Cover Page for Project Approval Request			
1. **Country/Region**:	Honduras	2. **CIF Project ID#**:	
3. **Source of Funding:**	☐ FIP	☐ PPCR	[X] SREP
4. **Project/Program Title:**	*Honduras Renewable Energy Finance Facility (H-REFF)*		
5. **Type of CIF Investment:**	☐ Public	[X] Private	☐ Mixed
6. **Funding Request in million USD equivalent:**	*Grant:* IP resources, IDB 0.95	*Non-Grant:* IP resources, IDB 5 Set-aside resources, IDB 15 **Total 20**	
7. **Implementing MDB(s):**	Inter-American Development Bank (IDB), Multilateral Investment Fund (MIF)		
8. **National Implementing Agency:**	Management Company: Sustainable Energy Central America (SECA), S.A. National SREP Focal Point: Jesus Mejia, Vice minister of INSEP (Ministry of Infrastructure and Public Services)		
9. **MDB Focal Point and Project/Program Task Team Leader (TTL)**:	SREP Focal Points IDB: Claudio Alatorre calatorre@iadb.org	Project team leaders IDB: Zachary Levey zacharyl@iadb.org	

10. **Project/Program Description** (including objectives and expected outcomes)**:**

The second component of the Honduras Investment Plan (IP) is called ADERC (*Apoyo al Desarrollo de las Energías Renovables en Conexión con la Red*, or Grid-connected Renewable Energy Development Support). ADERC is divided into two subcomponents: generation and transmission. The ADERC-generation private sector subcomponent had a total budget of USD 10 million of reimbursable SREP resources, to be implemented by the Inter-American Development Bank and the International Finance Corporation. The ADERC-transmission public sector subcomponent had a budget of USD 4 million of non-reimbursable resources, to be implemented by the IDB. In addition, USD 2.4 million of non-reimbursable resources were allocated to technical assistance and capacity building activities, to be implemented by the two banks. It was specified that MDBs would seek to achieve the best allocation of resources in terms of building on each institution's strengths, learning from each other, minimizing transaction costs, and maximizing cost effectiveness.

On June 5, 2015, a USD 500,000 project preparation grant for the ADERC transmission subcomponent (called "Renewable Energy Transmission in West and North Zones"), submitted by the IDB, was approved by the SREP Trust Fund Subcommittee.

The H-REFF proposal is submitted by the IDB, and involves the utilization of one part (USD 5 million) of the reimbursable resources allocated to ADERC-generation, one part (950,000) of the remaining non-reimbursable resources allocated to technical assistance and capacity building activities and USD 15 million of Set-Aside Resources allocated for this project (*Strengthening of the ADERC H-REFF in Honduras*). IFC will submit separate proposal for the utilization of the balance of funds following their business development efforts.

Access to clean and sustainable energy services, poverty alleviation, and economic opportunity in Honduras are inextricably linked. Energy provides a key input for many productive activities and holds great influence over the ability of communities and young people to improve their incomes and well-being. Clean energy technologies also can help reduce greenhouse gas (GHG) emissions linked to climate change, and can help small businesses, farms and families improve their resilience to cope with climate threats.

In Honduras almost 20% of the population does not have access to electricity and costs of energy are among the highest in Latin America, due to heavy reliance on imported fossil fuels. Honduras is endowed with an extraordinary wealth of natural capital that could be harnessed to deliver clean and affordable energy services, including hydro, biomass, solar, geothermal and wind resources. Despite this potential, over 2.3 GW from renewable sources remain untapped.

The renewable energy sector opens up new economic opportunities for SMEs and well-paying job opportunities for young people in rural communities. Small enterprises, in particular, face major barriers to entry in the renewable energy sector, often lacking access to finance and technical experience in social and environmental risk management to bring their projects to fruition.

The Multilateral Investment Fund (MIF) of the IDB Group, with funding from the Scaling Up Renewable Energy Program in Low-Income Countries (SREP), will establish a highly innovative investment Facility called the Honduras Renewable Energy Financing Facility (H-REFF). The H-REFF will help to close a critical financing and skills gap in the renewable energy sector in Honduras by providing capital tailored to the needs of small-scale renewable energy entrepreneurs along with technical know-how and training to promote best practices in social and environmental risk management, job training for young people in the local communities and access to basic services for communities. The H-REFF will be the first Honduras-focused investment fund for renewable energy and clean technology deployment.

USD 20 M in SREP resources will be used as an equity investment to capitalize the Fund (USD 15 M from the Set-Aside and USD 5 M from component II of the IP as described above), which will have an overall target capitalization of USD 44.4 M. In addition, up to USD 0.95 M (IP resources) in non-reimbursable resources will be used to create a technical assistance window for the program.

The Fund will support investments in 22 renewable energy SMEs, create 2,500 jobs, reduce 5.7 million tons of CO_2-equivalent, generate 427 MWh per year from renewable sources, and create 153 MW of renewable energy installed capacity.

11. Consistency with Investment Criteria:

See pages 12 to 16.

12. Stakeholder engagement:

See page 15.

