

I. Transaction Overview

The proposed transaction is an OMJ senior loan of US\$3 million to Fundación Covelo (Covelo), which would then on-lent these funds to its network of Microfinance Institutions (MFIs) throughout the Central American region in order for them to provide credit lines for the purchase of renewable-energy solutions to low income families, micro and small entrepreneurs and municipalities who have little or no access to affordable, reliable and safe energy. An additional US\$3 million will also be provided by Covelo for the proposed project.

Fundación Covelo will introduce financial instruments adapted for the renewable energy solution market, as well as for low income customers' needs. A technical cooperation that is related to this project will also help Covelo and the MFIs to develop specific financial instruments that are adapted¹ for renewable energy solutions, and for the technical providers to improve their distribution channels through marketing promotions, educating communities, after sales services, etc.

II. Environmental and Social Impacts and Risks

The operation will provide microloans for renewable energy solutions in all Central American Countries including Belize. Establishing this financing platform will provide tangible benefits for the low-income inhabitants and the other diverse market actors. The project does not expect to have negative impact on the environment due to financial nature of the transaction and to the promotion and expansion of renewable energy solutions.

There are many social potential benefits associated with this transaction as it will provide access to renewable energy solutions for households and productive activities, such as: solar photovoltaic home-lighting systems that could be a cost-effective substitute for kerosene; and lighting and battery charging for radio and TV versus acquiring diesel fuel and others. Energy demands of low-income populations are varied, including electricity for basic needs such as lighting and refrigeration, informational needs such as information and communication technologies, and productive needs such as powering water pumps and electrical fencing. Likewise, the potential benefits of the provision of these renewable-energy solutions include increased income opportunities and sustainable and clean light for work, study and recreation; fewer respiratory and eye problems (Kerosene and Oil displacement); and reduced CO² emissions. The impacts and risks associated with this transaction can be mitigated with the implementation of an appropriate Environmental and Social Management System (ESMS) at the MFIs and Covelo.

II. Strategy for Environmental and Social Due Diligence

Based on Directive B.13 of the Environment and Safeguards Compliance Policy (OP703), and given that this is a loan to a financial intermediary, this operation is not subject to an environmental impact classification. During the due diligence phase, the IDB will assess Covelo's capacity for a proper environmental and social risk management and it will establish

¹ For the type, maturity and suitability of product replacement, existence of a second-hand market: Micro credit or leasing and the effect the product has on the client (the substitution effect and the income generation effect.)

how environmental and social risk should be assessed and monitored on its MFI's network. Based on the outcome of this exercise, the environmental and social requirements of the operation will be defined, which will be reflected in the ESMR and in the Loan Agreement.

The environmental and social due-diligence will focus on the components listed below and will attempt to identify areas where the Bank's participation could result in a benefit to Covelo by promoting good financial practices:

- An assessment of Covelo's current environmental policies and tool kit.
- An assessment of Covelo's compliance with all ESHS and labor legislation applicable in Honduras.
- An assessment of Covelo's tools and capacity to replicate environmental and social risk financial instruments' for its network.
- Covelo receives training on environmental and social issues for Financial Institutions.