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Enabling poor rural people
to overcome poverty

Introduction of IFAD Blend Lending Terms

Note to Executive Board representatives

Focal points:

Technical questions:

Iain Kellet

Chief Financial Officer
Tel.: +39 06 5459 2403
e-mail: i.kellet@ifad.org

Brian Baldwin

Senior Operations Management Adviser
Tel.: +39 06 5459 2377
e-mail: b.baldwin@ifad.org

Dispatch of documentation:

Kelly Feenan

Head, Governing Bodies Office
Tel.: +39 06 5459 2058
e-mail: gb_office@ifad.org

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Abbreviations and acronyms

IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFI	international financial institution
LIBOR	London Interbank Offered Rate
SDR	special drawing rights

I. Executive summary

1. IFAD is proposing to align its lending terms with those of the International Development Association (IDA). Currently IFAD has two loan instruments that are no longer applied by the IDA for new loans – hardened terms and intermediate terms. This document contains a proposal to discontinue these instruments for new loans and introduce a new instrument – blend terms – in their place.
2. The proposal will have no effect on existing loans. IFAD’s ordinary or highly concessional lending terms will remain unchanged.
3. In considering the impact of this proposal on individual Members several factors need to be taken into account:
 - (a) The blend terms interest rate is fixed at 1.25 per cent with a service charge of 0.75 per cent, therefore it has an effective fixed rate of 2 per cent. In this context, “fixed” means that all loans made to countries eligible for blend terms will be made at 2 per cent and that this rate will not change over the life of the loan. This differs from the current intermediate terms where the interest rate is variable and is 50 per cent of the London Interbank Offered Rate (LIBOR), plus a spread. This difference has two main impacts:
 - (i) Currently LIBOR is close to reaching a record low, which means that at the moment intermediate terms are very favourable; indeed, they are more favourable than highly concessional terms. However, this situation is unlikely to continue for the 20-year life of an intermediate loan. Even a small increase in LIBOR would eliminate the benefits of the current situation.
 - (ii) Since a fixed rate loan means that the interest rate charged on the loan does not change for the life of the loan, loan repayments for the entire duration of the loan can be determined in advance and be built into planning assumptions accordingly. With the current intermediate loan instrument it is impossible to forecast how large future repayments might be. This is an unquantifiable but nevertheless very real benefit of the new blend terms.
 - (b) The blend terms instrument has a maturity five years longer than the current intermediate terms. When comparing cash streams that take place over different time periods, a common approach is to reduce the value of flows that will take place in the future by discounting and then to use the sum of these discounted flows as a comparator for the value of these cash streams.(present value). When comparing the present value of a loan taken on intermediate terms with one taken on blend terms, the extra time allowed to repay more or less balances out the higher interest cost.
 - (c) The proposed alignment with IDA includes alignment of eligibility criteria as well as alignment of terms. This means that a number of countries that are currently eligible for highly concessional terms will no longer be eligible (listed in table 4).
4. Care must be taken when considering this proposal not to include factors that would occur irrespective of whether or not the proposal came into force. In particular, there are several Members whose economic performance has improved to a level where they are likely to graduate out of highly concessional terms anyway. This paper does not attempt to forecast which Members might make this transition and makes comparisons with current (2011) terms. It is possible that some countries that appear to be disadvantaged by the proposal would be entirely unaffected.

5. In the case of the current hardened terms product, IFAD has only been authorized to provide loans at the same terms offered by IDA until a new loan policy is adopted. In practice, IFAD has provided only two loans on hardened terms.

