# Mobilizing Capital for Agricultural Development with the Development Credit Authority

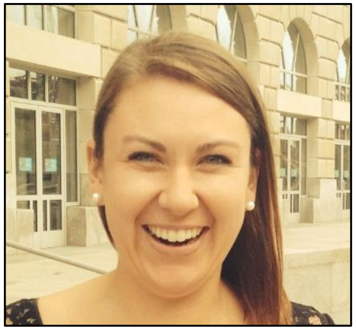
# Today’s session is the first in a series of webinars on agricultural finance

| Topic | Date |
|---|---|
| **Mobilizing capital for agricultural development with the Development Credit Authority** | TODAY |
| **Understanding what makes an agribusiness “investable”** | October 10$^{th}$, 10 a.m. EST |
| **How best to engage with local financial institutions on agriculture programs** | October 24$^{th}$, 10 a.m. EST |
| **How to use agricultural finance interventions to drive youth employment** | November 7$^{th}$, 10 a.m. EST |
| **Investor perspectives on agriculture in emerging markets** | To be confirmed |

# Learning objectives

- To help participants **understand why the DCA is important** to catalyzing agricultural investment in target countries
- To **provide a complete overview of the DCA**, how it works and when it is best employed
- To **outline the five DCA guarantee products** with supporting case studies
- To **show how multiple USAID tools can be combined** in an intervention
- To **walk participants through an interactive case study** matching USAID tools (including DCA) to a specific situation

# Your presenters today



**Megan Rapp** is the Senior Advisor for USAID's Development Credit Authority (DCA) office, where she is co-leading the office's new strategy focused on increased private finance for development and product innovation. Prior to her role as Senior Advisor, she was DCA's Africa Regional Team Lead and expanded the Africa guarantee portfolio from $484 million to $2.1 billion.

**Shyam Sundaram** is an Associate Partner at Dalberg Advisors and leads Dalberg's work in Talent, Trainings and Leadership programs. Shyam also leads much of Dalberg's work on agriculture and food security and previously designed and facilitated a three-day AgFinance Training for USAID staff in Washington DC.

**Mark Pedersen** is a Project Manager at Dalberg Advisors where he focuses on inclusive finance, strategy and Base-of-the-Pyramid business models. Mark has worked extensively in emerging markets as both a consultant and an entrepreneur, including as the co-founder and CFO of a for-profit social enterprise in Latin America.

# Rules of the Road


- ***Ask questions – this is a learning environment!***
- ***When not talking, remember to mute yourself!***
- ***If anything is unclear ... Please flag! It may be unclear to someone else as well.***

# Key terms

| | Definition |
|---|---|
| **Agricultural finance** | The provision of multiple types of services (both direct and indirect financial tools) dedicated to supporting both on- and off-farm agricultural activities and businesses including input provision, production, distribution, wholesale, processing and marketing. |
| **Agricultural finance intervention** | An activity which is designed specifically to compensate for a market failure and has the specific objective of catalyzing private sector investment in agriculture.<br><br>Agricultural finance interventions are typically implemented by development actors and meant to provide temporary support. |
| **Agribusiness** | For the purposes of this training, an agribusiness is defined as any business – large or micro – along the agricultural supply chain including input provision, production, distribution, wholesale, processing and marketing. <u>Smallholders are not considered agribusinesses unless they are affiliated with a larger entity (e.g., a cooperative).</u> |

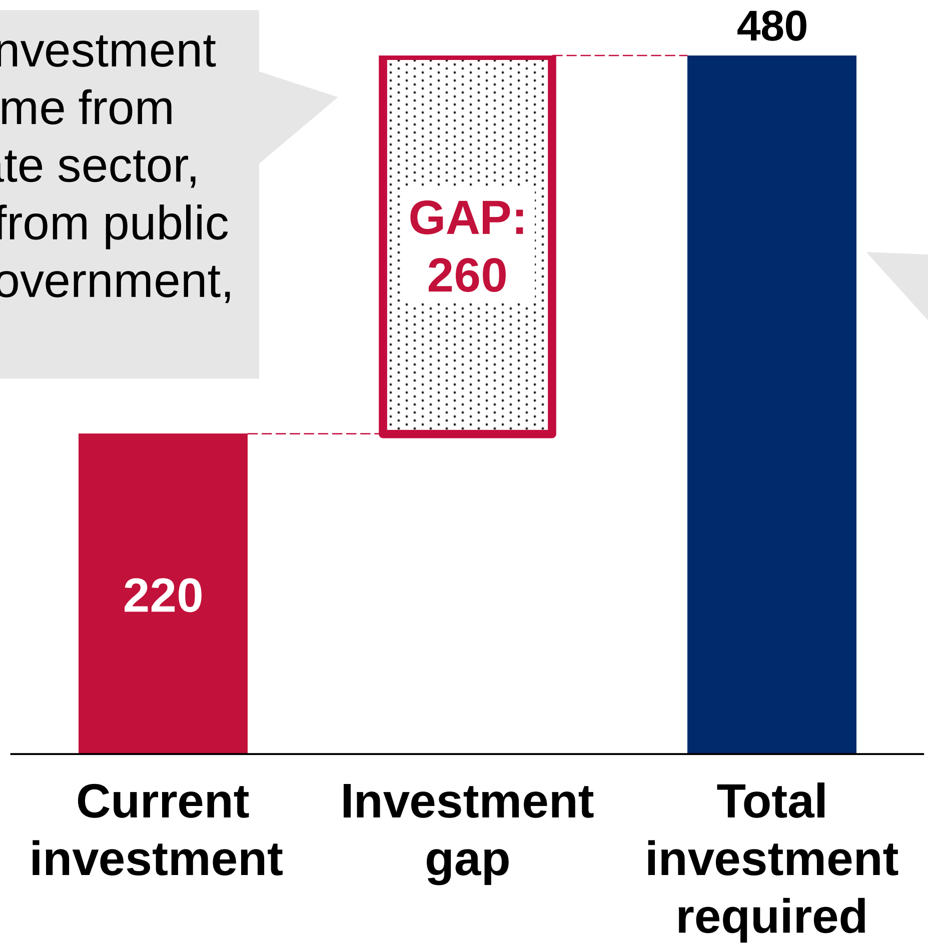
# Agenda for today

1. **Setting the context: why is a DCA for agriculture important?**
2. When does it make sense to use a DCA product?
3. What are the specific products available under DCA?
4. Designing and implementing DCA guarantees
5. Model engagement walkthrough
6. Concluding thoughts

# There is a large unmet need for agricultural finance

## Estimated annual investment needed in agriculture and food security to reach SDG 2: Zero Hunger by 2030 (USD billion / year)

