

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

HONDURAS

NATIONAL SUSTAINABLE TOURISM PROGRAM (HO-0195) LOAN PROPOSAL

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I. FRAME OF REFERENCE

A. Socioeconomic setting

- .1 Despite the macroeconomic stability displayed by Honduras over the past decade, per capita income has remained virtually static (US\$702 in 1992, compared to US\$712 in 2003). The country faces structural difficulties stemming from its high level of external debt and weak foreign exchange earnings, compounded by high rates of poverty and inequality in income distribution, which make it a candidate for the HIPC program. To address this situation, the country has designed a strategy to boost the rate of economic growth, reduce poverty levels and improve governance. The Bank has been supporting this strategy.
- .2 The Government of Honduras views tourism as a strategic sector, among other reasons because: (i) the sector has demonstrated a capacity to achieve high growth rates—tourist arrivals grew by 8.5% per year in 1992-2002, and foreign currency earnings rose from US\$115 million in 1996 to US\$373 million in 2003; (ii) there is a triple coincidence in that several focal points of tourism development are in the country's least developed areas; the sector has excellent potential to generate employment for low-skilled individuals; and total employment in the sector has grown rapidly to reach a level of 85,000 jobs in 2003, double the corresponding 1996 figure; and (iii) the country has natural, cultural/historical attributes of the quality needed to compete on international markets.

B. The sector

1. General

- .3 Roughly 550,000 tourists visited Honduras in 2002, with 52% coming from the Central American region, 23% from the United States and 8.7% from Europe. The large number of tourists originating in the United States chiefly reflects the links that Honduran emigrants maintain with their country of origin. An analysis of the reason for visits shows that Central Americans visit Honduras mainly for work (49.2%), while Europeans (67.4%) and those from the United States (36.4%) for the most part come on vacation. European and American tourists stay longest on average (16 and 14 days, respectively), while Central Americans tend to stay for shorter periods (6 days). American tourists spend the most hard currency (US\$873 per visitor), followed by Europeans (US\$585), with Central Americans spending less (US\$311 per visitor). The sector's growth prospects are good, particularly in view of current efforts to integrate the country's tourism circuits with the rest of Central America. The World Tourism Organization (WTO) has projected growth on the order of 3.8% for 1995-2020. The potential of this market was demonstrated in 2002 and 2003, for while international tourism shrank by 4% and 2.1%, respectively, the Central American tourism market grew in both periods, expanding by 4.2% in 2003.

2. Diagnostic assessment of resources and opportunities

- .4 Honduras has tourist attractions spread across its various regions, which coordinate through the National Sustainable Tourism Strategy, known Spanish-language acronym, ENTS. The

ENTS design process included diagnostic study of supply and demand in the country's seven regions.

1.9 ***Coastal zone.*** This zone mainly attracts local tourists and visitors from within the region, with a range of tourism alternatives concentrated in the cities of La Ceiba and Tela. Although La Ceiba enjoys a certain level of weekend activity throughout the year, the presence of a significant seasonal factor makes robust and job-creating tourism activity unsustainable. Demand is very homogeneous, based on sun and beach tourism, and there is demand for alternative adventure services. The most active tour operators in the zone confirm that demand is mainly international.

1.10 The tourism services available are of low quality, with no regulations or controls over such key issues as food handling or supply management. The region's attractions are poorly defined and are not marketed internationally. Trips tend to be planned from the leading distribution centers (Tegucigalpa, San Pedro Sula), or else arranged at travel agents in the leading countries of origin (Guatemala and El Salvador). The key action identified is the Los Micos tourism project in Bahía de Tela, which will form part of an Integrally Planned Center (CIP) in Bahía de Tela. In addition to the Los Micos hotel project, the CIP will include a cruise ship pier, improved access infrastructure, and support for regional development in various fields. Restoration of the Omoa Fort is also planned, to connect tourism circuits in the zone and link them to the Maya Trail.

1.11 In its initial development stage, the Los Micos project involves the following investments: construction of two hotels (four and five stars, respectively, with a total capacity of 400 rooms), 130 villas, an 18-hole golf course, public utility infrastructure financed by the national sustainable tourism program (PNTS), and acquisition of 312 hectares of Honduran Tourism Institute (IHT) land for project development, for an estimated total cost of US\$105 million. A third four-star hotel, forming part of phase I, will be developed after the fourth year of operation.

