest risk profile. The Construction Equity Fund is planned to become operational at the end of 2020. It is estimated that private investors will provide about 65 percent of the capital to the Construction Fund, and most of the private capital will go into Tier 3.
- a Refinancing Fund that will finance the future ownership and management of the final water infrastructure projects. The fund will mainly be financed by commercial investors (an estimated 85 percent of the capital), but some DFI capital may also be needed, because the investments may still have a relatively high risk profile compared to other markets. The commercial investors are to some extent expected to have access to political and commercial risk guarantees from ECAs. The Refinancing Fund is expected to become operational in 2021.

Investment decisions within the Development Fund, the Construction Equity Fund and the Refinancing Fund will be managed by investment committees, with representatives from the investors and independent experts.

### **3.2 Resources and staffing**

The fund manager has a staff of about 50 professionals, recruited from about 25 countries, who are specialised in climate, investment and development. The majority of the staff are based on the regional offices in Singapore and Cape Town. An additional 15 – 20 water and investment experts are expected to be recruited in relation to the start-up and management of CI2. IFU and the fund manager have opened discussion on the opportunity for IFU to second an employee to the fund manager in order to ensure optimal synergies between CI2 and Danish expertise.

### **3.3 Financial management and exit**

*Exit:* CI2 is expected to be launched in 2020, and it is envisaged to be closed in 2037 when all the financed projects have been constructed, put into operation, and subsequently sold or transferred to the final owners responsible for the future operation and management. All remaining capital and proceeds from the MFA contribution of DKK 50 million to the CI2 through IFU will, together with the remaining proceeds from IFU's own investment in Tiers 2 of the Construction Equity Fund, be transferred back to IFU and be integrated into IFU's equity.

### **3.4 Reporting**

CI2 will provide quarterly and annual reports on progress and performance on the Development Fund, the Construction Equity Fund and later also the Refinancing Fund. In addition to reporting on fund management and monitoring, fund status, fund performance, development and construction update, the reports will also address ESG progress and performance issues. The quarterly progress reports will e.g. provide a detailed overview of health/safety, social/labour and environment performance. Further the reporting also covers community development activities (cf. Section 2.4). The ESG progress reporting on planned investment activities will be based on IFC performance standards and include risk rating according to each investment.



#### **4. RISKS**

The water infrastructure investment projects, to be prepared and implemented by CI2, are considered relative risky due to exposure to country, political, thematic and commercial risks. The political and reputational risk can be high in water investments. Access to clean water is a human right, and CI2, therefore, will not invest in complex water infrastructure projects which could have negative effects on poor and vulnerable stakeholders. The special fund structure of CI2 further addresses risk challenges through the incorporation of specific risk mitigation measures in relation to the project development, construction and operation phases. Donor funds are reserved to cover the risky project development phase and take the highest risk during the construction phase. In addition, cooperation agreements may be established with one or hopefully several ECAs in order to facilitate access to political and commercial risk guarantees.

The fact that the investments will be spread on several countries and various types of water infrastructure projects will further mitigate and spread the risk. The main contextual, programmatic and institutional risks are presented annex 4.

Annexes

Annex 1: Context analysis

<b>1. Overall development challenges, opportunities and risks</b>
<b><i>Briefly summarise the key conclusions from the analyses consulted and their implications for the programme regarding each of the following points:</i></b>
<ul style="list-style-type: none"> <li>- An estimated 2.1 billion people lack access to safe and readily available water at home, and more than 4 billion people lack access to sanitation compatible with the SDG on water and sanitation.</li> <li>- Inadequate water and sanitation systems at all levels in developing countries have great negative impact on social and economic development</li> <li>- The climate changes is an additional factor which can significantly aggravate the water and sanitation situation</li> <li>- The World Bank has indicated that water related losses in agriculture, health, income and property could lead to a GDP decline of up to 6% by 2050 and lead to sustained negative growth in some regions.</li> <li>- There is a need to significantly increase water infrastructure investments, and that requires innovative PPP investment arrangements to ensure substantial mobilisation of needed private capital.</li> <li>- The newly launched CI2 appears to be a promising international initiative to address some of the water and sanitation challenges.</li> </ul>
<b><i>List the key documentation and sources used for the analysis:</i></b>
<p>The issues are addressed in a number of documents from various sources including:</p> <ul style="list-style-type: none"> <li>- A number of documents prepared by international organisations including World Bank, OECD, UN Water, WHO etc.</li> <li>- Various CI2 documents</li> </ul>
<b><i>Are additional studies / analytic work needed? How and when will it be done?</i></b>
<ul style="list-style-type: none"> <li>- There is no need to conduct additional contextual studies and analyses at this stage.</li> </ul>

