

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).

3.3 Due to the recent movements in the Euro/US\$ spot market, the mark-to-market of the Swap has been moving in a negative manner against the DBJ. This has resulted in the DBJ having to fund a separate margining account with cash of US\$5.750 million and Government of Jamaica Bonds of US\$6.123 million, representing the excess above the Margining Threshold. However, although this affects DBJ's interest payments (around 50% of its total liability), if the current exchange rate conditions were to be maintained until maturity, the value of the EUR loan Principal Repayment that DBJ will have to make at maturity would have improved in US\$ terms. In other words, although the negative mark-to-market of the interests payments of the Swap have been increasing due to the weakness of the Euro against the US\$, if the current exchange rate levels were to be maintained until maturity, the loan Principal (which was not included in the hedge) would substantially benefit from a weaker Euro.

3.4 Given the significant weakening of the Euro, the DBJ faced large negative mark-to-market movements under the Swap and has been required to fund a margin account for the excesses over the Margin Threshold. Therefore, the main concern of the DBJ now is to address having to place more cash or Government of Jamaica Bonds as collateral as the Euro continues to weaken against the US\$.

4.0 RESTRUCTURING THE TRADE

4.1 In order to address the situation, the DBJ and Citibank, in concurrence with the MOFPS, agreed on a proposal to restructure the Swap with the following terms:

- i. Restructure the Interest Payment of the Swap through the purchase of Options. By including in the Swap, Options to receive payment if the Euro depreciates below US\$1.30, the foreign exchange sensitivity of the Swap is reduced. The restructuring was executed as an amendment of the existing Swap so the effect of the options is applied to the current mark-to-market. The idea is that if the Euro continues to depreciate, the options increase in

value and to some extent works to compensate for the negative mark-to-market of the Swap. The purchase of these options was achieved through the increase in the spread of the US\$ payments from 7.75% to 8.29%.

- ii. Margin Account Funding. Subject to the requirement of (iii) below, Citibank agreed that as an alternative to the original margining arrangement of the Swap, the Margin Account will be funded gradually by the DBJ making separate semi annual payments of 1.5% of the principal amount (approximately US\$2.3 million semiannually) into this account up to US\$40 million. This payment will be in addition and separate to the option payments described immediately above. The funds in this Margin Account remain the property of the DBJ (although they are pledged to support the negative mark-to market). The Margin Account will therefore be capped at US\$40 million (and amounts in excess of said cap will be returned to DBJ). In addition, the amounts in this Margin Account will be reduced by US\$2.5 million on each Interest Payment date commencing August 2011 and will be returned to DBJ/GOJ.
 - iii. Issuing a Government Guarantee. Citibank agreed not to make further margining calls on DBJ pursuant to the original margining arrangement of the Swap and, instead, adopt the revised arrangement for the Margin Account describe in the paragraph (ii) above, provided that the Government of Jamaica Guarantee was in place before the end of April 2009.
- 4.2 Finally it was agreed, that if an acceptable Government Guarantee were not in place by the end of April 2009, the original margining arrangement under the Swap will apply and DBJ will be required to fund, with cash or Government of Jamaica Bonds, the entire amount of the MTM exposure above the Margining Threshold. The DBJ has subsequently asked for an extension to the end-of May 2009.
- 4.3 It is to be noted that the revised terms of the Margining Arrangement will offer some improvement/reduction in the financial outlay required under the cross currency swap component. However, based on current market conditions the

DBJ will continue to post negative mark-to-market in the short run given the current spot rate of Euro/US\$ and the low US\$ exchange rate.

