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Second Interim Evaluation Management Response

The three Funding Agreements that govern the relationship between SDTC and the Government of Canada (signed, respectively, March 2001, 2004 and 2005), as they relate to the SD Tech Fund™, require that SDTC develop an evaluation framework and complete independent interim evaluations. As stated in the third funding agreement the interim evaluations should “assess whether the Fund is meeting its purposes and objectives and, to the extent possible, whether adjustments to the program can and should be made.” It should “focus on the administration of the Fund and provide commentary on the overall operation of the Foundation in meeting the purposes of the Fund, including an evaluation, in aggregate, of the Project Impact and Market Impact, of Funded Projects by Market Sector as estimated as of the date of the evaluation.”

Robinson Research, in association with TNS Canadian Facts, conducted an independent evaluation of SDTC’s progress towards its mandate up until December 31, 2008 the details of which are described in the report titled “Evaluation of the SD Tech Fund™ of Sustainable Development Technology Canada, Second Interim Evaluation Report”. The scope and methodology of the evaluation was formed with input from representatives of Natural Resources Canada, Environment Canada, SDTC’s Board of Directors, SDTC Management, industry and the investment community. The report was made public by June 30, 2009 as required by the funding agreement.

This response briefly discusses the main recommendations made by the evaluators including some of the actions that have already been taken and some of the actions that will be taken in response to the report.

Overall Response

SDTC is pleased with the findings of the report and feels it is a fair and balanced assessment of whether SDTC is meeting its purposes and objectives. The results are positive concluding:

“...strong support for the need for the Fund and for its continued existence.”

“The Fund is aligned with the current priorities of the Government of Canada.”

“The funding gap continues to exist and the evidence indicates the Fund does not displace private sector funding for projects.”

“The need for the Fund is unquestioned among all key informants and they voice strong support for the role it is playing in the development of clean technologies in Canada.”

“the Fund seems likely to generate significant net benefits over the next decades”

“The net benefits are very large. This implies that increasing the scale of the SD Tech Fund activities would generate a continuing net social gain and recapitalizing the Fund should rank high among government’s investment opportunities.”

The report’s conclusions and recommendations focussed on potential adjustments to SDTC’s operating model which SDTC has grouped into four key areas: Recapitalization of the Fund, Terms of the Funding Agreement, Operations and Government Communications.

Recapitalization of the Fund

a) Recommendation – “the issue of recapitalizing the Fund should be addressed in the near future. The largest component of the Fund, climate change and clean air projects, has committed virtually all of its funds. If disruption is to be avoided in the Fund’s operations and in the development of new clean technologies, a clear indication of the government’s intent with regard to recapitalization should be available in the next few months.” ...

SDTC Response - SDTC accepts these recommendations and has been seeking recapitalization of the SD Tech Fund. The SD Tech Fund will have fully allocated money set aside for technologies addressing Climate Change and Clean Air by November 2009. Money, set aside for water and soil related technologies, is expected to be allocated by the end of 2010.

b) *“We recommend that, if the agreement is renewed or modified, consideration should be given to specifying a date that would trigger consideration of future renewal at least two years in advance of the termination of the renewed agreement.”...*

SDTC Response – SDTC accepts the recommendation and will consider requesting a trigger date for funding renewal in future funding agreement negotiations. A clause with a similar objective is included in the Funding Agreement governing the NextGen Biofuels Fund.

c) *“We recommend that the cost-benefit results be taken into account when the government considers recapitalization of the Fund.”*

SDTC Response - SDTC is delighted with the results of the cost-benefit analysis which were described by the evaluators:

“The findings of an extensive cost benefit analysis indicate that the Fund seems likely to generate significant net benefits over the next decades. For the 25 projects included in this analysis, the Fund contributed \$61.6 million of the total investment of \$215 million. We estimate that the net present value of the total quantifiable benefits from this set of projects will range from about \$446 million to \$1.1 billion, with a central estimate of about \$750 million.”

For reference the central estimate of net present value of the 25 projects (\$750 million) exceeds that of Canada’s entire \$550M investment in the SD Tech Fund. The study did not consider the benefits of the other 129 projects funded by SDTC as at December 31st, 2008. Even the most pessimistic assumptions of the sensitivity analysis still showed the 25 projects were a worth while investment for Canadians. SDTC has been informed that at this early stage of a program’s (fund’s) evolution, this level of benefit is exceptional.

The results provide strong objective evidence in support of recapitalizing the fund. SDTC has already begun to integrate the results of the analysis in its communications with Government. SDTC will continue to point to other significantly positive results it has achieved as further objective evidence of the value to Canadians of the SD Tech Fund.

Terms of the Funding Agreement

The evaluation recommends adjustments to the operating parameters of the Fund as defined by the Funding Agreement between SDTC and the Government. These adjustments require agreed action between SDTC and the Government which can be addressed while negotiating a new funding agreement or through modification of an existing agreement.

a) Recommendation - that the approach of assigning funding targets based on primary environmental benefit “be re-examined in any future funding agreements. We suggest that when projects have significant impacts in more than one sector, allowing more than one benefit for those projects would more accurately reflect the reality of the technologies being developed.”

SDTC Response - SDTC accepts the recommendation and will work with the Government to change the way funds are allocated to environmental issues and/or technology priorities in future funding agreements.

