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Investing in rural people

Update on the Sustainable Level of IFAD12 PoLG

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

Ron Hartman

Director
Global Engagement, Partnership and
Resource Mobilization
Tel. +39 06 5459 2610
Mob.: +39 331 684 7665
e-mail: r.hartman@ifad.org

Jón Thorsteinsson

Deputy Treasurer
Tel.: +39 06 5459 2811
e-mail: j.thorsteinsson@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra

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

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Contents

Executive summary	ii
I. Introduction	1
II. Background	2
III. IFAD12 replenishment target scenario	3
IV. Current status of IFAD12 contributions	4
V. Updated level of sustainable PoLG for IFAD12 planning	4
VI. Conclusions and next steps	7
Annex I	
A. Scenario simulation US\$3.5 billion PoLG	9
Annex II	
A. Scenario simulation US\$3.8 billion PoLG	11
B. Lower size of PBAS and potential effect of balance by income category	12
C. Need to review agreed threshold for the debt to equity ratio	12
D. Potential effect on IFAD's credit rating	12

Abbreviations and acronyms

BRAM	Borrowed Resource Access Mechanism
CPL	concessional partner loan
DSF	Debt Sustainability Framework
LICs	low-income countries
LMICs	lower-middle-income countries
MLR	minimum liquidity requirement
PBAS	performance-based allocation system
PoLG	programme of loans and grants
RAC	Resources Available for Commitment
UPICs	upper-middle-income countries

Recommendation for approval

The Executive Board is invited to approve a sustainable PoLG of up to US\$3.5 billion for the IFAD12 replenishment cycle.

Executive summary

1. At the fourth session of the Consultation on the Twelfth Replenishment of IFAD's Resources (IFAD12), the IFAD President confirmed that Management would continue to work to mobilize further pledges and concessional partner loans for the IFAD12 period, and would present an update on the status of contributions to the Executive Board in September 2021. On that basis, the updated sustainable level of the IFAD12 programme of loans and grants (PoLG) would be presented to the Board for approval to allow planning of IFAD12 operations to commence.¹
2. After several financial reforms undertaken during the IFAD11 period, the IFAD12 Report² clearly laid out fundamental principles for maintaining a sustainable financial trajectory based on prudent financial and risk management in the context of the next three-year replenishment cycle. It is key to review assumptions for replenishment scenarios periodically, and re-assess IFAD's financing and commitment capacity through the new Resources Available for Commitment (RAC) methodology, should certain financial variables not materialize at the initially projected level. IFAD12 will furthermore be the first replenishment cycle following implementation of the Debt Sustainability Framework (DSF) reform and the sustainable replenishment baseline concept.
3. The official IFAD12 replenishment target remains at US\$1.55 billion, as endorsed by the Governing Council. This level of replenishment would allow for a sustainable PoLG of US\$3.8 billion. However, in line with all the reforms undertaken, it is important to begin planning based on updated assumptions to minimize the risk of overcommitment while maximizing efforts to reach the original target.
4. As agreed with Members, Management hereby presents to the Executive Board the status of IFAD12 contributions as at 30 June 2021, and the additional contributions expected with a high degree of certainty. On this basis, the Board is asked to approve the resulting updated sustainable IFAD12 PoLG. Upon Board approval, this PoLG level will be used to begin operationalizing IFAD12, including calculating country allocations under the performance-based allocation system. Should additional material changes in pledges materialize, Management will present a further update to the Board for consideration and approval. The yearly maximum RAC will, as is the usual practice, be presented to the Board at its December session, beginning with the session to be held in December 2021 for the RAC in 2022.
5. As at 30 June 2021, donor pledges amount to US\$1.149 billion. Based on current assumptions, Management is expecting, with a reasonable degree of certainty, additional contributions in the amount of US\$151 million, bringing the total to at least US\$1.3 billion and potentially reaching the target of US\$1.55 billion if most major donors increase their pledges in line with scenario D. At a replenishment level of US\$1.3 billion, and supported by total new borrowing of US\$1.1 billion, the maximum sustainable IFAD12 PoLG has been set at up to US\$3.5 billion. Both the additional replenishment contributions and new borrowing need to materialize during the cycle to ensure a financially sustainable trajectory for this level of PoLG.

¹ IFAD12/4/INF.2, IFAD12/4/Opening Statement, IFAD12/4/Closing Statement, IFAD12/3/INF.1/Rev.1.

² GC-44-L-6-Rev-1.

6. This PoLG for IFAD12 would be in line with the PoLG for IFAD11 even with contributions rising from US\$1.1 billion for IFAD11 to US\$1.3 billion for IFAD12. First, it is important to note that the approved DSF reform³ based on the sustainable replenishment baseline principle requires the total amount of DSF grants (both new approvals and compensation for past approvals), regular grants and administrative expenses to be covered by the new replenishment contributions. This was not the case in IFAD11. In addition, the approved PoLG in the past was always based on: (i) the target replenishment; and (ii) the expected additional reimbursement of forgone reflows from past approved DSF grants. Although these amounts have not historically materialized in full, the PoLG has not been revised downwards in an effort to maximize IFAD's contribution to its mission. However, this trajectory could not have continued indefinitely. The assumptions have been revised, and the proposed level of PoLG is deemed financially sustainable under the adjusted level of expectations.
7. A reduction in replenishment contributions compared to scenario D would have a direct impact on the sustainable level of grants and DSF, and consequently on the share of financing allocated to countries in different income categories, with low-income countries penalized the most.
8. While this paper presents an updated scenario with US\$1.3 billion in contributions for IFAD12, and requests Executive Board approval to begin planning against a revised sustainable PoLG of up to US\$3.5 billion, Management urges all Member States to remain committed to the agreed target of US\$1.55 billion. In the year of the 2021 United Nations Climate Change Conference (COP26), the Food Systems Summit and Building Back Better, and following unprecedented increases in poverty and hunger, the world is at a critical juncture. We must strive to ensure a fully funded IFAD12, and Management must raise awareness about the challenges of maintaining an ambitious level of target operations if unsupported by an adequate level of resources.

