Citizen-Centered Approaches
to State and Market

Economic Tools Mapping

DEVELOPMENT CREDIT AUTHORITY OF USAID

Market Building Initiative: A Program with the Aspen Institute

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Overview

In the 1998 Appropriations Act, Congress gave USAID the general authority to provide credit assistance (loan and bond guarantees) for any of the development purposes specified under the Foreign Assistance Act (FAA) of 1961, opening the legal and budgetary door to credit guarantee projects. To encourage risk-averse financial institutions to lend to creditworthy, but underserved borrowers in developing countries, USAID uses the Development Credit Authority (DCA). DCA stimulates lending through the use of partial credit guarantees and the reduction of risk and, therefore, collateral requirements. These risk-sharing guarantees, which generally cover up to 50% of loss on loans made by financial institutions and investors, use the private sector wealth to stimulate broad-based development sustainably.

Since DCA was established in late 1999, more than 267 partial credit guarantees have facilitated over $2.3 billion of private capital debt financing in more than 64 countries.[1] Through the DCA guarantee mechanism, USAID is able to leverage an average of $28 in private sector funds for every dollar spent by the U.S. Government.[2] Claims on the DCA portfolio amount to approximately 1%, demonstrating that the targeted borrowers are both a creditworthy and profitable source of commercial activity.[3] The DCA focuses on the following industries: agriculture, democracy and governance, economic growth and trade, environment, education and training, global health, global partnerships, and humanitarian assistance.

Structure

Development Credit Authority (DCA) is a broad financing authority that allows the Agency to use credit guarantees to pursue any of the development purposes specified under the Foreign Assistance Act (FAA) of 1961, as amended. DCA provides USAID with the flexibility to choose between appropriate financing tools - guarantees, grants, or a combination to achieve developmental outcomes. DCA activities are designed and managed by USAID's overseas missions, and are priced and financially monitored by USAID's Office of Development Credit in Washington. There are four structures for DCA guarantees: loan guarantees, loan portfolio guarantees, bond guarantees, and portable guarantees.

- Loan guarantees are utilized for financial institutions requiring liquidity over $1 million for developmentally impactful projects. These guarantees provide up to 50% coverage on principal loans dispersed in lump sums or multiple disbursements and have both lenders and borrowers identified up-front.[4]
- Loan portfolio guarantees support multiple borrowers within or across sectors in support of USAID development objectives. They provide 50% coverage on a series of loans from lenders to these borrowers and the USAID mission offices determine borrowers consistent with those objectives.[5]

[1] USAID Website, Development Credit Authority.
http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/
[2] Ibid.
[3] Ibid.
[4] USAID DCA Types of Guarantees- Loan Guarantees,
http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/types_loan_guarantee.html
[5] USAID DCA Types of Guarantees- Loan Portfolio Guarantees,
http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/types_loan_portfolio_guarantee.html

- Bond guarantees are utilized in functioning capital markets or in countries interested in deepening them, but in which lenders are unwilling to lend under desired terms (for instance, if a pension fund is forced to invest locally or faces low bond rates). This guarantee format also provides 50% coverage for bond investors, strengthens credit ratings, and deepens capital markets.[6]
- Portable guarantees for specific companies or institutions give secure access to loans over $1 million dollars without an identified off-lending recipient for development purposes. The borrower can then compare loan packages before the guarantee of 50% of principal is utilized. [7]

These four guarantee classes are outlined in box 2 below in further detail. USAID's loan or bond guarantees are often complemented by USAID-assisted training that help banks better perform cash-flow analysis, due diligence and risk management on loans to underserved sectors.

