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PADCO

PLANNING AND DEVELOPMENT COLLABORATIVE INTERNATIONAL, INC.

CONCEPT PAPER

USAID HOUSING GUARANTY LOAN PROGRAM

IN THE

ORGANIZATION OF EASTERN CARIBBEAN STATES

Prepared for
RHUDO/CAR
and the
Office of Housing and Urban Programs
Agency for International Development
Washington, DC

Prepared by
Ken Kopstein
PADCO, Inc.
1012 N Street, NW
Washington, DC 20001

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TABLE OF CONTENTS

GLOSSARY OF ABBREVIATIONS

ALGICO	-	American Life and General Insurance Company
AVT	-	Agricultural Venture Trust
BMFC	-	Barbados Mortgage Finance Company
BNTF II	-	Basic Needs Trust Fund II
CDB	-	Caribbean Development Bank
CDC	-	Commonwealth Development Corporation (U.K.)
CFSC	-	Caribbean Financial Services Corporation
CHF	-	Cooperative Housing Foundation
CLUSA	-	Cooperative League of the U.S.A.
CME	-	Capital Markets Entity (proposed entity)
EC Dollar	-	Eastern Caribbean Dollar (OECS Currency)
ECCB	-	Eastern Caribbean Central Bank
EIB	-	European Investment Bank
FAA	-	Foreign Assistance Act (U.S.)
FHLMC	-	Federal Home Loan Mortgage Corporation (U.S.)
Freddie Mac	-	Federal Home Loan Mortgage Corporation (U.S.)
GDP	-	Gross Domestic Product
GNP	-	Gross National Product
HG	-	USAID Housing Guaranty Loan Program
HMB	-	Home Mortgage Bank (Trinidad)
IFC	-	International Finance Corporation
LAC	-	Latin American Countries
NDB	-	National Development Banks (OECS countries)
NDF	-	National Development Foundations (OECS countries)
936	-	Section of the U.S. Internal Revenue Code referring to certain tax exemptions provided U.S. corporations for specified investments in the Caribbean with funds derived from Puerto Rico business income.
NIS	-	National Insurance Scheme (OECS government provident funds)
OECS	-	Organization of Eastern Caribbean States
PVO	-	Private Voluntary Organization
RDO/C	-	Regional Development Office/Caribbean (USAID)
RHUDO/CAR	-	Regional Housing and Urban Development Office/Caribbean (USAID)
SLMFC	-	St. Lucia Mortgage Finance Company
UNDP	-	United Nations Development Programme
USAID	-	United States Agency For International Development
USAID/Barbados	-	USAID Mission in Barbados serving the OECS

NEW PROJECT DESCRIPTION

PROJECT TITLE: OECS Local Currency HG

PROJECT NUMBER: N/A

FUNDING:

TYPE OF FUNDING:

A) HG - Local Currency EC $27 million (US $10 million) (5-year disbursement)

B) Grant - US $640,000 to US $950,000 (2-year disbursement)

A. CONSISTENCY WITH MISSION STRATEGY

In the RDO/C's Annual Action Plan, 1992-93, many of the projects described have elements that could benefit from a HG and could use an OECS HG to highlight project objectives, e.g., in such areas as infrastructure development and maintenance (Regional Infrastructure Maintenance Project), environment (Privatization and the Environment: St. Lucia), hurricane damage containment, stimulate local employment and contracting (Basic Needs Trust Fund II) and financial markets development (Private Sector Initiatives Project). Two of the above projects would be particularly relevant to an OECS HG:

a) Private Sector Initiatives Project

USAID has funded two major studies in capital markets development:

- OECS Capital Markets and Financial Institutions Project (1989); by Robert Nathan & Associates and Price, Waterhouse
- Capital Markets and Private Sector Development in the OECS (Draft, 1991) by Downing, Shorey and Staples

The Eastern Caribbean Central Bank (ECCB) has built upon the Nathan study and is pursuing avenues to foster capital markets development in the OECS. The USAID/Barbados Mission is providing continuing support to this activity area and the regional local currency HG would further the Mission's program objectives by using the HG as a vehicle to foster regional acceptance for capital market issues.

b) Basic Needs Trust Fund II (BNTF II)

The BNTF II seeks to "assist local communities and governments to construct, rehabilitate and modify structures to... withstand the effects of hurricanes and to stimulate local employment and private contracting." All of these objectives could be furthered by an OECS HG which could: (i) provide an avenue for dispensing information to lenders and lower-income households on building design/technology related to hurricane damage prevention and (ii) (as housing programs do) stimulate local employment and private contracting through home improvement and construction.

B. RELATIONSHIP TO AID AND OTHER DONOR ACTIVITIES

AID has funded the Caribbean Financial Services Corporation (CFSC) and the Agricultural Venture Trust (AVT) as vehicles to promote venture capital investment in private sector enterprise in the OECS; the CFSC is now also pursuing ways to develop capital market activities. The Eastern Caribbean Central Bank (ECCB) has built upon the AID-funded capital markets project to make capital markets development in the OECS a priority.

Other donor sources are involved in, or exploring, capital markets activity and housing finance, e.g.

- Commonwealth Development Corporation
  - Major stockholder in several housing finance corporations and seeks to improve their resource mobilization capabilities
  - Studying approaches to accessing regional capital market sources, e.g., conversion of hard currency into EC dollars and accessing 936 funds
  - Stockholder in CFSC; supportive of CFSC capital markets initiatives
  - studying feasibility of regional property development, including lower-income housing

- IFC and EIB
  - Stockholders in CFSC
  - Seeking to promote new business enterprise

- Home Mortgage Bank (Trinidad)
  - Donor supported, e.g., IFC and FHLMC (TA)
  - Priority to assist in developing secondary mortgage market in OECS

- Caribbean Development Bank (CDB)
  - Substantial donor support channeled through CDB for housing, environment and private sector capital development

C. RELATIONSHIP TO OVERALL USAID POLICY OBJECTIVES

The OECS Local Currency HG would promote AID objectives in:

- Capital markets development
- Private sector enterprise development
- Minimizing foreign exchange risk on AID-supported projects
- Expanding long-term finance for lower-income housing and strengthening the housing finance sector

D. PROJECT DESCRIPTION

The OECS Local Currency HG has two funding alternatives:

- Alternative 1: Local Currency Bond Issue
- Alternative 2: U.S. Dollar Collateralized Loan

HG authority can be under the Worldwide Private Sector Housing Guaranty Project, as both alternatives use the private sector as the funding vehicle.

1) ALTERNATIVE 1: LOCAL CURRENCY BOND ISSUE (Refer to Chart 1: General Structure for Local Currency Bond Issue)

- No U.S. dollars used; no exchange rate risk
- U.S. guaranty used to collateralize local currency (EC dollars) bond issue purchased by OECS investors, EC $ bonds will be i.e. the source of HG financing
- Local Capital Markets Entity (to be a subsidiary of an existing OECS organization, supplemented by local and donor equity investors) would issue bonds, on-lend funds to primary lenders, service bond payments and administer any defaults by primary lenders. Capital Markets Entitycould use HG as basis to establish regional capital markets function.

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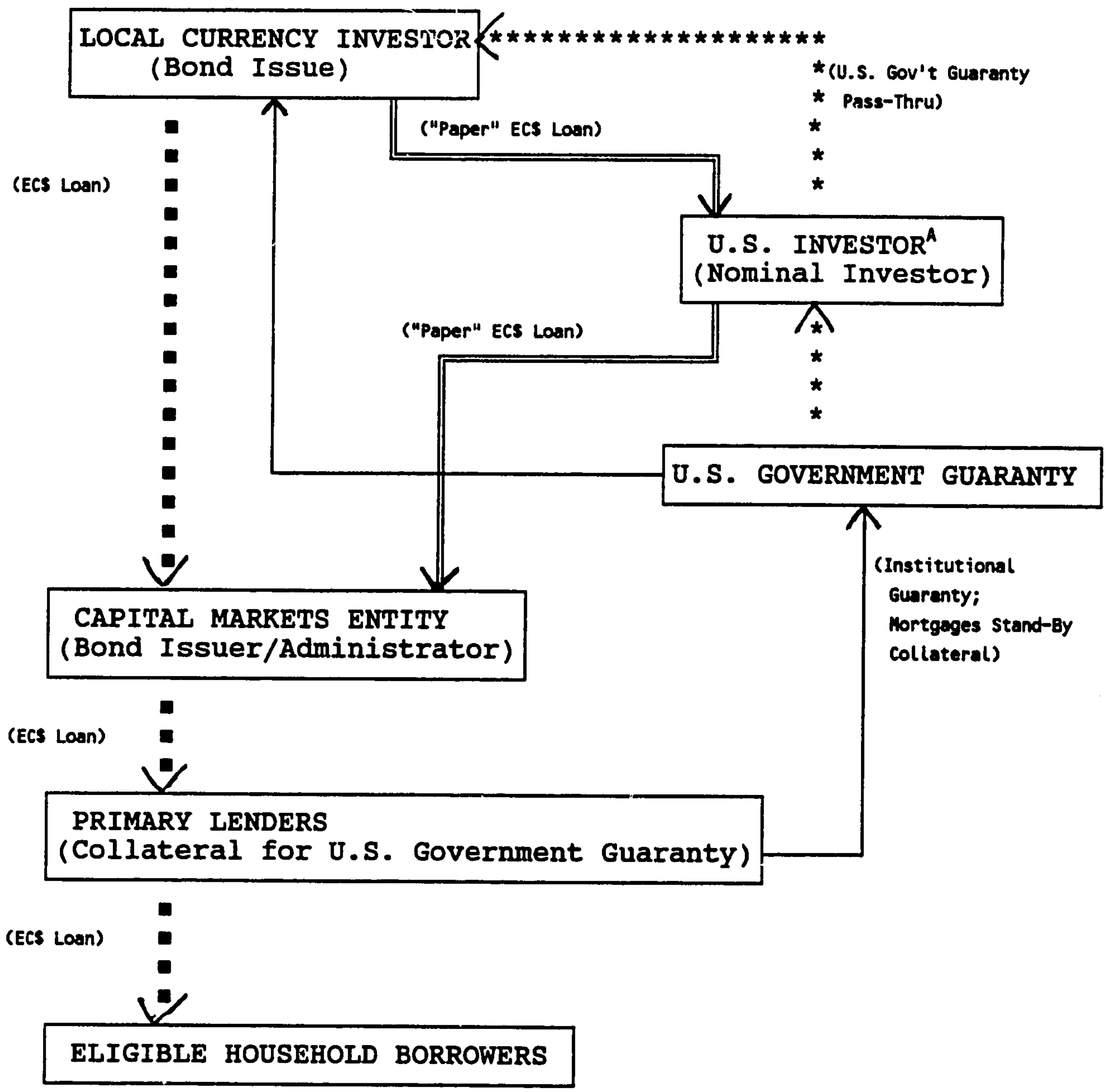
CHART 1:

GENERAL STRUCTURE FOR LOCAL CURRENCY BOND ISSUE



[A] Note: U.S. Government guarantees would be preferably applied directly to local currency bonds; this could be implemented if the requirement for a "U.S. Investor" were waived.

LEGEND:

■■■■■■ Effective Loans —— Effective Guaranty

═══ "Paper" or Nominal Loans ***** "Paper" or Nominal Guaranty

- Collateral for the U.S. Government guaranty will be provided by primary lender institutional guarantees and, secondarily, by over-collateralized loan portfolios, i.e. the Panama HG model (project #525-HG-013); no host country guarantees.

- U.S. investor may be required by USAID regulations; waiver would be advantageous as U.S. investor serves no role in local currency bond issue. Imposition of U.S. investor requirement only adds another layer of intermediation and costs.

- Technical assistance available in region through Home Mortgage Bank (HMB) of Trinidad, which operates successful secondary mortgage market in Trinidad and has indicated desire to assist in OECS secondary mortgage market development.

2) **ALTERNATIVE 2: U.S. DOLLAR COLLATERALIZED LOAN (Refer to Chart 2: Collateralized Loan Structure HG)**

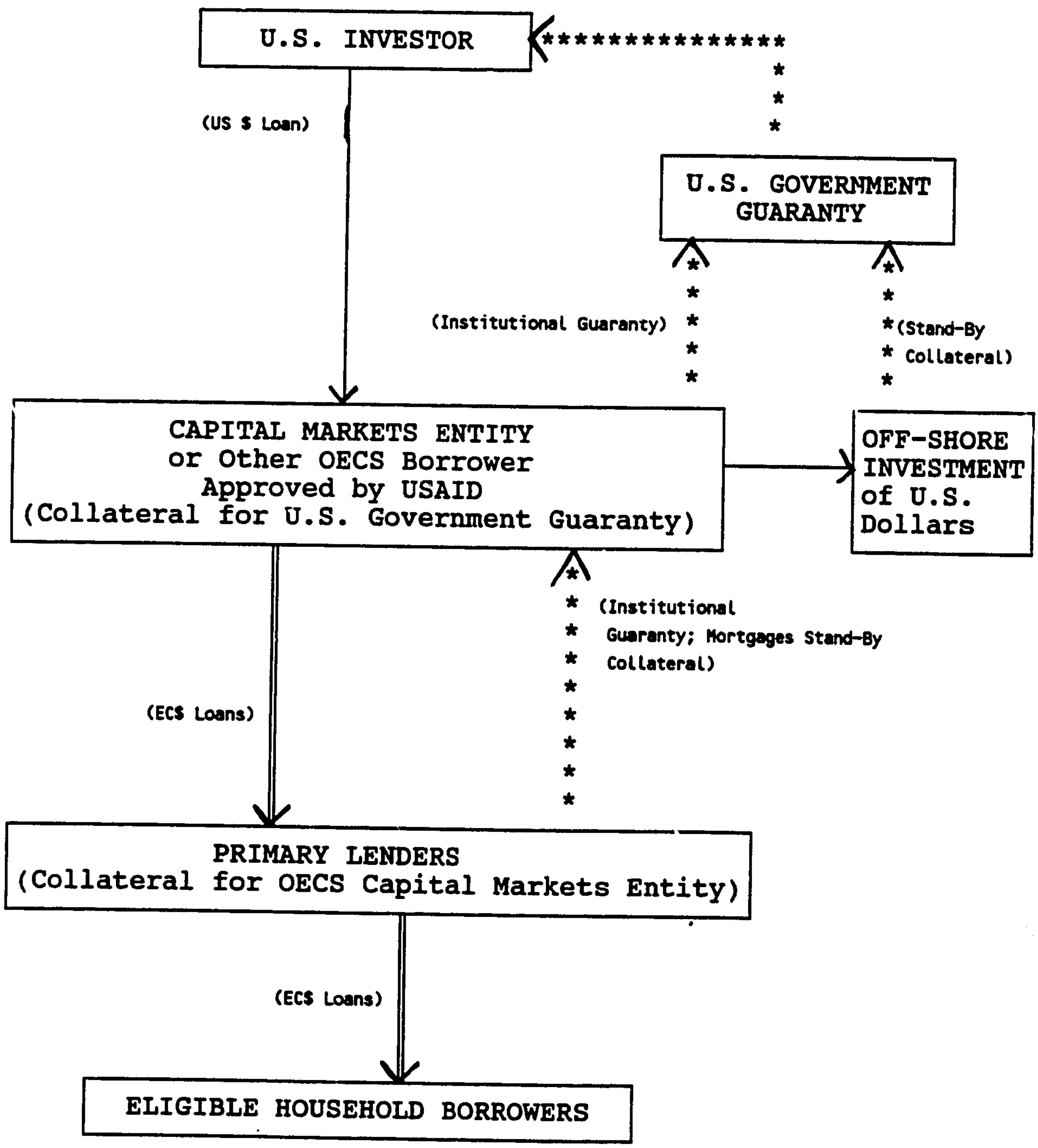
- Less advantageous than Alternative 1 because it does not promote regional capital markets development as much and has some element of exchange rate risk; Alternative 1 preferred option.

- Collateralized loan is a mechanism to convert hard currency (e.g., U.S. $) loan into local currency loan by using a financial intermediary to borrow hard currency and on-lend local currency to ultimate borrowers, i.e. in the OECS HG, the ultimate borrowers are primary lenders who make loans to eligible households. This structure was recommended to CDC by the consultant; CDC is now negotiating to use this structure with an OECS bank on its sterling loans.

- OECS financial intermediary could be, e.g., a Capital Markets Entity (described above and serving here as an investment vehicle for OECS investors such as insurance companies and pension funds) or other major local borrowers/investors, such as insurance companies. The Capital Markets Entity (CME) or other local investors would have to have capital/financial guarantees, acceptable to USAID, which would provide the requisite guaranty to the U.S. Government for its HG guaranty. The U.S. dollar off-shore investments by the CME, and primary lender collateral provided for the local currency loans, could also have stand-by assignments that would serve as additional collateral for the U.S.

CHART 2:

COLLATERALIZED LOAN STRUCTURE HG



Legend:

U.S. Dollar Loan
EC Dollar Loan
*********** Guaranty

Government guaranty. No host country guarantees would be provided.

- The CME would invest U.S. dollars, received under HG, off-shore at a spread (e.g., in expatriate/foreigner mortgages on OECS properties) and repay the U.S. investor in U.S. dollars. The CME would on-lend an equivalent amount of EC dollars to participating primary lenders (capital for local currency loans received from shareholders, probably in the form of loans; other local HG borrowers (e.g., insurance companies) would probably use their own funds). The interest rate and terms on the U.S. dollar and EC dollar loans would not be tied in any manner; thereby, the U.S. dollar and EC dollar loans could have different interest rates and terms.

- The primary lenders would guarantee repayment to the CME and on-lend funds to eligible households.

E. PLANNED IMPLEMENTATION ARRANGEMENTS

The consultant's mission was to provide a concept for an OECS HG; a defined program is not in place and would require additional organization. However, there is substantial interest evidenced by prospective participants in putting together a HG under both alternative structures.

The following potential program participants have been identified for each element in implementing a Local Currency Bond Issue HG.

a) U.S. Investor

- U.S. financial institution, e.g., Citicorp or Bankers Trust Company
- U.S. insurance company, e.g., American Life and General Company
- Private voluntary organizations, e.g., Cooperative Housing Foundation
- U.S. owned company operating in the OECS, e.g., Coopers and Lybrand

b) Capital Markets Entity (bond issuer and administrator)

- Caribbean Financial Services Corporation
- St. Lucia Mortgage Finance Company

- Colybrand Company Services, Ltd. (a subsidiary of Coopers and Lybrand)

(Home Mortgage Bank of Trinidad has indicated a willingness to provide technical support and become an equity stockholder in the Capital Markets Entity)

c) Primary Housing Lenders

(only St. Lucia was visited in the field investigations other potential lenders listed, below, were identified in a previous study)

i) St. Lucia

- St. Lucia Mortgage Finance Company (SLMFC)
- St. Lucia Cooperative Bank
- Selected Credit Unions in St. Lucia

ii) Other potential primary lenders

- Dominica Mortgage Finance Company
- National Commercial Bank of Dominica
- Bank of Nevis
- St. Vincent Mortgage Finance Company

b) Bond Purchasers

- Major regional life insurance companies
- National Insurance Schemes
- Private sector pension funds

F. SUSTAINABILITY

The OECS Local Currency HG is a vehicle to promote regional capital markets development in the OECS. If it is successful, it could be a precursor to an on-going regional capital markets entity, which could, over time, expand capital market functions to create, e.g., a secondary mortgage market for all (mostly non-HG) housing loans, an informal stock exchange (thru a stockbrokerage operation), other long-term debt and equity issues for commercial enterprises and leasing finance. The ECCB reports that OECS commercial banks may be over-extended in long-term home mortgages and a secondary mortgage market could be well received to promote liquidity in the mortgage market. The HMB's success in Trinidad, and its corporate strategy to expand into the OECS, is another positive factor indicating the potential sustainability of strengthening the OECS mortgage market using the HG as the initial activity to generate the institutional and regional capacity.

G. MANAGEMENT

The RHUDO/CAR proposes authorizing a direct hire Housing Officer to be situated in the USAID/Barbados Mission to manage the OECS HG, explore an additional HG for Barbados and to augment the Mission's related programs.

H. POTENTIAL ISSUES

i) Are the Local Currency Bond Issue HG, or alternatively, the U.S. Collateralized Loan HG, structures acceptable to AID?

- Can a waiver be granted for a U.S. investor under the Local Currency Bond Issue alternative?

ii) Is the primary lender or CME/local borrower collateral for the U.S. Government guaranty acceptable?

- Is the Panama HG model acceptable for collateral guarantees?

iii) Can the Worldwide Private Sector Housing Guaranty Project be used for the OECS HG or must a new authorization be obtained?

iv) Is the proposed US $10 million OECS HG authorization, with tranches over 5 years, acceptable?

v) A technical person is necessary to organize the potential participants into a HG program; can USAID provide the requisite direct hire, PSC and/or consultant TA?

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CONCEPT PAPER

USAID HOUSING GUARANTY LOAN

IN THE

ORGANIZATION OF EASTERN CARIBBEAN STATES

EXECUTIVE SUMMARY

1.0 OBJECTIVES

1.1 Concept For REGIONAL HG

1.2 Eliminate Exchange Rate Risk With Local Currency HG

1.3 Promote Regional Capital Markets Development

1.4 Increase Private Sector Lower-Income Housing Finance/Decrease Reliance on Government Funding.

2.0 REGIONAL SOLUTION REQUIRED

2.1 Small Market on Each Island

2.2 Move Toward Regionalism In OECS

3.0 OECS HG CONSISTENT WITH USAID/BARBADOS OBJECTIVES

3.1 Private Sector Initiatives

a) Two capital markets development studies
b) Development of capital markets on-going assistance

3.2 Basic Needs Trust Fund II

a) Building codes
b) Low-cost housing technology for environmental and hurricane concerns

4.0 BACKGROUND - OECS

4.1 Stable Democratic Nations

4.2 Healthy Economies

a) GDP average growth rate 4.2%/annum 1980-85 and 5.2%/annum 1985-88

b) World Bank predicts favorable continued growth rates; 4%/annum in medium to long term

c) 3rd Highest performance rating Latin America, 1990, by USAID

4.3 Potential For Economic Shocks Could Adversely Affect Economies

a) End of agricultural trade preferences
b) Tourism downturn

4.4 Stable Currency, Linked to U.S. Dollar

5.0 FINANCIAL SECTOR - OECS

5.1 Substantial Excess Liquidity

a) Estimated excess liquidity over EC $1 billion, March 1991
b) 80% of OECS financial assets deposited in commercial banks due to lack of investment options in the OECS
c) Savings growth substantial

- Commercial bank deposits increased EC $1.3 billion or 73% in 1986-1990 period
- World Bank predicts substantial savings increase in future

d) Liquidity in some OECS countries may be diminishing; commercial banks may be over committed to long-term loans—ECCB observation

5.2 Demand for Long-Term Investment

a) USAID-funded studies indicate need for capital markets development
b) Few opportunities for equity and long-term debt investments

- Capital flight due, in part, to lack of OECS investment opportunities, not security of investment

c) Investors seeking investment options

- Equities (Stock)
- Long-term AAA-rated debt

d) Major Investors Include:

- Life Insurance companies
- Private Pension Schemes
- National Insurance Schemes

- Available resources from major investors far exceeds HG resource requirements and foreseeable equities requirements

5.3 Housing Finance

a) Commercial banks

- Substantial housing loans; mostly upper-income households
- Prefer short-term lending, compelled to make housing loans due to substantial excess liquidity
- Liquidity for long-term loans uneven amongst banks; mismatched maturities a problem
- May be over-extended in long-term loans; housing loans may decrease

b) Government Entities

- Substantial resource for lower-income housing by on-lending to housing finance entities and commercial banks

c) Housing finance entities lack financial resources

- St. Lucia Mortgage Finance Company (SLMFC) receives over 50% of loan funds from NIS; SLMFC needs EC $8 million more per annum
- Many credit unions in St. Lucia do not accept deposits and are in need of more resources
- National Commercial Bank of Dominica needs long-term funds to make mortgages
- Bank of Nevis needs US $2.5 million per year to finance mortgages

6.0 DEMAND FOR HOUSING FINANCE IN THE OECS

6.1 No market analysis conducted as part of this consultancy

6.2 Barbados HG as example

a) 3½ years (1983-1987) US $10 million in HG funds loaned

b) With more than double the population and a near equal and growing GDP in the OECS, housing finance demand by lower-income households in the OECS should equal or exceed that in Barbados as experienced in the mid-1980s.

6.3 St. Lucia Anecdotal Case Study (very limited sample)

a) St. Lucia Mortgage Finance Company indicates annual need for EC $8 million (US $3 million) for home loans; primarily serves lower-income market

b) St. Lucia Urban Development Corporation has 3,000 to 6,000 housing plots in development or planning. Most plots are for lower-income households. Average plot cost EC $8,000; total financing requirements for approximately 3,000 plots now in development/upgrading estimated at EC $24 million (US $8.7 million).

c) Three community based credit unions indicated they loan in excess of capacity to make additional housing loans.

d) In summary, just the 6 institutions interviewed in St. Lucia could readily absorb at least US$5 million in HG funds over 5 years.

e) The U.S. Ambassador to the OECS has recently received a request from the St. Lucian Prime Minister for U.S. assistance in housing finance

6.4 Other OECS Countries Anecdotal Housing Demand (very limited sample)

6.4.1 Dominica

a) Bath Estates and Pound Area are two government projects with a substantial low-income household element. Financing for low-income house replacement/upgrading, alone, is estimated by UNDP (1988) to exceed US $1 million

6.4.2 St. Vincent (exclusive of the Grenadines which were not reviewed)

a) UNDP study in 1988 indicated a program for the 1990 - 1994 period, for low-income household lots and core units totalling housing for 3,650 families, costing in 1988 EC dollars, EC $12,813,000 (US $4,746,000)

6.4.3 Grenada

a) UNDP 1989 study indicated a need for EC $1.3 million (US $480,000) for financing upgrading

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of one squatter settlement (River Road) of 342 households

b) Bankers Trust Company had in October 1991, a request from the Government of Grenada to assist in obtaining housing finance and has indicated a significant unmet demand for housing finance.

6.4.4 Nevis (exclusive of St. Kitts which has not been reviewed)

a) The manager, Nevis Housing and Land Development Corporation, a government agency, indicated strong demand for housing in Nevis in July 1991; the Government of Nevis owns about 5,000 acres of land, some of which will be used for housing development.

7.0 HOUSING GUARANTY LOAN CONCEPT FOR OECS

- Alternative 1: Local Currency Bond Issue
- Alternative 2: U.S. Dollar Collateralized Loan

Both scenarios would utilize local private sector entities to collateralize and lend HG program funds which could make the OECS HG prospectively eligible for the USAID Worldwide Private Sector Housing Guaranty Project. A combination of the two above alternatives, under a single program structure, is a third possible option.

a) Regional Perspective

- Regional perspective promotes capital market structure for OECS and improves utilization of liquidity in the OECS
- Regional perspective allows some countries with populations/demand too small to be viable in-and-of itself to avail itself of HG funds
- Regional perspective has better opportunity to be sustainable over time

b) U.S. $10 Million HG Proposed

Based on analysis of demand in the OECS and absorption under the Barbados HG, it is estimated that at least US $2 million per year, for five years, for a total of US $10 million, could be absorbed in HG funds in the OECS.