³ EB 2019/128/R.44.

I. Introduction

- 1. The approved Twelfth Replenishment of IFAD's Resources (IFAD12) replenishment target is US\$1.55 billion, to finance a programme of loans and grants (PoLG) of up to US\$3.8 billion.**⁴ At the final session of the IFAD12 Consultation, the President confirmed that Management would continue to work to mobilize further pledges and concessional partner loans (CPLs) for IFAD12, and would present an update on the status of contributions to the Executive Board in September 2021. On that basis, the updated sustainable IFAD12 PoLG would be presented to the Board for approval to allow planning of the IFAD12 operations to commence.
- 2. As at 30 June 2021, total pledged contributions to IFAD12, including the grant element of CPLs, stand at US\$1.149 billion.** This is the highest level of core contributions ever pledged to the Fund. It has been achieved thanks to extraordinary increases in contributions by many Member States, across all Lists. Nevertheless, it is well below the scenario D target of an overall increase of 40 per cent compared to IFAD11. Further pledges are expected to materialize over the coming months and throughout the IFAD12 period. However, in line with the reforms undertaken during IFAD11 and with the agreements reached for IFAD12, Management needs to plan for an IFAD12 PoLG based on the actual amount of contributions that is considered highly likely and the actual level of CPLs.
- 3. Management is expecting, with a reasonable degree of certainty, to reach contributions of at least US\$1.3 billion. Based on this assumption, the updated sustainable IFAD12 PoLG is set at up to US\$3.5 billion.** Once approved by the Executive Board, the updated PoLG of up to US\$3.5 billion will be used to prepare the initial IFAD12 performance-based allocation system (PBAS). Should additional material changes in pledges materialize, Management will present a further update to the Board. In line with the Agreement Establishing IFAD, it is the responsibility of the Board to determine the proportion of the Fund's resources to be committed in any financial year, with due regard to the long-term viability of the Fund and the continuity of its operations. This will be done for IFAD12 through the Resources Available for Commitment (RAC), as is the usual practice, to be presented to the Board at the December session beginning with the session to be held in December 2021 for the maximum 2022 envelope.
- 4. As highlighted in recent data, the COVID-19 pandemic has resulted in historically unprecedented increases in global poverty and hunger.** Almost 100 million more people were living in extreme poverty in 2020 than estimated pre-COVID,⁵ and almost 120 million more people went hungry in 2020 than in 2019. Globally, 2.3 billion people lacked year-round access to adequate food. At this critical juncture, IFAD's Member States, particularly borrowers, understand the importance of IFAD's investments: the largest overall percentage increase in IFAD12 contributions has come from low-income countries (LICs) and most countries doubling their contributions are from List C, despite the effects of the pandemic.
- 5. In the year of the United Nations Climate Change Conference (COP26), the Food Systems Summit and Building Back Better, we must strive to ensure a fully funded IFAD12.** Reaching the IFAD12 targets would ensure full delivery of target operations during the IFAD12 period, with a strong focus on LICs and lower-middle-income countries (LMICs). If all major donors increased their pledges in line with scenario D, closing the remaining gap of US\$400 million could be well

⁴ GC resolution 219/XLIV.

⁵ Global Economic Prospects, June 2021. World Bank.
<https://openknowledge.worldbank.org/bitstream/handle/10986/35647/9781464816659.pdf>.

within reach. The formal evaluation point will be the IFAD12 midterm review to be conducted at the beginning of 2023.

II. Background

6. **During IFAD11, IFAD implemented a series of financial reforms to strengthen its financial sustainability.** These reforms were intended to achieve two main goals: (i) strengthening IFAD's financial soundness to return to a sustainable trajectory; and (ii) maximizing concessional financing, including grants, to countries most in need.
7. **In IFAD12, the Fund will safeguard the long-term benefits of reforms introduced under IFAD11.** As promised to its Members in the context of the IFAD12 Consultation, the Fund is committed to maximizing its concessional support to the poorest countries, within prudential limits to maintain its own financial sustainability. IFAD's poorest Member States will be the largest beneficiaries of these efforts as they are the most likely to rely on its support over the medium to long term.
8. **IFAD12 will be underpinned by gradual growth in leverage made possible by the policies implemented, improved financial discipline and strong credit ratings.** In the closing statement of the 132nd session of the Executive Board, President stated that in order to effectively double its impact by 2030 and fulfil its mandate, IFAD needs to expand both core and borrowed resources to contribute to bridging the financing gap for Sustainable Development Goals (SDGs) 1 and 2.⁶ In order to enhance its impact, IFAD has consistently increased its PoLG, supported by donor contributions and, since IFAD9, through borrowing. While replenishment contributions are and will remain the bedrock of IFAD's capitalization and commitment capacity, borrowing will be allowed to grow in a prudent manner, within the limits approved by the Executive Board and in line with the capital available.
9. **IFAD12 is a cycle in which several dynamics built up over the past decade converge:** a growing PoLG, a larger share of DSF grants and faster disbursements have increased pressure on IFAD's capital and liquidity. These dynamics, while fully in line with the efforts to maximize contributions to IFAD's development mandate, have to be analysed and managed carefully not only in the short term, but most importantly in the medium to long term as the organization can only continue contributing to its mission and supporting its priority target groups by preserving its own financial sustainability.
10. **The main financial variables will need to be monitored and managed prudently.** Liquidity, together with capital, is the most important lever to deliver operations and absorb shocks. IFAD's liquidity level has declined gradually over the past decade due to three mutually reinforcing factors: (i) increasing approvals of loans and grants; (ii) a growing share of grant approvals in the overall PoLG; and (iii) faster disbursements. While all of these developments help to achieve IFAD's development objectives, they have placed strains on liquidity and capital.
11. **The level of undisbursed operations will also need to be managed carefully.** During IFAD11, Management presented the rationale for revising IFAD policies in support of the new financial architecture. Maintaining PoLG size despite not fully meeting replenishment contributions targets, has added to the strong growth in undisbursed loans and grants, from US\$2.7 billion in IFAD7 to an estimated US\$6.0 billion by the end of IFAD11, and has stretched liquidity and capital.
12. **The increase in PoLG that began under IFAD9 and continued under IFAD10 and IFAD11 was not fully matched by actual resources received against planned levels** (i.e. actual contributions vs. replenishment targets). Since IFAD7,