<b>2. Fragility, conflict, migration and resilience</b>
<b><i>Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:</i></b>
<ul style="list-style-type: none"> <li>- The proposed investment in CI2 does not directly address fragility, conflict, migration and resilience, but responsible and sustainable water infrastructure investments can have an</li> </ul>

important positive impact on fragility, stability and maybe also migration through improved living conditions
<b>List the key documentation and sources used for the analysis:</b>
- A number of organisations and documents address this issue, e.g. World Bank, WHO, UN water etc.
<b>Are additional studies / analytic work needed? How and when will it be done?</b>
- Not needed

<b>3. Assessment of human rights situation (HRBA) and gender<sup>7</sup></b>
<b>Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:</b>
<b>Human Right Standards (international, regional and national legislation)</b> CI2 will be working in a complex and diverse country environment, and some of the many stakeholders may not always give high priority to sustainability standards including human rights, gender etc. CI2 has adopted sustainability policies and procedures, which are based on international standards incl. the UN Guiding Principles.
<b>Universal Periodic Review</b>
- The CI2 investors include a number of donors and DFIs, and they will through their governance representation keep the sustainability and human rights issues on the agenda and ensure that the CFM addresses these issues professionally.
<b>Identify key rights holders in the programme</b>
<b>Identify key duty bearers in the programme</b>
<b>Human Rights Principles</b>
- All CI2 investments will be subject to a stringent due diligence process, which will ensure that the investment projects adhere to the principle of good corporate governance, and comply with the principle of good business conduct etc. CI2 will apply sustainability standards, including UN guiding principles for business and human rights.
-
<b>Gender</b>
- CI2 will give high priority to gender equality, and the role of women in relation to access to water for households.
<b>Youth</b>
-
<b>List the key documentation and sources used for the analysis:</b>
-
<b>Are additional studies / analytic work needed? How and when will it be done?</b>

<sup>7</sup> The purpose of the analysis is to facilitate and strengthen the application of the Human Rights Based Approach, and integrate gender in Danish development cooperation. The analysis should identify the main human rights issues in respect of social and economic rights, cultural rights, and civil and political rights. Gender is an integral part of all three categories.

- No

#### 4. Inclusive sustainable growth, climate change and environment

***Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:***

- The CI2 investments in water and sanitation are envisaged to strengthen the sustainability agenda among the involved stakeholders. CI2 has resources to actively support the stakeholders with technical assistance and capacity building.
- CI2 has the required policies, resources and experience to handle these sustainability issues

***List the key documentation and sources used for the analysis:***

***If this initial assessment shows that further work will be needed during the formulation phase, please list how and when will it be done?***

No need of additional assessments at this stage.

#### 5. Capacity of public sector, public financial management and corruption

***Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:***

- Capacity building of public stakeholders including water authorities, water utilities etc. may be required, and resources for such activities will be available in CI2.
- Legal work in various jurisdictions will be necessary to pioneer the legal framework for new transformative PPA like arrangements within the water sector.
- Under-priced water and sanitation services

***List the key documentation and sources used for the analysis:***

-

***Are additional studies / analytic work needed? How and when will it be done?***

- No additional studies are required

#### 6. Matching with Danish strengths and interests, engaging Danish actors, seeking synergy

***Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:***

- CI2 can be an important platform for IFU, and Danish investors, equipment suppliers, utility and consulting engineering companies, who wants to pursue promising future market opportunities within water infrastructure investment in developing countries.

