

North American Development Bank (NADBank)

FY2005 Appropriation	FY2006 Scheduled Request	FY2006 Arrears Request	FY2006 Total Request
\$0	\$0	\$0	\$0

The North American Development Bank (NADBank), and its sister institution, the Border Environment Cooperation Commission (BECC), were chartered under the auspices of the North American Free Trade Agreement (NAFTA) to address the serious environmental problems in the U.S. - Mexican border region. NADBank is funded equally by the United States and Mexico and started operations in FY1995. It provides financing (i.e., loans, guarantees, and grants) for environmental infrastructure projects that have been certified by the BECC and are located, in the U.S., within 100 km of the U.S. - Mexico border or, in Mexico, within 300 km of the U.S.-Mexico border. Under their joint Charter, BECC and NADBank may only develop, certify, and finance environmental infrastructure projects.

In March 2002, President Bush and President Fox approved a set of reform proposals designed to improve the performance of BECC and NADBank in fulfilling their environmental mandates along the border. On April 5, 2004, President Bush signed into law H.R. 254, which authorizes the implementation of two of these reforms, namely, authority to make grants out of paid-in capital and to expand the border region in Mexico. The necessary changes to the BECC/NADBank Charter were approved by the Mexican Senate on April 8, 2003. The new Charter took effect on August 6, 2004. Both governments are working to implement these reforms, which include making NADBank financing more affordable, expanding the institutions' geographic scope on the Mexican side, replacing the two institutions' separate boards of directors with a single board, and conducting a review of the project cycle to identify ways to improve efficiency.

For FY2006, the Administration is not requesting any funding for NADBank. Congress has appropriated the full \$225 million in U.S. paid-in capital and authorized the full \$1.275 billion in U.S. callable capital.

Key Facts

- NADBank was created with \$450 million in total paid-in capital and \$2.55 billion in callable capital, to be subscribed equally by Mexico and the United States. To date, Mexico and the United States have contributed a combined total of \$348.8 million to NADBank.
- Ninety percent of NADBank's total capital is dedicated to financing environmental infrastructure projects in the border region. The remaining 10% is allocated to separately operated domestic programs in each country that assist communities in adjusting to the displacement of workers caused by trade liberalization. The United States program is called the Community Adjustment and Investment Program (US CAIP).

Note: Internet website: www.nadb.org; NADB Fiscal Year: April 1- March 31

- During 2004, the NADBank Board approved \$10.22 million in loans for four projects, bringing the committed total to \$103.85 million in loans for 23 projects.
- The Low Interest Rate Lending Facility (LIRF), established in 2000, was initially funded with \$50 million in paid-in capital but this was increased to \$100 million in August 2002, as part of the reforms agreed by Presidents Bush and Fox. LIRF interest rates are sufficient to maintain the real value of NADBank capital, but lower than NADBank's standard market-rate loans. The NADBank Board approved two LIRF loans in 2004, one in Mexico for US\$2.5 million and one in the U.S. for \$6.13 million, bringing total Board-approved LIRF loans to date to \$34.21 million.
- Through the Border Environmental Infrastructure Fund (BEIF), NADBank provides grant financing for water treatment and wastewater treatment projects in either country. This program is 100% financed by separate appropriations to the U.S. Environmental Protection Agency (EPA), which has allocated \$516.17 million to the BEIF. As of December 2004, the NADBank had recommended, and EPA had approved, BEIF grant financing for 54 projects in both countries which have for this total amount. Of this, \$184.14 million had been disbursed.
- As of December 2004, the NADBank Board has approved eight grants for solid waste projects, four in Mexico and four in the U.S., through the Bank's Solid Waste Environmental Program (SWEP), a program created in 1999 that is funded out of retained earnings. These grants total \$3.99 million. Of this, \$1.43 million had been disbursed.
- The NADBank also funds technical assistance programs under its Institutional Development Cooperation Program (IDP), which provides grants to communities for capacity-building activities such as user rate studies, utility line surveys, user registry updates and management studies. To date, the NADBank has provided \$13.5 million in IDP grants for 154 studies. As part of the IDP, the NADBank also operates the Utility Management Institute (UMI), which trains utility managers and enhances the ability of communities to build, operate and maintain infrastructure projects sustainably. To date, the UMI has trained 542 participants from water and wastewater utilities representing 101 communities on both sides of the U.S.-Mexico border.

Promoting U.S. Objectives

Reform of BECC and NADBank

In response to NADBank's meager lending record in the 1990s, the U.S. and Mexican governments began an effort in 2000 to improve the effectiveness of NADBank and BECC in fulfilling their mission. Upon taking office in 2001, President Bush joined with President Fox in calling on their respective governments to formulate an urgent plan for broad reforms of these institutions.

