



Board of Executive Directors

For consideration

On or after 23 November 2011

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4 November 2011

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Simultaneous Disclosure

To: The Executive Directors
From: The Secretary
Subject: Honduras. Proposal for a “Contingent Loan for Natural Disaster Emergencies”

Basic Information: Loan type Facility Financing (FAC)
Borrower Republic of Honduras
Amount up to US\$70,000,000
Source Single Currency Facility of the Ordinary Capital

Amount up to US\$30,000,000
Source Fund for Special Operations

Inquiries to: Guillermo Collich (extension 2064) or Juan Martínez Álvarez (extension 1216)

Remarks: This operation is being presented in accordance with the rules and procedures of the Contingent Credit Facility for Natural Disaster Emergencies (document GN-2502-2), approved pursuant to Resolution DE-27/09.

Also, the operation is included in document GN-2617, “2011 Operational Program Report”, approved by the Board of Executive Directors on 4 May 2011. The loan amount exceeds the ceiling established for Group D countries. Therefore, it does not qualify for approval by simplified procedure.

Reference: GN-1838-1(7/94), DR-398-11(4/11), GN-2502-2(2/09), DE-27/09, GN-2617(4/11)

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

HONDURAS

CONTINGENT LOAN FOR NATURAL DISASTER EMERGENCIES

(HO-X1016)

LOAN PROPOSAL

This document was prepared by the project team consisting of: Guillermo Collich (ICF/CMF), Project Team Leader; Juan Martínez Alvarez (ICF/CMF), Alternate Team Leader; Juan José Durante (ICF/CMF); Sarah Almonte (ICF/CMF); Sergio Lacambra (INE/RND); Nalda Morales (PDP/CHO); Juan Carlos Martell (PDP/CHO); Kevin McTigue (LEG/SGO); and Annabella Gaggero (ICF/CMF).

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| REQUIRED | |
| 1. | Monitoring and evaluation plan http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36079890 |
| OPTIONAL | |
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| 2. | Automatic redirection list (ARL) (Appendix I to the loan contract) http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36345258 |
| 3. | Financial terms and conditions of the contingent loan http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36331746 |
| 4. | Economic analysis: cost-effectiveness http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36363586 |
| 5. | IDB. Natural Disasters Financial Risk Management: Technical and Policy Underpinnings for the Use of Disaster-linked Financial Instruments. IDB. Technical note IDB-TN-175 http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35406452 |
| 6. | IDB (ICF/CMF): Honduras: Creation of a Reserve Fund for Responding to Natural Disaster Emergencies. Evaluation of financial and operational feasibility. September 2008 http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1808649 |
| 7. | IDB (ICF/CMF): Natural Disaster Management in Honduras: Elements for a Financial Strategy. August 2011 http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36338640 |
| 8. | IDB. Indicators of Disaster Risk and Risk Management: Honduras. Using the System of Indicators for Disaster Risk and Risk Management 2005-2007. October 2009 http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36343485 |
| 9. | IDB. Catastrophe risk profile of Honduras. http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35551644 |
| 10. | Integrated Disaster Risk Management and Finance Approach (GN-2354-7). http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36485670 |
| 11. | Contingent Credit Facility for Natural Disaster Emergencies (GN-2502-2). http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36485672 |
| 12. | Action Plan for Improving Disaster Risk Management 2005-2008 (GN-2339-1) http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36485668 |

13. Implementation of multilateral debt relief and concessional finance reform at the IDB. Proposal for the implementation of a Debt Sustainability (DSF) and Enhanced Performance-Based Allocation (PBA) framework
<http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36485671>
14. Letter of request for the contingent loan from the Government of Honduras
<http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=2015173>

ABBREVIATIONS

| | |
|----------|---|
| ARL | Automatic Redirection List |
| CCF | Contingent Credit Facility for Natural Disaster Emergencies |
| CCLIP | Conditional Credit Line for Investment Projects |
| CIDA | Canadian International Development Agency |
| COPECO | Comisión Permanente de Contingencias [Standing Commission on Contingencies] |
| CUT | Cuenta Única del Tesoro [Single Treasury Account] |
| DSF/PBA | Debt Sustainability and Enhanced Performance-Based Allocation framework |
| FSO | Fund for Special Operations |
| GDP | Gross domestic product |
| GTZ | German Technical Cooperation Trust Fund |
| IDB | Inter-American Development Bank |
| IOM | International Organization for Migration |
| JICA | Japan International Cooperation Agency |
| OECD/DAC | Organisation for Economic Co-operation and Development / Development Assistance Committee |
| SDC | Swiss Agency for Development and Cooperation |
| SEFIN | Ministry of Finance |
| SIAFI | Sistema de Administración Financiera Integrada [Integrated Financial Management System] |
| SINAGER | Sistema Nacional de Gestión de Riesgos en Honduras [National Risk Management System in Honduras] |
| UAP | Unidad Administradora de Proyectos [Project Management Unit] |
| UEPEX | Unidades Ejecutoras de Proyectos con Recursos Externos [Execution Units for Externally-financed Projects] |
| UNDP | United Nations Development Programme |
| UNFPA | United Nations Population Fund |
| UNICEF | United Nations Children's Fund |
| USAID | United States Agency for International Development |

PROJECT SUMMARY

HONDURAS CONTINGENT LOAN FOR NATURAL DISASTER EMERGENCIES (HO-X1016)

| Financial Terms and Conditions ¹ | | | | |
|---|-------------------------------|-------------------------------------|--|---|
| Borrower: Republic of Honduras | | Financing source: | Ordinary Capital | FSO |
| Executing agency: The borrower, acting through its Ministry of Finance (SEFIN) | | Amortization period: ⁱ | 30 years | 40 years |
| | | Grace period: ⁱⁱ | 5.5 years | 40 years |
| Source | Amount (US\$ millions) | Disbursement period: ⁱⁱⁱ | 5 years | |
| | | Interest rate: | SCF-fixed | 0.25% |
| IDB (Ordinary Capital) | 70 | Inspection and supervision fee: | * | N/A |
| IDB (FSO) | 30 | Credit fee: | * | N/A |
| Total | 100 | Currency: | U.S. dollars from the Single Currency Facility | U.S. dollars |
| Project at a Glance | | | | |
| Project objective/description: The objective of the operation is to help absorb the potential impact of severe or catastrophic natural disasters on the public finances of Honduras by increasing the availability, stability, and efficiency of contingent financing to respond to emergencies caused by such events (paragraph 1.23). | | | | |
| Special contractual conditions: | | | | |
| 1. Conditions precedent to disbursements: (i) the Bank has verified the occurrence of a contractually eligible event; (ii) execution of the Integrated Natural Disaster Risk Management Program, previously agreed upon with the borrower, is proceeding satisfactorily for the Bank; and (iii) the borrower has presented, within 90 days after the occurrence of an eligible event, a disbursement request indicating the amount required, and whether the disbursement is to be charged against the contingent loan or against the loans identified on the automatic redirection list (ARL), and in the latter case, the borrower will specify the ARL loan or loans from which the proceeds will be drawn (paragraph 2.4). | | | | |
| 2. Conditions on the disbursements: (i) the maximum amount of each disbursement is limited to the lesser of the following: (a) the available undisbursed balance of this loan; and (b) the maximum amount set in the Operating Regulations for the type, location, and intensity of the eligible event (paragraph 2.7); and (ii) the Bank will recognize as a justified expenditure up to 100% of the amount of eligible expenditures actually incurred and paid by the borrower from the date of the occurrence of the eligible event, and for a period of up to 180 calendar days immediately thereafter (paragraph 3.8). | | | | |
| Exceptions to Bank policies: None | | | | |
| Project consistent with country strategy: | | | | |
| | | Yes [X] | No [] | |
| Project qualifies as: | | SEQ [] | PTI [] | Sector [] Geographic [] Headcount [] |

¹ The financial terms and conditions are consistent with the provisions established in document GN-2442 regarding a blended structure of OC and FSO resources, and the applicable financial conditions in both cases. It should be noted that Ordinary Capital for blended operations is subject to different financial conditions than Ordinary Capital for regular loans, inasmuch as it has an amortization period of 30 years and a grace period of 5.5 years.

