

**DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
NOT FOR PUBLIC USE**

EL SALVADOR

SMALL PROJECTS FINANCING PROGRAM

PROPOSAL FOR FINANCING AND TECHNICAL COOPERATION FOR:

**AGENCIA DE DESARROLLO LOCAL DE MORAZÁN (ADEL MORAZÁN)
(SP/TC-96-04-02-7-ES)**

This document was prepared by the project team consisting of: Rafael Rivera (COF/CES); José A. de la Torre (LEG/OPR); Leyda Fajardo (LEG/OPR); Marcela López (SDS/MIC); and Lara Goldmark (SDS/MIC), Project Team Leader.

CONTENTS

Page

EXECUTIVE SUMMARY

I.	FRAME OF REFERENCE	1
A.	Socioeconomic context	1
1.	Microenterprises in El Salvador	1
2.	Department of Morazán	1
3.	Additionality of the program	2
B.	Statement of nonobjection	2
C.	Government strategy	2
D.	Bank strategy	3
E.	The Bank's experience with microenterprise in El Salvador	3
II.	THE INTERMEDIARY	4
A.	Identity, origin, and objectives	4
B.	Administrative organization	4
C.	Activities carried out	4
D.	Lending technology	5
E.	Financial analysis	6
F.	Characteristics of the target group	8
G.	Strengths and weaknesses of ADEL Morazán	9
III.	THE PROGRAM	10
A.	Objectives	10
B.	Description of the program	10
1.	Loan component	10
2.	Technical-cooperation funding	10
C.	Cost and financing	11
D.	Sizing	11
IV.	PROGRAM EXECUTION	12
A.	Responsibility for execution	12
B.	Credit Regulations	12
C.	Technical-cooperation component	12
D.	Progress reports	14
E.	Mid-term evaluation	14
F.	Environmental concerns	15
V.	PROGRAM FEASIBILITY AND RISKS	16
A.	Socioeconomic feasibility	16
B.	Institutional feasibility	16
C.	Financial feasibility	16
D.	Risks of the operation	17
VI.	JUSTIFICATION AND RECOMMENDATIONS	17

LIST OF ANNEXES

Annex I	Plan of operations
Annex II	Financial statements
Annex III	Credit Regulations

LIST OF APPENDICES

Proposed resolution

ABBREVIATIONS

ADEL Morazán	Agencia de Desarrollo Local de Morazán [Morazán Local Development Agency]
CESI	Committee on Environment and Social Impact
FIAES	Americas Initiative Fund for El Salvador
MIF	Multilateral Investment Fund
PRODERE	United Nations Development Programme for Displaced Persons, Refugees, and Returnees
UNDP	United Nations Development Programme

PROPOSAL FOR FINANCING AND TECHNICAL COOPERATION FOR:

AGENCIA DE DESARROLLO LOCAL DE MORAZÁN (ADEL MORAZÁN)

(SP/TC 96-04-02-7-ES)

EXECUTIVE SUMMARY

AMOUNT AND SOURCE:	IDB:	US\$500,000
	Technical cooperation:	US\$150,000
	Local counterpart funding:	<u>US\$ 15,000</u>
	Total:	US\$665,000

The total amount of the financing will be ECU 602,030 (equivalent to US\$650,000) drawn on the European Union's Special Fund for Financing of Microenterprises in Latin America.

FINANCIAL	Amortization period:	20 years
TERMS AND	Grace period*:	5 years
CONDITIONS:	Disbursement period:	4 years
	Credit fee:	1%

* The grace period will only apply to the principal.

Maintenance of value will be applied to the resources of the financing.

OBJECTIVES: The general objective of the program is to open up access to credit to microenterprises through support for an institution to offer financial services to segments not currently being served. Its specific objectives are: (i) to broaden access to financial services to low-income groups working in microenterprises in urban areas of the department of Morazán; and (ii) to expand the financial services offered by ADEL Morazán through an institutional strengthening program, thereby laying the foundation for possible graduation of the institution and its incorporation into the formal financial sector.

DESCRIPTION: The proposed program consists of the following components:

- a. Credit component: This component will enable the agency to expand its portfolio and meet the credit needs of low-income clients.
- b. Technical-cooperation component: These resources will be used to: (i) make the necessary

adjustments in the credit methodology, including the design of new products, adjustment of the interest rate, and institution of a strict collection program; (ii) improve the computerized system for accounting and portfolio information; (iii) prepare a long-term business plan for ADEL Morazán to remain on the market on a solid footing and to eventually graduate to the formal financial sector; (iv) conduct a mid-term evaluation; and (v) train ADEL Morazán staff through such events as a technical seminar to be held with the participation of other institutions in the department.

ENVIRONMENTAL CLASSIFICATION: The Committee on the Environment and Social Impact (CESI), at its meeting of February 6, 1998, reviewed the profile for this project. Its recommendations have been incorporated into the project design.

POVERTY TARGETING: The target population will be low-income microentrepreneurs in the department of Morazán, for whom access to credit would help increase their development capacity.

RISKS: The resources of the operation will enable ADEL Morazán to expand its operations in the department of Morazán. One risk is the strong likelihood that the department may receive other resources on subsidized terms that might distort the credit market. To mitigate their impact, during year one of program execution, a technical seminar on the sustainability of financial services for microenterprise will be held with the participation of other institutions working in the department and the international organizations financing their activities. The seminar is expected to develop performance standards to be met by all the institutions in the department that participate in the microcredit market and to stimulate flexibility on the part of other donors, which in the past have required local institutions to grant loans at highly subsidized rates.

THE BANK'S COUNTRY STRATEGY: Among the areas of activity assigned priority in the Bank's strategy for El Salvador is support for microenterprise through measures to develop efficient markets for financial and other services that cater to microenterprises.

SPECIAL CONTRACTUAL CONDITIONS: It is recommended that the following special conditions be included in the loan and technical-cooperation agreement, in addition to the general contractual conditions:

Prior to the first disbursement of the technical-cooperation funding, ADEL Morazán will submit the terms of reference for the microfinance expert to the satisfaction of the Bank (paragraph 4.7).

Prior to disbursement of the loan component, ADEL Morazán will submit to the Bank:

- (i) a strict collection program and a decrease in delinquency indicators, along with evidence that a proper policy has been implemented for loan loss provisioning (paragraph 4.4); and
- (ii) evidence that the Credit Regulations agreed upon with the Bank have entered into force (paragraph 4.2).

The ADEL Morazán program will undergo a mid-term evaluation once 50% of the resources have been committed, in order to ensure fulfillment of the project objectives (paragraph 4.13).

