An international perspective on municipal borrowing

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within the Scope of the Conference "Urban Investment Partnership Conference"

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Preamble

I am an **independent** consultant and I have been invited to South Africa by the National Treasury, the Development Bank of Southern Africa and the Department of Cooperative Governance of the Republic of South Africa.

I am **not** an official representative of GIZ or any other German Government organisation.

The findings, interpretations, and conclusions expressed in this presentations are entirely my **own,** based on my **academic** experiences. They do not necessarily represent the view of the GIZ or any other German government organisation.

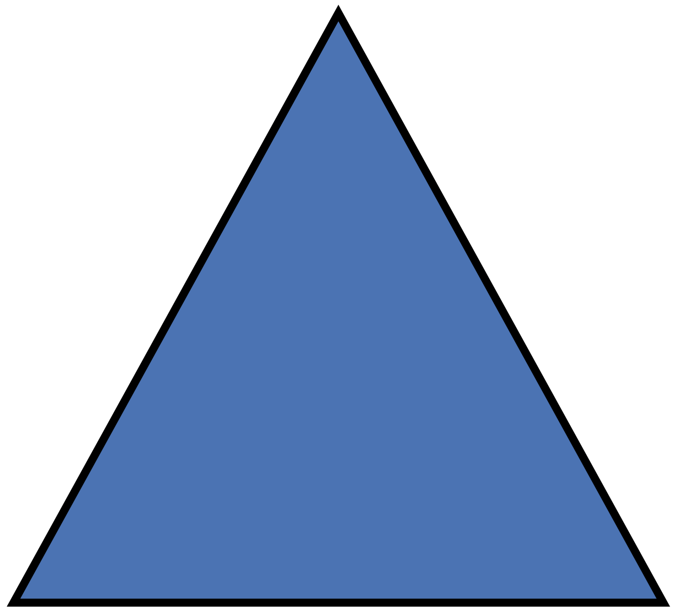
Structure

1. Introduction
2. Municipal borrowing in Hungary
3. Infrastructure financing in Slovakia
4. UK guarantees scheme for infrastructure
5. Conclusion

Introduction

The three basic elements of public finance are

Expenditures



Revenues **Debt**

Introduction

Possible options for the local government borrowing system:

- Severe restriction and generally no independent local borrowing
  - Ethiopia, China (until 2015)
- Pooled municipal government debt in a provincial government agency
  - Canada
- A municipal bond system
  - USA, Mexico, Poland, Czech Republic, Slovakia, Hungary
- Commercial and private bank
  - France, Belgium (Dexia)
- Public “saving banks”
  - Germany

Introduction

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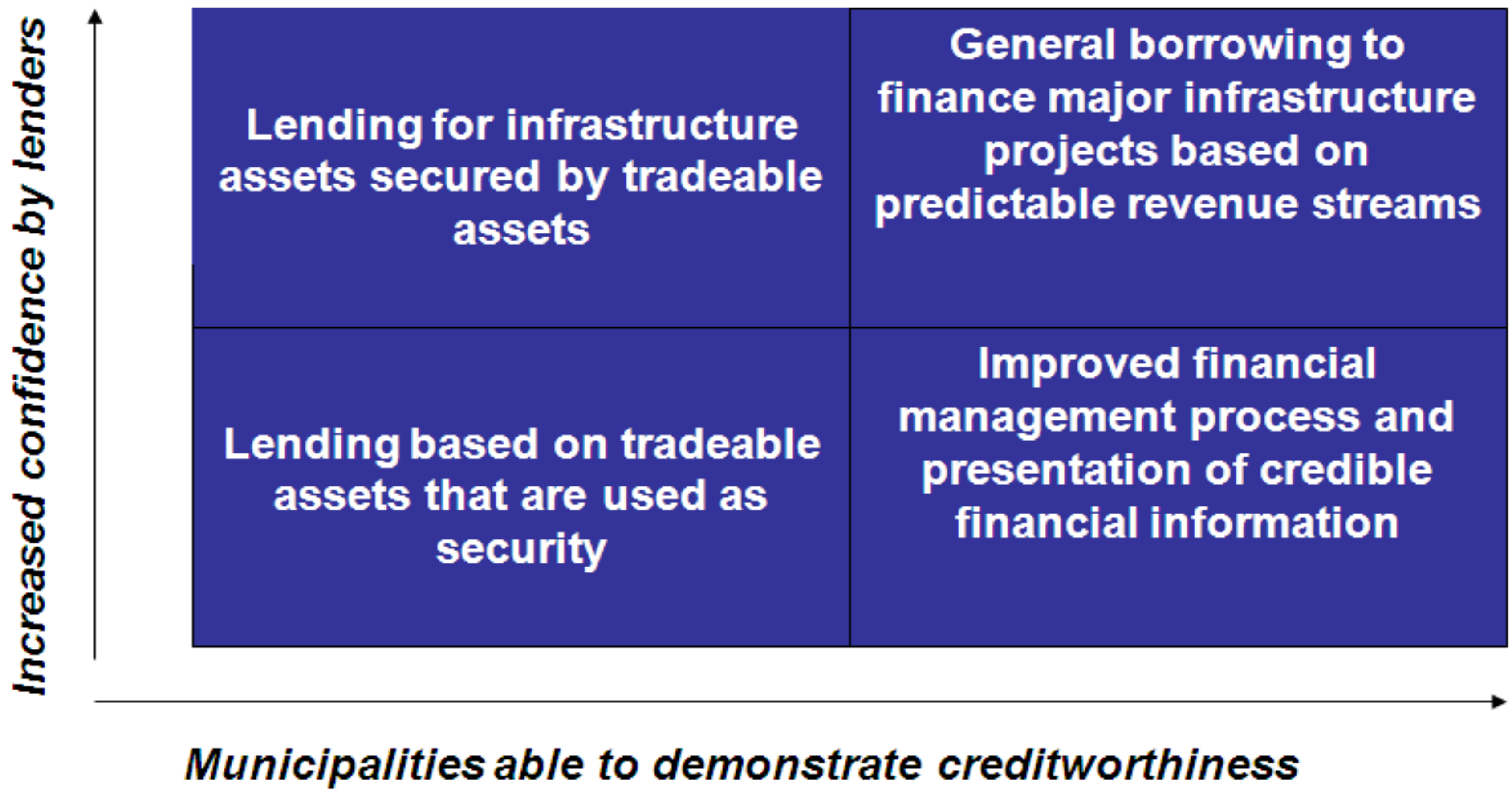
Possible sources of infrastructure financing in metropolitan areas

