ZIMBABWE

FRAMEWORK FOR EVALUATING, MONITORING AND MANAGING GUARANTEED AND ON-LENT LOANS

Zimbabwe Public Debt Management Office

MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

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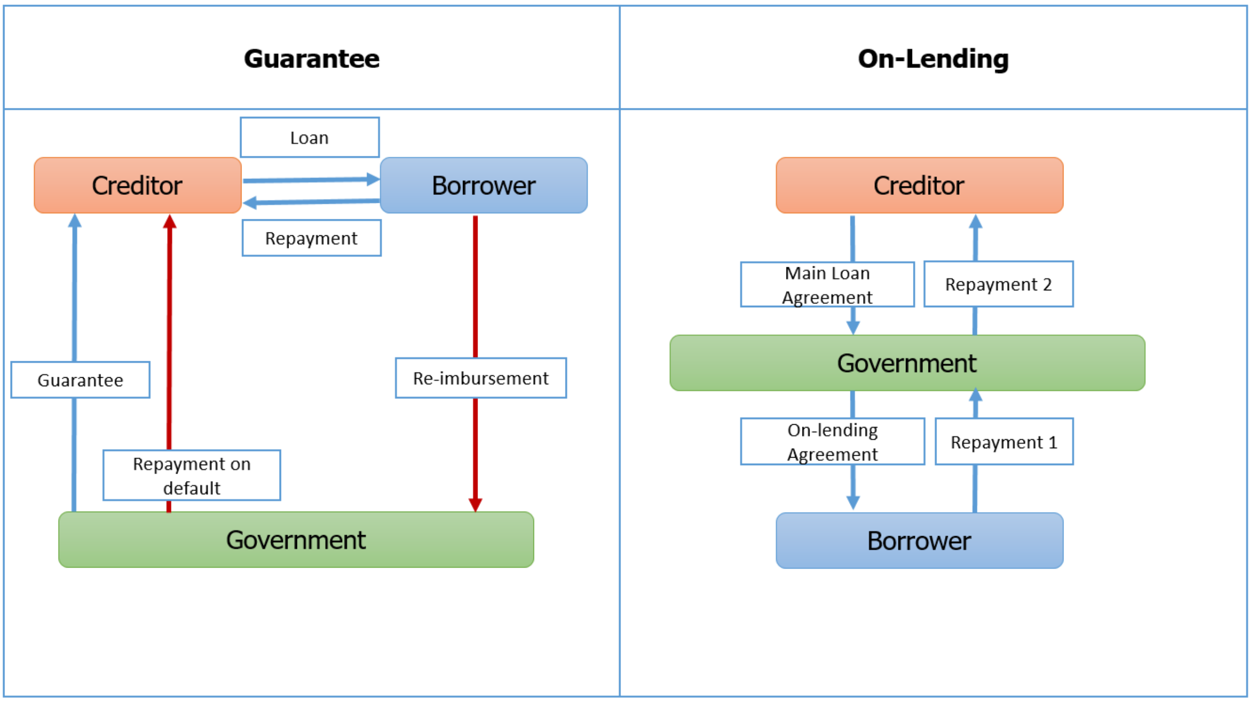
Introduction

1. The objective of this document (Framework for Evaluating, Monitoring and Managing Guaranteed and On-lent Loans) is to assist the Zimbabwe Public Debt Management Office and other relevant departments to evaluate guarantees and on-lending in a transparent and objective process. The Framework spells out all the relevant stages that requires efficient and effective evaluation, monitoring and managing of guaranteed and on-lent loans. It also provides an evaluation methodology that involves a credit risk assessment and scoring for determination of relevant fees. In addition, this Framework is useful to Public Entities, Municipalities, Local Authorities and other stakeholders intending to borrow, by providing full information on the processes and procedures for borrowing.

2. Government, as part of financing for development, offer guarantees and provide on-lending loans to credit worthy borrowers. The difference between the two arrangements are shown in Figure 1 below;

Figure 1: Process Flow of a Guarantee and On-lending



3. Under the Guarantee arrangement, the borrower is able to obtain a loan from the lender on condition that Government provides a guarantee that, in the event of default, the

Government will take on the responsibility of repaying the loan. In the case of on-lending, the Government through the Ministry of Finance and Economic Development (MoFED) receives a loan from a lender or raises finance via a security issuance and then lends these funds to the borrower. It is worth noting that the Government can on-lend directly or through an agent.

