9 The Energy Efficiency National Fund

9.1 Ireland has a target of improving its energy efficiency by 20% between 2009 and 2020. In order to meet this objective, the Department of Communications, Climate Action and Environment (the Department) introduced a number of national energy efficiency plans.

9.2 The Carbon Revenue Levy Account was established in September 2010. Relevant electricity producers were required to pay a levy on their carbon emissions, which was paid into the account. In addition, a special dividend from the ESB was also paid into the account. These funds were used to subsidise the energy costs of large energy users (for example, large businesses).

9.3 In 2012, after a legal challenge, the collection of the levy was discontinued. In March 2014, the final balance on the account was disbursed as follows[1] — €35 million to the Energy Efficiency National Fund (EENF)[2] and €9.4 million to the Office of Public Works (OPW) for energy efficiency schemes for the public sector. The OPW's allocation was used for the 'Optimising Power@Work' programme, the objective of which is to raise awareness of energy efficiency in the public sector and to reduce its energy use.

9.4 The EENF was established to provide loan financing to both private and public organisations in order to

- support the delivery of energy efficiency improvement programmes and other energy efficiency measures, and
- promote the development of a market for energy efficiency improvement measures.

Energy Efficiency National Fund

9.5 Instead of investing directly in energy efficiency projects, the Department, advised by NewERA, decided to establish a 'qualifying investor fund' (QIF) managed by outside fund advisors.[3] The QIF advisors identify and manage the investment projects.

9.6 The QIF was registered as a company called Ireland Energy Efficiency Investments plc (hereafter the QIF). In addition to the funding from the EENF, the company sought the involvement of private investors, allowing the QIF to pool the resources of the EENF with funding from the private sector.

9.7 The Department has stated that the potential benefits of using a QIF included access to private sector funding, access to external expertise to develop the energy services sector in Ireland and the use of energy performance contracting. In addition, in light of the Exchequer position at the time, the QIF was designed to provide a new funding instrument while complying with both the limits on project expenditure impacting on the Government deficit and State aid requirements.

9.8 There are potential risks for the Department in accepting a minority interest in an externally-controlled investment fund. These include

- The Department does not have control over the investment decisions, including the pace at which those investments are made.
- The Department may incur significant professional services costs.

1 The Electricity Regulation (Amendment) (Carbon Revenue Levy) Act 2010, which established the account, provided for the transfer of funds for the benefit of the Exchequer.

2 The EENF is held in a Paymaster General deposit account under the control of the Department.

3 A qualifying investor fund (QIF) is a regulated investment structure targeted at sophisticated and institutional investors, and which may provide tax benefits to investors who are not resident in Ireland. A QIF is operated in accordance with the Alternative Investment Fund Managers Directive (Directive 2011/61/EU).

9.9 This report examines how the QIF was established, what involvement the Department had in overseeing its activity, the level of investment in energy efficiency projects that was achieved, and the professional service fees and expenses that were incurred since its inception.

The establishment of the QIF

9.10 Three Government decisions were made during the period from February 2013 to March 2014 to establish the EENF and to use a QIF as its investment vehicle. It was set up with the expectation that the QIF would generate an annual return for the investors of at least 8%, net of fees and expenses.

9.11 In August 2013, the Department issued a request for tender for outside investment experts to manage the QIF. The investment advisors role was to identify appropriate investment projects, negotiate the contract details, and manage the contracts until their conclusion.

9.12 On 14 November 2013, Sustainable Development Capital LLP (SDCL) was selected to manage the QIF. As the manager of the QIF, SDCL receives an annual fee from the QIF for its services. It was also responsible for appointing the investment manager and the fund administrator.

9.13 The QIF was envisaged to have three stages in its development

- an **investment period** — May 2014 to May 2017 (with provision for this to be extended for one year) — where projects would be identified by SDCL and contracts signed, and investments would start to provide a return for the QIF
- a **post-investment period**, to start after May 2017, where the QIF would be closed to new investments, but those that had been agreed would continue to be managed by SDCL
- an **exit period** where the company's activities would be divested to a third party, estimated to occur in May 2024.

9.14 The Department stated that the QIF structure is very common in the Irish market and considered by investors to be an attractive and efficient fund structure. It stated that this is evidenced by the third party commercial investors who agreed to participate in the QIF and who continue to participate.

