

# IADF BULLETIN



## *FINANCING LOCAL GOVERNMENT*

Volume 2, Issue 2

February/March, 2005

### **International Association of Development Funds**

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### **IADF Database: A Marketing Opportunity** by Steve Thomas, Executive Director, IADF

One of the important activities of the IADF is its Municipal Development Fund Database. This database covers substantial information on the operations of a large number of specialized municipal lending institutions.

If your local government finance institution is not among those in our database, please take the time to fill out one of our information request forms so that we may include your institution. The IADF Fund Database is a unique, comprehensive way to benchmark your institution against others. . **Information Request Forms** are available on our website.

Please send any information to [stthomas@developmentfunds.org](mailto:stthomas@developmentfunds.org). Many thanks and we look forward to hearing from you soon.

Steven G. Thomas  
Executive Director  
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**Further information on the IADF can be obtained from our newly redesigned website: [www.developmentfunds.org](http://www.developmentfunds.org). Submissions can be sent to [info@developmentfunds.org](mailto:info@developmentfunds.org).**

### **NEWS DESK**

Compiled by: Sophie Guiny

#### **Armenia: World Bank Supports Improvement of Water and Wastewater Services in Yerevan**

World Bank, February 24, 2005  
[www.worldbank.org](http://www.worldbank.org)

The World Bank's Board approved an International Development Association (IDA) credit of US\$20 million for the Yerevan Water and Wastewater Project (YWWP). The credit will assist the Armenian Government in its efforts to improve Yerevan's water and wastewater system by continuing and expanding accomplishments achieved under a previous IDA-financed Municipal Development Project (MDP).

The YWWP will help provide Yerevan with safe, continuous water supply while reducing environmental pollution. This is the third IDA-financed water and wastewater project in Armenia. The World Bank also financed the initial Municipal Development Project to support Yerevan's Water and Sanitation Company (YWSC) and a more recent (FY04) Municipal Water and Wastewater Project for Armenia's medium and small-sized cities.

The Project benefits directly from Yerevan's successful experience with a management contractor recruited under the MDP. For the YWWP, Government will increase private sector involvement and competitively recruit an operator for YWSC under a lease contract. The Project will finance investments in YWSC during the first five years of the lease.

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The Project has two components: a YWWP Fund and Technical Assistance. The YWWP Fund will finance investments undertaken by the water utility operator during implementation, which will yield energy savings, improved reliability of supply, and reduction of environmental pollution. The Technical Assistance component will fund interim operational management of YWSC, project financial and technical audits, and incremental operating expenses.

The Credit will be made to Armenia on standard IDA terms, including 40 years maturity and a 10-year grace period. Since joining the World Bank in 1992 and IDA in 1993, the commitments to Armenia total approximately US\$ 860 million for 38 operations.

### **Russian Federation: World Bank Supports Municipal Development of the City of Kazan**

World Bank, February 24, 2005  
[www.worldbank.org](http://www.worldbank.org)

The World Bank's Board of Executive Directors approved a US\$125 million Kazan Municipal Development Loan to the Russian Federation. The operation aims to support the city of Kazan in achieving financial sustainability, improving municipal asset management, and strengthening social protection and the provision of housing and communal services. It will facilitate the gradual phasing out of special provisions for Tatarstan during 2005-2007 and assist Kazan in adapting to the changes in relations between the federal center, Tatarstan, and the city.

Tatarstan is entering the final stage of a long process of normalization of its relationship with the federal center. Its capital and largest city, Kazan, with population of 1.1 million people, is the seventh largest city in Russia. The city of Kazan acquired the legal status of a municipality in September 2004. The project will enable the city's efficient financial and economic transition to a full-fledged municipality, in the context of Tatarstan's integration into Russia's fiscal management arrangements.

The operation will support Kazan in its efforts to accelerate the implementation of the comprehensive "Kazan Development Strategy Up to the Year 2015" approved in 2003. Expected outcomes: include improvements in the city's overall fiscal situation and asset management; more efficient provision of housing, utility, and social services to the population through better targeting of social assistance; greater transparency and accountability; and enhanced attractiveness of the municipality as a center for investment, higher education, and tourism.

The city of Kazan has already undertaken reforms in several key areas by:

- Improving municipal financial management through better financial planning, treasury control, gradual phasing out of overdue payables, better public procurement practices, and better management of municipal assets;
- Targeting of social protection measures through the monetization of in-kind benefits and concentration of subsidies to reach vulnerable groups; and
- Strengthening housing and utilities management through the elimination of budget subsidies to enterprises in district heating, the privatization of housing maintenance services, and entering into a management contract with a competitively selected private company to run the water supply facility.

The project is designed as a two-tranche development policy operation. The first tranche in the amount of US\$ 50 million is planned to be disbursed upon loan effectiveness later in 2005. The

second tranche in the amount of US\$ 75 million could be disbursed following IBRD's review and determination that policy actions pertaining to the second tranche release have been undertaken and are satisfactory. This is notionally planned for early 2006.

