



**Corporación Financiera de América del Norte  
S.A. de C.V. SOFOM, E.N.R.**

**LOAN POLICIES AND PROCEDURES**



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## I. INTRODUCTION

The *Corporación Financiera de América del Norte, S.A. de C.V. SOFOM, E.N.R.*, (COFIDAN), formerly a limited-purpose financial institution, was established by the North American Development Bank (NADB), which is headquartered in San Antonio, Texas, and the United Mexican States through the offices of the Mexican Ministry of Finance and Public Credit (SHCP). The purpose of COFIDAN is to make loans in the environmental infrastructure sector to Mexican states and municipalities, as well as to their government-run agencies and institutions, and to private companies for projects and programs that have been duly approved by the Board of Directors of the North American Development Bank (NADB) (hereinafter the “Board of Directors”). In the financing operations that COFIDAN executes with NADB, the latter will bear the credit risk; therefore, COFIDAN will not need to establish reserves against such risk. Likewise, in the financing operations that COFIDAN and NADB execute, COFIDAN will transfer to its borrowers the conditions determined by NADB, including the interest rate and amortization period; therefore, COFIDAN will not incur any liquidity or interest rate risks. Moreover, COFIDAN’s asset and liability transactions are denominated in the same currency, so there is no foreign exchange risk.

Activities related to project development, selection and evaluation, the procedures for obtaining financing and disbursements referred to in these Loan Policies and Procedures will be performed by COFIDAN, through the North American Development Bank, which will be responsible for keeping and safeguarding all the information.

## II. POLICIES FOR MAKING LOANS

COFIDAN is authorized to make direct loans with its own funds. Since risk-sharing is fundamental to sound banking practices, COFIDAN may require other participants to provide a portion of the funding required for a project in the form of grants, equity contributions, or other loans. Projects must have sufficient revenue, equity, grants or other financial support to ensure repayment of COFIDAN’s loan.

In addition to reducing COFIDAN’s share of risk in a project, success in attracting other sources of financing for COFIDAN-financed projects maximizes COFIDAN resources available for funding other projects and provides further evidence that a project has a demonstrable and reasonable assurance of repayment. COFIDAN fully cooperates with other public and private sources of investment capital for the environmental infrastructure projects for which COFIDAN provides loan financing.

The following are the basic policies for making loans that govern COFIDAN participation in an environmental infrastructure project.

**A. Eligible Borrowers.**

1. Eligible borrowers are divided into two categories, Governmental and Private Borrowers.

- a) A “*Governmental Borrower*” is defined as any political subdivision of the government of Mexico, including states, municipalities or other governmental entities.
- b) A “*Private Borrower*” is defined as any other private enterprise in the territory of Mexico, including corporations, financial institutions, investors, and non-governmental organizations.
- c) The borrower for a project being sponsored by a *public-private partnership* will be considered a Governmental Borrower.

**B. Project Location.** Projects must be located in the U.S.-Mexico border region, which is defined as the area in Mexico that is within 300 kilometers south of that border. A project may be located outside the border region if the NADB Board of Directors determines that the project would remedy a transboundary environmental or health problem.

**C. Certification.** To be eligible for COFIDAN loan financing, a project must be certified by the NADB Board of Directors.

**D. Eligible Sectors.** The environmental infrastructure projects that may be certified by NADB and financed by COFIDAN are defined as those that will prevent, control or reduce environmental pollutants or contaminants, improve the drinking water supply, or protect flora and fauna so as to improve human health, promote sustainable development or contribute to a higher quality of life. Moreover, preference is given to projects relating to water pollution, wastewater treatment, water conservation, municipal solid waste and related matters. The general characteristics of projects eligible for NADB certification and COFIDAN financing are described below.

| ELIGIBLE SECTORS           |   |
|----------------------------|---|
| 1. <b>Priority Sectors</b> | a) <u>Water pollution</u> projects encompass facilities for the collection, transportation, treatment, storage and distribution of potable water from the sources of supply (groundwater or surface water) to the user. Facilities include, but are not limited to, buildings, structures, equipment and other appurtenances for: the collection of surface water or groundwater supplies, storage facilities such as natural impoundments or reservoirs; transportation of water by aqueducts, whether open channel, pipelines, or tunnels; treatment systems necessary to meet potable water standards; distribution systems to meet the requirements for domestic, commercial, industrial and fire-fighting purposes, including pipe |

| ELIGIBLE SECTORS             |   |
|------------------------------|---|
|                              | <p>systems and networks, pumping stations, storage facilities, fire hydrants, service connections, meters and other appurtenances; and storage, handling, treatment, recycling or reclamation systems for solids resulting from the treatment of water.</p> <p>b) <u>Wastewater treatment</u> projects encompass facilities for the collection, conveyance, treatment and disposal of wastewater and solids derived from the treatment of such wastewater. Wastewater is water carrying wastes from residential, commercial or industrial buildings that is a mixture of water and dissolved or suspended solids, liquids or gases. Facilities include, but are not limited to, buildings, structures, equipment, and other appurtenances for: sewers (gravity, pressure, or vacuum); interceptors; force mains; pumping and lift stations; treatment systems for primary, secondary or tertiary treatment of wastewater necessary to meet treatment standards; industrial and commercial pretreatment; storage, handling, treatment, recycling or reclamation of solids resulting from the treatment of wastewater; and systems for the disposal of effluent or solids.</p> <p>c) <u>Municipal solid waste</u> projects encompass facilities that are designed to collect or dispose of municipal solid waste (i.e., waste generated by households and commercial establishments, but excluding construction and hazardous wastes). A municipal solid waste project could include purchase of garbage collection and disposal equipment, closure of disposal sites, or facilities for transfer or disposal of municipal solid waste, or for recycling or recovering useful material from municipal solid waste.</p> <p>d) <u>Related matters</u> include industrial and hazardous waste projects, water conservation projects, water and wastewater hookups for housing, and recycling and waste reduction projects.</p> |
| <b>2. Additional Sectors</b> | <p>Additional types of projects that may qualify as environmental infrastructure projects include, but are not limited to, projects that improve air quality, public transportation projects, projects related to clean and efficient energy, and projects that improve municipal planning, development and water management.</p>   |

**E. Financial Terms and Conditions.** The terms and conditions of a COFIDAN loan will be appropriate to the project financed and structured with a view toward preserving COFIDAN’s resources.

