MUNICIPAL BORROWING: SYSTEMS, CONSTRAINTS & CHALLENGES

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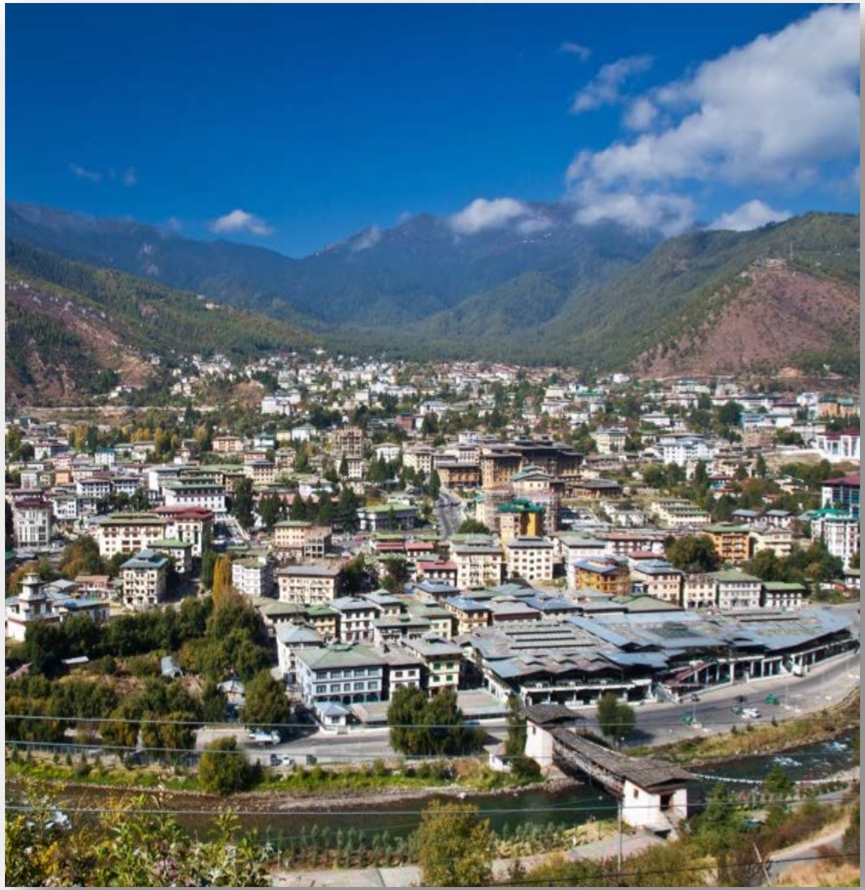
Main Points



