MINISTRY PAPER NO

GOVERNMENT GUARANTEE OF A LOAN OF EURO 204.4M FROM THE DEVELOPMENT BANK OF JAMAICA LIMITED (DBJ) TO THE NATIONAL ROAD OPERATING AND CONSTRUCTING COMPANY LIMITED (NROCC) AND RELATED CROSS-CURRENCY SWAP TRANSACTIONS

1. INTRODUCTION

The Honourable House of Representatives is being asked to approve the Government's support to the DBJ by way of the granting of Guarantees under the provisions of the Approved Organizations and Authorities Loans (Government Guarantee) Act in respect of the following transactions:

I. Loan of Euro 204.4 million from the Development Bank of Jamaica Ltd. (DBJ) to the National Road Operating and Constructing Company Limited (NROCC),

II. DBJ's satisfaction of certain credit conditions required by Citibank under the terms of a cross-currency swap entered into on March 1, 2008, as described below.

2.0 OVERVIEW

2.1 Cabinet by Decision No. 37 /08 dated November 3, 2008 approved the granting of a Parliamentary Guarantee to come into effect in April 2009 to support a Loan of EURO 204.4 million from the Development Bank of Jamaica Ltd. (DBJ) to the National Road Operating and Constructing Company Limited (NROCC), under the provisions of the Approved Organizations and Authorities Loans (Government Guarantee) Act (the Act).

2.2 Cabinet is also being asked to note Decision No.11/07 dated April 2, 2007 to support the operations of NROCC in the amount of US$29 million per annum for 3 years. Of this amount of US$29million, US$24.1 million represents the annual debt service obligation on the loan from Bandes Venezuela and the remaining US$4.1 million represents the servicing of DBJ bond.

3.0 BACKGROUND

3.1 In March 2008, the DBJ, with the permission of the Ministry of Finance and the Public Service, accepted a proposal to enter into a Euro/US$ Cross Currency Coupon Swap with Citibank (the Swap). This Swap was to protect the DBJ's Euro 204.4 million exposure under the Bandes loan against currency fluctuation risks. Through the Swap, the DBJ fixed a Euro/ US$ exchange rate of 1.5240 (i.e. 1 Euro = 1.5240 US$) only with respect to all the interest payments throughout the remaining life of the loan, while leaving the loan principal amount unhedged. The background to the decision to hedge the interest payments on this loan was the prevailing exchange rate fluctuations given the volatility of the Euro and its appreciation in value vis-à-vis a relatively weak United States Dollar. The exchange rate of the Euro/US$ reached a high of US$1.5910 in July 2008. The objective of the Hedge was to minimize the exchange rate risk/costs on the interest payments arising from these fluctuations.

3.2 The original terms of the Swap included (i) a fixed rate of 1.5240 US$ per Euro, (ii) a payment by Citibank to DBJ in Euro at the rate of 7.50%, and (iii) a payment by the DBJ to Citibank in US$ at the rate of 7.75% for every interest payment occurring on each February 15 and August 15 up to 2027. The Swap was subject to monthly market valuations (the mark-to-market or MTM) and requires that if there is a negative fluctuation in the EUR/US$ rate against the DBJ's position in excess of US$10 million (the Margining Threshold), the DBJ was required to fund a separate margining account with either cash or Government of Jamaica Bonds for an amount of the excess above the Margining Threshold. For long term swaps (i.e. greater than 10 years) it is market practice to have this type of margining arrangements in place where as a result of a negative mark-to-market one of the parties may be required to place as collateral (in cash and/or marketable securities) an amount equivalent to the excess over a certain threshold amount).