



PROJECT PROPOSAL

REFINANCING OF EXISTING DEBT FOR THE MUNICIPALITY OF HERMOSILLO, SONORA UNDER THE REFINANCING UMBRELLA OF THE NADBANK COVID-19 RECOVERY PROGRAM

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INTRODUCTORY NOTE

In response to the crisis caused by the COVID-19 pandemic, the NADBank Board of Directors approved a two-year financing program in May 2020 to support projects that have both environmental benefits and direct positive impacts on the economy and well-being of residents in the U.S.-Mexico border region. Under the COVID-19 Recovery Program (ProRec), the Board may consider approval of loan proposals for refinancing existing debt on environmental infrastructure (public and private projects) or for public entities, such as water utilities, whose mandate is aligned with the NADBank mission, as well as projects that have a recognizable environmental benefit but are focused on delivering significant social, health or economic benefits to border communities.

In November 2020, the Board certified and approved funding for an umbrella program under ProRec to expedite the refinancing of existing debt for public entities affected by COVID-19. The Umbrella Program for Refinancing Existing Debt of Public Entities establishes the guidelines and expedited procedures for the certification and financing of these types of operations, which in general have similar characteristics. Individual projects under the umbrella program shall be approved in accordance with the following procedures:

- A. Approval of project proposal by the NADBank Technical and Environmental Committee.
- B. Publication of the proposal for a 30-day public comment period, with no unresolved comments.
- C. Ratification of compliance with the eligibility criteria by the Managing Director and Chief Environmental Officer.
- D. Notification sent to the Board of Directors within 15 days of financial closing.

EXECUTIVE SUMMARY

REFINANCING OF EXISTING DEBT FOR THE MUNICIPALITY OF HERMOSILLO, SONORA UNDER THE REFINANCING UMBRELLA OF THE NADBank COVID-19 RECOVERY PROGRAM

- Project:** The project consists of refinancing up to \$410 million pesos (US\$20 million) of existing debt for the Municipality of Hermosillo, Sonora (the “Project”).¹ This proposal meets the eligibility requirements of the NADBank ProRec Umbrella Refinancing Program.
- Project Objective:** The purpose of the Project is to reduce debt service requirements for the Municipality and thus increase available cash flows for the maintenance and operation of existing infrastructure, as well as lessen the need to raise taxes or fees, and help the Municipality to continue providing critical public services and infrastructure for the benefit of its residents, including solid waste collection and management, roadways, public parks, stormwater, street lighting and public security.
- Expected Outcomes:** The estimated outcomes resulting from refinancing up to \$410 million pesos (US\$20 million) of existing debt for the Municipality are:
A reduction of approximately \$9 million pesos (US\$439,000) in debt service obligations during the first year of amortization.
Increased cash flows will result in:
- i) Improved liquidity to facilitate the ongoing provision of critical public services; and
 - ii) The refinancing is expected to reduce debt service obligations by approximately \$46.3 million pesos (US\$2.25 million) during the first five years of amortization.
 - iii) Less likelihood of possible rate increases in public services and/or property taxes.
- Population to Benefit:** 936,263 residents in the municipality of Hermosillo.²
- Project Sponsor:** Municipality of Hermosillo (the “Municipality”).

¹ Unless otherwise noted, all U.S. dollar figures are quoted at an exchange rate of \$20.5 pesos to the dollar, according to Bloomberg.com on January 7, 2022.

² Source: Mexican national statistics institute, *Instituto Nacional de Estadística, Geografía e Informática* (INEGI), Mexican Census 2020, <https://www.inegi.org.mx/app/areasgeograficas/?ag=26>

Borrower: The Municipality.

Project Cost: Up to \$410 million pesos (US\$20 million).

NADBank Loan: Up to \$410 million pesos (US\$20 million), through the Umbrella Program for Refinancing Existing Debt of Public Entities under the NADBank COVID-19 Recovery Program.