ⁱ The amortization periods are counted from the date of each disbursement under the contingent loan contract.

ⁱⁱ The grace periods are counted from the date of each disbursement under the contingent loan contract.

ⁱⁱⁱ The period of availability of loan proceeds (disbursement) may be extended for up to five additional years at the country's request and the Bank's discretion. In the event of an extension, the amortization period, grace period, and credit fee charges will begin from the date said extension takes effect, and will apply to the undisbursed available balances of the contingent loan.

* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period. When new funds are disbursed, the credit fee will accrue from 60 days from the effective date of the contingent loan contract to the date of the corresponding disbursement(s) and will be calculated based on the amount of the corresponding disbursement(s).

I. DESCRIPTION AND RESULTS MONITORING

A. Frame of reference, problem addressed, and rationale

- 1.1 This operation is part of the Contingent Credit Facility for Natural Disaster Emergencies established in document GN-2502-2 of 13 February 2009. This facility, under which contingent loans such as this operation can be structured, is one of the Bank's principal tools for supporting countries in their efforts to improve financial management of the risks of disasters caused by natural events.

1. Vulnerability to natural disasters

- 1.2 During the past century, Honduras has suffered severe consequences caused by various types of natural disasters, such as earthquakes, floods, and hurricanes, which have affected a total of approximately 4.7 million people. Historic records on disasters over the past 30 years show that the frequency of events has been increasing, which indicates a greater concentration of the country's vulnerability, especially to climate-related events.¹ by way of illustration, in recent decades the country experienced three hydrometeorological events in the period 1974-1978 compared with 10 events in the period 1999-2003.
- 1.3 The United Nations ranks Honduras among the 20 most vulnerable countries in the world to flooding and the most vulnerable to hurricanes.² In the last 30 years, 12 hurricanes have been recorded in the country, with an average of almost 1,300 deaths and 155,000 affected people per event, with total losses equaling US\$4 billion.³ Among the most devastating hurricanes were Fifi in 1974 and Mitch in 1998, which affected 23% and 38% of the population, respectively. An analysis of damage calculated as a percentage of GDP shows that Fifi caused damages equivalent to 52% of GDP and Mitch caused damages equivalent to 72% of GDP. More recently, the country has been hit by other severe hydrometeorological events, such as Tropical Depression 16 in October 2008. Damages caused by this event were estimated at 0.1% of GDP⁴ (approximately US\$125 million⁵).

2. Financial vulnerability

- 1.4 Honduras is a low-income country that has benefitted from debt relief initiatives. As a result of this process, the total public sector debt of Honduras fell from 77.9% of GDP in 2000 to 19.6% of GDP in 2007. Between 2007 and 2008, the country was

¹ Vulnerability has been exacerbated by rapid urban growth and unplanned settlement patterns, in a setting of limited land use planning, few environmental controls, and inadequate design and enforcement of construction standards. Moreover, climate variability is expected to further increase the country's vulnerability, particularly along the northern and southern coasts.

² Reducing Risk, 2004. United Nations Development Programme (UNDP).

³ M-DAT: "The OFDA/CRED International Disaster Database." *Université Catholique de Louvain* - Brussels - Belgium, www.em-dat.net.

⁴ Rehabilitation and reconstruction plan for damages. State Secretariat of the Office of the Presidency.

⁵ At the request of Honduras, the Bank responded to the national emergency by reformulating its loan portfolio by US\$27 million.

able to finance the majority of its deficit on concessional terms, allowing it to bring down its debt to 16% of GDP.⁶ Nevertheless, the political and economic crisis of 2009 resulted in a debt increase to 23.7% of GDP. In 2010, public debt as a percentage of GDP was 26.3% and external public and private debt was 24.4%. In October of that year, an agreement was signed with the International Monetary Fund, in which the government committed to continue implementing the fiscal reform in order to achieve long-term public and external debt sustainability.⁷

- 1.5 According to the IDB report on [Indicators of Risk and Risk Management](#), updated to 2009, Honduras registers a disaster deficit index of 4.27 (among the highest for the 18 countries analyzed). In other words, the maximum anticipated loss for 50-year or more events is over four times greater than the financial resources the country currently has available for responding to these types of events. Therefore, in the case of extreme events (such as Hurricane Mitch), the public sector would not have the financial capacity to assume fiscal responsibility for the extraordinary expenditures necessary to respond during the emergency and rehabilitation phases or to replace the public infrastructure that would likely be affected.
- 1.6 In conclusion, although sound management of the public debt, together with prudent public spending and a favorable outlook vis-à-vis economic growth and inflation rates in the coming years, would all point to a bright future in terms of medium-term macroeconomic stability in Honduras, the occurrence of a large-scale disaster⁸ is one of the principal contingent fiscal liabilities for the country and could compromise its stability. It is therefore extremely important for the country to make progress toward developing a financial strategy that will allow it to establish appropriate financial coverage for attending to catastrophic disaster emergencies.

3. Disaster risk management in Honduras

- 1.7 Motivated by the catastrophe caused by Hurricane Mitch, the Government of Honduras began the process of expanding the scope of its legal and institutional framework for emergency preparedness and response, for the purpose of incorporating and strengthening comprehensive disaster risk management. In order to include new prevention and preparation management areas in the natural disaster risk management framework, the structure of the Standing Commission on Contingencies (COPECO)⁹ was expanded.
- 1.8 In 2000, with the support of a World Bank loan in the amount of US\$10.8 million, the Government of Honduras began implementing the Natural Disaster Mitigation

⁶ Honduras participates in the Heavily Indebted Poor Countries (HIPC) Initiative.

⁷ Honduras and the International Monetary Fund: <http://www.imf.org/external/country/hnd/index.htm>.

⁸ [See optional link 7](#). Based on the country's disaster risk profile, the study assumes that a severe or catastrophic natural disaster occurs every 25 to 30 years, affecting approximately 10% of the population and costing—for spending during the emergency and rehabilitation phases (the first six months following the event) alone—approximately US\$335 million (1.8% of GDP).

⁹ COPECO was created in 1990 as the government agency reporting to the Office of the Presidency of the Republic and responsible for the ongoing handling of disaster responses (www.copeco.gob.hn).

Project for the purpose of improving the capacity to reduce vulnerability to natural events at both the national and municipal levels. The project concluded in 2007, achieving advances in: (i) introducing a national surveillance and warning system for floods and droughts and creating the National Hydrological Forecasting Center; (ii) designing methodological manuals on risk management for the first, second, and third cycles of basic education, and a national awareness campaign; and (iii) generating vulnerability maps and risk reduction plans for 61 of the 128 municipios deemed high risk. The IDB, for its part, has financed several components of the MARENA program (1077/SF-HO), including: (i) generating vulnerability maps in 35 municipios; (ii) creating 57 municipal emergency committees and 171 local committees; and (iii) developing 7 early warning systems at the local level.

- 1.9 In 2009, a process was conducted to consult and inform stakeholders regarding the creation by law (Executive Order 151/2009) of the National Risk Management System in Honduras (SINAGER). The creation of SINAGER enables the establishment of a framework for coordinating the country's efforts in terms of comprehensive disaster risk management, as well as a common strategy under a national risk management plan. The law includes strengthening COPECO's autonomy and authority, and it identifies financing arrangements for the sustainability of SINAGER.
- 1.10 All of the measures that are being taken by the Government of Honduras in the field of natural disaster risk management are being supported by international cooperation through a risk management board consisting of United Nations agencies (UNDP, UNFPA, UNICEF, IOM), bilateral cooperation agencies (CIDA, JICA, GTZ, SDC, USAID, Italian Cooperation), the World Bank, and the IDB, which ensures close coordination, complementarity, and opportunities to capitalize on the synergies of activities proposed by participants.
- 1.11 During the past decade, with the support of international cooperation, the country has taken significant steps toward comprehensive disaster risk management; however, important challenges remain, including: (i) consolidating the progress made with the Natural Disaster Mitigation Project in terms of prevention and mitigation at the municipal and community levels, expanding coverage to municipios identified as high and medium risk (of the country's 298 municipios, 128 have been classified as high risk and 120 as medium risk); (ii) conducting risk assessments and country vulnerability analyses in order to design programs for transferring risk and properly handling residual risk;¹⁰ and (iii) the country's limited capacity for disaster risk financial management and planning, given insufficient resources for developing and operating financial mechanisms and instruments for disaster risk retention and transfer.

