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Investing in rural people

## Financial framework for IFAD10

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Consultation on the Tenth Replenishment of IFAD's Resources –  
Second Session

Rome, 9-10 June 2014

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For: **Review**

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## Abbreviations and acronyms

DSF	Debt Sustainability Framework
HIPC	Heavily Indebted Poor Countries Debt Initiative
IBRD	International Bank for Reconstruction and Development (World Bank group)
IFAD10	Tenth Replenishment of IFAD's Resources
IFI	international financial institution
IPS	Investment Policy Statement
KfW	Kreditanstalt für Wiederaufbau (German Government-owned development bank)
MLR	minimum liquidity requirement
PBAS	performance-based allocation system
PoLG	programme of loans and grants
SCF	sustainable cash flow

## Executive summary

1. During the period of the Tenth Replenishment of IFAD's Resources (IFAD10), country demand for donor resources for agriculture and rural development will remain high – much higher than the supply. Demand is estimated at more than US\$200 billion annually, while supply from the donor community is estimated at less than US\$12 billion. Country-by-country analysis by IFAD's country programme managers shows that demand for IFAD funding of agricultural projects, when climate costs are factored in, amounts to US\$5.5 billion over the IFAD10 period. This means that all conceivable levels of resources that IFAD would have available, at its current lending rates, could be absorbed by its borrowers and grant recipients.
2. IFAD's programme of loans and grants (PoLG) increased dramatically from IFAD6 to IFAD8 and stabilized in IFAD9. The IFAD7 PoLG represented a 40 per cent increase over IFAD6. Similarly, the IFAD8 PoLG represented a 50 per cent increase over IFAD7. Thus in a period of six years, the PoLG more than doubled from US\$1.4 billion in IFAD6 to US\$3 billion in IFAD8, and was maintained at that level in IFAD9.
3. This increase has been partly sustained by an increased level of donor contributions. However, as evidenced in table 2 of the main text, the funding from external contributions remained at about 34 per cent. The majority of the resources to support total funding requirements had to come from IFAD's internal resources, current and projected. To address this need, in IFAD7 advance commitment authority (ACA) was extended from three years (in IFAD6) to five years of future loan reflows. In IFAD8, the largest increase in the PoLG in IFAD's history had to be supported by another increase of ACA from five to seven years of future loan reflows.
4. However, the extraordinary exercise of IFAD7 and 8 is not repeatable, as the increase in ACA has already de facto allocated future resources to support past commitments. This has highlighted a need to introduce a measure of the projected timing of inflows and outflows over a longer time horizon.
5. In recognizing this, as of IFAD9 IFAD introduced the sustainable cash flow (SCF) approach to determine the PoLG level that IFAD can commit to delivering under a given core contribution replenishment envelope. This approach introduces a new dimension critical to IFAD operations: the time of the materialization of flows. The SCF was introduced in recognition of the fact that, in planning its operations over a given replenishment, paramount consideration must be devoted to the long-term impact on IFAD's liquidity position and financial sustainability of the decisions taken today. It was recognized that IFAD's committable PoLG in every replenishment should be assessed to a level that does not endanger the future of the Fund.
6. IFAD's financial sustainability is defined as the condition under which IFAD can maintain a constant real level (i.e. inflation-adjusted) of future PoLGs for an assumed constant level of real core contributions – while also maintaining its liquidity at or above the minimum liquidity requirement (MLR) prescribed by policy for the duration of projections (currently 40 years). This long-term view is crucial, as it allows Management to make informed decisions about the commitments that IFAD can take on over one replenishment without jeopardizing the future finances of the Fund.
7. In the light of that main constraint, a PoLG level in one replenishment period is defined "cash flow sustainable" if, by projecting all cash inflows and outflows resulting from that PoLG and future PoLG levels supported only by core contributions (assumed flat in real terms), IFAD's liquidity balance never falls below its MLR for the length of the projection horizon.

8. For projection of the SCF level of future PoLGs, IFAD is thus relying only on core contributions as the funding source, given that these are and historically have been IFAD's main source of funding. Complementary contributions received to support a given replenishment are considered for that specific replenishment, but are not assumed to be repeatable in future replenishments.
9. In addition to the funds that materialize in a given replenishment period, IFAD can also commit to delivering its PoLG by using projected future net flows, thereby considering also the projected need for outflows. The possibility to commit against future cash availability is possible because IFAD's PoLG disburses over several years and thus does not have to be fully cash funded at the time of the approval of the loans and grants by the Executive Board.
10. In committing against future net flows, the importance of accurate long-term cash flow projections is paramount in assessing the impact on IFAD's liquidity and in ensuring that IFAD is not overcommitting in a given replenishment, compared with the available and projected funds under a set of core assumptions.
11. Three scenarios for IFAD10 relying on core contributions are proposed for consideration based on analysis of the demand for IFAD financing: low (IFAD10 PoLG of US\$2.8 billion), medium (IFAD10 PoLG of US\$3.0 billion) and high (IFAD10 PoLG of US\$3.2 billion). The level of core contributions needed to support these PoLG levels is shown in table 7 of the main text. The three core contributions levels required to support a PoLG of US\$2.8 billion, US\$3.0 billion and US\$3.2 billion are forecast at US\$1.338 billion, US\$1.437 billion and US\$1.534 billion respectively.
12. In addition, IFAD relies on the member contributions needed to compensate for forgone reflows from IFAD's participation in the Debt Sustainability Framework (DSF), to be provided on a pay-as-you-go basis in addition to core contributions. The level of DSF contributions needed over the IFAD10 period is US\$3.4 million and is projected to increase in line with the continuation of DSF grant approvals.
13. Should DSF-related contributions be provided not as additional contributions, but as part of member core contributions, then, all else being equal, the level of the SCF PoLG would decrease. This impact would be particularly significant in future replenishment periods in which the amount of compensation for the forgone principal from DSF approvals becomes more and more significant (see paragraphs 28-30 of the main text).
14. In accordance with IFAD's replenishment resolution, "... the structural gap may not exceed 15 per cent of [the target replenishment level].... The Fund's programme of loans and grants will be adjusted to reflect the shortfall from the target." Scenario I in annex II shows changes in the levels of PoLG scenarios under the assumption that only 85 per cent of the target level of core contributions is reached in IFAD10.

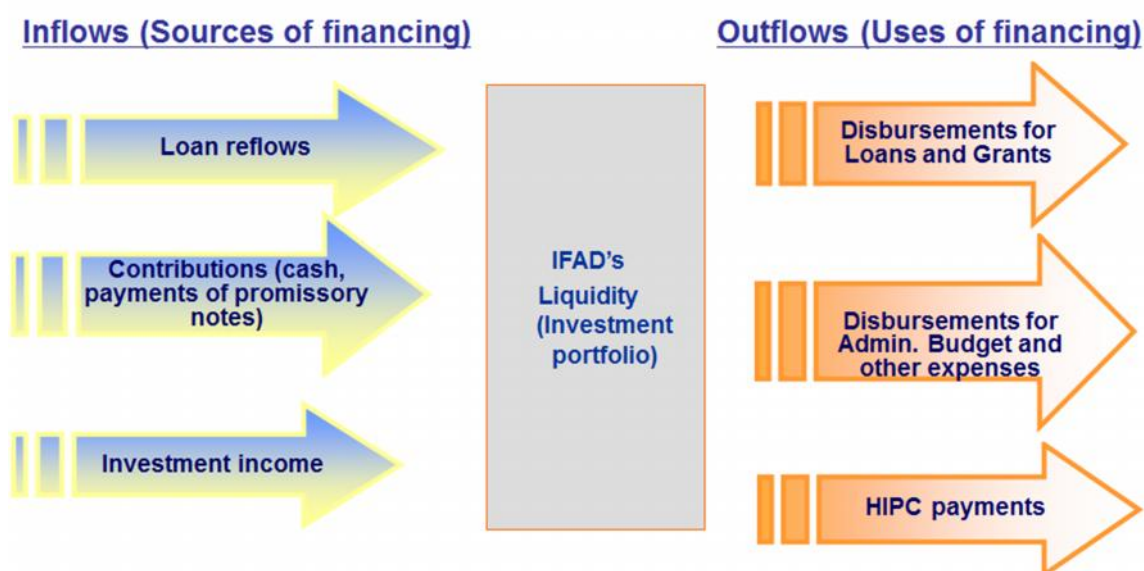
## Financial framework for IFAD10

### I. Introduction: IFAD's cash flows and determination of the programme of loans and grants based on a sustainable cash flow approach

1. Since its inception, IFAD has been funded by core contributions from its Member States in the form of grants – its main external resource – and, from that, resources generated by its internal resources, mainly loan reflows and investment income.
2. IFAD's financial resources fund its programme of loans and grants (PoLG), administrative expenses and costs related to the Heavily Indebted Poor Countries Debt Initiative (HIPC). Graph 1 shows the main cash inflows and outflows affecting IFAD's liquidity.