Uses and Sources of Funds:
(Million MXN)

Uses	Amount	%
Refinancing of existing debt	\$ 410	100.0
TOTAL	\$ 410	100.0
Sources	Amount	%
NADBank loan	\$ 410	100.0
TOTAL	\$ 410	100.0

PROJECT PROPOSAL

REFINANCING OF EXISTING DEBT FOR THE MUNICIPALITY OF HERMOSILLO, SONORA UNDER THE REFINANCING UMBRELLA OF THE NADBANK COVID-19 RECOVERY PROGRAM

1. PROJECT OBJECTIVE AND EXPECTED OUTCOMES

The project consists of refinancing up to \$410 million pesos (US\$20 million) in existing debt for the Municipality of Hermosillo (the “Municipality”) in Sonora (the “Project”).³ The refinancing will be approved and implemented through the Refinancing Umbrella of the NADBank COVID-19 Recovery Program (the “ProRec Umbrella Program”).

The purpose of the Project is to reduce debt service requirements and thus increase available cash flows for the maintenance and operation of existing infrastructure, as well as lessen the possible need to raise taxes or fees, which will help the Municipality to continue providing critical public services and infrastructure for the benefit of its residents, including solid waste collection and management, roadways, public parks, stormwater, street lighting and public security. The refinancing is expected to reduce debt service obligations by approximately \$46.3 million pesos (US\$2.25 million)⁴ during the first five years of amortization. In the first year of amortization, the savings generated are equivalent to approximately 10% of the solid waste management budget or 33.7% of the municipality’s paving expenses in fiscal year 2021.

2. ELIGIBILITY

2.1. Project Type

The Project complies with the requirements of ProRec, as the Sponsor is a public entity whose mandate is aligned with the NADBank mission, given that the Municipality provides public services to its residents, including solid waste management, roadways, public parks, stormwater, street lighting and public security, as well as maintains and operates related infrastructure.

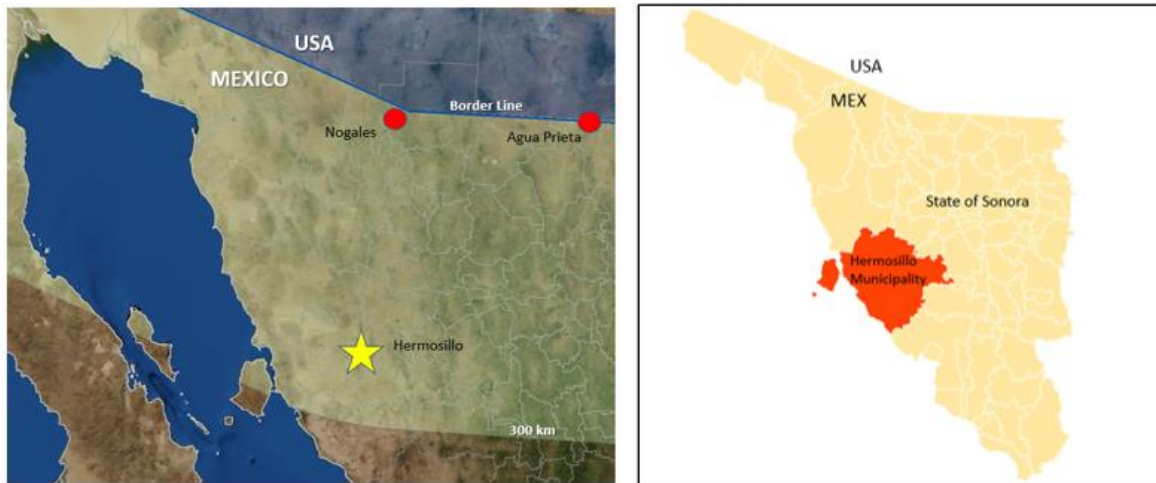
³ Unless otherwise noted, all U.S. dollar figures are quoted at an exchange rate of \$20.5 pesos to the dollar, according to Bloomberg.com on January 07, 2022.

⁴ Source: Boletín Oficial Órgano de Difusión del Gobierno del Estado de Sonora
<http://www.boletinoficial.sonora.gob.mx/boletin/images/boletinesPdf/2021/12/2021CCVIII53II.pdf>

2.2. Project Location

The municipality of Hermosillo is located approximately 155 miles south of the U.S.-Mexico border in the state of Sonora. The city of Hermosillo is the municipal seat, and the geographical coordinates of the town center are approximately 29° 4' 22.80"N and 110° 57' 21.55"W. Figure 1 shows the location of the municipality of Hermosillo.

