



# **Promoting Private Finance for Local Government Infrastructure**

---

Ranjit Lamech

**Sector Leader**

**Infrastructure Economics and Finance Department**

**The World Bank**

Second Conference on Financing Municipalities and Sub-National Governments

Washington DC

October 1, 2004



- **Demand for Sub-National Engagement**
- **Bank Group Objectives**
- **Our Market Space**
- **Achieving Private Capital Access – The Steps**
- **Demand Snapshots – Colombia and India**
- **Key Elements of Sub-National Support**
- **Conceptualizing a Bank Group Support Facility**
- **What can the WBG provide at present?**

# Demand for Sub-National Engagement



## Demand Drivers

- Trend to devolve fiscal and service provision responsibility to local governments
- Public sector financing of infrastructure services ranges from 70-90% of the total
- Local governments responsible for between 40-60% of the total.
- Potential demand high....

## But the reality is ...

- Most public and local government infrastructure service providers...
  - Do not have a strategy/roadmap to improve creditworthiness
  - Often present substantial governance and regulatory risks
  - Do not have transparent, updated and audited books of accounts
- Although there is some “low-hanging fruit”
  - Large municipalities with stable revenue base – State/regional capitals.
  - Evolving MDFs and publicly capitalized financing vehicles
- Small size of individual sub-national entity and their needs can constrain direct financial engagement by MFIs.



## **Achieving effective decentralization of fiscal responsibility and service provision**

- **Mechanics of devolving fiscal responsibility – transfers and authority**
- **Fiscal Accountability Framework – monitoring and supervision by the Central Govt.**
- **Engagement mainly through adjustment and lending operations**
- **Our approach sometimes constrained by sovereign guarantee requirement.**

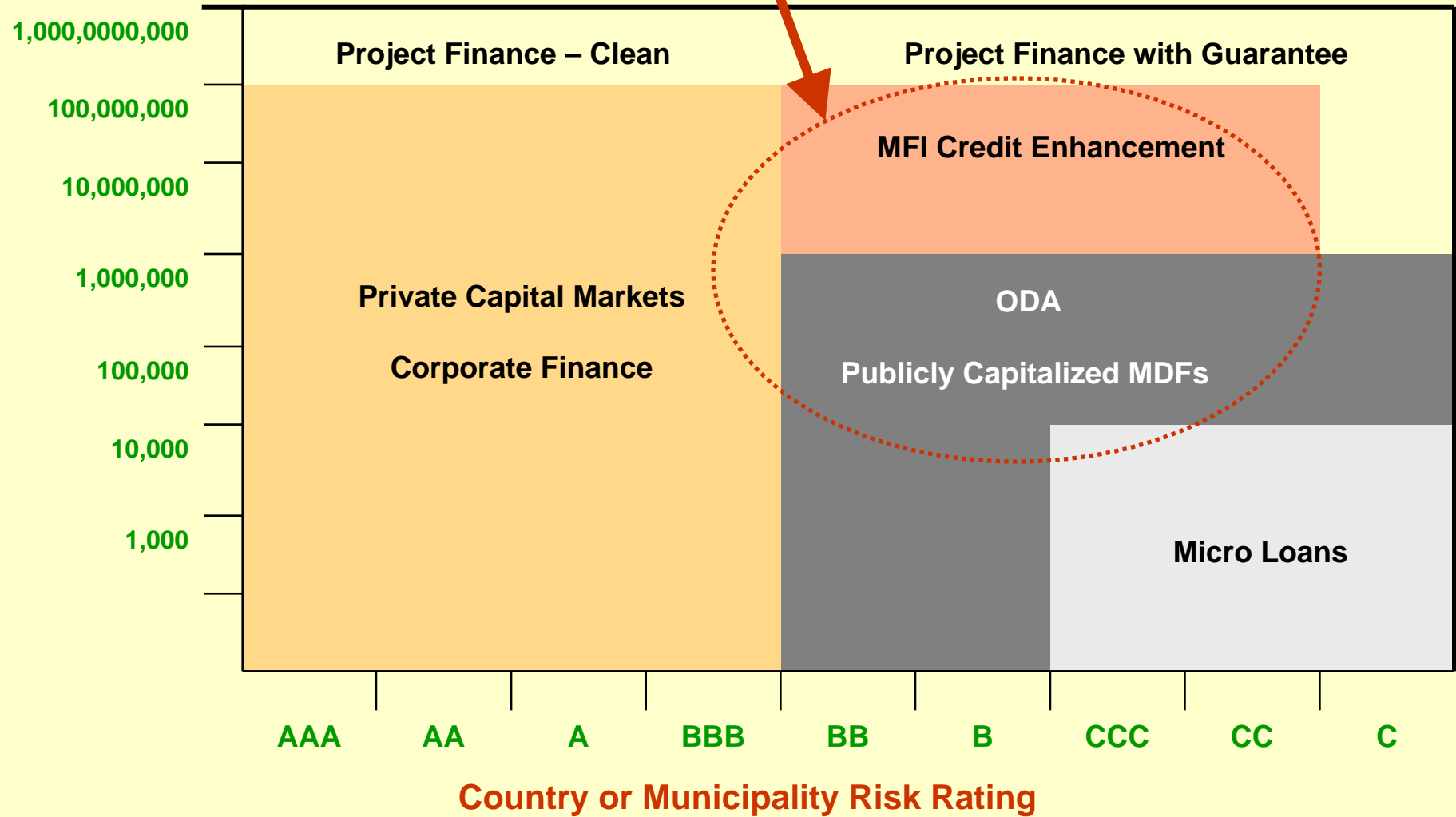
## **Achieving sustained access by public service providers to private capital markets**

