An Overview of Development Bank and Guarantee Agency Services for Infrastructure Finance

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AN OVERVIEW OF DEVELOPMENT BANK AND GUARANTEE AGENCY SERVICES FOR INFRASTRUCTURE FINANCE

Introduction

1. This document provides a brief overview of development bank and guarantee agency approaches to the evaluation of loan proposals, summarising key common features in services offered, the application process, and selection criteria.

2. Brief summaries of three infrastructure project appraisals by development banks, illustrating some of the points covered in the document, are also provided. Internet links to the full appraisal reports are listed.

Role of Development Banks and Guarantee Agencies

3. Development banks and guarantee agencies are among the most widely used mechanisms of extra-budgetary funding and assistance for infrastructure projects. Established at local, national, regional, and international levels, both types of institutions offer funding and advice to projects that may not have access to commercial banks and insurers, primarily owing to a long project term, country risk, an inadequate return rate, or a limited local banking sector.

4. While some development banks and guarantee agencies offer overlapping services, the two are traditionally differentiated by the development bank focus on lending and the guarantee agency focus on insurance. Grants sometimes feature in bank and agency packages, but as a rule, projects are treated as commercial ventures, with payment/repayment schedules. Both banks and guarantee agencies are mandated to foster "development" (broadly defined as improvement of indicators relating to basic services and human capital). Infrastructure projects are not surprisingly a major focus of activity, given their typically higher capital costs, steady revenue generation potential, and development effects.

Services of Development Banks and Guarantee Agencies

Bank loans, investment, and leasing

5. Loans are the primary instrument of development bank support for infrastructure projects, and are conceptually similar to commercial loans, although they frequently feature below-market interest rates, longer terms, customized repayment schedules, and a greater degree of technical assistance in realizing the project. As a variant on loans, leasing arrangements are sometimes agreed; in this case, the bank buys an asset and leases it to the contracting party, with a possible ownership transfer at the end of the lease. Banks may also opt for equity participation, traditionally as minority partners, subject to a set of conditions relating to such matters as management and divestment. Similarly, banks may also invest through in-house or external private equity funds.

Bank technical assistance

6. Development banks are also well-known for advisory services related to infrastructure projects. Experts at these banks may help borrowers craft an overall project strategy, improve management capability, and ready the project for submission to commercial lender. They may also assist in linking the project into other initiatives, as well as in preparing an application for the bank's own financial products and services. Grants for advisory services are often available, though loans are also common.

Guarantees

7. The core mission of guarantee agencies is to sell insurance for equity investments and loans in areas deemed too risky for commercial insurers. They typically offer longer-term coverage (7-20 years) at annual rates based on the political, regulatory, and security conditions of the project country, the nature of the project, and the monetary amount involved; policies will reimburse a given percentage of the loan or investment if it fails as a result of those in-country conditions or other stipulated reasons. The lender or investor in the project initiates the coverage request and customarily pays for the cost of insurance, which is then reflected in project costs. Guarantee agencies also play a key role in corralling capital and additional insurance: their vetting and determination of insurability for a project signals to other lenders, investors, and insurers that the project is worthy of consideration, and guarantee agencies sometimes help borrowers approach new funding and insurance sources.

Processes involved in obtaining development bank loans and guarantees

8. Securing the involvement of development banks and guarantee agencies in an infrastructure project often involves the following steps:

- Self-screening by project initiator – initiator determines if there are obvious mismatches between project profile and bank/agency criteria.

- Initiator submits financing/insurance request – submission of high-level project description and credentials; bank/agency then determines if project is appropriate for detailed appraisal; bank/agency frequently offers to assist in document preparation.

- Formal review process – bank/agency performs intensive due diligence on project, focusing on repayment capability, technical dependability, and development potential; extensive interaction between proponent and bank/agency; site visits possible.

- Adjustment of proposal pursuant to bank/agency findings and willingness; project details may be made public, extent dependent on bank/agency.

- Disbursement of funding, assistance, or coverage is governed by (usually) negotiated terms; the national government of the host country is party to agreements.

9. The timeframe for the process and each step within it varies dramatically by organization and transaction type, though six months is something of a minimum. The formal review predictably occupies the largest proportion of time.

Key criteria for obtaining development bank loans and guarantees

Screening criteria

10. At the highest level, development banks and guarantee agencies look for projects that conform to their purview and specialties, often formulated as yes/no, stop/go-type checks that do not consider the individual merits of the project but rather ensure that the project is *prima facie* suitable for the bank or agency. These screening criteria typically include:

- Project country membership in the bank or agency, or a project location in the bank or agency's geographical mandate.

- Type of financing, insurance, or assistance sought—does the bank offer it?
- Timing/duration of financing and insurance.
- Project and initiatior profile – public/private, nonprofit/for-profit, multinational/domestic, syndicate/solo .
- Alignment with mission of bank or agency.
  - Whom does the project benefit?
  - Urgency of problem addressed by project.
  - Type of project (sector/subsector).
  - Size of project.