5.0 ISSUES

- 5.1 Cabinet Decision No. 37/08 of November 3, 2008, which approved the provision of a GOJ Guarantee in respect of the Bandes Loan, did not extend to the Swap with Citibank nor the obligations of DBJ to fund the margining arrangement under the Swap. In order for Citibank to implement the margining arrangement described in Section 3 above, they will require a satisfactory GOJ guarantee to cover both the Bandes loan and the DBJ's obligations in respect of the proposed revised margining arrangements described above.
- 5.2 The attached Appendix I set out the schedule of coupon payments under the Swap, while Appendix II reflects the operation of the proposed revised Margining Account including the required additional margin payments into that account.
- 5.3 Citibank has further indicated they would be prepared to accept a GOJ blanket Guarantee to cover the amount of the maximum MTM exposure of the transaction (estimated at US\$79 million). This estimate is the result of the worst case scenario and assumes that all market factors will move against the DBJ.
- 5.4 The total guarantees in respect of the Euro 204.4 million loan will now be for the amounts of Euro 204.4 million and US\$79.00 million.
- 5.5 The costs of unwinding or terminating the transaction is approximated to US\$58 million, as a result the decision to continue with a revised margining agreement is more cost effective to the DBJ given that the DBJ will not be required to make a financial outlay of this amount.

6. **RECOMMENDATION**

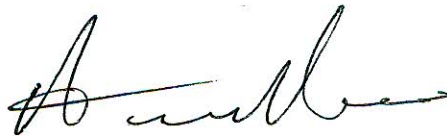
6.1 The Honourable House of Representatives is accordingly asked to approve:

1. Guarantees under the provisions of the Approved Organizations and Authorities Loans (Government Guarantee) Act of the following transactions:

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

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

6.2 I will move the appropriate resolution in due course.

A handwritten signature in black ink, appearing to read 'Audley Shaw', with a stylized, flowing script.

Audley Shaw, M.P.