II. Background

6. All the lending terms described in IFAD's Lending Policies and Criteria have been developed in close alignment with those of the International Bank for Reconstruction and Development (IBRD) and the IDA. Chapter IV "Lending Terms and Conditions" indicates that Member Countries "having a gross national product (GNP) per capita of USD 805 or less in 1992 prices or classified as International Development Association (IDA)-only countries, shall normally be eligible to receive loans from IFAD on highly concessional terms" (paragraph 31(a)(i)).
7. IFAD's ordinary term loans are provided in line with the "variable ordinary interest rate of international financial institutions" (paragraph 33(a)) and, in this regard, IFAD originally used the currency pool variable rate as offered by the IBRD. IFAD's intermediate terms were set at 50 per cent of the reference rate in order to establish an intermediary rate between highly concessional and ordinary terms loans as a reflection of the blend terms¹ made available to IDA borrowers to ease the transition from highly concessional to ordinary terms.
8. The IFAD rates for ordinary and intermediate loans were established annually on the basis of the July-December variable interest rates of the IBRD currency pool loan rate. The Executive Board was informed each September of the rates to be used for the subsequent year² through an information paper.
9. In 2007, the IBRD, responding to the reduced use of its currency pool lending, approved a simplification in IBRD loan pricing and set the IBRD variable interest rate at the LIBOR, minus four basis points.
10. Subsequently, it was noted that all other international financial institutions (IFIs), including the IBRD, updated their interest rates much more frequently and, as a consequence, their rates were more aligned with market rates. To bring IFAD rates closer to those offered by the market and by the other IFIs, the Executive Board approved the following modifications to the previous lending terms (see EB 2009/97/R.46/Rev.2):
 - (a) That the periodicity of the update of the IFAD reference interest rate be amended from 12 months to 6 months on the basis that IFAD is moving into line with practices currently applied by other international financial Institutions;
 - (b) That the applicable rate will be based on the SDR LIBOR six-month composite rate, with due regard for IFAD's unique mandate;
 - (c) That the Board will henceforth be informed of the applicable interest rate through publication on the IFAD website; and
 - (d) That the amendment will take effect as of January 2010.
11. The Board requested further clarification on the practices of other IFIs, the proposed methodology, and the long-term implications of the revisions. This information was provided to the Executive Board in December 2009.³ For reference, as published on the IFAD website, the ordinary terms for 1 July to 31 December 2011 are 1.3 per cent per annum and the intermediate terms are 0.65 per cent per annum.

¹ For example, in 2001, IDA's blend terms were a service charge of 0.75 percent, 10-year grace period, 25-year maturity

² In EB 95/55/R.45, the Executive Board delegated the President of IFAD "... to establish the IFAD reference rate of interest routinely on the basis of the IBRD July-December variable interest rate, without prior Board approval, but on the understanding that the Board would be notified of the reference rate of interest established."

³ EB 2009/98/R.14 IFAD's lending terms and conditions: Interest rate for the year 2010 for loans on ordinary and intermediate terms.

12. In 2009, several countries receiving hardened terms⁴ lending from IDA requested access to a similar lending product from IFAD. Following the discussion on the need to introduce hardened terms at the December 2009 session of the Executive Board,⁵ the Governing Council (in February 2010) in resolution 158/XXXIII decided that:
- “In the interim period prior to the adoption of the revised Lending Policies and Criteria by the Governing Council, the Executive Board shall have the authority to create a category of lending terms similar to the hardened terms offered by the International Development Association (IDA) and apply such terms to IFAD loans to countries to which IDA provides hardened terms.”
13. The hardened terms introduced included, as for highly concessional loans, a service charge of 0.75 per cent per annum, a maturity period 20 years, including a grace period of 10 years. In effect, the difference with respect to highly concessional loans was a reduction in the loan repayment period from 40 to 20 years (thereby increasing the pace of loan reflows to IFAD).
14. On this basis, the Executive Board in September 2010 (EB 2010/100/R.24/Rev.1) approved a SDR 8.9 million loan for the Rural Asset Creation Programme in the Republic of Armenia. The Board approved a further SDR 12.25 million loan for the Integrated Rural Development Project in the Republic of Azerbaijan in May 2011 (EB 2011/102/R.26/Rev.1) on hardened terms.