Legislative Framework

4. The Minister of Finance is mandated by the Constitution of the Republic of Zimbabwe and the Public Debt Management Act (PDM Act) to on-lend and issue guarantees. The PDM Act provides for the roles of the:
   - Zimbabwe Public Debt Management Office (ZPDMO) to assess guarantee and on-lent applications, participate in all negotiations with lenders in such agreements, monitor the performance as well as reporting on the same;
   - External and Domestic Debt Management Committee (EDDC) to assess guarantee and on-lending applications and make recommendations to the Minister based on the finding of the assessment;
   - Minister to issue guarantees on behalf of the Government, charge guarantee fees and provide recommendations to Parliament on the applicable limit on guarantees for any fiscal year; and
   - Parliament to set the limit on guarantees for any fiscal year.

Ceilings on Guaranteed and On-lent Loans

5. Ceilings on guarantees and on-lent loans are determined after the following analytical considerations;
   - Maximum sustainable debt based on a public debt sustainability analysis;
   - Medium Term Debt Strategy;
   - Annual Borrowing Plan; and
   - Examining all available financing resources.

Application and Information Requirements

6. The following should be submitted by the Beneficiary during the application process:

- Application/recommendation letter from the Line Ministry including the following:
    i. Extract Resolution from Council or Board of Directors;
    ii. Valid signed Term Sheet from the Lender(s);
    iii. Draft Agreements from Lenders duly initialled by both/all parties in case of guaranteed loans;
    iv. Borrowing Plan (Annual Borrowing Limit); and
    v. Detailed Project Proposal.

- Financial Information
    i. Audited financial statements for the past three (3) years. Provisional statements will be required where audited statements are not available;
    ii. 3-year cash flow projections as well as underlying assumptions. Ideally the cash flow projections should account for principal and interest repayments;
    iii. Latest aged analysis of trade receivables and payables; and
    iv. Latest Management accounts.

- Full details of current borrowing position of the beneficiary;
    i. Name of Lenders;
    ii. Types of facilities;
    iii. Amount approved;
    iv. Date approved and repayment completion dates;
    v. Current utilization/outstanding balance/arrears report;
    vi. Repayment terms;
    vii. Full details securities/collateral provided; and
    viii. A borrowing plan and a Debt Management Strategy.

Institutional Responsibilities for Authorising, Assessing, Monitoring and Reporting

7. The PDM Act Section 7 (2) mandates the EDDC to make recommendations to the Minister concerning all public borrowing external and domestic including guarantees and on-lending.
8. The EDDC composition is as follows:

- Secretary for Finance and Economic Development who is also the Chairperson of the Committee;
- The Governor the Reserve Bank of Zimbabwe (RBZ);
- The Attorney General;
- Secretary of Line Ministry (as and when necessary); and
- ZPDMO as secretariat to the Committee.

9. The EDDC is assisted by a technical committee which is the EDDC Working Party (EDDC WP). Members of the EDDC WP are from the following departments:

Table 1: The EDDC Working Party

Department	Justification
Zimbabwe Public Debt Management Office	Chair and Secretariat
Accountant General's Office	Debt Settlement
Financial and Capital Markets	Market Research
International Cooperation	Relations with external creditors, IFIs and Development Partners
Fiscal Affairs	Macro Framework
Expenditure Management	Expenditure and Priority Projects
Revenue	Revenue projections
Legal Services	Legal advice
Financial Markets, Exchange Control and Economic Research Divisions of the RBZ	Domestic debt issuance, Exchange rate and Economic research
Legal Advice, Legislative Drafting and Civil Divisions of the Attorney General's Office	Legal advice

10. The EDDC WP may invite any other person(s), whose expertise may be required, to attend any meeting of the EDDC WP and taking part in the deliberations of the meeting.