- The Danish water sector has a lot to offer, but it is still relatively small and fragmented when it comes to development and investments in complex and integrated water infrastructure projects in developing countries.
- Possible synergies with the Strategic Sector Cooperation programme will be explored e.g. in relation to South Africa and Ghana.

***List the key documentation and sources used for the analysis:***

-

***Are additional studies / analytic work needed? How and when will it be done?***

- No additional studies needed at this stage.

## 7. Stakeholder analysis

***Briefly summarise the key conclusions and implications for the programme of the analysis of the below points:***

The key stakeholders include investors, public authorities, utility companies, suppliers and service companies, user groups (households and companies) etc.

- CI2 investors: The investors are expected to include bilateral and multilateral donors, DFIs, private investors (institutional, impact, financial institutions etc.)
- Contractors, equipment suppliers and consulting engineering companies
- The local stakeholders can only be assessed in relation to the specific projects that have been selected to be developed and constructed.

***List the key documentation and sources used for the analysis:***

-

***Are additional studies / analytic work needed? How and when will it be done?***

- Will only be necessary in relation to the specific project proposals.

## **Annex 2: Partners**

### **1. Summary of stakeholder analysis**

Preliminary consultations have been held with other DFIs, who all appreciated joint efforts to strengthen project development and investment in water infrastructure. However, it would require significant time, effort and investment to develop these intentions into a concrete joint initiative of a similar scale as CI2.

The launch of CI2 was therefore a very timely and appropriate proposal. CI2 has the same fund structure as CI1, which was a winning initiative of The Global Innovation Lab for Climate finance (2015) – a global forum that supports the identification and piloting of climate finance instruments.

No additional stakeholder analyses have been conducted due to the fact that CI2 is based on a well-established CI1 structure, and the same fund manager as is managing CI1. The CI2 investor group is still not known, but it is expected that it to a large extent will comprise the same donors, DFIs and private investors that have invested in CI1.

### **2. Criteria for selecting programme partners**

The programme partners in relation to the specific investments will be selected during the project identification and preparation phase.