¹⁰ In a context of financial management of risks, the concept of residual risk refers to the risk that remains after financing and/or transferring risk.

4. The operation in the context of the Bank's country strategy with Honduras and the sector

- 1.12 This operation dovetails with the country's efforts to improve the financial management of natural disaster risks. It is in line with the Bank's Disaster Risk Management Policy (documents GN-2354-5, GN-2354-7, and GN-2354-11) and its Integrated Strategy for Climate Change Mitigation and Adaptation and for Sustainable and Renewable Energy (document GN-2601-1). The proposed operation is also consistent with the Bank's current country strategy with Honduras, which points to a catastrophic natural disaster as one of the main risks that could compromise the established development targets. Making coverage available through this loan is one of the financial management measures that will help to mitigate that risk.
- 1.13 In addition to this operation, the Bank is currently supporting the Republic of Honduras in the area of comprehensive disaster risk management through execution of: (i) a technical cooperation operation (HO-T1102) in the amount of US\$1 million to strengthen capacities for disaster risk management, principally by strengthening the institutional capacity of SINAGER; and (ii) a Conditional Credit Line (CCLIP) for the Integrated Disaster Risk Management Program (HO-X1013). The objective of this US\$75 million credit line, approved in 2009, is to help generate suitable conditions for more efficient and effective comprehensive disaster risk management and thus reduce the potential adverse economic impacts of severe or catastrophic events.
- 1.14 The first individual loan under the CCLIP is a US\$19 million project for Disaster Risk Prevention and Mitigation (HO-L1031), which supports investments in prevention and mitigation, as well as institutional strengthening and capacity building for disaster risk management. Its specific objectives are: (i) to adopt disaster risk prevention and mitigation measures in the most vulnerable municipios through a participatory risk management and mitigation works planning process; and (ii) to strengthen the capacity and interagency coordination for comprehensive disaster risk management. In 2011, US\$1.5 million has been disbursed mainly for the execution of structural disaster risk mitigation works at the municipal level.
- 1.15 In addition to its efforts to strengthen risk management policies, Honduras has decided to advance financial management by designing and establishing a financing and risk-transfer program that will enable the country to have coverage for financing natural disaster emergencies. To this end, the government considers it a priority to have ex ante sources of financing, such as this loan, which will make more resources available to cover expenditures generated by severe and catastrophic natural disaster emergencies.

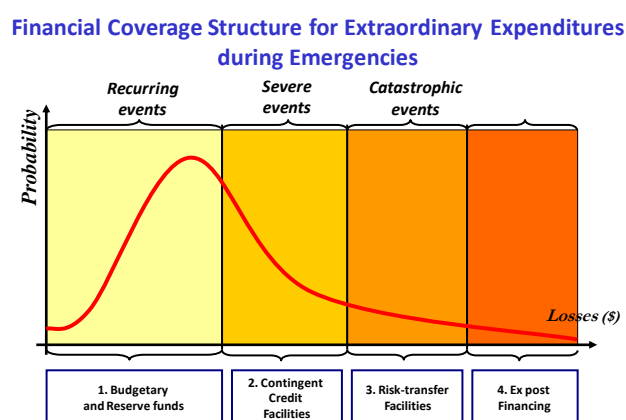
5. Bank-financed natural disaster risk transfer and financing programs

- 1.16 Since 2005, the Bank has been working to develop a strategy for comprehensive disaster risk management within the framework of the resulting Action Plan for Improving Disaster Risk Management 2005-2008 (document GN-2339-1). In 2008,

the Integrated Disaster Risk Management and Finance Approach policy (document GN-2354-7) was approved and operational development began. This finance approach includes various mechanisms and instruments to improve financial planning and coverage for disaster risks.

- 1.17 One of the specific objectives of this finance approach is to support the Bank's borrowing member countries in designing and implementing programs to finance and transfer the financial risks caused by disasters that would likely be faced by the public sector during emergencies caused by severe or catastrophic events, using a combination of financial instruments that offer broader and more stable and efficient coverage with respect to the risk of extraordinary expenditures.

- 1.18 The natural disaster risk transfer and financing programs proposed by the Bank within the framework of its finance approach presuppose budget and financial constraints, such that no single instrument is capable, on its own, of efficiently covering all risk levels, and it is therefore imperative to utilize various instruments that can be adapted to effectively cover specific portions of risk, depending on the probability of their occurrence and on the magnitude of the disaster (in terms of the size of the affected population and the level of extraordinary public spending generated by the emergency).¹¹



- 1.19 As the figure above illustrates, for the natural disaster risk transfer and financing programs it is recommended to use budget resources directly or to create reserve funds or multiyear budgetary provisions in order to cover high-frequency, less-severe disasters. Low-frequency disasters of a severe or catastrophic nature, which usually generate much higher extraordinary expenditures, are more efficiently financed in economic terms through long-term contingent debt instruments and risk transfer instruments, such as insurance and/or catastrophe bonds (CAT bonds). Lastly, it should be noted that there will always be events for which ex ante financial coverage is not fiscally sustainable because, although their frequency is very low, the losses they generate are exceedingly high.¹²

- 1.20 **Potential benefits.** The potential benefits of focusing on these types of ex ante financing programs for the emergency phase are greater than their potential costs. The natural disaster risk transfer and financing programs allow countries to achieve

¹¹ IDB. *Natural Disasters Financial Risk Management: Technical and Policy Underpinnings for the Use of Disaster-linked Financial Instruments in Latin America and the Caribbean*. Technical note IDB-TN-175. Washington, D.C.: April 2010. [Link](#).

¹² World Bank. *The Management of Catastrophe Risk Using Pooled Insurance Structures*. Pollner (2001).

more cost-efficient and available coverage by bridging the liquidity gap that governments typically face on these occasions, resulting from a combination of increased spending, reduced revenue, and incremental barriers to credit resources in terms of access and cost.

- 1.21 In other words, the provision of ex ante financial coverage for large-scale disasters partially reduces the risk of worst-case scenarios in terms of the impact of the disaster on public accounts by providing financing to contend with the costs of emergencies. This has been verified in Bank studies,¹³ which confirm that having financial coverage to ensure liquidity in the event of a severe disaster guarantees steadier long-term economic growth when compared with the absence of such coverage, because resources can be mobilized quickly to meet the needs arising from the emergency, in addition to eliminating the necessity of using public accounts to finance extraordinary unbudgeted expenditures.
- 1.22 The aforementioned studies also analyzed the volume of international assistance provided between 1960 and 2002 to Latin American countries that suffered disasters causing significant economic losses. Although international aid reached the countries, it was not enough, covering, on average, just 8.6% of the losses, and only 5% to 10% of that aid was provided in the form of liquid funds. The shortage of international aid has become more evident in recent years due to the increase in the number of catastrophic events and the global economic situation. It is therefore clear that there is a growing need for financial coverage that will allow countries to guarantee an adequate response to natural disaster emergencies without relying on international aid, since experience shows that the amount and availability of aid can be uncertain. More recent reviews of humanitarian aid figures indicate that the actual levels of this type of assistance have held steady but are expected to trend downward, taking into account just the rise in the frequency, severity, and impact of these events and increasingly constrained fiscal environment around the world.

B. Objectives and expected outcomes

- 1.23 The objective of the operation is to help absorb the potential impact of severe or catastrophic natural disasters on public finances by increasing the availability, stability, and efficiency of contingent financing to respond to emergencies caused by such events.
- 1.24 The specific objective of the operation is to make resources more readily available and to increase the stability and efficiency of the country's ex ante financial coverage in order to respond to emergencies arising from natural disasters of a severe or catastrophic nature.
- 1.25 This contingent loan operation will make it possible for Honduras to have immediate access to liquid financial resources in order to promptly cover the extraordinary expenses that are likely to arise during emergencies related to severe or catastrophic disasters, particularly hurricanes.