13. Gender considerations:

See page 15.

14. Indicators and Targets (consistent with results framework):

Core Indicator[1]	Target
Increase in RE generation capacity and supply (MW)	Up to 153
Annual electricity output from renewable energy as a result of SREP interventions (MWh)	Up to 427
Tons of CO_2e emissions avoided in lifetime	5,700,000

[1] See p.16

Development Indicator(s): a) Number of SMEs benefited b) Jobs (temporary and permanent)	 Up to 22 Up to 2,500

15. **Co-Financing:**		
	Amount (in USD million):	*Type of contribution:*
MDBs	4	Equity
Other investors (private sector and DFIs)	40	Equity
Commercial Banks (project by project)	346	Debt
Co-Financing Total:		

16. Expected Board/MDB Management[2] approval date:
IDB approval: August 2015

[2] In some cases activities will not require MDB Board approval.

H-REFF

IDB Private Sector SREP Proposal for Submission to the SREP Sub-Committee

TABLE OF CONTENTS

List of Abbreviations 5

I. Country and Sector Context 6

II. Program Choice – Why a Renewable Energy Investment Fund? 6

III. Proposed Program 7

IV. Program's Strategy for Achieving Market Transformation 12

V. Consistency with SREP Investment Criteria 12

VI. Annex II – Additional information available upon request 17

VII. Annex III - Estimated implementation and supervision costs of investment operations 17

LIST OF ABBREVIATIONS

AHPER	*Asociación Hondureña de Productores de Energía Renovable* (Honduran Association of Renewable Energy Producers)
AMCHAM	*Cámara de Comercio Hondureño Americana* (Honduran-American Chamber of Commerce)
ARECA	Accelerating Renewable Energy Investment in Central America and Panama
CABEI	Central-American Bank for Economic Integration
CICC	*Cámara de Comercio e Industrias de Cortes* (Commerce and Textile Industry Chamber)
CO_2	Carbon dioxide
CO_2e	Carbon dioxide equivalent
COHEP	*Consejo Hondureño de la Empresa Privada* (Honduran Private Enterprise Council)
DFI	development finance institution
ENEE	*Empresa Nacional de Energía Eléctrica* (State-owned Utility)
ESR	environmental and social responsibility
GDP	gross domestic product
GHG	greenhouse gases
GIIRS	Global Impact Investment Rating System
GP	general partner
GW	Gigawatt
H-REFF	Honduran Renewable Energy Finance Facility
HNL	Honduran Lempira
IDB	Inter-American Development Bank
IIC	Inter-American Investment Corporation (IDB Group)
IFC	International Finance Corporation
LAC	Latin America and the Caribbean
LP	limited partner
MDB	multilateral development bank
MIF	Multilateral Investment Fund (IDB Group)
MW	Megawatt
MWh	Megawatt hour
PPA	power purchase agreement
PV	photovoltaic
RE	renewable energy
SIEPAC	*Sistema de Interconexión Eléctrica de los Países de América Central* (Central American Electrical Interconnection System)
SME	small or medium-sized enterprise
SREP	Scaling-up Renewable Energy in Low Income Countries Program
SREFF	Self-Supply Renewable Energy Finance Facility
TA	technical assistance
USD	United States Dollars
VC	venture capital

I. COUNTRY AND SECTOR CONTEXT

Access to clean and sustainable energy services, poverty alleviation, and economic opportunity in Honduras are inextricably linked. Energy provides a key input for many productive activities and holds great influence over the ability of communities and young people to improve their incomes and well-being. Energy serves as a critical input to light homes and businesses, for providing access to basic services, such as healthcare, clean water and modern sanitation services, and for expanding economic opportunity and employment. Clean energy technologies also can help reduce greenhouse gas (GHG) emissions linked to climate change, and can help small businesses, farms and families improve their resilience and cope with climate threats.

Energy costs in Honduras are among the highest in Latin America due to heavy reliance on imported fossil fuels to generate electricity and extremely high technical losses and commercial losses in transmission and distribution. In 2013, Honduras spent 13.2% of GDP on fossil fuel imports, which accounted for 57% of the national energy supply. The economic strain and volatility inherent in Honduras' present energy regime impacts economic growth and erodes the competitiveness of local businesses that are the engine for employment and opportunity creation.

Honduras is endowed with an extraordinary wealth of natural capital that could be harnessed to deliver clean and affordable energy services, including hydro, biomass, solar, geothermal and wind resources. Despite this potential, over 2.3 GW of renewable energy potential remain untapped, much of which could be developed from small-scale, family owned hydro projects. The Honduran government has made reducing the country's dependency of fossil fuel a priority, and created new incentives to increase the share of energy produced from renewable sources in its energy matrix. The state-owned utility, Empresa Nacional de Energía Eléctrica (ENEE), has awarded contracts (called Power Purchase Agreements or PPAs) for renewable projects (small hydro, geothermal, and biomass & waste).

