

**INTER-AMERICAN DEVELOPMENT BANK**



**MEXICO**

**BALAM FUND I, L.P.**

**(ME-L1136)**

**ENVIRONMENTAL AND SOCIAL MANAGEMENT REPORT  
(ESMR)**

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## *I. INTRODUCTION*

- 1.1. The project consists of a senior loan granted by the Inter-American Development Bank (“IDB”) for up to US\$50 million (the “Project”) to Balam Fund I, L.P. (the “Fund”) for the support of the environment by investing in small- to medium sized environmental infrastructure projects in the renewable energy (including solar, wind, geothermal, biomass, hydro, etc.) and energy efficiency (including industries, energy, water, urban transport, buildings and communities, etc.) sectors in Mexico. These investments are intended to cover the financing gap that the renewable energy and energy efficiency project sponsors face. The IDB participation in the Fund will increase the Fund’s investment capacity.

## *II. OPERATION DESCRIPTION*

- 2.1. The Fund is expected to be structured as follows:
  - a. A Canadian entity expected to be supported by FONADIN, a public infrastructure fund, development banks and private investors, with total capital commitments expected to be sought of approximately US\$200 million. Included in such amount is the proposed US\$50 million senior loan from the IDB, as well as capital commitments by TRG and BK (each defined below) in an aggregate amount of US\$10 million.
  - b. A Mexican special purpose vehicle or fideicomiso (the “Trust”) is expected to issue the equivalent of US\$200 million in certificados bursátiles fiduciarios de capital de desarrollo (“CKDs” or “Certificates”) in the Mexican capital markets as a parallel fund.
- 2.2. The objective of the Fund is to make investments in small- to medium-sized projects in the renewable energy, clean tech and energy efficiency investment market in Mexico through the acquisition of equity as well as senior or subordinated debt. The objective of the Fund is to make investments in those small- to medium-sized projects which currently are not being financed due to the relatively new and emerging nature of the renewable energy and energy efficiency investment market in Mexico, scarcity of private commercial funding and limited investor appetite for these investments due to their size, perceived technology and/or demand risks. The Fund is expected to invest in proven technologies both in new projects (greenfield) and in operating projects (brownfield) in those sectors.
- 2.3. The projects will be located in Mexico, will comply with all applicable laws and regulations . The Fund’s renewable energy investments will indirectly contribute to the reduction of carbon dioxide (CO<sub>2</sub>) emissions.
- 2.4. Likewise, the Fund will conduct their projects in line with Multilateral Financial

Institutions social and environmental practices. The target investment opportunities will comply with an Environmental and Social Management System (ESMS) to be implemented and as agreed with the IDB.

- 2.5. FONADIN managed a selection process for the identification of an entity to sponsor and manage the Fund, resulting in the selection of TRG Management LP (including its affiliates, “TRG” or “Fund Manager”) and BK Renewables Ltd. (including its affiliates, “BK”). TRG is an asset management firm focused on investing in emerging markets. BK is an investment advisory and private equity group currently focused on the sectors of land development, building materials, renewable energy and finance. Balam Fund I GP, L.P., was formed by TRG and BK to serve as general partner of the Fund (“General Partner”). TRG will serve as the manager of the Fund, and will have a sub-advisory agreement with BK. Additionally, the Fund will partner with Vector Cuatro, an experienced provider of specialized technical and financial advisory services in the renewable energy sector based in Spain.

### *III. PROJECT STATUS AND COMPLIANCE*

- 3.1. Due to the nature of the proposed facility, this operation is classified as a financial intermediation operation as per the requirements of Directive B.13 of the IDB Environment and Safeguards Compliance Policy (OP-703). The potential investments of the Fund will be exclusively Category B and C projects, and subject to a Fund-led environmental and social review to confirm eligibility and compliance with IDB policies, including environmental and social policies.<sup>1</sup> The Fund Manager will be responsible for implementing an ESMS satisfactory to the IDB and other MFIs, a template for the design of which will be provided by the IDB. The assessment of project eligibility will be performed by the Fund Manager, and as needed independent environmental and social consultants will be used by the Fund to assess environmental and social risks/impacts associated with the project, compliance with the IDB policies and any potential gaps that might require an Environmental and Social Action Plan. The environmental and social information gathered for the first three projects will be reviewed by IDB to assess implementation and operation of the ESMS and recommend any adjustments needed to comply with the respective policies.