¹³ IDB. *Disaster Risk Management*. Freeman, Mechler, et al. (2002), *inter alia*. [Link](#)

C. Results indicators

- 1.26 At the output level, this contingent loan consists of Honduras having access to contingent financing in order to cover extraordinary public spending during emergencies arising from severe or catastrophic natural disasters.
- 1.27 In keeping with the specific objective, the expected outcomes of this operation are: (i) an increase in the country's contingent financial coverage available for meeting extraordinary public spending needs during emergencies arising from severe or catastrophic natural disasters; and (ii) the efficiency of this financial coverage. In order to verify the efficiency of the loan's financial coverage, the difference between the financial cost of the Bank's loan and that of Honduras's long-term sovereign external commercial debt will be monitored on an annual basis.
- 1.28 Given the contingent nature of this operation, loan proceeds will be disbursed only upon verification of the occurrence of an eligible event during the effective period of the loan contract. In that eventuality, the availability and efficiency of the proceeds of this loan will be measured on the basis of: (i) the speed with which the proceeds are delivered; and (ii) a reduction in the financial cost per extraordinary emergency expenditure unit financed through borrowing (the cost of loan proceeds compared with the cost that would have resulted from borrowing on the international financial market under those circumstances).
- 1.29 Indicators for the measurements mentioned in the previous paragraph would be, respectively, the following: (i) the number of days elapsed from the time the country requests a disbursement from the Bank to the time the loan proceeds are made available to the borrower; and (ii) the financial cost of the loan proceeds, compared with the financial cost of Honduras's long-term external commercial public debt at the time the loan disbursement is made.¹⁴

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instrument

- 2.1 This operation will be set up as a regular investment loan financed with resources from the Bank's Ordinary Capital and from the Fund for Special Operations (FSO) at a ratio of 70% and 30%, respectively. Bank loans to the country must be structured in this way in order to be consistent with the 2007 agreement between Honduras and the Bank in the framework of implementation of multilateral debt relief and concessional finance reform at the Bank. This operation is consistent with the "Proposal for the implementation of a Debt Sustainability (DSF) and Enhanced Performance-Based Allocation (PBA) framework" (documents GN-2442 and GN-2442-32).

¹⁴ The cost reduction will be verified by comparing the spread over LIBOR for the resources provided under this operation at the time of each disbursement with the spread for Honduras's long-term sovereign external commercial debt on the same date in international over-the-counter markets.

- 2.2 The main operational and financial features of the loan are as follows: (i) the borrower will be the Republic of Honduras and the executing agency will be the Ministry of Finance (SEFIN); (ii) the financing will be for a maximum amount of up to US\$100 million drawn either from the contingent loan proceeds or from the available undisbursed balances of pre-approved loans on the Automatic Redirection List (ARL),¹⁵ which will be included in the loan contract (see [optional link 2](#)); (iii) disbursements will be available for a period of five years, which may be extended at the borrower's request and the Bank's discretion for up to five additional years; and (iv) all disbursements of Ordinary Capital resources will be made in U.S. dollars from the Single Currency Facility of the Bank's Ordinary Capital.
- 2.3 Contingent loans granted under the Bank's Contingent Credit Facility for Natural Disaster Emergencies (CCF) have specific features intended mainly: (i) to provide immediate access to liquid financial resources in order to cover the extraordinary expenditures associated with emergencies in a timely manner; and (ii) to ensure that the financial conditions are appropriate for supporting the country during that critical time when an emergency has been caused by a severe or catastrophic event. In order to address such circumstances, CCF loans have some specific operational terms and conditions, including:
- a. Amortization and grace periods for Ordinary Capital and FSO resources are counted from the date of each disbursement, in the case of both proceeds drawn from the contingent loan and proceeds drawn from the available balances of loans included on the ARL.¹⁶
 - b. The period of availability of loan proceeds may be extended at the borrower's request and the Bank's discretion for up to five additional years, through notification to the borrower in writing. In the event of an extension, the amortization period, grace period, and credit fee charges will begin from the date said extension takes effect, and will apply to the undisbursed available loan balances.

1. Main features of the operation

- 2.4 **Availability of resources.** Loan proceeds can be disbursed if an eligible event occurs during the effective period of the loan contract. Conditions precedent to the disbursements are: (i) that the Bank has verified the occurrence of a contractually eligible event; (ii) that the Bank has not suspended eligibility for disbursements from the contingent loan in response to a determination of unsatisfactory execution of the Integrated Natural Disaster Risk Management Program, previously agreed upon with the borrower; and (iii) that the borrower has presented, within 90 days

¹⁵ The ARL includes current Bank loans with Honduras with balances available for disbursements, which could be automatically redirected in the event of a natural disaster.

¹⁶ If the decision is made to use proceeds from loans included on the ARL, the amounts of said loans will be cancelled and converted to form part of a new subloan of the contingent loan, assuming its financial terms and conditions (see [optional link 3](#)).

after the occurrence of an eligible event, a disbursement request indicating the amount required, and whether the disbursement is to be charged against the contingent loan or against the loans on the ARL. In the latter case, the borrower will specify the ARL loan or loans from which the proceeds will be disbursed. All of the ARL loans will be blended to be consistent with the DSF/PBA.

- 2.5 It should be noted that disbursements processed during the funding availability period of this contingent loan will be subject to the biannual allocations of FSO resources (document GN-2442) and the OC/FSO blend approved for those allocation periods.
- 2.6 **Eligible events.** Events are eligible if they fall within the parameters relating to type, location, and intensity agreed upon with the borrower and described in the Operating Regulations for the loan. The Bank and the Honduran government have agreed that this loan will initially provide coverage for hurricanes¹⁷ (associated wind and rains) and earthquakes of severe or catastrophic intensity affecting the territory of Honduras. Following loan approval, however, the Operating Regulations may be revised to include the coverage of other disasters, e.g. flooding.
- 2.7 **Determination of event eligibility and disbursement limits per event.** A natural disaster will be considered an eligible event for disbursement of loan proceeds only when the Bank has verified the occurrence of an event that falls within the contractually agreed upon parameters relating to type, location, and intensity. The maximum amount that can be disbursed for any eligible event is subject to two simultaneous limits: (i) the available undisbursed balance of this contingent loan; and (ii) the maximum amount set in the Operating Regulations for the type, location, and intensity of the event declared as eligible. If the event is not eligible, no loan proceeds can be disbursed.
- 2.8 The Operating Regulations (see [optional link 1](#)) will take effect at the moment the loan contract becomes effective and will be attached thereto as Appendix II. These Operating Regulations will also include all the specific factors related to the functioning of the eligibility triggers for disbursements, as well as the maximum amount that can be disbursed according to the intensity of each eligible event.
- 2.9 **The Integrated Natural Disaster Risk Management Program.** As stipulated in document GN-2502-2, the Integrated Natural Disaster Risk Management Program is an initiative of the Honduran government with the objective of making a formal commitment to the Bank in terms of the country's proactive efforts to promote, through concrete actions, the effective development of comprehensive disaster risk management. The government program includes activities grouped into the following strategy areas agreed upon with the Honduran government: (i) governance and development of the governing framework; (ii) risk identification; (iii) risk reduction; (iv) disaster management; and (v) financial risk

¹⁷ Hurricanes are defined according to the Saffir-Simpson sustained winds scale, which determines that for an event to be considered a hurricane it must have sustained winds of 74 mph or more. For further information on the definition of eligible events, see the Operating Regulations. [Link](#).

management. The existence and satisfactory implementation of the program is a requirement established by the Bank for gaining access to CCF resources, for the purpose of ensuring that its interventions are consistent with its other disaster risk management policies, which focus on promoting preventive actions and measures and ex ante planning. Agreement regarding the content and scope of the Integrated Natural Disaster Risk Management Program for this operation has been reached between the country and the Bank,¹⁸ and it includes indicators on implementation progress for each of the strategy areas mentioned above. The program will enter into effect as of the effective date of the loan contract and will have an execution period of five years, equal to the period of coverage availability provided by the contingent loan.

