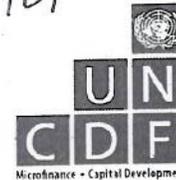




CDB 152/441/01

(1)



LOCAL ECONOMIC DEVELOPMENT FINANCE INITIATIVE FOR TANZANIA (LFI-T)

Programme UNDAF Cluster: Governance (3)

Programme Impact: Tanzania financial systems unblocked to enable and promote inclusive local economic development (LED).

Programme Outcomes: (1): Improved capacities of public and private project developers to identify and develop small-to-medium sized infrastructure projects essential for inclusive LED; (2): Increased ability and willingness of domestic financial sector to provide financing for small to medium-sized LED infrastructure projects; (3): Improved national business-enabling environment for domestic resource mobilization for inclusive LED, including integration into existing government processes, programs, and structures; (4): Increased interest and support of the international development community for inclusive LED project development and finance; (5): Increased effectiveness and leverage of limited public sector funds, both of the host government and development partners, by mobilizing significant levels of private sector finance for catalytic LED projects.

<p>Programme Duration: 2012-2015 Anticipated start/end dates: March 2012/June 2015</p> <p>Fund Management Option(s): UNCDF Core: Parallel One UN Fund: Pass-Through Government: Parallel Other Non Core: Cost sharing with UNCDF. If other UN agencies join this programme, it will be converted to a join programme using the pass-through modality for non-core contributions. Private Investment Resources: Parallel</p> <p>Execution Modality: National Implementation</p>	<p>Total estimated budget: USD 5, 100,000</p> <p>1. Funded Budget: USD 4,500,000</p> <p> UNCDF USD 1,000,000 One UN Fund USD 3,500,000</p> <p>2. Unfunded budget: USD 600,000</p> <p>Credit Enhancement Gap USD 20,000,000 (estimate).</p> <p>Credit Enhancement to be made available for mobilizing up to USD 40,000,000 of private sector capital.</p>
<p align="center">On behalf of UN organizations</p> <p>Name: Alberic Kacou Position: Resident Coordinator UN</p> <p>Signature: </p> <p>Date: 14/5/2012</p>	<p align="center">On Behalf of Government of Tanzania</p> <p>Ministry of Finance Name: J. J. R. BURETTA Position: Ag. Commissioner</p> <p>Signature: </p> <p>Date: 4/6/2012</p>
<p>Name: David Morrison Position: Executive Secretary, UNCDF</p> <p>Signature: </p> <p>Date: 20 April 2012</p>	<p>Prime Minister's Office Regional Administration and Local Governments (PMORALG)</p> <p>Name: Position: </p> <p>Signature: </p> <p>Date: 21/05/12</p>

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Executive Summary

All stakeholders worldwide have recognized the critical role of the private sector in fostering economic growth, poverty reduction, and the attainment of the Millennium Development Goals (“MDGs”). At a time of tight public budgets and the need for local economies to deal with a globalizing world, public funding alone is not a solution. If local development is to be successful and sustainable over the longer term, the private sector needs to be fully mobilized. Yet, despite the commitment of all UN Member States to mobilizing the private sector in the 2002 Monterrey Consensus and many other initiatives, concrete results on the ground have been insufficient.

The Tanzania Local Economic Development Finance Initiative (“LFI-T”) is an innovative programme of the Tanzania government designed by the United Nations Capital Development Fund (“UNCDF”) that strives to make a significant development impact by ensuring that domestic financial systems are unblocked to enable and promote inclusive local economic development (“LED”). The programme intends to achieve this goal through implementation of some strategic small and medium-size LED infrastructure projects developed in coordination with multiple Regional Administration and Local Government Authorities in Tanzania. The demonstration infrastructure projects will be strategically selected for their potential impact in unleashing the potential of local economies and advancing local development, including both traditional and industrial infrastructure projects such as energy projects, transport, warehouses, and food processing plants.

The programme will include implementation of national capacity development programs to ensure long-term sustainability coupled with the demonstration small and medium-size LED infrastructure projects. Capacity development will include training of local Technical Service Providers, national and local government officials, bank officers, and project sponsors, as well as the provision of information-enabling resources and scalable communication and management platforms using basic on-line technologies.

The programme aims to improve the ability and willingness of the relevant stakeholders to use domestic finance for LED and to create enabling national and international environments for sustained participation of the domestic financial sector in LED through five main outcomes:

- *Outcome 1*: Improved capacities of Tanzania public and private project developers to identify and develop small-to-medium sized infrastructure projects essential for inclusive LED.
- *Outcome 2*: Increased ability and willingness of the domestic financial sector to provide financing for small to medium-sized LED infrastructure projects.
- *Outcome 3*: Improved Tanzania business-enabling environment for domestic resource mobilization for inclusive LED, ensuring integration into existing government processes, programs, and structures.
- *Outcome 4*: Increased interest and support of the development community for Tanzania inclusive LED project development and finance.

- *Outcome 5*: Increased effectiveness and leverage of limited public sector funds, both of the host government and development partners, by mobilizing significant levels of private sector finance for catalytic LED projects.

The LFI-T Programme is innovative on several levels. First it applies proven financial techniques to the recognized imperative of responding to pent up demand for infrastructure projects that block local economic development, impeding the ability of local stakeholders (such as farmers and MSMEs), to access markets and improve their livelihoods. This approach integrates the best practices of the development community in using the existing credit enhancement products such as partial guarantees and first loss facilities, combined with technical assistance in project development. The end result is increased aid effectiveness, leveraging limited official sector resources (government, ODA, etc.) by mobilizing the private sector to finance projects critical to local economic development.

Second, the LFI-T Programme employs practical mechanisms to scale up development finance in Tanzania nationwide, combining the use of targeted capital and credit enhancement with “learn by doing” capacity building interventions. These interventions are necessarily targeted at increasing the capacity of both the government and the private sector to develop and finance infrastructure projects. By engaging the government (local and national) with project sponsors and providers of finance in these demonstration projects, there is a demonstration effect that can be replicated nationwide. To enable replication, the programme employs cost-effective on-line tools to disseminate success stories, enabling-information for informed decision-making, and communication tools to empower government officials and private sector participants. Performance metrics are used to create momentum and facilitate the identification of success stories, major impediments, and scaling up.

This innovative LFI-T Programme approach will be executed through four programmatic components: a) project development activities that enable the identification and development of up to 15 demonstration projects to create “proof of concept” financing models that facilitate access to the domestic financial sector for investments in strategic, smaller scale infrastructure projects; b) finance and credit enhancement facilities to enable jumpstarting the process of project identification, development and deal/financing structuring (i.e., “LFI-T Fund” and other credit enhancement structures); c) capacity building activities that provide for the training of public and private stakeholders and increased government capacity to facilitate finance, project development, and business-enabling environments (using modern on-line tools to enable national scaling up, identification of impediments and possible remedies, and tracking accountability); and d) performance tracking activities that provide a foundation for benchmarking the dissemination of and incentives for the replication of all programme components.

Given the high-level of financial expertise, project development experience, and related capacity-building competencies that are required for delivering all four LFI-T Programme components and expected outcomes, UNCDF will engage an expert global implementation technical service provider with demonstrated successful track records across the full set of required outputs to guide the implementation of all the technical activities of the overall LFI-T Programme.

Advancing the MDGs & Poverty Reduction

LFI-T advances all the Millennium Development Goals (“MDGs”), as private sector development inherently reduces poverty and improves the capacity of developing country citizens and their governments to provide food security, education, clean water, and medical care.

Poverty reduction, the 1stMDG, is advanced through LFI-T by its efforts to unlock domestic financial sectors and improve business-enabling environments that are a prerequisite for private sector growth, local economic development, improved infrastructure, and job creation.

Advancing Aid Effectiveness

Today more than ever, public sector funding is limited and aid effectiveness is paramount. LFI-T is aimed at leveraging limited public sector funding and building in-country capacity to access long-term private sector financing. With private sector savings pools in the form of bank accounts, pension funds, insurance and other financial products growing in virtually all of the emerging markets countries, the opportunities to marshal these resources for the collective benefit of all are developing apace.

The budget for introducing/deepening the LFI-T Programme in Tanzania (excluding reimbursable funding provided by partners and private sector sources) is estimated at US\$ 5.1 million over a four-year period (2012-2015).¹ The targeted amount of private sector finance to be mobilized directly by the LFI-T Programme in the first two to three years using the LFI-T Fund is US\$10 million. By the end of the programme (June 2015), greater private finance (\$30-40 million) is expected to be mobilized through additional credit enhancement, leveraging up to ten times the cost of the programme.

After programme completion, the successful proof of concept is expected to have created a significant demonstration effect: Domestic banks and institutional investors are expected to have gained sufficient experience with financing small and medium infrastructure projects so that these institutions are now comfortable doing so with limited or no third-party credit support. Replication is estimated at US\$100 million in additional project finance. Therefore the total amount of infrastructure financing resulting from the LFI-T Programme is expected to be in the range of US\$140 million – US\$150 million, up to 30 times the programme cost.

¹ Since the LFI-T Programme has been delayed by eight months, the revised time period for the programme is three years and four months.

List of Acronyms and Abbreviations

CBG	Capacity Building Grant
CGAP	Consultative Group to Assist the Poor
DFI	Development Finance Institution
DFLE	District Forum for Local Economic Stakeholders
DAO	Delivering as One (DaO)
GPG	General Purpose Grant
GoT	Government of Tanzania
GIN	Government-Investor Network (see www.ffdtoolkit.org)
GPOBA	Global Partnership for Output-Based Aid
IAPC	Inter-Agency Programme Committee
IFI	International Financial Institution
INFRADEV	Infrastructure Experts Group (see www.infradev.org)
IP	Implementing Partner
JSC	United Nations Steering Committee
LED	Local Economic Development
LFI-T	Local Economic Development Finance Initiative
LGA	Local Government Authority
LGCDG	Local Government Capital Development Grant System
LGFWG	Local Government Finance Working Group
LGLB	Local Government Loans Board
LGRP	Local Government Reform Programme
MoF	Ministry of Finance
MPEE	Ministry of Planning and Economic Empowerment
MSME	Micro, Small and Medium Enterprise
OBA	Output-Based Aid
ODA	Official Development Assistance
PMO-RALG	Prime Minister's Office Regional Administration and Local Government
PDF	Project Development Facility
TSPs	Technical Service Providers
PCG	Partial Credit Guarantee
PMC	Programme Management Committees
PMO-RALG	Prime Minister's Office – Regional Administration and Local Government
PO-PSM	President's Office - Public Service Management
PPIAF	Public-Private Infrastructure Advisory Facility
PPP	Public Private Partnership
PRG	Partial Risk Guarantee
PWG	Programme Working Group
SLEM	Support to Local Economy in Mwanza Program
SME	Small and Medium Enterprises
SMJ	Small Municipal Jurisdiction
TCX	The Currency Exchange Fund
Tsh	Tanzanian Shilling
UNCDF	United Nations Capital Development Fund
UNCMT	UN Country Management Team
UNDAP	UN Development Assistance Plan
UNDP	United Nations Development Programme
USAID	United States Agency for International Development

Glossary of Terms

Bankable: Project or proposal that has sufficient collateral, future cash flow, and high probability of success to be acceptable to commercial banks and institutional lenders for financing.

Source: Business Dictionary <http://www.businessdictionary.com/definition/bankable.html>

Infrastructure: The basic physical and organizational structures needed for the operation of a society or enterprise, or the services and facilities necessary for an economy to function. The term typically refers to the technical structures that support a society, such as roads, water supply, sewers, electrical grids, telecommunications, and so forth. Viewed functionally, infrastructure facilitates the production of goods and services; for example, roads enable the transport of raw materials to a factory, and also for the distribution of finished products to markets and basic social services such as schools and hospitals.

Traditional Infrastructure: Physical networks necessary for the functioning of a modern industrial country, such as roads, energy, water, telecommunications, etc. Local economic development is often blocked by lack of traditional infrastructure, such as adequate roads, irrigation systems, local power systems, etc.

Industrial Infrastructure: Manufacturing infrastructure, including industrial parks and special economic zones, mines and processing plants for basic materials used as inputs in industry, specialized energy, transportation and water infrastructure used by industry, plus the public safety, zoning and environmental laws and regulations that govern and limit industrial activity, and standards organizations; agricultural, forestry and fisheries infrastructure, including specialized food and livestock transportation and storage facilities, major feedlots, agricultural price support systems (including agricultural insurance), agricultural health standards, food inspection, experimental farms and agricultural research centers and schools, the system of licensing and quota management, enforcement systems against poaching, forest wardens and fire fighting.

Social Infrastructure: The health care system, including hospitals, the financing of health care, including health insurance, the systems for regulation and testing of medications and medical procedures, the system for training, inspection and professional discipline of doctors and other medical professionals, public health monitoring and regulations, as well as coordination of measures taken during public health emergencies such as epidemics; The educational and research system, including elementary and secondary schools, universities, specialized colleges, research institutions, the systems for financing and accrediting educational institutions; Social welfare systems, including both government support and private charity for the poor, for people in distress or victims of abuse.

Source: Wikipedia <http://en.wikipedia.org/wiki/Infrastructure> (edited by GlobalDF)

Mortgage/Mortgageable - A legal agreement that conveys the conditional right of ownership on an asset or property by its owner (the mortgagor) to a lender (the mortgagee) as security for a loan. The lender's security interest is recorded in the register of title documents to make it public information, and is voided when the loan is repaid in full. Virtually any legally owned property can be mortgaged, although real property (land and buildings) is the most common.

Source: Business Dictionary <http://www.businessdictionary.com/definition/mortgage.html>

Non-Recourse Financing - Non-recourse debt or a non-recourse loan is a secured loan (debt) that is secured by a pledge of collateral, typically real property, but for which the borrower is not personally liable. If the borrower defaults, the lender/issuer can seize the collateral, but the lender's recovery is limited to the collateral. If the property is insufficient to cover the outstanding loan balance (for example, if real estate prices have dropped), the difference between the value of the collateral and the loan value becomes a loss for the lender.

Project Finance - The financing of projects dependent on the project cash flows for repayment rather than having recourse to a foreign government, financial institution or established corporation. The type of financing used is non-recourse (i.e., no recourse to the Project Sponsor or government).

Source: Webster on-line Dictionary <http://www.websters-online-dictionary.org/definitions/Project+Finance?cx=partner-pub-0939450753529744%3Av0qd01-tdlq&cof=FORID%3A9&ie=UTF-8&q=Project+Finance&sa=Search#922>)

Project Sponsors: The entity responsible for the project overall management is commonly referred to as the Project Sponsor. Project Sponsors usually have an equity stake in the project of at least 15%. Project Sponsors can be from either the public or private sectors. Private sector Project Sponsors can be large or small private sector entities. Public sector Project Sponsors can be local, national, or international entities. *(However, it is important to note that for projects to be financially viable, the Project Sponsor must have a committed Programme Manager with a demonstrated capacity to manage such projects by presenting a solid track record of similar projects that have been successful in producing revenue and paying their debts.)*

Put: An option contract giving the owner the right, but not the obligation, to sell a specified amount of an underlying asset at a set price within a specified time. The buyer of a put option estimates that the underlying asset will drop below the exercise price before the expiration date. When an investor purchases a put, he or she expects the underlying asset will decline in price. The investor will then profit by either selling the put options at a profit, or by exercising the option. If an investor writes a put contract, he or she is estimating the stock will not decline below the exercise price, and will not fall significantly below the exercise price.

Source: <http://www.investopedia.com/terms/p/put.asp#axzz1g4MQFtZS>

Tenor: Length of time that must elapse before a loan becomes due for final payment.

Source: Business dictionary <http://www.businessdictionary.com/definition/tenor.html>

General References for Project Finance

Harvard Business School Project Finance Portal: <http://www.people.hbs.edu/besty/projfinportal/>

This portal is a reference guide for practitioners, researchers, and students seeking information about project finance, infrastructure finance, and public-private partnerships (PPP). In addition to bibliographical references for books, articles, and case studies, the site contains links to hundreds of related sites containing data as well as information about particular projects and companies/organizations involved with project finance.

For Glossary of Project Finance Terms and Acronyms, go to:

<http://www.people.hbs.edu/besty/projfinportal/glossary.htm>

The Law and Business of International Project Finance, A Resource for Governments, Sponsors, Lawyers, and Project Participants

3rd Edition, Scott L. Hoffman, Evans, Evans & Hoffman, LLP



Map No. 3667 Rev. 5 UNITED NATIONS
January 2005

Department of Peacekeeping Operations
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1. Situation Analysis

1.1 Background

All stakeholders worldwide have recognized the critical role of the private sector in fostering economic growth, poverty reduction, and the attainment of the Millennium Development Goals (“MDGs”) and other internationally agreed development goals. At a time of tight public budgets and the need for local economies to deal with a globalizing world, public funding alone is not a solution; if local development is to be successful and sustainable over the longer term, the private sector needs to be fully mobilized. Yet, despite the commitment of all UN Member States to mobilizing the private sector in the 2002 Monterrey Consensus and many other initiatives, concrete results on the ground have been insufficient. This was again highlighted at the 2008 Financing for Development (FfD) Summit in Doha and the UN 2010 MDG Summit in New York. Despite the consensus on the critical role of the private sector, the basic financial, legal and fiscal infrastructure required for private sector development is still widely lacking in many developing countries, arresting private sector development at local and national levels.

The recent global financial crisis has led to additional challenges, given decreases in official development assistance and further reduced availability of finance and risk capital in developing countries. Therefore the longstanding imperative for mobilizing private sector capital and leveraging limited official sector funds has escalated in importance. The Doha Declaration stresses that “greater efforts are required to support the creation and sustenance of a conducive environment [for mobilizing domestic financial resources for development] through appropriate national and international actions.”

Whereas the engagement of the domestic financial sector in larger industries in developing countries has somewhat improved in recent years, financing of local economic development remains a matter of concern. Despite the fact that in many cases there is untapped domestic capital, which could be used to support small and medium-scale infrastructure development at the subnational level, this capital is not available for LED actors, whether they are local governments or private businesses.

However, private sector capital can be successfully unlocked and mobilized using technical financial structures and instruments that mitigate risk. For example, infrastructure projects in developed countries and developing countries use the financial approach of non-recourse financing, in which the project is a legal entity with “ring-fenced” revenues that are earmarked for paying debt service. Furthermore, many risk mitigation instruments are already available that have proven successful in leveraging limited official sector support, such as the partial guarantees offered by the World Bank, regional development banks, and many donors such as USAID.

UNCDF is endeavoring to use these financing techniques to mobilize domestic financing for relatively small infrastructure projects that are critical for supporting local economic development and to use these targeted financial interventions hand-in-hand with capacity building mechanisms to empower both government officials and the private sector to scale up local development finance, also improving the business-enabling environment.

1.2 General Profile of Tanzania

Tanzania is one of the poorest countries in the world. (According to UNDP estimates, Tanzania ranked 160 out of 183 countries on the basis of Gross National Income per capita on a purchasing power parity basis.) Fortunately Tanzania is one of the most politically stable countries in Africa. It is a parliamentary democracy in which, over the last two decades, political pluralism has been introduced. Peaceful, multi-party elections have been held every five years since 1995.² This has allowed for steady economic growth and in 2010 GNI per capital was fifty percent higher than in 1990, well above the global average increase during this period.³ This was achieved even though the country's population growth (2 percent per year) is amongst the most rapid in the world. However, in 2010 nearly a third (13 million) of the 43 million Tanzanians continue to live below the basic needs poverty line of approximately 40 US\$ cents.⁴

Tanzania's annual GDP growth since 2001 has been greater than 7 percent, significantly above the sub-Saharan African average, with some deceleration following the global financial crisis in 2008. The macro-economic situation has been steady despite global shocks: inflation was at a single digit for most of this period. The government used fiscal stimulus and loosened monetary policy to ease the impact of the global recession following the global financial crisis of 2008. As a result GDP growth in 2009-10 was a respectable 6% per year.⁵ The exchange rate is stable as a result of improved foreign exchange reserves and moderate inflation. The level of external debt has decreased from a high of over 50 percent of GDP in 2003 to 36 percent of GDP in 2010. The country has benefitted from debt relief owing to its eligibility in the Heavily Indebted Poor Countries Initiative.

Tanzania's economy depends heavily on agriculture. While 80% of the work force is employed in agriculture, it accounts for only 28% of GDP due to the low productivity of the sector. This low productivity arises mainly from inadequate infrastructure investment, access to farm-inputs, extension services and credit, application of modern technology, trade and marketing support plus heavy dependency on rain-fed agriculture and unsustainable use of natural resources. Despite reform efforts, lasting structural change has proven elusive. Rural private sector and community institutions are undeveloped, further compounding inefficiencies and service gaps.

