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EL SALVADOR

GLOBAL CREDIT LOAN FOR FINANCING ENERGY EFFICIENCY IN SMALL AND MEDIUM-SIZED ENTERPRISES

(ES-L1132)

LOAN PROPOSAL

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REQUIRED

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OPTIONAL

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(*) At the request of the borrowing country, the information contained in this electronic link is confidential in accordance with the country-specific information exception in paragraph 4.1 i of the Bank's Access to Information Policy (document GN-1831-28).

ABBREVIATIONS

BANDESAL	Banco de Desarrollo de El Salvador [El Salvador Development Bank]
CNE	Consejo Nacional de Energía [National Energy Council]
CTF	Clean Technology Fund
ESI	Energy Savings Insurance [information system]
GCF	Green Climate Fund
GDP	Gross national product
GHG	Greenhouse gas
IFI	Intermediary financial institution
MSMEs	Micro, small, and medium-sized enterprises
SMEs	Small and medium-sized enterprises
SSF	Superintendencia del Sistema Financiero de El Salvador [Financial System Superintendency of El Salvador]

PROJECT SUMMARY

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<table>
<tr><th colspan="5">Financial Terms and Conditions</th></tr>
<tr><td colspan="3" rowspan="4">Borrower: Banco de Desarrollo de El Salvador (BANDESAL)
Guarantor: Republic of El Salvador
Executing agency: BANDESAL</td><th colspan="2">Green Climate Fund (GCF)[a]</th></tr>
<tr><td>Amortization period:[b]</td><td>20 years</td></tr>
<tr><td>Disbursement period:</td><td>5 years</td></tr>
<tr><td>Grace period:</td><td>5.5 years[c]</td></tr>
<tr><th>Source</th><th>Amount (US$)</th><th>%</th><td>Interest rate:</td><td>Fixed at 0.75%</td></tr>
<tr><td>IDB – GCF:</td><td>20,000,000</td><td>50</td><td>Commitment fee:</td><td>0.50%</td></tr>
<tr><td>Local:</td><td>20,000,000</td><td>50</td><td>Service fee:[d]</td><td>0.50%</td></tr>
<tr><td>Total:</td><td>40,000,000</td><td>100</td><td>Approval currency:</td><td>United States dollar</td></tr>
<tr><th colspan="5">Project at a Glance</th></tr>
<tr><td colspan="5">Project objective/description: The objective of this program is to support efforts in El Salvador to reduce energy consumption by small and medium-sized enterprises (SMEs) and thereby bring down greenhouse gas (GHG) emissions by making suitable financing more readily available in the financial system in order to enable greater investment in energy efficiency.</td></tr>
<tr><td colspan="5">Special contractual conditions precedent to the first loan disbursement: Approval of the Credit Regulations by BANDESAL, with the Bank's prior no objection (paragraph 3.5), will be a condition precedent to the first disbursement of the loan proceeds.</td></tr>
<tr><td colspan="5">Exceptions to Bank policies: The Board of Executive Directors is asked to approve a partial waiver to the Bank's Operational Policy OP-303, "Guarantees Required from the Borrower," for the Republic of El Salvador to guarantee only the loan repayment obligations stemming from this operation, to include interest, fees, and the local counterpart contribution (paragraph 3.2).</td></tr>
<tr><th colspan="5">Strategic Alignment</th></tr>
<tr><td colspan="2">Challenges:[e]</td><td>SI ☐</td><td>PI ☑</td><td>EI ☐</td></tr>
<tr><td colspan="2">Crosscutting themes:[f]</td><td>GD ☐</td><td>CC ☑</td><td>IC ☐</td></tr>
</table>

(a) The loan proceeds, as well as the funds for technical cooperation operation ES-T1258 (currently in preparation and to be processed in parallel with this operation), were approved by the GCF Board of Directors on 30 June 2016. The GCF funds will be used in accordance with the provisions of the Accreditation Master Agreement signed by the GCF and the IDB on 29 August 2017, following Resolution DE-31/17 (document GN-2895), and in accordance with the provisions of the Funded Activity Agreement (FAA) for this program, which will be signed by the GCF and the IDB once the IDB Board of Executive Directors approves this loan proposal. The GCF funds will be available for the program once the FAA is signed and enters into force.

(b) The period commences as of the effective date of the loan contract. Payments will be made semiannually. The amortization, service fee, and commitment fee payments will be made on the same date as the interest payments.

(c) Payments will be made in 30 installments commencing on the first interest payment date following the fifth anniversary of the effective date of the loan contract.

(d) The service fee established by the GCF is applicable to loans financed with GCF resources. The service fee is used to cover administrative and resource mobilization costs. It is payable on the outstanding balance of the loan.

(e) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

(f) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. PROJECT DESCRIPTION AND RESULTS MONITORING

A. Background, problems, and rationale

1.1 El Salvador has a small, open, and dollarized economy with a productive structure geared toward services and consumption, and heavy trade dependence on the United States. Following a 2% contraction in gross domestic product (GDP) in 2009, the Salvadoran economy has staged a gradual recovery and expanded at an average annual rate of 2.5% since then.[1] The country's economic activity is closely linked to the consumption of electric energy.[2] El Salvador's GDP grew by 2.3% in 2017, in line with a positive year-on-year growth trend, while the demand for energy in the wholesale electricity market expanded at annual rates of 4% or less over the last 10 years.[3]

1.2 El Salvador has implemented a legal, institutional, and strategic framework for energy[4] and instituted a National Energy Policy for the 2010-2024 period. Efficient energy use and the promotion of alternative energy sources are important factors in the Salvadoran government strategy. This is a result of the country's dependence on petroleum products for power generation and transportation (approximately 56% of the energy matrix is thermoelectric, followed by hydroelectric (31%) and geothermal (13%) sources), and the dearth of alternative energy generation resources.[5]

1.3 Although El Salvador's share of global greenhouse gas (GHG) emissions is very low (0.04% of global emissions),[6] high dependence on fossil fuels to generate energy has resulted in a high national GHG emissions factor for electricity compared to other countries in the region (43% higher than the average for

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[1] See International Monetary Fund, World Economic Outlook, October 2017, and Central Reserve Bank Statistics.

[2] National Energy Policy 2010-2024. National Energy Council (CNE).

[3] According to CNE data, energy consumption in 2015 totaled 6,311 GWh as compared to 6,067 GWh in 2014, which is equivalent to a 4% increase.

[4] In 2007, the Salvadoran Legislative Assembly approved the CNE Law. In 2009, the CNE began to operate as the apex agency for the country's energy policy. The institutional framework for energy also includes the Superintendencia General de Electricidad y Telecomunicaciones [Electricity and Telecommunications Superintendency], the Fondo Nacional en Electricidad y Telefonía [National Electricity and Telephony Fund], and the Unidad de Transacciones [electricity market administrator].

[5] El Salvador is a net importer of fossil fuels, the importing cost of which is equivalent to 7.3% of GDP (2012). In addition, the country's imports of oil derivatives totaled 41,000 barrels of oil equivalents per day (BOED), amounting to an 81% increase with respect to the 1999-2002 period and a 60% increase with respect to the 2005-2008 period. Electricity consumption per sector is 39% for industry, 34% for residential users, and 27% for commercial users. In 2013, energy and liquefied petroleum gas (LPG) subsidies represented 1.2% of GDP, declining to 0.8% of GDP in 2015 due to the drop in fossil fuel prices. The policy adopted by the country to address the sector's challenges, particularly with regard to the constraints on expanding energy generation, has focused on diversifying the energy matrix (with a preference for developing renewable energy), promoting energy efficiency, and supporting regional electricity integration.

[6] Intended Nationally Determined Contribution of El Salvador under the United Nations Framework Convention on Climate Change, November 2015.

Latin America and the Caribbean)[7] and therefore a high potential for reducing GHG emissions through energy efficiency measures. In this regard, in its Intended Nationally Determined Contribution (INDC) presented to the United Nations Framework Convention on Climate Change (CMNUCC), the Government of El Salvador has undertaken to promote energy efficiency and support renewable energy as a way of implementing a low-carbon economy, reducing the country's dependence on oil derivatives and lowering its GHG emissions.

1.4 The Salvadoran government's strategy to promote energy efficiency and reduce GHG emissions has focused particularly on the potential of promoting energy savings measures in the business sector as a way to reduce the energy costs of businesses, thereby enabling them to boost their productivity and competitiveness.[8,9] In fact, energy consumption accounts for a significant portion of business costs in El Salvador.[10] A study conducted in the country in 2015 to assess the opportunities for investment in energy efficiency in the business sector[11] found that energy costs account for 11% to 17% of the operating costs of businesses and that there is indeed a large potential for energy savings in the market in general. According to an analysis presented in that study, if investment in energy efficient technologies for air conditioning, motors, boilers, and cold rooms were prioritized, whether in private service buildings, at micro, small, and medium-sized enterprises (MSMEs) or large companies,[12] annual reductions in emissions would total around 28,757 tons of CO_2.[13]

1.5 While opportunities to invest in energy efficiency exist for a wide range of Salvadoran businesses, smaller enterprises have special potential given their crucial role in El Salvador's economic growth, productive diversification, competitiveness, and job and income generation. According to the most recent census,[14] the business segment comprised of MSMEs accounts for 99.6% of the country's businesses,

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7 The most recent National Report from the Government of El Salvador to the Convention on Climate Change estimated that energy emissions account for 39.1% of the country's GHG emissions, i.e., some 5.9 million tons of CO_2eq. The GHG emissions factor for the electrical grid is higher than the average for the region since the Salvadoran matrix is highly dependent on fossil energy sources (0.4727 kg CO_2/kWh for Latin American and the Caribbean compared to 0.677 kg CO_2/kWh for El Salvador).