Own revenues	Generated from taxes, fees, charges, licenses and fines
Public contribution	Generated form cash or donation
Household contribution	Sometimes without any legal framework
Government grants	Special purpose grants
	Block grants
External loans by national finance institute	The use of debt instruments
International donor programmes	In-kind contribution or direct grants
Public –Private – Partnership	Private partners have a profit and not a political incentive

Introduction

Likely scenarios for a municipal lending market to evolve without support



Introduction

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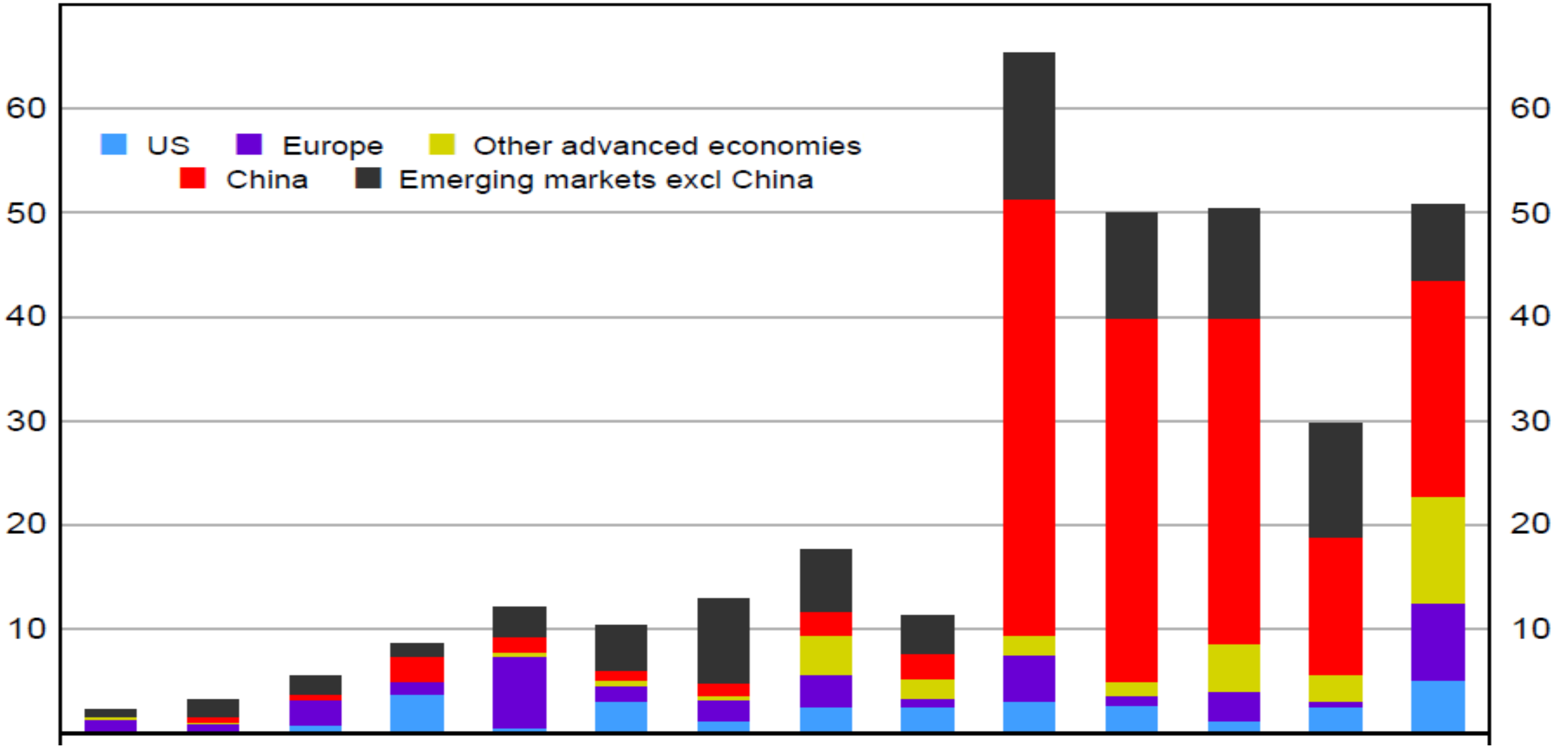
Volume of infrastructure bonds in US-$ billion from 2000 until 2013