Graph 1

IFAD's main cash flows

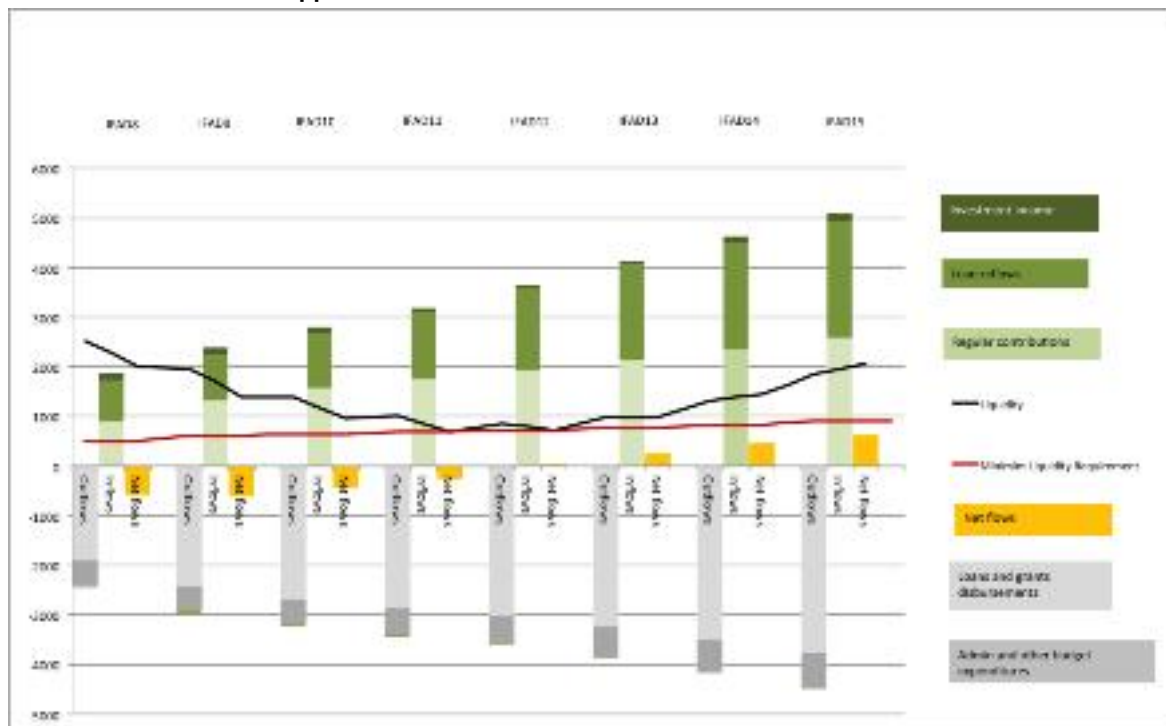


3. IFAD's liquidity, or the investment portfolio, is the sum of all cash inflows and the source of all cash outflows. IFAD's investment portfolio is invested in a range of fixed-income instruments in line with IFAD's Investment Policy Statement (IPS)<sup>1</sup> and amounted to US\$1.9 billion at 31 December 2013. IFAD's investment portfolio is already fully committed against disbursements for loans and grants under past and current PoLGs.
4. For the reasons highlighted in the executive summary, as of the Ninth Replenishment of IFAD's Resources (IFAD9), IFAD introduced the sustainable cash flow (SCF) approach to determine the PoLG level that IFAD can commit to delivering under a given core envelope. This approach was introduced because, in planning IFAD's operations over a given replenishment, paramount consideration must be devoted to the long-term impact on its financial sustainability of the decisions taken today – in light of the extended loan disbursement and repayment pattern, compared with the replenishment period.

<sup>1</sup> EB 2013/110/R.29

5. IFAD's financial sustainability is defined as the condition under which IFAD can maintain a constant real (i.e. inflation-adjusted) level of future PoLGs for an assumed constant level of real core contributions – while also maintaining its liquidity at or above the minimum liquidity requirement (MLR) prescribed by policy for the duration of projections (currently 40 years). This long-term view is crucial, as it allows Management to make informed decisions on the commitments IFAD can take on over one replenishment without jeopardizing the future finances of the Fund.
6. In light of that main constraint, a PoLG level in one replenishment period is defined "cash flow sustainable" if, by projecting all cash inflows and outflows resulting from that PoLG and future PoLG levels supported only by core contributions (assumed flat in real terms), IFAD's liquidity balance never falls below its MLR for the length of the projection horizon.
7. IFAD's MLR is defined in IFAD's liquidity policy (EB 2006/89/R.40) and is established at the level of 60 per cent of annual projected gross disbursements, including liquidity shocks. As shown in graph 1, IFAD's cash outflows mainly relate to disbursements for loans, grants and administrative expenses. Taking gross disbursements as a measure (i.e. only cash outflows without expected inflows) is a very prudent approach. In any given year, it is highly unlikely that IFAD will not be able to rely on any inflows.
8. The variables that define and impact the level of the SCF PoLG are all assumptions about future trends and cash flow patterns underlying IFAD's financial framework, for example inflation assumptions, investment return projections, disbursement patterns of IFAD's commitments, and the forecast composition of the PoLG (see annex III for the assumptions underlying financial projections).
9. This means, in turn, that should any of the variables impacting cash flow projections change, the long-term sustainability of a given PoLG level should be reassessed and, if needed, corrective actions taken.
10. One fundamental tenet of the SCF model is that, while holding core contributions constant in real terms (i.e. growing at the rate of inflation), the PoLG level supported by core contributions is projected to be achievable indefinitely in real terms, without IFAD breaching its MLR in any future year.
11. The SCF logic is thus based on projection of the future availability of core contributions, as these are IFAD's traditional and most reliable source of funding. Future SCF PoLG projections are based only on these contributions.
12. Should the condition of cash flow sustainability be breached, for example by an overcommitment in any given replenishment period, all other parameters being equal, IFAD would need to readjust the ratio of contributions versus the PoLG in future replenishments to bring cash flow projections back into line with the minimum liquidity threshold. This means that either a higher level of contributions would be required in future replenishments to keep the PoLG flat in real terms, or the PoLG would have to be decreased accordingly in future replenishments.
13. Graph 2 summarizes the concept of the SCF PoLG. IFAD's liquid assets (i.e. its investment portfolio) as represented by the black line are currently projected to decrease for as long as outflows are higher than inflows. The MLR is currently projected to be reached in 2021. After that, inflows from commitments of past and future replenishments are expected to be larger than outflows, thus increasing IFAD's investment portfolio balance. If, based on a given level of replenishment, IFAD commits to a PoLG level that is cash flow sustainable as defined above, IFAD's investment portfolio will, over the course of the forthcoming 40 years, not fall under the floor of IFAD's MLR as represented by the red line.