The renewable energy sector opens up new economic opportunities for SMEs, rural communities and young people. The energy sector in Honduras has traditionally afforded opportunities only to a handful of large companies that are well staffed and funded. For instance, as recently as 2010, two companies – Grupo Terra and Lufussa – represented 82.3% of energy sold to ENEE, which came primarily from fossil fuel fired power plants. Small-scale renewable energy technologies, such as small hydro plants, open up new opportunities for small, family-owned companies and young entrepreneurs to make the energy sector a more inclusive market. Many of the energy purchase contracts have gone to small actors and non-traditional market participants, which has created new opportunities for small business. A large number of these new renewable energy SMEs are owned by former engineers, project developers and technicians that worked previously for one of the large energy companies. In addition to grid-connect renewable energy, the rapidly declining technology costs are making self-supply and off-grid energy solutions viable for rural and island-based businesses and households, such as rooftop solar PV, solar water heaters, small-scale wind, and biogas. These renewable energy technologies can help small businesses and households save money, increase productivity in rural areas and preserve business continuity during extreme weather events, thereby harnessing potential mitigation-adaptation synergies when possible.

II. PROGRAM CHOICE – WHY A RENEWABLE ENERGY INVESTMENT FUND?

Despite the government's commitment to increasing the share of renewable energy in the country's energy mix, gaps in regulation and licensing guidelines, low capacity of project developers, weak access to long term financing, and insufficient transmission infrastructure to accommodate renewables continue to inhibit the large scale implementation of Honduras' low carbon objectives.

Small renewable energy enterprises, in particular, face major barriers to entry in the renewable energy sector, often lacking access to finance and experience to bring their projects to fruition. In 2013, the MIF

and IFC, as part of the SREP preparation and consultation process, commissioned an exhaustive assessment of the market barriers facing local private sector actors in Honduras, which identified several key challenges that could be addressed. The market study included an assessment of projects registered with state-owned utility along with several roundtables, consultations with key stakeholders and surveys.

The market study and consultation process found that there is a notable financing and skills gap for small-scale, family owned, renewable energy projects that will prevent at least 500 MW of technically sound and fair-priced projects with PPAs from getting built in the next 5 years. The local commercial banking sector, as well as several development agencies (e.g., CABEI, IIC), already offer debt financing to service the debt requirements of projects, usually for up to 70% of the total construction costs. However, renewable energy SMEs are often confronted with a distinct mismatch between the needs of the projects and the conventional financial sector products, including such issues as loan terms and collateral requirements. With limited funds of their own and relatively little experience in project development, these renewable energy SMEs struggle to bring technically sound projects forward.

In addition to financial barriers, there are number of critical non-financial barriers impacting small scale renewable energy projects. First, many SMEs in the new wave of renewable energy sector entrepreneurs have relatively less experience with project development, particularly around social and environmental risk management. Second, many small-scale renewable energy projects, require additional technical studies and analysis that can be a barrier for securing financing for innovative business models and small-scale projects. Third, although small-scale renewable energy projects can contribute to creation of well-paying employment opportunities and economic benefits for rural communities, many times the workforce in the nearby communities does not have the core competencies to take full advantage of formal work opportunities.

The IDB, as part of the Scaling Up Renewable Energy Program in Low-Income Countries (SREP), will establish a highly innovative investment Facility called the Honduras Renewable Energy Financing Facility (H-REFF). The H-REFF will help to close a critical financing and skills gap in the renewable energy sector in Honduras by providing capital tailored to the needs of small-scale renewable energy entrepreneurs along with technical know-how and training to promote best practices in social and environmental risk management, job training for young people and women in the local communities and access to basic services for local communities. The H-REFF will be the first Honduras-focused investment fund for renewable energy and clean technology deployment.

III. PROPOSED PROGRAM

A. General Description

The intended impact of the project is to reduce greenhouse gas emissions, catalyze and promote investment and entrepreneurship in rural energy, and expand economic opportunities in rural areas. The intended results are that small-scale renewable energy project receive private sector financing, GHG emissions reduced, new green jobs created, and increased stalled capacity from non-conventional renewable sources.

The Honduran Renewable Energy Finance Facility (H-REFF) is a highly innovative financing mechanism that will help to close a critical financing and skills gap in the renewable energy sector in Honduras. The H-REFF will focus on renewable energy SMEs that use non-convention renewable energy technologies to deliver off-grid and grid-connected power generation to businesses and households, including small hydro (less than 15 MW), biomass, biogas, wind, and small-scale solar PV. The facility will also support highly innovative distributed generation and off-grid projects such as rooftop solar, solar water heaters, biogas, and energy efficiency.

SREP funding will enable the IDB to test innovative fund structure tailored to cash flows and financing needs of small-scale renewable energy projects in Honduras. SREP resources will be used as equity and up to USD 5M be used as catalytic first loss capital to mitigate risk perceptions of investors and enable the fund to target more innovative and smaller scale projects that would otherwise not be possible. The Facility will provide primarily mezzanine financing instruments[3]. In addition, the facility will combine investment capital with an innovative technical assistance window that will strengthen the capacity of renewable energy SMEs in social and environmental and facilitate employment opportunities, particularly for young people and women, in the local communities.