Minister of Finance and the Public Service

May 19, 2009

Appendix 1

CROSS CURRENCY SWAP			RESERVE ACCOUNT		EUR PUT OPTION	
Start	End	# days	DBJ RECEIVES	DBJ PAYS	DBJ PAYS	DBJ RECEIVES
			€ 204,000,000.00	\$310,896,000.00	\$310,896,000.00	Assuming a Spot of 1.26
			7.50%	8.29%	1.50%	
15-Aug-08	13-Feb-09	182	€ 7,905,000.00	\$13,158,673.20	\$2,331,720.00	\$76,189.75
13-Feb-09	14-Aug-09	182	€ 7,650,000.00	\$13,029,824.08	\$2,331,720.00	\$306,000.00
14-Aug-09	12-Feb-10	182	€ 7,650,000.00	\$13,029,824.08	\$2,331,720.00	\$306,000.00
12-Feb-10	13-Aug-10	182	€ 7,650,000.00	\$13,029,824.08	\$2,331,720.00	\$306,000.00
13-Aug-10	14-Feb-11	185	€ 7,650,000.00	\$13,244,601.40	\$2,331,720.00	\$306,000.00
14-Feb-11	12-Aug-11	179	€ 7,650,000.00	\$12,815,046.76	\$2,331,720.00	\$306,000.00
12-Aug-11	14-Feb-12	186	€ 7,650,000.00	\$13,316,193.84	\$2,331,720.00	\$306,000.00
14-Feb-12	14-Aug-12	182	€ 7,650,000.00	\$13,029,824.08	\$2,331,720.00	\$306,000.00
14-Aug-12	14-Feb-13	184	€ 7,650,000.00	\$13,173,008.96	\$2,331,720.00	\$306,000.00
14-Feb-13	14-Aug-13	181	€ 7,650,000.00	\$12,958,231.64	\$2,331,720.00	\$306,000.00
14-Aug-13	14-Feb-14	184	€ 7,650,000.00	\$13,173,008.96	\$2,331,720.00	\$306,000.00
14-Feb-14	14-Aug-14	181	€ 7,650,000.00	\$12,958,231.64	\$2,331,720.00	\$306,000.00
14-Aug-14	13-Feb-15	183	€ 7,650,000.00	\$13,101,416.52	\$2,331,720.00	\$306,000.00
13-Feb-15	14-Aug-15	182	€ 7,650,000.00	\$13,029,824.08	\$2,331,720.00	\$306,000.00
14-Aug-15	12-Feb-16	182	€ 7,650,000.00	\$13,029,824.08	\$2,331,720.00	\$306,000.00
12-Feb-16	12-Aug-16	182	€ 7,650,000.00	\$13,029,824.08	\$2,331,720.00	\$306,000.00
12-Aug-16	14-Feb-17	186	€ 7,650,000.00	\$13,316,193.84	\$2,331,720.00	\$306,000.00
14-Feb-17	14-Aug-17	181	€ 7,650,000.00	\$12,958,231.64	\$360,760.00	\$306,000.00
14-Aug-17	14-Feb-18	184	€ 7,650,000.00	\$13,173,008.96		\$306,000.00
14-Feb-18	14-Aug-18	181	€ 7,650,000.00	\$12,958,231.64		\$153,000.00
14-Aug-18	12-Feb-19	182	€ 7,650,000.00	\$13,029,824.08		\$153,000.00
12-Feb-19	14-Aug-19	183	€ 7,650,000.00	\$13,101,416.52		\$153,000.00
14-Aug-19	14-Feb-20	184	€ 7,650,000.00	\$13,173,008.96		\$153,000.00
14-Feb-20	14-Aug-20	182	€ 7,650,000.00	\$13,029,824.08		\$153,000.00
14-Aug-20	12-Feb-21	182	€ 7,650,000.00	\$13,029,824.08		\$153,000.00
12-Feb-21	13-Aug-21	182	€ 7,650,000.00	\$13,029,824.08		\$153,000.00
13-Aug-21	14-Feb-22	185	€ 7,650,000.00	\$13,244,601.40		\$153,000.00
14-Feb-22	12-Aug-22	179	€ 7,650,000.00	\$12,815,046.76		\$153,000.00
12-Aug-22	14-Feb-23	186	€ 7,650,000.00	\$13,316,193.84		\$153,000.00
14-Feb-23	14-Aug-23	181	€ 7,650,000.00	\$12,958,231.64		\$153,000.00
14-Aug-23	14-Feb-24	184	€ 7,650,000.00	\$13,173,008.96		\$153,000.00
14-Feb-24	14-Aug-24	182	€ 7,650,000.00	\$13,029,824.08		\$153,000.00
14-Aug-24	14-Feb-25	184	€ 7,650,000.00	\$13,173,008.96		\$153,000.00
14-Feb-25	14-Aug-25	181	€ 7,650,000.00	\$12,958,231.64		\$153,000.00
14-Aug-25	13-Feb-26	183	€ 7,650,000.00	\$13,101,416.52		\$153,000.00
			€ 268,005,000.00	\$457,676,133.16	\$40,000,000.00	\$7,879,189.75

RESERVE ACCOUNT	EUR PUT OPTION	TOTAL
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Start	End	# days	DBJ PAYS \$310,896,000.00 1.50%	DBJ RECEIVES Assuming a Spot of 1.26	MARGIN ACCOUNT without CAP	Interest on Balance Libor 0.30%	Margin with CAP
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OPENING BALANCE

