Financing Municipal Infrastructure

Urban Infrastructure Finance Workshop

2-3 June 2009
Background / context
Government / World Bank collaboration on urban issues

• Three focus areas for urban analytics:
  – Spatial (Presidency)
  – Housing (National Dept of Housing)
  – Infrastructure Finance (National Treasury)

• Roundtable on all three Dec 2007
• Spatial and Housing workshop April 2008
• Finance workshop November 2008
• Finance workshop June 2009
The urban agenda

• **Spatial and housing:**
  – Issues identified
    • Urban South Africa is very low density by global standards, and this creates inefficiencies
    • Barriers to densification
  – Housing not always in the right places for jobs, etc.

• **Infrastructure finance:**
  – Current research largely completed – see Synthesis Report
  – Policy options are on the table
  – Ripe for consultations and feedback
  – Government will decide the way forward
A few words on spatial Geography

• Like other countries, South Africa is undergoing an urban transition

• Urbanisation and densification:
  – Are inevitable
  – Generate productivity and economic growth

• Old regime tried to stop workers living close to jobs/opportunities

• Government now provides housing for poor, though not necessarily close to jobs / opportunities
Spatial Distribution of Gauteng's Population seen from the South West
Spatial distribution of population in Gauteng (2001 census) compared to Jakarta, London and Paris

London: 7 M people

Paris: 8 M people

Jakarta (Jabotabek): 16 M people

Gauteng: 8.7 M people
1960 Population Density

Legend
Municipal Boundary
<all other values>
GROUP
1
2
3
Population Density
VALUE
0
0 - 10
10.00000001 - 15
15.00000001 - 50
50.00000001 - 100
100.00000001 - 150
150.00000001 - 500
500.00000001 - 1,000
1,000.00000001 - 1,500
1,500.00000001 - 2,000
2,000.00000001 - 84,923

Data source: UNEP/GRID
http://na.unep.net/globalpop/africa/
1980 Population Density

Legend
Municipal Boundary
<all other values>

GROUP
1
2
3

Population Density
VALUE
0
0 - 10
10.000000001 - 15
15.000000001 - 50
50.000000001 - 100
100.000000001 - 150
150.000000001 - 500
500.000000001 - 1,000
1,000.000000001 - 1,500
1,500.000000001 - 2,000
2,000.000000001 - 84,923

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Focusing on Finance

• Today’s workshop:
  • What is ‘urban’ in South Africa?
  • Are investment needs what and where we think they are?
  • Where can municipalities get the money?
    • Development charges and impact fees
    • MIG options
    • Borrowing options
    • PPP and integrated project development options
Global financial and economic crisis

- 6 months ago, many thought developing countries would not be hard hit
- That now appears wrong
  - This will be protracted
  - Worst may be ahead

- Opportunities to lay the foundation for rapid and inclusive growth in the next cycle
A lesson from China?

• For China, the East Asia crisis of 1998-2002 had impacts similar to current global crisis
• China responded with 5 year fiscal stimulus, mostly in infrastructure investment
• Investment targeted bottlenecks to growth
• Investment paid off, with economic growth much greater than expenditure
• Releasing bottlenecks led to phenomenal growth rates – Justin Lin, WB Chief Economist
Mostly urban

Group 1: 27 municipalities
- 80% of South Africa’s GVA!
- 52% of population
- 54% of investment need
- 6% of land area
- Munis’ budgeting /spending capacity increasing sharply
- Most of SA’s municipal borrowing capacity
- Interesting to private sector lenders
Mostly rural

- Group 2: 140 local municipalities
  - 79% of land area!
  - 25% of population
  - 20% of investment need
  - 15% of GVA

Large and small towns
Most commercial farming
Municipal performance mixed
Limited borrowing capacity
Also mostly rural

- Group 3: 70 local municipalities
  - 5% of South Africa’s GVA!
  - 27% of population
  - 26% of investment need
  - 16% of land area
  - Little or no borrowing capacity

Mostly rural
Subsistence farming
Municipal performance mixed to low
Urban vs. rural is a false dichotomy

- One national economy
- Transfers to rural areas largely financed by taxes from urban areas
- Jobs for rural dwellers and their kids will increasingly be in urban areas
- Successful rural areas are generally close and connected to successful urban centers
- Social outcomes can / should be relatively flat across spaces
Today’s program

- Understanding the needs of different municipalities
- Understanding the financial capacities of different municipalities
- The role of development charges
- The role of borrowing
- The role of PPPs and their kin
- Experiences of large municipalities
- Exploring the options
Tomorrow’s program

• DBSA and the urban agenda
• Private sector banks and the urban agenda
• Technical capacity in municipalities
• Jo’burg “drill-down”
• Integration session
• Planning for implementation
Thursday – a different workshop

- Same venue – open to all
- World Bank’s global urban strategy
  - Role of cities
  - Urban challenges
  - World Bank at work
  - A new urban agenda
  - Implementation
options
Group 1
Key Issues from matrix

• R271 billion capex needed over 10 years
• 91% of capex needed for growth and rehab

• Urban densification for efficiency, and so poor are closer to opportunities

• These 27 municipalities play a critical role in national economy

• Need to increase local revenues to keep pace with input costs
• Need for better allocation of local revenue instrument impacts

• Need for longer term borrowing to increase leverage
• Need for greater critical mass in secondary market
Group 1
Policy options from matrix

