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Bond Banks Around the World

Moody's Investors Service has prepared this special comment for publication in conjunction with next month's conference of the International Association of Development Funds on Financing Municipalities and Sub-National Governments. Our topic, Bond Banks Around the World, is particularly appropriate to the conference focus on the role of specialized financial intermediaries in financing municipalities.

Bond banks typically offer investors access to a diversified, geographically dispersed portfolio of borrowers, thus limiting exposure to narrowly-focused credit problems. The terms of bond bank loans to municipalities often closely match the bond banks' own borrowing terms in order to minimize interest rate, maturity and currency risks.

A basic similarity among all bond banks is that each relies on its member municipalities to repay their individual loans, so that the bond bank may meet its obligations. Yet bond banks follow a variety of approaches in providing additional security for their debt.

In Denmark (*KommuneKredit*) and Sweden (*Kommuninvest i Sverige Aktiebolag*), a significant element in the legal arrangements securing the bond bank debt is the "joint and several" obligation of member municipalities to pay the debt, in case an individual member is unable to support its share. For British Columbia's *Municipal Finance Authority*, a different route is followed to reach roughly the same goal: if necessary to pay the Authority's debt, the Authority has an obligation to levy property taxes on all land and improvements in the province — including the City of Vancouver, the only municipality in the province that issues its own securities to finance capital projects.

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In the case of the *Japan Finance Corporation for Municipal Enterprises* and Norway's *Norges Kommunalbank*, the bond bank's debt is simply guaranteed by the national government. The ultimate guarantor of debt issued by Finland's *Municipality Finance Plc* is MGB, a public institution with member municipalities consisting of 98% of the national population. In New Hampshire, the *New Hampshire Municipal Bond Bank* issues two types of bonds, one carrying a guarantee of the state government and the other without such a guarantee.

For the *Maine Municipal Bond Bank* and its Vermont counterpart (as well as for New Hampshire and British Columbia), additional security is provided for bond bank obligations by a requirement for a substantial debt service reserve -- typically equal to the peak future year debt service amount, but in some cases 125% of average annual debt service. Should it become necessary to replenish the reserve, the three US state governments offer a "moral obligation pledge" to seek legislative appropriations to do so. (The respective legislatures are not legally bound to make such appropriations, however). The *Puerto Rico Municipal Finance Agency* also maintains a debt service reserve backed by the Commonwealth government's moral obligation pledge. British Columbia's *Municipal Finance Authority* also is obligated to replenish its reserve, if necessary through use of its taxing power; no support is pledged by the provincial government.

For the three US bond banks, an additional mechanism available to assure payment from member municipalities is the ability of a state to withhold and "intercept" state aid payments otherwise available to a municipality, and use such payments to fulfill the municipality's obligation to the bond bank. This arrangement is similar to that employed in Mexico for state loans secured by federal *participaciones* (revenue-sharing payments), and in Argentina for some provincial loans and bonds secured by federal *ingresos de coparticipación*. Puerto Rico's centralized arrangement for collecting municipal property taxes — and the legal authority to withhold and intercept such taxes to pay a municipality's debt service — also assures the municipality's payment obligation to the *Municipal Finance Agency*.

Copies of Moody's latest reports on bond banks may be obtained by calling 800.811.6980 toll free in the United States or Canada, or from elsewhere please call 1.212.553.1658. Reports are available for:

- Japan Finance Corporation for Municipal Enterprises*
- KommuneKredit (Denmark) Report Number:55087
- Kommuninvest i Sverige Aktiebolag (Sweden) Report Number: 57866
- Maine Municipal Bond Bank Report Number: 66040
- Municipal Finance Authority of British Columbia Report Number: 64684
- Municipality Finance plc (Finland) Report Number: 56413
- New Hampshire Municipal Bond Bank*
- Norges Kommunalbank (Norway) Report Number: 48699
- Puerto Rico Municipal Finance Agency*
- Vermont Municipal Bond Bank*

* *Summary Opinion or other short report available.*

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