

NICARAGUA

NATIONAL SUSTAINABLE ELECTRIFICATION AND RENEWABLE ENERGY PROGRAM (PNESER) FIRST LOAN

(NI-L1040)

LOAN PROPOSAL

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ELECTRONIC LINKS	
1.	Environmental and social management report http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35052026
2.	Annual work plan http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35078800
3.	Full procurement plan http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35078700
4.	Monitoring and evaluation arrangements http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35154442
OTHER REFERENCES	
	Memorandum of understanding between the Nicaraguan authorities and international cooperation and finance agencies for the PNESER http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35078210
	Fiduciary annex http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35078805
	Technical and project preparation support files http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35076761
	Primary document of the PNESER http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35078748
	Annex VIII. New institutional structure for execution of the PNESER http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35078694
	Program technical and economic assessment http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35062497

ABBREVIATIONS

AECID	Agencia Española de Cooperación Internacional para el Desarrollo [Spanish Agency for International Development Cooperation]
AWP	Annual work plan
CABEI	Central American Bank for Economic Integration
CDM	Clean Development Mechanism
CIF	Climate Investment Fund
DISNORTE	Distribuidora de Electricidad del Norte S.A.
DISSUR	Distribuidora de Electricidad del Sur S.A.
EE	Energy efficiency
EIB	European Investment Bank
EIRR	Economic internal rate of return
ENATREL	Empresa Nacional de Transmisión Eléctrica
ENEL	Empresa Nicaragüense de Electricidad
ENPV	Economic net present value
ESCO	Energy services companies
ESIA	Environmental and social impact assessment
ESMF	Environmental and social management framework
ESMP	Environmental and social management plan
ESMR	Environmental and social management report
FODIEN	Fondo para el Desarrollo de la Industria Eléctrica [Electricity Industry Development Fund]
ICFA	International cooperation and finance agencies
IFC	International Finance Corporation
KEXIM	Korean Eximbank
LAIF	Latin America Investment Facility
MEM	Ministry of Energy and Mines
MHCP	Ministry of Finance
MOU	Memorandum of Understanding
MW	Megawatt
NDF	Nordic Development Fund
OR	Operating Regulations
PNESER	Programa Nacional de Electrificación Sostenible y Energía Renovable [National Sustainable Electrification and Renewable Energy Program]
RE	Renewable energy
SECCI	Sustainable Energy and Climate Change Initiative
SIN	Sistema Interconectado Nacional [National Interconnected System]
SREP	Scaling-Up Renewable Energy Program for Low Income Countries
PEU-MEM	Program Execution Unit
WB	World Bank

PROJECT SUMMARY

NICARAGUA NATIONAL SUSTAINABLE ELECTRIFICATION AND RENEWABLE ENERGY PROGRAM (PNESER) FIRST LOAN (NI-L1040)

Financial Terms and Conditions					
Borrower: Republic of Nicaragua				OC	FSO
Executing agencies: Ministry of Energy and Mines (MEM), Empresa Nacional de Transmisión Eléctrica (ENATREL), and Empresa Nicaragüense de Electricidad (ENEL).			Amortization period:	30 years	40 years
			Grace period:	6 years	40 years
Source	Amount		Disbursement period	4 years	4 years
IDB I – NI-L1040	US\$30,500,000	100%	Interest rate:	SCF - Fixed	0.25%
(OC)	US\$15,250,000		Inspection and supervision fee:	*	N/A
(FSO)	US\$15,250,000		Credit fee:	*	N/A
			Currency:	US\$ SCF	US\$
PNESER Program Structure and Financing					
The proposed operation represents the first loan from the Inter-American Development Bank (IDB) for the National Sustainable Electrification and Renewable Energy Program (PNESER, or “the program”). The program structure allows IDB resources to be contributed in a modular fashion in 2010, 2011, and 2012 through operations to be submitted independently for approval by the Board of Executive Directors, with investments that are justified and viable autonomously but enable the targets in the Results Framework to be met gradually and cumulatively. The design is based on the availability of concessional resources, and serves to leverage resources from other donors, while maintaining the concessionality agreed upon by the Government of Nicaragua with the international community as part of the country’s debt reduction arrangements.					
IDB I (NI-L1040) (2010):	US\$30,500,000	¹ International Cooperation and Finance Agencies (ICFA): World Bank (WB); International Finance Corporation (IFC); Spanish Agency for International Development Cooperation (AECID); Korean Eximbank (KEXIM); Latin America Investment Facility (LAIF); European Investment Bank (EIB); Central American Bank for Economic Integration (CABEI); Climate Investment Fund (CIF) / Scaling-Up Renewable Energy Program for Low Income Countries (SREP), and the Nordic Development Fund (NDF).			
IDB II (NI-L1050) (2011)	US\$22,000,000				
IDB III (2012)	US\$25,000,000				
Other financing ¹	US\$280,900,000				
Local contribution and third parties	US\$22,600,000				
Total program cost	US\$381,000,000				
Project at a Glance					
The objective of the National Sustainable Electrification and Renewable Energy Program (PNESER) is to support the efforts of the Nicaraguan government to reduce poverty by promoting access by a significant portion of the population to efficient, sustainable electricity service, while supporting creation of the conditions to move forward on a change to the energy mix that contributes to better conditions for mitigation and adaptation to climate change. PNESER will support seven components: (i) rural electrification by network extension; (ii) normalization of service in settlements; (iii) expansion in isolated areas with renewable energy; (iv) preinvestment and studies for generation projects with renewable energy; (v) energy efficiency programs; (vi) strengthening the transmission system in rural areas; and (vii) sustainability of ENEL isolated systems.					
Conditions precedent to the first disbursement of the first loan (NI-L1040): (i) the structure has been created within the MEM that will serve as the Program Execution Unit (PEU-MEM) for subprogram I and coordinate the entire PNESER (see paragraph 3.2); (ii) the program Operating Regulations have been approved (see paragraph 2.2); (iii) the memorandum of understanding (MOU) has been signed with the ICFAs, and the PNESER Monitoring Committee has been formed (see paragraphs 2.2 and 3.3); and (iv) a framework agreement has been signed between MEM and Distribuidora de Electricidad del Norte S.A (DISNORTE) and Distribuidora de Electricidad del Sur S.A (DISSUR) (see paragraphs 1.14 and 1.17).					
Conditions precedent to the first disbursement of each subprogram for the first loan (NI-L1040): (i) resource transfer and execution agreements have been signed with each coexecuting agency for the respective subprogram (see paragraph 3.5); (ii) the updated annual work plan (AWP) for the first year has been delivered (see paragraph 3.4).					
Special execution conditions: (i) Program execution will be based on the AWP. For a project whose subsidies, incentives, or reimbursable contributions (Components 1, 2, 3, and 5) are financed with program resources to be included in an AWP, it must have a framework agreement (see paragraphs 1.14, 1.17, 1.20, and 1.26) signed with the distributors/operators; (ii) for a subproject identified in paragraph 2.4					

to be included in an AWP, it must have an environmental classification approved by the IDB; (iii) the executing agencies will be responsible for implementation of the environmental and social management framework for the program, as well as environmental and social monitoring of the measures included in the environmental and social management plans (ESMPs) for each project, and delivery of reports and audits as stipulated in paragraph 8.1 of the environmental and social management report (ESMR). The IDB will approve the environmental and social impact assessments (ESIAs) for the subprojects mentioned in item (ii) above; and (iii) ENATREL and ENEL must comply with the financial indicators described in paragraph 2.14.

Exceptions to Bank policies: None.

Project consistent with country strategy: Yes ☒ No ☐
Project qualifies as: SEQ ☒ PTI ☐ Sector ☐ Geographic ☐ Headcount ☐
Procurement: See updated Procurement Plan.

* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period. SCF = Single Currency Facility.

I. DESCRIPTION AND RESULTS MONITORING

A. Background and rationale

- 1.1 **Problems and challenges in the sector.** Nicaragua, the country with the second-lowest income in Latin America and the Caribbean, has one of the lowest rates of electricity service coverage in the region, representing a significant barrier to socioeconomic development. While electrification has increased gradually from coverage of 30% in 1971 to 65%¹ in 2009, it remains far from the target agreed by the Central American countries of achieving 90% coverage in all countries by 2020. Of the 390,000 dwellings not listed as electricity customers, it is estimated that at least 340,000 (1.8 million people) lack electricity service, and the remainder are customers illegally connected to the grid who live in substandard settlements and have low-quality, nonstandard service that is unsafe and unreliable. This problem affects not only those connected illegally, but legal customers. In all, there are an estimated 164,000 dwellings (legal and illegal customers) in these settlements.
- 1.2 To increase electricity coverage in the country, in addition to legalizing the illegal users by normalizing service in these settlements, network extension and electrification projects are needed in isolated areas. To connect new users by expanding the grid, the Government of Nicaragua (GoN) will use proven subsidy methods already authorized in the legal framework (see paragraphs 1.10 and 1.11). However, considering that many areas have distribution circuits of considerable length, and would not have the capacity to supply new loads at the rated voltage levels, it is necessary to strengthen the system's transmission grid. The connection of new users in isolated areas has been impacted in the past by: (i) problems facing the Empresa Nicaragüense de Electricidad (ENEL) at the 31 agencies that serve isolated systems, due to management problems, the high cost of operation due to the use of fossil fuel plants, and the nature of small, hard-to-access markets and scattered communities; and (ii) the lack of a national policy and strategy to serve these markets.
- 1.3 The absence of timely investments has made the country highly dependent on electricity produced by hydrocarbons, the proportion of which has increased to 65%² of power generated in 2009, despite the country's endowment of significant unexploited renewable energy (RE) resources (geothermal, wind, and hydroelectric energy). The high initial investment costs, especially for the development of RE and particularly for geothermal energy projects, pose a barrier to the scaled up use of RE and for private sector involvement in this segment. Lastly, as international experience has shown, the country should seek not only to increase generation using RE sources, but to reduce its energy intensity index (3.89), which is more than twice the average for the Latin American region (1.7),³ meaning that the country makes relatively inefficient use of its energy.