Tanzania's industrial sector is one of the smallest in the world (as a percent of GDP) and lacks diversification. Output comes largely from traditional, low tech industries: agricultural processing (sugar, beer, cigarettes, sisal twine); diamond, gold, and iron mining, salt, soda ash; cement, oil refining, shoes, apparel, wood products, fertilizer. The mining sector is expanding

² There has been a gradual increase in political pluralism in Tanzania, but Chama Cha Mapinduzi (CCM), the ruling party, remains dominant in government and parliament. Tanzania's current president, Jakaya Kikwete, won 80% of the votes cast in the December 2005 presidential election. In October 2010, President Kikwete was reelected for a second term with 61% of the votes cast. The ruling CCM won 70% of the seats in parliament.

³ See [Human Development Report 2011](http://hdr.undp.org/en/) (<http://hdr.undp.org/en/>).

⁴ See [United Nations Development Assistance Plan \(UNDAP\) July 2011-June 2015 United Republic of Tanzania](http://www.tz.undp.org/docs/undp_assistance_plan_july_2011_to_june_2015.pdf), United Nations Steering Committee, December 2010
http://www.tz.undp.org/docs/undp_assistance_plan_july_2011_to_june_2015.pdf

⁵ The Economist Intelligence Unit predicts real GDP growth of 7.1% in 2011 and 7.5% in 2012. Inflation is expected to reach 7.7% in 2011 and 6.5% in 2012. The country is currently benefiting from the high price of gold—Tanzania's main export—which remains high due to the global market and the weakness of the U.S. dollar.

and attracting potentially large flows of FDI.⁶ And tourism continues to be a key contributor to the country's economy.

Today one of the key impediments to development in Tanzania is the country's inadequate infrastructure. According to the work of the 2008 Africa Infrastructure Country Diagnostic (AICD), only one-third of households in Tanzania have access to an improved water source while the overwhelming majority lacks access to improved sanitation. Coverage of electricity and road networks in Tanzania are low even by regional standards, with only 11 percent of households having access to electricity and only 28 percent of the rural population living within 2 km of an all-weather road.⁷

Public revenues have been inadequate to meet the country's needs for infrastructure investment. Current outlays, which typically get funded first, exceed the reliable revenue sources (external budget support and domestic revenue) by over 20 percent. As a result, domestically financed investment depends on the remaining, less stable resources, which leaves it vulnerable to unexpected, cost-increasing cutbacks.⁸

Inadequate infrastructure investment is one of the chief reasons for low rural sector productivity in Tanzania. Given that global experience has shown that gains in agriculture productivity disproportionately benefit the poor and play a key role in reducing poverty, increased investment in infrastructure within rural areas should be given high priority.

Due to Tanzania's enviable record of political stability and the government's efforts to introduce economic and social reforms, Tanzania is the recipient of substantial foreign aid, both financial and in the form of technical support.⁹ Currently about one-third of the government budget comes from foreign aid.¹⁰ In addition, since 2001, Tanzania has benefited from a substantial reduction in its external debts under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). Several donors have recently provided bilateral debt relief to Tanzania.

However, Tanzania's rapid population growth is far outpacing the growth of domestic revenue and foreign aid combined, putting pressure on the delivery of public services in the infrastructure and social areas. Even with substantial foreign assistance, many basic needs cannot be met. The National MDG Midway Evaluation: 2000-2015, concluded that Tanzania (as of 2008) was not on track to achieving several of the MDGs.¹¹ Progress on MDGs related to primary education enrolment and equity were evident, but not in others such as income poverty and maternal health.

⁶ Over the past decade gold production and exports have increased from negligible to around US\$1.5 billion (one-fourth of total export revenues). There also appears to be considerable potential for the production of nickel, uranium, and gas, all of which are attracting investments for exploration and development.

⁷ World Bank, Africa Development Indicators 2007.

⁸ IMF, Article IV Consultation, page 15.

⁹ Tanzania is the fourth largest foreign aid recipient in the world in terms of total flows (excluding Iraq and Afghanistan). Aid to Tanzania is projected to peak in 2011 at 10 percent of GDP.

¹⁰ Tanzania domestic revenue collection ratios have increased in recent years, but at roughly 15 percent of GDP, remain low by international standards.

¹¹ United Republic of Tanzania, Millennium Development Goals Report: Mid-way Evaluation: 2000-2008, page iii, <http://www.tz.undp.org/docs/MDGprogressreport.pdf>

In recognition of this failure, a new national strategy for growth and poverty reduction (MKUKUTA II and MKUZA II) was recently launched.¹² This strategy envisions a much greater role for the private sector:

*The major shift of this Strategy from its predecessor is high drive and scaling up the role and participation of the private sector in economic growth and employment generation and creation, through strengthening business climate for efficient use of factors of production, investing in people and infrastructure development, and sustaining the already achieved socio-economic progress.*¹³

One of the thrusts of the new strategy is to support growth through increased infrastructure spending, especially in transportation, power generation, and irrigation. Inadequate infrastructure is considered a key constraint to capacity building, the business environment, productivity and subsequently higher growth in the country and in the region. While concessional loans and grants will remain the main source of financing for development spending, the authorities are currently exploring sources for semi-concessional and non-concessional external borrowing, as well as domestic funding sources.¹⁴ Most importantly, the government will seek to enlist private sector financing as well as greater private sector development of infrastructure projects.

Given the large resource requirements and the budgeting and borrowing constraints, the Government will encourage private sector investment and participation in priority areas of drivers of growth and reduction of poverty. The Government recognizes the need for private sector to mobilize the public sector in infrastructure development and the provision of services.¹⁵

The strategy also reflects the GoT's growing concern to foster markets and private sector development and focuses on appropriate roles for the public and private sectors and on the strengthening of both state and private sector capacities and institutions. Its aim is to promote economic growth that is equitable, socially broad-based and unambiguously focused on poverty reduction.

In order to enhance efficiency in resource utilisation and service delivery, the Government is also continuing with implementation of its structural reform agenda, based on four core reform programmes:

- Public Sector Reform Programme
- Public Financial Reform Programme
- Local Government Reform Programme
- Legal Sector Reform Programme

¹² MKUKUTA II was approved in September 2010 and launched in January 2011. It covers the period 2010/11 to 2014/15.

¹³ National Strategy for Growth and Reduction of Poverty (NSGRP) II, Ministry of Finance and Economic Affairs, July 2010, page 27.

¹⁴ IMF, Article IV Consultation, pages 55-56.

¹⁵ National Strategy, page 101.

In addition, the Government is continually improving the business environment to support private sector led growth, through a Roadmap for Improving the Business Climate that was adopted by stakeholders in 2010.

1.3 Analysis of Key Issues

Responsibility for meeting the enormous demand for infrastructure in developing countries increasingly has shifted from national to sub-national governments. But local governments authorities (LGAs), especially those outside major cities, often lack the policy and institutional frameworks, management skills and, the financial resources and well-prepared financeable projects to fulfill this responsibility. Moreover, local business-environments often present daunting investment and business challenges, given significant legal, regulatory and operational impediments that impede investment and private sector development.¹⁶

In fact, given the current weak state of LGA finances in Tanzania, it is not realistic for local governments to enter the credit markets at this time. It is therefore even more important that LGAs develop their capacity to act as facilitators for private sector development, identifying possible infrastructure projects and possible project sponsors, helping to resolve impediments in the local business environment and enabling-information. In this way, LGAs can address local needs for finance and infrastructure.

With regards to the financing gap for infrastructure, there are many obstacles. Even if official bilateral and multilateral financing is available to a country, such financing usually requires sovereign guarantees, which are often unavailable due to fiscal constraints at the national level. In addition, such financing is primarily lent in foreign currencies, and ways must be found by the recipient to mitigate the foreign exchange risk of such loans. The most promising of these capital sources are the country's own domestic savings that have been mobilized by domestic banks and institutional investors (primarily pension funds and insurance companies). Thus there is a need to develop sources of local currency financing for local infrastructure projects.

Moreover, there is a lack of bankable projects and little funding for developing them. LGAs need to develop their knowledge of project development requirements and sources of possible ways to fund the needed development of business plans, feasibility studies, engineering studies, legal contracts, etc.

Further, LGAs require greater capacity to improve their local business environment, enabling the development of infrastructure projects viable over the longer term that can both facilitate and serve a thriving local community. In this regard, LGAs need to develop their capacity to facilitate the identification and development of infrastructure projects, as well as reduce the impediments and issues that hinder the development of projects and their sustainability.

Therefore the funding gap for infrastructure is not just because LGAs lack funds, but also because LGAs lack adequate capacity to facilitate the development of the private sector and

¹⁶ Leading work in this area of improving business-enabling environments has been done by the IFC. See <http://www.ifc.org/ifcext/sme.nsf/Content/BEE>

business-enabling environments. The lack of LGA finance is thereby amplified by the LGA capacity gap in facilitating other sources of capital and project development.

This imperative for building the facilitation role of government has been acknowledged by the Tanzania government. For example, the 2025 Tanzania Development Vision states that the specific role of the State is ensuring that a “*legal and regulatory framework is in place and functioning..., and ensure that mechanisms for promoting dialogue, consultations, and networks of various actors in development are put in place and made to work.*”¹⁷ Thus there is the acknowledged need to strengthen the capacity of local governments to act as facilitators of infrastructure project development as well as the creation of business-enabling environments, improved legal and regulatory frameworks, and mechanisms for promotion dialogue, consultation, and networks.

1.3.1 Decentralization and Local Governance in Tanzania

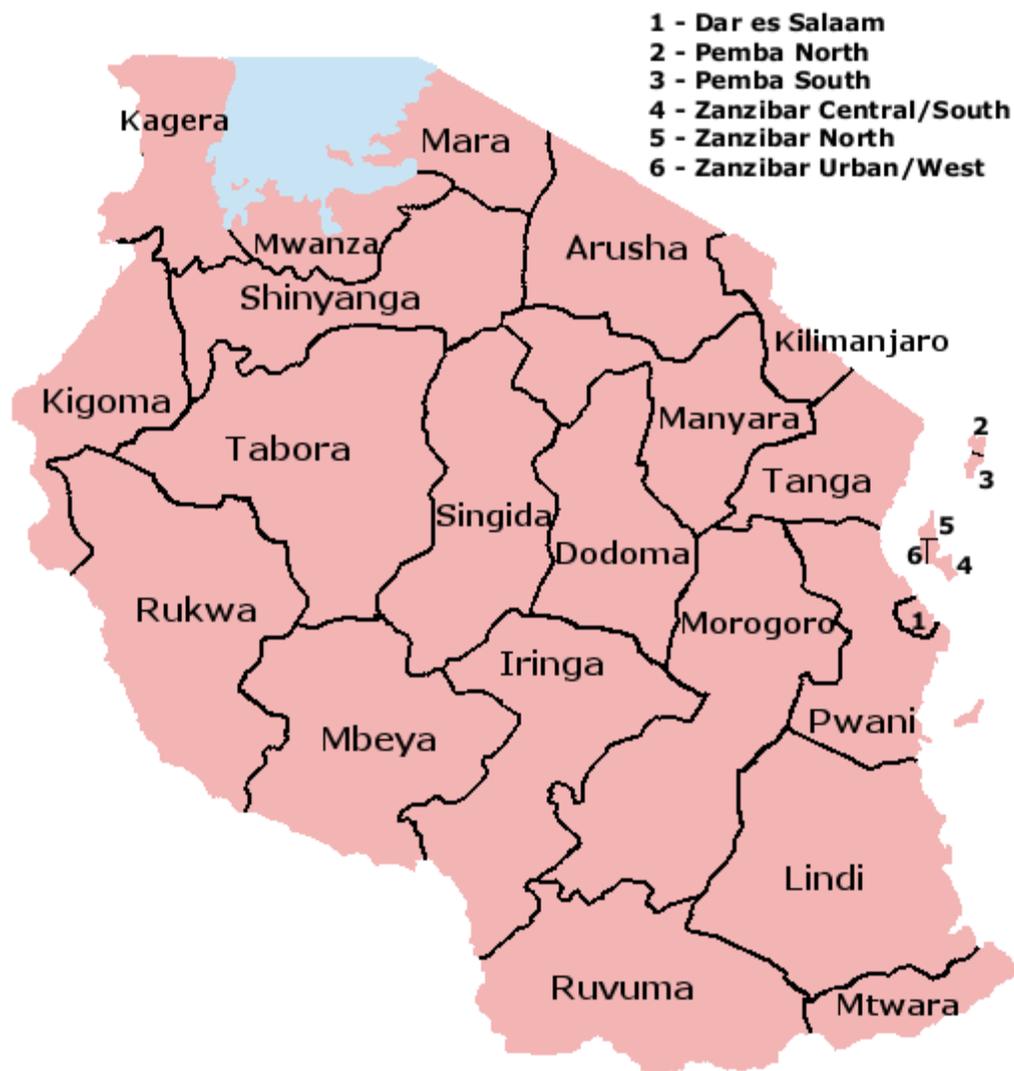
The Constitution of the United Republic of Tanzania states that “there shall be established local government authorities in each region, district, urban area and village in the United Republic, which shall be of a type and designation to be enacted by Parliament or House of Assembly” (chapter 8). It further stipulates that the “purpose of having local government authorities is to transfer authority to the people.” Thus decentralization is firmly based in the Tanzanian Constitution.

Tanzania is divided into 26 regions (mkoa), 21 on the mainland and five in Zanzibar (three on Unguja, two on Pemba). A Region is headed politically by a Regional Commissioner (RC) while the head of the Civil Service at that level is the Regional Administrative Secretary (RAS).

The role of the Regional Administration is to provide a “multi-skilled technical resource for supporting local development initiatives to exploit locally identified opportunities and link Central Government Ministries, Departments and Agencies (MDAs) as well as Development Partners to the Local Government Authorities (LGAs).”¹⁸

¹⁷ The Tanzania Development Vision 2025, Planning Commission, The Republic of Tanzania, page 24.
<http://logintanzania.net/docs/vision2025.pdf>

¹⁸ PMO-RALGA website at http://www.pmorLGA.go.tz/regional_profiles/index.php



One hundred and fourteen districts (wilaya), each with at least one council, have been created to further increase local authority; the councils are also known as local government authorities (LGAs). There are 133 councils operating in 114 districts; and consist of 4 within cities, 17 in municipalities, 6 in town councils and 106 in district councils. The 27 urban units are further classified as city councils (Dar es Salaam, Mwanza, Tanga, and Mbeya), municipal councils (Musoma, Bukoba, Shinyanga, Kigoma, Tabora, Sumbawanga, Singida, Dodoma, Arusha, Moshi, Morogoro, Iringa, Songea, Mtwara, Kinondoni, Ilala, and Temeke) or town councils (Kibaha, Korogwe, Lindi, Babati, Njombe and Mpanda). At the District level, there is the District Commissioner (DC) as the principal assistant to the Regional Commissioner at that level and the District Administrative Secretary (DAS) as the head of the Civil Service.

Local government authorities are primarily divided into two major groups: (i) District Authorities, which include district councils, township authorities, ward development committees (WDCs), village councils (VCs) and vitongoji (or hamlets); and (ii) Urban authorities, which consist of city councils, municipal councils, town councils, WDCs and mitaa. Under Local Government Laws, local government authorities have been assigned wide-ranging functions. These include promoting social welfare and economic well-being; furthering rural and urban

social economic development; controlling and improving agriculture, trade, commerce and industry; enhancing health, education and the social, cultural and recreational life of their inhabitants; and developing, mobilizing and applying productive forces in the war on poverty, disease and ignorance.

The ongoing Local Government Reforms have resulted in new relations between the Regions and the LGAs, whereby the former now have been charged with the role of policy interpretation, advice, coordination, monitoring, enforcement and creation of an enabling environment for the LGAs to discharge their duties. In other words, Regions are more of facilitators rather than providers.

The GoT has been working since the late 90s to empower the LGAs through promotion of fiscal decentralization, legal harmonization, and human resources autonomy. This effort is called Decentralization by Devolution (D by D). The overall purpose of D by D is to achieve devolution of Government role and functions, and to that end transform LGAs into competent strategic leaders and coordinators of socio-economic development, accountable and transparent service delivery and poverty reduction interventions in their areas of jurisdiction.

The Local Government Reform Programme (LGRP) is an attempt to accelerate D by D. LGRP I (implemented during the period 2000-2008) has been followed by a second phase LGRP II (covering the years 2008-2013). The objective of the programme is to bolster each LGA's capacity to be a strategic leader and coordinator of local socio-economic development and to ensure accountable and transparent services to people for the betterment of their lives.¹⁹ Accordingly, LGAs have become responsible for basic social services in their areas of jurisdiction, such as primary education, healthcare, agricultural extension, village water supply and sewerage, and the construction and maintenance of local roads.

To date, the LGRP has achieved, among other things, an increased awareness of local government reform, enhanced capacities of local authorities and more people's participation in local development. However, more effort is required fully to achieve the reform objectives. While the strategy for D by D is in place and supported at the highest level by the government, it is not adequately embedded across Ministries, Departments and Agencies (MDAs) and LGAs. The legislative framework is not yet D by D compliant and there is a need for further effective devolution of fiscal resources and human resource management.

The primary focus of LGRP II (D by D) will be to further strengthen the LGAs so that they can seize the opportunities of the more enabling institutional and organizational environment to make a difference to socio-economic development, public service delivery and poverty reduction in their areas of jurisdiction. In addition, the Programme will shift strategic attention to ensuring that the higher level LGAs enable and support lower level LGAs and communities to participate more effectively in development initiatives.

The strategic objectives of the LGRP II (D by D) are to:

- Eliminate the policy, institutional, legal, organizational and operational bottlenecks for the realisation of D by D policy at all levels of government;

¹⁹ PMO-RALG website can be accessed at http://www.pmoralaGA.go.tz/projects/view_projects.php?intItemID=2 .

- Build LGA capacity to be efficient and effective organisations as the primary, inclusive and accountable lead actors in the planning, implementation and delivery of basic social services, socio-economic development and poverty reduction interventions in their areas of jurisdiction; and
- Enhance the participation and demand for accountability and integrity by citizens for efficient and effective use of public resources, delivery of public services and poverty reduction.

Therefore, the core accountability of LGAs has been established in delivering basic social services and facilitation of local economic development.

The Tanzanian government also explicitly recognizes the essential role of the private sector in delivering on economic growth and infrastructure, as well as the government’s role as a facilitator in mobilizing the private sector by creating business-enabling environments and mobilizing the private sector for investment in infrastructure. For example, the 2025 Tanzania Development Vision states “*Investment in infrastructure must be spearheaded by the government. This investment must also involve the private sector and communities generally.*”²⁰In fact, the Vision states that “*the role of the State must be to ensure a legal and regulatory framework is in place and functioning, undertake directly and encourage other actors to undertake investments in infrastructure development, and undertake directly and encourage others to invest in education and training.*” The Vision also recognizes that the rule of law and governance is critical, promoting a “*culture of accountability.*”

1.3.2 Local Economic Development in Tanzania

Tanzania’s Decentralization by Devolution fits well with an economic development approach that has come to be known as “*local economic development*” (LED), which is being actively pursued in many countries around the world and Africa. The basics of LED are well described by the Local Economic Development Network of Africa (LEDNA):²¹

LED aims to enhance peoples’ economic opportunities and quality of life through a process in which public, private and civil society actors work collectively towards improving the competitiveness and employment prospects of a defined territory.

The approach developed as a result of dissatisfaction with the results of top down, supply side, economic development policies in generating economic growth that is equitable and sustainable. Such policies have often achieved considerable success in increasing economic growth but their results are usually disappointing in terms of dealing with stubborn inequality trends between people and between places.

²⁰ The Tanzania Development Vision 2025, Planning Commission, The Republic of Tanzania, pages 20-21. <http://logintanzania.net/docs/vision2025.pdf>

²¹ Local Economic Development Network of Africa (LEDNA) website at <http://ledna.org/info/led-introduction>

This is because top down policies cannot by themselves ensure that investment flows into more labour intensive productive activities or into the poorest regions. This is particularly the case in African countries where the poorest regions suffer from major constraints in levels of infrastructure, finance, technology and human skills, discouraging potential domestic and foreign investment.

LED is an innovative bottom up approach to generating economic growth that is equitable and sustainable through unleashing the economic potentials of every territory. LED is based on the concept that every territory has comparative advantages whose potential can be enhanced if actions are taken to tackle the bottlenecks currently inhibiting their success.

