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AGENCY FOR INTERNATIONAL DEVELOPMENT
PROJECT IDENTIFICATION DOCUMENT FACESHEET (PID)

1. TRANSACTION CODE: A = Add, C = Change, D = Delete — Revision No.

DOCUMENT CODE: 1

2. COUNTRY/ENTITY: Costa Rica

3. PROJECT NUMBER: 515-0187

4. BUREAU/OFFICE: A.I.D. — A. Symbol: LA — B. Code: 05

5. PROJECT TITLE (maximum 40 characters): Private Sector Export Credit

6. ESTIMATED FY OF AUTHORIZATION/OBLIGATION/COMPLETION

A. Initial FY: 82

B. Final FY: 85

C. PACD: 86

7. ESTIMATED COSTS ($000 OR EQUIVALENT, $1 =)

FUNDING SOURCE	LIFE OF PROJECT
A. AID	$15,000
B. Other U.S. 1.	
B. Other U.S. 2.	
C. Host Country	
D. Other Donor(s)	
TOTAL	$ 15,000

8. PROPOSED BUDGET AID FUNDS ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. PRIMARY TECH. CODE 2. Loan	D. 1ST FY 1. Grant	D. 1ST FY 2. Loan	E. LIFE OF PROJECT 1. Grant	E. LIFE OF PROJECT 2. Loan
(1) SDA	900		810		$10,000		$10,000
(2) ESF (Local	900	810		$5,000		$5,000	
(3) currency)							
(4)							
TOTALS				$5,000	$10,000	$5,000	$10,000

9. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

10. SECONDARY PURPOSE CODE

11. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

12. PROJECT PURPOSE (maximum 480 characters)

To assist with the resolution of the current productive private sector liquidity crisis, to enhance the capacity of the productive private sector to earn foreign exchange, and to reestablish COFISA as a development oriented financial institution.

13. RESOURCES REQUIRED FOR PROJECT DEVELOPMENT

Staff:

Mission Staff	3 p.m.
Financial Analyst	2 p.w.
Economic Analyst	1 p.w.
Credit Insitution Management Specialist	4 p.w.

Funds
$8,500 (Tech. Asst. Contract, credit institution management specialist)
3,000 (per diem, transportation for AID TDY assistance)
$11,500

14. ORIGINATING OFFICE CLEARANCE

Signature: Daniel A. Chaij

Title: Mission Director

Date Signed: MM 06 DD 11 YY 82

15. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

16. PROJECT DOCUMENT ACTION TAKEN

S = Suspended, A = Approved, D = Disapproved, CA = Conditionally Approved, DD = Decision Deferred

17. COMMENTS

18. ACTION APPROVED BY — Signature — Title

19. ACTION REFERENCE

20. ACTION DATE: MM DD YY

AID 1330-2 (8-79)

LIST OF ACRONYMS

ADL	Arthur D. Little Inc.
AID	(U.S.) Agency for International Development
BANEX	Banco Agro Industrial y de Exportaciones
CACM	Central American Common Market
CDSS	Country Development Strategy Statement
COFISA	Corporación Costarricense de Financiamiento Industrial S. A.
D.A.	Development Assistance
ESF	Economic Support Fund
GDP	Gross Domestic Product
GOCR	Government of Costa Rica
LIBOR	London Inter-Bank Borrowing Rate
PID	Project Identification Document
SBN	Sistema Bancario Nacional
USAID	United States Agency for International Development (Mission Level)

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*Bulk Annexes - available at LAC/DR and Mission files.

I. THE PROJECT CONTEXT AND RATIONALE

A. Macro-Economic Context

In its past two CDSS submissions (FY 1982 and FY 1983), and more recently in the Program Assistance and Approval Document prepared for this year's $20.0 million ESF loan to Costa Rica, USAID/Costa Rica has amply documented the origins and evolution of the country's current economic crisis. These documents describe in detail the long term, structural nature of Costa Rica's economic problems, which have resulted from past industrialization policies which promoted import substitution to the detriment of the expansion of nontraditional exports, a large and, up until recently, rapidly expanding public sector, a fiscal deficit, which is currently running at an annual rate of about 17% of GDP, and a large ($4 billion) foreign debt. With an abrupt shift in the terms of trade in 1977, the country's economy entered into a downward spiral which has yet to bottom out. Unemployment currently stands at 9.2% and it is expected to reach 14% by year's end. In 1981, the real GDP declined by 3.6%, the second straight year of decline. Inflation shows no sign of abating and is currently running at somewhat more than 10% per month. The Costa Rican colon has continued to lose value with respect to the dollar, dropping from an open market rate of 38 colones to the dollar at year's end to around 48 today (mid-May 1982); the colon has lost more than 80% of its December, 1980 value, when the currency was first floated. No sector of the Costa Rican economy or population has been untouched by these events.

The deepening economic crisis has severely exacerbated the problems faced by the private sector. The number of unemployed rose by 37% from March 1981 to March 1982. Since November of 1981, the number of employed persons dropped by 36,000, or 4% of the total workforce. Credit become extremely scarce and foreign exchange expensive at a time when both are critically needed to revitalize the economy; confidence in what the future holds has waned very considerably as private sector access to these two crucial inputs has all but been cut off.

During 1980 and 1981, over 60% of all new domestic credit was destined for the public sector. Credit outstanding to the private sector dropped by some 21% in real terms during 1981 in comparison with 1980. During the first six months of 1981, manufacturing industry received only one-third of the real flow of new credit that had been made available during the same period in 1978. In mid-1981, the level of credit outstanding to this sector was 40% lower, in real terms, than in mid-June, 1977. High delinquency rates for outstanding bank loans have contributed to substantial illiquidity in the banking system, and credit restraint in the face of IMF-stipulated stabilization requirements further added to the tightness of new lending. Thus the private sector has been forced to bear a disproportionate share of the monetary belt-tightening burden at a time when new credit was most critically needed to rekindle economic activity.

The devaluation has had serious consequences for many Costa Rican producers. The import-intensive structure of Costa Rican industry has meant that the costs of imported raw materials which are crucial to keep industrial production moving tripled and even quadrupled in a period of less than a year. Word of the country's economic woes has caused previously available external suppliers' credit sources to dry up. Manufacturers, as a result have had to resort to their own resources (when they have been able to) in order to finance their increasing working capital costs. Because many, if not most, Costa Rican firms holding foreign debt are seeking to renegotiate payment schedules with their creditors, there is little hope for increased inflows of private capital in the near term to make up for the shortage of domestic credit. The current amount of private sector debt held by foreign creditors is estimated between $900 million and $1.5 billion.

Over the past year, the Mission has commissioned a number of studies which, in one form or another, have shed some light on the credit demand question (please refer to Annexes G, H. and I). All agree that there exists a very substantial unsatisfied demand for credit, although the composition of this demand apparently is changing (for example the relative demand for dollar credit has dropped in the face of the effectively negative interest rates for colon credit currently available in Costa Rica) and estimates of its magnitude vary. The concensus is that the national banking system's 1982 credit program does not adequately reflect the combined effect of last year's 100% plus inflation and the large devaluation of the local currency, and as such will be grossly inadequate to meet effective demand. Costa Rican business associations are unanimous in their claims of an urgent need for massive injections of credit into the productive sector (further analysis of the short and long range demand for colon and dollar credit will be required; the Mission's strategy for Project Paper development contemplates such analysis).

The adverse factors described above have dealt serious blows to Costa Rica's private sector. The critically needed structural transformation (described in the Mission's last two CDSS submissions) from a highly protected import substitution-based economy to one geared to extra-regional export expansion cannot begin to take place without adequate credit flows to the private sector. These cannot be realized currently with internal credit creation due to the need to limit overall internal credit expansion, and the public sector's own financing requirements. Significant external private capital inflows are extremely unlikely in the face of the current attempts to renegotiate external debt by both the public and private sectors, foreign exchange illiquidity, and general uncertainty. This leaves open as the only viable near-term alternative financing that which may be provided by bilateral and multilateral development assistance organizations.

B. COFISA's Past

At the time of COFISA's (Corporación Costarricense de Financiamiento Industrial S. A.) founding, the public banking system, which was nationalized in 1948, had proved unable to meet the credit needs of the private sector. Public bank response to industrial credit applications was slow and generally placed more emphasis on the adequacy of collateral than on in-depth project evaluation. Political pressures, it was felt, also influenced credit decisions. A private industrial development corporation such as COFISA, it was concluded, was necessary.

In December 1963, A.I.D. made a loan to a group of Costa Rican entrepreneurs for the creation of COFISA, a private development finance company. The A.I.D. loan, COFISA's capital and international commercial bank lending (not formally cofinanced) supported the development and operation of a credit program to help meet the capital requirements of the private industrial sector.

The loan was for $5.0 million at 2 percent interest for 20 years with a 5 year grace period. As a prerequisite to initial disbursement under the A.I.D. Loan, COFISA was obliged to secure committments of an additional $1.0 million to be paid in as capital during the anticipated three-year A.I.D. loan disbursement period.

By 1968, after over five years of operation, an A.I.D. mission evaluation of the COFISA project showed positive results:

"By March 31, 1968, COFISA had made 449 loans for a total of $11.2 million; 55 of the loans for $2.6 million were made to cover fixed investment in new industrial establishment, and 61 operations for $1.7 million to provide working capital to new industries. A total of 132 loans for $2.8 million financed fixed investement in expanding firms and 201 operations for $4.1 million working capital in expanding firms".

In addition to realizing its credit program objectives, the project had clearly accomplished its principal purpose--the establishment of COFISA as a viable institution.

In May 1969, A.I.D. signed a second loan agreement with COFISA. The second project resulted from nearly three years of negotiations which began in early 1966 when the first loan was about to become fully committed to sub-projects. The purpose of the second project was more specific than, and at least as ambitious as, the first:

"To provide financing for economic diversification. To establish an effective lender for agricultural development in competition with the nationalized commercial banks. To insure the continued expansion of the successful private development bank. To increase support for the CACM by assisting industries dependent on the CACM market. To help finance rapid economic growth while Costa Rica is taking needed fiscal and monetary measures. To help develop a domestic capital market and encourage the investment of Costa Rican capital at home". The A.I.D.-financed portfolio grew rapidly during the early stages of the project. More importantly, however, COFISA began a campaign of seeking and securing commercial financing from numerous sources. In 1969, COFISA's obligations to commercial financiers totaled approximately $873,000. By 1973, that amount totaled approximately $8.4 million. Commercial financing then increased to over $23.3 million in 1976, nearly $46.5 million in 1978, and over $69.7 million by 1980.