¹ Of a total of 1.1 million occupied dwellings, 711,000 are electricity service customers.

² In 2009, 1,085 GWh (or 35% of the 3,100 GWh generated) came from renewable sources.

³ See the report, *A Survey of Energy Productivity in the Americas*. IDB. September 2008.

- 1.4 **Sector institutions.** The Ministry of Energy and Mines (MEM), created in 2007 to replace the National Energy Commission, assumed the function of developing and expanding electrification in rural areas and locations where electricity industry operators are not interested in participating. Through the Fondo para el Desarrollo de la Industria Eléctrica [Electricity Industry Development Fund] (FODIEN), the MEM has implemented rural electrification projects with financing from multiple donors. Nevertheless, resources have been limited and have only allowed marginal increases in service coverage with high costs per dwelling connected. Moreover, the MEM's functions include developing policies and planning for the sector, promoting energy efficiency (EE), and conducting preinvestment studies for the development of renewable energy resources. State-owned Empresa Nacional de Transmisión Eléctrica (ENATREL) is responsible for power transmission in the country. ENEL, also state-owned, is responsible for 30% of the country's generation, with the remaining 70% in the hands of private companies. ENEL is responsible for the isolated systems left over after the concession of distribution areas to private companies Distribuidora del Norte (DISNORTE) and Distribuidora del Sur (DISSUR).
- 1.5 **The country's strategy and the IDB in the sector.** The strategy pursued by the Nicaraguan government in the electricity sector to overcome the sector's challenges includes: (i) the reduction of dependence on fossil fuels for electric power generation; (ii) the expansion of private sector investments in hydroelectric, geothermal, and biomass generation;⁴ (iii) the expansion of electricity coverage; (iv) the promotion of EE programs; (v) loss reduction; and (vi) maximization of opportunities arising with the Central American Electric Interconnection System (SIEPAC). These activities have been supported by the IDB and other donors, particularly actions that target rehabilitating existing hydroelectric infrastructure, strengthening the transmission system, EE and loss control programs, and several coverage expansion programs in isolated systems.
- 1.6 In this context, the Nicaraguan government, acting through the MEM, has requested support from the international financial community to execute Nicaragua's National Sustainable Electrification and Renewable Energy Program (PNESER, or "the program"), which supports and supplements efforts to significantly transform the electricity sector by substantially increasing national electricity coverage, contributing to the reversal of dependency on hydrocarbons in the energy mix through the use of RE sources, and implementing EE measures. The PNESER is based on the 2020 Central American Sustainable Energy Strategy, whose overall objective is to ensure the energy supply with the quality, quantity, and diversity of sources necessary to guarantee sustainable development, while addressing social equity, economic growth, governance, and environmental compatibility, in

⁴ Concessions have been granted and are in operation for hydroelectric, geothermal, and wind power projects with private investments of nearly US\$2 billion, including Tumarín (hydroelectric), Momotombo, San Jacinto, El Hoyo, Chiltepe, Caldera de Apoyo, Casitas, and others (geothermal), Amayo, Eolo, and Blue Energy (wind).

accordance with international environmental commitments. To date, a number of international cooperation and finance agencies (ICFAs) have expressed their interest in participating in the program's financing, including the World Bank (WB), the International Finance Corporation (IFC), Korean Eximbank (KEXIM), the Spanish Agency for International Development Cooperation (AECID), the Latin America Investment Facility (LAIF), the Central American Bank for Economic Integration (CABEI), the European Investment Bank (EIB), and the Nordic Development Fund (NDF). The PNESER is also expected to be included as a pilot program for the Program on Scaling-up Renewable Energy in Low Income Countries (SREP) of the Climate Investment Fund (CIF).

- 1.7 **IDB involvement in the sector.** The IDB's strategy in the electricity sector has allowed it to support the Nicaraguan government's activities and make a positive impact on the electricity sector. Through the Electricity Sector Support Program, loans I, II, and III, activities have been supported in the areas of RE generation, transmission, and a pilot program was started on normalizing service in settlements.⁵ Technical assistance is also being provided to support other areas, including energy efficiency (Energy Efficiency Development in Nicaragua, ATN/JF-9884-NI), renewable energy (Wind Power Park Feasibility Study on Corn Island, ATN/SU-9576-NI, and Development of Wind Power Generation in Isolated Systems, ATN/SF-9634-NI) and access to the Clean Development Mechanism (CDM) (ATN/OC-11766-NI). Confidence in the sector's institutional framework is having a positive impact by attracting private investment in electric power generation,⁶ the reserve margin is increasing, and energy rationing has been reduced considerably.⁷ Relations between the Nicaraguan government and the predominantly private operators in the sector have improved, and major agreements have been ratified by the National Assembly to address debts falling due and improve the electricity sector's financial position in general.
- 1.8 **Contribution to the IDB's Sustainable Energy and Climate Change Initiative (SECCI).** The PNESER's activities will contribute significantly to the IDB strategy of promoting RE and EE under the SECCI initiative. In addition to the specific components aimed at RE promotion and EE implementation, the expansion of electricity coverage to areas that currently lack this service will help reduce the consumption of petroleum derivatives and deforestation caused by the mass consumption of firewood, which represent the primary energy sources commonly used by populations in rural areas now without electricity service. It also seeks to extend EE implementation in urban areas without normalized electricity service. As

⁵ Informe de Gestión de Normalización del Servicio Eléctrico a Usuarios en el Barrio Mariana Sansón [Management Report on Normalizing Electricity service for Users in the Mariana Sansón Neighborhood], 13 August 2009. <http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35078304>

⁶ Nearly 700 megawatts are being developed in private generation projects such as Hidro-Pantasma, Larreynaga, El Salto-Y-Y, Tumarín, wind projects including Amayo, Eolo, and BluePower, and geothermal concessions in various parts of the country.

⁷ The rationing in the country in 2007 was discontinued in 2008. Today the country has a reserve of nearly 40%.

part of the program and with the support of technical cooperation operation ATN/OC-11766-NI, the IDB and the Nicaraguan government will finance the development of the baseline for emissions for the Nicaraguan electricity sector in order to facilitate incorporation of the program, or of its projects, into the CDM.

- 1.9 **Rationale.** The program is focused on meeting the needs of the Nicaraguan energy sector in terms of electricity coverage and transformation of the energy mix through the promotion of RE and EE, and is in line with the basic principles of the IDB's country strategy with Nicaragua. The strategy aims to contribute to poverty reduction, development of productive infrastructure, and the IDB's SECCI initiative.
- 1.10 In an electricity sector that combines public and private participation in generation and distribution activities, in a competitive market setting, based on lessons learned,⁸ this program focuses on supporting the government in undertaking or creating incentives for the development of investments that, since they do not yield immediate returns, would not be undertaken by private operators without a subsidy, incentive, or support in the form of public resources. These include the connection of new users far from the grid, joint solutions with operators to normalize service in settlements, promotion of solutions to extend service to isolated areas, promotion and implementation of EE, and preinvestment studies for RE projects (hydroelectric, geothermal, wind) for subsequent development by private investors.
- 1.11 The subsidies are authorized in the current legal framework by Law 272 on the Electricity Industry of 1998, which provides: "The State may grant financial resources to distributors to cover the cost, in whole or in part, of the investment in electrification projects that do not show adequate levels of profitability in small towns or rural areas not included in their investment program, within or near their concession areas." The Nicaraguan government has established similar arrangements in the past.

B. Objective, components, and cost

- 1.12 The objective of the National Sustainable Electrification and Renewable Energy Program (PNESER) is to support the efforts of the Nicaraguan government to reduce poverty by promoting access by a significant portion of the population to efficient, sustainable electricity service, while supporting creation of the conditions to move forward on a change to the energy mix that contributes to better conditions for mitigation and adaptation to climate change. The program will support seven components: (i) rural electrification by network extension; (ii) normalization of service in settlements; (iii) expansion in isolated areas with renewable energy; (iv) preinvestment and studies for generation projects with renewable energy; (v) energy efficiency programs; (vi) strengthening the transmission system in rural

⁸ There has been ample successful experience in expanding rural coverage in countries with public-private participation, showing that the system of proposed subsidies is the most effective way to bring electricity to communities that lack the service, including experiences in Chile (see program CH0174), Peru, and Guatemala (see program GU-L1018).

areas; and (vii) sustainability of ENEL isolated systems. For execution purposes, the program has been divided into three subprograms.