Currently, as prescribed by the funding agreement, SDTC allocates funding to categories based on the primary environmental benefit of the technology. SDTC is to fund \$270M into projects “primarily” addressing climate change, \$80M into projects “primarily” addressing clean air and \$200M into projects “primarily” addressing clean water and/or clean soil. In addition to the overall climate change and clean air category there are subcategories of allocation of at least \$50M to cleaner fossil fuels and \$50M to the hydrogen economy. By changing the allocation determinant from the “primary benefit” to that of “an important benefit” would allow SDTC flexibility to more rapidly deploy funds and to focus more on those technologies that offer attractive co-benefits. At the end of 2008, 88% of SDTC’s projects had more than one environmental benefit.

b) Recommendation – “the operating budget be reviewed to ensure that it supports the full scope of capacity building efforts that have been developed by the Fund.”

SDTC Response - SDTC accepts this recommendation. In future funding agreement negotiations SDTC anticipates additional operating budget to address increased capacity building activities. Through a review of its portfolio companies SDTC has concluded that additional capacity building efforts are required to help companies:

- attract additional sources of financing during and after development and demonstration work, and
- partnering with other commercial entities to address market barriers and provide important user references to technologies

c) Recommendation – “the Funding Agreement should be revisited to establish a disbursement target date that is more in keeping with the nature of the projects that have emerged from Canada’s technology development community.”

SDTC Response - SDTC accepts this recommendation and based on experience to date will work with the Government to adjust target disbursement timelines in future funding agreement negotiations to better reflect the reality of the marketplace.

Operations

SDTC is pleased with the findings with respect to its operations. The evaluation comments on the results of several initiatives undertaken by the Fund prior to this evaluation to improve processes and to build applicant capacity. The results include:

- Improved SOI and Proposal success rates;
- Reduced time to sign project contracts;
- For a number of types of contracting delays there has been reduced incidence
- Decrease in the time taken to review milestone reports and process progress payments, and
- Improved adherence to project schedules.

a) Recommendation – “the Fund should continue to review the SOI, proposal and contract requirements to identify any areas that may call for detail in excess of that required for prudent project management and protection of public assets. The ongoing scrutiny of the processes, typically a review after each funding round, should ensure that each stage only calls for the critical information used to identify projects that should proceed to the next stage. Wherever feasible the information required at each stage should relate directly to that provided in the previous stage.”

SDTC Response - SDTC accepts the recommendation and intends to continue to review the funding process requirements. Although the evaluation found that the majority of respondents felt the level of effort and requirements were appropriate there is still a vocal minority who feel too much detail or effort is required to receive funds from SDTC.

SDTC has always worked to maintain a balance between level of effort and making the best and fairest decisions to protect public funds. SDTC will continue to review its processes to reduce any excess detail required in the funding process.

b) Recommendation – “the Fund should continue its work to identify the reasons for delays in the release of holdback funds, segregating time under the Fund’s control, which includes the time taken by its subcontractors, and identifying strategies to minimize the time under its control. Any extended payment periods should be attributable to the proponents’ delays in providing the required submissions.”

SDTC Response - SDTC accepts the recommendation which draws upon the experience of the initial completed projects which were the first to test processes for releasing final payments. SDTC has already taken a number of actions to address delays in payments. The evaluation has noted that some improvement in delays of holdback payments has already been made. Actions taken by SDTC include:

- Revised the requirement for a full financial audit of the project. SDTC now arranges for a simpler and less expensive risk-based audit. The impact of this change in terms of cost, quality of audit evidence and timeliness is still being assessed.
- Instituted a process to identify projects nearing completion to facilitate planning and tracking of completed projects processing. This is intended to identify status and bottlenecks and facilitate timely remedies
- Initiated a regular review with financial audit and environmental consultants on the above forecast for work load planning and priority setting
- Introduced early initiation of the audit assessment in advance of project completion and submission of final project reports.

SDTC will continue to monitor the progress of payments and work to adjust its processes where possible.

Government Communications

The evaluation comments very positively on SDTC's progress in communications with Government: "SDTC continued to work on the relationship issues discussed in the First Interim Evaluation and its efforts have been applauded by colleagues in Government departments who strongly support the Fund's communication initiatives."

SDTC has taken several communications initiatives since the 2006 evaluation. During the period from June 2008 to June 2009 SDTC has had on average approximately one senior level meeting per week with departments and political staff. In addition, SDTC has continued with the government monthly meetings it initiated prior to the 2006 evaluation. These meetings include representatives from Natural Resources Canada, Environment Canada, Agriculture Canada, Foreign Affairs & International Trade and Industry Canada. Also SDTC has worked closer with communications staff in the departments and Minister's offices to raise the profile of the Government's investments through SDTC - during the past six months SDTC has held four media events with MPs.

Recommendation – "SDTC initiate discussions with appropriate government officials to identify additional communication channels. Ideally, the channels would respond to the information needs/expectations of both sides while avoiding imposing additional burdens on either side. Possible avenues:

- *Periodic discussions involving SDTC staff and specialists with departmental scientists or officials to identify general findings that could be shared while protecting the confidentiality and intellectual property of projects. This should be an exchange, responding to the interests of both SDTC and departments.*
- *When significant issues or questions arise that are not adequately covered by information already provided, meetings triggered by either side between senior SDTC/departmental/political levels to discuss those issues."*

SDTC Response - SDTC accepts this recommendation and will continue to work with government departments to adapt avenues of information exchange to the advantage of all those involved.

Conclusion

The SDTC mandate, model and fund expectations have been both re-validated and determined to be strong, providing important value to Canadians.

SDTC is pleased with the results of this second interim evaluation which validates the organization's hard work over the past eight years and provides specific opportunities to further improve the organizations effectiveness and efficiency in the years ahead.

SDTC accepts all of the recommendations in the evaluation and will take appropriate action. In particular SDTC will continue to work urgently with Government on addressing recommendations concerning recapitalization of the fund.