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Client Alert Commentary

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DFC Releases Guidelines to Implement the DFC-DPA Loan Program: Financing US Projects in Response to the COVID-19 Crisis

The guidelines are intended to facilitate loans to the private sector to support domestic industrial base capabilities.

Key Points:

- Under the new DFC-DPA Loan Program, DFC will extend loans in amounts of up to US$500 million for the next two years to eligible projects located in the United States and its territories, and may be structured as a balance sheet, corporate-type financing or a non-recourse or limited-recourse project financing.
- The loans are aimed at private sector companies seeking financing to establish, expand, convert, or modernize their US production capacity or retool and restructure their supply chains, whether as part of the national response and recovery to the COVID-19 pandemic or simply to address supply chains vulnerable to disruptions.
- The DFC guidelines are effective immediately so as to enable DFC to begin swift implementation of the DFC-DPA Loan Program.

The DFC and What It Does

The United States International Development Finance Corporation (DFC) is the development bank of the United States — typically, DFC invests in projects in developing economies by providing debt financing, equity investments, political risk insurance, and technical assistance. In January 2020, DFC consolidated and modernized the former Overseas Private Investment Corporation (OPIC) and the Development Credit Authority of USAID (DCA USAID), and was equipped with expanded financial resources of up to US$60 billion and new investment tools.

DFC's mandate allows it to invest in many sectors, including infrastructure (power, transportation, water, and communications), technology, healthcare, and agriculture (including the food industry and food supply chains). DFC carries out its investments abroad by: (i) providing debt financing by making loans and guarantees that may be denominated and repayable in either US dollars or other currencies, (ii) making equity or quasi-equity investments directly in eligible entities or investment funds, (iii) issuing insurance or reinsurance policies to private sector entities and qualifying sovereign entities to protect investments in whole or in part against political risk, and (iv) awarding grants for feasibility studies and technical assistance.

The New DFC-DPA Loan Program

Background

Building on the authority granted to the President of the United States pursuant to Title III of the Defense Production Act of 1950 (DPA), on May 24, 2020, the White House issued Executive Order 13922 (EO 13922) delegating authority to DFC's CEO to respond to the COVID-19 outbreak. While DFC typically focuses its investments in developing nations, EO 13922 instructed DFC to extend loans to projects located in the US that "create, maintain, protect, expand, or restore the domestic industrial base capabilities supporting: (i) the national response and recovery to the COVID-19 outbreak; or (ii) the resiliency of any relevant domestic supply chains." The DFC-DPA Loan Program and DFC's guidelines to facilitate loans to the private sector to support domestic industrial base capabilities (Guidelines) are the direct result of this delegation of authority.

Eligibility

Pursuant to the Guidelines, eligible projects are those that meet the criteria listed in EO 13922 summarized above. In particular, DFC will make loans to private sector entities "if financial assistance is not otherwise available from a private source on reasonable terms," and if the project satisfies all of the following key conditions:

- The loan supports the production or supply of an industrial resource, critical technology item, or material that is essential to the national defense
- US industry cannot reasonably be expected to provide the needed capacity, technological processes, or materials in a timely manner without the loan
- The loan is the most cost-effective, expedient, and practical alternative method for meeting the need
- The prospective earning power of the applicant and the character and value of the collateral security provide a reasonable assurance of repayment of the loan

The types of projects contemplated under EO 13922 and eligible for loans under the DFC-DPA Loan Program are exceedingly broad. Historically, DFC (and its predecessor agencies, OPIC and DCA USAID) focused on expanding US business and American investment dollars into emerging markets and thereby reinforcing US foreign policy and national security interests. The DFC-DPA Loan Program is the first major DFC initiative that focuses squarely on US domestic industries and supply chains. Any proposed plant, manufacturing facility, or other type of project (whether in healthcare, technology, food supply, energy, or infrastructure) that would provide a beneficial impact to addressing the COVID-19 pandemic or would otherwise serve to strengthen supply chains across a host of industries could be eligible for funding. The DFC-DPA Loan Program thus opens up DFC funds to a large new pool of project applicants in the US, such as:

- Manufacturers ranging from makers of personal protection equipment and medical devices and supplies (*e.g.*, ventilators, shields, masks, and respirators) to makers of air filtration and air conditioning systems, as well as glass and other modular enclosure systems
- Companies in the automation and technology sectors, such as builders of custom machinery and automated systems for critical COVID-19 supplies and manufacturers of automated robotic systems and other automated applications

- Pharmaceutical and biotech companies active in the research, development, and manufacturing of COVID-19 therapy treatments, antivirals, vaccines and vaccine components, and the production of test kits and other testing equipment, and other companies in the US that manufacture drugs and pharmaceutical ingredients, such as common antibiotics, generic drugs, and over-the-counter pain medications (which today are mostly sourced from countries outside the US) used to treat HIV, depression, Alzheimer's disease, and other ailments
- Manufacturers of communication equipment or IT that are particularly vulnerable to geopolitical supply chain disruptions, such as trade suspensions
- Food industry companies, such as food manufacturers and meat processing plants, seeking to reconfigure their physical plants to require less manual labor and more automation

Key Terms and Conditions

Below is a chart comparing some elements of DFC's ongoing debt financing program for developing economies with the DFC-DPA Loan Program as set out in the Guidelines.

