Eco.business Fund Annual Review – 2017 Performance

Contents

eco.business Fund Annual Review - Summary Sheet		
Title: eco.business Fund		
Programme Value: £20 million		**Review Date:** February 2018
Programme Code: GB-GOV-GB-7-P00052-ICF-P0003-ECO.B	**Start Date:** Fund inception: January 2015 Promissory Note: December 2015	**End Date:** Provision for Defra investment to be returned in December 2030

Summary of Programme Performance

Year	2017	2018	2019	2020	2021	2022	2023
Programme Score	**A**						
Risk Rating	Moderate						

Introduction

This is the first Annual Review (AR) of the Eco.business Fund (EBF). A delayed logical framework development for DEFRA was completed in 2018, building on the fund's existing Theory of Change, and there were no agreed indicator targets for the 2017 calendar year which this review covers. For this reason, the performance of indicators is assessed against the baseline data from 2016 – essentially a proxy for change since Defra's investment.

Due to this, the scoring of this Annual Review will be a result of descriptive evidence of the funds progress so far. This is unfortunate, as we note through the AR, progress developing the fund has been strong. However, looking forward, the newly finalised DEFRA log frame has milestones in place for 2018 onwards; all subsequent ARs will have targets with which to review performance. The next AR covering the 2018 calendar year will be completed in March / April 2019.

Although a Defra AR has not taken place, performance reviews are undertaken by the fund Advisor (Finance in Motion) and results reported to the board quarterly; external auditing is also commissioned yearly. These reports are predominantly focussed on the financial performance, integral to the Fund.

Summary of progress since inception

The Fund completed its third full year of operation in December 2017 and has grown from being a newcomer in the sector lacking a track record, into an increasingly recognised financier and knowledgeable partner in a range of sustainably focussed activities in a large and sectorally diverse region. The Fund became profitable in the second year of operation, earning a return for its investors and striving for a positive environmental impact. Today, the Fund is an established player among its partners whose key duty of providing commercially viable financing to sustainable producers and businesses is complemented by a strong technical assistance arm that provides additional value to beneficiaries. Despite this initial growth path, the Fund is only at the beginning of its operations, and the work continues to present challenges as well as opportunities for achieving results.

Summary of progress since January 2017

The Fund

In 2017, the Fund increased the number of partner institutions it is working with from four to ten and succeeded in entering three new countries (Nicaragua, Panama and Colombia). It now operates in six different countries across Central and South America, contributing to an increased geographical diversification. The outstanding portfolio as of end 2017 amounts to $156 million – 100% of available capital had been utilised for on-lending. [redacted] The Fund focuses on four activity sectors:

Agriculture and agribusiness, fisheries and aquaculture, forestry and sustainable tourism – to date, due to the financing landscape in countries of operation fund activities have been highly concentrated in agriculture versus the other three focus sectors. (This topic is discussed further in Section B). Key crops in the partner institutions' portfolios are coffee, banana and pineapple but activities financed also include cocoa, sugarcane, flowers, forest plantations and others. The Fund is also in demand among other funders to partner in syndicated transactions. Three out of the ten operations are syndicated deals with multilateral financiers.

The Fund also made progress on conceptual topics in 2017. Among others, the direct investment policy is now in place which sets out the rules and guidelines under which the Fund can directly invest into businesses and projects. This will allow the Fund to invest and directly promote carefully selected corporations that identify with its mission and complement the Fund's approach to investing in local financial institutions. As of 2018 several projects have been identified, including a commercial plantation of a native tree species and a large certified coffee plantation (both projects in Colombia), and are currently being screened by FiM's investment officers. Next year's Annual Review will comment on this further. Furthermore, the theory of change has been developed over the last year. The document now defines the Fund's short and long-term outcomes and the channels through which they will be achieved. The theory of change is a key element in the impact framework that the Fund will be developing over 2018 and which will allow it to systematically measure and report on the impact of its activities.

The Eco Development Facility (Eco DF)

In 2017, the Eco Development Facility (Eco DF) achieved significant growth in terms of number and volume of approved projects, from 8 approved projects with a total budget volume of USD 600,000 in 2016, to 15 approved projects with a total budget volume of nearly USD 1.1 million in 2017 on various environmental topics. As part of the positioning of the Fund as a new key player and strategic partner of financial institutions interested in promoting the green agenda in the region, the Eco DF successfully co-sponsored and organised events and workshops related to sustainability, green finance and particular agricultural crops in El Salvador, Colombia, Argentina and United States during the year.

With the objective to increase and share knowledge through awareness raising material for different target groups, the Eco DF launched deforestation assessments in six target countries, disseminated five crop profiles and three client stories, and sponsored the production of two promotional videos that showcase the Fund's mission and vision, the partners' efforts to serve environmentally and socially sustainable businesses, and the impact the funds can have on the businesses of its end-clients.

Monitoring and Evaluation

The Fund now has a developed logical framework for DEFRA that has been created in the lead up to this first Annual Review process. The baseline provided for this purpose are figures from the end of 2016; this essentially represents the performance of the Fund before Defra investment. 2017 will be treated as *Year 1* for the purpose of the DEFRA LogFrame. The financial data included is also as of the end of the 2017.

The DEFRA Log Frame currently has output indicators in place with milestones beyond 2017, 2017 data and a baseline. However, targets for 2017 are absent as development of the DEFRA LogFrame was still ongoing. As a result, the output indicators will be scored against the 2016 baseline. The impact and outcome level indicators are now developed but due to their nature some are not reporting at this early stage of the Fund's life, particularly at Impact level. With that in mind the impact and outcomes are assessed both quantitatively and qualitatively.

