Report on DFC's Progress in the Northern Triangle

July 2022

Legislative Language:

H.R 117-84, p.82, 117th Congress, 2022 "Northern Triangle—The Committee directs the DFC CEO to submit a report to the Committees on Appropriations, not later than 90 days after enactment of this Act, detailing assistance provided for El Salvador, Guatemala, and Honduras with specific objectives and benchmarks for the use of such assistance, the mechanisms for safeguarding the assistance from corrupt influences, and how such assistance promotes economic growth within those respective countries. Such report should also include a plan outlining DFC's objectives and priorities in Central America and the Agency's role in strengthening the bilateral economic relationship between the United States and Central America."

Summary:

As the only global region that has a direct impact on U.S. soil and borders, the Western Hemisphere is considered a priority region for the current Administration in 2022. DFC is committed to providing the private sector in developing countries the option of values-driven, transparent investments. It is seeking to enhance this commitment in the region through its support of Executive Office initiatives, such as the Partnership for Global Infrastructure Initiative (PGII) and The Root Causes of Development in the Northern Triangle (RCS). Additionally, DFC is prioritizing climate adaptation and resilience (especially nature-based solutions), gender empowerment, food security, and sustainable agriculture across our portfolio.

Central American countries, and especially the Northern Central American countries of El Salvador, Guatemala, and Honduras are critical partners in promoting prosperity, stability, and development throughout the Western Hemisphere. DFC is committed to supporting investments that address critical development challenges in Northern Central America, and it targets opportunities where DFC can serve as a stabilizing force and provide economic opportunities to empower local communities. DFC is prioritizing El Salvador, Guatemala, and Honduras because of its developmental mandate and so that it can help address economic push factors like poverty, violence, and food insecurity — all of which drive high rates of migration from the region. To this end, since July 2021, DFC has completed over $103 million of transactions, and is seeking to increase its portfolio in the region over the remainder of FY22.

Section 1: Mission and Sector Priorities

Under the BUILD Act, DFC is called to invest into highly developmental projects funded by private sector partners, with the intention of being a catalyzing force to develop countries' respective private sector environments. Although DFC is required by mandate to work exclusively with private sector partners, it is an important entity for developing and strengthening the bilateral relationships between the U.S. and developing nations around the world. DFC offers countries a potential partner who can help mobilize and catalyze larger private sector financing, and a path to financing its internal development without the need to assume additional sovereign debt. Additionally, DFC offers a viable alternative to exploitative financing from authoritarian states, and the opportunity to demonstrate its ability to develop under high financial, environmental, social, and labor standards. Should partner countries pass reforms and create opportunities that encourage responsible private sector growth, DFC financial tools will be able to not only provide immediate financing but encourage other stakeholders to invest in their countries as well, including other multilateral development banks (MDBs) and private sector entities. DFC ultimately measures success by the amount of developmental impact it can catalyze with every individual transaction.

DFC will play a central role in the US government's efforts to develop the private sector and investment climates in Northern Central America. In the coming year, DFC intends to prioritize sectors where development finance is most likely to have an immediate catalytic impact in developing local economies. Just as importantly, DFC is seeking to assure that local populations, especially those from historically marginalized communities, equally share in the prosperity and growth of the private sector in their countries, and that they will reap palpable benefits from development finance. By focusing on this mission, DFC is signaling to our Northern Central American partners that it is an important and reliable partner for unlocking or incentivizing private sector capital for economic development going forward.

To this end, DFC intends to prioritize the following sectors over the coming year:

- *Sectors Focusing of Migration Management and Reduction*: DFC supports the RCS and the Development Finance Framework, which seek to find long-term solutions for managing migration from Central America. DFC is best equipped to support this effort by catalyzing private sector investment into sectors that create jobs, provide economic opportunity, and provide access to key social services. To that end, DFC is considering the problem holistically, and focus its attention on the following sectors:
    - MSMEs (job creation and financial inclusion of underserved populations)
    - Food Security/Sustainable Agriculture
    - Affordable Housing
    - Healthcare Resilience and Infrastructure
    - Education
    - Special Focus on Supporting Women and Indigenous Peoples

- *Climate Adaptation and Resilience*: As Central America and Southern Mexico become increasingly vulnerable to the effects of climate change, DFC should focus on identifying nature-based solutions, and incorporating climate-smart solutions to its future projects. Additionally, debt-for nature swaps present an opportunity to promote sustainable environmental programs, while also helping to address the issue of existing long-term debt in the sub-region.

- *Critical Infrastructure:* DFC is targeting transactions that provide funding in countries seeking more private sector funding into infrastructure and energy sectors, much of which has historically been funded and operated by the governments. In addition to investments into renewable energy, DFC is hoping to identify viable transactions related to toll roads, port infrastructure, information and communications technology (ICTs), and opportunities to develop the digitization of these economies.