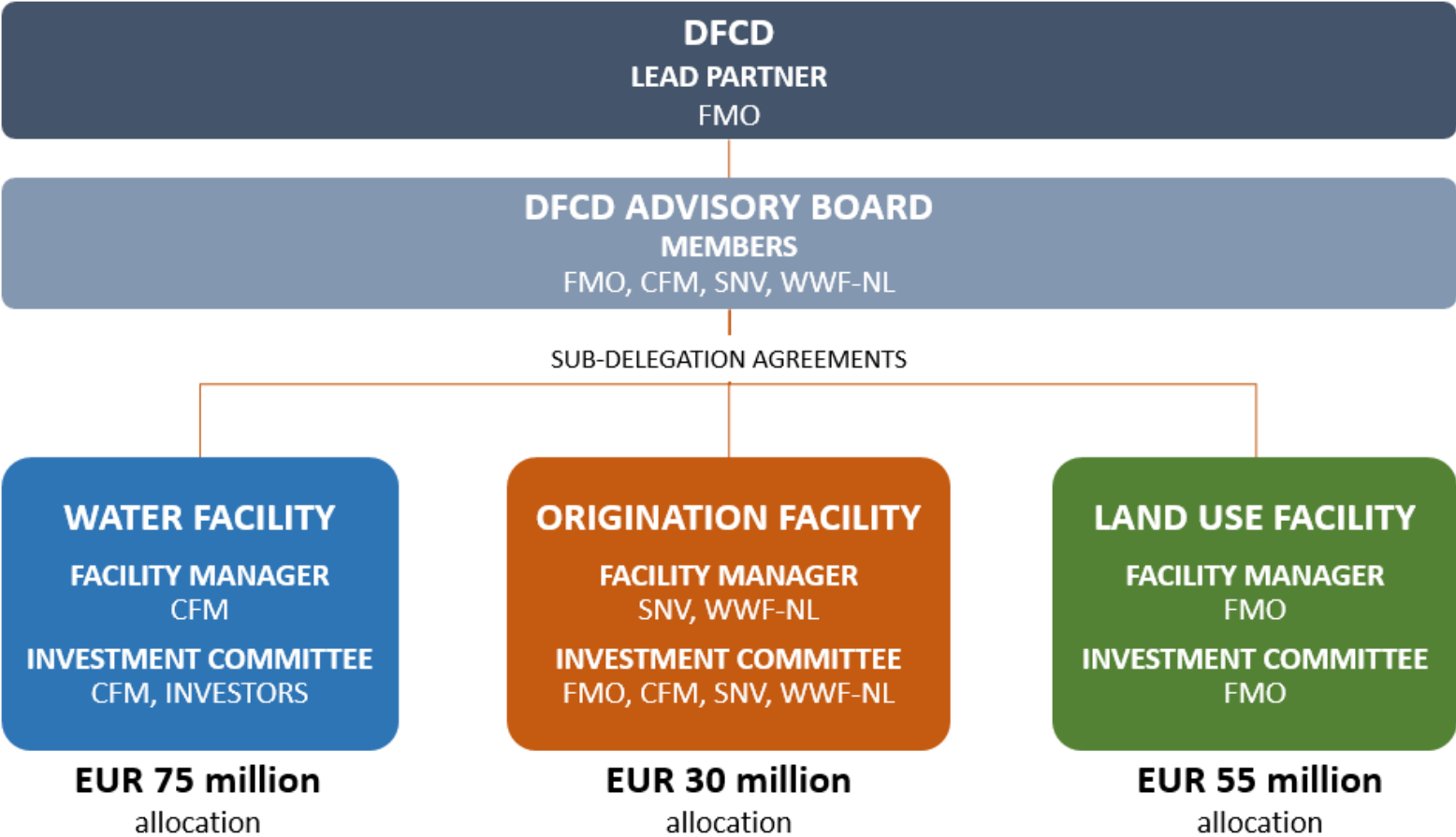
### **3. Brief presentation of partners**

CI2 will be managed the Climate Fund Managers, which is jointly owned by FMO and Sanlan InfraWorks, a South African infrastructure investment company. The purpose of fund manager is to structure and operate financing facilities for climate change mitigation and adaptation sectors including energy, water and sustainable cities. The fund manager is also managing CI1, which a few years ago was launched with a total capital of EUR 850 million.

### Annex 3: CI2 - Preliminary results framework of engagement

		Support to IFU for investment in CI2
Development objective of the fund and immediate objective of capital contribution		<p><i>Development objective:</i> Contribute to improved access to safe drinking water; improved effective wastewater treatment and effective use of water resources in developing countries in support of the achievement of SDG 6.</p> <p><i>Immediate objective:</i></p> <ol style="list-style-type: none"> <li>4. CI2 is operational as an innovative international blended finance vehicle for the promotion of responsible and sustainable water and sanitation investment solutions that can be scaled to accelerate progress towards achievement of SDG 6.</li> <li>5. Strengthened IFU and the Danish water sector's experience and opportunity to engage in an increased number of water infrastructure projects in developing countries</li> </ol>
Impact Indicators		The impact of CI2 investments will be determined on the basis of the individual investments projects which will be implemented across sub-sectors. Impact assessment will be based on the established CI2 impact indicators, which will be further developed during the establishment of the fund.
Engagement Title of Fund		Same as above
Outcome indicator		<p>The principal outcome indicators will include:</p> <ul style="list-style-type: none"> <li>• Total number of people benefiting from improved wellbeing, economic prospects and livelihood</li> <li>• Volume of private finance mobilised for climate change investment</li> <li>• Reduced or avoided greenhouse gas emission</li> <li>• Share of renewable energy in total energy mix</li> <li>• Amount of urban water supply per day</li> <li>• Amount of urban wastewater safely treated per day</li> <li>• Amount of industrial wastewater treated per day</li> <li>• Reduced losses of drinking water (non-revenue water) per day</li> </ul>
Baseline	Year 2020	Ex-ante baselines will be prepared by CI2 during project development. Follow-up reporting on the specific indicators will be provided in annual reports.
Target	Year 2037	Specific targets for the various indicators will only be prepared at a later stage, when the size of the fund is finally known and the pipeline of investment projects further developed.