8 National Energy Policy. CNE.

9 See in particular the arguments presented by Michael E. Porter and Claas van der Linde (1995), Towards a New Conception of the Environment-Competitiveness Relationship, Journal of Economic Perspectives, vol. 9, number 4, to show how a reduction in energy consumption can have a positive effect on the competitiveness of businesses.

10 See National Energy Policy. CNE.

11 See Study of demand for energy projects, prepared by BASE in 2015.

12 According to the 2015 BASE study, approximately 380 businesses of various sizes would be the market niche for investing in energy efficiency in the industrial, commercial, and service sectors.

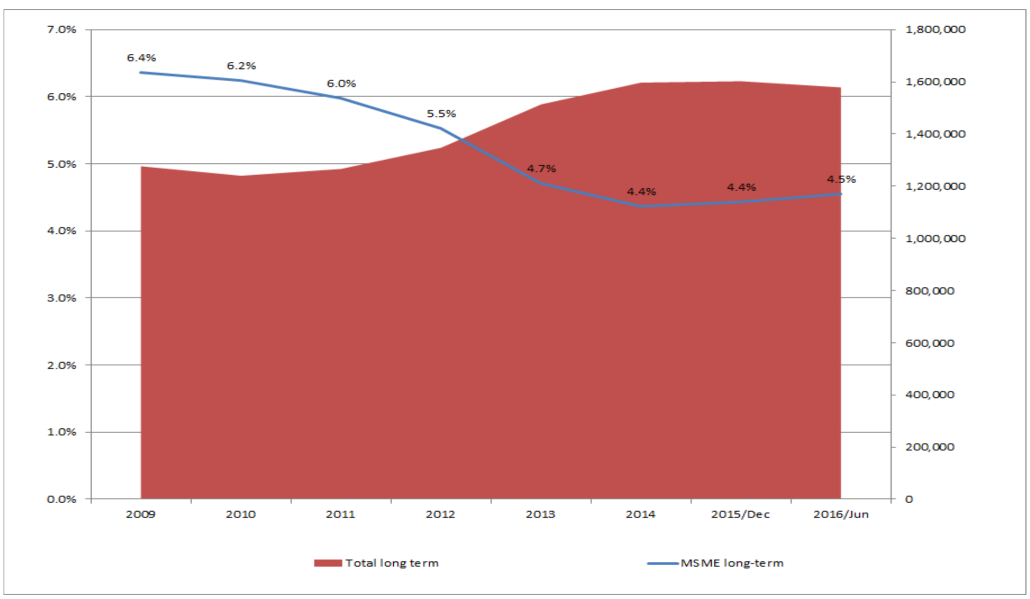
13 The methodology for estimating the reduction in annual CO_2 emissions is based on inputs from the 2015 BASE study and on information provided by BANDESAL. These inputs consider MSME segmentation criteria, technical aspects of the various technologies, average loan size, and average savings from technological equipment multiplied by the national emissions factor. The energy savings are verified by means of a methodology that considers international standards and involves estimates based on the technical features of the newly installed equipment versus the replaced equipment.

14 National Census of El Salvador, 2005.

generating 58.5% of jobs and 30% of the GDP.[15] However, Salvadoran MSMEs face difficulties in gaining access to more modern technologies and migrating toward more productive business models. This is largely due to their low investment levels, which are in turn a result of their limited access to credit.[16] According to the 2015 Business Competitiveness Survey, MSMEs that fail to obtain credit in the financial system seek financing from other companies and suppliers (21%), sell off assets (21%), cut back on planned investments (17%), dismiss personnel (17%), and/or request family loans (13%).[17] Alternative sources of financing outside the financial system are generally more costly for MSMEs.

1.6 To illustrate MSMEs' limited access to credit, loans issued to this market segment as of year-end 2015 by intermediary financial institutions (IFIs) regulated by the Financial System Superintendency of El Salvador (SSF) accounted for nearly 21% (US$2,551,500,000) of total loans in the financial system. This share of total credit was distributed as follows: 12% to medium-sized enterprises, 3% to small enterprises, and 6% to microenterprises. Similarly, as of the same date, 146,252 loans were issued to MSMEs, accounting for a mere 7% of the total of 1,961,518 loans issued within the regulated financial system. Of all loans for more than 2 years (1,602,586), only 4.4% (70,966) were issued to MSMEs as of year-end 2015, and the MSME share of loans of this type has clearly been on a downward trend since 2009. Figure 1 shows the trend for long-term lending to MSMEs in El Salvador.[18]

Figure 1. Number of loans in El Salvador with maturities exceeding 24 months (2009-2015)



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[15] More recent unofficial estimates (Chorros, 2010) show that enterprises of this type may account for a 43% share of GDP and generate 65% of total jobs.

[16] Doing Business in a More Transparent World. World Bank – International Finance Corporation, Economic Profile for El Salvador, 2016.

[17] Business Competitiveness Survey, FUSADES, 2015.

[18] The data for performing these calculations were processed internally by the SSF at the Bank's request.

Source: Information provided by the SSF.

1.7 A critical factor limiting the availability of medium- and long-term credit for productive investments such as in energy efficient technologies in the Salvadoran financial system is that the funding structure of IFIs is concentrated in short-term deposits, failing to provide matching terms for the granting of medium- and long-term loans. In fact, an analysis of deposits taken by IFIs as of June 2017 shows that only 3.3% of deposits had maturities of more than one year, as illustrated in Table 1. In the specific case of banks, the percentage of long-term deposits is even lower (2%).

Table 1. Deposits in the financial system in El Salvador (June 2017, US$ millions)

	Banks	Credit unions	Savings and loan associations	Total	%
Demand deposits	6,378.2	101.9	21.3	6,501.4	54.6
Time deposits with maturities of up to one year	4,369.2	275.3	112.6	4,757.0	40.0
Time deposits with maturities of more than one year	229.9	143.7	13.3	386.9	3.3
Restricted or inactive deposits	242.7	14.9	2.0	259.6	2.2
Total	**11,219.9**	**535.8**	**149.2**	**11,904.9**	**100.0**

Source: Authors' own calculations based on SSF data.

1.8 A study of the loans received by banks once again shows a high percentage of short-term loans. Specifically, 34% of the loans received from national and foreign lenders have maturities of up to one year (see Table 2). With this funding structure, IFIs have no incentives to provide medium- and long-term credit, and this limits their ability to fully perform their role of financing growth through credit for investments.

Table 2. Loans received by banks in El Salvador (June 2017, US$ millions)

Loans	Amount	%
I. Loans with maturities of up to one year	689.8	34%
II. Loans with maturities of one to five years	767.8	38%
III. Loans with maturities of five years or more	551.5	27%
Total	**2,009.1**	**100%**

Source: El Salvador financial system.

1.9 An interesting piece of information to take into account is that the IFIs in the Salvadoran financial system have been favoring consumer loans to the detriment of

business loans and residential mortgages, which could have consequences for the availability of productive credit for MSMEs. In fact, according to SSF data, business loans' share of the total loan portfolio of IFIs has been declining, from 47% in 2007 to 40% as of year-end 2016.[19]

1.10 While the share of medium- and long-term loans to MSMEs (i.e., the type of loan that would cover investments in energy efficient technologies) is not yet significant, potential demand can be projected. The results of a study conducted by the IDB in 2014 on credit to MSMEs in El Salvador estimate unmet demand for medium- and long-term credit at approximately US$98 million. In addition, a study on the opportunities to promote investments in energy efficiency points to the existence of a universe of 4,503 small enterprises and 770 medium-sized enterprises, respectively 18% and 3% of which could require immediate financing for investments in energy efficiency.[20]

1.11 Limited MSME access to medium- and long-term credit is a serious barrier to investment in energy efficient technologies, which involve higher costs than traditional, less energy-efficient technologies. Consequently, promoting investment in energy efficient technologies by enterprises requires the availability of longer-term financing to ensure that the investment will not affect the enterprises' cash flow.[21]

1.12 The market study of opportunities and barriers to invest in energy efficiency found that, aside from the limited supply of investment credit for energy efficiency projects,[22] these investments face a series of additional barriers, including:

a. MSMEs have insufficient knowledge and information on the real risks and returns of investments in energy efficient technologies and have no confidence in the capacity of local technology and energy service providers to structure projects that will generate the energy savings needed to repay the investments and the loan. The uncertainty of being able to repay the loan leads MSMEs not to prioritize investments in energy efficiency over other productive investments.

b. While the Salvadoran economy includes a substantial number of providers of technology and energy savings solutions with proven technical capabilities,[23] these providers are relatively small and lack the financial capacity required to take investment risks. Consequently, they depend on the MSMEs' decision to take a financial risk and invest in a technology upgrade to achieve energy efficiency.

c. IFIs lack knowledge about the returns and risks associated with projects of this type. Thus, they do not consider the cash flows associated with these projects

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[19] El Salvador financial system, June 2017.

