

# Financing Instruments and Modalities

Flexibility in  
development finance

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In this publication, \$ refers to US dollars.

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# Introduction

THE ASIAN DEVELOPMENT BANK (ADB) uses development finance to fight poverty and support economic and social growth in the world's most dynamic region, Asia and the Pacific.

ADB provides loans, guarantees, equity, and grants as well as specialist advisory services. It finances public and private sector projects. These include physical investments, reforms, and "knowledge support." ADB offers technical assistance for project and program preparation, implementation, development-related research, and policy reform. ADB's clients are the sovereign governments of the region, together with public and private sector entities.

ADB's financing instruments include debt (loans), grants, guarantees (credit- and political risk-based), and equity. All these instruments are essentially variations on a common theme—to provide long-term financing and ideas for development purposes.

In 2005, a number of additional financing instruments were introduced as part of ADB's Innovation and Efficiency Initiative (IEI). The IEI as a whole is a central element in the ADB's overall Reform Agenda. With the exception of local currency, IEI's financing instruments are operating on a pilot basis until mid-2008.

This brochure describes four IEI financing instruments and modalities:

- Multitranche Financing Facility;
- Non-sovereign Public Sector Financing (NSP) Facility;
- Refinancing Facility; and
- Local Currency Loans (which is also described in its own separate ADB brochure)

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# ADB's Innovation and Efficiency Initiative (IEI)

LAUNCHED IN NOVEMBER 2003, the IEI is a central part of ADB's Reform Agenda. Its purpose is to increase ADB's effectiveness as a partner, deliver results, and respond more quickly and comprehensively to development challenges.

Across its priority areas, the IEI aims to improve ADB's business model, align its programs more closely with client priorities, reduce bottlenecks in processing development assistance, and expand its product offerings.

## **IEI – Priority Action Areas<sup>1</sup>**

### **Country Partnership Strategies**

Results-based country strategies with strategic clarity covering investments to create future development impact.

### **Simplified Business Processes**

Approaches, procedures, practices, and operations related to developing and administering the investment pipeline.

### **Procurement and Consulting Services**

Guidelines relating to consultancy services and the procurement of goods and works.

### **Cost-sharing and Expenditure Eligibility**

Flexible cost-sharing arrangements and other financing parameters, and additional items eligible for ADB financing.

### **Financing Instruments and Modalities**

New financing instruments, accompanied by an independent credit risk management function and improved processing and assessment procedures and practices.

<sup>1</sup> Safeguard policies are being reviewed separately, the aim being to make them more output-oriented.

# IEI Financing Instruments and Modalities

**Multitranche Financing Facility**

**Non-sovereign Public Sector Financing (NSP) Facility**

**Refinancing Facility**

**Local Currency Loans**

THESE NEW FINANCING INSTRUMENTS are intended to provide ADB clients and its operational teams with additional alternatives to help finance development in large individual projects and longer-term investment programs arising out of sector roadmaps.

The instruments are not meant to replace ADB's existing instruments. They expand the alternatives available within ADB's portfolio of development finance solutions, while preserving its credit standing.

These instruments allow ADB to improve its services to existing and new clients seeking development finance. They are specifically designed to:

- provide a financing plan for a program of investments in an integrated package or series of related projects intended to achieve an overall development outcome;
- efficiently mobilize additional financial resources, including domestic savings, and international finance;
- minimize currency mismatches at the project and client levels;
- reduce transaction costs; and
- provide refinancing to fundamentally sound projects with high development impact but weak financing plans.

The IEI financing instruments and modalities were approved in August 2005. The first three are being implemented on a pilot basis. Local currency loans have been mainstreamed and are not part of the pilot.

# 1. Multitranche Financing Facility (MFF)

**Flexible framework for loans and guarantees; applied to an investment program coming out of a roadmap; spread over time in “slices” or tranches; combines physical and nonphysical investment activities.**

**Clients: Public sector (sovereign; sub-sovereign, e.g. local and provincial governments; state-owned enterprises; and government agencies) as well as the private sector.**

THE MFF IS A FLEXIBLE FRAMEWORK that allows ADB to finance, using future loans and guarantees, an agreed and interrelated investment program coming out of a sector roadmap.

Typically, the MFF will include multiple subprojects, sequenced over the medium to long term, and include physical investments as well as implementation support and capacity building. The overall program is organized in a series of funding blocks or slices, known as “tranches”.

The MFF allows specific development goals to be met through a planned program of activities. It represents a longer-term partnership between ADB and its clients, built on trust and confidence.

The kinds of programs for which an MFF may be used include:

- multiple subprojects in a sector to be implemented in series (for example, a series of road sections to be developed across a country over the next 10 years within the context of a related transport planning and administration policy framework);
- large stand-alone investment projects that have a series of discrete, sequential, and interrelated components (for example, a large electricity generation supply project which involves separate investments such as land acquisition, site preparation, construction, installation, and the like); and
- a credit line to fund financial intermediaries (for example, a series of loans to a local bank to support an ongoing credit program for local small- and medium-sized enterprises).