- **Enhancing entity creditworthiness**
- **Formulating cost-efficient funding strategy – market-based and targeted subsidies when necessary**
- **Mitigating risks for initial entry to capital markets**
- **Engagement through entity specific capacity building, loans and guarantees**

# Our Market Space



Project Size (US\$, log scale)



Source: Chart adapted from Camdessus Panel Report on Financing Water Infrastructure, March 2003

# Achieving Private Capital Access – The Steps



## Stage 1 Capacity Development

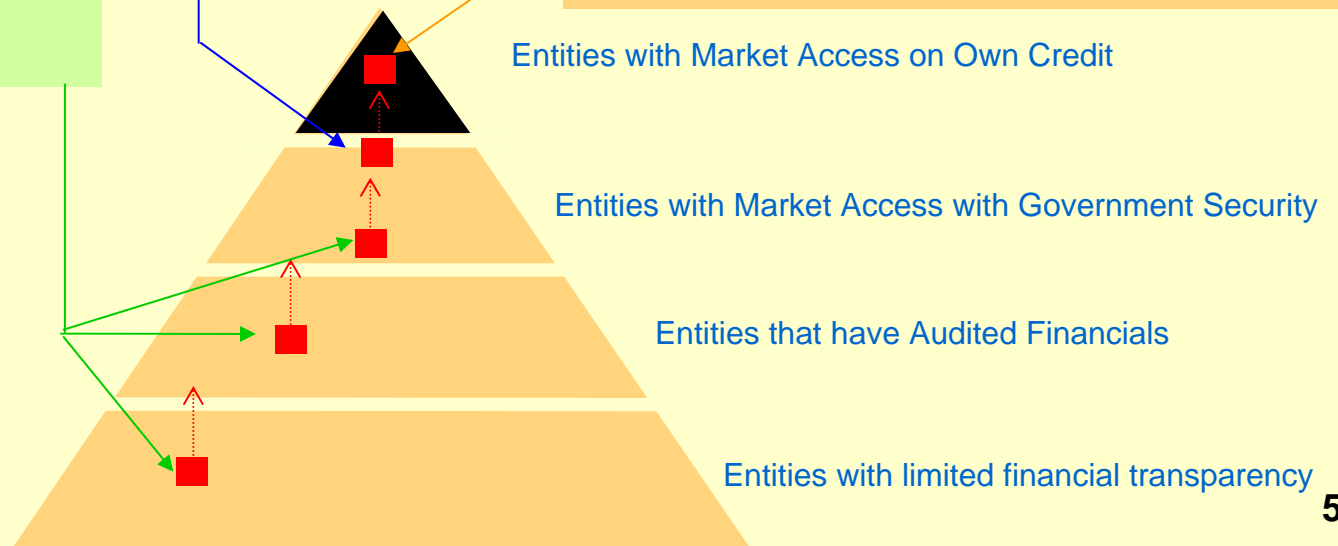
- Identify public entities with potential for capital market access
- **Capacity building** support
  - Financial transparency
  - Regulatory framework
  - Governance improvements
  - Credit rating process
- **Financing Plan**
  - Capital investment needs
  - Available sources of funding
  - Potential for private capital access

## Stage 2 Financing

- Transaction Design Development
- Instruments
  - IBRD Loan/Guarantee
  - IFC – Municipal Development Fund
  - [Prospective Bank Group Facility financing without Sovereign Guarantee]