Consistent with the transition to commercial financing was COFISA's change from long-term to short-term sublending. The COFISA short-term portfolio as a percentage of the entire COFISA sublending portfolio increased from 21% in 1968 to over 57% in 1980. While still involved in long-term lending, COFISA had, by 1980, effectively become a commercial (or retail) financial institution.

In 1975, COFISA established an offshore financial arm in Panamá as a result of the perceived need for an external entity which could capture foreign currency deposits locally, and reinvest them in productive economic activities in Costa Rica, rather than being remitted overseas or to international banks. This entity, COFISA International S.A., was founded with the prior approval of A.I.D. and registered as a foreign financial institution with the Costa Rican Central Bank. COFISA International has provided financing for a large number of agricultural and industrial projects, and currently has an outstanding portfolio of some $26.3 million spread over approximately 500 loans.

C. <u>COFISA's Current Status</u>

1. <u>Evolution of COFISA's Financial Crisis</u>

From 1975 to 1980 COFISA continued its course of growth as a major Costa Rican financial institution. During the period, the <u>financiera</u> made almost 1500 new loans for a value of <u>colones</u> 835.5 million (or almost $100 million) increasing by 138 percent the amount of credit it had channeled into the Costa Rican economy during its first eleven years of operation. The corporation's capital (total shockholders' equity) more than doubled during the period (from <u>colones</u> 34 million to more than <u>colones</u> 86 million) and its net operating profit in 1980 was <u>colones</u> 15.4 million compared to 1975's <u>colones</u> 5.2 million. COFISA added thirty new overseas banks and other financial institutions to its correspondent bank network during the period, almost doubling the number in five years. In October, 1978 USAID/Costa Rica brought in a team of consultants from AID/W to review COFISA's financial situation and to suggest future action which would continue to safeguard the AID loan without hampering COFISA's orderly growth. The team found COFISA to be in good financial shape and, based on what they characterized as a corporation's "good management, continued growth, and consistent profitability" recommended that AID allow COFISA's debt to equity ratio to rise to ten to one (10:1), and eventually consider a twelve to one (12:1) ratio. The latter suggestion was predicated on continued close monitoring of COFISA's basic financial ratios and performance by USAID/Costa Rica. In short, COFISA was determined to be a healthy financiera.

COFISA was not, however, immune to events and pressures in the wider Costa Rican economy, and as matters took a sharp turn for the worse in 1980, COFISA's fortunes began to change. In mid-1981, a USAID/Costa Rica analysis of COFISA's performance showed an alarming increase in the financiera's borrower delinquency and default; new lending activity had dropped markedly, and was limited almost exclusively to short term uses. Clearly, COFISA's borrowers were feeling the pinch affecting the economy, and the Mission, in consultation with COFISA, concluded that a formal in-depth analysis of the financial health of COFISA should be undertaken at the end of the corporation's financial year in October, 1981.

The July, 1981 Supreme Court decision regarding the effective devaluation of Costa Rica's currency dealt a devastating blow to COFISA. From that point on, COFISA (Costa Rica) debtors had the legal right to service their dollar-denominated debt, or indeed pay it off completely, in colones valued at the grossly overvalued official colon/dollar exchange rate (many COFISA borrowers had in fact been attempting to do this prior to the Court ruling, putting COFISA in the anomalous situation of refusing loan payments, which contributed to markedly increased portfolio delinquency). The ruling resulted in a veritable mad dash by COFISA clients in July to pay off their debts, during which time over $5.2 million of outstanding loans were paid off at the official exchange rate, causing exchange losses of an estimated colones 85 million (considering the then existing free exchange rate of approximately colones 25 to the dollar) which was equal to almost twice the corporation's common stock value. In accepting these payments at the official exchange rate, COFISA acted on the recommendation of their legal counsel which reasoned that it was more advisable to secure the colon cash in question, and so alleviate the financiera's liquidity crisis, than to contest the payments and tie the money up in lengthy court proceedings which might last as long as a year. The immediate impression nonetheless was that COFISA was on the verge of bankruptcy and financial collapse, with dire repercussions for its creditors, its clients and their employees, and, indeed, for the Costa Rican economy as a whole.

An additional factor complicating COFISA's financial situation has involved the process by which importers were provided access to the foreign currency which they required to purchase imported inputs for production and to satisfy other foreign obligations. Beginning during the last quarter of 1980, the Costa Rican balance of payments crisis left the Central Bank with insufficient dollars to meet the needs of these businesses. While continuing to require that dollar earnings be liquidated at the then official rate of exchange of 8.60 colones to the dollar, the Central Bank issued promises to pay dollars when they became available. As the dollar shortage worsened, the accumulation of these promises to pay created a growing backlog, known locally as "la presa".

Beginning in December 1980, the value of the colon was forced to float, at which point it began a course of rapid devaluation. Unable to liquidate "la presa", the Central Bank offered most businesses, which had "registered" their dollar obligations at the a variety of alternatives for repayment. Most popular among the alternatives were dollar denominated certificates of deposit. These certificates were scheduled to mature in three years and would earn semiannually paid interest at LIBOR. By October of 1981, it become clear that the Central Bank were to not be able to meet its interest payment obligations to certificate holders. Final disposition of the status of certificates continues uncertain, they will probably be rescheduled together with of Costa Rica's entire public external debt.

In September of 1981, COFISA was involved in a legal debate with the Central Bank regarding a COFISA claim to $8.4 million in Certificates of Deposit. These frozen COFISA assets represented a major factor in the financiera's financial problems[1/].

2. Chronology of Protective/Remedial Actions

In a move to protect itself from the consequences of the July 1981 Supreme Court devaluation decision, COFISA "prepaid" in late July its outstanding debt to AID for both loans 010 and 019 by means of depositing the colon equivalent (at the overvalued official exchange rate) of the loans' balances to the AID/GOCR Two-Step Fund. While USAID/Costa Rica at the time reserved judgement as to the legality and validity of this action, the measure has subsequently been accepted by the GOCR as legal and proper, thus acknowledging the Government's responsibility to repay to AID the outstanding balances on the two loans.

By September, 1981, COFISA's cash flow problems has become so serious that it was no longer able to service its more than $60 million in debts. To avoid the legal consequences which would result from failure to honor obligations to domestic dollar time depositors[2/], COFISA exhausted its last cash reserves to cancel these obligations. No new deposits were accepted and no new loans made. Unable to make even the

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1/ By March 1982, the Central Bank had honored COFISA's claim. Issuance of the $8.4 million in certificates was promised provided that COFISA's creditors would accept the certificates at face value in payment against the COFISA debt. The status of the certificates in the COFISA debt restructuring is discussed in detail in the Preliminary Financial Analysis, Annex C.

2/ Actually, holders of "investment certificates". Costa Rican law does not permit private banks or financieras to take either sight or time "deposits".

slightest payments to its remaining creditors, COFISA initiated a process of negotiation with the more than fifty foreign banks to whom it remained indebted. The banks appointed, from their ranks, a liaison committee to represent their interests and with whom COFISA could negotiate. After several meetings, it was decided that all of the creditor banks would agree to a temporary moratorium on COFISA debt collection, and that efforts would immediately be initiated to identify the most expedient means of resolving the situation.

Given the importance of COFISA as a major financial institution, and the importance of COFISA's borrowers to the country's economy, the Mission decided in September 1981, to undertake an in-depth study to determine what measures might be prudently taken by AID to assist with the resolution of COFISA's problems. Arthur D. Little Inc. (ADL) was contracted to conduct an analysis of COFISA and its loan portfolios. The specific objectives of the analysis were (a) to determine the potential for survival among COFISA's borrowers, (b) to provide COFISA with information regarding the recoverability of its portfolio with which it could negotiate with its creditors toward a possible rescheduling of its obligations, and (c) to suggest means by which AID could assist COFISA and its borrowers to attain and maintain long-term viability. (A complete report on the study and its results is included as Annex D). The results of the ADL study produced a basis upon which several remedial initiatives have been undertaken:

- Based on analysis of the condition of COFISA borrowers and the use of a computer model, ADL was able to assist COFISA to project possible cash inflow assumptions several years into the future. These projections provided COFISA with information with which it could propose alternatives for the rescheduling of its debt to its creditors.

- ADL provided COFISA with several observations and recommendations regarding organizational and procedural requirements which COFISA would have to meet to be able to successfully reestablish a long-term development lending program.

- As a basis for specific recommendations to AID for the provision of further assistance to COFISA, ADL offered the following summary conclusion:

  "COFISA can overcome its present difficulties if certain variables are resolved in its favor. These variables include the satisfactory renegotiation with its creditor banks, the amount of and use to which dollar certificates (la presa) can be put, and the ruling of the Supreme Court of Costa Rica regarding the legal exchange rate applicable on COFISA Costa Rica contracts."1/

- Several specific recommendations were made as a result of the ADL study regarding a "new USAID loan to COFISA". The recommendations included suggested positions on key issues; limitations and restrictions which should be placed on the use of new funds; and institutional, procedural and managerial considerations. (Many of the ADL recommendations have been incorporated into the design of this proposed Project.)

On March 2, 1982, COFISA met in Panama with the liaison committee and, using the results of the ADL study, presented a "Prospective Flow of Funds" (see Annex F) upon which a rescheduled COFISA debt could be based. While no specific conclusion was reached in Panamà, a follow-up meeting was held in Miami on April 29, 1982 at which the entire group of creditor banks presented COFISA with a proposed "extension agreement"2/ which had the following salient characteristics:

- COFISA would be given a one year period during which no interest or principal payments would be required.

- During the one year period, COFISA would closely examine its subloan portfolio, rescheduling subloan repayments where appropriate and exercizing guarantees where necessary.

- At an appropriate point during the one year extension, COFISA would provide its creditors with the cash flow results of its portfolio rescheduling as the basis upon which a specific rescheduling of COFISA's obligations would be made.

- As a condition of the extension, COFISA would provide its creditors with liens on all COFISA assets and immediately turn over to the banks all of its liquid dollar assets. Included among these assets would be the $8.4 million in

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1/ As described later in this section, COFISA has successfully negotiated the receipt of $8.4 million in certificates from the Central Bank.

The Supreme Court ruling regarding the legal exchange rate has not yet been made. In the absence of a ruling, the preliminary financial analysis (Annex C) assumes a decision unfavorable to COFISA and projects portfolio recovery accordingly.

2/ The entire text of the proposed agreement is included as Annex J.

Certificates of "La Presa" which COFISA would receive from the Central Bank, and any additional certificates which COFISA could purchase with its local currency income. The banks would in turn, accept the certificates at face value in cancellation of principal.