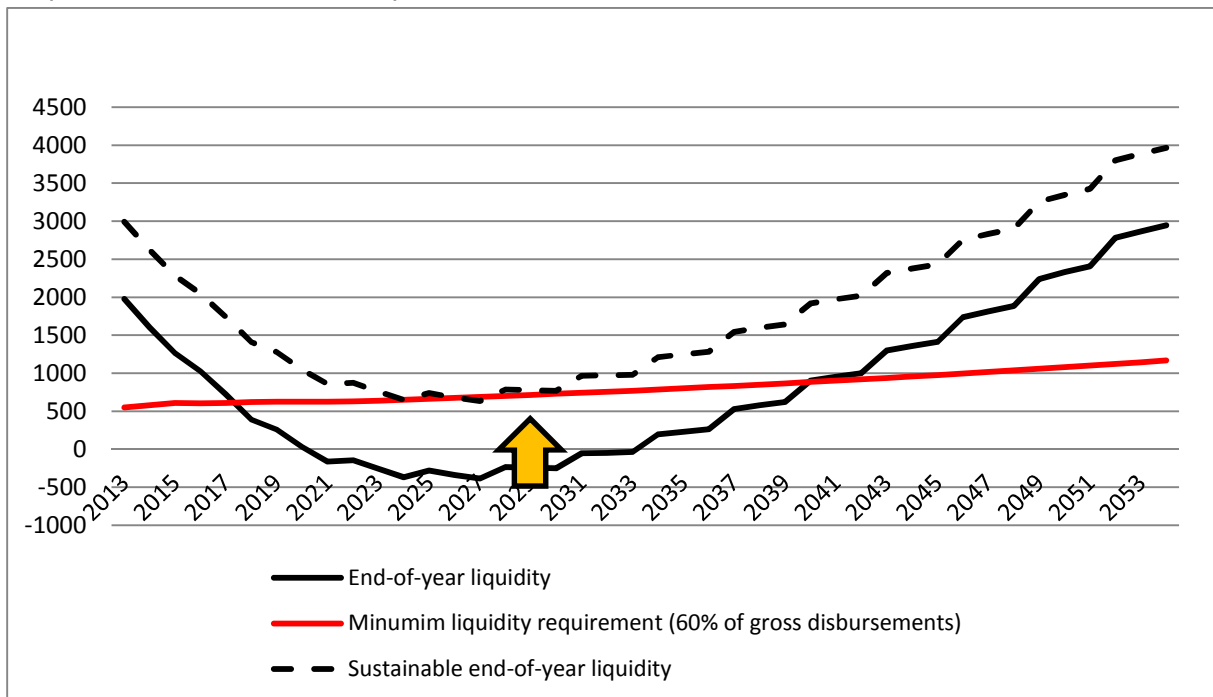
Graph 2  
Sustainable cash flow approach for PoLG determination



14. IFAD's investment portfolio balance has been decreasing as forecast over the past replenishment, in line with projections, due to outflows being higher than inflows. IFAD's investment portfolio is already fully committed against future disbursements for loans and grants approved under past and current PoLGs. This means that, should IFAD stop approval of new loans and grants after IFAD9, the full amount of the investment portfolio would have to support disbursements from commitments already entered into by IFAD, and there would be no leeway to further increase IFAD's delivery of loans and grants.
15. As mentioned, an over commitment in a given replenishment above the SCF equilibrium level or changes in projections could lead to a breach of the MLR. In this case, the model would have to be brought back to equilibrium by either higher inflows or lower outflows. All other parameters being unchanged, this means that a proportionally higher level of contributions would be needed in future replenishments (higher than the assumed level of flat real-term contributions) or that the PoLG should be adjusted downwards, thereby decreasing projected outflows. The result of this adjustment on the projected liquidity curve is shown in graph 3.

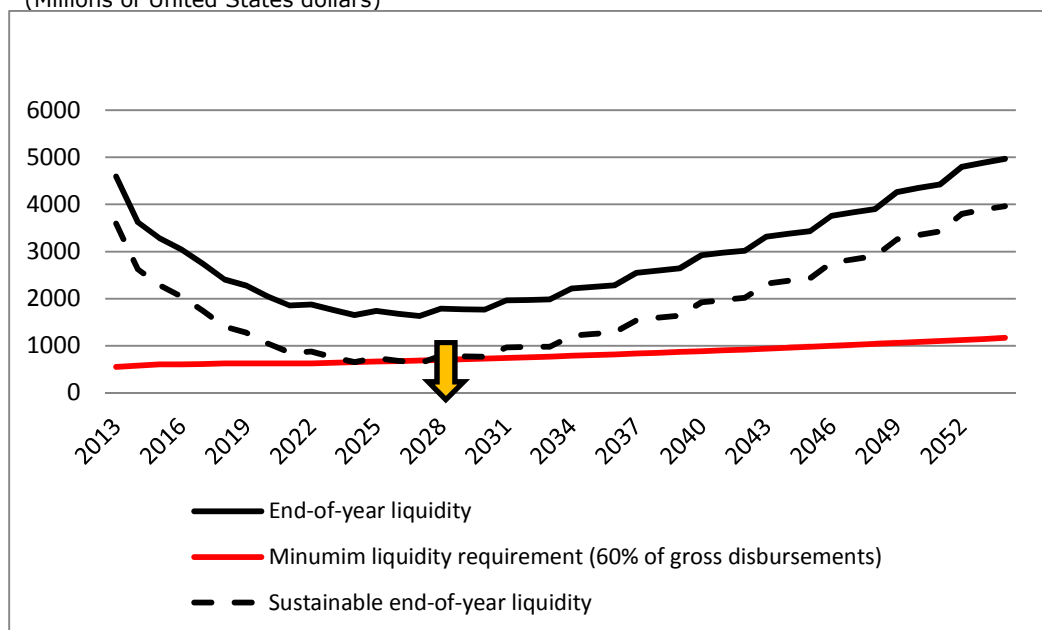


Graph 3  
**Adjustment of projected liquidity if MLR is breached**  
 (Millions of United States dollars)



16. On the other hand, should projections change favourably so that IFAD can reasonably project that its liquidity balance will be higher than the MLR, it can afford to commit and disburse more. In this case, the SCF PoLG level could be adjusted upwards. Graph 4 shows the impact of such an upward adjustment of the PoLG on the liquidity curve. The liquidity level would decrease overall, because a higher PoLG level would involve higher projected disbursement. Such an event could be triggered by a change in one or more variables that would impact projections positively, as further described in table 1. For example, an upward revision of investment return assumptions over the long run would allow for an increase in committable funds.

Graph 4  
**Adjustment of projected liquidity if higher than MLR**  
 (Millions of United States dollars)



17. Cash flow projections are thus crucial to the SCF approach to determining the PoLG. All financial flows deriving from past, current and future assumed levels of replenishment contributions and PoLGs are projected over a 40-year horizon, based on several assumptions about trends and profiles provided by the relevant internal and/or external parties (see annex III for assumptions underlying the projections). In line with the IFAD financial structure, of which the IFAD financial model represents a simplified but accurate reality, all cash flow projections are inherently interlinked. Thus a change in one variable could potentially be countered by a change in another and offset the final impact on the SCF PoLG. However, considered in isolation, changes in variables that result in an increase in IFAD’s liquidity also increase IFAD’s potential PoLG. Changes that impact IFAD’s liquidity negatively would have an adverse impact on the PoLG. Table 1 summarized the sensitivity of the PoLG to changes of single variables in isolation.