⁶ EB 2021/132/INF.10.

the cumulative shortfall of proceeds from contributions against approved targets has been around US\$650 million. The Report on IFAD’s Development Effectiveness (RIDE) 2021 indicates that 89 per cent of the IFAD11 replenishment target has been met.⁷ Delivering the target PoLG despite not fully reaching the contributions target was only possible due to the very high levels of liquidity and low level of leverage on IFAD’s balance sheet a decade ago. It was achieved within agreed policies at the time and to maximize the Fund’s development mandate. However, as recognized by the recent financial reforms, this trajectory could not continue indefinitely.

13. **IFAD12 contributions and borrowing were projected at ambitious but realistic levels in determining the target IFAD12 replenishment scenario D (see table 1).** The IFAD12 replenishment report laid out fundamental principles for a prudent financial and risk management approach in the context of the next three-year replenishment cycle, recognizing that all financial variables are interlinked. IFAD must manage the trade-offs between them and, should any of these variables not materialize at the targeted levels, IFAD will need to adjust the others to ensure its financial sustainability. As noted in the IFAD12 replenishment report, with increasingly constrained liquidity and capital, and introduction of the sustainable replenishment baseline principle, IFAD12 replenishment contributions below the target will have a direct impact on IFAD’s ability to provide grants, and will also impact leverage capacity – necessitating reductions in grants, concessionality and the overall PoLG compared to the target scenarios.

III. IFAD12 replenishment target scenario

14. The IFAD12 replenishment target remains as stated in the replenishment resolution, shown in scenario D in table 1 below. Under this scenario, a replenishment target of US\$1.55 billion (including US\$50 million in CPL grant elements) would allow for a sustainable PoLG of up to US\$3.8 billion (based on a number of assumptions to ensure a financially sustainable trajectory). Other scenarios resulting in PoLG levels ranging from US\$3.4 billion to US\$4.2 billion were also reviewed during the replenishment discussions but were either considered insufficiently ambitious (in the case of scenario C), or required unrealistically large increases in contributions (scenario E).

Table 1
Replenishment scenarios and PoLG for IFAD12
(Millions of United States dollars)

	End IFAD11	Scenario C	Scenario D	Scenario E
Replenishment target	1 100	1 350	1 550	1 750
Total PoLG	3 500	3 400	3 800	4 200
Sustainable total grants	790	600	750	840
<i>DSF grants</i>	595	450	600	690
DSF reserve		50	50	50
Regular grants	190 ^o	100	100	100
Level of concessionality (end of IFAD12)	52%	47%	49%	50%
Leverage ratio IFAD12 (debt/equity)	17%	29%	28%	27%
Total new IFAD12 debt	-	1 275	1 225	1 200
Deployable capital (end of IFAD12)	30%	19%	19%	19%

Source: IFAD12 replenishment report GC 44/L.6/Rev.1.

15. The other main variable in scenario D is non-CPL borrowing of US\$1.0 billion. Important assumptions underlying the financial sustainability of such a scenario relate to the actual uptake of IFAD financing at the assumed financing terms. The aim for IFAD12 is to direct 100 per cent of core resources to LICs and LMICs. At the

⁷ See Results Management Framework target 3.1.1.

same time, the aim is to provide upper-middle-income countries (UMICs) with financing ranging between 11 per cent and a maximum of 20 per cent of the overall PoLG (which would imply a percentage at least equal to that of IFAD11), to be financed entirely with borrowed resources through IFAD’s new Borrowed Resource Access Mechanism (BRAM).⁸ The remainder of borrowed resources should be lent to creditworthy eligible LICs and LMICs through the BRAM.⁹

IV. Current status of IFAD12 contributions

16. As at 30 June 2021, IFAD12 pledges amounted to US\$1.149 billion, including US\$23 million in CPL grant elements. Two CPLs have been confirmed, by Finland and India, for EURO 60 million and US\$20 million respectively. Expressed in United States dollar terms, the amount of the two CPLs combined is US\$93 million.
17. Therefore, as shown in table 2, in order to achieve the replenishment contributions target under scenario D, IFAD donors will need to pledge approximately US\$374 million in core contributions and US\$27 million as grant elements of additional CPLs, for a total of US\$401 million in additional contributions. The amount of additional CPLs required is US\$132 million.