The loan component will be carried out in two stages: US\$300,000 equivalent will be allocated to the first stage and US\$200,000 equivalent to the second stage. Disbursement of the second stage resources will be subject to verification that certain performance goals have been achieved during the first stage (see paragraphs 3.7 and 4.14).

No more than 30% of the loan component resources will be disbursed until 90% of the technical-cooperation funding has been disbursed (paragraph 4.6).

At the request of ADEL Morazán, an advance of funds of up to 15% of the total amount of the technical-cooperation funding may be established in order to ensure a timely flow of funds for the program (paragraph 4.10).

I. FRAME OF REFERENCE

A. Socioeconomic context

- 1.1 Although its economy and employment have achieved positive growth rates since 1990, El Salvador continues to have a serious poverty problem, especially in rural areas. Annual per capita income (US\$1,247) in 1996 was higher than in other Central American countries. 1/ However, due to the uneven distribution of income in the country, the number of people living in poverty is high. Two thirds of the total population, approximately four million people, live below the poverty line or in extreme poverty.
- 1.2 Due to the long conflict the country endured and the relocation of over one million people, the number of women heads of household has increased dramatically. Women now dominate economic activities in rural areas. The insecurity caused by the increase in violence and the importance of remittances to family income are also major factors considered the results or the effects of the prolonged conflict.

1. Microenterprises in El Salvador

- 1.3 According to official sources, there are approximately 400,000 microenterprises in El Salvador. 2/ These play a significant role in the Salvadorian economy in generating employment and producing wealth. According to the 1997 "White Book", 3/ over the past four years microenterprises have contributed 24% to 35% of GDP and employ 31% of the labor force.

2. Department of Morazán

- 1.4 The department of Morazán is located in the eastern part of the country. With a population of 160,146, representing 3% of all Salvadorians, it is one of the most underpopulated departments in the country. Of the Morazán department inhabitants, 73.4% live in rural areas, compared with the national average of 49.6%. Also noteworthy is the fact that the department's population is younger than the national average: 55.6% are under age 20, compared with a national average of 50.2%.

1/ IDB country paper, 1997.

2/ Ibid.

3/ *Libro Blanco de la Microempresa* ["White Book on Microenterprise"], San Salvador, El Salvador, 1996, White Book Coordination Committee. The document was the result of an interinstitutional effort in which government agencies, international development agencies, and private, nonprofit institutions participated.

- 1.5 A high percentage of the population in the department is currently classified as living in extreme poverty. Official sources of information show that the infant mortality rate in Morazán is 33% higher than the national average and the illiteracy rate is double the national average, while access to such services as electricity, housing and water is below the national average. Of the 26 municipalities in the department, nine are the most underdeveloped in the entire country. ^{4/} In addition, it should be noted that 34.4% of heads of household in the department were women in 1994, higher than the national average of 27.3%.

3. Additionality of the program

- 1.6 The area of influence of ADEL Morazán is one of the poorest in the country. During the armed conflict, Morazán was the center of military operations and is the main department of origin of Salvadorian emigrants to the United States. Financial services for urban microenterprise in this area are therefore scarce. Among the few microcredit institutions operating in Morazán, mention should be made of Bancomo (a practically unsustainable institution that is about to close operations); Fundación Campo (which has a small agricultural portfolio, a sector in which ADEL Morazán does not operate); Asociación Norte Padecoms, which finances urban microenterprises but coordinates its activities with ADEL Morazán; and commercial banks, which do not serve microenterprises at all. The ADEL Morazán initiative is the only one in the department that shows the potential to become sustainable in the long term.

B. Statement of nonobjection

- 1.7 ADEL Morazán submitted a request for financing and technical-cooperation funding to the Bank under the Small Projects Financing Program. The Government of El Salvador, through the Ministry of Finance, issued a statement of nonobjection to financing for the proposed program on July 4, 1997.
- 1.8 According to its charter, ADEL Morazán is legally empowered to take on loans from national and international institutions and to grant credit to its members, for the purpose of improving their socioeconomic status.

C. Government strategy

- 1.9 The strategy of the Government of El Salvador includes identifying and promoting mechanisms to mobilize domestic savings and promote the flow of funds to the microenterprise sector on market terms. The proposed program will support the government strategy since it is designed to strengthen ADEL Morazán's capacity to identify,

^{4/} Household and multipurpose survey, 1994.

place, and recover loans to microentrepreneurs, according to the principles of financial discipline and prudential policy.

D. Bank strategy

- 1.10 Among the areas of activity assigned priority in the Bank's strategy for El Salvador (document GN-1981 of 1997) is support for microenterprise through measures that would establish the conditions needed to develop efficient markets for financial and other services that cater to microenterprises. The existence of efficient markets for financial and other services for microenterprises is expected to help stimulate the development of businesses with growth potential and the creation of new enterprises. The technical-cooperation project pipeline included in the country paper strategy includes two small projects each year (1997 and 1998).
- 1.11 It should also be noted that the proposed operation is consistent with the general goal of the Bank's strategy for microenterprise development (document GN-1938-3), which is to broaden economic opportunities in Latin America and the Caribbean through sustainable, vigorous development of microenterprise. The objective of the strategy is to promote the conditions necessary for growth and development of the sector in the region: favorable policies and regulatory framework; solid, sustainable institutions offering financial and other services to meet the demand from microenterprises; improved access for low-income microentrepreneurs (including women and indigenous peoples) to financial and business services; and greater, uninterrupted, permanent flows of resources for investment in microenterprises.

E. The Bank's experience with microenterprise in El Salvador

- 1.12 The Bank's experience with microenterprise in El Salvador includes the execution of a number of projects such as credit programs for crop-growing and livestock-farming and for the construction of infrastructure. A total of nine microcredit programs have also been carried out under the Small Projects Financing Program. In some cases, problems have arisen during execution, generally due to the lack of efficient, transparent financial administration on the part of the executing agencies. Nevertheless, one highly successful case was operation SP/SD-9136-ES, executed by AMPES, whose credit affiliate became an intermediary in the formal sector, Financiera Calpiá and has been serving the financial needs of a considerable number of microenterprises since mid-1995. In addition, a global credit program for microenterprise (PR-1946 of October 19, 1993) was designed and implemented through formal-sector intermediaries. It is currently at its final stage of execution, and the term for disbursement in full expires on November 9, 1998.