**75%** of investment could come from the private sector, the rest from public funds (government, ODA)



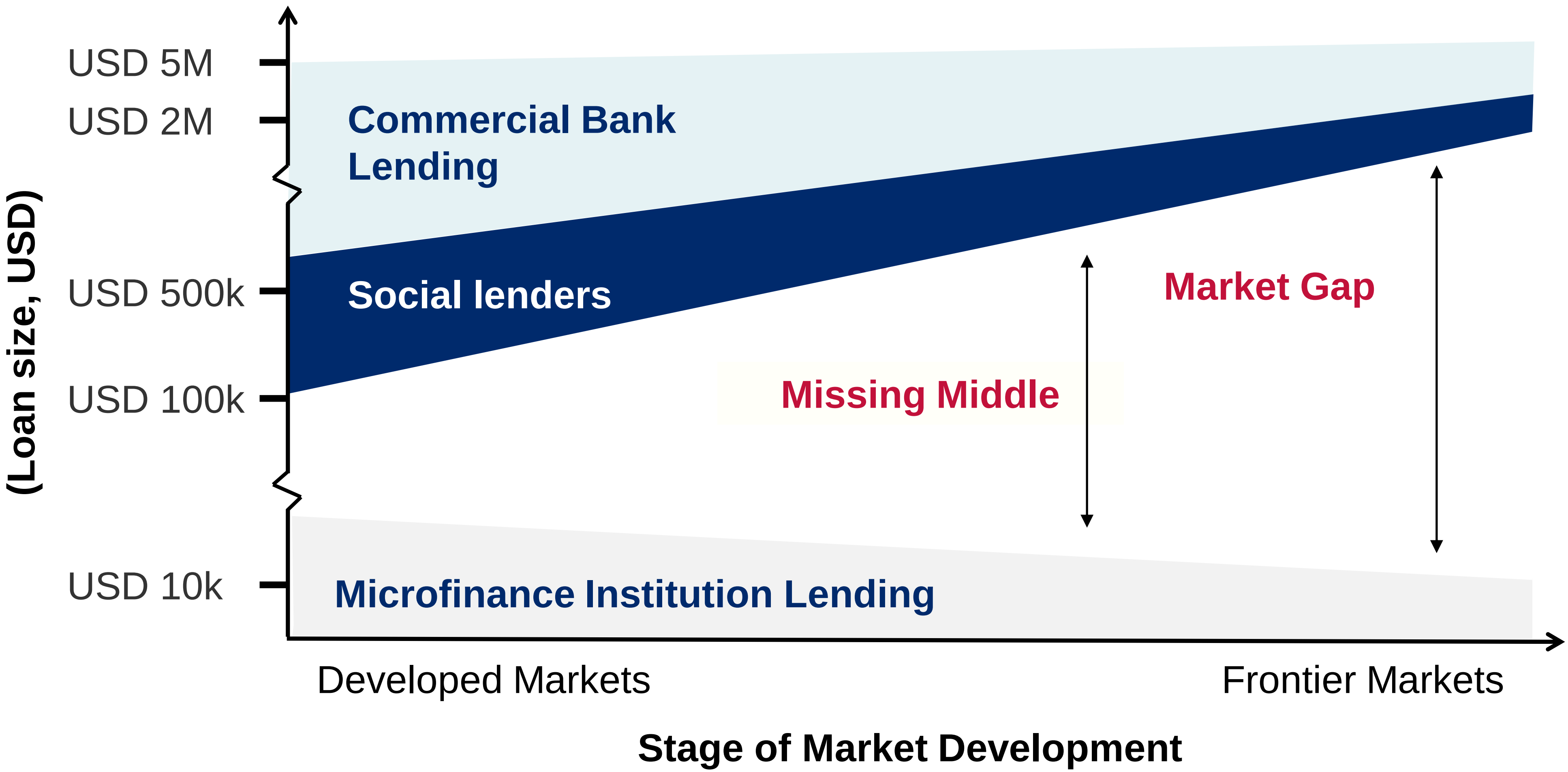

**Investment needs:**

- Enhanced production
- Value-addition
- Infrastructure
- Safety nets

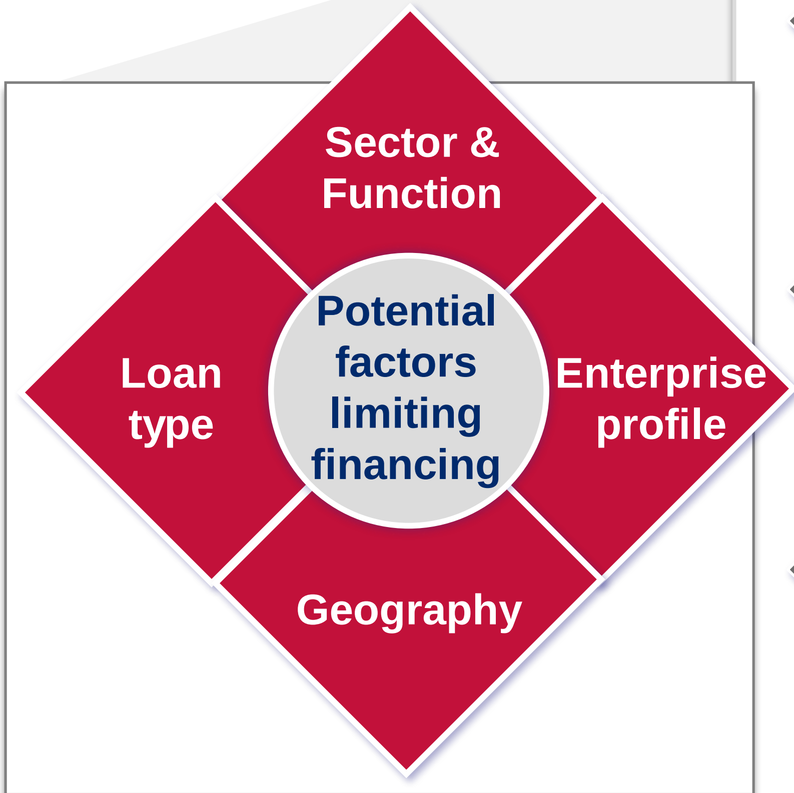
Source: United Nations Commission for Trade and Development, 2014. *World Investment Report 2014.*

# The financing gap is greatest for agribusinesses that need medium-sized loans…

## Debt finance is most limited for agribusinesses requiring capital between **USD 50K - USD 2 Million**



# … but this "missing middle" can also be defined using other criteria aside from the investment size needed




*<u>Banks may also be unwilling to finance an agribusiness because of certain characteristics</u>*

### Sector & Function

- Sub-sector (e.g., poultry, dairy, livestock)
- Specific functions (e.g., distribution)

### Enterprise profile

- Number of employees
- Turnover rate

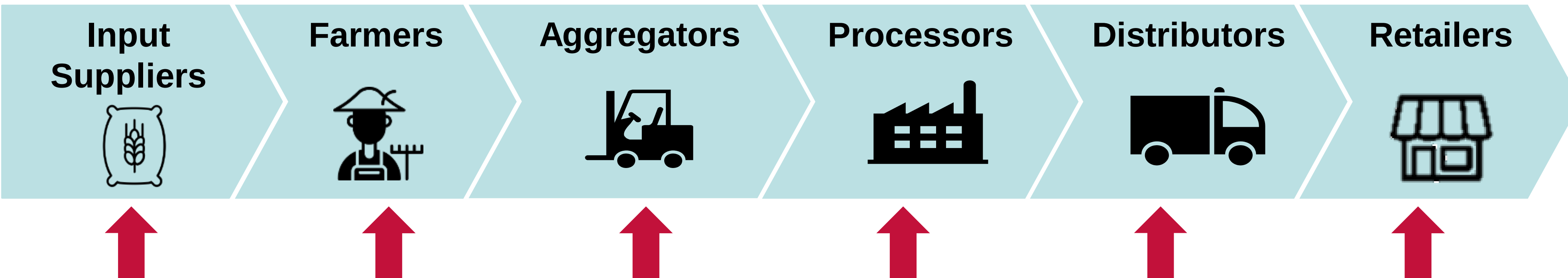
### Geography

- Location within a given country
- Urban vs. rural

### Loan type

- Loan terms needed
- Loan duration

# Agribusinesses across the supply chain need finance…




**Actors in each segment need access to some type of finance; meeting the needs of multiple segments has reinforcing effects.**

Source: *Policy Brief #3: Investment in Agriculture.* International Institute for Sustainable Development website, September 2015.