Three internal DEFRA ICF KPIs have been selected for use at the Outcome level and are:

- ICF KPI 5: Number of direct sustainable jobs created or supported as a result of ICF support. (Number of people)
- ICF KPI 11: Volume of public finance mobilised for climate change purposes as a result of Defra ICF funding. ($m)
- ICF KPI 12: Volume of private finance mobilised for climate change purposes as a result of Defra ICF funding. ($m)

Outputs for DEFRA monitoring have been decided based on the objectives of the Fund to promote business and consumption practices that contribute to biodiversity conservation, to the sustainable use of natural resources and to mitigate climate change and adapt to its impacts. The outputs have been defined in the list below and include the following progress highlights:

OUTPUT 1: EBF has a diversified portfolio supporting a range of geographies and sectors

Highlights include 10 types of agricultural commodities supported in 2017 compared to a baseline of 10 and 6 countries of operation compared to a baseline of 3.

OUTPUT 2: Broad support to sustainability practices reflected in the composition of the portfolio

A particular highlight is that 7 Green List measures are now incorporated by sub borrowers from a baseline of 5.

OUTPUT 3: Provision of continuous and sufficient Technical Assistance (TA)

10 financial institutions are now supported compared to just 4 in 2016 and the Development Facility has completed 9 TA projects where it had only completed 4 in 2016.

OUTPUT 4: Improved partnerships and development of activities with other sector stakeholders

By the end of 2017 the Fund had realised a cumulative total of 3 loans in partnership with other institutions compared to only 1 in 2016.

Key lessons

Working with Partner Institutions that are not only truly committed to providing financing using the eligibility criteria of the Fund, but that also have the right elements in place to make it work, is critical.

For example, having a strong team that is serving the agricultural sector, with previous experience working with "green" products or a strong commitment to set-up such a team; and having an Environmental and Social Management System (ESMS) in place, or being willing to develop one. For example, the success of the Fund's collaboration with [redacted], a partner institution in El Salvador, which resulted in the expansion of the Bank's sustainability team, was determined to a large extent by the Bank's close relationship with producers, its knowledge of the farming sector and willingness to better integrate sustainability in their lending practices.

Developing eligibility criteria has to involve Partner Institutions (PIs) early in the development stages. Early involvement enables the formation of a more complete picture of funding opportunities based on local and institutional knowledge. It also helps address the challenge of ensuring *buy-in* from the beginning of the eligibility criteria application process. This is done through open and transparent communication, team work and trust building. By involving the partner institution early on, it is also possible to develop a shared agenda and objectives which can then lead to an increased stakeholder feeling of ownership.

Impact monitoring is a critical activity for the Fund, but at the same time, it has proven difficult to collect relevant information through financial institutions that allows measuring the impact of the Fund. The Fund takes a pragmatic approach to measure its impact, leveraging on existing information and providing the right incentives for PIs to report on impact. The resources and time spent on developing an impact framework are testament to this.

Technical Assistance offered by the Fund is a key and differentiating factor to be able to do business in the region. Latin America is a highly competitive market; most financial institutions have access to local and international lenders and have a solid base of depositors. The eco.business Fund has been able to establish a footprint in the market given its value proposition, which combines funding with tailor-made technical assistance projects.

Summary of recommendations for the next year

Looking ahead to the end of 2018, the Fund expects a year of further diversification and sustained growth, in terms of geographies, types of partner institutions (e.g. microfinance organizations), activities financed and end-borrowers reached. Targets are included in the DEFRA Log Frame.

1. **To complete both the DEFRA Log Frame and the Fund's Impact Framework in 2018.** As the new *Impact Framework* is developed alongside colleagues at Finance in Motion and external consultants, the outcomes and impact aspects of the DEFRA Log Frame could be further developed alongside this. The target for the end of 2018, is to have the Impact Framework fully operational, significant progress on milestones and indicators across all levels of the DEFRA Log Frame should be made. These two documents will work in a complementary fashion to support internal and external reporting. It is critical that this document is completed as soon as possible.

3. **To develop ICF KPI 15 during 2018.** Progress should also be made on developing a model for reporting on Transformational Change (ICF KPI 15) for the Fund to bring our reporting in line with DfID best practice.

A. Introduction and Context

In December 2014, KfW, the German Development Bank, Conservation International and Finance in Motion set up the eco.business Fund. The Fund´s mission is to promote business and consumption practices that contribute to biodiversity conservation, to the sustainable use of natural resources and to mitigate climate change and adapt to its impacts. Initially working in Latin America and expanding to the Caribbean and potentially to Africa. Finance in Motion acts as the Advisor of the Fund.

Defra committed £20 million in December 2015 which was drawn down in two installments in February and August 2016. However, this will be the Fund's first Annual Review. With that in mind this report will be a summary of the Fund from the point of Defra investment – essentially a two-year performance review since December 2015.

The Fund pursues its mission by providing financing and/or technical assistance to qualified financial institutions (FIs) and businesses in four focus areas:

- Sustainable agriculture and agribusiness
- Sustainable fishery and aquaculture
- Sustainable forestry
- Sustainable tourism

These four sectors are pivotal pillars of the Latin America and Caribbean (LAC) economy but are also significant contributors to the region's environmental footprint and are increasingly affected by climate change. The Fund believes that companies in these sectors need to transform their business models to become more sustainable; allow efficient and innovative business practices; and secure viability for both the company and the environment in which they operate. More specifically, the Fund intends to support an industry shift towards business practices that conserve biodiversity, use natural resources sustainably, and mitigate and/or become more resilient to climate change.