Table 1  
**Impact on SCF PoLG of changes in variables in isolation – sensitivity of PoLG**

Variable	Change in variable	Change in PoLG (all else being equal)
Level of regular contribution	Increase	Increase
Length of disbursement	Increase	Increase
Interest rates on IFAD’s loans	Increase	Increase
Cancellation rate on loans and grants	Increase	Increase
Investment returns	Increase	Increase
Loans as percentage of PoLG	Increase	Increase
Grants as percentage of PoLG	Increase	Decrease

## II. IFAD's financial structure: Resource requirements and sources of funds

18. In line with the "soft loan" windows of sister international financial institutions (IFIs), IFAD's main source of funding has always been traditional replenishment in the form of grants. The limitation of this structure, however, is that in times of challenging global financial conditions, when donors are not in a position to replenish IFAD in the amount it would need to meet demand, IFAD cannot rely on other institutionalized sources of funding, primarily the financial markets. Financial markets are the primary source of funds for the "hard loan" windows of other IFIs (African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, International Bank for Reconstruction and Development [IBRD], Inter-American Development Bank).
19. IFAD uses its replenishment funds to provide not only grants but also loans to be repaid by borrowers. This feature represents the strength of IFAD's financial structure. To deliver a given PoLG level as committed for a given replenishment, in addition to member contributions, IFAD can rely on loan reflows (principal and interest payments) from previously approved and disbursed loans as a critical source of funding.
20. Table 2 shows resource requirements (use of funds) and sources of financing over three replenishment periods, based on both target level of member contributions and target levels of the PoLG.

Table 2

### Target replenishment and PoLG levels: Resource requirements and sources of funds<sup>a</sup>

Resource requirements	IFAD7			IFAD8			IFAD9
	US\$ million	Percentage of total	US\$ million	Percentage of total	US\$ million <sup>b</sup>	Percentage of total	
(1) Programme of loans and grants	2 000	88	3 000	85	3 000	84	
(2) Operating costs, HIPC payments	276	12	517	15	561	16	
<b>Total resource requirements (1+2)</b>	<b>2 276</b>	<b>100</b>	<b>3 517</b>	<b>100</b>	<b>3 561</b>	<b>100</b>	
<i>Sources of funds</i>							
(1) Member contributions - target	720	32	1 200	34	1 500	42	
<b>Subtotal: external resources (1)</b>	<b>720</b>	<b>32</b>	<b>1 200</b>	<b>34</b>	<b>1 500</b>	<b>42</b>	
(2) Loan reflows during replenishment, including cancellations	905	40	1 079	31	1 158	33	
(3) Investment Income during replenishment	379	17	245	7	(33)	-1	
<b>Subtotal: internal resources (2+3)</b>	<b>1 284</b>	<b>56</b>	<b>1 325</b>	<b>38</b>	<b>1 125</b>	<b>32</b>	
(4) Future net flows <sup>c</sup>	272	12	993	28	937	26	
<b>Subtotal: internal resources and future net flows (2-4)</b>	<b>1 556</b>	<b>68</b>	<b>2 317</b>	<b>66</b>	<b>2 061</b>	<b>58</b>	
<b>Total sources of funds (1-4)</b>	<b>2 276</b>	<b>100</b>	<b>3 517</b>	<b>100</b>	<b>3 561</b>	<b>100</b>	

<sup>a</sup> The IFAD7 and IFAD8 breakdown applies the logic of SCF for information. These replenishments were carried out under the advance commitment authority (ACA) approach.

<sup>b</sup> The IFAD9 amounts are based on target levels. This explains the difference from amounts presented in table 6.

<sup>c</sup> Future net flows represent projected inflows net of projected outflows. The main future inflows are loan reflows, future contributions and investment income, net of disbursements for loans, grants and administrative and other expenses (see also paragraph 34).

21. The table presents target replenishment and PoLG figures for comparison with the IFAD10 contribution scenarios in table 7 below. Other replenishment papers – in particular the programme of work paper – present similar tables of actual contributions and PoLGs.
22. As evidenced in table 2, only 32-42 per cent of IFAD's total resource requirements over the past three replenishments have been funded through external resources. The remaining resource needs have been funded from internal resources and future net flows. As a comparison, the share of partner grant contributions was 76 per cent in International Development Association (IDA)15, 64 per cent in IDA16 and 65 per cent in IDA17.

## A. IFAD's resource requirements

23. IFAD's main resource requirements relate to its programme of loans and grants, administrative expenses and HIPC-related costs. As shown in table 2 above, IFAD's PoLG represented from 88 to 84 per cent of IFAD's resource needs over the past three replenishment periods (broken down in table 3).

Table 3

### Breakdown of overall PoLG\*

<b>Loans</b>	72.5%
<b>Grants</b>	27.5%
DSF grants	21.0%
Global/regional grants	5.0%
Country-specific grants	1.5%
<b>Total</b>	<b>100.0%</b>

\* As currently reflected in IFAD's financial model, based on 10-year historical average.

24. **Loans.** Commitments for loans represent some 72.5 per cent of IFAD's PoLG. Table 4 presents lending terms as approved by the Executive Board in December 2012 (EB 2012/107/R.31/Rev. 1). It describes IFAD's current loan products, but Management is actively exploring the introduction of other potential lending modalities to increase the range of options open to borrowers. Options being considered include but are not limited to loans denominated in specific currencies, rather than in special drawing rights, and the choice of a fixed rather than variable spread on ordinary term loans. These modalities will be developed and presented to the Executive Board for approval during the Tenth Replenishment of IFAD's Resources (IFAD10).

Table 4

### IFAD lending terms

	<i>Maturity (years)</i>	<i>Grace (years)</i>	<i>Interest</i>	<i>Service charge</i>
Highly concessional	40	10	0%	0.75%
Blend	25	5	1.25%	0.75%
Ordinary	15-18	3 <sup>a</sup>	IFAD reference rate (variable) plus spread <sup>b</sup>	-

<sup>a</sup> The Executive Board may vary the grace period for the repayment of loans received on intermediate and ordinary terms.

<sup>b</sup> IFAD's rate for ordinary lending is the six-month Libor rate for the four SDR currencies (Euribor rate for EUR) weighted by the SDR weights. SDR weights are calculated based on SDR units and exchange rates as published periodically by the International Monetary Fund. The rate is set on a six-month basis. The IBRD variable spread for loans with maturity greater than 15-18 years is applied.

25. The average composition of IFAD's loan portfolio (i.e. of 72.5 per cent of the overall PoLG) over the past 10 years (2002-2012) is presented in table 5.

Table 5  
**Composition of IFAD's loan portfolio**

<i>Loan type</i>	<i>Percentage of loan portfolio (average 2002-2012)</i>
Highly concessional	74.0
Blend <sup>*</sup>	10.3
Ordinary	15.7

<sup>\*</sup> Blend terms were introduced in December 2012 and replaced intermediate terms. The average of 10.3 per cent is calculated including previously approved intermediate/hardened terms.

26. **Regular grants.** IFAD's global/regional and country-specific grants account for up to 6.5 per cent of IFAD's PoLG.
27. **HIPC.** IFAD provides debt relief to countries eligible under the HIPC. It funds its participation through external contributions (paid directly to IFAD by Member States or transferred through the HIPC World Bank Trust Fund) and its own resources. As at December 2013, total external contributions amounted to about US\$282.4 million (of which US\$210.9 million was provided by the Trust Fund), and contributions from the Fund's own resources amount to US\$154.7 million. To date, IFAD has already committed the required debt relief to all 35 HIPC countries that have reached their "decision points". HIPC cost estimates include debt relief to HIPC-eligible countries not yet at decision point (Eritrea, Somalia, the Sudan). It is estimated that these three countries may reach completion point in the period 2015-2020. Thus IFAD is forecasting receipt of additional external contributions in the form of a transfer from the trust fund for 67 per cent of the HIPC reflows forgone from 2015 to 2020 in the amount of US\$104 million.
28. **Debt Sustainability Framework grants.** In addition to its regular grant programme, IFAD has joined other IFIs since 2007 in implementing a Debt Sustainability Framework (DSF) to ensure that the poorest countries' development efforts are not compromised by the re-emergence of unsustainable levels of debt. From 2007, DSF grants approved to date total US\$1.2 billion. According to projections, DSF grants will account for approximately 21 per cent of the overall annual PoLG over the medium term.
29. In December 2013, IFAD's Executive Board endorsed the compensation modalities for the forgone principal repayment. It is assumed that DSF approvals and the required level of compensation for the forgone principal on a pay-as-you-go basis will be provided in addition to core contributions.
30. The estimated level of compensation required as a result of IFAD's implementation of the DSF on a pay-as-you-go basis over the IFAD10 period is US\$3.4 million. This amount is forecast to increase to US\$40 million over the IFAD11 period and US\$104 million over the IFAD12 period. If such compensation is not in addition to core contributions, but rather embedded in donor pledges, then this will, everything else being equal, reduce the level of the achievable SCF PoLG. The amount of this reduction is proportionally larger the more the DSF forgone principal amount materializes.
31. **Operating costs.** IFAD's operating costs are funded from IFAD's regular resources. They are mainly represented by IFAD's administrative budget<sup>2</sup> and capital budget, which are approved annually by the Governing Council. In addition, one-time budgets funded from IFAD's regular resources can also be approved by the Governing Council when deemed necessary.