II. THE INTERMEDIARY

A. Identity, origin, and objectives

- 2.1 ADEL Morazán is a private foundation for departmental development, established in 1993, whose members are 15 social institutions in the department. ADEL Morazán is itself a member of the ADEL network, to which another three institutions in El Salvador and 14 in Central America belong. It obtained full legal status on June 20, 1996.
- 2.2 The purpose of ADEL Morazán is to promote economic initiative in the department of Morazán. ADEL Morazán wishes to expand its credit services, which it currently offers to low-income microentrepreneurs in the department.
- 2.3 ADEL Morazán has received financial support from different organizations that are part of the United Nations system, such as the United Nations Development Programme (UNDP) and the International Labor Organization (ILO), the United States Agency for International Development (USAID), the European Union, Catholic Relief Services (CRS), the Enterprise for the Americas Initiative Fund for El Salvador (FIAES), and the international cooperation agency of Spain. These institutions have supported ADEL Morazán because it is a solid institution that has demonstrated its capacity to administer funds and to achieve good results in its work with the communities in the department.

B. Administrative organization

- 2.4 Senior management consists of the General Assembly, the Board of Directors, and the Consultative Committee. The general manager is responsible for operations and for administration of the institution's resources. Three operations units report to the general manager: (i) training and product diversification; (ii) finance and economic stimulation (credit); and (iii) project planning, preparation, and evaluation. ADEL Morazán currently has a staff of 28.

C. Activities carried out

- 2.5 The main projects carried out by ADEL Morazán are designed to support the development of agricultural activities and the quality of the environment in the area through the improvement of lots, the promotion of new soil conservation technology and irrigation systems, and the provision of courses on environmental protection.
- 2.6 Its microenterprise financing activities began in 1995 after it obtained resources from Ayuntamiento Vitoria-Gazteiz in Spain and a guarantee fund transferred to it from the United Nations

Development Programme for Displaced Persons, Refugees, and Returnees (PRODERE) under the UNDP and later converted into a lending fund. Using this support, ADEL Morazán placed 111 loans totaling US\$57,000 in 1996. At year-end 1997, the ADEL Morazán portfolio consisted of 1,200 loans, with an active balance of US\$348,000 and an average loan amount of close to US\$300.

- 2.7 ADEL Morazán manages a single credit instrument: individual loans for working capital and the purchase of machinery. The loans are granted at five urban centers located on average 60 kilometers from ADEL Morazán headquarters. The portfolio consists essentially of women microentrepreneurs (62% of the clientele) and finances business and production activities.
- 2.8 The chart below summarizes the financial product offered by ADEL Morazán:

Lending criteria	Terms and conditions
Minimum amount	1,000 Salvadorian colones (US\$114)
Maximum amount	40,000 Salvadorian colones (US\$4,540)
Maximum term	3 years
Average term	1 year
Grace period	maximum 2 months
Annual interest rate	19%-21%
Fee	3% on principal
Security	Collateral and guarantees
Late fee	3% of installment

D. Lending technology

- 2.9 The lending technology used by ADEL Morazán is an innovative blend of two methodologies: individual credit and community banking. It is individual credit in the sense that any member of the community may apply for a loan, and every client is solely responsible for repaying his or her own debt. At the same time, it is similar to the methodology used by community banks, because ADEL Morazán takes advantage of the knowledge the community members have of their neighbors and includes an element of community pressure, through a Support Committee, to ensure repayment. The committee consists of leading entrepreneurs in the area representative of the target clientele. Committee members are not paid, but are eligible for ADEL Morazán loans. The committee's main functions are to: (i) promote the supply of credit; (ii) review loan applications;

(iii) select loan recipients; and (iv) monitor the portfolio and intervene in the case of delinquent loans.

- 2.10 An ADEL Morazán extension worker is also a member of the committee. The committee is authorized to approve loans in amounts of up to Q5,000 (US\$570). For higher amounts, the request is forwarded to the ADEL Morazán Loan Approval Committee, made up of the general manager, the finance unit coordinator, the credit project coordinator, and the extension worker. Loans in amounts greater than Q15,000 are approved with the participation of the ADEL Morazán Board of Directors.
- 2.11 Every Monday, the extension workers review the status of loan repayments at ADEL Morazán headquarters. For payments and collections, ADEL Morazán uses the teller services of a commercial bank, which is why information on repayments reaches ADEL Morazán with some delay. 5/ If any loans are delinquent, the extension workers visit the clients. Should they not be able to collect payment, they mobilize the Support Committee members. If the situation persists, a letter from the attorney is sent and then judicial proceedings are launched.
- 2.12 ADEL Morazán provides training courses in basic accounting, marketing, and loan management to its clients free of charge. Nonmandatory courses in leadership, women in business, and other subjects are also offered. The courses are open to entrepreneurs who are not clients, since ADEL Morazán receives subsidies from donors for each course participant.

E. Financial analysis

- 2.13 The financial analysis of ADEL Morazán was based on its financial statements for fiscal years 1995, 1996, and 1997, which are attached in Annex II, quoted in United States dollars. It should be noted that ADEL Morazán uses an accounting system for nonprofit associations.
- 2.14 **Assets.** ADEL Morazán's productive assets consist of the liquid, short-term investments, the loan portfolio, and long-term investments. At year-end 1997, they totaled US\$1.9 million. Guarantee deposits amounted to US\$625,000, a fund deposit contributed by USAID (90%) and ADEL Morazán (10%). The financial return on the deposit will be allocated to lending and technical assistance operations. Stock in Financiera Calpiá 6/ represents another investment, which, in addition to a financial return, has

5/ This situation should be remedied by connecting the ADEL Morazán system electronically with the bank's information systems.

6/ Financiera Calpiá is a microfinance institution that has become a formal financial institution thanks to support from the MIF.

provided ADEL Morazán with the opportunity to gain first-hand knowledge about the operation of a sustainable microfinance institution.

- 2.15 **Asset quality.** It is important to note that two nonperforming assets were identified under the heading "notes receivable": a US\$18,977 deposit in a community bank and a US\$208,295 loan to the Tangolona Cooperative. The community bank deposit was granted to ADEL Morazán free of charge by the PRODERE program under the UNDP, but its recovery is uncertain since the bank is an informal institution that has ceased operations. As for the Tangolona Cooperative, although it is not operating either, there is the possibility that some property might be recovered (even though such property was not used as collateral for the loan granted). This loan was also transferred from PRODERE free of charge.
- 2.16 **Liabilities.** Liabilities totaled US\$1.2 million at year-end 1997 and reflect the commitments and agreements ADEL Morazán has undertaken with donors to date. The USAID fund's counterpart is one component of the liabilities. Also included is the counterpart for the item listed under assets as "Projects under way", which contains the funds received from donors that have not yet been spent but have been committed for project execution.
- 2.17 **Net worth.** At year-end 1997, the net worth amounted to US\$678,893, slightly less than the figure for 1996. It consists of initial member contributions of US\$2,300, with the balance made up of grants from donor organizations, which are used to generate tangible assets (fixed assets, investments, etc.).
- 2.18 **Loan portfolio.** In 1997, ADEL Morazán considerably increased its portfolio, from US\$67,800 as of December 31, 1996, to US\$347,000 as of December 31, 1997. This inordinate increase of over 500% has overwhelmed the management support of the institution, as reflected in the high delinquency rate.
- 2.19 **Delinquency rate.** The proportion of the portfolio with payments over 30 days past due was 15.4%. Another factor to bear in mind is that ADEL Morazán has yet to make any loan loss provisions. The table below details the status of past due payments:

