

IADF BULLETIN



FINANCING LOCAL GOVERNMENT

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IADF Happenings

This month has seen the IADF speed up work on its Conference and execute a change of office to a new location in Washington, DC.

As many of you have noticed from our website, we have moved to a different address within Washington, DC. We cordially invite you to drop by our Tenleytown address to chat, pick up a copy of our latest newsletter, or register for the Conference in person. Please also note that we will have a **new fax number**. Remember this when sending in your Conference registration.

The Conference is coming together nicely, with several speakers confirmed, including Joaquim Levy, Secretary of Treasury of Brazil; Roopa Kudva of CRISIL in India; John Wasielewski of USAID; Sumeet Thakur of the IFC, and others.

One item that should not escape your view is to **prepare for the Conference early**. Don't delay- **register now** to avoid issues with visas or hotel reservations! Even if you are not sure about attending the Conference, if you have any interest, **obtain your visa today**. This will offer you the option of attending closer to the event.

As always, please do not hesitate to call us with any questions regarding the event. We hope to see you in Washington.

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www.developmentfunds.org/programs.htm

NEWS DESK

--Compiled by Laura Robinson

Argentina seeks to limit public spending
Ft.com
June 15, 2004

Néstor Kirchner, Argentina's president, introduced a bill on Monday that would force provincial and national governments to limit indebtedness and control public spending. The bill, which

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facing congressional scrutiny, would fulfill part of Argentina's promise to the International Monetary Fund in its three-year agreement last September to place government spending at all levels on a firm footing.

The bill aims to allow future spending increases at the national and regional level only when there is an increase in gross domestic product. It also aims to reduce the burden for heavily indebted local governments. The government's gesture to push through the fiscal responsibility law may persuade the IMF to turn a blind eye to the lack of progress on the politically complex issue of revenue-sharing. But some economists point out that rushing it through misses an opportunity.

Annan, Lula Call for Using Free Trade to Raise Global Living Standards

Worldbank.org
June 15, 2004

Amid calls from poor countries for the elimination of agricultural subsidies, UN Secretary-General Kofi Annan urged representatives of 180 nations to push for free trade agreements that will raise global living standards.

"Let us help developing countries take full advantage of trading opportunities," Annan said Monday at the opening of the United Nations Conference on Trade and Development. "And let us find our way to a development-led approach to trade and other policies that will enrich and empower all the world's peoples."

Brazilian President Luiz Inacio Lula da Silva, who has become a strong voice on free trade issues since taking office last year, said the developing world should learn how to use globalization instead of denouncing it. While activists condemn globalization as unfettered free trade that benefits multinational corporations, Silva said it can be harnessed - to help poor countries gain greater market access, eliminate misery and obtain funding to improve infrastructure and technology. Silva, echoing the views of many conference delegates, said poor countries will grab a larger share of world trade if they can find ways to reduce barriers among themselves. He said 44 developing countries who signed the Global System of Trade Preferences will hold new talks on reducing tariffs. Silva also said he hopes to enlist 40 new member countries from the developing world. The GSTP accord "lets developing countries eliminate reciprocal commercial barriers without the need of extending the same concessions to the developed world," Silva said.

Lula da Silva and Annan called for a boost of South-South trade, especially between the G20 member countries -led by Brazil, India and South Africa—but also with the poorer nations of the G77.

IMF Chief Says Iraq Debt Forgiveness is up to Creditors

Worldbank.org
June 15, 2004

International Monetary Fund Managing Director Rodrigo Rato said Monday the IMF was not making a recommendation on forgiving Iraqi debt and that the issue must be decided by the country's creditors.

On May 27, the IMF presented the Paris Club of Iraq creditors with an estimate of Iraq's total debts and a range of scenarios for debt relief. The IMF is not making the findings public. The Paris

Club of 19 government creditors has set a goal of reaching a debt relief agreement for Iraq by the end of 2004. The group estimates Iraq owes them about \$42 billion, with the largest debts owed to Russia, Japan, France and Germany. Latest estimates put Iraq's total debts at about \$120 billion.