[20] See Study of demand for energy projects, prepared by BASE in 2015.

[21] Average financial recovery times for technologies with the greatest energy savings potential in MSMEs are: 4.7 years for electric motors, 5.5 years for boiler and air conditioning equipment, and 5.3 years for cold rooms.

[22] See Study of demand for energy projects, prepared by BASE in 2015.

[23] The total number of providers of these technologies in El Salvador is estimated at approximately 50.

as a basis for their credit analysis, preferring to apply a traditional, "security-based" approach for purposes of granting loans.[24]

1.13 It is worth noting that MSMEs in El Salvador also have to contend with high nonfinancial barriers that inhibit their productivity and postpone their growth.[25] The most insidious factors include insecurity and crime, which have a direct impact by raising costs of production, generating losses, discouraging investment, and hindering job creation. It is estimated that, in the second quarter of 2015, 27.7% of businesses in El Salvador were victims of crimes, the most frequent being theft of vehicles and/or merchandise, extortion, and assault or theft of payroll funds.[26] Lastly, a significant proportion of MSMEs with no access to credit are owned or led by women. Occasionally, the biased perception that women are not creditworthy is coupled with lack of information regarding their background as businesswomen, which can ultimately lead to a systematic rejection of their credit applications.[27,28]

1.14 **Government initiatives and the role of the El Salvador Development Bank (BANDESAL).[29]** The country has a National Energy Council (CNE) that has been coordinating and promoting a series of activities to encourage good practices and investments in energy efficiency as part of the National Energy Policy. In particular, the CNE has been supporting the participation of private enterprises and training MSMEs to invest in energy savings through the program "El Salvador Ahorra Energía" [El Salvador Saves Energy].

1.15 These efforts have been deployed in close collaboration with an institution devoted to MSME promotion and support (the National Micro and Small Enterprise Commission (CONAMYPE)) and with the support of the Financial System to Promote Development, in which BANDESAL participates along with two development funds under its administration: the Economic Development Fund (FDE) and the Salvadoran Guarantee Fund (FSG).[30]

1.16 BANDESAL's mission is to "provide financial and technical support to promote the development of viable and profitable investment projects in the country's productive sectors, to help: (i) promote the growth and development of all productive sectors; (ii) promote business development and competitiveness; (iii) foster the development

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[24] The survey conducted for the Study of demand for energy projects confirmed that, while banks are including generic green lending strategies, designing specific products, and training their staff, this lending modality is still at an early stage of development.

[25] See Enterprise Survey El Salvador 2016.

[26] See Business Competitiveness Survey, December 2015.

[27] See Demirguc-Kunt et al. (2013) Financial Inclusion and Legal Discrimination Against Women: Evidence from Developing Countries, Narain (2009) Gender and access to finance, and DiCaprio (2016) Trade Finance Gaps, Growth, and Jobs Survey.

[28] According to Fundera (2016) The State of Online Small Business Lending – Focus on Women Entrepreneurs, the rejection rate in the United States is 3% higher (68%) for women than for men. In addition, the average loan amount is lower for women entrepreneurs.

[29] BANDESAL was created as an autonomous public institution of indefinite duration, with separate legal status and its own assets, under Supreme Decree 847 of 2011 issued by the Legislative Assembly of El Salvador. BANDESAL has continued activities that were being conducted by the Multisector Investment Bank (BMI), founded in 1994. For further information, see BANDESAL: Institutional performance and risk management.

[30] BANDESAL and CONAMPYME have had a collaboration agreement since 2012 aimed at promoting and fostering access to credit to drive investments in energy efficiency and renewable energy.

of MSMEs; (iv) promote development of the country's exports; (v) create jobs…"[31] BANDESAL maintains a stable financial structure, with high liquidity and a sound capital base, allowing it to properly manage credit risks. As of June 2017, BANDESAL had US$577.6 million in assets, funded by US$349.6 million in liabilities and US$228 million in capital. BANDESAL's net second-tier loan portfolio totaled approximately US$370 million, 61% of which was allocated to MSMEs (22% to microenterprises, 23% to small enterprises, 16% to medium-sized enterprises) and 87% was comprised of loans for more than 24 months.[32] It should also be noted that BANDESAL's entire second-tier portfolio for MSMEs has grown by an average of 14% per year over the last four years. In 2013 alone, the outstanding balance of its second-tier loans for MSME investment projects grew by US$42 million.[33] Despite this growth, BANDESAL has no nonperforming loans as of the present date.

1.17 In recent years, BANDESAL, in keeping with government guidelines, has been progressively and satisfactorily implementing a business line to increase MSME investments in renewable energy.[34] The results of this experience point to market potential and have confirmed the need to expand the line's scope to include energy efficiency, with emphasis on a comprehensive financial strategy that combines an increase in medium- and long-term credit with the development of nonfinancial incentives that boost market confidence. BANDESAL expects to capitalize on the knowledge generated in this experience with a view to launching its first line of energy efficiency financing.

1.18 **The Bank's experience and lessons learned.** The Bank is accumulating execution experience with BANDESAL through the program Global Credit Loan for Financing Productive Development in El Salvador (3271/OC-ES). BANDESAL's performance as an executing agency has been satisfactory and the resources of this portfolio operation are being disbursed faster than initially planned due to the rise in demand by IFIs. In addition, BANDESAL is a recipient of resources from the Regional Energy Savings Insurance and Risk Management Program (technical cooperation operation ATN/CF-15453-RG), which is being executed by the Bank and financed by the Danish government through the Danish Energy Agency. This technical cooperation program supports BANDESAL in: (i) analyzing the potential demand for credit for energy efficiency projects by SMEs; (ii) boosting BANDESAL's capacity to manage socioenvironmental risks; (iii) boosting its capacity for monitoring and evaluation of impacts and outcomes; and (iv) improving its institutional management capacity. The lessons learned from various projects in the region show that the execution capacity of executing agencies can be strengthened by a line of credit with nonfinancial instruments that supports the structuring of demand for energy efficiency projects and reduces the risks associated with investments of this type. In fact, this strategy is being piloted in Colombia and Mexico through loan operations

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31 Law on the Financial System for Development Promotion.

32 BANDESAL Annual Report and internal data.

33 For further information, see BANDESAL: Institutional performance and risk management.

34 This is the Programa Empresa Renovable [renewable business program], which the German government's Kreditanstalt für Wiederaufbau [Reconstruction Credit Institute] has been financing since 2014. The program consists of a credit line to promote environmental reconversion and energy efficiency, with fixed rates, terms of up to 12 years, and technical assistance for companies in all economic sectors.

2983/TC-CO and 3335/OC-ME and nonreimbursable technical-cooperation operations funded through Clean Technology Fund (CTF) resources (ATN/TC-14011-CO and ATN/TC-14889-ME, respectively). To ensure that BANDESAL's execution capacity is further strengthened, the lessons learned and technical instruments[35] generated through these experiences will be transferred to BANDESAL under the proposed program, since it includes nonreimbursable technical cooperation resources in addition to the loan (reimbursable) proceeds. Lastly, by increasing the availability of medium- and long-term financing, the design of the program will complement the efforts being pursued by other Bank operations, namely 2583/OC-ES and 3170/OC-ES, to strengthen the competitiveness of MSMEs.

1.19 **Rationale.** Overcoming the barriers to investment in energy efficiency projects requires an intervention that fosters potential demand through a combination of the following instruments: (i) medium- and long-term financing with suitable conditions for energy efficiency projects (credit supply); and (ii) tools that impact the decisions of businesses to prioritize and take on financing for energy efficiency, particularly in the SME segment (credit demand). This strategy will be implemented through three mutually complementary interventions:[36]

a. **First, the proposed operation will provide BANDESAL with additional medium- and long-term resources** from the Green Climate Fund (GCF),[37] which, combined with BANDESAL cofinancing, will help to expand the availability of financing for investment projects in energy efficient technology by creditworthy Salvadoran businesses through IFIs.[38] It is estimated that the proposed program could support 494 SMEs.[39] By the conclusion of the execution period, the financing provided under the program will result in energy savings of 36.5 GWh. Thanks to the program, BANDESAL will be able to offer the market the first line of credit exclusively dedicated to promoting energy efficiency investments.

b. **Second, the operation will be accompanied by the implementation of incentive mechanisms created through the activities of technical cooperation project ES-T1258**, a separate operation with GCF resources currently in preparation. Technical cooperation operation ES-T1258 will focus on developing three instruments aimed at mitigating the lack of Salvadoran business confidence in the acquisition of more efficient technological equipment: (i) development of pragmatic measurement methods based on

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[35] These include tools for developing strategic green finance mapping and financial modeling for energy efficiency credit lines and specialized financial products manuals.