In March 2002, in Monterrey, Mexico, President Bush and President Fox approved the following recommendations of a bi-national working group:

- Improving the Affordability of NADBank Financing: To provide a greater level of financial flexibility so that its capital can be used more effectively and creatively, the NADBank would increase the affordability of its loans through an expansion of its Low Interest Rate Lending Facility (LIRF) and be permitted to make grants and concessional loans out of its paid-in capital. Originally established in 2000 with \$50 million in paid-in capital, the LIRF was doubled to \$100 million in August 2002. Legislation to authorize the use of paid-in capital for grants and concessional loans (H.R. 254) was signed into law by President Bush on April 5, 2004, and, with the new Charter in place, this authority is now in effect.
- Geographic Scope: To expand the capacity of both institutions to address important bi-national environmental needs, the geographic scope for BECC/NADBank operations in Mexico would be expanded from 100 km to 300 km from the border. This expansion would be coupled with a financial differentiation system that concentrates grants and low interest rate loans for projects in the poorest communities located within the current border region of 100-km, in both countries. The geographic limit in the United States would remain unchanged at 100-km from the border. Legislation to authorize the geographic expansion in Mexico (H.R. 254) was signed into law by President Bush on April 5, 2004, and, with the amended Charter in place, the expansion to 300 km is now in effect.
- Organizational Structure and Process: To improve functional coordination and operational efficiency between BECC and NADBank, the two boards of directors would be replaced by a single board to oversee both institutions. This new board would have representation from the federal governments, the border states and the public. With the new Charter in effect, the single board of directors has replaced the separate boards of the BECC and the NADBank. The Administration is in the process of appointing the two non-federal U.S. members of the new BECC/NADBank board of directors.
- Comprehensive business process review: A comprehensive business process review would be initiated to identify ways to improve overall project design, certification, financing and implementation. The review is being conducted by an independent consultant chosen by both governments and includes broad consultations with stakeholders in both countries. A final report and recommendations, including a proposal for a results measurement framework, has been made available for public comment and is being considered by the board of directors.
- Private Sector: A more concerted effort should be made to involve the private sector in the sponsorship and financing of BECC/NADBank projects, both in the original environmental sectors of water, wastewater and solid waste treatment, and in the expanded environmental areas: air quality improvement, water conservation, hazardous waste reduction and mitigation, public transportation, and clean energy. NADBank project development efforts to date suggest that there is more private sector interest in the expanded areas than the original sectors.

In November 2000, NADBank's Board of Directors approved a set of policy measures aimed at increasing NADBank's financing activities, namely: expansion of the Bank's activities into new environmental sectors, creation of the LIRF, authorization for management to recommend equity investments for Board consideration, and creation of a technical assistance program for solid waste project development.

The new environmental sectors identified by the NADBank and BECC Boards include air quality improvement, water conservation, hazardous waste reduction and mitigation, public transportation, and clean energy.

As of December 2003, thirty-five project sponsors had submitted "Step 1" applications for BECC certification of projects in the new sectors. The Bank is working with the private sector on several projects in these sectors.

Through the LIRF, increased to \$100 million in August 2002, the NADBank can charge interest rates that are lower and more affordable, but still sufficient to maintain the value of the paid-in capital. The operating guidelines for the LIRF reflect three considerations: (1) the program should primarily benefit poorer border communities, (2) the program should not crowd out private investment, and (3) interest rates should cover projected inflation and administrative costs as well as project risk. The NADBank Board is currently reviewing the LIRF program, and may modify the eligibility criteria and program implementation in light of the experience to date.

Water Conservation Investment Fund

In August 2002, the NADBank Board established a Water Conservation Investment Fund (WCIF), using \$80 million in retained earnings, to provide grant financing to critical water conservation projects in the U.S. and Mexico. This initiative reflected shared U.S.-Mexico concerns over difficult water conservation issues in the border region, which have been exacerbated by drought in recent years. The U.S. and Mexican governments agreed that the two countries would share equally in the fund, with \$40 million allocated to each country.

In May 2003, the NADBank announced a preliminary list of 20 U.S. projects in the four border states to receive WCIF grants, selected by means of a competitive process. Mexico proposed using its entire \$40 million allocation for a single project, which the NADBank approved. As of December 31, 2004, the BECC has certified all 21 projects, and the NADBank has approved 16 WCIF grants totaling \$72.5 million. Final NADBank review is underway for the remaining five U.S. projects. Contracts to implement all of the approved projects have been awarded and disbursements for 13 of these projects have begun.

Strengthening Relations with Mexico

The NADBank has functioned as a partnership in which both countries have worked together to address shared problems in a mutually advantageous manner. The NADBank contributes to improved growth prospects for Mexico by aiding structural reform in Mexico through utility service pricing reforms, support for decentralization, and facilitation of greater private sector participation in infrastructure.

Supporting the Environment, Increasing Productivity and Raising Living Standards

The NADBank's mission is to enhance the affordability, financing, long-term development and effective operation of infrastructure that promotes a clean, healthy environment for the citizens of the U.S.-Mexico border region. NADBank projects are designed to alleviate many of the significant health problems afflicting the border region, thereby enhancing living standards, contributing to improved worker productivity and supporting regional economic development efforts. In addition, the NADBank's technical assistance and training programs improve efficiency at utilities and contribute to increased human capital in the border region.