1. **General Principles.** In considering a request for a loan, COFIDAN must:
  - Take into account the ability of the borrower to obtain the loan from private sources of financing on terms which, in the opinion of COFIDAN, are reasonable for the borrower;
  - Pay due regard to prospects that the borrower and its guarantor, if any, will be in a position to meet their obligations under the loan contract; and
  - Establish that the rate of interest, other charges and the schedule for repayment of principal are appropriate for the purposes or project in question.

In approving a loan for a project, the Board of Directors must find that the project/sponsor is economically and financially sound and pay due regard to the prospects that the project/sponsor will be able to generate sufficient revenue, to meet debt servicing obligations.

## 2. Lending Limits.

a. **Single Obligor Limit (SOL).** The maximum allowable credit exposure approved for a particular obligor—through loans to the obligor, loans guaranteed by the obligor, and/or any other applicable credit instrument, net of disbursements repaid and any financing cancellations—is 15% of the NADB’s available capital resources (defined below).

An additional 10% of the NADB’s available capital resources will be allowed for an obligor whose loans above the 15% limit meet one of the following criteria:

- i. The loan is fully secured by readily marketable collateral (defined below); or
- ii. The loan payment mechanism is a “*fideicomiso*,” a Mexican municipal or state irrevocable trust in which the payment and/or guarantee is funded by committed “*participaciones*” or any other revenue from a public entity that by law may be used as source of payment or guarantee; or
- iii. The loan is to a State or political subdivision and it constitutes a general obligation of the State or political subdivision (defined below).

Once a loan is approved, it remains approved even if the level of available NADB capital resources falls such that the obligor exceeds the single obligor limit.

Available capital resources are defined as NADB’s funded, unimpaired paid-in capital, plus undesignated retained earnings, plus eligible callable capital, where “funded” means the paid-in capital that the shareholders have paid NADB; “unimpaired” means that there is no existing obligation or designation associated

with this paid-in capital (for example, it is not dedicated to community adjustment and investment purposes or to a specific program); and “eligible callable capital” is the callable capital that corresponds to current borrowings by NADB.

Readily marketable collateral is defined as financial instruments and bullion that are salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based upon actual transactions on an auction or similarly available daily bid and ask-price market.

A general obligation of the State or political subdivision is defined as an obligation backed by the credit and taxing power of the issuing jurisdiction or by a borrower not possessing general powers of taxation, when an obligor possessing general powers of taxation has unconditionally promised to make payments into the trust or otherwise provide funds to cover all required payments on such obligation.

**b. Maximum Loan per Project.** COFIDAN may provide a loan for up to 85% of the eligible costs of a project, depending on project risks and other characteristics. In the case of public sector loans, regardless of the amount, and private corporate loans or loans with corporate guarantees that do not exceed USD \$20 million, the Bank may finance up to 100% of project eligible costs, provided the loans have an alternate source of payment or guarantee that demonstrates capacity for full repayment of the loan regardless of the ability of the project to generate revenue. In addition, for projects with eligible costs up to and including \$1 million, COFIDAN may provide a loan for up to 100% of the eligible costs of a project, depending on project risks and other characteristics. Actual loan amounts will be based on a borrower’s ability to afford a particular loan for a particular project, determined by COFIDAN’s standard credit analysis, taking into account factors such as current level of indebtedness, capacity to service current and proposed debt and credit quality.

**3. Eligible Costs.** COFIDAN may provide loan financing to meet the costs and expenses related to the purposes of a loan. Costs eligible for COFIDAN loan financing may include the acquisition of land and any buildings thereon, site preparation and development, design, construction, reconstruction, rehabilitation, improvement, the acquisition of necessary machinery and equipment, legal, finance, and development costs, interest during construction, contingency or reserve funds, taxes, customs and other duties, and other incidental costs approved by COFIDAN.

**4. Forms of Loans.** A loan is executed through a loan agreement and attendant documentation entered into by the borrower and COFIDAN and, if necessary, between COFIDAN’s borrower and NADB. COFIDAN may make loans in different forms, as long as the financing documentation contains terms and conditions that protect COFIDAN’s interests in a manner comparable to the protections of typical COFIDAN loan documents. Forms of loans include, but are not limited to, direct loans, bond purchases,

lease agreements, back-leveraged loans, revolving line of credits, credit guarantees and stand-by revolving loans.

**5. *Maturities.*** COFIDAN may offer loan maturities up to 30 years, depending on individual project requirements, such as the ability to afford the annual debt service. Grace periods are negotiable and may cover the anticipated project construction and start-up phase. Term structure must be appropriate to the type of project financed and generally consistent with market practice for such projects. In general, the total repayment term shall not exceed the useful life of the project, except for public sector projects and loans with corporate guarantees where the source of cash for debt service payment does not depend on the revenue generated by the relevant project.

**6. *Currency; Exchange Risk.*** The cost of a currency exchange hedge has to be included in COFIDAN loans because of the funding provided by NADB.