[36] This strategy was recognized by the International Climate Finance Lab as one of the most promising financing strategies aimed at promoting and leveraging private investments in energy efficiency. See Energy Savings Insurance. The Global Innovation Lab for Climate Finance.

[37] As indicated above, the GCF is a financial mechanism arising from the United Nations Framework Convention on Climate Change (UNFCCC) that provides highly concessional reimbursable financial resources and grants to promote climate change mitigation and adaptation.

[38] All investment projects presented by creditworthy businesses from any sector of the economy will be eligible for this program, provided they meet the requirements specified in the program's socioenvironmental management plan.

[39] In addition, it is expected that at least 30% will be owned or managed by women.

international standards (such as ISO 50001) that can specifically and transparently demonstrate the energy savings capacity of a given piece of equipment; (ii) development of a standard contract that commits local technology providers to properly installing, monitoring, and guaranteeing the performance of the equipment to ensure that the expected energy savings are achieved;[40] and (iii) design of an energy performance bond or insurance that covers the business owners and local technology providers monetarily in the event of a contingency that prevents achievement of the energy savings under the standard contract. The mechanism for implementing these tools envisages the participation of independent local validation agencies and commercial surety and insurance companies as a way of boosting business confidence, particularly that of SMEs since they are part of the program. It is worth noting that technical cooperation operation ES-T1258 also envisages activities for the design of an IT system for monitoring, reporting, and verification of energy savings under the financed projects, as well as initiatives for promoting the program among key market participants (SMEs, energy service and technology providers, IFIs, government agencies, and energy distributors).

c. **Third, coordinated work with IFIs and equipment providers is crucial for overcoming the barriers.** The previously described tools and mechanisms could also foster greater IFI participation in this market by mitigating the credit risk for subloans of this type. In addition, the program could take advantage of the advances made by a group of first-tier banks working on the design of energy efficiency products and training loan officers to offer this new type of lending. This group of banks could provide an early demand stimulus by promoting credit for investments in energy efficiency.[41] At the same time, the work with equipment providers is crucial since they have direct contact with the businesses, are aware of their needs, and are able to influence their decisions on investment. Providers will be a central part of the activities of technical cooperation operation ES-T1258, with the expectation that they will introduce the measurement methodologies and standard contract into their equipment marketing package and become promoters of the program's benefits, as well as act as a bridge between the business owners, the first-tier banks, and the surety and insurance company.

1.20 The proposed program has been designed taking into account the policy guidelines aimed at countering the barriers faced by SMEs, energy sectors, and others. These guidelines include: (i) the Salvadoran Five-year Development Plan 2014-2019, which prioritizes development of the productive and competitive capacities of MSMEs in line with the dynamics of the territorial, national, and international economy, and emphasizes "efficient energy use and energy savings;" (ii) the

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[40] The specifics of the standard contract are described in the technical cooperation document and the terms of reference of technical cooperation operation ES-T1258. It is a turnkey contract that establishes the measurement details, energy savings commitments, and resolution alternatives in case of nonperformance or unexpected events. A differentiating element of the standard contract is the inclusion of monetary withholdings for the equipment provider as a percentage of the financed equipment cost. The amounts withheld are gradually released as the promised performance and energy savings are achieved.

[41] Under its Energy Efficiency Program, the United States Agency for International Development (USAID) in El Salvador is working with four commercial banks on this issue.

Salvadoran National Energy Policy for the 2010-2024 Period, which seeks to promote the rational use of energy resources in the public and private sectors by improving the existing legislative and regulatory framework, encouraging private sector investment in energy efficiency, and launching aggressive information campaigns on the need for a more rational use of limited energy resources; and (iii) the Plan of the Alliance for Prosperity in the Northern Triangle, which emphasizes policies and actions to promote strategic sectors and thereby enable MSMEs to successfully join value chains and create quality jobs, particularly in areas with high poverty, crime, and emigration rates. This plan also includes guidelines for diversification of the energy matrix in the Northern Triangle countries, seeking legislative and regulatory changes and investments to promote renewable energy sources and encourage energy efficiency.[42]

1.21 **Strategic alignment.** The proposed operation is consistent with the Update to the Institutional Strategy (UIS) 2010-2020 (document AB-3008) and is aligned with the development challenge of "low productivity and innovation," by improving access to financing for projects that raise MSE productivity, as well as with the crosscutting issue of "climate change and environmental sustainability," by helping to reduce GHG emissions through the financing of energy efficiency projects. The program will contribute to the Corporate Results Framework (CRF) 2016-2019 (document GN-2727-6) since it will increase the number of financed SMEs and reduce GHG emissions. While the operation is not directly aligned with the three priority areas described in the Country Strategy with El Salvador 2015-2019 (document GN-2828), it does contribute to the energy and productive development dialogue areas. The proposed program is consistent with the IDB Integrated Strategy for Climate Change Adaptation and Mitigation, and Sustainable and Renewable Energy (document GN-2609-1), as well as with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-7), under the pillar of improving the efficiency and scope of bank credit intermediation for the productive sector. Lastly, the operation is included in the 2018 Operational Program Report (document GN-2915) for El Salvador.

1.22 All program resources will be invested in climate change mitigation activities, in accordance with the joint multilateral development bank (MDB) methodology for tracking climate finance. These resources contribute to the IDB Group's target of increasing the financing of climate change-related projects to 30% of all operation approvals by year-end 2020.

B. Objectives, components, and cost

1.23 The objective of this program is to support efforts in El Salvador to reduce energy consumption by SMEs, and thereby bring down GHG emissions, by making suitable financing more readily available in the financial system in order to enable greater investment in energy efficiency.[43]

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[42] The activities of technical cooperation operation ES-T1258 with the CNE include mapping technology equipment providers throughout El Salvador. This operation will take advantage of the results of that mapping exercise to determine whether the allocation of credit resources geographically matches the municipios prioritized by the plan.

[43] Suitable financing is understood to mean maturities of more than two years.

1.24 **Single component.** The program envisages a single reimbursable financing component. The operation will be structured in the form of a global credit loan of US$20 million to BANDESAL (as borrower and executing agency) provided by the GCF and administered by the Bank, cofinanced by BANDESAL with its own resources for an additional US$20 million. Through BANDESAL, the loan program will provide medium- and long-term funding (maturities of more than two years) to local IFIs, for them to onlend to businesses to finance energy efficiency projects (see program operating flow).

1.25 **Eligibility.** Investment projects in energy efficient technologies that contribute to a reduction in CO_2 emissions[44] and are presented by SMEs from any sector of the economy[45] will be eligible for this program. The projects will be financed by local IFIs that meet the risk management requirements of BANDESAL and have a financing quota at BANDESAL.[46] The projects will be required to meet the criteria described in the loan program's Credit Regulations, including the provisions of the socioenvironmental management plan.

1.26 **Beneficiaries.** The program beneficiaries will be SMEs in all sectors of the economy with limited or no access to the long-term credit needed to invest in energy efficiency. The program will monitor women's participation in the financed enterprises, whether in leadership or management positions or as business owners. Lastly, the program will be open to the country's businesses as a whole, without regard to their geographic location.

1.27 As previously indicated, the loan program will be supplemented by technical cooperation operation ES-T1258 (in preparation), the nonreimbursable funds for which (US$1.7 million) are also provided by the GCF and will be used to develop energy savings measurement and financial risk transfer instruments to encourage the structuring of technically sound and financeable investments in energy efficiency.[47] The technical cooperation operation will be executed by BANDESAL in accordance with the Bank's procurement policies.

C. Key results indicators

1.28 The program's main impact will be a reduction in CO_2 emissions associated with program investments in energy efficiency projects.[48] The outcomes will be: (i) the number of SMEs that obtain loans with the program's proceeds to finance energy

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[44] On a preliminary basis, but without limitation, the program will consider investments in electric motors, boilers, air conditioning, and cold rooms.

[45] For purposes of classification by business size, the program will use the current definitions issued by the Central Reserve Bank of El Salvador.

[46] Participation is open to first-tier IFIs subject to inspection and supervision by the SSF (regulated), or unregulated IFIs that meet the conditions set by the BANDESAL risk management system. BANDESAL's experience financing unregulated IFIs has been positive, owing to its eligibility and supervision system that is underpinned with best practices (see BANDESAL Institutional Performance and Risk Management). BANDESAL's client portfolio includes more than 10 unregulated IFIs with an excellent credit history for repaying their credit lines.

[47] The resources for technical cooperation operation ES-T1258 (US$1.7 million) were approved by the GCF on 30 June 2016, together with the resources for the loan program (US$20 million). The Bank's Management will approve technical cooperation operation ES-T1258 through a parallel process.

[48] The energy savings will be in relation to the installed capacity of the beneficiary enterprises.

efficiency investments; (ii) the energy savings achieved through investments in energy efficiency;[49] (iii) the leveraging of funds associated with the investments in energy efficiency under the program; (iv) the average maturity of loans to final beneficiaries; and (v) BANDESAL's energy efficiency loan portfolio. The output will be the amount of program funds allocated to eligible beneficiaries (see Annex II).

