

# *Linking Cities With Domestic Capital*

Durban 2004

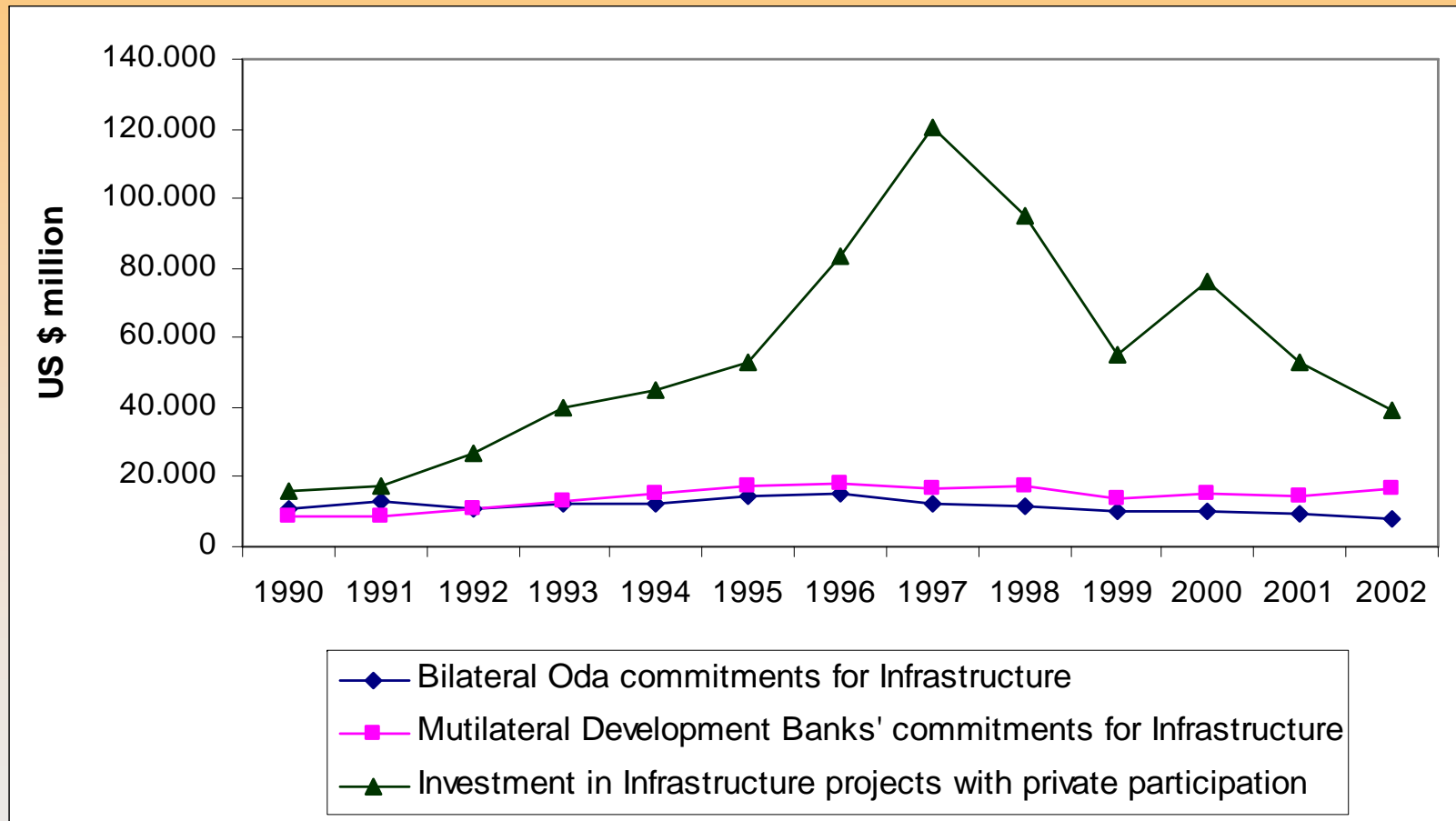
## Where we are today

- ✓ Huge infrastructure backlog, especially in environment enhancing, urban amenities, such as water, solid waste treatment and solid waste management.
- ✓ Global trends indicate that Africa has 38% of its population unserved by safe water and 40% by sanitation, Asia 19 % and 52 %, Latin America 15% and 22 % respectively,
- ✓ Camdessus report has broadly estimated an annual investment of USD 17 billion for water, and USD 32 billion for sanitization,
- ✓ Limited availability of grants and equity from higher levels of government to support these investments. Increased decentralization of responsibilities sometimes not backed by devolution of powers / finance to cities.