\$1bn Issue Awaits Philippines Election Result

Ft.com
June 16, 2004

The Philippines, Asia's biggest sovereign debt issuer outside Japan, is being prevented from selling at least \$1bn worth of bonds because of investor unease over the slow count of the May 10 election result. This could mean the bond issue will be delayed until after the expected rise in global interest rates next month.

Government financial managers said they were unlikely to borrow abroad before the winner of last month's elections is proclaimed on or before June 30, the constitutional deadline. Investor jitters over the slow parliamentary tally were keeping the cost of borrowing high, they said.

President Gloria Macapagal Arroyo, a US-trained economist who is preferred by investors over her main rival, film actor Fernando Poe Jr, is narrowly leading an official count by the Congress. However, the parliamentary count has been marred by lengthy debates over rules and procedures. Analysts have warned that failure to declare a winner by June 30, when Mrs Macapagal's term ends, could increase political instability and encourage coup attempts.

The government, which has total outstanding debt of about \$61bn, has already covered all of its \$1.8bn commercial requirement this year but it still needs to borrow for National Power Corp, the financially insolvent government-owned power company that is having difficulties raising money on its own.

Moody's Investors Service, the credit rating agency, downgraded the Philippines long-term foreign currency bond rating to Ba2, two notches below investment grade, with a negative outlook in January. It said this was due to political concerns and the government's inability to contain the fiscal deficit.

INTERVIEW

Mr. Elio Codato The World Bank Sector Leader for Finance, Private Sector Development and Infrastructure for Brazil

Mr. Elio Codato has over twenty five years of professional experience in the areas of public finance, and urban and municipal management. Since joining the Bank, Mr. Codato has worked primarily in the Latin America and Caribbean Region where he has been involved in a number of projects in the water and urban sectors in Argentina, Bolivia, Brazil, Chile, Colombia, El Salvador, Panama, Paraguay, Peru, and Venezuela. He has also contributed to the design of projects in Croatia, India, Mozambique, Nicaragua, Pakistan and Vietnam, and the urban sector strategy for Indonesia. His areas of specialization and interest include municipal and infrastructure finance, private sector participation in the provision of infrastructure services, city strategic planning, slum-upgrading, and natural disaster management.

IADF: What is the World Bank's role in lending to local governments?

EC: The World Bank's Articles of Agreement, require that a sovereign member of the World Bank guarantee any loan made by the Bank. Thus, the Bank can only lend to local governments with the full guarantee of the sovereign, which essentially means that the sovereign agrees with the developmental purpose of the loan. The role of the Bank is that of a banker of last resort, meaning that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower.

IADF: What are the key urban issues in Latin America?

EC: The key urban issues in Latin America center around the fast paced, high level of urbanization and the skewed distribution of income and the benefits of development. There are large numbers of informal settlements that lack adequate levels of infrastructure, i.e. clean water, sanitation, roads, etc. The governments are also plagued with weak capacity (both managerial and fiscal) to cope with urbanization and support development requirements. Additionally, there is a lack of adequate mechanisms - including local capital markets - for financing urban infrastructure investments

IADF: How important is local government finance to Latin American development?

EC: Local government financing is critical to Latin American development. Latin America is becoming highly urbanized; it is projected by the UNDP (United Nations Development Program)

that 76.5% of the population will live in urban areas by next year. Without adequate decentralized local government financing, governments cannot improve the basic urban infrastructure facilities such as water supply sanitation, roads and healthcare services, which are all critical to large metropolitan areas.

Therefore, financial management improvement at the city level coupled with the strengthening and deepening of local capital markets are key to local government finance in Latin America and, ultimately, to development.

IADF: What are the most pressing issues in local government finance?

EC: The most pressing issues in local government finance are: 1) the need for local governments to have adequate taxing powers and develop their own tax base; 2) the need for reliable revenue streams, including a predictable and stable system of inter-governmental transfers; 3) clear and transparent rules for budgeting, financial management and disclosure of information; and 4) a local capital market that is capable of responding to the demand for infrastructure investments, i.e., long-term money at a reasonable cost.