1.29 **Economic analysis.** The economic analysis of the program considers the changes in energy expenditure, including various types of maintenance expenses for electric motors, boilers, air conditioning, and cold rooms. The analysis period is eight years, based on the average of the technologies under consideration, incorporating the elements introduced by the program to achieve a structuring of demand, particularly the monitoring, installation, and verification costs, costs for the risk mitigation instrument (bond), and the costs of discarding replaced equipment (i.e., not reintroduced into the market). The analysis also considers the changes in energy consumption trends that would accompany the expected economic growth with respect to the product (increase in the use of installed capacity of the units to be replaced), and the flows are discounted at the rate set by the Bank for this type of analysis (12% real rate). The analysis also includes externalities (decline in emissions) to determine the social benefit (private benefit, including these externalities). The economic analysis takes into account two types of investment that boost efficiency and have been identified in interviews with providers of the various technologies: it considers the increases in efficiencies associated with early investments in equipment as the program is introduced, as well as the increases in efficiencies resulting from a larger investment (essentially in highly efficient equipment). The economic analysis explores the sensitivity of outcomes to changes in key factors such as energy prices, equipment efficiency, trend in energy consumption, investment cost, and maintenance cost. The program's net present value (NPV) is US$27.01 million and remains positive for the sensitivity scenarios considered (including a high-stress scenario), while the internal rate of return (IRR) is 24%. Therefore, the economic analysis concludes with a recommendation to proceed with the program.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 **Origin and use of resources.** The global credit loan program will be financed in United States dollars (US$) from GCF resources and will consist of a single credit component in an amount of up to US$20 million. In accordance with GCF requirements, these proceeds will be supplemented by BANDESAL by way of local counterpart contribution in the amount of US$20 million.[50]

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[49] Relative indicators of energy input over power output will capture the energy savings and performance of the equipment financed by the program. Since the program will finance investments in efficient equipment with a view to generating savings in relation to the installed capacity of the enterprise, it will establish baselines for calculating energy savings based on ex ante engineering measurements or onsite physical estimates.

[50] The loan proceeds will be disbursed once available at the Bank in accordance with the requirements established in the Funded Activity Agreement (FAA) and in line with the provisions of the loan contract signed by BANDESAL and the Bank.

2.2 **Disbursement plan.** According to preliminary estimates, the program resources will be committed in four years and disbursed in a period of five years from the effective date of the loan contract.[51] There will be a 1:1 ratio between the funds provided by the Bank and BANDESAL's counterpart contribution (see Table 3).[52]

Table 3. Preliminary estimate of disbursements
(US$ millions and %)

	Year 1	Year 2	Year 3	Year 4	Year 5	Final
Program funds allocated to eligible projects	1.6	3.2	6.3	12.6	16.3	40
IDB	0.8	1.6	3.2	6.3	8.2	20.0
BANDESAL	0.8	1.6	3.2	6.3	8.2	20.0
Cumulative IDB	0.8	2.4	5.5	11.8	20.0	
Cumulative IDB (%)	4%	12%	28%	59%	100%	

2.3 **Disbursement methods.** The Bank will transfer the resources for the program's single loan component to BANDESAL by means of portfolio rediscounts.[53] The disbursements will be made to reimburse BANDESAL for the transfers to first-tier IFIs that have loan quotas at BANDESAL and have submitted subloan contracts in compliance with the eligibility conditions provided in the Credit Regulations. BANDESAL will semiannually deliver to the Bank a projection of the funds needed to address the first-tier IFIs, in order to allow the Bank to request funds from the GCF.

B. Environmental and social risks

2.4 According to Directive B.13 of the Bank's Environment and Safeguards Compliance Policy (Operational Policy OP-703), the operation does not require classification. Since the program provides BANDESAL with funding for second-tier lending operations, its environmental and social impacts and risks will occur at the level of the subloans and are not predictable ex ante. Projects that promote the sustainable use of natural resources have a positive social and environmental impact. However, some of these projects could have an adverse effect on the environment if their intended technology replacement is not properly managed. The program's financial intermediation risk is rated low (FI-3), since the potential risks it could face are not significant. To mitigate these risks, BANDESAL will have a socioenvironmental strategy in place to identify them, ensuring that the IFIs and the subborrowers implement the relevant risk mitigation measures. This strategy will be included in the Credit Regulations, as described in the Environmental and Social Management Report (ESMR).

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51 The resources are understood to have been committed as of the date on which the IFIs and the borrowing enterprises sign the respective contracts.

52 In accordance with GCF requirements, BANDESAL will maintain a 1:1 ratio between the GCF resources and the counterpart contribution throughout the effective period of the loan contract.

53 However, all disbursement modalities established in the Bank's Financial Management Guidelines (document OP-273-6) will be available to BANDESAL if needed.

C. Fiduciary risks

2.5 An institutional capacity assessment of BANDESAL has found that it has the capability to perform the loan operation's fiduciary management activities. Therefore, fiduciary risk has been determined to be low, primarily because BANDESAL has the required organizational structure, regulations, systems, and human talent. BANDESAL's recent experience as the executing agency of loan 3271/OC-ES has been satisfactory.

D. Other project risks and key issues

2.6 **Development.** The risk that there will be limited demand to finance investment projects in energy efficiency has a medium likelihood of occurrence. While conservative assumptions have been used to arrive at estimates of potential demand that could be met with program resources, investments in this type of fixed assets to generate energy savings are not common in the Salvadoran market. A mitigating action will be implemented, using the resources of technical cooperation operation ES-T1258 to create incentives that can stimulate SME demand by highlighting the economic benefits of adopting energy-efficient equipment and the security of having energy savings that can be monetized to cover the cost of the loan for these investments.

2.7 **Sustainability.** The program is expected to maintain continuity and exert a long-term effect on how IFIs act to provide access to financing for energy efficiency projects and meet demand for longer maturities, for the following reasons: (i) the program is based on a long-term commitment by the Salvadoran government and BANDESAL, in view of the national targets in terms of reducing energy consumption and the fact that BANDESAL is undertaking to cofinance the program and reinforce its lines of credit for energy efficiency projects; (ii) the funds from subloan recoveries will be used to make additional loans in activities of the same type, allowing the IFIs to accumulate experience in financing projects of this type and better manage the type of risk inherent in these operations; and (iii) the activities of technical cooperation operation ES-T1258 in support of the loan will develop nonfinancial and risk transfer instruments that support a better business climate and the structuring of technically sound and bankable investment projects in energy efficiency. This intervention should have a transformational impact on the market and make it possible for the financing of energy efficiency investments to continue to occur even when the IDB line of credit has been fully repaid.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 **Borrower, executing agency, and guarantor.** The borrower and executing agency will be BANDESAL, an autonomous public institution of indefinite duration with separate legal status and its own assets, created under Supreme Decree 847 of 2011 by the Legislative Assembly of El Salvador. BANDESAL: (i) is supervised by the Financial System Superintendency of El Salvador (SSF); (ii) has the fiduciary and operational capacity required for successful implementation of the program; and (iii) is creditworthy, with excellent risk management practices. BANDESAL operates as a second-tier bank that uses a network of IFIs to meet credit needs in all sectors of the economy (see BANDESAL: Institutional performance and risk management).

The aforementioned institutional characteristics will enable BANDESAL to provide intermediation, monitoring, and evaluation of the proposed loan program.

3.2 **Exceptions to Bank policies.** The Republic of El Salvador will act as guarantor of the payment obligations under the loan, including interest, fees, and the local counterpart contribution. The Board of Executive Directors is asked to approve a partial waiver to the Bank's Operational Policy OP-303, "Guarantees Required from the Borrower," with regard to the program execution obligations. This waiver is justified since article 11 of the State Financial Administration Law provides that obligations associated with the execution of loans are outside the legal mandate of Salvadoran authorities. BANDESAL is also doing a good job executing a similar project with the Bank, in terms of performance and the achievement of expected outcomes.

3.3 **Execution and administration**. For the purposes of this program, BANDESAL will appoint a management team comprised of professionals from its various divisions, including a program coordinator. The management team will be responsible for: (i) execution and supervision of proper use of the loan proceeds; (ii) provision of the human, technological, and budgetary resources necessary for implementation, as planned and on schedule; and (iii) delivery to the Bank of the documentation required to satisfy the disbursement conditions, and the fulfillment of other operational conditions required for execution.[54]

3.4 The program's execution will require the entry into force of a system established in the Credit Regulations and agreed upon by the Bank and BANDESAL. The Credit Regulations will set out specific procedures, conditions, and requirements for the use of funds, including: (i) eligibility criteria for IFIs, final beneficiaries, and other program activities;[55] (ii) terms and conditions to be applied by BANDESAL and the IFI when providing subloans to the final beneficiaries, including those necessary to ensure that the financing provided by the Bank with GCF resources is not exposed to greater credit risks than the counterpart resources; (iii) other parameters, requirements, and/or restrictions to regulate the use of resources by BANDESAL, the IFIs, and the final beneficiaries, respectively; (iv) methodologies for applying financing concessionality to ensure that SMEs benefit from the program; (v) methodologies to ensure that a 1:1 ratio is maintained between financing with GCF resources and financing with the counterpart throughout the term of the Bank loan; (vi) methodologies for applying rate reduction rewards to SMEs; (vii) the production of audited reports on financial activities using financing with GCF funds, in accordance with the relevant financial reporting rules; (viii) terms for BANDESAL to establish and maintain a system to compile and keep the program information needed to prepare program progress and midterm and final evaluation reports; and (ix) corrective measures, including measures to prevent access to financing in the event of noncompliance with the Credit Regulations.