700,000.0

15-Aug-08	13-Feb-09	182	\$2,331,720.00	\$76,189.75	\$3,107,909.75	\$1,050	\$3,108,960
13-Feb-09	14-Aug-09	182	\$2,331,720.00	\$306,000.00	\$5,745,629.75	\$4,663	\$5,750,293
14-Aug-09	12-Feb-10	182	\$2,331,720.00	\$306,000.00	\$8,383,349.75	\$8,625	\$8,391,975
12-Feb-10	13-Aug-10	182	\$2,331,720.00	\$306,000.00	\$11,021,069.75	\$12,588	\$11,033,658
13-Aug-10	14-Feb-11	185	\$2,331,720.00	\$306,000.00	\$13,658,789.75	\$16,550	\$13,675,340
14-Feb-11	12-Aug-11	179	\$2,331,720.00	\$306,000.00	\$16,296,509.75	\$20,513	\$16,333,573
12-Aug-11	14-Feb-12	186	\$2,331,720.00	\$306,000.00	\$18,934,229.75	\$24,500	\$18,995,794
14-Aug-12	14-Aug-12	182	\$2,331,720.00	\$306,000.00	\$21,571,949.75	\$28,494	\$21,662,007
14-Aug-12	14-Feb-13	184	\$2,331,720.00	\$306,000.00	\$24,209,669.75	\$32,493	\$24,332,220
14-Feb-13	14-Aug-13	181	\$2,331,720.00	\$306,000.00	\$26,847,389.75	\$36,498	\$27,006,439
14-Aug-13	14-Feb-14	184	\$2,331,720.00	\$306,000.00	\$29,485,109.75	\$40,510	\$29,500,000
14-Feb-14	14-Aug-14	181	\$2,331,720.00	\$306,000.00	\$32,122,829.75	\$41,250	\$32,500,000
14-Aug-14	13-Feb-15	183	\$2,331,720.00	\$306,000.00	\$34,760,549.75	\$37,500	\$37,500,000
13-Feb-15	14-Aug-15	182	\$2,331,720.00	\$306,000.00	\$37,398,269.75	\$33,750	\$40,000,000
14-Aug-15	12-Feb-16	182	\$2,331,720.00	\$306,000.00	\$40,035,989.75	\$30,000	\$42,500,000
12-Feb-16	12-Aug-16	182	\$2,331,720.00	\$306,000.00	\$42,673,709.75	\$26,250	\$45,000,000
12-Aug-16	14-Feb-17	186	\$2,331,720.00	\$306,000.00	\$45,311,429.75	\$22,500	\$47,500,000
14-Feb-17	14-Aug-17	181	\$360,760.00	\$306,000.00	\$45,978,189.75	\$18,750	\$48,000,000
14-Aug-17	14-Feb-18	184		\$153,000.00	\$46,131,189.75	\$15,000	\$47,500,000
14-Feb-18	14-Aug-18	181		\$153,000.00	\$46,484,189.75	\$11,250	\$47,500,000
14-Aug-18	12-Feb-19	182		\$153,000.00	\$46,437,189.75	\$7,500	\$47,500,000
12-Feb-19	14-Aug-19	183		\$153,000.00	\$46,590,189.75	\$3,750	\$47,500,000
14-Aug-19	14-Feb-20	184		\$153,000.00	\$46,743,189.75	\$0	\$0
14-Feb-20	14-Aug-20	182		\$153,000.00	\$46,896,189.75	\$0	\$0
14-Aug-20	12-Feb-21	182		\$153,000.00	\$47,049,189.75	\$0	\$0
12-Feb-21	13-Aug-21	182		\$153,000.00	\$47,202,189.75	\$0	\$0
13-Aug-21	14-Feb-22	185		\$153,000.00	\$47,355,189.75	\$0	\$0
14-Feb-22	12-Aug-22	179		\$153,000.00	\$47,508,189.75	\$0	\$0
12-Aug-22	14-Feb-23	186		\$153,000.00	\$47,661,189.75	\$0	\$0
14-Aug-23	14-Aug-23	181		\$153,000.00	\$47,814,189.75	\$0	\$0
14-Feb-24	14-Feb-24	184		\$153,000.00	\$47,967,189.75	\$0	\$0
14-Aug-24	14-Aug-24	182		\$153,000.00	\$48,120,189.75	\$0	\$0
14-Feb-25	14-Feb-25	184		\$153,000.00	\$48,273,189.75	\$0	\$0
14-Aug-25	14-Aug-25	181		\$153,000.00	\$48,426,189.75	\$0	\$0
13-Feb-26	13-Feb-26	183		\$153,000.00	\$48,579,189.75	\$0	\$0

\$40,000,000.00

\$7,879,189.75

Appendix 2

Maximum Impact of the Mark To Market of the DBJ Transaction

The maximum mark to market of the DBJ transaction is calculated as follows:

Maximum (Negative) Mark to Market of the Cross Currency Swap + Maximum (positive) Value of the Options purchased

1. Mark-to-Market (MTM) of the Cross Currency Coupon Swap

The mark-to-market of the Cross Currency Coupon swap is impacted by the following variables:

- EUR/USD spot rate
- EUR interest rates
- USD interest rates

The mark-to-market of the swap can be either negative or positive.

