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"The U.S. - Mexico Border: A Discussion on Subnational Policy Options"
The Wilson Center Mexico Institute and El Colegio de la Frontera Norte

Policy Brief:
"The Future of the North American Development Bank"
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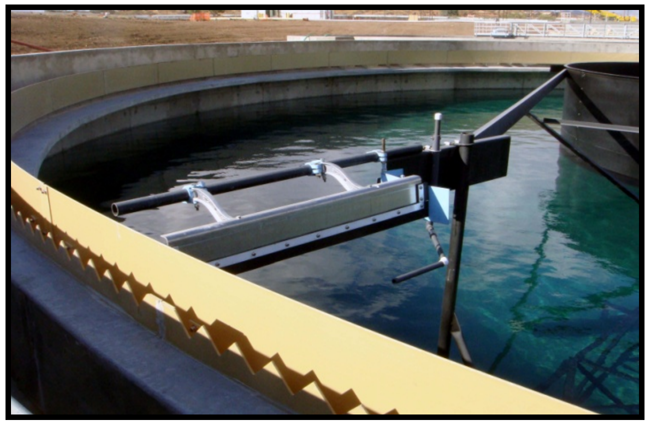
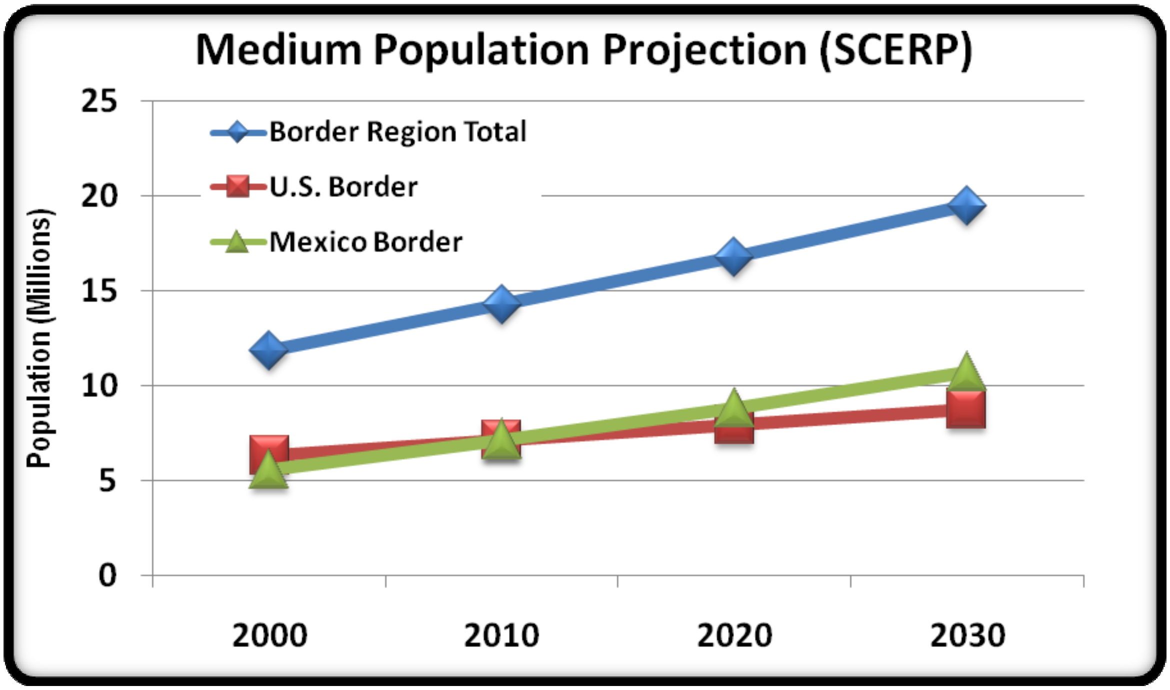


1. NADB's Evolution:

A. A Bank for the Border:

The U.S.-Mexico border is confronting violence, security concerns and stressed trade flows, along with the longstanding issues of immigration, environmental decline and growing inequality. Both sides know that business as usual does not work. Sovereignty constraints have led to the application of 19th century solutions to current challenges. The paradigms that continue to define how the border evolves need to be changed, with joint responsibility and enhanced cooperation as the key tenets.

Many of the border issues do not recognize political boundaries and cannot be solved by unilateral approaches. Population growth rates on both sides almost double those of national levels as a result of intense migration. The flow of trade and investments has increased significantly since the passage of the North American Free Trade Agreement (NAFTA), placing a huge strain on overburdened infrastructure—already failing years ago—to keep up with demand. Cooperation in infrastructure development continues to be critical for the region as a whole.