3. Institutional structure

1.13 The Ministry of Tourism (SETUR) is the government agency responsible for designing sector promotion policies. Its offshoot, the Honduran Tourism Institute (IHT), implements the public actions that SETUR considers necessary to promote and develop the sector, requiring active coordination with the rest of the government apparatus. The IHT was created through Legislative Decree 103-93 of 27 May 1993 and is regulated by the National Tourism Council. Serving on the Council are the Minister of Tourism, who chairs it; the Minister of the Interior and Justice; the Minister of Public Works, Transport and Housing; and three private-sector members appointed by the Honduran National Board of Tourism.

1.14 In order to promote sector development, the government has established the National Tourism Office, with responsibility for interagency coordination and setting priorities for public investments targeted on the sector. SETUR, for its part, has established municipal tourism commissions with a view to decentralizing its actions. These commissions are already functioning in 56 municipios, with financing from IHT,

mayoral offices, and communities. They work actively on institution-strengthening, promotion of small-scale infrastructure works, and management of local tourism projects.

1.15 The private-sector institutional structure comprises numerous organizations, brought together under the National Board of Tourism. The leading organizations include the Honduran National Association of Hotels and Related Businesses (AHAH), the Honduran Association of Tour Operators (OPTURH), the Honduran Airlines Association (AHLA), the Honduran Car Rental Association (AHRVE), and the Honduran Transport and Tourism Cooperative (COTATYH).

1.16 There are countless local organizations formed around small-scale businesses and activities linked to tourism (handicrafts, tradespeople, etc.) and community and ethnic organizations (Maya-Chortí and Garífunas), which are very important for the tourism sector in certain parts of the country.

1.17 SETUR works on a regular basis in various fields with specialist public and private bodies, including: (i) the Honduran Institute of Anthropology and History (IHAH), which has an anthropological research department and a restoration department; (ii) the Ministry of Public Works, Transport, and Housing (SOPTRAVI), which includes the Civil Aviation Directorate. The latter supervises operation of the country's four international airports, and is responsible for approval and oversight of national and private airports and heliports throughout Honduras; (iii) the Honduran Social Investment Fund (FHIS), which promotes local development through rural social and productive infrastructure projects in small and medium sized cities, to serve the poorest population groups; and (iv) the ENEE Electric Power Company, responsible for electrification works in the country.

1.18 In addition, for promotion of the Los Micos Tourism Project in Bahía de Tela (see paragraph 1.10), SETUR has created a semipublic corporation known as Desarrollo Turístico de la Bahía de Tela (DTBT), to promote development through partnerships with local and foreign private investors of recognized capacity and experience in the sector. To make the operation financially viable both for the private investors that will put up the capital and for private banks, which will jointly finance the productive investments (i.e. investments other than basic infrastructure), debt and capital will be consolidated in the DTBT, turning it into a holding company with various subsidiaries (hotels, golf). This decision has been taken in order to pool the risks involved in individual businesses and make it easier to obtain loans, since this arrangement allows the banks to gain access to subsidiaries' assets and incomes. The capital investment to be made by the government corresponds to the public utility infrastructure to be built by the IHT (approximately US\$15 million including the cost of works supervision), and capitalization during the first five years of the payments that DTBT will have to make for the land to be acquired from the IHT.

1.19 In conjunction with an investment bank, DTBT has thus far concluded financial structuring studies for the hotel and recreation investments, obtained letters of commitment amounting to US\$18 million from private investors, received proposals

from specialist hotel operators, and initiated contacts with private banks to obtain the necessary funding.