In addition to loans, the MFF may also incorporate ADB guarantees—Partial Credit Guarantee (PCG) and Political Risk Guarantee (PRG). The MFF may also include cofinancing. ADB will encourage financial participation by other parties in the overall funding package.

Structured to provide debt for each tranche, the MFF provides the ability to secure financing “as it is needed” against the agreed plan. It results in commitment fees only being applied on committed amounts rather than on the total value available under the facility.

The MFF allows ADB to deliver financial resources for an agreed program or specific set of investments in a series of separate financing tranches.

Each tranche may be made either as a loan or a guarantee. Each tranche may have different financial terms and currency denominations.

Given its flexibility and multiyear nature, the MFF requires a significant assessment of the sector (roadmap), the proposed investment plan and program (including attention to development impact, timing, and scope of included specific projects), as well as the capacity to administer and implement all the elements such as policy or regulatory reforms.

The MFF also includes a detailed proposal for the investment program’s monitoring, evaluation, and reporting and a due diligence capability to prepare a future deal flow.

Processing an MFF requires the development of a Framework Financing Agreement (FFA).

The FFA records the clear understandings and objectives of the parties, sets out the reasons the MFF is being provided, and targets a set of specific physical and nonphysical investments activities agreed between its clients.

The MFF can be used across all sectors in which ADB provides financing, and can be funded out of ADB’s Ordinary Capital Resources or the Asian Development Fund.<sup>2</sup>

All MFF projects must comply with ADB’s standard policies including the procurement guidelines, governance and anticorruption policies, and policies on safeguards and social dimensions.

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<sup>2</sup> In both cases, subject to availability.

## **2. Non-sovereign Public Sector Financing (NSP) Facility**

**Loans and guarantees for development projects without central government (sovereign) guarantees.**

**Clients: Public sector (government agencies, state-owned enterprises, local and provincial governments).**

THE NSP FACILITY PROVIDES DEBT FINANCE (loans and guarantees) on a direct basis to selected non-sovereign public sector entities without a central government (sovereign) guarantee.

Non-sovereign public sector entities include government agencies, state-owned enterprises as well as local and provincial governments.

The potential borrowers under the facility may already be clients of ADB (albeit financed with sovereign guarantees) or may be new clients in eligible countries.

The NSP facility is designed to support projects and programs that deliver clear development objectives and are aligned with an individual country's priorities and ADB's strategies to reduce poverty and support sustainable growth.

Borrowers under the facility should provide access to public goods and services that have significant development impact—for example, water, wastewater, waste management, power, energy, transport, and telecommunications—or those that improve business competitiveness such as export finance agencies.

The borrowers should be financially viable and should operate under appropriate governance and regulatory arrangements.

Under the facility, ADB directly assumes the credit risk of the borrower without additional support from the central government. Processing this type of financing requires detailed due diligence and independent risk assessment.

The due diligence process covers technical, commercial, financial, legal, regulatory, safeguards, management, governance, institutional, and related matters. ADB intends to follow best market practices in this regard.

Financial terms (pricing) are set on a commercial basis, similar to the regime applying to ADB's private sector loans.

Management will comprehensively assess due diligence, financial terms, and the project's transaction structure before seeking approval by ADB's Board.

All financing under the facility must comply with ADB's standard policies including the procurement guidelines, governance and anticorruption policies, and policies on safeguards and social dimensions.

### **3. Refinancing Facility**

**Selective support to the restructuring of existing projects that may require additional capital or that could benefit from improved financing arrangements.**

**Clients: Public and private sector entities assessed on a case-by-case basis.**

ADB'S PREFERENCE has generally been to finance new investment projects which contribute to a country's and ADB's goals in poverty reduction through economic and social development.

However, occasionally it is also desirable to extend support to existing investment projects during their operational phase. The refinancing facility is designed to provide additional flexibility and facilitate ADB's involvement in existing projects and programs in client countries.

Under the refinancing facility, the proceeds of an ADB financing can be used to restructure existing debt. This allows ADB to support and/or expand projects (public, private, or PPP) that are burdened by a legacy of inappropriate or onerous financing plans.

It also allows the expansion of projects with additional capital and the provision of management, technical, and policy advice.

Any project considered for the refinancing facility must be technically, economically, and socially viable. The project must also demonstrate that if the ADB refinancing were to proceed, the project would also become financially viable. Refinancing is not a business goal in itself, but an additional tool for ADB to achieve desired developmental outcomes for carefully selected important projects.

