



## Subnational Finance

# Overview of Program and Instruments



Urban Learning Days - March 12, 2009

 **IFC**  
INTERNATIONAL  
FINANCE CORPORATION  
THE WORLD BANK GROUP

# Contents

- **Scope of Subnational Finance Initiative** – application of subnational products: objectives, partners and sectors
- **Key Considerations for Accessing Subnational Finance** – Demand for commercial financing; Regulatory Environment; Central Government Support
- **Financial Products and Terms** – credit assessment and pricing
- **Detailed Case Studies** – debt and structured instruments
- **Summing up** – benefits, differences, and more
- **Q&A**

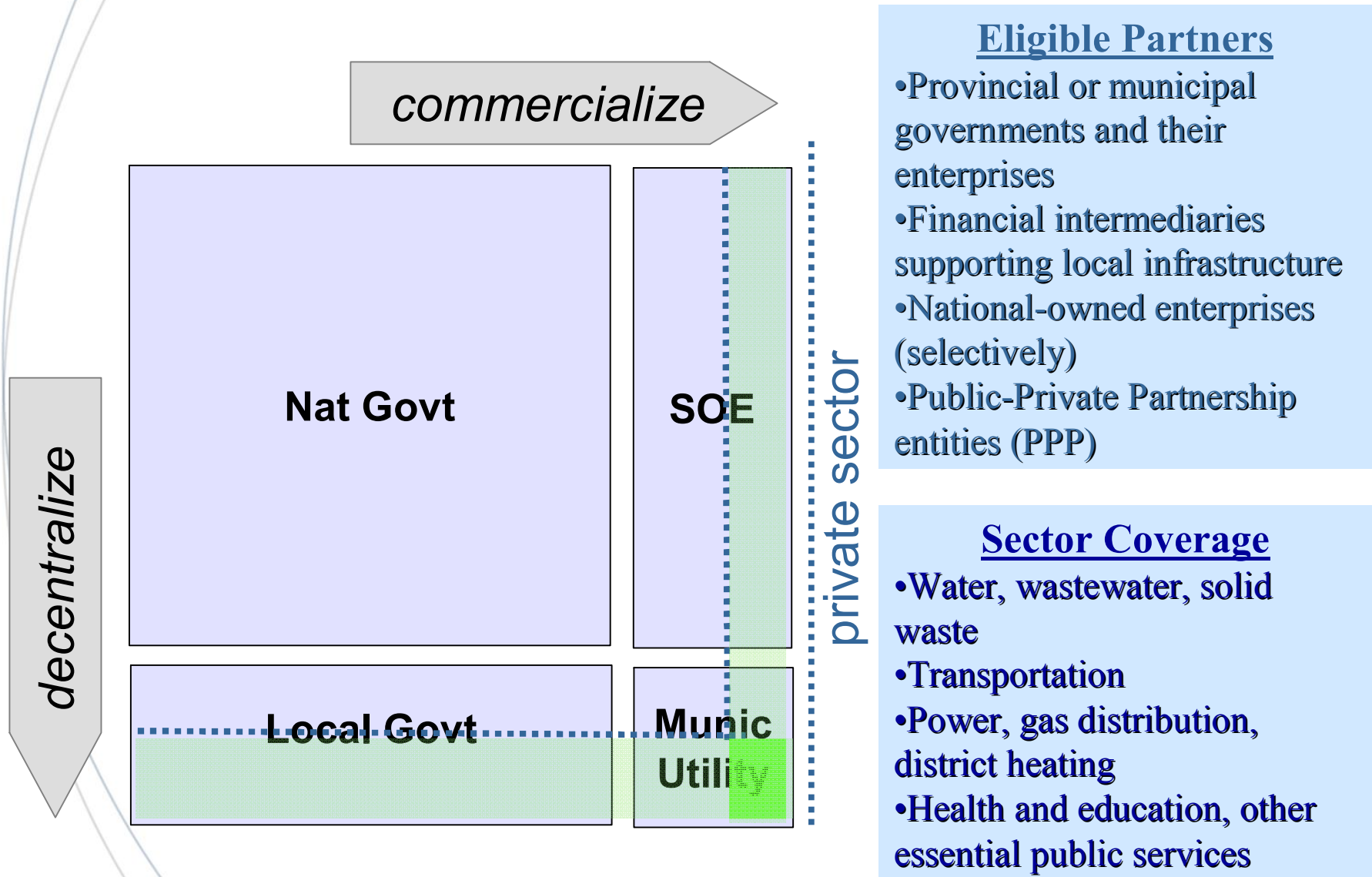


# Objectives of WBG Subnational Finance

- **Finance local development projects**
- **Assist subnational entities to gain access to financial markets**
- **Deepen financial markets**