C. The country's sector strategy

1.20 The Government of Honduras has selected tourism as one of four pillars of economic growth in the country. Available data on demand and key markets (cultural, adventure, nature, cruise ship, etc.) show that there is strong potential for significant growth in the number of tourist arrivals over the next few years. This could lead to greater foreign currency earnings, job creation, and diversification of local economies, particularly in regions offering a concentration of easily accessible attractions, such as the north coast. 1.21 SETUR has set a national goal of sustainable tourism development, i.e. equitable, socially and environmentally responsible, and focused on improving the quality of life among local populations. *For that purpose, it has formulated a clear long-term vision for the sector and is completing design of the ENTS, which has been the subject of a wide-ranging process of consultation with entrepreneurs and local organizations, together with surveys to reach consensus with all indigenous and Afro-Honduran population groups within the program areas of influence.* The design of the ENTS has pursued the following strategic criteria:

1.22 *Strategic criterion #1: Focus on geographic areas that have major potential for the country's development, in order to trigger an expansion of tourism activity to other regions of Honduras based on the returns and spillover effects.*

1.23 The different regions are not equally prepared to receive tourism activity. Although all of them start from an early stage of tourism development, three regions stand out for their attraction capacity and existing experience: the Bay Islands, Copán, *and the coastal zone*. The first two already have some tourism development and solid market positioning. Their problems stem from two related factors: firstly, the need to reorganize activities to deal with the lack of sustainability in current tourism models; and secondly, the need to attract a broader and better spectrum of visitors, who are more likely to arrive if access conditions in Copán and the quality of services in both areas improve.

1.24 The coastal zone, in contrast, has a problem of positioning. Although some demand is discernible, a potential international market remains to be exploited. This market corresponds to sun and beach tourism, which, in combination with nature tourism opportunities, could generate growth in the sector capable of triggering regional development. The Tela CIP, which includes the Los Micos hotel project and a cruise ship pier, along with actions to manage and improve regional infrastructure, could represent a major milestone for tourism development in the country.

Nonetheless, this requires firm support from the public sector in terms of infrastructure improvements, and from the private sector in terms of complementary services to position the region effectively in the Caribbean setting.

1.25 The other regions are potentially more suited to domestic tourism (central corridor or southern zone) or international tourism on a smaller scale.

1.26 *Strategic criterion #2: Take steps to reach demand segments that have greater growth potential, match the country's special features and existing tourism resources, and distinguish Honduran tourism from that of other countries in the area. This involves a combination of nature, adventure, and cultural tourism, generating authentic experiences for visitors by enabling them to participate in their leisure time in daily Honduran life.*

1.27 Honduras could set itself apart by exploiting “geotourism”—defined by the National Geographic Society as tourism experiences in which the visitor is involved in the social and cultural reality of the host country. Honduras has been at the forefront of this concept since the signing of a National Geographic Society agreement for development and promotion of this country-specific product brand, and efforts to promote scientific, academic, volunteer, and educational (SAVE) tourism.

1.28 Based on the foregoing principles, six key strategies have been formulated, together with lines of action in each case (see strategy table in the project technical files).

1.29 The future of Honduran tourism depends not only on investments in large infrastructure projects and hotel facilities, but also on development of a network of small businesses providing auxiliary services such as laundry, maintenance, transport, security, catering, accounting and information technology, recreational activities, etc. The competitiveness of tourism destinations depends on the capacity of the industry to innovate and continuously improve product quality. Large tourism enterprises will only gain advantages over global competitors if they have an efficient network of suppliers to satisfy an increasingly sophisticated demand.

D. The Bank's sector strategy

1.30 The Bank's country strategy with Honduras aims to support government efforts to implement the poverty reduction strategy (PRS), which has the following objectives: (i) accelerate sustainable economic development through increased competitiveness; (ii) increase the productive capacity of low-income population groups; and (iii) strengthen the country's institutional capacity and governance by supporting the decentralization process and local economic development. The proposed program is consistent both with the Bank's strategy and with the PRS, since it aims to improve the competitiveness of tourism, which has been identified as one of the pillars of national economic development. To maximize the local development impact, the program will promote related productive activities and mechanisms to expand private-sector and civil-society participation in the sector.

1.31 The Bank has several PNTS-related operations in execution (loans and technical cooperation), including the Bay Islands environmental management program, phase II (PMAIB2) (1113/SF-HO); the competitiveness development program (1125/SF-HO), which includes tourism as one of the key sectors; and several technical cooperation operations, including one for the management of protected areas in the context of regional tourism on the north coast (ATN/SI-8649-HO), the results of which have been included in the ENTS, and taken into account in preparation of this operation. The

PTSMM-HO subcomponent of the Mundo Maya regional program (Belize, El Salvador, Guatemala, Honduras, and Mexico) was designed by means of technical-cooperation operations at a cost of US\$3 million, funded through nonreimbursable contributions from donor countries administered by the Bank (Sweden, Norway, Korea, United Kingdom, Denmark, France, the Netherlands, and Japan). Japan was the principal contributor at US\$1.65 million (ATN/JF-6782-RS and ATN/JF-8328-RS).