The Fund currently channels dedicated financing to local producers via selected local Financial Institutions (FIs), and in limited cases will provide direct financing for innovative, small scale, high-impact businesses and projects. Investment activities are often complemented by the provision of technical assistance to local financial institutions and their clients. Financial instruments offered include in a range of debt instruments but typically are medium to long-term senior loans and subordinated debt as well as syndicated loans.

Individual loans from financial institutions to final borrowers refinanced by the Fund need to fulfil one of the following conditions:

- The final borrower holds a sustainability certification
- The activity financed is included in the Fund's Green List of eligible measures with a positive impact on biodiversity, climate change and resource efficiency
- The Fund will also finance innovative measures developed by partner institutions that contribute towards achieving its mission

Investment into the eco.business Fund contributes towards Defra's and HMG meeting their strategic and climate objectives.

B: PERFORMANCE AND CONCLUSIONS

Annual outcome assessment

As mentioned in the summary, the outcome level indicators within the DEFRA Log Frame are still under a degree of development, and unlike the Outputs they do not all have baseline data. Broadly the Fund is growing, diversifying and continues to leverage both public and private finance.

For DEFRA, Outcome now defined as:

1. EBF's success in contributing to biodiversity conservation, the sustainable use of natural resources and climate change adaptation and mitigation; and this success creating an incentive for others to also act towards these goals.
2. Level of behavioural change embedded in downstream lenders and financial institutions.

Outcome 1 – Performance: Metrics within Outcome 1 show that 55,789 ha of land is now managed sustainably against a baseline of 45,002. Of this 42,020 is held by sub-borrowers that are committed to zero-deforestation activities. $2.2 million of private finance and $9.1 million of public finance has been mobilised for climate change purposes; and 3,700 jobs have been supported by sub-borrowers as a result of EBF financing.

Outcome 2 – Performance:

Metrics within Outcome 2 show that an increasing number of end-clients of the fund are currently incorporating sustainable, over 200.

Progress on Outcome Targets:

The eco.Business Fund is on track to meet its targets for key indicators such as financing volume or the number of hectares under sustainable management and committed to deforestation-free activities. The fund is likely to outperform its targets in terms of job support, given the investments in the pipeline with micro-finance institutions and the fund's support to job-intensive food processing activities.

Overall output score and description

As discussed, progress against outputs will be reported against baseline data as there are no milestones for 2017. The following table provides a summary of the performance of each output a sub score for each indicator. This is extrapolated on in **Section C**.

Impact weighting of Outputs

Output have been weighted in accordance to their importance to the success of the Fund and alignment with Defra ICF's strategic priorities.

NUM	OUTPUT DESCRIPTION	PERFORMANCE SUMMARY	SCORE	WEIGHT (%)
1	EBF has a diversified portfolio supporting a range of geographies and sectors		**A**	**35%**
2	Broad support to sustainability practices reflected in the composition of the portfolio		**A**	**35%**

3	Provision of continuous and sufficient Technical Assistance		**A**	**15%**
4	Improved partnerships and development of activities with other sector stakeholders		**A+**	**15%**

Assumptions

The main assumptions upon which the creation of the eco.business Fund were based are still in place and represent the cornerstone of the Fund's business case. No major adjustments were required since inception.

The Fund's objectives on biodiversity conservation, the sustainable use of natural resources and climate change mitigation and adaptation are pursued in four focus sectors. However, the economic reality in Latin America is that except for agriculture, the three remaining sectors (forestry, fishery/aquaculture and eco-tourism) are largely unattended by the financial sector. While the Fund is constantly raising awareness among financial institutions for financing producers and companies in these sectors, it is rare that they take a strategic interest in them. While in future the proportion of financing directed to forestry, fishery/aquaculture and eco-tourism is likely to grow as the Fund develops strategies to promote financing to these sectors, agriculture will likely remain by far the most relevant of the four target sectors for the Fund.

Currently, the Fund has a healthy pipeline of investors which is the prerequisite for continued growth.

C: DETAILED OUTPUT SCORING

Output Title	EBF has a diversified portfolio supporting a range of geographies and sectors		
Output number per LF	1	**Output Score**	**A**
Risk:	Moderate	Impact weighting (%):	35%
Risk revised since last AR?	N/A	Impact weighting % revised since last AR?	N/A

Indicator(s)	**Milestones (Baselines)**	**Progress**
1.1. Number of financial institutions in the EBF´s portfolio	4	10
1.2. Number of commodities supported (e.g. crops)	8	10
1.3. Number of countries in which the Fund operates	3	6

Key Points

All the indicators for this output exceeded the baseline data from 2016. This is discussed in further detail below.

Progress:

Number of Sub-borrowers supported by the fund since its inception has increased [redacted], reflecting the marked increase in the number of new financial institutions that entered the fund's portfolio in 2017.

The number of FIs in the EBFs portfolio markedly increased in 2017 to 10 from 4. This is due to the geographical expansion of the fund's activities, with financial institutions from Colombia, Nicaragua and Panama entering the fund's portfolio in 2017.

These FIs are spread throughout 6 countries, an increase from 3 in 2016. The portfolio now reaches Panama, Colombia, El Salvador, Nicaragua, Costa Rica and Ecuador. The largest portion of the portfolio is in Panama [redacted] – a 38.4% share.

There are now 10 crop types supported compared to 8 at the end of 2016. Coffee assumes the largest share of the sub-loan commodity portfolio (46%) followed by banana, pineapple and cocoa as the main crops being financed; predominantly through working capital loans. Other activities that make up the remainder include other fruits, flowers, other vegetables, sugarcane, rice and commercial forest plantations (pine).

