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Institutional Blending via Second-Tier Lender FINDETER in Colombia

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Summary Overview

Location: Colombia, Latin America

Approach to Blended Finance: FINDETER functions as a second-tier lender and provides discounted loans to domestic commercial banks that lend to local entities to finance infrastructure projects. FINDETER was initially set up with equity provided by the Government of Colombia and loans from the World Bank and the Inter-American Development Bank. Thanks to its good credit rating, it can borrow at better rates than commercial banks and provide them with lending capital, while commercial banks retain 100 percent of the credit risk of municipal borrowers. A voluntary intercept provision plays a critical role in credit enhancement, increasing security and investor confidence for both FINDETER and the first-tier lender.

Context

Following decentralization in Colombia during the 1980s, many municipalities faced challenges accessing finance for development projects, having had little or no previous experience borrowing long-term debt. Likewise, commercial lenders were not used to lend to municipal governments.

FINDETER (*Financiera de Desarrollo Territorial*) was created to facilitate decentralization for local governments, and address the long-term financing constraints for infrastructure projects. As a specialized financial intermediary, it channels transfers from the central government to local governments through its loans to first-tier financial institutions, primarily commercial banks. Costs are lowered through the rediscounting of loans that commercial banks make to local borrowers. In addition to lending activities, technical assistance is extended to service providers accessing FINDETER finance, typically in the form of project preparation support. FINDETER's second-tier lender status makes it an unconventional type of municipal development fund.

The Inter-American Development Bank and the World Bank provided financing to FINDETER at the outset. The Government of Colombia served as a guarantor for the multilateral loans. Today, FINDETER's funding comes primarily from the issuance of certificates of term deposits (a savings certificate with a fixed maturity issued by a bank), but it continues to have access to long-term funding from multilateral institutions. Revenues from existing loans finance a large share of FINDETER activities. The Government of Colombia owns the majority approximately 92 percent in 2014) of FINDETER's shares, with the remaining shares owned by local governments. The Fund's AAA local credit rating and international long-term BBB rating (Fitch) has helped it access less expensive financing.

Financial Structure and Approach to Blended Finance

The way in which FINDETER operates is as follows: a local government body applies for a loan through a commercial bank; FINDETER appraises the local government's proposal in parallel with the commercial bank, and upon approval (if accepted) the loan package is granted. The first-tier lender provides a loan to the sub-national government, and FINDETER then lends the amount to the first-tier lender at a discounted rate.

Figure 1 shows the discounting process for FINDETER. The commercial bank is responsible for repaying the rediscounted loan to FINDETER, independently from repayment by the local borrower. This means that the commercial bank takes on 100 percent of the credit risk.

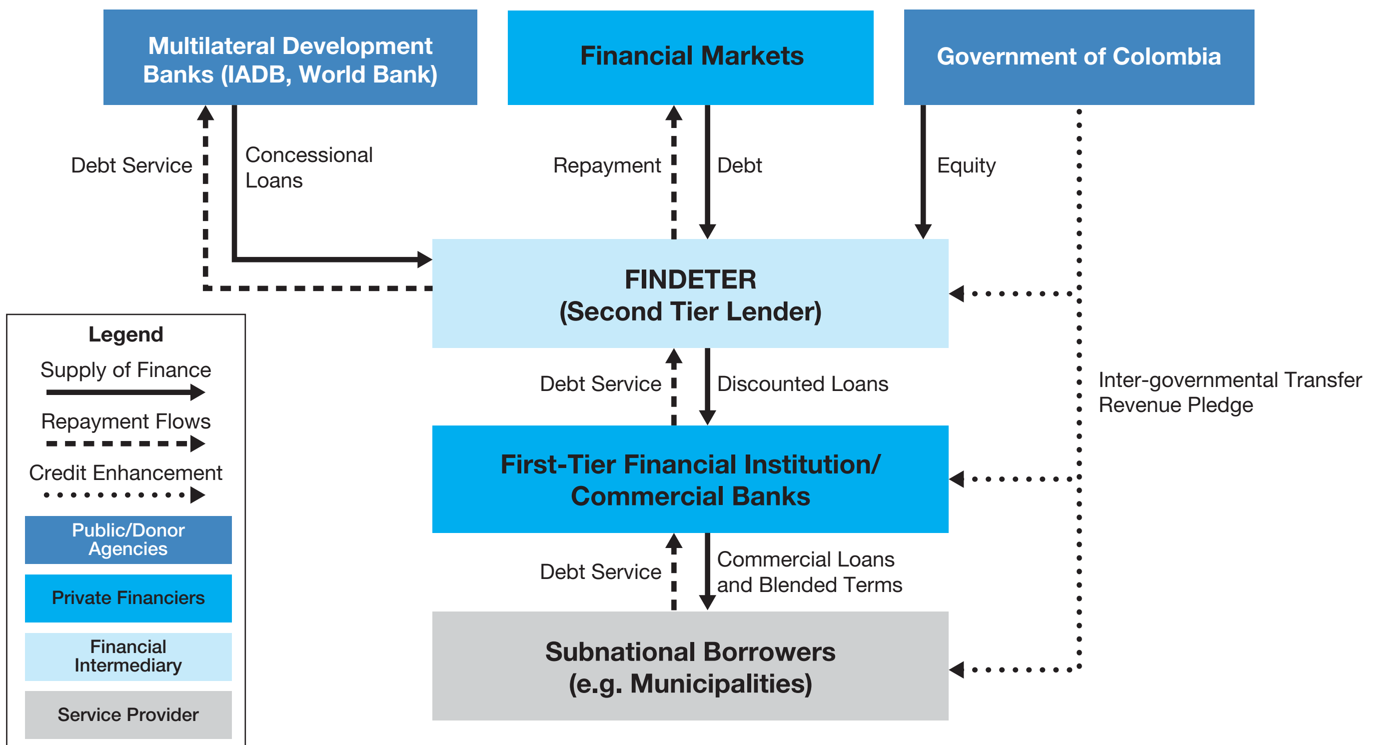
A crucial component of the financial structure is the establishment by the borrowing local government of an account into which intergovernmental payments flow. The first-tier lender (commercial bank) has the right to intercept revenues if loan payments are not made, and in turn, to endorse these revenues to FINDETER. The pledging of municipal revenues is significant because, if a participating bank becomes insolvent, FINDETER can still collect its payment directly from the bank's local borrowers. The intercept provision has helped maintain a low percentage of non-performing loans.