**7. *Interest Payments; Calculation of Interest Rates.*** Interest on outstanding balances will be payable on specified installment dates and at least annually. Interest rates for particular loans may be established at loan closing and will depend on the interest rate structure for which the financing is approved. COFIDAN will charge a fixed or variable market-based interest rate in the following manner:

i. ***Interest Rate.*** COFIDAN will charge an interest rate expressed as a spread relative to U.S. Treasury securities, LIBOR rate or any of its substitutes (i.e. SOFR), or TIIE rate, or any other reference rate widely used by the market in U.S. dollars or Mexican pesos. In determining the Interest Rate for a financing, COFIDAN will consider the applicable NADB Base Rate plus an Applicable Margin as defined below.

ii. ***Base Rate.*** The base rate for financing will be the cost of NADB's funding, unless there is targeted funding for a specific lending program, in which case the cost of the targeted funding will become the base rate. The base rate will be adjusted to the term of the financing by considering the modified duration of NADB's cost of funding and adjusting by the yield curve of NADB's issued debt.

iii. ***Applicable Margin.*** A margin will be charged over the Base Rate. This Applicable Margin will be constructed to cover an administrative spread and a risk premium, based on the following guidelines and expressed in basis points (bps; one basis point is equal to 1/100th of 1%):

- (1) an administrative spread to cover NADB's current administrative expenses. This component of the spread will be constructed by comparing the Bank's administrative and other expenses to the Bank's revenue generating assets. The spread will be updated periodically, and the updated calculation will be available at NADB's webpage; plus.

- (2) a risk premium, within a range of 5 - 400 bps, related to the characteristics of the loan, including term, size, presence of other lenders (i.e. complexity of the loan), contract revenue source and quality of the purchaser, among others, as well as debtor's capitalization, experience and third- party support.

iv. Payment of points up front. A borrower may pay points up front, provided that the amount of basis points over the benchmark in the all-in interest cost of the loan, excluding any commitment fee, does not exceed 550 basis points.

**8. Commitment Fee.** The purpose of the commitment fee is to offset the opportunity cost of allocating resources for the exclusive use of particular borrowers. The borrower will be charged a commitment fee on the undisbursed balance of the loan, which will begin to accrue 30 days after the date of the first disbursement of a loan. For loans with scheduled disbursements for which the interest rate for each disbursement is set on the date of the disbursement, the commitment fee will accrue on the undisbursed balance of disbursements that deviate from the scheduled dates or amounts. The commitment fee will be set by NADB.

**9. Other Fees.** COFIDAN may charge other fees similar to those charged by other local lenders for similar loans.

**10. Demonstrable and Reasonable Assurance of Repayment.** All loans made by COFIDAN must offer a demonstrable and reasonable assurance of repayment. To comply with this requirement, COFIDAN must determine that demonstrable and reasonable assurance exists that the borrower will be able to repay the loan in accordance with the loan repayment schedule. Factors considered in making such a determination vary, depending upon the borrower and the nature and size of the project being financed, but generally relate to the capacity of the borrower and/or project to generate sufficient revenue through user fees or other dedicated sources of revenue to service its debt. Should COFIDAN determine that a project's revenue or a borrower's financial position do not meet the requirement of demonstrable and reasonable assurance of repayment, additional security arrangements, guarantees or sources of repayment, or additional grant or equity support will be required.

**11. Security.** Loans from COFIDAN must be secured with project and/or borrower cash flows, which may take the form of user fees, dedicated taxes, earnings from the sale of project output, other project earnings, or other dedicated sources of revenue. COFIDAN may also require borrowers to secure their loan with any other type of guarantee, including but not limited to the following: a mortgage on fixed assets (land, plant, and other buildings), a mortgage on or security interest in movable assets (equipment and other business assets), a pledge of a project sponsor's share in the project, and the assignment of the sponsor's insurance policies and other contractual benefits. The value of the guarantee, together with the cash flows, must be greater than the loan outstanding at the time of closing. In order to ensure that the value of project

security is properly maintained, COFIDAN will inspect the security as frequently as it deems necessary.

**12. Limited Recourse Financing.** Limited recourse financing refers to a loan for which the primary sources of funds for repayment are the revenue derived from the operation of the project and the project's assets. COFIDAN may provide limited recourse financing, provided that the project has a demonstrable and reasonable assurance of repayment from project cash flows and other project assets.

**13. Recourse Financing.** COFIDAN will, where appropriate, require recourse to a project sponsor or guarantor if it determines that a loan's security provisions are insufficient to ensure that the loan has a demonstrable and reasonable assurance of repayment. In the case of a local or regional Governmental Borrower, such recourse may include:

- i. Pledges of federal, state or local tax revenue ("*participaciones*") or any other revenue from a public entity that by law may be used as a source of payment or guarantee.
- ii. Establishment of a utility service district or enterprise fund, which could be designed to allow the project to draw on other sources of revenue in the service area.
- iii. Tax revenue in general, fees and charges collected by local governments and public enterprises.
- iv. Irrevocable revolving lines of credit and similar guarantees.

In the case of private sponsors, such recourse refers to any other revenue or assets that would sufficiently cover the debt service, regardless of the capacity of the financed project to generate such debt service by itself.

**14. Federal Guarantees.** In the case of loans to Private Borrowers or to regional or local Governmental Borrowers, COFIDAN may require that the federal government of the country in which the project is to be carried out, or a public institution or a similar agency of such federal government acceptable to COFIDAN, guarantee the repayment of the principal and the payment of interest and other charges on a loan.

**15. Other Guarantees.** COFIDAN must be protected against project performance and completion risks through appropriate guarantees. For that reason, COFIDAN may request limited or general guarantees from project sponsors, borrowers, equity investors, contractors, suppliers, operators or other relevant parties to guarantee technical, operational, or financial performance and completion of a project.

**16. Debt Service Coverage Ratio (DSCR).** The DSCR requirement ensures that sufficient cash flow is available to cover the required debt service. In principle, it is the ratio of the total available anticipated cash flow to the required debt service. A value over 1 provides a margin of security for COFIDAN.

**a. Definitions.** The formula for calculating the DSCR will be specifically defined for each loan based on the characteristics of the transaction and/or borrower and the payment mechanism. Where possible, preference will be given to commonly used, market standard formulas. The justification for, and recommendation of, a specific formula for each proposed loan, along with the minimum level of coverage required, will be included in every certification and financing proposal submitted to the NADB Board of Directors for its review and approval.