- During the one year extension period, COFISA would also forward to its creditors all dollar cash which it receives in excess of its normal operating expenses.

Given that both AID (in order to consider a new loan to COFISA) and COFISA required more assurance from the banks that a rescheduling would indeed occur (thus enhancing the probability of longer-term COFISA viability - a precondition to a new AID loan), a modification to the proposed extension terms is currently being prepared. This modification establishes a "fallback" rescheduling which, should COFISA and the banks be unable to agree to a full rescheduling during the one year extension, would be automatically in force. It is anticipated that this modified agreement will be approved by both the banks and the COFISA board by mid-June, 1982.

In anticipation of a satisfactory rescheduling with its creditors, COFISA is finalizing negotiations with the Central Bank for receipt of the $8.4 million in certificates and is purchasing (with its colon income) as many additional certificates as possible because these dollar certificates are heavily discounted.

D. The Relationship of the Project to Costa Rica's Strategies for Economic Stabilization and to the CDSS

1. The Role of the Private Sector in Relation to GOCR and Mission Strategies

Lack of foreign exchange led to a reduction in imports in 1981 of approximately 29% (in real terms), which slightly offset the growth of the country's trade imbalance. The reduction, however, was not confined to non-essential imports. Practically all imports were significantly reduced, including capital goods, construction materials, raw materials and intermediate goods. For this and other reasons, the country's real GDP for 1981 showed a 3.6% decline.

Clearly, significant economic recovery depends on the country's ability to earn more foreign exchange. The private productive sector produces nearly all of Costa Rica's foreign currency earnings; and, while the GOCR has yet to develop a consistent private sector strategy, it recognizes that conditions must be improved for private sector productivity if stabilization and recovery are to be achieved. The newly elected GOCR administration, which assumed office in May, 1982, is expected to take several measures which relate directly to the private sector. After reaching agreement with the IMF and its creditor banks, the GOCR is expected to:

- Develop a policy structure which will relieve the problems of producers resulting from discriminatory foreign exchange registry requirements and access restrictions; and,

- Develop viable approaches to the expansion and diversification of exports, with particular emphasis on seeking new markets for non-traditional products.

The Mission 1984 CDSS establishes a strong committment to support for the Costa Rican private sector:

> "The keystone of the Missions efforts between now and FY 1987 is the provision of resources which Costa Rica needs to reactivate industrial and agricultural production............ These resources will enable us to respond rapidly and effectively to the financial recuperation, export expansion and credit needs of Costa Rica's private sectors. Financial recuperation will involve helping keep key private sector financial institutions, such as the Costa Rican Industrial Financing Corporation (COFISA)..........from closing down."

2. COFISA's Role in the Private Sector: Project Rationale

a) COFISA has been one of Costa Rica's most significant sources of credit for the private sector.

As of September 1, 1981, COFISA had granted credit worth almost one and a half billion colones to its Costa Rican borrowers, a sum which (calculated at exchange rates at the time of lending) equaled more than $175 million. In addition, COFISA Internacional (The financiera's Panama based subsidiary) had placed $83.4 million by the same date. In all of its operations, COFISA had, therefore, multiplied by twenty five times the resources AID provided with its two loans in the sixties (010 and 019, each for $5.0 million). COFISA's operations touch virtually every sector of Costa Rican industry with particular emphasis being concentrated in agriculture, livestock, agro-industry, industrial construction and industrial services, which together amount for over half of the financiera's historic lending portfolio.

The value of COFISA's consolidated outstanding loan portfolio of colones 1.2 billion last September, 1981 was equal to approximately 10% of the Costa Rican national banking system's (SBN) balance of credit to the private sector at that time. This in itself is a remarkably high percentage when considering that the SBN is a nationalized system which does not permit private financial institutions such as COFISA to (among other restrictions) capture demand deposits from the public. A comparison of COFISA's operations to those of Costa Rican private banks gives a further picture of COFISA's relative importance. A Mission-financed study of bank liquidity conducted in March, 1982 revealed that these private banks had an outstanding portfolio of approximately $85.0 million with Costa Rica's private sector. COFISA's March 15, 1982 portfolio value was estimated at $42.2 million[1/] making it the country's largest single private lending institution. (It should be noted that the $85 million figure does not include other financieras operating in Costa Rica, whose current operations the study's authors considered "insignificant")

Based on the ADL analysis and COFISA management estimates, between 200 and 300 of its 800 Costa Rican borrowers would fold should COFISA be forced into bankruptcy. These firms together employ thousands of workers, and when further considering these workers' families, the overall potential impact of a COFISA bankruptcy becomes clear.

b) COFISA has been the Costa Rican Private Sector's most substantial link with the International Financial community.

Prior to the crisis in which it currently finds itself, COFISA had established correspondent banking relationships with over 70 international banking institutions in the United States, Europe, and Latin America. While the lines of credit which the financiera had negotiated with these institutions are currently suspended, it is not unreasonable to expect that, given improvement in the Costa Rican economy and COFISA's survival of the current crisis, many of these credit lines could be reactivated. COFISA's earlier virtually umblemished record (the financiera's problems began only with the floating of the colon in September, 1980) and excellent reputation should go far in making these credit sources available once again to the Costa Rican private sector, and so complement and reinforce the economic recovery towards which this project, and indeed the Mission's entire program, is directed.

c) COFISA's current crisis cannot be significantly attributed to major managerial flaws or other internal factors which would hamper the efficient management of a new project. The Mission feels that, with the assistance of this project, along with successful rescheduling of its current debt and other important measures, COFISA should be able to reestablish itself as a viable and important development finance institution.

COFISA had a 16 year history of continued growth and contribution to the economic development of Costa Rica before events

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1/ This figure was presented to the COFISA Liaison Committee from a recent analysis conducted by two member banks thereof.

beyond the financiera's control sharply reversed this trend and brought it to the brink of bankruptcy. As clearly stated in the ADL study of COFISA's operation: "It was apparent from the beginning that this situation had been mostly brought on COFISA by external causes of both a legal and financial nature." In the conclusion of its study report, ADL states: "COFISA............. has a proven track record, an extensive clientele of borrowers and well established business relations with abroad spectrum of international banks and other financial agencies."

In addition to meeting the short run needs of COFISA's current and potential clients which are immediate and of an emergency nature (i.e. working capital financing), COFISA should be able in the longer term to regain its developmental focus and so continue its previous record of aiding the economic growth of Costa Rica. The financiera's solid international reputation before the events of the last few months and its many years of experience with lending to the Costa Rican private sector will, with the help of this project, enable it to make a significant contribution to private sector productivity.

d) Working with COFISA itself provides AID with the only feasible means of extending the assistance which is required by those of COFISA's current borrowers which, given the additional assistance, can survive; and the survival of these borrowers is of major importance to the productive capacity of the country.

It is difficult to quantify the significance of preserving COFISA as a mechanism through which credit can be extended to existing and new COFISA borrowers. It is equally difficult to quantify the importance of COFISA's current links to the international financial community. However difficult to quantify, the ADL study and Mission staff analyses conclude that these factors are of substantial importance to the Costa Rican economy and represent a major portion of the rationale for the development and funding of this project.

The project proposed in this document will inject resources directly into the country's private, productive sector. It will provide essential credit to ordinarily viable businesses which are currently faced with terminal liquidity problems. It will enable producers to secure necessary inputs for production. It will permit large numbers of businesses to continue operation and continue to provide a means of livelihood for thousands of Costa Rican workers.

II. PROJECT DESCRIPTION

A. Goal and Purposes

The goal of this project is to reestablish dynamic growth in the Costa Rican economy. More specifically, the project has three primary purposes:

- o To assist with the resolution of the productive private sector liquidity crisis;
- o To enhance the capacity of the productive private sector to earn foreign exchange; and
- o To reestablish COFISA as a development oriented financial institution.

(See Preliminary Logical Framework, Annex B)

B. Detailed Project Description

The Project will consist of a $10 million loan and the equivalent of $5 million in local currency. COFISA will subloan at market rates of interest and will include short, medium and long-term lending. While credit demand analyses indicate that both short and long-term credit is critically needed, the project will respond first to the areas of most acute need. Thus, during the first year of operation, most sublendings will be short-term loans primarily for the purchase of raw materials and intermediate goods and to satisfy immediate working capital needs. COFISA will be required, however, by conditions of the A.I.D. loan agreement to convert a substantial portion of its dollar portfolio into "developmental"[1/] lendings as soon as possible. The extent to which this transition can occur will be further examined during Project Paper preparation. Much of the "developmental" portfolio will, of necessity,

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1/ "Developmental" subloans are those which finance one or more of the following:

- o nontraditional production
- o production for nontraditional markets
- o domestic raw material production
- o new, significantly labor intensive enterprises
- o high domestic value added production
- o substantial growth in the production capacity of the subborrower
- o enterprises which are critical to the maintenance and/or restoration of the country's productive capacity
- o reactivation of existing idle productive capacity

be longer-term and will require of COFISA additional risk taking and considerable analytical and monitoring effort.

Preference will be given by COFISA to current subborowers which, given successful restructuring of their existing debt, will require and be able to successfully utilize new credit to maintain and expand their production.

Dollar subloans will be made to foreign exchange earners who could service these loans if colon devaluation continues. In addition to satisfying the credit requirements of these foreign exchange earning businesses, the availability of dollar denominated credit may encourage them to initiate or expand export marketing of their products.

The project's colon denominated loan portfolio will be directed toward non-foreign currency earners. The preferential consideration that will be given to selected current COFISA clients will be of particular significance to the colon portfolio. The crisis in which many of these debtors currently find themselves has been caused or seriously complicated by the impact of the colon devaluation on their dollar obligations. These borrowers will not be willing or able to assume additional dollar debt, particularly since most of them are not dollar earners. Access to colon credit is essential to the recovery of these clients. It is anticipated that the entire COFISA colon subloan portfolio will consist of these and other non-dollar earning borrowers. Colon denominated lendings will also be predominantely short-term during the early phase of project operation, and (as with dollar lending) be gradually redirected toward "developmental" lending. Priority consideration will be given to borrowers which provide essential local services and/or domestically produced inputs for export producers and to borrowers which produce/manufacture substitutes for imports.

Discussion is currently underway regarding the most appropriate mechanism for providing COFISA with the local currency loan, and the appropriate mechanism will be fully developed during the intensive review. A proposal currently being considered would involve designating for lending to COFISA the local currency generations of a $5 million grant portion of the initial ESF tranche. The mechanism would include a $5 million cash transfer to the Central Bank which would sell the dollars to private producers. The local currency generated as a result of the dollar sales would be deposited by the Central Bank in special account from which withdrawals could be made by USAID for COFISA colon sublendings[1/]. In accordance with the terms of the Loan Agreement, COFISA would then repay the loan (in colones) into a special SBN account belonging to the

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1/ The Central Bank would agree to disburse colones as needed at the exchange rate of the day.