Days past due	Amount (thousands of colones)	% of amount past due	Number of loans
31-60 days	215	7.1	89
61-90 days	84	2.8	48
91-180 days	113	3.7	61
> 180 days	55	1.8	40
TOTAL DELINQUENT	467	15.4	238

- 2.20 **Interest-rate-setting.** ADEL Morazán sets the interest rate based on market standards and according to negotiations with each donor agency. Certain donors pressure ADEL Morazán to subsidize its lending rate. ADEL Morazán's annual lending rates on outstanding balances thus vary from 19% to 21% and are quite similar to bank rates in the department, which range from 20% to 22%.

F. Characteristics of the target group

- 2.21 Of ADEL Morazán's credit clients, 38% are men and 62% are women. All have small economic units with one to five employees. The activities currently being financed can be broken down into the following sectors: trade (55%), manufacturing (40%), agriculture (3%), and services (2%).
- 2.22 According to official sources, a family of five, the average family size in Morazán, needs a monthly income of Q2,960 to meet its basic needs for food, clothing, health, education, and housing. The data available from ADEL Morazán show the following indicators for its subborrowers:

INCOME BRACKET Monthly average in colones	NUMBER OF CLIENTS	PERCENTAGE
100 to 500	23	2
501 to 1,000	149	13
1,001 to 1,500	217	19
1,501 to 2,000	229	20
2,001 to 2,500	103	9
2,501 to 3,000	137	12
3,000 and above	286	25
TOTAL	1,144	100

- 2.23 ADEL Morazán credit users show monthly incomes that do not differ greatly from the statistics on household income found in other sources. For example, the World Bank reports that annual household income in El Salvador was \$22,495 for 1996. ^{7/} It should be noted that 54% of ADEL Morazán's clientele have annual incomes below \$24,000 (up to \$2,000 a month).

G. Strengths and weaknesses of ADEL Morazán

- 2.24 Two main strengths in ADEL Morazán have been identified: the lending technology and institutional motivation. The main weakness identified is the lack of tools for financial management.
- 2.25 **ADEL Morazán's lending technology.** The essential feature of the technology used is the Support Committee, in which entrepreneurs who are members of the target community participate. This strategy provides for better knowledge of the potential clientele and reduces operating costs, and it is consistent with the aspiration of ADEL Morazán leaders to create a cooperative specializing in microcredit.
- 2.26 **Institutional motivation.** Since ADEL Morazán's supply of credit has been well received by the clientele, and the activity has had an impact on the target population and has potential for growth, ADEL Morazán leaders and staff are highly motivated to carry this Small Project through. With the goal of becoming a permanent source of credit for microenterprises and in order to attract savings and reinvest them in the department, ADEL Morazán has committed itself to working towards eventual conversion into a

^{7/} IBRD, "El Salvador: Rural Finance, Performance, Issues and Options". January 1997, Annex 3, Table 0-1.

formal financial institution. Considering the small size of ADEL Morazán's current portfolio and its financial costs, it would need an estimated 10 years to achieve this goal, during which it would have to consolidate its portfolio and improve its financial administration.

- 2.27 **Operating tools for financial management.** Although ADEL Morazán's loan portfolio indicators are acceptable, and are certainly better than those of other institutions in the department, its financial management needs to be strengthened and its lending methodology improved. To date, due to a lack of awareness, basic portfolio indicators such as the percentage of the portfolio at risk and operating efficiency have not been used. In addition, as mentioned earlier, provisions have not been made for loan losses. The accounting, financial, and portfolio information systems need major adjustments to become useful tools for decision-making.

III. THE PROGRAM

A. Objectives

- 3.1 The general objective of the program is to open up access to credit to microenterprises through support for an institution that offers financial services to segments not currently being served.
- 3.2 Its specific objectives are: (i) to broaden access to financial services to low-income groups working in microenterprises in urban areas of the department of Morazán; and (ii) to expand the financial services offered by ADEL Morazán through an institutional strengthening program, thereby laying the foundation for eventual graduation of the intermediary to the formal financial sector.

B. Description of the program

1. Loan component (US\$500,000)
- 3.3 The reimbursable resources will enable the institution to expand its portfolio and meet the credit needs of low-income clients.
2. Technical-cooperation funding (US\$150,000, nonreimbursable)
- 3.4 The nonreimbursable resources will be used to: (i) make the necessary adjustments in the lending methodology, including the design of new products, adjustment of the lending rate, and institution of a strict collection program; (ii) improve the computerized system for accounting and portfolio information; (iii) prepare a long-term business plan for ADEL Morazán to remain in the market on a solid footing and to eventually graduate to the formal financial sector; (iv) conduct a mid-term evaluation; and

(v) train ADEL Morazán staff through such events as a technical seminar to be held with other institutions in the department.

C. Cost and financing

- 3.5 The total cost of the financing will be the equivalent in ECUs of US\$650,000: US\$500,000 for the loan component and US\$150,000 for the technical-cooperation component. The local counterpart contribution will be US\$15,000. The program will be financed with resources from the European Union Special Fund for Financing of Microenterprises.
- 3.6 The amount of the loan will be the equivalent of US\$500,000 in ECUs on the date of project approval, disbursed in local currency according to standard Bank procedures. The loan component will have a disbursement period of four years, an amortization period of 20 years, and a grace period of seven years. A fee of 1% annually will be charged. ^{8/} The technical-cooperation funding will be nonreimbursable, in the amount of US\$150,000 in ECUs, disbursed in local currency according to standard Bank procedures.
- 3.7 Execution of the loan component will be carried out in two stages: US\$300,000 equivalent will be allocated to the first stage and US\$200,000 equivalent to the second stage. Disbursement of the second stage resources will be subject to verification that certain performance levels have been achieved during the first stage (as detailed in paragraph 4.14).
- 3.8 The grace period will only apply to the principal. Interest will be payable annually, in order to establish financial discipline in the institution. In addition, maintenance of value will be applied to the resources of the financing. The principal will be amortized over the 15-year period following the grace period.