**b. Application.** Except as noted below, a minimum DSCR of 1.2, or its equivalent, depending on the formula and/or the cash flow scenario used for calculating the DSCR pursuant to paragraph (a) of this section 16, will be required for all NADB loans.

i. For loans to public sector borrowers in the U.S. or Mexico where the pledged revenue is sufficient to cover the debt service, a minimum DSCR of 1.0 will be required.

ii. For loans to Public-Private Partnerships in which revenue, in an amount sufficient to cover the debt service, is pledged as a source of payment or guarantee, a minimum DSCR of 1.0 will be required.

iii. For construction-only or other short-term loans when there is no cash flow generation prior to project completion or the repayment of the principal amount, or when the accrued interest is capitalized, a minimum DSCR may not be required, provided the borrower demonstrates a credible and strong source of payment for the loan, including its debt service.

iv. For loans to investment-grade corporates, a minimum DSCR may not be required provided that alternative financial indicators, appropriate to the relevant industry, are utilized to evaluate repayment risks and monitor the credit quality evolution of such borrower.

**17. Reserves.**

**a. General.** Reserve requirements address two key objectives: mitigation of project risk and development of sound financial practices by COFIDAN’s borrowers. To these ends, COFIDAN shall require a debt service reserve, except as stated under the standard reserve parameters below, and may also require other reserve funds in making a loan to a borrower, as defined herein:

- Debt service reserve (DSR) to meet debt payment obligations in situations when the borrower does not have available cash. The DSR provides a level of liquidity that will minimize default risks in situations that adversely affect borrower cash flows.
- Operations and maintenance reserve (OMR) to fund non-recurring operations and maintenance costs that might arise from catastrophic events.
- Repair and replacement reserve (RRR) to cover emergency repairs or replacements whose magnitude may surpass what is normally dealt with in the operational budget.

**b. Reserve Requirements.** COFIDAN establishes reserve requirements on the basis of an analysis of a project’s technical and financial risks. These elements determine reserve levels and the timeframe for funding them, within the standard parameters shown in the table below.

With respect to the DSR, OMR and RRR requirements, the basis for the establishment of the reserve amounts shall be described in the financing proposal provided to the Board of Directors.

Reserves must remain funded until the COFIDAN loan is fully repaid. The borrower may then dispose of the reserves at its discretion; COFIDAN, however, encourages maintenance of reserves beyond the life of the project to build and maintain the technical and financial capacity of the project and project sponsor.

**STANDARD RESERVE PARAMETERS**

| Type of Project  | Reserve Amount                 | Timeframe to Fund Reserves                                  | De-Funding        |
|--|--------------------------------|---|-------------------|
| <b>Debt Service Reserve (DSR)</b>                                  |                                |   |                   |
| Municipal projects financed by utility or other municipal revenue. | 6 to 12 months of debt service | Up to 30 or 60 months from first disbursement, respectively | Upon loan payback |

| Type of Project   | Reserve Amount  | Timeframe to Fund Reserves                                  | De-Funding        |
|---|---|---|-------------------|
| State, municipal or utility projects with irrevocable trust payment and/or guarantee structure for which the payment and/or guarantee is funded by state, municipal or other utility revenue                    | 1 to 3 months of debt service   | Up to 30 or 60 months from first disbursement, respectively | Upon loan payback |
| Municipal projects financed by utility or other municipal revenue, backed by a tax pledge (" <i>participaciones</i> ")  | 2 to 3 months of debt service   | Up to 24 or 36 months from first disbursement, respectively | Upon loan payback |
| Private sector projects   | 2 to 12 months of debt service  | Up to 12 months from first disbursement                     | Upon loan payback |
| Municipal or utility projects with an irrevocable state or municipal payment and guarantee trust structure for which the payment and/or guarantee is funded by federal tax revenue (" <i>participaciones</i> ") | No debt service reserve required  |   |                   |
| Construction-only and other short-term loans  | No debt service reserve, credible source of repayment required.                             |   |                   |
| All other transactions not covered under the parameters described above   | To be recommended by NADB based on the factors set forth in paragraph 17.c.                 |   |                   |
| <b>Operations and Maintenance Reserve (OMR)</b>   |   |   |                   |
| All projects  | Up to 3 months of O&M project budget, determined by COFIDAN's Technical Services Department | Up to 36 months from first disbursement                     | Upon loan payback |
| <b>Reserva para renovaciones y reposiciones (RRR)</b>   |   |   |                   |
| All projects  | Up to 10% of project equipment value, determined by COFIDAN's Technical Services Department | Up to 48 months from first disbursement                     | Upon loan payback |

**c. Debt Service Reserve.** The main factors considered by COFIDAN in establishing DSR requirements are:

- Quality of the guarantee provided and / or collateral pledged.
- Loan payment mechanism.
- Current available cash flows and reserves.
- Overall financial health of the borrower (financial ratios).
- Construction period and timeframe for the project to generate new cash flows in relation to the project debt amortization schedule.

Other factors that are reviewed in so far as they have an impact on the project include:

- Any existing loan covenants and debt service.
- Debt repayment profile (if any) and historical experience with creation of reserves.
- Customary requirements of other creditors in the same industry, geographic area and current market conditions.

The quality of the guarantee or collateral will substantially impact the level and timeframe for funding the debt service reserve.

**d. Operations and Maintenance Reserve.** Factors considered in establishing OMR requirements include:

- Budgeted project operations and maintenance costs.
- Historical and projected trends of project operations and maintenance costs.
- Adequacy of internal operational controls.
- Experience of the operations and maintenance management team.
- Risks associated with the type of project.
- Existing operations and maintenance reserves or reserves required in the past.
- Customary business practices in the industry and/or region.

The procedure for establishing an operations and maintenance reserve includes an inspection of revenue and expenses for recent years and identification of consistencies and trends. The analysis also considers the factors for revenue shortfall or extraordinary expenses associated with the type of system, such as water, wastewater or solid waste, to get a sense of the level of risk associated with the operation.

**e. Repair and Replacement Reserve.** Factors considered when establishing RRR requirements include:

- Value of project equipment subject to wear and tear and its expected useful life.
- Risks associated with the type of facility or project equipment.
- Adequacy of internal operational controls.
- Existing RRR or reserves required in the past.
- Customary business practices in the industry and/or region.