Unión de Cámaras (a long established umbrella organization representing all of the various Costa Rican producer/business chambers). The colones would be drawn from the account by Unión de Cámaras to finance a project which would be managed by the Unión and/or other private sector groups with the prior approval of the USAID Mission. This project would assist with export and investment promotion and to further other objectives of the Caribbean Basin Initiative.

The $5 million grant, therefore, would accomplish several objectives: it would assist the GOCR with its balance of payments problems, provide a substantial local currency fund with which COFISA would make critically needed colon credit available to the private sector, and provide a $5 million local currency grant to Unión de Cámaras for purposes of further assisting the economy through promotion of exports and investment.

C. Summary of Credit Portfolio Characteristics

1. Dollar Portfolio

a. Eligible Borrowers: exporters

b. Interest Rates: Commercial rates plus 1% (see preliminary financial analysis) for which each borrower will be issued an equivalent amount of COFISA stock.

c. Terms:

- Short, medium and long term lendings

2. Local Currency Portfolio

a. Eligible Borrowers:

- Providers of essential services to exporters
- Domestic producers of inputs to production/manufacture for export
- Import substitution producers/manufacturers
- Priority attention will be given to selected current COFISA clients

b. Interest Rates: Commercial rates plus 1% for which each borrower will be issued an equivalent amount of COFISA stock.

D. Project Management

While COFISA's management has been basically strong and appropriately structured for many years, this project proposes a major COFISA transition to what we have termed as "Developmental" sublending. Implicit in such a reorientation are staffing changes, training, new procedures and policy structures. The project will also require a much improved management information system through which reliable, timely information can be processed and utilized. Such a system will probably be built upon COFISA's existing and well developed computer capability. (Full discussion of these changes is contained in Section III, A - Preliminary Institutional Analysis)

To finance the management changes which will be required, the General and Administrative costs for the first year of project operation are projected at 6% of the outstanding AID financed portfolio, including both the colon and dollar portfolios.

E. Restrictions, limitations and Project Design Issues

The Preliminary Financial Analysis (Section III and Annex C) provides a detailed description of the assumptions upon which the project will be developed. Several key issues, however, deserve additional discussion here.

1. Separation of the New AID Financed Portfolio

Preliminary financial analyses (see Section III.B and Annex C) indicate that income from the recovery of COFISA's current portfolio will have to be supplemented with earnings generated by new commercial financing in order to fully repay COFISA's current debt. This assumes the current Mission position that no funds generated by AID financing may be used to pay existing debt1/. In order to protect AID financed assets from current creditors, specific legal and procedural mechanisms will be required. COFISA's creditors have, to date, fully agreed with this separation, and plan to include specific facilitating language in any COFISA extension and/or rescheduling agreement.

1/ It is suggested that consideration be given to the lifting of this restriction after year ten. This would enable COFISA to more quickly cancel its remaining "old" debt and repair its credit standings with its current creditors, thereby more quickly reopening these important lines of credit to the Country's productive sector. Given this likelihood of renewed access to commercial credit, this use of project generated funds after year ten would not be likely to slow the pace of COFISA recapitalization.

Recent discussions with COFISA and bank steering committee lawyers, however, indicate that it is possible that no legal agreement could sufficiently protect project assets. A possible alternative could be provided through the establishment of a new and separate COFISA corporation for housing of the AID financed project. It was originally assumed that the creditor banks would oppose such an arrangement because it would not put AID support directly behind COFISA which is their debtor. Discussion with the creditors' steering committee, however, suggests that the banks may favor the arrangement as a more satisfactory means of separating the new portfolio from COFISA's existing indebtedness.

This possibility should be thoroughly explored for its legal, political and practical feasibility during the course of further project development.

2. GOCR Guarantee

The 1963 and 1969 AID loans to COFISA were made without GOCR guarantees because of Costa Rican legal restrictions on such guarantees for private entities. The issue was again debated during the development of the AID project with BANEX. Again, no GOCR guarantee or other acceptable alternative was possible. The $5 million D. A. loan portion of this project would also have to be made without a GOCR guarantee. As with the BANEX project, a "Risk Minimization Fund" is proposed which would provide AID with substantial protection in the event of a COFISA default. The "Risk Minimization Fund" is described in detail in the Preliminary Financial Analysis and in Annex E.

3. Additional COFISA Leveraging

The revitalization of COFISA will require intensive recapitalization efforts. This project proposes to provide COFISA with its principal means of recapitalization. The Preliminary Financial Analysis includes a detailed discussion of the proposed restrictions that would accompany a loan agreement regarding the utilization of AID funds and income directly generated with AID funds for anything but directly related expenses and recapitalization.

Consistent with this strategy for recapitalization is the restriction against further COFISA borrowing until the overall COFISA debt to equity ratio (including its current foreign bank debt) is reduced to 10:1. The Preliminary Financial Analysis and Annex C indicate that the 10:1 ratio should be reached by year four of the project. Also discussed in the Financial Analysis is the likely importance of further borrowing to the eventual full amortization of COFISA's current debts.

4. Counterpart Contribution

COFISA's current circumstances preclude the possibility of counterpart - at least until several years into the project. The

Preliminary Financial Plan and Analysis provides for the recapitalization of COFISA, and the Proforma Cash Flows demonstrate steady growth in the capital base. It is recommended that, in lieu of a COFISA counterpart, requirements be limited to the proposed restrictions regarding payment of dividends and other uses of income generated from the project be established.

5. Demand for Dollar Credit

Preliminary analysis has demonstrated that the dynamics of dollar credit demand involve matters of complex economics as well as GOCR policy, additional analysis and understanding of this issue will be required in order to accurately design this project.

6. "Special Stock Purchase"

The "special stock purchase" feature which is described in the Preliminary Financial Plan and Analysis has been poorly received by COFISA's current stockholders. While the Mission has tentatively determined that this feature would assist with COFISA recapitalization, further "popularize" COFISA ownership, and encourage savings; more analysis is necessary in order to structure this feature in a fashion which will be more acceptable to current stockholders. Determination must also be made regarding the pricing of COFISA stock for purposes of this feature.

III. PRELIMINARY ANALYSES

A. Preliminary Institutional Analysis

The ADL study, along with Mission and other contracted assessments have permitted a preliminary analysis of COFISA's structure, policies and procedures, and management systems. While additional analysis will be required as the project design is developed, it is clear, at this stage, that successful implementation of the proposed project will require significant modification in several areas of COFISA management.

The ADL study discovered that the information that is currently collected and processed by COFISA on its loans and borrowers is not adequate, either in quantity or quality, to efficiently manage the type of portfolio which is envisioned by this project.

Although COFISA's computerized information system is well developed and allows for prompt updating and monitoring of repayment behavior, it does not easily provide for such commonly required reports as ageing and delinquency rates and ratios. ADL also observed that neither COFISA's creditors nor the Central Bank (in its capacity as a regulatory agency) have required the collection or processing of evaluative information on the COFISA portfolio.

These findings regarding management information are representative of the overall COFISA management style. Having become a "retail banker", borrowing from commercial financial institutions and lending to Costa Rican businesses, COFISA's structure and staffing, its policies, procedures and its management systems were all geared to the brokering of money. Volume and repayments had, approximately, become the standards against which the financiera evaluated its performance; and, until the onset of the current economic crisis and colon devaluation, its performance was considered to be exceptionally good.

The project which is being currently proposed will require that COFISA reorient its management, and redesign its structure and systems, so as to facilitate efficient operation within the context of what we have described as "developmental lending". Loans will have to be managed as "projects" to be considered for their economic and financial viability as well as on the basis of collateral and guarantees. The objectives of enhancing foreign exchange earnings and identifying and targeting specific areas of credit shortage will govern day-to-day operations.

Among the specific areas of change which will be considered in detail during further project design and included:

- the development of a credit policy framework which accommodates "developmental" lending and a credit application processing/approval system which can respond in an agile and sensitive fashion;
- staffing changes and training required to provide more thorough project analysis and supervision;
- redesign of the management/customer information system to regularly provide high quality, reliable information; and,
- evaluation of loans based on the measured progress of borrowers' "projects" toward realization of their objectives.

It is expected that these adjustments would begin immediately following project approval and be completed during the first few months of project implementation. While analysis must yet be conducted regarding the costs of these management changes, initial estimates suggest that the 6% (of portfolio) General and Administrative expenses which have been assumed and projected will sufficiently finance the changes.

B. Preliminary Financial Analysis

The following is a resumé of the Project's Financial Plan, Analysis and conclusions derived from a detailed description (Annex C) of the several assumptions underpinning our preliminary financial analysis of the proposed project, as well as twenty year cash flow projections for both the proposed local currency and the dollar portfolios. Also included in Annex D is the Mission's projection of COFISA's capitalization and the evolution of the COFISA debt to equity ratio.

The project paper's financial analysis will also include sensitivity tests to demonstrate the effect of varying interest rate spread assumptions, and fluctuations in the colon/dollar exchange rate, on project feasibility.

1. Background and Assumptions

Although one of the stated purposes of this project is to reestablish COFISA as a development oriented financial institution, it is not likely that there will be strong demand in the immediate future for either dollar or colon-denominated long term loans. Until such time as the productive private sector is prepared psychologically and materially for more investment in plant, equipment, and permanent working capital, primary credit demand will be for self-liquidating short-term loans to cover purchases of raw materials, payment of general and administrative expenses, or pre-export financing. Furthermore, those companies which do not earn dollars will not be willing to assume dollar debt. Even those who do earn dollars may not wish to take the risk of a long term dollar loan, the repayment of which depends on access to foreign currency though continued export markets for their products.

Initially, therefore, COFISA's subloan portfolio will consist primarily of short-term lendings which respond to areas of most acute need.

As this document is being prepared, COFISA principals are negotiating with their creditor banks toward a restructuring of the current COFISA foreign debt which totals more than $50 million. (A detailed discussion of COFISA's current debt and status of negotiations with creditors is included in Section I.C.). Clearly, any new sublending activity by COFISA is contingent upon a successful restructuring of this existing debt. Indeed, this project proposal assumes that such a restructuring, supplemented by earnings from an eventually reactivated COFISA commercial portfolio, will permit full cancellation of COFISA's current debt within 10 years of project implementation (see Annex D). This Preliminary Financial Plan and Analysis assumes a completely independent, newly financed portfolio which will operate independent of, and protected from COFISA repayment of its existing obligations. The only anticipated relationship between this new AID financed project and COFISA's existing obligations may result from new subloans made through this project to borrowers which are currently indebted to COFISA. Even in these cases, it is assumed that activity financed by this new project will be legally protected (to the extent feasible) from existing creditors.