Source: Ehlers, Packer and Remolona, 2014

Municipal borrowing in Hungary

- Since 1995 the local bodies in Hungary have financed their infrastructure through **municipal bonds**.
- In addition, Hungary received **€ 25.3 billion** from the European Union ("Cohesion fund") for the time period 2007-2013
  - E.g. more than 400 kms of new road have been built and 1,700 kms of road have been renewed;
  - Direct investment aid provided for more than 32,000 SME projects
  - The Cohesion fund is a **matching grant**
- The majority of the loans and some municipal bonds were issued in foreign currencies such as Swiss franc or €.
  - Since 2008, private households as well local units have been confronted with a huge **devaluation** of the Hungarian Forint

Municipal borrowing in Hungary

On October 27th, 2012 Prime Minister Viktor Orbán announced that the central government would assume the **entire debt portfolio** of 1,956 towns with a population of **less than five thousand** and some of the debt of the towns with a higher population.

In 2014, the government assumed the remaining debt of **all** towns with **more than five thousand inhabitants,** as well.

However, leaving local governments to their **fate** would have resulted in even more serious problems for the Hungarian national economy, leading to the failure of local public services and almost certainly in the end to the total financial collapse of public finances.

Infrastructure financing in Slovakia

PR1BINA project

(PPP Project - R1 Expressway in Slovakia)

Fully operational since 2012, the R1 Expressway runs for 52 km east of Bratislava and bypasses the city of Banska Bytrica.

Infrastructure financing in Slovakia

The initial project preparation started way back in 1993 and in 2008 the Slovakian government signed a **public-private-partnership** contract with Granvia, a consortium of Vinci Concessions (France) and ABN Amro Highway (Netherlands).

The 30-year contract covers **financing**, **design**, **construction**, **operation** and **maintenance** of the 52 km expressway consisting of four separate sections.

The concession company will be remunerated through an annual royalty paid by the grantor.

Infrastructure financing in Slovakia

On November 29th, 2013 the Granvia Consortium, project sponsor of the R1 Expressway in Slovakia, was able to **replace** the original **bank loan** with a € 1.24 billion **bond** issue to refinance outstanding debt on the PPP project.

The R1's bond refinancing was **over-subscribed**, with half the bonds placed with European institutional investors. It is the largest unwrapped, non credit-enhanced issue for a PPP in Europe.

The bond replaced a € 1bn of loans that had been signed in August 2009 by **a club of 13 banks**, including the EBRD and KfW, and in doing so sharply reduced the project's debt costs.

UK guarantees scheme for infrastructure

- The value of lending to new UK infrastructure projects **halved** from £ 6 billion before the financial crisis to £ 3 billion in 2010.
- In October 2012 the Infrastructure Act became law, allowing central government to issue **guarantees** to projects meeting a broad definition of infrastructure.
- Furthermore, the UK Treasury also aims to attract **new sources** of finance into infrastructure projects, such as pension and institutional investors.

UK guarantees scheme for infrastructure

- More **than 200 enquiries** received by the UK Treasury.

- The first **guarantee** was issued in April 2013 and by December 2014 the Treasury had agreed guarantees with a value of £1.7 billion (excluding interest) to 7 projects (and 1 standby facility), with 39 more projects pre-qualified for a guarantee.