## **4. Local Currency Loans**

**Loans structured in the local currency of a country to help reduce the mismatch between income received in a domestic currency and debt repayments in a foreign currency.**

**Clients: Public and private sector entities in selected developing member countries where ADB has secured appropriate access to capital markets.**

UNTIL RECENTLY, ADB ONLY OFFERED THE LIBOR-BASED LOAN in US dollars, yen, and euro.

ADB can now offer loans denominated in a local currency which may help borrowers mitigate the potential mismatch between borrowing in a foreign currency and having income streams to repay liabilities in its domestic currency.

This product can be particularly attractive to private and state-owned enterprises and local governments, as well as public services, utilities, and infrastructure projects that are subject to regulated tariff regimes.

ADB can only offer local currency loans in selected developing member countries where it has secured all relevant approvals to access the local capital market.

At present, the product has been made available in People's Republic of China, India, and Philippines. It is expected to be available shortly in other countries.

A separate brochure that explains in more detail the rationale for introducing Local Currency Loans, as well as the main features of the product, is available from ADB's Public Information Center.

# Implementation

The new instruments<sup>3</sup> are being implemented on a pilot basis for an initial 3-year period (from 1 September 2005 to 31 August 2008), after which performance, suitability, and outcomes will be evaluated. If IEI financing instruments are found to be sound, relevant, and effective, then these products will be mainstreamed into ADB's operational toolkit.

To date, over 20 potential programs have been identified for MFF with 10 already approved (\$5.333 billion) by the Board. Two NSP facilities have been approved for public sector entities. Refinancing transactions are yet to be considered. Local currency loans have been offered in several countries and three transactions were approved in 2006.

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<sup>3</sup> Except local currency which is already mainstreamed.

# Case Studies

## **Pakistan: National Highway Development Sector Investment Program MFF**

Road-based transport is crucial in Pakistan. Roads connect people, jobs, freight, and markets. This infrastructure is a backbone for the country's future economic development.

Pakistan's National Highway Authority forecast an investment need of more than \$2 billion in new highway developments in the next decade.

As part of introducing a coordinated National Highway Development Plan, a \$773 million multitranche financing facility (MFF) with ADB was established for Pakistan to finance a series of highway projects over the next 5 years.

In addition, the MFF will support program planning, implementation, and policy reform work. This includes the potential for public-private partnerships and future cofinancing for highway development.

The MFF operates from 2006–2011. The first tranche is a \$180 million loan to finance around 370 kilometers (km) of upgrades on national highways: N25 (Hub-Uthal section), N50 (Khanozai-Zhob section), and N70 (Multan-Muzaffargarh section).

The ADB Board approved the MFF in December 2005.

## **Indonesia: South Sumatra to West Java Phase II Gas Pipeline Project (NSP Facility)**

Natural gas represents an important domestic energy resource to fuel economic development in Indonesia, particularly for industrial use. PT Perusahaan Gas Negara (PGN) is Indonesia's largest utility involved in gas transmission, distribution, wholesaling, and retailing. It operates over 1,000 km of high-pressure transmission pipelines.

To assist PGN finance the development of the 660 km (\$650 million) South Sumatra-to-West Java phase II gas pipeline, ADB approved a \$200 million debt package to PGN.

An important feature of the ADB financing package was the combination of three loans: a \$75 million direct loan to PGN, without Government guarantee, from ADB's ordinary capital reserve; an up to \$75 million loan under ADB's Complementary Financing Scheme (CFS) to be funded by one or more commercial banks; and an up to \$50 million loan under ADB's CFS to be funded by Kreditanstalt für Wiederaufbau. In addition, Islamic Development Bank is expected to provide a direct loan of up to \$65 million.

The balance of the project's financing will come from PGN resources including operating cash flow, part of its IPO proceeds, and bond issues.

The ADB Board approved project funding in August 2006.

As part of its Innovation and Efficiency Initiative, the Asian Development Bank (ADB) introduced a set of new financing instruments such as the Multitranche Financing Facility, Non-sovereign Public Sector Financing Facility, Local Currency Financing, and Refinancing Facility. Launched in 2005 in response to the emerging needs of ADB's clients, these provide flexible options for funding physical investments and advisory work in development programs and projects.

### **About the Asian Development Bank**

The work of the Asian Development Bank (ADB) is aimed at improving the welfare of the people in Asia and the Pacific, particularly the nearly 1.9 billion who live on less than \$2 a day. Despite many success stories, Asia and the Pacific remains home to two thirds of the world's poor. ADB is a multilateral development finance institution owned by 66 members, 47 from the region and 19 from other parts of the globe. ADB's vision is a region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their citizens.

ADB's main instruments for providing help to its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance. ADB's annual lending volume is typically about \$6 billion, with technical assistance usually totaling about \$180 million a year.

ADB's headquarters is in Manila. It has 26 offices around the world and has more than 2,000 employees from over 50 countries.

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