1.32 The proposed program will support the national government strategy to promote sector development as outlined above. In particular, the program aims to consolidate and enhance the effectiveness and efficiency of work done by SETUR in two areas: firstly, as coordinator of public action, both nationally and locally, to benefit tourism development; and secondly, as a catalyst for private sector investment, both domestic and international, to make it the main driver of sector development. Although these actions will help make the country's tourism sector more competitive in the Central American region, it is essential to ensure that development thus generated is responsible and sustainable in economic, social, environmental, and cultural terms.

II. THE PROGRAM

A. Objectives and description

2.1 The program seeks to promote the development of sustainable tourism in Honduras—development that is responsible and sustainable in economic, environmental, social, and cultural terms. Implementation of a tourism development model of this type will make an effective contribution to social and economic development in regions that have tourist potential, some of which coincide with the country's least developed areas, by raising employment levels, creating business opportunities, and improving basic services. This will simultaneously improve living standards among the local population, increase foreign exchange earnings, and conserve the natural and cultural heritage that underpins tourism activity.

Priority investments identified in the National Sustainable Tourism Strategy (ENTS): to promote new tourism products based on the sustainable use of natural resources, which have been accorded high priority in the ENTS. Priority programs include development of protected areas in Bahía de Tela, construction of a scientific, academic, volunteer and educational (SAVE) tourism center, and protection of public beaches on the north coast.

2.5 Public utility infrastructure for the Los Micos project: to catalyze private investment in the Los Micos hotel project, which has potential to become an international pole of attraction for the country's sun and beach tourism, simultaneously boosting other tourism circuits.

2.6 Tourism Development Fund (FFT): to promote private investment in the micro, small, and medium-sized enterprises (MSMEs) needed to ensure quality improvements in tourism products and services in Honduras.

1. Public investments to support sustainable tourism development

2.14 Development of protected areas in Bahía de Tela (US\$1.816 million). These investments are centered on the three protected areas existing in Bahía de Tela: the Jeannette Kawas National Park (PNJK) (US\$337,000), the Lancetilla Botanical Garden (JBL) (US\$1.106 million), and the Punta Izopo National Park (PNPI) (US\$373,000). The following actions are envisaged: (i) development of baseline and monitoring of existing natural resources (scale 1:25,000 to 1:50,000) in each area; (ii) design of contents and installation of signposting for each area, both internally and externally up to 100 km from the entrance; (iii) construction of bird watching towers (3 in PNPI and 1 in PNJK); (iv) construction of viewing points with interpretive maps (2 in PNJK and 1 in PNPI); (v) an access control booth in the PNJK; (vi) support for Lancetilla Punta Sal and Texiguat Protection Foundation (PROLANSATE) in management of the two parks; (vii) construction and improvement of footpaths and installation of interpretive information (5.7 km in PNJK, 5.3 km in JBL); (viii) construction and equipping of a center for visitors and nature interpretation in the JBL, with a built area of approximately 800 m², including library, multipurpose room, nature interpretation room, handicraft shop, management area and parking lot.

2.15 Creation and implementation of a center for the promotion of scientific, academic, volunteer and educational (SAVE) tourism (US\$1 million). This includes the preparation of final designs, construction, equipping, and implementation of a SAVE tourism center. The center will be located in the neighborhood of the Pico Bonito National Park and will provide services enabling researchers, students, and visitors to observe and study the natural world. It will have a built area estimated at 1,080 m², including a lodging area (20 rooms with bathroom with a total capacity for 60 people), restaurant, library and study room, multipurpose room, research hall, small thematic laboratories, and an administration and services area. Although the center will be built by the IHT, right of use will be granted to the SAVE-Honduras Foundation, which will be responsible for promoting the SAVE strategy.