7.1 Alternative 1: Local Currency Bond Issue

7.1.1 Program Summary

The Local Currency Bond Issue would replace the traditional HG loan structure of U.S. investors loaning U.S. dollars to a host country. To replace the US dollar loan a housing bond issue in the OECS would raise EC dollars for on-lending directly to primary lenders. Primary lenders would provide the requisite collateral for the U.S. Government guaranty. The U.S. Government guaranty would enable the issuance of bonds to finance lower-income housing loans. All program funds then would be in EC dollars, i.e., funds raised from bonds, funds on-lent to primary lenders, housing loans to eligible households and repayments of housing loans and housing bonds; the foreign exchange rate risk normally associated with U.S. dollar loans to developing nations would be eliminated.
A local Capital Markets Entity would be identified to perform the role of EC dollar bond issuance and administration; the Capital Markets Entity would perform the roles generally performed by U.S. underwriters and U.S. investors in providing the traditional U.S. dollar HG loan. The local Capital Markets Entity would most likely be a subsidiary of an existing Eastern Caribbean organization, possibly supplemented with additional equity investment by regional and international investors.

Refer to Chart 1: General Structure For Local Currency Boond Issue

7.1.2 U.S. Government Guaranty

The local currency bond issue would involve a U.S. Government guaranty to bondholders for bonds issued within the OECS and bought with EC dollars; bond repayments would similarly be in EC dollars so there would be no exchange rate risk to borrowers. Under the HG program structure, it may be necessary to involve a U.S. investor, which, under Alternative 1, would really be a passive conduit function merely put in place to satisfy regulatory requirements. The OECS Capital Markets Entity would perform the role of "Investor".

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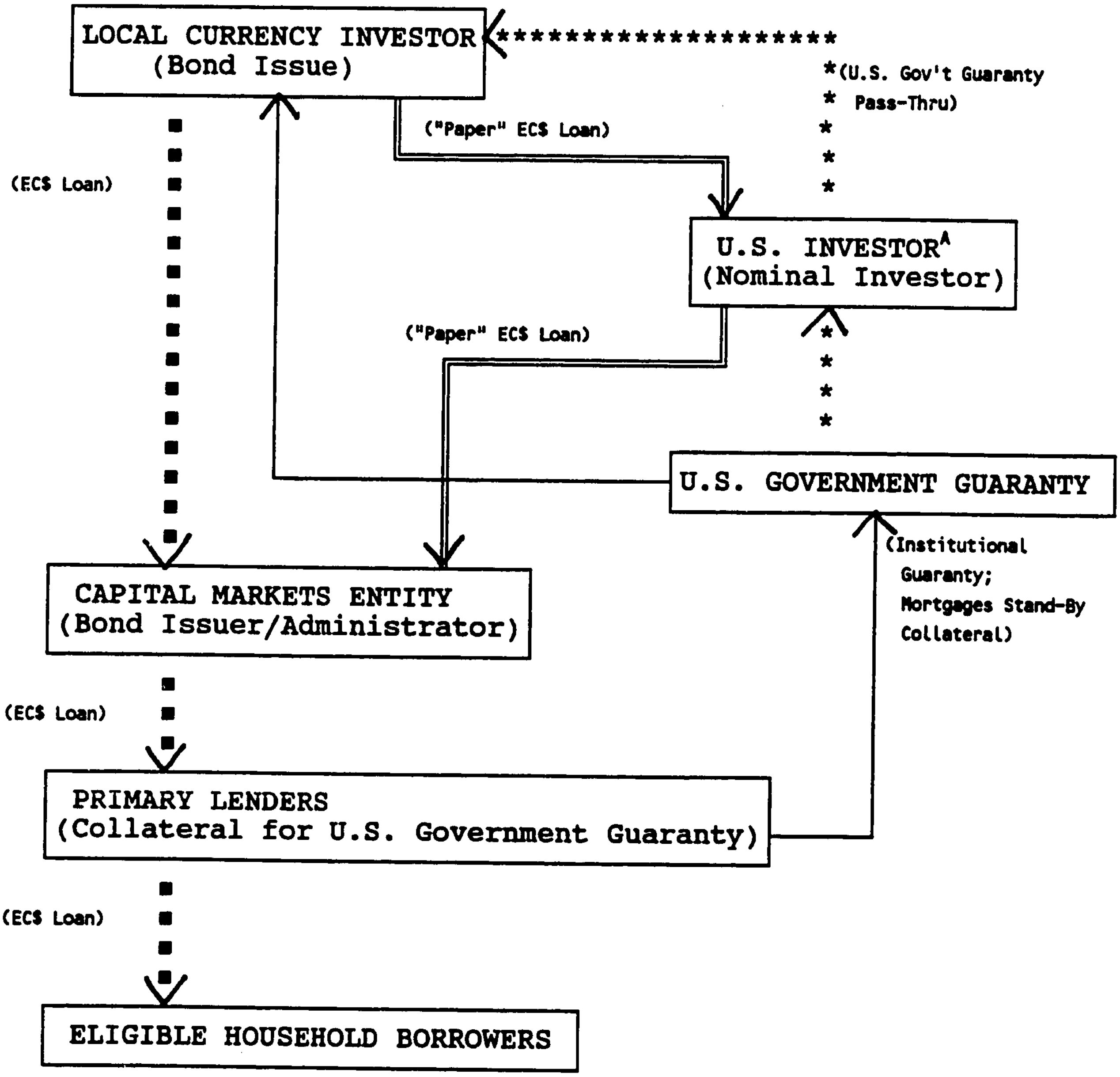
CHART 1:

GENERAL STRUCTURE FOR LOCAL CURRENCY BOND ISSUE



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LEGEND:

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═════ "Paper" or Nominal Loans
────── Effective Guaranty
***** "Paper" or Nominal Guaranty

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7.1.3 Collateral USAID--The Panama HG Model

The Panama Private Sector Low-Cost Shelter Program (HG loan number 525-HG-013) serves as a model for obtaining adequate collateral for USAID in an OECS HG. Collateral would mainly be provided by the primary lending institutions.

7.1.4 Program Participants

Potential program participants have been identified for each element in implementing a Local Currency Bond Issue.

a) U.S. Investor

- U.S. financial institution, e.g., Citicorp or Bankers Trust Company
- U.S. insurance company, e.g., American Life and General Company
- Private voluntary organizations, e.g., Cooperative Housing Foundation
- U.S. owned company operating in the OECS, e.g., Coopers and Lybrand

b) Capital Markets Entity (bond issuer and administrator)

- Caribbean Financial Services Company
- St. Lucia Mortgage Finance Company
- Colybrand Company Services, Ltd. (a subsidiary of Coopers and Lybrand)

(Home Mortgage Bank of Trinidad has indicated a willingness to provide technical support and become an equity stockholder in the Capital Markets Entity)

c) Primary Housing Lenders

(Only St. Lucia was visited in the field investigations; other lenders, listed below, were identified in a previous study)

i) St. Lucia

- St. Lucia Mortgage Finance Company (SLMFC)
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- Selected Credit Unions in St. Lucia

ii) Other Potential Primary Lenders

Dominica Mortgage Finance Company

- National Commercial Bank of Dominica
- Bank of Nevis
- St. Vincent Mortgage Finance Company

d) Bond Purchasers

- Major local life insurance companies
- National Insurance Schemes
- Private sector pension funds

7.1.5 Technical Assistance Available in the Region

The Home Mortgage Bank (HMB) of Trinidad serves as a model for the proposed OECS Local Currency Bond Issue HG an has indicated willingness to provide technical assistance (and, possibly, equity) for an OECS Capital Markets Entity.

7.1.6 Regional Privately-Issued Debenture

The Caribbean Financial Services Company is preparing to issue a US $2.5 million convertible debt issue in the OECS and Barbados; the debentures will have a 10-year term. The CFSC debenture issue was able to resolve regional tax and alien land holding impediments with exemptions from each OECS government. The success of CFSC can be built upon with the proposed HG Local Currency Bond Issue.

7.1.7 OECS Country and Eastern Caribbean Central Bank (ECCB) Approvals

The approval of each OECS country and the ECCB should be obtained for the OECS regional HG structure. Preliminary indications are that approvals are obtainable.

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7.2 Alternative 2: U.S. Dollar Collateralized Loan (Refer to Chart 2: Collateralized Loan Structure HG)

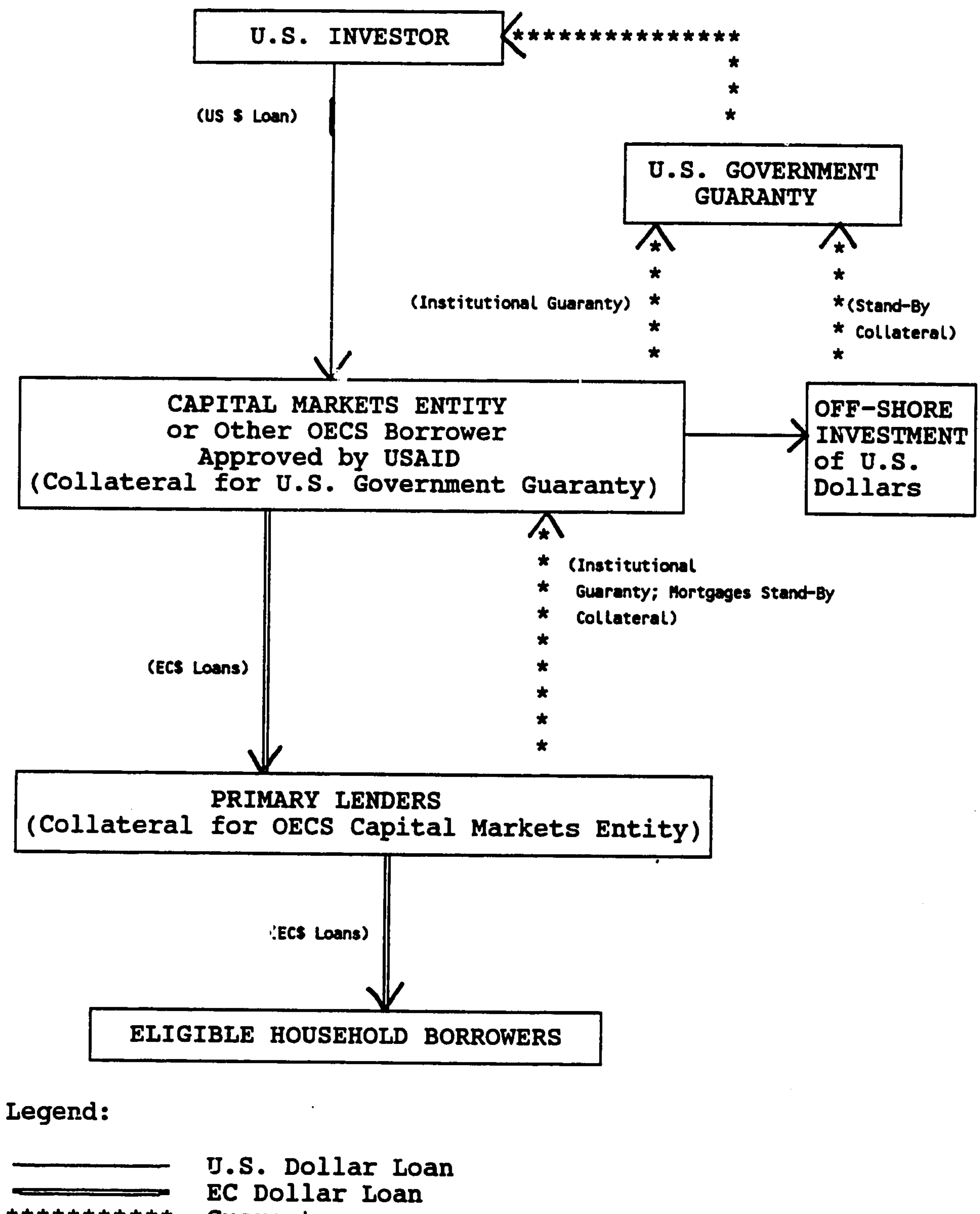
A collateralized loan is one in which a foreign lender lends funds to a second local institution in a foreign currency (e.g., U.S. dollars) and the local institution (e.g., the Capital Markets Entity or a local insurance company) on-lends an equivalent amount of local currency to the foreign lender's ultimate borrower, e.g., OECS primary lenders for HG loans. The local institution merely serves as an intermediary for the foreign lender; the local currency loan is at acceptable interest rates to the local lender, reflects local market conditions and is not tied to the foreign currency loan terms. The foreign currency loan portion is usually invested off-shore in foreign investments at a spread over the foreign loan interest rate.

With an OECS Capital Markets Entity, having acceptable (to USAID) capital/guarantees provided by insurance company and other shareholders, a U.S. dollar loan HG structure could be implemented for an OECS HG. The Capital Markets Entity would solve a major administrative problem for local insurance companies and other investors, i.e., portfolio management and shared loss risk.

The problem of exchange rate risk would also be minimized by equivalent off-shore investments by the borrower. The U.S. Government guaranty would be collateralized by satisfactory local (e.g., Capital Markets Entity) guarantees and, secondarily, by the off-shore investments of U.S. dollars and primary lender guarantees.

CHART 2:

COLLATERALIZED LOAN STRUCTURE HG



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8.0 TYPES OF LOANS

There are three considerations regarding the types of loans:

- Housing Loans to eligible household borrowers
- HG financing for primary lenders
- Loan participation (co-financing) by primary lenders

8.1 Housing loans to eligible household borrowers

The proposed OECS HG would permit loans for any eligible housing-related purpose for households with qualifying incomes.

Home loans would include:

- Home improvements
- Plot purchase and/or titling
- Squatter area upgrading (infrastructure loan for each household)
- Purchase of existing house
- New construction

The major use of HG housing loans will most likely be for home improvements and plot purchases.

8.2 HG Financing For Primary Lenders

There are two basic methods for on-lending HG funds to primary lenders:

a) Refinancing housing loans

b) Block advances (loans) to primary lenders

There are advantages and disadvantages to both on-lending approaches. Most HG programs and the closest examples, i.e., the Barbados HG and the Home Mortgage Bank of Trinidad, use the refinance approach.

8.3 Loan Participation (Co-financing) By Primary Lenders

The Panama HG Model contained a requirement that primary lenders contribute 20% of each HG loan out of their own

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resources. A 20% to 25% participation by primary lenders should also be considered for the OECS HG, both to:

a) Provide additional security for the Capital Markets Entity

b) To extend HG financing to more eligible households.

9.0 COLLATERAL FOR HG LOAN

USAID's collateral requirements for the U.S. Government guaranty should be modelled on the Panama HG (Loan Number 525-HG-013), which essentially used guarantees by primary lenders, with the underlying mortgage loans as stand-by collateral in case of default by a primary lender. In the Panama HG, primary lender collateral replaced host country guarantees for HG collateral requirements; this would also be proposed for the OECS HG.

10.0 TECHNICAL ASSISTANCE REQUIREMENTS

10.1 Technical Assistance

10.1.1 Program Delivery Plan TA

Although many of the elements are evident in the OECS for successful implementation of a local currency HG, there is no technical resource or organization to pull all the elements together into a final program. Thereby, USAID could fund a technical advisor to prepare a Program Delivery Plan (PDP), which would entail evaluating institutions, organizing the structure and bringing investor/ Capital Markets Entity/primary lender entities together, as well as preparing formal documentation for USAID for the HG loan.

10.1.2 Housing Bond Structure TA

The Home Mortgage Bank of Trinidad (HMB) has expressed a willingness to provide technical assistance to an OECS housing bond Capital Markets Entity. If HMB is unable to provide the technical assistance, the Federal Home Loan Bank Board of New York may be called upon to provide the requisite assistance.

10.1.3 Sinking Fund/Home Loan Insurance Scheme

The HMB has indicated that FHLMC (Freddie Mac) and/or the Canadian Mortgage and Housing Corporation could potentially provide assistance in structuring a home loan insurance scheme. The HMB is considering implementation of a mortgage insurance scheme in Trinidad.

10.1.4 Building Technology TA

- Hurricane prevention
- Low-cost housing techniques

10.1.5 Credit Unions TA

- Improve resource mobilization
- Strengthen home loan lending capacity

10.1.6 Long-Term Advisor

A long-term advisor, attached to the Capital Markets Entity, would be extremely beneficial to not only implementing an OECS HG but to also advancing other capital markets functions that could be introduced by the Capital Markets Entity.

10.1.7 Mission Housing Officer

A Housing Officer assigned to the USAID/Barbados Mission would provide technical back-up to the Capital Markets Entity and the long-term advisor, administer the HG program, evaluate a new HG for Barbados, and also assist the Mission in implementing the Private Sector Initiatives and the BNTF II programs that are elements of the 1991-1995 Mission strategy.

10.2 TECHNICAL ASSISTANCE BUDGET

The technical assistance described, above, would involve the projected following annual budget allocations:

Technical Assistance	1992 Budget	1993 Budget
Program Delivery Plan TA	$ 80,000	$ N/A
Housing Bond TA	20,000	20,000
Housing Loan Insurance Scheme TA	50,000	20,000
Building Technology TA	30,000	30,000
Credit Unions TA	40,000	40,000
Long-Term Advisor (seconded to the Capital Markets Entity	150,000	160,000
Total TA	$370,000	$270,000

If a Mission Housing Officer position was established, it could be project-funded or direct hire. If it is project-funded the total TA budget would be increased as follows:

Mission Housing Officer (Housing Officer project-funded; line item not required if direct hire)	$150,000	$160,000
Adjusted Total	$520,000	$430,000

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11.0 MAJOR IMPLEMENTATION ISSUES SUMMARY

The mission for this study was to present a concept paper on initiating a HG in the OECS. It is not a completed program but, rather, an identification of a possible structure for a HG program if all the apparent elements for a successful HG can be brought together. As a concept paper, therefore, there are a number of outstanding issues that need to be resolved to bring the concept closer to an actual program.

11.1 STRUCTURE ACCEPTABLE LOCAL CURRENCY HG

a) Acceptable Capital Markets Entity
b) Workable interest rate and term on bonds
c) Arrange liquidity mechanism for bonds, if necessary
d) Identify acceptable and creditworthy primary lenders
e) Determine absorption rate for HG funds
f) Obtain necessary government exemptions for a regional bond Issue
g) Determine if HG program will provide advances to primary lenders or refinance loans

11.2 STRUCTURE ACCEPTABLE U.S. DOLLAR COLLATERALIZED LOAN HG

a) Alternative to local currency HG if that concept proves unworkable
b) Determine whether U.S. dollars can be raised locally from OECS investors.
c) Determine if a Capital Markets Entity (as proposed) or insurance companies are acceptable borrowers for U.S. dollar loans, i.e., there are acceptable corporate guarantees for HG debt service payment and exchange rate risk.

11.3 OBTAIN INDIVIDUAL OECS COUNTRY AND ECCB APPROVALS FOR HG LOAN STRUCTURE SELECTED

11.4 DETERMINE ACCEPTABILITY OF ALTERNATIVE COLLATERAL FOR U.S. GOVERNMENT GUARANTY

a) Country risk analysis, if necessary
b) Determine acceptability of primary lender and loan collateral substituting for host country guarantees, i.e., modified Panama HG model; determine feasibility of implementing program based on primary lender collateral.

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11.5 REVIEW ADVISABILITY OF SINKING FUND TO FURTHER COLLATERALIZE U.S. GOVERNMENT GUARANTY AND TO ESTABLISH REGIONAL, ON-GOING MORTGAGE INSURANCE SCHEME

a) Evaluate added costs to borrowers against collateral benefits for the U.S. Government

b) Evaluate lender receptivity, effectiveness and security of a regional OECS loan insurance scheme over self-insurance schemes by lenders

11.6 DETERMINE NEED FOR A U.S. INVESTOR

a) Determine if a U.S. investor is required for a local currency bond issue not involving U.S. dollars or can the requirement be waived
b) Determine if a U.S. investor is required for a U.S. dollar HG with U.S. dollars raised on the OECS
c) Determine if competitive bidding is applicable for a local currency bond issue
d) Determine eligibility and costs of potential U.S. investors if such investor is required

11.7 DETERMINE MEDIAN INCOME FOR OECS COUNTRIES

a) Determine if there is to be one median income for all OECS countries or separate median incomes for each country
b) Determine median income for OECS
c) Determine whether to use the loan funding criteria (a) loan amounts affordable to below-median income households or (b) to require eligible households for each loan.
d) Determine whether customary loan underwriting in OECS and Barbados HG are acceptable

11.8 DETERMINE HG AUTHORIZATION LEVEL AND DISBURSEMENT SCHEDULE

a) Determine if the OECS is to be defined as one country or six countries. Determine if the OECS region is restricted to US $5 million in total under the Worldwide Private Sector Housing Guaranty Project.
b) Determine whether OECS HG should be at US $10 million or at another level of authorization
c) Determine feasible disbursement schedule

11.9 EVALUATE OECS CUSTOMARY UNDERWRITING CRITERIA FOR HOME LOANS

a) Determine acceptability of alternative forms of collateral to first mortgages

b) Determine acceptable income: debt service ratio, with and without alternative collateral

11.10 DETERMINE IF HG LOAN GUARANTEES WILL BE APPROVED BY U.S. TREASURY FOR 936 FINANCING

a) 936 funding could potentially be applicable under Alternative 2: U.S. Dollar Collateralized Loan HG

11.11 DETERMINE LEVEL OF TECHNICAL ASSISTANCE FOR OECS HG

a) Program Delivery Plan TA
b) Bond Issue TA
c) Home Loan Insurance Scheme TA
d) Building Technology TA
e) Credit Unions TA
f) Long-Term Advisor (Seconded to Capital Markets Entity)
g) Mission Housing Officer

12.0 CONCLUDING REMARKS

This is a concept paper, not a completed program. Given the preliminary nature of the field investigations, it was quite positive to learn of the many pieces that already exist for putting together a successful local currency HG. Some of the major pieces include:

- Willing local OECS investors to purchase HG-related housing bonds.

- Willing primary lenders.

- Significant apparent demand for home improvement loan and plot financing for lower-income households.

- Several qualified existing local OECS entities to sponsor a HC Capital Markets Entity.

- Willing equity investors to capitalize, and/or provide guarantees for, a Capital Markets Entity.

- Available excellent technical assistance in the region or from a U.S. Government agency.

A regional HG program will further advance the regionalization of informal capital markets that may, in the future, then promote more formal associations with other capital markets in the Caribbean or at least serve to provide greater flexibility for achieving long-term debt and equity financing in the OECS countries.

As a concept, a regional local currency HG appears to be an excellent idea; only increased effort, sponsored by USAID, will determine if the concept merits realization into a program.

CONCEPT PAPER

USAID HOUSING GUARANTY LOAN PROGRAM IN THE ORGANIZATION OF EASTERN CARIBBEAN STATES

1.0 INTRODUCTION

1.1 CONCEPT PAPER, NOT COMPLETED PROGRAM

The scope of work (SOW) for this consultancy identified the purpose of this mission as being to assist RHUDO/CAR to develop a concept paper for a Housing Guaranty Program (HG) in the Organization of Eastern Caribbean States (OECS) to support (a) regional development initiatives expressed by Commonwealth Development Corporation (CDC) and regional insurance companies and (b) regional development of capital markets and mortgage finance system. The SOW is contained in Appendix 1.

This consultancy builds on prior work conducted by the consultant for CDC in June/July, 1991 which identified positive prospects for a "private sector" financial intermediation entity to promote <u>both</u> equity and long-term debt capital markets on a regional basis in the OECS (private sector means, in this context, private sector entities augmented by financial support from international agencies and from entities that are joint government/private sector enterprises).

Although significant elements for promoting an OECS regional capital markets entity exist, the product of this consultancy is to present a <u>concept</u> on how the elements may be brought together under a local currency HG program as a precursor to a much more extensive capital markets financial intermediation role for a regional entity. The elements for a successful capital markets entity exist, however, more extensive work must be performed to bring the prospective parties together and a local currency HG program may be an excellent vehicle to do so. Although there are prospects for initiating a regional local currency HG and a regional capital markets entity as a concept, it must be noted that this consultancy has not yielded a final program that can immediately implement the regional HG. However, USAID can be a major impetus for promoting greater capital markets activity with (a) USAID support for technical assistance in the creation of the capital markets entity and (b) a local currency HG program as the initial capital markets activity.

1.2 MISSION OBJECTIVES

There were four objectives for this mission:

- Prepare a concept paper for a regional USAID HG in the OECS
- Eliminate foreign exchange rate risk with local currency HG
- Promote development of regional capital markets in the OECS
- Increase private sector lower-income housing finance/decrease reliance on government funding.

1.2.1 Prepare a Concept Paper for a Regional USAID HG Loan in the OECS

The six (6) independent countries of the OECS are individually very small economies and populations. As individual countries, a HG may not be feasible so the OECS is viewed as one market area for a regional HG under this consultancy.

1.2.2 Eliminate Foreign Exchange Rate Risk With Local Currency HG

The previous study by the consultant pointed to a potential for raising long-term funds within the OECS in Eastern Caribbean (EC) dollars and, thereby, eliminate the possible foreign exchange rate risk associated with loans denominated in foreign "hard" currencies. The regional HG may be a vehicle to raise long-term debt, e.g., housing bonds, in local currency; the U.S. Government guaranty on the local currency bonds providing incentives for initiating a regional local currency bond issue. The U.S. Government HG guarantees would be a vital element in instilling investor confidence in the regional bond financing mechanism and the lower-income housing purpose is likely to garner support from OECS governments to break down regulatory barriers to a regional bond issue.

1.2.3 Promote Development of Regional Capital Markets in the OECS

A HG local currency bond issue (as described in detail, below) is a mechanism that could promote regional capital markets activity in the OECS. The regional concept for a local currency bond issue HG by necessity would involve regional capital markets activity for long-term debt. Thereby, if a regional local currency HG could be implemented, it would be a positive, proactive measure for fostering further capital markets activity, particularly if it gave rise to a regional capital markets entity which could evolve, over time, into expanded capital markets functions of significantly greater scope than the HG itself.

1.2.4 Increase Private Sector Lower Income Housing Finance/Decrease Reliance on Government Funding

Substantial funding for lower income housing in the OECS is provided by governments directly, or indirectly, through, e.g., National Development Banks (NDB) and national insurance (provident) schemes (NIS). The scope of this consultancy did not permit an in-depth analysis of OECS government financial support for lower income housing, however, other studies have indicated substantial government funds being directed toward housing.[1] A regional HG, using local currency financing through issuance of long-term bonds, would mobilize significant funds from the private sector to supplant or supplement government housing finance. In the long-term, a successful housing bond mechanism could serve as the basis for creating a secondary mortgage market in the OECS, (as is on-going in Trinidad with the Home Mortgage Bank) and be a continuing mechanism to reduce reliance on government housing finance. Thereby, a relatively small HG could, over a period of years, foster long-term changes in the OECS for the provision of housing finance on a regional basis by the private sector, which could relieve some pressure on governments for this financing.

1.3 WORLDWIDE PRIVATE SECTOR HOUSING GUARANTY PROJECT

In 1986, the Worldwide Private Sector Housing Guaranty Project provided about US$ 35 million in HG authority worldwide. Amongst the program's targets, it was to draw private sector lenders into the process to develop low-income shelter. The proposed OECS HG would rely on private sector lenders as the fulcrum for using local currency bond funds to originate lower-income housing loans and would provide sorely needed financial resources to certain private sector lenders which do not have extensive resource mobilization capabilities to expand their housing lending to lower-income households, particularly those financial institutions substantially serving lower-income households, e.g., credit unions and housing finance companies. Other private sector lenders, such as indigenous commercial banks, would also be encouraged to extend more lending to lower-income households.