The loan is a Variable Spread Single Currency Loan with a five-year grace period and 17 year maturity. The loan will be made to the Russian Federation and then passed on as a grant to Kazan. The Russian Federation joined the World Bank in 1992. Since then, commitments to the country total to more than US\$13 billion for 59 operations.

### **IDB approves \$19,860,000 loan for community investments in Panama Canal watershed**

Inter American Development Bank  
[www.iadb.org](http://www.iadb.org), February 4, 2005

The Inter-American Development Bank today announced the approval of a \$19,860,000 loan to Panama for a project to finance priority investments in local communities and key activities for an integrated management of the Panama Canal Watershed. The project, which will be executed by the Ministry of the Presidency with assistance from the Executive Secretariat of the National Council for Sustainable Development and the Panama Canal Authority (ACP), has a total cost of \$35 million. The project will promote gradual development in the 5,528-square kilometer watershed, based on the sustainable use of its natural resources and with a high degree of participation of the local communities and agencies involved in various sectors. Investments will be focused in the watershed's 2,131-square kilometer western region, home to approximately 36 thousand people living in 500 small settlements with high levels of poverty and little access to basic services. The project's resources will finance activities identified in the watershed's development strategy, which was supported by a grant from the IDB-administered Japan Special Fund. The project will also bolster the dialogue between the national government and the communities through the 31 local committees established in the watershed.

Responding to problems voiced by the communities, the activities eligible for financing were grouped in four areas:

- Property registry and titling in the western region of the watershed.
- Rehabilitation and expansion of the hydro-meteorological and water quality network.
- Development of complementary watershed management tools to improve monitoring.
- Establishment of short- and medium-term mechanisms to finance community projects.

An investment fund will be established during the first year of project execution with \$10 million in seed capital from the ACP . The fund may also receive resources from other donors to continue financing community projects in the watershed.

The project reflects lessons learned from previous programs supported by the IDB and other donors in Panama, as well as the experiences of the Panamanian Social Investment Fund, the Interagency Commission of the Panama Canal Watershed and the non-profit Fundación NATURA, all of which emphasized community participation and extensive consultations with stakeholders. Under the project's execution structure, the communities will play a leading role in shaping annual action plans through the local committees.

Panama will contribute a total \$15,140,000 in counterpart resources to the project. The IDB loan is for 20 years, with a 5 ½-year grace period and a variable interest rate.

## **Updated Ratings And Default Study For International Local And Regional Governments 2004**

Standard and Poor's

[www.standardandpoors.com](http://www.standardandpoors.com), February 15, 2005

Standard & Poor's Ratings services has updated its study on the performance of long-term issuer credit ratings on local and regional governments (LRGs) outside the U.S. The underlying data covers more than 300 LRGs rated either on a public or confidential local currency basis by Standard & Poor's from Jan. 1, 1975 to Dec. 31, 2004. The data supports the following conclusions:

Higher rating categories are associated with lower levels of default; higher rating categories generally correlate with higher degrees of stability; the probability of a rating change increases over time; and LRG ratings are more stable than corporate ratings.

For local currency ratings in the public domain, creditworthiness improved slightly in 2004, with upgrades exceeding downgrades by 17 to 16. (These figures do not include foreign currency or national scale ratings.) Among European LRGs, there were five upgrades in Central and Eastern Europe (CEE), compared with three in Western Europe. Canada saw the most upgrades of any country (five), while there were three upgrades in Australia and New Zealand, and one in Latin America. In contrast, the 16 downgrades all took place in Western Europe, the majority of which were prompted by the downgrade of the Republic of Italy to 'AA-' from 'AA', lowering the credit ceiling for Italian LRGs.

The outlook for Western Europe is marginally more promising for 2005, reflected in there being six positive outlooks versus five negative outlooks. CEE countries, however, have six positive outlooks versus no negative ones. LRGs in Australia and New Zealand, meanwhile have 18 of 19 on stable outlook. Of 48 Canadian LRGs, six are on positive outlook, although the deficits of certain larger provinces are likely to increase. Mexican LRGs will face similar challenges to previous years, but Standard & Poor's believes their overall credit quality will remain stable.

For complete lists of Standard & Poor's LRG ratings, see link: <http://www2.standardandpoors.com/servlet/Satellite?pagename=sp/Page/FixedIncomeNewsAnalysisPg&r=1&b=2&f=&s=&ig=&i=&l=EN&fr=1&fs=&fig=&ft=4>

## **EBRD and EU support Krakow Public Transport**

European Bank of Reconstruction and Development (EBRD)

[www.ebrd.org](http://www.ebrd.org), February 10, 2005

In one of the first projects in Poland planned to be co-financed with EU Structural Funds the EBRD is lender of record for a loan to the Krakow public transport company MPK for PLN110 million (€25 million equivalent). The loan will finance the acquisition of new trams and infrastructure improvements.