2.16 Comprehensive management of North Coast beaches (US\$1.1 million). This will involve formulation of a regional plan for public use and environmental improvement of over 100 km of beaches in Honduras's Caribbean coastal area (Omoa to Trujillo), which will provide a regulatory framework for the conservation and sustainable use of beaches as public goods, and assistance in settling disputes that arise over the boundaries of public use zones. The capacity of the beaches will be determined, and zoning established for areas of public or restricted use, and restoration zones. *Funding will also be provided for civil works to improve public access and environmental quality on 13 km of urban and rural beaches among the Garífuna communities of Tornabé and San Juan, and the city of Tela.* Public use, security, communications, and cleaning equipment will be purchased for those beaches. These investments will be complemented by a coastal water quality monitoring program to support compliance with an internationally recognized environmental certification program in Bahía de Tela, using beaches adjacent to the Los Micos project to disseminate good practices.

2. Promotion of private investment in the sector (US\$17 million)

2.17 This component will finance actions to boost private sector participation in the tourism sector, both by investors capable of developing large projects and by small and medium-scale entrepreneurs and community organizations that find it hard to finance their projects. The actions have been divided into two subcomponents.

a. Basic infrastructure for the Los Micos project (US\$14 million)

2.18 The funds for this subcomponent will be used by SETUR/IHT to finance basic infrastructure both within the Los Micos project and in its immediate vicinity, given that this is considered a high priority for the development of sun and beach tourism in Honduras. The investments envisaged are described below.

2.19 **Paved roads**, including construction of the main road (5.1 km) and secondary roads (6.4 km) in the project area; *access roads to Miami village (8.08 km) and to Tornabé (0.88 km); and the main avenue in Tornabé (1 km)*;

2.20 **Drinking water supply for the project** (13 liters/sec) *and for the inhabitants of Miami (2 liters/sec) and Tornabé (11 liters/sec)*, to supplement infrastructure built previously by the National Water and Sewerage Service (SANAA), involving the capture of raw water in the Bañadero reservoir, transport to the project vicinity, *and diversion to supply the population of Tornabé*. This includes a conventional water treatment plant with an initial capacity of 26 liters/sec; a 1,000 m³ storage tank; a distribution network within the project using 16.97 km of PVC piping, and transport to Miami over a distance of roughly 3.5 km through 100 mm piping.

2.21 **Wastewater disposal system: *Collection of wastewaters from the towns of Miami and Tornabé*** as well as from the Los Micos project, and their transport to a wastewater treatment plant. The plant will include preliminary, primary, and secondary treatment using activated sludge and a sludge digester. The treated water will be reused regularly to water gardens and the golf course; and occasional surpluses in rainfall periods will be transported to a branch of Los Micos Lake, having satisfied national effluent disposal standards. Communal septic tank systems with effluent infiltration fields will be used to meet those standards in Tornabé and Miami.

2.22 **Electric power system:** This will include a 600 m segment of primary overhead network, metering equipment at the entrance to the project; underground distribution in the project area; an emergency power plant for administrative offices, general services, and pumping stations; and a street lighting system.

2.23 **Rainwater drainage system:** This consists of a network of trunk collector channels, using gravity drainage towards the zones, strengthened by a 2.5 km navigable channel of variable cross-section leading to Laguna Quemada. The channels will be turfed in low speed zones, with a masonry surfacing elsewhere.

The water will be discharged into the lakes projected for the golf course or in Laguna Quemada. Sand traps have been planned at strategic locations.

2.24 System for the disposal of solid waste from the project and from the towns of Tornabé and Miami: The project at its height, together with the towns of Tornabé and Miami, will generate roughly 11.7 tons of refuse daily, including sludge from the wastewater treatment plant. The investments envisaged to handle this volume include: closure of the Tornabé waste dump, six containers to operate as transfer stations and recycling deposit, a compacter truck with 15 m³ capacity, and adaptation of a 1 hectare land plot to serve as an additional sanitary landfill area for the city and receive the project's solid waste.

2.25 The basic public utility infrastructure described above will be delivered by the IHT to DTBT, against the corresponding amount in the form of equity shares.

b. Tourism Development Fund - FFT (US\$3 million)

2.26 The program will also help boost development opportunities for smaller businesses and ensure a sustained increase in the quality of the products and services offered in the tourism sector. For that purpose, the IHT is setting up the Tourism Development Fund (FFT), to offer financial support to micro, small, and medium-sized enterprises (MSMEs) in tourism and related sectors (restaurants and hotel suppliers, firms providing related services such as maintenance and laundry), and to businesses with direct links to the tourism sector, such as handicraft makers.