Issues:

The bulk of the Fund's sub-loans are invested in agricultural activities that represent by far the largest share of assets of the four eligible sectors in the banks' portfolios in the region. Although the fund is also active in other sectors, such as forestry, it has proven challenging to find eligible investment opportunities covering forestry, fisheries and aquaculture or tourism, as these sectors and the associated value chains are typically less covered by commercial banks.

The lack of financing outside the agricultural sector is also a product of the design of the Green List which caters principally to agricultural production and processing, and the concentration of certified companies in certification schemes that focus on agriculture. Despite seven eligible standards in fishery and aquaculture and well-established certification schemes for forestry (FSC and PEFC), the Fund's sub-loan portfolio has limited exposure to companies working in these sectors.

C: DETAILED OUTPUT SCORING

Output Title	Broad support to sustainability practices reflected in the composition of the portfolio		
Output number per LF	2	**Output Score**	**A**
Risk:	Moderate	Impact weighting (%):	35%
Risk revised since last AR?	N/A	Impact weighting % revised since last AR?	N/A

Indicator(s)	**Milestones (baseline)**	**Progress**
2.1. Number of sustainability standards represented in the portfolio of sub-borrowers	7	7
2.2. Number of Green List measures represented in the portfolio of sub-borrowers	5	7
2.3. Outstanding Amount (USD millions) invested in certified sub-borrowers*	[redacted]	[redacted]
2.4. Outstanding Amount (USD millions) invested in green list measures*	[redacted]	[redacted]

Key Points

Output indicators 2.3 and 2.4 do not have objectives in terms of the distribution of the portfolio between the Green List and sustainably certified standards. After discussion with the EBF we believe that providing milestones here would implicitly assume that we have objectives in terms of split. We will plot expected progress in the milestones cells of the Log Frame but these will not be performance based, instead these two indicators will be used to track changes in the market or in portfolio make-up over time.

Three out of four of the indicators for this output have exceeded the data in the baseline, while indicator 2.1 has remained constant. The risks section (Section E) discusses the limitations in expanding certified standards when agricultural practices take up the majority of the portfolio and this indicator is only expected to increase slowly to a maximum of 15 by 2022.

This output has been scored as an **A.**

Progress:

In 2017, the share of sustainability standards in the fund's portfolio has gone slightly down from 81% to 76%, [redacted]. Indeed, several of the new financial institutions that entered the fund's portfolio in 2017 have on-lent to businesses based on their use of practices pertaining to the Green List, such as agroforestry systems or improved irrigation systems: the outstanding portfolio invested in Green List sub-borrowers has risen [redacted] (from 19% to 24% in relative terms).

C: DETAILED OUTPUT SCORING

Output Title	Provision of continuous and sufficient Technical Assistance (TA)		
Output number per LF	3	**Output Score**	**A**
Risk:	Moderate	Impact weighting (%):	15%
Risk revised since last AR?	N/A	Impact weighting % revised since last AR?	N/A

Indicator(s)	**Milestones (baseline)**	**Progress**
3.1. Number of on-going/outstanding TA projects	13	24
3.2. Number of financial institutions supported	4	10
3.3. Number of completed TA projects	4	9
3.4. Budget spent on TA projects (USD million)	[redacted]	[redacted]

Key Points

Across all metrics the scale of TA support provided has increased. Specific progress and notable examples follow below. This output has been scored an **A.**

Progress:

Regarding Technical Assistance interventions, it is worth mentioning the following project examples:

- [redacted] **Partner Institution 1: Environmental and Social Management System (ESMS)**: The Eco DF is supporting the bank to improve its ESMS in order to allow for better assessment and mitigation of risk factors in the projects it finances.
- [redacted] **Partner Institution 2 ESMS**: The Eco DF contributed to the development of policies, procedures, processes and tools needed by [redacted] a PI in El Salvador for the implementation of a new ESMS. [redacted] The PI developed skills and competences through trainings, monitoring and reporting results on the use and implementation of its new ESMS in order to be prepared for the pilot stage, launched in Q4 2017.
- **Assessment of Deforestation Status and Identification of Mitigation Measures** in Selected Latin American Countries: Four deforestation assessments were completed during 2017: Panama, Colombia, Dominican Republic and Guatemala. The deforestation assessment of Panama was a key input for the investment proposal [redacted], in a partner institution, and the assessments

for Guatemala and Dominican Republic were used for business development activities in this country.

- **Training Sponsorship Program**: Staff members from different areas of [redacted] a Partner Institution attended the event of Sustainability Week in Cartagena, Colombia, held between the 24th to the 26th of April 2017. The event was organized by IIC and delivered a training on Environmental and Social Management for the Financial Sector. [redacted]

Issues

To assist the fund growth expectations the focus of Eco DF during the first years was primarily on a) supporting sponsorship activities for investees and b) undertaking activities that focused on key elements critical to a successful Fund establishment. These included concept development, studies and other research, development activities, and development of awareness raising materials. As the Fund growth increased, DF's focus shifted towards supporting Fund investees.

In 2018 and the following years, the Eco DF aims to approve and implement activities that focus on fostering results and impact, promoting a culture of information and enhancing eligibility criteria for both partner institutions of the Fund and its end-clients. Examples include partnerships with data and information providers useful for impact screenings and assessments, such as the Integrated Biodiversity Assessment Tool (IBAT) for businesses or the support to ISEAL in the construction of a platform that will compile resources on impact related to sustainability standards. The Eco DF will also conduct studies to better understand sustainability practices in agricultural production, and disseminate findings to partner institutions and sub-borrowers, especially in the coffee sector (e.g. follow-up to the survey conducted in El Salvador with [redacted] a partner institution on coffee producers).