Figure 1
MUNICIPALITY LOCATION MAP



2.3. Project Sponsor and Legal Authority

The public-sector Project sponsor is the Municipality of Hermosillo, Sonora (the “Municipality” or the “Sponsor”), a public entity legally incorporated under the Mexican Constitution, the Constitution of the State of Sonora and the Municipal Code of Hermosillo. Although the Sponsor may seek a comprehensive approach to refinancing all its existing debt in 2022, this refinancing proposal is presented under the terms set forth in Article 23 of the Financial Discipline Law for States and Municipalities.⁵

⁵ Approval of the local State Congress is not required when the original loan conditions are improved—meaning that the effective interest rate is reduced—and the balance, original term and amortization profile remain unchanged.

3. CERTIFICATION CRITERIA

3.1. Technical Criteria

3.1.1. General Community Profile

According to the 2020 Mexican census, the municipality of Hermosillo has a population of 936,263, which represents 31.8% of the state population.⁶ Between 2010 and 2020, the municipality experienced an average annual growth rate of 1.62%, higher than that of the state of Sonora (0.96 %).

According to the latest economic census in 2019, commerce and manufacturing constitute the most important sectors in Hermosillo (44.9%).⁷ Other services represents the second largest sector for the municipality (18.3%). Overall, Hermosillo's economy constitutes 45.7% of the state GDP.⁸

According to the National Council on Social Development Policy Assessment (CONEVAL), in 2018, 28.2% of the population of the state of Sonora was living in poverty, while the poverty index nationwide was 41.99%.⁹ In 2020, the Mexican national statistics institute, INEGI, reported an unemployment rate of 3.6% for the municipality of Hermosillo and 4.9% for the state of Sonora. The latter was 0.3% higher than the national rate of 4.6%.¹⁰

The status of public services in Hermosillo is described in the following table.

⁶ Source: INEGI, 2020 Population and Housing Census, <https://www.inegi.org.mx/app/areasgeograficas/?ag=26>

⁷ Source: DataMéxico, Hermosillo, <https://datamexico.org/es/profile/geo/hermosillo#empleo-ocupaciones>

⁸ Source: Ibid.

⁹ Source: Consejo Nacional de Evaluación de la Política de Desarrollo Social [National Council on Social Development Policy Assessment] (CONEVAL), *Informe de pobreza y evaluación 2020: Sonora* [2020 Poverty Report and Assessment: Sonora], https://www.coneval.org.mx/coordinacion/entidades/Documents/Informes_de_pobreza_y_evaluacion_2020_Documentos/Informe_Sonora_2020.pdf

¹⁰ Source: INEGI, Press Release No. 115/21, inegi.org.mx

Table 1
BASIC PUBLIC SERVICES AND INFRASTRUCTURE IN HERMOSILLO

Water*			
Coverage:	96.7%		
Water supply source:	The water source is Sonora River and the Costa de Hermosillo and La Poza aquifers, both of which are located within the northwest watershed. There are three dams and 76 water wells. The water is treated prior to distribution at three plants with a combined capacity of 2,700 lps (61.6 mgd).		
Number of hookups:	322,638		
Wastewater Collection*			
Coverage:	91.5%		
Number of connections:	294,882		
Wastewater Treatment*			
Coverage:	93.1%		
Treatment facilities:	Plant	Type	Capacity
	San Pedro	Activated sludge	15 lps (0.34 mgd)
	Los Arroyos	Activated sludge	113 lps (2.57 mgd)
	Hermosillo	Activated sludge	2,500 lps (57 mgd)
	La Sauceda	Activated sludge	50 lps (1.14 mgd)
	Others	Activated sludge	259 lps (5.9mgd)
	Total		2,937 lps (67 mgd)
Solid Waste**			
Coverage:	97%		
Final disposal	Landfill		
Street Paving**			
Coverage	76%		

* Source: The local water utility, Agua de Hermosillo, water report (<http://aguadehermosillo.gob.mx/aguah/wp-content/uploads/2021/09/Hermosillo-CU-CONAGUA-CEA-ANUAL-2020-Rf-firmado-y-oficio-recibido-CP-025-2021.pdf>).

