CREDIT ENHANCEMENT PRACTICES
SUPPORTING INVESTMENT IN INFRASTRUCTURE
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CREDIT ENHANCEMENT PRACTICES

General Overview

❖ Definition
❖ Benefits
❖ Covered risks
❖ Forms of credit enhancement
❖ Partial Credit Guarantees in detail
Financial instrument designed to lower repayment risk of debt and security instruments

Its main objective is to improve the credit profile of borrowers

Its main function is to create more confidence among investors by decreasing perceived and actual risks of investment losses and that way expand financing resources for the beneficiary borrowers

The customary use of credit enhancement in development finance is providing partial credit guarantees to qualifying borrowers against the risks associated with lending either on concessional and market-based terms

In most instances credit enhancement is a complex structured finance transaction requiring strong knowledge and financial capacity of the guaranteeing institution
Main Benefits

1. Reduction of interest rate
2. Extension of debt maturity
3. More favorable debt amortization/repayment schedule
4. Easement of debt covenants
5. Extended list of available lenders
6. Introduction of new borrowers to the market
7. Introduction of large scale lending operations (never supported by local market)
8. Implementation of more ambitious projects with lesser risk
Credit risk
Currency risk
Liquidity risk

External, e.g., Macroeconomic challenges
Internal, e.g., Cost overruns, project performance
Teething troubles of maturing markets

Regulatory changes out of control of investors
Political instability amplifying regulatory uncertainty
Excessive transaction costs / corruption

Consequences of natural hazards
Physical / environmental challenges
Social unrest

Financial
Economic
Political
Other risks

Risk Covered

CITY RESILIENCE PROGRAM
## Forms of Credit Enhancement in Infrastructure Finance (1)

<table>
<thead>
<tr>
<th>Tool</th>
<th>Description</th>
<th>Key features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partial credit guarantee</td>
<td>Equivalent to structuring a <em>wrapped security</em> as defined more broadly in the structured financed field; it is an irrevocable promise by a third party financial institution to reimburse the creditor/investor in case of obligor’s technical default up to a certain amount (e.g. repaying principal and/or interest)</td>
<td>Typical guarantee amounts to 30-50% of total obligation</td>
</tr>
<tr>
<td>First-loss provisions</td>
<td>Refer to any instrument designed to protect investors from the loss of capital that is exposed first in case of erratic cash flows. It shields investors from a pre-defined initial losses. Often structured as a Partial Guarantee described above.</td>
<td>These could be debt, equity or derivatives instruments such as cash facilities or guarantees.</td>
</tr>
<tr>
<td>Cash collateral</td>
<td>Cash or equivalently liquid commercial papers collected and held in reserved account for the benefit of creditors</td>
<td>Lower percentage, on-demand coverage</td>
</tr>
<tr>
<td>Letter of credit</td>
<td>Written commitment by a financial institution to guarantee recovery of a specified cash amount in the event of any cash shortfalls in the project</td>
<td>Lower percentage (10-15%), on-demand coverage</td>
</tr>
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</table>
### Forms of Credit Enhancement in Infrastructure Finance (2)

<table>
<thead>
<tr>
<th>Tool</th>
<th>Description</th>
<th>Key features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political risk insurance</td>
<td>Cover private lenders and investors for certain risks of lending to sovereign or sub-sovereign borrowers. By definition, a Political Risk Guarantee (PRG) necessarily needs to include <strong>private participation in the project</strong>. Some risks covered entail currency inconvertibility, political force majeure such as war, regulatory risk and fulfillment of government payment obligations.</td>
<td>PRGs are used often and favorably in green energy/energy efficiency projects.</td>
</tr>
<tr>
<td>Loan syndications</td>
<td>The process of involving <strong>several different lenders</strong> in providing various portions of a loan. Loan syndication most often occurs in situations where a borrower requires a large sum of capital that may be too much for a single lender to provide or outside the scope of a lender's risk exposure levels.</td>
<td>Interest rates on this type of loan can be fixed or floating, based on a benchmark rate.</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>The practice of <strong>insurers transferring portions of risk portfolios to other parties</strong> by some form of agreement to reduce the likelihood of paying a large obligation resulting from an insurance claim. Reinsurance allows insurers to remain solvent by recovering some or all of amounts paid to claimants</td>
<td>The premium paid by the insured is typically shared by all of the insurance parties involved.</td>
</tr>
</tbody>
</table>
## Forms of Credit Enhancement in Infrastructure Finance (3)