11. The EDDC WP ensure that, before any recommendation for contracting a new loan is submitted to the EDDC:

- Assessment is based on project priorities outlined in the country's economic development plan;
- The final approved loans and guarantees do not exceed the annual borrowing ceiling for that fiscal year consistent with the Medium Term Debt Strategy and borrowing plan;
- The overall increase in debt is in line with the total Debt Sustainability Analysis parameters and in accordance with the provisions of the PDM Act.

On-lending Process

12. On-Lending Process – Steps

i) MoFED mobilises the funds;

ii) This funding has two sets of borrowing; in the first, the Lender offers a loan to the Government (after negotiation, approval and preparing the primary loan agreement). In the second stage, the Government lends it to the Public Entity and a secondary loan agreement between the Government and the Public Entity is concluded. The primary loan and the on-lending are negotiated and signed at the same time;

iii) When the Line Minister approves the request for funding from an entity, the application request for on-lending is submitted with the supporting documents to the MoFED (see 'Application and Information Requirements');

iv) The EDDC WP evaluates and assess the application using the credit risk scoring assessment/evaluation (see 'Credit Risk Scoring Assessment/Evaluation);

v) The EDDC WP submit to the EDDC, results of the evaluation and assessment, including recommended decision on level of applicable fee(s).

vi) The EDDC deliberates on EDDC WP recommendations and recommend decisions to the Minister of Finance;

vii) The Minister of Finance approves/not approve the on-lending taking into consideration recommendations from the EDDC;

viii) On-lending loan agreement is signed and conditions precedent (Legal Opinion, setting up escrow account, Parliament approval, on-lending fees) met for disbursements to start;

ix) Repayments are made by Public Entity to the Government in accordance with the secondary loan agreement, and then the Government utilises this to repay the Lender. Currently, the beneficiary of an on-lent loan makes a direct payment to the lender and confirmation of payments are submitted to the Accountant General's Office and the ZPDMO to ensure proper accounting and recording;

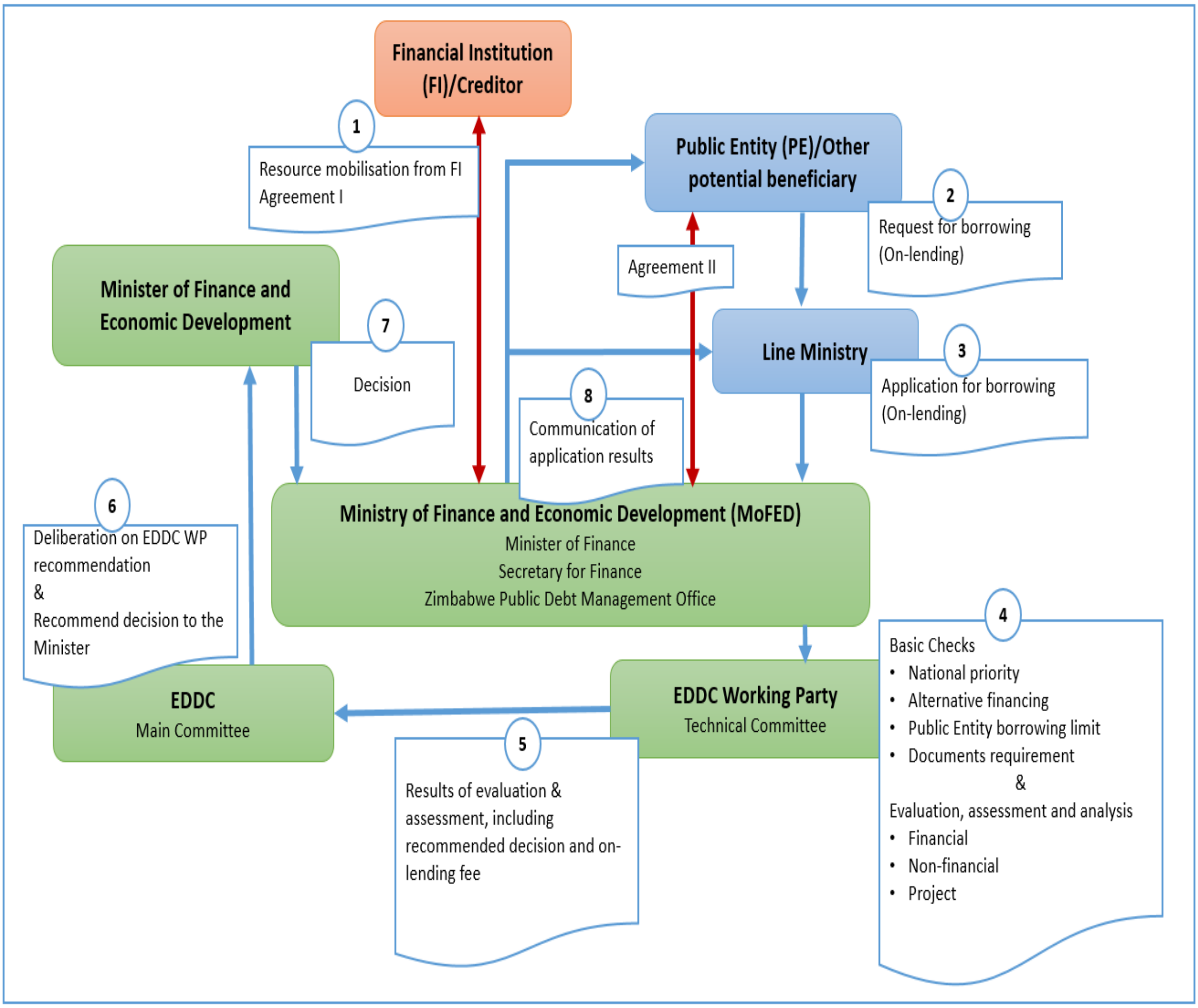
x) Repayments are completed on time in accordance with the two loan agreements;