D. Sizing

- 3.9 As of December 31, 1997, ADEL Morazán's portfolio totaled US\$347,000. Disbursements during the first year (assuming an amount of approximately US\$125,000) would therefore represent a 49% increase in the portfolio. This is considered prudent, given the rapid growth in the portfolio in 1997. It should also be noted that ADEL Morazán will have to use the period prior to disbursement of this component (estimated to last one year) to strengthen the current portfolio.

^{8/} It is recommended that ADEL Morazán's liabilities be in the same currency as its microcredit portfolio, which consists solely of obligations in local currency.

IV. PROGRAM EXECUTION

A. Responsibility for execution

- 4.1 ADEL Morazán will be responsible for administration and execution of the proposed program. It would enter into a contract for the financing and technical-cooperation funding and would carry out the program according to the terms of this document and its annexes. The program activities will be carried out by ADEL Morazán's current staff, with the support of the individual consultants to be financed under the technical-cooperation component.

B. Credit Regulations

- 4.2 Program execution will be governed by the Credit Regulations agreed upon with ADEL Morazán, attached as Annex III hereto.
- 4.3 The lending rate for the subloans will be computed so as to cover the following five elements: (i) operating costs of the lending program; (ii) financial costs, including the opportunity cost of the money; (iii) inflation; (iv) loan loss provisioning; and (v) a profit margin.
- 4.4 Prior to disbursement of the loan component resources, ADEL Morazán will submit to the Bank a strict collection plan and program to reduce delinquency indicators, along with evidence that a proper loan loss provisioning policy has been adopted.
- 4.5 During execution of the proposed program, ADEL Morazán will take the measures necessary to ensure that delinquency in the portfolio of loans granted remains below 5% for payments more than 30 days past due. In the case of noncompliance with this provision, the Bank reserves the right to defer disbursements, but will take into account any circumstances that would justify a temporary increase in delinquency. To this end, ADEL Morazán will submit information to the Bank on a semiannual basis on the status of the loan portfolio.

C. Technical-cooperation component

- 4.6 To achieve the objectives of the technical cooperation, ADEL Morazán will hire an expert in microfinance to advise ADEL Morazán on its lending methodology and accounting management and to prepare a business plan. ADEL Morazán's lending rate and loan loss

provisioning policy will be adjusted. ^{9/} To ensure that these adjustments are made, it is recommended that the technical-cooperation component be executed prior to the loan component. Hence no more than 30% of the loan component resources will be disbursed until 90% of the technical-cooperation funds have been disbursed. In addition to the microfinance consultant, ADEL Morazán will hire a computer expert to examine the information system, make the necessary changes, and train ADEL Morazán staff in management and programming of the new system.

- 4.7 ADEL Morazán will be responsible for hiring the specialized consultants, which it will do according to Bank procedures for the selection and hiring of consultants. As a condition precedent to the first disbursement, ADEL Morazán will submit the terms of reference for the microfinance consultant to the satisfaction of the Bank.
- 4.8 During the first year of project execution, ADEL Morazán will hold a seminar on the sustainability of financial services for microenterprises. In addition, during project execution, other activities will be carried out to train ADEL Morazán staff, through specialized consultants, international internships, and courses given by specialized institutions.
- 4.9 As part of the technical-cooperation component, software will be purchased to improve the information system for portfolio management. ADEL Morazán will be responsible for the procurement of goods under the program and will follow the applicable Bank standards, procedures, and policies.
- 4.10 At ADEL Morazán's request, an advance of funds may be established in the amount of up to 15% of the total technical-cooperation funding, to ensure a timely flow of funds for the program. Establishment and replenishment of the advance will be considered disbursements. To obtain a replenishment of the advance, ADEL Morazán will submit to the Bank for consideration detailed accounts on the use made of the funds received.

^{9/} The fact that it does not go into debt to finance the portfolio does not imply that financial costs should be eliminated from computation of the lending rate. In fact, receiving soft money should be an opportunity for ADEL Morazán to gradually improve its returns and to achieve the standards for performance of operating costs and the portfolio in question. Once such returns have been achieved, the hypothetical financial cost will enable it to build up its net worth and gradually penetrate the capital market to finance the growth of its portfolio.

D. Progress reports

- 4.11 During program execution, within 60 days after the end of each calendar year, ADEL Morazán will submit to the Bank a progress report on the program. The last progress report will constitute the final report and will contain a summary of the results achieved compared with the original objectives of the program. Based on the results achieved, the report will include data on improvements in ADEL Morazán's institutional capacity, particularly with respect to expansion of its services to low-income groups.
- 4.12 For a period of five years from the year in which disbursements begin, within 120 days after the close of each calendar year, ADEL Morazán will submit to the Bank its financial statements and those of the program, certified by an independent auditor or an independent public accounting firm, to be hired to the satisfaction of the Bank as a condition precedent to the first disbursement of the loan.

E. Mid-term evaluation

- 4.13 In order to help strengthen ADEL Morazán and to correct any deficiencies that may arise during program execution, a consultant with experience in this type of microenterprise program will conduct a mid-term evaluation to gauge fulfillment of the objectives and conditions of execution of the program components once 50% of the financing has been committed. The Country Office in San Salvador will directly hire the necessary consulting services to conduct the evaluation, using resources from the technical-cooperation funding.
- 4.14 The purpose of the evaluation will be to review the goals achieved through program execution and to determine the progress made by ADEL Morazán in expanding its lending services and in improving its financial management. The main indicators used in the evaluation, to be monitored by the Country Office of the Bank in El Salvador, are as follows:

Indicator	Target range
Growth in active portfolio	>20%<50%
Operating expenses/Average portfolio	<20%
Productivity per advisor	>300 clients
% of portfolio with payments >30 days past due	<5% (a)
Real lending rate	(b)
Maximum leverage	5 times the net worth

(a) Including portfolio penalties and adjustment for refinancing.

(b) Including the operating costs of the lending program, financial costs, the opportunity cost of the money, inflation, loan loss provisioning, and a profit margin.

4.15 In addition to the financial indicators, during the mid-term evaluation, the data ADEL Morazán has on the income brackets of its clientele will be reviewed and it will be ascertained whether the criteria for environmental protection are being applied in the awarding of subloans.

4.16 The Bank will review the findings reported and the recommendations made in the evaluation and, if it deems them satisfactory, will authorize the intermediary to continue to commit resources chargeable to the financing, or, if applicable, to take the necessary measures. The remaining resources of the loan component (50%) will not be disbursed until ADEL Morazán demonstrates successful financial performance, that is, within the parameters suggested above.