An additional, indirect relationship between the project and current COFISA circumstances results from the prohibition under this project against new COFISA borrowing until such time as its debt to equity ratio returns to 10:1. For purposes of calculating this ratio, COFISA's current debt has been included. Therefore, the repayment schedule which is negotiated with current creditors and COFISA recapitalization via this new project will be the principal factors in determining the point at which COFISA will be able to assume additional, new debt. Our preliminary analysis (see Annex D) indicates that this point should be reached in year four.

One of the primary purposes of this project is to reestablish COFISA as a development oriented financial institution. Realization of this objective will require, among other things, that COFISA develop its own capital base upon which it can build future operations. It is assumed, therefore, that all earnings generated from this project will be transferred to the COFISA capital base which will finance an independent subloan portfolio. As described later in the specific assumptions for the projected cash flow, (Annex D) this COFISA capital base will grow via several income sources, including all net earnings from AID financed sublendings, the diversion of 1% of the interest payments on all subloans into a special COFISA stock purchase program[1/] and all transfers of excess balances from the "risk minimization fund" (see Annex F) during amortization of the AID loan.

As an alternative to a GOCR guarantee for the $10 million D.A.-funded dollar portfolio, the Mission has developed a mechanism which would substantially reduce the risk to AID in the event of a COFISA default. The mechanism (described in detail in Annex F) consists of a fund which will be created and maintained through the payment by COFISA of a specific portion of its interest payments on the $10 million AID loan into an interest earning, escrow account. The balance of the account would be payable to AID in the event of a COFISA default. COFISA will make semi-annual payments totalling three percent of the average outstanding balance of the AID loan during the loan's ten year grace period, and two percent thereafter until the balance of the account is equal to the outstanding balance of the AID loan. Projections estimate (see Annex F) that this point of equilibrium will be achieved by year

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1/ The Special Stock Purchase feature is a mechanism whereby a sum equal to one percent of all AID-financed loan balances will be used to recapitalize COFISA and, through the issuance of shares, to further popularize the ownership of COFISA by its borrowers. This is accomplished through the designation of one of the percentage points of interest payments to the purchase of Special stock in the name of the borrower. (COFISA is currently owned by over 400 stockholders, no one of which owns more than 5%).

twelve, as COFISA begins to amortize the $10 million AID loan. The fund will, therefore, provide maximum protection during the period of loan amortization. As COFISA repays the AID loan, the balance of the account will be reduced accordingly by transferring funds from the account into the COFISA Capital Base sublending portfolio. Thus, in addition to providing AID with protection against default, this mechanism will further extend credit to Costa Rica's productive sector and augment COFISA's capital base.

2. Observations and Conclusions

Care has been taken to maintain a conservative basis for all of the above described assumptions. Even so, their projection over the twenty year period indicate the project can successfully realize its objectives:

a) By year three, the dollar subloan portfolio will average slightly more than $10.2 million, counting COFISA capital base sublending in addition to the AID-financed lending (see Annex D); similarly the colon subloan portfolio will average over 334 million colones. By year twenty, the total of the dollar portfolio is estimated at over $30 million. The colon portfolio for year twenty is projected at almost 2.0 billion colones. Thus, the project has reasonable potential for responding to the private sector's financing problems.

b) The dollar denominated portfolio will consist entirely of lendings to exporters. Given this availability of dollar credit and the intended "developmental" orientation of these lendings, producers/manufacturers for export will be able to maximize their potential for export market development. It is also expected that supplier credit and other commercial credit lines will reopen to Costa Rican producers once their creditworthiness is reestablished. This project can help producers/manufacturers to survive the current crisis and reestablish themselves in the international marketplace. Additionally, both dollar and colon credit is expected to be used to further develop domestic infrastructure necessary for export production and export, such as increased productive capacity, transportation, and communication systems.

The project, therefore, is expected to enhance the capacity of the productive private sector to earn foreign exchange.

c) Both the colon and dollar cash flow projections (see Annex D) show conservative, but sure growth of the COFISA capital base. Separate COFISA capital base sublending portfolios are projected in order to demonstrate this growth. Given a successful restructuring of its current debt, COFISA should establish early in the AID loan grace period a substantial enough capital base to bring its debt to net worth ratio to within the AID required 10:1 area (see d, below). This would enable COFISA to secure additional borrowings to increase the size of its operations. As the Project Paper is developed, a specific schedule will be established for the transition of COFISA's portfolio to "developmental" lendings. Thus, the growth of the COFISA capital base and the establishment of a substantial "developmental" subloan portfolio will allow the project to reestablish COFISA as a major, development oriented financial institution.

d) Using as a basis the model prepared for COFISA by Arthur D. Little Inc., we have projected likely cash inflows through COFISA's recovery of its current portfolio. Based on these projections, we have calculated a possible rescheduling of COFISA's current obligations. Utilizing this projected rescheduling, together with the proforma cash flow projections prepared for the proposed AID funded project, we have calculated an illustrative COFISA recapitalization schedule[1/].

Annex D, Section 3 presents a projection of this evolution of COFISA's capitalization and its debt to equity ratio, demonstrating that the financiera will be able to amortize its existing debt within 10 years of the start of the project. The old debt will be amortized using proceeds from COFISA's existing portfolio and, once these inflows are fully realized, from capitalized profits earned from a new commercial loan portfolio which COFISA will be able to develop after year 4, once within the AID-stipulated 10:1 debt to equity ratio limit.

For purposes of this analysis, we have assumed fairly conservative leveraging by COFISA. After year 9, COFISA is assumed to reach a maximum commercial borrowing of $45.0 million, which drops its debt to equity ratio to as low as 3.8:1 in year 11.

1/ Also using the ADL computer model, cash inflow projections were prepared for the March 2nd Panama meeting of COFISA's creditors. These projections were audited and presented to the bankers by Peat, Marwick, Mitchell & Co. (PMM). The projections prepared by us in this PID differ substantially from those presented in Panama. This is due to the nearly $18 million in "la presa" certificates and $3 million in cash which COFISA has accumulated for payment against the principal amount of their debt. These amounts exceed original expectations and allow for our more optimistic projections.

For purposes of reference, the PMM projections are included as Annex E.

IV. PROJECT PREPARATION STRATEGY

A. State of Negotiations with COFISA

As described in Section I, COFISA's negotiations with its creditors are expected, by mid-June, 1982, to produce an extension agreement and/or debt rescheduling agreement. The Mission's position since the inception of discussion regarding this project has been that a rescheduled COFISA debt would be a prerequisite to any possible new A.I.D. loan. The pending extension/rescheduling agreement may satisfy this prerequisite. The Mission will closely monitor further negotiations between COFISA and its creditors, and seek assistance from AID/W General Counsel and the Regional Legal Advisor as legal documents are produced.

COFISA management and senior COFISA staff members have participated fully in the design of this PID. Mission staff will maintain this close contact throughout the process of further project design.

B. Major Issues

Several pending issues will significantly effect the design of this project and, perhaps, the outcome of this proposal. They include:

1. the successful negotiation of a COFISA debt restructuring satisfactory to A.I.D. This issue is throughly discussed in Sections I and II.

2. formal agreement by COFISA's creditors to legally and procedurally separate funds and assets associated with a new A.I.D. loan from those COFISA funds and assets to which they currently have or will seek claim. This issue is discussed in Section II, it represents a firm prerequisite to proceding with further project design. The development of legal documents and management procedures for implementing this separation will occur during Project Paper preparation.

3. the uncertain real demand for dollar credit which exists under current economic circumstances. This issue is discussed in Sections I, II and III, and the Mission is in the process of studying the matter. Current Mission experience with the BANEX project suggests that dollar credit demand, however reduced, continues to exist; and a recently completed ROCAP economist analysis of the issue supports a Mission developed theory that the reduced demand is a temporary phenemenon which will correct itself as pending GOCR adjustment measures take effect.

This issue, however, will substantially influence project design and Project Paper development.

4. the payment of dividends to stockholders. As COFISA's rescheduling negotiations with its creditors are completed, and as the project design is advanced, it must be determined at what point COFISA should be allowed to pay dividends. The Mission feels that modest dividend payments should be allowed once the major objective of COFISA recapitalization is realized (as evidenced by the reduction of the debt to equity ratio to 10:1) and both the colon and dollar portions of the loan have been completely drawndown and sublent. Dividend payment at that point would be consistent with the objectives of the "special stock purchase" feature of the project (see Preliminary Financial Analysis). COFISA's current creditors may wish, however, to restrict COFISA from the payment of any dividends until obligations to them are fully satisfied.

C. Project Preparation Requirements and Schedule

Much of the analysis of the Costa Rican Private Sector which is being initiated for the development of our strategy for the Caribbean Basin Initiative will provide the Mission with information necessary to complete the design of this project. Assistance required for the development of the Project Paper, which is scheduled to be submitted for AID/W review in early August, 1982, will include:

- a financial analyst for two weeks during the first half of July;
- an economic analyst for one week in early July;
- expertise in the area of financial institution management, information systems, credit analysis, lending procedures/systems and monitoring for three to four weeks beginning in late June; and
- legal assistance with early project design immediately following PID approval, and with final design of legal aspects of the project in early August.

PRIVATE SECTOR REVITALIZATION I

Preliminary

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

AID 1020-28 (7-71)
SUPPLEMENT 1

(INSTRUCTION: THIS IS AN OPTIONAL FORM WHICH CAN BE USED AS AN AID TO ORGANIZING DATA FOR THE PAR REPORT. IT NEED NOT BE RETAINED OR SUBMITTED.)

Life of Project:
From FY 82 to FY 85
Total U.S. Funding $10.0 million
Date Prepared: 5/10/82

Project Title & Number ______

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: (A-1)	Measures of Goal Achievement: (A-2)	(A-3)	Assumptions for achieving goal targets: (A-4)
To Reestablish dynamic growth in the Costa Rican economy	A 6.% p.a. growth rate during the 1985-1990 period	Central Bank	1. Other economic factors will complement project efforts. 2. Costa Rican political stability continues.