These actions need to be taken through a partnership between local governments, private sector actors, national ministries, public sector agencies, and non-governmental organizations who all contribute in different ways to the promotion of LED.

LED therefore:

- *Focuses on a specific geographical area*
- *Is based on a partnership between the public, private and civil society sectors*
- *Is based on market principles and promotes international competitiveness*
- *Is based on promoting productive sectors and value chains in which the area has or could have comparative advantages*
- *Is based on making comprehensive investments which tackle the obstacles facing priority productive sectors or value chain*

Tanzania does not have an explicit national policy framework dedicated to promoting LED, even though its principles are implicitly recognized in its stated development objectives. Moreover, Tanzania has established a highly favorable macro-economic and policy framework that opens the way for pursuit of LED. In addition, government and development partners have launched a number of initiatives that provide a supportive context for LED.²²

1.3.3 UNCDF Local Economic Development Programs in Tanzania

UNCDF contributes to the achievement of the Millennium Development Goals in the least developed countries through a variety of innovative approaches in both local development and microfinance. The organization offers a unique combination of investment capital, capacity building, and policy and technical advisory services. UNCDF's local development programmes support national decentralization strategies and seek to improve social services, governance, and pro-poor infrastructure at the local level by providing technical assistance and investment capital directly to local authorities. UNCDF's microfinance programmes provide poor households and enterprises with enhanced access to a wide range of financial services by promoting inclusive financial sectors and providing investment capital for financial institutions. UNCDF currently

²² UNCDF, *The State of Local Economic Development in Selected Southern-East African Countries*, UNCDF 2011.

invests in 39 LDCs with a total programme portfolio amounting to approximately US\$200 million.

UNCDF has been a pioneer in helping local governments develop their capabilities to undertake pro-poor local economic development (“LED”). This approach emphasizes the importance and leadership of local authorities in playing a positive role in the economic development of their localities. Local governments’ role includes creating an enabling environment for business at the local level and making investments that unlock the potential of key productive sectors. Due to its many years of experience with local authorities, UNCDF is uniquely positioned to make a positive contribution in this important area.

UNCDF’s LED approach has a particularly good fit with the Government of Tanzania’s strategy for economic development and its programme of Decentralization by Devolution. In Tanzania UNCDF’s approach is to invest with the poor – strengthening and reinforcing the productive capacity and self-reliance of poor communities by increasing their access to essential local infrastructure and services. UNCDF works to strengthen these communities’ influence over economic and social investments that directly affect their lives and livelihoods.²³

Between 1997 and 2003, UNCDF, in partnership with UNDP, the Norwegian Agency for Development Cooperation (NORAD) and the Government implemented two programs: Support to Decentralization Programme (SDP) in Mwanza Region and Support to Good Local Governance Programme, in support of the Government’s decentralization efforts. Through these two programs, UNCDF and UNDP contributed to supporting government efforts to establish the necessary technical and financial means to effectively decentralize its planning and financing functions to the lowest levels of local government and supporting the development of an active local private sector. The two programmes were implemented in all six districts of Mwanza region, namely Ukerewe, Geita, Magu, Sengerema, Misungwi, and Kwimba. The lessons learned from these programs and similar programs supported by UNCDF in Uganda are key to the current formula and performance-based Local Government Development Grants system.

In line with the government’s Joint Assistance Strategy (JAST) and in response to the National Strategy for Growth and Poverty Reduction, in 2006 the government in partnership with UNCDF and UNDP developed a five-year second-generation program, Support to Local Economy in Mwanza (SLEM) that uses the Local Economic Development approach. The SLEM is an integral part of the Local Government Reform.

The overall goal of the SLEM programme was to reduce poverty in the Mwanza region. The programme focused on working with two rural districts, Sengerema and Misungwi. The programme aimed at strengthening and promoting an enabling environment for sustainable, equitable poverty reduction and pro-poor economic development and growth. During the last four years, with the leadership of the two councils, the programme has been pioneering an innovative approach to pro-poor local economic development that stresses partnerships between local governments, the private sector and community groups to come together to mobilize and manage local and accessible resources to unleash local entrepreneurship and stimulate the local economy.

²³ See UNCDF website for Tanzania at http://www.tz.undp.org/who_uncdf.html

The programme has generated many useful lessons and experiences and has confirmed that the leadership of LGAs can be meaningful and efficient only if it actively promotes the full participation of all local public and private stakeholders in managing economic activities, and if it actively creates a sound investment climate as a core component of sustainable development. Through SLEM, the two districts have each managed to: (i) establish and run the District Forum for Local Economy Stakeholders which ensures the poor are enabled to voice their interest, prospective resources and needs; (ii) construct and run Business Development Centres that provide a variety of services including Internet, training, extension, marketing, information, etc; (iii) enter a partnership with a local reputable Microfinance institution to run a credit scheme; and (iv) enable two districts through institutional mapping, value chain analysis and economic appraisal to understand the structures of their economies, identify their comparative advantages, and make informed decisions. The programme has come to an end (December 2010) and now is in the process of being closed.

Another key LED programme in which Tanzania is participating is Gender Equitable Local Development (GELD). GELD is a regional UN joint programme that aims to ensure equitable local economic development that takes into consideration the needs and interests of disadvantaged sections of the population and places particular emphasis on women. The Programme intends to identify strategies and mechanisms for improving women's access to resources and services at the local level, through gender-sensitive planning, programming and budgeting. The programme is implemented by UNCDF and UNIFEM and is built on UNIFEM's work in the area of local level-responsive planning, budgeting and monitoring and UNCDF's technical assistance to local authorities in LDCs. The programme also builds on the expertise of UNDP and UN-HABITAT with regard to decentralization and local governance. These agencies have consolidated their experience in supporting performance-based responsive planning and budgeting for local development for the effective achievement of the goals of this programme.

The programme was launched in December 2009 and is in the initial stages of implementation. It is being introduced in Tanzania and five other African countries.

1.3.4 Lessons Learned

There are a number of major efforts currently underway to increase funding for infrastructure projects in Africa. However, most of these focus on large traditional infrastructure projects—major roads and ports, national power production and distribution systems, urban water and sewer systems, and telecommunications. But the relatively small infrastructure projects that local governments have begun to identify though their LED efforts have received much less attention and financial support. This is a problem that UNCDF has recently begun to address with its Global Local Economic Development Finance Initiative (Global LFI).

Based on the experience of UNCDF's previous work in Tanzania, key reasons contributing to inadequate domestic financing of LED would appear to be the following:

- LED is a complex undertaking requiring time and national and international partnerships. Delivering economic development to a locality or region is complex, as it is

subject to influences well beyond the control of local, regional or national governments. Equally, the timeframe for seeing results is closer to a business cycle (12-15 years) than to the electoral cycle (3-4 years). As a result, local development is more likely to succeed if it is treated as a long-term partnership between public, private, and institutional sectors, both nationally and internationally. Further, the national and local private sector acts as the more stable foundation for pushing LED, with greater continuity that can serve as the engine for LED, ensuring broad-scale development impact and sustainability.

- Bankable projects are the starting point for unblocking domestic finance. The most critical bottleneck to accessing finance is the lack of bankable projects. Finance is not available because requests for finance tend to be just “concepts” or “wish lists,” lacking business plans, feasibility studies, market assessments, engineering and legal inputs, etc. The skills and capital required for developing bankable projects and businesses are frequently lacking in developing countries. Often the large equity investment requirements imposed by commercial lenders and high costs of accessing legal and financial advice to structure projects and business deals make it almost impossible for small investors to develop projects. Targeted donor intervention can be the fulcrum for jumpstarting the development of projects and mitigating the risks that impede their bankability.

- Risk perception of lenders must be addressed. The perception of risk is another critical bottleneck preventing small-to-medium sized infrastructure projects and businesses from accessing private capital from banks and institutional investors, such as pension funds and insurance companies in developing countries. Local financial institutions often have less expertise in evaluating the technical and market risks of non-recourse project financings. This distortion of risk sometimes causes lenders to deny financing to potentially viable projects. Therefore, local banks need to be inducted into the development and financing of the LED projects, through targeted credit enhancements supplemented with overall training, so they can assume their inherent role as leaders of the country’s LED finance.

- Performance monitoring must be instituted to ensure release of domestic funds. Developing country governments often do not have adequate systems in place to identify key operational problems and investment impediments reported by the private sector and/or that measure the responsiveness of the government in addressing such issues. Neither are there typically systems in place to measure accomplishments and the development impact of development finance transactions that result in the mobilization of private capital. The absence of government consultation networks with the private sector and performance indicators usually results in diminished capacity to identify problems and hinders the ability to mobilize support for improvements. The development of such consultation networks and metrics through LFI-Twill provide needed visibility and momentum, enhancing donor effectiveness and capturing lessons learned.

- Information exchange and coordination between LED stakeholders and participants of financial markets must be improved, with a systematic training programme that includes a roadmap with roles of all parties, knowledge resources, and management systems. Sustainable capacity development cannot occur without access to information, tools, and lessons learned. There are three levels on which coordination and communication often fail: between LED stakeholders, between LED stakeholders and domestic financial institutions, and between national and international stakeholders. Government officials know of the need for infrastructure

projects, but lack the knowledge of what projects might be viable, how to structure them, and which yield the greatest development impact. They also lack knowledge as to the technical requirements of project development finance, the available resources, and information about investment impediments hurting the LED business-enabling environment. The private sector, including banks, while interested in developing infrastructure projects, often does not know of the ways the government and the donor community can work with it to structure projects that have an acceptable risk and reward profile. In a world with asymmetric information, banks are more likely to lend to larger firms and projects, which typically are better prepared, more transparent, use international accounting standards and whose risks are better understood - or at least familiar.

Building communication venues between the public and private sectors, complete with enabling-knowledge resources, empowers champions from the public and private sectors to take effective action to correct these information asymmetries. Thus, availability of tools and systems to improve information exchange and facilitate coordination at all levels is a critical condition for releasing domestic finance.

2. Programme Strategy

2.1 UN Development Assistance Plan for 2011-2015

The Tanzania Local Economic Development Finance Initiative (LFI-T) will be an integral part of the United Nations Development Assistance Plan (UNDAP) for 2011-2015.

UNDAP is the business plan of 20 UN agencies, funds and programmes in Tanzania for the period July 2011 to June 2015.²⁴ This ‘One plan’ for Tanzania supports the achievement of the international development goals, the Millennium Declaration and related Millennium Development Goals (MDGs), and national development priorities which are consistent with the MDGs. The UNDAP is a single, coherent business plan for all UN funds, programmes and agencies in Tanzania, in which each is responsible for delivery on a set of key actions that jointly contribute to shared results. UNDAP enhances national ownership and UN accountability by articulating the precise UN contribution to the national priorities outlined in the national poverty reduction strategies.²⁵ The UNDAP responds to the UN mandate and mission in Tanzania in ensuring inclusiveness of all state and non-state actors in the development of the country.

UN programme interventions in the UNDAP are strategic, focused and interlinked with the aim of delivering a more coherent, convergent and dynamic country programme of UN support. The four-year UN country programme for Tanzania has a total budget of US\$777 million. The programme focuses on strengthening the country’s enabling environment for the fulfillment of human rights and pro-poor growth, building national capacity to deliver basic services, while increasing coverage and quality. UNDAP strengthens and builds national capacities of state and non-state actors in policy and programme implementation, budgeting and strategic financial allocation, monitoring, evaluation and resource mobilisation.

The UNDAP is organized around three clusters of activity in line with the GoT’s national strategy. In Cluster 1, UNDAP proposes support for capacity development aimed at strengthening the key drivers of inclusive pro-poor economic growth (US\$180million, 23 percent of UNDAP total programme budget). Cluster 2 targets enhancements of sector partner capacities in education, health, HIV and AIDS, WASH and social protection for sustained and rapid achievement of the MDGs (US\$323million, 42 percent of UNDAP total programme budget). Cluster 3 addresses the enabling environment for development – effective and democratic governance and delivery of public services (US\$270million, 35 percent of UNDAP total programme budget).

UNDAP outcomes focus on strengthening the country’s enabling environment, building national capacity to deliver basic services and effectively deliver pro-poor growth and humanitarian assistance. To these ends, UNDAP focuses primarily on an implementing partners’ capacity

²⁴ United Nations Development Assistance Plan (UNDAP) July 2011-June 2015, United Republic of Tanzania, United Nations Steering Committee, December 2010.

²⁵ National Strategy for Growth and Reduction of Poverty (NSGRP) II, Ministry of Finance and Economic Affairs, 2010. In Tanzania, this document is known as “MKUKUTA II.”

development. However, a small number of key actions (accounting to almost a third of the programme budget) are directed to service delivery, mostly for piloting projects that can be up-scaled in the future.

The GoT faces significant capacity challenges in managing development and achieving the MDGs. Monitoring and reporting on the implementation of poverty reduction strategies require continued improvement, while the coordination of implementation, evidence-based planning and budgeting needs strengthening. Aid management, including the dialogue structure with stakeholders, still poses a significant challenge.

International financial institutions and bilateral donors are directly financing large-scale development projects or providing General Budget Support (GBS) to Tanzania. The UN's comparative advantage lies in its ability to enable national stakeholders, through technical assistance and knowledge sharing, to better manage the economy, promote economic equity, and spur productivity and job creation. These attributes in the economy can make major inroads in reducing income poverty.

Included in the UNDAF are interventions at the sub-national level, where economic actors will be provided support services to improve their productivity, particularly in those sectors such as agriculture, manufacturing and the services sectors where more livelihood opportunities exist for low-income households. The plan encompasses interventions to strengthen value along the supply chain, particularly for smaller off-farm enterprises. Alongside this, technical assistance targets support structures and institutions for promoting public-private partnerships so that they can play a better role in providing services to small and medium enterprises and job seekers.

Thus the UNDAF supports national and sub-national initiatives that provide support to enterprise creation and enhance productivity in agriculture and agro-industries including sustainable access to markets that will enable more producer households and small businesses to enter the economic mainstream and broaden the base of economic participation.

2.2 LFI-T and the UNDAF

The LFI-T Programme addresses the UNDAF focus on economic growth (Cluster 1) and on governance and the delivery of public services (Cluster 3). UNCDF has been assigned specific roles in each area, in Cluster 1, in the area of micro-finance and local economic development and in Cluster 3, in the area of financing to advance local economic development (LGA financing).

The experience of implementation of the Support to Local Economy in Mwanza revealed that improvement of local basic and economic infrastructure is the key for promotion of local economic development, improved social-economic service delivery and growth. Unfortunately, local government sources of financing are limited, as they depend on central government grants and own sources. Deepening fiscal decentralization--in particular widening the sources of funds that can be available to finance local infrastructure--is also one of the GoT's key priorities as incorporated in the approved Local Government Reform Programme II (Decentralization by Devolution) Vision, Goals and Strategy, July 2009-June 2014:

Outcome 1: An enabling institutional and political environment framework to empower LGAs.

Output 3.5: Assessment of alternative financing instruments by 2012. Pilot of the financing instruments by 2014.

And Sub-component Three of the D by D Programme (Fiscal Decentralization) is:

Strategic Initiative 5.To diversify LGA financing through innovative instruments (loans, bonds, PPP).

Through UNDAF 2011-2015, UNCDF is planning to support the government to develop and implement a pilot programme for developing alternative sources of financing for selected bankable infrastructure projects expected to yield local economic benefits and provide capacity-building interventions that enable national up-scaling.²⁶ Therefore the LFI-T Programme is designed to provide a substitute for direct financing of LGAs by funding infrastructure projects directly (i.e., the programme does not provide direct financing for LGAs but helps them respond to critical infrastructure needs in their localities).

2.3 Programme Rationale

In its ongoing work with local governments in low-income developing countries, the United Nations Capital Development Fund (“UNCDF”) has found that infrastructure bottlenecks are a key barrier to local economic development. The lack of key basic traditional infrastructure (such as irrigation systems, local power systems, roads, etc.), industrial infrastructure (such as markets, warehouses, food processing facilities, etc), and social infrastructure (such as health clinics and primary schools) often frustrates even the best local government efforts to stimulate private sector development. Unfortunately, in many low-income countries neither the central nor local governments have the funds needed to meet more than a fraction of these basic infrastructure needs. While development partners and development finance institutions can help, they can only fill a small portion of the financing gap.

In 2009 UNCDF undertook an Environmental Scan for Tanzania -- a preliminary investigation of the key opportunities and challenges associated with financing of such local infrastructure. The scan showed that there were several positive factors in Tanzania that work in favor of being able to access market financing for local infrastructure projects: decentralized authority for project finance; local eagerness to find financing for essential infrastructure; income-generating projects; local capacity readiness; possible user fee levies; potential of central government support; potential mortgage-able asset securitization; commercial bank willingness to lend; and local demand for long-term local currency assets.²⁷

²⁶ UNCDF and the GoT are also planning (as part of the UNDAF 2011-2015) to promote LED through Strengthening Capacity of Planning Commission/PMO-RALGA. This programme, which builds on the lessons from the Mwanza SLEM programme, is designed to strengthen the government’s capabilities in analyzing LED policies and providing assistance in clearly defining mandates, functional assignments and coordination between centre and local governments.

²⁷ See Tanzania Report prepared by GlobalDF (a nonprofit activity of Samuels Associates): <http://www.uncdf.org/gfld/docs/infradev.pdf>

- Decentralized Authority for Project Finance: Based on conversations with national and local government officials, it appears that the GoT is willing, and perhaps, even eager, for local governments and other project sponsors in the private sector to obtain funding for infrastructure investments from the markets without the support of government guarantees. As noted in the introduction, the Government of Tanzania is also encouraging the private sector to sponsor infrastructure projects and has recently launched a Public Private Partnership (PPP) programme. The government officials interviewed in the mission see the LFI-T Programme as an opportunity to mobilize private sector funds to finance needed infrastructure projects.

- LGA Eagerness to Find Funding for Infrastructure: Local governments are eager to find ways to finance critical local infrastructure, including working with private sector or public sector project sponsors. Local government representatives interviewed during the mission said that the lack of adequate infrastructure is the primary roadblock they face in their efforts to promote local economic development. They believe that their current sources of infrastructure financing -- grants and other transfers from the central government and own-source revenues -- are inadequate to meet the financing needs.

- Availability of Income-Generating Projects: Given pent-up demand and the current low level of local government infrastructure investment, it is to be expected that there are many infrastructure projects that could generate sufficient income to justify long term borrowing, even at relatively high interest rates. The LGAs are confident that there are many unfunded projects that would have sufficiently high rates of return to warrant borrowing from such indigenous sources of hard-credit financing as banks, pension funds and capital markets. Experience from other countries suggests that when infrastructure bottlenecks are broken by well-planned and executed projects, the return on investments in such assets is relatively high.²⁸ This should be especially true in a country such as Tanzania, which is politically stable and has a relatively high level of literacy and a market-based economy.

- Local Capacity Readiness: Local Stakeholders, including LGA officials, farmer associations and private project sponsors, appear to be developing the capabilities needed to identify potential infrastructure projects that can advance local economic development and to help create a local business-enabling environment critical to the success of the LED projects. The low levels of capital expenditure by LGAs suggest that they do not have much experience in structuring or financing long-term investment projects. And the historic lack of previous borrowing suggests that they have even less experience in developing projects that are marketable and capable of attracting private finance. But there has been considerable effort in recent years to train LGA staff so that they can manage the many functions being passed down to them as part of the decentralization process, including the identification of possible LED projects and responsiveness to local business needs. LGA staffs can help to facilitate the identification of project sponsors and define how projects can contribute to LED. Further there are many training programs building the skills of farmer associations and private sector companies, and building linkages to larger companies. Thus, there is at least a basic level of business and financial knowledge with market outreach to build upon.

- Possible User Fee Levies: Some infrastructure projects will be able to market goods and services sufficient to generate the income needed to support and finance the project. But in other

²⁸ IMF, **Creating Sustainable Fiscal Space for Infrastructure: The Case of Tanzania**, 2008.

cases, revenue is best generated through user fees levied by a local government.²⁹ In Tanzania, LGAs, as well as private stakeholders or associations, can levy and collect user fees for infrastructure services to provide the income needed for operations, maintenance and debt service. LGAs can also outsource the collection of such fees.³⁰

- Potential of Central Government Support: As the GoT is eager for LGAs and private project sponsors to develop their capacities for supplying local public services and supporting local economic development, they have expressed their strong support for the proposed approach to financing essential industrial, traditional, and social infrastructure. Such support will likely be even more forthcoming if the projects chosen fit into the various development plans and strategies that have been prepared by the national government.