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<sup>1</sup> For the Fund, the Fund Manager will conduct a review of the proposed project to determine 1) basic eligibility with respect to the IDB exclusion list, 2) environmental classification of the project with respect to the B.3 Directive of the Environment and Safeguards Compliance Policy (OP-703), and 3) project compliance with all relevant laws, regulations and IDB Policies including Directives B.2 through B.12 of OP-703, Disaster Risk Management Policy (OP-704), Involuntary Resettlement Policy (OP-710), Gender Equality Policy (OP-761), Indigenous Peoples Policy (OP-765), and the Access to Information Policy (OP-102).

#### *IV. ENVIRONMENTAL AND SOCIAL RISKS AND IMPACTS*

- 4.1. The key potential environmental and social impacts and risks will be related to the Fund's investments in renewable power generation projects and natural gas fired cogeneration projects, expected to represent 60-80% of the commitments of the Fund. Unless otherwise determined by the General Partner after consultation with the applicable committee, the Fund will not invest more than (i) 25% of the total commitments in particular developer or energy supply company, (ii) 25% of the total commitments to any particular portfolio company, and (iii) 40% of aggregate commitments to any particular technology platform or solution carried out by a portfolio company.
- 4.2. The envisioned power generation projects are expected to include small- to medium-sized hydro<sup>2</sup>, wind power, biomass, natural gas fired cogeneration and solar-photovoltaic. Clean tech and energy efficiency projects are expected to include co-generation, energy service companies (ESCOs), public lighting and retrofitting buildings, among others. The financing of capital expenditures for power generation projects could result in moderate to significant environmental and social impacts based on the specific characteristics, location and the social context of the individual project. These impacts can include, among others, i) land degradation and conversion (flooding, access roads, transmission lines) and impacts on water bodies; ii) community impacts (land acquisition, tenure, physical resettlement, population influx); iii) cumulative impacts associated with multiple hydro dams or diversions and other projects using the same watershed; iv) biodiversity impacts associated with both construction and operation (dams, wind power); v) worker and community health and safety impacts and risks during construction and operation phases; vi) labor related issues. The potential environmental and social impacts and risks will be assessed by the Fund Manager following a project review procedure to be set forth in the ESMS that occurs prior to financing. The key outcomes of the assessments will be disclosed to the investment committee for review and to confirm compliance with IDB policies and standards. Per the investment conditions of the Japan Bank for International Cooperation (JBIC) and the loan conditions of IDB, Category A projects will be excluded from financing and the ESMS will include classification guidance to ensure that projects are properly categorized.

#### *V. MANAGEMENT OF ENVIRONMENTAL, SOCIAL, HEALTH AND SAFETY AND LABOR IMPACTS AND RISKS*

- 5.1. On approval and constitution of the Fund, and prior to making any investments, the Fund Manager will be required to develop and implement an environmental and social management system (ESMS) agreed upon with the IDB that will detail environmental, social, labor, health and safety policies and procedures to properly

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<sup>2</sup> Defined as less than 30 MW of power output and not involving the construction of large dams as defined by the World Commission on Dams.

identify, assess, categorize, mitigate and monitor the potential environmental and social impacts and risks associated with each Fund investment.