The type of equipment or installations will have an impact on the amount and timing of establishing the RRR. A solid waste project that has simple equipment will not have the same needs as a wastewater treatment plant that will suffer greater wear and tear on specific equipment, such as pumps, and lesser wear on long-term installations such as sewer lines.

**18. Use of Loan Proceeds; Procurement.** COFIDAN will impose no condition that the proceeds of a loan be spent in the territory of the U.S. or Mexico. COFIDAN will take measures to ensure that the proceeds of any loan made by COFIDAN are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency. All COFIDAN loan proceeds must be expended in accordance with COFIDAN's procurement policies and procedures, which are outlined in the document entitled, "Procurement Policies and Procedures."

**19. Other Terms and Conditions.** COFIDAN shall have the power to determine any other terms and conditions it deems necessary to ensure a demonstrable and reasonable assurance of repayment of such loans.

**F. Information and Disclosure Policies.** COFIDAN promotes an open information policy, to the extent practicable and consistent with sound commercial practices.

**G. Revisions to and Waivers of Policies.** The provisions of the section "Policies for Making Loans" may be changed only by a decision of the Board of Directors, based on a policy paper. In exceptional circumstances, the Board of Directors may approve a waiver to the provisions of the section, "Policies for Making Loans" for a specific financing proposal. In that case, the waiver will be presented as part of such proposal and must have been approved in advance by the NADB Board of Directors.

### III. PROCEDURES FOR MAKING LOANS

To assist project sponsors in determining whether their environmental infrastructure projects are eligible for NADB certification and COFIDAN loan financing, NADB or COFIDAN can provide preliminary guidance regarding potential financial designs and structures of projects. As part of this process, COFIDAN will encourage communities to engage in long-term planning for their infrastructure needs and to establish effective and sustainable methods of operation.

In working with project sponsors on preliminary financing proposals, COFIDAN will determine whether the ability of projects to qualify for COFIDAN loans might benefit from grant support from NADB's Technical Assistance Program (TAP). During this time, NADB may also assist project sponsors in securing complementary loans, equity, grants or other forms of financing from a variety of public and private sources, including the Border Environment Infrastructure Fund (BEIF) funded by the U.S. Environmental Protection Agency (EPA). COFIDAN's evaluation of a project's financial proposal will identify the levels of non-reimbursable financial support a project might need to meet repayment obligations and ensure affordability of the project for the relevant border community's ratepayers.

Once a project sponsor has determined to secure COFIDAN loan financing for an eligible environmental infrastructure project, the sponsor should apply for project certification and financing from NADB. The certification guidelines are contained in the document entitled "NADB Project Certification Criteria and Process." The NADB Board of Directors approves project certification and financing simultaneously. NADB will work on a cooperative basis with the project sponsor to ensure that all requirements for certification and financing are addressed in a timely manner. The following procedures must be followed to access loan financing:

**A. Application.** Applicants for financing must indicate to COFIDAN in writing their interest in obtaining financing, which may be done by electronic means directed to staff member(s) assigned as the point(s) of contact for the applicant. Applicants should provide, at a minimum, the following: name and location of the project, the general objectives or type of project, the loan amount requested, and the sponsor's or project's contact information. For those loans in which a procurement process is required, the procurement notice or bid invitation may be considered sufficient indication of interest in financing.

**B. Acceptance Agreement.** The project sponsor or the borrower must enter into an acceptance agreement with NADB prior to the use of material resources by NADB/COFIDAN in the development or financing of the relevant project. The acceptance agreement includes provisions for payment of expenses incurred by NADB in analyzing the project sponsor's loan proposal. For most projects, NADB/COFIDAN will require the advice of outside financial consultants, legal counsel, engineers and other advisors. There may also be other costs associated with conducting proper due diligence. Consistent with standard commercial practice, NADB/COFIDAN will pass through these costs to the project sponsor.

**C. Loan Financing Proposal.** The project sponsor or borrower must provide the necessary information to develop a comprehensive financing proposal with detailed information for Board consideration. COFIDAN will review the material submitted in a timely manner to

determine if it includes all the information required. If COFIDAN determines that the information is incomplete, it will explain the deficiencies to the applicant. As applicable, the material requested from the sponsor or borrower may include, but not be limited to, the following information.

| GUIDELINE FOR INFORMATION REQUIREMENTS |  |
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| <b>1. General Project Information</b>  | <ul style="list-style-type: none"> <li>a) A project description that includes:               <ul style="list-style-type: none"> <li>i. information on the applicant (potential borrower): name, address, phone, email, fax; names and positions of legal representative and key project contact person;</li> <li>ii. a description of the project, its objectives, environmental benefits, impacts, participants and main characteristics, outcomes and population to benefit;</li> <li>iii. the total cost with a breakdown by main category of the expected financial structure (equity, grants, debt);</li> <li>iv. project schedule; and</li> <li>v. a brief description of the planning, construction, operation and maintenance processes.</li> </ul> </li> <li>b) Where appropriate, a feasibility study containing a detailed description of all aspects of the project, to include description, location, legal status, ownership and background on key elements of the project, such as the status of agreements, licenses, local partner participation, guarantors, and financing.</li> <li>c) Draft agreements, to the extent available, for key elements of the project, including supply, off-take, revenue and operations and maintenance.</li> <li>e) Where applicable, a description of how the project fits into the long-term master plans of the service system and the long-term strategic plans of the community or communities in the service area or affected areas.</li> <li>f) Where applicable, a description of the user fee system in place for the service area, including both historical and projected data on rate levels, comparability of rates to</li> </ul> |