## Where We Are: Trends

- ✓ Public Expenditure still accounts for 1970s level
- ✓ Bilateral and multilateral ODA commitments for infrastructure have declined, both in absolute terms and as percentage of total commitments
- ✓ Private Sector Funding has fallen since 1997, instead of compensating the declining ODA and public funds as expected

# Where We Are: Trends in Private Sector Investment



08/01/2005

K. Rajivan/ Building the Knowledge Base  
on Financing Local Government

# Where We Are : Stylized Facts

- ✓ Current situation in LDCs
  - ✓ City debt from governments/ government owned financial institutions on basis of guarantees
  - ✓ Project Implementation by Parastatals/ Cities
  - ✓ Under investment in Urban
  - ✓ User charges rarely covering even O&M
- ✓ Lending now
  - ✓ Potential drying up of institutional sources based on state guarantees on account of ceilings on contingent liabilities
  - ✓ Limited low cost / equity / grant type funds.
  - ✓ Excess supply of commercial funds including multilateral
  - ✓ Little impact on urban poverty

# Can We Begin With an Agenda?

Given these facts :

- ✓ Economic growth with equity requires city governments to be a free and responsive developer of urban infrastructure rather than an indifferent service provider.

Urban reform agenda should therefore include:

- ✓ City investment plans based on the consent of the governed
- ✓ Mainstreaming the needs of the urban poor which can no longer be swept under the carpet
- ✓ Creation of sustainable financial structures which link liberalizing domestic capital markets with city financing needs.

# Why do we need debt ?

- ✓ Clear on theoretical and practical grounds
- ✓ City infrastructure, water, waste water treatment, are long-term assets and financing costs should be shared across generations- time externalities argument
- ✓ Benefits of improved water and its treatment extend across city boundaries- space externalities argument
- ✓ In practice, city infrastructure backlogs too huge to be financed by current taxes- In developed countries, 75% of waste water investments are financed by debt, while LDC private debt for public infrastructure has been insignificant.

## What are the Types ?

- ✓ Long tenor debt needed to finance capital intensive, lumpy investments with gestation periods- waste water treatment system takes 3 yrs to build involving construction and connection risks with little cash flows
- ✓ Drawdown flexibility, minimal interest rate risks and principal moratoriums during construction periods to avoid negative cash flows
- ✓ Such debt would therefore be long term money looking for stable and relatively risk free returns- for example, insurance, pension funds and perhaps the city affluent themselves

# What government and cities can do ?

- A regulatory framework, specifying parameters of financial decentralization- revenue streams from higher levels of government are formula based, and their assignability well articulated in law.
- ✓ Management systems including accounting practices of cities which allow disclosure of dues to and dues from others.
- ✓ Well developed pipeline of investments with tariffs structures grounded in community acceptance so as to withstand political cycles.
- ✓ Project management capabilities so that assets can be created quickly, minimising the implementation gap enabling user charges to be levied to service debt.
- ✓ Clear division of responsibility and powers between cities and parastatals so that implementation of longer term CDS can be launching pads for a financing strategy.

# What governments and cities can do ?

- ✓ A legal framework permitting pension / provident funds investments in city financing
- ✓ A macro economic framework which enables long tenor funds to flow into urban financing
- ✓ Tax laws which are non distortionary