Miejskie Przedsiębiorstwo Komunikacyjne S.A. (MPK) is the city's sole public transport operator, with a network of 119 bus and 23 tram routes and some 314 million passengers in 2003. With assistance mobilized by the EBRD, the company is now undergoing modernization. A new public sector contract will define the rights and obligations of the City of Krakow and MPK, set objective targets and introduce a transparent remuneration system to ensure a stable commercial framework for the company. The separation of regulatory, operations and infrastructure management will help to maintain service quality, while increasing efficiency and reducing operating costs, said Thomas Maier, EBRD Director of Municipal and Environmental Infrastructure. The selection of a private bus operator to run part of the bus services, planned for a tender during 2005, will foster competition. A priority for MPK is the modernization of its rolling stock. The company's 426 trams have an average age of 22 years, and its buses are on average 7.7 years old. The acquisition of 24 new low

floor trams with EU and EBRD funds will represent significant improvement as will the renewal of infrastructure.

## **EUR26.5 million for modernization of Dubrovnik port - EBRD loan finances extension of key Croatian harbor**

European Bank of Reconstruction and Development (EBRD)

[www.ebrd.org](http://www.ebrd.org), February 1, 2005

As more and more cruise passengers flock to Dubrovnik, a €26.5 million EBRD loan aims to help modernize Gruz Harbor to meet the growing demand.

The loan is part of a plan by the Dubrovnik Port Authority to upgrade its facilities. Basic infrastructure will be modernized, including expansion of berth capacity to accommodate as many as three of the new generation of 300-metre cruise ships at one time. EBRD First Vice President Noreen Doyle, speaking at a signing ceremony in the city, said the project will allow Dubrovnik to burnish its already enviable position as one of the most popular destinations in the Mediterranean tourism market.

The Bank's investment in this public infrastructure will help create attractive business conditions for subsequent private-sector participation in the port's development, Ms Doyle added. The second phase of the development will involve construction of all the facilities a modern passenger port should have, such as a passenger terminal, parking spaces for cars, leisure and entertainment facilities and a shopping centre..

The EBRD support has also led to the mobilization of grants from the UK, US, Spanish, Dutch and Italian governments to pay for consultancy assistance for different stages in the development's preparation.

## **EUR issue by Nederlandse Waterschapsbank N.V. (NWB)**

Nederlandse Waterschapsbank

[www.nwb.nl](http://www.nwb.nl), February 14, 2005

Nederlandse Waterschapsbank (NWB) has placed an EUR 250 million issue. The joint-lead managers are Barclays Bank PLC and Rabobank International. NWB is an AAA/Aaa rated public sector bank.

The bond, which was issued under the EUR 25 billion EMTN programme, will be repaid in full on 17 February 2020. The settlement date is 17 February 2005.

The coupon is 3.875% and the issue price is 99.086%. The bonds will be listed on Euronext Amsterdam.

## **USD issue by Nederlandse Waterschapsbank N.V. (NWB)**

Nederlandse Waterschapsbank

[www.nwb.nl](http://www.nwb.nl), January 17, 2005

Nederlandse Waterschapsbank (NWB) has placed an USD 500 million issue. The joint-lead managers are Barclays Capital and RBC Capital Markets. NWB is an AAA/Aaa rated public sector bank.

The bond, which was issued under the EUR 25 billion EMTN program, will be repaid in full on 30 September 2009. The settlement date is 21 January 2005.

The coupon is 3.875% and the issue price is 101.060%. The bonds will be listed on Euronext Amsterdam.

## **Several bond issues and raises for BNG**

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Bank Nederlandse Gemeenten (BNG)  
www.bng.nl, February 2005

BNG, the Dutch Public Sector Agency, rated AAA/Aaa/AAA, has increased by USD 250 million the USD 1 billion 2.375%, due September 15, 2008 issue, originally issued on June 24, 2003. This fifth increase brings the total outstanding amount to USD 2.75 billion.

This new tranche has an issue and a re-offer price of 96.539%. Based on this re-offer price, the yield is 3.417%. Settlement date is February 18, 2005, plus 153 days accrued interest. This tranche will be fungible with the original issue 40 days after settlement. The issue will be listed in Amsterdam. Lead manager is Credit Suisse First Boston.

BNG has also launched a CHF 200 million issue.

Due March 17, 2014, the deal has a coupon of 2.250% and the issue price is 100.785%. The yield is 2.153%. Settlement date is March 17, 2005. The issue will be listed in Switzerland and Amsterdam. Lead manager is ABN AMRO, a syndicate has been formed

BNG has increased by AUD 50 million the AUD 100 million 5.00%, July 16, 2010 issue, originally launched on July 16, 2003. This sixth increase brings the total outstanding amount to AUD 450 million.

This new tranche has an issue price of 98.241% and a re-offer price of 96.616%. Based on this re-offer price, the yield is 5.735%. Settlement date is February 9, 2005, plus 208 days accrued interest. This tranche will be fungible with the original issue 40 days after settlement. The issue will be listed in Amsterdam. Lead manager is RBC, a syndicate had been formed.

