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# Establishment of the Leading Asia's Private Sector Infrastructure Fund

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**Asian Development Bank**

## ABBREVIATIONS

ADB	–	Asian Development Bank
JICA	–	Japan International Cooperation Agency
OCO	–	Office of Cofinancing Operations
PSOD	–	Private Sector Operations Department
US	–	United States

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## I. INTRODUCTION AND SUMMARY OF PROPOSAL

1. This paper recommends that the Asian Development Bank (ADB) (i) establish the Leading Asia's Private Sector Infrastructure Fund, and (ii) accept and administer contributions to the fund from the Japan International Cooperation Agency (JICA), in accordance with the terms and conditions set out in this paper.

2. The fund will cofinance nonsovereign infrastructure transactions in developing countries in Asia and the Pacific. JICA will capitalize the fund with \$1.5 billion in equity, and ADB will deploy and administer the fund's capital alongside ADB's nonsovereign operations. The fund is expected to leverage and complement ADB's existing nonsovereign platform to fill financing gaps and increase access to finance for infrastructure projects in the region. It will extend ADB's operations by deploying both commercial and concessional capital from the same fund, and cofinancing will be provided in the form of loans, equity investments, and mezzanine finance transactions.

## II. BACKGROUND AND RATIONALE

### A. ADB–Japan Cooperation on Infrastructure Financing

3. In discussions with ADB in early 2015, Japan sought ways to boost support for private infrastructure projects and promote public infrastructure development. Subsequently, ADB and Japan explored the potential for new cofinancing partnerships for both public sector and private sector operations.

4. In November 2015, ADB and JICA—the agency through which much of Japan's support will flow—reached an agreement in principle to establish two new modalities to stimulate about \$16 billion in new infrastructure financing in developing countries in Asia and the Pacific.<sup>1</sup> Firstly, to stimulate investment in quality and sustainable private sector infrastructure in Asia and the Pacific,<sup>2</sup> ADB will establish and act as trustee for a \$1.5 billion trust fund for cofinancing nonsovereign<sup>3</sup> infrastructure projects. Combined with ADB's own capital and that of commercial cofinancing partners, the fund is expected to provide financing of at least \$6 billion—and will enable ADB to expand large-scale private infrastructure operations by leveraging JICA's official development assistance and risk-bearing capacity. Secondly, to promote quality and sustainable public sector infrastructure development in the region, ADB and JICA will provide \$10 billion (\$5 billion each) in cofinancing to sovereign borrowers by the end of 2020.<sup>4</sup> This paper discusses only the \$1.5 billion fund.

### B. Benefits for ADB from the Fund

5. The fund is likely to result in several benefits for ADB. It will assist ADB in meeting the priorities of the Midterm Review of Strategy 2020<sup>5</sup>, including infrastructure development, poverty

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<sup>1</sup> ADB. 2015. *ADB and Japan Partner to Support \$16 Billion Infrastructure Investment*. Manila.

<sup>2</sup> Including through public–private partnerships.

<sup>3</sup> “Nonsovereign” refers to any loan, guarantee, equity investments, or other financing agreement that is (i) not guaranteed by a government; or (ii) guaranteed by a government under terms that do not allow ADB, upon default by the guarantor, to accelerate, suspend, or cancel any other loan or guarantee between ADB and the related sovereign entity.

<sup>4</sup> The two parties will collaborate to support long-term investment plans using an ADB multitranche financing facility. They will also provide necessary technical assistance for preparing and implementing projects, leveraging the comparative advantages of each institution.

