

A photograph of two wind turbines in a field. The turbines are white with red and white striped towers. The background is a clear blue sky and a flat, brownish field. The text "Nonsovereign Operations" is overlaid in white on the image.

Nonsovereign Operations

ADB believes that development and poverty reduction can be attained only with a vibrant, confident, and healthy private sector. In adopting the second medium-term strategy in 2006, ADB has placed the highest priority on catalyzing investment.

Beyond providing money, ADB assists host countries and private sector clients in a way that mitigates risks, facilitates regulatory dialogue, and provides technical expertise.

ADB's Private Sector Operations Department (PSOD) directly assists developing member countries (DMCs) through projects with development impact, which may, however, have limited access to capital. PSOD participates in projects through nonsovereign loans (loans to the private and public sectors, including state-owned enterprises); equity investments; and credit enhancement products (including guarantees and B-loans, where ADB arranges a complete financing package for a project and thus encourages local and international commercial banks to participate). Entities seeking assistance from ADB for a private sector project benefit not only from financial assistance but also from the expertise and guidance of the ADB team.

Operations are directed mainly to the capital markets and financial sectors, and to the infrastructure sector. The regional operations departments began processing nonsovereign projects in 2007.

Nonsovereign operations grew continuously, with total new financing reaching a record \$1.8 billion (Table 11) in 2007, 23% above the level for 2006. Growth was relatively uniform across various sectors. New debt financing approvals grew 50% (from \$575.0 million to \$865.0

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Financing Energy Efficiency in the People's Republic of China



ADB's public and private sector operations groups work closely together

Energy demand in the People's Republic of China (PRC), the world's second-largest energy consumer and one of the largest emitters of greenhouse gases, is growing rapidly to support the economic growth needed to raise the living standards of the large population. Energy efficiency will moderate growth in fossil energy demand, ease the upward pressure on energy prices, and improve energy security.

Despite the recent policy shift in favor of energy efficiency, however, market barriers still limit energy efficiency in the PRC. ADB approved the Energy Efficiency Multiproject Financing Program to meet the need. It will provide credit guarantees up to CNY800 million (\$114.2 million) in favor of selected financial institutions to cover the credit risk associated with financing energy efficiency projects. The program aims

to mobilize available domestic funds to much-needed energy efficiency projects and enable a large number of energy end users to improve energy efficiency.

The program will demonstrate the potential for energy efficiency in retrofitted and new buildings, which are untapped areas of energy efficiency, and set standards for competitors to follow. More efficient use of energy will improve the global and local environment. The program will also support the Government's efforts to build a resource-saving society through private sector participation. It will help remove barriers to investments in energy efficiency by showing that energy efficiency projects are bankable and encouraging the private sector to invest in them. The program is fully in line with ADB's country and sector strategies as well as the Government's strategic intentions.

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million) and guarantees trebled (from \$124.8 million to \$376.0 million). In the past 2 years, credit enhancement products such as guarantees and B-loans supplemented direct loan financing and equity investments. Because of this, the total nonsovereign financing approved in 2006 and 2007 equaled the financing approved in 1996–2005. The average size of projects processed by PSOD increased from \$44.0 million for 9 projects in 2000 to \$65.0 million for 27 projects in 2007. PSOD staff members grew from 38 in 2000 to 66 by the end of 2007.

PSOD operations were once again evenly divided between infrastructure and financial services, with new infrastructure financing at \$900.0 million and financial market financing at \$846.0 million. Infrastructure financing went to the energy, transport, water and waste disposal, telecommunications, and other sectors where ADB participation has a clear development impact, with special priority given to renewable energy use and energy efficiency. For example, a 3.5 billion rupee loan was approved for a wind power project in India, and a \$107.0 million financing program with credit guarantees will be used by commercial banks to fund energy-efficient projects in the People's Republic of China. In the capital markets and financial sectors, priority was given to projects that strengthen and deepen the financial markets in DMCs, such as the development of the secondary markets for nonperforming assets, diversified payment rights securitization for banks and other forms of securitization finance, and small and medium-sized enterprise finance.

Nonsovereign operations have diversified geographically. At the end of 2007, nonsovereign projects were being administered in 20 DMCs (compared with only 13 a decade earlier), after the approval of the first private sector projects in Mongolia, Afghanistan, Lao People's Democratic Republic, Maldives, Cambodia, and the Central Asian republics of Kazakhstan, Azerbaijan, and Georgia.

At the same time, the portfolio quality of private sector financing continued to improve, with impaired assets as a percentage of total nonsovereign-backed financing falling to 2% from 22% in 2000.

