MUNICIPAL BORROWING
PRESENTATION STRUCTURE

MUNICIPAL BORROWING
DEBT INSTRUMENTS AND IMPACTS

MUNICIPAL BORROWING
THE BIG PICTURE
MUNICIPAL BORROWING
Debt Instruments & Impacts
Impacts of Municipal Debt

Effects of borrowing depend on the type and how it is done:
- Borrowing will degrade the financial position of a LG if it used to avoid a hard budget constraint
- The “Golden Rule”
Different types of debt have specific issues and risks

- Short and long-term borrowing
- Local and foreign currency denominated borrowing
Terminology and issues

**LOANS**
1. Borrower
2. Lender
3. Maturities must match
4. Small-scale borrowers don’t have a choice

**BONDS**
1. Issuer
2. Bondholder
3. Liquid secondary market brings in more investors
4. For large scale borrowers
Specific Types of Bond

“General obligation” bonds

Revenue bonds
  • TIF bonds

Green bonds

Retail bonds
Credit enhancements

- Guarantees, insurance
- Intercepts
- Reserve funds
- Sinking funds
- Covenants
Debt service

Size matters
• How much total?
• How much each period?

Shape matters
Different payment structures

- Bullet at end of term
  - Loan of R 100 000 000 with 10% interest

- Level principal and interest payments over 10 years
  - Loan of R 100 000 000 with 10% interest

- Level principal payments over 10 years
  - Loan of R 100 000 000 with 10% interest
More on structure – an example

Stacked obligations at level amortization

- Bank 1
- Bank 2
- Bank 3
- Bank 4
Which do you prefer, why?
Knowledge is power

Lenders have knowledge advantage

Municipalities need to be smart
MUNICIPAL BORROWING

The Big Picture
Municipal Debt Market Ecosystem

**INVESTORS**
- Bond purchasers (pension funds, institutional investors)

**MARKET FACILITATORS**
- Private/Commercial Banks
- Intermediaries: Govt. Dev. Banks/MDFs; Bond Banks etc.
- Int’l Development Banks/Donors (e.g., IFC, AFD)
- Credit Rating Agencies (e.g., Moody’s, S&P)
- Financial & Other Advisors
- Project Preparation Facilities (e.g., C40 Cities Finance Facility)

**BORROWERS**
- Municipality
- Urban Utility (e.g. Water Utility)

**RISK BEARERS/MITIGATORS**
- Monoline insurers
- Credit Enhancement Facilities (e.g., LGUCC, Philippines), USAID
Very divergent systems across developed and developing markets:

- US $3trn vs India $100m/annum

In the developing world, activity tends to be highly constrained:

- Africa: significant only in South Africa
- South Asia: limited largely to India, which has a modest market
- East Asia: mixed and limited experience, e.g., Philippines; Indonesia; China is unique
- LAC and ECA: some experience (e.g., Colombia, Hungary)
Why Is This?

Four factors determine access by cities to debt finance

1. Financial sector and investment community
2. City or project revenue sources – the intergovernmental fiscal system
3. The quality of financial data and FM systems of the city
4. The legal and regulatory framework
In developing countries barriers to all these areas tend to be severe

- Analysis (e.g. India; Vietnam) and experience (e.g. South Africa) shows that the binding constraints tend to be on the demand and regulatory sides
- National governments control most of the policy decisions and levers in these areas, even on issues such as FM (municipal accounting standards; the municipal audit process)
- Cities control many of the demand-side factors, particularly the quality of FM and data
- The reform necessary to expand cities’ access to credit markets and PPP and LVC investors often raises fundamental policy and political issues, e.g. the degree of autonomy of local governments; management of potential fiscal risks
Of the 500 largest cities in developing countries, only 95 (19%) are currently rated as investment grade by an international or local rating agency.

Only 32 cities - out of the largest 500 - have issued a bond at the municipal level; these cities are in 12 countries (Argentina, Bolivia, China, Colombia, India, Mexico, Paraguay, Peru, Russia, South Africa, Uruguay, Vietnam).

**Breakdown by Region**

<table>
<thead>
<tr>
<th>Region</th>
<th>Cities in top 500</th>
<th>Inv. Grade Rated Cities</th>
<th>Countries in region with rated cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>EAP</td>
<td>178</td>
<td>12</td>
<td>China*, Armenia, Indonesia</td>
</tr>
<tr>
<td>ECA</td>
<td>44</td>
<td>9</td>
<td>Belarus, Bolivia</td>
</tr>
<tr>
<td>LAC</td>
<td>92</td>
<td>34</td>
<td>Kazakhstan, Russia, Thailand</td>
</tr>
<tr>
<td>MNA</td>
<td>43</td>
<td>0</td>
<td>Colombia, Mexico, Serbia</td>
</tr>
<tr>
<td>SAR</td>
<td>82</td>
<td>35</td>
<td>Paraguay, Peru, Ukraine</td>
</tr>
<tr>
<td>SSA</td>
<td>61</td>
<td>8</td>
<td>Uruguay, India, Côte d'Ivoire</td>
</tr>
</tbody>
</table>

* Does not include Local Government Financing Vehicles

** 3 Cities in Vietnam have issued bonds, but ratings are not publicized.
The Regulatory Environment: International Examples

MARKET-BASED SYSTEMS

USA
SOUTH AFRICA
POLAND
PHILIPPINES
HUNGARY

RULES BASED SYSTEMS

INDIA
VIETNAM

DIRECT CONTROL SYSTEMS

- Well-defined systems
- Semi-defined systems
- Poorly-defined systems
- In-flux systems
Addressing the Challenge

Nationally controlled regulations & systems
- City revenue sources and powers
- City accounting and financial management
- Borrowing regulations

City controlled factors
- Quality of financial data and reports
- Financial management
- Project bankability
South Africa Municipal Borrowing

Rand (billions)  Growth in Long Term Borrowing

Addressing the Challenge

- **City governments**
  - Maximize revenues, strengthen financial management and improve data to enhance creditworthiness
  - Strengthen project quality
  - Equip themselves to deal with sophisticated lenders
  - Lobby national governments for regulatory reform

- **National governments**
  - Strengthen municipal fiscal systems (e.g. revenue autonomy)
  - Improve regulatory systems for municipal borrowing
  - Support non-distorting interventions to stimulate the market (e.g. advisory services; credit-enhancement facilities)

- **MDBs and Donors (public and private)**
  - Support city and national governments with TA to achieve the above
  - Support targeted credit-enhancement interventions to de-risk transactions in an imperfect environment
  - Facilitate relationships between investors and city borrowers

- **Investors**
  - Pioneer the business drawing from experience in developed markets