1. City borrowing should be seen in fiscal context

2. Municipal finance in cities has specific issues – and risks

3. The market for municipal debt has its own 'ecosystem'

4. Cities in developing countries have barriers to debt

5. Approaches to address these challenges

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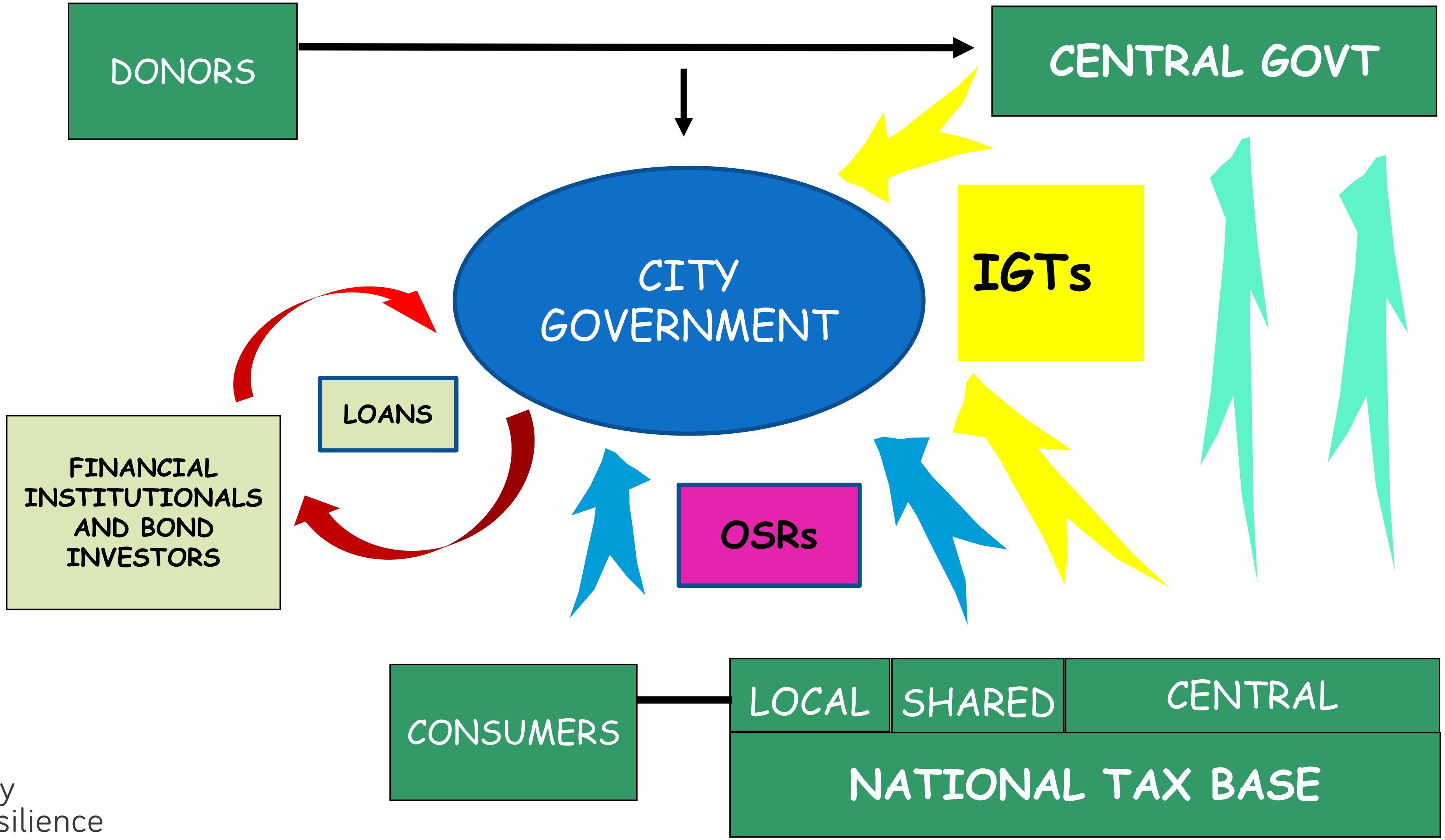
City Borrowing in Fiscal Context



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Characteristics of Municipal Debt

Fiscal Instruments

- ✓ Strengthen the balance-sheet of the city
- ✓ But are limited, subject to budget and political contestation, and often highly controlled in developing countries

Borrowing

- ✓ Converts future revenue into capital which is immediately available, hence encumbers rather than generates revenue
- ✓ Has “neutral” impact on the balance sheet of the borrowing entity and cannot be used to close a structural fiscal gap
- ✓ Thus best understood as a financing rather than a funding mechanism
- ✓ But can be used in conjunction with fiscal instruments to fund infrastructure investments

Different types of debt have specific issues and risks

- ✓Short and long-term borrowing
- ✓Local and foreign currency denominated borrowing
- ✓Bonds, revenue bonds and green bonds

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Municipal Debt Market Ecosystem

Investors	Bond purchasers (pension funds, institutional investors)	Private/ Commerical Banks	Intermediaries: Govt. Dev. Banks/MDFs; Bond Banks etc.	Int'l Development Banks/Donors (e.g., IFC, AFD)
Market Facilitators	Credit Rating Agencies (e.g., Moodys, 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		