xi) The Public Entity reports quarterly to ZPDMO in line with the PDM Act; and

xii) Throughout the life of the loan, ZPDMO monitor performance of the on-lent loan.

xiii) Figure 2 below shows the process flow on evaluation and granting of on-lending.

Figure 2: Process Flow on the Evaluation and Granting of On-lending



Guarantee Process

13. Guarantee Process - Steps

i) A Public Entity requests for a loan from a Financial Institution (FI), FI agrees to lend on condition of a Government guarantee. The ZPDMO is made aware and participates in all discussions;

ii) The Public Entity approaches the Line Minister for approval in line with the PDM Act. The Line Minister confirms that the project for which a loan and guarantee is required has national priority or within the National Development Plan. The request by the Public Entity is required to be supported with financial and technical feasibility appraisals;

iii) When the Line Minister approves, an application request for a guarantee with the supporting documents is submitted to the MoFED (see 'Application and Information Requirements');

iv) The EDDC WP evaluates and assess the application using the credit risk scoring assessment/evaluation (see 'Credit Risk Scoring Assessment/Evaluation);

v) The EDDC WP submit to the EDDC, results of the evaluation and assessment, including recommended decision on level of guarantee and fee(s).

vi) The EDDC deliberates on EDDC WP recommendations and recommend decisions to the Minister of Finance;

vii) The Minister of Finance approves/not approve the guarantee taking into consideration recommendations from the EDDC;

viii) Copies of the guarantee are sent to the Line Minister and the beneficiary of the Guarantee; and

