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What's Holding Back Clean Energy Lending in Central America?

Inter-American Dialogue's Latin American Energy Advisor

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The Washington-based Inter- American Development Bank earlier this year announced the approval of a $30 million medium- term financing facility for a Honduran bank to support loans to environmentally sustainable projects. The bank is developing a portfolio of loans to small- and medium-sized businesses in biofuels and other sustainable sectors. How important is lending to small- and medium-sized energy companies for their success? What challenges do banks face in Central America, in terms of regulatory measures or political uncertainty, as they seek to tap the SME market and emerging-industry businesses like those in the clean energy sector?

A: Avril Benchimol, climate change specialist at the Multilateral Investment Fund of the Inter-American Development Bank:

"In 2010, Latin America and the Caribbean saw the largest absolute increase in renewable energy investment among the regions of the developing world: new investment jumped 39 percent to $13.1 billion. This increase in investment flows was largely a response to regulatory changes in favor of clean energies in the region. However, at the SME level, three main obstacles have limited clean energy development: lack of long term repayment mechanisms from major SME finance providers, little awareness of the existence and benefits of these clean technologies and financial regulations instability in certain Central American countries. Renewable energy financing usually requires longer repayment terms and new credit methodologies to structure green investment. For example, credit methodologies for loans on energy efficiency should incorporate flows of energy savings into the loan payment mechanisms. Although SME financial providers have expressed their interest in developing green finance, they are also requiring assistance and long-term financing to initially be able to finance longer maturities. In countries like El Salvador and Nicaragua, financial regulations are also a main stumbling block for green finance. In El Salvador, the government is currently discussing new laws that might impose interest rate ceilings on the loans of microfinance institutions (MFIs). If MFIs do not have the flexibility to structure green finance products due to interest rate caps, they may abandon their interest in financing green initiatives. Regulations in favor of clean energies are a first necessary step to promote and develop the clean energy sector at the SME level. However, continued and reliable access to green finance is also crucial to develop clean energy markets in Central America."

A: Carlos Imendia, economic consultant based in San Francisco:

"It's a win-win initiative for Honduras. The country's banks are slowly improving, but are still beaten by arrears and need to diversify their portfolios, which are highly concentrated in consumption via credit cards and personal loans and in a handful of large corporations. Also, SMEs are starving for medium- and long-term financing to enhance capacity and amid ripe new opportunities in sectors such as energy. Honduras has huge potential for expanding clean energy production without competing with food demands, not only from solar, hydro or eolic sources, but also from jatropha, corozo and higuerillo. Natural resources and people eager to exploit them abound, but rules and regulations in the sector are in short supply. There is also a lack of public policies to enhance the business environment in those fields, so risks can be magnified or perceived as such. This situation can end up in banks demanding high interest rates and blowing away the chance for the small entrepreneurs to exploit benefits. The other risk is lending to small and medium-sized companies which are only undercover branches of big and established business in the energy sector, both clean and dirty. It would be wise if the Inter-American Development Bank flexes its muscle and knowledge capacity and goes beyond a simple second-tier financing facility with a commercial bank and deepens the social inclusion and sustainable development dimensions behind the new SME portfolio of Atlántida by promoting inclusive business among enterprises and low-income producers in the rural areas."

A: Mario Arana, director of the Nicaraguan Foundation for Economic and Social Development and president of Polaris Energy Nicaragua:

"Medium- to long-term financing for investment projects is urgently needed for the development of clean energy projects of smalland medium-sized enterprises for various reasons. On the one hand, the structure of the region's bank deposits is very short term, which makes it difficult for banks to lend at longer terms than their deposit bases allow in order for them to maintain adequate reserves. It is no coincidence that bank loans are concentrated in consumer and personal credit loans. On the other hand, even with a better deposit structure, bank supervision measures can represent a difficulty for the financing of new projects. Being new projects, it is difficult to find financing for renewable energy projects if what is required is that they have some history and audited financial statements for at least three years with collateral requirements beyond the projects themselves, especially in a context of political uncertainty. In turn, the region continues to show a deficiency in the development of capital markets. The business of the regional exchanges are concentrated in sovereign securities, not corporate ones. Medium-term funds such as those granted by the Inter-American Development Bank fill a gap and improve the possibilities for more vigorous development of capital markets and renewable energy investment projects."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*