- 2.10 Loan proceeds will be used exclusively for attending to extraordinary public spending necessitated by eligible natural disaster emergencies. In order to be recognized as acceptable by the Bank, these expenditures will be incurred and paid within 180 days immediately following the initial date of occurrence of the eligible event. It is important to note that the type of expenditures that are eligible is broadly defined, and will be limited only by a negative list of expenditures included in the loan contract.
- 2.11 Some of the types of expenditures that could be considered eligible are: (i) emergency medical equipment; (ii) vaccines and medication; (iii) facilities and equipment for temporary shelters; (iv) food for affected populations; (v) emergency personnel needed to provide victim assistance; (vi) short-term leasing of energy, transportation, and communications equipment and facilities, and warehouses for storage; and (vii) temporary infrastructure rehabilitation and restoration of basic services to the population immediately following the disaster.

B. Main risks and mitigating measures

1. Environmental and social safeguard risks

- 2.12 No adverse environmental or social impacts are anticipated because any resources disbursed under this loan can only be used to finance extraordinary public expenditures necessitated by an emergency, and because SEFIN, acting as executing agency, guarantees that any resources disbursed will be used in compliance with the country's social and environmental laws. In addition, a negative list will be included of the types of expenditures that may not be financed with proceeds from this loan.
- 2.13 In accordance with the provisions set forth in Directive B.13 of the Environment and Safeguards Compliance Policy (documents GN-2208-20 and OP-703), this operation does not require classification.

¹⁸ This program will, to a large extent, cover activities similar to those addressed in the Disaster Risk Prevention and Mitigation Project (HO-L1031) mentioned before.

2. Fiduciary risk

- 2.14 **Risk of errors in the verification of acceptable expenditures.** There is a risk that certain expenditures financed with loan proceeds will not meet the contractually stipulated eligibility criteria and that the Bank is prevented from approving them. This risk, however, is considered minor because the systems for managing budget and accounting information to be used by SEFIN to process reimbursements for the expenditures financed under this loan will provide sufficient information to properly identify, check, and verify their eligibility, prior to their reimbursement. Moreover, in the event that such a risk were to materialize, the loan contract will include efficient solutions to quickly and effectively correct the situation.

3. Other operational risks

- 2.15 **Risk of higher costs due to insufficient loan resources on the ARL.** During the effective period of the contract, whenever the amount of the available balances of the ARL loans falls below the undisbursed balance of this loan, the borrower will begin to pay credit fees on the amounts corresponding to the difference, for the period during which they remain uncovered and undisbursed.
- 2.16 To mitigate this risk, there are plans to proactively monitor the undisbursed balances of loans on the ARL. In order to preemptively address this type of situation, the Bank and the country would agree to amend the ARL in order to include new loans. To streamline this process, it is expected that the country will ask the Bank to include a clause in the loan contract stating that all future investment loans made to the country by the Bank during the effective period of this contingent loan are to be included in their entirety as available balances on the ARL, as in the case of the contingent loan made to the Dominican Republic (DR-X1003).
- 2.17 **Risk of suspended eligibility for disbursements of the loan.** The execution status of the Integrated Natural Disaster Risk Management Program could be found unsatisfactory by the Bank during the availability period of the loan, in which case the Bank could suspend the country's eligibility to receive disbursements from this operation if it does not take the corrective action deemed necessary by the Bank in a timely manner. In order to mitigate this risk, the Bank will conduct periodic monitoring of the execution status of the program, as well as annual evaluations of the program.
- 2.18 If, as a result of any of these evaluations, the Bank determines that the Integrated Natural Disaster Risk Management Program is not being executed satisfactorily, the borrower will be notified of the specific actions it must take within a maximum period of 90 days following the date of notification in order to remain eligible for disbursement of resources under this operation. Only after this period has elapsed may the Bank suspend the borrower's eligibility to receive disbursements from the loan if it continues to find performance unsatisfactory.

- 2.19 In this regard, it is worth noting that the country has shown and continues to show clear signs of its firm commitment to develop and implement comprehensive disaster risk management, and this, combined with the monitoring safeguards described above, means that the risk of suspension of disbursement eligibility during the effective period of this loan is regarded as low.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Main arrangements for the operation

- 3.1 The borrower for the operation will be the Republic of Honduras, and the executing agency will be the Ministry of Finance (SEFIN). Within SEFIN, the operation will be executed by the Project Management Unit (UAP).
- 3.2 **Disbursement requests.** In addition to the other requirements described in detail in the Operating Regulations, requests for disbursements charged against the loan will be presented within 90 days after the occurrence of an eligible event, specifying the requested disbursement amounts. If the borrower opts to use loan resources from the ARL, the requests must specify the loan or loans from which the proceeds will be disbursed and the specific amounts required from each.
- 3.3 **Disbursement mechanism.** Every disbursement against the loan will be made in accordance with the financial terms and conditions established for this operation (documents GN-2442 and GN-2502-2), regardless of whether the resources come from the contingent loan or from other Bank loans included on the ARL.
- 3.4 In the event that the borrower chooses to include resources directly from the contingent loan in a disbursement request, the Bank will charge the corresponding credit fee accrued retroactively beginning 60 days after the effective date of the loan contract. The fee will be charged only on Ordinary Capital amounts disbursed directly from the loan, and will not be applied to resources from the ARL (see [optional link 3](#) and document GN-2502-2: paragraphs 4.12 to 4.15).
- 3.5 **Eligible expenditures.** The proceeds disbursed from the loan can be used to finance extraordinary current public expenditures necessitated by emergencies resulting from eligible events and meeting the following requirements: (i) they are not explicitly included among expenditures contractually excluded from financing or on the negative list included in the loan contract; (ii) they are legal according to the laws of Honduras; (iii) they are directly related to the emergency caused by the natural disaster for which the loan was provided; and (iv) their procurement and payment is verifiable, documented, and clearly recorded, and they have been properly dimensioned and priced.
- 3.6 **Fiduciary aspects.** In all fiduciary aspects, this operation will be governed by the rules set forth in document GN-2502-2 (see paragraph 4.20), which establishes, *inter alia*, that the borrower will be subject to applicable national laws on the procurement of goods, works, and services in the case of natural disasters.

Annex III, on fiduciary agreements and requirements, contains an in-depth analysis of all of the fiduciary aspects concerning this operation.

B. Monitoring and evaluation arrangements

- 3.7 **Annual monitoring of the Integrated Natural Disaster Risk Management Program.** During the effective period of the loan contract, as described in paragraph 2.13 above, the Bank will conduct periodic monitoring of the Integrated Natural Disaster Risk Management Program to determine whether execution is proceeding satisfactorily, using the indicators established for such purpose. These evaluations will be conducted at least once per year.
- 3.8 If execution of the program is found to be unsatisfactory, the Bank, after exhausting the contractually agreed upon preventive measures, may notify Honduras of the suspension of eligibility to receive loan disbursements. Notwithstanding the above, in accordance with the provisions of the CCF (document GN-2502-2, paragraph 4.25), once the Bank has granted the initial eligibility to receive disbursements under this loan, the eligibility will last for the duration of the loan, unless the Bank formally notifies the country of the suspension of that eligibility as a result of unsatisfactory performance in the Integrated Natural Disaster Risk Management Program.
- 3.9 **Disbursement monitoring.** In accordance with document GN-2502-2, the Bank will recognize up to 100% of the amount of eligible expenditures actually incurred and paid by the borrower from the date of the occurrence of the eligible event, and for a period of up to 180 calendar days immediately thereafter.
- 3.10 The project will have a special account for disbursement of funds, which will be administered by SEFIN. The borrower, through SEFIN, will justify the use of disbursements by means of a written declaration of proper use, which will be presented to the Bank within 365 calendar days after the date of onset of the eligible event for which the Bank disbursed the resources in question.
- 3.11 Within a term not to exceed two years following each disbursement, the Bank, at its full discretion and at no cost to the borrower, may commission independent external audits to verify the proper use of the expenditures declared as eligible. If, as a result of any of these audits, the Bank were to detect that loan proceeds had been used to finance ineligible expenditures, it could require the borrower to immediately remedy the situation or reimburse the amounts in question.
- 3.12 **Loan evaluation.** The operation will be monitored and evaluated in accordance with the provisions of the [Monitoring and Evaluation Plan](#). Evaluation provisions specific to CCF operations will also be taken into account (document GN-2502-2, paragraphs 4.27 and 4.28).