** Source: *Plan de Acción 2019* [2019 Action Plan] <https://www.proyectosmexico.gob.mx/wp-content/uploads/2019/06/Plan-de-acci%C3%B3n-Hermosillo.pdf>

lps = liters per second, mgd = million gallons a day.

Current COVID 19 Situation

Nationwide in Mexico

According to the Mexican Ministry of Health, as of January 9, 2022, Mexico had reported 4,360,219 COVID-19 cases with a total death toll of 313,999. The state of Sonora recorded 127,259 total infections and 9,220 deaths during the same period.¹¹

¹¹ Source: Mexican Health Ministry (SSA), <https://datos.covid-19.conacyt.mx/>

The COVID-19 health crisis has forced the implementation of containment measures, such as border closures, regional isolation and social distancing through the suspension of academic and non-essential economic activities. These measures have partially paralyzed the Mexican economy, negatively impacting the production of goods, services and supply chains, as well as significantly reducing international trade and investments due to increased uncertainty about future economic growth.¹² This situation has also caused a general reduction in income, along with job losses.¹³

Since March 2020, Mexico has reported operational shutdowns in several sectors of the economy caused by the absence of imports and the restriction of certain activities. In the first quarter of 2020, economic growth (GDP) had declined 1.2%.¹⁴ At the end of the second quarter of the same year, GDP had dropped 17.3%.¹⁵ According to the Mexican Institute of Social Security (IMSS), more than 1.1 million jobs were lost in Mexico from March through July 2020. In the months of April and May 2020 alone, employment in the manufacturing, retail, and food and hospitality sectors fell 30.8%, 32.2% and 63.5%, respectively.¹⁶

Mexico has 49 social programs to address the current health crisis.¹⁷ Of those programs, 20 are aimed at increasing access to health services to reduce the spread of the COVID-19 disease; 26 are intended to help reduce the effects on household income through the direct transfer of financial support to the population; and three programs implement actions aimed at increasing access to water and wastewater services, thus supporting the hygiene practices necessary to reduce the spread of COVID-19 among the population.

The Ministry of Finance and Public Credit (SHCP) indicated in July 2021 that the domestic market was strengthening due to the progress made by the national vaccination program against COVID-19, which has allowed economic activities in the country to resume. In July 2021, SHCP reported a recovery rate of 99.6% in economic activity and 98.8% in employment compared to their pre-pandemic rates.¹⁸ SHCP also reported real annual growth of 2.4% in tax revenue compared to the first half of 2020, which allowed federal agencies to increase direct spending by more than \$88.6 billion pesos (US \$ 4.4 billion) in social, economic and government-related work.¹⁹

¹² Source: SHCP. *Informes sobre la Situación Económica, las Finanzas Públicas y la Deuda Pública al segundo trimestre de 2021* [Reports on the Economic Situation, Public Finances and Public Debt for the first quarter of 2021], (https://www.finanzaspublicas.hacienda.gob.mx/work/models/Finanzas_Publicas/docs/congreso/infotrim/2020/it/01_inf/itindc_202001.pdf).

¹³ Source: Ibid

¹⁴ Source: International Labor Organization, *México y la crisis de la COVID-19 en el mundo del trabajo: respuestas y desafíos* [Mexico and the COVID-19 Crisis in the World of Work: Responses and Challenges], (https://www.ilo.org/wcmsp5/groups/public/---americas/---ro-lima/---ilo-mexico/documents/publication/wcms_757364.pdf).

¹⁵ Source: Ibid.

¹⁶ Source: Ibid.

¹⁷ Source: CONEVAL, *Programas relevantes para la atención de la emergencia sanitaria provocada por la enfermedad producida por el virus SARS-CoV-2 (COVID-19)* [Mexican Programs for the care of the health emergency caused by the SARS-CoV-2 virus (COVID-19)]. https://www.coneval.org.mx/Evaluacion/IEPSM/Documents/CPP_2021/COVID.pdf

¹⁸ Source: SHCP. *Informes sobre la Situación Económica, las Finanzas Públicas y la Deuda Pública al segundo trimestre de 2021* [Reports on the Economic Situation, Public Finances and Public Debt for the second quarter of 2021], (https://www.gob.mx/cms/uploads/attachment/file/658179/Comunicado_No_045.pdf)