The idea of creating a financial institution to cater specifically to infrastructure needs along the border had been discussed long before NAFTA was negotiated. It finally materialized due to growing concerns that the controversial passage of NAFTA would worsen environmental conditions, particularly in the water and wastewater realms. In that context, the North American Development Bank (NADB) and the Border Environment Cooperation Commission (BECC) were established in 1994 with a view to preserve and enhance the environment and promote sustainable development in the U.S.-Mexico border region.

A framework with two institutions was designed to keep credit decisions and fiduciary responsibilities independent of a key objective: the maximization of grassroots participation in promoting and supporting projects. Each project must pass through a public certification process performed by BECC, located in Ciudad Juarez, Mexico, in order to be considered for financing from NADB. BECC requires the project and/or project sponsor to meet criteria related to human health and the environment; technical and financial feasibility; community participation; compliance with legal and regulatory requirements; and sustainable development.

Both organizations have a lean operation and compact structure with approximately 50 employees each. The Bank is headquartered in San Antonio, Texas, hosted by the City's government.

NADB is capitalized in equal parts by the U.S. and Mexican governments, with a structure that includes US$450 million in paid-in capital and US$2.55 billion in

callable capital, for a total of US$3 billion. The Bank has no outstanding borrowings on its balance sheet, but in the near future will need to issue debt as it reaches its direct lending capacity. The callable capital commitments of both governments will allow it to access financial markets under competitive terms.

NADB's administrative expenses are financed with income from lending operations and earnings on investments from paid-in capital, while its program activities have been financed from designated retained earnings accumulated in past years.

Despite progress achieved within the context of their mandate and resources, BECC and NADB have been repeatedly questioned since their origin. As the only permanent institutional bodies to emerge under the treaty, they carried the burden of the unrealistic expectations generated by the overselling of NAFTA and its side agreements in order to gain support for its passage.

To assess their performance, the backdrop of what NADB and BECC have been allowed to do by their limited mandate is clearly relevant. Neither federal government was particularly enthusiastic about the Bank's creation. It was constrained from the onset in terms of the sectors it was mandated to cover; the severely limited credit capacity of the water utilities; the constitutional and structural impediments to lending on the Mexican side; the difficulty of competing with municipal bond markets on the U.S. side; and the restrictions imposed by certification and lending rules.

It has taken several years for both institutions to gain traction, with grant programs and mandate and procedural reforms being decisive factors. The Appendix details the Bank's programs, performance and current challenges.

B. NADB's Initial Mandate Reforms:

The scope of their mandate—including the geographic jurisdiction and environmental nature of the sectors in which they can operate—and the specific functions of each institution are defined in an agreement between the two governments (the "charter").

In the fall of 2000, in the context of the election of Presidents Vicente Fox and George W. Bush, the opportunity emerged for the two governments to carry out a comprehensive review of the BECC and the NADB's mandate and performance. President Fox publicly acknowledged the Bank as a central part of his "NAFTA Plus" vision, leading to efforts to structure and negotiate a thorough reform: an improved structure; expanded sectors and geographic jurisdiction; additional funds and financing instruments; expedited certification and financing procedures; and more flexible credit guidelines. The aftermath of September 11,

2001 derailed the discussions—along with a broader U.S.-Mexico agenda—and led to a slower and more moderate reform process, reliant on scattered governmental and Congressional initiatives.

In 2000 the BECC and the NADB boards of directors resolved to allow the two institutions to move forward with an expansion of the scope of their activities within the confines of the original charter, while maintaining water, wastewater, and solid waste projects as a priority. The reform added other sectors with an impact on the environment and projects that ultimately provide a better quality of life for border residents: air quality improvement, cleaner and renewable energy, energy efficiency, and industrial and hazardous waste.

In August 2004 an amended BECC-NADB charter went into effect, creating a single Board of Directors for both institutions and expanding their geographic jurisdiction in Mexico, breaking at least in this regard the symmetry embedded in their design. Their jurisdiction now covers 300 km (approx. 186 mi.) south and 100 km (approx. 62 mi.) north of the border. Projects beyond these areas may be eligible if they directly impact or remedy a transboundary environmental or health problem.

A single ten-member Board of Directors now governs the two institutions. The Board is comprised of three federal government representatives, a representative of a border state, and a representative of the general public who resides in the border region, from each country. The chairmanship alternates between the U.S. and Mexico every year. Having a single board has allowed for improved coordination between the two institutions, a significant issue during the early years. It has resulted in shortened timeframes for project development, financing and implementation, and faster rates of disbursement.

As an international agreement between two countries, any changes to the Bank's charter must be legislatively authorized. The environmental sectors were expanded by the Board under the language of the original charter and did not, therefore, require an amendment or legislative approval. The expansion of geographic jurisdiction and the creation of a joint board did require legislative action (H.R. 254).

2. <u>Further Roles and Mandate Reform</u>:

Many agencies and programs have a bearing on border issues, but the region still lacks an effective and cohesive institutional base, particularly on a bilateral scale. Prevailing political thinking in Washington—and to a certain extent in Mexico City—and the current economic situation are not conducive to creating supranational structures; so while Europe bursts with a cumbersome and bloated institutional life, North America remains anemic by comparison.