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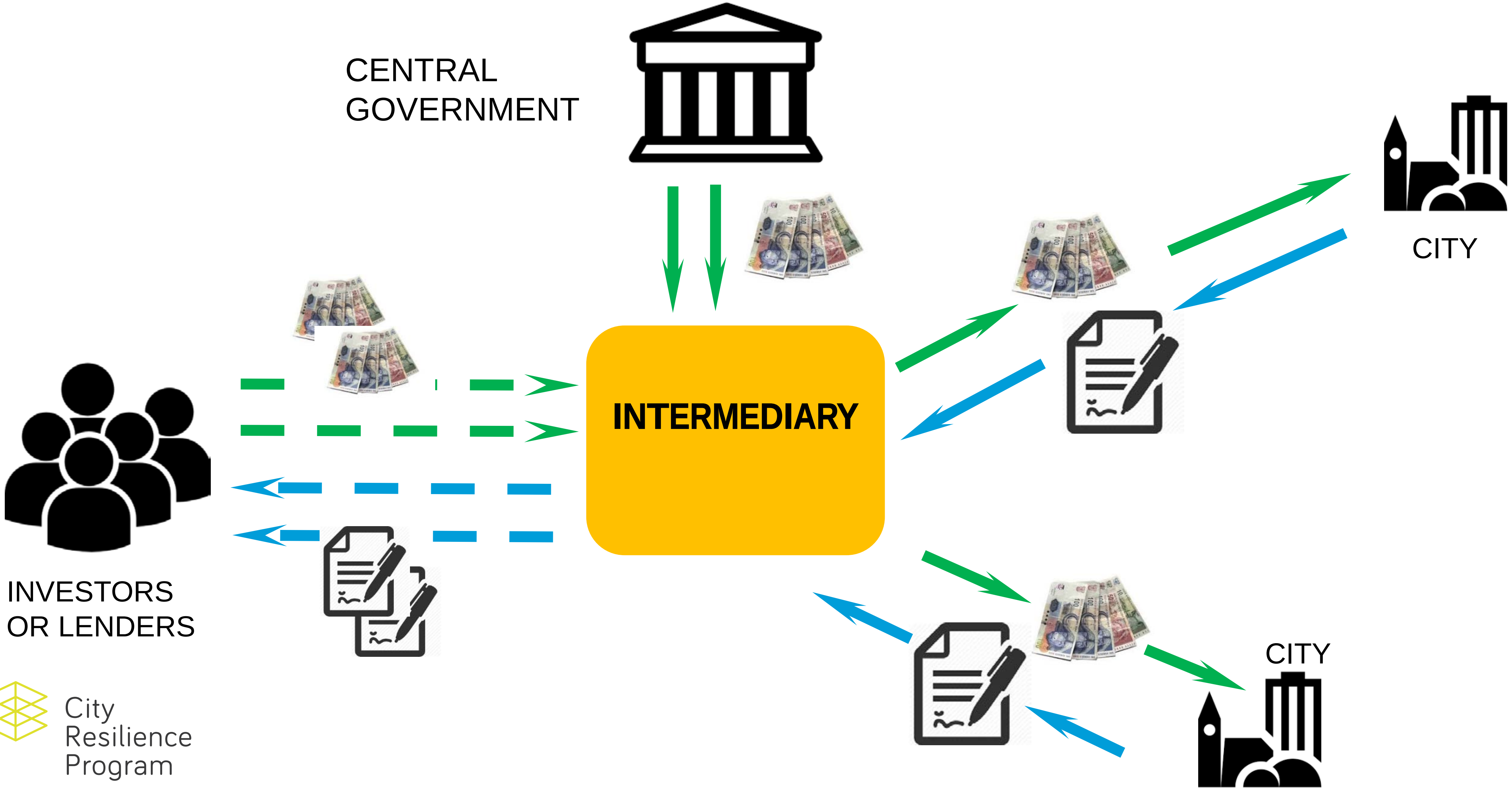
Intermediaries: Bond Banks, MDFs, Cooperatives



