

ENVIRONMENTAL AND SOCIAL STRATEGY

Central American Mezzanine Infrastructure Fund II (CAMIF II)

- 1.1 **Background.** The Central American Mezzanine Infrastructure Fund (“CAMIF I”) received a US\$60 million loan from the Inter-American Development Bank (the “IDB”) that was approved in 2006, and since then has invested in infrastructure, social infrastructure and agribusiness projects in Central America, the Dominican Republic, Mexico and Colombia. CAMIF I focused on mid-size companies and projects. All but one of the operations supported with IDB funds fell into the environmental and social Categories B or C.
- 1.2 **Description of the operation.** As a result of the success achieved to date by CAMIF I, and in light of its strong pipeline well in excess of US\$150 million (which is expected to be fully committed by 1Q2013), LAP Latin American Partners LLC (“LAP”), which is the managing shareholder of CAMIF I’s current manager EMP Latin American Management II LLC (“EMPLA”), is in the process of organizing and raising a second fund, CAMIF II (the “Fund”), that will continue to support the financing of mostly infrastructure projects as well as assist in covering the long-term, quasi capital financing needs of mid-size companies in the target regions.
- 1.3 CAMIF II will have characteristics fundamentally similar to CAMIF I, leveraging on the experience and network for deal sourcing gained through the latter. The main difference is that CAMIF II will have an expanded mandate allowing it to deploy capital in Caribbean countries (all of which are IDB-member states) and target new sectors, namely manufacturing, microfinance and non-bank financial services. Notwithstanding this, the investment guidelines will call for a 60% allocation of funds in infrastructure projects. The Fund is expected to have over 10 investments, each typically in the range of US\$15 million – US\$25 million. The IDB is considering providing CAMIF II with a US\$100 million loan. CAMIF II’s potential pipeline is not defined yet, however based on information made available by the client at this time, it is expected that the environmental and social impact categories of the individual potential projects will mainly be in the category B and C range.
2. **The Fund Manager.** LAP or a single-purpose Affiliate will be the Fund Manager of CAMIF II, and is composed of the same management team as CAMIF I. The Fund Manager has been implementing an Environmental and Social Management System (ESMS) as part of CAMIF I and it is expected that the same ESMS will be implemented and maintained for CAMIF II to manage environmental and social risk and impacts of CAMIF II investments. Through an IDB technical cooperation, the Fund Manager benefited from the support of a consulting firm during the first 2 years of operation,

including 2 rounds of training and monitoring of progress until the ESMS was fully implemented and operational.

- 3.1 **Environmental and Social Impacts and Risks.** The key potential environmental impacts and risks will be related to the Fund's investments in infrastructure, social infrastructure, natural resources, and manufacturing projects and to a lesser extent financial services. It is planned that CAMIF II will make over 10 investments, which would include infrastructure and natural resources as with CAMIF I (e.g., port expansions, agribusiness, small hydroelectric plants, telecommunication) or in the new target sectors manufacturing, and non-bank financial services. The proposed investments could result in adverse environmental and social impacts, which will vary in nature, intensity and duration based on the specific characteristics, location and the social context of the each individual project. It is expected that the Fund Manager will continue the practice of (i) engaging as early as possible with the IDB for feedback, support and the validation of the category and (ii) hiring environmental and social consultant to evaluate potential impacts and risks of more complex investments. LAP has offices in Tegucigalpa, Mexico City and Washington DC.
- 3.2 Other risks to the IDB associated with CAMIF II could include: (a) environmental credit (financial) risks to the Fund, affecting its sustainability and its ability to repay the IDB, (b) reputational risks as a consequence of the Fund Manager or project borrower's activities, practices, image, or lack of compliance with local, international and/or IDB environmental, social, and/or labor policies or requirements, and (c) to a lesser degree, environmental, social, health and safety or labor liabilities associated with the Fund Manager's facilities or operations.
- 3.3 Environmental credit risks refer to potential negative effects on the Fund's financial sustainability because of: (i) risks due to the Fund Manager's financial programs (lending, equity, etc.), such as reduction in asset values held as securities due to environmental liabilities or increased probability of non-repayment of loan due to environmental or social issues (e.g. clean-up costs, law suits, fines, etc.); and (ii) to a lesser extent, depending on the Fund Manager, risks associated with their physical facilities and operations, such as environmental liabilities in their buildings/offices due to PCB transformers, asbestos, lead paint, etc. or Fund Manager employees having occupational health and safety problems due to poor working conditions/environment (e.g. inadequate emergency preparedness, lack of fire exits, etc).
- 3.4 Reputation risks are mainly associated with (i) the Fund Manager and/or any project borrower's involvement in projects, activities, practices, or sectors (either as part of CAMIF II or outside of CAMIF II) that have significant public opposition or concerns, and (ii) if there is material non-compliance by the Fund Manager or projects with the IDB

established environmental, social, and health and safety requirements that is not properly resolved.

4. **Management of Environmental and Social Aspects.** The ESMS implemented by CAMIF I contains the key elements of a management system (e.g. definition of roles and responsibilities, training, procedure for operational processes, management reviews etc.). Additionally, the ESMS has the necessary elements to ensure consistency with the IDB safeguards policies and the IFC performance standards, which are all referenced in the ESMS. For example, the ESMS provides for screening of subprojects against exclusion criteria, impact categorization of proposed subprojects, undertaking of due diligence and monitoring procedures commensurate with the levels of impacts, the structuring of subprojects so that they meet environmental requirements, and where necessary require corrective actions as part of the contractual agreements.
5. **Environmental Impact Categorization.** Due to the nature of the proposed operation which specific investments are not known as this time, the team proposes that this operation be classified as a financial intermediation operation as required by the Directive B.13 of the IDB's Environment and Safeguards Compliance Policy (OP-703). The underlying projects to be supported by the facility are expected to be Category B or C for its environmental and social impact. It will be clarified during the due diligence whether Category A operations will be considered for investment by CAMIF II.
6. **Approach for the Environmental and Social Due Diligence.** The Bank will review the track record and assess the Fund Manager's performance in terms of implementing the agreed ESMS for each potential and existing investment under CAMIF I, including the supervision of existing investments to ensure loan requirements are satisfactorily implemented in sub-projects. The Bank will conduct a preliminary identification of any especially sensitive impacts or risks that may be posed by projects in CAMIF II's proposed pipeline, including reputation risks. In addition, it is proposed to select one of the higher risk CAMIF I investments as part of the due diligence. Opportunities for improving the ESMS, review applicable policies and standards, the Fund Manager's internal processes and communication with the IDB will be identified, as appropriate, in order to enhance CAMIF II's effectiveness in managing environmental and social risks.

During due diligence, the project team will seek to confirm that (i) potential environmental and social risks and impacts are adequately identified and assessed, (ii) requirements for environmental and social management are commensurate with the impacts and risks of each investment and that these are established in relevant documents, and (iii) the environmental and social aspects of investments are adequately monitored and reported upon, both consistent with CAMIF I's ESMS. One element assessed and discussed with the team during the due diligence will be related to the plan LAP will put

in place to manage CAMIF II while maintaining satisfactory supervision of the CAMIF I portfolio.

The findings of the due diligence will be reported in an Environmental and Social Management Report (ESMR), which will also include any actions or activities and its timeframe that will need to be conducted as part of the Bank supporting this operation.