| GUIDELINE FOR INFORMATION REQUIREMENTS |   |
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|  | <p>other service areas in the border region, legal authority and capacity to raise rates and the collections system.</p>  |
| <b>2. Project Participants</b>         | <ul style="list-style-type: none"> <li>a) The potential borrower should present information describing its organizational and technical structure.</li> <li>b) Sponsors must provide all relevant financial information, including audited financial statements.</li> <li>c) If the sponsors are part of a joint venture or consortium, information should be provided for all relevant participants. Shareholders’ and/or partnership agreements should also be provided.</li> <li>d) Sponsors and guarantors must provide sufficient evidence that they are empowered to assume the COFIDAN loan.</li> <li>e) The information necessary for the Know Your Customer (KYC) process will be required for both the entities and individuals relevant to the transaction, namely: official identifications, legal and corporate powers, administrative responsibilities, shareholder positions, corporate structures, related entities, taxpayer registration, and legal domiciles, among others, as well as any other information required by applicable laws.</li> </ul> |
| <b>3. Technical Information</b>        | <ul style="list-style-type: none"> <li>a) A project summary indicating, among other things: the project to be financed; the proposed expansion and improvements; compliance with environmental standards and regulations; and, if available, parties expected to be involved in building, operating and maintaining the project.</li> <li>b) A detailed estimate of operating costs.</li> <li>c) A description of the project costs and specifications, with a breakdown of the costs by category.</li> <li>d) If applicable, a detailed description of the measures taken to protect against project completion risk, including liquidated damage provisions, performance bond requirements, and other guarantee arrangements.</li> <li>e) A project implementation and disbursement schedule, which includes all phases of the project process: planning,</li> </ul>  |

| GUIDELINE FOR INFORMATION REQUIREMENTS |  |
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|  | <p>bidding, contracting, design, construction, preliminary and regular operation and maintenance.</p> <p>f) Un plan de operación y mantenimiento.</p> <p>g) If applicable, a capital improvement program.</p> <p>h) If applicable, an overall procurement plan.</p>  |
| <b>4. Economic Information</b>         | <p>a) Where necessary for a market risk assessment, economic information about the project service area should include, among others, economic growth, population trends, income trends and economic activity.</p> <p>b) Where applicable, the service area’s customer profile, including customer mix; system hook-ups; service area demand; service history; percentage of demand covered by the service; sales by category of customer; number of customers by category (including population served but not metered); largest customers by revenue and service; sales system and procedures (service coverage; other service methods; billing and collection history during the last three years); and an assessment of potential opposition to rate hikes.</p> <p>c) Where applicable, market information on the service area, including ten years of historical usage; rates and collections data; present and projected needs and capacity of the service; system demand forecast with assumptions; description of competition, if any; projected market share; identity and location of customers by class; and strategies for hook-ups, rates, and collections.</p> |
| <b>5. Financial Information</b>        | <p>a) A breakdown of anticipated project costs and expenditures, as applicable, from the initial planning phase through start-up, including interest during construction and working capital requirements, by major cost category.</p> <p>b) A summary of the anticipated project financing plan and security package, including the proposed source, amount, currency, and terms of debt, equity investments, and grants; the sources of finance in the event of project cost overruns; and a description of contingency reserves and escrow accounts. Information on the terms, security requirements and the status of financing commitments</p>  |

**GUIDELINE FOR INFORMATION REQUIREMENTS**

from other lenders to the projects, if applicable, should be provided.

- c) As required and applicable, audited annual financial reports for the last five fiscal years; financial reports for the current fiscal year; and budget for the following fiscal year.
- d) Where applicable, an analysis of unit costs and rates by category for the last five years and projected for the next five years; and a comparative rate analysis with other cities in the region.
- e) If applicable, projected annual financial statements covering the period from project development through final maturity of the proposed COFIDAN loan, to include balance sheet, income statement, cash flow statement, projected debt, and debt service ratios. Projections should also include a sensitivity analysis.
- f) Finance sources: equity, debt, grants; debt/bond issuance history; information on outstanding and other proposed loans and liabilities.
- g) Where applicable, the relevant assumptions for developing financial projections, including, but not limited to, the bases for estimates of user fees or other dedicated sources of repayment; operating and administrative costs, depreciation, amortization and tax rates; and local government policy on user fees/rates.
- h) Where the currency of the loan differs from the currency of project revenue, a description of the measures that will be taken (hedging or recourse arrangements) to protect the borrowers, the COFIDAN loan or third-party guarantees from exchange risk.
- i) Where COFIDAN requires recourse to a project sponsor or guarantor, detailed financial information on the capacity of the sponsor or guarantor to meet its financial obligations must be provided, as well as a detailed description of the potential collateral.
- j) A description of the principal risks and benefits of the project to the sponsors, lenders, and guarantors.

| GUIDELINE FOR INFORMATION REQUIREMENTS        |  |
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|   | <p>k) Where applicable, a description of the types of insurance coverage to be purchased for both the pre- and post-completion phases of the project.</p>  |
| <p><b>6. Legal/Regulatory Information</b></p> | <p>a) A description of progress made toward obtaining all essential government authorizations, licenses, permits, and other legal requirements, including ordinances authorizing project and other license/concession provisions. There must be a reasonable assurance that all required operating permits will be obtained when necessary.</p> <p>b) Where applicable, a description of rate-setting procedures, as well as the corresponding rate ordinances or resolutions.</p> <p>c) Where applicable, any sales contracts and supply agreements.</p> <p>d) Documentation and other evidence that project sponsors, borrowers, guarantors and other contractual partners:</p> <ul style="list-style-type: none"> <li>i. are legally organized, are in compliance with the relevant legal formalities, and have legal personality;</li> <li>ii. are empowered to contract loans with COFIDAN in the currency offered by COFIDAN;</li> <li>iii. are empowered to undertake obligations to act as specified in the loan contracts of COFIDAN;</li> <li>iv. have the legal power to carry out such changes in organization and structure as might be needed for the project;</li> <li>v. are not the subject of material adverse litigation;</li> <li>vi. are acting consistently with, and are not in breach of, other contracts and obligations; and</li> <li>vii. where applicable, are able to submit to any arbitration required by the loan agreement and adapt their procurement procedures to COFIDAN policies.</li> </ul> <p>e) Appropriate board resolutions, legal opinions, certifications and similar assurances of compliance with legal requirements.</p> |