# … and actors require different types of finance

**[Non-exhaustive]**

**Working Capital**

Day-to-day purchasing needs

- Own funds
- Short-term debt
- Trade credit

**Asset Finance**

Investment in fixed and movable assets

- Leasing
- Hire-purchase
- Long-term debt/equity

# However, multiple factors limit access to finance

## Market Imperfections

- Few financial products tailored for agribusinesses and producers
- High lending rates
- Lower-risk alternative investments
- Risk-averse lenders who often lack experience lending to agriculture

## Borrower Demographics

- Limited access to financial institutions
- Poor or non-existent credit history
- Insufficient collateral
- Minimal book keeping

**Agribusinesses and producers of all sizes lack financing**

# Given these gaps, why are guarantees helpful?

**Guarantees unlock private lending** to agribusinesses and smallholders that would otherwise not occur due to the riskiness inherent to agriculture or due to the lack of collateral on the part of smallholders or agricultural MSMEs.

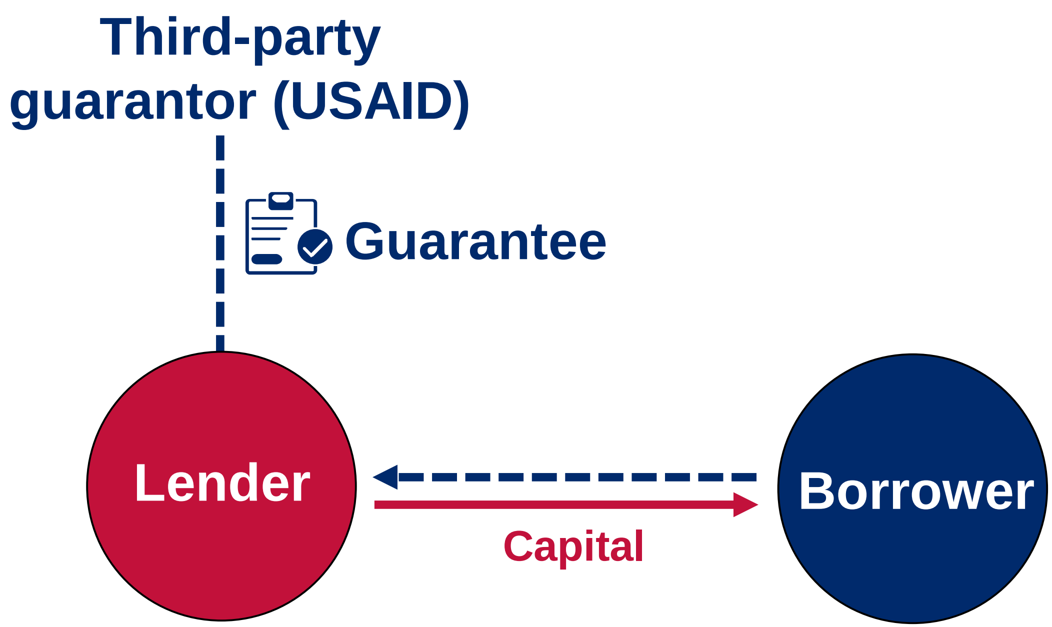
**Guarantees can initiate a cycle of continued local lending** that persists even after guarantees have terminated.

**Guarantees multiply impact.** Each DCA dollar spent on agricultural guarantee subsidies catalyzes on average 19 dollars in private lending.

Source: Credit Management System, accessed September 24, 2018. Dalberg analysis.

# How does a guarantee generally work?

**Description:** Guarantees are agreements between a third-party and a lender where the third-party agrees to pay the lender some proportion of their losses if the borrower fails to repay all or some of their loans.




Source: Factsheet on the DCA, Development Credit Authority website, accessed August 6, 2018.

# The DCA is a specific type of guarantee – what is it and why does it exist?

## What is the DCA?

- DCA is the legislative authority that permits USAID missions to issue partial loan guarantees to private lenders to achieve development objectives.
- Missions are responsible for integration into mission strategy, ensuring development impact, and managing the guarantee and any supporting technical assistance mechanisms.
- DCA office is responsible for supporting the missions in project development, risk assessment, and implementation of their guarantee.
- DCA is not its own program, nor is it a grant or contract mechanism.

## Why does the DCA exist?

To mobilize commercial debt solutions for underserved borrowers.

To catalyze local, regional or international private lending.

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# How is the DCA guarantee unique from grants and contracts? (I/II)

| | Guarantees | Grants | Contracts |
|---|---|---|---|
| Description | • A third-party (USAID) agrees to pay partial loan losses if a borrower fails to repay a lender | • Financially support a recipient in its accomplishment of a public purpose | • Used to obtain goods or services from an awardee |
| Level of USAID control | Legally-binding risk-sharing agreement with lender | Moderate level of control through grant conditionality | High level of control via contractual obligation and repeated payments over time |
| Is OAA involved? | No | Yes | Yes |
| USAID Mission Lead | Activity Manager (AM) | Agreement Officer's Representative (AOR) | Contracting Officer's Representative (COR) |

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# How is the DCA guarantee unique from grants and contracts? (II/II)

| | Guarantees | Grants | Contracts |
|---|---|---|---|
| Who is involved externally? | • Lender (LGs, LPGs, LPGs, BGs)<br>• Borrower (LGs, PGs, BGs) | • Recipient (direct) | • Awardee |
| Funders? | Private lenders or investors | USAID FROM THE AMERICAN PEOPLE | USAID FROM THE AMERICAN PEOPLE |
| Design timeline | 6 – 12 months | 6+ months | 12+ months |
| How are USAID funds obligated? | Phoenix inter - governmental transfer from USAID to US Treasury | GLAAS actions transferring money from USAID to an implementing partner | |
| Type of partnerships | Equal risk-sharing partnerships | Donor-implementing partner relationships | |
| IEE required? | Yes | Yes | Yes |

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# The DCA is a very important tool for agricultural finance

| | **Agricultural portfolio** / Total portfolio | |
|---|---|---|
| **Value of credit (USD)** (made available since 1999) | **1.8 billion** out of 5.3 billion | 34% |
| **Number of guarantees** | **248** out of 557 | 45% |
| **Number of borrowers** | **230,737** out of 347,510 | 66% |

Source: Credit Management System, accessed September 24, 2018. Dalberg analysis.