B. Investment Strategy

The primary investment focus of the facility will be small-scale renewable energy SMEs that are owned by local entrepreneurs who do not have sufficient funds and expertise of their own to take their projects forward. The facility will aim to build a portfolio in renewable energy projects that have contracted revenues through long-term Power Purchase Agreements. The remaining commitments may be used to invest in off-grid and energy efficiency projects that use renewable energy technology, such as roof top solar, solar water heaters and biogas. The Fund's investment strategy can be summarized as follows:

Technologies: The facility will invest in proven non-conventional grid-connected or self-supply renewable energy technologies, including small hydro (less than 15 MW), biomass, biogas, solar, wind, and waste-to-energy, as well as energy efficiency technologies (energy efficiency investments are expected to not exceed 10% of the Fund).

Sector focus: Given that the hydropower is the most abundant renewable energy resource in Honduras, most investment opportunities will be in small-scale grid-connected hydropower plants. Other technologies such as wind, small-scale solar, biomass, biogas and energy efficiency could represent a smaller portion of the total portfolio.

C. Expected Financing Plan (subject to individual investor approval)

Source of funds		**Fund Equity**		**Grant**	**Debt**	**Total**
		USD M	%	USD M	USD M	USD M
SREP IP resources	Through IDB/MIF	5	45.5%	0.95		5.95
SREP Set aside resources		15				15
MDB resources	IDB/MIF	4	9.0%			4
DFIs	DFI 1	3	45.5%			3
	DFI 2	10				10
Other private investors and DFIs		6.6				6.6
General Partner's contribution		0.4				0.4
Lenders (commercial banks and DFIs)					346	346
Total		**44**	100%	**0.95**	**346**	**390.95**

[3] Subordinated debt, convertible debt or other securities, preferred shares, golden shares, senior debt with revenue participation, or other performance-based instruments.

D. **Financial Instrument**

SREP funding will enable the IDB to test a highly innovative financing mechanism that will help to close a critical financing and skills gap in the renewable energy sector in Honduras. SREP resources will be used as equity to capitalize the Fund as a limited partner of which a portion of SREP resources will be structured as a first loss. The beneficiary of the Fund's investments will be Honduran renewable energy projects.

E. **Technical Assistance & Knowledge Management**

The objective of this component is to capitalize a Technical Assistance Support Fund to provide financing for:(i) pre-investment support services; (ii) capacity building in social and environmental management and community engagement; (iii) enhancement of employment opportunities and benefits for local communities; (iv) rating of the Facility under the Global Impact Investment Rating System (GIIRS); (v) knowledge management and dissemination; (vi) up to three rounds of independent evaluations and legal costs associated with the investment; and (vii) administration of the technical assistance component. This component will have the same execution period as the Facility.

Indicative TA Budget

Activity	**SREP Amount**
Activity 1: Pre-investment support services	$370,000
Activity 2: Capacity building in environment and social risk management	$165,000
Activity 3: Employment Opportunities and Community Benefits	$120,000
Activity 4: Knowledge and Dissemination	$80,000
Activity 5: GIIRS Rating	$30,000
Activity 6: Legal costs and 3 independent evaluations	$110,000
Activity 7: Technical Assistance Administration	$75,000
Total	$950,000

Pre-investment support services. As a means to strengthen the technical and business fundamentals and financial viability of potential investments, the Facility will partly cover the cost of technical and feasibility studies needed to achieve investable projects as well as other forms of assistance to portfolio companies, such as corporate governance and business development. If, as a result of performing such studies the project succeeds on obtaining investment capital from H-REFF, then costs would be included in the project's investment plan, so that technical assistance funds could be replenished back to the

Facility.

Capacity Building in Environmental and Social Risk Management. Designing and implementing a social and environmental risk management system has become crucial to ensuring that renewable energy projects – especially hydroelectric generation plants – can maintain community support and avoid opposition and even business interruption. The system should identify all social and environmental risks and, in agreement with the project sponsors, define mitigation measures, for which specific action plans and budgetary allocations should be created. The Facility will develop a series of training modules and workshops for local renewable energy enterprises and entrepreneurs on how to create an effective company-community renewable energy engagement plan, which can be implemented along with renewable energy investment. The training modules will take into account existing work on this topic, such as the community engagement for hydropower methodology guide developed by ARECA and the Hydropower Sustainability Assessment Protocol developed by the International Hydropower Association and build upon those to create actual presentation materials and guides. The trainings will include a methodology and guidance directives for bidirectional communication between developer and community, which allows for managing expectations and ensuring community understanding of the project (e.g., 'socialization'). In addition, the guidance directives will provide tools to enable the developer to receive useful inputs from the community and identify mutually beneficial opportunities for sharing project benefits and promote gender equality through the project cycle, taking into account IFC Performance Standards and IDB safeguards. In addition, the Facility will develop its own Environmental and Social Review guidelines compliant with IDB safeguards that will be applied to portfolio companies, as well as best practices in investment funds, such as corporate governance and other relevant topics.

