LOCAL CURRENCY FUNDING

- MINIMIZING FINANCIAL RISK FOR PROJECT COMPANIES IN DEVELOPING COUNTRIES

ifu

INVESTMENTS FOR DEVELOPMENT

IFU MAKES INVESTMENTS IN DEVELOPING COUNTRIES TOGETHER WITH DANISH COMPANIES.
WE OFFER SHARE CAPITAL AND LOANS IN EUR, USD AND DKK AND NOW ALSO IN LOCAL CURRENCIES.

WHY CONSIDER LOCAL CURRENCY FUNDING?

Loans in local currency can eliminate the currency exposure for companies operating in developing countries.

A company may prefer a local currency loan instead of a foreign currency loan for one or both of the below reasons:

- If it has its main income in a local currency.
- If it wants to minimize the credit risk and uncertainty connected with a foreign currency loan.

Loans in local currency can be provided to new as well as ongoing project companies.

Foreign currency loans, e.g. in EUR, USD or DKK, provided to a project company in a developing country may lead to losses for the company and hurt business sustainability. If the local currency depreciates significantly, it can turn into a credit shock for the company, as the costs of servicing the loan will increase significantly. Funding in local currency can reduce the currency exposure and thereby minimize the credit risk for project companies and their investors.

Normally, a local currency loan will carry a higher nominal interest rate compared to a foreign currency loan. However, this should be compared to the expected lower repayments on the loan in local currency, as it is generally accepted that the local currency will depreciate relatively against the hard currencies over time.

Figure 1 below shows a sample of some of the worst currency crises in recent years. As an example, the figure shows that a foreign currency loan financed company in Russia would have experienced a tripling of its debt measured in RUB in 1998.

FIGURE 1
CURRENCY CRISES (ONE YEAR DEPRECIATION)

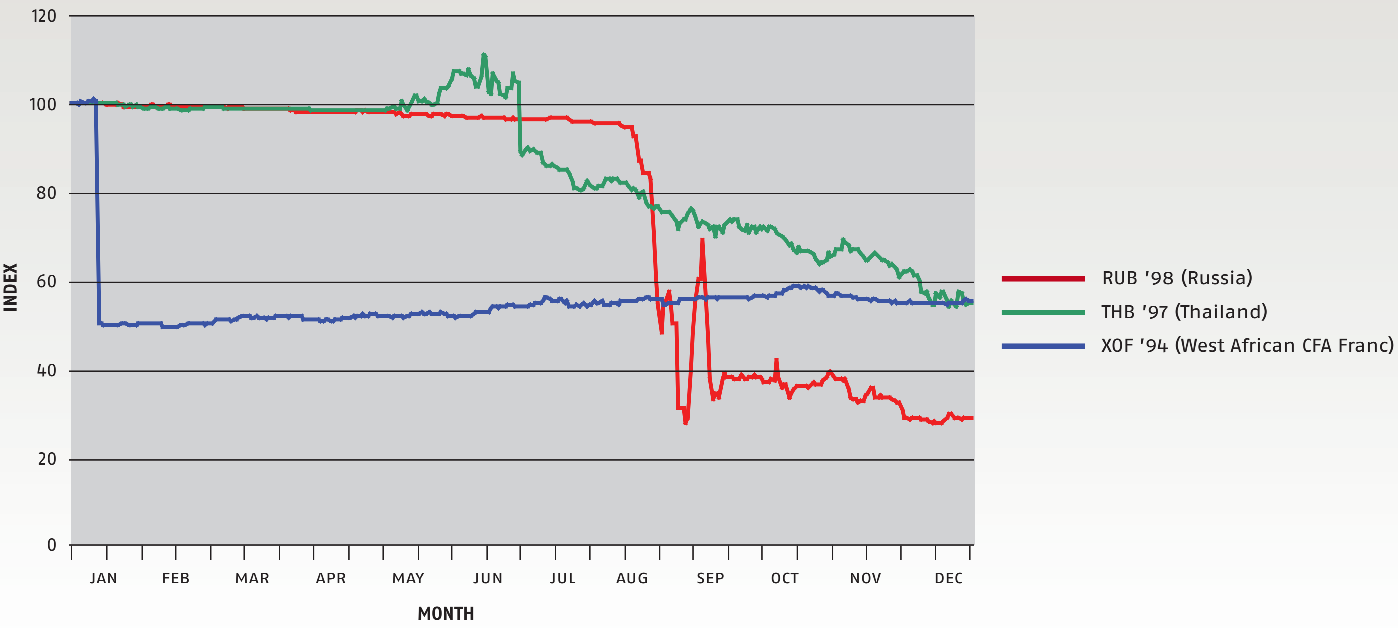
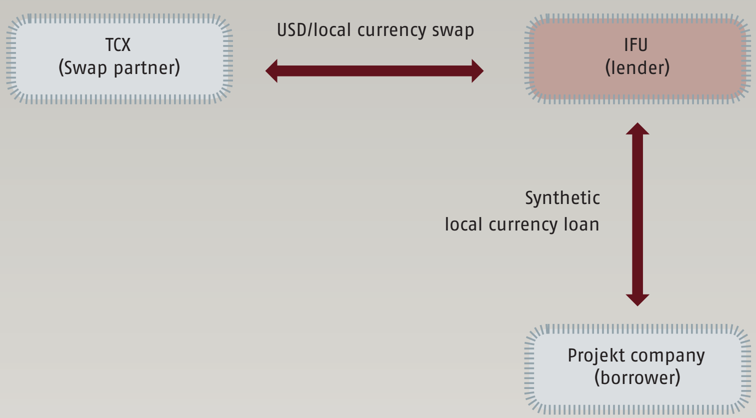