**1. Subprogram I. Ministry of Energy and Mines (MEM)
(Components 1 to 5)**

- 1.13 **Component 1. Rural electrification by network extension (PNESER: US\$112.6 million, including US\$16.6 million for NI-L1040).** This component will provide access to electric power to rural populations that currently have no service, through the extension of distribution networks in concessioned and nonconcessioned areas. The PNESER target is to provide access to electricity service to 117,390 dwellings, in 3,666 communities in rural areas, among the 310,000 dwellings that currently lack electricity, of a total of 1.1 million occupied dwellings.
- 1.14 Program resources will be used to cover the cost of connecting new users to the grid. The MEM will advance the cost of the investments necessary to extend coverage to the distributors. Part of this will be provided as a subsidy to new users to cover the nonprofitable part of the investment that cannot be recovered by service providers through user charges. This part will be based on the calculation analysis methodology proposed for the program, which shows that, with this subsidy, operation of the projects will provide them with the same rate of return recognized in the regulations for their activity as distributors.⁹ The distributors will reimburse the MEM for the profitable part of the investment, whose calculation method, as well as execution procedures, will be established in the framework cooperation agreements signed by the MEM and the distributors, prior to inclusion of the projects in the annual work plan (AWP) of the PNESER program. The framework agreements also include, among other things, eligibility conditions for the network extension projects and the economic and financial evaluation method to be used. **As a condition precedent to the first program disbursement, a framework agreement will have been signed between MEM and DISNORTE and between MEM and DISSUR.**
- 1.15 As part of this component, resources are included to prepare the preliminary designs for the projects. The technical, socioenvironmental, economic, institutional, and financial evaluation of the projects, supervision, compliance with the environmental and social management plan (ESMP), monitoring and certification of contract performance and financial management, and record-keeping and reporting will be supported by an advisory and supervisory firm commissioned using resources budgeted under “Engineering and administration” for Subprogram I. Loan NI-L1040 will finance, specifically for this component, a portion of the coverage extension projects included in the 2010 and 2011 AWP, whose nonreimbursable subsidies/investments will be financed by the program.

⁹ In the absence of the subsidies, rates would reach levels that exceed the customers’ willingness and ability to pay.

- 1.16 **Component 2. Normalization of service in settlements (PNESER: US\$44.9 million, including US\$6.3 million for NI-L1040).** This component comprises the adaptation of the power distribution system's networks and the implementation of legalization and technical adaptation measures for the consumption of electricity in spontaneous settlements. The settlements are defined by the proportion of illegal users consuming electricity, and specific actions will be undertaken for neighborhoods with 100% illegal users, neighborhoods with legal and illegal users (mixed), and vulnerable neighborhoods with 100% legal users.
- 1.17 This component will allow the normalization of 164,000 dwellings located in 648 identified settlements, including the improvement of distribution networks, service connections, meters, and the cost of minimal internal installations. Of these 164,000 dwellings, about 113,500 are listed as customers of distributors, and 50,500 are illegal customers, but in general, they all receive inadequate service due to the continuous theft that overloads the networks, and the power losses. The program includes the distribution of energy-efficient light bulbs in order to keep consumption and power bills low for new users. With the financing resources, the MEM will deliver to the distributors all of the resources for the investments. Part of this will be delivered as a user subsidy to cover the nonprofitable part of the investment that cannot be recovered by service providers through user charges. This part will be based on the calculation analysis methodology proposed for the program, which shows that, with this subsidy, operation of the projects will provide them with the same rate of return recognized in the regulations for their activity as distributors. The distributors will reimburse the MEM for the profitable part of the investment, whose calculation method, as well as execution procedures, will be established in the framework cooperation agreements signed by the MEM and the distributors, prior to inclusion of the specific projects in the AWP of the PNESER program. **As a condition precedent to the first program disbursement, a framework agreement will have been signed between MEM and DISNORTE and between MEM and DISSUR.**
- 1.18 As part of this component, resources are included for the MEM to support the social management program, which in pilot projects¹⁰ has proven to be a necessary condition for the success of these types of programs. As in Component 1, the advisory and supervisory firm for Subprogram I will support all activities related to engineering, supervision, and administration. Loan NI-L1040 will finance a portion of the 2010 and 2011 AWP, whose nonreimbursable subsidies/investments will be financed by the program.
- 1.19 **Component 3. Expansion in isolated areas with renewable energy (PNESER: US\$19.4 million, including US\$0.5 million for NI-L1040).** This component will support the identification and implementation of electricity supply solutions for rural areas not connected to the National Interconnected System (SIN), promoting the use of RE inside and outside areas granted under concessions to private

¹⁰ The Electricity Sector Support Program included four pilot projects: two located in León that are operating, and two more in Managua, now under construction.

- distributors. This component includes the development of micro and/or small hydroelectric projects, wind power plants, or other RE sources such as photovoltaic solar power, aimed at promoting sustainable development, while improving the sustainability of the electricity supply to approximately 10,000 of the 310,000 dwellings lacking service in Nicaragua. This component will also promote the reduction of anthropic pressure on forest areas and significant reduction of the costs of electric power through the replacement of power generation systems using diesel or other fuel alternatives like kerosene, batteries, lanterns, and candles.
- 1.20 In accordance with the country's existing legal framework, this component will finance the contributions necessary to move forward with the projects identified through the provision of subsidies to new users. Like the projects under components 1 and 2, the subsidies granted to users will always be subject to the maximum allowable subsidy amount, whose calculation method and execution procedures will be established in the framework cooperation agreements entered into between the MEM and the operators. The construction and administration of the isolated projects will be the responsibility of ENEL, of the distributors or operators in their respective concession areas, or of other civil society operators such as micro and small power service providers, nongovernmental organizations, electricity cooperatives, or users' associations, simulating community participation, selected by the MEM.
- 1.21 The program Operating Regulations (OR) will indicate the criteria for prioritizing service to areas, as well as the eligibility conditions for projects, including at least the economic and financial evaluation methodology to be used and the minimum sustainability framework for the isolated systems, given their life cycle, which must be at least 10 years. The criteria for prioritizing service will be based on the diagnostic assessment and service strategy for isolated areas throughout the country (concessioned and nonconcessioned areas).
- 1.22 As part of this component, resources are included to conduct studies for the development and preparation of new isolated system projects, including analysis on whether electrification using isolated systems, with the selected technical specifications, actually represents the best alternative for providing the service, as well as setting the rates applicable to each individual project based on the beneficiary community's ability to pay. As in Component 1, the advisory and supervisory firm for Subprogram I will support all activities related to engineering, supervision, and administration, including, as needed, the activities for strengthening the MEM, training operators, promotion, and community development, particularly with respect to community consultation and participation activities, as well as support for the review of eligibility conditions, economic and financial evaluation, and preliminary activities to support the potential application of the CDM. Loan NI-L1040 will finance the first phase of the community development, training, and strengthening program.
- 1.23 **Component 4. Preinvestment and studies for generation projects with renewable energy (PNESER: US\$21.1 million, including US\$0.4 million for**

- NI-L1040).** This component seeks to provide and improve the conditions, information, and strategies for planning and expanding power generation, necessary to promote the development of RE generation projects. Preinvestment studies and demonstration projects will be financed to increase the use of renewable energy sources, chiefly hydroelectric, geothermal, biomass, wind, and solar power. Nicaragua has a high available potential (geothermal: 1,500 megawatts (MW), hydroelectric: 2,000 MW, wind: 800 MW, and biomass: 200 MW), of which only 5.2% has been developed due to the absence of baseline surveys. The implementation of this component will help create the conditions to change the energy mix, currently highly dependent on petroleum. The component includes RE projects focused on: (i) studies and optimization of alternatives, (ii) design of structures and equipment for the selected alternatives, (iii) economic, financial, environmental, and social feasibility analyses for hydroelectric projects, (iv) installation of a solar power demonstration project connected to the SIN, and (v) completion of the geological map and the prefeasibility phase of the Cosigüina Volcano geothermal project. It also includes other investments in wind and solar power studies.
- 1.24 On the hydroelectric front, financing will be provided for the Master Plan for the Río Grande de Matagalpa Basin and Upper Río Coco Basin, which involves an assessment of the hydroelectric potential of these basins, providing the country with a portfolio of projects of different magnitudes of investment that will be available to potential developers in order to facilitate exploitation of these renewable resources.
- 1.25 The prioritization of the studies planned in this component will be based on the review of the National Generation and Transmission Expansion Plan. Resources from loan NI-L1040 allocated to this component will support the MEM's review of this plan.
- 1.26 **Component 5. Energy efficiency programs (PNESER: US\$17.2 million, including US\$1.9 million for NI-L1040).** This component will support the implementation of EE programs aimed at reducing the demand for power and current energy consumption in Nicaragua, chiefly cooling and lighting in various consumer sectors. Various financial mechanisms will be used to support electricity consumers, who will reimburse the MEM for the resources invested in proportion to the savings obtained. These resources will be used for the subsequent implementation of other EE measures identified and selected by the MEM in the medium to long term as part of its EE program. The method for calculating the reimbursement, as well as the execution procedures, will be established in framework cooperation agreements with energy services companies (ESCOs) or other eligible operators, which will be signed prior to inclusion of any project in the AWP of the PNESER program, and whose models and eligibility criteria are being developed with support from the work financed by technical cooperation project NI-T1034, Energy Efficiency Development in Nicaragua (ATN/JF-9884-NI), being executed by the MEM.