14. Repayments are made by Public Entity to the Lender.

15. The Public Entity reports quarterly to ZPDMO in line with the PDM Act.

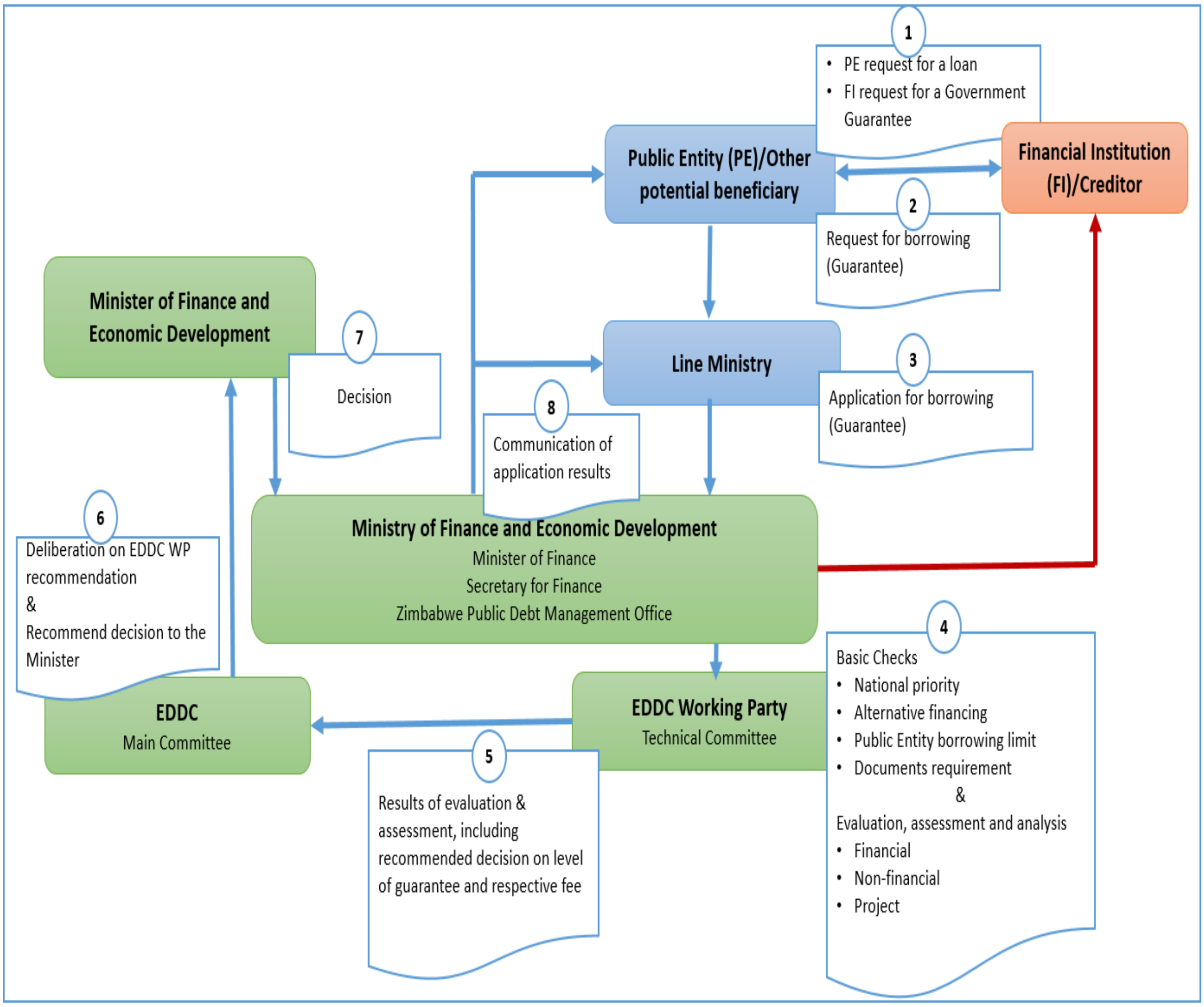
16. In case of a default, any liability incurred in terms of the Government Guarantee shall only be called up upon provision of satisfactory proof that all available legal

channels for recovering an outstanding debt owed by the beneficiaries of the Guarantee have been exhausted.

17. Upon expiry of the Guarantee, and/or until all amounts due under the terms and conditions of the Guarantee are met, the beneficiary of the Guarantee will return the original copies of the Guarantee to the ZPDMO for cancellation.

18. Figure 3 below shows the process flow on the issuance of a Government guarantee.

Figure 3: Process Flow on the Evaluation and Issuance of a Government Guarantee



Credit Risk Scoring Assessment/Evaluation

Basic Checks

1. Basic checks on Beneficiary/borrower is done answering the following:
   - Is the project within national priority list?
   - Is there alternative financing?
   - Is the Public Entity within its borrowing limit?
   - Is information submitted by the entity adequate/ in line with Statutes?
   - Has the institution defaulted on past agreements?