Thereby, the proposed OECS HG meshes well with the Worldwide Private Sector Housing Guaranty Project objectives and could be considered for authorization under it; this would reduce the time requirements and complexity required for a new country authorization.

1.4 REGIONAL HG SOLUTION NECESSARY DUE TO SMALL SIZE OF EACH OECS COUNTRY

The six (6) independent countries in the OECS are very small in population, land area and Gross Domestic Product (GDP). In 1990, the OECS population was estimated at 587,000 for the 6 independent nations, which represents about 3% of the Caribbean Region total. Land area is about 2,811 square kilometers or slightly over ½ of 1% of the Caribbean Region total land area. 1988 GDP was estimated at US $641 million or about 3% of the Caribbean Region total. See Table 1 for statistical comparison in the region. When reviewing the economies for each individual country, it becomes readily apparent that the opportunities are comparatively small to sustain separate viable HGs for each individual country. Regionally, however, the field investigations indicated positive potential for a HG.

TABLE 1: CARIBBEAN REGION POPULATION, LAND AREA AND GDP

	Population ('000s) 1990	Area (Sq. Km.)	GDP (1988 US $M)
Barbados	261	430	823
Belize	182	22,965	231
Dominican Republic	6,971	48,400	7,349
Guyana	1,040	214,970	477
Haiti	7,509	27,750	1,309
Jamaica	2,521	10,991	2,871
Surinam	403	163,820	736
Trinidad & Tabago	1,283	5,128	3,958
Subtotal	20,170	494,454	17,820
Independent OECS Countries			
Antigua & Barbuda	86	442	163
Dominica	81	750	82
Grenada	120	344	96
St. Kitts & Nevis	50	269	68
St. Lucia	139	617	147
St. Vincent & Grenadines	111	389	106
Subtotal	587	2,811	641
Total	20,757	497,265	18,466

Source: United Nations (population), World Bank (GDP); provided in USAID study "Urbanisation in the Caribbean."

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1.5 USAID 1990 PERFORMANCE RATING FOR OECS REGION 3RD OF 16 IN LATIN AMERICA; HIGHER FOR INDIVIDUAL COUNTRIES WITHIN OECS

The RDO/C[2] prepared a country performance profile for each Latin American country which depicts current conditions, trends and specific actions relating to a series of economic, social and political indicators. Tables 2 and 3 provide RDO/C's performance ratings summary for 1990; Table 2 with the OECS' 6 countries combined, Table 3 disaggregating each OECS country separately.

The RDO/C analysis indicated that the OECS, as a region, was third highest ranked in Latin America. On an individual country basis, 4 of the 6 OECS countries placed in the top five rankings. The LAC ratings are an indication of the strength of OECS countries and, thereby, desirability for a HG.

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TABLE 2: LAC PERFORMANCE RATINGS SUMMARY, 1990 WITH OECS COUNTRIES BUNDLED AS A REGION

	OVERALL PERFORM RANKING	OVERALL PERFORM (100%)	MACRO POLICY (50%)	SOCIAL SERVS (20%)	ENVIRON MGMT (10%)	DEM/HR COMMIT (20%)
Costa Rica	1	82.9	38.0	16.9	8.0	20.0
Jamaica	2	79.7	39.5	16.2	7.0	17.0
Eastern Caribbean	3	78.8	38.8	16.2	5.8	18.0
Belize	4	77.0	39.5	14.0	5.0	18.5
Bolivia	5	75.5	42.5	12.5	5.0	15.5
Panama	6	75.1	39.5	16.6	5.0	14.0
Honduras	7	72.6	34.4	15.7	7.0	15.5
Colombia	8	70.3	36.1	16.7	5.0	12.5
El Salvador	9	70.2	40.7	12.0	5.0	12.5
Ecuador	10	69.7	32.0	13.7	7.0	17.0
Peru	11	59.6	30.4	11.7	5.0	12.5
Guatelmala	12	58.9	28.7	11.7	6.0	12.5
Dominica Republic	13	56.7	21.2	15.0	5.0	15.5
Haiti	14	55.9	28.6	11.3	5.0	11.0
Guyana	15	51.0	25.5	13.0	3.0	9.5
Nicaragua	16	50.7	17.0	14.7	5.0	14.0

RDO/C scorings place the Eastern Caribbean region 3rd in the LAC ranking, while the Bureau's scorings place it 6th. RDO/C recommends that the Bureau accept RDO/C's proposed scores.

Source: Annual Action Plan, FY 92-93; Regional Development Office/ Caribbean, USAID, January 1991.

TABLE 3:

**LAC PERFORMANCE RATINGS SUMMARY, 1990
WITH OECS COUNTRIES INDIVIDUALLY RANKED**

COUNTRY	OVERALL PERFORM RANKING	OVERALL PERFORM (100%)	MACRO POLICY (50%)	SOCIAL SERVS (20%)	ENVIRON MGMT (10%)	DEM/HR COMMIT (20%)
St. Lucia	1	89.2	46.0	16.7	8.0	18.5
Dominica	2	84.6	41.5	16.6	8.0	18.5
Costa Rica	3	82.9	38.0	16.9	8.0	20.0
St. Vincent	4	82.4	42.0	16.9	5.0	18.5
St. Kitts	5	81.2	40.0	16.2	5.0	20.0
Jamaica	6	79.7	39.5	16.2	7.0	17.0
Belize	7	77.0	39.5	14.0	5.0	18.5
Bolivia	8	75.5	42.5	12.5	5.0	15.5
Panama	9	75.1	39.5	16.6	5.0	14.0
Honduras	10	72.6	34.4	15.7	7.0	15.5
Colombia	11	70.3	36.1	16.7	5.0	12.5
El Salvador	12	70.2	40.7	12.0	5.0	12.5
Ecuador	13	69.7	32.0	13.7	7.0	17.0
Grenada	14	69.0	32.4	14.6	5.0	17.0
Antigua	15	66.7	31.0	16.2	4.0	15.5
Peru	16	59.6	30.4	11.7	5.0	12.5
Guatelmala	17	58.9	28.7	11.7	6.0	12.5
Dom. Republic	18	56.7	21.2	15.0	5.0	15.5
Haiti	19	55.9	28.6	11.3	5.0	11.0
Guyana	20	51.0	25.5	13.0	3.0	9.5
Nicaragua	21	50.7	17.0	14.7	5.0	14.0

Source: Annual Action Plan, FY 92-93; Regional Development Office/ Caribbean, USAID, January 1991.

1.6 OECS HG CONSISTENT WITH USAID/BARBADOS OBJECTIVES

In the RDO/C's Annual Action Plan, 1992-93, many of the projects described have elements that could benefit from a HG and could use an OECS HG to highlight project objectives, e.g., in such areas as infrastructure development and maintenance (Regional Infrastructure Maintenance Project), environment (Privatization and the Environment: St. Lucia), hurricane damage containment, stimulate local employment and contracting (Basic Needs Trust Fund II) and financial markets development (Private Sector Initiatives Project). Two of the above projects would be particularly relevant to an OECS HG:

a) Private Sector Initiatives Project

USAID has funded two major studies in capital markets development under predecessors to the Private Sector Initiatives Project:

- OECS Capital Markets and Financial Institutions Project (1989); by Robert Nathan & Associates and Price, Waterhouse
- Capital Markets and Private Sector Development in the OECS (Draft, 1991) by Downing, Shorey and Staples

The Eastern Caribbean Central Bank (ECCB) has built upon the Nathan study and is pursuing avenues to foster capital markets development in the OECS. Refer to Appendix 2 for an ECCB article on this subject. The Downing, et. al. study confirms the basic premiss that capital markets development in the OECS is a highly desirable objective. The USAID/Barbados Mission is providing continuing support to this activity area and the regional local currency HG would further the Mission's program objectives by using the HG as a vehicle to foster regional acceptance for capital market issues.

b) Basic Needs Trust Fund II (BNTF II)

The BNTF II seeks to "assist local communities and governments to construct, rehabilitate and modify structures to... withstand the effects of hurricanes and to stimulate local employment and private contracting." All of these objectives could be furthered by an OECS HG which could: (i) provide an avenue for dispensing information to lenders and lower-income households on building design/

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technology related to hurricane damage prevention and (ii) (as housing programs do) stimulate local employment and private contracting through home improvement and construction.

1.7 OECS COULD ABSORB US $10 MILLION IN HG AUTHORIZATION

Based on field investigations, the consultant is of the opinion that the EC dollar equivalent (EC $27 million) of US $10 million in HG authorizations could readily and effectively be utilized in the OECS over a 5-year period or shorter term. That would entail issuance of EC $5.2 million (US $2 million) per year in regional bonds over 5 years. A case study on one island, i.e., St. Lucia, revealed that probably a large portion of that amount could be used annually by one housing finance company and three credit unions and so, when aggregating the six OECS countries, the absorption of US $10 million in HG authority for a local currency HG appears feasible and may prove the need for expanded HG authority over time.

2.0 OECS BACKGROUND

2.1 POLITICAL STRUCTURE

2.1.1 Confederation of Eight Nations

The OECS is a confederation of six independent countries and two British territories. The two British territories (Montserrat and Anguilla) are excluded from the HG consideration because they are subject to the sovereignty of Great Britain. The six independent countries comprise the subject area and consist of:

- Antigua and Barbuda
- Dominica
- Grenada
- St. Kitts and Nevis
- St. Lucia
- St. Vincent and the Grenadines

(refer to Table 1, above, for information on the population, land area and GDP of these six countries)

The OECS is a confederation, where each country has its own set of laws, regulations and tax structures. It is tied together by the prospects of mutual advantage and a common monetary currency.

2.1.2 Strong Democratic Traditions

The RDO/C ranks the OECS third as a region amongst 16 Latin American countries for its commitment to democratic/human rights commitment, with a score of 18 out of 20; four individual OECS countries rank higher than the composite rating. There are long-standing democratic traditions in the OECS that also promote a favorable business climate and economic development based on principles of a market economy.

2.1.3 Move Toward Regionalism

There is a continuing dialogue in the OECS to create greater regional integration between countries. There is a single central bank and currency, there is relatively unfettered movement of capital between OECS countries and there is continuing consideration of common trade tariffs, labor migration and capital markets.

2.2 SUMMARY OF ECONOMIC CONDITIONS

Due to the a) U.K. trade preferences for bananas, b) growth in tourism, c) lack of devastating hurricanes, d) transfers from expatriates and e) multilateral grants and concessionary loans, OECS economies have been strong in the latter 1980s and in the early 1990s. From 1985 to 1988 the real growth in OECS GDP averaged 5.2% per annum; this was in contrast to the Caribbean Region as a whole which experienced GDP average annual growth in the same period of only 1.4%.[3] The World Bank forecasts a medium to longer term average annual GDP growth of 4% for OECS countries as a whole "in the absence of external (economic) shocks." The key to maintaining this favorable economic performance will be in the successful diversification of the economies away from single-commodity agro-exports given special trade preferences, the absence of adverse weather conditions and adequate capital to sustain economic development in light of reductions in multilateral grants and concessionary loans. Diversification in export agricultural products is viewed as being critical to sustain the long-term growth in this sector. Tourism growth is viewed as the most viable area to sustain economic performance. Manufacturing may also play a major role in economic diversification, however, manufacturing expansion may be impeded because of small domestic markets, relatively high wage rates, and inconvenient transportation access. Development of small to medium size enterprises has been recommended to enhance import substitution and diversify the economy.

Economic shocks could significantly reverse the positive growth projections. Outcome of the European Economic Community merger on trade preferences is an unknown event and the OECS countries could be severely impacted with elimination or reduction of trade preferences in 1993. The opening of Cuba to American tourists could moderate growth in the OECS tourism industry as U.S. tourists are the primary visitor group. A recession in the U.S. and Europe could reduce tourist visits. The strengthening of the U.S. dollar could negatively impact agro-exports and tourism as the EC dollar is linked to the U.S. dollar; a strong U.S. dollar will make agro-exports and tourism for the European market relatively more expensive and less competitive. Another hurricane could devastate agricultural production for a period. Multilateral aid and concessionary loans, used to finance a majority of government infrastructure and development projects, is being reduced to the region. Thereby, the OECS is vulnerable to external economic shocks which could impede the favorable economic growth forecast for the region. With a prospective tightening in economic conditions likely in the 1990s, more sophisticated financing techniques will be beneficial to ease capital constraints and finance recovery and economic diversification.

When considering the downside, the economic analysis usually appears pessimistic. However, given the progressive governmental attitudes toward economic growth and favorable indicators, the OECS economies are generally viewed as being sound and future growth trends positive.

Below are summaries of OECS country economic conditions, excerpted from the RDO/C Annual Action Plan, FY 92-93, Appendix D.

2.2.1 Antigua and Barbuda

"The 1988 per capita GNP in Antigua and Barbuda for its population of 84,600 people, was US $2,800. The country's economy continues to be led by tourism, which has stimulated growth in related sectors such as construction, transport, public utilities and trade. Despite government efforts to diversify the economy by expanding other sectors, the combined GDP share of agriculture and manufacturing fell gradually from 9% in 1985 to an estimated 7% in 1989. The key policy issues facing Antigua and Barbuda concern the country's fiscal imbalance and the need to reduce external payments arrears. The Government will need to introduce further revenue raising measures and exercise tight control over current expenditures. The country's performance as measured by the Bureau's indicators can be characterized as positive, even though performance in these terms is less strong than the other OECS countries. On the other hand, the average per capita income in Antigua and Barbuda is higher than in the other OECS countries."

2.2.2 Dominica

"Dominica's 1988 GNP per capita for the population of 81,000 people was approximately US $1,660. Dominica's economy is primarily based on agriculture, which represents more than 30% of GDP and 75% of merchandise exports. Bananas continue to be the leading crop, accounting for over 70% of the value of total 1988 exports. Manufacturing is a growing sector, accounting for 8% of GDP in 1988 and having expanded at an annual average rate of nearly 7% between 1984 to 1988. Construction accounted for nearly 5% of GDP, having expanded in 1987-88 at an average annual rate of 11%. Tourism in Dominica plays less of a dominant role in the economy, compared to other countries in the OECS, reflecting the absence of tourism assets in Dominica such as white sand beaches. Nevertheless, potential exists for specialized tourism, where the promotion of outdoor activities, ecology, diving, health spas and scenery could generate steady development of the sector. The World Bank asserts that Dominica's long term growth prospects hinge on the country's ability to rapidly expand agricultural and manufacturing exports. The priority for agricultural diversification may intensify with the coming integration of the European Economic Community scheduled in 1992, an event with policy implications potentially critical to Dominica given its reliance on banana exports to the United Kingdom. Overall real GDP growth is projected at 4% per year on average during the 1989-94, assuming no banana shock. A banana shock could change the picture considerably."

2.2.3 Grenada

"The 1988 per capita GDP for Grenada's population of approximately 100,000 people was US $1,370 per year. Grenada is a small open economy based largely on agriculture, which accounts for a third of the work force, about a fifth of GDP and about 90% of export crops. Primary crops include cocoa, nutmeg, mace, bananas and other fruits and vegetables. The World Bank estimates that tourism receipts account for nearly half of Grenada's foreign exchange earnings from exports of goods and non-factor services in recent years. Agricultural exports are the other primary source of foreign exchange. Construction has played an important role in the country's growth representing 10.6% of GDP, and manufacturing and mining lesser roles contributing 5.2% and 0.4% of the GDP. The World Bank reports Grenada's growth prospects as strong, given that agriculture is already highly diversified and that tourism and manufacturing have considerable scope

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for development. These attributes can serve the Government in meeting its medium term objectives of achieving a sustainable rate of economic growth, reducing unemployment and improving the standard of living the country's inhabitants. However, to make good of its prospects and objectives, the country will need to address its fiscal imbalances and improve its regulatory system. Grenada's performance can be characterized as mixed, though on balance positive."

2.2.4 St. Kitts and Nevis

"The 1989 GNP per capita for the population of 43,400 people in the country of St. Kitts and Nevis, was US $2,770. St. Kitts and Nevis is a small, highly open economy which is based primarily on tourism, the cultivation and refining of sugar, and an incipient export-oriented enclave sector. In 1988, agriculture represented 9.7% of GDP, manufacturing represented 14.5%, and construction represented a little over 10%. Apart from the need to increase its public sector savings, the policy framework for St. Kitts and Nevis is generally strong and the country's overall performance can be characterized as positive. The World Bank projects real GDP growth at 5% per year from 1989-94 through a rapid growth in tourism and associated increases in construction, and an expansion in electronic assembly. Sugar's contribution to growth is expected to gradually decline."

2.2.5 St. Lucia

"The 1989 GDP per capita for St. Lucia's population of 148,000 people, was US $1,796. The St. Lucia economy has been based traditionally on agriculture, with bananas as the main crop. In 1989, agriculture production represented approximately 16% of GDP. During the course of the 1980s however, tourism, construction and enclave type manufacturing have also become important income earners, representing 10.2% and 7.0% respectively, of 1989's GDP. St. Lucia's economy currently reflects a diversified blend of strength not found in such balance in the other OECS countries. St. Lucia's overall performance, in economic, social, environmental and democratic terms can be summarized as both positive and consistent. A primary near term policy issue will be the implications of the impending integration of the European Economic Community in 1992."

2.2.6 St. Vincent And the Grenadines

"The per capita GDP for the St. Vincent and the Grenadines population of 115,000 people in 1989 was US $1,270. The country's largest income earners are agriculture (14.2% of GDP), manufacturing (7.6% of GDP) and construction (7.3% of GDP). It is dependent on a few export commodities, primarily bananas, and a small number of export markets with the United Kingdom being the most important. The country's bananas which are exported to the UK receive preferential access. The adverse impact of a possible banana shock in St. Vincent and the Grenadines is projected to be less severe than in Dominica or St. Lucia, but nevertheless, would be of major concern. The country's second most important export market is Trinidad and Tobago which purchases the bulk of the root crops grown in St. Vincent and the Grenadines."

2.3 OECS FINANCIAL SECTOR STRUCTURE

The OECS financial sector consists of:

- Central Bank
- Development Banks
- Commercial Banks
- Pension and Provident Funds
- Private Insurance Companies
- Non-Bank Financial Institutions
- Venture Capital Entities

2.3.1 The Eastern Caribbean Central Bank

The ECCB was founded on October 1, 1983 and is primarily a regulatory body and monetary agent. It is in its infancy, still, and many of the intermediation roles performed by other central banks to assist economic development have yet to be initiated.

2.3.2 Development Banks

The Caribbean Development Bank (CDB) and National Development Banks (NDB) in OECS countries were formed to provide long-term development finance. Their performance to date, however, indicates that they may not be as effective as desired in channeling long-term finance to the private sector. In 1986, for example, the development banks in the OECS Region extended only EC $63.5 million in loans.[4] The NDBs cannot generate their own funds, at present, and are largely dependant on the CDB for financing. A USAID study[5] indicated that the NDBs were "beset by a number of problems which have made their track record not as good as hoped."

2.3.3 Commercial Banks

There are foreign-owned and indigenous commercial banks. The commercial banking sector is dominated by four foreign-owned commercial banks. Many of the indigenous commercial banks are owned by national governments and have, thus, garnered substantial deposits, from the National Insurance Schemes and parastatals. There are other small, indigenous commercial banks, such as the St. Lucia Cooperative Bank and Bank of Nevis, which are private institutions. Commercial banks hold the great majority of the region's assets and liabilities and are, substantially, short-term lenders. Commercial banks do not transfer funds from one country to another because of political reasons; there is no intermediation mechanism for them to do so either on their behalf.

As of December 1990, commercial bank credit distribution was:[6]

- 22% - Personal Mortgage
- 19% - Other
- 18% - Consumer Credit
- 14% - Distribution
- 10% - Tourism
- 9% - Government
- 5% - Manufacture
- 3% - Agriculture

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2.3.4 National Development Foundations

The NDFs are small institutions capitalised by a USAID US $10 million grant. NDFs finance small business enterprises but do not appear able to generate their own source of financing to expand operations.[7] NDF lending through 1987 amounted to only US $1.85 million.

2.3.5 Pension And Provident Funds

The National Insurance Schemes (NIS), which are government-instituted citizen provident funds, have served to generate substantial domestic savings for long-term investment. At present, these NIS are highly liquid and serve to finance a variety of development projects, including the St. Lucia Mortgage Finance Company. As indicated during an interview with the St. Vincent NIS, recognition of these national provident funds as lenders has vastly expanded the requests for financing for housing, parastatals and governments. Thereby, the draw on NIS resources will be significant in the future and this will probably restrict funding availability for private sector requirements, e.g., middle to upper-income housing. At present, much of the NIS funds are deposited in commercial banks because (as one USAID study indicated there is an "absence of financial instruments to channel savings into long-term investment.")[8]

Private pension schemes were thought to have largely been merged with the NIS. However, field investigations revealed substantial and growing private pension funds in major corporations. These private pension funds appear to have significant liquidity with few long-term investment options domestically; thus a substantial amount of private pension funds appear to be invested off-shore.

2.3.6 Private Insurance Companies

There are several regional life and casualty insurance companies operating through-out the OECS countries, largely based in Barbados and Trinidad. There are no statistics available indicating the level of assets held by these insurance companies, however, from field investigations it appears to be substantial. One insurance company interviewed indicated that they had in excess of EC $5 million each in St. Lucia and St. Vincent that could now be

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invested in appropriate investments; this liquidity, for this one company, is growing between EC $500,000 and EC $600,000 per annum in each country. Two other insurance companies interviewed would not reveal specific figures, but indicated they were substantially higher than the EC $5 million figure for each country. As with the NIS, insurance companies do not have long-term instruments or equities in which to invest. For political reasons and currency control regulations in their headquarters countries, insurance companies tend to want to invest their funds locally where they are accumulated. All the insurance companies interviewed would welcome an intermediation mechanism to invest funds in long-term equities and debt. The USAID study[9] indicated that insurance companies now invest their funds, on average, as follows:

- 30% to 40% in mortgages
- 10% to 20% in government bonds
- 25% to 30% in local deposits
- minuscule portion in property and corporate shares

It is interesting to note that insurance companies directly originate mortgages through their insurance agencies and, thus, are one of the leading mortgage lenders in the OECS countries. The insurance companies indicated, however, that an intermediation mechanism, such as housing bonds or mortgage-backed securities, might prove attractive as an alternative to some direct lending or to place excess liquidity invested otherwhere.

2.3.7 Non-Bank Financial Institutions

The ECCB does not directly regulate, nor collect data on, non-bank financial institutions so there is little data available. Non-bank financial institutions include: savings banks, mortgage finance companies, credit unions and building societies. The credit unions, in particular, appear to be increasing in importance. In Dominica, for example, credit unions controlled, in 1987, over 50% of that country's deposits and offer a full-range of financial services. In 1987, OECS credit unions held shares and deposits worth EC $58 million; combined shares and deposits had been growing at

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annual rate of 31.7% between 1982 and 1987.[10] In most countries, credit unions are short-term lenders, primarily, but appear to want to expand into housing mortgages. In St. Lucia, the credit unions have been exploring ways to use NIS funds for member home improvement loans and the SLMFC has been discussing ways to provide the technical back-up for them to undertake mortgage lending. Other non-bank financial institutions appear to be relatively small; some appear to have resource mobilisation problems, such as SLMFC. For non-bank financial institutions, including credit unions, the problem with long-term lending is obtaining sources of long-term finance to match-up maturities; they tend not to have the capital base to expand long-term lending, prudently, by themselves.

2.3.8 Venture Capital Entities

There are several sources for business capital in the OECS, however, as forcefully depicted in the study "Capital Markets And Private Sector Development In the OECS", most of this financing is in the form of loans, primarily short-term loans. There are very limited sources for equity investments and long-term loans for business in the OECS; these "equity" sources include:

- Caribbean Financial Services Corporation (funded, in part, by USAID)
- Agricultural Venture Trust (USAID-sponsored organization)
- National Development Foundations (reportedly, only one NDF provides equity financing and that on a limited basis)
- International Donor Sources (CDC, EIB and IFC)

2.4 REGULATORY STRUCTURE OF THE OECS FINANCIAL SECTOR

Although the OECS countries are under the ECCB, each country maintains its own regulations regarding financial sector institutions, taxation, currency controls, deposit/lending rates and alien property ownership. For example:[11]

- Some countries tax interest earned on deposits, most do not.

- Some countries tax lender interest income on mortgage loans, some do not up to certain levels of interest and mortgage principal.

- Some have statutory provisions governing lending interest rates.

- All countries seem to have adopted minimum rates (i.e. 4%) on deposits.

- Different taxes and fees are charged commercial banks.

- All countries have alien landholding acts, which restricts property ownership by citizens of other OECS countries and foreigners in owning a country's property. This definition has been interpreted to include financial instruments and may be an impediment to a capital market mechanism if exemption for a HG local currency bond issue is not obtained; CFSC has obtained these exemptions from all OECS countries.

The myriad regulations existing in the OECS appears to make a financial intermediation/capital market role difficult on the surface. However, indications of ECCB support for a capital markets operation during the field investigation, and CFSC's precedent of obtaining exemptions, should facilitate overcoming the barriers to establishing a regional HG bond issue. The complexity of the legal/regulatory framework, however, can be viewed as an opportunity for USAID to promote a valuable function in the OECS that other outside entities (e.g., a merchant bank) might otherwise have difficulty in establishing.

2.5 OECS FINANCIAL SECTOR PERFORMANCE

The OECS financial sector has been buoyed by the favorable economic performance of the latter 1980s and 1990s. The large foreign exchange earnings of agriculture and tourism, coupled with sizable income transfers from expatriates, have rendered the financial sector substantially liquid. In March 1991, the ECCB reported that commercial banks had substantial excess liquidity estimated at over EC $1 billion; excess liquidity being roughly defined as the difference between a) statutory reserves and loans and advances and b) total liabilities. Table 2A depicts rough estimates of commercial bank excess liquidity by country. The insurance companies also appear to be highly liquid. No statistics on insurance

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company assets were available, however, interviews during the field investigations with three major regional insurance companies indicated substantial liquidity. The National Insurance Schemes in OECS countries have accumulated sizable financial resources; the field investigation also revealed a growing number of private pension schemes which have substantial financial assets. In short, there are very substantial domestic financial resources in the OECS countries.

Below are selected outline highlights of the OECS financial sector performance.

2.5.1 Excess Liquidity

a) Substantial excess liquidity, e.g. commercial banks over EC $1 billion in excess liquidity in 1991. Refer to Table 2A: Rough Estimate of Commercial Bank Excess Liquidity in the OECS Countries, March 1991 and Table 2B: Liquidity of the OECS Commercial Banks

b) Liquidity applied substantially to short-term investments because there are limited capital markets to create long-term debt and equities investments

c) Some OECS countries have tight money supply, others highly liquid; no mechanism to transfer excess liquidity.

TABLE 2A:

Rough Estimate of Commercial Bank Excess Liquidity in the OECS Countries, March 1991. (in millions of EC Dollars)

	Total Liabilities	Statutory Reserves/ Loans and Advances	Rough Estimate of Excess Liquidity
Anguilla	225,443	(150,711)	74,732
Antigua	864,758	(658,114)	206,674
Dominica	379,427	(277,322)	102,105
Grenada	455,604	(334,145)	121,459
Montserrat	130,339	(99,587)	30,752
St.Kitts-Nevis	499,611	(357,378)	142,233
St. Lucia	912,695	(689,155)	222,877
St. Vincent	501,570	(305,946)	195,624
Total	3,969,447	2,872,358	1,097,089

Source: Quarterly Banking Statistics, Period Ended March 1991. ECCB.