Main focus of borrowing strategy:
• Extend maturities
• Increase borrower demand
• Develop secondary market

So:
• Capital grants could be unconditional and pledgeable where council has adopted a long-term capital strategy
• MIG formula could give more to municipalities which are more leveraged
• Could have a special fund for feasibility and pre-procurement studies
• Could have a policy framework for development charges
• Could provide support for long-term capital planning
• Could target DBSA support at maturities and capital market development
Group 2

Key Issues from matrix

• R98 billion capex needed over 10 years

• 85% of capex needed for growth and rehab

• Large and small towns play a critical role in agriculture and regional trade

• Large group, large land area, big differences between these municipalities
Group 2
Policy options from matrix

• Disaggregated analysis on key issues and policy options?
• Annual capacity / performance assessment?
• Capacity building, tailored to gaps identified in assessment?
• Mentoring programs

• National funding for feasibility and pre-procurement studies?
• Integrated development approaches, with ongoing management support?
Group 3
Key Issues from matrix

• R132 billion capex needed over 10 years
• 69% of capex needed for growth and rehab

• Small tax base, highly dependent on transfers
• Most marginalized populations
• May need to rethink institutions
Group 3
Policy options from matrix

• Further research on group 3 issues and policy options

• Annual capacity / performance assessment?
• Capacity building, tailored to gaps identified in assessment?
• Mentoring programs

• Strong and supportive provincial interventions in terms of Section 139?
• Reallocation of powers and functions?
• Consolidation of local government into a single tier?
• More role for NGOs?
Strategic issues for Group 1

1. Upstream processes leading to capital investment
2. Extending municipal borrowing, consistent with policy framework
3. Revisiting MIG and other capital transfers
4. Policy framework for development charges
5. (Rethink land use planning and housing policy framework)
Strategic issue 1: upstream processes

• Upstream: before capital investment, municipalities need:
  – Prioritized, costed schedule of infrastructure needs
  – long term capital plan what is to be funded when? How?
  – Specific projects identified, feasibility and pre-design work, environmental assessment

• Bottleneck: these capital-related needs compete on current budgets

• Solutions: Allow MIG to pay upstream costs? Special fund / TA to assist?
Strategic issue 2: municipal borrowing

• Urgent need for better data
  – outstanding LT debt from lender side
  – Reconcile with reports from muni borrowers
  – Key indicators
  • Gross and net new LT debt in the quarter / year
  • Maturity profile
  • Form of debt (bonds vs. loans)
  • Weighted average interest rates / spreads
Strategic issue 2: municipal borrowing

- Most long term borrowing will be by Group 1
- Borrowing is **not** for munis without stable operating surpluses
- Main objectives of long term municipal borrowing strategy:
  - Increase borrower demand
  - Extend maturities
  - Develop secondary market
Strategic issue 2: municipal borrowing

• Borrower side policies:
  – Upstream support to increase demand
    • Capacity building
    • Funding for pre-design stages
  – MIG rethink to:
    • incentivize responsible leverage
    • Increase “shovel-readiness”

• Lender side policies
  – Work with DBSA / banks to lengthen maturities and increase secondary market
Space for additional borrowing?
Supply of municipal securities dwindling
Strategic issue 3: revisiting MIG

- What effect is MIG having? Two views:
  - Crowding out borrowing?
  - Laying a foundation for increased borrowing?

- How could/should MIG be changed?
  - More flexibility for anyone interested in using it to support borrowing, provided:
    - stable operating surplus
    - Not over-leveraged (e.g. annual debt service ≤ 70% of annual operating surplus)
  - Incentives for:
    - Borrowing per se?
    - Borrowing long term?
    - Borrowing in the form of bonds?
Strategic issue 4: development charges

• Issue: legal uncertainty and poor data result in underpricing impacts
  – Inadvertent subsidy to commercial and high-end residential?
  – Risk of legal challenges

• Possible solutions:
  – Develop legal and regulatory framework to authorise / encourage better use of development charges
  – Develop costing models for various services and impacts to demonstrate how such charges could / should be calculated
Strategic issue 5: spatial and housing

• Issues:
  – Legal and regulatory framework for spatial development perpetuates apartheid-era approaches and continues to embed inefficiencies and high costs

• Possible solutions:
  – Review legal and regulatory framework for planning to authorise / encourage higher densities and greater efficiencies in urban areas
  – Review housing policies to focus on individual and family subsidies that are portable in time (i.e. rentals) and in space (citizens decide space/location trade-offs for themselves)
Inclusive approach

• Planning, borrowing, transfers and charging tools should be available to any municipality which meets eligibility criteria, whichever group they are in:
  – e.g. stable operating surplus, good management history and own-borrowing for MIG flexibility
  – Minimum standards for development charges

• WDR issue of “spatially blind policies”
Who must be involved?

1. Upstream processes:
   1. NT
   2. Municipalities
   3. DBSA
   4. DCGTA
   5. Planning commission

2. Municipal borrowing:
   1. Treasury DDGs
   2. DBSA
   3. DCGTA
Who must be involved?

3. Revisiting MIG and other capital transfers
   1. Munis
   2. DCGTA

4. Policy framework for development charges
   a. National Treasury
   b. Municipalities
Who must be involved?

5. land use planning and housing subsidies
   a. National treasury
   b. DCGTA
   c. Human Settlements
   d. Planning commission