C: DETAILED OUTPUT SCORING			
Output Title	*Improved partnerships and development of activities with other sector stakeholders*		
Output number per LF	4	**Output Score**	**A+**
Risk:	Moderate	Impact weighting (%):	15%
Risk revised since last AR?	N/A	Impact weighting % revised since last AR?	N/A

Indicator(s)	Milestones (baseline)	Progress
4.1. Number of external events organised for the EBF	1	7
4.2. Number of events EBF has participated in	5	22
4.3. Number of investments realized by the Fund in partnership with other institutions (e.g. syndicated loans)	[redacted]	[redacted]
4.4. Investments realized by the Fund in partnership with other institutions (USD millions)*	[redacted]	[redacted]

Key Points

Output indicator 4.4 does not have milestone objectives in terms of the size of investments realised by the Fund in syndication. After discussion with the EBF we believe that providing milestones here would implicitly assume that we have these objectives. We will continue to plot expected progress in the milestones cells of the DEFRA Log Frame but these will not be performance based, instead these two indicators will be used to track changes in the market over time. We will plot progress against the number of loans syndicated as this does have projected milestones.

All four indicators have improved on 2016 baseline some significantly, particularly around the events organised and participated in. With this in mind the output has been scored an **A+.**

Progress:

Sponsoring/participation in events:

- **4th Colombia Biodiversidad Festival** in Colombia, the Fund sponsored the symposium "Climate Change and Biodiversity." Three experts analysed the issue from the perspectives of the academia, the public sector, and international development agencies. The festival was attended by more than 70,000 people from Bogotá, Medellín, and Tuluá. This fourth instalment of the event was organized by the non-profit organization Envol Vert and offered cultural spaces, exhibitions, environmental cinema, and workshops for children, along with various symposiums focusing on the most urgent issues affecting biodiversity.

- **World Coffee Science Summit** in El Salvador, the Fund organized the panel "Financing sustainability in the coffee sector in Latin America". The Fund highlighted the importance of shade-grown coffee conservation in El Salvador, not only due to soil conservation and biodiversity conservation, but also due to the role shade forests play in recharging water and feeding the main aquifers that serve drinking water to the majority of Salvadorian population. More than 600 people from 18 countries attended.

Issues:

There are no major issues regarding the compilation and monitoring of these indicators, as these metrics are directly measurable by the fund. Setting milestones, however, may be challenging for output indicators 4.1 and 4.2, given the diversity in the nature and importance of the events that the fund could organize or participate in.

Recommendations:

The performance based milestones have all increased and in some cases significantly. Depending on the 2018 data some consideration should be given to re-baselining the milestones if they can be met and exceeded too easily.

D: VALUE FOR MONEY & FINANCIAL PERFORMANCE

Key cost drivers and performance

The key costs incurred by the Fund can be summarized in two categories: The Direct Operating Expenses (DOE) and the fees of the Advisor. While some of these costs are fixed, the bulk are variable costs that decrease as the Fund´s portfolio increases.

[redacted]

The increase in Fund efficiency during 2016 had a positive effect on the overall financial performance that translated in the Fund reaching profitability in its second year of operation, which is projected to continue in 2017. This performance will allow the Fund to expand its operations to further markets in the target region.

DEFRA´s investment is in Junior Shares, which is the first loss taking tranche. It did not take any losses in 2017 and is not projected to take any losses for 2018. As such, the full value of Defra's investment remains in the Fund.

VfM performance compared to the original VfM proposition in the business case

Economy: [redacted] Costs of Fund operation are covered by the returns on capital in the fund. As such, no value has been lost on Defra's initial investment. In terms of the cost of inputs, operating expenses have fallen faster than expected, as discussed above.

Efficiency: [redacted] We see a highly efficient funding operation. Progress has been made on utilising this funding to broaden support of a range of sustainability standards, and the portfolio has diversified to partner with 10 financial institutions. Further progress is required on increasing access to small and medium sized on-lenders, work which should accelerate in the coming year.

Technical assistance funding to date has been broadly focused on increasing the impact of funding through identification of focus areas of high deforestation, together with embedding of sustainability criteria within the frameworks of partner institutions. This should ensure that funding is driving progress towards the desired outcome of the project. A further shift in focus in 2018 away from initial outreach and engagement work towards on-the-ground implementation assistance and scoping should improve the value for money of spending.

Effectiveness: The Fund has broadly met or exceeded baselines across program outcomes – this suggests that early progress towards the desired project outcome is being made. Without clear milestones for 2017, the effectiveness of the Fund cannot be quantitatively assessed at this point.

However, in qualitative terms, the Fund has delivered on lending in all target countries, with over 55,000 hectares of land under sustainable management [redacted]

[1] At 2018 average £/$ exchange rate of 1.355

Program delivery is considered to be broadly on track and delivering effectively. The finalisation of the Fund-level impact framework will be crucial in fully assessing the effectiveness of the Fund – as such, this should be considered a priority going forward.

Equity: [redacted]

From a gender perspective, the fund is largely investing in agriculture, a sector traditionally dominated by men (which represent around 80% of agricultural workers in the region). However, the fund has also started to invest in 2017 in food processing companies, a sector in which women are typically better represented, especially in the fish processing industry. In 2018, Defra expects investments will be increasingly directed to women as the fund enters the microfinance segment, which focuses on businesses in which women are much better represented both as workers and as business leaders or agricultural holders.

Assessment of whether the programme continues to represent value for money

Given the lower than expected variable operating costs for the Fund, combined with consistent portfolio growth and a significant increase in partner financial institutions engaged, the Defra investment continues to represent good value for money. Expansion of on-lending to smaller producers will be necessary in delivering on development and livelihoods objectives, in line with ODA funding requirements.