<sup>5</sup> ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

reduction and inclusive economic growth, and environment and climate change. The fund will also assist ADB in achieving several lending portfolio targets and operational goals, including (i) scaling up private sector development and private sector operations in all operational areas, reaching 50% of annual operations by 2020; (ii) significantly increasing support for environmentally sustainable development, including projects to reduce greenhouse gas emissions and address climate change; and (iii) increasing assistance for regional cooperation and integration to at least 30% of total activities by 2020.<sup>6</sup>

6. The fund will help alleviate some of ADB's internal growth constraints. ADB has developed a strong nonsovereign investment platform with close to \$9 billion in approvals and \$17 billion in capital mobilized since 2010.<sup>7</sup> Infrastructure development has been ADB's main nonsovereign focus, representing about 65% of its nonsovereign business. ADB's nonsovereign operations are expected to nearly double in volume and number of transactions by 2020. However, nonsovereign growth is potentially constrained by several barriers, including (i) exposure limitations, particularly single transaction, obligor, country, and counterparty limits imposed by ADB policy;<sup>8</sup> (ii) ADB's limited capacity to finance transactions with strong potential for high impact development outcomes but subject to marginal economics or other financing challenges; and (iii) ADB's resource constraints. The ADB–JICA partnership through the fund creates an opportunity to expand nonsovereign operations.

7. The fund will contribute significantly to ADB's mission of reducing poverty in Asia and the Pacific. Asia's overall infrastructure financing needs for 2010–2020 are estimated at \$8 trillion—about \$730 billion per year—with priorities in energy and transport (82%).<sup>9</sup> Sustainable energy, water, and transport solutions not only are good for the environment but are also key national security issues for many countries in Asia and the Pacific. ADB recognizes the importance of sustainable investments in the region and has been investing more than \$2 billion in clean energy projects each year since 2011.<sup>10</sup> ADB will seek similar financing arrangements with other development partners to meet the UN's Sustainable Development Goals, increase climate financing, support quality and sustainable infrastructure development, promote private sector development and operations, and address other development issues.

### III. OBJECTIVE AND SCOPE: COMMERCIAL AND CONCESSIONAL PROGRAMS

8. The fund will provide cofinancing to nonsovereign infrastructure projects at different stages of development, including early stage, growth stage, and greenfield and brownfield projects. It will support projects with strong anticipated development impacts and alignment with the strategies of ADB and JICA. The fund will undertake project finance (nonrecourse or limited recourse) and corporate finance transactions, and will seek to support a range of private sector participation modalities including public–private partnerships, joint ventures, private finance initiative projects, and privatizations, as well as conventional project finance.

9. The fund will provide cofinancing to projects in ADB's developing member countries in Asia and the Pacific. Eligible project types will include the following infrastructure subsectors: (i) energy, including renewable energy generation, energy efficiency and conservation, and natural gas transmission and distribution; (ii) water and other urban infrastructure and services, including water, wastewater, and solid waste management; (iii) transport, including road

<sup>6</sup> ADB. 2011. *Strategy 2020 Brochure*. Manila.

<sup>7</sup> ADB. 2015. *Faster Approach to Small Nonsovereign Transactions*. Manila.

<sup>8</sup> ADB. 2014. *Review of the Asian Development Bank's Exposure Limits on Nonsovereign Operations*. Manila.

<sup>9</sup> ADB. 2015. *Investor Presentation*. <http://www.adb.org/sites/default/files/page/41282/adb-investor-presentation.pdf>

<sup>10</sup> ADB. 2015. *Clean Energy Program: Accelerating Low-Carbon Development in Asia and the Pacific Region*. Manila.

transport, water transport, rail transport, air transport, multimodal logistics, urban roads and traffic management, and urban public transport; (iv) information and communication technology; and (v) health. ADB and JICA may agree to add other sectors.

10. The fund will provide financing to companies and projects, as well as to financial intermediaries (e.g., holding companies, local currency vehicles)<sup>11</sup> where there is a link to infrastructure.

11. The fund's resources are expected to complement and extend ADB's operations, and the fund will be structured with both a commercial program and a concessional program. The commercial program is expected to comprise most of the fund's activity.

12. Under the commercial program, the fund's resources will be used to cofinance larger infrastructure projects requiring significant capital where ADB financing may be limited by exposure limits. Such cofinancing will be provided using the same market-based terms and conditions as ADB's nonsovereign financing committed to the same transaction. In contrast, the fund's concessional financing program will provide for fund-sourced financing on terms that are different from those committed by ADB. Such differences will include differentiated credit, pricing, seniority, tenor, or share class. For highly developmental transactions, the concessional program will help fill financing gaps that might otherwise exist under conventional nonsovereign financing arrangements.