# Linking Cities And Private Finance

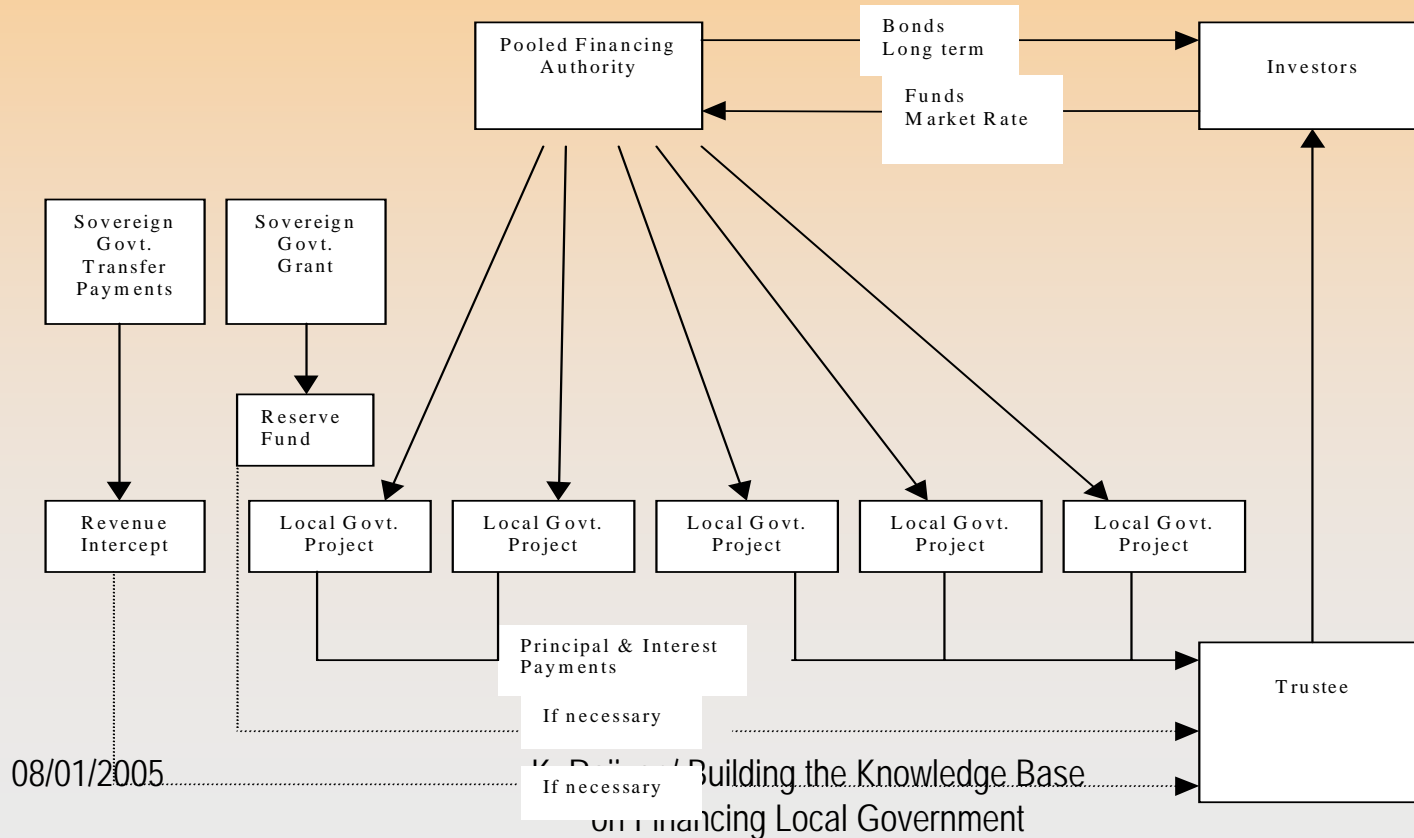
Examples From Tamilnadu,  
Mexico...

# Capital Market Solutions: Tamilnadu Partnerships with DCA

- A Pooled entity namely, a Trust called Water and Sanitation Pooled Fund (WSPF) has been registered.
- Objective is to link civic financing needs with the capital market.
- The use of DCA as a market creation tool.

# Capital Market Solutions

PAPER ONE  
RESERVE FUND MODEL  
STRUCTURE  
Simplified Flow of Funds  
For Reserve Model Pooled Financing