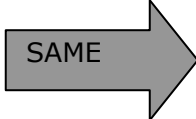
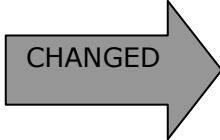
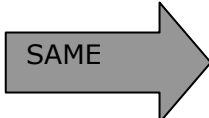
III. Consolidation of IDA blend and hardened terms loan products in 2011 and IFAD’s proposed initiative

15. During the IDA16 discussions, it was noted that the adjustment of blend and hardened terms could strengthen IDA’s finances and long-term financial capacity. It was therefore agreed that, starting in July 2011, IDA’s two separate credits – blend credits and hardened term credits – would be consolidated into a single instrument, the blend terms loan product with a final credit maturity of 25 years, a grace period of five years, an interest rate of 1.25 per cent per annum and a service charge of 0.75 per cent.
16. To increase the level of internally generated resources for commitment by IFAD and to continue the alignment with evolving IBRD and IDA lending terms, two initiatives are proposed:
- (a) Replacement of IFAD’s existing intermediate lending terms with the blend lending terms for selected countries; and
 - (b) Withdrawal of IFAD’s existing hardened lending terms.
17. It should be noted that:
- (a) The above changes would not be retroactive; they would apply only to new loans; and the terms of existing loans would not be affected.
 - (b) IFAD’s existing ordinary and highly concessional terms loans would remain unchanged.
18. The diagram below illustrates how these changes will be incorporated into IFAD’s operating model. Both highly concessional and ordinary terms remain the same. However, the intermediate terms and the recently introduced hardened terms are replaced by the new blend terms.

⁴ In 2009, IDA’s hardened terms had a 10-year grace period, 20-year maturity with standard service charges giving a grant element of 40 per cent. In 2009, IDA’s blend terms were a 10-year grace period, 35-year maturity with standard service charges giving a grant element of 57 per cent.

⁵ EB 2009/98/R.13/Rev.2

Figure 1
Current IFAD terms versus proposed IFAD terms

<i>Current IFAD terms</i>		<i>Proposed IFAD terms</i>
Highly Concessional 10-yr Grace 40-yr Maturity Service charge 0.75%		Highly Concessional 10-yr Grace 40-yr Maturity Service charge 0.75%
Intermediate Terms 5-yr Grace 20-yr Maturity Interest rate 50% of IFAD reference rate + spread		Blend Terms 5-yr Grace 25-yr Maturity Service charge 0.75% Interest rate 1.25%
Hardened Terms 10-yr Grace 20-yr Maturity Service charge 0.75%		
Ordinary Terms 3-yr Grace 15-18-yr Maturity Interest rate IFAD reference rate + spread		Ordinary Terms 3-yr Grace 15-18-yr Maturity Interest rate IFAD reference rate + spread

IV. Proposed introduction of the new blend terms for eligible countries

19. To implement these initiatives IFAD will introduce blend terms aligned with the blend terms offered by IDA, which, if approved by the Governing Council (or by the Executive Board if the Governing Council delegates it the authority to do so), will be applied to eligible borrowers beginning in 2013. These terms would be available to countries formally categorized as creditworthy and able to access IBRD and IDA resources, and those countries whose GNI per capita has been above the operational cut-off for IDA eligibility for more than two consecutive years.
20. As a consequence, a number of countries currently eligible for loans on highly concessional terms on the basis of income criteria alone would become eligible for loans on blend terms because of a higher level of economic and financial development making borrowing from IBRD accessible to them. The countries that would be subject to the new blend term are listed in table 1.
21. The proposed blend terms would have a maturity of 25 years, a grace period of five years, an interest rate of 1.25 per cent per annum and a service charge of 0.75 per cent, which are the same as the terms offered by IDA.
22. The impact of the change in lending terms for each country that may be affected is shown in table 1 in terms of nominal values. The table assumes that the same performance-based allocation system (PBAS) allocation⁶ under the Eighth Replenishment period 2010-2012 would be available for lending in 2013-2015 to the countries listed.
23. The table indicates the total repayments of principal and interest under existing terms and the repayments assumed under the proposed blend terms. In nominal terms, the differences are not high. The positive impact of US\$40 million from loan reflows presented in the intersessional paper (REPL.IX/2/R.5/Add.1) is generated by the shorter grace period of five years, which allows faster repayment of loan reflows of committed funds to be used for future commitments.