**D. Evaluation of the Financing Proposal.** COFIDAN, with the assistance of NADB and outside consultants as necessary, will perform a comprehensive analysis of each complete financing proposal. This process will include an in-depth review of project/loan risks (including credit risks, construction risks; operating risks; technology risks; management risks; input/supply risks; market risks; foreign exchange risks; interest rate risks, and regulatory risks) and the financial structure of the project. Through this analysis, COFIDAN must ensure that projects are technically, environmentally, financially and economically sound, that project sponsors have the institutional, managerial and structural capacity to carry out projects, and that the loan proposal meets all of the basic policies governing COFIDAN loans, as set forth in this document. In performing this analysis, COFIDAN generally considers the following factors:

| FACTORES DE EVALUACIÓN DE CRÉDITOS |  |
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| <b>1. General</b>                  | <ul style="list-style-type: none"> <li>a) If applicable, if the project is a part of a long-term strategic or master plan that promotes the most effective use of integrated resources, including capital.</li> <li>b) The project design and cost shall be appropriate for projects of similar type and size.</li> <li>c) Appropriate least-cost solutions will be encouraged for all aspects of a project, especially its operation and maintenance.</li> <li>d) Appropriate new designs and technologies will be acceptable so long as the technology risk is not borne by COFDIAN.</li> <li>e) Where applicable, if the project generates user fees or other dedicated sources of revenue in the service area and demonstrates that an effective system for collecting the user fees or dedicated revenue is in place.</li> <li>f) Where applicable, the rate setting and approval process must be transparent and should allow the implementation of timely and adequate rate increases, as necessary.</li> <li>g) Where applicable, effective demand management and public awareness strategies should be incorporated into project designs.</li> <li>h) Supply unit pricing and costs should reflect market-based pricing, consistent with COFIDAN's procurement guidelines.</li> </ul> |

| FACTORES DE EVALUACIÓN DE CRÉDITOS |  |
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|                                    | <ul style="list-style-type: none"> <li>i) Concessions and contracts let by governmental bodies to private companies shall have been procured under fair, reasonable, competitive and transparent procedures consistent with COFIDAN's procurement guidelines.</li> <li>j) Where applicable, sponsors or their guarantors shall have authorized levels of rates and charges sufficient to repay all debt, cover operations and maintenance costs, and fund all reserves, as specified in the loan documents.</li> </ul>   |
| <b>2. Project Participants</b>     | <ul style="list-style-type: none"> <li>a) Project sponsors, borrowers, guarantors and other contractual partners must be able to demonstrate the technical, managerial, and financial capabilities to perform their respective obligations within the project.</li> <li>b) Project sponsors, borrowers and guarantors must demonstrate that they are empowered to assume and discharge financial obligations deriving from the loan contracts, especially obligations for receiving, maintaining and managing funds, as well as making payments on loans.</li> <li>c) Project sponsors, borrowers and guarantors must have sufficient assets to meet their obligations.</li> <li>d) As appropriate, project sponsors or borrowers must show that they have the legal power to set rates for the project and the capacity to implement rate increases, where user fees are a key component of project security. If project sponsors or borrowers do not have the legal capacity to set rates, the guarantee of the entity that does have the legal power to set rates may be required.</li> <li>e) In the assessment of project management, where applicable, project sponsors or borrowers must demonstrate that they have the capacity to provide service at a reasonable price, implement capital improvement programs independently, and undertake the necessary accounting and financial reporting requirements specified by COFIDAN.</li> </ul> |

| FACTORES DE EVALUACIÓN DE CRÉDITOS |  |
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| <b>3. Technical</b>                | <p>a) Project technology must be appropriate and effective. To the extent possible, a project sponsor or borrower must obtain all permits and licenses to construct and operate a project prior to initial disbursement, and there must be a reasonable assurance that all required operating permits will be obtained when necessary. The project sponsors and borrowers must provide a description of all licenses and permits required for a project, and a plan for securing such licenses and permits. COFIDAN will require the sponsor or borrower to periodically report on the program for securing such licenses and permits.</p> <p>b) A technical feasibility study or sufficiently detailed engineering information must be provided to demonstrate the technical feasibility of the project.</p> <p>c) A comprehensive operations and maintenance plan for the term of COFIDAN’s financing must be provided to ensure the ability of local utilities to operate and maintain the system.</p> <p>d) The project’s procurement procedures must be consistent with COFIDAN’s procurement procedures.</p> |
| <b>4. Economic</b>                 | <p>a) The service area of the proposed project is a focal point in the evaluation of credit risk and, therefore, when appropriate, must be able to sustain a level of user fees or other dedicated sources of revenue sufficient to service project debt.</p> <p>b) If applicable, an economic analysis of the project must be available in order to measure the adequacy and stability of the project’s customer base, the sensitivity to economic cycles, future capital needs, and when appropriate the adequacy, competitiveness and affordability of user fees or other dedicated sources of revenue.</p> <p>c) If applicable, the economic analysis of the service area must support a determination that over the life of the project the service area will be economically viable and the project debt will be serviced.</p>   |

