Document:	EB 2020/130/V.B.C.5
Date:	17 September 2020
Distribution:	Restricted
Original:	English

E

IFAD

Investing in rural people

Proposal to enter into a borrowing agreement with the Agence Française de Développement to support the IFAD11 programme of loans and grants

Note to Executive Board representatives

Focal points:

Technical questions:

Alvaro Lario
Associate Vice-President
Chief Financial Officer and Chief Controller
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: a.lario@ifad.org

Benjamin Powell
Director and Treasurer
Treasury Services Division
Tel.: +39 06 5459 2251
e-mail: b.powell@ifad.org

Natalia Toschi
Treasury Senior Officer
Tel.: +39 06 5459 2653
e-mail: n.toschi@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra
Chief
Institutional Governance and Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

Executive Board — 130th Meeting
Rome, 8-11 September 2020

For: **Approval**

I. Executive summary

1. In 2017, IFAD entered into a borrowing agreement with Agence Française de Développement (AFD) to borrow EUR 200 million to support the funding of the programme of loans and grants (PoLG) for the Tenth Replenishment of IFAD's Resources (IFAD10) period.[1]

2. IFAD now proposes to enter into a second borrowing agreement with AFD to borrow EUR 300 million. This loan is key to providing the necessary funding for the IFAD11 PoLG. Additional funding needs for IFAD11 are estimated at approximately US$450 million, updated from the amount indicated in the 2019 Resources Available for Commitment document.[2]

3. Negotiations with AFD began several months ago and concluded in late August. Therefore, due to time constraints, it was not possible to submit the full document to the Audit Committee for review in advance. This tabled document however presents the same level of information included in previous documents related to sovereign loans presented to the Audit Committee for review. The loan proposal will be submitted to the Executive Board by correspondence between September and October 2020 to allow the President of IFAD and the AFD Chief Executive Officer to sign the agreement as planned on 12 November in Paris on the occasion of the Finance in Common Summit. This will allow IFAD to encash the loan by December 2020.

4. The loan is fully compliant with the provisions and financial ratios prescribed by the Sovereign Borrowing Framework (SBF). If fully encashed during the IFAD11 period, it will result in an increase in IFAD's debt equity ratio from 8.1 per cent to 11.3 per cent, comfortably below the 35 per cent threshold established in the SBF. Further details are presented in the following paragraphs.

II. Agence Française de Développement

5. AFD is the operator for France's bilateral development finance mechanism. It is a public industrial and commercial institution with the status of specialized financial institution. Its actions are in line with the policy set out in France's framework document, Development Cooperation: a French Vision.

6. AFD receives public resources (grants and interest subsidies) to implement the projects it supports. The bulk of AFD's financing comes from the international financial market and it raises funds at financial market conditions, which are pegged to the rating of the French State.

7. AFD's public resources are provided by its supervisory ministries: the Ministry of Foreign Affairs to finance projects via subsidies and co-development projects via grants; the Ministry of the Economy and Finance to cover the cost of the interest subsidies on the loans that AFD allocates to its beneficiaries abroad and in the French overseas provinces; and the Ministry of the Interior to reduce the cost of loans allocated in the French overseas provinces.

8. AFD is both a credit institution and a public institution and is subject to all the accountability requirements related to this dual status: provision of statutory statements for the French Prudential Supervisory and Resolution Authority and Financial Markets Authority; and reports to the supervisory ministries, Court of Auditors and national representation and the Development Assistance Committee of the Organization for Economic Co-operation and Development.

[1] EB 2016/119/R.38
[2] EB 2019/128/R.37

III. IFAD11 funding update

9. The most recent financial model update points to a funding gap for IFAD11 on the order of US$450 million. With the loan from AFD, IFAD will be able to substantially reduce this funding gap.

10. The conversations held by Management with AFD in recent months advanced rapidly thanks to the pre-existing borrowing agreement. Appropriate due diligence on IFAD was ensured through discussions by video conference.

IV. Proposal to borrow from AFD and adherence to the SBF

11. Management is proposing to borrow up to EUR 300 million from AFD to finance part of the IFAD11 PoLG.

12. In line with the requirement of the SBF,[3] AFD is eligible to lend to IFAD because France's core contribution to IFAD11 is more than 100 per cent of the amount received in the previous replenishment cycle (IFAD10).[4]

13. In line with section VI, paragraph 24 of the Framework, the required reporting on the new loan is provided below.

A. Analysis of the proposal

14. In terms of main features, the new loan structure will be aligned with the previous loan from AFD:

    Currency of denomination: Euro;

    Maturity: 20 years;

    Grace period: 5 years;

    Interest rate: 6-month Euro Interbank Offered Rate (Euribor) + spread;

    Cost compensation fees: 0.1 per cent;

    Commitment fee: waived for 16 weeks after signing, then 0.5 per cent on undrawn amounts.

