REPORT AND RECOMMENDATIONS

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED LOAN

TO THE

ELECTRICITY AUTHORITY

OF

CYPRUS

April 8, 1963
1. I submit the following report and recommendations on a proposed loan in an amount in various currencies equivalent to U.S. $21 million to the Electricity Authority of Cyprus.

PART I - HISTORICAL

2. Cyprus became an independent republic within the British Commonwealth in 1960 and became a member of the Bank on December 21, 1961. An economic mission visited Cyprus in December 1961, and on the basis of its findings the Bank agreed to consider lending for suitable projects. In March 1962 the Government requested the Bank to assist in financing a project for the expansion of the electric power system and a mission visited Cyprus last June to appraise the project.

3. Negotiations with representatives of the Cyprus Government and the Cyprus Electricity Authority were completed in Washington in February 1963.

4. If the proposed loan is approved, it will be the Bank's first loan to Cyprus.

PART II - DESCRIPTION OF THE PROPOSED LOAN

5. The main characteristics of the proposed loan are as follows:

Borrower: The Electricity Authority of Cyprus.

Guarantor: The Republic of Cyprus.

Amount: The equivalent in various currencies of $21 million.

Purpose: To help finance the construction of (1) a 60 MW thermal power station at Mein and (2) expansion of the power transmission and distribution systems.


Interest Rate: 5-1/2% per annum, including 1% commission.

Commitment Charge: 3/4 of 1% per annum.
PART III - THE PROJECT

6. An appraisal report on the project (TC-345a) is attached (No.1).

7. Until 1952 public supplies of electricity in Cyprus were available in only 17 out of some 600 towns and villages. The power was produced by small diesel units many of which were in poor condition and distribution was very limited. In 1952 the Electricity Authority of Cyprus was established. It has since acquired all the public supplies and has constructed a steam generating station and an island-wide transmission network. The generating station, situated at Dekhelia, has an installed capacity of 70 MW and will be expanded by an additional 14 MW unit which will come into operation very shortly. The transmission system consists of over 300 miles of 66 KV overhead lines.

8. Sales of electric power have increased steadily in recent years at the rate of about 10% a year. At the same time, investment in new capacity has been inadequate and it has been impossible to meet demand in full. Forecasts of energy requirements through 1968 have been made by the Electricity Authority and its consulting engineers. The estimated increase averages 7.3% a year and is considered conservative.

9. The project for which the proposed loan would be made consists of (a) the construction of the first stage of a new oil-fired thermal generating station at Poni on the southern coast of Cyprus, this stage to have two generating units of 30 MW each; (b) the construction of 95 miles of new 66-KV transmission lines and of four new substations; and (c) the reinforcement and extension of the distribution system, including the installation of 610 distribution transformers, the construction of 1,120 miles of new distribution lines, and the reconstruction of 120 miles of old distribution lines.

10. The proposed project is technically sound and provides the most economical means of expanding electric power supplies in Cyprus. Its cost is estimated at £30 million, of which £21 million will be in foreign exchange. Rather more than half the local currency costs will be provided by the Electricity Authority from retained earnings, and the Government will provide the balance on reasonable terms if the Authority is unable to obtain satisfactory financing from private sources.

The Borrower

11. The Electricity Authority is an autonomous body, governed by a Board appointed by the Government. The Board appoints the General Manager, who is also Chief Engineer. The present General Manager is a capable and experienced engineer who has been on the staff of the Authority since its inception in 1952. The staff, with the help of consulting engineers, is fully capable of constructing and operating the project.

12. The permanent capital of the Authority consists of the proceeds of five successive bond issues totaling £7.88 million ($22 million) raised by the Government and re-lent to the Authority. The Authority
pays only interest on this capital, which is regarded by the Government as a permanent capital contribution rather than as a loan.

13. The Authority has the power to fix rates so that revenues will be sufficient to cover all operating and financial expenses, to make provisions for repaying borrowed moneys and to produce whatever surplus the Authority considers reasonable. The present level of rates is adequate and is estimated to provide a rate of return on net fixed assets in operation averaging about 7% over the next few years. It is estimated that total debt service will be covered on the average 1.7 times over the next few years. It is expected that during the period 1962-68 the Authority would be able to cover from its own resources about one-third of the finance needed for its expansion.

14. The present financial situation of the Authority is sound and it should have no difficulty in servicing its debts, including the proposed new borrowing.

Loan from the United Kingdom

15. The United Kingdom has made a loan to the Electricity Authority, guaranteed by the Cyprus Government, amounting to £2 million to assist in financing the project. The loan is repayable in 20 years with a grace period of 5 years. Interest will be equal to the cost to the U.K. Treasury of borrowing in the London market plus 1/4% and will be determined as and when the funds are withdrawn. The loan is tied to purchases in the United Kingdom. However, it is intended that all imported equipment would be obtained on the basis of international competitive bidding. Purchases made in the U.K. as a result of this bidding would be financed out of the U.K. loan, if at the time the interest on it were not higher than that on the Bank loan. To the extent that the U.K. loan is so used, the Bank loan would be cancelled. On the other hand, if the interest on the U.K. loan were higher, the Authority would use the Bank loan.