Table 2B:

Liquidity of the OECS Commercial Banks Loan-to-Deposit Ratio--Indigenous and Overseas Banks As of September 30[12]

	1990	1989
St. Vincent	64%	65%
Dominica	77%	67%
St. Kitts	80%	80%
St. Lucia	82%	79%
Grenada	84%	81%
Antigua	97%	93%
OECS	81%	78%
OECS excluding Antigua	77%	74%

Source: Eastern Caribbean Central Bank

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2.5.2 Savings

a) Savings growth substantial in absolute terms; in some countries, however, lower than GDP growth. Refer to Table 3: Commercial Bank Deposits Outstanding at December 31 and Table 4B: Average Rates of Gross Investment and Savings

b) World Bank predicts substantial future growth in savings. Refer to Table 4A: World Bank Projections of Investment Savings and Long-Term Capital Inflows

c) Major resource mobilizers of long-term savings include:

- National Insurance Schemes
- Private Life Insurance Companies
- Private Pension Schemes

Table 3:

Commercial Bank Deposits Outstanding at December 31
EC $ million[13]

Central/Local government	85.4	39.3
Statutory & Govt Corporations	398.0	227.9
Business Firms Individuals	1,682.9	907.4
Non-bank financial Institution	141.7	121.6
Foreign currency	169.2	69.5
Total OECS residents	2,845.7	1,587.3
Non residents	339.3	250.7
TOTAL DEPOSITS	3,185.0	1,838.0

Table 4A:

World Bank Projections of Investment Savings
And Long-Term Capital Inflows[14]

	INVESTMENT (% of GDP)		SAVINGS (% of GDP)		FOR. CAP. INFLOWS (US $ millions)	
	2000	Prev.*	2000	Prev.*	2000	1987
Antigua	23	36	31	11	-65	69
Dominica	25	37	15	-4	19	23
Grenada	25	43	20	2	-5	31
St. Kitts	24	24	24	-6	1	16
St. Lucia	28	28	26	13	9	20
St. Vincent	28	40	17	-5	19	20

* "Prev." denotes the previous period shown in Table 4B.

Table 4B:

Average Rates of Gross Investment and Savings
(as a % of GDP)[15]

Country	Period	Investment	Savings
Antigua	1977-85	35.9	
	1982-85		10.0
Dominica	1977-85	36.5	-4.2
Grenada	1980-85	42.6	2.3
St. Kitts	1977-85	39.0	
	1983-85		-5.5
St. Lucia	1977-85	46.0	12.6
St. Vincent	1977-85	40.1	-5.1

2.5.3 Capital Flight Due, In Part, to Lack of OECS Investment Opportunities, Not Security of Investment

a) No regional capital markets

b) Government bonds major long-term investment (problems with timely payments to bond holders)

c) Insurance and pension entities highly desirous to make long-term OECS investments but lack investment opportunities. Refer to Table 5: Investment Portfolios of U.S. and OECS Pension Funds and Insurers

Table 5:

Investment Portfolios of U.S. and OECS Pension Funds and Insurers (c. 1985)[16]

Investment	OECS N.I.S.	U.S. Insurance	U.S. Pension
Comm. Bank Deposits	65%	0%	0%
Corp. Bonds and Loans	0%	32%	22%
government Paper	30%	24%	20%
Mortgages	*	16%	2%
Equity	0%	13%	46%
Other	5%	15%	10%
Total	100%	100%	100%

* A portion of the investments in both government paper and commercial banks fund residential mortgages.

2.5.4 Commercial Banks Dominate Financial Sector

a) 80% of OECS financial assets. Refer to Table 6: Institutional Composition of OECS and U.S. Capital Markets (1986)

b) Traditionally short-term lenders

c) Substantial home lending, primarily for upper-income; high level of home lending ascribed to substantial excess liquidity and not change in commercial bank lending policies.

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Table 6:

Institutional Composition of OECS and U.S. Capital Markets (1986)[17]

Intermediary Institution	Percentage of total assets of ... OECS Fin'l System	US Fin'l System
Commercial banks	80%	33%
Savings and Loan Assn	0%	15%
Life Insurance Co.	(not avail.)	11%
Private pension funds	0%	11%
N.I.S., state/local pension	11%	6%
Mutual funds	0%	6%
Finance companies	(in "non-banks")	5%
Casualty Insurance Co.	(not avail.)	4%
Savings banks	0%	3%
Money-market funds	0%	3%
Credit Unions	2%	2%
Development banks	3%	(incl. above)
Non-banks	4%	(incl. above)
Total	100%	100%

2.5.5 Financial Institutions Serving Lower-Income Home Loan Market Are Ill-Liquid; Lack Resource Mobilization Capacity

a) Mortgage Finance Companies and Credit Unions are ill-liquid, lack resource mobilization capability

b) Governments finance much of lower-income housing

- N.I.S.
- Development Banks
- Direct Finance

(For example, St. Lucia Mortgage Finance company receives over half of its financial resources from the National Insurance Scheme; the National Commercial Bank of St. Vincent funds substantial number of mortgages with N.I.S. deposits)

c) Credit Unions interviewed in St. Lucia indicated they do not accept deposits and resources are limited to member capital;

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thereby, at least the limited sample of credit unions interviewed lacked significant resource mobilization capacity and indicated that, because of a lack of financial resources, they could not meet the housing finance demand of their members, especially for longer-term loans.

2.6 DEMAND FOR HOUSING FINANCE IN THE OECS

2.6.1 No market analysis conducted as part of this consultancy

2.6.2 Barbados HG as example

a) 3½ years (1983-1987) US $10 million in HG funds loaned

b) Barbados had 44% of the population (1990) of 6 OECS countries, 128% of the OECS GDP (1988)

c) Substantial demand in Barbados still exists. Barbados Mortgage Finance Company (BMFC), alone, indicates several million BDS in HG funds could be absorbed annually by that institutions; BMFC loaned BDS $5 million in HG loans under the former program

d) With more than double the population and a near equal and growing GDP in the OECS, housing finance demand by lower-income households in the OECS should equal or exceed that in Barbados as experienced in the mid-1980s.

2.6.3 St. Lucia Anecdotal Case Study (very limited sample)

a) St. Lucia Mortgage Finance Company indicates annual need for EC $8 million (US $3 million) for home loans; primarily serves lower-income market.

b) St. Lucia Urban Development Corporation has 2,000 to 3,000 housing plots in development, plus plans to upgrade another 1,000 squatter plots in Vieux Fort; another 3,000 plots in planning. Most plots are for lower-income households. Average plot cost EC $8,000; total financing requirements for approximately 3,000 plots now in development/upgrading estimated at EC $24 million (US $8.7 million).

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c) St. Lucia Cooperative Bank indicates that they would utilize several EC $ million in HG loans if available.

d) Three community based credit unions indicated they loan in excess of EC $1 million in housing loans annually and have substantial demand in excess of capacity to make loans. e.g., Laborie Corporative Credit Union has 2,000 members (estimated 60% to 70% below medium income) but can only make 70 to 80 housing loans (EC $500,000) per year with present resources. Credit unions in St. Lucia have about 14,000 members.

e) In summary, just the 6 institutions interviewed in St. Lucia could readily absorb at least US $5 million in HG funds over 5 years.

f) The U.S. Ambassador to the OECS has recently received a request from the St. Lucian Prime Minister for U.S. assistance in housing finance.

2.6.4 Other OECS Countries Anecdotal Housing Demand (very limited sample)

2.6.4.1 Dominica

a) Majority of Dominica houses were constructed of wood, are old (in 1981 almost one-half of houses were built prior to 1970), are deteriorating and are in need of upgrading or replacement; indicates substantial demand for home improvement/replacement financing.

b) Bath Estates and Pound Area are two government projects with a substantial low-income household element. Bath Estates comprises 248 housing units and the Pound Area 96 housing units. Financing for low-income house replacement/upgrading, alone, is estimated by UNDP in 1988 to exceed US $1 million.[18]

2.6.4.2 St. Vincent (exclusive of the Grenadines which were not reviewed)

a) UNDP study in 1988[19] indicated a program, slated for the 1990 - 1994 period, for low-income household lots and core units totalling housing for 3,650 families, costing in 1988 EC dollars, EC $12,813,000 (US $4,746,000)

b) UNDP identified 6 initial and land sites for the projects totalling 548 plots.

2.6.4.3 Grenada

a) UNDP 1989 study[20] indicated a need for EC$1.3 million (US $480,000) for financing upgrading of one squatter settlement (River Road) of 342 households.

b) Bankers Trust Company[21] had in October 1991, a request from the Government of Grenada to assist in obtaining housing finance and has indicated a significant unmet demand for housing finance.

2.6.4.4 Nevis (exclusive of St. Kitts which has not been reviewed)

a) The manager, Nevis Housing and Land Development Corporation, a government agency, indicated strong demand for housing in Nevis in July 1991; the Government of Nevis owns about 5,000 acres of land, some of which will be used for housing development.[22]

b) The Bank of Nevis has indicated an annual need for EC $5.4 million (US $2 million) in external financing for housing (at all income levels) for that institution, alone.[23]

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3.0 HOUSING GUARANTY LOAN CONCEPT FOR THE OECS

3.1 BACKGROUND FOR A HG

3.1.1 Regional Perspective

Although it may prove feasible to implement a HG loan program in a single OECS country, the regional perspective is superior because:

a) Regional perspective promotes capital market structure for OECS and improves utilization of liquidity in the OECS.

b) Regional perspective allows some countries with populations/demand too small to be viable in-and-of itself to avail itself of HG funds.

c) Regional perspective has better opportunity to be sustainable over time as it aggregates 6 small country markets into one significant market area and, if one country market should falter for some reason, the other countries may well continue to absorb program funds.

3.1.2 U.S. $10 Million HG Proposed

Based on analysis of demand in the OECS and absorption under the Barbados HG, it is estimated that at least US $2 million per year, for five years, for a total of US$10 million, could be absorbed in HG funds in the OECS. There are significant local sources to provide these funds within the OECS and, thereby, a local currency HG would be feasible.

3.1.3 Two Alternative HG Program Structures

- Alternative 1: Local Currency Bond Issue

- Alternative 2: U.S. Dollar Collateralized Loan

Both scenarios would utilize local private sector entities to collateralize and lend HG program funds (the Panama model discussed below). The USAID Worldwide Private Sector Housing Guaranty Project could prospectively be used for a HG authority because of the private sector role. A combination of the two above alternatives, under a single program structure, is a third possible option.

3.1.4 Need To Determine Median Income

The question of determining the Medium Income has presented difficulties because there is a dearth of available income distribution data in OECS countries. The USAID/Barbados Mission Economist has indicated she will assist in trying to determine the applicable medium income. The OECS 1991 censa have not been analyzed, as of yet, but would probably form the basis for establishing the medium income. Without knowing the medium income, maximum HG eligible household incomes and affordable loan amounts and terms could not be analyzed with any precision. OECS countries define lower-income more liberally than USAID's medium income may indicate as eligible HG borrowers; thereby, on re-flows of the HG program funds, the eligible income level may well be liberalized to conform with individual country definitions as was done in the Barbados HG.

3.2 ALTERNATIVE 1: LOCAL CURRENCY BOND ISSUE

3.2.1 Program Summary

The Local Currency Bond Issue would replace the traditional HG loan structure of U.S. dollars being on-lent to a host country. The Local Currency HG would provide for a housing bond to be issued in the OECS that would raise EC dollars for on-lending directly to primary lenders. Primary lenders would provide the requisite collateral for the U.S. Government guaranty. The U.S. Government guaranty would enable the issuance of bonds to finance lower-income housing loans by instilling confidence in local bond investors for providing the investment. All program funds then would be in EC dollars, i.e. funds raised from bonds, funds on-lent to primary lenders, housing loans to eligible households and repayments of housing loans and housing bonds; the currency exchange rate risk normally associated with U.S. dollar loans to developing nations would be eliminated.

A local organization would be identified to perform the role of EC dollar bond issuance and administration; this local organization (hereinafter referred to as the Capital Markets Entity) would perform the roles generally performed by U.S. underwriters and U.S. investors in providing the traditional U.S. dollar HG loan. The Capital Markets Entity would most likely be a subsidiary of an existing Eastern Caribbean organization, possibly supplemented with additional equity investment by regional and international investors. This is the structure of the Home Mortgage Bank (Trinidad). The Capital Markets Entity would raise EC dollars through an EC housing bond issue and on-lend these funds to participating primary lenders to make housing loans to eligible households. The Capital Markets Entity would collect payments from the primary lenders and pay the bondholders.

Refer to Chart 1: General Structure for Local Currency Bond Issue.

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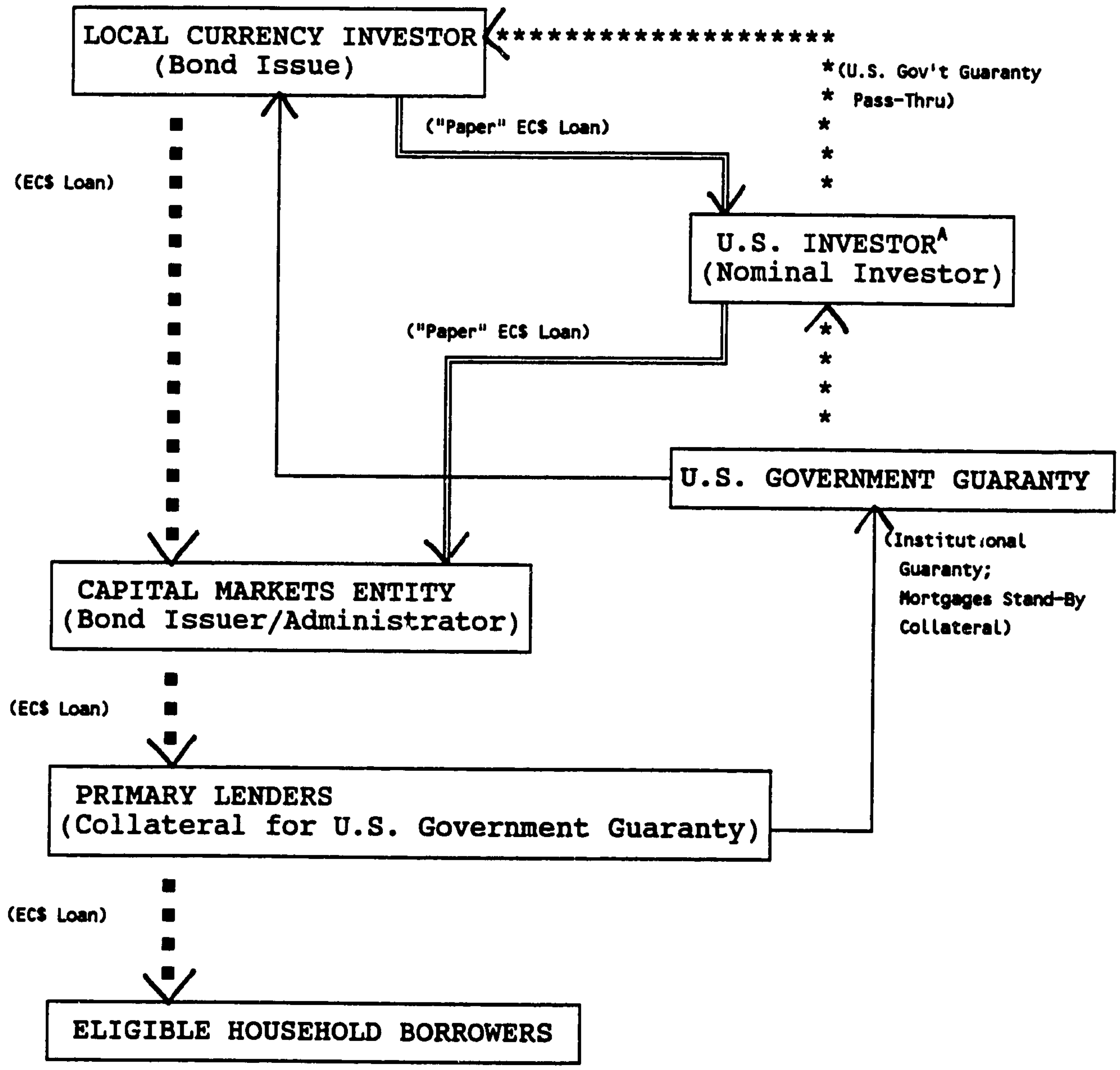
CHART 1:

GENERAL STRUCTURE FOR LOCAL CURRENCY BOND ISSUE



^ Note: U.S. Government guarantees would be preferably applied directly to local currency bonds; this could be implemented if the requirement for a "U.S. Investor" were waived.

LEGEND:
■■■■■■ Effective Loans ——— Effective Guaranty
═══ "Paper" or Nominal Loans ***** "Paper" or Nominal Guaranty

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3.2.2 Background

a) U.S. Government Guaranty

The local currency bond issue would involve a U.S. Government guaranty to bondholders for bonds issued within the OECS and bought with EC dollars. Under the HG program structure, it may be necessary to involve a U.S. investor (technical definition, below, in Section 3.2.7), which, under Alternative 1, would really be a passive conduit function merely put in place to satisfy regulatory requirements. The OECS Capital Markets Entity would perform the role of "Investor".

b) Potential Program Participants

Potential program participants have been identified for each element in implementing a Local Currency Bond Issue. These potential participants have indicated some level of interest in the program but were not requested to provide any formal commitment to participate; formal requests to participate should only be made after USAID determines that the program structure is potentially acceptable and decides to proceed with attempting to implement the HG. Potential program participants include:

i) U.S. Investor

- U.S. financial institution, e.g., Citicorp or Bankers Trust Company
- U.S. insurance company, e.g., American Life and General Company
- Private voluntary organizations, e.g., Cooperative Housing Foundation
- U.S. owned company operating in the OECS, e.g., Morning Star Holdings, Ltd., or Coopers and Lybrand

ii) Capital markets Entity (bond issuer and administrator)

- Caribbean Financial Services Company

- St. Lucia Mortgage Finance Company

- Colybrand Company Services, Ltd. (a subsidiary of Coopers and Lybrand)

  (Home Mortgage Bank of Trinidad has indicated a willingness to provide technical support and become an equity stockholder in the Capital Markets Entity)

iii) Primary Housing Lenders
(St. Lucia used as case study)

- St. Lucia Mortgage Finance Company (SLMFC)

- St. Lucia Cooperative Bank

- Selected Credit Unions in St. Lucia

  (only St. Lucia was visited in the field investigations to interview OECS primary lenders. Time did not permit any major effort to identify an array of participating primary lenders; lenders listed, below, were identified by the consultant in a previous study for another agency)

- Dominica Mortgage Finance Company (sister company to SLMFC and owned by CDC; now dormant but may be reactivated or enter into joint venture)

- National Commercial Bank of Dominica (wants to expand mortgage function, seeking additional financial resources)

- Bank of Nevis

- St. Vincent Mortgage Finance Company (sister company to SLMFC and owned by CDC; now dormant but may be reactivated or enter into joint venture)

iv) Bond Purchasers

- Major local life insurance companies
- National Insurance Schemes
- Private sector pension funds

c) Collateral for USAID - The Panama HG Model

The Panama Private Sector Low-Cost Shelter Program (HG loan number 525-HG-013) serves as a model for obtaining adequate collateral for USAID in an OECS HG. Collateral would mainly be provided by the primary lending institutions; it is also recommended that a sinking fund be established (as a mortgage insurance vehicle) to further collateralize primary lender repayments (this is now being considered for the proposed HG in Sri Lanka). A more detailed discussion on collateral for the U.S. Government guaranty is presented, below, in Section 3.6

d) Technical Assistance Available in the Region

The Home Mortgage Bank (HMB) of Trinidad serves as a model for the proposed OECS Local Currency Bond Issue HG. As of June 30, 1991, the HMB had issued over TT dollars 253 million in housing bonds. The HMB bond program receives continuing assistance from the U.S. Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac) and HMB has indicated that bond documents, marketing program, automated systems and technical assistance would be provided to an OECS entity as proposed herein. The HMB further indicated that they may also be interested in purchasing equity (shares) in the Capital Markets Entity serving as the OECS bond issuer for the HG program.

e) Regional Privately-Issued Debenture

The Caribbean Financial Services Company (CFSC) is preparing to issue a US $2.5 million convertible debt issue in the OECS and Barbados; the debentures will have a 10-year term. The CFSC debenture issue was able to resolve regional tax, alien land holding and currency control restrictions with exemptions from each OECS government. The success of CFSC can be built upon with the proposed HG Local Currency Bond Issue.

3.2.3 The Capital Markets Entity

The Capital Markets Entity would fulfill the role of issuing local currency bonds and on-lending them to participating primary lenders. It would also be responsible to administer repayments, including collateral provided by any defaulting primary lender. It should be sufficiently capable to administer the bond issue. It would not be a primary lender for home loans. The Capital Markets Entity would most likely be affiliated with an existing financial institution, probably as a subsidiary entity with additional local and international equity shareholders. Possible sponsoring organizations to form a Capital Markets Entity include:

- Caribbean Financial Services Corporation
- St. Lucia Mortgage Finance Company (perhaps in conjunction with Commonwealth Development Corporation, its majority stockholder)
- Colybrand Company Services, Ltd.
- Home Mortgage Bank of Trinidad (probably as joint venture with, or as a major shareholder in, another entity)

(All four institutions have preliminary indicated interest in fulfilling this sponsor role and at least three have the capital base to form a credible Capital Markets Entity. In Appendix 3 are financial statements for CFSC, SLMFC and HMB).

The Capital Markets Entity could also fulfill other capital market functions over time in addition to the HG program. Additional functions would be advantageous to assist the issuer to be financially self-sustaining and to promote additional capital market operations. Additional capital market functions may include (these functions could be added over time and as proved feasible; they would not be a prerequisite to initiating a HG Local Currency Bond Issue):

- Secondary Mortgage Market function for all forms of housing mortgages; would probably be much more extensive than HG program and involve substantial refinancing for existing mortgages. The Home Mortgage Bank serves as the model.

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- Stock brokerage function (which would establish on informal stock exchange as a precursor for merging OECS equities and debt trading with, e.g.,, the Barbados Stock Exchange; Botswana has established this model with the introduction of Stockbrokers Botswana Ltd. in 1989)

- Issuance function for new stock issues (Colybrand is now undertaking this role for the Dominica Electricity Company)

- Issuance and underwriting function for long-term debt instruments and equities (shares), e.g., for commercial businesses.

- Leasing company function (recommendation in the USAID-funded study "OECS Capital Markets and Financial Institutions Project")

If the sponsoring organization established a subsidiary to undertake capital market functions, there are a number of potential equity investors that would consider equity participation. Those indicating interest in a very cursory, unsystematic sampling include:

- Private Insurance Companies
- Private Pension Schemes
- Public National Insurance Schemes
- Commonwealth Development Corporation
- Home Mortgage Bank of Trinidad

The amount of equity potentially available with reasonable return expectations is sizable in the OECS because there are few options for long-term investment.

3.2.4 Exemptions Required

As demonstrated in the two USAID-funded studies concerning OECS capital markets and by CFSC's experience with its debenture issue, at least two exemptions may have to be obtained from each OECS government in order to have a regional bond issue:

- Exemption from withholding tax on bond interest (this is different from tax-exemption on the bond interest; the withholding tax is really a surcharge imposed by some OECS governments on securities)

- Exemption from Alien Landholding Acts (which restricts foreigner-owned securities as well as real property)

Some OECS countries provide tax-exemptions to housing lenders on interest earned (e.g., St. Lucia) for home loans below a certain amount; other countries do not. It may be possible to obtain tax-exemption for bondholder interest on the HG Local Currency Bonds if that proves to be a desired objective. This tax-exemption subsidy element for a HG loan program, and its desirability, require further consideration before a recommendation can be made.

The CFSC has been able to obtain the requisite exemptions from each individual OECS government for its debenture issue and, thereby, has already pioneered the regional private sector issuance of debt; the HG Local Currency Bond Issue should be non-controversial, as OECS governments have evidenced strong support for lower-income housing finance.

3.2.5 Bond Purchasers

A cursory, random sampling of potential OECS investors for a local currency bond proved that there is both substantial liquidity and interest in purchasing long-term bonds, especially with a U.S. Government guaranty. The consultant interviewed four private insurance companies and all indicated interest; three of the four indicated they would consider initial investments in a HG bond totalling EC $11.4 million (US $4.2 million); with additional investments possible in subsequent years. An important finding was that the insurance companies preferred long-term (10-20 years), fixed interest rate bonds; long-term bonds could have matched maturities for HG housing loans and, thereby, eliminate the requirement for a liquidity mechanism (discussed below in Section 3.2.6) on roll-over of shorter-term bonds against longer-term home loans.

In a previous study conducted by the consultant, there was similar interest in long-term debt investments expressed by government National Insurance Schemes (analogous to the U.S. Social Security System) and private sector business pension schemes. In fact, frustration was expressed by these investors at having so few options for their investments. The "Capital Markets and Private Sector Development in the OECS" draft report confirmed this finding. That report indicated that statutory and government corporations (in large part the National Insurance Schemes) in the OECS had in December 1990, EC $398 million (US $147 million) in deposits at commercial banks and that 65% of OECS pension fund and insurer financial assets were in commercial bank deposits; this substantiates the findings that there are few investment opportunities for these entities. In comparison, that study noted that similar U.S. pension/insurance entities had zero percent of their financial assets in commercial bank deposits. Refer, above, to Table 3: Commercial Bank Deposits Outstanding at December 31 and Table 5: Investment Portfolios of U.S. and OECS Pension Funds and Insurers.

It is also illustrative to point out a case study in St. Lucia to demonstrate NIS' willingness to invest long-term funds at reasonable interest rates. The St. Lucia NIS has loaned in excess of EC $12 million to the SLMFC at 6% to 7% interest on 20-year repayment terms for lower-income home loans.

There appears to be more than sufficient willing investors to purchase at least the local currency equivalent of US $10 million in EC dollar bonds on a long-term basis. The one undetermined area is the interest rate. As this study was at a very preliminary phase in initiation of a possible HG, potential investors really could not be requested to make a commitment on interest rates. The essential issue is whether the bond interest rate, plus USAID and bond-related costs, would yield sufficient spread for primary lenders to make a profit. Preliminary indications are that with a U.S. Government guaranty a negotiated workable interest rate could be achieved.

3.2.6 Liquidity Mechanism

A liquidity mechanism in a bond issue is necessary when there is a mis-match between the maturities of the bond issue and the underlying debt instruments, i.e., for a HG Loan, the individual housing loans. As discussed, below, the great majority of HG resources will probably be applied to housing loans under 10 years, e.g.,, for home improvement and plot purchase loans. Thereby bond issues of 10-years or more would suffice to match maturities.

Given the vagaries of market conditions, it would still be prudent to arrange a stand-by liquidity mechanism in the event shorter-term bonds become more advantageous. A liquidity mechanism could be provided by an insurance company, a commercial bank, a NIS, or the Eastern Caribbean Central Bank (ECCB). Under this scenario, the liquidity guarantor would agree to purchase unsold bonds on re-issuance until the bonds could be sold.