- Many of the infrastructure projects would create potentially mortgage-able assets that could help to secure funding: In countries with solid legal systems, loans secured by mortgages carry much lower risk -- and hence require lower interest rate premiums -- than those without. In countries with less solid or untested legal systems, such as Tanzania, the benefit of mortgage-able assets is less -- but still significant. As many of the local infrastructure projects will create tangible assets, this could make it easier to obtain loans and lower their cost.

- Commercial Bank Willingness to Lend: Several commercial banks in Tanzania, particularly those that have extensive networks of local branches throughout the country or have a developmental focus, are interested in exploring the market for lending to infrastructure projects. If banks lend to projects, they will likely seek additional security (such as mortgages) and use very conservative cash flow-based underwriting techniques. This is particularly true for loans made with limited or no government guarantees. Initially, tenors will be shorter and interest rates higher than ideal, but as banks gain experience — and if this experience is good — their credit terms should improve over time.

- Demand for Long-Term Local Currency Assets: Tanzanian pension funds and insurance companies need long-term local currency investments that provide a higher return than government securities or bank deposits. Thus they have an interest in investing in relatively safe securitizations of pooled projects. The mismatch of assets and liabilities that makes long-term lending so difficult for banks is usually not a problem for institutional investors, such as pension funds and many insurance companies. Thus these investors are often key sources of infrastructure funding in countries with highly developed capital markets. While Tanzania is many years away from having such developed markets, the substantial and growing funds held by Tanzanian institutional investors could become an important source of funding for small infrastructure projects. In the interim, some institutional investors may be willing to join with

²⁹ Local governments are allowed to raise certain revenues from taxes, levies and fees. The procedures for levying and collecting these sources of revenue are dictated by the Urban Authorities (Rating) Act and the Local Government Finances Act. LGAs have discretion to change local tax rates, albeit within centrally established limits. The taxes, levies, fees and revenue sources which local governments are mandated to raise under the Local Government Finances Act are listed in the Act.

³⁰ Studies have indicated that outsourcing usually results in more revenue collected than when collected by LGAs themselves. Some of the benefits of outsourcing include the following: it is often more cost effective than using LGA staff; there is less day-to-day political interference; and it produces more predictable revenue flows. However, measures are needed to prevent corruption and ensure that the agents' profit margins are not excessive. When properly managed and monitored, outsourced revenue collection may help ensure the reliability and timeliness needed if the revenues are earmarked for debt servicing.

banks in funding pools of projects or other credit enhancement structures, without going through the process of securitizing the loans.³¹

2.4 Programme Design

2.4.1 Programme Strategy and Approach

The overall *goal of the programme* is to release additional domestic capital for Tanzania inclusive LED executing demonstration projects coupled with targeted capacity-building interventions.

To achieve this goal, the programme will focus on addressing the widely acknowledged problem of blocked domestic financial sectors, resulting in a suboptimal allocation of funds to productive uses critical to development. As a result, social resources are used at a sub-optimal level, resulting in diminished total social benefits. In essence, the project strategy consists of bringing the supply and demand to an optimal level by reducing perceived risks and transaction costs of financial services for all LED stakeholders and participants of the finance market. The approach will be systematic and technical in nature, focused on jump-starting the process of mobilizing domestic private sector financial resources in both commercial banks and institutional investors through the selective targeted use of public resources.

The supply side is represented by domestic financial institutions and the demand side is represented by LED project developers which may include private businesses as well as local governments and the non-government sector. Since LED project developers, particularly those dealing with small and medium-scale infrastructure, are unsure about their ability to formulate financially sound and viable projects, the demand for financial services is relatively low. Since domestic providers of financial services are unconvinced about the ability of loan-takers to repay, the costs of providing financial services are high, and supply of such services remains limited.

For the purposes of strategy formulation, the programme distinguishes four major institutional groups engaged in LED:

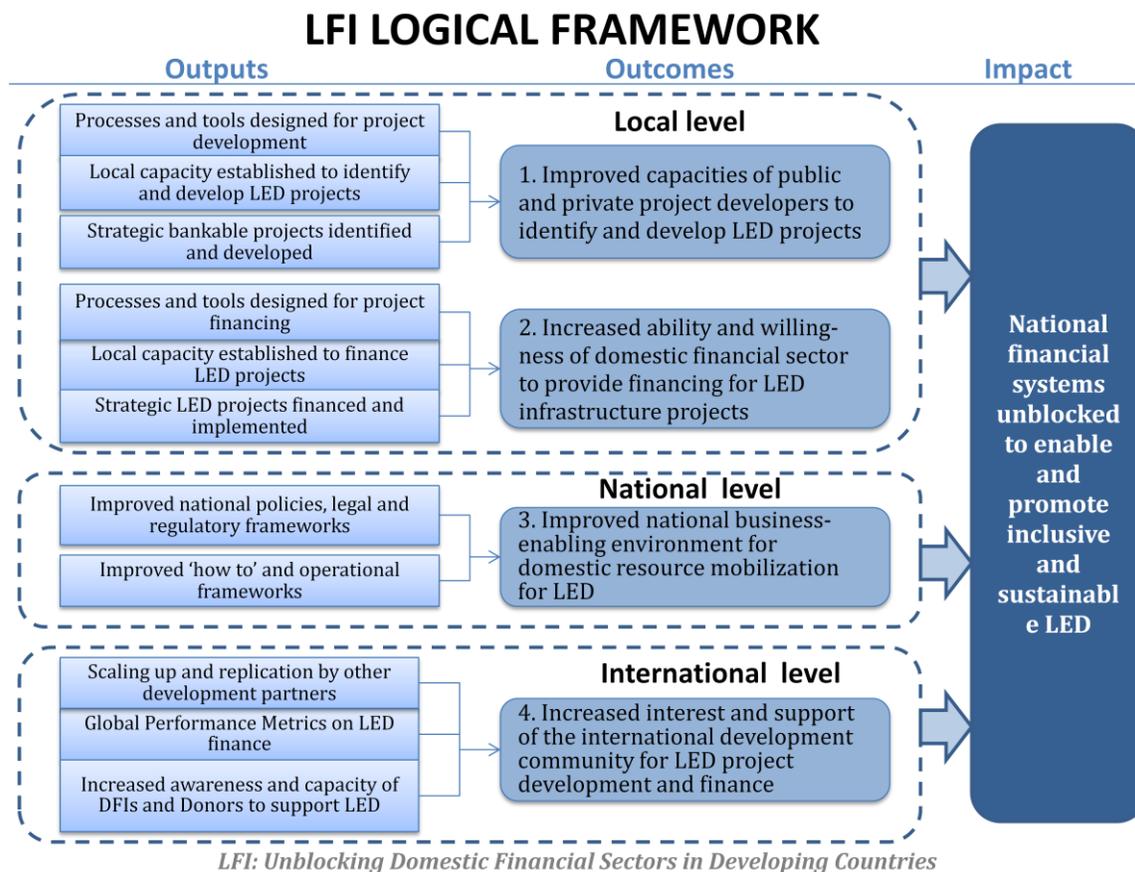
- **LED project developers:** Private businesses, local governments, domestic non-government sector. This includes farmers and SMEs suffering today from a lack of basic industrial infrastructure,

³¹ Pension funds in Tanzania provide a significant potential source of finance for infrastructure. The National Social Security Fund, the country's largest with 450,000 members, had Tsh 807.5 billion in assets (US\$ 534.7 million) in May 2011. There are additional assets in the smaller funds such as the Public Service Pension Fund (198,000 members) and the Parastatal Pension Fund (78,000 members). These pension fund assets are growing rapidly given the relatively youth of the enrollees. A comparable pool of assets is held by insurance companies in Tanzania. However, today the funds are not investing in infrastructure projects; rather, institutional investors have tended to over-concentrate their investments in low return government debt and bank deposits. Institutional investors do not have the underwriting capabilities or relationships with borrowers that banks do. And they are normally required to invest most of their funds in very safe (or highly rated) securities. Both factors work against their lending directly to infrastructure projects. Using pooling or other credit enhancement structures as an intermediate step may reduce the risk sufficiently to make it possible for pension funds to invest, especially if the pools can be structured and tranced so that the institutional investors can purchase the least risky tranches.

such as warehouses, processing plants, cold storage facilities, and traditional infrastructure services (irrigation, energy, transport, etc.).

- **Domestic financial sector and related services:** Commercial banks, institutional investors, such as pension funds, as well as service providers such as public and private credit bureaus, consulting and accounting firms, lawyers and others that are needed to building internal capacity for developing and financing infrastructure projects.
- **National and local governments:** Ministries and agencies defining development and financial policies and regulatory and operational frameworks, such as ministries of local government, finance, investment promotion, investment, trade and commerce, government regulators and others.
- **International development community:** UN family and Bretton Woods institutions, bilateral development partners, multilateral development agencies and international non-government organizations which provide invaluable technical assistance at the local level.

The LFI-T Programme thus aims to improve the ability and willingness of the stakeholders to use domestic finance for LED and create enabling national and international environments for sustained participation of the domestic Tanzania financial sector in LED.



2.4.2 The Innovative Nature of the LFI-T Programme

The LFI-T Programme is innovative by employing proven techniques in finance at the local level in new ways, concurrently with learn-by-doing training programs and enabling tools providing enabling-information and public-private consultation with issue tracking.

First, to unblock sources of local private finance, the Programme applies proven financial techniques such as nonrecourse finance³² to fund infrastructure projects, thus overcoming a gap that blocks local economic development, impeding the ability of local stakeholders (such as farmers and MSMEs), to access markets and improve their livelihoods. This approach also integrates the best practices of the development community in using the existing credit enhancement products such as partial guarantees and first loss facilities, combined with technical assistance in project development. The end result is increased aid effectiveness, leveraging limited official sector resources by mobilizing the private sector to finance projects critical to advancing local economic development.

Second, the LFI-T Programme employs practical mechanisms to scale up development finance in Tanzania nationwide, combining the use of targeted capital and credit enhancement with “learn by doing” capacity building interventions. These interventions are necessarily targeted at increasing the capacity of both the government and the private sector to develop and finance infrastructure projects. By engaging the government (local and national) with project sponsors and providers of finance in these demonstration projects, there is a demonstration effect that can be replicated nationwide. To enable replication, the programme employs cost-effective tools to disseminate success stories, enabling-information, and consultation outreach tools to empower government officials and private sector participants. Performance metrics are used to create momentum and facilitate the identification of success stories and major impediments, which enables scaling up.

This innovative LFI-T Programme approach will be executed through four programmatic components: a) project development activities that enable the identification and development of up to 15 demonstration projects to create “proof of concept” financing models that facilitate access to the domestic financial sector for investments in strategic, smaller scale infrastructure projects; b) finance and credit enhancement facilities to enable jumpstarting the process of project identification, development and deal/financing structuring (i.e., “LFI-T Fund” and other credit enhancement structures); c) capacity building activities that provide for the training of public and private stakeholders and increased government capacity to facilitate finance, project development, and business-enabling environments (using modern on-line tools to enable national scaling up, identification of impediments and possible remedies, and tracking accountability); and d) performance tracking activities that provide a foundation for benchmarking the dissemination and incentive the replication of all programme components.

³² Non-recourse debt or a non-recourse loan is a secured loan (debt) that is secured by a pledge of collateral, typically real property, but for which the borrower is not personally liable. If the borrower defaults, the lender/issuer can seize the collateral, but the lender's recovery is limited to the collateral. If the property is insufficient to cover the outstanding loan balance (for example, if real estate prices have dropped), the difference between the value of the collateral and the loan value becomes a loss for the lender.

Given the high-level of financial expertise, project development experience, and related capacity-building competencies that are required for delivering all four LFI-T Programme components and expected outcomes, the Programme staffing will need to include senior experienced finance experts to guide all programme activities.

2.4.3 The Financing Approach: Leveraging Limited Official Funds

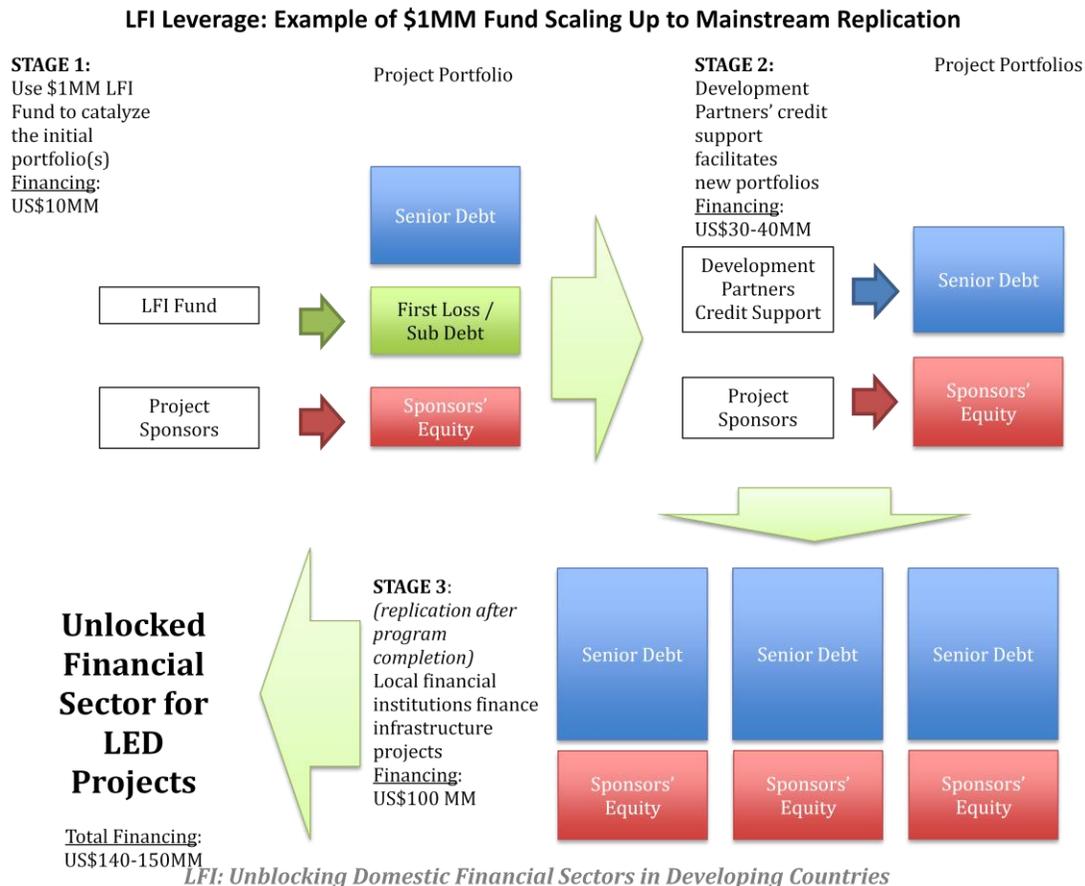
The LFI-T financing approach is designed to create financial structures and processes that leverage limited public sector funding. Today more than ever, public sector funding is limited and aid effectiveness is paramount. LFI-T is aimed at leveraging limited public sector funding, building in-country capacity to access long-term private sector financing. With private sector savings pools in the form of bank accounts, pension funds, insurance and other financial products growing in virtually all of the emerging markets countries, the opportunities to marshal these resources for the collective benefit of all are developing apace.³³

The targeted amount of private sector finance to be mobilized directly by the LFI-T Programme in the first stage using the LFI-T Fund is US\$10 million, with greater private finance mobilized in the second stage through additional credit enhancement (US\$30-40 million), leveraging up to ten times the project cost.

After the programme is completed in 2015 (Stage 3), leverage is likely to reach 30 times the cost of the program. The new financing approaches, if successful, are likely to be replicated in the marketplace. Domestic banks and institutional investors will have gained sufficient experience with financing small and medium infrastructure projects that these institutions are now comfortable doing so without third-party credit support. With an estimated US\$100 million in additional projects finance without third-party credit support, the total infrastructure financing resulting from the LFI-T Programme is likely to be in the range of US\$140 million – US\$150 million.

³³ For more background on ways to leverage official sector funding, see the World Economic Forum Report directed by the GlobalDF Executive Director, Dr. Barbara Samuels: “The Untapped Potential for Development Finance Institutions to Catalyse Private Investment,” <http://www.weforum.org/PDF/FINANCING/MONTEYRY.PDF>

LFI-T Leverage: Example of US \$1MM Fund Scaling Up to Mainstream Replication



The above diagram is based on the following assumptions:

(1) In Stage 1, the LFI-T Fund is used to provide first loss credit support to one or, perhaps two, Project Portfolios with a value of US\$10 million to US\$12.5 million per portfolio (or through other credit enhancement structures);

(2) In Stage 2, Development Partners provide credit support totaling US\$20 million, which facilitates the financing of three or four additional Project Portfolios (or one-off projects) with a total value of US\$30-40 million; and

After programme completion (Stage 3), there is replication of the proof of concept: Domestic banks and institutional investors have gained sufficient experience with financing small and medium infrastructure projects that these institutions are now comfortable doing so with limited or without third-party credit support.

Therefore, as noted in the prior section, the total infrastructure financing resulting from the LFI-T Programme (both direct and independent replication in the market) is estimated to be in the range of US\$140 million – US\$150 million, up to 30 times the programme's cost.

The specific financing approach that will be utilized is based on the development of local infrastructure projects working with project sponsors (private or public sector).³⁴ Financing for the projects would be secured from local commercial banks and institutional investors, with substantial financial and technical support provided by development partners and development finance institutions. This project financing will be on a “nonrecourse” basis -- debt servicing will be dependent solely upon the revenues generated by the projects. Project sponsors, LGAs, and the central government will not assume any responsibility for debt servicing. This type of nonrecourse financing has been used for large infrastructure projects but has rarely been applied to the smaller scale of projects that could be most beneficial for local economic development.

While small projects are difficult and costly to finance individually, there is the potential for pooling a number of projects and obtaining financing for the pool as a whole. The pooling structure makes it easier to attract lenders and helps to spread the transaction costs among a number of borrowers. A pool of loans is also more attractive to lenders because pools spread the risks of debt repayment interruption or default. Pooling a number of project loans therefore diversifies the credit risk for lenders.

The proposed financing model has the following elements:

- A pooled financing facility, or similar credit enhancement financial structure, will be created to finance infrastructure projects, if possible multiple projects, with each lender participating in the pool taking its prorata exposure to each of the projects;
- The target size of the pooled financing facility will be at least US\$10 million;
- The pooled financing facility will have support from one or more development partners which would provide credit enhancements (such as loan guarantees that in the aggregate would equal 50% of the amount of the pooled financing facility, or another risk mitigation feature such as a first-loss facility);
- The pooled financing facility will be structured using a project finance approach, whereby loans made by the facility would be repaid solely from the cash flows generated by individual projects – not from the general financial resources of the project sponsors or local governments;
- Individual projects will be structured using a project finance approach, with certain risks, such as construction cost, technical performance, and environmental compliance, being assured through contractual undertakings by third-parties;
- The pooled financing facility will initially target four – eight projects for the first stage;
- Project sponsors will develop projects with technical assistance provided by UNCDF and development partners, and to the degree possible, from their own resources;

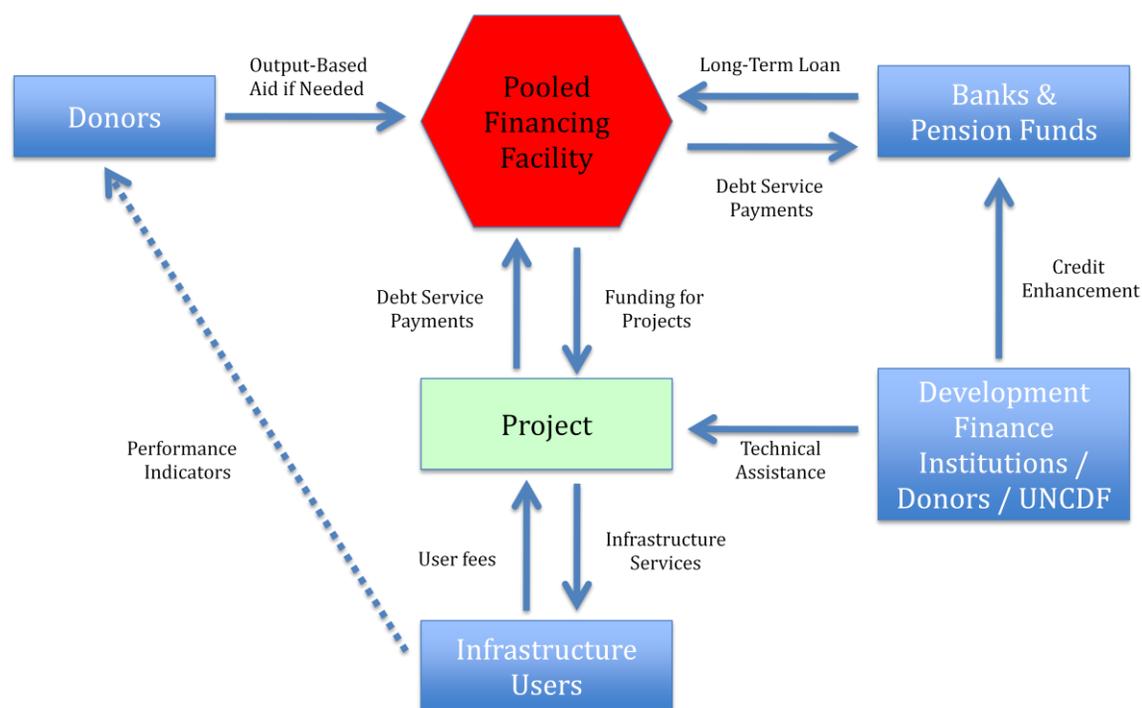
³⁴ Potential project sponsors include international and regional private sector companies, as well as local private sector entities that are engaged in local economic activity and need to build their capacities to manage and deliver industrial infrastructure services (such as SME farmer associations, agricultural middlemen, etc).