#### **IV. IMPLEMENTATION ARRANGEMENTS**

13. Under this proposal, an ADB-managed trust fund will be established and capitalized by JICA. The fund will be designed to use and leverage ADB's nonsovereign operational platform, and will be structured to maximize flexibility and the deployment of capital. The fund's resources will be deployed over a 5-year investment period from the effective date of the fund's establishment. All proceeds and income (e.g., interest, principal repayments, dividends, and sale proceeds) will flow back to JICA (net of fees and costs) once received by ADB as the trustee.<sup>12</sup> To protect and diversify the fund's portfolio, exposure limits will be set, including thresholds governing single transaction limits and aggregate single country portfolio limits that ADB and JICA agree upon.

14. As the trustee, ADB will administer and manage the fund's resources, and will have the authority to approve, commit, and disburse these resources. ADB will implement and administer the fund's resources in accordance with the terms of the fund documentation, including, without limitation, to determine and enter into any amendments, waivers, restructurings, workouts, and litigation.<sup>13</sup>

15. Upon signing of the fund agreements, ADB will identify potential financing opportunities for the fund. ADB will perform initial due diligence on selected transactions in accordance with ADB's procedures for nonsovereign operations and will send an information package to JICA to

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<sup>11</sup> Private equity funds will be excluded from financial intermediaries.

<sup>12</sup> Typically, proceeds will flow back over a 15-year repayment period for loans and at the end of 7-year holding period for equity investments.

<sup>13</sup> However, JICA will retain the right to request transfer to it of any fund investment upon, in the case of any loan, payment default, and in the case of any equity investment, impairment of the investment.

review. Under the commercial program, upon receiving JICA's endorsement,<sup>14</sup> ADB will continue with its due diligence, negotiate financing documents, and make commitments on behalf of ADB and the fund. ADB will disburse fund resources for the transaction once conditions precedent have been met. For the concessional program, where the fund will provide financing on terms different than those committed by ADB, JICA will review the outline financing terms and conditions and will agree to these before ADB commits the fund's resources. As necessary, separate deal teams may be formed within ADB to represent the separate interests of the commercial and concessional financing components in a transaction.

16. ADB will act as the lender of record or investor of record for the fund's capital.<sup>15</sup> The fund will use ADB's operational platform, including its private sector screening, structuring, credit, underwriting, and approval systems. Projects financed by the fund will also use ADB's development monitoring and reporting framework, and will adhere to ADB's safeguards policy<sup>16</sup> and anticorruption and integrity strategies and policies.<sup>17</sup> ADB's applicable risk management policies and guidelines will also be applied to the fund's transactions.

17. As the trustee of the fund, ADB will exercise the same duty of care and diligence in the administration and management of the fund as it exercises with respect to other third party resources of a similar nature. JICA will release from liability and indemnify ADB for the activities it undertakes as the trustee.

18. As the Fund will focus exclusively on cofinancing nonsovereign operations, ADB's Private Sector Operations Department (PSOD) will manage the Fund according to the Fund's contribution arrangements. PSOD will also liaise with ADB's Office of Cofinancing Operations (OCO) for issues relating to supporting the cofinancing relationship with JICA, and with other departments and groups within ADB as needed.

## V. CONTRIBUTIONS

19. Contributions to the fund will be made by JICA in United States (US) dollars and deposited in one or more US dollar accounts as specified by ADB. JICA will provide contributions to the fund as needed. The fund's resources will be held, administered, and invested at ADB's discretion, in accordance with ADB's applicable investment policies, procedures, and practices for cofinancing funds held by ADB.

20. Any income earned from the fund's resources, including interest accrued, will be credited to the fund's account and will be used as necessary to defray the fund's administrative expenses<sup>18</sup> and fees. ADB will make withdrawals from the fund's account(s) as necessary to meet expenditures for eligible activities supported by the fund.