<table>
<thead>
<tr>
<th>Tool</th>
<th>Description</th>
<th>Key features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contingent credit lines</td>
<td>Surety instrument approved <em>ex ante</em> to backstop the main debt by providing <em>cash resources for debtor in case of severe exogenous shocks</em> (e.g. natural disasters, political or economic turmoil).</td>
<td>Can be implemented through capital grants, subordinated loans or even interest subsidies to target specific issues affecting the project's viability.</td>
</tr>
<tr>
<td>Viability gap funding (VGF)</td>
<td>Used specifically and heavily in infrastructure to cover for the heavy upfront <em>funding that is required to kick start projects</em>. An analysis of the viability of a proposed project points out the weak areas that prevent large-scale funding from being obtained.</td>
<td></td>
</tr>
<tr>
<td>Performance bond</td>
<td>Specific type of a financial surety instrument issued by a financial institution (insurance company or a bank) to <em>guarantee satisfactory completion</em> of a project and ensure that the project has enough liquidity to be completed even in case of an unfortunate event (e.g. contractor contract breach, construction or financing breakage)</td>
<td>Covers up to 100% of project value. Widely used to secure design-build contracting obligations.</td>
</tr>
</tbody>
</table>

* Internal credit enhancement measures (such as excess spread or cross-/ overcollaterization) which are customary for loan pooling and securitization are excluded from this list; the focus here is on external credit enhancement measures such as providing third party financial guarantees to obligors engaged in infrastructure finance.
Case in focus: Partial Credit Guarantee – illustrative flowchart

Key points on Credit Guarantee:

- Financial surety offered by a 3rd party in addition to debt service warrantees and indemnities provided by borrower and its sponsors
- Improves standard loan term available to the subject borrower in the marketplace (decreasing interest rate, extending maturity)
- Offered through structures that are able to raise or place funds into a reserve which can be used to repay interest and/or principal in case of erratic project cash flows
- Partial guarantee covers a fraction of the total amount of loan facility
Covered risks – reasons of default that qualify for guarantee call (in exceptional cases, guarantee may cover debt service default regardless the reason of default)

Guarantee term – period of validity of guarantee (typically covers duration of the loan, subject to additional clauses on the callable period and the guaranteed amount)

Callable period – period of loan service when debt service default may cause call of guarantee

Guarantee coverage

- Covers outstanding principal and/or accrued interest up to certain amount, within callable period
- Guarantee contract specifies maximum portion of total principal and/or interest covered; typically 25-40%, in exceptional cases up to 100%; may change over the course of debt maturity

Accelerable / non-accelerable – whether guarantee can be re-aligned with accelerated debt repayment

Guarantee agreement: in addition to key terms specified above the agreement may regulate matters of particular concern such as use of proceeds of guaranteed debt, compliance with guarantor’s social and/or environmental safeguards, guarantor consent requirements for project changes, and transfer of rights. Such matter may also be regulated in a separate Project Agreement where Guarantee Agreement becomes a constituent project documentation
Partial guarantee to cover P&I payments up to 40% of outstanding principal, callable starting from 10th anniversary of debt service.
CREDIT ENHANCEMENT PRACTICES

Sample transactions

- Brazil
- Turkey
- Nigeria
- Pan-European
- Bulgaria
- India
Project description: The World Bank's worked with the State of Sao Paulo to design the Sao Paulo State Sustainable Transport Project aimed at rehabilitating and upgrading approximately 750 km of motor roads and the reconstruction of two bridges for inland waterway transport on the Tiete River.

Total investment: US$729 million

Key stakeholders: State and federal government, private sector, IBRD

Key project finance: Banco Santander commercial loan (US$ 300 million), IBRD loan (US$ 300 million) and State of Sao Paulo equity (US$ 129 million)

Guarantors: Government was a primary guarantor on commercial loans. MIGA issued a non-honoring guarantee for US$ 361 million to Banco Santander SA of Spain. This guarantee provided specific coverage of Santander’s loan to the State of Sao Paulo.

Structure of credit enhancement
World Bank Treasury facilitated the mobilization of additional financing from international private banks with the help of MIGA credit guarantee non honoring of sovereign financial obligations. Tenor extended from 7-8 years to 12 years.
Project description: In December 2010, MIGA issued a NHSFO guarantee of $19.5 million insuring an investment by WestLB AG (currently Portigon AG) in the expansion of Istanbul's light-rail transit network. WestLB later approached MIGA to seek additional coverage for a much larger loan for financing extension of Metro's M4 line. In the former case, WestLB AG was the lead agent for a consortium of lenders.