- 1.27 Execution of this component will allow implementation of the EE program being prepared with resources from technical cooperation project NI-T1034, including the following measures: (i) replacement of 2 million incandescent bulbs with compact fluorescent light bulbs in the residential sector; (ii) replacement of 20,000 40-watt magnetic fluorescent lamps with 32-watt electronic lamps in the government sector; (iii) replacement of 25,000 mercury lamps with sodium-vapor lamps or other efficient technology for public lighting in the country; (iv) installation of 13 solar water heater systems in five hospitals, three hotels, and five industrial facilities; (v) completion of engineering and development for the application of solar energy in cooling and climate control; and (vi) installation of 750 photovoltaic solar systems for productive use in Nicaragua. Technical cooperation project NI-T1034 also supports the Nicaraguan government in performing the actions identified in Presidential Decree 2-2008, the “Energy Usage Order” of 30 January 2008, whose Article 4 instructs the MEM to seek out projects to promote the efficient, rational use of various forms of energy.
- 1.28 Likewise, part of the component includes resources for the completion of targeted studies and analyses including: preparation of EE standards; development of policies, a national program, and a bill on EE; definition of EE indicators for energy consumption sectors; market studies for the use of new technologies (light-emitting diodes, high-efficiency fluorescent, automation systems, and fiber optics); promotion, training, institutional strengthening, and marketing; market studies on efficient equipment and systems in order to segment the target market; technical support for the MEM and intermediary financial institutions for the design, piloting, evaluation, and development of financing frameworks tailored to the characteristics of each market segment; financial advisory support for ESCOs; support for the potential application of the CDM; and the design of environmental monitoring and evaluation mechanisms for the disposal of waste related to lighting equipment. PNESER’s advisory and supervisory firm will support the MEM in all aspects of the technical, socioenvironmental, economic, institutional, and financial evaluation of the projects, supervision, control, and certification of compliance with contracts, and providing information to the MEM.
- 1.29 Loan NI-L1040 will provide specific financing for certain efficient lighting projects for the: (i) replacement of 250,000 incandescent bulbs with compact fluorescent light bulbs in the residential sector; (ii) replacement of 3,000 40-watt magnetic fluorescent lamps with 32-watt electronic lamps in the government sector; and (iii) replacement of 25,000 mercury lamps with sodium-vapor lamps or other efficient technology for public lighting in the country. In terms of consulting studies, loan NI-L1040 will contribute resources to: (i) prepare and monitor the implementation of the EE projects described above in this paragraph; (ii) prepare EE standards; (iii) develop policies, a national program, and a bill on EE; (iv) EE indicators for energy consumption sectors; and (v) perform training and institutional strengthening activities.

2. Subprogram II. Empresa Nacional de Transmisión Eléctrica (ENATREL) (Component 6):

- 1.30 **Component 6. Strengthening the transmission system (PNESER: US\$146.3 million, including US\$2.1 million for NI-L1040).** This component will finance the substations and transmission lines required to improve the EE of the electricity transmission system, provide a reliable supply to the new users to be connected to the grid, and incorporate new RE sources into the Nicaraguan system. Initially, the construction, remodeling, or expansion of seven substations, including their transmission lines and other related work used to support the loads in their areas of direct influence, were identified as necessary for the expansion of coverage. This component also includes the equipment necessary to build ENATREL's capacity to operate and maintain the works. As part of the PNESER engineering and administration component, the ENATREL subprogram includes resources to support administration, supervision, audits, and necessary studies. Loan NI-L1040 will finance the operation and maintenance equipment procurement program that will build ENATREL's operating capacity.

3. Subprogram III. Empresa Nicaragüense de Electricidad (ENEL) (Component 7):

- 1.31 **Component 7. Sustainability of ENEL isolated systems (PNESER US\$9.9 million, including US\$1.5 million for NI-L1040).** This component will finance the actions necessary to improve the sustainability of the isolated systems operated by ENEL, by replacing fossil fuel generation with renewable energy and improving the institutional and operating capacity of the systems under ENEL's responsibility. The component includes resources for: (i) "Institutional strengthening of the isolated system agencies," which will strengthen the management and operating capacity of the isolated system agencies through the procurement of equipment, assets, training, and services that enhance the abilities and operating capacities of the ENEL agencies on the Caribbean coast of Nicaragua; (ii) "Development of preinvestment studies on isolated systems," which will support the development of preinvestment studies in the area where there is potential for developing renewable energy projects, which can replace fossil fuel generation in the medium term; and (iii) "Investment projects with renewable sources," which will support renewable and alternative investments replacing fossil fuel generation in the area of influence of the isolated systems. The contribution of loan NI-L1040 to this component will be used to finance the program to strengthen the ENEL isolated system agencies.
- 1.32 **Engineering, administration, and supervision.** For each of the three PNESER subprograms, resources have been earmarked to support administration, supervision, audits, and studies necessary in the execution of the respective components. These resources will be financed by all of the ICFAs, including a portion to be covered by this operation.

- 1.33 **Program cost and financing.** Table 1 presents the total cost and financing of the PNESER program, estimated at US\$381.0 million. The IDB will contribute US\$77.5 million of that amount (in three loans to be approved in 2010, 2011, and 2012), and US\$280.9 million will come from various cofinancing entities that have expressed their interest in participating in the program: WB, IFC, KEXIM, AECID, LAIF, EIB, CABEL, NDF, and the CIF through the SREP window. The remaining US\$22.6 million will be a counterpart contribution from the budgets of the MEM, ENATREL, and ENEL for payment of administrative and financial expenses when they are not financed by their respective source. The itemized budget for operation NI-L1040 is presented in Table 2.

Table 1. Cost and Financing Table for PNESER
(US\$ millions)

INVESTMENT CATEGORY	TOTAL 2010-2014												
	IDB	WB	IFC	KEXIM	AECID	LAIF	EIB	CABEL	NDF	SREP	Third parties	GoN	Total
MEM SUBPROGRAM – 1 to 5	67.6	20.0	5.1	-	-	-	-	65.0	5.2	22.6	23.2	16.2	224.8
1. Engineering, supervision, and administration	1.9	0.6	0.1	-	-	-	-	1.8	-	0.5	-	9.3	14.2
2. Direct costs	63.1	19.4	4.9	-	-	-	-	63.2	5.2	22.1	23.2	(0.0)	201.1
2.1 Network extension	38.1	12.1	3.5	-	-	-	-	38.1	-	-	15.1	(0.0)	106.9
2.2 Settlement normalization*	15.0	4.8	1.4	-	-	-	-	15.0	-	-	6.4	-	42.7
2.3 Isolated areas with REs	0.5	2.5	-	-	-	-	-	-	-	12.9	1.6	-	17.5
2.4 Preinvestment in REs	4.5	-	-	-	-	-	-	-	5.2	9.2	-	-	18.9
2.5 Energy efficiency	4.9	-	-	-	-	-	-	10.1	-	-	-	-	15.0
3. Financial expenses	2.6	-	-	-	-	-	-	-	-	-	-	6.9	9.6
ENATREL SUBPROGRAM – 6	2.5	-	-	25.1	25.5	10.1	50.7	10.0	-	16.0	-	6.4	146.3
1. Engineering, supervision, and administration	0.5	-	-	2.7	-	-	-	1.5	-	1.6	-	-	6.2
2. Direct costs	2.0	-	-	22.4	25.5	10.1	50.7	8.5	-	14.4	-	-	133.6
2.6 Strengthening transmission	2.0	-	-	22.4	25.5	10.1	50.7	8.5	-	14.4	-	-	133.6
3. Financial expenses	0.1	-	-	-	-	-	-	-	-	-	-	6.4	6.5
ENEL SUBPROGRAM – 7	7.4	-	-	-	-	-	-	-	-	2.4	-	0.0	9.9
1. Engineering, supervision, and administration	0.3	-	-	-	-	-	-	-	-	0.3	-	-	0.5
2. Direct costs	6.8	-	-	-	-	-	-	-	-	2.2	-	-	9.0
2.7 Strengthening isolated systems	6.8	-	-	-	-	-	-	-	-	2.2	-	-	9.0
3. Financial expenses	0.3	-	-	-	-	-	-	-	-	-	-	0.0	0.4
SUBTOTAL	77.5	20.0	5.1	25.1	25.5	10.1	50.7	75.0	5.2	41.1	23.2	22.6	381.0

* These resources will be invested within the framework of the memorandum of understanding signed between the government and the distributors, and will correspond to commitments by both to address the situation of the settlements.