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<sup>14</sup> JICA will consider transactions individually and will need to provide consent for the fund's resources to be used in each transaction. Consent will be provided at ADB's concept review stage to allow transactions to be processed with sufficient certainty for co-financiers, recipients, and other stakeholders.

<sup>15</sup> ADB will need to make policy and institutional arrangements act in the capacity of an "equity investor" of record.

<sup>16</sup> ADB. 2009. *Safeguard Policy Statement*. Manila.

<sup>17</sup> ADB. 2010. *Anticorruption and Integrity: Policies and Strategies*. Manila.

<sup>18</sup> Administrative expenses include bank service charges, cost of external audits, and finance charges that may be incurred in purchasing required currencies and in remitting funds.

## VI. ADMINISTRATIVE ARRANGEMENTS

21. In return for ADB's services as the trustee of the fund, JICA will arrange for the Fund to pay ADB asset management fees and performance fees. Such fees will permit ADB<sup>19</sup> to mobilize sufficient resources to identify, structure, close, disburse, and administer investment opportunities for the fund.

22. ADB will hold and administer contributions separately from its own resources and resources of other ADB-administered trust funds. Following its standard procedures, ADB will maintain records and accounts that identify the contributions made and the commitments to be financed from the available funds, including eligible activities and administrative expenses. ADB will provide JICA with regular reports on the fund's performance, including financial statements audited by ADB's external auditors following ADB's fiscal year. The fund will cover the cost of these audits. ADB may also provide JICA with other reports and information, as reasonably requested by JICA. JICA and ADB will regularly meet after the establishment of the fund to provide strategic guidance, as well as to review and assess the fund's progress.

23. ADB will have no liability to JICA for the nonpayment of principal, interest, or other amounts, or for other forms of nonperformance by the recipient of any financing, or for partial or complete loss of contributions to the fund. ADB will be indemnified against any loss, liability, cost, claim, action, or demand that may be incurred or may be made against it arising out of, or in connection with, the fund's activities, except as may result from ADB's gross negligence or willful misconduct.

24. Under the proposed fund documentation, either ADB or JICA may at any time and upon reasonable notice in writing, terminate the fund's agreements. In such circumstances, neither ADB nor JICA will have any claim against the other by reason of such termination or cancellation. However, it will be agreed that from the date on which ADB receives a termination notice it will not allocate or commit any more of the fund's resources.

25. The contributions made by JICA to the fund will be administered in accordance with ADB's applicable policies and procedures, as may be amended from time to time. These include its framework to prevent and combat fraud and corruption, as well as its screening procedures to prevent the use of ADB resources to finance terrorist activity.<sup>20</sup>

## VII. RISK MANAGEMENT AND MITIGATION

26. Risks to ADB from establishing and administering the fund include the following:

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<sup>19</sup> ADB will use its sponsor-funded staffing program to facilitate implementation of the fund.

<sup>20</sup> In line with ADB member countries' obligations to give effect to the relevant decisions of the United Nations Security Council (taken under Chapter VII of the Charter of the United Nations)

- (i) **Non-deployment of fund commitment.** The risk posed by the failure to deploy the full extent of the fund's resources within the prescribed investment period is mitigated by ADB's large-scale private infrastructure operations and record of financing infrastructure projects. In addition, the fund's terms will include a provision that will allow for ADB and JICA to agree to extend the investment period by up to 2 years.
- (ii) **Failure to exit equity investments.** The risk posed by the failure to exit equity investments within the period of the fund is mitigated by the fund documentation, which will require flexible sale arrangements to exit individual investments by the fund. For investments made in local currency, the fund may bear a loss from the conversion from local currency to US dollars.
- (iii) **Nonperforming loans or impairments of equity investments.** The risk posed by the nonperformance of any loan or the impairment of any investment made by ADB as the trustee is mitigated by most of the fund's cofinancing being made on terms identical to those of ADB. The historical record indicates that the risk of nonperformance or impairment is low. Where the fund invests on concessional terms, JICA will endorse the principal terms that differentiate such financing from ADB's. JICA has been made aware that there is a risk of partial or complete failure of any investment made by the fund.
- (iv) **Conflict of interest.** The risk posed by failing to mitigate and safeguard against potential (or perceived) conflicts of interest where ADB uses the fund's resources under the concessional program is mitigated by the use of separate ADB transaction teams, as necessary, such that the conflicts of interest can be minimized.