Discussions with several possible liquidity guarantors indicated that there is potential for arranging a liquidity guarantee in the OECS.

a) The Bank of Nevis has expressed interest in using the ECCB Inter-Bank Lending Facility for a liquidity mechanism.

b) The ECCB was presented with the concept of using an OECS commercial bank's (e.g., Bank of Nevis) borrowing from the Inter-Bank Lending Facility to provide the liquidity mechanism. The Inter-Bank Lending Facility is an ECCB operation to enable member banks to borrow from each other; similar to the U.S. Federal Reserve Discount Loans. Because of the U.S. Government guaranty, the proposal was to grant prior authority to the commercial bank to borrow in excess of its credit limit (if necessary) from the Inter-Bank Lending Facility to temporarily refinance outstanding HG-related bonds. The ECCB will consider this liquidity mechanism.

c) Citibank, N.A., in Puerto Rico, expressed interest in providing the liquidity guaranty.

d) Bankers Trust Company (through its Puerto Rico subsidiary, Bankers Trust Caribe Capital Markets, Inc.) expressed interest in providing the liquidity guaranty.

e) American Life and General Insurance Company was presented with the concept and would consider providing the liquidity guaranty with further information and after internal review of whether or not their participation was desirable from a business vantage.

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As a fall-back position, one or more of the OECS NIS or NDBs would probably provide the liquidity guarantee.

3.2.7 The U.S. Investor

There may be a technical requirement in the HG program that may require the U.S. Government guaranty to be given to a U.S. investor, even in a Local Currency Bond Issue where no U.S. investor may be involved. It would be preferable if the requirement for a U.S. investor could be waived by USAID, if so permitted under the Foreign Assistance Act (FAA). A determination by USAID Legal Counsel should be sought on this point. If a U.S. investor requirement were to be a program element, this would only add costs (no entity would do this without a fee) to the OECS HG without any concomitant benefit; in fact, it would complicate the structuring of a Local Currency Bond Issue by introducing another layer of financial intermediation.

The term "eligible" investor is defined in the regulations as "(1) United States citizens; (2) corporations, partnerships, or other associations including nonprofit associations, created under the laws of the United States any state or territory thereof, or the District of Columbia and substantially beneficially owned by United States citizens; and (3) foreign corporations, partnerships, or other associations wholly (95% or more) owned by one or more such United States citizens, corporations, partnerships, or other associations."

Presuming the U.S. investor requirement will be imposed, there are several options:

a) U.S. financial institution, e.g., Citicorp or Bankers Trust Company, which are major underwriters in Puerto Rico for 936 financing and thereby, have a business interest in gaining additional exposure to potential OECS clients as a participant. These financial institutions could also serve as the bond trustee and this may suffice in terms of fee requirements.

b) U.S. insurance company, e.g., American Life and General Insurance Company (ALGICO), which has a beneficial interest in promoting a local

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currency HG as an investment vehicle for its funds and for the attendant publicity and goodwill it may garner as a participant. ALGICO expressed the concerns that it incur no financial exposure serving as the U.S. Investor and the need to earn some fee for this service. ALGICO could obtain a fee for this service as part of also providing a liquidity guarantee, if it decided to perform that function as well.

c) Private voluntary organization, e.g., Cooperative Housing Foundation (CHF), which has a long-term association with the HG program, has an interest in promoting local currency HGs and could benefit by the goodwill in developing future business in the OECS. CHF could be compensated for serving as the U.S. investor by channeling the OECS HG technical assistance component through CHF. Another possible PVO would be the Cooperative League of the U.S.A. (CLUSA); no conversations were held, however, with CLUSA.

d) U.S.-owned companies, e.g., Coopers and Lybrand or Morning Star Holdings, Ltd. There are few U.S. companies operating in the OECS and no banks. Thereby, there are few opportunities to use U.S. companies to serve in the investor role. There are, however, several potential U.S. companies, e.g., partnerships, such as Coopers and Lybrand, which is associated with the U.S.-based firm, and would have an interest in participating in the HG to further their business services group, Colybrand Company Services, Ltd., which may also serve as an advisor, administrator or equity investor for the Capital Markets Entity. Other small, U.S.-owned companies, such as Morning Star Holdings, Ltd. could function as the investor but may not be very substantial in-and-of themselves.

The U.S. investor requirement can probably be resolved, depending on whether the investor incurs any contingent or direct liabilities and whether the compensation paid does not impinge on the HG's feasibility.

3.2.8 Summary/Local Currency Bond Issue

There are a sufficient number of qualified institutional participants, sufficient apparent demand for HG housing loans, abundant local liquidity to purchase bonds and a willingness to try to structure a HG transaction that a Local Currency Bond HG has real potential of being organized.

The approval (in the form of requisite exemptions) of each OECS country and the ECCB should be obtained for the OECS regional HG structure. The OECS HG should be non-controversial because most island governments give substantial financial support for lower-income housing and would most likely welcome regional resources for this purpose. ECCB has indicated general support for promoting regional capital markets and, thereby, should be supportive of a regional HG.

3.3 ALTERNATIVE 2: U.S. DOLLAR COLLATERALIZED LOAN

3.3.1 The Collateralized Loan HG Structure

A collateralized loan is one in which a foreign lender lends funds to a second local institution in a foreign currency (e.g., US dollars) and the local institution (e.g., the HG Capital Markets Entity or a local insurance company) on-lends an equivalent amount of local currency to the foreign lender's ultimate borrower, e.g., OECS primary lenders for HG loans. The local institution serves as an intermediary for the foreign lender; the local currency loan is at acceptable interest rates to the local lender, reflects local market conditions and is not tied to the foreign currency loan terms. The foreign currency loan portion is usually invested off-shore in foreign investments at a spread over the foreign loan interest rate. This financing structure was recommended to CDC, in a prior consultancy, and CDC is now negotiating with an OECS bank a possible collateralized loan transaction for one of its British sterling loans in the OECS.

The U.S. Dollar Collateralized Loan HG could be structured as follows (refer to Chart 2: Collateralized Loan Structure HG):

a) U.S. dollars would be raised through the customary HG procedure of a U.S. investor on-lending funds to the OECS borrower in U.S. dollars and secured by a U.S. Government guaranty. (Options for raising the U.S. dollars in the OECS and Puerto Rico are discussed below in Section 3.3.3)

b) The U.S. dollar would be on-lent to an OECS borrower. The OECS borrower could be the Capital Markets Entity (described above in Section 3.2), providing an intermediation service for a pool of OECS investors, or a major OECS financial institution, such as an insurance company or consortium of insurance companies.

c) The OECS borrower would provide acceptable (to USAID) institutional guarantees to secure the U.S. Government guaranty to the U.S. investor.

   The U.S. Government could also receive additional stand-by collateral from the OECS

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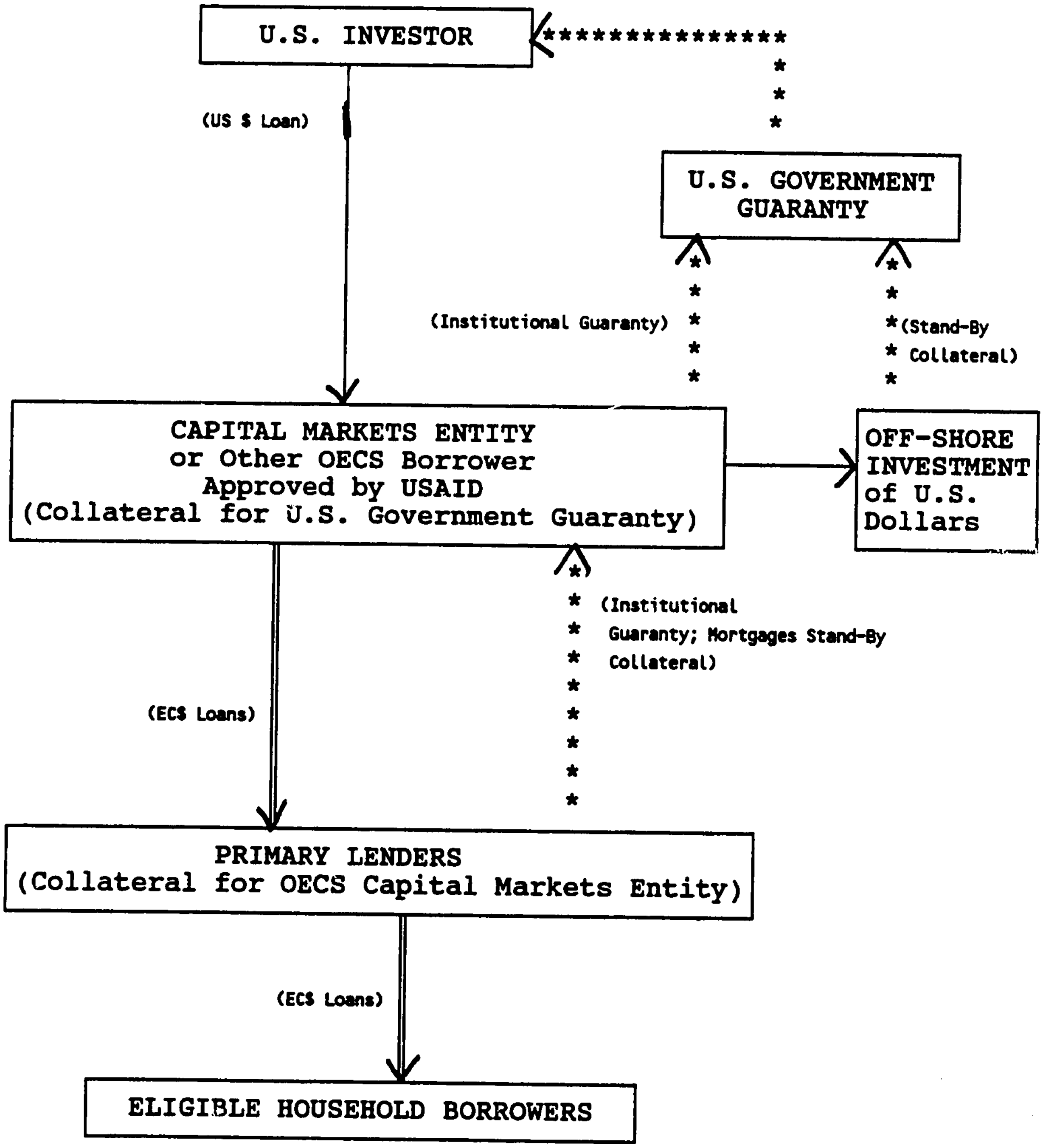
CHART 2:

COLLATERALIZED LOAN STRUCTURE HG



Legend:

——— U.S. Dollar Loan
═══ EC Dollar Loan
*********** Guaranty

borrower. As discussed, below, this could be in the form of stand-by assignments of the U.S. dollar off-shore investments and primary lender collateral provided for the local currency loans. No host country guarantees would be provided under this scenario.

d) The OECS borrower would either (i) directly supply the equivalent local currency (EC dollars) for the U.S. dollar loan for on-lending to HG participating primary lenders or (ii) raise the local currency within the OECS through loans or bonds, secured by the OECS borrower, for on-lending to HG participating primary lenders.

e) The interest rate and loan terms of the U.S. dollar and local currency loans would not be tied in any manner and, thereby, each loan structure would be lent in accordance with market conditions for their respective geographic areas.

f) The OECS borrower would invest the U.S. dollar loan off-shore in investments that yielded a spread over the U.S. dollar loan debt service requirements. This would serve two purposes: (i) minimize the foreign exchange rate risk as the U.S. dollar would be in "hard" currency investments yielding cash flow in "hard" currency and (ii) provide additional collateral for the U.S. Government guaranty (probably in the form of a stand-by assignment of the off-shore investment assets in the event of OECS borrower default). For example, one insurance company would employ the U.S. dollar loan proceeds for expatriate/foreigner mortgages (lent in U.S. dollars) to finance purchases of property on their luxury tourist facility in St. Lucia; the insurance company estimated it could use US $20 million.

g) Participating primary lenders would provide the same collateral to the OECS borrower as that described in Alternative 1, above, and in accordance with the Panama HG model.

h) Participating primary lenders would originate home loans to eligible households as defined under the HG program.

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3.3.2 Demand for Collateralized Loan Structure By OECS Borrowers

The OECS demand for the collateralized loan transaction appears to be substantial for many forms of business. The Caribbean Financial Services Corporation has recently (1991) begun offering a similar financing format under what it terms "currency swap". In a previous study conducted by the consultant there was substantial demand evidenced for this financing. In this current study for USAID, three insurance companies indicated a strong interest in this financing vehicle; one insurance company indicated it could use at least US $1 million, a second insurance company US $3 million and a third insurance company US $20 million. Approval under currency exchange regulations would have to be obtained, however, no one indicated any impediment to obtaining approval.

3.3.3 Alternative Sources for the U.S. Dollar Loan

There is also the possibility of a cost effective alternative to raising the US dollars loan in the United States. With so many U.S. dollars being reported by some OECS banks as being available in the OECS, and the substantial need to invest these funds off-shore, it may be possible to raise the U.S. dollars locally in the OECS, with U.S. Government guarantees, at a lower interest rate than obtainable in the United States.

Another possibility is to raise the U.S. dollar loan for the OECS HG in Puerto Rico, either with 936 funds or retail bank loans. 936 funding has certain impediments, as discussed below in Section 5.0. The retail loan market in Puerto Rico appears to be very liquid because of all the 936 funds available. Citibank reported that a 20-year retail loan (without U.S. Government guarantees) was recently placed at 8.05% interest; with a U.S. Government guaranty, the interest may even be below 8%.

3.4 TYPES OF LOANS

There are three considerations regarding primary lender loans:

- Housing Loans to eligible household borrowers
- HG financing for primary lenders

- Loan Participation (co-financing) by primary lenders

3.4.1 Housing Loans to Eligible Household Borrowers

The proposed OECS HG would permit loans for any eligible housing-related purpose for households with qualifying incomes.

Home loans would include:

- Home improvements
- Plot purchase and/or titling
- Squatter area upgrading (infrastructure loan for each household)
- Purchase of existing house
- New construction

The major use of HG housing loans will most likely be for home improvements and plot purchases. Relatively little HG program loan funds will probably be used for new construction due to the high cost to build new homes. In the Barbados HG, over 90% (3,400 out of approximately 3,600 loans)[24] of the HG loans were for home improvements and that should be an indication of similar demand in the OECS. There is a relatively low population increase in the OECS, estimated at 1% to 2% per annum, due to significant out-migration of working age persons for employment purposes. The major demand for new construction then stems from the need for replacement housing and relocatees to places of employment, e.g., tourism and urban areas.

Home improvement loans have substantial demand in OECS countries because many homes are made of wood (which are damaged over time by tropical living conditions) and overcrowding; both conditions create demand for home improvements and expansion. Further, in urban areas, there is an increasing demand for rental housing; home improvement loans could be used for additions to accommodate urban renters and provide additional income for eligible borrowers. A third use for home improvement loans would be for squatter home upgrading, both for infrastructure and home improvements.

There is significant plot development for lower-income households in several OECS countries, e.g., as described above in St. Lucia, and to a lesser extent in Dominica, Grenada and St. Vincent. Thereby, a significant portion of HG funds could potentially be used for plot purchases by eligible households and/or for titling squatter plots.

New construction would have to be either subsidized or self-help housing to be affordable to below-medium households. There are some indications of small programs for these types of housing, e.g., in Dominica for Bath Estates and the Pound Area, but it does not appear extensive in the OECS countries. Thereby, the likelihood is that relatively modest amounts of HG funds will be used for new construction.

3.4.2 HG Financing For Primary Lenders

There are two basic methods for on-lending HG funds to primary lenders:

a) Refinancing housing loans

b) Block advances (loans) to primary lenders

There are advantages and disadvantages to both on-lending approaches. Most HG programs and the closest examples, i.e., the Barbados HG and the Home Mortgage Bank of Trinidad, use the refinance approach. Either the loan refinancing or block advance methods are acceptable.

Under either refinancing or block advance mechanisms the primary lenders would guarantee repayment of the HG funds to the Capital Markets Entity; the home loans would be standby collateral exercised by the Capital Markets Entity only in the event of default by a primary lender. This is discussed in more detail, below, under section 3.5 Primary Lenders.

3.4.3 Loan Participation (co-financing) by Primary Lenders

The Panama HG model contained a requirement that primary lenders contribute 20% of each HG loan out of their own resources. A 20% to 25% participation by primary lenders should also be considered for the OECS HG, both to:

a) provide additional security for the Capital Markets Entity, and

b) to extend HG financing to more eligible households.

3.4.4 UNDERWRITING CRITERIA IN THE OECS

The underwriting standards used by many OECS financial institutions providing housing loans are more liberal than generally used in HG programs. A limited sample of financial institutions in St. Lucia revealed that the debt service to income ratio is often between 30% to 50% of a household's income. For example:

Lender	Debt Service: Income Ratio
St. Lucia Cooperative Bank	30% to 45%
Credit Unions	Up to 50%
Urban Development Corporation	33.3% to 50%

What appears to be unusually liberal underwriting standards is sometimes off-set by other collateral, e.g., Credit Unions often require share purchases/compulsory deposits of 40% of a loan amount. Thereby, the OECS HG may want to incorporate local customary lending practices if it can be established that there are acceptable collection levels being achieved and/or other forms of collateral justify the more liberal underwriting standards.

A second issue regarding underwriting criteria is that of the definition of family income to ascertain HG eligibility. In the Barbados HG, 100% of the primary earner's income, plus only 50% of the secondary earner's income, was used to qualify households for income eligibility. Children were excluded from the household family income calculation. Given the high cost of construction and plots in the OECS countries, this definition of eligibility for the OECS HG would be beneficial to qualify more households.

3.5 PRIMARY LENDERS

3.5.1 Lender Participation

The study period only permitted a very limited sampling of OECS lenders to identify potential participating lenders for the proposed OECS HG. Even at this cursory level, there were strong indications of lender interest amongst those financial institutions that serve both broad-based and lower-income households. One large commercial bank exhibited no interest at this time because of substantial excess liquidity. All other lenders contacted evidenced interest in participating in the HG program and include:

- St. Lucia Mortgage Finance Company (SLMFC) - Financial Statement in Appendix 3.
- Credit Unions (3 large St. Lucian community-based credit unions interviewed)
- St. Lucia Cooperative Bank (privately held commercial bank)
- Bank of Nevis (privately-held commercial bank) - Financial Statement in Appendix 3.
- National Commercial Bank of Dominica (government-owned commercial bank) - Financial Statement in Appendix 3.

In addition, Commonwealth Development Corporation (CDC) controls two dormant mortgage finance companies (with financial assets in place) in Dominica and St. Vincent that could potentially be reactivated as separate or joint venture institutions. CDC is the majority stockholder in SLMFC and SLMFC could provide the managerial requirements for operating the two additional finance companies.

No contact was made with lenders on Grenada, St. Kitts, or Antigua to determine interest on these islands.

Based on the response received by the consultant, there are strong indications for interest in HG program participation by lenders and the response would be expected to be similar on islands not

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visited especially in Antigua, where there is a reported mounting lack of liquidity in the economy.

3.5.2 SLMFC Technical Assistance to Credit Unions

SLMFC has also indicated that they would be interested in serving as a technical assistance resource in St. Lucia to provide technical assistance to, and perhaps even some form of additional guarantees for, Credit Union lenders participating in the HG program. SLMFC's role could improve credit union home lending capacity and sophistication.

3.5.3 Creditworthiness of Lenders

The "CAMEL" test of creditworthiness was not attempted as part of this study to analyze potential lenders. Financial statements on a limited sample of potential participating lenders are in Appendix 3.

The limited amount of information available, however, did indicate a sufficient capital base for most of the lenders. The Bank of Nevis had a 1990 capital: asset ratio of 7%. The National Commercial Bank of Dominica had a 1990 capital: asset ratio of 17%. The SLMFC will shortly receive additional capital contributions that will raise its capital: asset ratio to about 19%. St. Lucia credit unions do not now take deposits so most of their assets are capital. OECS credit unions are generally experiencing substantial growth in their financial resources. In the 1987 through 1990 period, OECS credit unions financial resources (share plus deposits) generally grew at an average annual rate of 30.8%, from EC $42.5 million at the end of 1986 to EC $124.4 million at the end of 1990. This is sparse information on which to evaluate the credit-worthiness of OECS potential participating lenders but it does provide a glimpse that indicates healthy financial institutions.

3.5.4 Collections

Both St. Lucia Mortgage Finance Company and St. Lucia Cooperative Bank indicate that their collections experience has been excellent, with almost no defaults and virtually no loss on housing loans. The St. Lucian credit unions indicated that they did not have records to provide collections

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data (to be fair the consultant met with representatives of the 3 credit unions away from their offices and the officials probably just did not personally know any details and so indicated they had no records).

Collections experience was not investigated with any other lenders in this study. Based on the consultant's prior study a very limited sample of lenders in Dominica, St. Vincent and Nevis similarly indicated that collections were excellent, minimal defaults occurred and virtually no loan losses were incurred. There does not appear to be any political, legal or custom constraints in the OECS precluding efficient foreclosure on defaulting borrowers. Thereby, efficient loan servicing can be implemented and direct and meaningful incentives are in place for a borrower to avoid loan default.

3.6 COLLATERAL FOR A HG LOAN

USAID's collateral requirements for the U.S. Government guaranty should be modelled on the Panama HG (Loan Number 525-HG-013), which essentially used guarantees by primary lenders, with the underlying mortgage loans as stand-by collateral in case of default by a primary lender. Refer to Appendix 4. for a description of the Panama HG collateral requirements. In the Panama HG, primary lender collateral replaced host country guarantees for HG collateral requirements; this would also be proposed for the OECS HG.

The basic collateral requirements for primary lenders in the Panama HG included:

a) Over-Collateralization of HG loan portfolio by 125%

b) Full institutional guarantees by the primary lenders

c) Individual mortgage loans as stand-by collateral

d) Loan substitution in HG portfolio for any defaulting loan(s)

e) One semi-annual prepayment of debt service by the primary lenders

f) Co-financing (participation) by primary lenders in each household loan (20% co-financing)

g) Primary lenders must meet institutional credit worthiness test ("CAMEL" rating)

h) Annual external audits for each primary lender

i) Acceptable underwriting criteria must be used by primary lenders

The Panama HG differs in some respects from the proposed OECS HG, mainly in the emphasis on types of loans and lenders. The Panama HG emphasized new construction; the OECS HG will probably emphasize small loans for home improvements. The Panama HG emphasized banking institutions exclusively; the OECS HG may well have substantial credit union lending. The differences between Panama and the OECS may require some adjustments to the criteria imposed on lenders, e.g., first mortgage liens may not be justified for small home improvement loans (substitute collateral may be acceptable, such as compulsory deposits now used by credit unions, second mortgages, or guarantors) and the test for capital adequacy may have to be adjusted to evaluate credit unions, which are substantially financed by member capital.

The original Panama HG proposed establishment of a sinking fund, but it was later deleted from final program design; the sinking fund concept in conjunction with a mortgage insurance scheme should be considered for the OECS HG. A properly structured sinking fund, as part of a mortgage insurance scheme, would add significantly to collateral for the U.S. Government guarantee and serve as a basis for establishing a home loan mortgage scheme for all housing loans. Refer to Appendix 5 for a concept paper, prepared by the consultant, on a Housing Loan Insurance Scheme proposed for the impending HG loan in Sri Lanka. The Sri Lankan scenario differs markedly from that in the OECS, but the basic financial structure of the home loan insurance scheme proposed in Sri Lanka provides background information.

A sinking fund/home loan insurance scheme will add costs for borrowers; an evaluation of the benefits for additional collateral as compared to additional costs should be undertaken. Many housing lenders now charge guarantee fees on self-insurance schemes for home loans originated by them. It may not be more expensive to home loan borrowers with a regional OECS home loan insurance scheme, if that regional scheme can replace lenders self-insured schemes. Self-insured schemes by lenders range from 3% of the insured risk (risk is generally 15% to 20% of the whole loan) to 2.5% on the whole loan amount.

4.0 TECHNICAL ASSISTANCE REQUIREMENTS

4.1 TECHNICAL ASSISTANCE

4.1.1 Program Delivery Plan TA

Although many of the elements are evident in the OECS for successful implementation of a local currency HG, there is no technical resource or organization to pull all the elements together into a final program. The OECS, in particular, lacks management depth and what technical people are available are generally overloaded with their day-to-day responsibilities. A CFSC, CDC, or SLMFC might evidence genuine interest in sponsoring a Capital Markets Entity, however, without technical resource back-up, they may not be able to devote appropriate attention to implement the concept. Thereby, USAID could fund a technical advisor to prepare a Program Delivery Plan (PDP), which would entail evaluating institutions, organizing the structure and bringing investor/Capital Markets Entity/primary lender entities together, as well as preparing formal documentation for USAID for the HG loan.

4.1.2 Housing Bond Structure TA

The Home Mortgage Bank of Trinidad (HMB) has expressed a willingness to provide technical assistance to an OECS Capital Markets Entity. Aside from travel expenses and some minor other expenses, HMB's technical assistance should be inexpensive. If HMB is unable to provide the technical assistance, the Federal Home Loan Mortgage Corporation (which has provided on-going technical assistance to HMB in housing bond issuance) may be called upon to provide the requisite assistance.

4.1.3 Sinking Fund/Home Loan Insurance Scheme

The HMB has indicated that the FHLMC (Freddie Mac) and/or the Canadian Mortgage and Housing Corporation could potentially provide assistance in structuring a home loan insurance scheme. The HMB is considering implementation of a mortgage insurance scheme in Trinidad.

This technical assistance should be available at little cost. Barbados has a government mortgage insurance scheme administered by the Insurance

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Corporation of Barbados; the Insurance Corporation may potentially be prevailed upon (instead of FHLMC, if it is unavilable) to provide technical assistance in initiating a home loan insurance scheme. Again, as this is a local resource, technical assistance may be available at minimal cost.

4.1.1 Building Technology TA

The RHUDO/Jamaica's Caribbean-wide responsibilities in disaster and hurricane relief efforts, coupled with the USAID/Barbados Mission BNTF II program, would benefit from initiating technical assistance under the proposed OECS HG in two areas:

- Hurricane Damage Prevention Information
- Low-Cost Housing and Housing Components Design to reduce hurricane damage

Information assembled under this TA could be passed along to participating lenders and casualty insurers for dissemination to household borrowers. Primary lenders may be requested, for example, to encourage borrower adoption of these housing and/or components designs into new construction or home improvements.

4.1.5 Credit Unions TA

USAID has a worldwide program to strengthen credit unions. The OECS HG would probably involve many of the OECS credit unions as primary lenders. The credit union movement is rapidly growing in the OECS and could greatly benefit from TA at this embryonic stage to institute proper loan orgination and servicing systems; the HG loans could serve as the basis for providing this TA to credit unions. In addition, many credit unions appear to lack resource mobilization capacity and TA could significantly enhance their capability to generate funds well beyond the HG program.

4.1.6 Long-Term Advisor

A long-term advisor, seconded to the Capital Markets Entity, would be extremely beneficial to not only implementing an OECS HG but to also advancing other capital markets functions that could be introduced by the Capital Markets Entity. A USAID-funded long-term advisor would be a substantial inducement for a Capital Markets Entity to vigorously pursue an

OECS HG program. Overhead is one factor hampering Eastern Caribbean entities from expanding, because the market is so small that the start-up costs may be prohibitive. With USAID assistance, the Capital Markets Entity start-up costs would be minimal and, if successful, the Capital Markets Entity could evolve, over time, into a fiscally self-sustainable and profitable capital markets financial intermediary.

4.1.7 Mission Housing Officer

Once the OECS HG is approved, it would be advantageous to have a HG Housing Officer assigned to the USAID/Barbados Mission. The Housing Officer would provide technical back-up to the Capital Markets Entity and the long-term advisor, administer the HG program, evaluate a new HG for Barbados, and also assist the Mission in implementing the Private Sector Initiatives and the BNTF II programs that are elements of the 1991-1995 Mission strategy; both programs contain substantial housing, infrastructure, and environmental planning components and privatization of governmental services (particularly related to infrastructure and urban services); all these activities areas are ones to which a Mission Housing Officer could constructively contribute.