# Agenda for today

1. Setting the context: why is a DCA for agriculture important?
2. **When does it make sense to use a DCA product?**
3. What are the specific products available under DCA?
4. Designing and implementing DCA guarantees
5. Model engagement walkthrough
6. Concluding thoughts

# DCA guarantees have to follow six principles

| | | |
|---|---|---|
| 1 | **Development mandate** | The DCA guarantee must address specific sustainable development objectives of the USAID mission. |
| 2 | **Demand-driven** | The DCA is not its own program, but a tool designed to support specific operating units. |
| 3 | **Complementarity** | The DCA guarantee tool is designed to complement existing or planned USAID programs. |
| 4 | **Continued lending** | Private lending to the targeted sector or borrower group should continue after guarantees end. |
| 5 | **Additionality** | Guarantees should be used when it is <u>unlikely</u> that the transaction would occur without it. |
| 6 | **True risk-sharing** | Lending partners must place their own capital at risk in the transaction, and USAID pays part of loan losses of principal only if there is a default. |

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# Therefore, DCA guarantees are best used in the following situations:

| SITUATION | EXAMPLE |
|---|---|
| • When the financial sector is keen to invest in agriculture but requires **risk-sharing** | • A Côte d'Ivoire cashew processor needed large-scale capital to expand production of a lucrative global crop. |
| • Where there is substantial **information asymmetry** between borrower and lender | • Cambodian banks have trouble evaluating the capacity of smallholder rice farmers to repay loans. |
| • When there is a reasonable prospect of loan repayment (**low projected default rate**) | • An East African bank is looking to invest in agricultural SMEs, but the risk is too high for them to meet their internal lending guidelines. |
| • When **loans would not otherwise be provided** | • Very few strawberry farmers in Kosovo access finance in a country where only 4% of loans go to agriculture. |

Sources: Development Credit Authority websites (*Growing Agribusiness in Ethiopia*, June 2018; *Côte d'Ivoire: Cashew Exporter Expands*, March 2017; *Kosovo: Credit for Farmers*, September 2012; *Mobilizing Credit for Agriculture, Cambodia*, September 2017).

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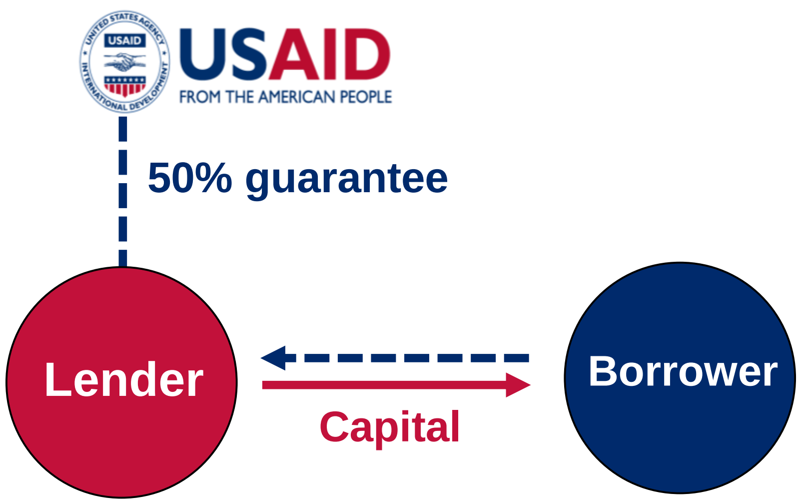
# There are five products available under DCA

1. Loan Guarantee
2. Portable Guarantee
3. Loan Portfolio Guarantee
4. Lease Portfolio Guarantee
5. Bond Guarantee

# 1 Loan Guarantee

**Description:** USAID provides a DCA guarantee to an identified lender on a single loan product between the lender and an identified borrower.




## Guarantee Terms

- DCA guarantees up to 80% of loan losses (typically 50%)
- Maximum term of 20 years
- Lender pays an origination and utilization fees to ensure commitment and additionality
- Guarantees may be denominated in local or foreign currency

Source: Factsheet on the DCA, Development Credit Authority website, accessed August 6, 2018.

# 1 Loan Guarantee

CASE STUDY

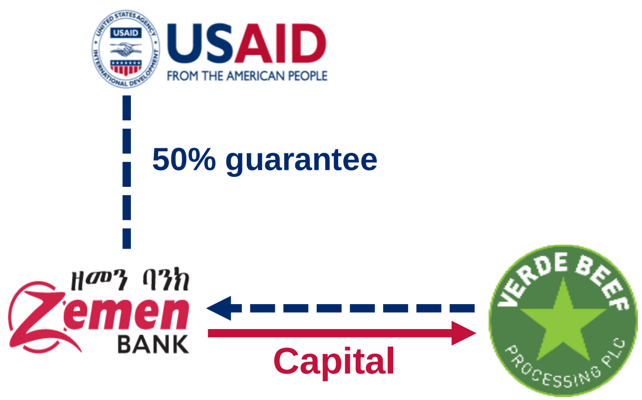
## Mobilizing capital for a beef company (Ethiopia)

### Background

- Verde Beef is an Ethiopian meat processor.
- Verde needed capital to scale up production.
- The local credit market did not offer sufficient credit for the type of growth required.

### Solution

- USAID promised to guarantee 50% of any realized loan losses for an 8-year, USD 5 million loan given to Verde Beef.
    - Lender: Zemen Bank
    - Borrower: Verde Beef



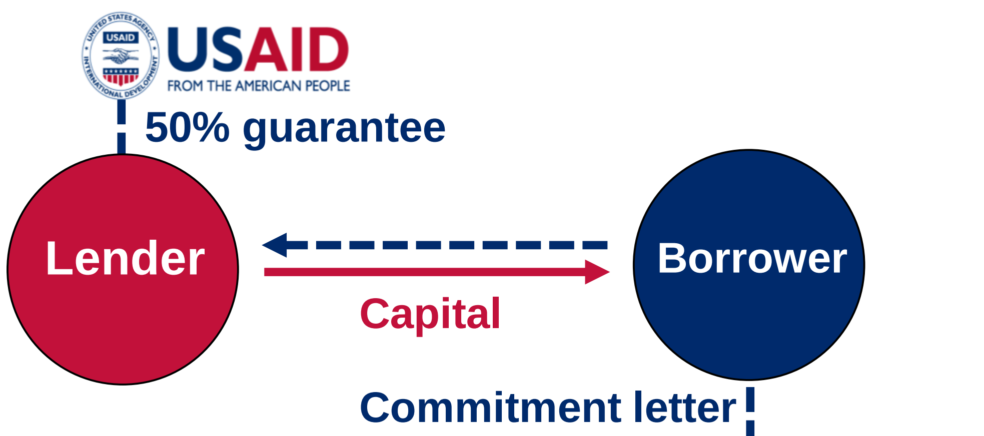

### Results

- Verde is building a new processing facility and slaughterhouse.
- The new processing facility and slaughterhouse positively impacted ~2,000 jobs through increased demand for cattle.

Source: *Mobilizing capital for a ground-breaking beef processing company in Ethiopia,* Development Credit Authority, September 2017.