Table 2

Actual pledges compared to IFAD12 scenario D (PoLG up to US\$3.8 billion) as at 30 June 2021
(Millions of United States dollars)

	<i>Target replenishment scenario D</i>	<i>Update as at 30 June 2021</i>	<i>Current gap to target</i>
Replenishment contributions	1 550	1 149	(401)
<i>Core contributions</i>	1 500	1 126	(374)
<i>CPL grant elements (included above)</i>	50	23	(27)
CPLs (face value)	225	93	(132)

V. Updated level of sustainable PoLG for IFAD12 planning

18. **Revised PoLG with current available resources.** Updated assumptions are required to allow Management to plan IFAD12 activities, define overall borrowing needs and establish IFAD12 PBAS allocations without the risk of overcommitment. The following sections outline updated IFAD12 assumptions and the revised level of sustainable IFAD12 PoLG. Once approved by the Executive Board, the updated PoLG will be used to prepare the initial IFAD12 PBAS allocations. Should additional material changes in pledges materialize, Management will present a further update to the Board. As indicated, the yearly RAC will continue to be presented to the Board at its December session beginning with the session to be held in December 2021.
19. A further review of the IFAD12 financial and related delivery targets may be considered as part of the IFAD12 midterm review if necessary.
20. Management has produced a revised scenario based on updated assumptions as shown in table 3 below (see annex I for further details on this revised scenario).

⁸ See EB/2021/132/R.9/Rev.1.

⁹ This represents between US\$240 million and US\$582 million in scenario D.

Table 3
Updated level of sustainable IFAD12 PoLG based on revised replenishment assumption
(Millions of United States dollars)

	<i>Target scenario</i>	<i>Revised assumptions</i>	<i>Change</i>
Replenishment contributions	1 550	1 300	-16%
<i>CPL grant elements (included above)</i>	50	23	-54%
Total borrowing	1 225	1 183	-3%
<i>Borrowing (net of CPL)</i>	1 000	1 090	+9%
<i>CPLs</i>	225	93	-59%
Total grants	750	550	-27%
Regular grants	100	75	-25%
DSF grants	600	425	-29%
Reserve	50	50	-
PoLG	3 800	3 500	-8%
Leverage ratio IFAD12 (debt/equity)	28%	30%	
Deployable capital (end of IFAD12)	16%	20-25%	

- (a) **Replenishment contributions.** Based on current information and in order to include an assumption of expected pledges yet to be received by donors, a replenishment level of US\$1.3 billion has been assumed for the revised scenario, approximately 16 per cent lower than the agreed target. This assumes that an additional US\$151 million in core replenishment pledges will be received, and no further CPLs. This is based on Management’s current minimum expectations regarding further contributions to be received. The revised IFAD12 replenishment contributions assumption is aligned more closely with scenario C of the replenishment consultation, albeit with a reduced CPL grant element stemming from the actual nominal amount of CPLs received thus far. Both the reduction in core contributions and the nominal amount of CPLs will have an impact on the sustainable PoLG. Should pledges not materialize at the projected level of US\$1.3 billion, the grant envelope will have to be reduced accordingly during IFAD12 in order not to compromise medium-term sustainability. Conversely, should pledges exceed US\$1.3 billion the total grant envelope could be increased.
- (b) **Borrowing:**
- (i) **CPLs.** Borrowing in the form of CPLs currently stands at US\$93 million, falling short of the US\$225 million target. It is important to recall that as CPLs are extended on very favorable (concessional) financial terms, their full nominal amount can be considered and allocated as core resources under the PBAS. CPLs therefore remain an essential source of financing for IFAD benefiting LICs and LMICs in particular, and Management calls on Members to continue exploring the possibility of providing CPLs in support of IFAD12.
- (ii) **Other borrowing.** Borrowing in non-CPL form would be needed at a level of US\$1.09 billion. Approximately US\$480 million is expected to be sourced through a new sovereign loan from the KfW Development Bank. The additional US\$610 million is currently expected to be raised through private placements. With the implementation of the Integrated Borrowing Framework on track, and once IFAD’s Euro Medium-Term Note Programme has been established, Management is confident that this level of borrowing will be within reach for the IFAD12 cycle. Based

on reasonable estimates of the funding cost that IFAD can achieve in non-CPL form, and comparing it with the average on-lending spread on ordinary terms, the average borrowing cost for the stock of existing and future debt on IFAD's balance sheet during the IFAD12 cycle is expected to remain lower than the average on-lending spread for ordinary terms.