FINDETER offers maturities of up to 15 years, which is notable, as loans to local governments without the involvement of FINDETER would normally not exceed five years. The strong credit rating and intercept provision help FINDETER lend for longer tenors at better rates.

Results

FINDETER has established itself as a viable financing institution, setting an example of the potential that second-tier lenders have to support the development of local credit markets. Today, water and sanitation investments represent one of the largest sectors of the FINDETER loan portfolio, with the sector receiving an estimated 28 percent of disbursements in 2014.

FIGURE 1 Institutional Blending via Second-Tier Lender FINDETER, Colombia: Financial Structure



At inception, FINDETER's project review period was long, taking an average of up to 18 months for completion, thereby limiting the attractiveness of this financial structure for municipal governments. In the mid-2000s, a streamlined process was introduced, allowing for an increase in lending activity. FINDETER now provides guidelines to the tier-one banks, so as to confirm standards were met on loan applications. Immediate rediscounting takes place upon confirmation.

FINDETER's success with the refinancing of municipal loans has helped commercial banks gradually become familiar with lending to sub-national governments and convince them to lend directly to municipalities with their own resources. The successful blending of concessionary and commercial financing at the national-level has fueled municipal government participation in local credit markets, thereby contributing to long-term market development.

Lessons Learned

Second-tier lenders can play an important role in municipal credit market development. FINDETER has embraced a number of roles to respond to market requirements, including by rediscounting loans, but also by providing technical assistance on project design to local governments. This has been critical for small- and medium-size municipalities that do not have sufficient support or prior experience with borrowing. The fact that the credit risk is fully borne by the first-tier lenders allows for greater flexibility and expanded investment potential for FINDETER.

Voluntary revenue intercepts helped lower risk. The intercept provides an extra level of confidence for investors (both first-tier lenders and FINDETER) by reducing the risk of non-repayment. The provision is a powerful form of security, and has helped promote access to commercial finance.

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This case study is part of a series prepared by the World Bank's Water Global Practice to highlight existing blended finance experiences in the water sector.

Blended finance refers to "the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets," as per the OECD definition (WEF OECD, 2015). Concessional funds can be used in a catalytic manner to open up new opportunities for commercial financing, by providing technical assistance to borrowers and lenders to help them become more familiar with each other, help structure transactions, provide credit enhancement mechanisms, etc.

Private capital flows can help with meeting immediate financing needs for investment in the water sector but ultimately need to be repaid. Repayable financing from private sources to the water sector can come in various forms, including as commercial bank loans, bonds or equity. To obtain such financing, water-sector actors need to be able to repay the borrowed amounts and the associated funding costs, which means that they need to be deemed "creditworthy" by providers of finance.

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