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[54] BANDESAL has a consolidated management team as a result of its experience in managing funds from bilateral and multilateral agencies, including the Bank. The management team and the program coordinator will also be responsible for the execution of technical cooperation operation ES-T1258.

[55] The eligibility criteria included in the Credit Regulations should be consistent with the energy efficiency categories and/or subcategories, as described in the joint MDB methodology for tracking climate finance.

3.5 **Special contractual conditions precedent to the first loan disbursement. Approval by BANDESAL and entry into force of the Credit Regulations, subject to the Bank's prior no objection, will be a condition precedent to the first disbursement of the program's loan proceeds.**[56] This condition will enable BANDESAL to adapt its internal processes and prepare the documentation related to the program requirements.

3.6 BANDESAL will open a separate bank account for the program (revolving account) solely to manage the reimbursable GCF funds and the reimbursements received by BANDESAL from the IFIs. During the term of the loan contract, BANDESAL may use any reimbursement or payment received from the IFIs into the revolving account, once the amounts payable to the Bank have been deducted, to finance new subloans consistent with the program objectives and the requirements established in the loan contract. BANDESAL will submit midterm and final progress reports to the Bank no later than 60 days after the tenth and twentieth anniversaries, respectively, of the loan contract's entry into effect, and will contain the content specified in the Credit Regulations.

3.7 During the loan execution period (five years), the loan program's special-purpose financial statements will be audited annually by an external audit firm acceptable to the Bank, to be engaged and paid by BANDESAL. The firm will report on the eligibility of the rediscounted subloans and promissory notes endorsed to BANDESAL. The audited financial statements will be submitted to the Bank no later than four months after the end of the executing agency's fiscal year, pursuant to procedures and terms of reference previously agreed upon with the Bank. BANDESAL will cover, with its own funds, the audit costs associated with of the annual financial statements.

3.8 The program's execution will also be carried out considering the work being done by national local agencies such as the CNE, which works to promote good practices and investments in energy in the Salvadoran market. In addition, the CNE leads an ongoing dialogue with energy generation and distribution companies, which the program could make use of to achieve a complementarity of efforts and synergy of actions.[57]

B. Summary of arrangements for monitoring results

3.9 The program will be monitored via semiannual and annual reports prepared by the executing agency and submitted to the Bank no later than 30 days after the end of each six-month period during the program disbursement period (five years), with information that, in addition to the aspects described in the Credit Regulations, will include progress indicators and indicators of fulfillment of the subloan eligibility criteria. Each year, the executing agency will prepare and submit to the Bank unaudited financial reports confirming that: (i) it is applying adequate concessionality to the IFIs and the borrowing enterprises; (ii) a 1:1 ratio is being maintained between

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[56] The entry into force of the Credit Regulations is also required by the GCF in order to make the first disbursement of its funds to the Bank.

[57] The CNE will use the proceeds of technical cooperation operation ES-T1258 to implement dialogue and coordination activities involving all interest groups in the energy sector with a view to identifying lessons learned that can strengthen its regulatory provisions and rules.

GCF and counterpart resources financing the program's projects; (iii) rate reduction rewards are being used as incentives for SMEs; and (iv) the use of the available resources in a designated revolving account for the program is in compliance with the Credit Regulations. BANDESAL will submit a final report to the Bank no later than 90 days after the end of disbursement period, to include the content specified in the Credit Regulations. BANDESAL will also submit annual unaudited financial reports to the Bank. It will submit the first such report within 120 days following the date the first loan payment is made. The second and subsequent reports will be submitted no later than 15 June of each year until the date the loan has been repaid in full. In addition, each year BANDESAL will: (i) report the percentage of total portfolio investments in energy efficiency projects using funds other than the Bank and counterpart resources; and (ii) confirm that the subloans fulfill the eligibility criteria established in the Credit Regulations. Upon request by the GCF, the Bank will supplement these reports with information on principal, repayments, interest, and fees. As indicated in paragraph 3.6, BANDESAL will report to the Bank on the use of these resources in the revolving account in years ten and twenty of the loan contract.

3.10 The program will use the standard procedures established by the Bank to supervise and evaluate investment operations and satisfy the GCF requirements. During program execution, BANDESAL will periodically report to the Bank on the evolution of the program indicators as established in the monitoring and evaluation plan and in the Credit Regulations. These procedures will also be consistent with the GCF requirements.

3.11 BANDESAL will provide the information necessary for the Bank to produce a project completion report (PCR) once all resources disbursed by the Bank have been accounted for. The monitoring and evaluation plan provides for independent evaluations. A midterm evaluation will be performed within 120 days after the second anniversary of the first disbursement, followed by a final evaluation within six months after the final disbursement of IDB funds to BANDESAL during the execution period. The proposed methodology entails conducting an ex post cost-benefit analysis, which will seek to determine the private savings resulting from lower energy consumption costs for businesses financed by the program, as well as the extent to which greenhouse gas emissions have been reduced as a result of the deployment of new technologies.

Development Effectiveness Matrix		
Summary	**ES-L1132**	
I. Corporate and Country Priorities		
1. IDB Development Objectives	**Yes**	
Development Challenges & Cross-cutting Themes	**-Productivity and Innovation -Climate Change and Environmental Sustainability**	
Country Development Results Indicators	**-Reduction of emissions with support of IDBG financing (annual million tons CO2 e)* -Micro / small / medium enterprises financed (#)***	
2. Country Development Objectives	**Yes**	
Country Strategy Results Matrix		
Country Program Results Matrix	**GN-2915**	**The intervention is included in the 2018 Operational Program.**
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		**Evaluable**
3. Evidence-based Assessment & Solution	**7.7**	
3.1 Program Diagnosis	**3.0**	
3.2 Proposed Interventions or Solutions	**1.7**	
3.3 Results Matrix Quality	**3.0**	
4. Ex ante Economic Analysis	**10.0**	
4.1 Program has an ERR/NPV, or key outcomes identified for CEA	**3.0**	
4.2 Identified and Quantified Benefits and Costs	**3.0**	
4.3 Reasonable Assumptions	**1.0**	
4.4 Sensitivity Analysis	**2.0**	
4.5 Consistency with results matrix	**1.0**	
5. Monitoring and Evaluation	**8.5**	
5.1 Monitoring Mechanisms	**2.5**	
5.2 Evaluation Plan	**6.0**	
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks*likelihood	**Low**	
Identified risks have been rated for magnitude and likelihood	**Yes**	
Mitigation measures have been identified for major risks	**Yes**	
Mitigation measures have indicators for tracking their implementation	**Yes**	
Environmental & social risk classification	**B.13**	
IV. IDB´s Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	**Yes**	**Financial Management: Budget, Treasury, Accounting and Reporting, Internal Audit. Procurement: Information System, Price Comparison.**
Non-Fiduciary		
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project		

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

Greenhouse gas emissions (GHGs) in El Salvador are low given its size but given the country's high dependency on fossil fuels for energy generation its emissions factor for GHGs stemming from electricity is 43% higher than the average for the Latin American region. Therefore, the government is prioritizing energy efficiency. Energy efficiency (EE) projects have longer payback periods and therefore require longer financing terms than are available. In El Salvador, SMEs face barriers in accessing finance, only 4% of loans with terms of more than 2 years are destined for firms of smaller size. Thus, the bias towards short-term credit is itself a barrier for EE initiatives for this group. A market study conducted as due diligence for the program shows the vast potential for EE investments. While there is untapped demand for EE investment in El Salvador, SMEs are not always familiar with the benefits of EE investments. Thus, in addition to providing financing at longer terms - through Technical Cooperation - the program will also catalyze demand for EE projects via the development of risk mitigation mechanisms among others. In fact, this second-floor credit line earmarked for the financing of EE projects by SMEs is the first of its kind for the country's development bank - BANDESAL. The Results Matrix adequately captures project benefits such as financial leverage, average loan maturity, GHG emissions reductions, and the impact on the BANDESAL portfolio. The economic analysis shows the program has a net benefit to society. At closure, the project will be assessed through an ex-post cost benefit analysis.

RESULTS MATRIX

Project objective:	The objective of this program is to support efforts in El Salvador to reduce energy consumption by small and medium-sized enterprises (SMEs), and thereby bring down greenhouse gas (GHG) emissions by making suitable financing more readily available in the financial system in order to enable greater investment in energy efficiency.

EXPECTED IMPACT

Indicators	Unit of measure-ment	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Total	Means of verification[1]	Comments
Impact											
Reduction in CO_2 emissions associated with program investments in energy efficiency projects	Thousands of tons of CO_2	0	2018	1.5	3.0	5.9	11.8	15.3	37.5	BANDESAL's ESI information system	The methodology for estimating the reductions in annual CO_2 emissions, measured in tons, considers SME segmentation criteria, technical aspects of the various technologies, average loan size, and an energy savings average per technological equipment multiplied by the national emissions factor. The energy savings are verified by means of a methodology that considers international standards and involves estimates based on the technical features of the newly installed equipment.[2]

1 It is worth noting that BANDESAL will have funds from technical cooperation operation ES-T1258 to develop the Energy Savings Insurance (ESI) information system, which will allow BANDESAL to capture detailed data on the financed energy efficiency projects. The consultations and reports of this information system will help to monitor the proposed operation and generate means of verification of the results matrix indicators.