Its mere existence and capacity for reform given its small size and overhead make NADB a valuable asset. Only an accountable and trusted institutional body with a mandate on both sides of the border and subject to bilateral oversight will allow for further resource transfers and productive interaction. With its track record of tackling difficult sectors and its untapped potential, NADB could truly become the long overdue border bank. It is time for NADB and its mandate to reach beyond the environment to other areas where it can be a vital funding and capacity-building instrument.

Mexico has sought a broader mandate for NADB since 2000. President Felipe Calderón has acknowledged its value and the need to continue expanding its role. He has underscored the "very positive outcomes" of NADB financing; his "commitment to promote" further "reforms of the Bank's mandate" in order to "eliminate restrictions and improve its operations"; and the need to increase single obligor limits and to expand the mandate to cover "infrastructure projects in general", and not just environmental projects (speech at the VI National Convention, American Chamber of Commerce; February 27, 2007).

Some progress has been made along Pres. Calderon's line of thinking. In 2008 the Bank authorized increasing the single-obligor limit, as well as financing for a new type of air quality improvement project: border crossing infrastructure.

NADB's role also fits within President Barack Obama's agenda in terms of the critical importance of infrastructure development, the need to tend to border issues, and the structuring of more positive and comprehensive cooperative efforts with Mexico. Both federal governments are sponsoring infrastructure programs along the border as part of their economic stimulus initiatives that will render synergies if closely coordinated.

A drawn-out debate has taken place among environmentalists along the border who would like BECC and NADB to continue concentrated on their current mandate and those who believe they should cater to much broader infrastructure needs and an extended jurisdiction. There is a valid argument in making sure these institutions remain focused and clearly there is still much to do environmentally. But there is a wider range of needs along the border that require urgent attention, face decreasing government funding, and are not profitable enough to be financed by commercial banks or the private sector. Addressing these needs would not only have a high impact on the quality of life of the population but would also foster job creation and economic development. In addition, covering more profitable sectors would enhance the Bank's ability to respond to projects lacking credit capacity.

Below are ten of the actions and policy initiatives that have been debated in recent years with regard to achieving an expanded and more effective role for NADB:

A. Expand the mandate to include additional infrastructure sectors:

The Bank requires a more flexible mandate that takes into account a broader set of criteria that do not focus excessively on quantifiable environmental benefits. Currently the Board sets very high environmental benefit thresholds on projects. Factors relating to the broader goals of infrastructure improvement and economic development should be considered in addition to environmental criteria in a balanced way.

Some sectors are more amenable than others for bilateral cooperation. Water—and environmental infrastructure in general—has been a must in view of its strategic importance as a shared and scarce resource on both sides of the border and given its growing complexity. Transportation and logistics, among other areas, is a natural choice: fostering the corridors concept, linking inland port projects and facilities on both sides, helping address the tradeoffs with security measures, promoting customs systems and bridge and road projects that have faced endless delays. Maximizing the use of current infrastructure and addressing mismanagement, coordination and harmonization issues should continue to be part of NADB's focus.

The Bank should become more fully engaged with the development and expansion of ports of entry and border crossings. In the context of security imperatives, investments aimed at facilitating the construction and improvement of crossings through public-private partnerships might be the most important contribution to the border's development today.

The need for legislation to authorize further expansion into other infrastructure sectors has been debated. Some suggest it is simply an issue for the governments to resolve. However, given the restrictive interpretations of the charter, if a favorable legislative climate develops its amendment would be advisable if broad mandate expansion were to be considered.

A lingering question is how much of a BECC certification process should be applied to projects in new sectors. Public and stakeholder participation in project development, approval and support has been a fundamental contribution of BECC over the years, but there is a concern—particularly among private sector investors—that it delays the funding process unduly. Expedited NADB lending approval processes will also be critical in order to foster more private sector participation.

As new sectors are addressed, it will be crucial to find even more creative ways to mitigate risks, foster long-term financing in the local currency, and leverage funds from different sources. A key role for the NADB will be to help enhance project conditions and provide guarantees in order to link with private financial markets

where affordable long-term funds in a multi-year programming context might be available.

B. Allow for more flexibility in the Bank's geographic jurisdiction:

Most analysts agree that the Bank should continue to be essentially a border institution. Beyond the fact that it best fills a void and a niche by remaining focused on the region, it would be politically unrealistic from a U.S. perspective to expect a bolder expansion of its reach anytime soon. However, working along trade corridors that directly affect the border would make sense, implementing the "perimeter" concept in a reasonable way.

C. Increase the channeling of federal and state funds through NADB, starting with a refurbished Border Environment Infrastructure Fund (BEIF):

There are socially critical areas of infrastructure that provide sound foundations for economic competitiveness but will not be profitable anytime soon and will continue to require strong government intervention. Governments should apply more strict "additionality" criteria to their limited investment: concentrate on what others cannot and focus on making a difference.