- Individual projects are expected to range in size from US\$100,000 to US\$3 million;³⁵
- The pooled financing facility will be managed by a strong local bank (“the Agent Bank”) that would take the principal responsibility for credit analysis of prospective projects (UNCDF will provide the staff of the Agent Bank with appropriate training in project finance if needed);
- The Agent Bank will seek to obtain participation in the pooled financing facility from as many local banks as possible to increase the size of the fund and to enable the participant banks to improve their skills in credit analysis of project financings;
- The LFI-T Technical Team will present potential projects to the Agent Bank for evaluation;
- Projects will be income-generating projects (i.e., projects that can charge user fees for their services or that have the ability to attract output-based aid to supplement the amounts that users are able to pay);
- Projects that are deemed “bankable” (i.e., able to make the payments for the needed level of debt) will be funded by the pooled financing facility, with banks – as a quid pro quo for receiving the 50% loan guarantees or other credit enhancements provided by development partners – committing to provide longer tenor financing than is normal for financing in the domestic market;
- It is expected that a period of one- two years will be required to select and develop an initial portfolio of projects and construct those projects that are chosen; and
- After the initial portfolio of projects has been operating successfully for a couple of years, the portfolio could be sold to pension funds and other institutional investors, thus freeing the banks funds to be redeployed in additional projects.

A diagrammatic representation of this financing structure is provided below. In the diagram, projects would be majority-owned by private sector project sponsors, although a local government authority might have an ownership stake if it contributed cash, land, or services. There also may be public sector sponsors, such as governmental organizations with project development experience.

³⁵ Projects larger than US\$ 3 million may be financed on a standalone basis or included if the pool is large enough to meet required diversification parameters. Also smaller projects than US\$100,000 could be envisaged in exceptional cases.

STRUCTURE OF THE POOLED FINANCING FACILITY



LFI: Unblocking Domestic Financial Sectors in Developing Countries

The above structure illustrates how the projects sponsored by public and private project sponsors are funded by a common pooled facility. The facility will be funded by the domestic debt markets with credit enhancements provided by development partners. The local government authority (e.g., regions and local districts) can play an important role by ensuring that projects advance local economic development, maintaining the needed business-enabling environment needed to maintain their viability, and in some cases by providing land or helping to collect user fees. Development partners can help build capacity through technical assistance, project development support, and credit enhancements.

This basic initial structure would be modified as needed to fit the requirements of Tanzania, targeted investors, and projects sponsors from the public and private sectors (e.g., international, national, SMEs).

The potential benefits of a pooled financing facility are as follows:

- Local infrastructure projects can be financed without reliance on the financial abilities of local governments or the central government; project sponsor financial contributions will be limited to equity and project development costs;
- Development partners can provide targeted support (e.g., technical assistance, guarantees, subsidies, loans, equity), leveraging the development impact of limited budgets by mobilizing local sources of private sector financing.

- Financial accountability and transparency will be assured by the lenders to the pooled financing facility because they would be at risk and would use typical project finance structures to protect their interests;
- Independent consultants (including engineers) can perform market assessment studies (including capacity to pay) and audit the costs of construction;
- Segregated accounts will control cash flow and insure that cash is used to pay: (1) first, operating expenses,(2) then, maintenance expenses,(3) next, debt service and, (4) finally, dividends to project owners;
- Project sponsors will gain experience in project development, without being at risk of having to pay project debts; and
- Lenders will gain experience in project finance credit analysis and, having gained a better understanding of project risks and how they can be mitigated, these lenders will eventually be able to provide financing with lessor no credit enhancements.

The end result of developing such financing facilities will also advance the development of local capital markets. Such financial mechanisms serve to unlock sources of local private sector finance, enabling the financing of infrastructure projects critical to local economic development and prerequisite to improving country competitiveness, job creation, and meeting the MDGs.

While the pooled facility or similar credit enhancement structure is being created, concurrent efforts to finance stand-alone infrastructure projects will also be explored. These stand-alone financings can take place during the time period needed to develop the above facility structure. Commercial banks with the support of development partners can warehouse these projects until the pooled financing facility is set up.

Implementation of a pooled financing facility will serve as a training programme for those firms and institutions that are direct participants in developing and financing its portfolio of projects. However, success in creating the local institutional framework for developing and financing small and medium-sized infrastructure projects will require a broad scale training program directed at government officials, potential project sponsors, including farmer organizations, Technical Service Providers, and financial professionals.

Nonrecourse project financing typically provides greater leverage and longer debt tenors than traditional bank financing, but it requires specific approaches to risk mitigation and supporting documentation in the form of marketing and engineering studies conducted by independent professionals. The LFI-T Programme will provide training for all relevant audiences that addresses:

- The benefits that can be achieved through the use of non-recourse project finance techniques,
- The risk mitigation requirements of nonrecourse project finance,
- Providers of risk mitigation,

- The requirements that must be fulfilled by the marketing and engineering studies that support the financing of a project, and
- Assessment of Technical Service Providers (TSPs) that can potentially perform these essential studies.

The goal of the LFI-T Training Programme is to: (1) create an awareness of the benefits and requirements of non-recourse project financing on the part of national and local government officials and potential project sponsors, (2) inform TSPs of the opportunities available in performing supporting studies that meet the requirements of project finance lenders, and (3) improve the credit skills and risk analysis abilities of local finance professionals so that financing of small and medium-sized infrastructure projects will become an accepted and routine part of the local economic environment.

2.4.4 Programme Outcomes and Outputs

The LFI-T Programme strives to make an impact by ensuring that Tanzania's financial systems are unblocked to enable and promote inclusive local economic development (LED). The programme includes five main outcomes and 13 associated outputs.

OUTCOME 1: Improved capacities of Tanzania public and private project developers to identify and develop small-to-medium sized infrastructure projects essential for inclusive LED.

This outcome targets the demand side of the equation and will result in an increased number of technically sound strategic LED infrastructure projects ready for funding. It includes the following outputs:

1.1: Processes, methodologies, and enabling tools are designed and/or introduced to identify and develop infrastructure projects essential for inclusive LED.

1.2: Local capacity established to enable local stakeholders (national and local government officials and the private sector) to identify and develop infrastructure projects essential for LED with support from development partners.

1.3: Ten to fifteen "proof of concept" demonstration LED projects identified, developed and structured to jumpstart the process and create a multiplication effect through "learning by doing" and incentivizing stakeholders.

OUTCOME 2: Increased ability and willingness of domestic financial sector to provide financing for small to medium-sized LED infrastructure projects.

This outcome targets the supply side of the equation and will result in an increasing number of LED infrastructure projects developed at the local level that are actually financed. It includes the following outputs:

2.1: Processes, methodologies, and enabling tools are designed and/or introduced to finance LED project proposals.

2.2: Local capacity established to increase the ability of the private sector to finance LED projects with appropriate credit enhancements.

2.3: Ten to fifteen LED projects financed to jumpstart the process through "learning by doing" and incentivizing stakeholders.

OUTCOME 3: Improved Tanzania business-enabling environment for domestic resource mobilization for inclusive LED, ensuring integration into existing government processes, programmes, and structures.

This outcome is related to the creation of an enabling national environment for domestic resource mobilization through upgrade of policies, legal, regulatory, and operational framework. When achieved, this outcome will provide support to reducing the obstacles to more active and substantive participation of all LED stakeholders. It will also provide support to the improvement of business-enabling environments for donor development partners (DPs), development finance institutions (DFIs), and other international actors willing to support LED. This outcome includes the following outputs:

3.1: Support to improved national policies, legal and regulatory frameworks to encourage domestic resource mobilization for sustainable and inclusive LED.

3.2: Support for improved "how to" and operational frameworks for inclusive LED project development and finance.

OUTCOME 4: Increased interest and support of the development community for Tanzania inclusive LED project development and finance.

This outcome is related to the creation of an enabling-international environment for designing and financing of small and medium-sized LED infrastructure projects. As a result, the support to and direct participation of the international community in LED, both technical and financial, will increase. This outcome includes the following outputs:

4.1: Additional scaling up and replication of LFI-T Programme by other DPs: Bilateral and multilateral DPs, UN agencies, DFIs, NGOs and others.

4.2: New Global Performance Metrics on LED finance designed, launched, and maintained to enable tracking, performance measurement, and galvanize momentum.

4.3: Increased awareness and capacity of donor DPs to provide effective interventions for LED, with UNCDF as a conduit for improved donor DP engagement for maximum LED development impact.

OUTCOME 5: Increased effectiveness and leverage of limited public sector funds, both of the host government and development partners, by mobilizing significant levels of private sector finance for catalytic LED projects.

This outcome is related to the need for greater effectiveness of official sector finance, both that

of host governments and development partners, in targeting their support for essential LED projects critical to private sector development, job creation, and poverty reduction. To meet this challenge, it is imperative that the development community become more skilled in creating specific financing mechanisms that enable greater ODA and government finance leverage of private finance in a dynamic catalytic fashion, building momentum and development results.

To advance this outcome, programme outputs will focus on immediately launching a LFI-T Fund that can jumpstart the mobilization of private finance with dynamic targeted focus on the bottlenecks and impediments blocking access on a project level. The Fund can provide a model for mobilizing the wider support of development partners in providing credit enhancement for the larger pool of projects. The targeted amount of total credit enhancement support for LFI-T is US\$20 million, enabling at least US\$40 million in private sector financing for LED projects.

Key functions of the LFI-T Fund, and possibly of other credit enhancement funds, will include the subsidization of costs of preparing professional feasibility studies and various kinds of risk mitigation. The Fund will provide funding on a matching basis to project sponsors to pay for the services of TSPs (local consulting, engineering, accounting firms) to prepare the feasibility studies that will be required to secure private sector financing. The Fund will also provide credit enhancement, primarily equity investments and first loss loans, as needed to attract bank and institutional investor financing of the project pools. This Fund and related credit enhancement support facilities will reduce the costs and risks to the private sector of financing LED projects.

The Fund will therefore serve as a "proof of concept" mechanism testing how to use limited official sector funding on a project level to jumpstart the process of developing and financing essential LED projects. As noted in Outcome Two, in most cases both project development and credit enhancement support will be obtained from existing donor and DFI programmes that the LFI-T will be mobilizing for this purpose. However, especially in the early stages of the effort, it will be more expedient for the LFI-T Programme to be able to provide such financial support itself, and also to create momentum for scaling up the activities detailed in Outcome Two.

Used effectively, this Fund and other credit enhancement facilities should achieve a substantial degree of financial leverage, advancing the outcome of greater official sector effectiveness. It is expected that for every dollar in public funds spent by the Fund, over ten dollars of private sector financing will be secured. This outcome includes the following outputs:

- 5.1: Set up, operate, and maintain the LFI-T Fund and other credit enhancement structures as required.
- 5.2: Attract bank finance to LED projects through the funding of project development and credit enhancement.
- 5.3: Attract institutional investor finance to LED projects through the funding of project development and credit enhancement.
- 5.4: Successful operation of the projects financed with the assistance of the Tanzania LFI-T Fund and other credit enhancement structures so that donors, DFIs and domestic financial institutions will be able to more accurately evaluate the risks of financing small to medium-sized infrastructure projects.

2.4.5 Programme Implementation

The LFI-T Programme is structured around implementation of targeted strategic LED catalytic projects at the local level in a wide range of districts during a period of four years.³⁶ The projects, seen as critical for unleashing the economic potential of local economies, include both traditional and industrial infrastructure projects such as energy projects, transport, warehouses, and food processing plants. Implementation of these projects, identified through a participatory and inclusive process, will require activation of all programmatic components, which include:

- **Project development activities** that enable the identification and development of up to 15 demonstration projects to create “proof of concept” financing models that facilitate access to the domestic financial sector for investments in strategic, smaller scale infrastructure projects. These activities include:
 - a) Project identification and informed decision-making (including through the UNCDF’s Local Economic Development approach),
 - b) Project development (feasibility studies, environmental and social assessments, project design, equipment selection, and negotiation of construction, input, output and project management contracts), and
 - c) Deal/financing structuring.

- **Finance and credit enhancement facilities** to enable jumpstarting the process of project identification, development and deal/financing structuring (i.e., “LFI-T Fund” and other credit enhancement structures);

- **Capacity building activities** that provide for the training of public and private stakeholders and increased government capacity to facilitate finance, project development, and business-enabling environments (using modern on-line tools to enable national scaling up, identification of impediments and possible remedies, and tracking accountability). This includes the preparation and certification of local Technical Service Providers (TSPs) who will extend high quality capacity building services to local banks, local and national level government officials and project sponsors (e.g., farmers associations).

- **Performance tracking activities** that provide a foundation for benchmarking the dissemination and incentives for the replication of all programme components, delineating the type, amount etc. of financial transactions, including the degree of leverage from targeted use of credit enhancement and ODA to facilitate transparency, replication and leveraging, both nationally and internationally.

The LFI-T Programme implementation process will unfold as follows:

³⁶ As noted in prior sections, the LFI-T Programme has been delayed by eight months, so the revised time frame for the programme is three years and four months.

1. Once the programmatic components are activated, a number of catalytic projects will be identified and developed.
2. Implementation of these catalytic projects will feed into a national process of policy, legislative, regulatory, and operational review to create an adequate enabling environment for LED financing through the domestic financial sector. At the same time, the experience accumulated during implementation of the projects will help refine and enhance mechanisms for supporting LED.
3. Improved national frameworks, systems, and tools will, in turn, encourage more bankable projects and facilitate their financing through the domestic financial sector. At the same time, implemented projects will serve as the “proof of concept” of the viability of the programmatic concept and approach, encouraging more investments into LED infrastructure. As a result, more domestic capital will be released for small and medium-sized LED infrastructure projects.

2.4.6 Selection of LFI-T Projects for Development and Finance

LFI-T Projects must be “bankable” projects that are catalytic to local economic development. Project sponsors can be private sector firms, public sector entities, or a combination of public and private sector entities. All projects will be set up in a “project company” as a separate legal entity to enable the ring-fencing of revenues required to access private sector finance (i.e., nonrecourse financing).

The total cost of the proposed projects should be between US\$100,000 and US\$30 million³⁷ with demonstrated local economic impact and financial viability, as detailed below. The specific criteria used for evaluating projects are based on best practices in infrastructure and development finance and are summarized below.

Local Economic Development Criteria: The purpose of the Tanzania LFI-T Programme is to catalyze local economic development (“LED”). All LED demonstration projects should therefore have a positive economic and social impact within the local region.

The types of alternative contributions to LED that projects can make include:

- Increased revenues to the suppliers of inputs to the project (for example, increased farmer income, etc);
- Spillover effects on the local value chain (for example, enabling linkages between local suppliers and regional, national, or international markets);
- Improvement of the local business-enabling environment (for example, reducing cost of energy, water, transport, other services, etc);
- Job creation (direct and indirect);

³⁷ As noted in earlier sections, while projects drafted for the pooled financing facility are likely to require no more than US\$3 million in financing, the Programme will also consider one –off larger projects for development and finance.

- Improvement of skills in local labor market; and
- Increased tax revenues to local government.

Financial Criteria: The purpose of the LFI-T Programme is to unlock the country’s financial sector so that LED projects can be financed with private finance (i.e., commercial banks, pension funds, etc). Therefore the only projects that can be considered are those that charge fees for their services. Other projects important for local economic development that do not generate revenues will need to be funded through grants, rather than debt.

For the LFI-T Programme to be successful in unlocking the private financial sector for catalytic LED projects, it will be critical to select 10 to 15 demonstration projects that will in fact prove the concept – demonstrating that LED projects can indeed succeed as viable operations and be able to service their debts in a timely manner over the time period of the loans. Therefore, the selected demonstration projects will need to meet private sector finance standards that require the highest credit quality.

To ensure the quality and sustainability of these first demonstration projects, it is important that projects have strong project sponsors that have financial capacity and technical expertise with a track record in such operations. A critical requirement is that project sponsors provide at least 25% of the total cost of the project as equity and also contribute to the cost of developing the project with feasibility and other studies. It is important to note that LGAs are not required to put cash equity into the projects, given their lack of cash resources. If LGAs propose projects in which they expect to participate as project sponsors, they can contribute land as equity. It will be important to ensure all projects meet the standards of bankability, engaging project sponsors or managers that have relevant experience meeting the requirements of ensuring project sustainability and success. On a selective basis, the LED Fund and development partners may provide funding for the needed project development studies either on a grant or reimbursable basis at financial close.

Further, to ensure adequate ability to pay debt service, the project will need to be incorporated as a stand-alone legal entity (“Special Purpose Vehicle”), with “ring-fenced” revenues dedicated to paying debt service to the bank.

Project Selection Process: Projects may be proposed for financing through the LFI-T Programme by government officials (national and local), private sector entities, community organizations, nonprofit organizations, and development partners.

Projects will be reviewed and selected in accordance with the criteria outlined in this document by the LFI-T Technical Team given their responsibility for evaluating proposed projects against the below technical criteria. All proposed projects will be validated with the respective local government as to their potential contribution to local economic development.

The status of projects (selection, development, structuring, and finance) will be reported by the UNCDF Technical Team to the Programme Working Group on Governance (Cluster III).

The below detailed “bankability” project finance criteria are based on “best practice” credit standards. These standards are important in ensuring the success of the first demonstration

projects, proving to the private financial institutions that LFI-T projects can meet the required performance in paying back their debts.

Detailed Project Finance Bankability Criteria

- The project should consist of a single plant/industrial facility (which may have ancillary off-site operations) that:
 - Is capital intensive (i.e., its capital cost is relatively high in relation to annual sales);
 - Employs proven technology;
 - Has a relatively long physical and economic life;
 - Can be managed successfully by any competent management team (i.e., management skill at operating this machinery is almost a “commodity”, rather than there being wide differences in outcome between the best operators and average or below average operators); and
 - Has an economic output that is determined primarily by its design and successful construction (this point is closely related to the previous point).
- The project’s revenues should be in the form of:
 - Commercially reasonable charges for its output, sufficient to pay all project operating expenses and debt service, plus provide an adequate return on equity to the project’s investor(s); or
 - Commercial revenues supplemented by output-based aid payments (where there appears to be a relatively high probability at the time of initial project development that the project will be successful in attracting output-based aid).
- The project should have revenues that:
 - Are sold pursuant to a long-term contract, or
 - That are sold on the open market where projected sales can be validated by an independent consultant’s report.
- The project should have an assurance of its supply of critical inputs that are purchased either:
 - Pursuant to long-term contracts, or
 - Are sourced locally under arrangements that assure an adequate supply at a reasonable cost.
- The project will be managed by an experienced management team that is:
 - Provided by the project sponsor, or
 - Hired pursuant to a management contract.
- The project can be structured so that it is owned by a separate legal entity has revenues that are “ring fenced” to assure their control and availability to pay project debt service.
- The total cost of the project should range between:
 - US\$100,000, and

- US\$30 million.
 - In exceptional cases, the projects chosen could be somewhat above or below these thresholds.
- The project should be sponsored by a firm or organization that can provide, either from its own resources or in combination with other shareholders, equity equal to at least 25% of the total cost of the project. LGAs can contribute land to meet their equity requirement, with cash equity from other partners as needed.
 - The project should have no adverse environmental or social impacts that cannot be effectively mitigated as part of the cost of the project.

2.4.7 Geographical Coverage and Scaling Up

While UNCDF has worked most closely on LED in Tanzania with the districts in the Mwanza region and will start immediately upon launch of the LFI-T working on projects that LGAs in the region (especially in Sengerema and Misungwi districts) have identified, the LFI-T Programme will be implemented in other districts across the country.