Credit Risk Assessment/Evaluation

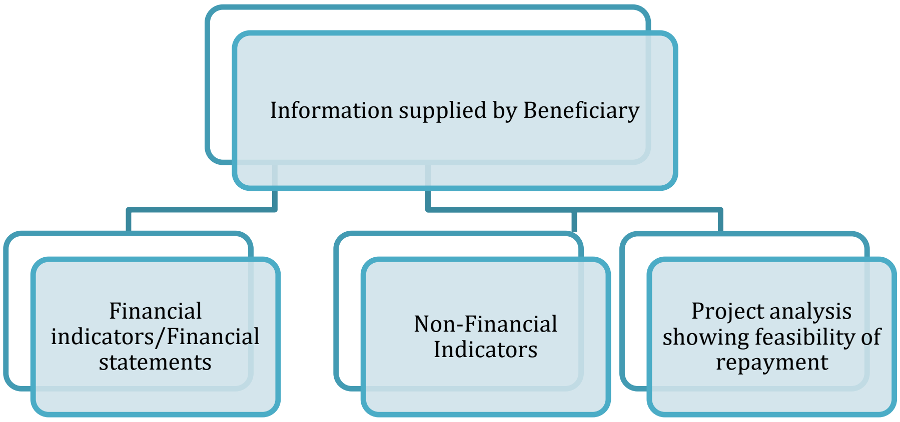
2. The PDM Act, Section 20 (3) states that 'Prior to issuance of loan guarantees, the Office shall conduct or cause to be conducted a due diligence assessment on the capacity of the beneficiary to repay the loan'. In line with this provision, a credit risk assessment is conducted, which has three components:

   - **Assessment of recent financial performance:** By examining the financial statements and extracting relevant data, the important financial ratios are calculated for each year and averages are obtained. The averages are then compared with benchmark values and the performance of the borrower is determined as shown in Table 1 below.

   - **Non-financial factors:** these are factors that influence the performance of the borrower within which the borrower operates. The scoring methodology is shown on Table 2 below.

   - **Project feasibility analysis:** Feasibility study consist of a number of projections, such as baseline and stress based scenarios. The analysis shows various cash flows (revenue and expenditure) as well as economic and financial rates of return.

Figure 4: Key Indicators for Analysis



3. Information from financial statements such as balance sheet, profit and loss account, cash flow position is submitted to estimate financial and non-financial indicators as shown on Figure 4 above. The other important information is beneficiary's project feasibility and repayment capacity. This baseline scenario is also submitted by the beneficiary, with major assumptions and policy changes highlighted.

Financial indicators

4. Given the information, a scoring exercise is undertaken to assess the credibility of the borrower:
   - Financial and non-financial variables and indicators are identified and scores assigned according to performance;
   - Weights are assigned according to their importance, from most relevant to least relevant for each indicator;
   - Liquidity indicators (i.e. current ratio) are given higher weights than solvency ratios (i.e. net worth) as liquidity represents capacity to service the debt. A scoring template for financial indicators is as shown on Table 2 below.

Table 2: Scoring Methodology: Financial Analysis

Financial Indicator	Benchmark	Weight	Score (0-5)	Weighted score
Financial Indicator 1				
Financial Indicator 2				
Financial Indicator 3				
Financial Indicator 4				
Financial Indicator 5				
Financial Indicator 6				
Financial Indicator 7				
Financial Indicator 8				
Total weighted score				

Scores: 1- very weak, 2- weak, 3- moderate, 4- good, 5- excellent, negative scores are assigned zero (0)

Non-financial Indicators

5. For the non-financial indicators, the factors outlined below are taken into consideration:

- **organisational structure**: whether borrower is working at the optimal level of efficiency;
- **industry prospects**: whether the industry in which the borrower works has prospects of improving market share competing well with others in the sector;
- **Socio- economic trends**: check the demand for the product that the borrower manufactures in terms of population growth, income of the consumers among other factors; and
- **Governance- political interference and data transparency:** Check whether Government interferes with Management decision making process. Also check whether relevant data is disclosed accurately, on time and in accordance with accepted standards and norms.
- **Legislative framework:** The laws and regulations are adequate, comprehensive, and clear and complied with.