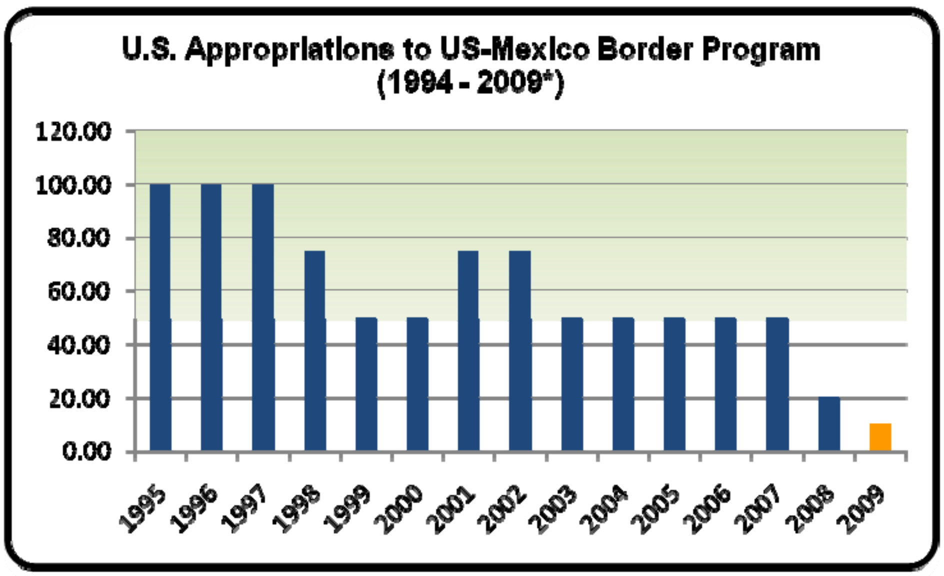
Subsidy allocation needs to be greatly improved to make sure it reaches the poorest segments of the population and achieves better capital-to-output quotients. There are benchmarks available that suggest the maximum amount that poor households should spend out of their median income on public services, which can serve as a guideline for affordability analyses and tailored subsidies. Revolving funds should be the vehicle for making better use of scarce grant funds, and U.S. experience in that regard is relevant.

The Bank has been successful in administering EPA funds, particularly serving as an efficient mechanism for applying them in Mexico to issues of priority to the U.S. government. Based on that experience, the Bank could be a conduit for other government funds, i.e. potential General Services Administration (GSA) resources for port of entry infrastructure on the Mexican side or other EPA funds, such as energy-related grants.

The BEIF (see Appendix) is a significant cooperation precedent that should be preserved and expanded. It has funded over US$533 million in water and wastewater infrastructure relevant to both sides of the border, making projects affordable for communities by allowing NADB to combine grant funds with loans. Every EPA grant dollar has leveraged approximately two dollars from other sources. In Mexico it is applied *pari passu* with Mexican funds and has led the Mexican National Water Commission (CONAGUA) to triple its investment in the border in the past three years. Every project, whether located in the U.S. or

Mexico, has provided an environmental and human health benefit for the U.S. Adequate oversight and transparency in the procurement and funding processes have been key to building bilateral trust in this program throughout the years.

Because of increasing funding limitations, BECC, in coordination with EPA and NADB, has implemented a prioritization process to identify projects which will address the most severe environmental and human health conditions existing in the border region. In the federal budget, funding allocated to the U.S.-Mexico Border Program that feeds the BEIF and BECC's Project Development Assistance Program (PDAP) dropped from almost US$50 million to US$20 million in FY2008 and only US$10 million has been proposed for FY2009 (see BECC-NADB chart below). That amount is not even sufficient to address five percent of total documented needs. Annual BEIF allocations of at least US$100 million should be justified for future funding cycles.



D. Review single-obligor lending limits:

In order to further ramp up its lending, the Bank periodically reviews its capital adequacy model and existing policies on lending limits. In 2006 it increased its credit exposure per project to cover up to 85 percent of the overall project cost (100 percent for projects costing US$1 million or less).

NADB has also established a single obligor limit equal to 15 percent of its available capital resources and 25 percent under certain conditions. Based on 15 percent, the current limit per borrower is estimated at US$65.3 million. This could be made more flexible based on federal guarantees that some projects could provide as backstop.

E. Advance the Bank's role on the U.S. side through stronger credit-enhancement capabilities:

The availability of a municipal bond market considerably limits the appeal of NADB financing in the U.S. The greater potential lies in assisting communities in accessing market funding as a guarantor and credit enhancer.

The intent of proposed legislation (H.R. 1060 introduced in February 2009) is to amend the Internal Revenue Code of 1986 to clarify that a NADB guarantee is not considered a federal guarantee for purposes of determining the tax-exempt status of bonds. It provides clarification that NADB is able to guarantee bonds issued by state or local governments in the U.S. without jeopardizing the federal tax-exempt status of payments of principle and interest on such bonds.