| Development Effectiveness Matrix | | | |
|--|--|--|---------------|
| Summary | | | |
| I. Strategic Alignment | | | |
| 1. IDB Strategic Development Objectives | Aligned | | |
| Lending Program | The intervention contributes to support: i) small and vulnerable countries, and ii) climate change initiatives, renewable energy and environmental sustainability. | | |
| Regional Development Goals | The intervention contributes to countries with planning capacity in mitigation and adaptation to climate change. | | |
| Bank Output Contribution (as defined in Results Framework of IDB-9) | | | |
| 2. Country Strategy Development Objectives | Aligned | | |
| Country Strategy Results Matrix | GN-2475 | Improve natural disaster response capacity and vulnerability of public buildings. | |
| Country Program Results Matrix | GN-2617 | The operation is included in the 2011 Country Program Document. | |
| Relevance of this project to country development challenges (If not aligned to country strategy or country program) | | | |
| II. Development Outcomes - Evaluability | Highly Evaluable | Weight | Maximum Score |
| | 8.9 | | 10 |
| 3. Evidence-based Assessment & Solution | 9.9 | 25% | 10 |
| 4. Ex ante Economic Analysis | 10.0 | 25% | 10 |
| 5. Monitoring and Evaluation | 5.7 | 25% | 10 |
| 6. Risks & Mitigation Monitoring Matrix | 10.0 | 25% | 10 |
| Overall risks rate = magnitude of risks*likelihood | Low | | |
| Environmental & social risk classification | B.13 | | |
| III. IDB's Role - Additionality | | | |
| The project relies on the use of country systems (VPC/PDP criteria) | Yes | The project relies on the use of Financial Sub-Systems: Budget, Accounting and Reporting. | |
| The project uses another country system different from the ones above for implementing the program | | | |
| The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions: | | | |
| Gender Equality | | | |
| Labor | | | |
| Environment | | | |
| Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project | | | |
| The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan. | Yes | The ex-post evaluation will compare the disposition of ex-ante coverage versus no coverage available (cost of borrowing for the country at the time of disaster), upon the occurrence of a disaster. The non-availability of coverage will imply to look for other sources of funding, as emergency spending has to be done anyway. The advantage obtained by this comparison is that you can evaluate how the financial cost differentials of the country's debt with the Bank loan behave and also see how these differentials evolve before, during and after a disaster. | |

The project is a contingent loan for natural disaster emergencies in Honduras. Its purpose is to cushion the potential impact that severe or catastrophic natural disasters could have on public finances of the country, through increasing availability, stability and efficiency of contingent funding for emergencies caused by this types of events. The project contributes to supporting small and vulnerable countries and climate change initiatives, renewable energy and environmental sustainability. In terms of regional goals, the intervention contributes to the generation of a growing number of countries planning capacity in mitigating and adapting to climate change. The project has been included in 2011 Country Program Document, and contributes to the strategic goal to improve municipality responsiveness and reduce vulnerability to natural disasters.

The diagnosis clearly identifies, based on empirical evidence, the main problem and the factors that determine it. The logic of the proposed intervention is clear. Impact, outcomes and outputs indicators are SMART, with baselines, targets and sources of information. The project has an ex-ante cost effectiveness analysis and a monitoring and evaluation plan in accordance with the guidelines of the Bank and the characteristics of contingent projects for natural disaster emergencies. The evaluation seeks to compare, ex-post, the ex-ante availability of financial funding versus no coverage availability (cost of borrowing for the country at the time of disaster), upon the occurrence of a disaster.

Finally, the main risks are identified, which are entirely low.

RESULTS MATRIX

| | |
|---------------------------|---|
| Project objective: | To help absorb the potential impact of severe or catastrophic natural disasters on public finances by increasing the availability, stability, and efficiency of contingent financing to respond to emergencies caused by such events. |
|---------------------------|---|

EXPECTED IMPACT

| Indicators | Units | Baseline | | Intermediate measurements | | | | | | Targets | | Source/Mean of verification | Comments |
|--|-------|----------|------|---------------------------|------|-------|------|-------|------|---------|------|--------------------------------|----------|
| | | Value | Year | Value | Year | Value | Year | Value | Year | Value | Year | | |
| EXPECTED IMPACT: To help absorb the potential impact of a severe or catastrophic natural disaster on the public finances of Honduras. ¹ | | | | | | | | | | | | | |

EXPECTED OUTCOMES

| Indicators | Units | Baseline | | Intermediate measurements | | | | | | Targets | | Source/Mean s of verification | Comments |
|---|------------------|----------|------|--------------------------------|------|--------------------------------|------|--------------------------------|------|------------------------------|------|---|---|
| | | Value | Year | Value | Year | Value | Year | Value | Year | Value | Year | | |
| EXPECTED OUTCOME 1: Availability and stability: an increase in the country’s contingent financial coverage available for meeting extraordinary public spending needs during emergencies arising from severe and/or catastrophic natural disasters. | | | | | | | | | | | | | |
| Amount of contingent financial coverage available to the country. | Millions of US\$ | 0 | 1 | 100 | 2 | 100 | 3 | 100 | 4 | 100 | 5 | Ministry of Finance (SEFIN) | The baseline represents the contingent financing currently available to the country for responding to disaster emergencies. |
| EXPECTED OUTCOME 2: Efficiency: that the available coverage be efficient, in terms of its financial cost and how quickly resources can be mobilized. | | | | | | | | | | | | | |
| Difference between the spread over LIBOR for the Bank loan and the spread for Honduras’ long-term sovereign external commercial debt. | Basis points | 700 | 1 | Difference between the spreads | 2 | Difference between the spreads | 3 | Difference between the spreads | 4 | Equal to or greater than 100 | 5 | IDB: Spreads publication, Finance Department. SEFIN: financial information system. | The financial cost of the Bank loan compared to the cost of Honduras’ long-term sovereign external commercial debt will be monitored. |

¹ Given the specific characteristics of this operation, it has not been possible to identify a suitable indicator for measuring the expected impact.

| Indicators | Units | Baseline | | Intermediate measurements | | | | | | Targets | | Source/Mean of verification | Comments |
|---|--------------|------------------|------|---------------------------|------|-----------------|------|-----------------|------|--|------|---|---|
| | | Value | Year | Value | Year | Value | Year | Value | Year | Value | Year | | |
| Speed with which access to resources can be obtained in the case of an eligible event. | Days | 90 | 1 | 20 | 2 | 20 | 3 | 20 | 4 | Maximum of 20 | 5 | IDB: Time calculated by ICF/CMF. SEFIN: Information systems of the External Debt Department. | The baseline represents the average time typically required to arrange the launch of a US\$ sovereign bond issue on the international market. |
| Cost of the loan in the case of an eligible event. Difference between the spread over LIBOR for the Bank loan and the spread for Honduras' long-term sovereign external commercial debt. ² | Basis points | N/A ³ | 1 | Cost difference | 2 | Cost difference | 3 | Cost difference | 4 | A reduction in the financial cost of debt-financed extraordinary emergency expenditures. | 5 | IDB: Spreads publication, Finance Department. SEFIN: financial information system. | The financial cost of the IDB loan compared to the cost of Honduras' long-term sovereign external commercial debt will be monitored, at the end of the months immediately prior to and following an eligible event. |

² If market information is not available on the spread for Honduras' long-term sovereign external commercial debt, the average spread for the countries of the region with the same rating will be used, in which case the information source would be Bloomberg, and the project team would perform the calculation.

³ The baseline would be the cost difference immediately prior to the eligible event, and would later be compared with post-event performance.

