


The Role of Banks in Supporting Urban  
Development

Sustainable Cities  
World Bank Urban Anchor

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## Introduction & Context

- “Financing sustainable cities” fits exactly with Dexia’s “raison d’être” : a European bank specialising in local authority finance worldwide.

As other banks, Dexia is touched by the current global financial turmoil but will continue to support Urban development thanks to the funding from European Governments that will help to pass the difficult time of liquid assets adjustment.

- An exponentially growing urban population creates huge demand in infrastructure:transport, energy, environmental infrastructures, social and health facilities, housing...etc; the financing needs have reached a momentum.
- To sustain and face this growth, banks require a stronger back-up to guarantee their funding when local players also need to resort to new solutions to finance the large infrastructure. Then the infrastructure in itself will play a major role in the economical and social development of the cities.

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## The crucial role of the local government (1)

- Public Authorities are the traditional forces of urban development: combining national, regional and local levels of government.
- The closer an actor is to the local realities, the more efficient this actor will be. The currently on-going political and institutional decentralization in most countries is a major driver for urban development when accompanied by a transfer of resources and responsibilities.
- National authorities will always remain responsible for a successful urban financing in regulating and clarifying the respective roles of each player.

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## The crucial role of the local government (2)

### Four priorities to ensure a safe local borrowing:

#### 1) Consistency between resources and expenditures

- A balanced choice of sources of revenues
  - national transfers assigned to sub-national level
  - fiscal decentralization
  - user fees
  - asset revenues
  
- A clear definition of the services to be delivered by each tier of government

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## The crucial role of the local government (3)

#### 2) A regulatory framework enacting the rules on local government debt

- Long term credit exclusively for capital investment - no borrowing for current expenditures or to cover fiscal deficit -
- Protected by prudential rules, e.g:
  - Annual maximum amount of borrowing for the new debt
  - Maximum amount for the annual debt repayment
  - Cap on the total outstanding debt (% of revenue)...
- Clear definition of the legal context:
  - Exclude chances of bail out to increase effectiveness of the debt management
  - Collaterals and guarantees
  - Deficit remedies and bankruptcy regulation

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## The crucial role of the local government (4)

### 3) Ability for local players to properly manage their finance

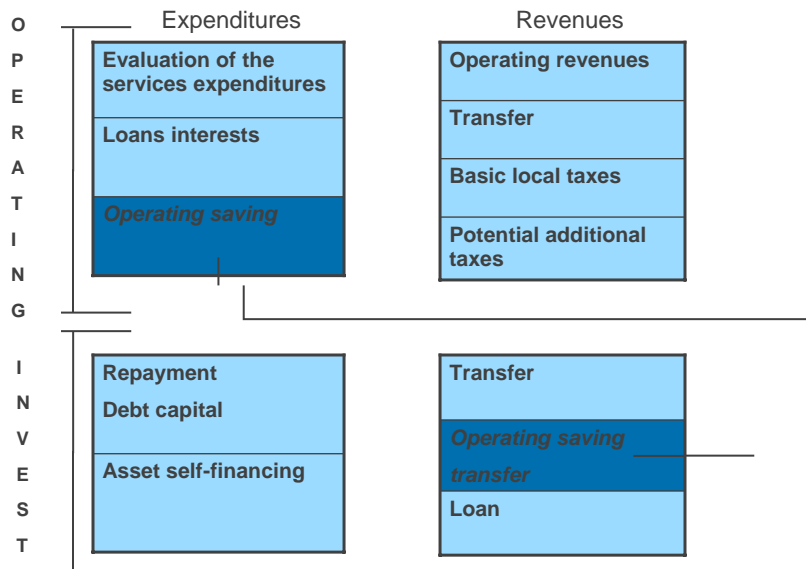
- Capacity building of the finance managers
- Adequate financial tools to plan budgets and programme investments:
  - ⇒ This should allow lenders to accurately analyse local governments finances and base their lending decision solely on the basis of **creditworthiness**, rather than on implicit guarantees by the central government

### 4) A rigorous and transparent financial management

- Regulations and reporting are key for an efficient control of public spending
- A balanced local budget allows savings

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## The crucial role of the local government (5)



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## The new bridges to leverage the shortage of public funds (1)

- Sustainable and balanced urban development schemes require innovative and very large financing schemes especially at the scale of mega-cities.
- A number of huge urban projects are not taken forward because private and public investors are unable to finance them on their own.

=> Therefore, there is a need to foster new investment capacities by resorting to private sector to design, build and finance infrastructure. Two major modes of production are developing:

- Private public partnerships

The public authorities will delegate – in the form of a limited and specific contract – the development and the management of public services to private partners.

- Project finance

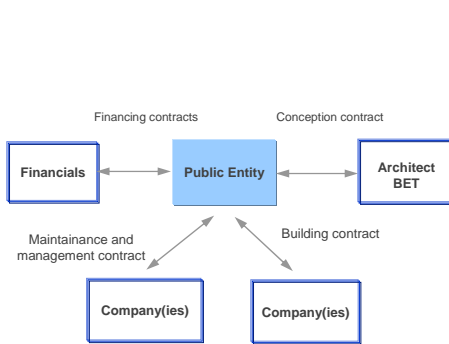
Project Finance involves the financing of a single asset. An SPV held by shareholders is created to own, build, finance and operate the asset. A debt provided by a syndicate of banks is granted to the SPV, which is repaid by the cash-flow generated by the asset, without any recourse on the shareholders.