Rules

The primary rules regarding DCA's operating activities are the 13 Guiding Principles. These cover the development objectives and the use of credit to achieve them and the relationship between financing and grant funding and their interchangeability. They stipulate restriction of use to non-sovereigns only and bar use for institutional budget support or to raise nominal assistance to specific borrowers. Furthermore, they delineate authority to operating units and developmental soundness review. It is required that DCA activity is demand driven and that true risk sharing, at 50% or below is maintained unless otherwise approved. The applicability of DCA financing is covered as well, requiring use only in the case that the transactions it covers would not otherwise occur, and that financing is made at market rates, based on risk and feasibility, in non-distortionary currency terms. Appropriateness of use for market imperfections and as a USAID exit strategy are also covered. Activities are further required to produce positive financial rates of return.[8]

There are restrictions on DCA guarantees use in addition to the guiding principles. The use of partial guarantees is primarily intended for countries and regions where USAID has an active presence. USAID may decline to offer credit assistance where risk analysis of a specific project demonstrates that the estimated risk is very high. Obligations are made to the US taxpayer are also a key principle in activity.

Financing

USAID missions identify, design, implement, monitor, and evaluate guarantee projects at the country level and the authorization and budgeting also falls within their purview. Missions are responsible for ensuring the developmental soundness of their projects while USAID's Credit Review Board and the

[6] USAID DCA Types of Guarantees- Bond Guarantees, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/types_bond_guarantee.html
[7] USAID DCA Types of Guarantees- Portable Guarantees, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/types_portable_guarantee.html
[8] USAID DCA Guiding Principles, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/guiding_principles.htm

CFO are responsible for the financial soundness and determination of cost for each Mission project. The Office of Development Credit Team (ODC), when requested, can assist Missions in project identification and design. The ODC Team may also assist in the process that leads to a determination by the CFO of the estimated cost of the proposed guarantee project (the "subsidy cost") that will be charged to the Mission's operating year budget.[9]

There are specific cost determination procedures for DCA activities as well. Under the Truth-In-Budgeting Act, the cost of a USAID loan guarantee is the estimated net cost of the assistance to taxpayers over the life of the guarantee, as expressed in present discounted value terms.[10] For example, if USAID makes a $10 million loan guarantee, the true cost will be determined for the most part by the risk of default. In simple terms, if the risk of default is estimated to be 10%, the cost to USAID's budget of a $10 million loan guarantee would be approximately $1 million. This cost would be approximately the same on a direct USAID $10 million loan made at interest rates similar to Treasury's cost of borrowing, assuming again a 10% estimated risk of default.

As for the credit guarantees themselves, partial guarantees are used as a credit enhancement tool with risk sharing on the part of private and public sector partners. Loan amounts typically fall in the $5-10 million range, but loan guarantees have been as low as $1 million and as high as $40+ million.[11]

Operations and Outcomes

DCA credit assistance is particularly useful for SME development, privatization, infrastructural provision, and energy investments. There are a number of positive outcomes, both direct and indirect, from DCA guarantees within developing countries. They promote private sector investment by encouraging financial institutions to lend large reserves of private capital for projects benefitting long-term growth. Often this lending is extended to underserved sectors which can demonstrate creditworthiness and reduce the perceived risk of investment. Guarantees directly reduce risk and encourage lending by sharing the burden of default up to 50%. They also build up the capacity of domestic financial institutions by reducing the risk of extending credit into new sectors and accompaniment of technical assistance with guarantee programs. In terms of lending impact, because of domestic financial intermediaries, impact is $50 leveraged dollars from each invested US dollar in loans- a particularly impressive figure.[12]

[9] USAID Development Credit,
http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/faq.htm
[10] Ibid.
[11] Ibid.
[12] USAID, The Benefits of USAID Guarantees,
http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/overview.html

