Joint Investment for Peace Initiative Annual Report

Fiscal Year 2022

DFC U.S. International Development Finance Corporation

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Introduction

U.S. International Development Finance Corporation's (DFC) Joint Investment for Peace Initiative (the Initiative) is a program to provide investments in, and support to, entities that carry out projects that contribute to the development of the Palestinian private sector economy in the West Bank and Gaza. This initiative launched in late 2021 following the enactment of the Nita M. Lowey Middle East Partnership for Peace Act (MEPPA), which authorized both the Initiative and a separate people-to-people program administered by the U.S. Agency for International Development (USAID).

To implement the Initiative, DFC uses its products to support private investment that: promotes Palestinian economic development, increases economic cooperation between Palestinians and Israelis and between Palestinians and Americans, and contributes to greater integration of the Palestinian economy into the international rules-based business system.

During 2022, DFC increased its engagement with the Palestinian and Israeli business communities to continue building a pipeline of potential transactions that will advance the Initiative's goals. DFC also worked with Palestinian businesses as they went through DFC's application process or prepared to file applications for support. Although no new projects were committed in FY 2022, DFC looks forward to the possibility that some of the leads it is developing will reach commitment in FY 2023.

The nature of DFC's portfolio and pipeline are both a function of the age of the Initiative and of the business environment in the West Bank and Gaza. Many Palestinian small- and medium-sized enterprises (SMEs) face challenges meeting DFC's criteria related to business size and experience. DFC is working closely with USAID's Small and Medium Enterprise Assistance for Recovery and Transition Project (SMART) and Building Regional Economic Bridges (BREB) programs to identify and prepare Palestinian businesses for potential and eventual DFC support.

DFC continued to cooperate closely with USAID and the Department of State, including U.S. Embassy Jerusalem, the Office of Palestinian Affairs, and USAID/West Bank and Gaza, to coordinate activities and identify potential projects or companies that might benefit from each agency's support.

This report has been prepared in response to annual Congressional reporting requirements in PL 116-260, Division K, Sec 8005(e).

Budget

As noted in last year's report, DFC and USAID agreed to allocate $3.5 million in FY 2021 MEPPA funds to DFC to support technical assistance for the Middle East Investment Initiative (MEII) Loan Guarantee Facility 3. Because USAID typically receives its funds one year after they are made available, DFC received the FY 2021 allocation in FY 2022. DFC's and USAID's agreed allocation for FY 2022 funds will be reported to Congress through a formal Congressional Notification by USAID. That allocation will be based on DFC's pipeline and an estimate of the likelihood of project commitment during the availability of the appropriation.[1]

Appropriations allocated to the Initiative will likely be used to fund subsidy costs for direct lending, loan guarantee facilities, or technical assistance once the projects reach commitment. Subsidy costs account for the risk and returns of an investment, and when the subsidy cost is negative, it reflects an expected return for DFC. Even when costs are positive, DFC's investment will still catalyze a much larger total amount of support. The allocation of MEPPA-related funds between DFC and USAID will be re-evaluated each year based on the availability of newly appropriated funding and programmatic needs of each agency.

Commitments and Business Development

Though no new projects reached commitment in FY 2022, DFC continues to undertake a range of efforts to deepen its pipeline of viable transactions that will advance the goals of the Initiative in the coming years. This is consistent with DFC's approach to building its pipeline in other priority areas, where individual projects can also take over a year (and often multiple years) to reach financial close. These efforts included outreach to Palestinian and Israeli businesses, potential joint ventures, as well as non-government organizations and think tanks interested in MEPPA. The engagement focused on increasing awareness and understanding of MEPPA, the Initiative, DFC's various products, the criteria used to review projects, and the application process. DFC also worked closely with colleagues in USAID and the State Department to coordinate and cooperate with their private sector development efforts in the West Bank and Gaza, including engagement with USAID's technical assistance providers that are working directly with the private sector.

In February 2022, DFC hosted a virtual "town hall" with the Palestinian business community and financial sector, drawing an audience of over 120 participants. The event featured remarks by DFC's Chief Development Officer, a member of DFC's Development Advisory Council, the head of the Office of Palestinian Affairs, and USAID's team lead for Economic Growth and Infrastructure in Jerusalem. The event helped generate dozens of transaction leads and build up DFC's pipeline of potential transactions.

In May, DFC Chief Climate Officer Jake Levine traveled to Jerusalem, Ramallah, and Jericho, where he met with representatives from the Palestinian and Israeli private sector as well as representatives from multilateral development banks. His visit surfaced potential transaction opportunities, advanced a few early-stage conversations with businesses, and further helped expand awareness of the Initiative among the Palestinian business community.