<sup>2</sup> IFAD's administrative budget includes fixed assets depreciation, one-time costs, the Independent Office of Evaluation's budget, charges for actuarial gains and losses on post-employee benefit schemes, investment charges, etc.

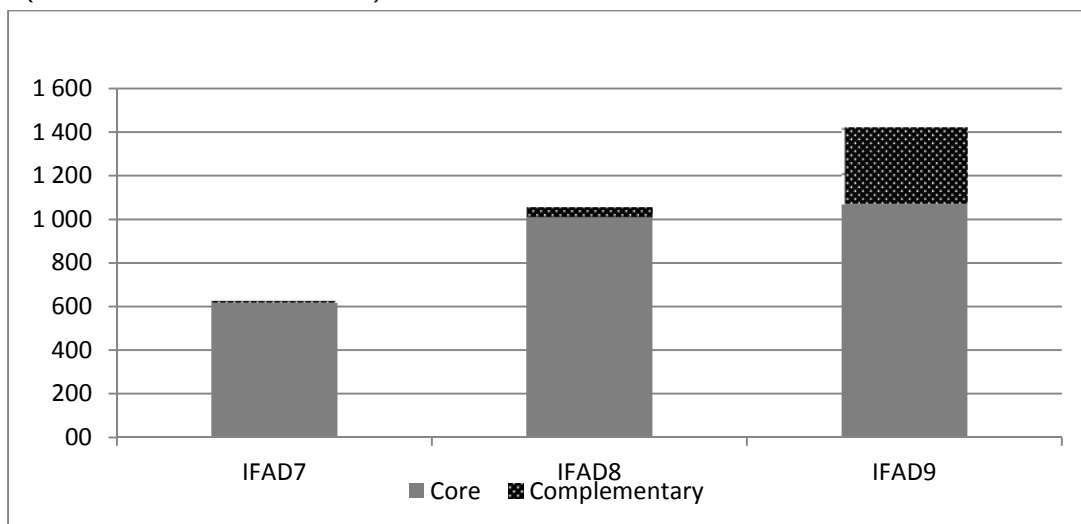
## B. IFAD's sources of funds

32. **Member contributions.** IFAD's core resources derive from contributions made by its Member States. Since the Fund's inception and over the course of nine replenishment cycles, donors have contributed more than US\$7.0 billion. The trend of member contributions has been increasing since IFAD's inception. Graph 5 shows replenishment contributions in the form of pledges (core and complementary<sup>3</sup>) over the period IFAD7-IFAD9 (IFAD9 as at 31 January 2014).

Graph 5

### Replenishment pledges for IFAD7, 8 and 9

(Millions of United States dollars)



33. **Internal resources.** IFAD's internal sources of funding during a three-year replenishment cycle consist of: (a) loan reflows (principal and interest or service charges net of cancellations and reductions), and (b) investment income.
- (a) **Loan reflows** consist of principal repayments on outstanding loans and related interest or service charges. As a resource stream, loan reflows are a reliable source of funding, thanks to the strong and stable repayment track record of IFAD's beneficiary (borrowing) countries. Over IFAD7 and 8, reflows averaged approximately US\$260 million annually.
- (b) **Investment income.** IFAD's investment portfolio is invested in line with the IFAD IPS approved by the Executive Board in December 2011 and reviewed annually by the Board. The portfolio's conservative investment style has particularly supported positive performance during periods of financial turmoil. In 2013, IFAD's investment portfolio was impacted by the overall negative trend of global fixed-income markets. Thus forecasts over the IFAD9 period have been prudentially adjusted downwards.
34. **Future net flows.** In addition to the funds that materialize in a given replenishment period, IFAD can also commit to delivering its PoLG by using forecast

<sup>3</sup> Complementary contributions were provided for the first time in the Governing Council resolution on IFAD2 (37/IX) and have since then been recognized by the Governing Council in all subsequent replenishments. These contributions, received on a voluntary basis, do not entitle a contributing Member to receive commensurate contribution votes. In practice, contributing Members may or may not propose specific use of such resources for the Governing Council's consideration. In cases in which the Governing Council decides positively on such proposals, the proposed use is specified in the resolution adopted by the Governing Council for the replenishment in question. Since IFAD2, the Executive Board has been delegated authority by the Governing Council (in its replenishment resolutions) to approve the use to be made of complementary contributions.

future net flows. Commitment against future cash availability is possible because IFAD's PoLG disburses over several years and thus does not need to be fully cash funded at the time of approval of loans and grants by the Executive Board. This feature allows IFAD to maximize the use of available and projected funds for new loans and grants and to commit to a PoLG level over and above the level of core contributions, relying on inflows that will materialize in the future to meet disbursements in later periods. The main future flows consist of assumed future replenishments, future loan reflows and future investment income, net of future disbursements for IFAD's loans and grants and future expenses.

35. In committing against future net flows, the importance of accurate long-term cash flow projections is paramount in assessing the impact on IFAD's liquidity and in ensuring that the Fund is not overcommitting in a given replenishment period, compared with the available and projected funds under a set of core assumptions.<sup>4</sup>

### III. Status of IFAD9

36. For IFAD9, the Fund committed to delivering a PoLG of US\$3 billion. Core contributions of US\$1.07 billion pledged so far, halfway into the IFAD9 period, will contribute to funding a PoLG of US\$2.23 billion. Complementary contributions of US\$353 million will fund grants under the Adaptation for Smallholder Agriculture Programme.
37. Table 6 provides the most current picture of the financial scenario of IFAD9. The data presented are based on actual figures for 2013 and updated projections for the years 2014-2015.

Table 6

**IFAD9 status as at 8 April 2014**

(Millions of United States dollars)

<b>Resource requirements</b>	
(1) Programme of loans and grants	3 000
(2) Operating costs, HIPC payments, interest	561
<b>Total resource requirements (1+2)</b>	<b>3 561</b>
<b>Sources of funds</b>	
(1) Core contributions	1 070
(2) Complementary contributions	353
<b>Subtotal: external resources (1+2)</b>	<b>1 423</b>
(3) Loan reflows during the replenishment, including cancellation	1 158
(4) Investment income	(33)
<b>Subtotal: internal resources (3+4)</b>	<b>1 125</b>
(5) Loan to IFAD*	400
(6) Future net flows	614
<b>Total sources of funds (1-6)</b>	<b>3 561</b>

\* Current projections show that the full value of US\$552 million will not be needed.

38. As shown in table 6, additional funding in the form of a loan to IFAD in the projected amount of US\$400 million is assumed to provide the funds necessary to deliver the target level PoLG of US\$3.0 billion. The loan is envisaged to fund IFAD's ordinary lending, as allocated in line with IFAD's performance-based allocation system (PBAS) for the period from December 2014 to December 2015.