# Capital Market Solutions

LIST OF POOLED PROJECTS				
Rs. In Million				
S.No.	Particulars	Project Cost	Loan amt sanctioned	Loan disbursed
	Water Supply Schemes:			
1	Ambattur Municipality	33.656	6.732	6.732
2	Tambaram Municipality	18.200	10.920	10.920
3	Madhavaram Municipality	32.500	10.575	10.575
4	Rajapalayam Municipality	8.500	5.100	5.100
	<u>Adjacent Urban Areas - AUA</u>			
5	(I) Alandur Municipality	42.700	40.300	40.300
6	(ii) Pammal Municipality	37.800	35.700	35.700
7	(iii) Ankapathur Town Panchayat	18.800	17.800	17.800
8	(iv) Ullagaram Town Panchayat	29.800	28.100	28.100
9	(v) Porur Town Panchayat	57.900	54.700	54.700
10	(vi) Maduravoyal Town Panchayat	14.600	13.800	13.800
11	(vii) Valsaravakkam Town Panchayat	18.900	17.900	17.900
12	(viii) Meenambakkam Town Panchayat	1.700	1.600	1.600
	Under Ground Drainage:			
13	Madurai Corporation	140.700	50.000	32.500
		<b>455.756</b>	<b>302.152</b>	<b>275.727</b>

# Capital Market Solutions

The subscribers include Banks and Provident Fund Trust. The sectorwise subscription of the bonds is as follows:

Sector	Rs. (Million)
Banks	302.5
Provident Fund Trust	1.6
	304.1

# Capital Market Solutions: Tamilnadu

## The terms of the issue:

Mode	: Private Placement Issue
Issuer	: Water and Sanitation Pooled Fund (WSPF) a trust, the deed of which is registered under the Indian Trust Act This will pool certain Water and Sanitation projects of 14 participating Urban Local Bodies (ULBs) and the issue proceeds would be utilized to refinance/finance these projects. Tamil Nadu Urban Infrastructure Financial Services Ltd., (TNUIFSL) would act as the Trust Manager
Issue Size	: Rs. 30.41 Crores
Coupon	: 9.20% p.a.
Tenor	: 15 years (With a put and call option at the end of 10th years)
Redemption	: In 15 equal annual instalments
Payment of Interest	: Annual payment of coupon on a diminishing balance method.
Security	: Unsecured Issue

# Mexico: Capital Markets Solutions

Potential for stand-alone municipal borrowing:

- Legal / regulatory framework for decentralization established
- If issuer has strong underlying rating - minimum structure
- If issuer has weak underlying rating - maximum structure
- Best Example : Master trust structures in Mexico for domestic bond investors, regulations for commercial bank lending
- Structures result in ratings above underlying government credit strength (general obligation)

# Mexico: Capital Market Solutions

SHCP

No longer guarantees state or local debt, engages in financial bailouts, or provides extraordinary support

Sub national entities

Greater independence in public debt management

Old Debt

(Until 31 March 2000)

- Mandate effective
- Seniority over new financings

New Debt

(After 31 March 2000)

- Subordinated to old debts
- New financing structures
- Credit ratings

# Financing Institutions in Developing Countries

- ❑ Brazil: *PARANACIDADE*
- ❑ Columbia: *FINDETER*
- ❑ Czech Republic: *Municipal Finance Co.*
- ❑ Philippines: *Municipal Development Fund*
- ❑ South Africa: *INCA*

# What Can International Agencies Do?

- ✓ Facilitate private capital to finance public assets,
  - ✓ Assist domestic institutions to integrate cities financing needs with national debt markets / commercial lending
  - ✓ Work with cities and national governments in identifying predictable devolution of powers and revenue streams,
  - ✓ Provide for better organisation of knowledge
- ➔ This would provide greater leveraging of scarce multilaterals financing

## Identify Knowledge Gaps with Partners Objectives of Alliance

To help create an International Association of Local and Regional Development Funds that will promote knowledge exchange among institutions in developing world

# Other objectives

- Ω Newsletter on Municipal Financing
- Ω Data base on Financing Institutions
- Ω Website for Knowledge Sharing  
([www.developmentfunds.org](http://www.developmentfunds.org))
- Ω Training exchange
- Ω Conferences
- Ω Action plans for selected countries
- Ω Best Practices Guides

# Alliance members

## Initial Members:

- Ω International Association (IADF)
- Ω World Bank
- Ω Inter-American Development Bank
- Ω Fitch Ratings
- Ω International Private Water Association

## *New Members*

- Ω Citi-Bank
- Ω Standard & Poors

The GDA will work with a  
new Municipal Finance Task  
Force  
supported by the Cities  
Alliance

THANK YOU

Questions/

Comments?