There are some border stakeholders that believe NADB's ability to enter into credit enhancement arrangements with U.S. border communities that issue tax exempt debt would provide a significant benefit to those communities by lowering the cost of their debt. The proposed legislation would lay to rest the fundamental concern that has inhibited NADB participation in tax exempt issuances.

F. Use NADB as the vehicle to test and expand municipal bond financing in Mexico:

Over the past twenty years, municipal reform in Mexico has concentrated mostly on the transfer of federal funds and key responsibilities, leaving local financial instruments, management structures and practices unchanged in many instances. The lack of transparency, professionalization and continuity at all levels of municipal government is still prevalent. Inadequate legal and contractual frameworks, board configurations, pricing practices and tariff structures, billing and collection systems, and staffing continue to encumber the performance of local public utilities and their access to credit.

By contrast, the U.S. tax-exempt municipal and revenue bond markets are pervasive and have had continued success and very low rates of default. The key is the fiscal setting and the significant firewall that exists between electoral politics and city or utility management. That separation is still a crucial challenge in Mexico for any market mechanism to work in the less developed sectors.

NADB can assist in the development of better conditions for municipal financing by strengthening its requirements and providing direct incentives for improved financial governance, especially on the Mexican side. It can also assist in testing new financing settings and tools, conducive to expanding municipal bond markets.

G. Use NADB as an instrument to foster, test and implement municipal reforms in Mexico:

Infrastructure finance in the developing world is beset not only by funding shortages, but by challenges in credit capacity, design, groundwork tasks, procurement, administration and control. Oftentimes, a project's constraint is not financial. Adequate conditions to fund and disburse are frequently lacking, and waste, corruption and the inability to properly manage projects are extensive. These constraints call for institutional strengthening and technical assistance.

At BECC and NADB, such efforts are of substantial importance to financing along the border. All NADB financing should be used to encourage institutional reforms and efficiencies. Good management leads to better financing alternatives, encouraging a virtuous cycle.

NADB has strived to transfer successful experiences in the U.S. to the Mexican side regarding city and utility management and municipal finance. It is engaged in over 150 border communities, assisting with utility and project development and providing training. Its Utility Management Institute (UMI) is enhancing the managerial, financial and leadership capabilities necessary to operate a successful utility (see Appendix).

H. Explore the possibility of a binational border investment fund to be managed by the NADB:

Initiatives for a North American Investment Fund linked to performance have been discussed for years in different forums, as evidenced by U.S. Senator John Cornyn's Bill S. 2941, introduced on October 7, 2004. The idea merits consideration again in view of the need to find innovative approaches to channel additional resources to the border.

I. Expand coordination with the Inter-American Development Bank and other institutions:

Some analysts argue that the World Bank or the Inter-American Development Bank could cover what NADB should be doing along the border. In fact, some of their programs aimed at the Mexican side of the border have been cancelled or have waned over recent years. In any event, the trend in development finance around the world is toward regional approaches and organizations better focused and geared toward specific needs and circumstances. Furthermore, NADB is the only multilateral development institution that can lend in the U.S., a clear advantage given the bilateral nature of the issues the border region faces.

That does not preclude the need for alliances to be made with any institutions that favor a partnership for infrastructure expansion in order to pool resources. This is particularly true of state and local agencies, as well as Mexico's recently established National Infrastructure Fund (FONADIN) and stimulus funding opportunities in both countries.

J. Give BECC and NADB a role in crafting a regional development plan and strategy to expedite and coordinate infrastructure development:

BECC and NADB are participating in efforts for greater coordination among U.S. and Mexican agencies involved in environmental matters, in order to develop border projects as efficiently as possible. The two institutions coordinate the development and financing of water and wastewater projects with EPA, CONAGUA, and both sections of the International Border and Water Commission (IBWC). BECC and NADB also coordinate with state and local authorities. The expansion and strengthening of these coordination efforts are essential for the successful development of future projects.

There are many examples of productive border collaboration around the world. The compromise achieved between sovereignty and arbitration issues with an ecosystem approach at the Canada-U.S. International Joint Commission (IJC) along the Great Lakes and the St. Lawrence River system, however limited, is worth exploring. The experience of regional utility districts for water, sewage, garbage, power, gas, transportation, telecommunications and other services in the U.S. should also be examined in order to foster joint binational management schemes. An initiative has been studied by the U.S. Congress to establish a regional economic authority for the border to address critical infrastructure development issues, creating synergies and avoiding duplication (see S. 458, February 2003; H.R. 2068, April 2007).