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project:
From FY 82 to FY 85
Total U.S. Funding $10.0 million
Date Prepared 5/10/82

Project Title & Number:

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Purpose (B 1)	Conditions that will indicate purpose has been achieved: End of Project status. (B 2)	(B-3)	Assumptions for achieving purpose (B-4)
1. To assist with the resolution of the current productive private sector liquidity crisis 2. To enhance the capacity of the productive private sector to earn foreign exchange 3. To reestablish the viability of COFISA as a development oriented financial institution	1. Colon denominated sublendings equivalent to $5 million to the productive private sector 2. Dollar denominated sublendings to private sector totalling $5 million 3. Steady growth of the COFISA capital base 4. A specifically scheduled transition of a designated portion of COFISA's sublending portfolio to "developmental" subloans as described in the PID	o COFISA records and reports o Audit of COFISA records as necessary o Subborrower interviews at scheduled points of project evaluation.	o COFISA's long-term ability to comply with the conditions of its rescheduled bank debt o Sufficient continued demand for credit o Gradual stabilization of the economy

AID 1020-28 (1 73)
SUPPLEMENT 1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project
From FY 82 to FY 85
Total U.S. Funding $10.0 million
Date Prepared 5/10/82

Project Title & Number.

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Outputs: (C-1)	Magnitude of Outputs: (C-2)	(C-3)	Assumptions for achieving outputs. (C-4)
	Approx. end of year balances ('000,000) 2 / 5 / 10	o Disbursement records o COFISA records and reports o Audits and evaluations as scheduled	o COFISA's long-term ability to comply with the conditions of its rescheduled bank debt o Sufficient continued demand for credit o Gradual stabilization of the economy
Colon subloan portfolio	₡ 399 / 569 / 721		
Dollar subloan portfolio	$ 8.0 / 13.1 / 16.6		

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project: From FY 82 to FY 85
Total U.S. Funding $10.0 million
Date Prepared 5/10/82

Project Title & Number

NARRATIVE SUMMARY		OBJECTIVELY VERIFIABLE INDICATORS			MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Inputs: (D-1)		Implementation Target (Type and Quantity) (C-2)			(D-3)	Assumptions for providing inputs: (D-4)
		Yr 2	Y5	Yr 10		
o AID Loan	colones	300 mil.	300 mil.	15 mil.	o Disbursement records	o COFISA's long-term ability to comply with the conditions of its rescheduled bank debt
	dollars	7.0 mil.	10.0 mil.	9.5 mil.	o COFISA records and reports	
o Reinvested retained earnings including transfers to dollar portfolio	colones	7.3 mil.	123.2 mil.	225 mil.	o Scheduled evaluation	o Sufficient continued demand for credit
	dollars	43 tho.	967 tho.	2.5 mil.		o Gradual stabilization of the economy
o Special stock purchases	colones	3.0 mil.	4.1 mil.	5.0 mil.		
	dollars	50 tho.	108 tho.	134 tho.		

INITIAL ENVIRONMENTAL EXAMINATION

PROJECT LOCATION: Costa Rica

PROJECT TITLE: Private Sector Revitalization I

FUNDING: FY 1982 Development Loan $10,000,000
ESF $ 5,000,000

LIFE OF PROJECT: Four (4) years

IEE PREPARED BY: Heriberto Rodríguez
USAID/General Engineer

DATE: June 4, 1982

ENVIRONMENTAL ACTION

RECOMMENDED: That the project will not have a significant effect on the environment and therefore a negative determination is appropriate.

CONCURRENCE: Daniel A. Chaij
Mission Director
USAID/Costa Rica

DATE: June 4, 1982

PROJECT DESCRIPTION

This project will consist of a COFISA subloan portfolio of $10 million U.S. dollar sublendings and the equivalent of $5 million in local currency sublendings. The credit will be primarily used for the purchase of raw materials and intermediate goods and to satisfy immediate working capital needs. The primary focus of the local currency subborrowers will be on local services and/or domestically produced inputs for export producers or produce/manufacture substitutes for imports. Dollar sublendings will be made exclusively to dollar earners, primarily exporters.

The general nature and scope of the project is such that it will have a beneficial impact. The complete Impact Identification and Evaluation Form follows:

IMPACT IDENTIFICATION AND EVALUATION FORM

Impact Areas and Sub-Areas[1]	Impact Identification and Evaluation[2]
A. LAND USE	
1. Changing the character of the land through:	
a. Increasing the population	N
b. Extracting natural resources	N
c. Land clearing	N
d. Changing soil character	N
2. Altering natural defenses	N
3. Foreclosing important uses	N
4. Jeopardizing man or his works	N
5. Other factors	
__________	____
__________	____
B. WATER QUALITY	
1. Physical state of water	N
2. Chemical and biological states	N
3. Ecological balance	N
4. Other factors	
__________	____
__________	____

1/ See Explanatory Notes for this form.

2/ Use the following symbols:
N - No environmental impact
L - Little environmental impact
M - Moderate environmental impact
H - High environmental impact
U - Unknown environmental impact

IMPACT IDENTIFICATION AND EVALUATION FORM

C. ATMOSPHERIC

1. Air additives -- N
2. Air pollution -- N
3. Noise pollution -------------------------------------- N
4. Other factors

______________________________ ______

______________________________ ______

D. NATURAL RESOURCES

1. Diversion, altered use of water ---------------------- N
2. Irreversible, inefficient commitments ---------------- N
3. Other factors

______________________________ ______

______________________________ ______

E. CULTURAL

1. Altering physical symbols ---------------------------- N
2. Dilution of cultural traditions ---------------------- N
3. Other factors

______________________________ ______

______________________________ ______

F. SOCIOECONOMIC

1. Changes in economic/employment patterns -------------- N
2. Changes in population -------------------------------- N
3. Changes in cultural patterns ------------------------- N
4. Other factors

______________________________ ______

______________________________ ______

IMPACT IDENTIFICATION AND EVALUATION FORM

G. HEALTH

1. Changing a natural environment ---------------------- N
2. Eliminating an ecosystem element -------------------- N
3. Other factors

H. GENERAL

1. International impacts -------------------------------- N
2. Controversial impacts -------------------------------- N
3. Larger program impacts ------------------------------- N
4. Other factors

I. OTHER POSSIBLE IMPACTS (not listed above)

PRELIMINARY FINANCIAL ANALYSIS ANNEX

This annex is divided into three sections. Sections 1 and 2 are twenty year cash flow projections for the dollar and local currency portfolios, respectively. Section 3 projects the evolution of COFISA's debt to equity ratio, the financiera's recapitalization, and the amortization of its existing debt.

1. Dollar Portfolio Cash Flow Assumptions

a. The dollar denominated subloan portfolio will be financed with an AID loan for $10 million for a period of twenty years with a ten year period of grace. COFISA will pay a fixed rate of 5% per annum (a designated portion of which will be paid into the "risk minimization fund" as described in Annex F).

b. AID funds for the dollar denominated portfolio will be drawn down according to the following schedule:

year one	$3.0 million
year two	4.0 million
year three	3.0 million
TOTAL	$10.0 million

c. The AID-financed portfolio is projected at $10 million from year three through year ten, at which time it is reduced annually by the amount of AID loan amortization.

d. A "COFISA Capital Base portfolio" is projected which will consist of sublendings governed by the same interest earnings and term assumptions as the AID financed portfolio. This "COFISA Capital Base portfolio" represents the COFISA capital base which is generated from (1) interest earnings from the AID financed portfolio, including a 1% additional interest charge by which subborrowers become COFISA shareholders, and (2) all transfers from the "risk minimization fund" as described in later assumptions and in Annex D.

e. A "Reserve Portfolio" is also projected which is financed from the bad debt reserve requirements of AID (2% on average outstanding AID portfolio) and the GOCR (5% of net earnings). This portfolio earns interest at a rate of LIBOR plus 2% and will include only highly liquid dollar investments which are compatible with the purpose of a bad debt reserve. This "Reserve Portfolio" will earn interest, therefore, according to the following schedule: 1st yr - 18%, 2nd yr - 17%, 3rd yr - 16%, 4th through 20th yrs - 15%.

f. The AID-financed and COFISA capital base portfolio is projected to earn interest according to the following schedule:

1st year	20%
2nd year	19%
3rd year	18%
4th thru 20th years	17%

One percent of all interest earnings realized from the above rates will form part of the "COFISA Capital base" portfolio. As established in the "Special Stock Purchase Feature", COFISA shares in corresponding amounts will be issued to subborrowers paying this additional one percent.

g. Annual Bad Debt losses are projected at 1.5% of the AID-financed portfolio.

h. Taxes are projected at 50% of net income after deductions. Although all dollar subloans will be administered through COFISA International, (the Panama subsidiary) and thus not be subject to Costa Rican taxes, the potential for tax reform in Costa Rica exists, and we have therefore made the assumption that all profits will be taxable.

e. During the ten year grace period, COFISA will pay semiannually into a "risk minimization fund" (see annex D) a total of 3% of on the average outstanding balance of the AID loan. Beginning with year ten and AID loan amortization, the amount paid into the fund is reduced to 2% of the average outstanding balance of the AID loan. The 2% payments continue until such time (estimated to occur in year twelve) as the balance of the "risk minimization fund" equals the outstanding balance of the AID loan.

j. General and Administrative expenses are estimated at 4% of AID financed dollar portfolio during year one and 3% thereafter. (This is in addition to the 2% during year one and 1% thereafter which is projected for the colon portfolio)

k. Reserves for bad debts are projected as follows:

o GOCR required - 5% of net earnings before taxes; and,

o AID required - 2% of average portfolio.

These reserves constitute a "Reserve Portfolio" which is projected to earn at a rate of LIBOR plus 2% through investment in highly liquid dollar paper.

l. The balance of the "Risk Minimization Fund" is projected to equal the amount of the outstanding balance of the AID loan during year twelve. At this point, the excess balance of the fund is annually transferred into the "COFISA capital base portfolio".

m. No dividend payments are assumed in this preliminary analysis.

n. Although the cash flow projection shows a $219,000 negative flow in year 11, several factors not reflected in the table would tend to mitigate against, and most likely eliminate, this shortfall. These are:

i) significant economies in COFISA operating expenses should be realizable by year 11, resulting in considerable savings. Rather than continuing at the assumed 3% of portfolio assumed for year 2 onward, such expenses should in fact drop proportionally.

ii) losses are projected very conservatively (i.e. larger than will most likely be the case); COFISA could very well not have to write off as much as is assumed.

iii) COFISA will be able to exercise considerable discretion in investing the legal reserve portfolio, for example in tax free instruments, dropping tax payments accordingly.

iv) A tax reform law currently being considered may well permit tax write-off for losses carried forward from tax year to tax year. This would dramatically change the income tax payments projected, and correspondingly improve the cash flow picture very markedly.