Coupled with the increase in financing, this trend underscores the success of ADB's new strategy for and approach to nonsovereign operations.

UNDERLYING APPROACH

These successes reflect ADB's strategy, which stresses the importance of private sector development and a close working relationship between ADB's public and private sector operations groups. These two go hand in hand and are at the core of ADB's relevance and strength. For example, the public sector operations group led the original privatization of a power utility company in Pakistan that made possible a successful competitive sale to the private sector. PSOD then provided a non-sovereign loan of \$150 million to a cofinancing project with other development institutions and private sector banks, enabling the Karachi Electric Supply Corporation to upgrade its generation facilities and its transmission and distribution network, and to cut power losses, use cleaner technology, operate more efficiently, and produce economic benefits for the country.

Despite the current turmoil in the financial markets, the liquidity of the global capital markets has never been higher. This presents a major challenge for multilateral development banks. All were established to financially support development—a role that today is better played by the capital markets. To remain vital, multilateral development banks must reexamine and redefine their absolute and comparative advantages.

Public-private partnership is the core offering of ADB. This pioneering approach is fundamentally different from the traditional approach of multilateral development banks, with its continued emphasis on providing financial liquidity. ADB undertakes transactions in developing member countries where overall risks may be perceived as relatively high but where the commercial deal is compelling and highly developmental. In so doing, ADB can help the private sector (both project sponsors and cofinancing partners) concentrate on business issues rather than the wider risk environment.

COFINANCING

As a matter of internal policy, PSOD directly funds no more than 25% of the total cost of any one project. In rare circumstances where small transactions are accepted for their high development impact, the department will directly support a higher percentage of the

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Dealing with Nonperforming Loans to Bolster Housing in the Philippines



Restructuring delinquent borrowers' loans

In the late 1980s, the National Home Mortgage Financing Company (NHMFC) embarked on the Unified Home Lending Program to finance low-income housing in the Philippines. As the houses were built, NHMFC purchased the mortgage-secured loans extended to home buyers by accredited financial institutions and housing developers, using funds borrowed from the Social Security System, the Government Service Insurance System, and the Home Development Mutual Fund (Pag-IBIG)—the funders.

The program faced growing difficulties in its 9 years of implementation. By 1996, large uncollected loan accounts made the funders reluctant to give more support.

In May 2004, NHMFC auctioned off the highly delinquent loans in the portfolio. DB Real Estate Global Opportunities IB, L.P. (DBGO) won in the bidding. ADB provided debt financing of up to \$33 million to Balikatan Housing Finance, Inc., the special-purpose vehicle jointly owned by DBGO and NHMFC, which acquired the nonperforming loans from NHMFC. ADB also invested in a 10% equity stake in Bahay Financial Services, Inc., a loan-servicing company established by DBGO to restructure and service the loans on behalf of Balikatan Housing Finance. A Philippine-peso bond issue—a first for ADB—provided the necessary funding.

The transaction strengthened the financial position of the funders and provided much-needed liquidity to the pension system, as NHMFC was able

to repay a part of its obligations to the funders. It also allowed NHMFC to substantially restructure its mortgage portfolio and to concentrate on being a secondary housing mortgage institution. Delinquent borrowers have been given the chance to restructure their loans and eventually own their homes without further encumbrances once their debts are fully paid. The transaction proved that low-income housing is creditworthy, and thus catalyzes much-needed housing finance from the private sector.

This transaction marked the first time that a local financial entity had sold nonperforming assets (NPAs) of such magnitude to a foreign investor, and showed domestic and international investors that the country was determined to solve its NPA problem. Introducing a replicable, market-tested mechanism for NPA resolution achieved a demonstration effect, and induced the growth of the NPA market in the Philippines, as it developed benchmarks, bankable structures, and trust in the enabling legal and regulatory environment. The transaction also sent a strong signal to Philippine banks that they had to deal proactively with their NPA problems.

ADB was involved in the transaction from the start, working alongside NHMFC and its external advisers to put together a bankable transaction structure. Given the difficulty of obtaining local or international debt financing, for a new and untested asset class, ADB's third-party financing support was critical.

The sale of NHMFC's highly delinquent loan portfolio helped jumpstart the nonperforming asset market

overall financing. PSOD's efforts therefore require a close and collaborative relationship with the financial community, which is enhanced by the various guarantee and cofinancing products ADB offers, demand for which has increased substantially in the last 2 years.

PSOD cofinanced with ADB's financial sector partners a total of 25 transactions, catalyzing \$425.0 million of direct new money for developing member countries, which went to projects with an aggregate cost of \$4.1 billion.