IADF: Does the World Bank lend to financial intermediaries for municipal projects? Which ones?

EC: Yes, the World Bank does lend to financial intermediaries for municipal projects. Two prominent examples are FINDETER in Colombia and Tamil Nadu in India. Additionally, in Latin America the World Bank has lent to six state level municipal funds in Argentina, Bolivia and Brazil. Outside of Latin America, the World Bank has also been a lender to financial intermediaries in the Philippines, Lebanon, Morocco and Tunisia.

IADF: What are the directions of change in financial intermediaries?

EC: Financial intermediaries are gradually becoming players in local capital markets to diversify their sources of funding, and to act as a bridge for the information gap between local governments and capital markets. These changes are largely dictated by the development level and depth of the local capital markets. Financial intermediaries will evolve in the direction of the market.

IADF: How do Latin American intermediaries differ from intermediaries in advanced economies?

EC: The primary difference is that Latin American intermediaries still heavily depend on official sources of funding (such as local development banks) given the incipient level of development of the local capital markets as compared to those in more advanced economies. Also, the instruments and services offered by Latin American intermediaries are much more conservative than intermediaries in advanced economies. Latin American intermediaries only offer loans to local borrowers whereas advanced economy intermediaries offer in addition to loans, such services as pooling arrangements and credit enhancement for city bond issues.

IADF: How is FINDETER different from other similar institutions?

EC: FINDETER's distinctive function is to act as a second tier financial institution meaning that it re-discounts loans to local governments through commercial banks.

There are two primary benefits to this: 1) the municipal risk is retained by the commercial bank thus removing the "moral hazard" element of lending operations between public financial entities and local governments; and 2) it requires commercial banks to partially fund municipal loans with their own capital, thus helping to mobilize additional resources from the local capital markets

IADF: Do you see much prospect for individual cities of Latin America floating domestic bonds in the near future?

EC: Yes. However, this prospect will continue to be limited inasmuch as local capital markets are still incipient in many Latin American countries and there are very strict controls in place for the issue of new debt, such as the ban on bond issues by local governments in Brazil until the year 2010.

In other parts of the world, India, for example, individual cities have floated domestic bonds. Bogotá, Colombia and Rio de Janeiro, Brazil have started the process of floating domestic bonds, but this will be the exception rather than the rule in Latin America as local capital markets are not fully developed and the information asymmetry for local governments persists.

IADF: What are the prospects for intermediaries to borrow from the domestic credit markets?

EC: Prospects are better for intermediaries than for individual cities because of the information asymmetry issue (information is more readily available for investors regarding intermediaries than individual cities). Even though many countries, such as Brazil and Colombia, for example, have established rules at the national level to guide and control local borrowing, financial intermediaries can help in dealing with the information asymmetry by packaging municipal loans and leveraging the intermediary's equity funds through bond issuance in domestic credit markets.

I believe financial intermediaries have a very important role to play in local infrastructure finance in emerging economies, just as that of municipal bond banks in the United States and specialized intermediaries in Europe, especially for smaller local borrowers.

IADF: How do you see World Bank urban lending changing in the future?

EC: The World Bank will continue to include loans for individual interventions such as for water sanitation, slum upgrading, etc. The number of loans supporting the development of specialized financial intermediaries should grow over time in response to the increased demand for local infrastructure finance in many of the member countries combined with the Bank's lack of capacity to respond to large numbers of individual requests for municipal loans.

The way to the future is to help countries develop these mechanisms so the local capital markets can take advantage. The World Bank needs to continue working with local governments to develop local financial institutions and to help these institutions gain access to the capital markets.