## VIII. RECOMMENDATION

27. The President recommends that the Board approve:
- (i) the establishment of the Leading Asia's Private Sector Infrastructure Fund substantially in accordance with the terms and conditions set forth in this paper, and
  - (ii) the acceptance and administration by ADB of contributions to the Leading Asia's Private Sector Infrastructure Fund from the Japan International Cooperation Agency in accordance with the terms and conditions set forth in this paper.

## PRELIMINARY DESIGN AND MONITORING FRAMEWORK

### Impact the Project is Aligned with:

- Increased private sector development and private sector operations in all operational areas, reaching 50% of annual operations by 2020;
- Significantly increased support for environmentally sustainable development, including projects to reduce greenhouse gas emissions and to address climate change;
- Increased assistance for regional cooperation and integration to at least 30% of total activities by 2020
- ADB's lending portfolio targets and operational goals based on Strategy 2020a

Results Chain	Performance Indicators with Targets and Baselines	Data Sources or Reporting Mechanisms	Risks
<b>Outcome</b> Financing mobilized to support project in energy, including renewable energy generation, energy efficiency and conservation and natural gas transmission and distribution, water and other urban infrastructure and services, transport, information and communication technology, and health	Total finance mobilized by the Fund for non-sovereign infrastructure projects in ADB's DMCs of \$6 billion by the end of 2021 (2016 baseline: 0)	LEAP Fund annual reports	Construction risks cause delays to commissioning, affecting transactions' economics  Off-taker and market risk affect the financial viability of transactions  Operation and maintenance issues cause underperformance of infrastructure assets
<b>Outputs</b> 1. The LEAP Fund established  2. Resources are deployed into non-sovereign infrastructure transactions in ADB's DMCs	1a. The LEAP Fund is established by the end of 2016  2a. 85% of the capital committed to the Fund is deployed for co-financing of ADB non-sovereign transactions by December 2021 (2016 baseline: 0)	LEAP Fund annual financial statements  LEAP Fund annual reports  LEAP Fund annual reports	ADB's non-sovereign operations are not able to accommodate additional financing resources  The Fund agreements constrain the deployment of the Fund's capital with regard to risk appetite and country allocations

<b>Key Activities with Milestones</b>
<ol style="list-style-type: none"> <li>1. The LEAP Fund established <ol style="list-style-type: none"> <li>1.1 Finalization of term sheet negotiations – March 2016</li> <li>1.2 ADB Board Approval for the Fund – March 2016</li> <li>1.3 Signing of Fund documentation –1H 2016</li> </ol> </li> <li>2. Resources are deployed into non-sovereign infrastructure transactions in ADB’s DMCs <ol style="list-style-type: none"> <li>2.1 Deployment of the Fund’s resources – 2017</li> </ol> </li> </ol>
<b>Inputs</b>
<ol style="list-style-type: none"> <li>1. LEAP trust fund: \$1.5 billion</li> <li>2. ADB co-financing: \$1.5 billion</li> <li>3. Cofinancing from commercial and other investors: \$2.5 billion</li> <li>4. Equity from sponsors: \$0.5 billion</li> </ol>
<b>Assumptions for Partner Financing</b>
Not Applicable

ADB = Asian Development Bank, DMC, Developing Member Country, LEAP Fund = Leading Asia’s Private Sector Infrastructure Fund

Source: Asian Development Bank.

<sup>a</sup> ADB, 2008. Strategy 2020: Working for an Asia and Pacific Free of Poverty Institutional Document, April 2008, Manila. Available online at: <http://www.adb.org/documents/strategy-2020-working-asia-and-pacific-free-poverty>