Annex 4: Governance of Dutch Fund for Climate and Development





## Annex 5: Preliminary Risk Management Matrix

### Contextual risk

<b>Risk factor</b>	<b>Likelihood</b>	<b>Impact</b>	<b>Risk response</b>	<b>Residual risk</b>	<b>Background to assessment</b>
Possible global financial instability and economic slow-down	Possible	Medium	A thorough project identification and preparation can reduce the risk, and CI2 has extensive experience with assessment and mitigation of risk parameters.	Minor	A global economic slowdown may affect private investors' appetite to invest in new water markets in developing countries
Political and/or financial instability in specific countries where CI2 has invested or plans to invest	Likely	Medium	The CI2 investment portfolio is expected to have a broad geographical coverage, and therefore will not be heavily exposed to any single countries. CI2 will further apply various risk mitigation mechanism throughout the project development, construction and operation phases.	Minor	Political or financial turbulence in a country could have major negative, but isolated, impact on CI2 investment activities.
Political and reputational factors due to investments that are violating water as a human right or in other ways resulting in negative impacts on poor and vulnerable stakeholders	Possible	Medium	CI2 will not invest in complex water infrastructure projects which could have negative effects on poor and vulnerable stakeholders. CI2 will invest in less sensitive projects including industrial projects.	Minor	Increasing water prices could lead to political and community turbulence.

### Programmatic risk

<b>Risk factor</b>	<b>Likelihood</b>	<b>Impact</b>	<b>Risk response</b>	<b>Residual risk</b>	<b>Background to assessment</b>
Inadequate interest among investors to provide the targeted investment capital to CI2.	Possible	Medium	Donors and DFIs have increasingly focus on the water sector, and it is therefore a good opportunity to increase attention among investors. CI2 is based on a known and tested fund structure, and the fund manager has a good track record.	Minor	The mobilisation of less capital than targeted would negatively effect the performance of CI2
Inadequate bankable investment projects	Possible	Medium	A key purpose of CI2 is to strengthen project development efforts through the establishment of an innovative mechanism that can promote the development of bankable projects and mitigate the risks of private investors.	Minor	Inadequate availability of bankable water infrastructure projects is a major constraint. It can be a long and risky process to develop and construct water infrastructure projects, and project development activities are therefore too limited to ensure a stable pipeline of bankable projects
CI2 unable to achieve a return on the investments that is acceptable to the private investors	Possible	Medium	CI2 is aware that it will not be able to invest in all types of water projects. Public water supply projects may be relatively challenging with regards to return, whereas industrial wastewater treatment may be relatively easy. However, CI2 will focus on the establishment of innovative financing and business models that can ensure satisfactory development outcomes for citizens and society, and at the same time an adequate return to the investors .	Minor	Water infrastructure projects are known for having a challenging risk-return balance due to high capital costs, long pay-back period, under-priced services etc.

### Institutional risk

<b>Risk factor</b>	<b>Likelihood</b>	<b>Impact</b>	<b>Risk response</b>	<b>Residual risk</b>	<b>Background to assessment</b>
Risk of departure of key personnel from Fund manager	Possible	Medium	The fund manager has a strong professional team and is recruiting additional staff. Good work conditions and incentives further reduce the risk of loss of key staff	Low	Loss of key personnel can have a negative impact on the performance of Climate Fund Manager and CI2
Violation of human rights, environmental standards etc. in the specific water infrastructure investment projects	Possible	Medium	CI2 and the fund manager will apply international sustainability policies and procedures in order to satisfactory address these issues.		There are often many stakeholders in water infrastructure projects, and violation of user rights etc. is possible and could in such cases constitute a major reputational risk.