PART IV - LEGAL INSTRUMENTS AND AUTHORITY

16. Attached are a draft Loan Agreement between the Bank and the Electricity Authority of Cyprus (No. 2), a draft Guarantee Agreement between the Republic of Cyprus and the Bank (No. 3), and the report of the Committee provided for in Article III, Section 4 (iii) of the Articles of Agreement (No. 4). The draft Loan and Guarantee Agreements conform generally with the pattern of agreements for power projects.

17. Section 5.08 of the draft Loan Agreement and Section 3.07 of the draft Guarantee Agreement are designed to ensure that adequate power rates will continue to be charged. Section 7.01 of the draft Loan Agreement specifies as additional conditions of effectiveness that:

a) The Authority and the Government shall have entered into an agreement providing that no repayment of the loans totaling £7.88 million made by the Government to the Authority will be made before the Bank's loan is fully repaid;
b) The Authority shall have made arrangements satisfactory to the Bank to obtain the funds to finance the balance of the cost of the Project. Since it is impracticable to fix the terms of this financing prior to making the loan effective, it has been agreed that the Government will enter into an agreement with the Authority under which the Government would undertake to provide the funds on reasonable terms if the Authority is unable to obtain them from other sources. (See para. 10)

PART V - ECONOMIC POSITION

18. A report entitled "The Economy of Cyprus" is attached (No. 5).

19. Cyprus is a semi-arid island of 3,570 square miles in the eastern Mediterranean. It was a dependency of the United Kingdom from 1878 to 1960. The population, which is estimated to be 565,000, is 80% of Greek origin and 18% of Turkish origin. Independence came to Cyprus as the result of a compromise between a demand by the Greek Cypriots, supported by the Government of Greece, for union with Greece (Enosis) and the insistence of the Turkish Government on partition of the island if British control were relinquished. An agreement was reached in 1960 under which the independence and territorial integrity of the island were guaranteed by the governments of Greece, Turkey and the U.K. and a constitution was established which contains provisions designed to safeguard the position of the Turkish minority.

20. Agriculture has traditionally been the mainstay of the economy. It still provides a living for more than half the population and accounts for more than 30% of exports. Over the past ten years, agricultural production has expanded with the increase in irrigation, which made it possible to grow citrus fruit, potatoes and early vegetables for export to the U.K. Mining, principally of copper and iron pyrites, accounts for about 50% of exports. Commodity exports, however, provide only about half of total foreign exchange earnings. Expenditures by foreign governments, principally by the U.K., provide most of the balance. These expenditures increased rapidly during the middle 1950's following the disturbances connected with the demand for Enosis and as a result of the establishment of British military bases in Cyprus. At the same time, export prices for copper and citrus fruit were favorable and during these years, the national income grew rapidly. The gross national product declined in 1959 and 1960 with a sharp reduction in military expenditures, but there was a good recovery in 1961 with the restoration of confidence after peace was established. Over the period from 1950 to 1961, the average annual growth in GNP was 3.5% and by 1961 the per capita product of about $1420 was one of the highest in the Mediterranean area.

21. Given political stability, Cyprus has the potential for further substantial economic growth. There are good export markets for copper, citrus fruit, early vegetables and table grapes. Tourism, too, could become an important foreign exchange earner. The economy remains, however, heavily dependent on expenditures by the U.K. Government, which were equal to 20% of GNP in 1961, and readjustment would be difficult.
if military expenditures were substantially and rapidly reduced. The U. K. has agreed to review Cyprus' financial requirements every five years in order to determine the amount of aid to be provided in the ensuing five-year period. This aid will be important in helping to finance the 1962-66 development program now being implemented. Cyprus will, however, require further aid from abroad to finance development. The program appears to be broadly in balance, with priority being given to infrastructure and water resources, and future economic growth will be largely dependent upon its successful implementation.

22. Cyprus' external debt at £11.6 million (US$24.5 million) is not high and debt service charges of about £1.5 million per year are equivalent to only 3.5% of current foreign exchange earnings. Cyprus would be well able to service the proposed loan.

PART VI - COMPLIANCE WITH ARTICLES OF AGREEMENT

23. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank.

PART VII - RECOMMENDATIONS

24. I recommend that the Bank make a loan to the Electricity Authority of Cyprus with the guarantee of the Republic of Cyprus, in an amount in various currencies equivalent to £21 million for a term of 20 years with interest (including commission) at 5-1/2% per annum, and on such other terms as are specified in the attached draft Loan and Guarantee Agreements, and that the Executive Directors adopt a resolution to that effect in the form attached (No. 6).

Attachments (6)

Washington, D. C. George D. Woods
April 8, 1963