SPOTLIGHT:

Bank Nederlandse Gemeenten (BNG)

- Laura Robinson

Location	Netherlands
Year founded	1914
Legal Status	BNG was set up in 1914 on the initiative of the Association of Netherlands Municipalities. BNG is a statutory two-tier company under Dutch law.
Chief Executive	Pim Vermeulen
Municipalities served	Dutch Municipalities
Total Fund Assets	83,905 million (euros)
Main sectors of lending	BNG acts as the principal Dutch public sector agency. Lending is limited to central and local governments, state-owned entities and state-guaranteed institutions within the European Union.
Staff (approximately)	480

Historical Background

BNG was founded in 1914 on the initiative of the Association of Dutch Municipalities, in order to provide the most advantageous loans to the Dutch public sector. Since then, BNG has been a fully government-owned enterprise (50% Dutch central government, 50% local government).

Objectives:

BNG's mission is to retain substantial market shares in the Dutch public and semi-public domain and to achieve a reasonable return for shareholders. In order to achieve these objectives, BNG works to maintain an excellent credit rating and solid client relationships.

Responsibilities

BNG acts as the principal financing agency for the Dutch Public Sector and conducts the business of banking on behalf of public authorities.

Supervision

BNG is monitored by the Supervisory Board. The Board combines the responsibilities of both operational supervision and strategic input. The Executive Board has day-to-day responsibility for the management of BNG's activities, the Supervisory Board is there to provide this team with advice and support alongside an explicit supervisory function.

Although BNG operates independently and without a formal guarantee by the Dutch State, the government is directly represented on the Supervisory Board; officials from both the Ministry of Finance and the Ministry of the Interior and Kingdom Relations are members. At least four members of the Board must belong to the executive of a Dutch municipality which is a shareholder of BNG.

The members of the Executive Board are appointed and dismissed

by the Supervisory Board. They jointly and severally have the power to represent BNG.

Organizational Structure

Share ownership of BNG is restricted to Dutch public sector entities. Owing to the restrictions on share ownership, BNG shares are not listed on any stock exchange.

BNG is a statutory two-tier company under Dutch law. 50% of BNG's equity is directly owned by the Dutch central government. The other 50% is owned by more than 90% of the Dutch municipalities and 11 of the 12 provinces. The central government's 50% stake has been held since 1925 and there have only been two share transfers among lower tier governmental entities in BNG's entire history.

Funding

BNG's funding needs currently amount to EUR 12-14 billion equivalent per annum. BNG is active in a large part of the world in order to raise funds and position itself as the principal agency on behalf of the Dutch public sector. BNG strives to issue 3 to 4 benchmark bonds denominated in euro or US dollar each year, and intends to create a yield curve in those currencies. The rest of the funds are raised through smaller retail type transactions and Medium Term Notes.

Due to BNG's high level of creditworthiness, investors are prepared to accept a lower risk premium. This, in combination with BNG's strong financial base, allows the bank to raise funding at competitive rates and keep lending rates as close as possible to the cost of funding.

Lending

Under BNG's articles of association, the fund's lending is limited to central and local governments, state-owned entities and state-guaranteed institutions within the European Union. Lending to borrowers outside BNG's core Dutch public sector business is limited by internal guide lines to a maximum of currently 15% of total assets (2000 to date: approx. 8% of total assets). With a market share of over 30%, BNG is the market leader of Dutch public sector finance.

BNG's credit exposure is extremely low. The majority of the loans and the securities portfolio consists of receivables from public authorities or receivables guaranteed by public authorities, with a 0% BIS weighting. Additionally, BNG has its own internal rating system for items that are subject to capital adequacy requirements, in order to identify and monitor differences in creditworthiness between clients.

BNG acts as the Dutch public sector agency. Although BNG's ten year monopolistic lending relationship with the municipalities and provinces ended in 1975, the bank still acts as the primary medium and long term lender to municipalities in the Netherlands, with a current market share of over 40%, in municipal debt.

Over 85% of BNG's total lending is 0% risk-weighted by the Netherlands Central Bank (DNB), as it is either granted to or guaranteed by Dutch public authorities. Dutch municipalities are in effect Dutch State risk.

With the implementation of the Capital Adequacy Directive in 1996, banks have been formally obliged to provide funds for the

market risk of equity and debt instrument positions. The risk-weighted capital adequacy of the bank, expressed as a BIS ratio, remained stable at 27% as per 31 December 2003. The liability capital consists mainly of Tier-1 capital and at year-end equalled 25% (2002: 26 percent).