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## The new bridges to leverage the shortage of public funds (2)

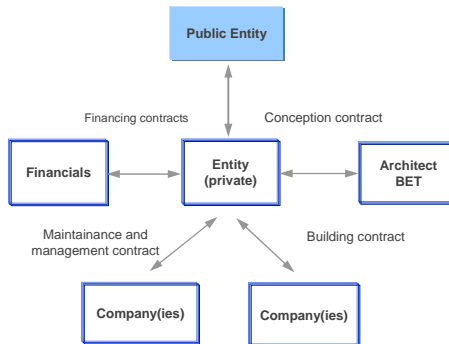
### Public Private Partnership

from a “DIY culture”



- Many contacts
- Risks / Costs

to an “Outsource culture”



- Public project mgmt
- Consolidation / Debt
- 1 contact
- Costs control

- Risk sharing
- Off budget / Debt

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## The new bridges to leverage the shortage of public funds (3)

### Project finance

- Financing local infrastructure under private management brings:

#### **Advantages**

- off balance sheet balancing
- risk sharing & technology transfer
- better leverage

#### **Constraints**

- legal & financial structure more complex
- increased financial margin
- necessity for the sponsors to provide financial support on their own

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## The new bridges to leverage the shortage of public funds (4)

### Project finance

- Six rules for successful project finance:

- Strong rationale for the project
- Clear and stable rules
- Room for flexibility in the contract
- Efficient management of the risks
- Adequate involvement of the Local Authority
- Willingness and implication of the private partners

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## The financial partners of urban development (1)

### The policy banks

- Throughout the 19th and 20th centuries, governments have used policy banks to steer the development, to reconstruct and to restructure the economy and the industry.
  - ⇒ Part of them are exclusively or mainly dedicated to local urban development.
  
- More than 25 industrialised countries, mostly European, have been creating dedicated funds:
  - Public Work Loan Board in the UK (1817),
  - Crédit Communal de Belgique (1860),
  - Banco de Credito Local in Spain (1925),
  - Norway Kommunal Bank (1926),
  - Japan Finance Corporation for Municipal Enterprises" (1957)
  - Caisse d'aide à l'Equipement des collectivités locales en France (1966)...
  
- These funds were either initiated by central governments who had the will not only to offer a suitable credit to emerging local authorities, but also to secure their financial environment. Or they were created by the local authorities themselves associated or not to the central government

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## The financial partners of urban development (2)

- The same objective have led to the creation of Municipal Development Funds (MDF) in approx. 40 emerging countries in the last decade:
  - Banobras in Mexico (1933),
  - Fonds d'Equipement Communal in Morocco (1959),
  - Taminaldu Urban development Fund in India (1988),
  - Findeter in Colombia 1989,
  - Kommunalna Bank in Slovakia (1992)...
  
- These institutions were meant to evolve from a totally public entity to a semi-public management with more autonomy in their credit policy, and to turn towards market-based funds, in order to widen the resources available for local government.
  
- Some of them did evolve, others did not.
  
- There is room for improvement and it is worth exploring how MDF can be the right partners to local authorities in helping to build a credit culture and in providing the suitable development financing..

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## The financial partners of urban development (3)

### International Financial Institutions (IFI's)

- Further to its investments in urban development, IFI's fulfil a special role:
  - With regard to the borrower and its governing bodies: to help setting up regulations on borrowing by building a local capacity in financial management, budget planning and control.
  - With regard to the MDF: strengthening their institutional capacity and organizational setting for service delivery.
  - With regard to the mobilization of private resources: by boosting the local sector markets or by creating one when there is none.

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## The financial partners of urban development (4)

### Specialized Financial Institutions or Commercial Banks

- SFI's across Europe often are the result of a transformation of local development funds. They are key players in the area of urban finance and are mainly active in one country.
  - As a comparison, in Anglo-Saxon countries, this role is held by commercial banks, or savings banks.
- Specialized market-based banks like Dexia are active in several countries and continents.
  - Specialized involvement is possible thanks to the fact that these banks have acquired a global expertise on local investment and large infrastructure financing and have developed branches in different countries with local knowledge and access to local networks.

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## The financial partners of urban development (5)

- The cumulated experience of the specialized intermediaries constitutes a comparative advantage, which deserves to be shared among the banking sector, both in developing and developed countries.
  
- Among the initiatives aiming to provide a platform for private and public banks active in public finance in order to develop a better market and industry understanding, it is worth mentioning:
  - the International Association of Development Funds, IADF, created in IFI's wake,
  - the International Centre for Local Credit, ICLC, founded 50 years ago by European entities which is now opened to other continents.

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## Conclusion

- Sustainable and efficient urban development requires public services and infrastructure of quality. But the demand for infrastructure both in its scale and urgency, largely exceeds the limited capacity for self-financing of local players both in developed and developing countries.
  
- Credit appears then as the critical element for needed local investment, and the key to a dynamic policy of long term investment for cities.
  
- A credit crunch now would have strong and negative knock-on effect on the future of cities and more precisely on mega-cities.
  
- Every involved player are now showing their concern and will undoubtedly cooperate towards a better future for the world's urban citizens.

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