BNG has increased by EUR 250 Million the EUR 1 Billion with a coupon that is based on the French TEC10 (Taux de l'Échéance Constante à 10 ans) as published daily by the Agence France Tresor minus 100 Bps, July 25, 2020 issue, originally launched on October 25, 2004. This first increase brings the total outstanding amount to EUR 1.25 Billion. This new tranche has an issue and re-offer price of 97.16%. Settlement date is January 31, 2005, plus 6 days accrued interest. This tranche will be fungible with the original issue 40 days after settlement. The issue will be listed in Luxembourg. Lead manager is Calyon

BNG has launched a USD 1.5 billion issue. Due March 30, 2010, the deal has a coupon of 4.00% and the issue price is 99.753%. The yield is 4.056%. Settlement date is January 26, 2005. The issue will be listed in Amsterdam. Lead managers are Citigroup, Dresdner KW and Morgan Stanley, a syndicate has been formed.

#### **Kommunalbanken increases share capital**

www.kommunalbanken.no, January 2005

In order to sustain growth, Kommunalbanken is to receive an increase in Share Capital from its owners - The Kingdom of Norway (80%) and KLP, the Norwegian Local Government Pension Fund (20%).

The increase amounts to NOK21.5mm (USD 3.45 million); shares have been subscribed and will be paid in with value 31 Jan 2005.

#### **DBSA lends support for challenges of development in the Western Cape**

South Africa – DBSA  
www.dbsa.org, February 2005

Cape Town – The Development Bank of Southern Africa (DBSA) has committed itself to assisting and supporting the Western Cape province and Unicity, in the targeted reduction of housing backlogs and related infrastructure services. According to the DBSA, this represents an accelerated thrust towards providing sustainable solutions to the province's problem of informal settlements.

Currently, it is estimated that the Western Cape has a backlog of more than 200 000 housing units, more than half of which pertains to the Cape Metropolitan area alone. It is estimated that approximately R10-billion is needed to offset the province's backlogs. The province's housing and related infrastructure challenges have been highlighted by the shack fires which have in recent times, affected thousands of people in informal settlements.

DBSA CE and MD Mandla Gantsho says the DBSA has earmarked R1-million in grant aid to be used in the provision of immediate emergency relief to the residents of Joe Slovo informal settlement at Langa near Cape Town, where more than 3 000 dwellings were recently razed by fires and about 12 000 people left destitute. This will be used to buy blankets, tents and to provide any additional logistical support in dealing with the tragedy.

“It is our view that solutions to tragedies of this nature should not focus on short term solutions only. The essence of building sustainable solutions lies in our ability to learn from our experience”.

“As such, the Bank has pledged an additional R10 million in concessionary funding for medium term assistance to the Unicity and Province to develop and implement a transitional resettlement plan for those affected”, says Loyiso Pityana, DBSA Regional Manager for the Northern and Western Cape.

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### **SPOTLIGHT: Michigan’s Clean Water State Revolving Fund (CWSRF) and Drinking Water Revolving Fund (DWRF)**

[[http://www.michigan.gov/deq/0,1607,7-135-3307\\_3515\\_4143---.00.html](http://www.michigan.gov/deq/0,1607,7-135-3307_3515_4143---.00.html) and  
[http://www.michigan.gov/deq/0,1607,7-135-3307\\_3515\\_3517---.00.html](http://www.michigan.gov/deq/0,1607,7-135-3307_3515_3517---.00.html)]

**By Sophie Guiny**

Location	Lansing, Michigan
Legal Status	Revolving fund
Date founded	CWSRF: 1988 DWRF: 1997
Main Sectors of Lending	Municipalities, water suppliers (public and private)
Credit rating	AAA/Aaa (Series 2004 Issue)
Total funds lent	CWSRF: \$ 2.09 billion DWRF: \$333.6 million
Directors	Chip Heckathorn, MDEQ Thomas Letavis, MMBA
Staff	22 (MDEQ) 4 (MMBA)

### **Background**

Michigan's Clean Water State Revolving Fund (CWSRF) was established in 1988 under the provisions of the 1987 amendments to the federal Clean Water Act. The Drinking Water Revolving Fund (DWRF) was established in 1997, under the provisions of the 1996 amendments to the federal Safe Drinking Water Act. Both funds are co-administered by the Michigan Department of Environmental Quality (MDEQ) and the Michigan Municipal Bond Authority (MMBA).

### **Objectives**

The purpose of the DWRF is to ensure that all Michigan water suppliers comply with the requirements of the Safe Water Drinking Act. Disadvantaged communities are a specific target group of the DWRF and can also benefit from technical assistance in addition to the loans. The CWSRF provides low interest loans to communities for water pollution control projects, specifically for the construction, upgrade or expansion of publicly owned wastewater treatment facilities or the construction of non-point source pollution control projects.

### **Eligibility**

#### *CWSRF*

The Clean Water State Revolving Fund (CWSRF) provides loans to cities, counties, townships, villages, Native American Tribes and other public bodies authorized under state law. Projects eligible for a SRF loan are construction activities on public wastewater facilities such as treatment plants, collection sewers, retention basins, infiltration removal, etc. New municipal wastewater systems are also eligible for SRF loans, provided they are needed for public health reasons. Storm water treatment facilities and non-point source control projects are also SRF-eligible. A companion fund, the Strategic Water Quality Initiatives Funds (SWQIF) targets two specific types of private sector projects. The first type is aimed at reducing the amount of groundwater or storm water entering sanitary or combined sewer leads. The second type is for upgrades or replacements of failing on-site disposal systems which create a risk to public health or the environment.