<sup>4</sup> As mentioned in paragraphs 16-18, one main assumption underlying IFAD's financial framework is that both core contributions and PoLG levels remain stable in real terms (i.e. grow at the rate of inflation). Other main assumptions of IFAD's financial model are presented in annex III.

39. The total amount borrowed over the IFAD9 period will align with the needs of additional funding beyond the funds IFAD can safely commit under the remainder of the IFAD9 period, based on updated projections.
40. Thorough analyses of the impact of the loan on IFAD's long-term sustainability and cash flows have been performed, based on updated projections and on the most recently discussed terms of the loan. These terms allow the closest possible matching with the terms of IFAD's ordinary lending (see annex IV for detailed assumptions underlying projections related to the loan).

#### **IV. Financial framework for IFAD10 (2016-2018)**

41. During the IFAD10 period, country demand for donor resources for agriculture and rural development will remain high – much higher than the supply. Demand is estimated at more than US\$200 billion annually, while supply from the donor community is estimated at less than US\$12 billion. Country-by-country analysis by IFAD's country programme managers shows that demand for IFAD funding of agricultural projects, when climate costs are factored in, will amount to US\$5.5 billion over the IFAD10 period. This means that all conceivable levels of resources that IFAD would have available, at its current lending rates, could be absorbed by its borrowers and grant recipients.
42. IFAD's capacity to deliver its PoLG over IFAD10 is thus constrained by the availability of funding sources. While continuing to explore additional sources of funding, IFAD needs to prudently plan its deliverable PoLG based on realistic assumptions of availability of resources and type of funding.
43. The preferred financing source for IFAD10 is core contributions. These represent the main source of funding for the Fund, as well as being the most reliable and stable.<sup>5</sup> The scenarios presented for IFAD10 are thus based on members contributing through this source of funding (i.e. core contributions to be allocated during the IFAD10 period in line with the PBAS).
44. Throughout IFAD's history, complementary contributions have revealed an unpredictable nature, as they have often been linked to specific one-off events and themes. Thus, should IFAD10 be partially supported by unrestricted complementary contributions, these will be used to support the IFAD10 PoLG but will not be projected to be repeated in future replenishment periods.
45. Three scenarios of target IFAD10 replenishment that rely on core contributions are proposed for consideration, based on analysis of the demand for IFAD financing: low (IFAD10 PoLG of US\$2.8 billion), medium (IFAD10 PoLG of US\$3.0 billion) and high (IFAD10 PoLG of US\$3.2 billion). The level of core contributions needed to support these PoLG levels is shown in table 7. The three levels of core contributions required to support a PoLG of US\$2.8 billion, US\$3.0 billion and US\$3.2 billion are forecast at US\$1.338 billion, US\$1.437 billion and US\$1.534 billion respectively.

#### **C. Funding of IFAD10 through core contributions<sup>6</sup>**

46. Table 7 presents the level of core contributions required to fund the three scenarios of the PoLG. In line with the logic of the SCF approach to determining the PoLG, the levels of PoLGs and core contributions are projected to be available to the Fund in future replenishments in a flat amount in real terms, thereby keeping the funding ratio stable over IFAD10 and future replenishments. A detailed breakdown of the uses and sources of funds under each scenario is presented in annex I.

<sup>5</sup> As an example, should IFAD be able to fund itself through additional borrowing during the IFAD10 period, the level of contribution to the PoLG would be dependent on the terms of the borrowing.

<sup>6</sup> Core contributions as defined in the Draft Resolution on the Tenth Replenishment of IFAD's Resources, paragraphs (b)(i) and (ii), which specify that core contributions are those for which Members receive voting rights and which are unrestricted as to their use.



Table 7

**Total funding needs from core contributions for low, medium and high scenario**

(Millions of United States dollars)

	<i>Low scenario</i>	<i>Medium scenario</i>	<i>High scenario</i>
<b>Resource requirements</b>			
(1) Programme of loans and grants	2 800	3 000	3 200
(2) Operating costs, HIPC payments, interest	593	593	593
<b>Total resource requirements (1+2)</b>	<b>3 393</b>	<b>3 593</b>	<b>3 793</b>
<b>Sources of funds (resource needs)</b>			
(1) Core contributions	1 338	1 437	1 534
(2) Internal resources during replenishment period and future net flows	2 055	2 156	2 259
<b>Total sources of funds (1+2)</b>	<b>3 393</b>	<b>3 593</b>	<b>3 793</b>
<b>Member contributions as percentage of total resource requirements</b>	<b>39%</b>	<b>40%</b>	<b>40%</b>
<b>Ratio PoLG/contributions</b>	<b>2.1</b>	<b>2.1</b>	<b>2.1</b>

47. Table 8 and graph 6 show the projected levels of future PoLGs and required core contributions under the medium scenario of an IFAD10 PoLG of US\$3.0 billion, under which core contributions for the future are flat in real terms, as are subsequent levels of the PoLG. All else being equal, the ratio of PoLG/contributions would remain stable at about 2.1.

Table 8

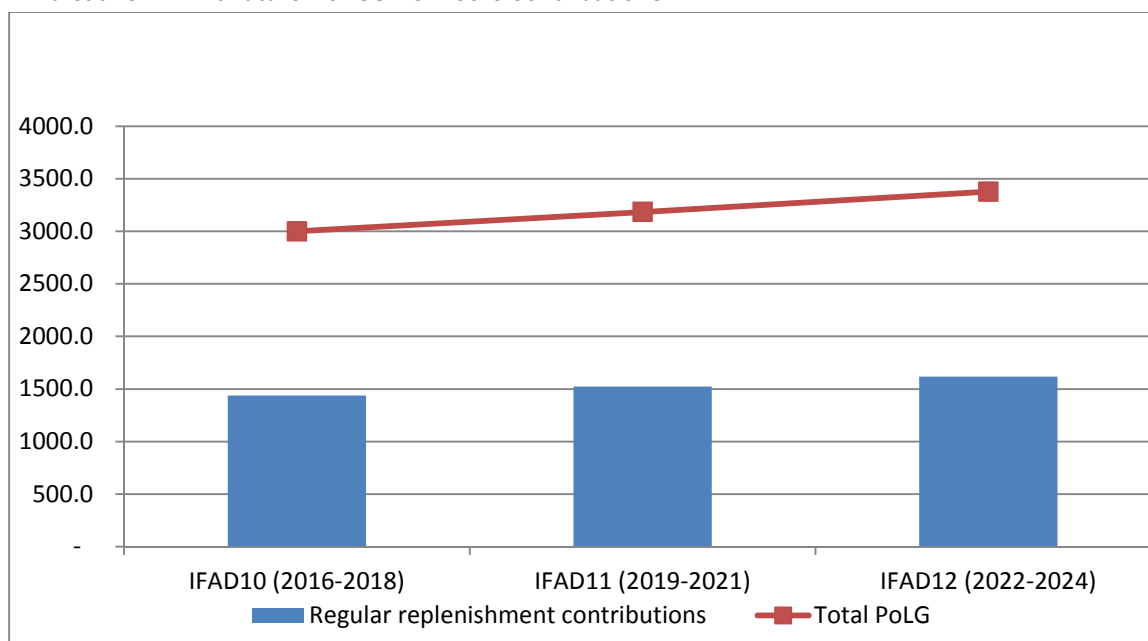
**Indicative IFAD10 and future PoLGs from core contributions flat in real terms\***

(Millions of United States dollars)

	<i>IFAD10</i>	<i>IFAD11</i>	<i>IFAD12</i>
Core contributions	1 437	1 524	1 618
<b>Total PoLG</b>	<b>3 000</b>	<b>3 184</b>	<b>3 378</b>
<b>Ratio PoLG/contributions</b>	<b>2.1</b>	<b>2.1</b>	<b>2.1</b>

\* Inflation assumed at 2 per cent per annum. Thus, over a three-year replenishment period, due to the compounding effect, contributions grow by 7.4 per cent.