Key Terms and Conditions	DFC-DPA Loan Program	DFC Debt Financing Program for Developing Economies
Project location	US and its territories	Low- and lower-middle-income countries and, subject to DFC's consideration, upper-middle-income countries
Financial product and maximum exposure amount	Loan amount to be determined on a project-by-project basis, but not to exceed 80% of the total cost of the project	Loans and guarantees of up to US$1 billion
Maturity of loan	Up to 25 years (and determined on a project-by-project basis taking into account the useful economic life of the asset)	Up to 25 years or even 30 years
Use of proceeds	(i) the acquisition, development, construction, ownership, or operation of facilities or equipment; (ii) working capital; or (iii) other costs associated with an approved project	To be specified in the finance documents to be signed with DFC
Interest rate	Rate to be determined by the Treasury Secretary, taking into account the current average yield on outstanding obligations of the US with remaining periods of maturity comparable to the maturity of the loan	Negotiated spread over the base-cost of funds

Fees and other charges	May be collected but are not specified	Vary on a project-by-project basis, but may include upfront retainer fee, facility origination fee, commitment fee, and maintenance fee
US person as sponsor	Not specified	Preferred

Potential Structures: Corporate or Project Financing

The Guidelines do not specify if DFC will require that the loans under the DFC/DPA Loan Program be structured as corporate loans (*i.e.*, relying on the balance sheet of the company sponsoring the project or on a corporate guarantee) or as non-recourse or limited-recourse loans (*i.e.*, using a special purpose vehicle (SPV) to implement the project on an off balance sheet, project finance basis). Currently, DFC works with both structures for its ongoing financing program for developing economies. DFC is likely to do the same for the loans under the DFC/DPA Loan Program.

The project finance model is based on the premise that the project will generate sufficient revenue to repay the loan. This, in turn, implies that the lenders will need to be confident that the project will be able to generate sufficient cash flows over the term of the loan to pay debt service during operations. As a result, project finance lenders will often demand long-term sales contracts (known as "offtake contracts") with creditworthy buyers to ensure a steady and sufficient level of cash flows to support the loan amount. Although some project financings are underwritten without an offtake contract, those projects are in sectors where there is a reasonably predictable and reliable market (such as, for example, the electric power space). Another key requirement of project finance is that the collateral package securing repayment of the loans should allow the project finance lender to foreclose on all material assets necessary to operate the project (*e.g.*, real estate and fixtures, major equipment, material contracts, deposit accounts): because the loan is non-recourse (or limited-recourse) lenders are relying solely on the future cash flows of the project for repayment of the loan, and thus the lenders need to have a claim on all material assets of the project if business is not successful.

While corporate-style loans may also be available, the DFC-DPA Loan Program opens project finance-style, non-recourse or limited-recourse financing to individual assets or projects (*e.g.*, a medical supply manufacturing plant, a food processing facility) in industries that have not historically enjoyed the benefit of these types of financing structures. Potential borrowers looking to take advantage of this program, accordingly, should begin thinking early and up front as to how to structure their businesses in accordance with project finance principles if they want to take advantage of the limited recourse nature of the credit facility. Working through all these details with loan applicants that may be new to project finance structures will ensure the viability of the DFC/DPA Loan Program.

Application Process

The Guidelines require interested parties to submit the DFC-DPA Loan Program Application Form online. Upon receipt, DFC will decide whether the proposed transaction meets the minimum eligibility requirements. During the screening process, DFC may request additional information from the applicant to help determine the viability of the proposed project. In the interim, applicants may request (or DFC may send) a letter of interest to show DFC's willingness to continue discussing the potential application.

Successful applicants will undergo environmental, credit, and legal due diligence. DFC may request the applicant to retain outside consulting services to assess relevant aspects of the project or the transaction, and these costs may be included in the financial plan. Upon successful completion of due diligence, the project will be submitted to DFC's CEO for approval, considering the eligibility requirements summarized above. If approved, the parties may sign a commitment letter based on an approved term sheet. Following approval of DFC's CEO, the parties will sign a finance agreement that will set out the definitive terms of the transaction and enable the borrower to request disbursement of the loan.

Key Takeaways: Opportunities and Challenges

The DFC-DPA Loan Program offering loans of up to US$500 million opens the door to companies seeking financing to establish, expand, convert, or modernize their US production capacity or retool and restructure their supply chains in response to the COVID-19 crisis. The potential pool of recipients for DFC-DPA Loan Program loans is far-reaching, with manufacturing, healthcare, pharmaceutical, automation and technology, and food supply companies likely to be among the main beneficiaries of this program.

The Guidelines are effective immediately without a review or comment period. This is largely because the COVID-19 pandemic presents an urgent need and because the duration of the DFC-DPA Loan Program is limited to two years. The Guidelines are clear on the substantive requirements and process required to apply for and obtain loans under the DFC-DPA Loan Program. However, the key eligibility requirements are not as clear. Given the immediate implementation of the DFC-DPA Loan Program, the authors of this *Alert* expect DFC to work through this point as deals are negotiated and closed.

Latham & Watkins will continue to monitor developments in this area.

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