2 The methodology for estimating the reductions in annual CO_2 emissions, measured in tons, is based on input from the Study of demand for energy projects (prepared by BASE in 2015) and on information provided by BANDESAL.

EXPECTED OUTCOMES

Indicators	Unit of measure-ment	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Total	Means of verification	Comments
Outcomes											
Number of SMEs that obtain loans with proceeds from the program to finance investments in energy efficiency	Number of enterprises	0	2018	20	39	78	156	202	495	BANDESAL's ESI information system	This indicator measures the number of SMEs per year that obtains loans through program resources. The baseline is 0, since BANDESAL does not currently have a line of credit for energy efficiency.
Energy savings achieved through investments in energy efficiency leveraged under the program	GWh	0	2018	1.4	2.9	5.8	11.5	14.9	36.5	BANDESAL's ESI information system	This indicator measures the reduction in energy savings in new energy efficiency projects that obtain loans through program resources. Relative indicators of energy input to power output will be measured in accordance with internationally accepted standard methodologies. The energy savings will be obtained by comparing the ex ante baselines provided by the SMEs with the energy results following the use of the new technologies.
Leveraging of funds associated with investments in energy efficiency under the program	US$ millions	0	2018	0.4	0.8	1.6	3.2	4.0	10.0	BANDESAL's ESI information system	This indicator only measures the volume of own investments in energy efficiency, in millions of dollars, by SMEs financed by the program, and excludes the amount provided under the program.
Average maturity of loans to final beneficiaries provided through the program	Years	0	2018					4.5	4.5	BANDESAL's ESI information system	This indicator measures the average maturity of loans provided by IFIs with program funds. The baseline is 0, since BANDESAL does not currently have a line of credit for energy efficiency.

Indicators	Unit of measure-ment	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Total	Means of verification	Comments
BANDESAL's portfolio of energy efficiency loans	US$ millions	0	2018	1.6	3.2	6.3	12.6	16.3	40	BANDESAL's ESI information system	This indicator measures the extent to which BANDESAL creates a dedicated energy efficiency loan portfolio. Since the program will create the first specific line of credit for energy efficiency at BANDESAL, the baseline is 0 and the annual targets correspond to the program resources.

Outputs

Outputs	Unit of measure-ment	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Total	Means of verification	Comments
Funds allocated to eligible beneficiaries under the program's line of credit	US$ million	0	2018	1.6	3.2	6.3	12.6	16.3	40	BANDESAL's ESI information system	This indicator measures the allocation of program funds to eligible beneficiaries per year. At the output level, the indicator is the loan amount provided, since demand has to be boosted to enable absorption of the funds by SMEs. At the outcome level, the indicator is the number of benefitted SMEs. In addition to this indicator, the following milestones will be monitored off-matrix:[3] **Milestone 1:** Number of SMEs (classified by size) that obtain loans with program resources. **Milestone 2:** Number of beneficiary SMEs led by women.

[3] For more details, see Table I.2.C. in the monitoring and evaluation plan.

Outputs	Unit of measure-ment	Baseline	Baseline year	Year 1	Year 2	Year 3	Year 4	Year 5	Total	Means of verification	Comments
											Milestone 3: Number of business plans for promotion and execution of the program. **Milestone 4**: Number of local certifiers contracted and operating. **Milestone 5:** Number of local certifiers trained.

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country:	El Salvador
Program:	Global Credit Loan for Financing Energy Efficiency in Small and Medium-Sized Enterprises (ES-L1132)
Executing agency:	Banco de Desarrollo de El Salvador (BANDESAL)
Prepared by:	Patricio Crausaz, Financial Management Specialist, and Marco Andres Alemán, Senior Procurement Specialist (FMP/CES)

I. EXECUTIVE SUMMARY

1.1 BANDESAL is El Salvador's public financial institution for development, having been created upon the entry into force of the Financial System Law for Development Promotion by means of Legislative Decree 847 of 11 October 2011. BANDESAL's mandate is to support the government's sector public policies with financial resources in order to promote the development of small and medium-sized enterprises, exports, job creation, and consequently the country's economic development. It gained experience managing Bank-financed operations as executing agency of a component of loans 2373/OC-ES "Program for Housing and Comprehensive Improvements for Informal Urban Neighborhoods" and 3271/OC-ES "Global Credit Loan for Financing Productive Development in El Salvador." The fiduciary management risk is considered low once the various factors are taken into consideration.

1.2 Given its nature, BANDESAL is not covered by the State Financial Administration Law, nor is it part of the General Budget or required to maintain its budget, cash management, and accounting records in the SAFI Integrated Financial Administration System. However, BANDESAL has its own reliable rules, procedures, mechanisms, and systems for institutional financial management, as described in the institutional capacity assessment report. BANDESAL is also subject to inspection and supervision by the Financial System Superintendency, and to oversight by the Office of the Auditor General as well as by an external auditor and a tax auditor, who certify the entity's financial position and the fulfillment of its tax obligations.

1.3 BANDESAL is covered under the scope of the *Ley de Contrataciones y Adquisiciones de la Administración Pública* [Government Procurement Law] (LACAP) and has an adequate organizational structure for the management of corporate procurement. The fiduciary evaluation finds BANDESAL has sufficient fiduciary management capacity to execute this operation.

1.4 For financial management of the operation, BANDESAL's own rules, procedures, and systems will be supplemented by applying the Bank's Financial Management Guidelines for IDB-financed Projects (document OP-273-6) and associated instructions.

II. THE EXECUTING AGENCY'S FIDUCIARY CONTEXT

2.1 BANDESAL's budget is reviewed during preparation by the Finance Division, the Management Department, and the Risk Committee before being submitted to the Board of Directors for subsequent approval by the Board of Governors. Projections are monitored monthly and compared against actual performance in a report submitted to the Board of Directors. Once BANDESAL's budget has been approved by its Board of Governors, appropriations are frozen and entries are made in the cash management and accounting modules of Sistema Banca 2000. This system allows each executed budget item to be recorded and booked, and it can also be used as a tool to control programs or credit lines and allocate quotas and available funds under them. Sistema Banca 2000 is an institutional enterprise resource planning (ERP) system purchased from an external supplier, and is used to manage all BANDESAL operations, with banking, investment, and debt modules fully integrated with accounting and cash management. The system allows specific credit lines to be created in order to record and track resources under each MSME financing program offered by BANDESAL either directly or through IFIs, facilitating their identification and control.

2.2 BANDESAL policies, procedures, and processes are clearly defined, and it has skilled professional staff supported by functional and reliable information systems as well as by clear work procedures for the performance of their duties.

III. FIDUCIARY RISK EVALUATION AND MITIGATION ACTIONS

3.1 The institutional capacity assessment of BANDESAL found that it has the capability to perform the program's fiduciary management activities. Therefore, fiduciary risk has been determined to be low, primarily because BANDESAL has the required organizational structure, regulations, systems, and human talent. BANDESAL's recent experience as the executing agency of loan 3271/OC-ES has been satisfactory.

IV. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF CONTRACTS

4.1 This operation's special-purpose financial statements will be annually audited by an external audit firm acceptable to the Bank and submitted during the program execution and disbursement period (five years).

4.2 BANDESAL will prepare Annual Performance Reports in accordance with the standards required by the GCF, which may be subject to performance audits. The same external audit firm acceptable to the Bank that carries out the program's financial audit may perform the management audits.

4.3 BANDESAL will appoint a project management team with specialist staff from its various divisions that will have execution responsibilities, and it will appoint a general coordinator of the project management team.[1]

4.4 Each year, BANDESAL will prepare and submit to the Bank unaudited financial reports confirming that: (i) it is applying adequate concessionality to the IFIs and the

[1] These appointments will not be conditions precedent to the disbursement of the loan proceeds.

financed enterprises; (ii) a 1:1 ratio is being maintained between GCF and counterpart resources financing the program's projects; (iii) rate reduction rewards are being used as incentives for SMEs; and (iv) the use of the available resources in a designated revolving account for the program is in compliance with the Credit Regulations. BANDESAL will submit annual unaudited financial reports to the Bank. It will submit the first such report within 120 days following the date the first loan payment is made. The second and subsequent reports will be submitted no later than 15 June of each year until the date the loan has been repaid in full.

4.5 Each year BANDESAL will: (i) report the percentage of total portfolio investments in energy efficiency projects using funds other than the Bank and counterpart resources; and (ii) confirm that the subloans fulfill the eligibility criteria established in the program's Credit Regulations.

4.6 BANDESAL will report to the Bank on the use of the GCF resources within 60 days after the tenth and twentieth anniversaries of the loan contract.