These figures are well above BNG's capital adequacy targets. The bank's minimum standards are 20% for the BIS ratio and 16% for the Tier-1 ratio.

Ratings:

The major rating agencies have recognized the strength of both BNG's underlying risk profile and the implicit government backing. This is evidenced by the continuously high ratings BNG has had since 1994, the year when they first were applied for: AAA/Aaa/AAA. BNG's excellent risk-profile is also reflected in its Moody's Financial Strength Rating and its Fitch Individual Rating, both of which have awarded BNG their highest possible ratings since 1996: A (BFSR) and A (Individual).

BNG Projects

BNG has no private clients and no exposure to non-government-related commercial entities, which are important factors supporting its creditworthiness.

BNG's core clients are:

- Municipalities
- Housing Associations
- Public utilities (electricity, gas, drinking-water, waste-disposal, infrastructure)
- Educational institutions
- Health care institutions

In addition to these core client groups, the Dutch public sector consists of a much broader spectrum of entities, such as provinces, water control corporations, port authorities, waste management companies, sporting institutions, libraries and record offices and fire departments. Within the limits of its regulations, BNG provides financial, paying agency and advisory services to the entire spectrum of Dutch public sector entities.

Municipal Development Fund of Georgia

- Stephen Medlock

Historical Background

The Municipal Development Fund of Georgia (MDF) was established by the government of Georgia via presidential decree in 1997. The MDF has a mandate to work with the Government of Georgia, international financial institutions including the World Bank, and other donors in providing financing to municipal development projects planned by local governments. The fund also achieves the goal set for it in the World Bank's Municipal Development and Decentralization Project I – the creation of a sound financial institution operating as a revolving fund for municipal development. The MDF's primary roles are financing municipal development through mobilization of internal and external capital, oversight and execution of MDF financed projects, and assistance to government and municipalities through

programs of institutional development, improvement of management capacity, and introduction of international experience into municipal government.

In August 2002 the World Bank Board of Directors approved a loan for the MDF to finance and oversee investments in over twenty local governments pursuant to the Municipal Development and Decentralization Project II which will be implemented over the period of FY2003-FY2006.

Location	Tbilisi, Georgia
Year founded	1997
Legal Status	Established by the Republic of Georgia, Supervisory Board appointed by President of Georgia, balance sheet is independent of Georgian Government
Chief Executive	Mr. Victor Metreveli, Executive Director
Municipalities served	The MDF operates within 11 municipalities with plans to expand to 20 under Municipal Development and Decentralization Project II: <ul style="list-style-type: none"> • Tbilisi • Batumi • Poti • Rustavi • Gori • Telavi • Ambrolauri • Ozurgeti • Kazbegi • Kutaisi • Zudigi
Total Fund Assets	Approx. \$1,363,000
Total Lending per annum	\$367,879.00
Main sectors of lending	Infrastructure lending including: <ul style="list-style-type: none"> • Roads • Water • Heating • Power • Sanitation • Urban Transport Systems
Staff (approximately)	38

Operations

The MDF works with its municipal partners in every step of infrastructure and service development. These areas of assistance include:

- Assisting local governments in preparing municipal investment projects
- Technical and financial analyses of investment proposals from municipalities
- Preparation of documentation for submission to the World Bank and Government of Georgia
- Managing disbursement and procurement procedures in accordance with the terms of the World Bank and the Government of Georgia
- Technical oversight of all MDF financed investment projects

- Guidance of the loan repayment process

The MDF promotes local economic development and infrastructure by:

- Financing investment of loans to MDF clients and mobilization of resources required from internal and external financing sources and loans repaid by MDF clients
- Management and implementation of investment projects financed by MDF loans
- Providing technical assistance to entities of the Government and MDF clients
- Providing programs of institutional development and improvement of management capacity

Supervision

The MDF is supervised by the MDF Supervisory Board, the Ministry of Finance, and the Office of the President.