Enhancing Employment Opportunities and Community Benefits. Renewable energy projects can provide well-paying temporary and permanent jobs to poor rural communities when provided with the proper skills and capacities. Renewable energy projects are mostly developed in rural areas where the local workforce does not have the core competencies to take advantage of formal work opportunities. Prior to the start of construction, the Facility's investee projects will organize workshops in the neighboring communities to inform the local population of the available opportunities, products and services required for the project at every stage (lodging, food, transport services, reforestation, cleaning of rights of way, cleaning camp, garbage collection, etc.). In addition, the project will also aim to enhance community benefits sharing schemes on the project level and become a reference point for developers in establishing an effective social license to operate. At the beginning each project, the Facility will conduct a baseline assessment of the principal abilities of the local population shall be performed to contrast it with the monitoring of the abilities and diversification of labor after the establishment of the renewable energy projects.

Global Impact Investing Rating System (GIIRS). The Facility will be rated under the GIIRS rating system. GIIRS Ratings are the gold standard for impact measurement in impact investing. GIIRS is a comprehensive and transparent system for assessing the social and environmental impact of developed and emerging market companies and investment funds with a ratings and analytics approach analogous to Morningstar investment rankings. GIIRS Ratings are rigorous, comprehensive, and comparable ratings of a company or a fund's social and environmental impact. It seeks to spark the impact investment industry by providing a tool that is intended to change investor behavior and unlock sidelined investment capital

through comparable and verified social and environmental performance data on high impact funds and companies seeking investment capital.

Knowledge and Strategic Communications Objective. The main knowledge gap that project will contribute to is on understanding what are the most effective financing models are for renewable energy SMEs. The knowledge objective is to systematize, document, and disseminate the experiences and lessons generated within the Facility in order to raise awareness about and encourage the replication of renewable energy investment in Honduras and the LAC region.

- Signal to other private investors that successful investments in renewable energy are viable in Honduras and
- Raise awareness, compare, and encourage the replication of mezzanine investment models for renewable energy SMEs in Honduras and the LAC region.

The main audiences will be investors, MDBs, and SMEs interested in replicating this model. To this end, a Project Fact Sheet will be developed containing key results from the project as well as main lessons learned, a How-to-guide explaining the model of the training for developers, a Thematic study on a mezzanine finance facility for renewable SMEs in low income countries, an infographic and participation in events to share the model and lessons learned.

F. **Monitoring and Evaluation (M&E) Strategy**

Baseline: The Management Team will capture the necessary data to monitor and evaluate performance and development impact of the companies. This data will come primarily from the companies' investment memorandums presented in the Investment Committees, and may be complemented by interviews and additional data requests when needed. Other relevant baseline data that cannot be provided through the aforementioned means could be obtained through the GIIRS rating process, which we encourage for all our invested Funds.

Monitoring mechanisms: The Facility will be responsible for setting up a monitoring mechanism and report to the MIF through the Annual Fund Supervision Report (AFSR) platform. As is characteristic in investment funds, the H-REFF is expected to apply a data-driven and hands-on supervision model in each of the portfolio investments. As a result, the Facility will prepare investor reports on the state of the portfolio on a quarterly basis and provide audited financial statements on an annual basis. The MIF will conduct monitoring through participation in the different Facility's committees, supervision missions, and the preparation of AFSR. In addition, when appropriate, the MIF will leverage the local and sector expertise available through the IDB country office. The Technical Advisor, Pedra Clau, will play an important role in monitoring portfolio companies. The Fund Management team will be subject to periodic external evaluations on overall Facility development objectives, adherence to investment guidelines and objectives, and effectiveness of fund management.

Evaluations: The project will be subject to up to three independent evaluations throughout the Facility's life. Key evaluation questions include: i) what is the appropriate financing instrument for renewable energy? ii) What is the impact and benefit of a facility with a longer lifespan in the renewable energy sector; iii) What is the impact of SREP resources on market transformation?

M&E Resources: The monitoring and evaluation will be carried out by the Management Team and MIF. The Management Team will do most of the monitoring as part of its daily activities. The TA will also finance key components of the monitoring such as the GIIRS rating process and will also finance the evaluations (as detailed in TA Budget).

IV. PROGRAM'S STRATEGY FOR ACHIEVING MARKET TRANSFORMATION

The project's strategy to promote market transformation and systemic change is based on: (a) the demonstration effect it expects to provide by supporting the first Honduras-focused mezzanine finance facility that will advance a critical portfolio of RE technologies and projects. By sharing knowledge and helping to reduce initial project development barriers (high due diligence and legal costs), the project will catalyze project development and access to financing for these projects, establishing a track record of their technical and financial performance. Such demonstration is expected to reduce risk perception associated with these technologies and financing models, thus enhancing access to financing and further replication in the future. (b) The building capacities among the stakeholders in the renewable energy sector to identify, evaluate, develop and finance these projects as well as engage with local communities and implement environmental impact mitigation strategies. In addition, the project will seek to build the capacities of local management team, which will be Honduras' first management team focused on small-scale renewable energy development. To support the market transformation objective of the program, the IDB will profile the lessons learned through the projects supported by disseminating case studies, as part of the Knowledge Management component.