Even without any gains realized by means of any combination of the above assumptions, COFISA would only have to limit the growth of its capital base in this year by the amount of the negative cash flow. The implications of this for future capitalization, loan amortization, and escrow fund transfers are insignificant.

COFISA DOLLAR PORTFOLIO PROFORMA CASH FLOW PROJECTION
U.S.$10,000,000 loan to be paid in dollars
(000)

SOURCES	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Beginning cash	-	41	181	328	415	477	506	545	583	626	178	(219)	361	66	189	297	465	634	801	973
COFISA capital base	-	-	41	224	552	967	1,444	1,952	2,497	3,580	5,156	6,786	7,015	10,710	13,807	16,922	19,974	23,023	26,070	28,163
AID loan portfolio	3,000	7,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	9,500	8,550	7,600	6,650	5,700	4,750	3,800	2,850	1,900	950	-
Reserve Portfolio	-	36	128	234	305	351	402	457	516	580	669	719	790	898	1,045	1,207	1,372	1,556	1,755	1,969
Interest earned AID portfolio	285	900	1,445	1,600	1,600	1,600	1,600	1,600	1,600	1,560	1,444	1,292	1,160	988	836	684	532	380	228	-
Interest earned COFISA portfolio	-	8	23	62	121	192	272	355	446	581	763	912	1,361	1,804	2,306	2,799	3,287	3,775	4,263	4,674
Interest earned reserve portfolio	-	6	20	35	46	53	60	68	77	87	97	108	118	135	157	180	206	233	263	295
Special stock purchases	15	50	86	104	108	112	117	122	128	134	136	148	150	174	196	217	239	259	281	297
Escrow fund transfer	-	-	-	-	-	-	-	-	-	-	-	465	2,318	2,147	1,976	1,805	1,634	1,463	1,292	1,121
TOTAL SOURCES	3,300	8,043	11,926	12,587	13,147	13,752	14,403	15,099	15,847	16,650	16,973	17,299	19,903	22,622	25,262	27,906	30,559	33,223	35,903	37,492
USES																				
COFISA capital base sublending	-	43	224	552	967	1,444	1,952	2,497	3,080	4,206	5,314	6,065	9,694	12,857	15,972	19,024	22,073	25,120	28,163	30,257
AID financial sublending	3,000	7,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	9,500	8,550	7,600	6,650	5,700	4,750	3,800	2,850	1,900	950	-
AID interest paid 2%	30	100	170	200	200	200	200	200	200	244	271	242	214	185	157	128	100	71	43	14
Operation expenses	60	150	259	312	323	336	351	367	384	402	414	413	450	523	589	653	716	779	842	890
Bad debt losses 1 1/2%	23	75	129	156	161	168	175	183	192	201	207	207	225	262	295	326	358	390	421	445
Income tax	63	216	327	347	368	394	423	453	485	526	567	671	756	911	1,050	1,188	1,322	1,457	1,592	1,662
Legal reserve 5%	6	28	61	97	136	178	223	272	324	381	463	515	598	696	809	937	1,079	1,236	1,408	1,589
Bad debt reserve 2%	30	100	173	208	215	224	234	244	255	268	276	275	300	349	393	435	477	519	561	593
AID loan amortization	-	-	-	-	-	-	-	-	-	500	950	950	950	950	950	950	950	950	950	950
Deposits for escrow fund 3%	45	150	255	300	300	300	300	300	300	244	180	-	-	-	-	-	-	-	-	-
TOTAL USES	3,257	7,862	11,598	12,172	12,670	13,244	13,858	14,516	15,221	16,472	17,192	16,938	19,837	22,433	24,965	27,441	29,925	32,422	34,930	36,400
Cash available end of year	43	181	328	415	477	508	545	583	626	178	(219)	361	66	189	297	465	634	801	973	1,092

2. Colon Portfolio Cash Flow Assumption

a. The colon-denominated subloan portfolio will be financed with a loan for the colon equivalent of $5 million, which has been calculated for purposes of preliminary cash flow projections at an exchange rate of US$1. to ¢60, (for a total loan amount of colones 300,000,000)[1/]. The terms of the loan are projected at ten years with five years grace. COFISA will pay a fixed rate of interest of 5%.

b. Drawdown of the colon-denominated loan will occur as follows:

year one	colones 210,000,000
year two	colones 90,000,000
TOTAL	colones 300,000,000

c. The "AID financed portfolio" is projected at colones 300 million until amortization begins during year six, at which point it is reduced by the amount of amortization of the local currency loan.

d. The portfolio will earn interest at a constant rate of 30%, 1% of which will be transferred to the COFISA capital base as COFISA stock (special stock purchase) in the name of the subborrowers.

e. A "COFISA capital base" portfolio is projected which will also earn interest at a constant 30%[2/]. This portfolio is financed from the 1% special stock purchase (described above) and all net earnings from the AID financed colon portfolio.

f. A "Reserve fund" portfolio is also projected. This portfolio is financed from the AID (2% on average AID financed portfolio) and GOCR (5% of net earnings before taxes) required bad debt reserves. This portfolio will consist of short-term, highly liquid investments in GOCR public paper. Earnings on these investments are assumed to be tax free.

1/ The specific proposed mechanism for the conversion of dollars to colones is currently being negotiated. Further discussion of the possible mechanism is contained in Section VII).

2/ While slightly above current colon interest rates, it is expected that rates will soon increase substantially. Thirty percent interest is determined to be a conservative average rate for the projected period.

g. An annual bad debt expense is projected at 1.5% of the AID financed portfolio.

h. General and administrative expenses are projected at 2% during year one, and 1% thereafter.

i. Income taxes are projected at 50% of net income after deductions.

COFISA, COLON PORTFOLIO PROFORMA CASH FLOW PROJECTIONS
(colones estimated rate ₡60 x US$)
(₡,000)

	1	2	3	4	5	6	7	8	9	10
SOURCES										
Beginning Cash	-	2,520	31,823	38,716	44,815	51,963	1,509	6,162	10,015	14,506
Cash Increases COFISA Capital Portfolio	-	-	2,520	35,143	73,059	177,874	289,817	351,476	417,588	457,603
AID Loan Drawdown and Reflows	210,000	300,000	100,000	300,000	300,000	240,000	180,000	120,000	60,000	
Reserves Financed Portfolio	-	4,830	10,005	14,461	19,645	25,422	37,671	38,988	45,275	52,922
Interest Earnings by AID Portfolio	30,450	87,000	87,000	87,000	87,000	69,600	52,200	34,800	17,400	-
Interest Earnings by Cofisa's Portfolio	-	731	9,959	21,187	34,183	66,651	86,513	103,700	124,005	145,611
Interest Earnings by Inv., Portfolio	-	1,449	3,001	4,338	5,893	7,686	9,801	11,696	13,717	15,077
Special Stock Purchases	1,050	3,025	3,434	3,730	4,178	4,698	4,734	4,776	4,876	5,071
TOTAL SOURCES	241,500	399,555	447,757	503,775	568,773	644,096	655,125	671,569	693,126	771,538
USES										
COFISA Capital Sublendings	-	7,520	35,143	73,057	117,874	229,817	291,476	422,588	477,603	502,107
AID Financed Sublendings	210,000	100,000	100,000	300,000	300,000	240,000	180,000	120,000	60,000	-
AID Debt Services	10,500	15,000	15,000	15,000	15,000	12,000	9,000	6,000	3,000	-
Operating Expenses	4,200	3,073	3,434	3,730	4,178	4,698	4,734	4,776	4,876	5,071
Bad Debt Losses	3,150	4,610	5,151	5,595	6,267	7,047	7,071	7,164	7,314	7,531
Income Tax	6,300	32,524	36,687	41,931	47,869	56,254	57,964	60,780	63,107	66,579
Legal Reserve 5%	630	3,955	7,774	12,104	17,265	21,274	29,560	36,173	43,170	50,617
Bad Debt Reserve 2%	4,200	6,050	6,687	7,461	8,357	9,397	9,428	9,552	9,752	10,047
AID Loan Amortization	-	-	-	-	-	60,000	60,000	60,000	60,000	60,000
TOTAL USES	238,980	367,732	409,076	458,960	516,810	642,507	649,163	661,533	678,822	701,847
Cash Available end of the year	2,520	31,823	38,716	44,815	51,963	1,509	6,162	10,015	14,506	19,691

	11	12	13	14	15	16	17	18	19	20
SOURCES										
Beginning Cash	19,691	85,336	96,207	111,557	129,211	149,661	173,350	200,788	232,567	269,383
Cash Increases COFISA Capital Portfolio	502,107	571,798	606,135	707,421	813,978	943,189	1,097,850	1,266,200	1,466,988	1,699,555
AID Loan Drawdown and Reflows	-	-	-	-	-	-	-	-	-	-
Reserves Financed Portfolio	60,659	68,027	79,628	92,056	106,451	123,130	142,450	163,831	190,757	220,788
Interest Earnings by AID Portfolio	-	-	-	-	-	-	-	-	-	-
Interest Earnings by Cofisa's Portfolio	151,371	175,779	203,702	236,056	273,525	316,926	367,198	425,426	492,871	570,992
Interest Earnings by Inv., Portfolio	18,198	20,663	23,809	27,616	31,935	36,939	42,735	49,449	57,227	66,236
Special Stock Purchases	5,218	6,061	7,024	8,140	9,432	10,928	12,662	14,667	16,995	19,689
TOTAL SOURCES	757,196	877,514	1,016,663	1,177,862	1,366,532	1,580,773	1,831,265	2,121,361	2,457,405	2,846,643
USES										
COFISA Capital Sublendings	571,798	606,135	707,421	813,978	943,189	1,092,850	1,266,200	1,466,988	1,699,555	1,968,938
AID Financed Sublendings	-	-	-	-	-	-	-	-	-	-
AID Debt Services	-	-	-	-	-	-	-	-	-	-
Operating Expenses	5,218	6,061	7,024	8,140	9,432	10,928	12,662	14,667	16,995	19,689
Bad Debt Losses	7,827	9,091	10,516	12,710	14,148	16,393	18,993	22,005	25,493	29,534
Income Tax	69,138	80,313	93,071	107,852	124,972	144,802	167,771	194,377	225,191	260,884
Legal Reserve 5%	58,441	67,505	78,006	90,172	104,266	120,593	139,507	161,417	186,797	216,197
Bad Debt Reserve 2%	10,436	12,123	14,058	16,229	18,864	21,857	25,324	29,340	33,991	39,379
AID Loan Amortization	-	-	-	-	-	-	-	-	-	-
TOTAL USES	672,858	781,227	905,106	1,048,631	1,216,871	1,407,423	1,630,457	1,888,794	2,188,022	2,534,622
Cash Available end of the year	85,336	96,207	111,557	129,211	149,661	173,350	200,788	232,567	269,383	312,317

3. Amortization of COFISA's existing debt, capitalization, and evolution of debt to equity ratio

The attached table demonstrates that COFISA will achieve a debt to equity ratio of 10:1 or less by year 4. The financiera's recapitalization and the amortization of existing debt are also shown, in accordance with the following notes:

1/ In accordance with projected cash inflows from its existing portfolio, COFISA is able to amortize old debt as indicated in the payments column for years one through six (interest payments are also made throughout the period, although these are not shown in this table). The beginning balance for outstanding COFISA debt of $36.5 million is derived as follows:

Outstanding liabilities 4/28/82	$56,316,380
Less payments to creditors, via:	
Certificates of deposit received from clients	8,400,125
Certificates of desposit issued by Central Bank	8,400,000
Cash	3,000,000
Net liabilities at beginning of Project	$36,516,255

2/ The A.I.D. colones loan is drawn down and amortized in accordance with the colones portfolio cash flow, Section 2 of this Annex.