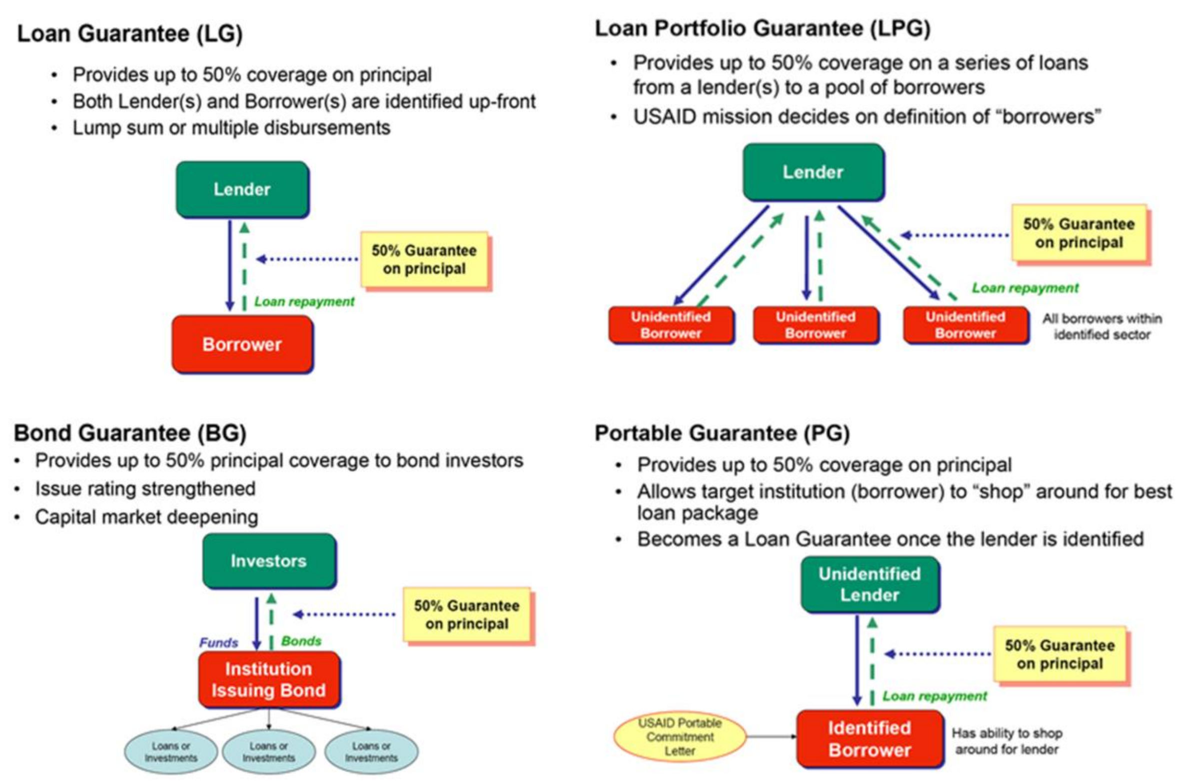
Box 1- DCA Guarantees: Armenia and Bulgaria

*Commercial Paper Issuance in Armenia***-** In Armenia's first commercial paper issuance, USAID provided a portable guarantee commitment to Cascade Credit to covering $12 million in commercial paper over three years. The DCA guarantee will help develop and expand capital markets in Armenia and promote financial intermediation through several specialized financial institutions. The proceeds of the issuance were to be primarily used for trade finance loans to expand the export sector.

*Greenhouse Gas Reductions in Bulgaria***-** USAID Bulgaria designed a $10 million loan portfolio guarantee to increase energy efficiency. This guarantee was used by United Bulgarian Bank to lend to municipalities and businesses, which used these loans to make efficiency upgrades to buildings and equipment. Over the next year, the electricity savings from the upgrades exceeded 37,000 mega watts, and fuel and thermal savings were over 1.4 million giga joules. Over the next 12 years, it is estimated that the reduction in greenhouse gas emissions resulting from the upgrades financed will be 530,000 tons.

See: http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/highlights.html

Box 2- Types of DCA Guarantees



See:
http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/types_of_guarantees.html

Further Resources

- ADS Chapter 249: Development Credit Authority- http://www.usaid.gov/policy/ads/200/249.pdf
- USAID Credit Guarantees: Promoting Private Investment in Development, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/YIR_2010.pdf
- Segura/MSI Concept Paper for DCA Evaluation- http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/concept_paper_dca_evaluation.pdf
- USAID DCA Video Summary- http://www.youtube.com/watch?v=neB5YAP6MH4