Negative mark-to-market is caused by:

- EUR weakening against the USD (for example the EUR moving from 1.50 to 1.20)
- EUR interest rates increasing (since the DBJ has a EUR Fix asset under the swap)
- USD interest rates decreasing (since the DBJ has a USD Fix liability under the swap)

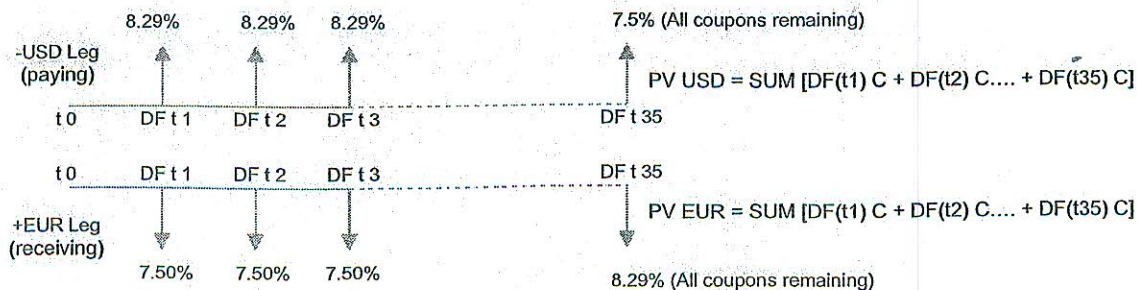
Positive mark-to-market is caused by:

- EUR strengthening against the USD (for example the EUR moving from 1.50 to 1.70)
- EUR interest rates decreasing (since the DBJ has a EUR Fix asset under the swap)
- USD interest rates increasing (since the DBJ has a USD Fix liability under the swap)

Currently the main driver of the negative mark-to-market has been the spot EUR/USD variable and to a lesser extent the decline in USD rates. The expectation is that although the EUR/USD might continue to slide, the USD interest rates and EUR interest rates will move in a favored direction to the Swap.

Valuation of Swaps

- The principle of valuation of any Cross Currency Swap is to bring to Present Value (PV) all flows (coupons + principal) of each leg of the Swap. In this case there is no principal.
- Each Cash Flow is discounted to Present Value by the corresponding discounting factor (DF) of each tenor of each currency which is derived from its corresponding Interest Rate market.
- Then the sum of all Present Values of each Cash Flow that DBJ is receiving is converted into USD (at current Spot). Now, both flows are in the same currency.
- Finally the Sum of all Present Values of both legs are subtracted. If there is a positive number it is positive for the DBJ or the number could be negative against the DBJ.
- At time zero both cash flows are equal. As the market moves (foreign exchange rates and interest rates) the value of the Swap changes.



2. Value of the Options:

The options will always have a positive value since they were bought by DBJ. The value of the options will depend on the volatility of the FX, time to maturity of the options and the spot FX rates.

Since the options will always have a positive value, these help reduce the negative Mark to Market of the Cross Currency Swap.

The combination of the maximum negative USD value of the Cross Currency swap and maximum positive value of the options is calculated at USD 79 million. This number will decline as we get closer to Maturity.

3.Scenarios:

Citi Calculates the worst case scenario based on a statistical model that estimate different movements of each of the market factor through time and estimate a worst case if all market factor move against the Client. These model is based on VAR (Value at Risk).