    Governing Law and Jurisdiction: the borrowing agreement will be subject to French law. Any disputes may be submitted to arbitration under the Rules of Arbitration of the International Chamber of Commerce.

15. The elements and levels of the overall cost negotiated with AFD reflect market practice in terms of how such sovereign loans are priced and are deemed consistent with the cost of funding of an institution with AFD's rating.

B. Use of borrowed funds

16. The loan proceeds will be on-lent, respecting the condition of financial sustainability. In practice, this means that funds will be on-lent at higher interest rates than the loan and with average maturity and grace periods not shorter than the loan. This implies that allocations for IFAD11 as determined through the performance-based allocation system will not be impacted by the borrowing.

17. In line with paragraph 17 of the SBF, the borrowed funds will be used in accordance with the Policies and Criteria for IFAD Financing. This means that borrowed funds

[3] SBF, para. 8: "IFAD will only enter into borrowing discussions with a Member State, or a state-supported institution supported by that Member State, if the Member State's core contribution to the latest replenishment (Core Replenishment Contribution R0) is at least 100 per cent of the amount contributed in the previous replenishment cycle (Core Replenishment Contribution R-1)."

[4] France pledged EUR 35 million core resources in IFAD10 and EUR 67.5 million in IFAD11.

will be on-lent at the current rate for IFAD ordinary loans, and no change to that rate is envisaged because of the different source of funding.

18. Given the spread applied to the loan and current projections on investment return and reflows generated by the funds, updated projections show that the loan is sustainable in that borrowing costs are fully covered without the use of core resources, as required by the SBF.

C. Financial ratios under the SBF

19. Section IV and annex II of the SBF set forth financial covenants that must be respected for IFAD to enter into a borrowing agreement. Borrowing an additional EUR 300 million during the IFAD11 period will not breach any of these covenants, as indicated below.

20. After the addition of the proposed EUR 300 million borrowing to the balance sheet, IFAD's highest level of debt-to-equity ratio is projected to increase from 8.1[5] per cent at end-2019 to 11.3 per cent, comfortably below the maximum 35 per cent limit established in the Framework.

21. The liquidity ratio is projected to decrease from 10.7 to 8.4 per cent, well above the minimum 5 per cent threshold established in the Framework.

22. The debt service coverage ratio is projected to increase from 1.2 per cent to 8.9 per cent, comfortably below the 50 per cent threshold established in the Framework.

D. Evaluation of risks

23. Currency risk is the main risk that IFAD could be exposed to if the funds were on-lent in a currency different than the euro. As per section VIII, paragraph 30, of the SBF, IFAD will eliminate this risk by ensuring that the funds are on-lent in the same currency as the loan, i.e. the euro. If possible, after appropriate currency hedging, United States dollar denominated loans may also be considered.

24. As described in the Framework, IFAD is in the process of building capacity, obtaining the necessary legal agreements and ensuring that the operational and functional steps are in place to enter into cross-currency derivatives to hedge the currency risk. In the future, this will enable IFAD to on-lend the funds in a different currency while being protected from currency fluctuations. The costs of such hedging transactions will be incorporated into projections to ensure that the self-sustainability clause is always respected.

25. The term risk, interest rate risk and liquidity risk are mitigated as per section VIII of the Framework. Cash flow projections have been updated with the latest actual 2020 numbers and assumptions validated by all relevant departments.

E. Management of borrowed funds

26. As indicated in the Report on the signing of the second individual loan agreement under the Framework Agreement with KfW Development Bank presented to the 116th session of the Executive Board,[6] in the interests of transparency and considering the different return target on the borrowed funds, Management has established a new investment portfolio, the asset liability portfolio. This portfolio is dedicated to the management of borrowed funds and follows a mark-to-market asset liability management strategy. The funds are kept in euros so as to avoid currency risk pending disbursements. The additional EUR 300 million will be included in the asset liability portfolio.

[5] EB 2020/129/INF.5.
[6] EB 2015/116/INF.2.

F. Reporting

27. IFAD will report on the resources mobilized under the borrowing agreement and the use of the funds in the Annual Report. The loan will be disclosed in IFAD's financial statements and audited financial accounts.