V. CONSISTENCY WITH SREP INVESTMENT CRITERIA

A. Increased Installed Capacity from Renewable Energy Sources

It is expected that the H-REFF will directly support approximately 153 MW of power generation capacity. The exact figure will vary according to the portfolio of projects that the fund invests in. In addition, the demonstration effect is expected to help catalyze further private sector renewable investment and development.

B. Low Emission Development

The project will support projects expected to reduce GHG emissions by an estimated 5.7 million tCO_2e over the life of the fund and its investments[4]. The IDB will document the GHG reductions and other environmental benefits such as waste reduction. Other co-benefits that will be at significant scale to be documentable include increasing energy security, reducing fossil fuel imports, building local capacities of local renewable energy entrepreneurs, transferring best practices in social and environmental risk management, creating new employment opportunities in rural areas and social and economic benefits to local communities.

C. Affordability and Competitiveness of Renewable Sources

H-REFF would be investing in RE projects with competitive electricity generation costs that contribute to the IDB goals of the long-term financial sustainability of ENEE and the energy sector. The cost of generation takes into account the cost per installed MW and the actual electricity generation of the project (as determined by the project's plant factor). H-REFF shall only invest in financially viable and sustainable energy enterprises, which must show competitive generation costs in order to be eligible for financing. The grid-connected projects in the existing pipeline have PPAs at around US USD 0.11-

[4] GHG emissions reductions over 20 years assuming an installed capacity of 45 MW from small hydros, 100 MW from solar PV & Wind and 8 MW from distributed generation, capacity factors of 50% for small hydros, 25% for a mix of solar PV & Wind and 15% for distributed generation, and a combined margin grid emissions factor of 0.67 tCO_2e /MWh for Honduras based on Clean Development Mechanism estimates.

0.12/kWh. Based on substantial experience in Honduras, the RE sector has shown its ability to generate at competitive costs and substantially lower than those projects of generating with fossil fuels.

Self-Supply projects using RE in Honduras are an attractive option for potential clients as prices are high for commercial and industrial consumers (around 18 to 25 USD cents per kWh). Off-grid projects using RE also provide an economic opportunity particularly when competing with diesel. For example in Útila (the third largest of Honduras' Bay Islands) the sole electric distribution company UPCO has been selling electricity to residential customers at a rate of USD 0.46/kWh (HNL 9.35/kWh). UPCO's all-in cost of generation with diesel is around USD 0.34/kWh.

D. **Productive use of energy**

Approximately 60% of the electricity demanded in Honduras is for productive uses, whereas 40% is for residential consumption. Grid-connected projects financed should be selling electricity for productive uses in a similar percentage. On the other hand, off-grid and self-supply projects to be financed could have a higher percentage for productive uses because there is potentially a linkage to support productive activities in the rural area as well in the industrial sector.

E. **Economic, Social and Environmental Development Impact**

The fund will have important economic, social and environmental impacts. First, energy costs in Honduras are some of the highest in Latin America, partially due to the reliance on expensive fossil fuel imports. This in turn has major impacts on local business and entrepreneurs, which are the engine for economic growth and job creation. Second, the fund will develop energy projects predominantly on the periphery of the electricity grid, where local communities have high rates of poverty and unemployment and limited access to basic services, such as healthcare, electricity and sanitation services. The fund will support new employment opportunity –especially for young people and women- for local communities in rural areas directly related to the projects, as well as the broader economic spillover. In addition, it is expected the investments of the fund will also enable many rural communities to gain access to electricity that would otherwise not exist, and also to participate in benefit sharing schemes with the projects. The fund will use technical assistance resources to enhance opportunities for women and young people related to the fund investments. Finally, the fund, by investing renewable energy, will have important benefits for the environment in terms of reducing greenhouse gas emissions as well as providing training and knowledge transfer to local developers on best practices in environmental and social risk management in renewable energy projects.

F. **Economic and Financial Viability**

Structured similarly to a venture capital fund, the H-REFF facility would have a cost-effective project identification, analysis, investment and asset management process. The facility shall appoint a professional management team that should attract pipeline projects in an expedite manner.

Funds by definition have a pre-determined life after which all their operations have to wind-up by selling all the portfolio companies at attractive prices in order to return capital plus a profit to the limited partners (LPs). Thus, sustainability for a fund refers to the fund's capability to maintain operations throughout its investment and divestment period, and this, in turn depends on the expertise and capabilities of the fund's management team (general partner and others), level of capitalization, and efficient use of human and financial resources, among others. To ensure that the Fund is sustainable during the investment and divestment periods, it has to manage the capital needed to implement its strategy. Funds that cannot sustain activities over the entire operational period are at risk for failing to achieve both development and financial return objectives.