# 2 Portable Guarantee

**Description:** DCA guarantees a future loan between an identified borrower and an unspecified lender. The borrower is given an official DCA commitment letter that, once a lender is identified, guarantees the loan up to specific risk thresholds.




**Note**: Portable guarantees may be less desirable due to lengthy processing times. Consider non-binding letters of intent (LOIs) for borrowers.

## Guarantee Terms

- DCA guarantees up to 80% of loan losses (typically 50%) for a maximum term of 20 years.
- Origination and utilization fees paid by the financial partner are calculated using the most conservative risk metrics to ensure true risk-sharing.
- Once a lender is identified, USAID negotiates a loan guarantee agreement with the lender. This can significantly increase the process time.

Source: Factsheet on the DCA, Development Credit Authority website, accessed August 6, 2018.

CASE STUDY

# 2 Portable Guarantee

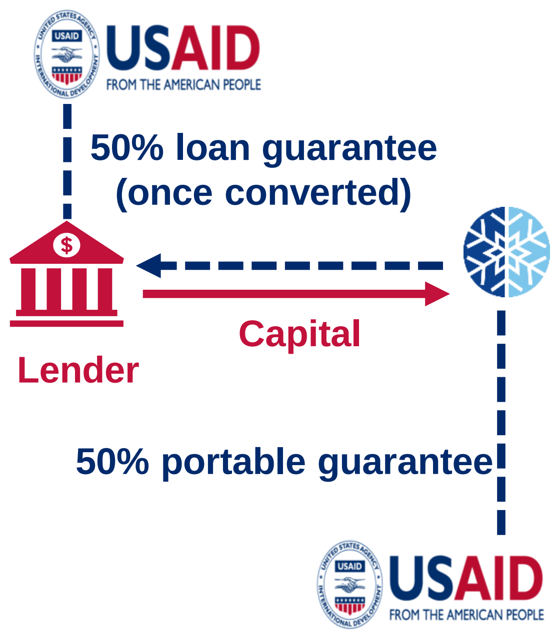
## Mobilizing Credit for Cold Chain Development (Morocco)

### Background

- FrioPuerto needed a USD 7 million loan to build a cold-storage facility.
- Local lenders felt the project was too risky, due in part to the greenfield nature of the company and the facility.
- The goal was to enable higher value-added horticulture exports in Morocco.

### Solution

- USAID provided a **portable guarantee** so FrioPuerto could "shop around" for the best lender.




### Results

- FrioPuerto built a 5,500 $m^2$ facility and created 380 new local jobs, directly and indirectly.
- The new facility gave local horticulture a channel for exports.


Sources: *Mobilizing Credit for Cold Chain Development*, *Morocco*, Development Credit Authority, 2015; FrioPuerto website, accessed August 2018.

# 3 Loan Portfolio Guarantee

**Description:** USAID provides a DCA guarantee to an entire portfolio of loans for borrowers in a defined group. The lender is identified but the specific borrowers are not.


* Typically structured with one lender but can include multiple lenders

## Guarantee Terms

- DCA guarantees up to 80% of loan losses (typically 50%)
- Maximum term of 20 years
- Lender pays an origination and utilization fees to ensure commitment and additionality
- Guarantees may be denominated in local or foreign currency

Source: Factsheet on the DCA, Development Credit Authority website, accessed August 6, 2018.

CASE STUDY

# 3 Loan Portfolio Guarantee

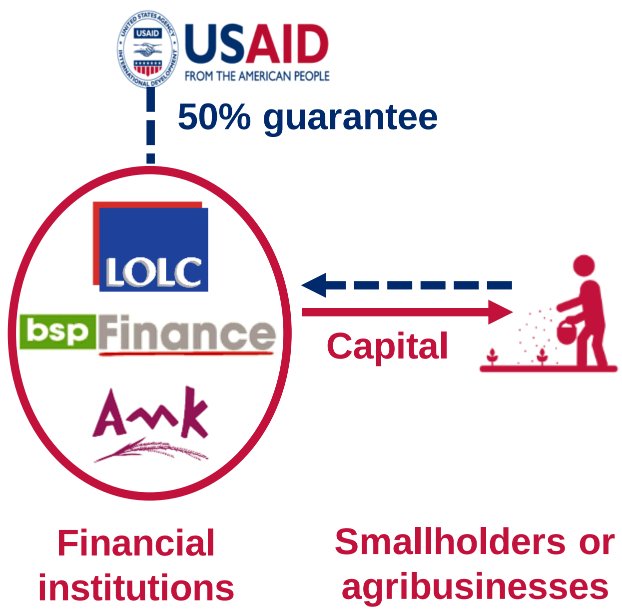
## Mobilizing Credit for Agriculture (Cambodia)

### Background

- 70% of Cambodians work in agriculture.
- Agriculture in Cambodia is vulnerable to weather shocks.
- Lending to agriculture is highly unpredictable and risky.
- Most farmers and agricultural SMEs cannot access much-needed credit.

### Solution

- DCA promises to guarantee 50% of realized losses for a portfolio of agricultural loans and leases for three financial institutions: AMK, LOLC and BSP Finance.




### Results-to-date

- The microfinance providers have disbursed a combined USD 1.8 million representing 274 loans, averaging USD 5,600 - USD 19,000 in loan size and 36-49 months in tenor (without defaults).
- By the end of year 5, 50% of the portfolio must go to women.

Source: *Cambodia: Mobilizing Credit for Agriculture, Cambodia,* Development Credit Authority, September 2017.

# 4 Lease Portfolio Guarantee

**Description:** USAID provides a DCA guarantee to an entire portfolio of finance/capital leases for all lessees (borrowers) in a defined group. The lessor is identified but specific borrowers are not.


* Typically structured with one lessor but can include multiple lessors

## Guarantee Terms

- DCA guarantees up to 80% of loan losses (typically 50%)
- Maximum term of 20 years
- Lessor pays an origination and utilization fees to ensure commitment and additionality
- Guarantees may be denominated in local or foreign currency
- Guarantee capital/finance leases, <u>not</u> operating leases

Source: USAID Development Credit Authority staff.

# 4 Lease Portfolio Guarantee

CASE STUDY

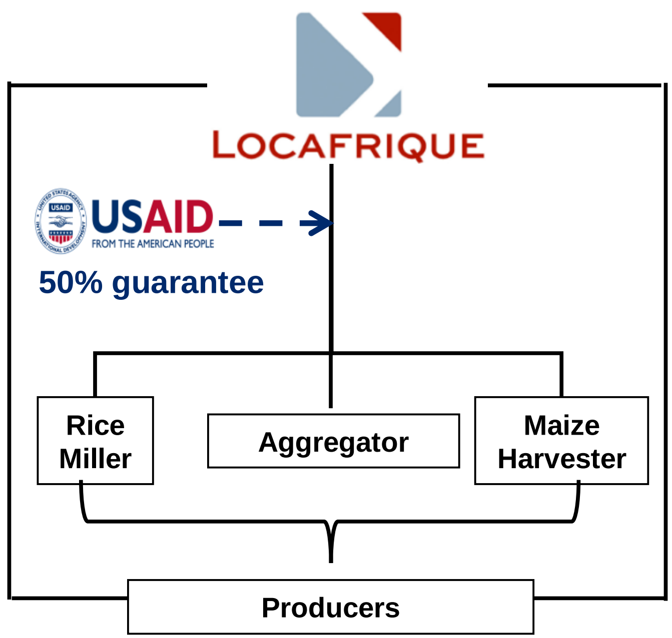
## Locafrique (Senegal)

### Background

- Agriculture in Senegal represents 75% of employment and 16% of GDP but only 4% of loans.
- There is high demand for mechanization and agro-processing due to strong growth in crop production in recent years.
- Farmers and agribusinesses in post-harvest handling and processing have difficulty accessing finance.