Progress will be assessed in further quantitative detail in the 2018 annual report.

Date of last narrative financial report	Q3 - 2018
Date of last audited annual statement	2017

The Audited annual statement was conducted by Ernest and Young (E&Y) and indicates that the financial statements give a true and fair view of the financial position of Eco-Business Fund SA, SICAV-SIF as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union ("IFRS").

E: RISK

½ page

Overall risk rating: ~~Minor/~~**Moderate**~~/Major~~/~~Severe~~

Overview of programme risk

Of the six risks currently identified, two have been categorised as minor, two were categorised as moderate and two as major.

The two outstanding major risks are:

1. Lack of development of the impact framework and ability to effectively quantify and assess the impact of the programme as a whole. EBF have not been successful at securing a over the past 2 years timely development of the impact framework, which is now being undertaken in house as significant progress is expected by the end of 2018.
2. Unrest in Nicaragua - President Ortega's attempt to reform the pension system has triggered protest and strikes. Very high political risk of a deteriorating security situation. Unrest could lead to deteriorating economic stability, deteriorating investment climate and a resulting impact on the banking system causing lower portfolio growth.

One of the minor risks, but one that is still developing is that in 2017 the list of eligible sustainability standard labels was adjusted to reflect the findings of a study submitted [redacted] a standard with significant penetration in Latin America for several of its major crops, such as coffee, was one of the labels that failed to pass this new screening.

A following study commissioned [redacted] further modified the list, with the rejection of certain relatively minor labels and the inclusion of several new ones, among which many are related to fisheries and aquaculture.

The change in the list of eligible standards, especially the removal of standards which had previously been considered eligible, may generate additional uncertainties in the Fund's commercial relationships with its partner institutions. Although, it is noted, the studies will also allow opportunities to incorporate additional labels – which will provide significant contributions to business practices that promote environmental and social sustainability.

F: COMMERCIAL CONSIDERATIONS

As of the end of 2017, ten partner institutions have received financing from the eco.business Fund. With many of the partner institutions, the Fund established relationships that go beyond purely commercial aspects. The Fund accompanies its partner institutions throughout the life of the credit line and strives to add value to the operations of its partners with regards to environmental and social practices. This stretches from operational enhancements (e.g. establishment or improvement of the partner institutions' Environmental and Social Management System (ESMS) and satellite monitoring) over E&S capacity building of executives and staff through trainings and participation in events and conferences, to support of selected clients of the partner institutions to undertake exposure visits, among other measures. Overall awareness raising, and technical assistance in particular, play a vital part in this regard.

The support of the Fund has led to a noticeably increased identification of some of its partner institutions with the environmental objectives of the Fund. The eligibility criteria of the Fund start being incorporated by its partner institutions when screening financing opportunities of its clients, and no partner institution thus far faced difficulties on-lending the resources of the Fund. [redacted] The Fund expects to engage in top-up credit lines for some of its partner institutions in 2018 as there is increased appetite for more environmentally sustainable lending. Clearly, not all partner institutions are equally engaged in the change process towards more sustainable banking practices that the Fund promotes. Generally, partner institutions are more engaged the more they value the support of the Fund (for instance partner institutions that have not received much TA in the past).

G: CONDITIONALITY

n/a

H: MONITORING & EVALUATION

Evidence and evaluation

The theory of change for the Fund states that the Fund should carry out specific activities that lead to positive effects, or short-term outcomes, which in turn trigger long-term change. Although the two impact pathways (Financial Institutions (FIs) and businesses) have their own route towards achieving the ultimate outcome, they reinforce one another and this reinforcement is crucial to driving transformational change in the market. The Funds Theory of Change can be found in Annex A.

The impact framework, which derives from the Theory of Change, is currently being developed and is expected to be fully operational by the end of 2018, with the publication of the fund's first impact report planned for the second half of 2019. Its objectives are to define and implement the procedures necessary to assess the impacts of the Fund's investments across five areas: Biodiversity and ecosystems; Water; Soil; Climate Change; and Socio-economic. Some of these impacts will be quantified, such as CO2 capture from agroforestry activities or the number of sustainable jobs supported, while others will remain fully or partly qualitative (e.g. impacts on biodiversity). The Fund's impact framework will draw on its own data sources (sub-loan reports, ad-hoc studies or assessments made for the Fund, especially through its Development Facility) as well as on third party information, mainly from the scientific literature. The impact framework will be continuously enriched as additional information is gathered and as the Fund as well as its partner institutions become more experienced at financing sustainable practices and better equipped to assess the associated impacts.

The approach of the Fund towards impact investment takes into account two goals: creating a positive change aligned with the principles of development finance and the generation of financial returns for investors.

In the absence and as part of the development of the complete impact framework, the picture below illustrates the context in which the Fund operates and the pathways through which it intends to achieve impact. These pathways represent the scope that is within the sphere of influence of the Fund, meaning there is a direct and explicit relationship between counterparties (i.e. Investors and the Fund or the Fund and FIs) and those pathways where the impact of the Fund is subject to circumstances outside its direct control like market conditions, or social behaviors.

Investors who commit resources to the eco.business Fund can be of private or public nature, Development Finance Institutions ("DFIs") and donors. These investors commit two types of capital to the Fund. First, investment capital aimed to finance businesses (via FIs or directly) to apply sustainable practices in the Fund's four focus areas. Second, grants channeled through the Development Facility of the Fund created to provide technical assistance to support FIs or businesses in the implementation of sustainable business practices.

The *Fund* itself channels investors' resources to its four focus sectors. The Fund Advisor does this through the financing of, capacity building on, and the promotion of business practices that have an effect on:

i. Biodiversity conservation,

ii. Sustainable use of natural resources,

iii. Climate change mitigation and adaptation.

