EMPLOYMENT SECTOR

Equipment finance for small contractors in public work programmes

ILO Position Paper

-- DRAFT --

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Contents

I Introduction

Small contractors working on labour based public works programmes often have limited access to formal financial services. Operating in countries where interest ceilings and collateral requirements generate a gap between small businesses and banks, the contractors are bound to rely on informal and ad-hoc types of financial services. The most prominent constraint contractors face in this situation is the difficulty to find appropriate financing for the acquisition of construction equipment. Less obvious but associated problems relate to the absence of savings, money transfer and insurance facilities.

The difficulties that contractors have in attracting finance can strongly affect the outcome of the public works programmes. They are at the basis of a variety of sub-optimal situations where construction companies delay operations, work with the wrong type of equipment and pull out because of sudden illiquidity problems. Faced with these realities, contracting agencies are often obliged to play a role in making financial services more accessible to small scale contractors. They either pre-finance operations, take some of the financial risk by guaranteeing bank loans or facilitate leasing or hire-purchase arrangements. The success of these interferences largely depends on the nature of the public works programme, on the specifics of the local financial market and on the degree to which the design of the arrangements is adapted to the local circumstances.

This paper aims to guide project managers involved in public works programmes in finding the best possible solution for the financing of construction equipment. The paper provides an overview of the various financial services one could opt for and explores ways to identify local financial partners.

II Equipment finance for small contractors

2.1 Small contractors

The ILO assists governments in developing countries in the design and implementation of employment-intensive public works programmes that increase the employment impact of investments. The use of labour-based methods in infrastructure programmes spreads the income benefits over the community, reduces foreign exchange risks and strengthens the domestic construction sector.

One of the objectives in many employment-intensive programmes is the strengthening of small contracting firms that employ local resources to implement the works. The local contractors receive technical training as well as assistance in business management and contracting procedures. Through the combination of training and consecutive work contracts, the firms get the opportunity to establish themselves in the domestic market for civil works.

2.2 How small contractors finance their equipment

Small contractors tendering for labour based construction contracts mostly use their own funds and family savings to invest in equipment. Using predominantly light equipment like trucks and tractors the contractors are flexible as to the type of work they undertake. A large share of the financial resources used for procurement comes from non-construction activities, such as transport and trade. In situations where the own funds of the entrepreneur are insufficient to purchase new equipment, second-hand trucks and machines are bought on the local market.

Suppliers credit seems to be the most common source of external financing of equipment amongst small contractors. Competition on the suppliers market defines whether equipment vendors sell on credit and what they charge in terms of down payment and interest. In many developing countries however, equipment firms only provide suppliers credit to larger firms operating in urban areas. The facility is restricted to trustworthy clients that have an established relation with the firm.

Some of the more general equipment used in infrastructure construction, like trucks and tractors, can be often be rented on the local market. The facilities and conditions to rent materials differ from country to country and from region to region. In many rural areas the demand for rentals exceeds supply, making it difficult for the contracting firms to rent appropriate and well-maintained materials.

2.3 Guiding principles to support contractor finance

Under-equipment of contractors can pose serious threats to the quality of the work performed and to the objectives of the public works programme. Therefore in many labour based public works programmes the contracting agency plays a role to facilitate the procurement of equipment by the contractors. The contracting agency either pre-finances equipment, stands guarantee for bank loans or sets up a hire-purchase scheme. The decision to opt for any of these mechanisms should be based on the following three principles.

Market rates
First of all the contractors should be faced as much as possible with a ‘real-life situation’. One of the common objectives of labour-based programmes is to build the capacity of contractors and to help them turn their business into viable enterprises. This means the contractors should be charged market interest rates, they should be required to arrange their own affairs and they should establish their own contacts with financial institutions. Any diversion from the situation the contractors will be faced with after the completion of the programme will diminish their chances to sustain their business successfully. A proven credit history and repayment record with a professional financial institution is a valuable asset for any contractor wanting to expand business.

Reimbursement capacity
A second principle is that the investment in equipment by the contractor should be justifiable from the income expected. In other words, contractors involved in the programme need to make a projection of their reimbursement capacity. Such a projection is based on the amount of income the contractors will be able to realise through future work contracts, taking into account that the companies should maintain sufficient working capital to run the operations. The assessment of reimbursement capacity of contractors under the rural roud project in Vakinankaratra and L’Amorono’I Mania Provinces of Madagascar is presented in box 1.