F. Environmental concerns

4.17 The intermediary will take special care to ascertain that its program beneficiaries are in compliance with Salvadorian legislation on the environment and that the activities being carried out under the subloans do not cause any environmental degradation, regardless of its type or impact. Certain eligibility criteria were included in the ADEL Morazán Credit Regulations (see Annex III) to limit financing for polluting activities and/or with an adverse impact on the environment, except when there is a plan to mitigate their adverse impact. The CESI considered the profile for this operation at its February 6, 1998, meeting.

4.18 It should be noted that, in addition to lending, one of the main activities carried out by ADEL Morazán has been environmental

education. ADEL Morazán has received assistance from the Enterprise for the Americas Initiative Fund for El Salvador (FIAES) to hold 33 community training workshops on such topics as environmental sanitation, conservation of soils and sources of water, and reforestation.

V. PROGRAM FEASIBILITY AND RISKS

A. Socioeconomic feasibility

- 5.1 The program will help improve the standard of living of low-income microentrepreneurs and their families in the department of Morazán. According to ADEL Morazán portfolio growth projections (see paragraph 5.3), during the project execution period, an estimated 9,000 loans averaging US\$350 each will be granted to microentrepreneurs in the department. Taking into account the staff of the microenterprises and the family members of the owners, 20,000 people should thus benefit from the project. The expected results are an increase in income for the target population, a larger number of enterprises receiving financing, and the development of a business culture and culture of repayment in the service area of the project.

B. Institutional feasibility

- 5.2 ADEL Morazán has demonstrated that it is highly motivated to adopt appropriate microfinance techniques for management of a sustainable lending program. However, due to a lack of know-how and the rapid growth of its portfolio in the past year, it will need a period for learning and consolidation before the proceeds of the loan can be disbursed. During that time, the technical-cooperation funding will be disbursed, with which ADEL Morazán can adjust its lending methodology, with the help of consulting services specialized in microfinance techniques and information systems.

C. Financial feasibility

- 5.3 ADEL Morazán's loan portfolio will have to grow so that it can achieve financial sustainability. ^{10/} The projected growth of ADEL Morazán's portfolio during the project execution period is detailed in the table below:

^{10/} In order to generate sufficient income to cover all the operating costs of a microcredit program (including high financial costs), an institution needs a portfolio of approximately US\$1 million.

Year	Portfolio at start of period <u>a/</u>	New resources	Financial income <u>b/</u>	Portfolio at end of period	Annual growth rate	Number of loans <u>c/</u>
1	350	125	45	520	49%	1,486
2	520	125	64	709	36%	2,026
3	709	125	85	919	30%	2,626
4	919	125	108	1,152	25%	3,291

a/ amounts in US\$

b/ based on a conservative estimate of an 11% annual spread, which is the additional margin that the low cost of the project resources should generate for ADEL Morazán, in addition to which there may be a growth margin for ADEL Morazán of approximately 3%

c/ based on the average portfolio for the period, divided by an average loan amount of US\$350 (slightly higher than the current average amount)

- 5.4 The financial feasibility of the project depends on ADEL Morazán calculating its lending rate based on the factors described above (see paragraph 4.3) and on the adjustments in its lending methodology to be made as part of the activities to be financed under the technical-cooperation component.

D. Risks of the operation

- 5.5 The resources of the operation will enable ADEL Morazán to expand its operations in the department of Morazán. One risk is the strong likelihood that the Department may receive other resources on subsidized terms that might distort the credit market. To mitigate this risk, during year one of program execution, a technical seminar on the sustainability of financial services for microenterprise will be held with the participation of other institutions working in the department and the international organizations financing their activities. The seminar is expected to develop performance standards to be met by all the institutions in the department that participate in the microcredit market and to stimulate flexibility on the part of the donors, which in the past have sometimes required local institutions to grant loans at highly subsidized rates.

VI. JUSTIFICATION AND RECOMMENDATIONS

- 6.1 Of the institutions working in the department of Morazán to meet the credit needs of microentrepreneurs, ADEL Morazán is the only one that has demonstrated the potential and the desire to manage a microcredit portfolio with acceptable financial indicators. Although it has the capacity to become a permanent, sustainable source of financial services for microenterprises in the department, it needs institutional strengthening to go hand-in-hand with the growth of its loan portfolio.

- 6.2 In view of the above analysis, it can be concluded that the program is feasible, pursuant to the terms and conditions proposed herein. The Management of the Bank therefore recommends that the Board of Executive Directors approve the financing and hereby submits the corresponding proposed resolution for financing and nonreimbursable technical-cooperation funding for ADEL Morazán.

PLAN OF OPERATIONS
INSTITUTIONAL STRENGTHENING FOR ADEL MORAZÁN
(TC-96-04-02-7-ES)

I. BACKGROUND

- 1.1 In addition to requesting a loan, Agencia de Desarrollo Local de Morazán [Morazán Local Development Agency] (ADEL Morazán), hereinafter also referred to as the intermediary, also requested nonreimbursable technical-cooperation funding to support execution of the program proposed in the financing document.

II. OBJECTIVES

- 2.1 The objectives of the proposed technical-cooperation project are the following:
- a. Strengthen the intermediary in financial management, specifically with regard to its microcredit portfolio.
 - b. Support the intermediary in designing a strategic plan, so that it can eventually become a sustainable, permanent source of credit for microentrepreneurs in the department of Morazán.
 - c. Support the development and dissemination of performance standards so that the technical know-how necessary for the provision of sustainable financial services to microenterprises will be accessible to other institutions operating in the department and to the donors that support them.

III. DESCRIPTION OF THE PROGRAM

- 3.1 The technical-cooperation project will be initiated prior to the loan program that would be approved concurrently. ADEL Morazán will be responsible to the Bank for execution of the technical-cooperation project. No more than 30% of the loan component resources will be disbursed until 90% of the technical-cooperation funds have been disbursed.

3.2 The objectives of the technical-cooperation project will be achieved by the intermediary through the activities described below:

A. Hiring of consultants

3.3 ADEL Morazán will hire an expert in microfinance to advise it on its lending methodology and accounting techniques, and to prepare a business plan. ADEL Morazán's policies on the lending rate and loan loss provisioning will be adjusted. In addition to the microfinance consultant, ADEL Morazán will hire a computer expert to review the information system, make the necessary changes, and train ADEL Morazán staff in the management and programming of the new system.

3.4 ADEL Morazán will be responsible for hiring the specialized consultants, according to Bank procedures for the selection and hiring of consultants. As a condition precedent to the first disbursement, ADEL Morazán must submit the terms of reference of the microfinance consultant to the satisfaction of the Bank.