2.27 The FFT will offer financial support (US\$2.5 million) through a system of matching grants, the proceeds of which will be used for preinvestment, investment, training, and technical assistance. The IDB Programs Coordination Unit (PCU) will select the fund manager through a competitive process (see paragraph 3.15), the cost of which is estimated at US\$500,000. Use and application of FFT funds are described in detail in the program Operating Regulations.

2.28 To be eligible for FFT funding, a business must: (i) be a micro, small or medium sized enterprise as defined by the project; (ii) be legally established or in the process; (iii) operate in the tourism sector or one directly related to it; (iv) operate in the country's tourist areas, preferably those included in the project; (v) enter into a contract with the FFT administrator, accepting the established conditions; and (vi) be willing to share experiences with other firms; in addition, (vii) preference will be given to firms that request funding in partnership with two or more enterprises.

IV. VIABILITY AND RISKS

A. Institutional viability

4.1 During project preparation the project team analyzed the Honduran Tourism Institute's (IHT) administrative and institutional capabilities, and confirmed that it has the capacity needed to execute the proposed project. The IHT has experience in executing projects with multilateral banks and is currently implementing three: two financed by the World Bank and one by the IDB (PMAIB2), which are progressing satisfactorily. In view of this experience, it was decided to establish a single Program Coordination Unit (PCU) for Bank projects, which will be staffed by individuals with experience in executing the

PMAIB2 and personnel that have coordinated execution of the Project Preparation Facility (PPF) used in preparation of this operation. The program also includes resources to strengthen the IHT in aspects of monitoring and evaluation, coordination of the Mundo Maya regional project, and related environmental monitoring and oversight tasks.

B. Socioeconomic viability

4.3 A detailed economic evaluation was made to verify that these investments are justified from the country standpoint. The projects analyzed were: Mundo Maya Sustainable Tourism Project (PTSMM), the Los Micos project, creation of the SAVE center, and development of protected areas in Bahía de Tela (see technical annexes in the RE2 files). The main outcomes for the two largest projects are presented below.

4.4 **Los Micos project.** The socioeconomic study (see technical annex in the RE2 files) evaluated the potential impact of this project on the economies of neighboring communities, recognizing the close links that may exist between tourists, firms, and households. For this purpose, social accounting matrices were estimated for the city of Tela and five community groups. The data were obtained from indirect information and surveys of households, businesses, and tourists. *The project's immediately neighboring communities (Miami, Tornabé, and San Juan) are predominantly populated by Garífuna people (over 87%),* but this is not the case in the city of Tela (14%). The level of schooling is very low, and a very large proportion of the population have experience of domestic or foreign migration. The main cause of emigration from the zone is a chronic lack of employment and low pay. The project's economic analysis (basic infrastructure and hotel development) was made from the standpoint of Honduran society as a whole, conservatively assuming that the private capital and financing for the productive component would be wholly sourced abroad. On this assumption, the net flows of economic benefits and costs will come from three main sources: (i) repayments to be made for the land by the semipublic corporation, Bahía de Tela Tourism Development (DTBT), less the opportunity cost of not being able to use it for other purposes; (ii) increases in family income obtained in the region and in the rest of the country as a result of the incremental value-added generated by the project, minus the opportunity cost of the productive factors used; (iii) the market value of government shares in DTBT, reflecting its participation in the project's net income flows.

4.5 Income and expenditure flows will be discounted at a rate of 12% per year; and, for the benchmark case corresponding to a conservative benefits situation, an internal rate of return (IRR) of 15.5% was obtained and a net present value (NPV) of US\$9.8 million. The NPV of incremental family income flows is US\$24.8 million, whereas the NPV of infrastructure investments is US\$14.2 million. The NPV of repayments to the government for the land is US\$5.6 million, if payment for the first five years is counted in the flow. The project's IRR drops to 11.7% in the worst-case scenario (hotel occupancy only 80% of that projected in demand studies, and costs 120% of those estimated). This analysis shows that the project is an attractive investment for the country in economic terms, largely because of its potential to generate incomes in depressed areas.