Simplicity
The time and money spent by the programme to set up an adequate financial scheme for the contractors has to correspond to the volume of works. Negotiations with possible financial partner institutions can be slow and can cause enormous delays in the actual works to be executed. Financial constructions tend to become more creative but also more complicated and expensive during negotiations that involve both donor agencies, contracting agencies and financial institutions.

2.4 Property issues

In many donor-funded public work programmes the necessary equipment is initially procured and financed by the donor. The equipment gets registered as property of the agency that implements the programme, normally either a Ministry of Public Works or Transport. With the equipment being registered in the name of a ministry, the options to set up a financing scheme to equip the contractors become more restricted. Firstly a government agency will not be legally allowed to sell the equipment to a financial intermediary such as a leasing agency. Secondly, since the government plays a double role as contracting agency and owner of the equipment, conflicts or interest can arise.

The following paragraphs will describe the different ways of financing equipment for small contractors. Whether the best option will be a leasing arrangement, a pre-payment of equipment or a guarantee for bank finance will partly depend on ownership issues and on whether or not the equipment has already been procured by the programme.

Madagascar: An assessment of borrowing limits for small contractors

Local commercial banks were willing to provide loans to small contractors provided that these met certain pre-established conditions, and in a situation where an external project guaranteed a certain minimum workload to the entrepreneurs concerned. Both the contractors and the banks estimated the loan reimbursement capacity of the borrowers to be in the order of 15% of their turnover. The financial condition applicable for medium-term loans or hire-purchase schemes were identical: 20% down payment, a two-year credit period for second-hand equipment or a four-year credit period for new equipment, monthly repayments and an interest rate of 25%. The study concluded that under these conditions small enterprises with a turnover of some $ 120,000 per year and a three-year workload could afford to buy a second-hand truck and second-hand compaction equipment, while keeping a 40-day cash flow reserve. For an enterprise to be able to afford to buy the same equipment new and to reimburse the loan while keeping an adequate cashflow, a minimum annual turnover of $ 350,000 and a three-year workload would be required.

Source: ILO: Employment-Intensive Infrastructure Programmes: Capacity building for Contracting in the Construction Sector, Bentall, Beusch, de Veen, 1999

III Leasing

3.1 What is leasing?

The most obvious choice for the equipment of the contractors is to look for a leasing arrangement. Leasing is a common way for SMEs to finance vehicles, machinery and equipment. Over the last decade the leasing industry in developing countries has seen a spectacular growth, with even micro-finance institutions becoming interested in the concept.

Financial leasing is a contractual arrangement that allows one party (the lessee) to use an asset owned by the leasing company (the lessor) in exchange for specified periodic payments. During the lease period legal ownership of the asset is retained by the lessor. Most leasing contracts will include the option for the lessee to purchase the asset at the end of the lease term for a nominal price.

The great advantage of lease finance for contractors is the absence of collateral requirements. The equipment itself will serve as security for the transaction. In case the contractor is unable to make the periodic payments the leasing company can simply repossess the asset. A leasing arrangement can be concluded quicker and simpler than a bank loan. Rather than looking into the credit history and the asset structure of the client, leasing companies will focus on the clients' ability to generate sufficient cash through the investment financed in the leasing arrangement. The down payment will often be low and the percentage of capital cost of the equipment financed high, enabling the contractors to keep their cash resources as working capital.

3.2 Types of leasing

Three different types of leasing can be distinguished[1]:

A. **Financial leasing** is an alternative to bank loan financing for equipment purchases. The lessor buys the equipment chosen by the client, who then uses it for a significant period of its useful life. Financial leases are also called full-payout leases because payments during the lease term amortize the lessors' total purchase costs (residual value is typically between 0% - 5% of original acquisition price), cover his interest costs and provide him profit. The lessee carries the risk of obsolescence, the costs of maintaining the asset and insurance. The lessee typically has the right to purchase the asset at the end of the lease contract for a nominal fee.

B. **Hire-purchase** is a hybrid instrument also providing an alternative to bank financing for the purchase of equipment. The instrument is typically used for retail or individual financing of motorcycles, sewing machines, refrigerators, and other small items. The lessee pays a higher down payment (sometimes up to 30% of the purchase price) and, with each lease payment an increasingly higher percentage of ownership is transferred to the lessee, thus building up equity. Ownership transfer is automatic once all required payments are made. Compared to a financial lease, this arrangement is judicially less secure for the lessor because the lessee is part owner of the asset. On the other hand, lessees have a sufficiently large stake in the equipment being acquired to avoid the risk of losing that stake through default.