4.2 TECHNICAL ASSISTANCE BUDGET

The technical assistance described, above, would involve the projected following annual budget allocations:

Technical Assistance	1992 Budget	1993 Budget
Program Delivery Plan TA	$ 80,000	N/A
Housing Bond TA	20,000	20,000
Housing Loan Insurance Scheme TA	50,000	20,000
Building Technology TA	30,000	30,000
Credit Unions TA	40,000	40,000
Long-Term Advisor (seconded to the Capital Markets Entity)	150,000	160,000
Total TA	$370,000	$270,000

If a Mission Housing Officer position was established, it could be project-funded or direct hire. If it is project-funded the total TA budget would be increased as follows:

Mission Housing Officer (Housing Officer project-funded; line item not required if direct hire)	$150,000	$160,000
Adjusted Total	$520,000	$430,000

5.0 936 PROGRAM

Section 936 of the U.S. Internal Revenue Code provides certain tax incentives to U.S. Corporations operating in Puerto Rico to provide funds for on-lending for eligible development projects in the Caribbean Region. The 936 program usually results in a 100 to 200 basis point savings in loans for eligible projects. Most 936 financing is in 5-year loans; loans rarely exceed 10-years because of the 936 tax incentive structure. The Government of Puerto Rico recognizes the need for longer-term financing and is attempting to initiate a liquidity mechanism to roll-over 936 loans, probably through the Development Bank of Puerto Rico.

Even if the loan structuring problem can be resolved, there is still the questions of whether the U.S. Treasury will authorize the use of the USAID Housing Guaranty in conjunction with 936 financing. Treasury believes that a U.S. Government guaranty is an additional subsidy over and above the tax exemption provided investors under the 936 program and, therefore, U.S. Government guarantees should not be used. The USAID Private Sector Revolving Fund Loan Guaranty Program has indicated that Treasury has precluded use of that USAID program's guarantees in conjunction with 936 financing.

Citibank, in Puerto Rico, did point out some interesting arguments to be presented to Treasury for permitting HG authority to be used in conjunction with 936 financing. Apparently, other forms of U.S. Government guarantees are now used with 936 financing, including: GNMA, FNMA, FHLMC and HUD guarantees.

If the loan structuring problem can be resolved and U.S. Treasury approval obtained, 936 financing for an OECS HG would be beneficial under Alternative 2: U.S. Dollar Collateralized Loan.

6.0 MAJOR IMPLEMENTATION ISSUES SUMMARY

The mission for this study was to present a concept paper on initiating a HG in the OECS. It is not a completed program but, rather, an identification of a possible structure for a HG program if all the apparent elements for a successful HG can be brought together. As a concept paper, therefore, there are a number of outstanding issues that need to be resolved to bring the concept closer to an actual program.

6.1 STRUCTURE ACCEPTABLE LOCAL CURRENCY HG

a) Acceptable sponsoring organization and Capital Markets Entity
b) Workable interest rate and term on bonds
c) Arrange liquidity mechanism for bonds, if necessary
d) Identify acceptable and creditworthy primary lenders
e) Determine absorption rate for HG funds
f) Obtain necessary government exemptions for a regional bond Issue
g) Determine if HG program will provide advances to primary lenders or refinance loans

6.2 STRUCTURE ACCEPTABLE U.S. DOLLAR COLLATERALIZED LOAN HG

a) Alternative to local currency HG if that concept proves unworkable
b) Determine whether U.S. dollars can be raised locally from OECS investors
c) Determine if local insurance companies are acceptable borrowers for U.S. dollar loans, i.e., acceptable corporate guarantees for HG debt service payment and exchange rate risk.

6.3 OBTAIN INDIVIDUAL OECS COUNTRY AND ECCB APPROVALS FOR HG LOAN

6.4 DETERMINE ACCEPTABILITY OF ALTERNATIVE COLLATERAL FOR U.S. GOVERNMENT GUARANTY

a) Country risk analysis, if necessary
b) Determine acceptability of primary lender and home loan collateral substituting for host country guarantees, i.e., modified Panama HG model; determine feasibility of implementing program based on primary lender collateral.

6.5 EVALUATE SINKING FUND TO FURTHER COLLATERALIZE U.S. GOVERNMENT GUARANTY AND TO ESTABLISH REGIONAL MORTGAGE INSURANCE SCHEME

a) Evaluate added costs to borrowers against collateral benefits for the U.S. Government

b) Evaluate lender receptivity, cost effectiveness and security of a regional OECS loan insurance scheme over self-insurance schemes by lenders

6.6 DETERMINE NEED FOR A U.S. INVESTOR

a) Determine if a U.S. investor is required for a local currency gond issue not involving U.S. dollars
b) Determine if a U.S. investor is required for a U.S. dollar HG with U.S. dollars raised on the OECS
c) Determine if competitive bidding is applicable for a local currency bond issue
d) Determine eligibility and costs of potential U.S. investors if such investor is required

6.7 DETERMINE MEDIAN INCOME FOR OECS COUNTRIES

a) Determine if there is to be one median income for all OECS countries or separate median incomes for each country
b) Determine if qualifying incomes include only 50% of secondary earner income
c) Determine HG loan qualifying criteria (a) loan amounts affordable to below-median households or (b) to require eligible households for each loan.

6.8 DETERMINE HG AUTHORIZATION LEVEL AND DISBURSEMENT SCHEDULE

a) Determine if the OECS is to be defined as one country or six countries. Determine if the OECS region is restricted to US $5 million in total under the Worldwide Private Sector Housing Guaranty Project or can it receive a higher authorization if demand and country risk analysis determine a higher level is justifiable
b) Determine whether OECS HG should be at US $10 million or at another level of authorization
c) Determine feasible disbursement schedule

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6.9 EVALUATE EASTERN CARIBBEAN UNDERWRITING CRITERIA FOR HG

a) Determine acceptability of alternative forms of collateral to first mortgages
b) Determine acceptable income: debt service ratio, with and without alternative collateral
c) Determine if Barbados HG qualifying household income criteria is acceptable

6.10 DETERMINE IF HG LOAN GUARANTEES WILL BE APPROVED BY U.S. TREASURY FOR 936 FINANCING

a) 936 funding could potentially be applicable under Alternative 2: U.S. Dollar Collateralized Loan HG
b) If Treasury approval obtained, evaluate 936 Loan Structure for long-term HG loans

6.11 DETERMINE LEVEL OF TECHNICAL ASSISTANCE FOR OECS HG

a) Program Delivery Plan TA
b) Housing Bond Issue TA
c) Home Loan Insurance Scheme TA
d) Building Technology TA
e) Credit Unions TA
f) Long-Term Advisor (Seconded to Capital Markets Entity)
g) Mission Housing Officer

a?

7.0 CONCLUDING REMARKS

This is a concept paper not a completed program. Given the preliminary nature of the field investigations, it was quite positive to learn of the many pieces that already exist for putting together a successful local currency HG. Some of the major pieces include:

- Willing local OECS investors to purchase HG-related housing bonds on a long-term basis; OECS investors having substantial liquidity well beyond potential HG requirements.

- Willing primary lenders, who traditionally serve the general population and others who serve mainly the below-medium income group, expressing interest in participating in an OECS HG.

- Significant apparent demand for home improvement loan and plot financing for lower-income household. (There is also substantial financing demand for new construction in the OECS, however, the high cost of new construction, in comparison with anticipated maxium HG loans, may render new construction impractical under the HG program).

- Several qualified existing local OECS entities to sponsor a Capital Markets Entity for a HG and who would be anxious to also expand into other capital market functions over time.

- Willing equity investors to capitalize, and/or provide guarantees for, a HG Capital Markets Entity that would allow it to expand its capital market functions.

- Available excellent technical assistance in the region or from a U.S. Government agency, for structuring a housing bond issue at little or no cost.

- Available technical assistance, both regionally and from a U.S. Government agency, for assisting in the implementation of a home loan insurance scheme for the OECS region.

A regional HG program will further advance the regionalization of informal capital markets that may, in the future, then promote more formal associations with other capital markets in the Caribbean, or at least serve to provide greater flexibility for achieving long-term debt and equity financing in the OECS countries.

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As a concept, a regional local currency HG appears to be an excellent idea; only increased effort, sponsored by USAID, will determine if the concept merits realization into a program.

Final Report, November, 1991

FOOTNOTES

1. Capital Markets and Private Sector Development in the OECS. Draft Report, October 11, 1991. By: Thomas Downing, David C. Shorey, and David M. Staples. Funded by USAID, Regional Development Office/Caribbean. Several references to government housing finance, e.g. Appendix B.

2. Annual Action Plan, FY 92-93, Regional Development Office/Caribbean, USAID, January, 1991. Pages 5,6,11 and 12.

3. Statistical data summarised from three documents:

   - Long-Term Economic Prospects of the OECS Countries. The World Bank, February 15, 1990.

   - Urbanization In the Caribbean: Prospects and Management Priorities. The Urban Institute, October 1990. USAID

   - Caribbean Countries Economic Situations, Regional Issues, and Capital Flows. The World Bank, 1988

4. OECS Capital Markets and Financial Institutions Project. Robert F. Nathan Associates, Inc. and Price Waterhouse. March 3, 1989. USAID

5. IBID.

6. Economic and Financial Review, Volume 8, No.4, 4 December 1990. The Eastern Caribbean Central Bank.

7. Op.Cit. OECS Capital Markets and Financial Institutions Project.

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18. Government of Dominica, Bath Resettlement Scheme. UNCHS. 1989

19. Government of St. Vincent and the Grenedines, Housing Sector Overview, Sites and Services and Squatter Upgrading. Len Ishmael. UNCHS. February 1989

20. Government of Grenada, River road Squatter Upgrading. UNCHS. March 1989

21. Carlos Burns, Chief Executive Officer, Bankers Trust Caribe Capital Markets, Inc. Interview, November 1, 1991.

22. Hastings R. Daniel, Manager, Nevis Housing & Land Development Corporation. Interview, July 1991

23. Rawlinson A. Isaac, Manager, The Bank of Nevis. Interview, July 1991

24. Evaluation of the Barbados HG. Consultant study performed for USAID, circa 1990.

APPENDIX 1:

STATEMENT OF WORK - CONSULTANT MISSION

SCOPE OF WORK

Concept Paper for Eastern Caribbean

Housing Guaranty Program

A. Background

The Organization of Eastern Caribbean States is a confederation of small island nations of the Caribbean. Their economies have been primarily agrarian. In the past decade, however, shifts to manufacturing, services and tourism activities have resulted in a rising level of urbanization. An analysis of the region, Urbanization in the Caribbean: Prospects and Management Priorities provided substantial information about these changes in the island nations. A major impact of the change is the need for housing.

An important limitation in the OECS countries has been the lack of regional capital markets and a mortgage financing system to mobilize investment to meet housing needs. National insurance companies, credit unions and building societies are searching for ways to access adequate capital for shelter for all income groups.

The Commonwealth Development Corporation has been working with OECS countries and is examining ways to establish a regional structure for providing mortgage financing in conjunction with various private sector insurance and banking corporations. CDC has expressed interest in working with AID on the establishment of such a vehicle. Moreover, several large insurance companies in the region would like to participate in such an activity (see attachment).

The purpose of this assignment will be to assist RHUDO/CAR to develop a concept paper for a Housing Guaranty Program to support this development initiative.

B. Work Tasks

The activities to be carried out include the following:

1. Review all pertinent data for this assignment such as RDO/C Regional Capital Markets Study, PRE/H World Wide Housing Guaranty Program Project Paper, RDO/C programming and strategy documents, studies of the 936 Investment Program for Puerto Rico, etc.

2. Identify the countries in the OECS who would participate in this program including which institutions by country and the level of HG resources required. Particular emphasis should be placed on demand by low income families, but demand of middle income families should also be considered. Since this is a concept paper, a demand analysis will not be required. Rather, a rough estimate of potential absorbtion of resources over a two to three year period should be provided.

3. Identify the structures through which resources would flow. This analysis would look at which organization at the regional and national levels would pass funds and originate mortgages. The consultant should determine how the HG

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program would be structured. For example, would a HG loan be required, would a USG guarantee of a local currency loan suffice or is there another preferred financial operation. The consultant should also examine who would guarantee the HG loan. Whatever guarantee is provided should be consistent with HG legislation.

4. Examine the feasibility of utilizing 936 financing of the program if indeed a HG loan is decided to be the appropriate vehicle for providing resources in support of the project. The consultant should contact private banks and appropriate USG agencies to determine the feasibility.

5. Develop a Technical Assistance Program in support of the development objectives, program management and auditing requirements. The consultant should identify the long and short term technical assistance needs of the program as well as the sources of funding.

C. Supervision

The consultant should work under the direction of RHUDO/CAR and in close collaboration with the RDO/C.

D. Reports

The consultant should submit a concept paper to RHUDO/CAR and participate in discussions of the same with RHUDO/CAR, RDO/C and PRE/H as needed.

E. Time of Performance

The assignment should be initiated o/a August or September and last 20 working days, fourteen of which will be in the Caribbean.

F) Budget

APPENDIX 2:

ECCB CAPITAL MARKETS ACTIVITY

A QUARTERLY PUBLICATION OF THE EASTERN CARIBBEAN CENTRAL BANK (ECCB) SEPTEMBER, 1991

THE ROLE OF THE EASTERN CARIBBEAN CENTRAL BANK IN THE DEVELOPMENT OF THE FINANCIAL SYSTEM

The Eastern Caribbean Central Bank area is comprised of eight (8) countries, namely, Anguilla, Antigua & Barbuda, Dominica, Grenada, Montserrat, St. Kitts & Nevis, St. Lucia, and St. Vincent & the Grenadines, with a combined area of 2,913 sq Km and a total population of 571,000.

The monetary and financial arrangements of the sub-region are fairly distinctive as it is headed by one of the few multinational Central Banks in existence. The only others are the Central African Monetary Union and the West African Monetary Union. They, however, differ from the ECCB in having a metropolitan power, France, as a member of their arrangements.

The financial system in the ECCB area as a whole can be described as underdeveloped with the commercial banking system, comprised of both foreign and local banks, being the dominant part of the sector with very few institutions operating at the medium and long ends of the market.

The economies of the area have experienced reasonable and steady rates of growth over the last five years and most of the countries have succeeded in balancing their budgets. It is therefore important for the continuation of economic progress that the private sector and the financial sector should play a leading role in the development effort.

A brief review of the existing financial system would be appropriate at this point. The Eastern Caribbean Central Bank was established in 1983 to succeed the Eastern Caribbean Currency Authority and is responsible for the regulation and development of the financial system. It has the power under Article 2 (e) of the Agreement "to regulate banking business on behalf of and in collaboration with the Participating Governments.

Continued on page two

MONEY AND CAPITAL MARKET DEVELOPMENT IN THE EASTERN CARIBBEAN CENTRAL BANK'S MEMBER STATES

In many developing countries today, the main sources of funds for medium and long-term lending are the domestic savings mobilized by commercial banks. These are usually supplemented by foreign savings in the form of loans from multilateral and bilateral institutions or from foreign banks. Only a small part of investment is funded by domestic or foreign equity. High debt to equity ratios will present few problems in an environment where firms continue to grow. However, once growth slows down or interest rates rise, the debt-service entailed by high debt to equity ratios strains the cash flow of enterprises and thereby increases their vulnerability. The main functions of money and capital markets are therefore, to establish a better balance between debt and equity, generate risk capital, encourage innovations, improve financial intermediation and reduce the potential for financial instability.

The member states of the Eastern Caribbean Central Bank (ECCB) are seeking to establish a stock market. But what in fact is a stock market? Like any other market, it is a place where items are bought and sold. In this case, the items traded are securities which could be one of three main types:

GOVERNMENT STOCK: issued by governments to raise money for financing developmental projects and programmes. They usually carry a fixed rate of interest.

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THE ROLE OF THE EASTERN CARIBBEAN CENTRAL BANK IN THE DEVELOPMENT OF THE FINANCIAL SYSTEM

Continued from page one

The purposes of the Bank are also clearly set out in Article 4. They are:

1. To regulate the availability of money and credit.

2. To promote and maintain monetary stability.

3. To promote credit and exchange conditions and a sound financial structure conducive to the balanced growth and development of the economies of the territories of the Participating Governments.

4. To actively promote through means consistent with its other objectives the economic development of the territories of the Participating Governments.

Four features of the ECCB are worthy of note;

1. The inability of any individual government to change the parity of the currency which must be by unanimous decision according to the Agreement.

2. The legal requirements to back the currency in circulation by a minimum of 60% of foreign assets.

3. The prescribed limitations on the Bank's ability to lend to governments.

4. The pooling of foreign exchange reserves.

The principal governing body of the Bank is the Monetary Council comprised of the Ministers of Finance of each member state, which provides guidelines and directives on matters of monetary and credit policy to the Bank.

The powers of the Bank are vested in a Board of Directors, one from each member country, which is responsible for the policy and general administration of the institution.

The Bank oversees a financial system consisting of 42 Commercial Banks with assets and liabilities in excess of EC 4 billion dollars. Over 150 Insurance entities, Credit Unions with assets in excess of EC$150 million, Development Banks, Finance Companies and Building Societies, and Offshore Banks.

The Central Bank has two important functions with respect to the financial system, namely

1. Regulation and supervision.

2. Development and innovation.

1. REGULATION AND SUPERVISION

Among the important attributes of a financial system are stability, safety and confidence. Central Banks on a worldwide basis have been charged, among their many functions, to carry out surveillance over the banking system so as to ensure the safety of depositors' money. The legal basis for this is laid down in laws covering the operations of financial institutions and giving powers of negotiation and intervention to the Central Monetary Authorities. The Banks are also obligated to keep reserves against their deposits and in some countries there are deposit insurance schemes. Of great importance, however, are the series of formal and informal contacts between the Central Banks and the commercial banks which go a long way towards establishing the framework and environment for a sound banking system in which depositors can have confidence.

2. DEVELOPMENT AND INNOVATION

Any society which is in the process of development and modernisation requires an efficient financial system which effectively mobilizes and allocates savings. On the one hand, there is the need for financial institutions and instruments which have wide geographic coverage and offer incentives for investing financial surpluses. On the other hand, there is also a financial need for institutions which can convert some of their savings to medium and long-term investments in order to stimulate economic growth. The existing financial system in the sub-region is somewhat unbalanced in that the dominant institutions, the Commercial Banks, control the largest share of financial resources, and according to their operations cannot borrow short and lend long. This, therefore, leaves the medium and long end of the market virtually starved of investible resources. In this context, the role of the Development Banks must be seriously expanded and new institutions like Venture Capital Funds and Unit Trusts etc. must be established to fill the vacuum in the financial system.

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The Central Bank through its research efforts and promotional activities must address the development of the financial sector as set out in the Agreement. We believe that full advantage must be taken of the existence of a functioning Currency and Monetary Union to facilitate this development.

With a strong and stable currency and moderate economic growth, the conditions are propitious for a major thrust in this direction. Our monetary policies are geared to continuing stability as providing positive incentives for savings and investments. It is the view that there is a need for the development of entrepreneurship in both the economic and financial sectors. We have been having and will continue to have meetings with all the various interests in the private and financial sectors to ensure the necessary development. We intend to see that there is an increased emphasis on training in the financial sector and the widest dissemination of information to educate and make our citizenry more sophisticated in these vital areas.

In the final analysis, this is one of the important areas of our economic life which needs urgent and particular attention if we are to modernize and develop our economies and societies and the ECCB is preparing itself to fulfil its mandate under the Agreement. [ ]

K. Dwight Venner
GOVERNOR
EASTERN CARIBBEAN CENTRAL BANK

MONEY AND CAPITAL MARKET DEVELOPMENT IN THE EASTERN CARIBBEAN CENTRAL BANK'S MEMBER STATES

Continued from page one

DEBENTURES: issued by companies to raise a specific amount of money at a fixed rate of interest.

STOCKS (or SHARES): issued by companies. Unlike other forms of investment where there is a fixed rate of interest, the return (dividend) on stocks and shares varies according to the success or profitability of the business in which the investment is made.

The stock market embraces the entire investment community which is normally linked by an extensive telecommunications network centred around the trading floor of the Stock Exchange. Anyone can invest in securities but it is important to assess your financial situation in order to ensure that you meet priority expenses before setting aside money for investment. This is the point at which you would get in touch with a stock broker who would conduct the transaction on your behalf.

A stock market is one aspect of money and capital market development in the ECCB States; the creation of a market for short-term instruments is another. The idea of developing a CARICOM Stock Exchange in which there is active participation by all member countries is regarded as a medium-term objective with the development and strengthening of national exchanges being seen as short-term goals. (In the course of consultations held in various territories with broad based committees comprising representatives from both private and public sectors, it has become evident that there is need for an institution such as a stock exchange or more appropriate, perhaps a brokerage house, in which both debt and equity instruments could be bought and sold. It was also noted that additional money market instruments were of general interests to managers of commercial banks and other institutions).

While the generation of economic surplus, by and large constitutes the basis for the emergence of finance, further economic development is contingent on how well these resources are mobilized and allocated. From our consultations in the territories, the main reason which have emerged in support of money and capital market development are as follows:

1. It will contribute to a more efficient allocation of funds from surplus to deficit units.
2. It will facilitate the conduct of monetary policy.
3. The needs of companies and investors could be met by the establishment of a secondary market in primary instruments.
4. The increased scope for diversifying investment will ensure that the area is better insulated against external shocks and disasters which may affect one territory differently from another.

Financial markets cannot however develop and operate efficiently if rules for trading, information disclosure etc. are not fully incorporated in the country's legislation. In particular the public needs to be protected from market manipulation. The regulatory body which fills this role is often the Securities and Exchange Commission (SEC).

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The SEC plays a similar role within the Capital Market as the Central Bank plays in the money market.

The need for investors protection derives from the nature of financial assets and the financial services industry. Regulation is desirable because the instruments traded in the securities market are unlike familiar consumer goods which can be seen or examined by the buyer. The prospective investor in the securities market has therefore to rely on information available to him on every particular issue and issuer to make a judgement. The objective of regulation is thus the protection of the investing public from unscrupulous practices in the sale of securities. In view of the fact that the Capital Market in the ECCB States is still in its embryonic stage, a Securities and Exchange Commission or supervisory body, by whatever name it is called will be required to focus primarily on capital market development until such time as there is a well developed and functioning securities market in place. The developmental function emanates from the widely held hypothesis that an efficient financial market can make important contributions to socio economic development and that healthy equity, bond and money markets are indicative of an efficient financial market.

The ECCB countries now need to take the necessary steps to remove the impediments to the creation of a single market in the area, in order to make the environment more conducive to capital market development. Amendments to the Alien Land-holding Licence Laws and harmonization of Exchange Control Regulations are two areas which require urgent attention. A suitable legal and regulatory framework and appropriate training in all the skills necessary for capital market activity would have to be undertaken at an early stage. It is our view that after the impediments to trading within our own currency area have been removed and after having established the rudiments of a stock exchange or brokerage house, we would be better placed to forge linkages with existing stock exchanges. In the meantime, the educational process is being pursued hand in hand with the establishment of a data bank for the compilation of detailed information on all the public companies which are known to exist in the area as a whole. [ ]

Errol N. Allen
DEPUTY GOVERNOR
EASTERN CARIBBEAN CENTRAL BANK

"PROSPECTS FOR AN EASTERN CARIBBEAN CENTRAL BANK AREA STOCK EXCHANGE"

As far back as 1987, there have been discussions within the OECS regarding the prospects for the development of a sub-regional stock exchange. In 1989, the final report of the OECS Capital Markets and Financial Institutions Project for the ECCB, sponsored by the USAID, was completed. Also, in 1989, as part of the Caricom Grand Anse Declaration, the establishment of the Caribbean Stock Exchange was raised. In both instances, the prevailing view had been that the OECS should seek to link with one of the existing exchanges, namely the Barbados exchange, rather than try to establish an exchange of its own. However, policy makers within the OECS/ECCB area have held the view that the sub-region should seek to establish its own Stock Exchange, or at least the rudiments of Capital Market Activity prior to establishing linkages with the wider regional exchanges. This approach, it is anticipated will allow the OECS/ECCB area to develop more familiarity and experience in Capital Market Activity which would provide benefits to the sub-region once it links with the other regional exchanges.

There are some basic prerequisites for the establishment of and the continued success of an equity market, such as, an organized Stock Exchange. These include the existence of a certain political, economic, institutional and policy environment which is conducive to the success of an equity market. First, a reasonably stable political environment is a necessary condition for economic growth and the establishment of a stock exchange. Political disruption and uncertainty would always affect economic activity, as companies postpone investments and scale down their growth projections as a result. Investors and Entrepreneurs must have a sense of confidence about the future in order for companies to expand their operations. Other prerequisites are as follows:

- A growing economy.
- A favourable government attitude and an economic structure in which private enterprise is allowed to play a significant role.
- Conducive macro-economic policies to ensure an attractive long-term yield for equities in comparison with other domestic and foreign investment alternatives.
- A sufficient demand for and supply of stocks.
- Reasonably well developed accounting and auditing standards.
- Tax treatment that does not discriminate against shares compared to alternative investments, or even temporary tax incentives in favour of share ownership and public companies.
- The existence of at least a small group of intermediaries or market makers, such as, brokers, dealers, underwriters etc.
- An adequate legal framework, including protection of outside investors and small investors through securities legislation and its enforcement.

EASTERN CARIBBEAN CENTRAL BANK AREA

LIST OF PUBLIC COMPANIES

ANGUILLA (3)

1. NATIONAL BANK OF ANGUILLA LTD
2. NATIONAL INVESTMENT COMPANY OF ANGUILLA LTD (NICA)
3. ANGUILLA ELECTRICITY COMPANY LTD (ANGLEC)

ANTIGUA & BARBUDA (1)

4. ANTIGUA COMMERCIAL BANK LTD

DOMINICA (2)

5. DOMINICA COCONUT PRODUCTS LTD
6. DOMINICA ELECTRICITY SERVICES LTD

GRENADA (2)

7. JONAS BROWNE & HUBBARD'S LTD
8. GRENADA BREWERIES LTD

MONTSERRAT (0)

NONE

ST. KITTS & NEVIS (9)

9. ST. KITTS-NEVIS-ANGUILLA NATIONAL BANK LTD
10. NEVIS CO-OPERATIVE BANK
11. ST. KITTS BOTTLING COMPANY LTD
12. ST. KITTS BREWERIES LTD
13. ST. KITTS-NEVIS-ANGUILLA TRADING AND DEVELOPMENT CO LTD (TDC)
14. S. L. HORSFORD & CO LTD
15. ST. KITTS NEVIS TELECOMMUNICATIONS LTD (SKANTEL)
16. ECONOMY TRADING CO LTD
17. THE BANK OF NEVIS LTD

ST. LUCIA (4)

18. ST. LUCIA CO-OPERATIVE BANK
19. MINVILLE AND CHASTANET LTD
20. COPRA MANUFACTURERS LTD
21. WINWARD & LEEWARD BREWERIES LTD

ST. VINCENT & THE GRENADINES (2)

22. DIAMOND DAIRIES LTD
23. ST. VINCENT BREWERIES LTD

The OECS/ECCB area has met several of these prerequisites and the Central Bank is further seeking to analyze the degree to which others can be met. The ECCB area has been in fact for the most part characterized by a stable political environment and growing economies over the last seven years. In addition, the ECCB area has also been characterized by a stable currency, a strong currency, and a single currency for the past 15 years, since the EC dollar was pegged to the US dollar at US$1.00 = EC$2.70. Therefore, it would seem that the ECCB arrangement already has exactly what the wider caribbean stock exchanges are seeking to develop. All other things equal, this should certainly speak to the speed and benefits which could accrue to the sub-region with the establishment of a stock exchange.