6. A scoring template for non-financial indicators is as shown on Table 3 below.

Table 3: Scoring Methodology: Non-Financial Analysis

Non-Financial Indicator	Score	Weight	Weighted Score
Organisational improvements			
Industry prospects			
Socio economic trends			
Governance framework			
Legislative framework			
Total weighted score			

7. The scores range from 0-5 and these represent:
   - negative score - 0
   - very weak - 1
   - weak - 2
   - average - 3 (benchmark score)
   - good - 4
   - very good - 5

Project feasibility analysis

8. Analysis is done to look at the ability of repaying the loan through the feasibility study submitted by the borrower. This includes:
   - Analysis of the feasibility study including stress tests submitted and the assumptions used; and
   - Assessment conducted on the economic rate of return and the financial rate of return in all scenarios in the feasibility report.

9. The following indicators are assessed:
   - **Annual Debt Service Cover Ratio (ADSCR)**: This indicator measures the ability to service the debt annually, measured as a ratio of net income (income minus

operational cost) to debt service (interest and principal). A moderate benchmark range is 1.5 and 2.0

- **Loan Life Cover Ratio (LLCR):** This indicator measures the ability to repay the principal payments over the life time of the project. It is measured as the ratio of the present value of net income to the outstanding debt stock. A moderate benchmark range is between 1.65 and 2.2.

10. Table 4 below shows the scoring template for project indicators.

Table 4: Scoring Methodology: Project Feasibility Analysis

Indicator	**Score**	**Weight**	**Weighted score**
ADSCR			
LLCR			
Total weighted Score			

11. Scores are collated on financial, non-financial and project specific as shown below:

Table 5: Final Credit Score

Category	**Score**	**Weight**	**Weighted Score**
Financial		0.5	
Non- Financial		0.2	
Project		0.3	
Total weighted score		**1.0**	
Final Credit Score (%)			

12. The EDDC Working Party recommends to the EDDC whether to offer a guarantee or not, and the percentage level of guarantee with all the details including the credit assessment results and respective fees.
13. Government guarantees are issued up to a level of 80% of the facility/loan amount.
14. The EDDC deliberates on the EDDC WP recommendations and submit recommended decisions to the Minister of Finance.
15. In the case of an on-lent loan, the process is the same.

Guarantee or On-lending Fees and Other Charges

Guarantee or on-lending fees

16. Guarantee or on-lending fee represents the credit risk that the Government faces when offering guarantees or on-lent loans. The fee will be a once off payment as a percentage of the amount guaranteed or on-lent payable on the date of collection of the Guarantee or On-lending Agreement. In accordance with the Public Debt Management Regulations (2019), the fee is on a graduated scale, ranging from 0.5 per cent (for lesser risky borrowers) to 2.0 per cent (for highest risk borrowers) as shown on Table 6 below. The risk level will be based on the credit risk assessment score.

Table 6: Credit Risk Scores and the respective fee

Credit Risk Score Range (%)	Fee (%) of Guaranteed/On-lending Amount
<55	Reject
55 – 65	2 .0
65 – 75	1.5
75 - 85	1.0
85 - 100	0.5

Other fees and charges

17. Other fees that may be charged in relation to guarantees include:

- ***Management fee:*** This fee is a charge made for monitoring the guaranteed or on-lent loan and its repayments. This is a one-off fee of 0.5 per cent of the total value of the loan.

- ***Evaluation fee*:** This fee may be charged for technically evaluating a borrower. This is a one-off fee of 0.25 per cent of the total value of the loan.

- ***Other fees and charges;*** this fee is charged for expenses incurred for a guarantee. This is a one-off fee.

18. All fees are payable to the Ministry of Finance and are not refundable. These fees including level of guarantee can be waived as decided by the Minister of Finance upon recommendations from the EDDC.

Timing of Receiving Applications and Responses

- The ZPDMO send out a call for borrowing applications (guarantees or on-lending) for the next financial year together with the budget call circular.
- All guarantee and on-lent loan requests are submitted at least 3 months prior to the final budget submission.
- Responses to the requests made are sent within 3 weeks from the day of the receipt of the applications by the ZPDMO.
- Unless for emergency cases like natural disasters, applications submitted outside the indicated timelines will not be considered.