Organizational Structure

The Municipal Development Fund's Executive Management:

- 1) Supervisory Board
- 2) Executive Director

The coordination of MDF activity and its management are under the auspices of the supervisory board. The board (including the chairperson) is appointed by the President of Georgia. The board currently has twelve members, including two chairmen in a unitary board structure. The President of Georgia appoints an executive director.

The MDF reports its quarterly progress to the World Bank, President of Georgia, and any other donor organizations via the office of the executive director.

Capital Sources:

The MDF is a self-funded revolving fund. The MDF repays interest free IDA loans with funds received from beneficiaries' payments of sub-loans. The MDF also repays interest-bearing IBRD loans through the same process. The fund also receives limited financing from local governments of Georgia. Reflows from loans in FY2002-2003 totaled USD 5,770,000. Under the World Bank's Municipal Development and Decentralization Program the MDF will receive USD 14,000,000 in IDA interest free loans between FY2003-2006. The terms and conditions of each MDF administered sub loan to its local clients are set up to insure the maintenance of a healthy long-term rate of return from MDF loans

The initial grant for the start up of the MDF was provided through the World Bank's Municipal Development and Decentralization Project I. This initial financing totaled USD 1,500,000.

MDF Projects

Consultancy Services

The MDF has conducted over twenty feasibility studies for local governments and self governments regarding the creation of modern urban infrastructure. The MDF hires consultancy firms itself to do these studies,.

Rehabilitation Works

Since FY2000 the MDF has rehabilitated

- underground and sewage systems in seven regions of Tbilisi

- water supplies of four municipalities
- 46 roads in Tbilisi, with four major road rehabilitations included
- 11 roads in 5 other municipalities
- 2 hospitals
- 7 other projects

Procurement and Construction

When rehabilitation options are not available because of the condition of the infrastructure (or in the case that such an urban program does not exist) the MDF will finance procurement and construction. Such projects have included:

- Installation of heating systems in all of Tbilisi's secondary schools
- Procurement of new equipment for Tbilisi Metro
- Procurement of garbage collection and disposal vehicles in Batumi
- Construction of Ambrolauri school and procurement of furniture for the school

Eligible Investments

The MDF finances creditworthy development projects via loans and grants. The goals of IDA lending to the MDF is to allow for MDF lending to be a mix of loans and grants. MDF loans and grants for investment projects financed from multilateral, bilateral, and Georgian resources are limited exclusively to rehabilitation and repair of existing service infrastructure and replacement of equipment required for:

- Repair and rehabilitation of water supply and wastewater networks
- Local road upgrades
- Drainage and public lighting upgrades
- Sanitation and solid waste management
- Markets and transport support facilities

MDF financing cannot be used for

- Commercial enterprises, land acquisition, working capital or other operating budget support
- Acquisition of used vehicles and equipment, maintenance and operation activities

Borrowing Terms

The Municipal Development Fund finances projects under the following terms:

- 20 percent of total project cost to be covered by client, 40 percent through IDA financed grants simultaneously approved by the Government of Georgia upon the MDF's appraisal of a beneficiary's creditworthiness, and 40 percent to be covered by MDP loan
- A fixed interest rate of 15 percent per annum
- Maturity in 10 years
- No project may exceed USD 600,000 per MDDP II guidelines
- 1 year grace period is given for repayment of the principle

Financial Eligibility Conditions

The MDF requires the following from all borrowers:

- Debt service on a potential loan does not exceed 25 percent of prior years operating surplus
- Total debt including the prospective loan must not exceed 60 percent of the ordinary income of the prior fiscal year

Local Governments must also be in accordance with the following budget performance guidelines:

- Arrears on salaries must not exceed 10 percent of total income
- Transfer payments to cover unplanned budget deficits do not exceed 25 percent of total income
- Local ordinary income must show increasing trends
- Local governments with unpaid debts to the MDF will not be considered for further loans

For more information on the MDF please visit:
<http://www.mdf.org.ge>

We invite submissions of comments, news items, and suggestions for future articles.

Please do not hesitate to contact us, your input is valued as we develop our newsletter.

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