Decision making and control in the QIF

9.15 The investment criteria to be met by the QIF are set down in the fund documents. The Department has no involvement in the day-to-day management of the QIF. However, a representative of the Department is a member of an investment advisory committee. NewERA acts as informal advisor to the Department.

9.16 The investment advisory committee exists to advise on general investment strategy and to be consulted by the investment advisor and the QIF in relation to potential conflicts of interest. The advisory committee receives quarterly activity reports, but has no control over operational matters. At September 2018, the most recent activity report the Department had received was for the first quarter of 2018. Decisions on investments, and their timing, are under the control of the investment manager and the directors of the QIF.

9.17 In addition to the information it receives from participating in the investment advisory committee, the Department as a shareholder also receives regular investment valuation statements detailing the current net asset value of the QIF per share and the total number of shares owned.

Investment activity of the QIF

9.18 Although the investment period was due to close in May 2017, the QIF's prospectus allowed for it to be extended by one year. This was foreseen in the Government approval. An extension was agreed by the QIF's board in March 2017 and the investment period was extended to May 2018. The Minister, as a shareholder, agreed to this extension.

9.19 The QIF may invest in both private and public sector projects. Two types of financing are available

- an energy performance contract, where funding is loaned to an energy services company
- direct lending to companies for energy efficiency projects.

9.20 From May 2014 to the end of March 2018, the QIF had invested a total of €3.4 million in three projects. Case A provides an example of an energy performance contract financed by the QIF.

Case A Major retailer — 60% energy saving project

The QIF funded the installation of a lighting system in premises of a major retailer under a fully-funded services contract, using an energy performance contract with a service delivery partner (a lighting contractor). The project involved the upgrading of 5,000 LED panels across seven stores to deliver energy savings. Lux levels (the quantity of light supplied) were measured and verified on a quarterly basis by the project delivery partner, with payments from the retailer conditional on the agreed lux levels being achieved.

The total investment by the QIF was around €2 million.

9.21 Based on information in the quarterly activity reports, this examination calculated the internal rate of return for the two projects which were largely complete by mid 2018. In both cases (including Case A), the rate of return exceeded the 8% indicated in the proposal to Government to establish a QIF.

9.22 On 9 April 2018, the board of the QIF sought shareholder agreement to extend the investment period by a further 12 months and to make changes to certain investment restrictions. The Department decided not to support this change.

9.23 The Department has stated that the other shareholders have decided to continue with their active involvement in the QIF beyond the end of the investment period on 8 May 2018. To facilitate the wishes of those investors, the Minister voted in favour of an ordinary shareholder resolution on 16 July 2018. The Department has indicated that while no further calls can be made on the State, the QIF remains in operation as a commercial enterprise.

Fees and expenses incurred by the QIF

9.24 The QIF uses the services of a range of financial, taxation and legal experts. In addition, it incurs annual fees and expenses payable to the investment advisors, the investment manager, the depositary[1] and the fund administrator. The management fee was set at 1.25% of the committed capital during the investment period. After the investment period closed, this was to change to 1% of the invested capital. The total fees and expenses incurred by the QIF to March 2018 were approximately €3.8 million. In addition, approximately €760,000 was paid directly to the QIF's investment advisor by its shareholders for preliminary charges.

9.25 Up to the end of March 2018, a total of €1.7 million in fees and expenses could be considered attributable to the State based on its proportionate shareholding. In addition to these fees and expenses, the EENF contributed approximately €300,000 directly to the investment advisor for preliminary charges.

Drawdown of funds

9.26 The Department committed to investing the full €35 million held in the EENF in the QIF. At end March 2018, private investors had committed to invest €38.8 million. The QIF draws down funds from these commitments to fund approved projects and to meet costs.

9.27 By the end of March 2018, only €6.4 million had been drawn down — €2.9 million of which was from the EENF (exclusive of the preliminary charges of €300,000 paid directly to the investment advisor).

9.28 Before the end of the extended closing date for investment, the directors of the QIF confirmed that a number of further projects had been committed to. €10.8 million was drawn down in two separate instalments from the EENF in May 2018. This brings the EENF's total investment to €14 million. The activity of the EENF is shown in Figure 9.1. The Department has stated that the balance of €21 million in the EENF will be used to fund the newly established Climate Action Fund.