C. An **operating lease** is not a means to finance equipment purchase. The lessee signs a contract with a leasing company for short-term use of a piece of equipment the leasing company has on hand, e.g. car rentals. The lessor recovers the capital cost of the equipment from multiple, serial rentals and the final sale of the asset. Maintenance costs and risks of obsolescence are borne by the leasing company.

3.3 The lease arrangement

In a standard financial lease the lessee – in this case the small contractor - selects the equipment and negotiates the main purchase terms with the supplier. In case the lessor selects the equipment a fee can be charged for this service.

While the asset itself serves as collateral under a lease arrangement some leasing companies will ask for additional collateral in the form of marketable securities, trade receivables or third party guaranties. Most lease contracts will contain a clause requiring the lessee to provide the lessor with certified financial statements during the period of the lease.

Leasing rates are often higher than bank interest rates. On top of the leasing rates the lessor will charge the client a nominal fee for the administrative costs related to the lease arrangement. The lessee will in most cases be responsible for the costs of maintenance, servicing and repairs of the equipment. Usually the lessee will be obliged to insure the equipment. Leasing arrangements still remain attractive as the up-front down payments are usually low and contracts can be structured to match the cash flow generation of the contractors business.

[1] Source: IFC, Leasing in emerging markets, 1996

Leasing companies offer different options for the client at the end of the lease term:

- The equipment can be purchased at residual value. The residual value is estimated at the beginning of the lease term, based on the likely market value at the end of the period.
- The client can renew the lease at a significantly reduced rental. Rentals during a secondary period are lower than in the primary period, usually about 5% of the original capital expenditure as a total annual secondary rental.
- The client receives a share in the profits of the equipment sale. At the end of the lease, the equipment will be sold to a third party and the client will be allowed to share in the benefit of the sale proceeds according to a distribution of proceeds defined in the lease contract.

3.4 Tax incentives

Tax incentives lie at the basis of the rapid expansion of the leasing sector in industrialised countries. In order to facilitate entrepreneurs' access to finance for productive equipment, many countries have embraced a tax system that is conducive for both lessor and lessee. The lessor, treated as the owner of the equipment, registers the full lease payment (principal and interest) as income but takes the depreciation of the asset, usually on an accelerated schedule. The lessee claims the lease payment as deduction from taxable income. Since the lease term is usually shorter than the economic life of the equipment, the lessee in fact "depreciates" the equipment more rapidly than it would in case of purchase of the equipment. Since both parties accelerate depreciation of the asset, total tax payments are decreased, to the benefit of the leasing industry.

While similar tax incentives might exist in developing countries, they are not the main reason for the expansion of leasing companies in Africa and Asia. The advantages of accelerated depreciation are not felt when tax authorities treat small and medium sized enterprises less accurately. Simpler security arrangements and convenience are more likely explanations for the growing importance of leasing.

3.5 Experiences involving leasing companies in contractor finance

Although developing countries are driving most of the growth of the leasing industry today, the operations of leasing companies are still limited to urban areas. It is often difficult, if not impossible, to fix arrangement between town-based leasing companies and small contractors operating in the rural areas.

The Uganda Transport Rehabilitation Project invited six different financial institutions for the leasing of equipment to contractors. All development banks and leasing companies approached were initially reluctant for a set of obvious reasons:

- The financial institutions have no branch offices in the rural areas and are therefore unable to monitor the performance of the contracting companies;
- The selection of contractors is done by the project on the basis of a different set of criteria than those that would be used by the financial institution to screen their clients;
- The contractors are first-time borrowers that lack expertise in financial management and book-keeping.

- Maintenance of the equipment becomes an issue when the project site is far from dealers and workshops.
- The involvement of the Ministry of Transport in most projects as implementing partner discourages the financial institutions as delays in payments to the contractors are foreseen.

3.6 Establishment of a leasing service

In areas where no leasing company exists the establishment of an equipment leasing service can be supported through the programme. The selection of an adequate financial institution that is willing to deliver the service is crucial. Possible partner organisations could be local commercial banks or micro-finance institutions. In order for the selected partner institutions to have enough time to go through all legal and financial details, preparations to set up such a service have to start at least ten months before the equipment is needed. To avoid dead ends in the negotiations with partner institutions it is advisable for the programme or contracting agency to study how conducive the regulatory framework is for the establishment of a leasing service.