Key stakeholders: Municipality of Istanbul (borrower), WestLB AG

Key project finance: Commercial loan

Guarantors: MIGA guarantee protecting against non honoring of sovereign financial obligations up to $409 million, tenor 9.5 years

Structure of credit enhancement
MIGA’s guarantee covers the risk of a default by Municipality of Istanbul on its obligation to repay principal and interest due to Portigon AG and the lenders related to this loan. The project is an example of how MIGA can cover sub-sovereign credit risk without the requirement of a national Ministry of finance guarantee.
Unlocking the potential for infrastructure financing in Nigeria

**Project description:** GuarantCo and the Nigeria Sovereign Investment Authority (NSIA) sponsored the creation of InfraCredit, a start-up local guarantor established to support long-term infrastructure financing in Nigeria. This is the first Nigerian-based credit guarantor focused on credit enhancing infrastructure bonds. It targets pension fund investors.

**Total investment:** InfraCredit capital is comprised of paid-in equity and “second loss” contingent funding, altogether up to US$200 million.

**Key stakeholders:** InfraCredit, NSIA, GuarantCo (a guarantee company sponsored by governments of Sweden, UK, Australia, Switzerland, and The Netherlands; supports infrastructure lending in local currency on emerging markets).

**Guarantors:** GuarantCo capitalized InfraCredit with US$50 million in the form of Callable Funding Facility; this facility will insure a first series of guaranteed transactions worth US$100 million.

**Structure of credit enhancement**
GuarantCo’s product is a coverage of second loss of InfraCredit. In turn, InfraCredit’s provides guarantees to derisk bonds issued by eligible companies, increasing the confidence of Nigeria’s pension funds to invest in long-tenor, Naira-denominated bonds.
**Project description:** The Loan Guarantee Instrument for Trans-European Transport Network Projects (LGTT) is an innovative financial instrument set up and developed jointly by the European Commission and the European Investment Bank (EIB) which aims at facilitating the private sector involvement in the financing of Trans-European Transport Network infrastructure (“TEN-T”).

**Total investment:** Up to €40 billion of Pan-European investments in TEN

**Key stakeholders:** EBRD, EIB, commercial banks

**Key project finance:** €1 billion in loan guarantees intended to support up to €20 billion of senior loans

**Guarantors:** EIB and the European Commission. Guarantees capped €200 million per project

**Structure of credit enhancement**
The stand-by liquidity facility (SBF) guaranteed by the LGTT should not normally exceed 10% of the total amount of the senior debt (up to 20% in exceptional cases). As a guarantee covenant, all free project cash flows shall go for debt’s principal refinancing without any profit left at the project level.
Project description: AES Corporation, a US-based energy company, was awarded a concession to finance, build, own, and operate a 600 MW lignite-fired power plant adjacent to the existing coal-fired power plant in the city of Galabovo, 270 km southeast of Sofia.

Total investment: €1.09 billion

Key stakeholders: AES Corporation, Newedge Group (of Societe General, a loan syndicator), EBRD, multiple private lenders, Alstom (contractor)

Key project finance: project achieved favorable debt-to-equity ratio of 30/70

Guarantors: MIGA issued €99 million in guarantees against political risks of default on loan repayment and equity returns.

In addition to MIGA, main guarantee coverage was provided by private credit export insurers, Coface and Euler Hermes

Structure of credit enhancement
MIGA’s coverage ensures lenders and equity provider that they will be compensated in the event that the investor defaults on debt payments due to a covered event (expropriation, war, civil disturbance). The guarantees are for 16 years.
**Project description:** First-of-a-kind partial credit guarantee facility in India to provide partial guarantees on rupee-denominated bonds issued by Indian companies to finance infrastructure projects. ADB takes on a part of that guarantee risk, improving the credit rating of an infrastructure project to A or AA.

**Key stakeholders:** Institutional investors (e.g. pension funds) that can only invest in assets graded AA or above.

**Key project finance:** rupee-denominated bonds

**Guarantors:** Asian Development Bank counter-guarantees the India Infrastructure Finance Company Limited (IIFCL) and other domestic finance companies that serve as primary guarantors on individual transactions.