# Scope of Subnational Finance Initiative



# Eligible Investments in Urban Sector

<b>HOUSING, OTHER REAL ESTATE DEVELOPMENT</b>	<b>Yes</b>	<b>Maybe</b>
Off-site infrastructure for housing	X	
Industrial estates, off-site infrastructure	X	
Tourism - off-site infrastructure	X	
<b>MISC MUNICIPAL</b>	<b>Yes</b>	<b>Maybe</b>
Street lighting	X	
Basic street beautification (not including large monuments)	X	
Town hall, municipal administration building improvements		X
Upgrading schools, health clinics	X	
New schools, health clinics	X	
Neighborhood parks, recreation areas, playgrounds, public-use sport facilities		X
Municipal management systems, cadasters, e-government		X
Marketplaces		X
<b>PUBLIC SERVICES</b>	<b>Yes</b>	<b>Maybe</b>
District heating, rehabilitation and EE in existing systems	X	
Water distribution	X	
Drinking water and sewage treatment plants	X	
Stormwater drainage, flood protection	X	
Solid waste disposal, landfills	X	
Urban street rehabilitation and improvement	X	
Traffic engineering, signing, signalling	X	
Bikeways, pedestrian walkways, NMT facilities	X	
Metros, commuter rail, light rail mass transit	X	
BRT - busway infrastructure, stations	X	
Intercity bus terminals		X



# WBG Subnational Program

- **Financing window:** Focus on municipal and provincial governments and their entities. Selective engagement with national SOE. Investments processed under IFC Articles, so need to show private sector development impact.
- **Carbon Credits:** Assist sub-national entities in: (i) augmenting their revenues by selling carbon credits through IFC or World Bank carbon credit facilities; or (ii) raise financing against the expected revenue from carbon credits.
- **TA grant window:** PPIAF window for subnationals with funding from WB DGF, IFC FMTAAS, DFID (\$7.5m annual budget) – Credit ratings, transaction assistance, deal structuring, creditworthiness improvement, post-transaction assistance, etc. 35 activities financed to date, of which 16 are in urban sector.



## Key considerations for accessing SN



# Key Questions - early screening:

- **1. Can we lend** to this borrower ? - check the regulatory framework
- **2. Is our pricing competitive?** - compared to other available sources of borrowing
- **3. Can they afford it ?** - financial capacity of the borrower to service the debt
- **4. What's the development impact ?** – does the investment make sense
- **5. What's the additionality** – What value do we bring beyond the financing



# Key Considerations -1

Credit risk assessment at the subnational level requires a careful review of the **political situation, socio-economic factors, strength of relevant institutions, and the legal and regulatory framework.**

Key considerations include:

- **Demand for commercial financing**
- **Regulatory Environment**
- **Central Government Support**

**Demand:** Do subnational entities responsible for providing essential infrastructure have positive cash flows against which to borrow, to finance unmet needs? To what extent are these flows dependent on revenue transfers from higher levels?



# Key Considerations - 2

- **Regulatory Environment:** Can these entities borrow without sovereign guarantees? From IFIs? In which currencies? Do they have autonomy in setting tax rates/fees? In deciding on level of expenditures? Are the revenue transfers formula-based and stable? Are there clear limits on subnational borrowing (debt stock & servicing)? Can they offer assets as security? Is there a clear (bankruptcy) framework in case of default?
- **Central Government support:** Is the central government generally supportive of subnational borrowing? What is the legal versus de facto requirement for central government approval? Are there any international agreements (e.g. IMF) that may restrict commercial borrowing or overall size of public sector debt? Is there adequate central government oversight and enforcement to ensure regulatory compliance at the local level? Is there precedent for LG bailouts that may create a moral hazard and encourage imprudent LG behavior?



## Products and Terms



# Sub-sovereign Investment Products

## Debt:

- Senior loans
- Subordinated loans
- Pooled loans/Bonds

## Structured:

- Partial credit guarantees
- Risk-sharing facilities
- Securitizations

## Equity and Quasi-equity:

- Long-term capital

## All products:

**Do not require sovereign guarantee**

**May be available in local currency  
Processed in 3-6 months ... if the client is ready**

**Limited TA bundled with financing. TA grants can be applied for separately (e.g. from PPIAF-SNTA)**

**Commercial pricing**



# Comparison of Loan Terms IBRD vs. SN

	<b>IBRD</b>	<b>WBG Subnational</b>
<b>Loan Size</b>	<b>Relatively large</b>	<b>Relatively small</b> \$5-50 million
<b>Pricing</b>	Libor + 75 to 77 bps	Libor+150 to 575 bps (indicative only)
<b>Loan Tenor</b>	Long term (up to 30 years)	Medium-long term (about 5-12 years)