### Solution

- DCA provided a 10-year, USD 5.6 million lease portfolio guarantee to Locafrique to increase equipment financing for firms and individuals.



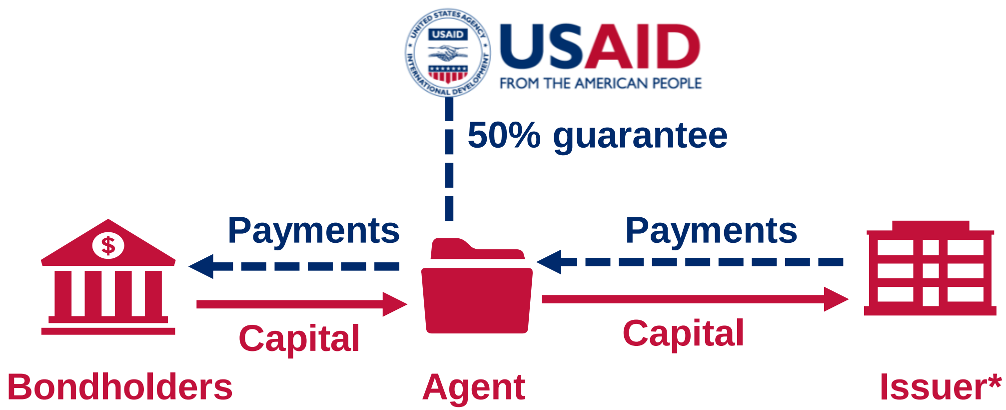

### Results

- 89 loans were disbursed, valued at USD 5.6 million.
- There were 18 defaults but the commercial viability of the broader portfolio led Locafrique to enter the agricultural lending market.
- Senegal's Ministry of Economics and Finance and the Italian development agency paid all of the USD 403,000 subsidy cost.

Source: *Building an Integrated Agricultural Sector, Senegal.* Development Credit Authority, September 2017.

# 5 Bond Guarantee

**Description:** Sometimes financial institutions that on-lend to agriculture, agribusinesses, or municipalities acquire finance through issuing bonds to a trust funded by third-party investors. DCA can provide a guarantee on those bonds.




*Issuer can be a fund, financial institution, municipality or agribusiness

## Guarantee Terms

- Same general terms as loan guarantees (fees, term, loan losses, currency, etc.)
- Issuer makes payments periodically to a bondholder's **agent**.
- The **agent** is typically the guaranteed party.
- The **agent** distributes payment to bondholders.
- If issuer defaults, the **agent** takes all reasonable steps to pursue payment before making a claim to USAID.

Source: Factsheet on the DCA, Development Credit Authority website, accessed August 6, 2018.

# 5 Bond Guarantee

CASE STUDY

## MFI Securitization (Armenia)

### Background

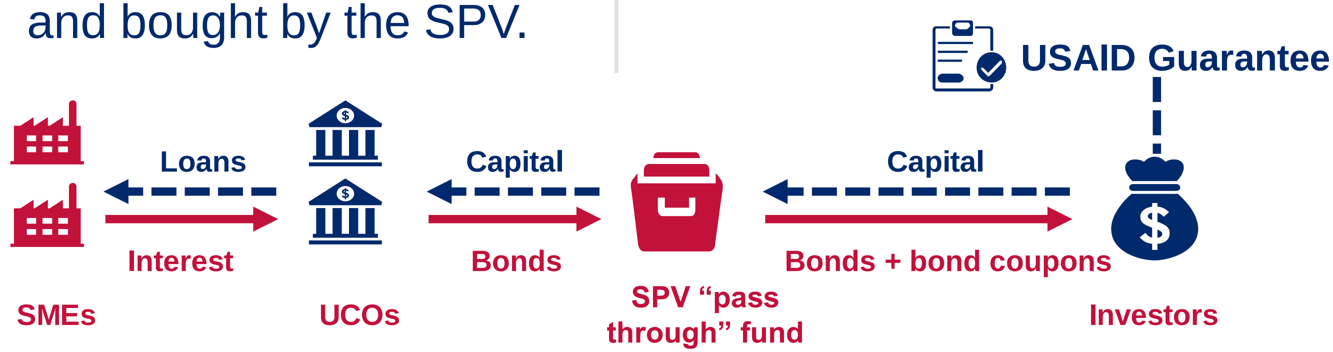
- Universal credit unions (UCOs) in Armenia have difficulty attracting funding that can be used to provide loans to their agricultural SME clients, in part because they are prohibited from taking deposits.
- Armenia formed two state-sponsored pension funds but their investment options in the country are limited.

### Solution

- A special purpose vehicle (SPV) fund was created to securitize the microfinance loans of five UCOs. Two pension funds and local banks then invested in the new bonds.
- USAID provided a four-year 50% guarantee on bonds issued by the UCOs and bought by the SPV.

### Results

- USD 5 million in new funding was made available to SMEs for rural development, including agricultural purposes.
- 69% of the securitized loans were in agriculture.
- The project was highly additive, representing the first securitized microfinance loans in Armenia.




Source: Development Credit Authority.

# Summary of the five DCA guarantee products

| | Loan | Portable | Loan Portfolio | Lease Portfolio | Bond |
|---|---|---|---|---|---|
| Description | DCA agrees to pay half of loan losses for a loan between a lender and a borrower | DCA provides a commitment letter so a borrower can find a suitable lender | DCA agrees to pay half of loan losses for an identified group of borrowers | DCA agrees to pay half of loan losses for an identified group of lessees | DCA guarantees bonds issued by a borrower to an investor (often a fund) |
| What does the guarantee cover? | Single, large loan | Single, large loan | Many similar loans | Many similar finance leases | One or multiple bond issuance |
| Who does DCA engage? | • Lending institution<br>• Agricultural SME | | • Lending institution | • Lending institution (with leasing capacity) | Bondholders through agent (individuals, banks, insurance companies, etc.) |
| Recipient of capital | Single agribusiness or agricultural lending institution | | Group of agribusiness | | Bond issuer (FI, municipality, agricultural SME, fund, corporate) |

# Guarantees can be combined with other USAID tools

**Grants**

Grants may be used either before providing a guarantee to demonstrate business model viability or alongside a guarantee to fund technical assistance such as trainings for the lender.

**Technical Assistance**

TA may improve the profitability or productivity of a firm, enabling more favorable terms.

**Policy Advocacy**

More conducive regulations or policies may lower collateral requirements or business costs, enabling a firm to seek loan financing.