With 15 years of experience, BECC and NADB can become hubs in designing a blueprint for the border's future, identifying success stories and best practices and testing them in the U.S.-Mexico border context. How to foster joint management of services and resources; how to facilitate border crossings while improving security; how to implement the perimeter and pre-clearance notion; how to create synergies between a powerful, aging society and a younger, developing one; how to build constituencies for a better interrelated and more competitive North American region.

Addressing the financing needs for border infrastructure would create the foundations for productivity and self-sustained growth in a way that would benefit the whole North American region. Each sub-region needs to identify the major deficiencies that limit

competitiveness and development and the best ways to resolve them. This should be fostered and coordinated under the stewardship of the ten border state governments.

As the U.S. and Mexico enter a new era of collaboration, the Border Governors Conference could establish a permanent task force to provide input and support to BECC-NADB as they continue to evolve. This would help multiply their contribution to the border's development, as a lynchpin of a new 21st century agenda for North America.

Appendix - Current Status and Challenges:

1. **Current status:**

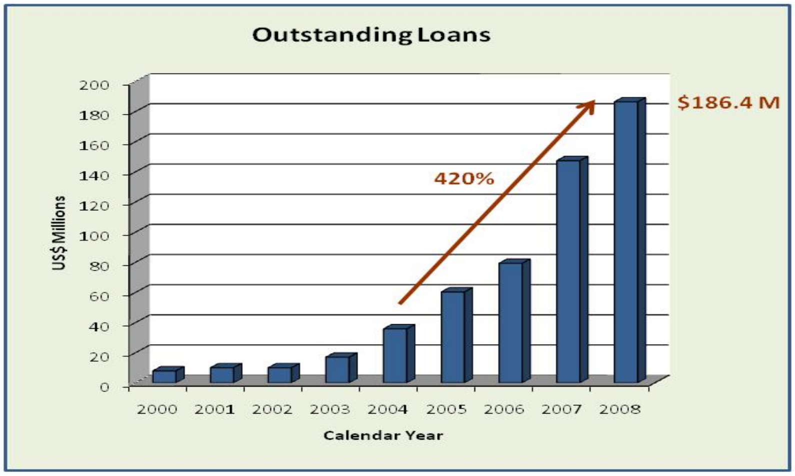
   NADB programs include funding for public and private sector projects. Loans are made in pesos or dollars. The Bank also administers federal grant funds and uses part of its retained earnings to make grants to meet affordability constraints in communities in need and priority sectors.

   The Bank creates conditions and incentives in public utilities for better governance and increased sustainability, allowing for gradual and reasonable service pricing adjustments. In addition to direct project financing, NADB uses a portion of its retained earnings to provide technical assistance and training to project sponsors for the purpose of strengthening the financial performance and efficiencies of utilities and ensuring the long-term sustainability of infrastructure.

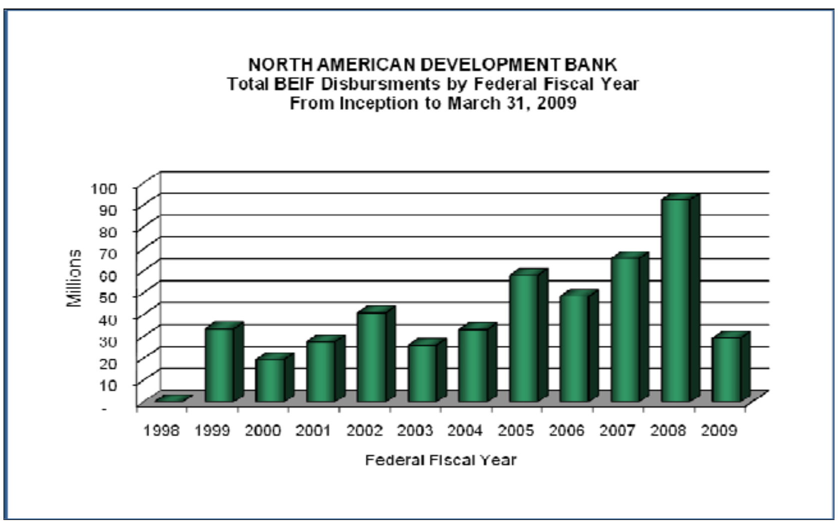
   The Bank was highly reliant on grant funds during its initial years due to the fact that projects were either not ready for financing or their public sponsors did not have adequate debt capacity. Given the limited creditworthiness of many environmental projects, NADB continues to provide partial grant funding to help make them more affordable for communities.