However, the ECCB area may be lacking in regards to several of the prerequisites namely: the lack of intermediaries or market makers, the lack of an adequate legal and institutional framework, as well as, the tax and policy framework conducive to the development of an equity market. Though, these areas would remain as major obstacles to the development of an OECS/ECCB Stock Exchange which policy makers should actively address, the more fundamental issue of the sufficient supply and demand of stocks requires investigation.

The ECCB has collected data on the public companies in the sub-region as part of this investigation (see tables on pages 5 & 11). Currently, there are 23 public companies in the OECS/ECCB area with a total issued capital of over EC$134 million. This compares to 42 companies in Jamaica with a total capitalization of EC$2.3 billion, 31 companies in Trinidad and Tobago with EC$1.1 billion in capital, and 13 companies in Barbados with EC$756 million in capital. The authorized Capital of the 23 companies is about EC$301 million. The companies are comprised of Indigenous Commercial Banks, a few privatized Public Utilities in electricity and telecommunications, Breweries, and Trading Companies (distributive trades). Of interest is the absence of major manufacturing or industrial concerns and tourist businesses. There may be several privately owned, or private limited liability companies, as well as, other utilities which could go public if there was an organized stock market where equity, as well as, debt issues could be floated. In addition, the public companies all seem to have a sizable float, that is the amount of authorized capital which could be issued on the market, (about 50% or EC$100 million). Of note also, is the fact that several of these public companies are themselves large institutional investors in each others shares and the shares of other private companies.

On a per capita basis, however, there seems to be a shortage of stocks when the sub-region is considered as a whole, since EC$233 of equity capital is available publicly per ECCB area resident. While, on the other hand $2,250 of equity capital is available publicly per capita in Barbados, $1,000 of equity per capita in Jamaica and EC$931.56 per capita in Trinidad and Tobago. The approximate per capita GDP of the ECCB area is EC$6,150.00 while this compares with EC$12,000.00 in Barbados, EC$3,105.00 in Jamaica, EC$19,305.00 in Trinidad and Tobago. Therefore, coupled with traditionally higher savings and investment rates in the ECCB area, increased availability of equity stock would be needed. It is anticipated that with the increased privatization of utilities and the existing number of public and private companies that the necessary supplies of stocks could be made available to an ECCB wide market. Demand for stocks may also be constrained by the individual territory markets. This demand would be substantially increased in a regional market where diversification could be achieved and by involving caribbean nationals abroad.

The ECCB is currently playing the role of catalyst for the development of a stock exchange and is continuing to research the prospects for an exchange. The major obstacles now would seem to be the legal impediments, the absence of market maker institutions, and the existence of tax structures which discriminate against equity ownership and public companies. In the final analysis it is the extent to which the region is able to overcome these obstacles which may well determine the prospects for an ECCB area stock exchange in the near future.

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PERSPECTIVE

REGIONAL CONSULTATION MEETINGS ON MONEY AND CAPITAL MARKET DEVELOPMENT

The Eastern Caribbean Central Bank and the Financial Secretaries of the member territories have been designated to comprise a Regional Steering Committee on the Development of Money and Capital Markets. As a result, the Central Bank has been sponsoring consultative meetings in the various territories to discuss money and capital market development with representatives from the Commercial Banks, Public Companies, Utilities, Accounting and Legal Professions, Chambers of Commerce, and the Non-Bank Financial Institutions including: Insurance Companies, Development Banks, National Development Foundations, Social Security Schemes, and Credit Unions. The Financial Secretary, the Accountant General, and the Attorney General representing each territory are also involved in these meetings. In addition, at the local level territorial steering committees on the Development of Money and Capital Markets have been designated with the Financial Secretary as Chairman of the committee and the ECCB Resident Representative as secretary.

So far, meetings sponsored by the ECCB have been held in five territories: St. Lucia, Antigua/Barbuda, Anguilla, Montserrat and St. Kitts/Nevis (Grenada has held local committee meetings). The ECCB is scheduled to hold meetings in Dominica, St. Vincent and the Grenadines, and Grenada next. As a result of the meetings held a variety of issues were raised, however, consensus seems to have developed in several areas which are restated here as follows:

1) It was also felt that with the reduced degree of concessionality of Government Debt, Aid to the region, and the diversion of Financial Flows to Eastern Europe and the Soviet Union, the ECCB area must earn Foreign Exchange and in turn look to the development of the Financial System to efficiently and effectively allocate funds available within the region.

2) There was agreement with the position that the OECS/ECCB area should go it alone in developing Money and Capital Markets prior to linking into the other regional markets. Here, it was felt that the common currency area, and the existence of one Central Bank provided certain advantages that the wider regional markets were lacking.

3) It was the general consensus that the Central Bank's involvement in the development of Money and Capital Markets was very important in that it provided confidence to participants, and served as the catalyst for development.

4) There was agreement on the need for updated and harmonized legislation in the areas of:-

   a) Companies Laws

   b) Alien Land Holding Laws

   c) Insurance Laws

   d) Banking Laws,

and the development of an efficient and timely mechanism for the harmonized amendment to the above laws.

5) The need to develop market maker type institutions in both Money and Capital Markets, such as, Discount Houses, Brokerage Operations, and Secondary Market Facilities was identified as a necessary condition for development.

6) There was agreement on the need for the development of Unit Trusts, Equity Funds, and/or Mutual Funds as avenues for attracting Foreign indirect investment and to provide advice to and access to a diversified and professionally managed portfolio of securities, for the small individual investor. This it was felt, could help protect the uninitiated investor from the vagaries of one investment, by the issue of an omnibus share.

7) There was agreement on the need for the development of a region-wide Venture Capital Fund to provide financing for productive areas which are unable to raise finance currently.

8) The importance of a Financial Publication to educate and inform the participants and general public of Financial Developments and activities in the Money and Capital Markets, was identified.

9) It was felt that the involvement of Caribbean nationals abroad in the development of Money and Capital Markets, due to their familiarity with more developed markets and their pool of foreign exchange

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earnings available for investment, should play an important role.

10) The need for proper regulation of Money and Capital Markets to protect invest...s and develop a level playing field was considered a necessary condition. It was agreed that securities legislation to establish the rules of the Markets and to regulate the activities of an organized exchange, would be needed.

11) It was also felt that the development of a Secondary Mortgage Facility would provide several benefits:-

a) Introduce liquidity to the system.

b) Attract funds from outside the region through investment in mortgage backed securities.

c) Allow the Financial Sector to better match funds, that is, Banks lending short and Insurance companies and Social Security Schemes lending long.

12) It was felt that the tax structure of member ECCB countries would need to be harmonized, or else capital would flow to the areas which had a tax advantage.

In addition, a number of other issues were raised which were specific to certain territories. For instance, in Antigua it was suggested that a Bond Market comprising private and public company, as well as, Government debentures should be developed prior to the Stock Market. While, at the St. Kitts meeting the suggestion of a guotation system, centralized at the Central Bank using computer and telecommunication technology to overcome the logistic problem in the currency area, was put forward.

Finally, in addition to the meetings listed above the ECCB is seeking to extend its contact with the participants in the Financial System including the commercial banks, and the non-bank financial institutions. This contact is being institutionalized through regular meetings with these institutions each year. At these meetings, various aspects of Money and Capital Market Development specific to the type of financial intermediary, are also being discussed.

[ ]

OPERATION OF THE TREASURY BILL MARKET IN THE EASTERN CARIBBEAN CENTRAL BANK REGION

One of the responsiblities of the Eastern Caribbean Central Bank is that of regulating the banking system in the ECCB area. This involves putting in place measures which would prevent an excess or shortage of liquidity in the system. In 1985 there was evidence of excess liquidity accumulating in certain segments of the banking system. In order to assist in the diversion of funds from banks with surplus resources to those in need of short-term liquidity, the ECCB began, in 1986, to actively participate in the Inter-Bank Money Market. In 1988, the ECCB also introduced the Treasury Bill Market to further assist the commercial banks in their liquidity management.

OBJECTIVE OF THE TREASURY BILL MARKET

Treasury Bills, which are short-term securities issued at a discount from face value, also have characteristics that make them a safe and convenient haven for the banks' cash surpluses. The Treasury Bill Market at the ECCB provides the commercial banks with the necessary liquidity on these Bills in times of cash shortage. These Bills are issued by sovereign Goverments (See Table) and, as a result, have a low default risk. The Treasury Bill Market at the ECCB therefore offers commercial banks an attractive short-term investment instrument with a secondary market.

Treasury Bills are issued to institutional investors, commercial banks and individual residents directly through the primsry market from individual Treasury Departments of member territories. It is in this primary market that the ECCB purchases its stock of Treasury Bills (ECCB's stock of Treasury Bills is limited by the Agreement of 1983 establishing the Central Bank) for sale in the Treasury Bill Market. These Treasury Bills are issued in denominations as small as $100 and as large as $500,000. The discount rates on Treasury Bills in member territories have remained relatively constant at levels which may be higher than commercial bank fixed deposit rates.

THE ROLE OF THE EASTERN CARIBBEAN CENTRAL BANK

The Central Bank sells (discounts) to the Commercial Banks a portion of its stock of Treasury Bills purchased from the Governments. To date, of approximately $196 million outstanding for the Governments within the ECCB region, the Central Bank

TREASURY BILLS AND BONDS OUTSTANDING AS OF JULY 31, 1991 (in millions)

	TREASURY BILLS		BONDS	
TERRI-TORIES	Amount Outstanding	%Share	Amount Outstanding	% Share
Anguilla	0	0.0	0	0.0
Antigua & Barbuda	39	19.9	54	28.0
Dominica	31	15.8	42	21.3
Grenda	44	22.4	41	20.8
Montserrat	0	0.0	5	2.5
St. Kitts & Nevis	26	13.3	11	5.6
St. Lucia	56	28.6	15	7.6
St. Vincent & The Grenadines	0	0.0	28	14.2
TOTAL:	196	100.0	196	100.0

holds a stock of $56.6 million nominal value (29% of the total outstanding), of which $50 million (88% of the Central Banks' holdings) is offered for sale to the Commercial Banks. The attractive features of this market are its convenience and flexibility. The Central Bank makes the Treasury Bills available for purchase, and stand, ready to buy (rediscount) these bills down to one (1) day before maturity. A list of Treasury Bills available for sale to date, coupled with the discount and rediscount rates, is circulated to the Commercial Banks within the ECCB region every fortnight. In addition, Commercial Banks are provided with the discount and rediscount prices offered at various days to maturity of the Bills. The banks may however, enquire by telephone or telex at any time for information about bills available for sale.

As of August 26, 1991, the amount of Treasury Bills outstanding from the Central Bank's stock outstanding was $22 million, (approximately 44% of the total available for sale to the commercial banks).

Of the $196 million outstanding for Governments in the ECCB area, about 15% is held by Commercial Banks, 32% by Social Security Schemes, while about 24% is held by Insurance Companies, Business Firms, and private individuals. Currently, three Governments in the region have no Treasury Bills outstanding (see Table). [ ]

GOVERNMENT BONDS

With the exception of Anguilla, Bonds are issued by all the other Participating Governments (see Table). Traditionally, the Bonds have been purchased by the ECCB; Banks (including the Commercial Banks and the Development Banks); Insurance Companies; Social Security Schemes; Business Firms; Private Individuals; and other Governments. As of July 31, 1991, there was approximately $196 million worth of Government Bonds outstanding, of which approximately 27% was held by the Commercial Banks; 36% held by Insurance Companies and Social Security Schemes; 20% held by the Development Banks, other Financial Institutions, Business Firms, private individuals, and other Governments; and 17% held by the ECCB.

The ECCB is limited by its Agreement established in 1983, as to the amount of member Governments Bonds which it can hold.

These Bonds, commonly known as debentures, are usually purchased at par; have a callable feature at the option of the governments; and pay interest semi-annually. Repayment of their interest and principal is guaranteed by the Participating Governments. The laws which provide Governments with the authority to issue Bonds require the establishment of sinking funds to guarantee the redemption of the face value of the Bonds. Therefore, governments put aside funds semi-annually into sinking funds, in addition to paying interest. This assures the bondholder/investor that funds will be available to redeem the Bonds.

OECS/ECCB AREA PUBLIC COMPANY CAPITALIZATION AUGUST 1991

TERRITORY	AUTHORIZED SHARES	AUTHORIZED CAPITAL	ISSUED SHARES	ISSUED CAPITAL	SUBSCRIBED CAPITAL	TOTAL CAPITAL SHARE	SHARE CAPITAL AVAIL-ABLE	# OF SHARES AVAIL-ABLE
ANGUILLA	40,500,000	$45,000,000	16,450,948	$17,800,948	$ 5,735,199	$23,536,147	$21,463,853	18,313,853
ANTIGUA & BARBUDA	3,762,500	$5,000,000	3,541,037	3,847,838	$0	$3,847838	$1,152,162	221,463
DOMINICA	4,000,000	$13,000,000	2,910,813	$11,108,130	$0	11,108,130	$1,891,870	1,089,187
GRENADA	8,000,000	$26,000,000	5,153,990	$14,148,032	$0	13,281,762	$7,718,238	2,432,637
MONTSERRAT0	0	$0	0	$0	$0	$0	$0	0
ST. KITTS/NEVIS	61.920,000	$86,500,000	32,335,544	$41,678,211	$2,023,700	$43,701,911	$42,798,089	27,560.756
ST. LUCIA	3,500,000	$17,000,000	1,683,124	$6,713,008	$0	$6,713,008	$10,286,992	1,816876
ST. VINCENT & THE GRENADINES	10,090,000	$109,000,000	3,120,800	#39,308,800	$0	$39,308,800	$69,691,200	6,969,120
TOTALS	131,772,500	$301,500,000	65,196,336	134,604,967	$7,758,899	$141,497,596	$155,002,404	58,403,892

NOTE: The per value of share are for $1, $5, $10 and $`100, and common and preferred shares are included. There are no public companies in Montserrat. Data was not available for four of the public companies at time of publication (2 in St. Kitts/Nevis and 2 in St. Lucia).

ST. VINCENT AND THE GRENADINES DEVELOPMENT BONDS

The Government of St. Vincent and the Grenadines announces the issue of a maximum of $30 million in Development Bonds as part of the Government's Investment Programme. The issue will be made available for subscription by ECCB area investors on November 1, 1991. The Bonds will carry a 7 1/2% coupon interest with a maturity of 10 years. Interest on the Bonds will be tax-free in St. Vincent and the Grenadines and the Bonds will have a call option over the last five years. The prospectus for the issue shall be made available throughout the region at the ECCB Resident Representative Offices, so that the Bonds can be subscribed by a wide range of individual, as well as, institutional investors in the ECCB area.

St. Vincent and the Grenadines currently has no Treasury Bills outstanding and $28.4 million in Bonds outstanding. In 1989/90, the recurrent budget surplus was $11.3 million and recurrent revenue was $136.9 million. Real GDP grew by 6.6% and recurrent revenue grew by 8.5% in 1990. The External Debt Service in 1990 for St. Vincent and the Grenadines was 6.1% of recurrent revenue. The Bond is expected to attract regional investors in medium-term investments seeking to diversify the traditional holdings of medium-term debt, such as, Insurance Companies, Social Security Schemes, Commercial Banks, Credit Unions, other non-bank Financial Institutions, Business Firms, as well as, other Governments. For further information on the Bond issue, contact the ECCB at Headquarters or the Ministry of Finance, the Government of St. Vincent and the Grenadines.

APPENDIX 3:

FINANCIAL STATEMENTS OF SELECTED EASTERN CARIBBEAN FINANCIAL INSTITUTIONS

THE BANK OF NEVIS LIMITED

BALANCE SHEET

AS AT JUNE 30, 1990

	Notes	1990	1989
SSETS:			
ash and short-term funds	3	$ 6,807,056	$ 3,265,644
oans and advances	4	6,938,895	5,857,652
tationery stock		85,132	81,509
remises and equipment	5	1,006,505	549,829
nvestment property	6	463,050	321,384
ther assets	7	134,467	31,224
		$15,435,105	$10,107,242
IABILITIES AND SHAREHOLDERS EQUITY:			
IABILITIES:			
eposits	8	$13,908,121	$ 9,262,606
ayables and accrued liabilities		332,706	213,761
rovision for income tax		44,346	39,373
		$14,285,173	$ 9,515,740
HAREHOLDERS' EQUITY	9	1,149,932	591,502
		$15,435,105	$10,107,242

he accompanying notes form an integral part of these financial statements.

APPROVED ON BEHALF OF THE BOARD

CHAIRMAN
Hanzel Manners

DIRECTOR
Richard Lupinacci

THE BANK OF NEVIS LIMITED

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED JUNE 30, 1990

	1990	1989
INTEREST INCOME:		
Loans and advances	$ 909,769	$ 799,852
INTEREST EXPENSES:		
Savings deposits	138,505	81,632
Fixed deposits	275,916	209,308
Other deposits	1,659	41,202
	416,080	332,142
NET INTEREST INCOME BEFORE LOAN LOSS PROVISION	493,689	467,710
Provision for loan losses	18,951	60,000
	474,738	407,710
OTHER OPERATING INCOME	256,572	149,402
NET INCOME	731,310	557,112
EXPENSES:		
General and administrative	564,730	398,165
Depreciation and amortization	27,909	12,980
Loss on disposal of equipment	16,144	-
Other bank charges	5,469	3,759
	614,252	414,904
EARNINGS FOR THE YEAR BEFORE TAX	117,058	142,208
Provision for income tax	4,973	16,055
NET EARNINGS FOR THE YEAR	$ 112,085	$ 126,153

The accompanying notes form an integral part of these financial statements.

CFSC

CARIBBEAN FINANCIAL SERVICES CORPORATION

BALANCE SHEET
(Amounts expressed in U.S. dollars)

	March 31 1991	March 31 1990
Assets		
Cash and short-term deposits	$ 3,527,653	$ 4,155,759
Accrued interest and other current assets	714,083	509,403
Customers' liability under acceptances	–	477,355
Loan and equity investments (Note 3)	16,258,269	11,664,649
Fixed assets (Note 4)	160,248	50,964
Risk minimization fund (Note 5)	802,290	616,495
	$ 21,462,543	$ 17,474,625
Liabilities		
Accounts payable and accrued liabilities	$ 160,313	$ 68,250
Acceptances	–	477,355
Dividend proposed	150,625	120,500
Long-term loans (Note 5)	16,863,555	12,936,745
	17,174,493	13,602,850
Shareholders' Equity		
Share capital - 30,125 shares	3,012,500	3,012,500
Statutory reserve (Note 6)	235,000	150,000
Retained earnings	1,040,550	709,275
	4,288,050	3,871,775
	$ 21,462,543	$ 17,474,625

Approved by the Board

John S. Goddard Director

Director

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CFSC

CARIBBEAN FINANCIAL SERVICES CORPORATION

STATEMENT OF INCOME
(Amounts expressed in U.S. dollars)

	Year ended March 31 1991	1990
INTEREST INCOME		
From investments	$ 1,293,724	$ 1,041,879
From other sources	389,198	302,563
	1,682,922	1,344,442
INTEREST EXPENSE	307,852	220,847
NET INTEREST INCOME	1,375,070	1,123,595
OPERATING EXPENSES		
Salaries and staff costs	293,281	187,981
Office and other expenses	99,677	68,149
Travel and promotion	60,827	46,205
Depreciation	40,314	17,855
Directors' fees	30,000	15,000
Professional fees	14,571	12,188
	538,670	347,378
INCOME BEFORE INVESTMENT PROVISIONS	836,400	776,217
Loan and equity investment provisions	269,500	390,500
NET INCOME FOR THE YEAR	$ 566,900	$ 385,717

CHAIRMAN'S STATEMENT

In the first half of 1991 The Home Mortgage Bank continued to register a strong financial performance as represented by the more than 40% increase in its net earnings per share. Against this background the bank will be paying a 3% interim dividend.

The begining of April saw the first full securitization of a residential mortgage portfolio in Trinidad and Tobago through the issue of mortgage pass-through securities called Mortgage Participation Certificates. This inital securitization amounted to a $10,022,556 pool of mortgages and was immediately fully subscribed by investors. We plan to issue two further MPC offerings in 1991.

No bond issues were arranged in the first half of 1991 and this was largely the result of our own strong cash position, high liquidity in the banking system and the limited number of mortgage assets available for purchase.

In the mortgage market we continue to offer the primary lenders a 10% mortgage facility for prospective homeowners interested in constructing new homes, and we have reduced our benchmark interest rate on the purchase of existing mortgage loans to 11%.

As the economy continues to recover and show some growth there has been more activity in the real estate sector. As a result of these developments we have increased the upward limit of the eligible price range from $400,000 to $500,000 expanding our coverage of homes to those priced between $150,000 and $500,000.

The Bank continues to emphasize the need to standardize mortgage documentation particularly the mortgage deed, the construction advancing format and the valuation format. These initiatives are necessary in the interest of reducing the cost of homeownership transactions and to improve efficiency and standards in underwriting by the primary lenders.

For the balance of 1991 we are optimistic of the Bank's continuing profitability together with increased mortgage purchases arising out of the above mentioned policy changes. In addition, the bank has recently amended its policy to encourage further sales from the Primary Lenders through non and partial recourse purchases so as to further stimulate the secondary market.

The Bank remains focused on its mission to provide, through our partnership with the primary lenders, sufficient and affordable mortgage financing to prospective homeowners in Trinidad & Tobago. It also intends to continue to publicize, inform and educate prospective and existing homeowners on the availability, pricing and structure of residential mortgage finance.

John J. Jardim
Chairman

UNAUDITED

Statement of Net Income for the Six Months Ended 30th June	1991 $000's	1990 $000's
Income	13,782	10,745
Less: Expenditure	11,354	8,886
Income before taxation	2,428	1,859
Less: Taxation	870	749
Net income for the period	1,558	1,110
Retained earnings at the beginning of the year	5,788	4,024
	7,346	5,134
Less: Interim dividend - 3%	480	-
Retained earnings at the end of the period	6,866	5,134
Earnings per $100 share	$9.74	$6.94

Balance Sheet at 30th June	1991 $000's	1990 $000's
Assets		
Cash, short term deposits and other assets	98,815	93,970
Mortgages	184,531	162,634
Total Assets	283,346	256,604
Liabilities		
Current liabilities	5,884	5,159
Bonds issued	253,225	228,830
Tax equalization reserve	1,371	1,481
	260,480	235,470
Shareholders' Equity		
Share capital	16,000	16,000
Retained earnings	6,866	5,134
	22,866	21,134
Total Liabilities and Shareholders' Equity	283,346	256,604

NATIONAL COMMERCIAL BANK OF DOMINICA

CONSOLIDATED BALANCE SHEET

AS AT JUNE 30, 1990

	Notes	1990 EC$	1989 EC$
ASSETS			
Cash and short-term funds	3	26,124,223	30,531,063
Short-term investments	4	7,958,871	11,895,110
Long-term investments	5	5,100,000	100,000
Loans and advances	6	72,547,526	56,590,865
Other assets	7	1,491,370	837,842
Premises and equipment	8	2,306,118	2,259,621
Statutory Reserve with Eastern Caribbean Central Bank	9	5,375,000	5,553,000
Customers liability for acceptances, guarantees and confirmed credits		2,060,332	3,056,403
		122,963,440	110,823,904
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES			
Deposits	10	95,236,988	90,199,387
Interest payable		1,148,065	926,990
Provision for income tax		576,192	849,124
Proposed dividends		1,500,000	472,500
Other liabilities	11	1,262,252	2,467,832
Acceptances, guarantees and letters of credit		2,060,332	3,056,403
		101,783,829	97,972,236
SHAREHOLDERS' EQUITY	12	21,179,611	12,851,668
		122,963,440	110,823,904

The accompanying notes form an integral part of these financial statements.

APPROVED ON BEHALF OF THE BOARD

FRANKLIN A BARON
CHAIRMAN

R.A. Didier
DIRECTOR

L.V. Lewis
GENERAL MANAGER

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NATIONAL COMMERCIAL BANK OF DOMINICA

CONSOLIDATED STATEMENT OF EARNINGS

FOR THE YEAR ENDED JUNE 30, 1990

	Notes	1990 EC$	1989 EC$
INCOME			
Income from loans and advances		7,528,775	6,272,157
Income from time deposits and short-term investments		2,821,007	3,465,282
Commissions and other earned revenue		2,174,426	1,936,424
		12,524,208	11,673,863
EXPENSES			
Interest on customer deposits		3,283,209	2,722,781
Salaries, staff benefits and allowances		1,708,434	1,659,829
General expenses		1,232,155	985,533
Provision for loan losses		100,000	300,000
Depreciation		351,407	256,738
Interest and other agency fees		48,868	32,772
Audit fee		35,200	33,000
Directors fees and expenses		35,800	31,658
		6,795,073	6,022,311
EARNINGS BEFORE TAX		5,729,135	5,651,552
PROVISION FOR INCOME TAX	16	1,176,192	1,440,067
NET EARNINGS FOR THE YEAR		4,552,943	4,211,485
EARNINGS PER SHARE	17	$5.12	$13.37

The accompanying notes form an integral part of these financial statements.