**Convening**

Convening stakeholders can result in shared sponsorship of guarantee programs, or valuable exchange of knowledge.

# Combining other USAID tools with DCA

CASE STUDY

## Background

**Smallholder farming, Mozambique**

- Agriculture represents 80% of Mozambique's GDP and 25% of its employment, but is vulnerable to drought and other weather shocks.
- **Agribusiness productivity and income are comparatively low** in Mozambique, due in part to a lack of mechanization and capital.
- **There is high demand for financing** to improve farm productivity via improved methods and equipment.

- However, as a consequence of crop volatility, **banks are hesitant to lend to the agricultural sector** which they consider risky.
- Banks also restrict loans on the grounds of insufficient borrower collateral and due to their lack of familiarity with agricultural lending.

- Banks like Opportunity Bank Mozambique and Banco Terra (BT) would lend to agribusinesses, but are hesitant due to risk. Sida, the Swedish development agency, is active in Mozambique.

Source: *Agriculture and Food Security,* USAID website, June 13, 2017. *Summary of Mozambique DCA Evaluation*. USAID, 2015.

# Combining other USAID tools with DCA

CASE STUDY

## Questions

1. What are the barriers to financial access for agribusinesses?
2. What tools could USAID use to reduce these barriers and how?
3. How can partners be engaged to make impact?

# Combining other USAID tools with DCA

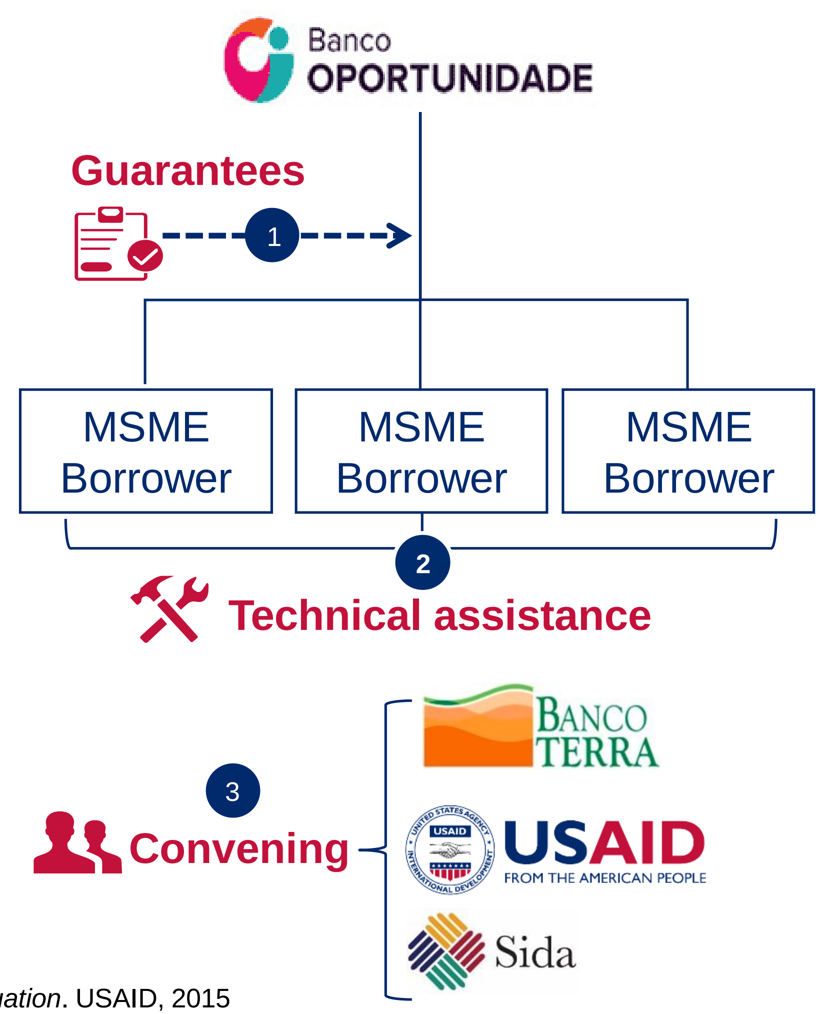
CASE STUDY

## Mozambique Agriculture Loan Portfolio Guarantee

### Engagement

1. DCA 50% negotiated a **loan portfolio guarantee** with Opportunity Bank Mozambique.
2. USAID provided **technical assistance (TA)** to agricultural MSMEs.
3. DCA brought together Sida and Banco Terra (BT) to negotiate a shared guarantee.

### Structure




### Results

- 429 group loans were provided, valued at USD 1.36 million.
- 70% of recipients were first-time borrowers and 25% were women.
- A new co-guarantee was negotiated between USAID, BT, and Sida which reduced USAID costs and provided TA and evaluation services.

Source: *Summary of Mozambique DCA Evaluation*. USAID, 2015

# Best practices: how to think about guarantees

- It is important to identify the specific challenges the borrower faces before prescribing solutions and applying tools.
- Remember that the cost of setting up the DCA guarantee (USAID's "subsidy cost") typically comes from Mission budgets, but can also come from gift funds (e.g., Foundations, Donors, Corporates, etc.) who want to partner.
- Guarantees should have development goals clearly documented upfront.
- Bond guarantees generally take more time than loan guarantees. First consider whether there are functioning capital markets, experienced underwriters, and local counsel to advise the process.
- Engagements can target the borrower directly (e.g. via LOIs) – not just the lending institution.

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

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6. Concluding thoughts

# How the DCA design and implementation process works

START

DURATION

1. Generate ideas and identify financial partner(s)
2. Negotiate deal with financial partner(s)
3. Complete risk assessment
4. Calculate subsidy cost (cost to USAID)
5. Present proposal to Credit Review Board
6. Finalize guarantee legal agreement

Design Phase: 6-12 months

7. Begin implementing and compliance monitoring
8. Support disbursements and impact
9. Pay out claims in case of realized loss
10. Evaluate impacts under the guarantee

Implementation Phase: 5+ years

FINISH

# Who pays for the upfront cost of the guarantee?

| | Sources of funds | Typical role |
|---|---|---|
| **USAID operating units** | USAID operating units allocate funds for DCA from a specific USAID mission program account (local, regional, specialty program, etc.) | As a development agency, USAID generally provides the majority of funds to pay for the cost of the DCA guarantee |
| **Financial partner** | Financial partners pay origination and utilization fees for the guarantee | Fees can be adjusted upwards or downwards depending on the risks |
| **Third-party donor** | Include organizations such as private foundations, development organizations and governments | External gift funds can be used to lower the cost of the guarantee to USAID |

Source: *ADS Chapter 249*, Development Credit Authority, August 2012.

# What is the flow of funds in a DCA guarantee?

The total upfront cost is based on the expected losses due to default…

… and is paid directly into a US Treasury account.