## Annex 6: Process Action Plan – Commitment to IFU for investment in Climate Investor 2

Time line	Activity	Documentation	Responsible
August – September 2019	Preparation of Concept Note	Concept Note	BVB
3 September	Concept Note forwarded to KFU	Concept Note	BVB
5 – 18 September	Public hearing	Concept Note	KFU
26 September	Programme Committee meeting	Concept Note	BVB
September - October	Preparation of programme document	Programme Document	BVB
28 October	Programme Document and Appropriation Cover forwarded to KFU	Final Programme Document and Appropriation Cover	BVB
13 November	Council for Development Policy	Minutes of meeting	KFU
November	Presentation of project proposal to the Minister for Development Cooperation	Signature	KFU
November	Appropriation bill forwarded to UPR	Appropriation bill	BVB
Beginning of December	Appropriation bill presented to the Parliamentarian Finance Committee	Appropriation bill	APD
Beginning of December	Signing of agreement with IFU	Legally binding agreement	BVB and IFU
Middle of December	Disbursement of funds to IFU	Receipt	BVB, IFU

### Formulation and quality assurance

It is suggested that the commitment to IFU for the investment in CI2 be exempted from the normal appraisal procedures. The main reason is that the responsible department (Sustainable Growth and Employment - BVB) has adequate capacity within the concerned thematic areas. However, BVB would like to establish a quality assurance group with specialists from Technical and Quality Support (KFU) and BVB in order to discuss key quality assurance issues connected with the formulation of the support. The group should meet as required during the preparation process. The issues to be discussed may include:

- The overall strategic approach and related development priorities including inclusiveness, sustainability, specific water and sanitation issues etc.
- The results framework, results measurement and reporting according to international standards.

## Annex 7: Signed Quality Assurance Checklist

### Summary of recommendations of the appraisal

<b>Title of (Country) Programme</b>	Climate Investor 2
<b>File number/F2 reference</b>	2019-18118
<b>Appraisal report date</b>	24.10.2019
<b>Council for Development Policy meeting date</b>	13.11.2019
<b>Summary of possible recommendations not followed</b>  (to be filled in by the responsible unit)	

### Overall conclusion of the appraisal

- Climate Investor 2 (CI2) is considered relevant and justified. It aims to accelerate urgently needed investment in the water sector in collaboration with the private sector and commercial investors. Acceleration of investment in the water sector is critical to achieve most of the SDGs and the Paris Agreement.
- CI2 combines knowledge from Climate Investor 1 (renewable energy) with the purpose of establishing an investment in a more complex sector such as water. Despite water is a sensible sector, it is viewed as critical to develop new and innovative business models and mechanism bridging the significant finance gap to achieve SDG6 by 2030 and accelerate climate change adaptation in the water sector.
- CI2 will invest at least 25 percent of the fund's capital in Low Income Countries (LIC) and at least 25 percent of the capital will be invested in North and West African counties incl. the Sahel. The project pipeline is in process of being developed with the purpose of maximizing positive impacts from the investments while avoiding adverse impacts and respecting basic human right to water. Impact indicators will monitor direct and indirect benefits for the local population and climate actions (waste water treated, reduced energy consumption, etc.)
- The Danish grant of DKK 50,0 is relatively small in comparison to the target of attracting capital of up to USD 1 billion. However, the grant element is a critical first step to develop well-prepared project proposals and attract commercial investors. Therefore, donors providing grants are the first to commit resources, which demonstrates the added value of the grant and at the same time allows Denmark to influence the design of CI2. The return rates in the water sector is considered to be slight lower than in the energy sector which makes the grant element even more important. However, it will be important that the Danish grant is complemented by a commitment by IFU to invest in the Construction Equity Fund to ensure adequate Danish resources to monitor and influence CI2.
- CI2 will build on the Climate Fund Manager's risk management framework, which is guided by the Responsible Investment Code. The Code applies for all project developers, contractors and project companies which again are expected to have adequate policies, management and reporting systems in place. The content of the Responsible Investment Code confirms commitment to the IFC performance standards, ILO core labour standards and UN Guiding principles on Business and Human Rights. Quarterly reports on progress will be presented to Donors, including progress on community development projects.
- Human rights, climate change and environment will be integrated in the project preparation and construction phases of each investment. The Responsible Investment Code provides detailed guidance on how to prepare environmental and social impact assessments, adequate content of safeguards, community due diligence and a a whistle-blower mechanism is available. Furthermore, the institutional set-up also include a collaboration with the NGO's WWF-NL and SNV.