B. Organization of a seminar

3.5 During the first year of project execution, ADEL Morazán will hold a seminar on the sustainability of financial services for microenterprises. It will encourage the participation of other local institutions and representatives of development agencies that provide financing for the activities of such institutions in Morazán.

C. Mid-term evaluation

3.6 The Bank, through the Country Office in San Salvador, will directly hire the necessary consulting services to conduct a mid-term evaluation of execution of the intermediary's program once approximately 50% of the financing has been committed.

D. Procurement of equipment

3.7 Hardware and software will be procured to support the proposed program. The cost of the equipment and materials to be purchased using resources from the technical-cooperation funding will be less than 30% of the total amount of that funding. ADEL Morazán will hold responsibility for the procurement of goods under the program and will follow Bank standards, procedures, and policies.

E. Training program and exchanges

3.8 The costs of courses in administration, computer systems, and lending technology for microenterprises will be covered to help train the intermediary's staff. While some of the courses will be given through the specialized consultants, training activities will

also be carried out through international internships and courses offered by specialized institutions.

IV. COST AND FINANCING

- 4.1 The total cost of the technical-cooperation project is an estimated US\$165,000 equivalent, of which US\$150,000 (on a nonreimbursable basis) would be financed according to the itemized budget shown in the table below. The nonreimbursable funding for the proposed operation will be drawn on the European Union Special Fund for Financing of Microenterprises in Latin America.

Program costs (equivalent in US\$)			
Category	ADEL Morazán	IDB	TOTAL
2.1 Consultant's fees		<u>55,000</u>	55,000
Microfinance expert <u>a/</u>		40,000	
Computer expert <u>b/</u>		15,000	
5.1 Staff training		<u>24,000</u>	27,000
ADEL Morazán staff <u>c/</u>		7,000	
Dissemination seminar	3,000	7,000	
Internships		10,000	
6.3 Equipment		<u>44,000</u>	54,000
Computer systems	10,000	44,000	
8.2 Evaluation <u>d/</u>		15,000	15,000
9.8 Contingencies	2,000	12,000	14,000
Total	15,000	150,000	165,000

a/ includes a microfinance expert for 10 months (US\$4,000/month)

b/ includes a computer expert specializing in management information systems for microcredit, for 5 months (US\$3,000/month)

c/ 10 modules x US\$700/module

d/ includes a mid-term evaluation once the intermediary has committed 50% of the resources of the financing

V. PROGRAM EXECUTION

- 5.1 The consultants will be hired by the intermediary, except for the consultant who will carry out the mid-term evaluation of the program, who will be hired directly by the Bank. As a condition precedent to the first disbursement, the intermediary will submit the terms of reference for the microfinance consultant, to the satisfaction of the Bank.
- 5.2 The intermediary will provide all the logistical support necessary for proper execution of the program in terms of secretarial services, office space, telecommunications services, electrical power, etc.

VI. JUSTIFICATION

- 6.1 The proposed technical-cooperation project is justified for the following reasons:
 - a. It will help support the intermediary in the management, oversight, and monitoring of the lending procedures and practices necessary to achieve a sustainable, permanent microcredit program.
 - b. It will support development of the operating tools for decision-making based on reliable information on the status of the portfolio.
 - c. It will promote cooperation between local institutions in the department of Morazán and the dissemination of appropriate techniques for the provision of sustainable financial services for microenterprise.
- 6.2 To a great extent, effective implementation of the proposed loan component will be contingent upon the proposed technical-cooperation component.

VII. DISBURSEMENTS

- 7.1 The proceeds of the Bank's contribution will be disbursed within a period of 48 months from the effective date of the agreement.
- 7.2 At the request of the intermediary, an advance of funds may be established in the amount of up to 15% of the total technical-cooperation funding, to ensure a timely flow of funds for the

program. Establishment and replenishment of the advance will be considered disbursements. To obtain a replenishment of the advance, the intermediary will submit to the Bank for consideration detailed accounts on the use made of the funds disbursed and spent.

VIII. REPORTS

- 8.1 Consultant's reports. The contracts into which the intermediary will enter with the consultants will include an obligation on the part of the consultants to submit to the intermediary, with a copy to the Bank for its approval: (i) semiannual progress reports, within 30 days after the end of each semiannual calendar period, beginning on the date the work is initiated, indicating the progress achieved in project execution; (ii) a final report, within 30 days after the date on which the consultant's work is completed, indicating the results achieved compared with the program objectives and making recommendations for the future; and (iii) any additional report the intermediary or the Bank may reasonably request regarding execution of the work.
- 8.2 Intermediary reports. The intermediary will submit to the Bank to its satisfaction: (i) annual progress reports on program execution, including comments on the work carried out by the consultants; (ii) an evaluation of the reports submitted by the exerts, within 30 days after the end of each contract; and (iii) a financial report audited by independent auditors, within 120 days after the close of the calendar year in which the final disbursement of the program is made, showing the use made of the Bank contribution.

IX. SUPERVISION

- 9.1 The consulting services will be supervised by the intermediary. The Bank will also supervise the proposed programs through the Country Office in El Salvador.

X. EVALUATION CRITERIA

- 10.1 The proposed technical-cooperation operation will be evaluated by comparing the proposed objectives with the extent to which they have been achieved, based on the reports described in paragraph 8.2 above, and by assessing the quality of the work carried out during project execution. The evaluation will consider the criteria

ANNEX I

Page 6 of 6

established to evaluate the financing and technical-cooperation program, as described in paragraphs 4.14 and 4.15 of the financing proposal.

ADEL MORAZÁN
BALANCE SHEETS AS OF DECEMBER 31
(in US\$)

ACCOUNT	1995	1996	1997
ASSETS			
LIQUID ASSETS	16,563.55	109,751.26	490,657.76
General cash			3,434.00
Petty cash	316.75	1,861.02	
Banks and accounts	16,246.80	107,890.23	138,469.82
Investments			348,753.94
CURRENT ASSETS	245,400.76	815,449.53	608,143.50
Loans receivable		348,002.41	346,992.41
Various debtors		70,556.75	1,021.20
Interest receivable		37,742.27	27,272.73
Notes receivable			227,272.73
Prepayments and deposits	22,159.09	221,648.10	1,682.56
Contributions and investments	223,241.67	137,500.00	
Inventory			3,901.88
LONG-TERM ASSETS	81,913.79	110,088.65	121,360.28
Investments			
Property and equipment	17,045.45	22,329.70	
Land			17,045.45
Buildings and construction under way		612.95	5,284.24
Furnishings, equipment, and vehicles	74,688.78	104,628.49	139,040.75
Accrued depreciation	(9,820.44)	(17,482)	(40,010)
DEFERRED ASSETS	0.00	760.00	646,326.07
Guarantee deposits			625,000.00
Deferred charges			
Unadjusted assets		760.00	21,326.07
Revenue stamps			
OTHER ASSETS	1,619.38	1,619.38	97.39
Programs and library	1,619.38	1,619.38	97.39
TOTAL ASSETS	345,497.48	1,037,668.81	1,866,585.01