Communities applying for CWSRF loans are required to submit a CWSRF project plan, composed of 6 parts:

- project background: need for a project, description of the existing system, population served
- analysis of alternatives
- selected alternative: detailed description of the selected project, including cost estimate
- environmental impacts, both direct and indirect mitigation of impacts
- public participation: a public hearing on the project is required by the CWSRF, and a public meeting is recommended

Local borrowers are required to have an investment grade credit rating or make other arrangements with the Michigan Municipal Bond Authority.

#### *DWRF*

The Drinking Water Revolving Fund (DWRF) can finance the construction of both publicly owned and privately owned water systems. To qualify for a DWRF loan, a project must target the renovation of waterworks, including wells, intake structures and cribs, pumping stations, treatment plants, storage tanks, pipelines and appurtenances, and security systems. Projects intended to primarily serve growth or provide fire protection are not eligible for DWRF loans. New water systems are eligible only if the current situation poses a serious risk to public health.

Activities that can be financed through the DWRF include project planning, engineering, legal and financial services, acquisition of land

if necessary to complete the waterworks project, construction costs, bid contracts and even reasonable administration costs.

Water suppliers are required to submit a DWRF Project Plan to demonstrate their eligibility. This plan is composed of six parts, following the same procedure as CWSRF loans.

### **Structure and Operation**

#### *CWSRF*

For the fiscal year 2005, the interest rate was set at 1-5/8%. The CWSRF works with a leveraged financial structure. It sells tax-exempt revenue bonds to reimburse municipalities for the cost of their wastewater projects. Coverage for the leveraged revenue bonds is ensured by a debt service reserve account, financed by federal grants and matching state funds. Funds are deposited into a Bond Reserve Fund - and the income earned from the investment of that fund covers the difference between the low rate provided to the local borrower and the rate paid by the state on the leveraged revenue bonds the state sells. Currently, the Fund lends at a 1.625% rate and pays approximately 5% on the leveraged bond, the coverage ratio would be 67.5%, which corresponds to leveraging the fund at a rate of 1.5 to 1. "Recycled" funds, coming from loan repayments and released accounts, are also used as leverage for the bonds.

Projects are financed by the CWSRF according to their ranking on Project Priority List (PPL). The PPL is established based on six criteria, which award points to the projects:

- water pollution severity
- enforcement: points are awarded if the project is necessary to comply a legal or judiciary requirement
- population
- ratio of wastewater discharge volume to receiving water flow
- failing on-site sewage disposal systems
- septage facilities

SWQIF (water quality) projects have their own criteria:

- expected improvement of water quality
- enforcement
- dilution ratio

#### *DWRF*

The DWRF operates with a financial structure similar to the CWSRF. The DWRF sells tax-exempt revenue bonds to reimburse municipalities for the cost of their waterworks projects. Coverage for the leveraged revenue bonds is ensured by a debt service reserve account, financed by federal grants and matching state funds. In the case of private water suppliers, the DWRF funds those suppliers through direct loans or through a partnership with a private lending institution.

The interest rate on DWRF loans is determined before each fiscal year, based on demand, market conditions, program costs and future needs. The DWRF interest rate is set below the market rate. For the fiscal year 2005, it was set at 2.125% for municipalities. Private water suppliers would receive an interest rate subsidy of the same amount.

The use of funds in the DWRF is determined on a yearly basis in the Intended Use Plan (IUP). Based on this IUP, projects are then financed according to their priority ranking on the Project Priority List (PPL). The PPL points are awarded based on a combination of criteria:

- drinking water system compliance
- infrastructure improvement (treatment, distribution and storage facilities)
- population served by the water supplier
- consolidation.

Special bonuses are given to project falling under the Wellhead Protection Plan or the Source Water Protection Plan. Disadvantaged communities also enjoy a preferential treatment, through additional priority points and extended loan terms.

Separate planning loans are also available to communities serving less than 10,000 persons.

## **Programs**

### *Source Water Assessment*

The 1996 federal Safe Drinking Water Act requires every state to submit a Source Water Assessment Program (SWAP). The Michigan SWAP identifies the different areas supplying drinking water and assesses their possibility of contamination, in order to inform the public.

### *Michigan Wellhead Protection Program*

The MDEQ also manages Wellhead Protection Grants. Between 1998 and 2003, almost \$7 million have been awarded to 435 communities under this program.

### *Technical assistance for small communities*

Federal DWRP appropriations also offer technical assistance to municipalities and non-community water suppliers serving less than 10,000 inhabitants. This program includes among other things special monitoring for arsenic.

### **Example of a DWRP project: City of Grand Blanc**

The city of Grand Blanc, near Flint, completed a \$4.4 million project in early 2004, financed by the Michigan DWRP, to improve its drinking water filtration plant. The city's raw water supply, drawn from the groundwater through 4 wells, has an average Arsenic concentration of 49 parts per billion (ppb) and its water treatment plant was unable to comply with the new Arsenic standard of 10 ppb set to take effect in 2006. The loan covered the planning, design and construction of an upgraded treatment facility that removed Arsenic using a membrane technology, and also provided enhanced softening to deal with high chloride levels and hardness. The city's water system serves a population of 8, 242. Compared to the option of open market financing, the low interest rate of the DWRP loan resulted in substantial savings to the city and its rate payers, which insured the long term adequacy, safety and reliability of its water system.