Section 2: Transparency and anti-corruption

Every transaction that DFC considers is given an Impact Quotient (IQ) score, based on each project's unique characteristics related to economic growth, inclusion, and/or innovation that identify how developmentally impactful the project can potentially be. The score also reflects adjustments based on identified social and environmental risks. DFC follows IFC Performance Standards on Social and Environmental Sustainability for identifying, assessing, avoiding, and mitigating social and environmental risks and impacts as a way of doing business responsibly. Once a project has been approved and funds have been disbursed, DFC monitors each project. Monitoring includes a combination of self-reported mechanisms (surveys, results tables, action plans), as well as externally assessed mechanisms (site visits, portfolio performance evaluations) for select projects. Monitoring continues until the terms of the agreement have been fulfilled, or DFC finds that the client has breached the terms of their agreement to a point where DFC is compelled to pull out of the transaction.

Particularly related to transparency and anti-corruption, IQ assesses this in two ways:

Assessing for risk of corruption and lack of enabling environment: If there is evidence that the regulatory environment is not conducive for achieving expected developmental impact, or if the developmental benefits to the local population may not be realized due to high levels of corruption (specifically for those projects that involve large sums of payments to the government), points may be deducted from the project's IQ score during due diligence. For example, MCC Country Scorecard for a given country may indicate that the regulatory environment for expanding SME loans is constrained by the inability to make non-collateralized loans. Scoring analysts may reach out to MCC, USAID Missions, or the Embassy Economics Officer to assist with this assessment, if it is not already addressed by DFC's credit reviewers.

Assessing for opportunities for a project to provide demonstration effects: As an indicator of success, demonstration effects aim to measure projects that may have sector-wide demonstration effects. These projects may involve products or processes that increase transparency and reduce corruption, such as infrastructure investments that are the first or one of the first to be competitively bid. Other projects may support host government initiatives and/or regulatory reforms that aim to increase competition in the sector, such as a privatization. Demonstration effects may also involve projects that will employ an innovative financial structure and/or business models that mobilize private sector participation and capital.

Section 3: Transactions concluded since January 1, 2022:

- **Bolstering lending to SMEs and healthcare projects in Honduras:** In support of expanding economic opportunities and access to healthcare for women, DFC, in partnership with USAID/Honduras, executed on a $3.5 million loan portfolio guaranty to

LAFISE Honduras in March 2022. This guaranty will support on-lending to small and medium enterprises (SMEs) that support gender equity and inclusion and companies supporting the health care response to ongoing effects of the COVID-19 pandemic. With the issuance of this DFC loan portfolio guaranty, LAFISE is expected to provide up to $7,000,000 total in lending.

Section 4: Transactions concluded since July 1, 2021:

- **Supporting the Purchase of COVID-19 Vaccines:** In support of building healthcare resiliency and addressing the effects of the COVID-19 pandemic, DFC, in conjunction with Citi, provided a risk management solution to Gavi, the Vaccine Alliance (Gavi) in September 2021. This transaction was to mitigate risk and overcome financial hurdles with governments that are funding COVID-19 vaccine purchases through the COVAX Facility. Of the $383 million in political risk insurance provided to Gavi, $50,000,000 was provided to support allocation of vaccines to Guatemala.

- **Financing Affordable Housing in Guatemala:** In support of the RCS's commitment to building economic security and creating safe communities, DFC committed to a $19.5 million loan to Destino Desarrollos Inmobiliarios Compañía Limitada in September 2021 for expansion of affordable housing construction Guatemala. As a result of this loan, an estimated 2,000 environmentally sustainable new dwellings are projected to be constructed, 740 of which will be occupied by women customers. An estimated 400 of these dwellings will be constructed in the Alta Verapaz department of Guatemala, directly benefiting underserved communities living in the Guatemalan Highlands.

- **Financing SMEs in Marginalized Communities:** In support of the RCS's commitment to expand opportunities for women, minorities, and other historically marginalized communities, DFC, in partnership with USAID/Guatemala, executed a $15 million loan portfolio guaranty to Banco Internacional S.A. (Interbanco) in September 2021. This transaction will enhance lending to SMEs, including those in the Western highlands of Guatemala and other regions with high migration rates, to support economic growth in struggling communities. With the issuance of this DFC loan portfolio guaranty, Interbanco is expected to provide up to $30,000,000 total in lending.

- **Supporting Women Entrepreneurs in El Salvador:** In support of the RCS's commit to expand opportunities for women, DFC, in partnership with USAID/El Salvador, approved a $15,500,000 loan guaranty to Banco Davivienda Salvadoreño SA in September 2021 aimed to increase lending to women-owned and women-led SMEs, as well as SMEs in high growth sectors of the economy, to support economic growth and job creation across El Salvador. With the issuance of this DFC loan portfolio guaranty, Davivienda is expected to provide up to $31 million in lending across the country.