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Municipal Debt: An International Perspective

- **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)

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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

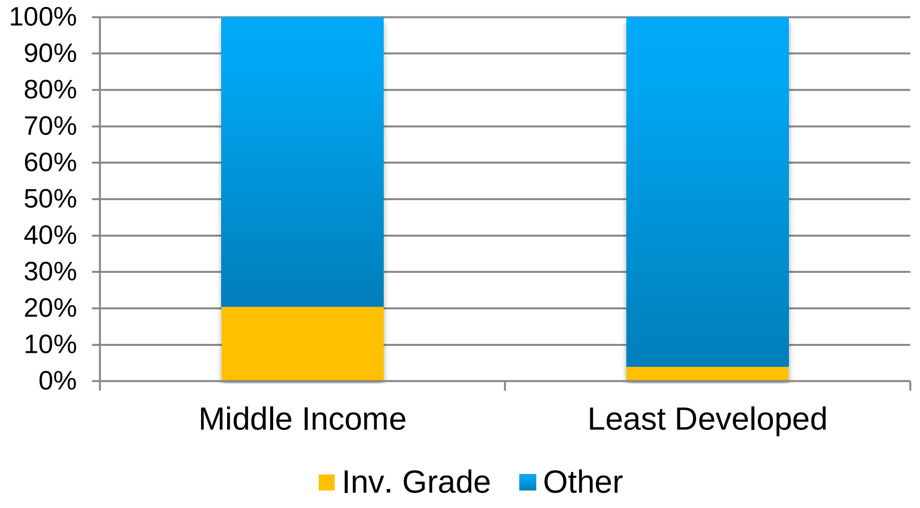
- **SUPPLY**
- **COMBINE TO PROVIDE DEMAND (“CREDITWORTHINESS”)**
- **INTERMEDIATES SUPPLY AND DEMAND**

- **In the 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

The Demand Side: Creditworthiness

- Of the 500 largest cities in developing countries, **around 90 (18%) are rated as investment grade by an international or local rating agency**
- **Only 32 cities have issued a bond at the municipal level**. These cities are in 13 countries (Argentina, Bolivia, China, Colombia, India, Mexico, Paraguay, Peru, Russia, South Africa, Turkey, Uruguay, Vietnam)

Percentage of top 500 cities with Inv. Grade Ratings, by Country Income Category



Breakdown by Region

	EAP	ECA	LAC	MNA	SAR	SSA
Cities in top 500	178	44	92	43	82	61
Inv. Grade Rated Cities	12	9	30	0	35	8
Countries in region with rated cities	China* Indonesia Thailiand Vietnam*	Armenia Belarus Kazakhstan Russia Serbia Turkey Ukraine	Argentina Bolivia Brazil Colombia Mexico Paraguay Peru Uruguay		India	Côte d'Ivoire Senegal South Africa Uganda

