Kenya School Risk Sharing Facility

HIGHLIGHTS
- Partnership with a local bank to support the private education sector in Kenya
- First risk sharing transaction in Kenya
- Replicates a similar successful education facility in Africa

THE PROJECT
The demand for education at all levels in Kenya has historically put heavy pressure on the public school system. In order to meet this demand, many private entrepreneurs have begun to provide academic and vocational education to various socioeconomic segments of the population. Despite significant gains in private school enrollment in recent years, the supply-demand gap for these education services continues to widen. To fill this gap and maintain educational quality, private schools must obtain financing for the acquisition of land, for the construction of new facilities, and for the purchase of education materials. Local banks can play an important role in providing the financing needed for this growth.

Understanding the business potential of private education in Kenya, K-Rep Bank has started to build a portfolio of local currency loans to private schools. To support the continued growth of this portfolio, IFC and K-Rep Bank have entered into a risk-sharing facility agreement. The ability to share potential credit losses with IFC has provided K-Rep Bank with the confidence to expand its support to the education sector and extend the tenor of its education loans. The tenor extension, in particular, should allow the bank to meet more effectively the longer-term funding needs of its education sector clients.

THE COMPANY
Kenya Rural Enterprise Program (K-Rep) was established in 1984 as a 5-year micro enterprise development project funded by USAID and other donors. Its mission was to provide support and loans to NGOs involved in small and micro-enterprise development. K-Rep eventually started making loans directly, leading to the establishment of K-Rep Bank in 1999. Although K-Rep Bank specializes in microfinance, it also offers mainstream banking services. K-Rep Bank shareholders are K-Rep Group Limited, IFC, Shorebank, African Development Bank (AfDB), Triodos, Netherlands Development Finance Company (FMO), Industrial & Commercial Development Corporation (ICDCI), and KWA (membership association for the staff and members).

FINANCING OBJECTIVES
The demand for education in Kenya has led to an impressive growth in the number of private schools. Loans available to Kenya’s private education sector are, however, generally short-term and not appropriate for the longer term investments needed for facility construction and equipment acquisition. The short tenor of the loans also puts a strain on the cash flows of schools and limits their ability to operate effectively.

To help address these funding challenges, IFC entered into a risk sharing facility with K-Rep Bank in an amount of up to KES 200mn (about US$2.8mn equivalent) on loans extended to eligible private schools to finance construction, purchase of educational materials, and other capital expenditures. IFC’s support of K-Rep’s lending program through this risk sharing facility is intended to augment the supply of medium-term lending available to the education sector.
THE STRUCTURE
The risk sharing facility is comprised of two tiers: a 5% first loss tier to be assumed by K-Rep Bank to cover the expected losses on the school loan portfolio; and a 95% second-loss tier to be shared by IFC (63%) and K-Rep Bank (37%). IFC’s share of the risk amounts to 60% of the total guaranteed loan portfolio, inclusive of the first loss threshold.

All school loans originated by K-Rep Bank reported to the IFC before the end of a defined “ramp up” period are included in the loan portfolio. For eligible defaulted loans, once the first-loss threshold has been reached, IFC will reimburse K-Rep Bank for 63% of any additional defaulted loan principal losses up to a maximum amount of KES 60mn (about US$857,000 equivalent).

The guaranteed loan portfolio is eventually expected to reach KES 200mn (about US$2.8mn equivalent). Once the portfolio of covered loans exceeds KES 80mn, K-Rep Bank may request an increase in the IFC guarantee to a maximum amount of KES 120mn (about US$1.7mn equivalent).

OUTCOME
The risk sharing facility is intended to allow K-Rep Bank to extend the tenor of its local currency loans to private schools. These longer-term loans will then allow the private schools to undertake investment projects which they would otherwise not be able to pursue. The success of K-Rep Bank’s private education sector lending business may also lead other banks to target this sector more aggressively. Increased competition should, in turn, improve the sector’s overall access to funding and bolster learning outcomes for Kenya’s children and youth.

This initiative is the second such risk sharing facility project for the education sector in Africa, joining a similar program initiated in Ghana in 2005. Both of these projects are expected to increase in size over time and to be replicated in other African countries.

TERMS AND CONDITIONS

<table>
<thead>
<tr>
<th>Amount of the Portfolio</th>
<th>KES 200mn (US$ 2.8mn equivalent)</th>
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<tbody>
<tr>
<td>Currency</td>
<td>Kenya Shillings</td>
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<tr>
<td>Issue Date</td>
<td>December 07, 2006</td>
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<td>Origination Period</td>
<td>3 years</td>
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<td>Termination Date</td>
<td>December 6, 2015, or the date on which the sum of all disbursements under the Guarantee has reached the Maximum IFC Guarantee Amount</td>
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<td>Maximum Reference Portfolio Balance</td>
<td>KES 200mn (US$2.8mn equivalent)</td>
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<tr>
<td>Maximum IFC Guarantee Amount</td>
<td>KES 120mn (US$1.7mn equivalent)</td>
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<td>Enhancement</td>
<td>IFC will reimburse K-Rep Bank for 63% of the principal-only credit losses that are in excess of a 5% first loss threshold</td>
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![Diagram of asset-liability distribution]