*Reimbursements for defaults*

**Lender**

In the case of default, the US Treasury reimburses the lender directly, with support from DCA compliance team and mission staff

# DCA guarantees can be customized within legal constraints

| Ideas for possible new programming | Can we do this? | | |
|---|---|---|---|
| | Yes | No | Maybe |
| Can we work with a sovereign entity? | | ✓ | |
| Can we issue guarantees for non-commercial debt? | | ✓ | |
| Can USAID partner with parastatals? | | | ✓ |
| Can USAID partner with funds? | ✓ | | |
| Can USAID partner with impact investors? | ✓ | | |
| Can USAID issue direct loans? | ✓ | | |

# Best practices: designing guarantees (I/III)

## Mission, People and Programs

- **Ensure mission and DCA staff set aside sufficient time** in the design phase for project development, negotiation, due diligence and pre-obligation activities.
- **Mission legal counsel (RLO) is essential** to the design process.
- **Map out the needs of the recipients and ensure that appropriate support infrastructure** is in place for the life of the DCA guarantee (e.g., bank training, TA for borrowers).
- **Ensure that PO and M&E includes the guarantee in the program evaluation cycle during the entire life of the guarantee.**

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# Best practices: designing guarantees (II/III)

## Structuring the guarantee

- Guarantees can be dollar or non-dollar denominated but **currencies earned from DCA activities (utilization fees, etc.) must match the currency of borrower liabilities**.
- **Ask the bank about revolving loans, and if the bank plans to use them, discuss it with DCA compliance** and book each draw-down as separate term loans that reduce the overall guarantee amount.
- **Ensure that the lender is assuming sufficient risk themselves**. For example, consider negotiating subordinate capital in a bond guarantee so that lenders face first-loss and USAID second-loss to incentivize prudent risk management.

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# Best practices: designing guarantees (III/III)

## Ensuring development impact

- **Document the baseline data**, including financial and development indicators.
- Before signing the DCA guarantee agreement, **document and communicate with the partner(s) the development goal and how/when/who will measure it**.
- **Highlight borrower impact as loans are disbursed**, both internally within Mission and externally.
- **At the end of the partnership, look at data to evaluate the impact through the mission evaluation process**.

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# Best practices: implementing guarantees

- **Missions should have a dedicated activity manager** (and backup manager) that have DCA integrated into work objectives.
- **Check in with the financial institution at minimum on a quarterly basis to maintain relationships, ensure disbursements and impact.** Correct course as needed.
- **Meet with banks in person to build trust** (not just through emails).
- **Engage proactively with the financial partner;** the institution is an equal-risk sharing partner, not USAID's implementing partner.
- There may be high turn-over at the financial institution, so it's helpful to have **annual (refresher) trainings with bank staff** on the DCA guarantee terms, goals, and usage.
- **Engage with multiple levels of decision-makers** at the bank (e.g., credit analysts, head of credit, bank management, etc.)

Source: *ADS Chapter 249*, Development Credit Authority (DCA), August 2012.

# Agenda for today

1. Setting the context: why is a DCA for agriculture important?
2. When does it make sense to use a DCA product?
3. What are the specific products available under DCA?
4. Designing and implementing DCA guarantees
5. **Model engagement walkthrough**
6. Concluding thoughts

# Walkthrough: case study on agricultural finance

## Problem

Farmer cooperatives in small, agrarian Silvania (fictional country) are dependent upon rice but the crop is highly sensitive to volatile weather. These cooperatives are looking for capital to raise presently low productivity and transition to higher value crops.

Finance is available in the market, but **cooperatives are constrained by high interest rates and relatively small loan sizes**. High collateral requirements limit loan applications.

**Loan officers at local banks are potentially interested, but generally reluctant to lend to cooperatives** due to an unfamiliarity with agricultural lending, high collateral requirements, low borrower credit history and a perceived lack of profitability in the context of high-cost, brick-and-mortar banking.

**The government places strict regulations** on starting businesses as well as tough requirements for documentation and collateral for acquiring loans.

## Question

What are the barriers leading to a financing gap?

# Walkthrough: laying out the situation

## Current situation

- Cooperatives often lack agricultural financing
- Banks are present but not engaging cooperatives
- Government regulations make business difficult for agribusinesses / cooperatives

## Barriers to financial access

- Agricultural lending is intrinsically risky
- Low risk tolerance for local banks and unfamiliarity with agriculture
- Unsuitable financing terms (high collateral)
- Complex regulatory procedures

## Question

What would a desired outcome look like?

# Walkthrough: what would a desired outcome look like?

## Current situation

- Cooperatives often lack agricultural financing
- Banks are present but not engaging cooperatives
- Government regulations make business difficult for agribusinesses / cooperatives

## Barriers to financial access

- Agricultural lending is intrinsically risky
- Low risk tolerance for local banks and unfamiliarity with agriculture
- Unsuitable financing terms (high collateral)
- Complex regulatory procedures

## Desired outcomes

- Lending after guarantees end
- Increased local investment in agriculture
- Increased loan provision
- Decreased collateral requirements
- More conducive regulations

## Question

To achieve these desired outcomes, which specific DCA tool could be most useful? What other tools could it be paired with?

# RECALL: There are five DCA guarantee products

| | Loan | Portable | Loan Portfolio | Lease Portfolio | Bond |
|---|---|---|---|---|---|
| Description | DCA agrees to pay half of loan losses for a loan between a lender and a borrower | DCA provides a commitment letter so a borrower can find a suitable lender | DCA agrees to pay half of loan losses for an identified group of borrowers | DCA agrees to pay half of loan losses for an identified group of lessees | DCA guarantees bonds issued by a borrower to an investor (often a fund) |
| What does the guarantee cover? | Single, large loan | Single, large loan | Many similar loans | Many similar finance leases | One or multiple bond issuance |
| Who does DCA engage? | • Lending institution<br>• Agricultural SME | | • Lending institution | • Lending institution (with leasing capacity) | Bondholders through agent (individuals, banks, insurance companies, etc.) |
| Recipient of capital | Single agribusiness or agricultural lending institution | | Group of agribusiness | | Bond issuer (FI, municipality, agricultural SME, fund, corporate) |

# Walkthrough: potential solutions

## Potential Solutions

- **Loan portfolio guarantee:** Provide a local currency portfolio guarantee for local rice farmers in coordination with one or multiple local banks
- **Technical assistance:** Provide training for loan officers and bank management on agricultural lending and how best to offer loan products
- **Technical assistance:** Train farmers on new techniques, book-keeping, “agriculture-as-business” and other productivity-enhancing measures.
- **Policy advocacy** & **convening:** Bring government and local banks together to streamline lending procedures and advocate for less stringent business requirements
- **Others?**

# Agenda for today

1. Setting the context: why is a DCA for agriculture important?
2. When does it make sense to use a DCA product?
3. What are the specific products available under DCA?
4. Designing and implementing DCA guarantees
5. Model engagement walkthrough
6. **Concluding thoughts**

# Concluding thoughts

- Remember to only use guarantees when:
  1. A transaction would not occur otherwise
  2. There is genuine risk-sharing with the client (financial institution)
  3. There is reasonable chance of borrower repayment

- Combining USAID tools can magnify impact

- Remember to consider whether there are actors in the wider financial ecosystem that could assist in the engagement.

- Banks are equal partners with USAID. USAID is not the client.

- Missions should look for resource partners (e.g., gift funders, co-guarantors) to increase their impact and scale of the guarantee and to support TA and/or evaluations.

- Be creative – look for new solutions within legal constraints.

# Question & Answer