

Supporting Energy Efficiency in Vietnam

Designing the Financial Structure of an Energy Efficiency Credit Line

OVERVIEW

Vietnam is one of the most energy intensive countries in East Asia. Only a few local financial institutions in the country have dedicated energy efficiency lending business lines. As a result, many companies are discouraged from participating in energy savings opportunities. The World Bank Treasury designed the financial structure of a US\$100 million credit line to Vietnam to help local financial institutions set up energy efficiency lending as a business line.

Background

Lack of access to financing is a significant barrier to energy efficiency investments in developing countries. The World Bank makes credit lines available to local banks and other financial institutions to offset costs incurred in establishing new energy efficiency lending business lines. Typically, the credit line is extended to the financial institution as a low interest rate loan via the national government. The financial institution then on-lends the funds to borrowers (industries and other private entities) to invest in energy efficiency projects.

Financing Objective

The Vietnam Energy Efficiency for Industrial Enterprises project aims to improve energy



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efficiency in the industrial sector by improving access to financing from local financial institutions. The World Bank approved a credit line in the form of an IBRD loan of US\$100 million to support the project. The funds would be on-lent by ministry of finance to pre-selected financial institutions, who would in turn lend the funds to industrial enterprises for energy efficiency investment sub-projects.

Appropriate financing terms are key to such credit lines. The World Bank typically requires that the financial institutions on-lend to the end-borrower at market rates to avoid creating market distortions and competitive advantages. But interest rates also have to be attractive enough to encourage and motivate industrial enterprises to undertake the necessary investments.

Financial Solutions

IBRD loan terms are fully flexible, offering a variety of maturities up to 35 years. Treasury Bankers work with borrowers to identify suitable loan terms.

Several options were considered for the project:

Option 1: The government could borrow from IBRD at 35 years and on-lend to the financial institutions at 10 years. The advantage of this option was that the government could pay for the primary loan over a long time.

Option 2: The government could exactly match the credit line (IBRD loan) terms with on-lending terms. Given that the average payback period of energy efficiency projects in Vietnam is five years, the government would borrow from IBRD at 5 years and on-lend to the financial institutions at 5 years; or the government would borrow from IBRD at 10 years and on-lend to the financial institutions at 10 years, allowing them to roll over (recycle) the funds to support several projects.

Option 3: The government could fully customize IBRD loan terms for each participating financial institution at source and fully meet their needs. The government would sign separate loan agreements under one US\$100 million loan package with IBRD. The maturity and amortization schedule for each loan in the package would be set according to the preference of each participating financial institution. For example, Loan 1: US\$50 million with final maturity of 10 years including grace period of five years. Loan 2: US\$50 million with final maturity of 5 years including grace period of two years.

The Treasury Banker worked with the project team, ministry of finance, and participating financial institutions to help them understand the options available and select the best option for project and debt management needs.

Outcome

The Ministry of Finance and the financial institutions jointly selected Option 2 for the following

reasons: 1) due to domestic regulation (decree 78 issued in 2010 regarding on-lending of the government of Vietnam's foreign loans), the government can only on-lend foreign, commercial and concessional loans (including IBRD) at the same terms as the primary loan; 2) the IBRD loan has maturity-based pricing, i.e., the lower the maturity the lower the interest rate. Fully matching the terms of the primary loan and the on-lent loan would allow the government and the participating financial institutions to take advantage of lower pricing for shorter maturity IBRD loans and keep the cost to the end-borrower as low as possible. This would encourage them to undertake energy efficient investments that would contribute to the government's energy investment plans; 3) matching financing terms with the needs of the end-borrower (payback period of the energy efficiency projects) help the government avoid tying up Vietnam's credit exposure with IBRD beyond project needs, thereby using IBRD resources more efficiently; and 4) finally, fully matching the repayment terms of the primary loan with on-lending terms helps minimize the government's risk.

The IBRD loan offers the borrower the option to start the repayment of the loan at commitment ("commitment-linked loan") or at disbursement ("disbursement-linked loan"). For the first time, the government of Vietnam selected disbursement-linked repayment terms, which gives the participating financial institutions additional time to identify suitable clients before the start of the repayment period. This was Vietnam's first fully customized IBRD loan. The Treasury team is now exploring local currency financing options that would add further value to the end-borrower.

Designing the financial structure of energy efficiency credit lines is one of the many ways the World Bank helps member countries become more resilient to economic shocks. IBRD's AAA credit rating, market presence, and convening power enables the World Bank Treasury Financial Products team to develop innovative new products to help clients maximize financing and mitigate risk.