Financial Institutions are the institutions that borrow directly from the Fund to finance eligible businesses or activities in their portfolio. FIs may also benefit from capacity building out of the Fund's Development Facility. Eligible businesses hold one of the 22 certifications on sustainable production selected by the Fund, and eligible activities have been identified by the Fund and incorporated in a "Green list".

Businesses are either *sub-borrowers* who benefit indirectly from the Fund's financing through the intermediation of FIs or direct *investees ("DIs")* who directly borrow from the Fund and who may also be assisted directly through the Fund's technical assistance activities.

Ultimately it is *the market* that benefits from the interventions of the Fund. At this level, the Fund aims to have an implicit effect by connecting the before mentioned stakeholders.

Some examples of activities carried out by the Fund that will have an impact on the three Fund's pillars are provided below for illustrative purposes.

For Biodiversity Conservation

Impact	Potential examples
Preserve, restore or improve the ecosystem services of areas upon which Fund activities or final borrowers are based	✓ Promote the use of agroforestry systems ✓ Promote the use of silvo-pastoral systems ✓ Promote the use of eligible standards (see 'spotlight on Rainforest Alliance' below)
Increase/preserve the area of biodiverse landscapes	✓ Fund eco-tourism projects ✓ Fund sustainable forestry projects ✓ Fund businesses that are part of the sustainable fishing food chain ✓ Fund fisheries using pole and line fishing methods and avoiding fishing aggregated devices
Reduce and mitigate key threats to biodiversity caused by business activities	✓ Raise awareness of biodiversity threats in partner financial institutions ✓ Avoid funding crops that are deforestation drivers in sensitive regions

	✓ Avoid funding activities located in protected areas

For Sustainable Use of Natural Resources

Impact	Potential examples
Conserve natural resources through the promotion of sustainable technologies	✓ Fund water – saving irrigation equipment ✓ Fund water-reuse and recycle technology
Enhance/preserve soil quality	✓ Support farms that have rotational grazing in place ✓ Fund livestock producers that adopt manure waste management ✓ Support farms practicing advanced soil preservation techniques (e.g. low tillage, crop cover, and crop rotation)
Reduce pollution	✓ Support businesses applying reduced or no chemical inputs (e.g. pesticides, fertilizers) ✓ Fund businesses that have water treatment initiatives ✓ Support businesses that have in place reutilization of crop residue ✓ Support bio-digesters within livestock producing units

For Climate Change Adaptation and Mitigation

Impact	Potential examples
Reduce the drivers of climate change (i.e. GHG emissions) by promoting climate mitigation practices	✓ Fund the purchase of energy efficient post-harvesting machines ✓ Fund water saving technologies ✓ Support businesses that avoid slash and burn ✓ Fund businesses that have deforestation mitigation policies in place
Address climate change effects by promoting adaptation practices	✓ Support farms that incorporate the use of more resilient crop varieties ✓ Fund coffee producers using shade-grown coffee ✓ Fund silvo-pastoral systems for livestock production

How is evidence disaggregated by sex and age, and by other variables?

The evidence currently compiled by the Fund on the impacts of its investments or the information that is reported by partner institutions in the context of the bi-annual sub-loan reports is not disaggregated by sex or by age. To minimize the burden on the partner institutions, which is already significantly higher than for standard loans, the Fund does not intend to ask its partners to directly report this information. Instead, the Fund proposes to rely on third party evidence, when it is available, to provide estimates of gender disaggregation for certain indicators of interest. An example would be to breakdown the estimates of number of jobs created or supported (KPI 5) by sex, it is intended that this will be incorporated going forwards and will be discussed during 2018.

Monitoring progress throughout the review period

The Fund's continuous monitoring approach consists in the following activities:

<u>1. Credit monitoring / monitoring of financial performance of investees</u>

In 2017, the Fund Manager followed its traditional credit monitoring approach consisting of quarterly risk reviews that are presented to the Rating Committee. The reviews were conducted for each partner institution and include a general review of performance in the recent quarter, spotting of trends, covenant monitoring and adjustment of ratings if necessary. In parallel, the Fund Manager introduced a company-wide new rating methodology following S&P guidelines and rated its entire portfolio according to this new methodology. In 2018, the new methodology will replace the old one, which introduces important new features that allow for better comparison of partner institutions across geographies.

2. Monitoring of the use of proceeds (sub-loan monitoring)

Partner institutions are required to report to the Fund Manager on the use of funds on a bi-annual basis. The Fund Manager controls that its resources are used in the eligible sectors following the respective criteria and whether the partner institutions abide by the minimum required on-lending rate. All partner institutions report loan-by-loan on a specified set of information (such as loan amounts, target sector, financed activities, loan type and sustainability standard) on an anonymous basis (no obligation to report names of sub-borrowers).

3. Monitoring/measurement of achieved results

With the development of the Theory of Change and the implementation of the impact framework, the Fund Manager will have a tool to systematically track achieved results. Thus far, the Fund Manager has conducted various sub-borrower visits and case studies, which contributed to gather useful information for impact evaluations and to identify sectors or production practices that could be eligible to receive support from the EBF. For example, a study of coffee producers in El Salvador, conducted by the EBF in collaboration with a partner institution, [redacted] allowed to better understand the benefits of shade-grown coffee in terms of preservation of ecosystems, sustainable use of resources as well as the effects of certification. This study also highlighted the numerous challenges of these mostly small holders in generating sufficient yields and livelihoods.

