

## CASE STUDY

# 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. But few Vietnamese companies seek to participate in energy-saving or renewable energy projects, in part because only a few financial institutions in the country have dedicated business lines to promote such investments. To improve this situation, the World Bank Treasury designed the financial structure of a US\$100 million credit line that helps Vietnamese 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. To minimize this barrier, the World Bank offers local banks and other financial institutions credit lines to offset costs incurred in establishing new business lines for energy efficiency lending. Typically, the credit line is extended to the financial institution as a low-interest loan via the national government. The financial institution then on-lends the funds to borrowers (industries and other private entities) for investments in energy efficiency projects.

### Financing Objective

The Vietnam Energy Efficiency for Industrial Enterprises project aims to improve energy efficiency in the industrial sector by improving access to financing from local financial institutions. In April 2017, the World Bank approved a credit



Supporting Vietnam in their quest become more energy efficient Photo credit: Thinkstock.

line in the form of an IBRD loan of US\$100 million to support the project. The Ministry of Finance will on-lend the funds to pre-selected financial institutions, which will in turn lend the funds to industrial enterprises for energy efficiency investment subprojects.

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

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

loan terms. For the Vietnam energy efficiency project, several options were considered:

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

**Option 2.** The government would exactly match the terms of the credit line (IBRD loan) with the on-lending terms. Given that the average payback period for energy efficiency projects in Vietnam is five years, the government would borrow from IBRD at five years and on-lend to the financial institutions at five 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 would fully customize IBRD loan terms for each participating financial institution at source and fully meet its 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 would be US\$50 million with a final maturity of 10 years, including a grace period of five years; and Loan 2 would be US\$50 million with a final maturity of five years, including a grace period of two years.

The Treasury banker worked with the project team, the Ministry of Finance, and participating financial institutions to help them understand the options available and select the best option for project and debt management purposes.

## Outcome

The Ministry of Finance and the financial institutions jointly selected Option 2, for several reasons: First, under domestic regulation (Decree 78 of 2010 regarding on-lending of the government's foreign loans), the government can on-lend foreign, commercial, and concessional loans (including IBRD loans) only at the same terms as the primary loan. Second, the IBRD loan

has maturity-based pricing—i.e., the lower the maturity, the lower the interest rate. Thus fully matching the terms of the primary loan and the on-lent loan offers the government and participating financial institutions lower pricing for shorter-maturity IBRD loans. It also keeps the cost to the end-borrowers as low as possible, which encourages them to undertake energy efficiency investments that contribute to the government's energy investment plans. Third, by matching financing terms with the needs of the end-borrower (concerning the payback period for the energy efficiency projects), the government avoids tying up Vietnam's credit exposure with IBRD beyond project needs and thus uses IBRD resources more efficiently. 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 of starting to repay the loan at commitment or at disbursement. 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 for 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 enable the World Bank Treasury Financial Products team to develop innovative new products that help clients maximize financing and mitigate risk.