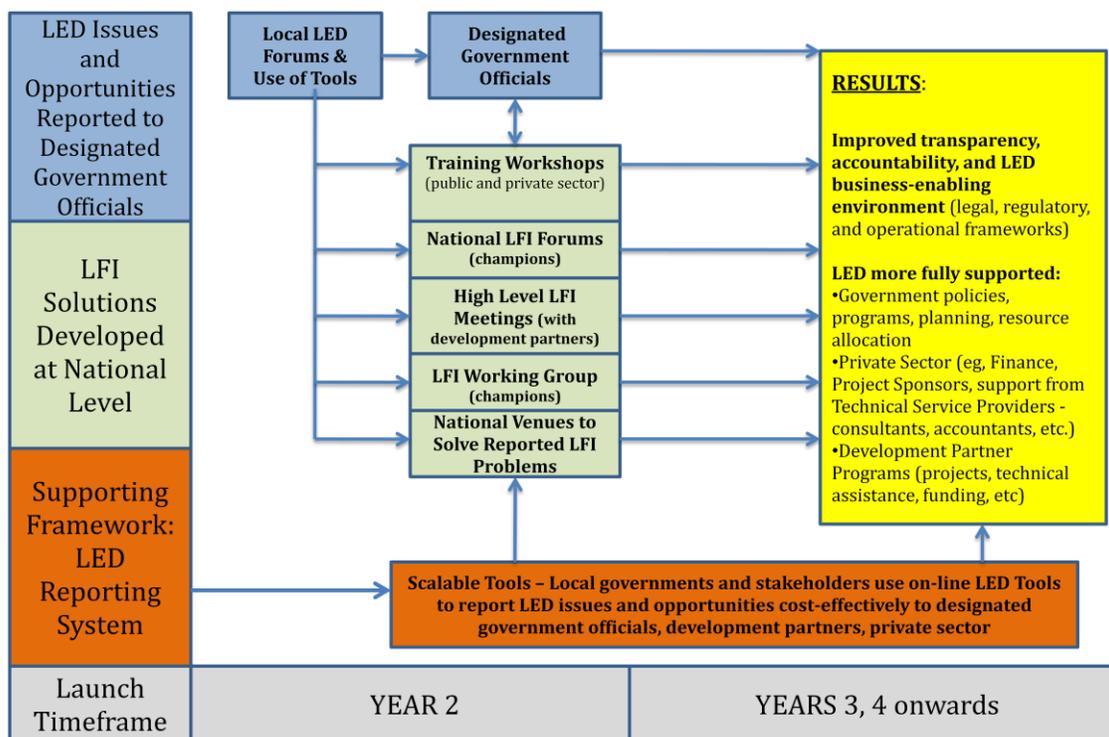
The programme is designed to be scalable at three levels:

Internally, the programme itself over time will increase in complexity and the intensity of its interventions, building on demonstration projects, lessons learned, and capacity-building programs. As the programme's methodologies and tools develop and are integrated into local public and private sector processes, the programme's ability to facilitate the release of domestic capital in Tanzania will increase. Simultaneously, the programme will experience vertical scaling up, feeding its experiences into national and international policies, legal, regulatory, and operational frameworks.

On the country level, the Tanzania programme will use a component-based approach to scale up. The project development, finance, capacity development, and performance tracking components will be scaled up nationally so that the relevant capacities are built at the local level throughout the target countries. With limited financial resources available for the credit enhancement, actual project development and implementation will be targeted on a few carefully selected projects to maximize the impact of demonstration and the programme's execution.

The use of scalable tools is illustrated in the diagram below.

EMPOWERING LFI WITH SCALABLE TOOLS



LFI: Unlocking Domestic Financial Sectors in Developing Countries

On the international level, the Tanzania programme will benefit from its inclusion in the UNCDF Global LFI-T Programme, which is designed to support country LFI Programmes with global resources and tools, facilitate South-South exchanges, and build international support for Country LFI Programmes through mobilizing global resources and experts.

Currently, LFI activities are being undertaken by UNCDF in Uganda with the support of GlobalDF. It is anticipated that the Global LFI Programme will incorporate the Tanzania LFI Programme and will operate in Tanzania, Uganda, and one to two additional countries to be selected.

2.4.8 Benefits for the Tanzania LFI Programme resulting from its inclusion in the UNCDF Global LFI Programme

The conditions blocking access to finance for small and medium-sized infrastructure projects in many developing countries are essentially the same as those described above for Tanzania. Similarly, many local banks in Tanzania are regional banks that operate in similar countries and may operate in one or more of the other countries selected for inclusion in the UNCDF Global LFI Programme. The development partners active in Tanzania are also likely to be active in the other countries included in the UNCDF Global LFI Programme.

As a result, the LFI-T Programme will benefit from the experience developed in other countries that face similar issues. Tanzania government officials will be informed about risk mitigation

and business-enabling environments that have been implemented successfully elsewhere (and can share their successes with other countries). Local banks that operate regionally may have previous experience with similar financing structures as a result of the Global LFI Programme. In addition, they may see additional profit opportunities in taking a structure from Tanzania and implementing it in other countries. Finally, development partners that are convinced of the benefit of a particular form of support in one country are likely to see that it can be useful in the other countries in the Global LFI Programme.

The UNCDF Global LFI Programme will include funding for certain activities that will benefit each of the countries in the programme. One of the most important of these activities is the provision of global enabling tools that empower developing country governments and private sectors by providing them with enabling knowledge resources management systems, and expert networks needed to scale up capacity for private sector development and LED. These global tools are designed as cost-effective mechanisms aimed at improving government capacity to engage the private sector and improve business-enabling environments, enabling the private sector to openly provide suggestions to governments, providing educational resources for professional development, and facilitating knowledge sharing. With the basic cost of these activities borne by the Global LFI Programme, relatively minor expenditures will be necessary to customize the tools and content for each country.

2.4.9 Major Challenges and Risks

The LFI-T is built around an innovative approach to financing infrastructure and incentivizing improved business-enabling environments that has yet to be fully tested, and requires a dynamic private sector orientation than is different from most development programs. Challenges that will be faced include the following:

Mitigating Political Interference by Setting Up Programme with Technical Finance Approach: The success of the LFI-T Programme requires that the technical processes of identifying, developing, and financing projects and capacity-building is done by the LFI-T Technical Team using the best practices required for securing private sector finance. It is critical therefore that the management of the programme be controlled by the Technical Team without political or bureaucratic interference or influence. The design, governance structure, and implementation guidelines of the LFI-T Programme are designed to mitigate this risk.

Mitigating Risk of Ineffectiveness through Alignment with Wide Range of Relevant Public and Private Entities: The LFI-T Programme needs to build on the existing Tanzania initiatives related to local economic development and finance, such as SAGCOT,³⁸ and also work with related government entities such as the Tanzania Investment Centre that has accountabilities for investment and enabling-business environments. The Programme is designed to partner widely as needed with public and private sector entities that can advance its success and development impact.

³⁸ The Southern Agricultural Growth Corridor of Tanzania (SAGCOT) is a public-private partnership which aims to boost agricultural productivity in Tanzania and the wider region. SAGCOT will promote “clusters” of profitable agricultural farming and services businesses, with major benefits for smallholder farmers and local communities. See <http://www.africacorridors.com/sagcot/>

Difficulty of Developing Projects: The greatest initial challenge is identifying and developing bankable projects. It will be critical that the LFI-T Team can immediately work with a wide range of public and private sector entities, including development partners, in sourcing possible projects, and very importantly, project sponsors with the capacity to develop and manage the projects. The Programme has an initial fund that can be used to address this issue, providing initial funds for feasibility studies, development of market studies, etc.

Potentially High Cost of Borrowing: The cost of borrowing will be a major determinant of whether project developers can successfully obtain financing for their infrastructure projects from commercial sources. At this time, since there is so little lending of this type in Tanzania, it is not clear what the interest rates and other costs of borrowing long term in Tanzanian shillings will be. In any case interest rates will be higher than the benchmark rates for lending to the government, which in turn are related to the rate of inflation. However, innovative finance programs such as AGRA's have found that even interest rates as high as 18% are considered breakthroughs in the domestic market.³⁹

For the lenders, the initial level of uncertainty about repayment risks will be high, even if the actual risks are not. But commercial lenders must price according to the combination of the uncertainty and risk they perceive. As experience with this type of financing is gained, the uncertainties will diminish and the costs should come down. The extra cost of uncertainty will need to be borne in whole or in part by the LFI-T Programme, in combination with government, DFIs, or donor support until such time as the cost of commercial borrowing is reduced to the point that project pools can be financed on their own. This support may be provided via low cost, direct subsidies to the borrowers, long term, low cost funding to the lenders or the provision of first loss or partial credit guarantees.

Impediments to Long Term Bank Financing: Even if banks in Tanzania are willing to lend to project sponsors of local infrastructure projects, they are constrained as to the tenor of their loans by the nature of their own sources of capitalization. These banks depend primarily on very short-term liabilities and demand deposits to fund their lending. This kind of mismatch between potential assets and existing liabilities would expose them to several risks that they are not prepared to assume and which their regulators would be loathe to have them assume even if they were inclined to take them on. However, if such institutions can obtain access to long-term local currency financing, they will be well placed to enter this market and seem prepared to do so. Long-term funding could come from indigenous sources such as pension funds and life insurance companies, development finance institutions, or development partners. Tenor extension might also be achieved by puts⁴⁰ or guarantees of longer tenor tranches provided by such organizations.

Impediments to Pooling: Putting a number of small infrastructure projects together for pool financing is not easy. The number and diversity of loans in a pool are major factors in

³⁹ AGRA states: "In Tanzania, AGRA and the Financial Sector Deepening Trust established a US\$2.1 million loan guarantee fund, securing a US\$10 million line of credit from the National Microfinance Bank (NMB). NMB agreed to lend to agro-dealers at interest rates of 18%, compared to the typical rate of 46% charged by microfinance institutions. As of late 2009, NMB had approved more than US\$1.5 million in loans to agro-dealers." <http://www.agra-alliance.org/section/work/finance>

⁴⁰ A put is an option contract giving the owner the right, but not the obligation, to sell a specified amount of an underlying asset at a set price within a specified time. The buyer of a put option estimates that the underlying asset will drop below the exercise price before the expiration date. Please see the Glossary for a more detailed definition.

determining the credit enhancement provided by pooling. Creating such pools takes time and money. This can be achieved in a number of ways -- by primary lenders making loans using their own funds and “warehousing” them until a sufficient number have been collected. As with the pooled finance facility, engaging credit enhancement support from development partners will be critical to mitigating the risks impeding access to private finance.

In the LFI-T Programme, the difficulty of setting up a pooled facility would be reduced by the envisioned small initial structure and credit enhancement support from development partners. Initially the structure would consist of a small number of banks jointly lending to a pool of a small number of projects. This pooled structure would serve to reduce and diversify the individual credit risk of each bank, with additional risk mitigation provided by development partners. As noted in the prior section, Tanzanian banks have confirmed they have important additional incentives to participate, as they would also benefit from being the lead “first movers” in an important new financial structure supported by the Tanzania government and development partners, as well as by enhancing their visibility in targeted markets.

Difficulties Posed by User Fees: While some project will designed to generate revenues by selling products or services on the open market, others will be dependent on collecting user fees set by LGAs. If user fees are used to repay loans, they should be set at socially and politically viable levels. Without experience, it is difficult to judge what these might be, but given the public’s lack of experience with user fees, initially they may need to be low. Collection of user fees can also be a problem, especially when the population is not accustomed to paying such fees. User fees can also be subject to considerable political risk. Projects will be carefully designed to mitigate these risks, with input from local governments and expert assessments.

A summary of risks and mitigants for the above challenges are below.

Risk	Level of Risk	Mitigants
1. Political interference in programme undermines ability to mobilize private sector finance	High due to intense government pressures given overwhelming financing needs	Defined programme structure protects government (i.e., UNCDF Technical Team to make all technical decisions as detailed in ANNEX 5 and have a direct reporting line to LFI Board)
2. Ineffectiveness	High due to challenge of developing bankable projects	Defined programme strategy of leveraging partnerships and working proactively with private sector (for example aligning with existing programs of TIC, SAGCOT, development partners, etc)
3. Difficulty of Developing Projects	High given lack of funds for project development	LFI Fund will jumpstart the project development process; also partnerships as needed in item 2 above will facilitate the identification of viable projects
4. Potentially High Cost of Borrowing	Medium given the historical track record of reduced interest rates when risk is reduced	LFI financing approach incorporates proven techniques that lower risk. Creating financial structures that reduce risk will reduce the high cost of borrowing; options include direct subsidies to the borrowers, long term, low cost funding to the lenders, or the provision of first loss or partial credit guarantees

Risk	Level of Risk	Mitigants
5. Impediments to Long Term Bank Financing	Medium given the historical track record of longer tenors when risk is reduced	LFI financing approach incorporates proven techniques that lower risk. Also initial long-term funding could come from indigenous sources such as pension funds and life insurance companies, development finance institutions, or development partners.
6. Impediments to Pooling	Medium given ability to warehouse loans	LFI financing approach includes options for warehousing loans. This can be achieved in a number of ways -- by primary lenders making loans using their own funds and “warehousing” them until a sufficient number have been collected. Also development partners can help by co-financing loans, or providing first loss. As with the pooled finance facility, engaging credit enhancement support from development partners will be critical to mitigating the risks impeding access to private finance.
7. Difficulties Posed by User Fees	Medium given inability of many people to pay fees	LFI financing approach includes options for output-based aid approaches that subsidize the poor people that cannot pay for services. As each of the selected projects will provide critical local services, it will enable the beneficiaries to increase their income. Therefore their ability to pay will be greater and create the basis for the sustainability of the project.

Given the innovative nature of the LFI programme and the above challenges, it will be critical that the government and the LFI Board follow the activities and defined roles as set forth in all the programme documents and its annexes.

3. Results Framework

The overarching goal of the LFI-T Programme is poverty reduction and the achievement of the Millennium Development Goals. The intermediate outcome of the LFI-T Programme is unlocking Tanzania's financial sector, enabling greater access to finance for essential infrastructure projects that will be catalytic for LED, private sector development, employment creation, poverty reduction, and improved living standards.

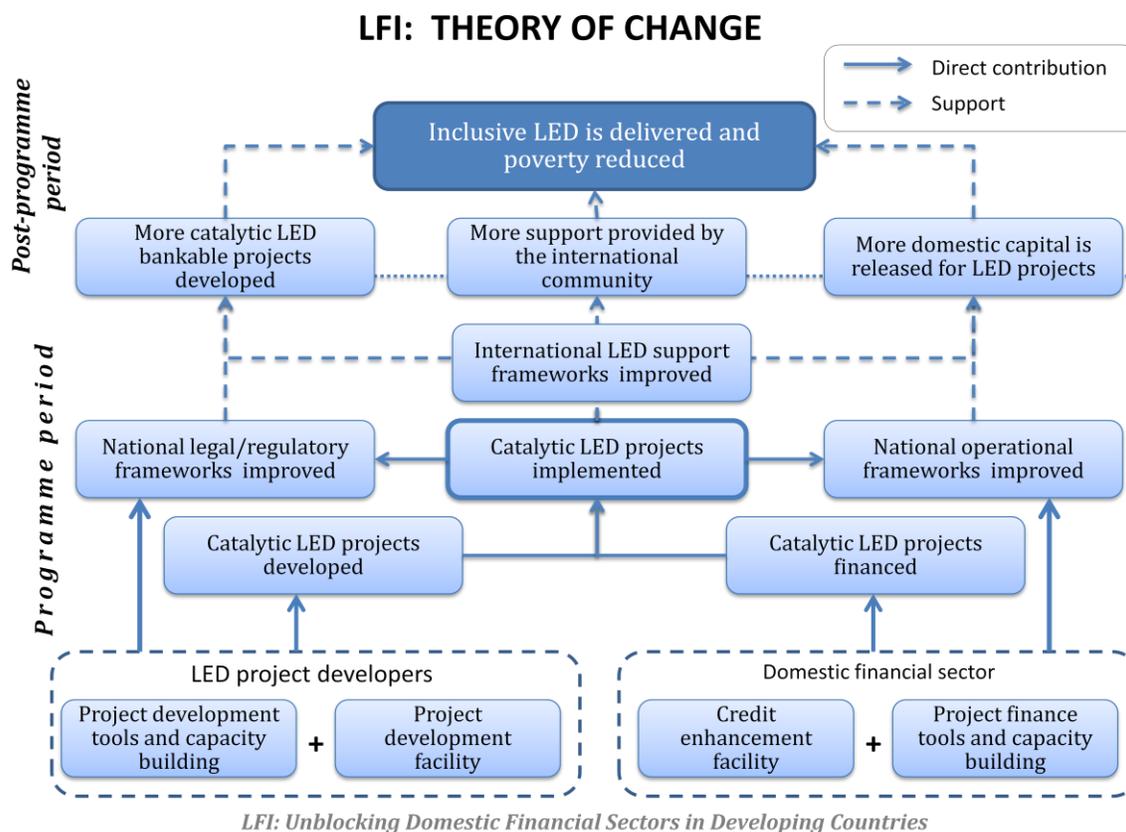
LFI-T is designed to advance Tanzania's UNDAF Cluster 3 for governance and public service delivery, by increasing access to new sources of finance for catalytic projects, using actual projects as an impetus to increase government capacity to improve the country's business-enabling environment.

The importance of leveraging limited official funding is core to the design of the programme. LFI-T strives to make a significant development impact by ensuring that domestic financial systems are unblocked to enable and promote sustainable local economic development. These projects, critical for unleashing the economic potential of local economies, may include mini hydroelectricity plants, warehouses, food processing plants, cross border truck parking yards, and similar economic infrastructure. Such projects can be largely financed through private sector, provided specific risks are mitigated.

The imperative for sustainability mandates a focus on capacity development. LFI-T has training programs for local Technical Support Providers ("TSPs"), national and local government officials, bank officers, and project sponsors, as well as the provision of enabling information-enabling resources and scalable communication and management platforms using basic on-line technologies.

The type of funding that we will be undertaking (nonrecourse project finance) is normally done only for very large projects. Most often large, international consulting firms are contracted for this work and it is common for hundreds of thousands of dollars to be spent on the preparation of the studies. This is acceptable as these costs amount to only a small percent of the overall project financing. The work needed to prepare feasibility studies for smaller projects is not proportionately less. Thus in order to keep down the cost of this work, it will be essential that local consultants be used as often as possible. While it appears that there are several qualified consultants of various types in Tanzania, most have never dealt with project finance. Thus it is proposed that training programs be developed and provided to TSPs who will undertake the various types of work (market research, engineering studies, financial analysis, etc.) needed to put together professional feasibility studies.

The figure below summarizes the logic of the LFI-T Programme.



The full results and resources framework table is attached as ANNEX 1.

4. Management and Coordination Arrangements

4.1 Implementation Modality

The UNDP is nationally executed under the overall co-ordination of the Joint Government – United Nations Steering Committee (JSC), co-chaired by the Permanent Secretary of the Ministry of Finance and Economic Affairs and the UN Resident Coordinator (RC).⁴¹

The UN Country Management Team (UNCMT) — composed of the RC, Heads, Representatives or Country Directors of UN agencies, funds and programmes, including Non Resident Agencies — manages and directs planning and implementation processes in fulfillment of the Delivering as One (DaO) Vision 2015 and agreed code of conduct. UNCMT members are accountable to the

⁴¹ United Nations Development Assistance Plan (UNDAP), page iii - v.

RC and each other for progress on DaO reform, effective implementation of the UNDAP, responsible use of resources and achievement of results.

The Inter-Agency Programme Committee (IAPC) composed of senior programme staff from all UN agencies leads the development, implementation, monitoring and evaluation of UNDAP programmes. It reports to the UNCMT and oversees Programme Working Group's results and reporting.

Reporting to the IAPC, UN working groups on Human Rights and Planning, Monitoring & Evaluation support the UNCMT's efforts to achieve results within the framework of the DaO reform process.

Ten interagency Programme Working Groups (PWGs) are responsible for coordination and implementation of the agreed ten UNDAP programmes, each with a UN lead agency to facilitate decision-making, coordination and coherence. UN agencies are accountable for agreed agency-specific results and targets established in the PWG work plans. The PWG and the implementing partners are collectively accountable for the success of the programme of cooperation. Programme Management Committees (PMC), co-chaired by the UN lead agency and a Government Lead counterpart, coordinate each PWG. The PMC agrees on, monitors, and reviews work plans and advises on funding requirements as well as key implementation modalities. Further, the PMC is responsible for the bi-annual reporting of PWGs and agrees adjustments to UNDAP Programme Matrices based on annual reviews. UN agencies and IPs (both government and civil society) are members of the PMC, with the participation of DPs as appropriate.