**Table 2. Cost and Financing Table for Loan NI-L1040
(US\$000)**

INVESTMENT CATEGORY	TOTAL 2010-2014		
	IDB	GoN*	Total
MEM SUBPROGRAM – 1 to 5	26,951	64	27,015
1. Engineering, supervision, and administration	787	-	787
2. Direct costs	25,000	-	25,000
2.1 Network extension	16,200	-	16,200
2.2 Settlement normalization*	6,100	-	6,100
2.3 Isolated areas with RE	500	-	500
2.4 Preinvestment in RE	350	-	350
2.5 Energy efficiency	1,850	-	1,850
3. Financial expenses	1,164	64	1,228
ENATREL SUBPROGRAM – 6	2,049	2	2,051
1. Engineering, supervision, and administration	-	-	-
2. Direct costs	2,000	-	2,000
2.6 Strengthening transmission	2,000	-	2,000
3. Financial expenses	49	2	51
ENEL SUBPROGRAM – 7	1,500	2	1,502
1. Engineering, supervision, and administration	224	-	224
2. Direct costs	1,211	-	1,211
2.7 Strengthening isolated systems	1,211	-	1,211
3. Financial expenses	65	2	67
SUBTOTAL	30,500	68	30,568

* The borrower will pay the program's credit fee.

C. Results Framework

- 1.34 The PNESER has a Results Framework (see Annex II) that presents results indicators associated with the program components. The two main outcomes for PNESER will be: (i) to contribute to the country achieving a rate of electricity coverage of approximately 85.5% by the end of the program, as part of the Nicaraguan government effort to reach the 90% target by 2020; and (ii) to support the authorities in generating new RE projects, by contributing to a transformational change in the energy mix in order to reach 86% generation from renewable energy sources by program end, and a 2020 target of 90% generation from renewable energy sources. Other expected outcomes of the program detailed in the Results Framework include: the reduction of power losses as a result of normalization of settlements, the reduction of electricity consumption due to energy efficiency programs and the increased reliability of the transmission system as a result of the transmission system strengthening.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financial instruments

- 2.1 The proposed operation represents the first loan from the Inter-American Development Bank (IDB) for the National Sustainable Electrification and Renewable Energy Program (PNESER). The program structure allows IDB resources to be contributed in a modular fashion in 2010, 2011, and 2012 through operations to be submitted independently for approval by the Board of Executive Directors, with investments that are justified and viable autonomously but enable the targets in the Results Framework to be met gradually and cumulatively. The design is based on the availability of concessional resources, and serves to leverage resources from other donors, while maintaining the concessionality agreed upon by the Government of Nicaragua with the international community as part of the country's debt reduction arrangements.
- 2.2 The international cooperation and finance agencies (ICFAs) that will support the PNESER and the Nicaraguan government authorities have agreed on a draft memorandum of understanding (MOU) for the PNESER¹¹ that will serve as the instrument coordinating the support of the ICFA signatories, who have agreed to the principles of coordination, alignment, harmonization, and transparency, as reflected in the MOU. The procedures are described in the MOU and will be developed in the PNESER program Operating Regulations (OR). The draft OR will be agreed upon between the ICFAs and the Nicaraguan government before execution begins on the first financing available for the PNESER. **As a condition precedent to the first disbursement of program NI-L1040, the program OR will have been approved, and the MOU will have been signed with the ICFAs.**

B. Environmental and social risks and mitigation measures

- 2.3 The PNESER has a positive net balance of environmental and social impacts, improving the living conditions of low-income populations, increasing the productivity of rural communities, and providing reliable electricity service to facilitate education and health services. The PNESER will allow beneficiaries to make better use of and promote RE sources, reduce fossil fuel consumption and anthropic pressure in forest areas. The projects aimed at distribution network extension, normalization of electricity service in settlements, and expansion to isolated areas with RE and EE pose potential moderate- to low-intensity impacts, of which the executing agency is aware, and for which it regularly applies mitigation measures, in accordance with existing national legislation and IDB environmental and social policies. At the same time, prospective geothermal drilling could affect the balance of ecosystems, generating high-temperature discharges of water and vapors affecting surrounding flora and fauna. Transmission lines in excess of 69 kV and substations could have potential environmental and social impacts such as

¹¹ Each ICFA will sign onto the MOU as their respective financing for the PNESER is approved.

property allocation and resettlements for right of way, access to tower location sites that could harm the environment. The new transmission lines pose risks for the population, as well as for migratory birds and fauna in general. For the geothermal prospecting studies and projects, high-voltage lines, and substations, in accordance with IDB policies, the preparation of environmental and social impact assessments (ESIAs) and environmental and social management plans (ESMPs) will be required in order to comply with national legislation and IDB environmental and social policies. The ESMP includes a series of typical measures for construction activities, most of which represent preventive and contingency measures. Mitigation measures are included in the project designs.

- 2.4 As part of program preparation and in accordance with its environmental and social strategy, an environmental and social management framework (ESMF) has been prepared and developed. It will be applied to all program investments regardless of their source of financing. The executing agencies will be responsible for implementation of the program's ESMF, as well as environmental and social monitoring of the measures included in the ESMPs for each project and the submission of reports and audits, as provided in paragraph 8.1 of the ESMR. The IDB will approve the environmental classification of the subprojects for small demonstration hydroelectric power plants, prospective geothermal drilling, transmission lines in excess of 69 kV, and substations. Moreover, the ESIAs will be conducted in accordance with current Nicaraguan legislation and will be duly reviewed and approved by the IDB. The instruments described in the ESMF, include: environmental assessment, EIA, ESMP, resettlement and public consultation plan. All of these will be included in the program OR to be applied as appropriate. The ESMF indicates the institutional responsibility for environmental and social management of the subprojects, which normally falls to the developer or operator of the subproject, for the preparation of EIAs, social diagnostic assessments, and ESMPs. The environmental authority, the Ministry of the Environment and Natural Resources of Nicaragua (MARENA), is responsible for oversight and monitoring, approval of the terms of reference for the ESIAs and ESMPs, and for monitoring compliance with them. In addition, the environmental management units of the Ministry of Energy and Mines (MEM) and Empresa Nacional de Transmisión Eléctrica (ENATREL) have the capacity to provide performance monitoring and oversight of enforcement of the ESMPs. The project manager or developer (e.g., the distributors Distribuidora del Norte (DISNORTE) and Distribuidora del Sur (DISSUR), Empresa Nicaragüense de Electricidad (ENEL), and ENATREL) will be responsible for contracting for the performance of the required environmental assessment, based on the type of project, and submitting them to the PNESER Monitoring Committee for approval and monitoring during execution. The PNESER financing includes resources for implementing the measures recommended in the ESMF to build the executing agencies' socioenvironmental management capacity with the necessary human resources, budget, and skills (Table 6 of the ESMF). For all program projects requiring an ESIA, public consultations will be held to engage the community potentially

impacted by the project. If submitted for IDB financing, projects located in protected area buffer zones, projects affecting indigenous populations, or where there is potential for resettlement will follow the respective IDB policies.¹² This program is classified as category “B” under the IDB’s Environment and Safeguards Compliance Policy (OP-703).

C. Fiduciary risk

- 2.5 The IDB’s fiduciary obligation to ensure the appropriate, efficient use of the funds is fulfilled in this operation by means of compliance with IDB financial and procurement policies and procedures, as indicated in the Fiduciary Annex included in the program’s electronic links. This annex establishes the provisions applicable to the execution of all program procurements he, as well as the fiduciary requirements for financial management and the governing provisions during project execution in matters of financial administration. During program execution, implementation of the plan to strengthen fiduciary requirements for financial management, agreed upon with the government, will be monitored and supported with program resources.
- 2.6 **Procurement.** Most of the resources for PNESER components 1, 2, 3, and 5 will be used to finance the subsidies and/or reimbursable contributions of the State for the development of rural electrification (both through network connections and in isolated systems), normalization of settlements, or promotion of EE, defined according to previously agreed methods reflected in the agreements between the respective public or private entities making the investment. Consequently, the execution and administration of these program resources will not include provisions on procurement.
- 2.7 For the remainder of the financing, procurements will be conducted: (i) in accordance with the specific rules of each donor, for procurements involving financing from a single donor; and (ii) in accordance with procurement procedures of one of the ICFA’s determined by common agreement among the financing ICFA’s, for procurements involving financing from more than one ICFA. Procurements to be financed by the IDB will be conducted in accordance with IDB policies (documents GN-2349-7 and GN-2350-7), and in the case of procurements financed by the IDB jointly with other ICFA(s), an agreement will be reached on the policies and procedures to be followed. Should it be necessary to request exceptions to IDB policies, they will be handled in accordance with current rules and procedures. The attached procurement plan provides details on the procurement processes to be used in the program for operation NI-L1040.