¹⁹ Source: Ibid

The latest figures reported by INEGI in its Global Indicator of Economic Activity indicate that the Mexican economy grew 6.2% during the first five months of 2021, compared to the same period in 2020.²⁰ In the labor market, at the end of June 2021, a total of 12.3 million jobs had been recovered, an average of 880 thousand jobs per month, since the start of the economic shutdowns caused by the pandemic.²¹

Sonora State

When the COVID-19 emergency was declared on March 25, 2020, the State of Sonora shut down commerce and non-essential activities, as well as promoted social distancing. These measures had economic and social impacts on its citizens. To alleviate the impacts of the pandemic, the State government implemented several social and economic programs to support its residents. The State of Sonora received more than \$3,300 million pesos through the federal Contribution Fund to allocate to approximately 8,000 projects, including water and wastewater, housing, health, education and municipal infrastructure.²²

Municipality of Hermosillo

According to the Mexican Ministry of Health, as of January 9, 2022, the municipality of Hermosillo had 53,275 COVID-19 cases with a total death toll of 2,975.²³ Due to the economic and social impacts of the pandemic, the Municipality carried out a series of actions to help its citizens, including promoting working remotely, staying home, enabling public services online and food pantry deliveries.²⁴

In an effort to reduce the spread of the virus, the Municipality, in coordination with the business sector, also carried out sanitizing efforts in several public areas, such as main roads, downtown, hospitals and bus stops.²⁵

In addition, water service discounts were applied in April 2020. During that period, the local water utility, Agua de Hermosillo, provided discounts totaling \$31 million pesos for more than 123,000 families and 13,000 businesses located in the municipality.²⁶ Since April 2020, water service suspensions and surcharges on past-due accounts were prohibited.²⁷

One of the cost-saving measures proposed by the Municipality is to refinance its existing debt, which would reduce its debt service obligations.

²⁰ The Global Indicator of Economic Activity is part of the national macroeconomic indicators that INEGI uses to monitor the evolution of the economy in the short term.

²¹ Source: SHCP. *Informes sobre la Situación Económica, las Finanzas Públicas y la Deuda Pública al segundo trimestre de 2021* [Reports on the Economic Situation, Public Finances and the Public Debt for the Second Quarter of 2021]. (https://www.gob.mx/cms/uploads/attachment/file/658179/Comunicado_No_045.pdf).

²² Source: Sonora State Government (https://www.sonora.gob.mx/images/documentos/boletin_oficial_EE25032020.pdf).

²³ Source: Mexican Health Ministry (SSA) (<https://datos.covid-19.conacyt.mx/>).

²⁴ Source: Municipality of Hermosillo (<https://www.hermosillo.gob.mx/covid/>).

²⁵ Source: Ibid.

²⁶ Source: Ibid.

²⁷ Source: Ibid.

3.1.2. Project Scope

The Project consists of refinancing up to \$410 million pesos (US\$20 million) in existing debt for the Municipality of Hermosillo. By refinancing at a lower interest rate, the debt service obligations are expected to be reduced by approximately \$46.3 million pesos (US\$2.25 million) during the first five years of amortization. For comparison purposes, this sum represents approximately 33.7% of the municipality's paving expenses in fiscal year 2021.

3.1.3. Technical Feasibility

Given the refinancing nature of the Project, a technical feasibility analysis is not applicable.

3.1.4. Land Acquisition and Right-of-way Requirements

Given the refinancing nature of the Project, land acquisition and rights of way are not applicable.

3.1.5. Project Milestones

The refinancing is expected to close in February 2022.

3.1.6. Management and Operation

All public infrastructure such as roadways, public parks, stormwater infrastructure and street lighting is owned and operated by the Municipality. Solid waste services are also provided by the Municipality.

3.2. Environmental Criteria

3.2.1. Environmental and Health Effects/Impacts

A. Existing Conditions

The Municipality of Hermosillo provides public services (solid waste management, roadways, public parks, stormwater, street lighting and public security, as well as maintains and operates related infrastructure) to more than 936,000 residents within its jurisdiction. The proposed refinancing will provide necessary financial relief to the Municipality, which will support the continued provision of services and future infrastructure expansion and improvements when required.