Recommendations by the appraisal team	Follow up by the responsible unit
<b>Programme Level:</b>	
Danish contributions and supervisory	
<ul style="list-style-type: none"> <li><i>The Danish grant of DKK 50,0 should be complemented by IFU investment in the Construction Equity Fund to add value to CI2 at different levels and enhance Danish added value.</i></li> </ul>	<p>This is addressed in the project document. If the IFU board against expectations does not approve an additional IFU commitment of own funds, then the MFA commitment will not be disbursed to IFU for investment in CI2. It is important that IFU participates as an active investor with own funds.</p>
<b>Thematic Programme Level:</b>	
<i>Impacts and results of investment</i>	
<ul style="list-style-type: none"> <li><i>Contribute and supervise development of a results framework, which include relevant impact indicators for both specific investments and aggregate indicators across the CI2 investment portfolio.</i></li> </ul>	<p>This is addressed in the project document. The donors and DFIs that invest in CI2 will, e.g. through their participation in the investment committees, contribute and supervise the development of the final results framework and reporting on indicators. All projects will be screened at an early stage during development.</p>
<ul style="list-style-type: none"> <li><i>Supervise if CI2 will be able to attract commercial investors and deliver return rates for investors in a complex investment sector such as water.</i></li> </ul>	<p>This has been addressed. CI2 will submit quarterly and annual progress reports where these issues will be addressed. The Investment Committees under the Development Fund, the Equity Construction Fund and the Refinancing Fund will also supervise these issues.</p>
<i>Governance</i>	
<ul style="list-style-type: none"> <li><i>Ensure that Denmark has access to progress reports and other critical information as contributor to CI2.</i></li> </ul>	<p>IFU will as an investor have access to progress reports and other critical information. It is likely that IFU will have a seat in the Investment Committee of the Development Fund.</p>
<ul style="list-style-type: none"> <li><i>Denmark should encourage CI2 to enter in a constructive and transparent dialogue with broader set of stakeholders, incl. local authorities, civil society and NGO's to avoid speculative assumption regarding the investments in the water sector.</i></li> </ul>	<p>CI2 already has a close dialogue with SNV and WWF-NL that are partners of DFCD. The CI2 fund manager has regular meeting with NGOs in order to contribute to an open and transparent dialogue.</p>

<b>Engagement Level</b>	
<i>Monitoring, compliance and supervision</i>	
<ul style="list-style-type: none"> <li>• <i>Ensure adequate resources to supervise the project pipeline, progress reports and other information to identify risks and opportunities.</i></li> </ul>	<p>This is addressed in the whole set-up of CI2. Resources are reserved to supervise the project pipeline and not least the project portfolio. Progress reports will be prepared on a quarterly basis.</p>
<ul style="list-style-type: none"> <li>• <i>Consider how Denmark will be engaged to supervise compliance to the Responsible Investment Code, e.g. through joined reviews and presentation of progress reports.</i></li> </ul>	<p>IFU will through its dialogue and supervision assess that CI2 and its project partners are acting in accordance with the code. Several donors and DFIs will invest in CI2, and MFA/IFU will therefore actively work for joint review etc. that among other can supervise compliance to the Responsible Investment Code.</p>

I hereby confirm that the above-mentioned issues have been addressed properly as part of the appraisal and that the appraisal team has provided the recommendations stated above.

Signed in..... on the .....

Appraisal Team leader, Morten Blomqvist

I hereby confirm that the responsible unit has undertaken the follow-up activities stated above. In cases where recommendations have not been accepted, reasons for this are given either in the table or in the notes enclosed.

Signed in.....on the.....

Head of BVB, Ole Thonke