NADBank projects in Mexico can directly benefit the United States by reducing the flow of raw sewage and other pollutants into the United States and into shared water bodies. For example, the Piedras Negras project described below will eliminate raw wastewater discharges in the Rio Grande River, a shared watershed between the United States and Mexico.

The following projects are examples of work the NADBank is doing in its original core sectors (water, waste-water and solid waste) that will yield substantial environmental improvements in the border region.

- Eagle Pass, Texas: The El Indio Water Supply Corporation will merge with the Eagle Pass Water Works System, replacing the two existing water treatment plants with a single regional water plant that will have the capacity to treat 19 million gallons per day (MGD). The project also includes such improvements as the expansion and rehabilitation of 162,383 linear feet of transmission lines to serve the Deer Run and El Indio service areas and surrounding *colonias*. BEIF grant: \$18 million; total project cost: \$105 million
- Piedras Negras, Coahuila: This three-phase project will provide full sewer service coverage to the Piedras Negras population over a 20-year period. It will also reduce the total amount of sewage produced and treat it prior to its discharge into the Rio Grande River. NADBank loan: \$2.5 million; BEIF grant: \$8.4 million; total project cost: \$56.8 million.

In addition to its core sectors, the NADBank is participating in the development of projects in new environmental areas, such as renewable energy and energy efficiency. The following are examples of projects under development in these new sectors.

- San Luis Rio Colorado, Sonora: Currently 76% of the streets in San Luis Rio Colorado are unpaved, so the community is considering a comprehensive air quality street paving project. Street paving would reduce dust (particulate matter) and thus improve local respiratory-related public health and overall air quality for the city.
- Brownsville, Texas and Matamoros, Tamaulipas: The project would consist of rerouting rails on the west side of town and construction of a new international rail bridge to eliminate congestion, thereby improving air quality and reducing risk of hazardous waste spills.

Support for Private Sector Development

The NADBank has the potential to expand its collaboration with private sector entities in support of both private sector development and environmental objectives. Three examples of projects in the early stages of development that might lead to NADBank collaboration with the private sector are:

- Reynosa, Tamaulipas: Four maquiladoras are cooperating on an energy efficiency project. They are working with an energy service company to implement replacement of lighting, control systems, HVAC, ventilation systems, boilers, and chillers. This project is being proposed as part of a joint effort with the Canadian government through the Sustainable Cities Initiative.
- Nogales, Arizona: The project would expand the port of entry to allow commercial trucks to cross the border into the U.S. under the auspices of the “Free and Secure Trade” (FAST) system. The project would help expedite truck traffic, alleviate traffic congestion, and reduce diesel emissions from idling trucks.
- Monterrey, Nuevo Leon. The project would involve the installation of new pollution control equipment to reduce emissions at a glass manufacturing plant.

Borrower Governance, Transparency and Internal Controls

The NADBank promotes stronger governance and internal controls among its client communities through its technical assistance/training initiatives.

- The Bank provides technical assistance through its *Institutional Development Cooperation Program (IDP)*. The IDP is a grant program designed to assist public utilities in the areas of institutional strengthening, managerial capacity and financial development, in order to ensure the long-term viability of each project. Examples of IDP projects include rate studies, line surveys, billing and collection systems and comprehensive management studies.
- Through the Utility Management Institute, sound management principles are taught to utility professionals from the border region. Funded under the IDP, the UMI provides an annual series of seminars giving utility managers and their staffs an opportunity for on-going professional development aimed at enhancing their managerial and financial skills. The basic program consists of seminars on organizational structure and planning, financial planning and management, and public participation and outreach.
- The NADBank requires covenants from all project sponsors for which it provides financing. NADBank’s auditor is increasing the NADBank’s focus on monitoring contract covenant compliance. A system for periodic and extensive reviews of contract compliance is in place, along with a firm willingness on the part of the NADBank to enforce contract covenants.

- Among the required covenants is adherence by project sponsors to the NADBank's policies and procedures which mandate observance of the generally accepted accounting standards applicable in the project sponsor's country of origin, and the maintenance of other financial controls. The NADBank requires project sponsors to maintain detailed, pertinent and consistent financial documentation relating to the Bank's project financing.

Information Disclosure

- The NADBank has an active and aggressive public outreach program. The NADBank maintains a website, www.nadb.org, on which comprehensive information regarding the NADBank's programs, projects and activities is available. The NADBank publishes two electronic newsletters. *Connections* provides general information on NADBank activities on a quarterly basis, and *NADBank News* publicizes all contracting and procurement opportunities relating to NADBank-funded projects in the U.S. and Mexico. The NADBank also regularly issues press releases regarding project-related activities. Under the amended Charter, the NADBank will have a minimum of two public meetings per year.