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## **INTERVIEW**

### **Chip Heckathorn, Chief, Revolving Loan and Operator Certification Section, Michigan Department of Environmental Quality**

By Shireen El-Wahab

IADF: When and how did you first become involved with the Funds?

CH: I joined the Department of Natural Resources in 1977 and initially worked with the Construction Grants Program, which was really the predecessor of these funds.

IADF: What have been the biggest challenges the DWRP and CWSRF have faced?

CH: They are really two-fold; firstly there is the challenge of getting accurate information into the hands of the people who need it- the owners of the systems and those consulting firms who do work for those systems, so they can make an informed decision about using these programs. Secondly, and currently, the Funds are faced with the problem of countering fiscal realities, that being declining federal appropriations and a state budget having difficulties providing required state match resources.

IADF: Why were these funds set up? What models were considered?

CH: The first impetus was the federal intention to get out of the grant business. The fed has and continues to want to get out of funding local water quality/public health improvement projects and free demands on the Federal budget, and therefore the revolving fund was initiated. The Federal government has always intended to capitalize these funds up to a certain point, and then stop. They had primarily authorized capitalization for the CWSRF from 1988 until 1995. Thereafter they have continued to fund that and the current Bush administration predicts that they will capitalize the CWSRF until 2011, and the DWF until 2018; those are the current horizons dictated by the desire to get annual lending capacity of the funds, nationally, up to a certain level - regarding the CWSRF this is \$3.5 billion/year and then be able to maintain this level. The first fund was the CWSRF. Following its success the DWRP was created, though this had to wait for the Safe Drinking Water Act to authorize its creation, which occurred in 1995.

IADF: Could you tell us a bit about the people who work on the Funds?

CH: Michigan Department of Environmental Quality (MDEQ) staff consists of environmental specialists (planners, geographers and resource specialists) that concentrate on the environmental impacts of proposed projects and engineering staff (sanitary engineers) that deal with the technical issues of permitting and constructing facilities. Michigan Municipal Bond Authority (MMBA) staff are financial experts that deal with the financial/bonding and legal issues involving the purchase of municipal debt. Total staffing is 26.

IADF: How do the two funds relate to each other?

CH: They are structurally almost identical and contain provisions that allow for cross collateralization. We are permitted by the Federal legislation to pledge assets of one fund to support financial activity in the other - but we have not done that to date.

IADF: You say that the funds target disadvantaged communities – who and how do they decide on this criteria, and also on the ratings of projects?

CH: In the DWRP there are specific provisions that provide additional assistance to disadvantaged communities, not just through provisions of the loan program. The DWRP houses programs besides the loan program. The Safe Drinking Water Act allows states to “set-aside” funding in the Drinking Water Program outside the loan process, for initiatives like Technical Assistance and Capacity Development and use these funds to assist public water suppliers, particularly small system owners. Three things specifically apply to disadvantaged communities in the loan program: priority ranking for funding is given to qualifying communities, they are given the option of extending their loan repayment to thirty years, whereas normally it is 20, and planning costs are forgiven. These advantages specifically apply to the Drinking Water program, not to Waste Water, though there are efforts in the Fed to adopt similar provisions in that program. The state makes the decision on disadvantaged communities, based on the relative burden of residential water bills as a percentage of median household incomes.

IADF: Is there any monitoring once loans have been given by you?

CH: We do inspect the projects during construction, but once the facilities are in operation system owners/operators must monitor the systems in a rigid fashion and provide regular submissions regarding facility performance to the state.

IADF: Have you ever had any defaults?

CH: To date we have had no defaults. The leveraged structure of the programs necessitates we minimize our risks- and requiring potential borrowers to demonstrate investment grade credit ratings as a condition of receiving assistance has to date ensured no defaults.

IADF: How many applications received per year- ratio of acceptance?

CH: In seven years of completed work (FY 1998- FY 2004), the Drinking Water Fund has completed 111 loans. It is difficult to give an exact answer on the number of applications received, but in five out of those seven years there was more money available than applicants. Lending capacity that is not used in a fiscal year is not lost, but rather carried forward to future years. The two years where there were more applications were FY 2000 and FY 2001. To date the vast majority of applications have been funded.

IADF: Why do you think there was a surge of applications in these years?

CH: Rather than a surge of applications it was a case of those projects applying being larger/more expensive.

IADF: What about the Waste Water Fund?

CH: In this case we have completed 16 years of funding, and made 237 loans. In only four of those 16 years did we limit our fundable range. Those not able to access funding in their first year of application often waited and received funds the following year. Those projects not receiving funding at all are rare, and it is often the case that here the community decides not to proceed, either because there is local opposition, such as failure of the board referendum or the applicant decides to proceed with another source of financing.