In general, the setting up of a leasing service is only feasible under the following circumstances:
- the partner institution is legally allowed to enter leasing contracts or can easily obtain a leasing permit;
- the equipment to be purchased has a stable market value;
- the registry system for debt obligations and security rights is well functioning;
- the institution can freely convert local currency into foreign currency.

3.7 Leasing – the legal and regulatory environment

An enabling legal and regulatory framework is necessary for the leasing industry to offer a competitive alternative to bank finance. The rights and duties of both lessor and lessee have to be clearly stated in the legal framework, providing lessors with straightforward procedures to repossess leased assets in case of default. As leasing companies do not take deposits from the general public they should normally be less stringently regulated than other financial institutions. However a certain degree of regulation in terms of prudential conditions for operation are generally considered beneficial for the development of the leasing sector.

Box 2 gives some characteristics of a leasing-friendly regulatory environment.

Box 1: Characteristics of a regulatory environment friendly to leasing

Banking regulations	Actions to promote leasing industry
Licencing	• Recognise existence of leasing • Restrict leasing to licensed institutions and require banks to set up separate subsidiaries to do leasing • Permit leasing companies to mobilise only term deposits
Prudential requirements	• Minimum capital requirements may be lower than for many other financial institutions • Other prudential requirements may be less strict than those for

	traditional deposit-taking institutions
Legal framework	
Lessor's ownership Lessee's rights Central registry	• Clearly stated with simple, effective and timely procedures for repossession if lessee defaults • Clearly stated uninterrupted use of leased asset for the lease period if lease rental payments are current • Registry system and procedures for debt obligations and security rights, especially movable property
Tax treatment	
Lessor Lessee Sales tax Capital allowances	• Allowed to depreciate assets; lease payment taxed as income; asset depreciated over a time period shorter than or equal to lease contract • Lease payments treated as deductible expense for tax purposes • Post-contract sale of leased asset exempt from sales tax • Given to lessor or lessee; equal treatment compared to other financing
Foreign investment regime	
Convertibility of leasing co's paid-in capital Corporate tax treatment Dividends and royalties Capital equipment imports (for on-leasing)	• Free convertibility to foreign currency-denominated deposit account • Comparable to other financial institutions • Free transferability and remittance; possible exemption from withholding tax • Should receive same customs and tax treatment as if imports were undertaken directly by end-users

Source: International Finance Corporation, Leasing in emerging markets, The World Bank and International Finance Corporation, Washington, DC, 1996

IV Pre-payment of equipment by the project

4.1 Deduction of equipment costs from the work payments

In many labour-based public work programmes the equipment needed for the work is purchased and pre-financed by the project. From the point of view of preparing contractors to sustain operations in real-life situations, the option of pre-financing equipment is second-best. The contractors are not faced with the procedures and realities of financial institutions and do not build up track records with the bank. However for the sake of simplicity pre-financing equipment seems a viable option for small public work programmes.

In most schemes the Ministry of Transport or Public Works becomes the de facto owner of the equipment. At the moment the equipment is handed over to the contractors, a loan agreement is signed between ministry and the contractor. The agreement allows the contracting agencies to deduct loan repayments from the work payments. In case of exclusion of a contractor from the work for whatever reason, the ministry will attempt to repossess the equipment and hand it over to new contractors entering the scheme.

Pre-payment arrangements and loan contracts with the Ministry of Transport or Public Works can run into problems as soon as the ministry becomes unable to either provide work or to pay the contractors in time. More complications arise when delays in payment are due to bad or slow performance of the contractors or to circumstances beyond the control of both the contracting agencies and the contractors. A loan contract will have to stipulate clearly in which circumstances the contractors are allowed to suspend their repayment schedule.

When contractual payments are made in local currency, the loan agreement would normally have to be stated in local currency as well. Repayments, however, can rapidly loose their value, certainly if installments are suspended due to factors mentioned above.

In some public work programmes, the funds accumulated with the repayments of the contractors, are used for maintenance of the works constructed or –possibly more sustainable – for training of local residents in maintenance issues.

