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Project Finance and Guarantees

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World Bank Guarantees Broaden Capital Market Access

The National Power Corporation (Philippines) and Jordan Telecommunications Corporation bond issues

The US 144A market

Rule 144A, passed by the US Securities and Exchange Commission (SEC) in 1990, established a new market for stocks and bonds in the US. The rule allows US and foreign issuers to issue securities which can be bought and traded only by institutional investors (such as insurance companies or pension funds) who have securities holdings of at least $100 million. Under 144A, issuers do not have to provide the extensive financial disclosure or undergo the lengthy approval process with the SEC as they would for the public market. As an indication of the size of the 144A market, over one-third of total US corporate borrowing is in the 144A market. It is a major source of long-term capital—144A bond issues typically have longer maturities than Eurobond issues.

The World Bank partial credit guarantee is a tool which can help governments and government entities access long-term financing on international credit (loan) and capital (bond) markets. Over the past year, the Bank's guarantee program has supported two bond issues for state utilities: a 15-year, US$100 million issue by the Philippines' National Power Corporation (NPC), launched in July 1994 and a 7-year, US$50 million issue by Jordan Telecommunications Corporation (TCC), scheduled for launch this month. (Another Bank-guaranteed bond issue, a 10-year, US$200 million issue by Hungary's State Development Institute, was launched in August 1990.) The maturity and pricing obtained with the support of the Bank's guarantee program are, for both issues, significantly better than those which could be achieved without the Bank's support.

Putting the NPC and TCC issues into a global capital market context, developing country borrowers took advantage of historically-low interest rates and launched a record number of bonds in 1992-1993. One might ask why, then, with this record borrowing by developing countries, is there a need for credit enhancement? The answer is that this record borrowing was, in fact, dominated by issues in a few countries in Latin America, Asia and Europe. Also, the weighted-average maturity of new issues during this period was only about six years[1]—not nearly long enough to fit into the revenue structure of a typical infrastructure project. The World Bank guarantee addresses both these problems of developing country borrowers by stretching maturity and facilitating market access.

NPC Bond Issue

With the support of the Bank's guarantee program, NPC was able to achieve a 15-year maturity, one-third greater than the longest maturity previously attained by an issue from a Philippine sovereign entity (10 years). The 15-year maturity was obtained at extremely favorable pricing of 250 basis points (2.5%) over the yield of US treasuries of the same maturity. This pricing compares favorably with that of previous Philippine issues of much shorter maturities. The bonds were successfully placed just seven months after the Philippines completed its second Brady commercial debt restructuring. World Bank support was structured as a put option for principal repayment at maturity. (The put option allows bondholders to present or "put" their bonds to the World Bank at maturity for payment of principal.)

The issue, underwritten by Morgan Stanley, tapped the Eurobond and US 144A markets (it is the first Bank-guaranteed transaction to tap the 144A market). It was primarily placed in the 144A market to access the longer maturities available in that market (compared with the Euromarkets) as well as introduce the Philippines and NPC to a new investor base consisting largely of institutional investors.

[1] *Private Market Financing for Developing Countries.* IMF, March 1995. Page 14

Benefits of World Bank Guarantees

World Bank guarantees (both partial credit and partial risk) provide borrowers with several benefits in addition to market access. These include longer maturity, lower cost of financing and tremendous flexibility in terms of market, instrument (loan or bond), currency and interest rate (fixed or floating).

Leyte-Luzon Geothermal Project

Peak electric power demand in the Philippines is expected to double by the year 2000 to 8.3 MW. Proceeds from the NPC bond issue, in parallel with a Bank investment loan, are being used to help finance the US$1.3 billion Leyte-Luzon Geothermal Power Project which is part of the Government's program to increase capacity to meet this demand.

The project is being implemented by NPC, Philippine National Oil Company (PNOC) and the Electricity Development Corporation, all state-owned companies, and has two components: (i) expansion of the Leyte geothermal field and (ii) construction of converter stations and related transmission lines and equipment. Capacity of the Leyte geothermal field will be expanded to 640 MW (from 200 MW) by the project. When completed, the project will enable the Philippines to replace coal- and oil-fired capacity with environmentally-superior geothermal power. In addition to expanding capacity, the project will better integrate the Leyte field into the national power grid.

Financing Plan:
Leyte-Luzon Goethermal
Power Project (US$m)

Power Transmission Component	
World Bank Loans	240
Bonds w/ World Bank Put	100
J-Exim	170
BITS[1] / Grant	39
GEF[2] / Grant	30
PNOC/NPC Internal Cash	134
Power Generation Component	
BOT Contract	240
TOTAL	1,333

[1] BITS: Agency for Technical and Economic Cooperation (Sweden)
[2] GEF: Global Environment Fund (World Bank)

TCC Bond Issue

The TCC issue breaks new ground for both the Bank and Jordan:

- *First* capital market issue for the Kingdom.
- *First* guarantee issued by the Bank for a telecommunications project (prior Bank guarantees have been mainly for power projects).
- *First* guarantee issued for a project in the Middle East.

Prior to the TCC issue, Jordan had been absent from the international financial markets since 1990, when it arranged aircraft financing for Royal Jordanian Airlines. Following its Brady debt rescheduling in December 1993, Jordan was eager to re-establish access to international financial markets. With the Bank's guarantee, it was able to obtain seven-year financing—the longest maturity obtained to date for a Middle-East borrower in the bond markets. It is important to note that the TCC issue comes just nine months after the Mexican financial crisis of last December, which effectively curtailed new issues by developing country borrowers until June of this year.