To ensure coherence and linkages with upstream policy frameworks, the PWGs will receive technical support from three Senior UN Cluster Advisors tasked with helping strengthen UN's contribution in providing strategic policy support on key policy areas to national counterparts, representing a unified UN position.

The UN, together with implementing partners (IPs), will develop Annual Programme Work Plans (APWPs) for each of the ten PWGs, using a common process. APWPs will align with GoT's fiscal planning cycle, July to June. This will allow the UN to participate meaningfully in national and sub-national planning and review mechanisms.

The following UNDAP Programme Working Groups (PWGs) are established:

- Economic Growth
- Environment and Climate Change
- Education
- Health
- HIV/AIDS
- Social Protection
- WASH
- Governance
- Emergencies and Disaster Reduction

- Refugees

In addition, there is the Zanzibar Coordination Group. PWGs are the interagency groups responsible for the coordination of the implementation of the agreed ten UNDP programmes.

LFI-T will be under the UN Programme Working Group on Economic Growth and the UN PWG on Governance.

The PWG structure does not, however, replace day-to-day technical engagement with the GoT; its primary purpose is to coordinate UN programming within the framework of the agreed UN division of labour.

The management and coordination arrangement of the LFI-T Programme has thus been proposed to facilitate three core areas: (1) national ownership, (2) alignment with existing country structures, and (3) sustainability of results achieved by the Programme. These three areas are detailed below:

- ***National ownership:*** The design and introduction of methodologies, systems and tools for LED finance will build upon local experience and be integrated into Tanzania's existing national and subnational frameworks and structures. The projects designed, financed and implemented with the support of the programme will be aligned with and contribute to the achievement of national and subnational development goals and programmes, including Decentralization by Devolution.
- ***Alignment with ongoing country programming and existing coordination structures:*** LFI-T is to be implemented in close coordination with other UNCDF and UN programmes currently implemented in Tanzania. LFI-T will coordinate with the Joint Steering Committee (JSC) and utilize existing coordination structures within the UN country team, making possible expansion of partnerships to other interested UN agencies and bilateral donors and development agencies.

Sustainability of results: LFI-T will ensure that the systems and methodologies developed under the programme are incorporated into national policies, legal, regulatory, and operational frameworks and are available as international best practices. LFI-T will provide relevant government agencies with scalable investor after care tools that enable identification of specific impediments and remedies, and intra-governmental coordination in resolving issues. Once the systems are established, the cost of maintaining them could be absorbed by public and/or private sponsors, thereby enabling long-term sustainability.

4.2 LFI-T Financing Management

The parallel funding modality will be used for Core Funds and this will respond to two categories. The first category involves UNCDF contributions which will be used to support a Technical Advisor for the Programme. The bulk of UNCDF funds will go to serve as the core

investment fund to contribute to the establishment of the LFI-T Fund to trigger further funding commitment by local banks. UNCDF will create a Tanzania LFI-T Fund using US\$1 million of the allocation to LFI-T from the One Budgetary Framework. This Fund will be available in the first two years of the programme to increase its capacity to be effective in jumpstarting the LED financing process.

The Tanzania LFI-T Fund will be available for the following uses in support of project development and financing:

1. First loss – subordinated debt
2. Equity (per constraints noted below)
3. Pre-investment loans for project development, to be repaid at closing of project financing (with a portion of the proceeds of the project financing)

UNCDF will serve as the manager responsible party for:

- Administration of the LFI-T Fund, and
- Measuring and reporting on development impact of the projects that are financed with the assistance of the LFI-T Fund.

In addition to its ability to be used to mitigate risk for senior lenders to infrastructure project financings and supplement the equity provided by project sponsors, the LFI-T Fund will help to attract support for project financing from development partners, as described in the immediately following section.

To create the LFI-T Fund, UNCDF will engage development partners to explore options of aligning programs with the support of the LFI-T Programme in Tanzania. One option is the creation of national and/or global funds to ensure the full range of instruments needed to mobilize private sector capital for financing of projects critical to local economic development. Development partners may engage in providing the following levels of support:

1. Debt financing:
 - a) Co-financing - Senior debt financing on a *pari passu* basis with financing provided by local, regional, and/or international banks
 - b) First Loss - Subordinated debt
2. Partial Guarantees (Credit and Risk) that cover political, regulatory, and credit risks impeding access to private capital
3. Equity⁴²
4. Pre-investment loans for project development, to be repaid at closing of project financing (with a portion of the proceeds of the project financing).

⁴² Equity funding will not be provided by UNCDF due to its restrictions on funds managed; any equity contributions will be made directly to the Fund by other partners.

UNCDF has made available a core fund of US\$1million in response to the above activity. Additional non-core funding is expected to be mobilized from other sources:

1. Bilateral Donors: Consultations have been initiated with among others, Sweden, Spain, Switzerland, and USAID regarding a partnership related to the UNCDF Global LFI Programme. Contributions may include a range of inputs such as credit enhancement, reimbursable grants, and technical assistance.
2. Development Finance Institutions: The second category of Parallel funds are those expected from the World Bank, African Development Bank, and from other international development financial institutions that go directly to the catalytic projects, providing credit enhancement or other financial support.
3. One UN Fund: The other funding source for the LFI-T Programme is the One UN Fund in Tanzania which uses a Pass-through mechanism for disbursement to the LFI-T. It is a joint multi-year resource mobilization and allocation system based on a One Budgetary Framework that is transparent about programme costs, the costs of ongoing reform efforts, as well as associated operational costs and the allocation of funds.

It is important to remember that the objective of the LFI-T Programme is to leverage the above limited official funds by mobilizing private sector finance. Therefore, as noted in the earlier sections, the LFI-T Programme expects to mobilize in the first stage US\$10 million for projects, increasing to US\$40-50 million by the end of the programme, in effect leveraging up to ten times the programme cost of US\$5.1 million. After programme completion, further replication of the LFI-T financing approaches by the marketplace is expected to result in up to US\$ 150 million in private sector finance for Tanzania projects over the longer term.

Background details on UNDAF Budget:

The 2011-2015 UNDAF budget reflects the total resources required for the implementation of the 10 UNDAF programmes for the four years, as well as the programme support costs. The budget is funded from UN agency core funds, those to be mobilised by agencies outside core and the One Fund. The latter is the mechanism through which donors finance the un-funded portion of the UNDAF budget for which UN agencies have indicated that resources need to be mobilized in Tanzania. The Joint Steering Committee (JSC) is responsible for overall management of the One Fund and approval for allocation of funds for activities in the 10 UNDAF programmes based on a set of agreed eligibility and performance criteria.⁴³

The four-year UN country programme for Tanzanian has a total budget of \$773MM. UNDAF's budget will be financed from three sources: funds UN agencies will invest from their agency core resources (16%), funds UN agencies have committed to mobilize (56%) and funds that the UN Country Management Team will collectively mobilize in Tanzania and channel via the One Fund (28%). The One Fund is the mechanism through which donors finance the un-funded portion of the UNDAF budget for which UN agencies have indicated that resources need to be mobilized locally in Tanzania. Resources provided by donors in Tanzania to support the

⁴³ United Nations Development Assistance Plan (UNDAF), page iii.

unfunded portions of the UNDAP will be pooled in the One UN Fund. The UN's preference is for un-earmarked funding. Nevertheless, earmarked funding can be accepted on an exceptional basis at Programme level.

The Joint Steering Committee (JSC) is responsible for overall management of the One Fund and approval for allocation of funds for activities in the 10 UNDAP programmes based on a set of agreed eligibility and performance criteria.

Under this arrangement the One UN Fund, which is \$3.5m has been committed to the LFI-T Programme. It is anticipated from the resource mobilization drive other donors as indicated above would join and a pass-through mechanism would be used for all other non-core funds.

Disbursements of funds under **LFI-T** will be made quarterly to the PMO-RALG, and PMO-RALG will in turn make disbursements to UNCDF, as the Technical Advisor and Responsible Party to the Programme. To ensure the LFI-T Programme is not hurt by delayed funding, the quarterly disbursed amounts will at a minimum cover all the budgeted expenses for the following quarter as detailed in this programme document. UNCDF will have the authority to disburse funds as called for by the programme activities and budget, with the signature by the UNCDF Chief Technical Officer.

Any unusual disbursements not detailed in the LFI-T Programme Budget will need to be approved by PMO-RALG and the LFI-T Programme Board. UNCDF will be expected to professionally maintain its books of accounts in accordance with NIM accounting and reporting guidelines, and will whenever required ensure that the books of accounts are available for inspection by the Programme Administrator and for monitoring by UNCDF. In addition, the PMO-RALG will provide financial reports to UNCDF on quarterly advances through quarterly financial reports received at UNCDF by the 15th of the first month following the quarter.

4.3 Programme Inputs

Inputs will be provided by UNCDF and Government of the United Republic of Tanzania as follows:

- **UNCDF and on behalf of One UN:**
 - Technical LFI Team consisting of a Country Team (Chief Technical Advisor and National Programme Officer) and UNCDF International Technical Service Provider
 - Technical support for Providing Capacity Development (public and private sectors) in project development, project financing, and improving local business-enabling environments
 - Technical support for the Development of Bankable project proposals, including securing project sponsors and sources of funding for developing project business plans, feasibility studies, etc

- Technical support for mobilizing private sector finance and securing the needed credit enhancement support
 - Technical support for managing the LFI-T Fund, and determining its allocations for project development and finance
 - Local UN Volunteer Staff for support to Pilot Projects
 - Targeted capacity development activities, including training and scaling-up tools
 - Core Funds for the Project Implementation Fund
 - Technical Back stopping from UNCDF Regional Office
 - Equipment: vehicles, IT equipment for DU and pilot districts
 - Monitoring visits and development of LFI-T Performance Benchmarks
 - Mid-Term and Final Evaluation Costs
 - M&E Missions
 - Documentation, printing, reporting, operations and monitoring costs
- **Government of Tanzania**
 - Programme Coordinator
 - Programme Steering Committee Sitings (once a year) ⁴⁴

4.4 Partnerships

The LFI-T approach fills a critical gap in the scope of coverage of a multitude of LED promotion and support approaches in current use by development partners. Its emphasis on strengthening the role of local government allows the LFI-T Programme to offer a highly complementary input to the landscape of LED promotion interventions that may focus on other areas such as private sector, value chain or development of micro, small and medium enterprises (MSME).

The programme will rely on partnerships and cooperation with a wide range of international and national stakeholders to maximize the programme's impact and to ensure that its interventions are harmonised with and complement the efforts of other partners, including the UN family and Bretton Woods institutions; private sector; national and sub-national governments; national and international development agencies; and civil society.

5. LFI-T Programme, Structure, and Implementation

As a One UN Programme, LFI-T is being implemented under a National Implementation Modality (NIM) with the PMO-RALG as the designated implementing partner. This positioning will enable close coordination and integration into relevant local governmental processes, focused on increasing the capacity of local governments to create local business-enabling environments and validate infrastructure projects developed under the LFI-T Programme. Given the importance of the Ministry of Finance and other government agencies and initiatives to

⁴² The costs of Steering Committee meetings are covered in the LFI-T budget.

improving the local business-enabling environment, the LFI-T Programme is also designed to integrate other government stakeholders through its Programme Board, and will further develop this process as needed over its implementation to ensure long-term sustainability.

As documented in the earlier sections, this innovative programme is aimed at mobilizing the Tanzania private sector, and therefore requires that all its activities be governed by the preconditions required to access domestic finance. This will mean the programme will need to have a dynamic private sector orientation and work programme, and strictly employ private sector technical criteria in all its activities. In short, to access private sector finance, it is vitally important to adopt private sector hard credit and engagement approaches that have been proven to work. Therefore the LFI-T Programme structure fully integrates the Tanzanian private sector and the expertise of the UNCDF Technical Team in providing the essential guidance to the Programme on how to achieve its objectives of mobilizing domestic private finance and improving the local business-enabling environment.

Moreover, the private sector expertise to design the private sector technical modalities are not currently available in Tanzania in either the private or public sectors. UNCDF as the technical advisor is responsible for providing technical international finance experts to lead programme development and implementation, including the infrastructure project development and finance processes as well as the capacity-building processes. The programme is designed to transfer this expertise to Tanzania, creating on-the-ground capacity through training, on-line tools, and the development of in-country Technical Service Providers.

The details of the Tanzania LFI-T Programme management and government structure are provided in the below sections, designed to explicitly support the specified LFI-T activities in alignment with the best practice of aligning programme structure with the needs for successful implementation of the programmed activities. Further details on programme roles by activity are provided in ANNEX 5.

5.1 The Programme Steering Committee of the LFI-T Programme

The Programme as required by the UN guidelines is overseen by a Steering Committee (also known in UN rules as a “Programme Board.”) Given LFI-T Programme objectives, the initial members of the LFI-T Steering Committee include ten or more members representing a range of public and private sector institutional stakeholders.

The LFI-T Steering Committee will be chaired by the Permanent Secretary of the Prime Minister’s Office for Regional Administration and Local Government (PMO-RALG). PMO-RALG will also serve as the Supplier. The primary supplier to the LFI-T Programme is UNCDF, who as responsible party will provide technical support, serving as the LFI-T Steering Committee Secretariat along with the government Programme Coordinator. The LFI-T Secretariat will provide key guidance to the Steering Committee on programme issues and developments.

The other Steering Committee members are:

1. Ministry of Finance: Coordinating/Executing Agency
2. Prime Minister's Office for Regional Administration and Local Government: Implementing Partner
3. United Nations Development Programme (Representing UN Task-Team for Governance)
4. United Nations Capital Development Fund (represented by the UNCDF Headquarters LFI Programme Manager and the Regional Technical Advisor)
5. Ministry of Agriculture
6. Tanzanian Investment Centre
7. Tanzania Business Council
8. Representative of Financial Institutions and Funds
9. Association of Local Governments of Tanzania (ALAT)
10. Tanzania Private Sector Foundation
11. Tanzania Planning Commission
12. Chair of Local Government Development Partners Working Group

Given the unique private sector orientation of the projects and the critical need to leverage other economic development initiatives, additional members may be appointed to the LFI-T Steering Committee. The LFI-T UNCDF Technical Team will provide recommendations on possible new members for the consideration of the Steering Committee to be approved by a majority vote. In addition the steering committee will invite additional global and national strategic parties to meetings.

The Programme Steering Committee, with the support of the Programme Secretariat (the Government Programme Coordinator and the UNCDF Technical Team), will provide regular reporting on the Programme activities to the PMO-RALG which is responsible for the oversight management of the Local Government Reform Programme (LGRP II).

The LFI-T Steering Committee is responsible for providing guidance and support to the LFI-T Programme so that the Programme is implemented as detailed in these programme documents and annexes, and realizes its stated objectives. If the LFI-T Programme has significant issues that threaten its ability to perform its activities, the Steering Committee has the authority to make decisions on how to resolve the problems so the programme can be resumed per the intended activities and workplan documented here. The Programme Steering Committee's guidance should be made in accordance with the attainment of the outcomes, outputs, and activities detailed in the Programme Document, complying with standards that shall ensure management for development results, integrity, and transparency. Any decision will be taken on a consensus basis.

In addition, the LFI-T Steering Committee plays a critical role in UNCDF-commissioned evaluations of the LFI-T Programme by ensuring the quality of the evaluation process and products, as well as ensuring the usage of evaluations for performance improvement, accountability and learning. Programme reviews by the Steering Committee are made at designated decision points during the running of the programme, or as necessary when raised by the Programme Coordinator and LFI-T Technical Team.

Based on the above, the LFI-T Steering Committee shall meet one time a year, and perform the functions below:

1. Provide guidance on how to ensure the successful implementation of the LFI-T Programme and its activities, so the stated outputs and outcomes are realized.
2. Provide suggestions on ways to scale up the programme, including ways to leverage existing public and private sector initiatives, and sources of funding from the public and private sectors, including technical support and credit enhancement.
3. Review the overall level of Programme-level funding and annual work plans, and provide suggestions on how to improve both the level and efficiency of funding and work plans.
4. Advise on resource mobilisation for the Programme and funds allocation in line with established procedures, such as the parallel for core and pass through for non-core modality, taking into account needs, priorities, and absorptive capacities of the Government of Tanzania.
5. Review Programme performance against the work-plans and provide suggestions on how to improve performance.
6. Exchange relevant information, share examples of best practices, and consider any matters related to the enhancement and implementation of the Programme and its various components. This includes discussing core issues related to the Programme, such as Project Financing, local government capacity for promoting local economic development, local investment potential, and private sector response.
7. Engage their respective institutional colleagues and larger networks to help identify and address any significant challenges, risks and opportunities, and provide input and suggestions to the UNCDF Technical Team on appropriate action. (Especially important is input from the LGRP II Technical Support Team, participating financial institutions and the private sector sponsors.)
8. Initiate reviews of the Programme, and advice on follow-up actions related to review and evaluation findings and recommendations, including audit.
9. Monitor the risks related to the implementation of the Programme, and recommend actions to the MoLG and UNCDF as necessary.

5.2 Role of the Prime Minister's Office for Regional Administration and Local Government (PMO-RALG)

The PMO-RALG is the designated implementing partner under a National Implementation Modality (NIM). At the level of the Programme Steering Committee, as the overall entity responsible for programme oversight, the PMO-RALG will have the role of implementing partner. The Director for Local Government is the designated Programme Coordinator and his outfit will provide secretarial services for all activities. The Programme Coordinator will work as a team with the UNCDF Technical Team, as detailed in ANNEX 5.

The Programme Coordinator is responsible for overseeing the programme as detailed in this programme document on behalf of the Implementing Partner within the constraints laid down by

the Steering Committee, utilizing the extensive support and guidance of the UNCDF Technical Team. As noted in earlier sections, the LFI-T Programme is built around an innovative approach to financing infrastructure, so it is critical that the Programme Coordinator responsible for day-to-day oversight will interface openly and dynamically with the UNCDF Technical Team regarding all activities employing fully their expert guidance and support. The Programme Coordinator's prime responsibility is to ensure that the programme produces the results (outputs) specified in the programme document, to the required standard of quality and within the specified constraints of time and cost.

The Implementing Partner appoints the Programme Coordinator. The ToR for the Programme Coordinator position will be developed by UNCDF and PMO-RALG to ensure a clear definition of the position and responsibilities, in alignment of those detailed in ANNEX 5 by activity. This is critical to ensure that the Programme Coordinator is protected from the risk of political pressures and influences that would undermine the required strict technical operation of all programme activities (as more fully explained in the later section "Major Challenges and Risks").

5.3 Critical Programme Implementation Role of UNCDF LFI Technical Team

As noted above, the success of the LFI-T Programme is dependent on the transfer of new finance and private sector modalities into ongoing public and private sector processes in Tanzania.

Given this private sector-orientation, objectives and design of the LFI-T Programme, the programme implementation structure fully integrates the UNCDF Technical Team (in-country UNCDF Team and UNCDF International Technical Service Provider) into programme management to ensure its success. As noted in earlier sections, the Programme requires extensive technical support given the innovative and private sector nature of the Programme.

Key components for a successful LFI-T Programme include the following requirements for the technical team and location:

1) **Ensuring the critical role of the UNCDF Technical Advisors into all programme management decisions across all LFI-T activities.** This is a best practice employed by leading development institutions such as the World Bank and PIDG to implement innovative hard credit market development projects. This best practice engages international finance experts to develop and finance projects as well as develop the requisite capacity building programmes (training and tools).⁴⁵

Based on this best practice, the UNCDF Technical Advisors will be positioned on two levels to facilitate the introduction of the new concepts needed to jump-start LFI-T in Tanzania so it can take root and be a self-sustaining program upon programme completion:

⁴⁵ See for example, the critical leading role given to senior technical experts essential to developing and financing infrastructure projects in leading development initiatives in leading programs such as the IFC's Advisory Services and the PIDG programs. See http://www1.ifc.org/wps/wcm/connect/REGION_EXT_Content/Regions/Sub-Saharan+Africa/Advisory+Services/ and <http://www.pidg.org/sitePages.asp?step=4&navID=4&contentID=166>

- UNCDF International LFI Technical Service Provider to design and guide the overall LFI-T Programme, who can train the local LFI-T Team; and
- In country LFI-T Team consisting of two positions of Chief Technical Advisor and National Programme Officer to provide day-to-day support for programme implementation, ensuring full integration of the new concepts and activities into Tanzania public and private sectors.