- (c) **Total grants.** In order for grants to be sustainable under the replenishment baseline approach, the total amount of regular and DSF grants was adjusted to US\$550 million reflecting the smaller new injection of capital available. In line with the sustainable replenishment baseline concept, new replenishment contributions must cover the past approved DSF burden falling due during the cycle, estimated at US\$88 million,¹⁰ new DSF and regular grants to be approved during IFAD12, and projected administrative expenses during the cycle. The sum of these amounts must be less than or equal to the new capital injected through replenishment (see table 2 in annex II for details). Within this overall envelope of US\$550 million of grants, the allocation for DSF grants has decreased by 29 per cent, or US\$171 million. This significant decrease in DSF grants leads to a notable decline in resources for LICs, as shown in the table 4 below. Additional financing in grant form would be US\$75 million for regular grants and US\$50 million for the reserve, to provide additional grants to countries falling into debt distress within the cycle or otherwise deemed eligible for multilateral debt relief programmes not compensated separately by Members.
- (d) **Sustainable PoLG level.** The sustainable PoLG under the new scenario based on revised assumptions is up to US\$3.5 billion, i.e. the same level of IFAD11. Under this scenario, at the end of IFAD12 the debt/equity ratio is an estimated 30.4 per cent, below the maximum threshold of 35 per cent, and deployable capital is estimated at between 20 and 25 per cent. If IFAD were to programme the target PoLG of US\$3.8 billion with the current lower expected level of replenishment, it would create a much higher need for IFAD to borrow in the short term, and especially the medium term, to meet disbursement obligations arising in the future (see simulation in annex II).
21. **With a lower replenishment, the share of resources provided to LICs naturally declines** both by value (from US\$1.4 billion to US\$1.1 billion) and as a percentage (from 43 per cent to 35 per cent) compared to IFAD11. This is in line with the declining number and size of LICs globally (down from 32 LICs in IFAD11 to 24 LICs in IFAD12). It should be noted that as the sustainable replenishment baseline including the DSF reform and ring-fenced DSF pool is a new principle being introduced from IFAD12 onwards, it is difficult to draw a direct comparison of the LIC share of resources with previous levels. The reduction is further exacerbated by the number of LICs in debt distress, which has increased while grant resources have decreased. Moreover, the ability of LICs to take up BRAM resources will depend on their creditworthiness and risk-based country limits. Should LICs not be in a position to absorb the BRAM resources as assumed, more borrowed resources could become available for LMICs and UMICs. Furthermore, as outlined in the rationale for establishing the BRAM, greater financial discipline must be applied to financing funded by borrowing, due to the obligation to honour debt repayments.
22. Given the overall decline in borrowing and the PoLG, the amount of resources for UMICs would also decline compared to IFAD11 levels by both value (from US\$440 million to US\$371 million) and percentage (from 13 to 11 per cent), while remaining at the agreed lower limit of 11 per cent of PoLG. Given that the pool of resources for both LICs and UMICs is limited, respectively, by the availability of DSF grants and borrowed resources, LMICs eligible for both PBAS and BRAM funding are

¹⁰ Forgone reflows for past DSF approvals are projected to increase in the future replenishment cycles. As per the DSF reform, the projected amount of DSF reimbursement of already approved DSF grants is available in document EB 2021/132/R.36.

expected to benefit from an overall increase in funding from US\$1.44 billion in IFAD11 to US\$1.83 billion in IFAD12, equivalent to an increase in their share of the PoLG from 43 to 54 per cent. This is in line with the expected increase in the number of LMICs included in the cycle (from 31 to 41 countries).

Table 4
Breakdown of PoLG by income category

IFAD11			Revised IFAD12 sustainable PoLG level				
Income category	Total amount	%	Core	Borrowed	Total amount	%	Variance from IFAD11
LICs, DSF-eligible	501	15%	377	-	377	11%	(124)
LICs, others	940	28%	554	240	793	23%	(147)
Total LICs	1 441	43%	931	240	1 171	35%	(270)
LMICs	1 444	43%	1 354	480	1 834	54%	390
Total LICs and LMICs	2 885	87%	2 285	719	3 004	89%	119
UMICs	440	13%		371	371	11%	(69)
Total	3 325	100%	2 285	1 090	3 375	100%	50

23. **Impact on funding by lending terms.** The expected split by lending terms in IFAD12 is directly linked to the split of available sources of funding: replenishment size, reflows and debt resources. As a result of deteriorating conditions and debt distress in some countries, coupled with the impact of the DSF reform, the share of PBAS resources allocated to countries on highly concessional terms would fall from US\$2 billion in IFAD11 to US\$1.2 billion in IFAD12 with the updated assumptions. The notable single change relates to countries eligible for highly concessional terms, which may have limited access to BRAM due to their debt sustainability. This said, LICs and LMICs are projected to take up 66 per cent (US\$719 million) of BRAM resources on concessional terms (see table 5 below).

Table 5
Breakdown of PoLG by lending terms

Lending terms	IFAD11			Revised IFAD12	
	Total amount	%		Total amount	%
DSF	596	17%		425	12%
SHC	-	-		407	12%
HC	1 393	40%		355	10%
Blend	445	13%		646	18%
Ordinary	891	25%		451	13%
Total PBAS	3 325	95%		2 285	
Ordinary-BRAM	-	-		1 090	31%
Reserve	-	-		50	1%
Regular grants	175	5%		75	2%
Total	3 500	100%		3 500	100%