- The scheme has a limit of £40 billion in guaranteed lending (excluding interest) and is currently due to close in December 2016. The following table summarizes all guarantees issued by the "scheme"

UK guarantees scheme for infrastructure

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Infrastructure supported under the Scheme

Project name	Description	Region	Date agreed	Finance supported by HM Treasury: Amount (£m)	Type	Final repayment date (duration of exposure)
Deals covered in our review						
1 Drax	Partial conversion of a coal fired power station to Biomass	North Yorkshire	April 2013	75	Guaranteed loan notes	2018 (4.5 years)
2 SDCL EE	Installation of energy saving lighting in 150 car parks	Nationwide	December 2013	9	Guaranteed loan notes	2017 (4 years)
3 Northern Line Extension	Extending the Northern Line to Battersea and Nine Elms as part of a regeneration project	London	November 2013	750	Standby refinancing facility (not a guarantee)	n/a[1] (see note)
4 Mersey Gateway	Construction of a new toll bridge over the river Mersey	North West	March 2014	257	Guaranteed bond	2043 (29 years)
5 INEOS Grangemouth	Construction of an ethane import and storage facility	Scotland	August 2014	228	Guaranteed bond	2019 (5 years)
Deals outside the scope of this review						
6 Speyside	Construction of a biomass power station in Moray Firth	Scotland	August 2014	48	Guaranteed bond	2028 (14 years)
7 University of Northampton	Relocation of university to new site	Midlands	November 2014	292	Guaranteed bond and loans	2058 (44 years)
8 Countesswells	Building of new housing in Aberdeen	Scotland	August 2014 (approved but not signed)	80	Guaranteed loan	
Total				**1,739**		

Conclusion

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- A lack of public funds for local infrastructure is always a sign of an unsound local public finance system in a country
  - Increase local **tax autonomy** and the **grants** from the center
- Limit and control the local debt
  - **No unlimited municipal bonds** or PPP and no borrowing in foreign currency, even if the credit costs are significantly lower
- If the risk of an infrastructure project is reduced or eliminated — by a highway that's operational, — it becomes much easier to attract professionally managed finance. Therefore use a **bridge financing,** e.g. a **syndicated loan** or a **central government guarantee.**

Annex:
Tamil Nadu Urban Development Fund in India

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The Tamil Nadu Urban Development Fund (TNUDF) was established in **1996** and is mainly financed by the regional government of Tamil Nadu as well as the **World Bank**.

The fund manager of the TNUDF is Tamil Nadu Urban Infrastructure Financial Services Limited (TNUIFSL). The regional government holds 49 % shares of the TNUIFSL and remaining 51 % shares belongs to three national banks. The daily management responsibility of this fund belongs to the ICICI Bank, which holds with 21 % the biggest share of all three Indian banks.

Annex:
Tamil Nadu Urban Development Fund in India

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Eligible Borrowers

- Urban **local bodies**
- Any **private institution,** who creates urban infrastructures.

Moreover, the TNUDF uses - besides **capacity building** – also the concept of "polled financing" for the infrastructure financing.

The idea of "**polled financing**" means that several projects are pooled and lumped together in a bond issuance and this can provide a significantly reducing transaction costs and improving pricing. Especially for smaller and less creditworthy local authorities is this concept reasonable.

Annex:
Land value capture in Germany

- Land value capture in Germany is **a local fee**, which is divided into technical development costs and traffic-related development costs.

- Technical development costs are costs incurred for the connection of land to supply and disposal networks. This includes **electricity**, **gas**, **public water supply** and **sewage** connection.

- Traffic-related development costs are costs for **roads**, **sidewalks** and **lighting**, public **parks**, children's **playgrounds**, **noise** protection walls, **telephone** and cable **television** network.

Annex:
Land value capture in Germany

- A **building permit** will only be granted if the development costs for the property are secured or even paid.

- Private landowners pay a maximum of **90 %** of the development costs and the remaining **10 %** are covered by the municipality.

- Development costs are distributed between private landowners on the basis of
    1. the nature and **extent of building / numbers of the floor**, e.g. for a noise protection wall
    2. the **size of the land**, e.g. for a local road
    3. the **land width**, e.g. for a sidewalk

Annex:
the financing model for highways in Austria

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- In Austria, ASFINAG, which is a privately organised enterprise owned by the central government, funds approximately 2,200 km of highways.
- The enterprise received a so-called “usufruct right” providing it powers to charge **user fees for highways** for 50 years since 1997.
- ASFINAG is responsible for the expansion of new highways as well as **maintain** the existing road network.
- ASFINAG issues bonds to raise capital which are backed by a **guarantee** by the Republic of Austria.