ACCOUNT	1995	1996	1997
LIABILITIES			
CURRENT LIABILITIES	0.00	27,653.88	23,240.76
Sight deposits			
Term deposits			
Taxes and withholdings payable		1,089.31	1,884.81
Notes and accounts payable		26,564.57	21,355.95
LONG-TERM LIABILITIES	0.00	0.00	0.00
Loans payable			
OTHER LIABILITIES	0.00	218,219.69	1,164,450.42
Advances to be settled			719,600.23
Guarantee deposits			
Unadjusted account			3,209.77
Administration of asset fund			47,662.47
Projects under way			393,977.95
Project contributions		218,219.69	
TOTAL LIABILITIES	0.00	245,873.57	1,187,691.18
NET WORTH	345,497.48	791,795.24	678,893.83
Contributions and grants			1,804.81
Reserves	877.81		791,638.42
Fiscal year deficit			(114,549)
TOTAL LIABILITIES + NET WORTH	345,497.48	1,037,668.81	1,866,585.01

ADEL MORAZÁN
CONSOLIDATED STATEMENT OF EARNINGS AS OF DECEMBER 31
(in US\$)

ACCOUNT	TOTAL	TOTAL	TOTAL
	1995	1996	1997
INCOME	167,867.02	386,975.42	365,361.29
Revenues of services	163,217.37	127,209	24,388.52
Financial products	3,592.83	34,388.79	110,884.80
Other income	1,056.82	225,376.84	15,861.05
Project income			206,819.38
Donations and contributions			7,467.16
Other returns and markdowns			(59.62)
EXPENDITURES	163,539.57	378,032.41	480,050.10
Administrative expenses	117,623.38	154,869.54	161,321.07
Project expenses	2,272.73	64,518.73	238,424.17
Commitments for projects under way	43,128.83	158,644.15	
Finance charges	514.63		5,541.42
Production costs			17,516.13
Other expenses			57,247.31
PLUS OR DEFICIT	4,327.45	8,943.01	(114,689)

CREDIT REGULATIONS

I. GENERAL CONDITIONS

- 1.1 The purpose of these Regulations is to establish the terms and conditions that will govern the lending program of ADEL Morazán (the intermediary). The program will be carried out by the intermediary according to the terms and conditions set forth below.

II. CRITERIA FOR PROJECT SELECTION

- 2.1 For a project to be eligible for financing, it must meet the following criteria: (i) the proposed project submitted by the microenterprise must be technically and financially feasible; (ii) it must strengthen and/or generate new employment opportunities; (iii) there must be accessible markets which could absorb the production generated under the project; and (iv) the project may not include activities that cause pollution or have an adverse impact on the environment unless the project includes a plan to mitigate such effects. The activiteis that may have a negative impact will receive technical assistance from ADEL Morazán. 1/

III. USE OF THE RESOURCES

- 3.1 The credit resources of the program may be used to finance the following types of projects:
- a. expansion of already established enterprises in order to increase their installed capacity;
 - b. reactivation of microenterprises that have ceased their productive activities but will resume them with the infusion of capital (limited number of such projects);
 - c. diversification of microenterprises that will undertake different productive activiites and will be considered for financing if the applicants are successful in their current line of business; and

1/ The Bank will provide ADEL Morazán with a list classifying the microenterprises by environmental category.

- d. working capital, to increase the volume of sales.

IV. RESTRICTIONS ON THE USE OF PROGRAM RESOURCES

- 4.1 The program resources may not be used to finance: (i) the purchase of real property; (ii) the payment of debts, dividends, or return on capital; (iii) the purchase of stocks, bonds, or other bearer securities; (iv) consumer needs; (v) rental or purchase of land, houses, or commercial buildings; (vi) the purchase of vehicles for personal use; or (vii) the payment of taxes.

V. TERMS AND CONDITIONS OF THE SUBLOANS

- 5.1 The subloans to be granted will be subject to the following general terms and conditions:
 - a. Currency of the loans and repayments: The subloans and their repayment will be made in local currency, under conditions that ensure their maintenance of value in real terms.
 - b. Terms: ADEL Morazán may grant the following types of loans to its clients: (i) short-term, for 0-3 months; (ii) medium-term, for 3-12 months; and (iii) long-term, for 12-24 months.
 - c. Lending rate: The lending rate will be calculated so as to cover the following five elements: (i) operating costs of the lending program; (ii) financial costs, including the opportunity cost of the money; (iii) inflation; (iv) loan loss provisioning; and (v) a profit margin.
 - d. Amount: ADEL Morazán will grant loans in amounts between Q1,000 and Q40,000.
 - e. Delinquency: ADEL Morazán will charge late fees in the case of nonpayment by the subborrowers, based on the standard amount on the Salvadorian financial market.
 - f. Guarantees: ADEL Morazán will accept the following guarantees: (i) fiduciary; (ii) collateral; (iii) mortgage; or (iv) a combination thereof.

VI. AMENDMENT OF THE REGULATIONS

- 6.1 The intermediary may suggest changes in these Regulations in order to adapt them to new circumstances or conditions that may arise during the course of program execution. Any amendment to these Regulations will enter into effect once the IDB has indicated its nonobjection in writing.

PROPOSED RESOLUTION

EL SALVADOR. FINANCING AND TECHNICAL COOPERATION TO THE AGENCIA DE
DESARROLLO LOCAL DE MORAZÁN WITHIN THE PROGRAM FOR
FINANCING SMALL PROJECTS

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, as Administrator of the Special Fund for the Financing of Microenterprises of the European Community, to enter into such agreement or agreements as may be necessary with the Agencia de Desarrollo Local de Morazán, of the República de El Salvador, to grant it, within the Program for Financing Small Projects, approved by Resolutions DE-85/78 and DE-147/79: (a) reimbursable financing for the execution of the program referred to in Document PR-____; and (b) non reimbursable technical cooperation for the execution of the program, in accordance with Annex I of said document.

2. That up to the sum of 459,400 ECU, is authorized for the purposes indicated in paragraph 1(a), and up to the sum of 137,820 ECU, for the purposes indicated in paragraph 1(b), both chargeable to the resources of the Special Fund for the Financing of Microenterprises.