Setting up of a Guarantee/On-lent Fund

19. All fees and charges for guarantees and on-lent loans are deposited in to the Consolidated Revenue Fund (CRF). It is considered as a revenue to the Government which can be used to cover any expenditure incurred.

Monitoring and Reporting

Project Implementation Reporting

20. The ZPDMO in liaison with other relevant departments monitor performance of guarantees and on-lending.

21. For the purpose of monitoring disbursements and utilisation of loans, as provided for in Section 5 item (n) of the Act, the Project Managers of respective Line Ministries are required to submit monthly and quarterly reports to the ZPDMO, on the following:

- Actual and projected loan disbursement;
- Utilisation of loans, by item;
- Repayment status for loans and guarantees; and
- Impact assessment and performance against targets, successes, challenges identified, and corrective measures taken.

22. The ZPDMO in liaison with the Line Ministry and other relevant departments shall carry out spot or physical checks on all debt funded projects.

Monitoring on-lent loans

23. The responsibility of monitoring the loan disbursements and repayments for on-lent loans lies with the Implementing Agency, the Implementing Ministry, Department of Programmes & Projects Monitoring and ZPDMO, using reports provided by beneficiary on performance of loans in terms of disbursements and payments. There will be two sets of information; one for the primary loan- lender to Government and a secondary loan- Government to the final borrower (i.e. on-lent loan beneficiary). The required information is recorded in the public debt management system and repayments monitored.

24. The beneficiary of on-lending (borrower) should also submit quarterly, data on disbursements and repayments. This data will be used to carry out reconciliation between borrower and ZPDMO.

25. Borrower must inform well in advance any foreseen difficulties in making repayments to the ZPDMO.

Monitoring guaranteed loans

26. The responsibility of monitoring the loan disbursements and repayments for guaranteed loans lies with the Implementing Agency, the Implementing Ministry, Department of Programmes & Projects Monitoring and ZPDMO, using reports provided by beneficiary on performance of loans in terms of disbursements and payments. The required information is recorded in the public debt management system and repayments are monitored.

27. The beneficiary of a guarantee (borrower) should also submit on quarterly basis:

- Data on disbursements and repayments due; and
- Carry out reconciliation of debt data between the two agencies.

28. The guarantee beneficiary must inform well in advance any foreseen difficulties in making repayments to the Public Debt Management Office.

Reporting and Disclosure of Guarantees and On-lent Loans

29. To enhance transparency and accountability on the management of loans, on-lent loans and guarantees, the ZPDMO produce and publish the following reports which include:

- information on the stock of guarantees and on-lent loans in line with the PDM Act and Regulations; and
- guarantees issued and on-lent loans signed in that financial year, and other information such as called up guarantee and sectors supported. This information should be included in the:
  i. Annual Public Debt Bulletin;
  ii. Bi-annual Report on Public Debt to Parliament; and
  iii. Quarterly reports to the Accountant General.

30. In addition, the Minister through the ZPDMO shall publish the terms of the guarantee or on-lent loans through a Government Gazette within sixty (60) days of concluding that agreement as provided in the PDM Act and the Constitution of the Republic of Zimbabwe.

Disclosure

31. Disclosure of this information is in accordance with accepted standards and practices which include:

- **Fiscal transparency standards:** As a basic standard, in accordance with the IMF's Code for Fiscal Transparency (2019), guarantees and on-lent loans and their beneficiaries, report on the gross exposure created by them and are published at least annually.
- **Statistical standard requirements:** Move towards reporting the statistics on guaranteed and on-lent loans in accordance with Government Finance Statistics (IMF, 2013), Public Sector Debt Statistics (IMF, 2011) System of National Accounts (UN, 2008). When reporting to the IMF and the World Bank, ensure their reporting requirements and formats are followed.

- **Accounting standards and practices:** The accounting presentation is moving towards an internationally adopted standards provided by International Public Sector Accounting Standards (IPSAS, 2018)