3/ The A.I.D. dollar loan is drawn down and amortized in accordance with the projected dollar portfolio cash flow, Section 1 of this Annex.

4/ New commercial debt is permitted beginning in year 4 as COFISA's debt to equity ratio is brought within the 10:1 maximum. COFISA is assumed to be able to leverage sufficient funds to generate cash to meet principal and interest payments on what remains of its old, preproject debt after year 6. For purposes of this illustrative analysis, we have assumed that only new, commercial debt necessary to enable complete repayment of old debts by year 11 is acquired. COFISA may be able to expand its operations more rapidly, remaining, of course, within the 10:1 limit.

5/ Beginning equity is assumed to be zero at the start of project.

6/ One percent interest is paid on all A.I.D.-financed colon and dollar portfolio subloans to broaden COFISA's capital base, subborrowers becoming shareholders (see parts 1 and 2 of this Annex).

7/ Bad debt reserves required by Costa Rican law (5%) and A.I.D. (2%) comprise this part of COFISA's equity base (see Section 1 and 2 of this Annex).

8/ Capitalization of profit on A.I.D. financed subloans, in accordance with cash flow tables, Section 1 and 2 of this Annex.

9/ Profit on new commercial portfolio, beginning year 4, is capitalized. A 4 1/2% spread is assumed, on the year's average portfolio.

10/ Beginning year 6, capitalized profit on new commercial portfolio is used to amortize old, preproject debt.

11/ Interest accrues on outstanding preproject debt at LIBOR, assumed to be 13% (Note: Up to year 6, cash inflows from COFISA's old portfolio will have covered interest payments on this debt; from year 7, this must be covered with proceeds from new commercial portfolio).

12/ This entry indicates net capitalization of COFISA after principal and interest payments on old debt.

COFISA

AMORTIZATION OF EXISTING DEBT, CAPITALIZATION, AND EVOLUTION OF DEBT TO EQUITY RATIO

($'000)

	1	2	3	4	5	6	7	8	9	10	11
Debt											
Existing debt preproject											
U.S.$36,516,255											
Payments: year 1 3,000	33,516	-	-	-	-	-	-	-	-	-	
year 2 2,793	-	30,723				-	-	-	-	-	
year 3 5,586	-	-	25,137	-	-	-	-	-	-	-	
year 4 5,586	-	-	-	19,551	-	-	-	-	-	-	
year 5 5,586	-	-	-	-	13,965	-	-	-	-	-	
year 6 5,586	-	-	-	-	-	8,379	5,379	3,979	2,479	679	-
	33,516	30,723	25,137	19,551	13,965	8,379	5,379	3,979	2,479	679	
AID Loan $ 5,000,000 (in colones)	3,500	5,000	5,000	5,000	5,000	4,000	3,000	2,000	1,000	-	
AID Loan $10,000,000 (in dollars)	3,000	7,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	9,500	8,550
$15,000,000	6,500	12,000	15,000	15,000	15,000	14,000	13,000	12,000	11,000	9,500	8,550
Commercial Debt	-	-	-	6,000	28,000	35,000	43,000	43,000	45,000	45,000	45,000
TOTAL DEBT	40,016	42,723	40,137	40,551	56,965	57,379	61,379	58,979	58,479	55,179	53,550
Equity											
Special Stock Shares(1% interest paid)	32	100	143	116	178	190	196	202	209	218	223
Reserves (5% and 2%)	116	295	475	632	778	946	1,107	1,278	1,462	1,660	1,867
Capitalization of AID Subloans's Profits	85	796	1,770	2,932	4,274	4,809	6,623	6,196	7,074	7,555	8,717
Capitalization of Commercial Subloans' Profits	-	-	-	270	1,530	3,105	2,040	1,974	2,073	2,073	3,356
Amortization of existing, pre project debt	-	-	-	-	-	(3,000)	(1,400)	(1,500)	(1,800)	(679)	-
Interest on existing preproject debt	-	-	-	-	-	-	(601)	(426)	(225)	(63)	-
Net Commercial Capitalization	-	-	-	270	1,530	105	39	48	48	1,331	3,356
TOTAL EQUITY	233	1,191	2,388	4,000	6,760	6,050	7,965	7,724	8,793	10,764	14,163
Debt to Equity Ratio	171:1	36:1	17:1	10.0:1	8.4:1	9.5:1	7.7:1	7.7:1	6.7:1	5.1:1	3.8:1

RISK MINIMIZATION FUND

Three basic reasons exist for the creation of the risk minimization fund.

- o A.I.D. making the loan to COFISA without a GOCR guarantee;
- o The fund, by defraying almost all of A.I.D.'s risk, will enhance COFISA's chances of regaining its status with the international credit community;
- o The fund will result in transfers from the escrow account to COFISA capital base financed portfolio during the period of loan amortization and will thus assure that COFISA's supply of long-term lending capital will be replenished during amortization.

The fund, as proposed, will have relatively low balances when repayment risks are lower. During the higher risk amortization period, the funds balances are higher and will probably cover A.I.D.'s complete exposure.[1/]

The funds which will be held in escrow by a U.S. financial institution, will be capitalized by the payment of a portion of the loan spread by COFISA. The assets of the fund will consist of A.I.D. approved interest-bearing U.S. dollar-denominated obligations of the GOCR or of its dependencies.

Annex I of the Loan Agreement will stipulate as follows:

Except as A.I.D. may otherwise agree in writing, the Borrower will make semi-annual interest payments into an escrow account, acceptable to A.I.D., at the following annual rates: three percent of the average outstading balance of the A.I.D. loan during the ten-year grace period and two percent thereafter until the balance of the escrow equals the outstanding balance of the A.I.D. loan. These funds will be used to acquire U.S. dollar-denominated debt instruments of the Government of Costa Rica or its dependencies which are acceptable to A.I.D. COFISA payments into the fund and earning thereon less escrow fees, if any, will remain the property of COFISA, but will pass to A.I.D., should

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1/ A.I.D. experiences with private/intermediate Credit Institutions in Costa Rica and other countries have shown that the risk of default is the greatest after loan amortization begins. This fund is designed, therefore, so that its balance will equal the outstanding loan balance (thereby providing full risk protection) beginning in year twelve, as COFISA makes its second full amortization payment. The fund balance continues to equal outstanding loan balance throughout amortization.

A.I.D. communicate to the escrow agent that the loan is in default. No other creditors, including depositors, will have any claim on the fund. A.I.D.'s exclusive claim on the fund in the event of default will not prejudice any other claims which A.I.D. may share with other creditors. Moreover, although COFISA property, the assets in the fund may not be counted either as equity in calculations of maximum allowable debt to equity or in COIFSA payments into the fund may be only with interest earnings (payments may not be made with A.I.D. loan funds or with the recuperated principal of the A.I.D. portfolio). Payments will continue until the funds balance, including accumulated interest thereon, equals the outstanding balance of the A.I.D. loan. If at the end of any A.I.D. loan payment period, the value of the assets in the fund's escrow account exceeds the balance of the A.I.D. loan, the borrower may with the COFISA capital written agreement of A.I.D. transfer such excess amounts into the base sublending portfolio. Any funds so transferred will be subject to the same conditions which are applicable to A.I.D. subloan principal and interest repayments.

The Loan Agreement will include the following covenant:

COFISA will establish and make payments into a reserve account to be held in escrow in a United States financial institution in accordance with the terms and conditions stipulated in Annex I of this agreement and those of an escrow agreement in form and substance to A.I.D.

The Loan Agreement will also include the following subsequent conditions precedent to disbursement:

Unless A.I.D. agrees otherwise in writing prior to any disbursement or its issuance of any commitment documents after the first interest payments is due, the borrower shall present evidence to A.I.D., in form and substance satisfactory to A.I.D., that it has entered into an escrow account for the risk minimization fund described in Annex I.

Table 1, below, contains projections of COFISA payments into the escrow, the amount's interest earnings, and its anticipated yearly balances over the life of the loan.

RISK MINIMIZATION FUND
(000)

Year	Balance AID Loan (year end)	Interest Payment to AID	Amortization	COFISA Payment to Fund	Interest Earnings of Fund	Fund Balance (year end)	Transfer to AID COFISA Portfolio	Ratio Fund to Loan Balance
1	3,000	30	-	45	4	49	-	0.02
2	7,000	100	-	150	22	221	-	0.03
3	10,000	170	-	225	63	539	-	0.05
4	10,000	200	-	300	124	963	-	0.10
5	10,000	200	-	300	200	1,463	-	0.15
6	10,000	200	-	300	290	2,053	-	0.20
7	10,000	200	-	300	397	2,750	-	0.27
8	10,000	200	-	300	522	3,572	-	0.35
9	10,000	200	-	300	670	4,542	-	0.45
10	9,500	244	500	244	840	5,626	-	0.59
11	8,550	271	950	180	1,029	6,835	-	0.80
12	7,600	242	950	-	1,230	8,065	465	1.00
13	6,650	214	950	-	1,368	8,968	2,318	1.00
14	5,700	185	950	-	1,197	7,847	2,147	1.00
15	4,750	157	950	-	1,026	6,726	1,976	1.00
16	3,800	128	950	-	855	5,605	1,805	1.00
17	2,850	100	950	-	684	4,484	1,634	1.00
18	1,900	71	950	-	513	3,363	1,463	1.00
19	950	43	950	-	342	2,242	1,292	1.00
20	-	14	950	-	171	1,121	1,121	1.00