Figure 9.1 Energy Efficiency National Fund, April 2014 to June 2018

	€m	€m
Received from Carbon Revenue Levy Account (April 2014)		**35.0**
Payments[a]		
May 2014	(1.1)	
January 2015	(0.3)	
June 2015	(0.8)	
October 2015	(1.0)	
May 2018[b]	(10.8)	**(14.0)**
Balance at June 2018		**21.0**

Source: Office of the Comptroller and Auditor General

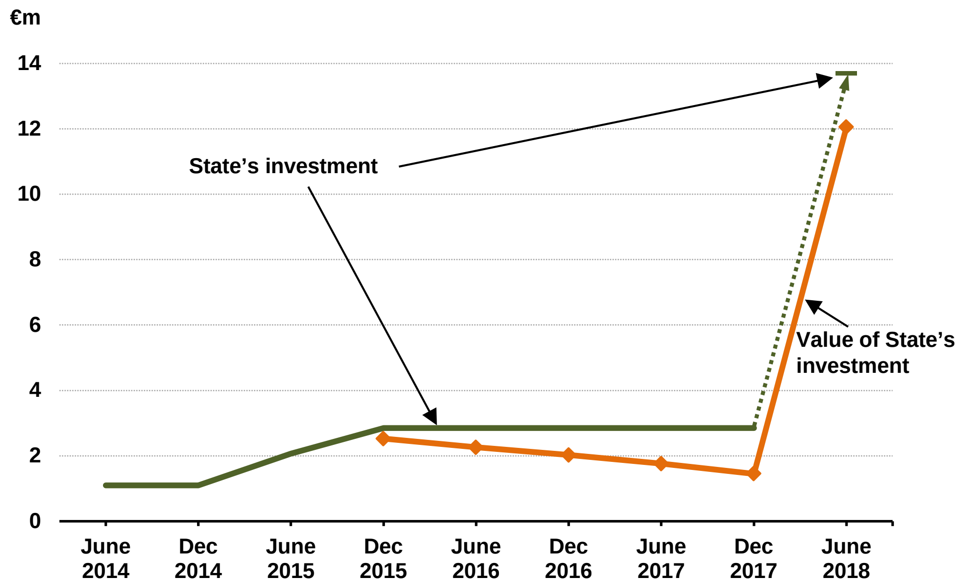
Notes: a Includes approximately €300,000 paid directly to the QIF's investment advisor for preliminary charges.

b Includes two transfers of €1.8 million and €9 million respectively.

1 The depositary of a QIF is responsible for the safe-keeping of its assets, the settlement of trades, and has oversight duties which require it to supervise the investment activities of the fund.

9.29 Figure 9.2 shows the State's investment in the QIF, and the movement in the value of that investment. The value of the State's investment in the QIF of €2.9 million at December 2017 was approximately €1.4 million. In June 2018, the value increased to approximately €12 million after the drawdowns of €10.8 million in May 2018.

Figure 9.2 Cost and value of State's investment, December 2015 to June 2018



Source: Investment valuation statement received by the Department from fund administrators. Statements not available for periods before December 2015.

Conclusions

9.30 Although the Government made €35 million available for investment in the QIF, only €2.9 million had been drawn down by March 2018. Just before the closure of the extended investment period in May 2018, a further €10.8 million was drawn down from the EENF for projects that the directors of the QIF confirmed had been committed to. This brings the total transfers from the EENF to €14 million. The Department has stated that there will be no further investment in the QIF by the EENF and that the balance remaining of €21 million will be transferred instead to the Climate Action Fund.

9.31 In seeking Government approval, the Department projected an annual rate of return on the investment of 8%, and anticipated a significant investment in energy efficiency in the State. The significant investment in energy efficiency projects has not yet been achieved.

9.32 The complex structure used to invest the EENF resulted in a disproportionately high level of costs to date. Effectively, it will cost the State at least €2 million in fees and expenses out of a total transfer from the EENF of €14 million.[1] However, the value of the State's investment into the future is not known at this stage.

1 The expenses incurred are paid from the QIF's resources, which includes both the capital drawn down and the income it receives from its operations. The figure of €2 million relates to the portion of total fees and expenses that can be considered to be attributable to the State's shareholding.