| <b>FACTORES DE EVALUACIÓN DE CRÉDITOS</b> |  |
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| <b>5. Financial</b>                       | <ul style="list-style-type: none"> <li>a) COFIDAN will examine and evaluate all factors of a borrower and a project, where appropriate, to determine whether or not it will generate sufficient revenue to cover the project’s long-term operations and maintenance costs, fund the required reserves, and repay the debt.</li> <li>b) Where applicable, the project should have long-term arrangements for the effective collection of user fees and other project revenue; long-term contracts, where appropriate, from creditworthy entities for the purchase of any project output; and, where necessary and customary, long-term contracts for the purchase of the project’s major project inputs such as fuel, raw materials, and for operations and maintenance. Such contracts should extend beyond the term of COFIDAN financing.</li> <li>c) The project should contain an appropriate allocation of risk to the parties best suited to manage those risks. A sensitivity analysis should indicate a sufficient debt service coverage ratio to ensure uninterrupted debt servicing for the term of the debt.</li> <li>d) The analysis of the creditworthiness of a borrower will include an analysis of the borrower’s debt service capacity that explicitly takes into account the sensitivity of the borrower’s creditworthiness to potential variability in interest rates; and the exposure element applied to the loan shall reflect this analysis.</li> <li>e) Where applicable, projects and project sponsors must obtain customary and adequate insurance against normally insurable risks, (e.g., theft of assets, fire, specific construction risks).</li> </ul> |
| <b>6. Legal/Regulatory</b>                | <ul style="list-style-type: none"> <li>a) Legal and regulatory analysis must demonstrate that the project meets all national, state and local legal and regulatory requirements of the place where the project is to be located.</li> <li>b) Loan documentation must conform to COFIDAN policies and guidelines.</li> </ul>  |

| FACTORES DE EVALUACIÓN DE CRÉDITOS |   |
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|                                    | c) Project sponsors, borrowers, guarantors and other contractual partners must demonstrate that they are empowered to undertake the obligations to act as specified in their agreements with COFIDAN. |

**E. Approval of Financing Commitment.** Upon completion of the evaluation of a financing proposal, COFIDAN will make an initial determination whether the proposal meets all of the policies governing its loan financing. Proposals meeting all policy requirements will be submitted for final approval as follows:

1. First, project certification and financing will be presented to NADB's Board of Directors.
2. Then, the general terms and conditions of the loan will be presented to COFIDAN's Board of Directors for approval.

**F. Negotiation and Execution of Loan Agreement.** COFIDAN will negotiate the final terms and conditions of the loan agreement with the borrower, consistent with the terms and conditions authorized by its Board of Directors. COFIDAN, working with outside legal counsel as necessary, will work with the borrower to prepare the relevant legal documentation for execution by COFIDAN and the borrower. The loan agreement will establish all the terms and conditions of the loan, including among others, provision for payment of principal, interest and other charges, maturities, and dates of payment, and the currency or currencies in which payment will be made to COFIDAN. Standard loan covenants will also be included as part of the loan agreement and, when appropriate, negative pledge, cross-default and prepayment clauses, as well. The following issues are among those also addressed in the final negotiation and drafting of a loan agreement:

- *Conditions Precedent to the Availability of the Loan.* Before drawing down the loan, the borrower must satisfy the conditions precedent to the availability of the loan specified in the loan agreement. Among such conditions, the borrower is usually required to provide COFIDAN with such documents as promissory notes, evidence of the borrower's authority to enter into the loan agreement, a legal opinion, a list of the items to be financed and a copy of the necessary authorizations from the authorities in the borrower's country. When the borrower has complied with all these conditions, COFIDAN will make the loan available to the borrower, in accordance with the disbursement schedule in the loan agreement.
- *Conditions Precedent to the Disbursement of the Loan.* Once the conditions precedent to the availability of the loan have been satisfied, the borrower may request a disbursement. The borrower may have to satisfy additional conditions precedent to the first disbursement of the loan and subsequent disbursements.

- **Reporting.** For each project financed by COFIDAN, the following financial and technical reports, as appropriate or applicable, as well as others specified in the loan agreement, will be required until the loan is repaid:
  - audited annual financial statements with unaudited monthly or quarterly financial statements;
  - annual budgets;
  - timely reports on any financial problems of the project;
  - monthly status reports on the project's development during construction;
  - annual operation and maintenance reports;
  - timely reports on any significant technical problems encountered by the project; and
  - interim and final reports on environmental and human health impacts of the project.

**G. Disbursement of Funds.** A detailed description of COFIDAN's disbursement policies and procedures can be found in the document entitled, "Disbursement Policies and Procedures."

**H. Project Supervision.** A detailed description of COFIDAN's supervision policies and procedures can be found in the document entitled, "Supervision of Procurement and Contracting."

**I. Project Closeout.** Once a project is completed, it requires a closeout report. Borrowers will provide the necessary information for NADB to produce the report, which includes information on the actual project built and its outcomes. The specific information needed for the report is defined on a per project basis and will be included as a covenant in the loan contract.

**J. Loan File Information.** COFIDAN's loan files will contain the information indicated below; however, at the discretion of COFIDAN, additional information may also be included in the files.

**1. *Application***, which must contain:

- a. the name of the applicant,
- b. the amount requested,
- c. the project to which it will be allocated, and
- d. if applicable, preference for a fixed or variable rate.

**2. *Authorizations***

- a. NADB Board of Directors, and
- b. COFIDAN Board of Directors.

**3. *Loan study.***

**4. Legal documentation of the borrowers and guarantors:**

- a. Federal Taxpayer Registration and proof of residence
- b. Documents of incorporation, as well any other information concerning their corporate purpose and their powers and authority with respect to the loan
- c. Documentation evidencing the powers and authority of the legal representatives and their corresponding official IDs.
- d. The authorization of the State Congress for pledging federal tax revenue ("*participaciones*") when used as a guarantee for the loan
- e. Borrowers other than a state or municipal entity or government-run agency, shall have to provide the information indicated in points 1, 2 and 3 above, along with their shareholder structure. Moreover, when the shareholders are entities, the information indicated in points 1, 2 and 3 above and the shareholder structure shall have to be provided for each shareholder. In the case of individuals, the following information shall have to be provided: the corresponding ID, proof of residence, Federal Taxpayer Registration, Unique Population Registration Number (CURP), principal activity and e-mail address, as well as any other information that may be legally required for this file.

This documentation must be updated whenever there are changes to the personality of the borrower and/or guarantor or that of any of the representatives of either one or, if applicable, their shareholders.

## CONTACT INFORMATION

For additional information regarding COFIDAN's policies and procedures, please contact one of the following NADB staff:

Director of Project Development  
Chief Financial Officer  
General Counsel

North American Development Bank  
203 S. St. Mary's, Suite 300  
San Antonio, Texas 78212

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