2) **Ensuring the LFI-T Team is located in a Dar Es Salam Office with easy access to the targeted participants that are critical to its success.** Most of the key programme participants are located in Dar Es Salem, including:

- Private sector financial institutions that are expected to provide finance (e.g., head offices of banks, pension funds)
- Targeted project sponsors who need to be recruited to develop and manage the projects in the districts (larger companies with funding and track records in similar projects);
- Technical Service Providers that can be trained in project finance and project development and serve to scale up the program (e.g., established consulting firms, accounting firms, lawyers)
- Government initiatives and institutions that are relevant to its activities (for example, Tanzania Investment Center, SAGCOT, etc).
- Development partners that are needed to provide credit enhancement and technical assistance support.

The UNCDF LED-FI Technical Team will therefore reside in an appropriate office in Dar Es Salem and regular trips will be conducted to the Dodoma offices of the RMO-RALG and LGAs as needed. The programme will bear the costs of the Dar office. UNCDF will arrange for the office space in coordination with the government.

5.4 Ministry of Finance

The Ministry of Finance has the executive role at the level of the Programme Steering Committee, thus representing the Government ownership of the programme as required by the POPP of UNCDF. The Ministry of Finance is responsible for facilitating policy issues related to the financing of Local Economic Development. As the ministry with the oversight responsibility over the financial sector, it has the key responsibility of facilitating policy review and development to enhance the objectives of the Programme. The ministry will guide in the interpretation of national regulations, procedures and processes to support project financing interventions under the programme.

As the ministry responsible for national economic planning, it will seek to harmonize the Programme with other national interventions and facilitate the pooling of joint efforts to achieve LFI-T objectives. The Programme will thus specifically include the staff of the ministry in its capacity development initiatives to facilitate their appreciation of the models and tools applied in the programme and able to respond to the defined roles above.

5.5 Other Programme Steering Committee Members

Ministry of Agriculture

The Ministry of Agriculture is the technical ministry responsible to the sector representing 80 percent of the livelihoods in Tanzania and even more in rural areas. It is imperative then that the pursuit of local economic development and the development of the necessary local infrastructure to support will require the active involvement of the ministry accountable for this sector.

The Ministry of Agriculture will thus provide the needed technical advice and support along the local economic chain in the selection, development, operations and maintenance of agriculture related sub-projects. It will provide the need technical information for the development of bankable projects documents and advice the Steering Committee on issues related to decisions on agriculture projects.

UNDAP Programme Working Group on Governance (Cluster III)

The Programme Working Group on Governance for the UNDAP is an interagency group responsible for coordination of the implementation of the agreed UNDAP outcomes under cluster III and responsible for accounting and reporting to the Inter-Agency Programme Committee (IAPC).

UNCDF

As noted in the earlier section, UNCDF's role is to provide the extensive financial and technical assistance required for the success of the LFI-T Programme. The financial assistance will be provided as per the programme budget and managed by the Implementing Partner according to the regular UNDP and UNCDF arrangements for National Implementation. Technical assistance will be provided by UNCDF as the Responsible Party. This role includes support provided by the UNCDF Technical Team (in-country LFI Team and UNCDF International Technical Service Provider) on all matters of strategic and operational character related to the Programme, given the innovative finance and capacity building components. The support will be in line with the detailed activities presented in this document, which will be represented in the Annual Work Plans of the programme.

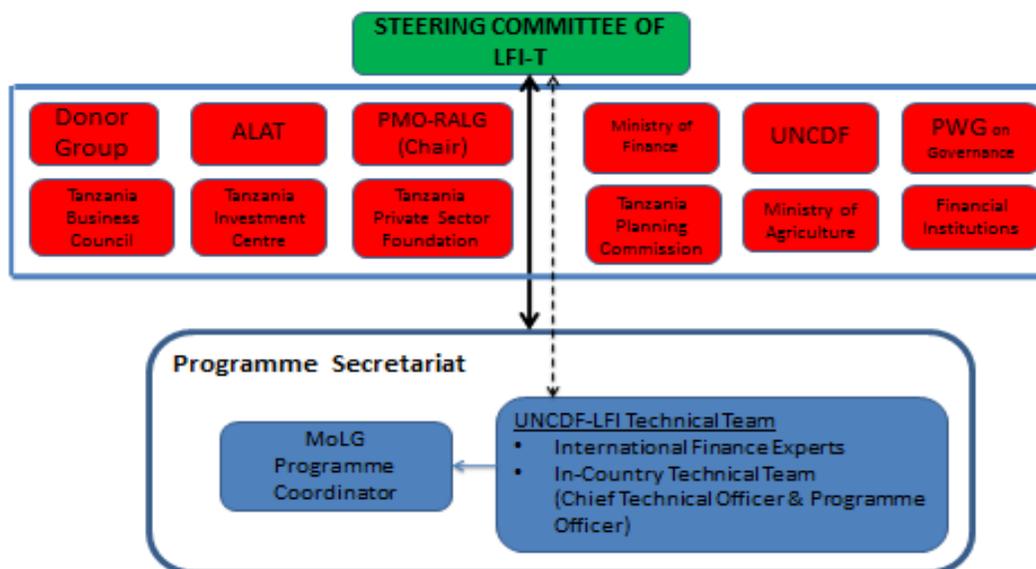
The UNCDF Technical Advisor and Programme Officer at the UNDP Country Office will also exercise the role of Project Assurance. The project assurance role supports the Programme Steering Committee by carrying out objectives and independent programme oversight and monitoring functions. This role ensures appropriate programme management milestones are managed and completed.

Other Members of the Steering Committee

The role of the other members of steering committee represent constituencies that are key stakeholders in the project and respective membership are key contributors as well as primary and secondary beneficiaries to the programme. These include Tanzania Investment Centre, Tanzania Business Council, Representatives of Financial Institutions and Funds, Association of Local Governments of Tanzania (ALAT), Tanzania Private Sector Foundation, Tanzania Planning Commission, and Donor Group on Decentralization are to represent the interest of the respective groups to ensure harmonization with the respective programmes and also advice on the technical quality of the programme in responding to its objectives.

The management structure for the Tanzania LFI-T Programme is designed to enable a proactive innovative approach required for the success of the programme. A basic sketch of the structure is provided below.

LFI-T MANAGEMENT ACCOUNTABILITIES



The above management structure illustrates the dynamic open team approach with the MoLG and UNCDF Technical Advisors (international and in-country) working together very closely. They will also interact directly and extensively with the various participants in the programme in both the public and private sectors for all the activities, including both project development finance and capacity building. This UNCDF Technical Team will bring critical knowledge and inputs, and will need to engage in all aspects of the programme development. Given the innovative nature of the programme, it will also be important for the UNCDF International Finance Experts to have direct contact with Steering Committee Members, engaging them in helping to develop and integrate the programme into both public and private sector processes. The partnerships with TIC and private sector entities are especially critical.

In terms of the infrastructure project development and finance process, the International Finance Advisory Team will bring the required extensive experience in structuring and financing infrastructure projects, a critical skill requirement for implementation of the LFI-T Programme. Nonrecourse project financings are substantially different from traditional corporate banks loans, and most commercial bankers do not have the experience or knowledge to implement project finance transactions. Both in their complex structures and in the time required to reach closing, nonrecourse project financings require management by professionals who have firsthand experience in completing these types of transactions. In terms of capacity building, the UNCDF International Technical Service Provider will also bring the requisite skills and tools to scale up the new innovative processes so that LFI-T approaches can take root in Tanzania and be scaled up nationwide.

6. Monitoring, Evaluation, and Reporting

Monitoring of LFI-T will be exercised by UNCDF through its Technical Regional Team and LFI Technical Team (LFI Country Team and International Technical Service Provider), with the participation of national stakeholders and implementing partners. UNCDF will make use of the existing monitoring tools as well as the performance tracking tools to be introduced under LFI-T to ensure continuous and efficient monitoring at the country programme level.

The monitoring efforts will be based on the following performance indicators:

- Change in the number of LED projects in Tanzania identified, developed, and financed;
- Change in the amount of domestic private finance mobilized for LED projects in Tanzania;
- Number and impact of the changes effected in national policy, legal, regulatory and operational frameworks to facilitate domestic resource mobilization; and
- Number of new partnerships, programs, and services in Tanzania with the support or participation of the international development community.

The LFI-T programme will undergo a process of mid-term review and evaluation (along with LFI-T programmes in other countries) according to the UNCDF evaluation policy.

Given the innovative nature of the LFI programme, the mid-term review will assess whether the project has made enough lead way into proving concept and the steering committee will re-confirm the validity of the project or take a decision on either re-directing some of the activities or stopping the project should there be no prospect for successful outcomes. The mid-term review will assess the achievement of the project based on the following criteria 2 years into the project and by 30th June 2014 at the latest:

1. 2-4 bankable projects are fully developed with finance committed from local banks or other private investors, and training and tools are in place;
2. The project been able to enlarge the Tanzanian LFI Fund (or other credit enhancement and project development support) beyond the initial 1 million to a level necessary to support more than 5 projects;
3. TSPs supporting the projects have consistently met the performance criteria set out in their contracts;
4. The project has secured a significant part of the \$20 million credit enhancement support, identified in the LFI-T Programme either for individual projects or for the LFI Programme nationally or globally.

The final evaluation will assess the programme's overall performance, the outputs and outcomes produced against its initial targets, the impact it has had on unlocking domestic capital for small and medium-sized strategic bankable infrastructure projects in a sustainable manner, its relevance to positioning UNCDF as a leader in local development finance, and fulfilling its mandate of helping countries bring finance to the poor, reduce poverty and meet their MDGs.

The LFI-T evaluation will build on the knowledge paper produced under the programme and fill in any gaps needed to highlight programmatic and technical lessons learned for the benefit of the local development finance industry, and advocate for improvements in financing small and medium-sized local development and infrastructure projects. The programme budget includes funding for monitoring and evaluation.

7. Legal Basis of Relationship

This Joint Programme Document shall be the instrument referred to as the Project Document in Article I of the Standard Basic Assistance Agreement between the Government of Tanzania and the United Nations Development Programme, signed by the parties on 30 May 1978.

The following provision shall be included in all sub-contracts or sub-agreements entered into under this programme document:

The Implementing Partners/Executing Agency⁴⁶ agree to undertake all reasonable efforts to ensure that none of the funds received pursuant to this Joint Programme are used to provide support to individuals or entities associated with terrorism and that the recipients of any amounts provided by Participating UN organizations do not appear on the list maintained by the Security Council Committee established pursuant to resolution 1267 (1999). The list can be accessed via <http://www.un.org/Docs/sc/committees/1267/1267ListEng.htm>.

⁴⁶ Executing Agency in case of UNDP in countries with no signed Country Programme Action Plans

8. Workplans and Budgets

Budget Overview and Justification

The objective of the LFI-T Programme is to unlock Tanzania’s financial markets for LED projects and improve the local business-enabling environment. To accomplish this objective, resource allocation must be targeted on activities that will lead to this goal.

It is important to note that the unlocking of financial markets will require major interventions by experienced financial experts in developing bankable projects, developing new financial structures that meet the credit standards of local financial institutions, and the development of training and enabling-tools to mainstream these capacities. Below, the budget is aggregated in the major expense categories, with a summary explanation of purpose.

EXPENSE CATAGORY	PURPOSE	AMOUNT (US\$)
1) LFI-T Fund	Jumpstart project development and finance process (available for feasibility studies, first loss, etc). While most funding for feasibility studies and risk mitigation will come from existing DFI and donor programs, the time constraints imposed by the need to organize a number of projects simultaneously to attract commercial financing will sometimes require that the LFI-T Programme itself provides such support.	\$1,000,000
2) Targeted Technical Support and Capacity Development Interventions	Guide the process of selecting and preparing bankable small infrastructure projects for LED; design and use of LFI-T Fund; secure project sponsors and financing for 10-15 projects; secure development partner support; design and implement training programs for the government, banks, and companies; create enabling-information and on-line tools for sustainability; create and maintain performance metrics; design and implement outreach venues (national and international) to disseminate best practices, including writing knowledge paper. The expected daily rate for the UNCDF International TSP is \$850/day. (Standard World Bank rates for this level of expertise is \$1,200/day; private sector rates for comparable expert are \$2-4,000/day)	\$1,816,500
3) LFI-T In-Country Staff and Costs	The International CTA for the LFI-T and the National Programme Officer	\$957,000
4) International Travel	This covers travel of required expertise and the regular supervisory missions from HQ and Region	\$306,800
5) LED Forums/Outreach	Venue and travel costs for LED participant information exchange forums.	\$129,500
6) Software	Additional programming to existing software programs for providing consultation mechanisms and enabling-information	\$115,000
7) Training	Venue and travel cost for LED participants training	\$148,000
8) Research	Enhance Project Finance Toolkit; identify case studies, best practices, enabling-info, etc; develop and maintain LFI-T	\$76,500

	performance metrics and index	
9) Publications	Publishing and Printing and distribution costs of reports and publications	\$27,500
10) Misc	Fund for unexpected expenses and minor budget overruns	\$26,764
11) Fees	7% UNCDF management fee and Evaluation activities	\$496,436
TOTAL		\$5,100,000

The detailed budget and workplans are attached in Annexes 2 and 3 respectively.

Attached is the timeframe schedule of activities envisioned in the LFI-T Programme.

Country Timeline of Activities (estimate)
Based on One UN Programme Timeframe July 2011–June 2015

(Based on programme date start March 1, 2012)

LFI-T Programme of Activities	Year 1 (4 months) March 1 – June 30, 2012				Year 2 July 1, 2012 – June 30, 2013				Year 3 July 1, 2013 – June 30, 2014				Year 4 July 1, 2014 – June 30, 2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Start Up Activities																
Hire New Staff & Set Up Office				X												
Outreach to targeted champions				X												
1) LFI-T ASSESSMENTS																
Refine existing Economic Scan (Activity 1.1.1) and Finance Scan (Activity 2.1.1)																
2) LFI-T COUNTRY TRAINING, OUTREACH, & TOOLS																
Technical Service Providers (TSPs) Workshops - 20 TSPs (Activity 1.2.1)				XX		X		X		X		X				
Training Workshops (20 people) (Activity 1.2.2)				XX		X		X		X		X		X		
Outreach events for LED (Activity 1.2.3) - National Workshop (“N”) 100 people - Regional Workshops (“R”) 30 people				N		R		R		R		R				
Expert Knowledge-Exchange (50 people) (Activity 1.2.4)				X				X				X				
High-level Government Event (60 people) (Activity 2.2.2)				X				X				X			X	
Knowledge Dissemination - using media (radio, internet, publications)				X				X				X			X	

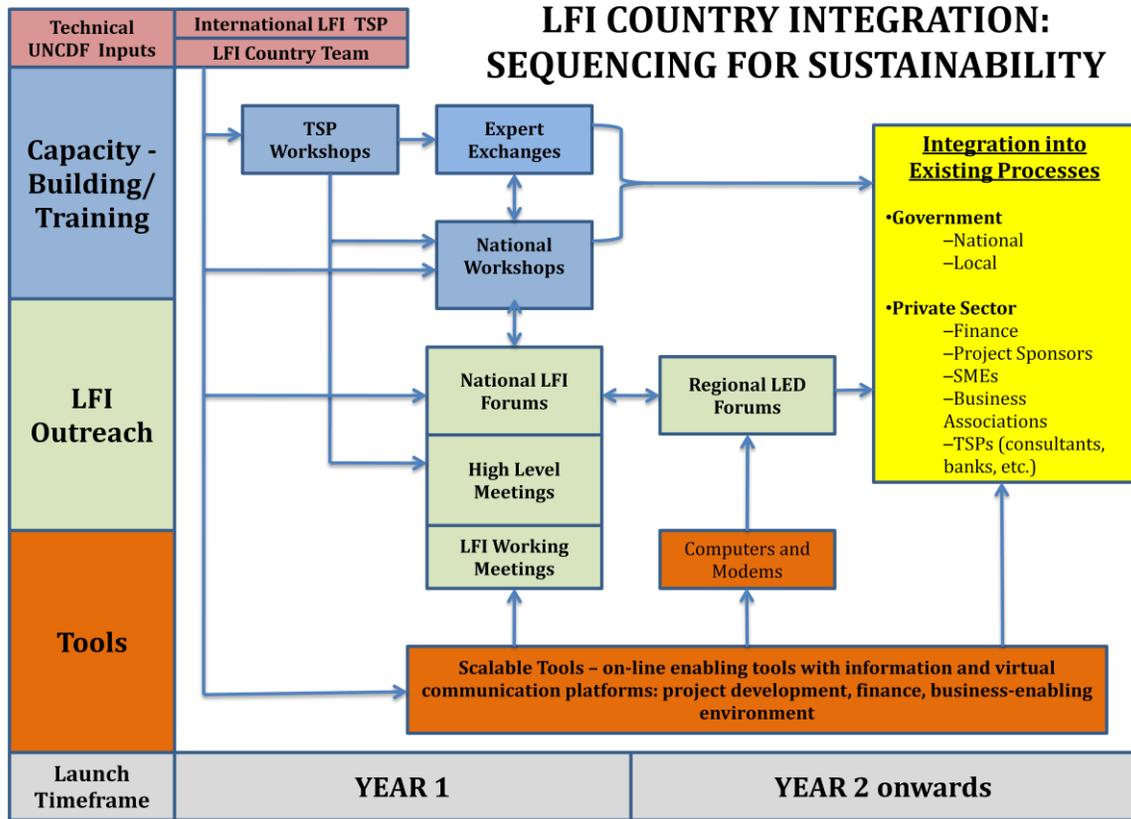
etc: Local, National, South-South (Activity 3.1.1)																
LFI-T Programme of Activities	Year 1 (4 months) March 1 – June 30, 2012				Year 2 July 1, 2012 – June 30, 2013				Year 3 July 1, 2013 – June 30, 2014				Year 4 July 1, 2014 – June 30, 2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Meetings National LFI-T Committee/Champions (Steering Committee at least once a year) (Activity 4.3.2)			XX	X	XX	X	XX	X	XX	X	XX	X	XX	X	XX	X
Development of Scalable Enabling Tools & Content (Activities 1.2.1, 1.2.4, 1.2.5, 3.2.1, 3.2.2, 3.2.3, 4.1.2, 4.2.1, 4.2.2)			X	X	X	X	X	X	X	X	X	X	X	X	X	X
3) LED PROJECT DEVELOPMENT																
Design methodologies to identify and develop projects (Activity 1.1.2)			X	X	X	X	X	X	X	X	X	X	X	X	X	X
Complete economic & financial scans and project development(Activities 1.3.2, 1.3.3)			X	X	X					X				X		
4) LED PROJECT FINANCE &LFI-T FUND																
Design methodologies to finance projects (Activity 2.1.2)			X	X	X	X	X	X	X	X	X	X	X	X	X	X
Identify and secure project sponsors (Activity 1.3.2)			X	X	X	X	X	X	X	X	X	X	X	X	X	X
Set up & use LFI-T Fund/other credit enhancements for leverage (Activity 5.1)			X	X	X	X	X	X	X	X	X	X	X	X	X	X
Secure partners for support (Activities 2.3.2, 5.2, 5.3, 5.4)			X	X	X	X	X	X	X	X	X	X	X	X	X	X

A key component of the work plan is the development of capacity, sequencing the activities so that long-term sustainability is created through the programme for LED finance. The below slide summarizes the development process, starting with the UNCDF International Technical Service Provider training the UNCDF Tanzania staff and developing a core of Technical Service Providers (TSPs) through workshops. The national TSPs will be selected from interested consultants, accountants, and bankers who are interested in providing their services in this emerging area of development finance. TSPs will be given free training in exchange for their help with larger workshops given at the national and local levels.

In addition, the programme has extensive LED outreach activities to build support in the government and with key private sector companies that can be instrumental in marshalling resources and ensuring the programme is being integrated into ongoing daily government and private sector processes related to project development and finance.

Scalability is provide through the availability of enabling on-line tools and communication platforms, that provide knowledge resources related to project development finance, risk mitigation techniques and services, and business-enabling environment.

Diagram - LFI-T Capacity Development



LFI: Unblocking Domestic Financial Sectors in Developing Countries

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10. Annexes

ANNEX 1: LFI-T Results and Resources Framework

ANNEX 2: LFI-T Budget

ANNEX 3: LFI-T Work Plan

ANNEX 4: LFI-T Programme Monitoring Framework

ANNEX 5: Roles in Implementing LFI-T Programme and Accountabilities

ANNEX 6: TOR for Tanzania LFI Chief Technical Advisor