   The BECC and the Bank's most recent status reports describe their programs and performance as follows:

   A. **The Bank's Loan Program provides direct financing for the construction of BECC-certified environmental projects. Its Low Interest Rate Lending Facility (LIRLF) allows the Bank the flexibility to offer loans at lower than market rates for non-investment grade projects in priority sectors. The growth of NADB's loan portfolio is evidenced by its balance, which more than quadrupled from 2004 to 2008.**



B. The ***Border Environment Infrastructure Fund (BEIF)*** **administers grant funds provided by the U.S. Environmental Protection Agency (EPA) which can be combined with NADB financing to make water and wastewater projects affordable even in the smallest and poorest communities. Current BEIF allocations total US$635 million and contracted grants for certified projects total US$533 million. Annual BEIF disbursements are shown in the NADB chart below.**



C. **The Solid Waste Environmental Program (SWEP) provides grant financing for the implementation of municipal solid waste projects using a portion of NADB's net earnings.**

D. **The *Water Conservation Investment Fund (WCIF)* provided grant financing for the implementation of water conservation projects in the border region. A total of US$80 million was allocated for that purpose, all of which has now been committed to 23 projects in irrigation districts in both countries.**

E. The *Institutional Development Cooperation Program (IDP)* is a grant program designed to assist public utilities in the areas of institutional strengthening and financial development, in order to ensure the long-term viability of each project. To date, NADB has authorized assistance for a total of 185 studies, benefiting 81 communities on both sides of the border.

F. The *Utility Management Institute (UMI),* funded through the IDP, offers water utility managers and their staff an opportunity for professional development aimed at enhancing their managerial and financial skills. One of the lynchpins for the development of sustainable infrastructure along the border is improving the operational effectiveness and efficiency of public utilities. The basic program consists of four seminars that focus on financial administration and planning, as well as management, team building and leadership skills. UMI also offers ongoing educational opportunities to participants who have completed the basic program, through specialized sessions on such topics as planning and managing infrastructure projects, designing and implementing appropriate rate structures, and crisis management. Now in its tenth year, a total of 1,355 utility professionals, representing 168 border communities in Mexico and the U.S., have participated in its seminars.

G. The *Project Development Program (PDP)* is a technical assistance program designed to help communities in the planning and design of environmental infrastructure projects. To date, NADB has authorized assistance for studies benefiting 65 communities.

H. *BECC's Technical Assistance Program* helps border communities prepare project proposals for certification that allows them to become eligible for funding consideration from NADB and other agencies. It covers studies related to environmental assessments; technical, economic and financial feasibility; preliminary and final design; evaluation of social and sustainability aspects of projects; public participation programs; operation and maintenance programs; and capacity building needs. BECC has approved more than US$36 million to assist 149 communities.

As of April 30, 2009, NADB was participating in 124 BECC-certified environmental infrastructure projects with US$916.7 million in loans and grants, of which 83 percent had been disbursed to project sponsors. These projects represent a total investment of US$2.66 billion. NADB participation represented about 35 percent of the total investment in these projects, with 59 percent going to projects in Mexico and 41 percent to projects in the U.S.

A breakdown of project financing by country is shown in the following table provided by NADB.

NADB Financing as of April 30, 2009
(Millions of U.S. dollars)

	Total	U.S.	Mexico
Projects with NADB funding	124	66	58
Total project costs	$2,662.1	$1,015.0	$1,647.1
Total contracted	**$916.7**	**$374.5**	**$542.2**
Loans	$294.3	$50.9	$243.4
BEIF	$533.5	$281.0	$252.5
SWEP	$8.7	$2.5	$6.2
WCIF	80.0	40.0	40.0
Total disbursed	**$760.4**	**$311.9**	**$448.5**

Of the 124 projects receiving funding from the Bank, 59 have been completed and are in operation, 54 are currently under construction or in various stages of completion, and 11 are in the design or bidding stage. NADB has also approved US$44.4 million in loans and grants for 7 projects for which funding agreements are in development.

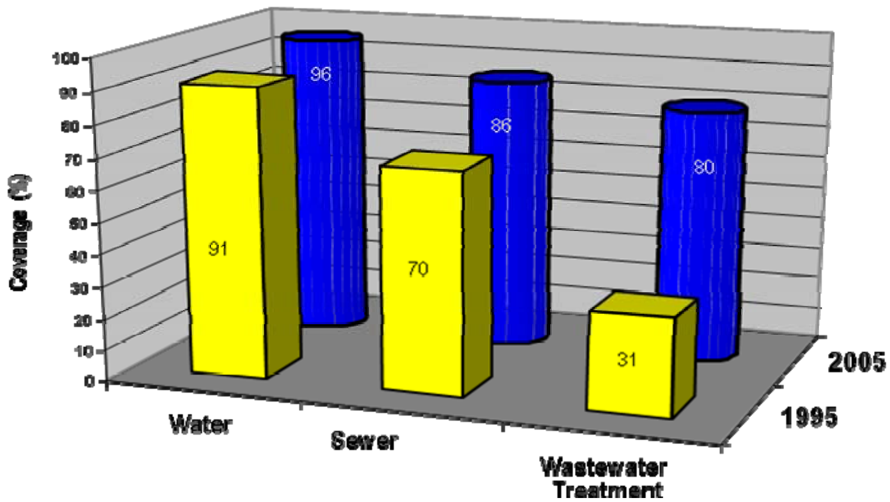
The composition of NADB's financing portfolio by sector as of April 30, 2009, along with some of its impacts, is presented below.