Project viability criteria

11. If the project meets these initial criteria, evaluation turns to the soundness of the project - will it likely be able to repay its lenders and investors and achieve its stated purpose in a manner and timeframe consistent with bank and agency conditions and norms? Key criteria often include:

- Project structure;
  - Other sources of financing, insurance, and assistance
  - Quality of project team
- Technical and operational feasibility;
  - Can permits/authorizations for the project be obtained?
  - Construction work plans and engineering documents
  - Availability of equipment, workers, power, and raw material supply
  - Operating and maintenance plans
  - Safety and security measures and plans
  - Benchmarking with similar projects
- Economic viability;
  - Project/business plan
  - Market background

  - Market forecast
  - Anticipated costs, revenue/funding, and returns – emphasis on cash flow
  - Capital movement/currency restrictions
  - Benchmarking with similar projects
- Contribution of project to common good;
  - Positive community/national/regional impact
  - No negative impact on other communities (no siphoning effects)
  - Amplifier effects (other sectors and communities benefit)
  - Anti-corruption measures
- Identification and mitigation of risk for all project areas;
- Alternatives – are there other and better ways of meeting the need addressed by the project?

Socio-environmental criteria

12. Given the increasing importance of social and environmental issues as considerations for lending and guarantee coverage, many development banks and guarantee agencies also heavily favour, if not require, projects that can demonstrate:

- Minimal social and environmental disruption;
- Conformity to relevant international codes;
- Mitigation of any anticipated effects;
- Use of best available practice and/or technology regarding socio-environmental issues;
- Stakeholder engagement, preferably throughout project life.

ANNEX

Case 1 Summary – World Bank Loan to Bosnia and Herzegovina

Project	Rehabilitate waste water treatment infrastructure in Sarajevo
Amount:	USD 35 million
Loan description	25 year maturity, 5 years grace, interest rate: 6 month LIBOR for Euro plus variable spread
Borrower's responsible agency	Ministry of Foreign Trade and Economic Relations, Sarajevo Water and Waste Company
Disbursement period	2011 to 2016
Project need	Waste water infrastructure (treatment plant and sewers) damaged during war; all waste water currently discharged untreated into local river system, with negative health, environmental, and economic impacts for downstream communities
Bank relevance evaluation	The bank found that the project conformed to its country strategy by focusing on restoration of basic services.
Economic/financial evaluation	The bank evaluated pollution reduction and compared it to projects costs, for an NPV of USD 54.9 million and an EIRR of 32%. The bank deemed consumer charges too low to cover operating costs of the new infrastructure, meaning that the project would complicate the water agency's already tight budget. The option of raising charges was found to be contentious and difficult. As the overall financial health of the agency is poor, the bank decided to assist in financial management reform, as well as in preparation for necessary rate increases. The bank cited corruption as a major risk. Project management and procurement thus had to adopt bank-approved guidelines and measures and agree to independent, external auditing.
Technical evaluation	The bank evaluated final design studies before granting approval. It also evaluated the ability of the water agency to lead a large scale infrastructure project, and suggested close coordination with bank-approved experts.
Socio-environmental evaluation	Positive and negative socio-environmental impacts of the project throughout its lifetime (construction through decommissioning) were evaluated through an independently-conducted environmental impact assessment. An environmental management plan was also instituted.
Key long-term project measurements	Quantified amount of pollutant removed at the treatment site; volume of waste water collected and treated; number of sewer connections; number of sewer blockages

Source: World Bank: http://www-wds.worldbank.org/servlet/WDSServlet?pcont=details&eid=000334955_20091203010616 (5.2.10).

Case 2 Summary – World Bank Loan to Mauritius

Project	Improve the national infrastructure, with an emphasis on transport (72% of funding), sanitation and flood management (14%) and energy (4%)
Amount	USD 50 million
Borrower's responsible agency	Ministry of Public Infrastructure, Land Transport and Shipping
Disbursement period	2010 to 2015
Project need	Infrastructure bottlenecks and failures are eroding Mauritius' export competitiveness
Bank relevance evaluation	The bank found that the project addressed the key constraints on private sector growth that were identified in recent bank reports on Mauritius.
Economic/financial evaluation	The bank evaluated a Mauritius government study of potential major bottleneck relief projects, quantified the value of bottleneck reduction at each site, and screened out projects that did not offer a 12% return rate. The selected road project was estimated to yield an NPV of USD98 million at a 10% discount rate and an economic rate of return of 51%. The bank found that the government lacked adequate institutional and human capacity to identify and fast track the implementation of high-impact infrastructure development projects. It therefore linked a technical assistance capacity-building programme to the loan. Other technical assistance includes financial reporting improvement. The bank also asked the government to use bank-approved procurement guidelines for the project, especially in dealing with dispute resolution.
Technical evaluation	The bank evaluated the technical design and maintenance solutions, citing use of the American Association of State Highway and Transportation Officials Guide as a plus.
Socio-environmental evaluation	The bank evaluated an environmental impact assessment and management plan prepared by the Ministry of Environment and National Development Unit. The bank noted particular concern over road widening measures that might cause loss or displacement to nearby residents and businesses. It highlighted that the Citizens Advice Bureau and the local MP and community leaders would be involved in public consultation and information dissemination on environmental, safety, and land acquisition aspects of the project. The bank also highlighted that four trees were to be planted for each tree felled. In general, the bank found that the Mauritius government was capable of identifying and monitoring socio-environmental impacts and creating mitigation measures.
Key long-term project measurements	Number and value of projects in the infrastructure sector implemented, being implemented, or ready for implementation; travel times (minutes) and number of accidents per year on specified road

Source: World Bank: http://www-wds.worldbank.org/servlet/WDSServlet?pcont=details&eid=000334955_20090907023318 (5.2.10).