¹² Environment and Safeguards Compliance Policy (OP-703), Involuntary Resettlement (OP-710), Indigenous Peoples Policy (OP-765), Disclosure of Information (OP-102), and Disaster Risk Management Policy (OP-704).

D. Execution risks

- 2.8 The main risks to program implementation were identified during preparation, as were proposed mitigation measures. First, problems could arise for the various stakeholders in implementing the proposed framework for calculating and applying the subsidies for new users. To overcome this risk, the inclusion of any project for components 1, 2, 3, and 5 involving the provisions of subsidies, incentives, or reimbursable contributions in the annual work plan (AWP) of the PNESER program will require agreement between the MEM and the entity receiving the funds as described in paragraphs 1.14, 1.17, 1.20, and 1.26. For distributors DISNORTE and DISSUR in components 1 and 2, which represent the highest percentage of the financing, the authorities and operators have been supported in reaching framework agreements that have been discussed, agreed upon, and will be signed prior to the first disbursement of the Bank loan proceeds.
- 2.9 As is the case in sectors requiring public investment, there is a risk that rural electrification or the development of EE and RE lose the priority status they currently have been given by the authorities, which could cause delays in program execution. This risk is limited by the program's social reach, the strong support of potential beneficiary communities, and the growing awareness of the importance of rural electrification to promote the sustainable economic development of rural areas. Likewise, awareness of climate change and the current vulnerability of the Nicaraguan system to oil price fluctuations have raised awareness of the need to increase RE use and EE.
- 2.10 Lastly, the potential difficulties that could arise in managing a program with multiple international cooperation and finance agencies led to the definition and signing of the MOU between the ICFAs and the Nicaraguan government as a coordination mechanism (see paragraph 2.2).

E. Other key issues and risks

- 2.11 **Institutional and financial viability.** The program will be executed by the MEM, ENATREL, and ENEL, which are currently executing agencies for the Electricity Sector Support Program (loans NI-L1021, NI-L1022, and NI-L1036), have broad experience with teams made up of high-level technical personnel, and which will receive technical support when needed. Moreover, the program's engineering and administration component includes resources to support the MEM with program accounting, financial control and management, record-keeping and reporting, and other program administration and strengthening activities.
- 2.12 The institutional capacity assessment of the MEM, ENATREL, and ENEL, using the IDB's Institutional Capacity Assessment System (ICAS), completed in late 2009, determined which areas of the MEM, ENATREL, and ENEL were to be strengthened before and during program execution (see the Fiduciary Annex). It proposed: (i) strengthening the financial administration system; (ii) strengthening the levels of effectiveness and efficiency in human resources; (iii) making service and asset administration more efficient; and (iv) establishing a safety and

contingency plan and strengthening the information system, with respect to the control capacity. It will also be necessary to build the capacity of the staff associated with the financial administration system in the case of the MEM and ENEL. The plan to strengthen financial management was agreed upon with the government and will be monitored during program execution (see paragraph 2.5).

- 2.13 Moreover, for components 1 to 3, actions will be implemented to increase beneficiary community participation in the project development and execution stages. In cases of projects for isolated systems, where participation by microenterprises and small businesses is expected, technical assistance will be provided on issues related to administration, marketing, operation, and maintenance of the systems.
- 2.14 Most program resources will be used to finance the support of subsidies granted by the government to make investments by third parties financially viable, within the framework of the agreements reached, under which the rules are set to ensure the financial viability and sustainability of the investments. With respect to ENATREL and ENEL, the agreements established in the framework of the Electricity Sector Support Program (loans NI-L1021, NI-L1022, and NI-L1036), which are being performed satisfactorily, will be maintained. The preliminary financial results for ENATREL in 2009 show that it met the financial indicators agreed upon in the loan contract, with internally generated cash accounting for 39% of the investments (compared to the 25% committed), an operating margin of 43.4% (compared to a commitment of 35%), and a debt service coverage ratio above 1.5. At the same time, progress continues on the action plan submitted by the IDB for institutional adjustments relating to the reorganization of ENEL and the companies resulting from its segmentation. The required preliminary draft legislation is expected to be submitted to the Legislative Assembly in the second half of 2010. ENEL has updated its financial statements and completed the independent audit of financial statements through December 2008. Some of the qualifications noted by the auditors with respect to ENEL's reorganization can only be resolved once the abovementioned bill is approved.
- 2.15 **Technical and economic viability.** A technical and economic evaluation of the program¹³ was completed with the support of an international consultant (see electronic links), and confirmed its viability. The evaluation focused on the sample projects for components 1, 2, and 6, representing the bulk of the investment activities. For component 3 on isolated systems, selection standards will be followed that ensure the viability and sustainability of the projects, and the strategy being developed will set criteria for their prioritization. For component 5 on EE, the program being prepared with technical cooperation operation NI-T1034 will include the technical and economic evaluation criteria.

¹³ See electronic links: Technical and economic evaluation of the program:
<http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35062497>

- 2.16 In addition to verifying the projects' viability, the evaluation identifies standards and methodologies to be followed for the selection of projects in each of these components. The economic and financial analysis model to be used in quantifying the investment subsidies for the individual projects was programmed and agreed upon with the Nicaraguan government. Application of the model requires the prior determination of efficient unit costs and other parameters including unit consumption and rates.
- 2.17 With respect to Component 1 (network extension), the average total cost per customer for projects eligible for subsidies is US\$1,244, of which US\$1,064 corresponds to networks, US\$106 to service connections and metering, and US\$59 to internal installations. The remaining US\$15 corresponds to service connections and metering for nonresidential customers. The average subsidy for the investment in networks is US\$809, so the average recoverable cost is US\$255, representing 24% of the average cost for investment in networks. Given the foregoing values, the budget for component 1 is sufficient to supply electricity to 117,390 dwellings, however this plan is maintained to cover the risk that the sample is not statistically representative. As the model requires, all individual projects eligible for subsidies have an economic internal rate of return (EIRR) above 12%. The economic net present value (ENPV) per dwelling supplied with electricity service, discounted at 12% as of January 2009, is US\$574.
- 2.18 The conclusions of the evaluation of component 1 include the need to promote execution of a sufficient number of preliminary designs to properly prioritize the projects and fully compensate for the elimination or postponement of uneconomic projects. Program resources have been included for such purpose.
- 2.19 For component 2, the economic viability was determined in light of the information obtained from four pilot projects, two in León, which are up and running, and two in Managua, which are under construction. The EIRRs of the four projects are between 13% and 27%. On average, the total cost of normalizing a customer in the sample, excluding the cost of the service connection and meters, is US\$240, yielding an ENPV of US\$274. The normalization of 130,000 dwellings would produce an ENPV of US\$36 million. The analysis of the sample shows that all projects considered are financially viable and therefore of interest to the distributor, as well as economically sound and therefore in the country's interest.
- 2.20 For component 6, two independent projects were evaluated. The first addresses the construction, remodeling, or expansion of the Estelí, San Ramón, Terrabona, Ocotol, El Sauce, and Yalí substations, including their transmission lines and other associated works, and is aimed at supporting the loads in their areas of direct influence, plus the increased power produced in the Santa Clara, Yalagüina, Villanueva, Centroamérica, Sebaco, and Boaco substations. This project has an ENPV indicator of US\$141 million at border prices, and an EIRR of 55%. The second project addresses the construction of the La Dalia substations, replacing the old El Tuma substation and the El Cuá substation, and has an ENPV of US\$15 million and an EIRR of 22%.