V. PROCUREMENT MANAGEMENT

5.1 The program is structured as a global credit loan. Accordingly, funds are provided to BANDESAL to rediscount credit operations of eligible IFIs, which onlend these funds to individuals or businesses that conduct activities consistent with the respective Credit Regulations. These operations are subject to the provisions of paragraph 3.2 of the Bank's Policies for the procurement of works and goods financed by the IDB (document GN-2349-9), which establish that, in such cases, the established private sector or commercial practices are applicable to any procurement carried out using these funds.

5.2 **Records and files.** The documentation for the subloans financed by the operation will be kept at the IFIs that review and approve the credit application, evaluating, *inter alia*, the eligibility of the operation as provided in the Credit Regulations. Therefore, the IFIs fully assume the credit risk and will be solely responsible for monitoring the portfolio.

5.3 BANDESAL's operations division will be responsible for keeping program records and files. The official formats for disbursement requests will be used to prepare and file program reports, recording the list of subloans subject to rediscount under the program financing.

VI. FINANCIAL MANAGEMENT

6.1 **Programming and budget**. The program budget will be managed by BANDESAL, applying the mechanisms and procedures used for its own budget, which is prepared annually for the fiscal/financial year beginning on 1 January and ending on 31 December and includes projections of portfolio investment, both first-tier and second-tier. The programming is reviewed each week on a rolling 12-month forward basis, and projections are monitored each month for submission to the Board of Directors, compared with actual figures. There is an established process for their preparation, approval, and execution. Pursuant to the Financial System Law for Development Promotion, the budget must be submitted to the Board of Directors for approval, and then submitted for approval by the Board of Governors. Although

unusual at BANDESAL, if the budget requires amendment, the same procedure must be followed for approval.

6.2 A specific credit line will be created for the program, which will allow for the control and monitoring of conditions, allocations of quotas and available funds in Sistema Banca 2000, which is supplied with information from the approved budget and integrates accounting records with cash management operations.

6.3 **Accounting and information systems**. Program accounting will be the responsibility of BANDESAL, using its own accounting system, in which accounting and cash operations are integrated and referenced to information from the approved budget. The movement of funds under the program will be shown in BANDESAL's financial statements in expressly assigned accounts. To prepare its financial statements, BANDESAL will apply accounting standards generally accepted in El Salvador and regulations issued by the Financial System Superintendency. The program's special-purpose financial statements will be prepared separately on a cash accounting basis in accordance with the provisions of the Bank's Financial Management Guidelines (document OP-273-6) and the Financial Reporting and External Audit Instructions, using information generated by Sistema Banca 2000, which will identify by source code and credit line any transactions involving GCF funds administered by the Bank, as well as the counterpart funds allocated to the program by BANDESAL. The accounts to be used for program execution and records must be identified, so that the relevant information is clearly and easily identifiable.

6.4 **Disbursements and cash flow**. The Bank will transfer the resources for the program's single loan component to BANDESAL by means of portfolio rediscounts.[2] The disbursements will be made to reimburse BANDESAL for the transfers to first-tier IFIs that have loan quotas at BANDESAL and have submitted subloan contracts in compliance with the eligibility conditions provided in the Credit Regulations. Every six months, BANDESAL will submit to the Bank a projection of the funds needed to address the first-tier IFIs, in order to allow the Bank to request funds from the GCF.

6.5 **Internal control**. As a public financial institution, BANDESAL applies the technical standards of specific internal control issued under the legislative provisions and the internal and external rules applicable to BANDESAL and the funds it manages and based on the global COSO standard. It has an audit and control division that reports directly to the Board of Directors, as well as an audit and control committee. Additionally, as an autonomous public lending institution, it applies the International Standards for the Professional Practice of Internal Auditing (ISPPIA).

6.6 BANDESAL has a risk division responsible for the evaluation, monitoring, and supervision of risks generated by its operations, including counterpart risk evaluation with each IFI in the local financial system.

6.7 **External control and reports**. External control of the program will be performed by an external audit firm acceptable to the Bank, to be engaged by BANDESAL. The firm may be the same one that audits the entity's basic financial statements, so as to gain a comprehensive view of control over the executing agency and program

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[2] However, all disbursement modalities established in the Bank's Financial Management Guidelines (document OP-273-6) will be available to BANDESAL if needed.

management. In the event of specific contracting for the program, it will be carried out through the simplified CQS method. The terms of reference will be previously agreed upon with the Bank; the terms of reference and request for proposals will be subject to the Bank's prior no objection. To ensure the effectiveness of the audit work, the firm will be engaged no later than September of the fiscal year in execution that is to be audited.

6.8 **Supervision**. The fiduciary supervision plan is shown in the following table:

Table 1. Fiduciary supervision plan

Supervision activity	Nature and scope	Frequency	Responsible party	
			Bank	Other
Operational	Review of progress report	Semiannual	Fiduciary and sector team	BANDESAL
	Portfolio review with executing agency	In accordance with the schedule agreed upon with the Ministry of Finance and the Bank	Head of Operations, fiduciary and sector team	STTP / Ministry of Finance / BANDESAL / IDB
Financial	Update of cash flow and disbursement schedule	With each advance of funds request when the program's circumstances so require	Fiduciary and operational specialists	BANDESAL
	Supervisory visits	Annual	Fiduciary specialist	Consultant
	Ex post financial and review audit	Annual	Fiduciary specialist	BANDESAL / External auditor
Compliance	Fulfillment of conditions precedent	One-time: Second half of 2018	Fiduciary team/Operations analyst	BANDESAL / IDB
	Pro forma budget and budgetary allocation	Annual, January of each year	Fiduciary specialist	BANDESAL
	Presentation of audited financial statements	Annual	Fiduciary specialist	BANDESAL / Auditor

6.9 **Execution mechanism.** The borrower and executing agency will be BANDESAL, which will be legally accountable to the Bank for payment of the debt, with the sovereign guarantee of the Government of El Salvador. BANDESAL will carry out the program's technical, financial, and procurement activities through an appointed management team comprised of experienced professionals from the entity's various areas with program execution responsibilities. The management team will be responsible for: (i) execution and supervision of proper use of the loan proceeds; (ii) provision of the human, technological, and budgetary resources necessary for implementation, as planned and on schedule; and (iii) delivery to the Bank of the documentation required to satisfy the disbursement conditions, and the fulfillment of other operational conditions required for execution. The GCF loan proceeds

administered by the Bank will be transferred by BANDESAL to the IFIs through its normal rediscount mechanism, or other mechanism agreed upon with the Bank (advances of funds against expected portfolio), at a market rate reflecting its financial cost of funds plus a spread to cover its operating costs, while ensuring that the final beneficiaries are provided more attractive interest rates than the market rates. BANDESAL will be responsible for identifying and selecting the eligible IFIs to participate in the program, pursuant to the Credit Regulations and its own policies and processes. The IFIs will set the amount of the subloans, the features of disbursements, interest rates and fees, maturities and frequency of repayment, and grace period, based on the characteristics of this program and of the lines operated by BANDESAL, a credit and eligibility analysis of the subloans, and the useful life of the program. Fiduciary management of the program will be the responsibility of BANDESAL's management division.

6.10 **Credit Regulations.** The points covered in these fiduciary agreements and requirements will be more fully described in the program Credit Regulations.

GLOBAL CREDIT LOAN FOR THE FINANCING OF ENERGY EFFICIENCY IN SMALL AND MEDIUM-SIZED ENTERPRISES

ES-L1132

CERTIFICATION

The Grants and Co-Financing Management Unit (ORP/GCM) received the commitment of the **Green Climate Fund (GRN)** for up to US$20,000,000 as confirmed by the Fund Coordinator, Brady Martin (ORP/GCM), March 30, 2018. An operation financed by the GRN receives a conditional certification given the circumstances of the Accreditation Master Agreement between GRN and the IDB. As such, a commitment by the GRN does not have validity until the Funded Activity Agreement (FAA) between the IDB and the GRN is agreed upon and signed for an operation. Therefore, this certification will remain conditional until the FAA is signed and effective.

Original Signed	June 15, 2018
Sonia M. Rivera Chief Grants and Co-Financing Management Unit ORP/GCM	Date

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/18

El Salvador. Loan ____/__-ES to Banco de Desarrollo de El Salvador
Global Credit Loan for the Financing of Energy Efficiency in
Small and Medium Enterprises

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, acting as Accredited Entity of the Green Climate Fund ("GCF"), to enter into such contract or contracts as may be necessary with Banco de Desarrollo de El Salvador (BANDESAL), as borrower, and with the Republic of El Salvador, as guarantor, for the purpose of granting the former a financing to cooperate in the execution of the Global Credit Loan for the Financing of Energy Efficiency in Small and Medium Enterprises (the "Program"). Such financing will be for the amount of up to US$20,000,000 from the resources of the GCF, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

2. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such agreement or agreements with the GCF as may be necessary to receive and administer resources from the GCF for the purposes of the Program and to adopt any other measures as may be pertinent for execution of said agreement or agreements.

3. That the authorization granted in paragraph 1 above will be effective once the corresponding agreement or agreements to which reference is made in paragraph 2 of this Resolution have entered into effect.

(Adopted on ___ __________ 2018)

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