B. Project Impacts

By refinancing up to \$410 million pesos (US\$20 million) in existing debt at a lower interest rate, the Municipality will reduce its annual debt service obligations and thus achieve more efficient debt service cash flows. The debt service obligation is expected to be reduced by approximately

\$46.3 million pesos (US\$2.25 million) during the first five years of amortization. For comparison purposes, this sum represents approximately 33.7% of the municipality's paving expenses in fiscal year 2021.

Residents will also benefit, as these savings will increase the financial capacity of the Municipality and lessen the need for possible rate or tax increases in order to continue providing adequate public services. This benefit has become increasingly relevant in communities that have been severely impacted by the economic downturn caused by the COVID-19 pandemic.

By refinancing its debt, the Sponsor will also be in a better position to continue operating its systems and/or pursue any necessary capital improvement project that may be required in the future.

C. Transboundary Impacts

Given the refinancing nature of the Project, no transboundary impacts are anticipated because of the Project.

3.2.2. Compliance with Applicable Environmental Laws and Regulations

Given the refinancing nature of the Project, compliance with environmental laws and regulations is not applicable.

A. Environmental Clearance

Given the refinancing nature of the Project, no environmental clearances are required.

B. Mitigation Measures

Given the refinancing nature of the Project, no environmental mitigation measures are necessary.

C. Pending Environmental Tasks and Authorizations

There are no environmental authorizations pending for the Project.

3.3. Financial Criteria

The Municipality of Hermosillo has requested a loan for up to \$410 million pesos (US\$20 million) from NADBank to refinance part of its existing debt. Table 2 shows the uses and sources of funding.

Table 2
USES AND SOURCES OF FUNDS
(Million MXN)

Uses	Amount	%
Refinancing of existing debt	\$ 410	100.0
TOTAL	\$ 410	100.0
Sources	Amount	%
NADBank loan	\$ 410	100.0
TOTAL	\$ 410	100.0

Based on a thorough analysis of both the Project and the Sponsor, NADBank has determined that the Project meets all eligibility criteria of the ProRec Refinancing Umbrella Program, since the Municipality of Hermosillo is a public entity that provides services aligned with the NADBank mission, which are eligible for financing under its certification criteria.²⁸ It is also located within the border region as required under the NADBank Charter. Moreover, the Project will help the Municipality free up cash flows through a more efficient debt payment structure that will help mitigate increased operating expenditures and/or reductions in revenue caused by the COVID-19 pandemic, allowing the Municipality to continue providing public services to its residents.

The source of payment for the loan will be the federal tax revenue ("*participaciones*") allocated to the Municipality from the General Fund and pledged to repay the new debt. The funds will be deposited into a trust to service the NADBank loan.

The savings resulting from reduced debt service obligations may directly benefit residents of Hermosillo by increasing the municipal government's financial capacity to maintain existing infrastructure and services, while reducing the likelihood of an increase in taxes or fees.

NADB's preliminary analysis verified that the Project Sponsor has the legal authority to contract the financing and has already pledged the revenue for the payment of the original debt obligations. Moreover, considering the characteristics of the Project and based on the financial and risk analysis performed, the proposed Project is financially feasible and presents an acceptable level of risk.

4. PUBLIC ACCESS TO INFORMATION

4.1 Public Consultation

NADBank published the draft project proposal for a 30-day public comment period beginning on January 12, 2022, and ending on February 11, 2022.

²⁸ The ProRec program includes loan proposals to refinance the existing debt of public entities whose mandate is aligned with the Bank's mission. Under the program, the refinancing is intended to 1) support public sponsors facing liquidity constraints or adverse refinancing conditions because of the COVID-19 pandemic; or 2) provide more efficient debt service cash flows for the operation and maintenance of existing infrastructure.

4.2 Outreach Activities

NADBank conducted a media search to identify potential public opinion about the Project. No specific articles or references to the Project were found. References to the impact of the COVID-19 pandemic on the community were found on the following website:

- *El Sol de Hermosillo*. (August 10, 2021) “Aumenta riesgo de transmisión de Covid-19; jóvenes los más afectados” [COVID-19 transmission risk increases; young people most affected]
<https://www.elsoldehermosillo.com.mx/local/aumenta-riesgo-de-transmision-de-covid-19-jovenes-los-mas-afectados-7069568.html>

No public opposition to the Project has been detected.