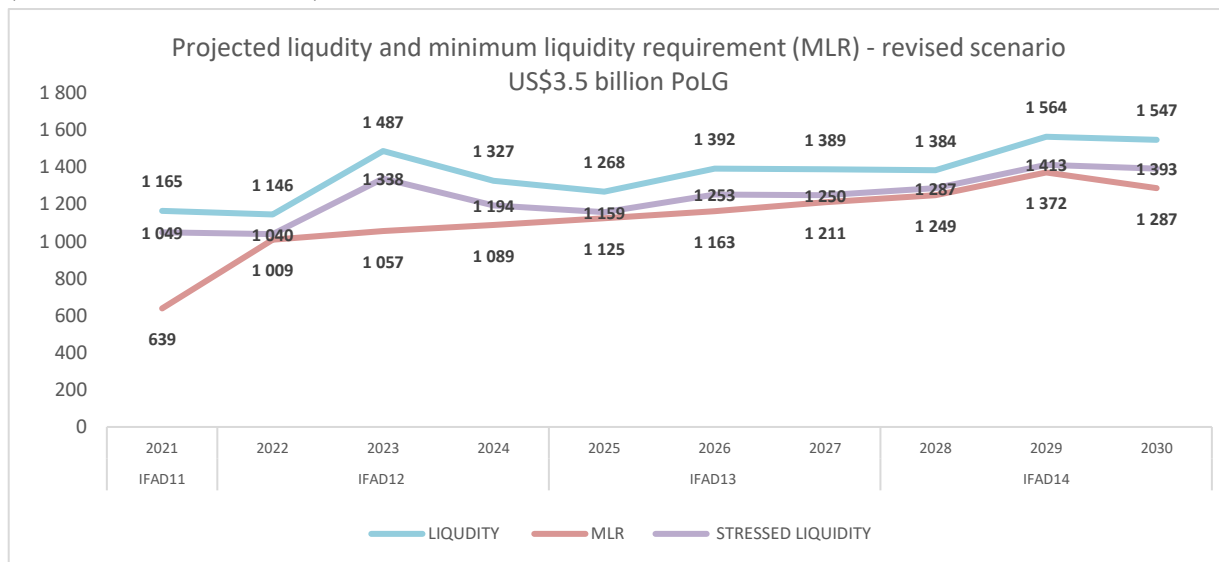
VI. Conclusions and next steps

24. Under the current updated assumptions, Management expects, with a reasonable degree of certainty, to reach replenishment contributions of US\$1.3 billion. While the IFAD12 replenishment target remains at US\$1.55 billion, Management is presenting the updated sustainable PoLG level to the Executive Board to begin planning for the IFAD12 period without the risk of overcommitting against resources that may not materialize.
25. Assuming a replenishment of US\$1.3 billion and borrowing of US\$1.1 billion, the sustainable PoLG is up to US\$3.5 billion. The current PoLG, current DSF grant allocation and highly concessional share is deemed sustainable from a financial trajectory point of view and reflects IFAD's current funding sources and sizes.

26. The decrease in the percentage of LIC resources and the increase in LMIC resources derive from the size of the replenishment relative to PoLG size. This is noteworthy, highlighting that in the past IFAD provided a total grant envelope that was not deemed sustainable according to the sustainable replenishment baseline concept. Finally, under an increased share of borrowed resources as funding sources, it is also natural that the percentage of countries borrowing on ordinary terms increases accordingly. Over the coming months the level of available resources will be updated and will form the basis for calculating the RAC for 2022 to be presented at the Executive Board in December 2021.
27. This is the first time since the conclusion of the replenishment consultations and before a new cycle begins that a formal reassessment of available resources versus the target replenishment and the resulting new level of sustainable PoLG is being submitted for approval by the Executive Board. Following the removal of the “structural gap” clause from the replenishment resolutions since IFAD11, this kind of assessment is a better way of updating financial assumptions and plans than a mechanical adjustment of the contributions target based on pledges received six months after approval of the replenishment resolution (as was the earlier practice, for example in IFAD10). This is an important milestone and best practice, in line with the increasing attention paid by both Members and Management to IFAD’s financial sustainability.
28. In order to maintain a sustainable trajectory, as undertaken to Members during the IFAD12 consultations, Management will also continue to review the financing and commitment capacity at least yearly to take into consideration updated assumptions and prevent uncontrolled pressure on IFAD’s liquidity and capital that would jeopardize its ability to programme future operations due to existing disbursement commitments.
29. Crucially, the foregoing reflects Management estimates of final IFAD12 contributions based on conservative assumptions. There is still time for Member States to pledge or increase their pledges, and the IFAD12 replenishment targets remain unchanged: US\$1.55 billion in replenishment contributions and a PoLG of up to US\$3.8 billion. Management is committed to advocating for additional contributions and CPLs in line with these agreed targets and continues to encourage all Member States to step up and pledge in accordance with scenario D, as many have already done. The G20, COP26 and Food Systems Summit all provide important opportunities and political momentum before the end of 2021 to ensure sufficient funding for investment in smallholder adaptation to climate change, food systems transformation, and supporting vulnerable rural communities to recover, rebuild and strengthen their resilience.

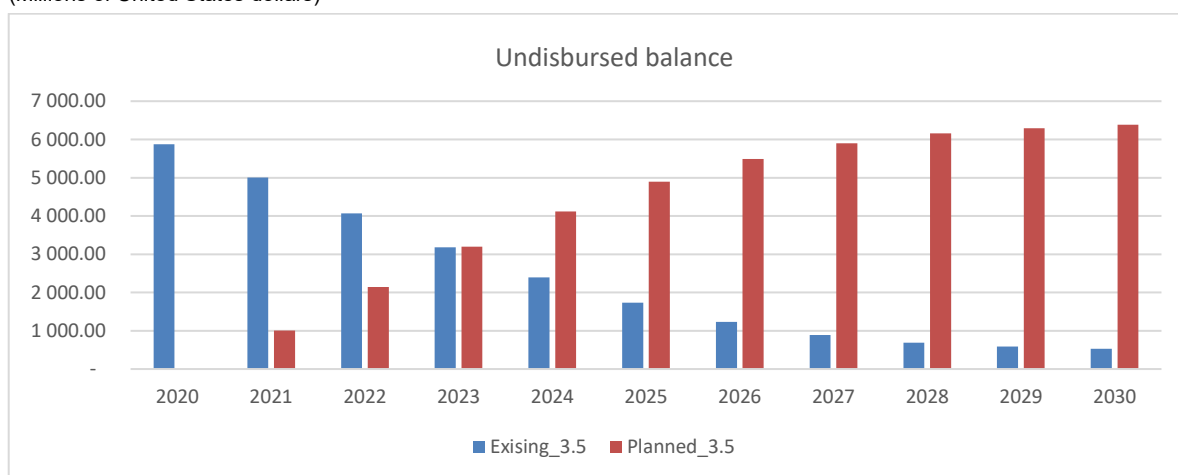
A. Scenario simulation US\$3.5 billion PoLG

Chart 1
Projected IFAD liquidity¹¹
(Millions of United States dollars)



- As long as core resources and new borrowing are obtained at their respective target levels, stressed liquid assets (liquidity discounted by a stress factor using credit agencies’ methodology)¹² is projected to stay above the MLR.¹³
- To assess the financial sustainability of the US\$3.5 billion PoLG scenario, it is necessary to look at a minimum of three replenishment cycles (up to 2030), due to the timing of approvals and loan disbursements. Chart 2 shows the impact of the approval of a US\$3.5 billion PoLG over the next three cycles and the impact on undisbursed balance for both existing and new loans and grants. It also depicts the sensitivity of the undisbursed balance to approvals of new loans and grants.