- Commercial, not concessional
- Pricing varies according to risk, other costs, and upside - no cross-subsidy between subnational clients
- Structure designed to reduce risk and improve all-in cost efficiency for the client

- **Why price commercially?**

- To make the program self-sustaining
- develop the market – mobilize beyond our own capital, avoid displacing emerging commercial players, prepare clients for future “graduation”
- enable sharing or selling down of exposure at the transaction or portfolio level
- signal the cost of capital to subnational clients, so they invest rationally and they aim to reduce their own risk
- It is the Board mandate for IFC and for this initiative.



# Loans

- **Fixed or floating, risk-based, market-rate pricing**
- **Flexible and customized deal structured to meet client needs - corporate finance and project finance**
- **Currency of choice (conditional on availability)**
- **Does not require national government guarantee, but will require strong cash flow and may be complemented by a security package**
- **Can help client syndicate additional loans from other financial institutions**
- **Features**
  - Long maturities, usually 5 to 12 years
  - Appropriate grace periods
  - Repayment tailored to cash flow projections
  - Investment size: > US\$5 million and up to 50 percent of project cost



# Structured Products

## Partial credit guarantee

- **Aims to offer minimum guarantee amount necessary to facilitate the transaction and to:**
  - Achieve the target rating (bonds)  
*or*
  - Obtain blue-chip borrower rates for the desired maturity (loans)
- **Usually less than 100 percent of outstanding balance; typically not severely back-ended**
- **Maximum guarantee amount can be expressed as:**
  - fixed percentage of the outstanding balance
  - variable percentage of the outstanding balance
  - fixed amount
  - number of installments



# Structured Products

## Risk-sharing facility

- **Aims to offer minimum risk coverage amount necessary to facilitate a transaction – typically, not more than 50 percent**
- **WBG will risk-share a loan granted by a local bank to a municipality, through a guarantee for punctual payments of the risk participation amount when the Bank accelerates the loan, or on any payment date**
- **A risk participation agreement is used when no legal agreement is possible between WBG and the municipality**



# Structured Products

## Risk-sharing facility – how it works

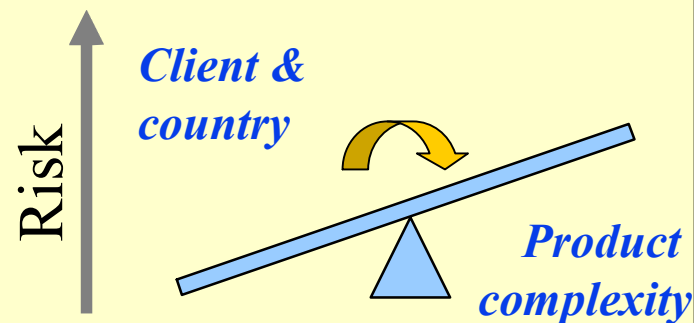
- **Local bank funds the loan, which remains on its balance sheet. Bank disburses the loan amount directly to the municipality and collects repayments.**
- **WBG relies on the local bank to include required covenants in the loan agreement for future loans, and to report all relevant information to the WBG.**
- **If municipality defaults on a payment, the local bank can accelerate the loan.**
- **Local bank will reimburse WBG if missed loan repayments are subsequently collected.**



# Choosing the right product

## Criteria:

- client objectives, capacity
- fit with local law and with market requirements
- risk, all-in cost efficiency
- market development, resource mobilization
- built-in incentives for the client



## Loans

- ✓ Simpler
- ⊘ Not always available in local currency

## Guarantees

- ✓ Can support local currency borrowings
- ✓ Financial market development impact
- ⊘ More complex (more actors, more documentation)

## Equity

- ✓ Partial privatization, IPO, new JV subsidiaries of SOEs, PPP
- ✓ Foster improvement in corporate governance



## CASE STUDIES



## DEBT



# Turkey – Istanbul Metro

## Senior Loan in urban transport sector

### Highlights

- **The World Bank Group's first direct engagement at the subnational level in Turkey without a sovereign guarantee.**
- **Loan to finance the construction of the 22 kilometers long Kadikoy-Kartal metro rail line.**
- **It will improve the lives of some 450,000 daily users by 2012, many from the poorest segments of the population in the Asian side of the city, who depend on public transportation to reach their employment and social services.**
- **WBG's participation helped close a financing gap for the project, and provided comfort to commercial lenders in a tightening global credit environment.**