4. Environmental & social reviews

In 2017, the Fund Manager conducted one environmental and social review of its partner institutions that included a country E&S risk screening. The E&S reviews will be restructured and updated in 2018 to assure as close as possible monitoring of any E&S related aspects in partner countries and with partner institutions.

5. Monitoring through relationship management (visits, meetings)

The Fund Manager maintains close relationships with its investees and supplements the standard monitoring as described under 1 to 4 with client visits and update meetings. Next to direct visits and visits in the context of the implementation of TA projects, meetings are arranged at industry conventions (e.g. FELABAN and Foromic) or sector events (e.g. UNEP FI).

ANNEX A: ECO BUSINESS FUND THEORY OF CHANGE (Please note this is updated since 2017 review)

Impact

The financial and real sectors in Latin America and the Caribbean, active in the four focus sectors, apply responsible business practices that contribute to:

- **Biodiversity conservation**
- **Sustainable use of natural resources**
- **Climate change mitigation and adaptation**

Long-term Outcomes

Financial Institutions

1. FIs are aware and have an active role in protecting ecosystems through the incorporation of sustainability as a qualifier for lending
2. FIs increase funding to businesses that apply sustainable practices while decreasing funding to non-sustainable businesses
3. FIs broaden the spectrum of sustainable businesses that are being financed
4. FIs participate or lead sector-wide initiatives to promote sustainable business practices at pre-competition level

Sub-Borrowers

1. Sub-borrowers increasingly incorporate sustainable practices as part of their strategy and operations, contributing to the protection of ecosystems
2. Sub-borrowers are able to access financial markets and have enough funding alternatives to support a profitable and sustainable strategy in the long-term

Short-term Outcomes

Financial Institutions

1. FIs incorporate environmental and social sustainability as a criteria for their credit evaluation process
2. FIs' commercial and risk staff are increasingly aware and act upon environmental risks embedded in the sectors and operations they finance
3. FIs are able to identify business opportunities related to climate change mitigation and adaptation
4. FIs develop specific lending products for sustainable businesses
5. FIs actively monitor and report on their results in promoting sustainable business practices

Sub-Borrowers

1. Sub-Borrowers increasingly become more proactive about environmental issues
2. Sub-Borrowers increasingly have goals in terms of:
   - Reducing/compensating GHG emissions
   - Using natural resources efficiently
   - Creating demand for sustainable products
3. Sub-Borrowers and consumers become more interested in a product offer that is more social and environmentally responsible
4. Sub-Borrowers are able to identify business opportunities related to climate change mitigation and adaptation
5. Sub-Borrowers use internationally recognized methods of reporting on impact

Outputs

Financial Institutions

1. **Funding:** FIs pre-screened (#), FIs visits (#), FIs approached (#), Eligibility memos presented (#), DDs completed (#), eco.business loan portfolio ($) (#), FIs in the Fund´s portfolio by country (#), Portfolio by country ($) (#), Portfolio by region ($) (#), Portfolio by focus sector ($) (#), On-lending rate by FI (%), Portfolio by eligibility criteria ($) (#), Portfolio by sustainability standard ($) (#), Portfolio allocated by Green List measure ($) (#), Portfolio by crop ($) (#).
2. **Technical assistance:** TA projects successfully completed (#) ($), TA projects under implementation (#) ($), TA projects approved (#) ($), Financial products developed (#), Trainings provided (#) (hours), Participants benefitted (#), ESMS developed, implemented or supported (#), E&S assessments completed by FIs (#), E&S monitoring tools implemented (#), Number of PIs publicly reporting on E&S topics.
3. **Activities with other stakeholders:** Events organized (#) , Events participated (#), Staff from banks attending industry events (#), Links to other stakeholders facilitated by the Fund (#), Alliances facilitated by the Fund (#), Catalyzed lending ($), Portfolio developed in partnership with EBF ($) (#).

Sub-Borrowers

1. **Funding:** Sustainable land managed (Has.), Sustainably produced volumes (Tons.), Sub-borrower revenues ($), Use of funds (e.g. working capital vs. fixed asset) ($), Yields (Tons per Ha), Employment (#), SMEs (#). (Other specific outputs will depend on the data that Sustainability standards approved by the fund gather and make publicly available for a particular certified entity).
2. **Technical assistance:** TA projects successfully completed (#) ($), TA projects under implementation (#) ($), TA projects approved (#) ($), Sub-borrowers benefited from TA (#), Trainings provided (#) (hours), Participants benefitted (#), M&E projects completed (#), M&E projects ongoing (#).
3. **Activities with other stakeholders:** Events organized (#), Events participated (#), Sub-borrowers attending industry events (#), Links facilitated by the Fund (#), Alliances facilitated by the Fund (#), Catalyzed lending ($), Client stories developed.

Activities

Financial Institutions

1. Funding

- Identify and provide funding to suitable FIs
- Develop eligibility criteria for on-lending.
- *Sustainability standards /Green List*

Financial Institutions

2. Technical assistance

- Design, implementation or upgrade of ESMS systems
- Build capabilities for on-lending.
- Market positioning

Sub-Borrowers

1. Funding

- Identify and provide funding to suitable businesses
- Fund lighthouse projects with demonstration effects

Sub-Borrowers

2. Technical assistance

- Build capacity in environmental risk management and best practices
- Impact monitoring and evaluation framework
- Market positioning

3. Activities with other stakeholders

- Establish active engagement with sustainability standards (e.g. continuous dialogue, participation in key industry forums and conferences)
- Coordinate with other impact lenders in order to pick-up lessons learned, provide a private sector prospective on conservation finance related initiatives and explore possible bilateral opportunities for collaboration
- Network with impact investors as a means of increasing potential funding for the work of the Fund
- Build links to research entities