⁶ As at December 2010.

Table 1
Difference in repayments⁷ (nominal terms)
(millions of United States dollars)

	<i>Loan Amount</i>	<i>Current Terms⁴</i>	<i>Repayments on Current Terms⁵</i>	<i>Repayments on Blend Terms⁵</i>	<i>Difference</i>
Angola	11.3	HC	13.0	13.5	0.5
Armenia	13.6	O	16.8	16.3	(0.5)
Bhutan	8.7	HC	10.0	10.4	0.4
Bolivia	18.2	I	21.1	21.8	0.7
Bosnia and Herzegovina	13.5	O	16.7	16.2	(0.5)
Congo	9.8	HC	11.3	11.8	0.5
Georgia	11.9	O	14.7	14.3	(0.4)
Guyana	4.2	HC	4.9	5.1	0.2
Honduras	18.7	HC	21.5	22.5	1.0
India	141.0	HC	162.2	169.3	7.1
Moldova	19.7	HC	22.6	23.6	1.0
Mongolia	11.8	HC	13.6	14.1	0.5
Pakistan	72.0	HC	82.8	86.5	3.7
Papua New Guinea	15.7	HC	18.1	18.9	0.8
Sri Lanka	22.2	HC	25.6	26.7	1.1
Timor Leste	4.6	HC	5.3	5.5	0.2
Viet Nam	63.9	HC	73.5	76.7	3.2
Total	460.6		533.7	553.2	19.5

HC – Highly concessional

I – Intermediate

O – Ordinary

24. To further illustrate the effect of adopting the new terms, a comparative analysis of the grant element of IFAD lending terms is provided in table 2. This was initially provided to the Executive Board in September 2010 in the IFAD lending terms and conditions – Hardened lending terms paper (EB 2010/100/R.10). The analysis has been updated to reflect the proposal to introduce blend terms. The table shows that the grant element of the current intermediate term (34 per cent) is similar to that of the proposed blend terms (35 per cent) and the progressive reduction in concessionality from highly concessional through intermediate/blend to ordinary terms correctly reflects IFAD's policy.

Table 2
Grant element of IFAD lending terms

	<i>Maturity (years)</i>	<i>Grace (years)</i>	<i>Interest</i>	<i>Service charge</i>	<i>Concessionality (grant element)</i>
Highly Concessional	40	10	n.a.	0.75%	63%
Intermediate Terms^a (to be withdrawn)	20	5 ^c	50% of IFAD reference rate (variable) plus spread	-	34%
Hardened Terms (to be withdrawn)	20	10	n.a.	0.75%	48%
Blend (proposed)	25	5	1.25%	0.75%	35%
Ordinary^a	15-18 ^b	3 ^c	IFAD reference rate (variable) plus spread	-	17%

Notes:

^a Intermediate and ordinary terms have variable interest rates. To apply the IDA methodology for Grant Element calculation, equivalent SDR weighted swap rates for 15 and 20 years maturity have been applied, and the IFAD spread has been added.

^b Maturity assumed at 15 years.

^c The Executive Board may vary the grace period for the repayment of loans received on intermediate and ordinary terms.

⁷ Based on current disbursement profile.

25. For illustrative purposes, table 3 shows different scenarios for the repayment of intermediate term loans based on varying LIBOR rates.