Chart 2
Projected increase in undisbursed balance due to new approvals
(Millions of United States dollars)



- Blue bars depict the undisbursed balance of existing loans and grants, i.e. approved up to IFAD11, while the red bars show the contribution to the overall undisbursed balance by new approvals from IFAD12 onwards. As early as 2023, 50 per cent of

¹¹ Projected liquidity at the beginning of the year.

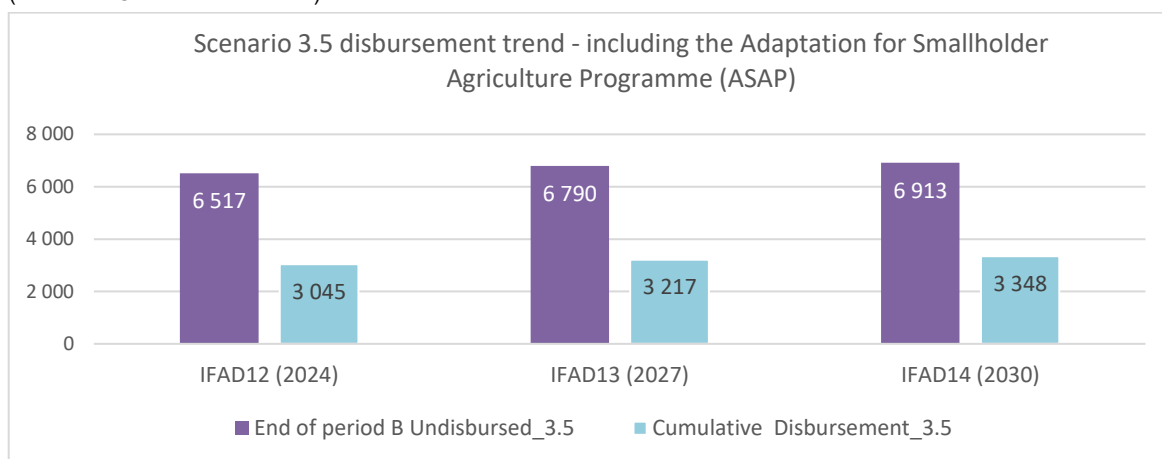
¹² The haircut level depends on asset allocation of the investment portfolio; it is expected to be in the range of 5 to 10 per cent at the beginning of IFAD12 and then move towards a level of 20 per cent.

¹³ Starting in 2022, the MLR is calculated as the sum of 12 months’ projected disbursements and borrowing obligations (interest and principal), as defined in EB 2020/131(R)/R.20/Rev.1.

the projected total undisbursed balance would comprise existing loans and grants and 50 per cent projected new operations.

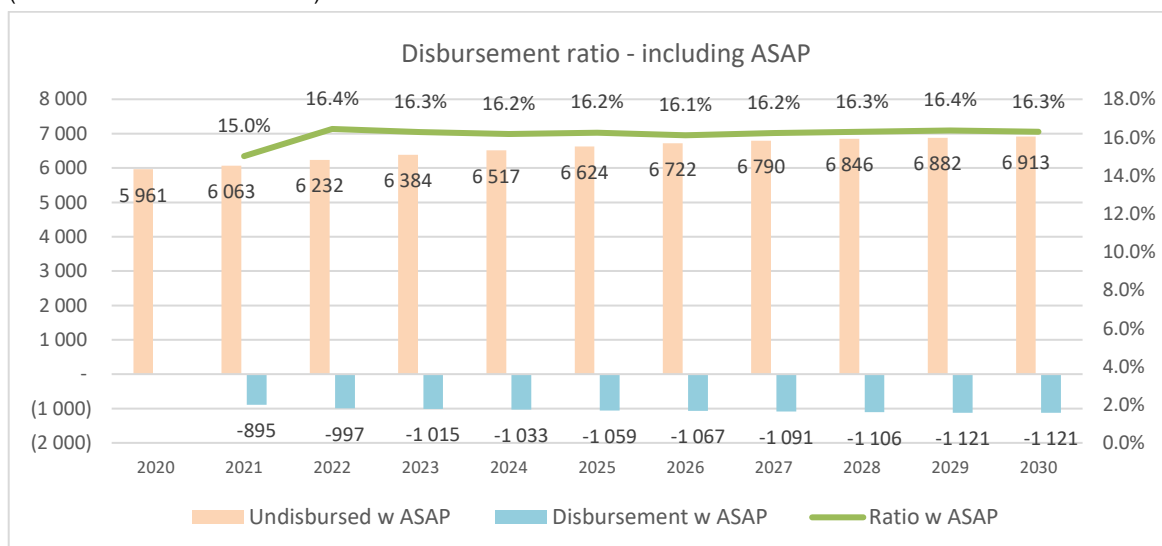
4. In order to sustain a US\$3.5 billion PoLG for IFAD12 with lower core resources than scenario C, borrowing would need to grow to US\$3.2 billion over the next three replenishments. Assuming a similar growth in debt for the next replenishments, IFAD is expected to reach the 35 per cent limit on the debt to equity ratio in 2026 (IFAD13).
5. For IFAD12, the projected new PoLG of US\$3.5 billion is higher than projected disbursements during the same three-year cycle (US\$3 billion). This dynamic of higher approvals than disbursements would result in an increasing undisbursed balance of IFAD loans and grants. In the graph below, the level of US\$6.0 billion of undisbursed PoLG projected at the end of IFAD11 is expected to grow to US\$6.5 billion in IFAD12 and, under similar approved levels of PoLG and disbursements in the next cycles, is expected to grow to US\$6.9 billion by IFAD14.