ST. LUCIA MORTGAGE FINANCE COMPANY LIMITED
PROJECTIONS FOR PERIOD 1991-1995
BALANCE SHEET

	ACTUAL 1990 EC$ ***	EXPECTED 1991 EC$ ***	EXPECTED 1992 EC$ ***	EXPECTED 1993 EC$ ***	EXPECTED 1994 EC$ ***	EXPECTED 1995 EC$ ***
FIXED ASSETS						
Office Modification	23422	33422	33422	33422	33422	33422
Furniture & Equipment	290649	290649	290649	290649	290649	290649
Motor Vehicle	69157	69157	69157	70000	70000	70000
	383228	393228	393228	394071	394071	394071
Depreciation	165048	223677	265034	250477	305077	359677
NET FIXED ASSETS	218180	169551	128194	143594	88994	34394
INVESTMENTS						
Mortgage Assets	23295298	25538871	31467620	36863202	41827432	46281834
	23513478	25708422	31595814	37006796	41916426	46316228
CURRENT ASSETS						
DEBTORS AND PREPAYMENTS						
Staff Debtors	21977	7809	7809	7809	7809	7809
Other Debtors	26393	0	0	0	0	0
Pre-payments	370	0	0	0	0	0
	48740	7809	7809	7809	7809	7809
INVESTMENTS						
Cash At Bank & On Hand	115920	127083	362892	367653	163224	149544
	164660	134892	370701	375462	171033	157353
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE (1) YEAR						
Dividend	225600	282000	552000	552000	552000	552000
CDC Loan	1049220	1016685	1016685	1016685	966848	842254
NIB Loan	680000	680000	680000	727500	962500	1250000
Trade Creditors	14192	11829	11829	11829	11829	11829
Accruals	61102	65750	65750	65750	65750	65750
	7048	0	0	0		
	2037162	2056264	2326264	2373764	2558927	2721833
ET CURRENT ASSETS	-1872502	-1921372	-1955563	-1998302	-2387894	-2564480
OTAL ASSETS LESS URRENT LIABILITIES	21640976	23787050	29640251	35008494	39528532	43751748
REDITORS: AMOUNTS FALLING UE AFTER MORE THAN ONE YEAR						
DC Loan	5988808	4972123	3955438	2938753	1971905	1129652
IB Loan	12320000	12140000	11460000	10732500	9770000	8520000
IB New Loans	0	3200000	8000000	15000000	21200000	27000000
ccruals	111025	140526	160199	180627	208195	237342
	18419833	20452649	23575637	28851880	33150100	36886994
OTAL	3221143	3334401	6064614	6156614	6378432	6864754

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ST LUCIA MORTGAGE FINANCE COMPANY LIMITED
PROJECTIONS FOR PERIOD 1991-1995
BALANCE SHEET

BC2

	ACTUAL BALANCE 1990 EC$ ***	EXPECTED BALANCE 1991 EC$ ***	EXPECTED BALANCE 1992 EC$ ***	EXPECTED BALANCE 1993 EC$ ***	EXPECTED BALANCE 1994 EC$ ***	EXPECTED BALANCE 1995 EC$ ***
APITAL AND RESERVES						
uthorised	3000000	3000000	6000000	6000000	6000000	6000000
alled Up Shares Fully Paid						
DC	1440000	1440000	2815200	2815200	2815200	2815200
ovt of St Lucia	1380000	1380000	1380000	1380000	1380000	1380000
IB	0	0	1324800	1324800	1324800	1324800
THER RESERVES						
xcess Loan Fees	150627	156828	156828	156828	156828	156828
xchange Fluctuation	0	0				
[illegible]ange Fluctuation [illegible]ision	75205	0				
appropriated Profits	175311	357573	387786	479786	701604	1187926
	3221143	3334401	6064614	6156614	6378432	6864754

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APPENDIX 4:

PANAMA HG COLLATERAL REQUIREMENTS

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PANAMA: PROJECT PAPER SUPPLEMENT

PRIVATE SECTOR LOW-COST SHELTER

AID/LAC/P-340
5/28/91

Loan Number: 525-HG-013
Project Number: 525-0287

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use of the Administrator will facilitate program implementation. Adequate safeguards for A.I.D. will remain in place.

The Administrator will still be selected by the Borrowers and A.I.D. jointly and in fact three U.S. money center banks, Chase Manhattan, Citibank and Bank of Boston, have expressed a strong interest in being chosen as the Administrator. The role of the Administrator will be to:

-Advise the Borrowers in raising the HG resources;
-Certify Borrowers' qualifications and eligible mortgages;
-Authorize the U.S. Lender, with A.I.D.'s concurrence, to disburse the HG funds to the Borrowers upon presentation of eligible mortgages;
-Receive the loan payments from the Mortgage Lenders and remit same to the U.S. Lenders;
-Monitor the Mortgage Loan Portfolio by ensuring that the loan terms and conditions are met; and
-In the event of any default, manage the loan portfolio of the defaulting institution(s) in accordance with the terms of the Implementing Agreement and the Loan and Guaranty Agreements. (see discussion on A.I.D.'s Security below)

B. Security for A.I.D.'s Guaranty.

Both the original HG as well as this supplement have been designed without a host country guaranty. A host country guaranty essentially insures A.I.D. from losses resulting from changes in the exchange rate and non-payment by the Borrower. In addition there is a commercial risk the Panamanian banks incur in making a mortgage loan. Since Panama uses the U.S. Dollar as the national currency and all loans are denominated in U.S. currency, the exchange risk is non-existent.

The financial risk remains and A.I.D. expects to cover itself from this type of risk by utilizing some of the legal and financial safeguards listed below. The final arrangements for protecting A.I.D.'s interest will be made after further discussions with the borrowers and during preparation of the loan documents.

-The mortgage loans which comprise each mortgage portfolio will be recorded with the Panamanian Recorder of Deeds and each mortgage will state that in the event a Borrower is in default, the Administrator will instruct the Recorder of Deeds to transfer the entire Mortgage portfolio to the Administrator. The Administrator on behalf of A.I.D. will have the legal authority to cure all defaults, should they occur;

-The outstanding value of the mortgage loan portfolio of each Borrower must exceed the amount of the HG loan component by a factor of 1.25 to 1.00;

-In the event a mortgage loan is in arrears by more than 60 days, the Borrower must replace that mortgage in the mortgage portfolio with another eligible performing mortgage, thereby ensuring that the 1.25 to 1.00 ratio is maintained;

-Each Borrower will place on deposit with the Administrator an amount equal to one semi-annual loan payment to the U.S. Lender to provide the Administrator with sufficient funds to cover loan repayments to the U.S. Lender in the event of a default prior to curing that default;

-Prior to borrowing the HG funds, each Borrower must meet the financial institution rating standard known as "CAMEL", (see Section V. of this report for definition) and continue to meet this rating standard for each year the HG loan remains outstanding;

-Each borrower will give A.I.D. a full faith and credit guaranty.

-Each borrower will provide to A.I.D. and the Administrator a quarterly status report on the HG mortgage loan portfolio; and

-Each Borrower will submit to an annual external audit by a U.S. affiliated Panamanian auditing firm and those audits will be made available to A.I.D. and the Administrator. The Banks will cover the commercial risk associated with mortgage lending by employing generally acceptable underwriting criteria, which in turn will enable the Banks to minimize any risk of a mortgagor defaulting. These underwriting criteria include the following:

-The Borrowers (the mortgage or commercial banks) will employ prudent underwriting procedures in part because all mortgages will consist of 20 percent of the Mortgage Lender's own funds;

-The Mortgage Lender will hold a first mortgage on each property mortgaged under this Program;

-All mortgage loans will carry hazard and life insurance; and

-The Loan to Value Ratio will be .72 to 1, meaning that the amount of a mortgage loan will never exceed 72 percent of the original sales price of the unit.

C. Financial Strength of Potential Borrowers.

Several Mortgage and Commercial Banks have expressed a strong interest in participating in the Program. Accordingly they have submitted financial information to A.I.D. to demonstrate their

All other borrowing and contracting arrangements as described in the original Project Paper remain unchanged.

V. Qualifying Financial Institutions

A. Conditions for Participation.

The principal criterion for a Panamanian financial institution to participate in the HG Program is meeting the ratings standard using the CAMEL methodology. The acronym, CAMEL, stands for the following:

- -Capital adequacy;
- -Asset quality;
- -Management;
- -Earnings; and
- -Liquidity.

Four of the five factors are determined objectively through the use of financial information from an institution and it's auditors. Only the management rating is subjective and even this is influenced by the rating in the other areas. Once the supplement to the Project Paper is approved, prospective Borrowers, most of which have already been identified, will be asked to give A.I.D. the necessary information to prepare the CAMEL analysis.

Commercial Banks, along with Mortgage Banks, will be permitted to participate in the Program. They must meet the eligibility requirements as set by Panamanian law which states that Banks, other than Mortgage Banks, operating in the Country, and which receive local savings deposits must invest 50 percent of those deposits in housing mortgage loans with terms of not less than 10 years. Commercial Banks will be permitted to participate along with the Mortgage Banks since they lend for housing and there is no reason to deny their participation.

The CAMEL analysis, in conjunction with Panamanian legal requirements, will permit A.I.D. to qualify an institution for participation in the Program. The eligibility requirements stipulated in the original Project Paper are no longer valid.

B. Description of the Financial Institutions.

Four financial institutions, all of which are licensed as General License Banks, have expressed interest in participating in the Housing Guaranty Program. These banks and the probable amount of loan funds they will initially request are:

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APPENDIX 5:

CONCEPT PAPER

HOME LOAN INSURANCE SCHEME

(SRI LANKA HG)

DRAFT

CONCEPT PAPER

HOME LOAN INSURANCE SCHEME
(Program Delivery Plan, HG-004)

1.0 DEFINITION

1.1 The Home Loan Insurance Scheme (HLIS) is defined as a program to insure primary lenders against a portion (e.g. 50% to 60) of potential loss arising out of individual borrower defaults on home loans originated pursuant to the USAID Housing Guaranty Program (HG) with the Government of Sri Lanka (GSL). It would be financed through minor additional interest charges on home loans. The HLIS will provide financial protection to primary lenders to enable them to pay back loans advanced to them by APEX or Sub-APEX lenders under the HG program without jeopardizing their viability to continue operations. The HLIS provides protection, also, to the Central Bank of Sri Lanka (CBSL) to recover funds on-lent to primary lenders by providing a pool of funds to back-stop primary lenders repayment to the CBSL. The HLIS will instill confidence in the financial sector to extend market rate financing to all primary lenders that may not be extended such credit without substantial additional costs imposed by commercial banks to accommodate their perceived commercial risk. The HLIS will, thus, provide the mechanism to generate home loan financing at lower costs than might otherwise be imposed if commercial banks had to charge for their perceived risk; this should result in lower overall costs to borrowers even with insurance premiums.

1.2 The HLIS may serve as a precursor to establishing a continuing, long-term mechanism for private sector home loan financing over-and-beyond the HG program. Home loans originated by the National Housing Development Authority (NHDA) would be covered, as a Government agency, under a separate Government guarantee and not be part of the HLIS.

2.0 BACKGROUND

2.1 The HG program provides funds for home loans to households below the median income. This lower income group is perceived by many formal sector lenders as a high-risk group. Thus, long-term credit has often been difficult for this income group to obtain and the smaller primary lenders,who serve this income group, also experience difficulty in raising funds from commercial banks to on-lend. The mortgage forgiveness under the Million Houses Program (MHP) appeared to destabilize certain primary lenders to this lower income group and increased perceptions that lending to these primary lenders has additional risk.

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2.2 Commercial bank concerns with smaller primary lenders, e.g. Thrift & Credit Cooperative Societies (TCCS), has a valid basis using formal bank lending criteria. Most smaller primary lenders (and even some of the larger ones such as State Mortgage and Investment Bank and Housing Development Finance Corporation) have a low capital base to collateralize the substantial influx of funds envisioned under the HG and other donor programs. The commercial banks' concern is that if a substantial amount of the HG loans generated by smaller primary lenders defaulted, they would not have the capital to sustain such a loss. This would destabilize the smaller primary lender and make Sub-APEX loans under the HG program difficult to recover. Commercial banks do not regard the loan portfolio of, for example, a TCCS as substantial collateral because they would not want to be in a position to take over the assets of a TCCS in order to collect loans due; this would be politically untenable. Since most of the smaller primary lender's capital is used for loans, there are very limited liquid assets (cash) to sustain any significant losses. By extending protection to primary lenders under the HLIS, this, in effect, extends their capital base coverage through the insurance provided by the HLIS

2.3 Commercial banks have indicated a strong reluctance toward bearing full risk in on-lending funds under the HG program to certain primary lenders; there is even resistance to on-lending funds with a partial guarantee without substantial compensation for their perceived risk. Thus, one prospective Sub-APEX lender indicated that they would impose an additional 5% in interest charges on loans if they had to assume even a 50% risk in on-lending funds to the TCCS. This additional 5% interest would have to be passed on to the primary lenders' borrowers and would probably raise overall interest rates beyond acceptable limits under the HG program. Another prospective Sub-APEX lender indicated that they would not on-lend funds to NHDA without a 100% Government guarantee. The TCCS and NHDA are viewed as two of the most important retail outlets for HG-generated home loans. The prospective Sub-APEX lenders viewed a home loans guarantee mechanism as a positive solution to mitigating perceived loan risks. If Sub-APEX risk was eliminated entirely, they would substantially reduce the on-lending interest rate, e.g. one prospective Sub-APEX lender indicated that without bearing financial risk for on-lending to primary lenders, they would reduce the on-lending interest rate 5% and would only charge a 1% administration fee over their cost-of-funds. Thus, if a HLIS could be implemented that cost borrowers just a minor amount more in additional interest on their loans, then they could be offered a lower overall interest charge on their loans.

2.4 The alternative to a HLIS is a GSL direct guarantee. A GSL guarantee could alter how both lenders and borrowers perceive the program and, in-and-of-itself increase non-payments because it may encourage borrowers to view the loan program as a grant program, especially with a substantial grant element already incorporated into the HG program. As proposed, herein, the HLIS would be financed by borrowers and continue risk (albeit reduced risk) to primary lenders.

Thus, the HLIS would be a market mechanism apart from government, financed by users of the funds. A similar concept has already been implemented by CBSL for the Small and Medium Scale Industry Credit Scheme and, thus, CBSL has experience in analyzing insurance requirements, collecting premiums and administering such a program with lenders.

3.0 PROPOSED HLIS STRUCTURE

3.1 Financial Structure

The proposed HLIS will have two components to finance the scheme:
(1) Sinking Fund
(2) Insurance Premiums paid by lenders and incorporated in borrower interest rates

3.1.1 Sinking Fund:

The Sinking Fund is a reserve established at the inception of the HG loan program out of a hold-back of a portion of program funds. The Sinking Fund would be used, in conjunction with insurance premiums, to provide financial resources to pay claims for home loan defaults. The Sinking Fund is to be used as a last resort; insurance premiums are supposed to cover anticipated risk.

The amount of funds required for a Sinking Fund depends on an actual analysis of risk associated with recovery of the funds on-lent to primary lenders. It is usually a small portion of total program funds, e.g. 5% of total program funds. As this allocation is borrowed from Treasury, it must be paid back with interest, from repayments on the remaining on-lent funds. The cost of financing the Sinking Fund would be incorporated in the CBSL interest rate on-lent to Sub-APEX and direct borrower lenders. Depending on the CBSL base interest rate from Treasury, the Sinking Fund could be a minor add-on or be incorporated already if the spread were sufficient between CBSL and funds on-lent to Sub-APEX lenders.

3.1.2 Insurance Premiums

The Sinking Fund would be supplmented by annual insurance premiums paid by primary lenders participating in the HG program. Insurance premiums are supposed to be set at levels sufficient to more than cover predicted claims. These premiums would, presumably, be passed on to borrowers in the form of a slightly higher interest rate on home loans and would be in addition to normal collateral required by primary lenders. The insurance premium would be paid only on the insured risk. Thus, if the HLIS

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insured 50% of loss, then the insurance premium would be paid only on 50% of loan funds. For example, if a 2% insurance premium were charged on a loan with 50% HLIS coverage, it would increase the effective interest rate on the home loan to the borrower by only 1%. (A 2% premium charge on 50% of a home loan equates to a 1% charge on the whole loan.) These insurance premiums would be prepaid each year by primary lenders to CBSL. The insurance premium could be adjusted based on the loss experience of individual primary lenders; thus, those primary lenders with 100% recovery could have the premiums reduced over time and those experiencing loss could have premiums increased.

3.2 Investment of Sinking Fund and Premiums

The Sinking Fund and premiums would be invested by CBSL, e.g. in Treasury Bills, to increase its principal over time. Thus, the amount necessary to establish the Sinking Fund and premium charges are reduced by the returns CBSL could reasonably expect to earn on re-investment of these funds.

3.3 Claims

Claims against the HLIS would arise when a borrower defaults on a home loan <u>AND</u> the lender has taken all prudent and necessary steps to recover the outstanding loan. Thus, the lender would have to pursue legal action, where applicable, to achieve recovery before a claim could be made. The claim to HLIS would only be against the <u>loss</u> incurred by the lender, not the whole loan. Further, the lender and the HLIS would split the loss in accordance with the insurance coverage provided. Thus, on a Rs.10,000 loan, if the primary lender recovers Rs.8,000, the loss would only be Rs.2,000. If the HLIS provided 50% insurance coverage, then the HLIS would pay Rs.1,000 to the lender to satisfy the claim and the lender would incur a Rs.1,000 loss. The HLIS would be protected against unfair practices by a primary lender by requiring that all property foreclosed by a lender must be sold at arms-length public auction. Similarly, if a primary lender held a compulsory deposit on shares (e.g. in a TCCS) as collateral for a home loan, that amount must also be applied against the loss before a claim can be made to the HLIS.

4.0 PRIVATE SECTOR ALTERNATIVE HLIS

There are four basic organizational approaches to the HLIS:

4.1 CBSL-funded (Sinking Fund), CBSL operated.
This is the organizational structure discussed above. Under this approach, the CBSL establishes the sinking fund, collects the insurance premiums, invests the financial resources and administers claims.

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4.2 CBSL-funded (Sinking Fund), Private Sector Trustee/Administrator operated.

This organizational approach would have the CBSL establish the HLIS and employ a private sector entity, e.g. an insurance company, to collect premiums, invest the financial resources and administer claims. The trustee/administrator would receive a fee for this service.

4.3 Joint CBSL/Private Sector funded(Sinking Fund and/or Capital), Private Sector operated

This organizational approach would create a partnership between the CBSL and a private sector entity, e.g. an insurance company, to capitalize the sinking fund. It would be operated on a profit-making basis by the private sector partner.

4.4 Private sector funded (Sinking Fund and/or Capital) Private Sector operated.

This organizational approach would have a private sector entity establish the sinking fund (under CBSL guidelines) with either its own capital and/or a loan from CBSL. The private sector entity would operate the HLIS on a profit-making basis.

(In all four basic alternatives, above, borrower premiums would supplement the Sinking Fund.)

4.5 The advantages to having a private sector entity involved in the HLIS are (a) it removes the HLIS from the public sector sphere and thus emphasizes that the maximum level of loan recovery must be achieved by participating primary lenders; (b) permits more flexibility for the private sector entity to more vigorously assist lenders in loan recovery, employ qualified staff, provide incentives and increase efficiency of operations and (c) establishes a mechanism to expand the HLIS to non-HG private sector home loans and, thus, potentially increases access to capital for primary lenders to make additional home loans.

5.0 FUTURE USE OF HLIS FUNDS

After the HG program has been completed, or if the HLIS reaches a stage where it is adequately capitalized to provide coverage for the HG program, the HLIS could be expanded to cover normal commercial home lending operations of state-owned and private sector primary lenders or could be used as additional resources to extend the HG program.

6.0 ROUGH PRELIMINARY FINANCIAL ANALYSES

Using certain reasonable assumptions, a rough financial analysis of the HLIS was performed. It revealed that with 5% of total program funds being escrowed in a Sinking Fund, coupled with insurance premiums of 2% on the risk (1% on the whole loans) and a 50% loss coverage (shared equally with primary lenders), the HLIS could sustain 19% losses of the total program funding and still break even; primary lenders would contribute another 19% if losses reached that extent for a total loss coverage of 38%. With commercial lending experiencing near zero percent loss in Sri Lanka, a 38% loss (HLIS plus primary lender share of loss) would be an unlikely event without some major economic calamity or Government intervention.

Variables can be changed. For example, to expand HLIS coverage, the Sinking Fund can be increased or insurance premiums increased. To decrease insurance premiums, the Sinking Fund could be increased or coverage reduced. There are many permutations to be considered and the formula that is eventually adopted must be worked through with the GSL and CBSL.

Below are two scenarios for the HLIS using the basic assumptions of

(a) 5% of total program funds being escrowed in a Sinking Fund;
(b) 2% insurance premium on risk (1% on whole loans) and
(c) 50% insurance coverage.

With these (and other assumptions) the financial projections in scenario 1 indicate that a 10% total program loss (5% paid by HLIS, and 5% paid by primary lenders) would yield a considerable cash surplus at the end of 10 years which could be used to (a) continue or extend home loan insurance coverage, (b) be used for direct loans or (c) be returned to Treasury. In scenario 2 a break-even analysis is presented, with the same assumptions, and would provide for a 38% total program loss (19% paid by HLIS and 19% paid by primary lenders). Scenario 2 should provide significantly more than sufficient loss coverage absenting any extraordinary economic shocks or governmentally imposed charges.

SCENARIO 1: 10% Total Program Loss
(5% paid by HLIS, 5% paid by Primary Lenders)

ssumptions:

Total Program funding	Rs.	400,000,000
Initial insurance fund balance	Rs.	20,000,000
Risk balance at beginning of period 1	Rs.	200,000,000
Annual rate of risk decline		10.0% of original balance
Premium as % of risk balance		2.00%
Administrative costs as % of premiums		8.00% (First period)
Increase of administrative costs rate		5.00% annually
Interest income as per cent of fund balance		15.00% annually
total loss during last 8 periods		5.00% of total Program funding

Loss during first two years assumed to be zero.

inancial Projections:

ERIOD (rs.)	FUND BALANCE	RISK BALANCE	PREMIUMS INCOME	INTEREST INCOME	BAD DEBT LOSS	ADMIN COSTS	ADMIN COST AS % OF PREMIUMS	NET CASH FLOW
1	20,000,000	200,000,000	4,000,000	3,000,000	0	320,000	8.00%	6,680,000
2	26,680,000	180,000,000	3,600,000	4,002,000	0	302,400	8.40%	7,299,600
3	33,979,600	160,000,000	3,200,000	5,096,940	2,500,000	282,240	8.82%	5,514,700
4	39,494,300	140,000,000	2,800,000	5,924,145	2,500,000	259,308	9.26%	5,964,837
5	45,459,137	120,000,000	2,400,000	6,818,871	2,500,000	233,377	9.72%	6,485,493
6	51,944,630	100,000,000	2,000,000	7,791,695	2,500,000	204,205	10.21%	7,087,490
7	59,032,120	80,000,000	1,600,000	8,854,818	2,500,000	171,532	10.72%	7,783,286
8	66,815,406	60,000,000	1,200,000	10,022,311	2,500,000	135,082	11.26%	8,587,229
9	75,402,635	40,000,000	800,000	11,310,395	2,500,000	94,557	11.82%	9,515,838
0	84,918,473	20,000,000	400,000	12,737,771	2,500,000	49,643	12.41%	10,588,128
1	95,506,601							
		Totals....	22,000,000	75,558,945	20,000,000	2,052,344		75,506,601

SCENARIO 2: 38% Total Program Loss
(19% paid by HLIS, 19% paid by Primary Lenders)

ssumptions:

Total Program funding	Rs. 400,000,000	
Initial insurance fund balance	Rs. 20,000,000	
Risk balance at beginning of period 1	Rs. 200,000,000	
Annual rate of risk decline		10.0% of original balance
Premium as % of risk balance		2.00%
Administrative costs as % of premiums		8.00% (First period)
Increase of administrative costs rate		5.00% annually
Interest income as per cent of fund balance		15.00% annually
total loss during last 8 periods		18.90% of total Program funding

Loss during first two years assumed to be zero.

inancial Projections:

ERIOD (rs.)	FUND BALANCE	RISK BALANCE	PREMIUMS INCOME	INTEREST INCOME	BAD DEBT LOSS	ADMIN COSTS	ADMIN COST AS % OF PREMIUMS	NET CASH FLOW
1	20,000,000	200,000,000	4,000,000	3,000,000	0	320,000	8.00%	6,680,000
2	26,680,000	180,000,000	3,600,000	4,002,000	0	302,400	8.40%	(7,299,600)
3	33,979,600	160,000,000	3,200,000	5,096,940	9,450,000	282,240	8.82%	(1,435,300)
4	32,544,300	140,000,000	2,800,000	4,881,645	9,450,000	259,308	9.26%	(2,027,663)
5	30,516,637	120,000,000	2,400,000	4,577,496	9,450,000	233,377	9.72%	(2,705,882)
6	27,810,755	100,000,000	2,000,000	4,171,613	9,450,000	204,205	10.21%	(3,482,592)
7	24,328,164	80,000,000	1,600,000	3,649,225	9,450,000	171,532	10.72%	(4,372,308)
8	19,955,856	60,000,000	1,200,000	2,993,378	9,450,000	135,082	11.26%	(5,391,703)
9	14,564,153	40,000,000	800,000	2,184,623	9,450,000	94,557	11.82%	(6,559,934)
10	8,004,218	20,000,000	400,000	1,200,633	9,450,000	49,643	12.41%	(7,899,010)
11	105,209							
		Totals....	22,000,000	35,757,552	75,600,000	2,052,344		(19,894,791)

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APPENDIX 6:

LIST OF CONTACTS

DURING THE CONSULTANT MISSION

APPENDIX 6:

LIST OF CONTACTS DURING THE CONSULTANT MISSION

1.0 U.S. GOVERNMENT

- G. Phillip Hughes, Ambassador, Barbados
- Mosina H. Jordan, Director, USAID/Barbados
- James T. Grossman, USAID/Barbados
- Vernita P. Fort, USAID/Barbados
- William Gelman, RHUDO/Jamaica
- Skip Kissinger, RHUDO/Jamaica

2.0 BARBADOS

- Barclays Bank PLC
  - Grant Phillips, Carribbean Director
  - Phillip W. Lee, Advances Manager

- Barbados Mortgage Finance Company, Ltd.
  - Harcourt A. Niles, Manager

- The Barbados Mutual Life Assurance Society
  - Dodridge Miller, Treasurer & Vice-President
  - Pat Downes, Assistant Vice-President-Investments

- Caribbean Development Bank
  - Marins St. Rose, Vice-President
  - Nizamuddeen Ameerally, Project Officer Infrastructure

- Caribbean Financial Services Corporation
  - David DaCosta, Managing Director

- Colybrand Company Services, Ltd.
  - Grenville W. Phillips, Managing Director

- Commonwealth Development Corporation
  - Bill Farmer, Representative

- Life of Barbados, Ltd.
  - Stephen E. Emtage, Vice-President
  - Stephen N. Nicholls, Financial Analyst

- USAID Consultants
  - Thomas Downing
  - David C. Shorey
  - David M. Staples

3.0 St. Lucia

- Commonwealth Development Corporation
  - David McDonald, Consultant

- Credit Unions
  - Silvanius Fontenard, President, Choiseul Cooperative Credit Union

  - Ignatius La Fuillee, Manager, Choiseul Cooperative Credit Union

  - Rudy Johns, President, Laborie Cooperative Credit Union

  - Angela Mariott, Secretary, Saltibus Cooperative Credit Union

- Government of St. Lucia
  - Adrian Dolcy, General Manager, Housing & Urban Development Corporation
  - John Winston, Acting Registrar of Cooperatives

- St. Lucia Cooperative Bank
  - Alnita F. Simmons, General Manager

- St. Lucia Mortgage Finance Company, Ltd.
  - R. Orlando Martyr, Chief Executive

4.0 ST. KITTS

- Eastern Caribbean Central Bank
  - Errol N. Allen, Deputy Governor
  - Ian Ferquson, Deputy Director, Banking
  - Eustace Liburd, Director, Research & Information
  - James L. Fleming, Special Assistant To The Governor

- Bank of Nevis
  - Hanzel Manners, Chairman
  - Richard Lupinacci, Director
  - Rawlinson A. Isaac, Manager

- Morning Star Holdings, Ltd.
  - Bill Barnard, Principal

5.0 TRINIDAD

- Colonial Life Insurance Company, Ltd.
  - L.A. Monteil, Financial Comptroller
  - Anthony Fifi, Managing Director, CLICO Properties, Ltd. (telephone)

- Home Mortgage Bank
  - Calder Hart, Chief Executive Office]
  - Peter Johnson, Director, Finance

6.0 PUERTO RICO

- Bankers Trust Caribe Capital Markets, Inc.
  Carlos A. Burns, Chief Executive Officer

- Citibank, N.A.
  - Armando D. Silva, Senior Vice-president, Citicorp Financial Services Corp.
  - Michael McMorris, Manager, Citibank (Jamacia)

- American Life and General Insurance Company
  - Lee Adler, President, Caribbean Region (telephone)
  - Irwin Brewster (telephone)

7.0 UNITED STATES (Via Telephone)

- American International Group
  - Steve Stack, Investments

- Cooperative Housing Foundation
  - James Upchurch, President

- Federal Home Loan Mortgage Corporation
  - Dan Driscoll, Vice-President

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