An innovative feature of the Bank's guarantee is that it is designed to enable Jordan to tap domestic sources of foreign currency, thereby mobilizing domestic savings for the country's infrastructure development. These savings are in the form of deposits held by Jordanians either working in the Gulf or who returned to Jordan following the Gulf War. This large pool of foreign currency (estimated at US$3 billion) is currently placed by Jordanian banks in the international money markets (aside from the required 35% which must be deposited with the Central Bank). The bulk of these deposits are short term, placed on a one-month, roll-over basis and yield a relatively low rate of return.

The structure of TCC issue marks a milestone for the Bank in terms of risk sharing. It is the first Bank-guaranteed financing for which there was no Jordanian sovereign guarantee to bondholders on either principal or interest payments. This means investors, though covered by the Bank's guarantee on principal repayment, are assuming TCC risk on the interest payments—thereby helping to establish the corporate credit of TCC in the capital markets.

Jordan Telecommunications Project

Efficient and well-functioning telecommunications are especially important to a country's services sector, which, in Jordan's case, accounts for over half its GDP. Jordan's economy, however, is hampered by poor telecommunications. This manifests itself in line shortages (only 77% of line demand is filled; without investment to expand

service, this will deteriorate to 55% by 1998), poor quality of service (a 40% call completion rate) and an imbalance between international and local service tariffs.

Financing Plan:
Jordan Telecom Project (US$m)

World Bank Loan	20
Bonds w/ WB guarantee	50
J-Exim	16
European Invest. Bank	55
ODA[1] and BITS[2] Grants	7
TCC Internal Resources	69
TOTAL	217

[1] ODA: Overseas Devt. Association (Great Britain)
[2] BITS: Agency for Technical and Economic Corporation (Sweden)

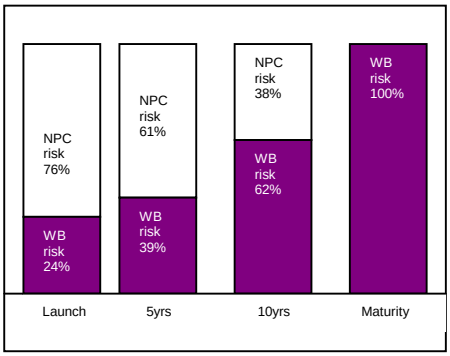
Proceeds from the TCC bond issue will be used to finance the Jordan Telecommunications Project. (A Bank A-loan is also being used to finance the project.) The project will help address Jordan's telecommunications problems through two components: (i) sector restructuring, which will help the Government develop the telecommunications sector and lead to eventual privatization and (ii) investment, which will result in a 6% increase in the number of lines and associated local and long-distance networks. The project is expected to be completed by the end of 1997.

Risk Sharing and Credit Appreciation: Related Concepts

Risk sharing is a key element of the Bank's guarantee program. In a Bank-guaranteed financing, the Bank "shares" risks with the market (i.e., investors and lenders) by covering only those risks that the market cannot bear. For partial credit guarantees, this generally means guaranteeing the later maturities (in the case of a bond, this means covering repayment at maturity). The extent of risk sharing for a bond issue backed by the Bank's partial credit guarantee can be measured by taking the present value of the bond's cash flows and tends to be a reflection of the market's perception of the creditworthiness of the country in question. In the case of the NPC issue, the present value of the Bank's put option on principal is about 24% of the present value of the bond's total cash flows (i.e., principal and interest payments), meaning that investors are assuming risk on about 76% of the bond's cash flows. For the TCC issue, the numbers are 58% and 42% for the Bank and investors, respectively.

The concept of inherent credit appreciation is closely related to risk sharing, and it is valuable in marketing Bank-guaranteed instruments to potential investors. Take the case of a Bank-guaranteed bond issue. At launch, the bond's notional credit rating is a "blend" of the AAA credit rating of the Bank, which is guaranteeing principal repayment, and the lower credit rating of either the government, if it is guaranteeing interest payments, or the issuing entity. When the bond reaches maturity, its credit quality has become that of the Bank. This results from the fact that at maturity, the only cash flow remaining is the Bank-guaranteed principal repayment. The chart below depicts the credit appreciation/risk sharing of NPC's issue.

NPC Bond Issue: Credit Appreciation



For further information on the Bank's guarantees for the NPC and TCC bond issues, please contact Ms. Farida Mazhar, PFG, tel. (202) 473-1235.

NPC and TCC Bond Issues: Summary Information

	National Power Company (Philippines)	Jordan Telecommunications Corporation
• Issue Amount	US$100 million	US$50 million
• Maturity	15 years (July 2009)	7 years (September 2002)
• Amortization	Bullet	Bullet
• Coupon	9.75% fixed, semi-annual	LIBOR + 110
• Issue Price	99.4	100
• Yield	US treasury + 250bp	n/a (floating-rate bond)
• Support Under World Bank Guarantee	Put option on principal at par at maturity	Guarantee of principal repayment at maturity
• Sovereign Guarantee	Interest only	None
• Lead Manager(s)	Morgan Stanley; co-managed by Salomon Brothers International	Banque Paribas and ANZ Gindlays Bank Plc

To obtain a copy of the brochure, *The World Bank Guarantee: Catalyst for Private Capital Flows*, please call (202) 458-0834. Please direct editorial comments to Andres Londono, tel. (202) 473-2326.