## Stage 3 Graduation

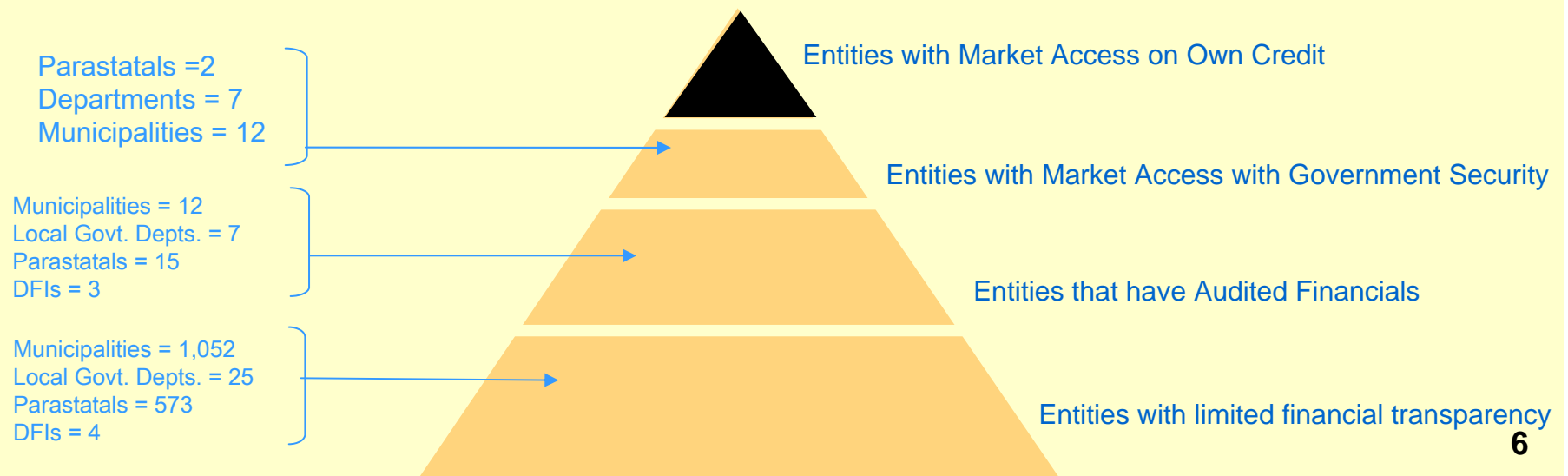
- Client achieves access to private capital on attractive terms without need for WBG support



# Colombia – Demand Snapshot



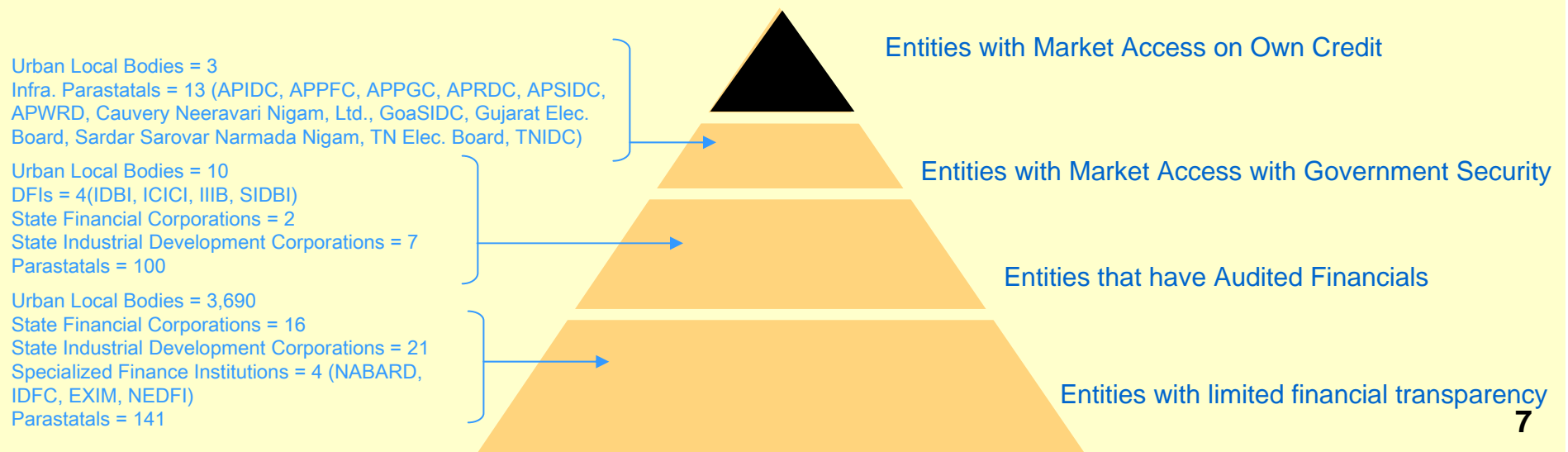
- Colombia is ranked fourth among top five emerging market recipients of private investment in infrastructure in Latin America with an investment of US\$ 15 bn over the past decade.
- Investment in infrastructure, from both public and private sources peaked at 4.7% of GDP in 1997, falling back to 2.5% of GDP by the year 2001. Public investment declined by 25% over this period, as a result of the economic crisis. Private investment dropped by 75% over the same period,.
- The investment needs for productive infrastructure to support economic growth are estimated to exceed US\$1.5 bn a year that include US\$ 258MM per year in generation capacity, and US\$ 519 million per year for transport 80% of which would need to be publicly financed. Total investment needs from 2005-10 are estimated at US\$ 3.1 bn
- Commercial banks account for more than 50% of total lending to subnational governments, either directly or through Findeter. Loans are available for up to 12 year maturities.
- Banks typically charge subsovereign borrowers competitive interest rates of 800 bp over the Fixed Deposit Rate (about 7.9 %). FINDETER has typically rediscounted all or a portion of that loan amount at the market average plus 2.5%.
- About 19 departments and municipalities have issued government bonds (TES) with tenors of 1 – 10 years. Santa fe de Bogotá, has issued bonds in the international market (2001).