FIGURE 2

ENTERING A LOCAL CURRENCY LOAN AGREEMENT



THE INSTITUTIONAL FRAMEWORK – IFU AND TCX

IFU has invested in The Currency Exchange Fund (TCX), which is a financial instrument that enables IFU and the other investors in TCX to offer long-term currency funding to projects and companies in developing countries.

WHAT IS TCX AND WHAT DOES IT OFFER?

TCX was established as a global partnership by 11 international development finance institutions and commercial banks, including IFU. TCX makes local currency funding available by offering its investors hedging instruments such as currency swaps and forward rate agreements to convert their hard currency loans into local currencies. TCX will offer complementary hedging instruments, which would otherwise not be available on the market, to reduce creditors' and borrowers' exposure to foreign exchange and local interest rate fluctuations on local currency long-term funding. Any foreign exchange gain or loss in the local currency funding is borne by TCX.

HOW DOES IT WORK?

Figure 2 above illustrates a typical transaction structure and the institutions involved in a local currency loan agreement.

The term "synthetic" refers to the fact that although the principle amount of the loan is fixed in the local currency, and the interest rate payable by the borrower is determined using local interest rate benchmarks, the actual payment flow between IFU and the domestic project company is settled in hard currency (often USD). Figure 2 above illustrates a typical transaction structure and the institutions involved in a local currency loan agreement.

TYPICAL TRANSACTION

In a typical transaction, IFU provides a loan to the project company. Payments of instalments and interest under the loan are denominated in local currency using a relevant local currency benchmark rate (see below) plus a fixed margin.

- On the day of disbursement, IFU disburses the USD equivalent of the agreed local currency loan amount using the spot rate of the day to the project company's bank account.
- On the same day, IFU executes a swap transaction with TCX to hedge the local currency risk. The local currency risk is now transferred to TCX.
- Upon repayment of principal or payment of interest, the project company transfers the USD equivalent of the payment obligations denominated in local currency converted using the spot rate on the day of payment to IFU.
- On the day of repayment on the loan, the payment under the USD/LCY swap between TCX and IFU is calculated so that IFU always receives the planned USD amount.

THE INDUSTRIALISATION FUND FOR DEVELOPING COUNTRIES

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EXAMPLES OF LOCAL CURRENCY REFERENCE RATES:

In principle, local currency financing can be applied in all countries eligible for IFU financing. At the current stage, TCX can facilitate interest swaps in 45 developing countries. The interest on a loan will normally consist of a reference rate plus a premium. The reference rate on a foreign loan, e.g. denominated in EUR, USD or DKK, would normally be USD Libor, EUR Libor or Cibor. The reference rate for a local currency loan will be an eligible local currency reference rate identified by TCX. Below are examples of such local currency reference rates

BDT	Bangladesh Taka	91-day, 182-day and 364-day T-bills
EGP	Egyptian Pound	3-month, 6-month, 1-year T-bills
INR	Indian Rupee	1-month, 3-month MIBOR
MZN	Mozambique Metical	1-month, 3-month, 6-month and 12-month MAIBOR
NGN	Nigerian Naira	91-day, 182-day, 364-day T-bills
VND	Vietnamese Dong	1-month, 3-month, 6-month VNIBOR

THE FOLLOWING SPECIFIC STEPS WILL BE TAKEN IN RELATION TO OBTAINING A LOCAL CURRENCY LOAN:

1. Preliminary discussions with the project company and/or the Danish partner involved in the investment concerning the possibility for local currency financing.
2. IFU will make a risk assessment and appraisal of the project based on information received from the project company.
3. IFU will make an assessment of the project's eligibility for local currency financing.
4. IFU will obtain an indicative "quote" (the interest rate to be applied), i.e. the local currency benchmark rate + risk margin, from TCX.
5. IFU and the project company will prepare the local currency loan agreement.
6. Final quote will be fixed at disbursement.

Existing loans in foreign currency can also be converted to a local currency loan. In these cases, an addendum to the existing loan agreement will be made, reflecting the change from foreign to local currency.

FOR FURTHER INFORMATION, PLEASE CONTACT IFU

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