Graph 6  
Indicative IFAD10 future PoLGs from core contributions



48. As shown in table 6 above, core contributions for IFAD9 as at April 2014 amounted to US\$1.07 billion. Should core contributions for IFAD10 be assumed flat in real terms from IFAD9, i.e. growing at the annual inflation rate of 2 per cent from the level of US\$1.070 million of IFAD9, equalling an amount of US\$1.135 billion, then the level of SCF PoLG for IFAD10 would be US\$2.464 million, as presented in table 9.

Table 9

**IFAD10 PoLG level from IFAD9 core contributions at flat level**

(Millions of United States dollars)

<b>Resource requirements</b>	
(1) Programme of loans and grants	2 464
(2) Operating costs,* HIPC payments, interest	564
<b>Total resource requirements (1+2)</b>	<b>3 028</b>
Sources of funds (resource needs)	
(1) Core contributions	1 135
(2) Internal resources during replenishment period and future net flows	1 892
<b>Total sources of funds (1+2)</b>	<b>3 028</b>
<b>Member contributions as percentage of total resource requirements</b>	<b>37%</b>
<b>Ratio PoLG/contributions</b>	<b>2.2</b>

\* This scenario assumes the part of operating costs relating to administrative expenses flat from the IFAD9 level.

49. In accordance with IFAD's draft replenishment resolution for IFAD10:

"While maintaining the target level for additional contributions as specified in subsection (c) above, the structural gap may not exceed 15 per cent of such target level. In the event that the structural gap exceeds 15 per cent at the end of the six-month period for the creation of new votes specified in subsection VIII(a) of this resolution, the target level for additional contributions (...) shall be adjusted so that the total amount of the pledges

received at that date represents at least 85 per cent of the target level. If such an adjustment becomes necessary, the President will immediately communicate the new target level to the Governors .... The Fund's programme of loans and grants will be adjusted to reflect the shortfall from the replenishment target."

50. Scenario I in annex II shows the adjusted levels of the PoLG under three IFAD10 scenarios assuming that the level of core contributions is equal to 85 per cent of the target level.

#### **D. Funding of IFAD10 through core contributions and unrestricted complementary contributions**

51. As stated in section B, throughout IFAD's history, complementary contributions have revealed an unpredictable nature, as they have often been linked to specific one-off events and themes and earmarked for specific uses. Thus, should IFAD10 be partially supported by complementary contributions, these will be used to support the IFAD10 PoLG but will not be projected to be repeated in future replenishment periods. Projections of future PoLGs will thus be rebased on the presence of core contributions only (flat in real terms) and subsequent PoLGs will thus be reduced accordingly.
52. Should members wish to make complementary contributions to reach the IFAD10 required target level, such contributions may have thematic elements. However, when allocating these contributions to the different types of grants and loan products that IFAD currently offers (highly concessional, blend and ordinary), they will be treated in the same way as core contributions and allocated through IFAD's PBAS. Thus they are referred to as unrestricted complementary contributions.
53. Table 10 shows a scenario under which an IFAD10 PoLG of US\$3.0 billion is supported both by core contributions and unrestricted complementary contributions for a total of US\$1.437 billion. For the reasons explained in paragraph 50, the portion of the total required funding envelope of US\$1.437 billion to be funded through unrestricted complementary contributions will not be assumed to be available in future replenishments from IFAD11 onwards. This will impact the projected future level of the SCF PoLG.
54. The higher the amount of unrestricted complementary contributions, the larger will be the impact of the assumed non-repeatability of such contributions in future replenishments. Scenario II in annex II shows the impact on future PoLGs of the assumed non-repeatability of complementary contributions using an illustrative amount of unrestricted complementary contributions.

Table 10

**IFAD10 funding through core contributions and unrestricted complementary contributions**  
(Millions of United States dollars)

	<i>IFAD10</i>
Core contributions and unrestricted complementary contributions allocated through the PBAS	1 437
<b>Total PoLG</b>	<b>3 000</b>
<b>Ratio PoLG/contributions</b>	<b>2.1</b>

## Breakdown of resource requirements and sources of funds with core contributions

IFAD10 PoLG scenarios and financing requirements – funding source: core contributions only  
(Millions of United States dollars)

	<i>Low scenario</i>	<i>Medium scenario</i>	<i>High scenario</i>
<b>Resource requirements</b>			
(1) Programme of loans and grants	<b>2 800</b>	<b>3 000</b>	<b>3 200</b>
(2) Operating costs, HIPC payments, interest	593	593	593
<b>Total resource requirements (1+2)</b>	<b>3 393</b>	<b>3 593</b>	<b>3 793</b>
<b>Sources of funds (resource needs)</b>			
(1) Core contributions	1 338	1 437	1 534
<b>Subtotal: external resources (1)</b>	<b>1 338</b>	<b>1 437</b>	<b>1 534</b>
(2) Loan reflows during the replenishment including cancellations	1 393	1 393	1 393
(3) Investment income	52	53	55
<b>Subtotal: internal resources during replenishment (2+3)</b>	<b>1 445</b>	<b>1 446</b>	<b>1 448</b>
(4) Future net flows	610	710	811
<b>Total sources of funds (1+2+3+4)</b>	<b>3 393</b>	<b>3 593</b>	<b>3 793</b>
<b>Member contributions as percentage of total resource requirements</b>	<b>39%</b>	<b>40%</b>	<b>40%</b>
<b>Ratio PoLG/contributions</b>	<b>2.1</b>	<b>2.1</b>	<b>2.1</b>

## Additional scenarios for IFAD10 and beyond

### Scenario I. Adjusted levels of IFAD10 PoLGs based on 85 per cent of target levels

- The scenarios in table 11 are presented to demonstrate impact on the PoLG level of such a shortcoming of core contributions compared with the established target level. In the medium scenario, a shortage of contributions of 15 per cent from the target level would immediately result in a level of SCF PoLG for IFAD10 that is lower by US\$439 million than the US\$3.0 billion level.

Table 11

#### Adjusted levels of IFAD10 PoLGs based on 85 per cent of target levels

(Millions of United States dollars)

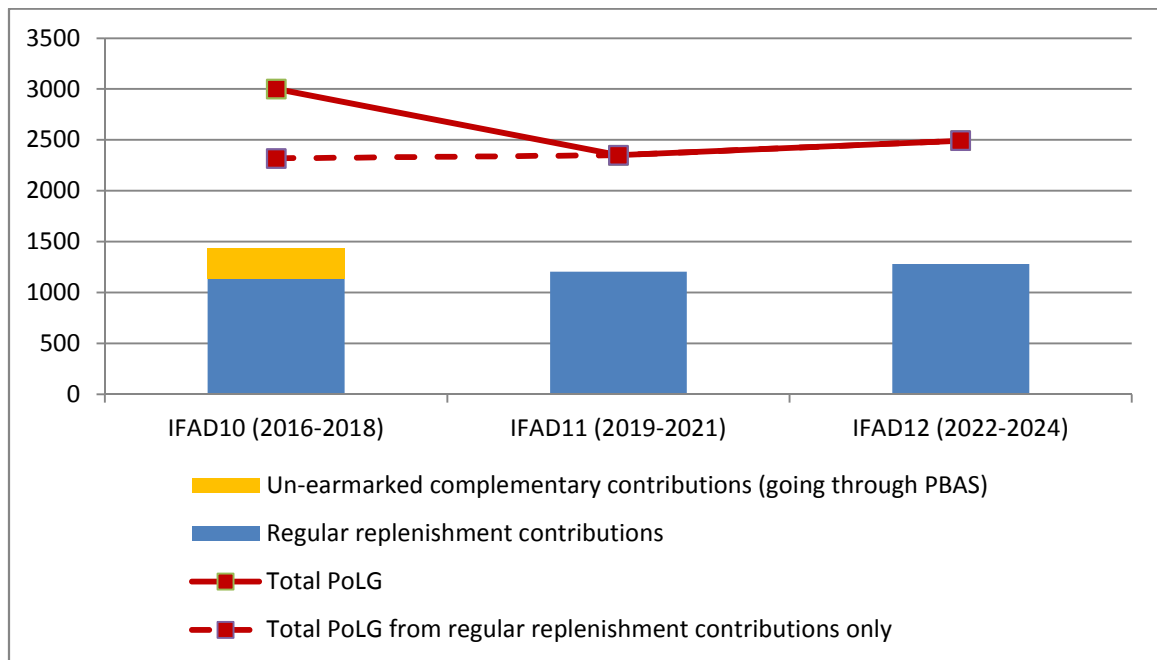
	<i>Low scenario</i>	<i>Medium scenario</i>	<i>High scenario</i>
100 per cent of core contributions	1 338	1 437	1 534
<b>Total PoLG</b>	<b>2 800</b>	<b>3 000</b>	<b>3 200</b>
<b>Ratio PoLG/contributions</b>	<b>2.1</b>	<b>2.1</b>	<b>2.1</b>
85 per cent of core contributions	1 137	1 221	1 304
<b>Total PoLG based on 85 per cent of core contributions</b>	<b>2 387</b>	<b>2 561</b>	<b>2 729</b>
Difference in total PoLG	<b>(413)</b>	<b>(439)</b>	<b>(471)</b>
<b>Ratio PoLG/contributions</b>	<b>2.1</b>	<b>2.1</b>	<b>2.1</b>