# India – Demand Snapshot



- India has attracted US\$ 3.9 bn in FDI in 2001 with a plan to increase the same to US\$ 8 bn annually.
- India was ranked second to Brazil in 2002 for private participation in developing country infrastructure with an investment of US\$ 5.1 bn.
- India requires US\$ 25 bn a year to fund its infrastructure needs. Commercial bank lending to infrastructure in 2003 was US\$ 5.9 bn.
- The actual annual growth in infrastructure for 2001-02 was only 3.8 percent as against the projected growth rate of 7.2%.
- The annual funding requirements for urban infrastructure alone amount to US\$ 8.3 bn of which only US\$ 1.1 bn is covered through Central Plan outlays.
- Of the approx. 3,700 ULBs, only 50 are creditworthy enough to access domestic capital markets. Government transfers finance more than 40 percent of consolidated local expenditures.
- ULB public borrowing tenors are of 7-15 years with interest rates of prime + 0.7 percent (Ahmedabad) to prime + 5.2 percent (Nagpur).
- 10 municipalities have accessed capital markets through 13 bond issues o/w 10 have been placed without govt. guarantees..
- Four functioning DFIs – IDBI, ICICI, IIBI, SIDBI.
- Pooled finance mechanisms being created to fund small and medium city infra projects e.g TNUDF, KUIDFC. TA requested from Bank for design of corporate structure, project identification, appraisal, negotiation and funding. Capitalization assistance requested for creation of National Urban Infrastructure Fund, and more specifically, funding assistance for design of soft loan component, and transaction design support for debt issue.



# Key Elements of Sub-National Support



## Capacity Development Assistance

- Legal and regulatory reforms to reduce regulatory risk.
- Fiscal risk management – implementing risk management guidelines for governments
- Financial statements – compliance with national accounting standards for independent audit and corporate credit rating
- Financing Plan – cost-efficient funding strategy: market-based financing options and optimal leverage strategy
- Entity Credit Rating – Conducting (with a recognized rating agency) a credit assessment to obtain an indicative rating, and defining measures for improving upon the same.