OUTPUTS

| Output | Units | Baseline | Year 1 | Year 2 | Year 3 | Year 4 | Target |
|--|------------------|----------|--------|--------|--------|--------|--------|
| • Milestones | | | | | | | |
| SOLE COMPONENT: Bank contingent financing for meeting extraordinary public spending needs during emergencies arising from severe and/or catastrophic natural disasters. | | | | | | | |
| • Financial coverage available | Millions of US\$ | 0 | 100 | 100 | 100 | 100 | 100 |

FIDUCIARY AGREEMENTS AND REQUIREMENTS

COUNTRY: Honduras

PROJECT NUMBER: HO-X1016

NAME: Contingent Loan for Natural Disaster Emergencies

EXECUTING AGENCY: Ministry of Finance

PREPARED BY: Nalda Morales (Financial Management) and Juan Carlos Martell (Procurement)

I. EXECUTIVE SUMMARY

The institutional assessment for the fiduciary management of the project was based on: (i) the fiduciary context of the country; (ii) the results of the fiduciary risk assessment; (iii) the analysis of the executing agency, based on the design of Bank project HO-L1055; (iv) work meetings with the project team during the orientation mission; and (v) meetings with Ministry of Finance (SEFIN) staff. As a result of this assessment, fiduciary agreements for procurement and financial management have been developed for execution of the operation, taking into account the provisions of the Contingent Credit Facility (CCF).

The operation will be executed by the borrower, through the SEFIN Project Management Unit (UAP). The institutional capacity assessment of the UAP, conducted in July 2010 as part of the preparation of Bank project HO-L1055 “Modernization of Customs at Puerto Cortés,” showed a medium level of risk in executing regular Bank investment loans, due to weaknesses in programming and organizational capacity, activity execution, and control capacity, specifically related to weaknesses in the use of integrated information systems and in aspects related to mechanisms for monitoring, tracking, and managing risk. Nevertheless, that assessment does not apply directly to this operation because the contingent nature of this operation means that loan proceeds will be disbursed only if the occurrence of an eligible event is verified during the effective period of the loan contract.

It should be noted, however, that the diagnostic assessments of Honduras’ systems for managing public finances reflect significant progress toward international best practices and standards, mainly in the implementation of the Integrated Financial Management System (SIAFI), the Single Treasury Account (CUT), and the decentralization of the treasury function. Resources from external financing are managed in the CUT, in special accounts, and payments to suppliers are made via transfers using the operational accounts of each project. The Bank’s portfolio is currently managed through the budget, treasury, and accounting subsystems; reports on externally-financed projects are generated by the Execution Units for Externally-financed Projects (UEPEX) module. The SIAFI also includes the “goods” subsystem, for control of assets for use procured by the government, whether with national funds or external financing. Implementation of the SIAFI is obligatory as from the fourth quarter of 2011.

This operation will be executed by the borrower through the SEFIN Project Management Unit (UAP), under the framework of the Contingent Credit Facility for Natural Disaster Emergencies (CCF) established in document GN-2502-2 of 13 February 2009. Therefore, in the context of the CCF and given the available information on the operation, in light of: (i) the special nature of the operation's disbursements; (ii) the fiduciary waivers for this operation under the CCF; (iii) the mechanism for reimbursing eligible expenditures that the executing agency will be required to use for this operation; and (iv) the obligatory implementation of the SIAFI and the UEPEX module before the end of 2011, the overall fiduciary risk for this operation is regarded as **low, and no additional mitigation measures are required.**

II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

Executing agency: The operation will be executed by the borrower, through the Project Management Unit (UAP) of the Ministry of Finance (SEFIN), under the framework of the Contingent Credit Facility for Natural Disaster Emergencies (CCF), established in document GN-2502-2 of 13 February 2009. SEFIN's UAP has recent prior experience executing Bank operations, namely: loans 1546/SF-HO, 1748/BL-HO, 2032/BL-HO, 2452/BL-HO, and 2467/BL-HO.

Fiduciary management: In terms of fiduciary management, due to the nature of the operation, the borrower will be subject to the procurement rules and regulations set forth in the CCF, which calls for enforcement of the country's own rules and regulations with respect to the procurement of goods and services during natural disaster emergencies, in accordance with any applicable local administrative laws and regulations.

Financial management: In terms of financial management, SEFIN will use: (i) the SIAFI (budget, accounting, and treasury subsystems); (ii) the UEPEX module; and (iii) the F01 form for issuing reports on the eligible expenditures reimbursed with proceeds from this operation. Thus, the operation's financial management will lie with the national system for financial administration.

III. FIDUCIARY RISK ASSESSMENT

As a country, Honduras has a level of fiduciary risk that is classified as high, the result of financial management risk that has been assessed as medium, and fiduciary risk related to procurement assessed as high, as determined by the recent diagnostic study performed using OECD/DAC methodology.

Nevertheless, the diagnostic assessments of Honduras' systems for managing public finances reflect significant progress toward international best practices and standards, mainly in the implementation of the SIAFI, the Single Treasury Account (CUT), and the decentralization of the treasury function. Resources from external financing are managed in special accounts in the CUT, and payments to suppliers are made via transfers using the operational accounts of each project.

At the present time, the Bank's portfolio is managed through the budget, treasury, and accounting subsystems, and the reports on externally-financed projects are generated by the UEPEX module. The SIAFI also includes the "goods" subsystem, for control of assets for

use procured by the government, whether with national funds or external financing. Implementation of the SIAFI is obligatory as from the fourth quarter of 2011.

As for the executing agency, the institutional capacity of the UAP was assessed in July 2010 as part of the preparation of Bank project HO-L1055 (Modernization of Customs at Puerto Cortés). This assessment revealed a medium level of risk in executing regular Bank investment loans, due to weaknesses in (i) programming and organizational capacity and activity execution; and (ii) control capacity, specifically related to weaknesses in using integrated information systems and in aspects related to mechanisms for monitoring, tracking, and managing risk. Nevertheless, that assessment does not apply directly to this operation.

In addition, fiduciary risk in terms of financial management is medium. The risk identified in activities related to control and use of information systems is being mitigated by implementing the SIAFI and the UEPEX module for financial management and for the generation of project reports. As of 2011, use of the system is obligatory for externally-financed projects.

For this operation, it should be noted that given its contingent nature, actual loan proceeds will only be disbursed upon verification of the occurrence of an eligible event during the effective period of the loan contract. Should such an event occur and the Bank disburses resources to the special account set up for the loan, the executing agency may only reimburse eligible expenditures upon receipt of a formal request for reimbursement of expenditures from a relevant agency. These expenditures must correspond to national budget line items that have been allocated and approved, authorization for execution must be approved, and they must be accompanied by the following supporting documentation in physical form: (i) the purchase order or requisition for the good or service; (ii) the shipping notice or other similar delivery confirmation for goods or services, which includes proof of receipt and acceptance of the item on the part of the competent authority of the agency procuring said good or service; (iii) the supplier's itemized invoice or statement of sum due; and (iv) the irrevocable payment order (bill of exchange) made by the competent authority of the purchasing agency.