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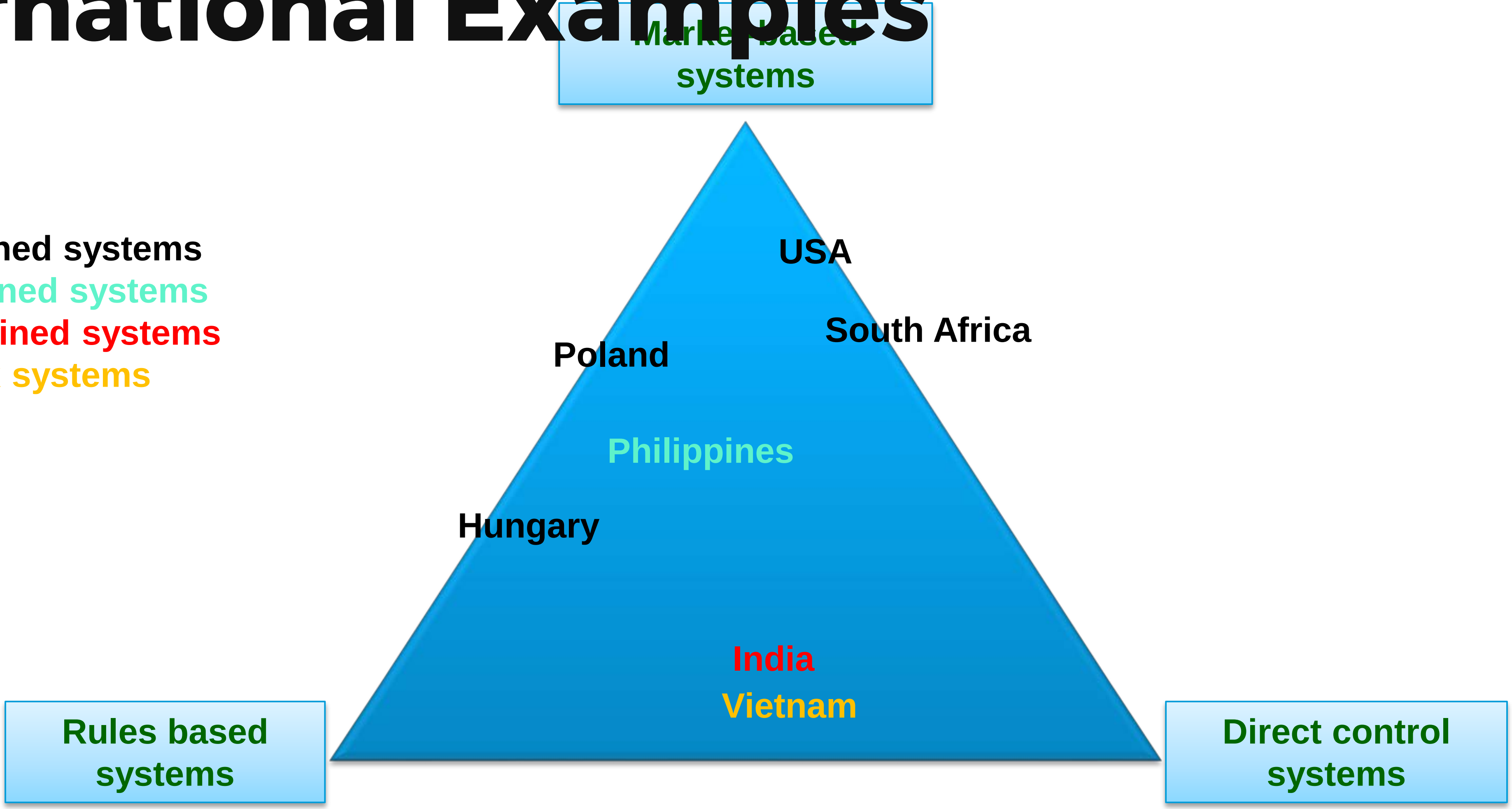
The Regulatory Environment: International Examples