**Structure of credit enhancement**

US$128 million in partial credit guarantees to back multiple bond issuances (i.e. supporting different projects). IIFCL can independently provide partial credit guarantee worth up to 20% of project value and up to 40% of project value with a co-guarantor/risk sharing partner. IIFCL can also lend directly. Total IIFCL project exposure are subject to 20% project value limit.
EXAMPLES OF GLOBAL CREDIT ENHANCEMENT FACILITIES
### World Bank Group products

<table>
<thead>
<tr>
<th></th>
<th>World Bank (IBRD+IDA)*</th>
<th>MIGA</th>
<th>IFC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risk Coverage</strong></td>
<td>Government / parastatal obligations and credit risk</td>
<td>Political risk; credit risk when borrower is a sovereign or sub-sovereign government or state-owned enterprise</td>
<td>Credit risk</td>
</tr>
<tr>
<td><strong>Eligible investment instruments</strong></td>
<td>Debt or payment obligations (international or domestic)</td>
<td>Equity, debt, and any other forms of trans-border investments</td>
<td>Debt (international or domestic)</td>
</tr>
<tr>
<td><strong>Pricing</strong></td>
<td>IBRD and IDA loan equivalency, risk managed through size of lending programs</td>
<td>Based on administrative costs, country and project risk</td>
<td>Commercially based</td>
</tr>
<tr>
<td><strong>Sovereign Guarantee needed as a primary guarantor?</strong></td>
<td>Yes</td>
<td>No (but projects has to obtain host country approval)</td>
<td>No</td>
</tr>
<tr>
<td><strong>Eligibility requirement</strong></td>
<td>The project must be of strong interest to, and have the express commitment of, the host Government</td>
<td>Requires foreign investor or lender</td>
<td>Private lenders and investors</td>
</tr>
<tr>
<td><strong>Major clients</strong></td>
<td>Host government -If it is a private project, it might be eligible for a World Bank Guarantee if it is the direct beneficiary of an obligation from the Government, a political sub-division of Government, or a Sovereign Owned Entity, which can be guaranteed by the WB.</td>
<td>Private sector</td>
<td>Private sector</td>
</tr>
</tbody>
</table>

*Whether the guarantee is issued by the IBRD or IDA depends on whether the host country of the project is eligible for IBRD support or is an IDA-only country.
Initially focused on the countries of the former Eastern Bloc, The European Bank for Reconstruction and Development (EBRD) expanded to support development in the democracies of 30 countries from Central Europe to Central Asia.

The EBRD has consistently provided co-financing, guarantees and syndications over the years, but has a renewed interest in credit enhancements recently.

One of the primary forms of EBRD support to infrastructure projects is B Loan syndication/junior debt, guarantees and targeted credit lines.

EBRD has employed credit-enhancement schemes heavily in the municipal and environmental infrastructure (MEI) sector (water, solid waste, urban transport, energy, etc).
Although about 90% of projects financed by the EIB are based in the EU member countries, the EIB also funds projects in about 150 other countries around the world.

The EIB provides guarantees both for senior and subordinated debt and for projects of various scale, ranging from complex Pan-European PPPs to supporting small and medium-sized enterprises.

Examples of EIB-guaranteed projects include a guarantee facility to cover medium term revenue risks for Trans-European rail network development, risk-sharing provided as part of initiatives for supporting small business such as JEREMIE and CIP, as well as Risk Sharing Finance Facility for projects in research, development and innovation.

The EIB has also actively supported the issuance of long-term bonds for PPP projects by providing contingent credit lines (i.e., cash that can be disbursed if the project is unable to repay the bondholders).
IFC and the Swedish International Development Cooperation Agency (SIDA) partnered to facilitate access of institutional investors to emerging-market infrastructure.

This partnership is based on the IFC’s Managed Co-Lending Portfolio Program (MCPP).

IFC’s invests in a junior tranche of MCPP loan portfolio (subordinated to senior investors of that loan portfolio) but maintains a first-loss position. This structure improves the risk position of the senior investors in MCPP.

SIDA shares risks by providing a guarantee against the first loss on a portion of the MCPP loan portfolio.

The IFC/SIDA partnership enables each US$1 invested to mobilize additionally US$8-10 from a third party.
ADB’s principal credit enhancement products include Political Risk Guarantees (PRGs) and Partial Credit Guarantees (PCGs). A majority of such guarantees cover borrowing in local currency, which facilitates local financing.

ADB guarantees cover a wide variety of debt instruments and may provide either comprehensive (financial risk) or limited coverage, including political risk.