a. Water, Wastewater and Storm Drainage: 77%

- **First-time water and sewer services provided for some communities;**
- **47 wastewater treatment plants and 57 sewer collection systems. In 1995, wastewater treatment coverage in Mexico along the U.S. border was 31 percent, with untreated wastewater being discharged into the Rio Grande and other shared waterways. Today, due in large part to projects financed by NADB, wastewater treatment is at over 80 percent and improving, while the national average remains at 36 percent. Given the natural propensity in water utilities to favor potable water projects for political reasons, progress on the wastewater treatment front is noteworthy. The higher quality effluent is improving the water supply in transboundary watersheds which serve as the only source of water for many communities in the region;**
- **Preventing the discharge of 300 million gallons per day of untreated wastewater into rivers and streams like the Rio Grande, Colorado and Tijuana Rivers, and Nogales stream. Equivalent to the discharges of a city of 7 million residents;**

- 18 water treatment plants and 25 water distribution systems (coverage on the Mexican side increased from 91 to 96 percent in ten years since 1995; the national average is 89 percent);

- 371,600 acre-feet of water saved per year (equivalent to more than half the water used annually by the city of Los Angeles, CA).



b. Air Quality: 10%

4.0 million square meters of paved streets reducing air pollution exposure to 3.3 million residents from vehicular traffic on unpaved streets.

c. Solid Waste: 2%

14 landfills benefiting 2.8 million residents with better waste collection and disposal services.

d. Clean Energy: 2%

Further expansion into other sectors—particularly those related to cleaner and renewable energy—is a priority, as the cost of fossil fuels and global climate change emerge as policy concerns for both the U.S. and Mexico. NADB is currently involved in developing projects related to biodiesel production, methane capture, wind energy, biogas, and industrial energy efficiency.

On April 16, 2009, Presidents Obama and Calderón announced the creation of the U.S.-Mexico Bilateral Framework on Clean Energy and Climate Change, which will focus on renewable energy, energy efficiency, and the mechanisms and capacity building needed to bring the "green" revolution and associated jobs to the border

region. NADB is expected to play a key role in this new initiative. By the end of May 2009, the Bank had approved a total of US$22 million in loan financing for its first two renewable energy projects in the border region.

In addition to increasing funding activity, BECC and NADB have had two operational objectives over recent years:

- **To reduce the time between project certification and funding approval, signing and disbursement; and**
- **To facilitate project implementation, expedite start-ups of project construction, and streamline oversight processes.**

The recent practice of submitting BECC certification and NADB financing proposals for approval simultaneously has helped ensure that projects move through the BECC-NADB development process in a more timely manner. Most projects are now ready to begin bidding and construction almost immediately following certification. In 2007 alone, the average time between financing approval and signing was reduced by 68 percent.

In the case of Mexican loans denominated in pesos, NADB had to go through a cumbersome process to comply with the Mexican Constitution provision that forbids state and local governments from incurring debt in foreign currencies or directly from agencies that are not deemed domestic. It established an innovative, non-regulated, multi-purpose financial institution in Mexico—known by its acronym as COFIDAN—to channel its loans to state and local public entities, and gained access to exchange-rate hedge mechanisms. It is now using a trust mechanism to facilitate the hedge coverage process. Loans can be disbursed in a lump sum to the trust and then gradually drawn down by the sponsor on a schedule based on construction progress.

2. <u>Current challenges</u>:

BECC and NADB need to continue improving their impact and performance assessment capabilities. Broadly, the value to the border region of the infrastructure work financed by NADB is evidenced in the improved quality of life for the estimated 12 million people who are directly benefiting from the projects they support. However, in carrying out their mission the BECC and NADB report that they continue to face the following fundamental challenges on both sides of the border:

A. Lack of comprehensive master plans and inadequate preparation of projects.

B. Limited financial, administrative, commercial and operating capabilities of some local utilities responsible for providing water, sewage and sanitation services.

C. High cost of projects and insufficient community resources.

D. Inadequate revenue for the sound operation and maintenance of existing systems, coupled with political resistance to user fee increases, particularly in the water, wastewater and solid waste management sectors. This political stance is pervasive even though the poorest segments of their communities are not connected to the systems and continue to pay much higher prices for informal and inadequate services.

E. Insufficient interest and limited success with private sector participation.

BECC and NADB seek to assist communities in addressing these challenges by:

a. Identifying additional sources of capital, credit, and grant funds, and structuring financial packages based on the reasonable capacity of communities to service debt and cover operation and maintenance costs.

b. Assisting in the improvement of the operating efficiency and capabilities of public utilities and other project sponsors by strengthening their institutional capacity to formulate and execute projects effectively.

c. Promoting structural changes that are essential to the long-term success of projects, including proposals for reforming the legal and institutional frameworks in which they are developed.

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