We are aware of some very large projects waiting in the wings, and also because the Fed proposes to reduce capitalization, and the state's ability to match this funding is stretched by the budget, I suspect at some point in the next 3-4 years we will again see demand for our program exceed our ability to lend

IADF: Do you foresee this as the challenge for the future?

CH: As I said we have known for a long time that our needs will at some point exceed our capacity to lend. There are three things we can do: limit our fundable range, find additional capitalization sources, which is easier said than done, and/or raise our interest rates.

IADF: Who and how do you set the funds' interest rates?

CH: We look at four variables as well as trends: the demand for money, (volume and number of applications), amount of money available, cost of compliance with the program's regulations, and the market interest rate. The demand for money is the most important because we could conceivably lend to all applicants if we raised our interest rates close to market rates, but then there would be no demand. We aim to keep our annual lending capacity at a stable and consistent level so that it is predictable and thus convenient to the construction market, and so we don't want to have to change our interest rates dramatically. At the start of the Fund's life (Waste Water Fund), it was 2%, then it went to 2.5% and now it is 1 and 5/8 %. It is a balancing act to provide the most subsidy while at the same time providing as much in loan assistance as we can things which pull in opposite directions.

IADF: Lastly, do you have any advice to others who are trying to set up similar funds?

CH: I advise them to look at what is out there, at the Federal CWSRF/DWRF models and the specific state nuances that are already in place. This revolving fund model had enjoyed huge amount of success. Those elements that best fit their needs should be selected while those that don't address specific needs should be eliminated.

**SPOTLIGHT:**  
Financiera de Desarrollo Territorial, S.A.  
(FINDETER)  
[www.findeter.gov.co]

By Nina D'Arcangelo

**Quick Facts:**

Location	Bogotá, Colombia
Date Founded	1989
Initial Financing	Government of Colombia, World Bank, IADB
Legal Status	Second-tier lender, State entity operating under the Minister of Hacienda and Public Credit
Duff & Phelps Credit Rating	Long term debt: AAA Short term: DP1+
Employees	180 (approx)
Contracts signed	410 (since 2001)
President	Maria Cristina Lodoño Juan

**History:**

After a period of decentralization in the early 1980s, many local governments gained administrative powers over many services, such as water and sanitation, health and education, and constructing sufficient roads. However, financing these projects proved to be difficult on both the borrowing and the lending ends. As a result, the Urban Development Fund (FFDU) was created in 1975, but soon expanded to Financiera de Desarrollo Territorial in 1989 under Law 57 in order to develop a domestic municipal credit market.

**Mission:**

Findeter's objectives include contributing to the efficiency of development of urban and rural infrastructure and improving the quality of life for Colombian citizens through advising, administering of resources, and financing public projects. It is a leader in infrastructure investment and offers high quality, innovative services and products.

**Responsibilities:**

Among the various functions pertaining to urban/rural infrastructure development listed in Article I of Law 57, established in 1989, are:

- Construction and improvement of infrastructure relating to the water and sanitation sector
- Construction, maintenance and remodeling of rural and urban roads, highways, bridges, and dams
- Garbage collection, treatment, and disposal
- Extension of urban and rural telephone lines
- Construction and maintenance of parks and sports fields

Also in Law 57, under Article IV, activities relating to financial assistance are listed:

- Discount credit to decentralized entities and municipal associations in order to carry out activities and programs relating to those in Article I
- Receive internal savings through the issuance of titles and subscription of other documents, in order to maintain internal credit contracts
- Helping organize financial records and build credit history
- Designing financial forecasts and evaluations for project feasibility and governance/practice worthiness

#### **Ownership & Supervision:**

The state of Colombia is the main shareholder with 85%, while the 14 departments of Colombia account for the remaining 15% of shares. Findeter acts as a “second-tier” bank under the supervision of the Colombian banking regulations. The central government and donors look towards Findeter for the promotion of institutional adjustments at the local level. Activities involving lending are supervised by a Vice President and division managers located at the main headquarters in Bogotá oversee the ten regional branches which administer daily responsibilities.

The assembly of shareholders, holds the function of adopting the statutes and reforms introduced by Findeter, which all require the approval of the National Government. The Board of Directors is comprised of a delegate representing the Housing and Public Credit Ministry, a delegate representing the Secretary of the Economy of the Presidency of the republic, the Head of the National Department of Planning, As well as Two representatives with their respective alternates of the territorial entities, elected from the assembly of Shareholders, distinct from the Nation, each for periods of one year. Their duties include:

- Secure the general politics for the management of the Organization
- Approve the Annual Budget
- Present for approval of the Assembly the financial Statutes and Reforms
- Dictate the rules of Credit
- Authorize the dispersion of loans that the financial sector makes to entities, for the realization of programs or projects of regional and urban development, through the financing and consultancy in reference to the design, execution and administration of projects or programs of investment related to the certain activities

#### **Programs:**

Findeter is part of two social services programs: RISR, the Resource for Regional Social Investment, and VIS, Vivienda de Interes Social. Findeter is one among nine entities that help realize the goals of RISR, which include financing for the construction of new infrastructure and the improving of existing infrastructure, totaling in 3246 projects with a value of \$778 million. Other participants include: Banco Agrario, Incora, Coldeportes, Inurbe, Minister of Education, IPSE, DRI, and Caminos Vacinales. Findeter’s responsibility to VIS, the housing aid program, was authorized under the Uribe administration in September 2002.