In H-REFF, the Fund possesses key attributes which maximize the likelihood that it will be able to operate successfully, raise funds, invest in the target firms, and divest. First, the Fund will commence operations at a time when the Honduras energy sector is undertaking a broader set of reforms of ENEE for a more sustainable sector; Second, a highly qualified management team made up of Central American nationals with more than 20 years' track record in renewable energy finance in Honduras and more than 50 years of combined direct project development/construction experience in Honduras will manage the facility. Third, the management team has substantial experience in dealing with best practices in social and environmental risk management and technical assistance funds to support and train project developers in proper project socialization with communities and environmental risk management. Fourth, the General Partner has already raised two funds for clean energy investment in Central America and has solid network to support pipeline and co-investment.

G. **Leveraging of Additional Resources**

SREP resources will have an important catalytic effect in mobilizing additional resources for the renewable energy sector. First, on the fund level, SREP resources will capitalize the first-ever Honduras focused renewable energy investment fund and mobilize at least USD 24 million in equity co-investment in the fund from the IDB, other DFIs and private investors that would not occur without SREP participation. Second, the fund will provide a financial product to the market that will enable currently unbankable projects to move forward, thereby leveraging up to USD 346 million in debt financing from commercial banks that would not have been possible. This means that the leverage ratio of SREP funds is approximately 18:1 if we take into account debt plus equity mobilized. Finally, the fund itself will have an important catalytic effect for the market that will likely have a long-standing, transformation impact on the local financial markets for expanding the availability of this type of financing.

H. **Co-benefits of Renewable Energy Scale-up**

This Program has a significant number of potential development co-benefits. Many of these are expected to have immediate direct impact and all are expected to become significant as the demonstration effect of the Program impacts in a scale larger than that of the directly supported investments. Expected co-benefits are:

- *Employment.* Creation of well-paying permanent and temporary jobs for young people and women in, poor rural areas
- *Energy security*. Development of renewable energy projects that sell at affordable prices that will diversify the energy generation mix, reduce depending on expensive fossil fuels, and contribute to economic growth and competiveness of the Honduran economy and local business sector.
- *Reduced energy costs*. The fund will target off-grid and self-supply projects that use renewable energy technologies that are also energy efficiency project that can reduce energy costs for businesses and households.
- *Community co-benefits.* The fund will invest in projects that create new jobs, access to basic services, and other co-benefits for local communities in some of the poorest areas of Honduras.
- *Creation of local capacity.* The fund will provide financing and know-how to family-owned, small enterprises, which will enable them to participate in the renewable energy market for the first time. Part of the value-added of the fund will be to provide support to this new wave of entrepreneurs in environmental and social management, corporate governance, business development and enterprise management. In addition, the fund will include a local management team, which will in turn create new local capacities for investment fund management in Honduras and Central America, thereby contributing to local financial market development.
- *Environment.* The promotion of renewable energy in Honduras will displace fossil fuels therefore reducing GHG emissions and improving air quality.

I. Stakeholder Consultations

As part of the development of the project a consulting firm was hired to develop the project in coordination with the Government of Honduras. As part of this effort two workshops were held with representatives of the Ministry of Finance (SEFIN), the Regulatory Energy Commission (now the Regulatory Electricity Commission, CREE), project developers, representatives from the Honduran Association of Renewable Energy Producers (AHPER), representatives from the banking sector, technical and engineering firms, the Ministry of Energy and Environment (SERNA) and the ENEE (state-owned utility). In addition, several additional missions were carried out to have to have technical meetings with representatives of the new focal point the Ministry of Infrastructure and Public Services (INSEP), CREE, SEFIN, SERNA and ENEE.

J. Gender

Several activities will be carried out as part of the technical cooperation component of the project to foster employment opportunities for women. The project will have specific targets to measure the number of women trained as part of these activities and the number of women that are employed as a result of the investments. The project will also measure the number of projects in which gender considerations are incorporated.

K. Implementation Potential

This Program will be implemented immediately upon its approval by the SREP Trust Fund Sub-Committee and the IDB Board. The Fund already secured enough co-investment from other investors for the Fund to begin operations. These other investors will be presenting to their respective approval committees at the same time as the IDB. There is a strong pipeline of potential investments already in place, which are technically sound and will be able to move forward with access to appropriated financing that a facility will provide and which is currently not available in the market. This will enable a swift transition from approval to the implementation phase, with up to five investments by the fund in the first year of operations.

L. Effective Utilization of Concessional Finance

SREP resources will be used to capitalize the first Honduras-focused investment fund in clean energy as well as the first Honduras-only fund supported by IDB. For this reason, SREP investment participation is critical for the IDB and other investor participation in the capitalization of the fund, which will in turn provide an important demonstration effect to the market and mobilize financing from local banks.

The fund will invest at market rates and provide a financial product that currently does not exist in the market due to risk perceptions of investors, maturity of the sector and the local financial markets. A small part of the SREP resources will structured as a first loss on portfolio investment write offs, which will enable the fund to attract co-investment, provide incentives for the fund to finance more, innovative higher risk deals with less experienced sponsor or business models, and help to mitigate perceptions of technical and economic performance risks, commercial and financial risks, country and political risks, and regulatory and institutional risks for the first Honduras-focused fund in this sector.