Chart 3
Trend of disbursements and total undisbursed level of PoLG
(Millions of United States dollars)



6. In order to ensure delivery against existing and future operations, IFAD will aim to achieve at least 16 per cent disbursement of the total amount undisbursed each year.

Chart 4
Expected disbursements under the revised scenario (figures include ASAP)
(Millions of United States dollars)



A. Scenario simulation US\$3.8 billion PoLG

1. Management ran a simulation to assess the impact on additional borrowing needs to achieve the PoLG of US\$3.8 billion under the consensus scenario approved by the Governing Council, with current resources and assumptions as outlined in the description of the revised scenario (US\$3.5 billion).

Table 1
(Millions of United States dollars)

	<i>Simulated replenishment scenario</i>
Replenishment contributions	1 300
<i>CPL grant element (included above)</i>	23
Total borrowing	1 283
<i>Borrowing (net of CPL)</i>	1 190
<i>CPL</i>	93
Cumulative borrowing IFAD12-IFAD14	3 880
Total grants	550
Regular grants	75
DSF	425
Reserve	50
PoLG	3 800
Leverage ratio IFAD12 (debt/equity)	32%

2. Overall, the sharp rise in borrowing needed to fill the wide gap between available contributions and CPLs at a much lower level than initially projected, US\$1.55 billion and US\$225 million respectively, and a PoLG of US\$3.8 billion, would exacerbate further the risk areas highlighted for the revised scenario with a US\$3.5 billion PoLG.
3. Specifically:
 - (i) The increase in the undisbursed balance under the US\$3.8 billion PoLG scenario would be higher than under the US\$3.5 billion PoLG scenario. By the end of IFAD14, the difference in the balance of undisbursed loans and grants between the two scenarios would be equivalent to an additional undisbursed amount of US\$460 million.
 - (ii) In order to maintain a disbursement ratio of 16 per cent (including non-Programme Management Department grants and ASAP) under the US\$3.8 billion PoLG scenario, disbursements would have to increase further in absolute terms, which would exacerbate the pressure on short term liquidity needs.
 - (iii) By the end of IFAD14 (2030), the cumulative increase in disbursements is equivalent to US\$439 million compared to the revised scenario, which would be reflected in much lower liquidity levels that would not comply with the MLR.
 - (iv) Growing borrowing obligations and disbursements would lead to a higher MLR under the US\$3.8 billion PoLG scenario (calculated based on the new liquidity policy definition). A higher MLR would lead to higher borrowing needs, resulting in a vicious circle.
 - (v) The 35 per cent limit on the debt to equity ratio could be breached as early as in 2025, the first year of IFAD13.

- (vi) Deployable capital depletion and leverage enter steeper trajectories that are not in line with developments reflected to the rating agencies, and can be perceived as not being prudent.

Table 2

Sustainable replenishment baseline approach for IFAD12

(Millions of United States dollars)

	<i>Target replenishment</i>	<i>Revised replenishment</i>
Contributions net of grant element of CPLs	1 500	1 277
Total grants	(750)	(550)
DSF compensation	(88)	(88)
HIPC	(18)	(18)
Total operating expenses	(557)	(557)
Baseline replenishment	Sustainable	Sustainable

4. As shown in table 2, a sustainable level of grants is sized according to the residual capacity of the replenishment baseline coverage. Unsustainable grants would accelerate capital utilization so that deployable capital would be eroded faster to unacceptable levels. It is important to note that based on the current level of pledges as at 30 June 2021, the sustainable replenishment baseline principle would not be respected. Therefore, should the amount of actual contributions not reach the US\$1.3 billion level, IFAD's sustainable grant level would have to be further reduced.

B. Lower size of PBAS and potential effect of balance by income category

5. The resources allocated through the PBAS are composed of IFAD's core resources and the full nominal amount of CPLs. Therefore, any reduction in one of these magnitudes has a direct effect on the amount of resources allocated through the PBAS.
6. In other words, although increasing the amount of other forms of borrowing to substitute the reduced amount of CPLs might enable IFAD to reach the same level of PoLG, the distribution of the PoLG would be affected, by increasing the amount of resources available to countries through the BRAM at the expense of the PBAS.

C. Need to review agreed threshold for the debt to equity ratio

7. The debt to equity ratio was defined in the Sovereign Borrowing Framework and revised in the Integrated Borrowing Framework to align its calculation with the definition applied under IFAD's Capital Adequacy Policy and with industry best practice and credit rating agencies' methodologies. The updated computation is somewhat more conservative than the previous definition.
8. In a scenario of increased borrowing and a lower share of core resources, the debt to equity ratio would increase faster than otherwise.
9. Such a scenario would call for a revision of the 35 per cent limit in IFAD13.

D. Potential effect on IFAD's credit rating

10. Weakening the capital and liquidity bases on which credit rating agencies issued AA+ ratings could jeopardize the scope for future rating upgrades or, worse, could expose IFAD to the risk of a downgrade.
11. A lower actual replenishment amount than the target level would also affect the perception by rating agencies of the strength of donor support for IFAD, an important factor in maintaining current ratings.
12. Increasing borrowing at a faster pace than planned would weaken the conservative leverage ratio underpinning the strong credit rating assigned to IFAD.