- 2.21 The two projects provide benefits in terms of incremental power supply at the low-voltage level, reduced transmission and distribution losses, and increased reliability. The evaluation improves in a downside scenario, where the benefits of loss reduction are not considered at the distribution level, and quality improvements associated with improved voltage regulation are not taken into account. Both projects show robust features, maintaining sound economic indicators despite potentially drastic changes in their primary variables. They are also scheduled effectively, since they are planned for the earliest possible date, and in the event of delay, their applicable ENPVs will fall.
- 2.22 In terms of the availability of energy in the country to meet the demand of the new customers who will gain access to electricity services, the program will have a positive impact. While component 1 entails a greater consumption of electricity estimated at 4 GWh/year, component 2 represents a reduction of 7.3 GWh/year, such that the system frees up 3.3 GWh/year of power generation. From the standpoint of power in the transmission and distribution systems, the program includes its own works aimed at meeting the demand. Consequently, not only does it place no restrictions whatsoever on existing systems, but it expands them to absorb the incremental demand. With respect to the availability of power at the generation level, the impact of component 2 more than offsets that of component 1, resulting together in a lower demand for power.
- 2.23 The execution of the initial portfolio for component 5 on EE presents a simple three-year term for recovery of the investment, and will have a positive impact on the environment with the reduction of 220 GWh in electricity consumption and 156,000 tons of carbon dioxide per year.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

- 3.1 The borrower will be the Republic of Nicaragua and the executing agencies will be: the Ministry of Energy and Mines (MEM) for Components 1 to 5, Empresa Nacional de Transmisión Eléctrica (ENATREL) for Component 6, and Empresa Nicaragüense de Electricidad (ENEL) for Component 7.
- 3.2 **Organization.** The organization proposed for program execution, described in greater details in the program annexes, seeks to take maximum advantage of the existing organizational structures at the MEM, ENATREL, and ENEL. In the case of the MEM, a temporary organizational structure is proposed for management and administration of the National Sustainable Electrification and Renewable Energy Program (PNESER), made up of a Program Director, who will have the specialized support of a Financial Coordinator, both full-time, and five Technical Coordinators responsible for each of the components, to be appointed by the Director General/Specific Director of the area of the Ministry responsible for execution of the respective component. This structure within the MEM will serve as the Program Execution Unit (PEU-MEM) for Subprogram I and coordinate the entire PNESER

- in relation to the ICFAs. **As a condition precedent to the first disbursement, the structure will have been created within the MEM that will serve as the PEU-MEM for subprogram I and coordinate the entire PNESER.** Moreover, for their respective components, ENATREL and ENEL will act through the executing agencies created and functioning for the Electricity Sector Support Program (loans NI-L1021, NI-L1022, and NI-L1036).
- 3.3 The PNESER Monitoring Committee, referred to in paragraph 2.2, will be made up of two representatives from signatory ICFAs (selected as established in the MOU), one from the MEM and one from the Ministry of Finance (MHCP). The Monitoring Committee will analyze and approve the applicable annual work plans (AWPs) and review reports and, upon prior approval by the ICFA whose source of financing is affected, any request for major changes to the PNESER. The reports described in this paragraph will be a single report for all signatory ICFAs. The execution units, both at the MEM, and at ENATREL and ENEL, will have the following functions, among others: (i) make internal arrangements at the respective institution with respect to the PNESER, coordinating the activities of the various agencies involved; (ii) conduct the selection and contracting processes for consulting firms, audit firms, and other technical assistance required, in accordance with IDB procedures; (iii) maintain the program's financial records; (iv) prepare and submit the six-monthly reports required by the ICFAs; and (v) compile, store, and maintain all information, indicators, and parameters necessary to help the ICFAs prepare the program completion report or any other necessary program evaluation. **As a condition precedent to the first disbursement, the MOU will have been signed with the ICFAs, and the PNESER Monitoring Committee will have been formed.**
- 3.4 **Execution mechanism.** The program will be executed on the basis of the annual work plan (AWP), which will identify the specific activities to be financed, the uses and sources of the resources, the planned targets, and expected outcomes for each. The executing agencies, supported by the organizational structure described above, will prepare the detailed AWP and submit them to the PNESER Monitoring Committee. The activities in the AWP will take into account the interconnectedness of the components and subcomponents, and the times when they are to be developed, to ensure achievement of the program's objectives. **As a condition precedent to the first disbursement of each subprogram for the first loan, the updated AWP for the first year will have been delivered.**
- 3.5 As a condition precedent to the first disbursement of each subprogram for the first loan, the IDB must receive a copy of the execution agreements entered into between the MHCP and the MEM for the resources for components 1 to 5, and the resource transfer and execution agreements entered into between the MHCP and ENATREL for component 6, and between the MHCP and ENEL for component 7. Among other considerations, these agreements will indicate: (i) the manner in which resources for the components under the loan will be transferred; (ii) the commitment to executing program activities in accordance with the terms and

conditions of the loan contract; and (iii) the commitment to use the loan proceeds and local counterpart only for program purposes.

B. Summary of arrangements for monitoring results

- 3.6 The Results Matrix will be the basic instrument for monitoring program outcomes. Two PNESER Monitoring Committee meetings will be held each year. The annual review meeting (April) will review performance for the prior year (progress on actions and targets met as planned in the AWP using the agreed indicators). This meeting will identify the support projections for the following year. The annual planning meeting (August) will discuss the general progress for the first half of the year (for the AWP for the year underway) and the proposed AWP for the following year.

**Development Effectiveness Matrix
Summary**

Indicator	Score	Maximum Score
I. Strategic Relevance	High	
1. IDB Strategic Development Objectives	5.5	10
Country Diversification	2.0	2
Corporate Initiatives	2.5	2.5
Harmonization and Alignment	0.0	3.5
Beneficiary Target Population	1.0	2
2. Country Strategy Development Objectives	5.4	10
Country Strategy Sector Diagnosis	1.8	6
Country Strategy sector objective & indicator	3.6	4
II. Development Outcomes - Evaluability	Satisfactory	
3. Evidence-based Assessment & Solution	8.4	10
4. Evaluation & Monitoring Plan	4.3	10
5. Cost-Benefit or Cost-Effectiveness	7.0	10
6. Risks & Mitigation Monitoring Matrix	7.5	10
III. IDB's Role - Additionality		
7. Additionality	3.0	10
Technical Assistance provided prior the project	3.0	3
Improvements in management of financial, procurement, monitoring or statistics internal controls	0.0	4
Improvements in environmental, health and labor performance	0.0	3

I. Strategic Relevance: This operation is being executed in Nicaragua, a Central American Group C/D country, through the "investment loan" instrument. Several international cooperation lenders are involved in its financing. Its objective is connected to the Bank's infrastructure and climate change initiatives. The project enhances social equity (SEQ). The project will not use country systems.

The country strategy does not contain a diagnostic assessment with empirical evidence of the sector, but does include sector objectives and indicators.

II. Evaluability: The problem to be addressed by the project is clear, and has been defined on the basis of empirical evidence. The effectiveness of the intervention model is based on the experience gained and lessons learned from previous projects in the country. The intervention logic is well-defined. There are indicators that make it possible to monitor the outputs to be generated with the financing. The project has cost-benefit analysis that covers its principal components. The project does not have a specific monitoring and evaluation plan. The project is classified as a category "B" operation; the main environmental and social risks have been identified as have the corresponding mitigation measures, but no indicators have been established that would make it possible to follow up on implementation of those mitigation measures.

III. Additionality: The design of this project was supported by technical assistance (NI-T1094).

NICARAGUA
NATIONAL SUSTAINABLE ELECTRIFICATION AND RENEWABLE ENERGY PROGRAM (PNESER)
(NI-L1040)

RESULTS FRAMEWORK / MATRIX OF INDICATORS

Program objective	The objective of the National Sustainable Electrification and Renewable Energy Program (PNESER) is to support the efforts of the Nicaraguan government to reduce poverty by promoting access by a significant portion of the population to efficient, sustainable electricity service, and to create the conditions to move forward on a change to the energy mix that contributes to better conditions for mitigation and adaptation to climate change.							
Results indicator	Baseline 2009	2010	2011	Target		2014	2020	Means of verification
Principal indicators								
Increase in electricity service coverage in the country	64.6%	68.5%	73.1%	77.9%	82.4%	85.5%	90.0%	MEM statistics
Occupied dwellings (thousands)	1,104	1,119	1,133	1,148	1,162	1,177		Institute of Statistics
Total users (thousands)	711	744	794	871	940	1,008		MEM statistics
Proportion of electricity generation from renewable sources	35.0%	37%	42%	55%	62%	86%	90.0%	MEM statistics
Total generation (GWh)	3,100	3,322	3,456	3,584	3,710	3,835		MEM statistics
Renewable generation (GWh)	1,085	1,207	1,467	1,985	2,301	3,297		MEM statistics
Other results indicators								
Reduction in consumption due to energy efficiency programs (initial projects)	0 GWh/year	0 GWh/year	130 GWh/year	160 GWh/year	190 GWh/year	221 GWh/year	221 GWh/year	MEM ex post evaluation
Reduction of power losses in settlements								
Increase in service reliability as a result of the transmission system strengthening	93.58 %	93.58 %	93.62%	93.67 %	93.7%	93.9%	94.3%	ENATREL statistics