M. Mitigation of Market Distortions

Currently there is very limited access to equity and quasi-equity financing for renewable energy in the Honduran market. This is particular problem for smaller scale projects that technically sound but are owned by less experienced small developers that do not have sufficient funds of their own to bring their to the local banks. The local commercial banking sector already offer debt financing to service the debt requirements of projects, usually for up to 70% of the total construction costs, which few small developers can comply with. Therefore, the fund will provide a differentiated financial project that will not compete or distort the market and mobilize financing from the local commercial banking sector. Incentives have been aligned in the fund for the fund to invest at as close to market rates as possible, so as to provide an important demonstration effector for the market and crowed-in, not crowd-out, other actors.

N. Performance Indicators

Key Performance Indicator		Baseline	Target
GHG emission reductions	Lifetime (cumulative, million tCO_2e)	0	5.7
Electricity production	New RE capacity (MW installed)	0	153
	Additional Power Generation (MWh/year)[5]	0	426,612
Number of RE technologies/applications demonstrated		0	5
Number of SMEs benefited		0	22
Number of jobs created (temporary and permanent)		0	2,500

[5] GHG emissions reductions over 20 years assuming an installed capacity of 45 MW from small hydros, 100 MW from solar PV & Wind and 8 MW from distributed generation, capacity factors of 50% for small hydros, 25% for a mix of solar PV & Wind and 15% for distributed generation, and a combined margin grid emissions factor of 0.67 tCO_2e /MWh for Honduras based on Clean Development Mechanism estimates.

VI. ANNEX I – ADDITIONAL INFORMATION AVAILABLE UPON REQUEST

Documents
Draft Version of Donors Memorandum

VII. ANNEX II - ESTIMATED IMPLEMENTATION AND SUPERVISION COSTS OF INVESTMENT OPERATIONS

MDB Request for Payment for Project Implementation Services (MPIS) - SREP Set-aside

SCALING UP RENEWABLE ENERGY PROGRAM IN LOW-INCOME COUNTRIES **MDB Request for Payment of Implementation Services Costs**			
1. **Country/Region**:	Honduras	2. **CIF Project ID#**:	
3. **Project Title:**	Strengthening of the ADERC H-REFF in Honduras		
4. **Request for project funding (USD million):**	*At time of country program submission (tentative):* *US$15 million*	*At time of project approval:* *US$15 million*	
5. **Estimated costs for MDB project implementation services (USD million):**	*Initial estimate - at time of Country program submission:* US$422,000 *Final estimate - at time of project approval:* US$637,500	*MDB:IDB* *Date:* July 20, 2015	
6. **Request for payment of MDB Implementation Services Costs (USD million):**	☐First tranche: US$211,000 X Second tranche: US$426,500		
7. **Project/program financing category:**	a - Investment financing - additional to ongoing MDB project ☐ b - Investment financing - blended with proposed MDB project X c - Investment financing - stand-alone ☐ d - Capacity building - stand alone ☐		
8. **Expected project duration** (no. of years):	13		
9. **Explanation of final estimate of MDB costs for implementation services:**	***If final estimate in 5 above exceeds the relevant benchmark range, explain the exceptional circumstances and reasons:*** The project has double the expected duration of the benchmark. In addition, it will involve multiple small investments that will require the supervision of a part time staff for the lifetime of the project.		
10. **Justification for proposed stand-alone financing in cases of above 7 c or d: N/A**			

MDB Request for Payment for Project Implementation Services (MPIS) - Investment Plan

SCALING UP RENEWABLE ENERGY PROGRAM IN LOW-INCOME COUNTRIES **MDB Request for Payment of Implementation Services Costs**			
1. **Country/Region**:	Honduras	2. **CIF Project ID#**:	PSREHN008A and XSREHN006A
3. **Project Title:**	"Program D": Component 2-ADERC and Component 3- ERUS (IDB Private Sector)		
4. **Request for project funding (USD million):**	*At time of country program submission (tentative):*US$ 7.975 million	*At time of project approval:* US$ 8.9 million (2.95+5.95)	
5. **Estimated costs for MDB project implementation services (USD million):**	*Initial estimate - at time of Country program submission: US$442,000* *Final estimate - at time of project approval:* US$462,500	*MDB:IDB* *Date:* July 20, 2015	
6. **Request for payment of MDB Implementation Services Costs (USD million):**	☐First tranche: US$221,000 X Second tranche: US$241,500		
7. **Project/program financing category:**	a - Investment financing - additional to ongoing MDB project X b - Investment financing - blended with proposed MDB project ☐ c - Investment financing - stand-alone ☐ d - Capacity building - stand alone ☐		
8. **Expected project duration** (no. of years):	6.5 and 13		
9. **Explanation of final estimate of MDB costs for implementation services:**	***If final estimate in 5 above exceeds the relevant benchmark range, explain the exceptional circumstances and reasons:*** The proposed MPIS are for two small projects instead of one. In addition one of them has a longer duration than in the benchmark (13 years).		
10. **Justification for proposed stand-alone financing in cases of above 7 c or d: N/A**			