- 5.2. The ESMS will include a policy statement and other provisions that set forth:
  - a. policies and standards of performance that (1) comply with: (A) all environmental, social, health, safety and labor regulatory requirements applicable in Mexico, (B) IDB's List of Excluded Activities for NSG operations, (C) the Fundamental Principles of Rights at Work, and (D) IDB and other applicable MFI standards (together referred to as the IDB Environmental and Social Requirements), and (2) seek to implement relevant international good practices;
  - b. roles and responsibilities across the Fund and related training;
  - c. the review procedures to ensure compliance with the Fund's policies and IDB policies (exclusion list, eligibility, screening, categorization, environmental assessment requirements, due diligence, public disclosure, and investment agreements);
  - d. development of project-specific Environmental and Social Management Plans (ESMP) and systems for each project supported by the Fund;
  - e. supervision and monitoring of the investment portfolio;
  - f. reporting requirements on compliance with the ESMS requirements, including compliance of investments funded by the loan with IDB policies; and
  - g. incorporation of grievance mechanisms and stakeholder engagement.
- 5.3. For Category B operations the Fund shall require the preparation of an Environmental and Social Impact Assessment (ESIA), and contract a third party consultant or in-house qualified professional to review the ESIA for each such operation, including conducting any site visits required during the due diligence process. For the first three Category B projects, the Fund Manager will share the findings of its environmental and social due diligence exercise with the IDB (see below for detail).
- 5.4. IDB will review and assess the implementation of the ESMS to its satisfaction and recommend any modifications, if necessary.

## VI. PUBLIC CONSULTATION

- 6.1. The Fund Manager will be required to ensure, as part of its due diligence, that adequate stakeholder engagement and public consultation, are performed as part of the project preparation and comply with local laws and applicable IDB policies as defined in the ESMS.

## VII. RECOMMENDATIONS AND REQUIREMENTS

- 7.1. The loan agreement (the "Loan Agreement") between IDB and the Fund will include the items listed below to reflect the Fund's agreement to implement the ESMS and environmental and social loan conditions that will apply to the Fund. These requirements notably include the following:
  1. A final version of the ESMS will be required to be approved by the IDB and formally adopted and put into effect by the Fund prior to first disbursement or first investment, whichever occurs first.
  2. At that time, the Fund Manager and General Partner will also demonstrate to the satisfaction of the IDB that all necessary arrangements have been made for the proper operation of the ESMS including staffing, training, allocation of responsibilities, etc.
  3. With respect to the Fund Manager's operations and activities, the Fund Manager will ensure and will confirm, on a periodic basis to the IDB, that there are no substantial or material liabilities or unmitigated risks associated with the Fund's employees, buildings or offices, or assets due to environmental or social matters, environmental claims or material complaints related to environmental or social matters.
  4. Prior to each disbursement, the Fund Manager shall certify compliance with all environmental social, health and safety, and labor requirements in the Loan Agreement and the ESMS. The compliance certification requires the implementation of the ESMS to (i) determine the eligibility of proposed projects by assessing the potential environmental impacts and risks, and (ii) report the results of this assessment together with measures to be implemented in a project-specific ESMP, if necessary, to control and mitigate impacts and risks.
  5. The IDB will require the Fund to keep operational its ESMS and apply it to all investments to be financed with IDB funds. The ESMS will contain all the elements described herein, (particularly in paragraphs 5.2 and 5.3) and will require projects to comply with local laws and the IDB policies, and provide for contractual and other arrangements through which the Fund can implement corrective and enforcement measures.

6. During the life of the Loan Agreement, the Fund Manager must prepare and submit semi-annually an Environmental and Social Compliance Report, in form, and content acceptable to IDB.
7. To provide for IDB monitoring of the loans's environmental, social, health and safety and labor aspects, the Loan Agreement shall provide for:
  - a. Direct IDB supervision actions (e.g., site visits, review of documentation, consultations with affected parties and third parties, etc.).
  - b. IDB's right to contract an external independent environmental consultant to perform more detailed portfolio audit, and/or project specific supervision/monitoring actions as deemed necessary by IDB through the life of the loan.
  - c. The Fund's agreement to share with IDB on a pro-active basis, and to the extent possible prior to investment, the first three Category B investments to be funded by the loan and the accompanying ESIA and ESMP for purposes of review, comment, and suggested enhancement of the ESMS.
  - d. Full cooperation of the Fund for all of the above activities, including reimbursement of all reasonable fees and expenses according to limits and criteria to be agreed between IDB and the Fund.