Intermediate progress indicators	Targets					
	Baseline 2009	2010	2011	2012	2013	2014
Component 1: Rural electrification by network extension						
Users connected, Total PNESER	0	21,202	44,760	73,030	98,944	117,390
Users connected, NI-L1040	0	5,300	16,491	22,380	22,380	22,380
Component 2: Normalization¹ of service in settlements						
Users normalized in settlements (PNESER)	0	31,658	77,047	117,548	150,760	164,045
Users normalized in settlements (NI-L1040)	0	7,915	27,176	38,524	38,524	38,524
Normalized users who are new customers (Total PNESER)	0	7,752	20,631	33,468	45,683	50,569
Normalized users who are new customers (NI-L1040)	0	1,938	7,096	10,316	10,316	10,316
Component 3: Expansion in isolated areas with renewable energy						
Strategy for serving isolated areas	None	Approved				
Users connected in projects with renewable energy in isolated systems	0	778	2,442	4,179	5,129	5,820
Users connected in projects with renewable energy in isolated systems (NI-L1040)	0	311	311	311	311	311
Component 4: Preinvestment and studies for generation projects with renewable energy						
Approved national power generation planning and expansion strategy (NI-L1040)	Out of date	Approved				
Master Plan for the Río Grande de Matagalpa Basin and Upper Río Coco Basin	None		Available			
MW of renewable energy with feasibility studies completed	0	0	0	100	200	358
System installed (500KW) – Demonstration project for power generation using photovoltaic systems	0	0	0	1	1	1
Study completed – Wind power prospecting and evaluation and feasibility study for wind power generation systems on six		0	0	0	0	1

sites for interconnection to the SIN	None					
Study completed – Feasibility study for the implementation of distributed power generation in Nicaragua	None	0	0	1	1	1
Component 5: Energy efficiency programs						
Lights installed – Public lighting savings plan	0	0	7,600	18,300	25,604	25,604
Lights installed – Replacement of incandescent bulbs with compact fluorescent bulbs in the residential sector (phase II)	0	0	1,500,000	2,000,000	2,000,000	2,000,000
Lights installed (NI-L1040)	0	0	750,000	1,000,000	1,000,000	1,000,000
Lights installed – Replacement of magnetic fluorescent lamps with electronic lamps in the government sector.	0	0	20,000	20,000	20,000	20,000
Lights installed (NI-L1040)	0	0	10,000	10,000	10,000	10,000
Heating systems installed – Demonstration project for the installation of solar heating systems in Nicaragua (phases I and II)	0	0	13	13	13	13
Systems installed (NI-L1040)	0	0	6.5	6.5	6.5	6.5
Systems installed – Engineering and development of solar cooling and climate control	0	0	50	75	75	75
Systems installed – Photovoltaic systems for the implementation of productive systems in rural areas in Nicaragua	0	0	100	350	750	750
Number of studies – Development of procedure for approval of energy efficiency regulations	0	1	1	1	1	1
Number of studies – Development of policy, national program, and bill on energy efficiency	0	1	1	1	1	1
Number of studies – Definition of energy efficiency indicators for energy consumption sectors in Nicaragua	0	0	1	1	1	1
Number of training sessions: Institutional strengthening in energy efficiency in: electricity, heating, compressed air, industrial processes	0	0	4	4	4	4
Number of training sessions: (NI-L1040)			1	1	1	1

Number of vehicles – Means of automotive transportation	0	1	1	1	1	1
Component 6: Strengthening the transmission system in rural areas						
Additional MW in remodeling or expansion of substations	0	0	0	55	70	130
MW (NI-L1040)	0	0	0	10	10	10
Km of transmission lines	0	0	0	30 double triad	50 double triad 50 single triad	50 double triad 164 single triad
Km (NI-L1040)	0	0	0	30 double triad	30 double triad	30 double triad
Component 7: Sustainability of ENEL isolated systems						
New commercial and administrative systems installed (NI-L1040)	0	0	28	148	148	148
kW of renewable energy evaluated.	0	0	5,150	6,270	7,133	8,133
Number of projects built.	0	0	0	0	1	1

¹ Normalization includes works for distribution, metering, and internal installations so customers can have a safe, reliable supply, appropriate commercial monitoring, and accurate electricity service metering. The target involves both existing customers, since they appear on the distributors' records, and illegal customers who will be incorporated as new customers. In addition to the total number of customers normalized, the indicator also shows new customers taken into account for the coverage indicator.

SUMMARY PROCUREMENT PLAN

NATIONAL SUSTAINABLE ELECTRIFICATION AND RENEWABLE ENERGY PROGRAM (PNESER) (NI-L1040)

Period covered by this Procurement Plan: January 2011 to June 2012

Ref. no. ¹	Category and description of procurement contract	Estimated cost of procurement (US\$000)	Procurement method ²	Review (ex ante or ex post)	Source of financing and percentage		Prequalification ³ (Yes/No)	Estimated dates		Status ⁴ (pending, in process, awarded, canceled)	Comments
					IDB %	Local/ Other %		Publication of specific procurement notice	Completion of contract		
1	GOODS										
1.1	Supply, civil engineering, and assembly of Sauce substation and 138 KV transmission line (C6)	7,556	ICB	ex ante	100		No	1 Sem 2011	2 Sem 2012	Pending	
1.2	Supply, efficient lamps, and EE heating systems (C5)	4,780	ICB	ex ante	50	50	No	2 Sem 2011	2 Sem 2011	Pending	Cofinanced by CABEL
1.3	Equipment for operation and maintenance of ENATREL lines and substation (C6)	1,450	ICB	ex ante	100		No	2 Sem 2011	1 Sem 2012	Pending	
1.4	Equipment for operation and maintenance of ENEL system (C7)	725	ICB	ex ante	100		No	2 Sem 2011	1 Sem 2012	Pending	
1.5	Modernization of the commercial system and computer and communications equipment for ENEL (C7)	420	ICB	ex ante	100		No	2 Sem 2011	1 Sem 2012	Pending	
2	WORKS										
2.1	N/A										
3	NONCONSULTING SERVICES										
	N/A										
4	CONSULTING SERVICES										
4.1	Execution supervision and support for the MEM subprogram (C 1 to 5)	3,990	QCBS	ex ante	30	90	No	1 Sem 2011	2 Sem 2014	Pending	PNESER cofinancing agencies

4.2	Execution supervision and support for the ENATREL subprogram (C6)	2,870	QCBS	ex ante	15	85	No	1 Sem 2011	2 Sem 2013	Pending	Idem
4.3	Execution supervision and support for the ENEL subprogram (C7)	404	QCBS	ex ante	28	80	No	1 Sem 2011	2 Sem 2014	Pending	Idem
4.4	Audit MEM subprogram (C 1 to 5)	376	QCBS	ex ante	30	90	No	1 Sem 2011	2 Sem 2014	Pending	Idem
4.5	Strengthening and sustainability consulting (C3)	500	QCBS	ex ante	100		No	1 Sem 2011	2 Sem 2012	Pending	
4.6	Planning studies (C4)	350	QCBS	ex ante	100		No	1 Sem 2011	2 Sem 2013	Pending	
4.7	Studies on strengthening EE (C5)	150	QCBS	ex ante	100		No	1 Sem 2011	2 Sem 2012	Pending	
4.8	Audit ENATREL subprogram (C6)	191	QCBS	ex ante	15	90	No	1 Sem 2011	2 Sem 2013	Pending	Idem
4.9	Audit ENEL subprogram (C7)	27	QCBS	ex ante	28	80	No	1 Sem 2011	2 Sem 2014	Pending	Idem
	TOTAL	23,789									

¹ If there are a number of similar individual contracts to be executed in different places or at different times, these can be grouped together under a single heading, with an explanation in the comments column indicating the average individual amount and the period during which the contracts would be executed. For example: an education project that includes school construction might include an item “school construction”, for a total value of US\$20 million, and an explanation in the comments column such as: “This encompasses some 200 contracts for school construction averaging US\$100,000 each to be awarded individually by the participating municipal governments over a three-year period between January 2006 and December 2008.”

² **Goods and works:** **ICB:** International competitive bidding; **LIB:** limited international bidding; **NCB:** national competitive bidding; **PC:** price comparison; **DC:** direct contracting; **FA:** force account; **PSA:** Procurement through specialized agencies; **PAs:** Procurement agents; **IA:** Inspection agents; **PLFI:** Procurement in loans to financial intermediaries; **BOO/BOT/BOOT:** Build, own, operate/build, operate, transfer/build, own, operate, transfer; **PBP:** Performance-based procurement; **PLGB:** Procurement under loans guaranteed by the Bank; **PCP:** Community participation procurement; **Consulting firms:** **QCBS:** Quality- and cost-based selection **QBS:** Quality-based selection **FBS:** Selection under a fixed budget; **LCS:** Least-cost selection; **CQS:** Selection based on the consultants’ qualifications; **SSS:** Single-source selection.

Individual consultants: **NICQ:** Selection based on a comparison of national individual consultants’ qualifications; **IICQ:** Selection based on a comparison of international individual consultants’ qualifications.

³ Applicable for new policies only for goods and works. For old policies, it applies to goods, works, and consulting services.

⁴ The “status” column will be used for retroactive procurement and updates of the procurement plan.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/___

Nicaragua. Loan ____/BL-__ to the Republic of Nicaragua
National Sustainable Electrification and Renewable Energy Program – First Financing

The Board of Executive Directors

RESOLVES:

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 contract or contracts as may be necessary with the Republic of Nicaragua, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a national sustainable electrification and renewable energy program – first financing. Such financing will be for the amount of up to US\$15,250,000 from the resources of the Single Currency Facility of the Bank's Ordinary Capital, corresponds to a parallel loan within the framework of the multilateral debt relief and concessional finance reform of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ____ 2010)

LEG/SGO/CID/IDBDOCS#35116273
NI-L1040

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

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(Adopted on ____ 2010)

LEG/SGO/CID/IDBDOCS#35116998
NI-L1040