Findeter Would like to work with partners who could act as financial intermediaries in their operations. Credit establishments defined in the organic statute of the financial system (banks, financial corporations, companies of commercial and cooperative financing) the decentralized entities of those territories whose goal would be the financing of activities pointed towards the object of social entity, all those the law permits.

#### **Financial Structure & Lending:**

Findeter receives its funding from its capital and retained earnings, as well as through external borrowing, primarily from the Inter-American Development Bank and the World Bank. As of this moment, Findeter has credit with multilateral organizations close to 95 million USD, which represents close to 30% of their financing.

Due to the fact that Findeter has a “second-tier” status, it is not a direct lender, however a local bank can request up to 100% of the total value of the project loan from Findeter to supplement local banks’ loans to eligible entities. Therefore, any commercial risk remains with the bank, not with Findeter.

#### **Terms of Lending:**

Credit Amount...	Up to 100% of the project
Total Term .....	Up to 15 years
Length for Repayment...	Up to 15 years
Form of Repayment.....	Fixed quote, (gradual creciente o decreciente)
Capital Grace Period.....	Up to 3 years
Interest Grace Period....	Up to 1 year for fiscal adjustment
Rate of discount...	Dependant on operation and length of loan

An important feature of the Colombian law allows local revenues to be used as loan security. This is important for Findeter, because it provides double insurance on the loan: if the borrower defaults on the loan, the intermediary bank is liable; in the event the bank fails to make repayments, as well, Findeter can still receive repayments from that bank’s municipal borrowers. Findeter, however, has yet to experience a situation in which a bank has been able to provide coverage for the borrower.

Although backing loans with revenues adds an extra coverage for Findeter’s loans, some risk still remains in the fact that there is little incentive to focus on appraising projects and management. Instead, banks concentrate more on pledging capacity which consequently could lead to “over pledging” or straining the succeeding administrations. In order to diminish some of this risk, Findeter requires that 30% of the total operation cost is backed by counterparty funds.

The client agrees to a form of payment with the intermediary and can select a form of payment of the interests and capital, by sending payments annually, each semester, each trimester, bi yearly or monthly, which ever was agreed upon at the time. The government has no role in the determination of financial conditions, and thus has not part in repayment and collateral issues.

#### **Eligibility**

Those entities that are eligible for requesting contracts for loans may come from the private or public sectors. These include:

*Public:* territorial affiliates – department, municipal, or district; special administrative entities – municipal associations or indigenous defense; public entities on the national level; regional television organizations (under Law 14, 1991)

*Private:* entities that provide formal/informal education at the pre-school, primary, secondary, and university

levels, including those that are of community or cooperative character

*Others:* community councils/boards/societies pertaining to development, recreation, or civil defense (under Article 138, Law 79/88); cooperative/non-for-profit organizations (under Article 138, Law 79/88); associations of small producers, indigenous communities, and family units for financing the development of production activities (under Law 218, 1995); organizations authorized to loan public services to municipals in rural zones or urban zones under the specifications of Law 142, 1994.

Examples of those groups eligible for Findeter's services are: University of Cartagena; Society of Aqueduct, Sewage, and Sanitation of Barranquilla, Risaralda Gas, University of Antioquia, and the Aqueduct and Sewage Enterprise of Bogotá.

**Requirements:**

All prospective clients must present the following items in order to be considered for Findeter's aid:

- letter for the credit request
- authorization of effective debt
- applicant's financial information
- authorization for consultation form to the CIFIN, the Center for Financial Information
- the project must comply with current laws and regulations concerning technology and sanitation
- certification for availability of additional funds if the project should need them
- studies, design, and budget of the project
- proof of project procedure within environmental guidelines
- Plan Development project certificate for the respective territory
- Letter for possible financial intermediary demonstrating the intention and approval of the project

Additional Requirements for those clients pertaining to the private education sector:

- Certificate of existence and legal representation
- License of operation

Additional Requirements for clients whose companies are public services:

- Certificate of existence and legal representation
- The company ought to present electrical safety, and the certificate of completion of indicators of management issued by the superintendent of Public Services

Findeter assumes no responsibility with respect to technical, sanitary and environmental aspects, they are the sole responsibility of the prospective client, and it is the environmental authorities responsibility in making sure that as projects develop, the client follows the policies in effect.

**Recent News:**

- In 2004, Findeter was responsible for financing \$275 million for important projects pertaining to the transportation sector. This much needed development took place in urban and rural parts of 18 departments and included projects such as paving existing roadways, constructing railways

for trams, and improving landing strips for airports.

- Between August 2002 and December 2004, Findeter has provided 350 millions of pesos worth of credit in the health sector. Other sectors include: education, 134.202 millions of pesos; tourism, 17.955 millions of pesos; and housing, 10.537 millions of pesos.