The ADB also extensively acts as Guarantor-of-Record where it “fronts” a guarantee contract for the entire amount of the guarantee and then transfers the exposure to one or more insurers who end up underwriting the risk.

Another customary form of credit enhancement pursued by ADB is the loan syndication. ADB runs a Complementary Financing Scheme whereby ADB acts as lender-of-record in joint lending transactions with other banks (including commercial banks) participating as B loan providers and benefiting from privileges and immunities of ADB.

*Example of ADB credit enhancement in the form of PCG was coverage of principal and interest due for first 3 years on a 5-years $950 million syndicated loan to the Export-Import Bank of Thailand. The PCG was fully counter-guaranteed by the Kingdom of Thailand.
EXAMPLES OF CREDIT ENHANCEMENT FACILITIES OFFERED BY IFIs

USAID – Development Credit Authority (DCA)

✓ USAID runs the DCA as a partial credit guarantee program designed to help generate additional lending opportunities in underserved markets

✓ Core objective is to mobilize local private capital in infrastructure and economic development

✓ Standard DCA guarantee products include individual loan guarantees, portfolio loan guarantees and portable guarantees (where DCA provides commitment to ensure loan-servicing performance of an identified borrower while lenders are not yet identified)

✓ Main features of DCA guarantees:
  - Backed by the full faith and credit of the U.S. Treasury
  - Covers loan principal and does not cover fees or interest
  - Typically structured as a pari passu guarantee (i.e. guarantees predetermined – customarily 50% - share of losses and participates in recoveries of losses alongside with the lender, not waiting for the lender to recover debt first)
  - Guarantees non-sovereign debt capital (e.g., cities, SMEs, commercial banks)
  - Flexibility to guarantee local and/or foreign currency
  - Guarantees loan maturities of up to 20 years
  - Guarantees may be paired with USAID or other technical assistance projects

*Since its inception in 1999, USAID’s Development Credit Authority (DCA) has issued guarantees that have mobilized up to USD 5.4 billion in credit to entrepreneurs in 76 developing countries.
The AfDB’s main guarantee products are: Partial Credit Guarantee and Partial Risk Guarantee

Partial Credit Guarantee (AF-PCG) is a comprehensive coverage that insures debt service obligations of sovereign borrowers and related state-owned enterprises in low-income African countries.

Partial Risk Guarantee (AF-PRG) covers private lenders against the failure of a government or a government-related entity to honor repayment obligations due to realization of well-defined political risks; such political risks could include political force majeure, currency inconvertibility, regulatory risks (e.g. adverse changes in law), and various forms of breach of contract by government and related entities; AF-PRGs have been extensively used to attract commercial financing in public sector utilities such as power, water, oil and gas, and mining.

Borrowers eligible for an African Development Bank’s loan are eligible for its Guarantee.

Maturities of covered debentures may extend up to 20 years.

* The AfDB has successfully implemented PCGs and PRGs in various African projects through the African Development Fund’s initiatives over the past two years. A significant example of these efforts is the PRG provided to coal-based independent power plants in Nigeria, enabling local private investors to come into the projects.
Interamerican Development Bank (IDB)

✓ Provides guarantees for the credit enhancement of loan and bond issuances, and for structured trade finance transactions and securities backed by assets or future flows.

✓ Offers flexibility to furnish local currency guarantees to enable greater local lending

✓ Has launched guarantee products to address specific project-level risks such as performance bonds. This also includes a special focus on risk-mitigation of green infrastructure projects to attract additional commercial financing in this green building

✓ IDB guarantee products range from partial credit guarantees on larger loans of up to $400 million to smaller guarantee products of $15-100 million targeting availability of capital to SMEs.
The Governments of Australia, UK, Sweden, Switzerland and Netherlands sponsored creation of infrastructure guarantee company GuarantCo.

Principal product are partial guarantees backing local currency loans and bonds which proceeds are used to finance infrastructure development needs.

Full spectrum of a GuarantCo products includes: partial credit and partial risk guarantees, first loss guarantees, tenor extension or liquidity guarantees as well as joint guarantees or counter guarantees.

The guarantee cover available from GuarantCo for any single transaction is between USD 5 million to USD 50 million or the equivalent amount in local currency.

GuarantCo will not typically cover more than 50% of the total debt of the project or corporate.

GuarantCo can cover senior and subordinated debt but not equity. Maximum tenor is 15 years.
THANK YOU