4.2 Administration of the scheme by a financial institution

In some cases the project or contracting agency chooses to subcontract a financial institution for the administration of the credit scheme. The involvement of the financial institution would ensure efficient financial management and administration of the credit scheme. The construction has the advantage of bringing the contractors in contact with a financial institution that could eventually render them financial services after the completion of the project. The cost of hiring the services of a financial institution though can be high and can easily off-set the advantages in smaller schemes.

The credit arrangement could resemble a leasing arrangement where ownership of the equipment goes to the contractor only after the last payment has been made. However, since the financial institution is not the de facto owner of the equipment and therefore runs no real financial risk, monitoring from the side of the financial institution will not be as thorough as it would be in a real lease arrangement. It is doubtful whether the financial institution would enter complicated and expensive legal procedures after the default of a client as it would in a straightforward debtor/creditor situation.

V Equipment pools

In some labour-based public works programmes ownership of the equipment is retained by a local government agency that sets up an equipment pool. The establishment of an equipment pool at a government agency has many disadvantages compared to other options described earlier.

- The equipment is usually not properly maintained. Local government agencies in developing countries have enough problems maintaining their own car park, let alone an equipment pool used by contractors.

- Contractors will understand that the equipment they need for the execution of the work will always be available at the equipment pool in a good state at the moment they need it. Where the contracting agency is at the same time owner of the equipment pool, the uneasy situation can occur where the Ministry c.q. contracting agency itself is blamed for delays in the execution of work.

- The rental rates set by government equipment pools are often set too low to cover the costs of maintenance and amortization. These low rates do not prepare contractors for real market rates and cause that in case of defect contractors will be reluctant to hire from the private sector instead.

VI Guarantees

6.1 The guarantee instrument

Commercial banks in developing countries are generally reluctant to lend to small contractors operating in rural areas for a set of obvious reasons:

- The contractors are often first-time borrowers without any track records at the bank.
- they are unable to fulfill the collateral requirements of the bank.
- they can not present their last years' financial statements to the bank.
- they are unable to finance 20-50 % of the investment from their own resources as required by the bank.

Banks will generally require collateral or third party guarantees as compensation for the perceived higher risk involved in lending to small contractors. In these situations a contracting agency can facilitate contractor's access to bank finance by providing them with guarantees. For a contracting agency there are three different possible ways to stand guarantee for a contractor: guaranteeing work, guaranteeing work payments or guaranteeing loans.

6.2 Guaranteeing work

The most simple solution from the perspective of the contracting agency is to prepare a letter guaranteeing the contractor a certain amount of work. By showing this letter to the bank the contractor will provide the bank with evidence of liquidity during the period that the work is guaranteed. Such a letter could be combined with other third party guarantees the contractors could find on their own behalf.

In most instances a document guaranteeing work by itself will not be sufficient for contractors to access credit for the procurement of equipment. A contracting agency can only guarantee work for a certain work contract, not for the duration of the whole programme. Moreover, guaranteeing work does not mean guaranteeing payment, which ultimately depends on the performance of the contractor and the administrative procedures of the contracting agency.

6.3 Guaranteeing work payments

In cases where banks consider letters of guarantee as described above as insufficient, the contracting agency can agree to make payments to the contractors through the bank, allowing the bank to withhold parts of the payments in case of bad loan repayment by the contractor. In many countries, however, the bank is legally not allowed to withhold such payments and in all instances the consent of the contractor has to be sought. Any contract, signed by the three parties, would have to state clearly the conditions under which the bank can withhold payments, for example:

- arrears and non-payment reach at least 90 days;
- the defaulting contractor has been appropriately warned.

The contract would have to state clearly which sums the bank would be allowed to withhold at what moments:

- missed installments only;
- penalty interest;
- outstanding principal;
- legal expenses.

The method is highly advisable in countries where the legal framework supports it. At no additional costs the contractors are backed in their efforts to establish contacts with a formal financial institution. One of the factors to take into account when pursuing a guarantee arrangement, is that banks do not always regard government agencies as the most reliable financial partners. A bank could ask for additional certainty that payments will be in time such as the existence of earmarked government funds or dedicated donor-fund accounts.

6.4 Guaranteeing loans

A third possible way to facilitate contractors' access to bank finance is to guarantee the loans that contractors take to finance their equipment. In practice this means that the programme would set up a guarantee fund at the basis of which it can provide the contractors with letters of guarantee. In a letter of guarantee the programme agrees to share the loan risk with the bank. In case the contractor fails to repay the loan, the programme pays part of the outstanding debt instead.