Case 3 Summary – Asian Development Bank Loan to Afghanistan

Project	Rehabilitate and reconstruct 447 kilometres of the national road network, power transmission and distribution lines, and damaged gas production, transmission, and distribution
Amount	USD 150 million
Loan description	Term of 40 years, including a grace period of 10 years, interest rate of 1% per annum
Borrower's responsible agency	Ministry of Finance will be the Executing Agency; implementing agencies (IAs) are the Ministry of Public Works for the roads infrastructure component, the Ministry of Water and Power for the power infrastructure component, and the Ministry of Mines and Industries for the gas infrastructure component
Disbursement period	2003 to 2013
Project need	Most of the infrastructure in Afghanistan is destroyed or damaged due to war
Bank relevance evaluation	The bank found that the project conformed to its country strategy by focusing on restoration of basic services to revive economic activity and create jobs. It cited a preliminary needs assessment performed by itself, the UN Development Programme, and the World Bank.
Economic/financial evaluation	The bank's evaluation of the road rehabilitation component compared the savings in vehicle operating costs and travel time costs, and the savings in future periodic and routine maintenance costs over a 20–year period against the initial investment costs and calculated an NPV of USD 167.5 million and an EIRR of 31.5%. On the power component, the bank calculated an NPV of USD 414 million and an EIRR of 32%. For the gas infrastructure component, the bank calculated an EIRR of 35%. The bank assessed ministerial capacity to implement the project and maintain infrastructure and found it poor. Consequently, the bank mandated that capacity-building training be a concurrent and major part of the project. It also found that the ministries were in many cases economically unviable, and so decided that the project would also focus on budget restructuring and consumer charge increases. The bank required that all project procurement adhere to the banks' Guidelines for Procurement.
Technical evaluation	Design appeared not to have been finalized. The bank instead proposed that its consultants drive and evaluate the design process. Protection of workers and infrastructure from violence was cited as a major concern.
Socio-environmental evaluation	The bank evaluated environmental impacts on a very high-level, apparently based on a general sense of impacts associated with similar infrastructure projects. It did, however, specify that its consultants would have to help the ministries in preparing environmental impact reports and management plans, which would govern the project from start to finish. The bank also required that community consultation take place in potentially affected communities, and stipulated that contractors bidding for work related to the project must show that benefits (namely employment) for local residents are maximized.

Source: Asian Development Bank: http://www.adb.org/projects/project.asp?id=36673 (5.2.10).

Sources

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Project overview and appraisal documents can be found at: http://www.adb.org/projects/

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Multilateral Investment Guarantee Agency. "Guarantees," "Technical Assistance." www.miga.org

Overseas Private Investment Corporation. "Financing," "Insurance." www.opic.org.

World Bank. "Project Cycle," "Public-Private Partnership in Infrastructure," "World Bank Guarantee Program." www.worldbank.org.
Project overview and appraisal documents can be found at: http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/0,,menuPK:115635~pagePK:64020917~piPK:64021009~theSitePK:40941,00.html

Selected List of Development Banks and Guarantee Agencies

Development banks and loan vehicles potentially available in Iraq

World Bank	www.worldbank.org
International Finance Corporation	www.ifc.org
Islamic Development Bank	www.isdb.org
Japan Bank for International Cooperation (JBIC)	www.jbic.go.jp
KfW (German Development Bank)	www.kfw.de
Netherlands Development Finance Company (FMO)	www.fmo.nl
Overseas Private Investment Corporation (OPIC)	www.opic.gov
Agence Française de Développement	www.afd.fr

Guarantee agencies

Multilateral Investment Guarantee Agency (MIGA)	www.miga.org
Compagnie Française d'Assurance pour le Commerce Exterieur (Coface France)	www.coface.com
Overseas Private Investment Corporation (OPIC)	www.opic.gov
Export Credits Guarantee Department (ECGD UK)	www.ecgd.gov.uk
PWC Hermes (Germany)	www.agaportal.de/en/dia/
Nippon Export and Investment Insurance	www.nexi.go.jp
Export Development Canada	www.edc.ca
Export Finance & Insurance Corporation (EFIC Australia)	www.efic.gov.au
Compania Espanola de Seguros de Credito a la Exportacion (CESCE Spain)	www.cesce.es
China Export & Credit Insurance Corporation (Sinosure)	www.sinosure.com.cn/ sinosure/index.html

Comprehensive lists of export credit and investment insurers can be found out:

http://www.berneunion.org.uk/bu_profiles.htm
http://www.berneunion.org.uk/pc_profiles.htm