The Initiative's two co-managers traveled to Jerusalem, Ramallah, and Jericho in November for

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[1] Per the MEPPA legislation, funds are appropriated to USAID and then transferred from USAID to DFC. The mechanism for such transfer is through the authority provided by section 1434(j) of the BUILD Act. For funds to be transferred to DFC, USAID first has to receive the funds. USAID typically receives funds one year behind their authorization. For example, FY22/23 funds are only expected to be available for transfer to DFC in mid-FY23. The process of transferring the funds also takes several months. Funds transferred from USAID to DFC gain one year of life, so FY22/23 funds become FY22/24 funds and will expire on DFC's books if not obligated against a committed transaction before 9/30/2024. Due to the lengthy timeline and process of transferring funds, and the difficulty for DFC to estimate funding needs until transactions have completed due diligence and received credit/management approval, sufficient MEPPA funds may not always be ready at DFC when a transaction is ready for commitment. In this case, DFC will add its own directly appropriated funds to ensure that a deal can close on the timeline required by the private sector client. Note that because funds have an expiry date, DFC does not want to over-estimate its funding needs and risk fund expiration (particularly when USAID could have used the funds).

meetings with Palestinian and Israeli business people, multilateral development banks, USAID technical assistance providers, and U.S. Embassy and USAID staff. This trip generated new transaction leads and advanced existing projects towards DFC application. The co-managers also joined the U.S. delegation to the U.S.-Palestinian Economic Dialogue held on November 14 in Ramallah. In December, Chief Climate Officer Levine again traveled to Jerusalem and Ramallah to continue discussions on potential projects, including in the renewable energy and climate sector in the Palestinian territories.

Investing and Supporting the Palestinian Private Sector and its Integration into the International Rules-Based Business System

Given the relatively small size of the Palestinian private-sector economy, many of the SMEs interested in DFC support have struggled to meet DFC's basic criteria for sound investments (e.g., sufficiently detailed business plans, shareholder information, audited financial statements, breakdown of funding sources and uses, and revenue projections). Where possible, DFC has worked with potential clients to guide them through the steps necessary to prepare an application and navigate the due diligence process. As part of this process, clients have commented that working with DFC on an application and due diligence helped them strengthen their business plans, processes, and policies – which have lasting, positive impacts on a business even if the transaction does not reach commitment or financial close.

DFC has also referred potential smaller ticket requests (i.e., under $1 million) to an on-lending program managed by the Middle East Investment Initiative (MEII), which is better positioned to meet their needs through local financial institutions and in local currency. In addition, DFC is working with USAID's SMART and BREB programs to identify projects that could benefit from their support to build and develop the companies, some of which may be able to apply for DFC support at a later date. This close coordination between USAID and DFC, as well as the medium- and long-term approach to developing the Palestinian private sector, is important to lay a strong foundation able to meet MEPPA's goals and objectives.

Over the course of 2022, DFC's support to the existing MEII Loan Guaranty Facility 3 project (LGF 3) continued to enable private sector lending to SMEs in the Palestinian territories – a critical element to develop the Palestinian private sector – by guaranteeing loans made by privately-owned commercial banks and local microfinance institutions (the Lenders).

The allocation of $3.5 million in MEPPA funds in FY 2021 enabled DFC to provide much-needed technical assistance funding for MEII's continued Coordinating Agent services, critical to facilitating access to finance for SMEs in the West Bank. This transaction facilitated increased lending to SMEs across the West Bank with monitoring support for existing loans through 2027.

Since its inception in 2006, loan guaranty facilities with MEII in the West Bank have proven sustainable and successful in supporting thousands of local SMEs. Through LGF 3 alone, MEII has processed 1,626 loans across nine private commercial lenders in the West Bank, amounting to almost $203 million disbursed to SMEs since 2016. Approximately 21 percent of SMEs LGF 3 has supported have been new borrowers, and MEII estimates that its lending has provided or sustained 9,376 jobs since LGF 3's inception. DFC is working with MEII to consider follow on opportunities.

Transparency and Sustainability

All DFC transactions must adhere to its established transparency and sustainability policies and procedures. These policies and procedures require DFC to share a Public Information Summary on dfc.gov, submit Congressional Notifications as required, and meet thorough environmental and social impact procedures applied by organizations such as the World Bank Group, the European Bank for Reconstruction and Development, the Inter-American Development Bank, and the U.S. Export Import Bank, among others. DFC expects any future transactions supported by the Initiative to adhere to all of DFC's transparency and sustainability policies and procedures.

Vetting and Oversight Process

All of DFC's transactions undergo DFC's established due diligence, credit, environment and social clearance, know-your-customer (KYC) vetting and monitoring processes. To ensure that DFC supports reputable investors and projects, KYC policies and procedures are used to assess the character and reputation of parties and beneficial owners in DFC supported projects. DFC uses a wide array of resources to conduct KYC due diligence. These resources include general background checks, checks against international sanctions lists, and checks against U.S. lists managed by U.S. government agencies such as the Departments of State, Treasury, and Justice. DFC also utilizes certifications, covenants, and representations in its legal agreements, where appropriate, to combat money laundering, sanctions, terrorist financing, and other matters.

During the life of a project, DFC conducts ongoing KYC due diligence on any new significant participants in or beneficial owners of such project. In addition, DFC monitors projects' financial performance and environmental, social and development impacts through on-site visits, review and analysis of the financial and policy reporting due under legal agreements, and compilation of annual loan reviews. All transactions supported by DFC through the Initiative will undergo these vetting and oversight processes, as well as the vetting practices for assistance for the West Bank and Gaza as set forth by USAID, as required by section 8006(b) of MEPPA.