Therefore, in the context of the CCF and given the available information on the operation, in light of: (i) the special nature of the operation's disbursements; (ii) the fiduciary waivers for this operation under the CCF; (iii) the mechanism for reimbursing eligible expenditures described above, which the executing agency will be required to use for this operation; and (iv) the obligatory implementation of the SIAFI and the UEPEX module before the end of 2011, the overall fiduciary risk for this operation is regarded as **low, and no additional mitigation measures are required.**

IV. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

The Government of Honduras will procure goods, works, and services in accordance with document GN-2502-2 of 13 February 2009, "Contingent Credit Facility for Natural Disaster Emergencies." In order to ensure timely and adequate availability of loan proceeds, immediately following an emergency situation caused by an eligible natural disaster, loan disbursements under the CCF are subject to the following fiduciary and procurement rules:

- The Bank will recognize up to 100% of the amount of eligible expenditures actually incurred and paid by the borrower from the date of the occurrence of the eligible event, and for a period of up to 180 days immediately thereafter.
- CCF loans are waived from Bank policies and procedures for the procurement of goods and services. Instead, the borrower's own rules and regulations will apply with respect to the procurement of goods and services during times of extraordinary fiscal spending arising from natural disasters, in accordance with any applicable regulations or local administrative laws.
- The borrower will justify the use of CCF loan proceeds by means of a written declaration of proper use, which will be presented to the Bank within 365 calendar days after the date of occurrence of the qualifying event for which the Bank disbursed the loan proceeds.
- The proceeds from the CCF loan can be used for expenditures, provided that: (i) they are not explicitly excluded in the corresponding CCF loan contract ("negative list"); (ii) they are legal according to the laws of Honduras; (iii) they are directly or indirectly related to the emergency caused by the natural disaster for which the loan is provided; (iv) their procurement and payment is verifiable, documented, and clearly recorded; and (v) they have been properly dimensioned and priced.
- The Bank, at its full discretion and at no cost to the borrower, may commission independent external audits to verify proper use of the expenditures declared as eligible. These audits will be performed within a period not to exceed two years following the conclusion of the corresponding disbursement period of the CCF loan.
- If, as a result of any of these audits of the CCF loan, it were found that loan proceeds were used to finance ineligible or improper expenditures, the Bank could require the borrower to immediately remedy the situation or reimburse the amounts in question.

V. AGREEMENTS AND REQUIREMENTS FOR FINANCIAL MANAGEMENT

In terms of agreements and requirements for the operation's financial management, the five key areas are analyzed below:

1. Programming and budget

The country's laws establish the mechanism for programming, formulating, approving, executing, reprogramming, and in some cases increasing the annual budget, through the Budget Act and the annual budgetary provisions issued by the Ministry of Finance and approved by the legislative branch, which form part of the Budget of Revenue and Expenditures of the Republic.

The SIAFI budget subsystem is used to process the annual budget, in its various stages, by applying the line item budget classifier. For reprogramming and potentially increasing the budgets of externally-financed projects, legislative approval is not required; it is enough for the Ministry of Finance to approve the agreement and modification of the corresponding quarterly payment.

2. Accounting and information systems

The SIAFI accounting subsystem is used by central government institutions. For the financial reports and accounting for this loan, the executing agency will use the SIAFI module F01 form, which receives all of its data from the budget and treasury subsystems. The cash-based accounting method is used, and International Accounting Standards and International Financial Reporting Standards are followed. The Bank may also use independent external audits to verify the eligibility of expenditures. These audits would be performed within a period not to exceed two years following the conclusion of the corresponding disbursement period of the CCF loan.

3. Disbursements

The Bank will disburse the loan proceeds to the executing agency in the form of advances of funds. The loan will have a special account for disbursements set up in the loan's name at the Central Bank of Honduras, which will be managed by the SEFIN Project Management Unit (UAP). Those funds will be transferred to the Single Treasury Account (CUT), from where they will be deposited in operational accounts to reimburse the expenditures made by competent authorities authorized to make purchases, or to pay suppliers.

Information will be provided in the form of the following reports issued by the SIAFI: disbursement and local contribution monitoring (F01), itemized list of payments by investment category, contracts account statement, and reconciliation of the special account.

4. Internal control and internal auditing

According to the institutional capacity assessment, there are weaknesses in the executing agency's internal control system; however, the executing agency's involvement in supervising the operation is deemed necessary, since the operation would be executed under emergency circumstances and since it does not envision any costs for audits, beyond those that may be commissioned by the Bank with its own resources.

5. External control and reports

Under the law establishing the Court of Accounts, external control is under its purview. Despite current technical limitations and financial constraints, the external auditing function for this operation can be performed by that institution.

Based on the above, it has been determined that the financial agreements and arrangements to be considered are the following:

- 1. Financial supervision plan:** Given the loan's contingent nature, disbursements will be reviewed on an ex post basis, and the SIAFI will be used. The Bank will supervise their use, and desk reviews will be conducted of both the disbursements and the reconciliation of the special account that the Bank will use to advance funds to the executing agency. Supervision will be the responsibility of the fiduciary specialist for financial management assigned to the operation (with the support of consultants, as necessary).
- 2. Execution mechanism:** Disbursement eligibility will be governed by the loan's Operating Regulations. The operation does not envisage co-executing agencies, and

the proceeds will be managed by SEFIN's UAP in the loan's special account and through the CUT mechanism. Funds will be disbursed in the form of "advance of funds to the executing agency," consisting of transferring proceeds to the special loan account such that the executing agency can reimburse eligible expenditures actually incurred and paid by units authorized to make purchases during an emergency on or after the date of occurrence of an eligible event and for a period of up to 180 days immediately thereafter.

3. **Rules and regulations acceptable to the Bank:** The rules and regulations established in the Contingent Credit Facility for Natural Disaster Emergencies (document GN-2502-2) apply. Additionally, and barring any contradiction thereof, in the event that document GN-2502-2 does not address the situation in question, the rules and regulations will also be used that are contained in the Financial Management Policy for IDB-financed projects (document OP-273-1), the Disbursement Guide, the Guidelines for Financial Reports and External Audit of Operations Financed by the Inter-American Development Bank, and the Financial Management Operational Guidelines for IDB-financed Projects (document OP-274-2).
4. **National policy on audit reports:** There is no national policy regarding the public disclosure of audit reports on externally-financed projects; their publication, therefore, is not considered necessary.
5. **Other financial management agreements:** In the event that proceeds are disbursed, they will be monitored in order to reasonably ensure their proper use.

VI. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF THE CONTRACT

After analyzing the fiduciary risks and identifying the fiduciary and financial management agreements and requirements for the operation, in order to facilitate negotiation of the loan contract by the project team, and primarily the Legal Department, the agreements and requirements that should be considered in the special provisions are:

1. The currency of the loan for the operation will be the U.S. dollar.
2. The exchange rate agreed on with the executing agency for accounting purposes will be the purchase rate published by the Central Bank of Honduras at the time of payment, using the Reuters system.
3. The Bank may, with its own resources, contract an auditing firm, using the "Audit Terms of Reference for Agreed-Upon Procedures" model. The auditors will be responsible for reviewing the expenditures financed with loan proceeds, to verify: (i) that they are not included among expenditures excluded from financing, i.e. on the negative list; (ii) that they are legal according to the laws of Honduras; (iii) that they are directly related to the emergency arising from the natural disaster for which the loan was provided; and (iv) that their procurement and payment is verifiable, documented, and clearly recorded, and that they are properly dimensioned and priced.
4. The disbursement method will be "advance of funds to the executing agency," consisting of transferring proceeds to the special loan account such that the executing agency can reimburse eligible expenses actually incurred and paid on or after the date of the

occurrence of an eligible event and for a period of up to 180 days immediately following it.

5. The loan proceeds will also be applied to the financing of taxes, fees, and customs duties on the goods and services procured in accordance with the financial parameters agreed upon with the country.¹
6. Use of the provisions set forth in the CCF policy (document GN-2502-2) for procurement (paragraph 4.20).

¹ Document CP-2507-8: HONDURAS, Financial Parameters, 30 August 2005.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/11

Honduras. Loan HO-X1016 to the Republic of Honduras
Contingent Loan for Natural Disaster Emergencies

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Honduras, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a contingent loan for natural disaster emergencies. Such financing will be for the amount of up to US\$70,000,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital, corresponds to a parallel loan within the framework of the multilateral debt relief and concessional finance reform of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Executive Summary of the Loan Proposal.

(Adopted on __ _____ 2011)

LEG/SGO/CID/IDBDOCS#36485641
HO-X1016

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/11

Honduras. Loan HO-X1016 to the Republic of Honduras
Contingent Loan for Natural Disaster Emergencies

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Honduras, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a contingent loan for natural disaster emergencies. Such financing will be for the amount of up to US\$30,000,000 from the resources of the Bank's Fund for Special Operations, corresponds to a parallel loan within the framework of the multilateral debt relief and concessional finance reform of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on __ _____ 2011)

LEG/SGO/CID/IDBDOCS#36485760
HO-X1016