In a guarantee arrangement the loan risk has to be shared between the bank, the contractor and the guarantee fund. In situations where the guarantee fund of the programme covers more than 80% of the risk, the bank is likely to become lax in monitoring and loan follow-up. At the other hand, banks will usually not agree with a coverage of less than 50%. Good risk sharing arrangements are in between 60% and 80%.

A letter of guarantee is a legal document that would state exactly what sums the bank can claim from the guarantee fund when the contractor defaults on the loan, for example:

- The guarantee fund will be liable for a percentage of outstanding loan capital and contractual interest.
- The guarantee fund will not be liable for penalty interest and legal expenses.
- The bank can call in the claim after 90 days of arrears, after a warning letter has been sent to the contractor and after legal action has been initiated.
- The bank will take legal action against the defaulter and will be responsible for legal costs incurred.
- The guarantee fund will have a right to a certain percentage of collateral proceedings collected after the claim has been paid out.

In order to ensure itself that the guarantee fund has enough liquidity to pay out claims, banks will often require that at least part of the guarantee fund be deposited in the bank. Although in most instances this is a reasonable requirement, the bank should never be permitted to withdraw funds on its own behalf and without the consent of the programme. Interest on the fund should be reasonable, that is comparable to medium-term deposit rates.

The establishment of a guarantee fund to facilitate contractors' access to bank finance is less advisable because of the extra costs and efforts involved. Moreover, the existence of the guarantee fund might provoke moral hazard on the side of the contractor who knows his bank loan to be guaranteed by a donor agency. The establishment of a guarantee fund however is an option in countries where it is illegal for banks to withhold payments as described earlier.

VII Conclusion

Already at the design stage of an employment-intensive public work programme an assessment has to be made of possible ways for the contractors to finance the necessary equipment. This will include an inventory whether there are institutions available and interested in providing equipment finance to the contractors.

Where possible, it is preferable to leave contractor finance up to the market, i.e. to involve an institution that would provide credit. Possible options are equipment suppliers, banks or leasing companies. When necessary, the programme or contracting agency can facilitate the arrangements by providing the contractors with guarantees on work or on payment.

In situations where the programme has to pre-finance equipment, it is advisable to confront contractors with a semi market situation. The administration of the scheme can be handed over to a bank or leasing company, as in the case study of Uganda. In order to avoid liquidity problems for the contractors, estimations have to be made of 1 the type of equipment contractors can afford 2 loan terms such as down payment and interest rate 3 the currency of the loan.

Whatever the financial infrastructure, equipment finance remains limited by the fact that public work programmes can not beforehand guarantee sufficient work to cover the necessary investments. Experience shows however that with a scheme conveniently adapted to the investment capacity of the entrepreneur, most firms will try to live up their debts in order to expand their business.

Case study 1: Equipment leasing in Uganda

1 Introduction

The feeder roads component of the Ugandan Transport Rehabilitation Project (UTRP) had amongst its objectives, the introduction of labour based /light equipment supported methods for feeder road maintenance and rehabilitation. In pursuit of this objective, the project set out to train and employ small and medium sized contractors to use the labour based approach in executing civil works.

The Government of Uganda (GOU) with assistance from the International Development Association (IDA) and Nordic Development Fund (NDF) agreed to provide, through a leasing arrangement, light equipment support to selected contractors upon successful completion of a structured training programme. An international consultancy firm that managed the implementation of the project also managed the lease agreement in conjunction with a domestic Bank on behalf of GOU.

2 Principal Features of the Lease agreement.

The lease agreement basically had the following features.

a) Procurement of Equipment

The government had the sole right in the selection and purchasing of the equipment. The equipment package (listed in par 3.0) is leased directly to the contractor for 48 months.

b) Collateral Securtity

No collateral security is required from the contractor. However, the equipment is registered in the name of the Government until the lease is fully paid back.

c) Insurance

The contractor has the responsibility of comprehensively insuring all equipment.

d) Maintenance

The contractor is responsible for maintaining the equipment at his/her expense.

e) Repayment schedule

The cost of the equipment is denoted in the local currency and is not affected by foreign exchange fluctuations that may occur in the course of repayment of the lease. Interest on the facility is charged at a fixed rate of 12% during the tenancy of the facility (Commercial rates prevailing at the time of executing this agreement were 5- 15% higher than the rate charged for the lease).

f) Obligations of the Client

The client is obliged to provide civil works contract to the contractor until the lease is over. Should the client default in providing a contract to the contractor, the repayment has to be frozen for the interrupted period that the contractor is without work.