C. Financial viability

4.9 A detailed financial analysis was made of the larger investments to verify that the income and expenditure flows would allow for them to be operated and maintained satisfactorily, and that they would simultaneously provide appropriate incentives for the economic agents involved. The investments analyzed in detail were: the Los Micos project, the Río Amarillo airport, the SAVE center, development of protected areas in Bahía de Tela, restoration of the Omoa Fort and the Río Amarillo archaeological site, and the drinking water and sanitation service in La Castellona (see technical annex in the RE2 files). The outcomes for the two largest subprojects are described below.

4.10 **Los Micos project.** The financial analysis was used to design the project's basic financial structure. Debt (roughly US\$62 million, of which US\$19 million is owed to the IHT for land) and capital (roughly US\$44 million, of which approximately US\$27.8 million would be contributed by private partners) are consolidated in DTBT, which acts as a holding company with various subsidiaries (hotels, golf course). It is considered feasible to obtain private funding over a 10-year period, with two years' grace following construction and an interest rate of 8%, given that collateral is available.

4.11 The results for the conservative scenario (with no possibility of refinancing the debt in year 4) show a return on equity (ROE) of 17.7%, with general corporate leveraging limited to 45%, to avoid compromising the debt service coverage ratio (DSCR) of 1.5 required by the banks. The optimistic scenario generates an ROE of 22.4% with DTBT corporate leveraging climbing to 50%, thereby complying with a minimum DSCR of 1.5. Numerous sensitivity analyses were performed by adjusting key variables for each of the cases mentioned. The ROE falls to 11.7% when occupancy rates are only 80% and investment costs 120% of those estimated. The analyses performed indicate that the project has sufficient income generating potential to attract private investments; and it is also considered feasible to obtain the necessary private funding. Indeed, on 15 March 2005 DTBT received letters from private investors interested in investing US\$18 million in the project.

E. Benefits and beneficiaries

4.18 The program's benefits and beneficiaries can be grouped together in four main categories: (i) at the most aggregate level, growth of the tourism sector will generate additional foreign currency earnings to the benefit of the economy as a whole; (ii) larger-scale projects (actions in Río Amarillo, Omoa, and Bahía de Tela) will promote employment and higher family incomes in the directly benefited zones (a total population of roughly 120,000 inhabitants), with FFT operations expected to benefit some 60 small enterprises related to the sector; (iii) *residents in La Castellona, Tornabé, and Miami (roughly 2,000 people) will directly benefit from the basic utility infrastructure to be installed (water and sanitation services, electric power, solid waste management, transport, communications); and they will also have use of the local public goods to be provided by the project;* (iv) the program will help guarantee financial and environmental sustainability in management of the country's natural and historical heritage (protected natural areas of Bahía de Tela and the Río Amarillo and Copán Ruins archaeological zones). Given that over 80% of the program's investments (direct costs) are targeted on parts of the country that are relatively deprived in terms of unmet basic needs (Copán and

the outskirts of the city of Tela), the program qualifies as a poverty-targeted investment (PTI) on geographic grounds.

F. Risks

4.19 The main risks identified are mentioned below.

4.20 **Complexity of the operation.** The program is complex because it will require various public and private entities to participate as coexecuting agencies. To mitigate this risk, an execution strategy has been designed that makes it possible to efficiently and effectively share responsibilities between IHT/PCU and the specialized entities, with the respective agreements providing for resources to enable them to carry out the tasks entrusted to them.

4.21 **Risk affecting private investments of the Los Micos project.** While the PNTS finances the basic infrastructure of this project, the productive investments are expected to be carried out in partnership with private investors who will make capital contributions to DTBT. The feasibility of obtaining private contributions has been verified in principle, based on market/financial analyses for the hotel development which have been used to carefully structure the financial plan. To mitigate the remaining risks, the loan contract ties Bank disbursements for this subproject to the obtaining of capital contributions and borrowing required for the private investments.

4.22 **The political cycle in the country.** To mitigate the risks inherent in an operation that will be approved during an election year, steps have been taken to ensure that the Tourism Development Strategy underlying the program is the outcome of a wide-ranging process of consultation and consensus with all relevant stakeholders.

The highest profile projects have been studied in detail and have been submitted to specific consultation processes in the most important cases (Río Amarillo airport and the Los Micos project). They are therefore considered national priorities rather than projects pertaining to a specific government.