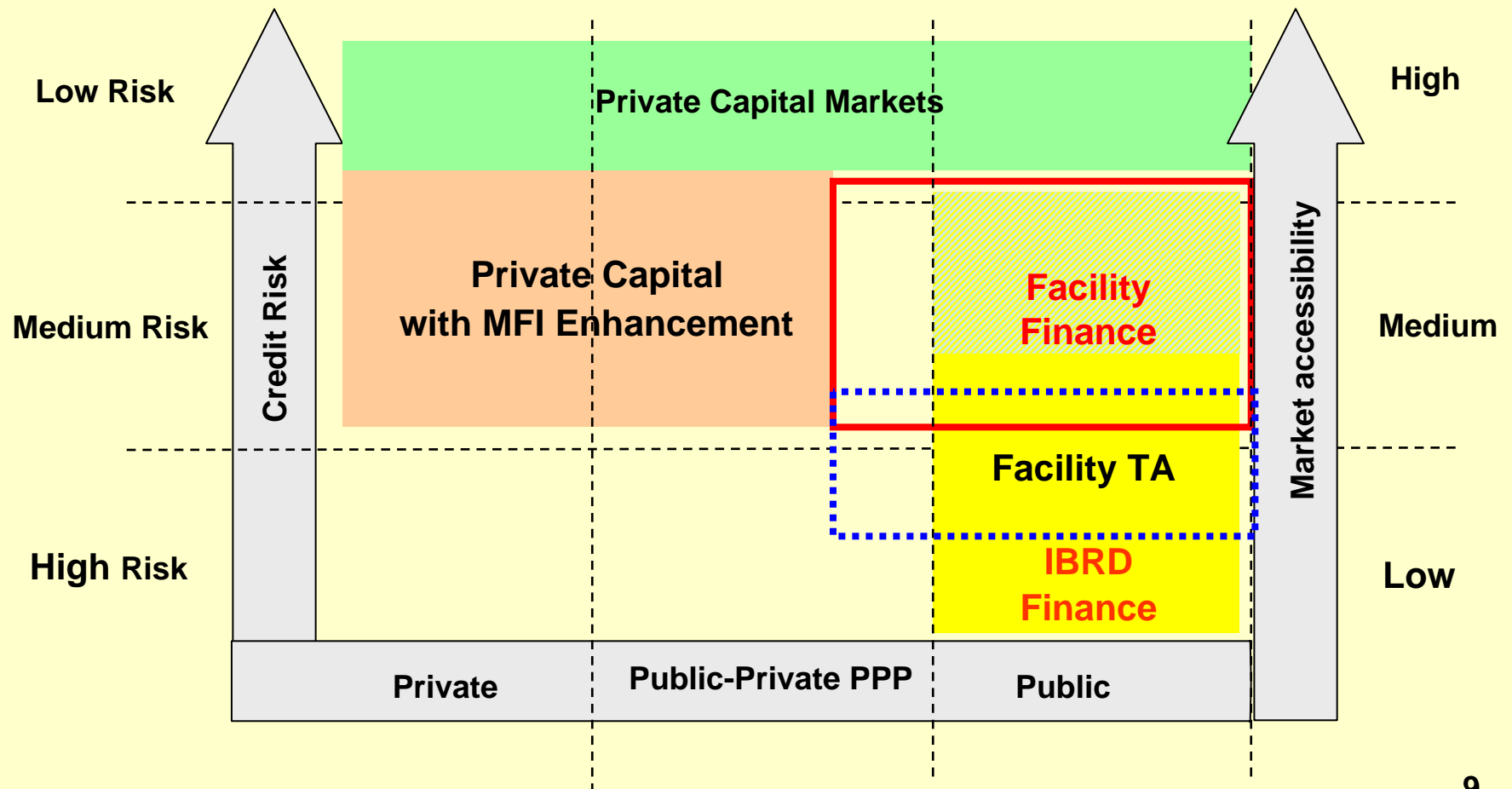
## Credit Enhancement and Lending

- Financing of client entity's infrastructure investment needs
- Credit enhancement to facilitate access to private bank and capital markets
- Financing/Guarantees to be provided without sovereign counter-guarantees

# Conceptualizing a Bank Group Support Facility



- Combining our Group competencies
- Financing without Sovereign Guarantees
- Public Sector Clients – sub-nationals, parastatals, and public contribution to PPPs
- Capacity building support



# What support can the WBG provide at present?



## IBRD and IDA lending and guarantees

- Remains the principal vehicle for sub-national project development and financing
- A sovereign counter-guarantee is required

## IFC Municipal Development Fund

- Active and operational – 3 transactions complete, several more under preparation.

## Capacity Development Assistance

- Available – through PPIAF, Cities Alliance and others
- Sub-national government clients seeking eventual access to market-based financing. Please contact us: [rlamech@worldbank.org](mailto:rlamech@worldbank.org) or go to [www.ppiaf.org](http://www.ppiaf.org)
- Our current engagements include: Municipality of Lima – Metrorail system; BOTAS, Turkey; National Urban Infrastructure Fund, India; Findeter, Colombia

A Bank Group financing and capacity building vehicle that combines the competencies and synergies of all our constituent parts, and development partners, is under evaluation.

Thank you!