Well-defined systems
Semi-defined systems
Poorly-defined systems
In-flux systems



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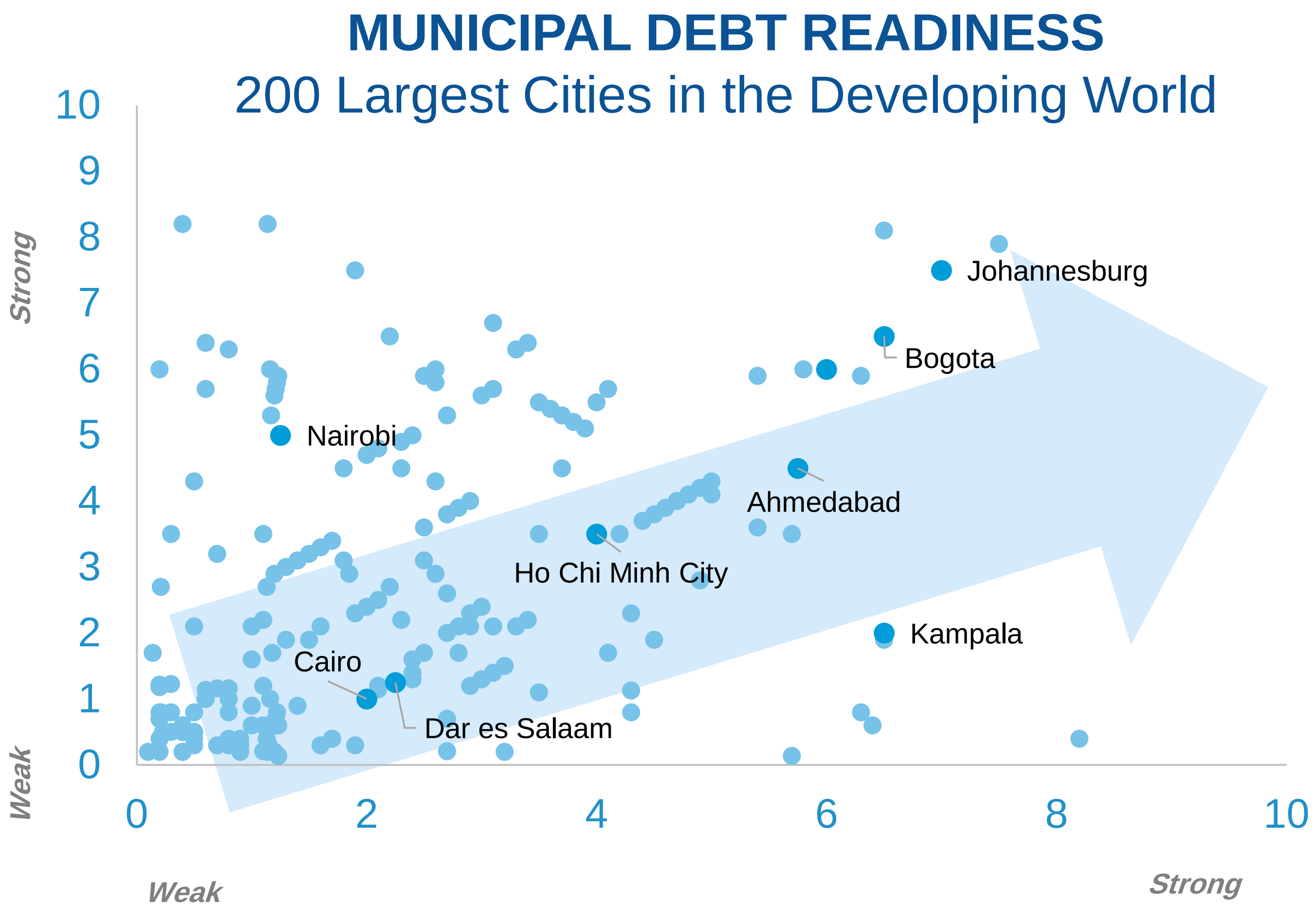
Addressing the Challenge



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

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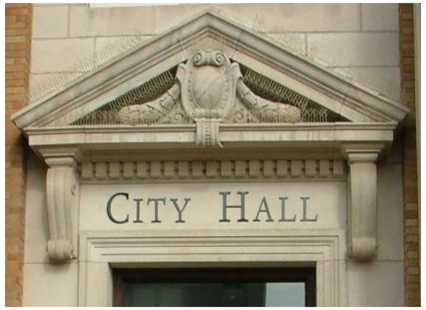
Addressing the Challenge (Cont.)



- **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

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Discussion