Table 3
Total loan repayments (principal and interest)^a

Year ^b	SDR Libor at 2% Intermediate (interest rate at 1.29%) ^c	SDR Libor at 4% Intermediate (interest rate at 2.29%) ^c	SDR Libor at 6% Intermediate (interest rate at 3.29%) ^c	Intermediate rate at half of SDR 6-month Libor Forward + spread 0.29 ^c	Blend (fixed interest rate at 2.00%) ^d
2014	0.03	0.06	0.08	0.03	0.05
2015	0.12	0.22	0.31	0.13	0.19
2016	0.26	0.47	0.67	0.32	0.41
2017	0.43	0.77	1.10	0.59	0.67
2018	0.59	1.05	1.51	0.89	0.92
2019	7.37	7.92	8.47	7.78	6.11
2020	7.43	8.02	8.61	7.90	6.23
2021	7.47	8.09	8.72	8.01	6.33
2022	7.51	8.17	8.83	8.11	6.43
2023	7.53	8.20	8.87	8.17	6.49
2024	7.48	8.12	8.75	8.09	6.45
2025	7.40	7.96	8.53	7.93	6.35
2026	7.31	7.81	8.31	7.80	6.25
2027	7.23	7.66	8.09	7.62	6.15
2028	7.14	7.51	7.87	7.44	6.05
2029	7.05	7.35	7.65	7.30	5.95
2030	6.97	7.20	7.43	7.16	5.85
2031	6.88	7.05	7.22	7.02	5.75
2032	6.80	6.90	7.00	6.87	5.65
2033	6.71	6.74	6.78	6.73	5.55
2034	0.00	0.00	0.00	0.00	5.45
2035	0.00	0.00	0.00	0.00	5.35
2036	0.00	0.00	0.00	0.00	5.25
2037	0.00	0.00	0.00	0.00	5.15
2038	0.00	0.00	0.00	0.00	5.05
Total	109.73	117.27	124.81	115.88	120.08
Present Value	55.71	60.14	64.57	59.20	55.33
Discount Rate (CIRR)^e	5.71%	5.71%	5.71%	5.71%	5.71%
Grant element	37.40%	28.79%	20.17%	n.a.	34.92%

^a All scenarios are based on the current 10-year average disbursement profile of a loan of US\$100 million. The disbursement profile used is the highly concessional one, interpolated to eliminate cancellations. Therefore each loan is assumed to disburse 100 per cent of face value over a 10-year period. Also, it is assumed that the disbursement profile is the same for all lending terms.

^b Figures will not change, but only shift in time, should the disbursement start in the same year of approval. It is assumed that the loan is approved in 2013 with a one-year effectiveness period before starting disbursement.

^c The spread applied by IFAD varies every six months. For these scenarios, spread is assumed fixed at 0.29 per cent (current World Bank applied)

^d In line with IDA terms, no spread is applied to blend terms.

^e The CIRR is the "Commercial Interest Reference Rate" published by the OECD and used for grant element calculation by IBRD and IDA

26. At the current LIBOR rate, the proposed blend terms are the same in present value terms as the existing intermediate terms. If LIBOR rises, the blend terms become more favourable.

27. It should be noted that the review of IFAD's current hardened and intermediate terms was foreseen, as referred to in the IFAD lending terms and conditions – Hardened lending terms (footnote 1, EB 2010/100/R.10)::

"Within the framework of the ongoing IDA 16 consultation, IDA deputies are discussing phasing out the category of hardened terms as created in 2002. The two existing lending categories of 'hardened terms' and 'blend terms' will be merged into a hybrid category of credit 'blend/hardened terms' available to countries eligible for IDA blend or hardened terms (25-year maturity period, 5-year grace period, 1.25 per cent interest rate). If approved, the change will be included in the IDA 16 resolution and become effective as of 1 July 2011. In the light of the IDA 16 decision, the continuation of the category of IFAD hardened terms will be reassessed within the context of the revision of the Lending Policies and Criteria, and appropriate proposals will be brought to the Executive Board for consideration and approval."