3 Equipment packages

The equipment type and quantities procured by the project for the contractors are as follows:

Description	**Quantity**
Tipper Trucks	12
Tractors	8
Trailers	16
Water Bowsers (towed)	8
Pickup Vehicle	7
Pedestrian Rollers	24
Motor Cycles	12
Water pumps	8
Poker Vibrators	4
Concrete Mixers	4
Culvert Moulds	36

The above equipment was initially packaged for 10 contractors who successfully completed the training programme. Each of the contractors was thus given a set of equipment costing between USD 96,000-191,000 depending on the management ability and performance of the company during the training programme.

The project management, after observing the initial performance of the contractors, came to the conclusion that the difference in output between the least and the more equipped contractors did not justify the retention of the additional equipment availed to the contractors. It therefore recommended the retrieval and reallocation of the under-utilized equipment from the 'over equipped' contractors to the second batch of six contractors.

Following the implementation of this measure, only 4 contractors maintained their original set of equipment whilst 5 contractors had pieces of equipment costing between USD 40,000-85,000 withdrawn from their equipment holdings. Ironically, the least equipped contractor of the batch performed creditably during the trial contract and had his equipment holding value increased from USD 96,000 to 140,000.

The equipment values for the second batch of contractors ranged from USD 47,000 – 115,000.

4 Recovered rental Analyses

The lease agreement for the first and second batch officially commenced in November 1997 and April 1999 respectively. Both agreements were concluded in December 2000 (38 months and 21 months lease periods) in consonance with the project completion date.

The effective lease period for the two batches fell short of the figures above due to the client's default in awarding contracts on time to the contractors and coupled with late payment of certificates for works accomplished. The rentals from both batches therefore had to be frozen by the project management for the interrupted periods(5-7 months).

4.1 First batch

The analysis considers 8 out of the 10 contractors originally equipped in lieu of the fact that one contractor was disqualified from the programme whilst the other took possession of the equipment for 21 months. The latter contractor is thus grouped with the second batch for the analysis.

The recovered rental over the 38 months period (less the interrupted periods) for the batch averaged 74 % of the loan value. Two contractors with equipment holding estimated at USD 140,000 managed to fully repay the loan whilst the most equipped contractors had serviced 62% of the loan.

4.2 Second batch

The recovered rental for this batch including one contractor from the first batch was 62 %. The least equipped contractor managed to fully repay the loan whilst the most equipped in the batch serviced only 47% of the loan.

The recovery rate for the second batch was quite impressive. An estimated 86% of rental due had been recovered from the contractors whilst that for the first batch was 75%.

Case study 2: Hire-purchase schemes in Zambia

1 Introduction

The UNDP/UNCDF funded Rehabilitation and Maintenance of Reeder Roads project in Zambia was designed to improve the quality of life in Eastern Province through rehabilitation and sustainable use of roads. The project trained small contractors in labour-based technology and employed them for the rehabilitation of 570 kilometers of feeder roads. The development of local contracting capacity, both for rehabilitation and maintenance, was one of the major objectives of the programme.

Seven local contractors, each responsible for 80 kilometers of road rehabilitation, were trained in labour-based methods. For the contractors to become the owners of the necessary fleet (two tractors, 3 trailers, one dead-weight roller, one pedestrian vibrating roller, one pick-up truck and one water pump), they each took a 120,000 USD loan from the UNDP/UNCDF project. An inventory was made of different NGOs and financial institutions that could both administer the loans and provide advice, assistance and training to the contractors. An NGO already involved in financial services was selected and contracted.

The contract with the NGO stipulates that the funds accumulating through the payments of the contractors would be used for the provision of training in business management, equipment maintenance and administration. Contractors were charged market interest rates.

2 Features of the hire-purchase arrangement

The agreement had the following features:

a) Procurement of equipment

The 120,000 USD equipment package for each contractor was procured by the project. The equipment was hired out to the contractors under a hire-purchase arrangement. With the last repayment the contractors become the owners of the equipment.

b) Collateral security

No collateral security is required from the contractor, but the equipment remains in the ownership of the project until the fulfillment of the loan repayment.

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