### Scenario II. Potential impact on future PoLGs of non-repeatability of unrestricted complementary contributions

- As mentioned in paragraph 50, complementary contributions are unpredictable in nature and cannot be projected to be repeatable. Graph 7 shows the impact on IFAD11 and IFAD12 SCF PoLGs supported only by core contributions flat in real terms from IFAD10 by assuming, for illustration, that US\$302 million of the total funding envelope of US\$1.437 billion comes in the form of unrestricted complementary contributions. This amount is part of the funding envelope in IFAD10 as a one-off injection that raises the IFAD10 PoLG from its "natural" level. However, by removing this amount from future projections, the size of IFAD11 and future PoLGs is rebased accordingly, thus not remaining flat in real terms from US\$3.0 billion, but reduced to a level of US\$2.3 billion in IFAD11, as supported only by core contributions of US\$1.135 billion flat in real terms.

Graph 7

**Level of PoLGs and contributions – full use of unrestricted complementary contributions in IFAD10 and reduction of future PoLGs**



3. Should the same level of unrestricted complementary contributions be made available to IFAD over future replenishments, the respective PoLGs would be increased to the highest possible level achievable under the SCF constraint.

## IFAD financial model assumptions – 2014

IFAD's financial model is updated on a yearly basis immediately after the closure of IFAD's financial statements.

Assumptions are reanalysed by the relevant departments that are asked to reconfirm their validity or provide updates to the trends and forecasts.

The departments involved in this exercise are the Programme Management Department, Controller's and Financial Services Division, Treasury Department and Budget Unit.

<b>Loan assumptions</b>	
<b>Length of loan disbursement profile (from approval year)</b>	10 years
<b>Composition of loan portfolio by window (percentage over loan portfolio)</b>	<p>Composition of loan portfolio in 2014:</p> <p>Highly concessional: 66.8%</p> <p>Ordinary: 19.2%</p> <p>Blend: 14.0%</p> <p>The profile adjusts between 2015 and 2018 based on country graduations. The 2018 (and onward) composition is:</p> <p>Highly concessional: 58.4%</p> <p>Ordinary: 26.7%</p> <p>Blend: 14.9%</p>
<b>Loan cancellation/reduction levels (percentage of approved amount):</b>	<p>Weighted average (by loan composition) of 13.1% as follows:</p> <p>Highly concessional: 11.3%</p> <p>Ordinary: 15.3%</p> <p>Blend: 14.0%</p>
<b>Interest rate on ordinary loans</b>	<p>2014: published IFAD rate for SDR loans</p> <p>2015 and future: SDR weighted Libor forward curve as at 31 December 2013</p>
<b>Lending terms – grace period</b>	<p>Highly concessional: 10 years</p> <p>Intermediate: 5 years</p> <p>Ordinary: 3 years</p> <p>Blend: 5 years</p>
<b>Lending terms – repayment period (inclusive of grace)</b>	<p>Highly concessional: 40 years</p> <p>Intermediate: 20 years</p> <p>Ordinary: 18 years</p> <p>Blend: 25 years</p>
<b>Lending terms – repayment profile</b>	Equal instalments; starting after grace period.
<b>Arrears (percentage)</b>	0.2% per annum on loan reflows
<b>Composition of grant portfolio by window (percentage)</b>	<p>Global/regional grants: 5% of PoLG</p> <p>Country-specific grants: 1.5% of PoLG</p> <p>DSF grants: 21% of PoLG</p>

<b>Grant disbursement profile by window</b>	Regular grants: 6 years for both windows
	DSF grants: 10 years
<b>Grant cancellations</b>	Zero for global/regional and country specific grants In line with highly concessional loans for DSF grants

<b>Financial assumptions</b>	
<b>Investment return</b>	2014: -1.0%
	2015: 0.5%
	2016: 1%
	2017: 1%
	2018: 1.5%
	2019: 2%
	2020 onwards: 2.5%
<b>Inflation</b>	2% p.a.
<b>FX rates against SDR</b>	Level at 31 December 2013 (SDR/US\$ at 1.54190 and constant in future)

<b>Administrative budget and other expenses</b>	
<b>Administrative budget growth</b>	Growing at inflation +1% from 2016 to 2018
	Growing at inflation from 2019 onwards
<b>HIPC</b>	HIPC forgone reflow estimates (interest and principal) and anticipated contributions updated annually. Assumption of US\$104 million in external contributions spread as follows: 2015: US\$2.1 million; 2018: US\$11.06 million; 2020: US\$91.61 million



## **KfW loan - assumptions (updated as at 08 April 2014)**

1. **Umbrella agreement** for overall amount of EUR 400 million, equivalent to US\$552 million (EUR/US\$ fx 1.38 as at 8 April 2014). IFAD is not bound by the umbrella agreement to borrow the total amount of US\$552 million.
2. **Indicative yearly amounts** of US\$125 million in 2014 and US\$275 in 2015 for a total estimated amount of US\$400 million over the period 2014-2015. The overall amount throughout the biennium will be reassessed based on the most updated projections of IFAD's commitment capacity.
3. **Individual loan agreements (ILAs)**  
ILAs will be tailored to closely match the pipeline of ordinary lending to be submitted to the Executive Board sessions in December 2014 and in 2015. The preliminary scenario assumes:
  - First ILA of US\$125 million in 2014
  - Second ILA of US\$201 million in 2015
  - Third ILA of US\$74 million in 2015
4. **Terms of loan**  
Each ILA is assumed to have the following terms:  
Maturity: 20 years  
Grace period: 5 years  
Annual interest rate: Euribor flattened 6 months forward  
Spread: 0.35 per cent
5. **IFAD lending terms and loan portfolio composition**  
100 percent of the onlending to IFAD's ordinary borrowers  
Projections of the loan flows are derived on the basis of IFAD lending-term parameters for ordinary loans in euro:  
Maturity: 18 years  
Grace period: 3 years  
Interest rate: IFAD's interest rate on ordinary loans denominated in euro. Forecast Euribor flattened six months forward curve from Bloomberg as at 31/12/2013:
6. **Loan disbursements**  
Loan disbursements are projected based on a 100 per cent (i.e. 0 per cent loan cancellation) ten-year profile.
7. **IFAD loan arrears:** 0.4 per cent per annum on loan reflows
8. **Return on investments:** in line with the assumptions on IFAD's financial model

Based on the above assumptions, the interest due to Kreditanstalt für Wiederaufbau (KfW) over the IFAD10 period is estimated at US\$16 million.