# Turkey – Financial Structure

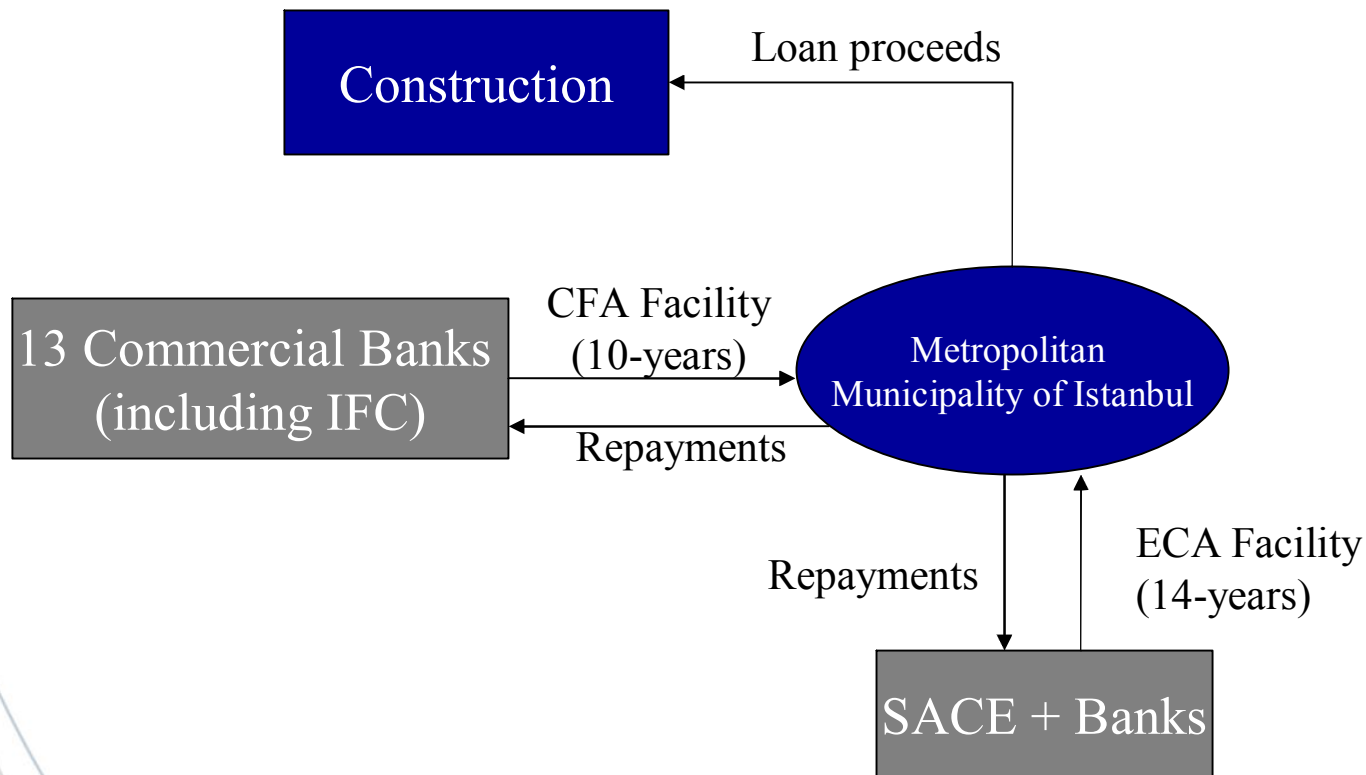
- **A 10-year CFA facility (senior unsecured loan) for up to Euros 50 million (US\$65 million) to the Metropolitan Municipality of Istanbul. IFC is one of 13 banks providing facility.**
- **A 14-year ECA facility of Euro 526 million commercial bank facility.**
- **Total project cost of Euro 751 million Project.**



# Senior Loan

- **Istanbul Metro, Turkey**

Senior unsecured loan to a municipality to help finance an urban transport project



# STRUCTURED



# South Africa - Johannesburg Bond Issue

## 12-year, long-maturity bond and partial credit guarantee for municipal services sector

### Highlights

- **Bond proceeds used to finance extension of basic infrastructure services across the city. Following financial close...**
  - ✓ **Water service extended to 8,350 dwellings (almost 27,000 persons)**
  - ✓ **Sewer service extended to 27,120 dwellings (almost 87,000 persons)**
  - ✓ **Additional transportation, electric, and social infrastructure projects undertaken using bond proceeds**



# South Africa - Johannesburg Bond Issue

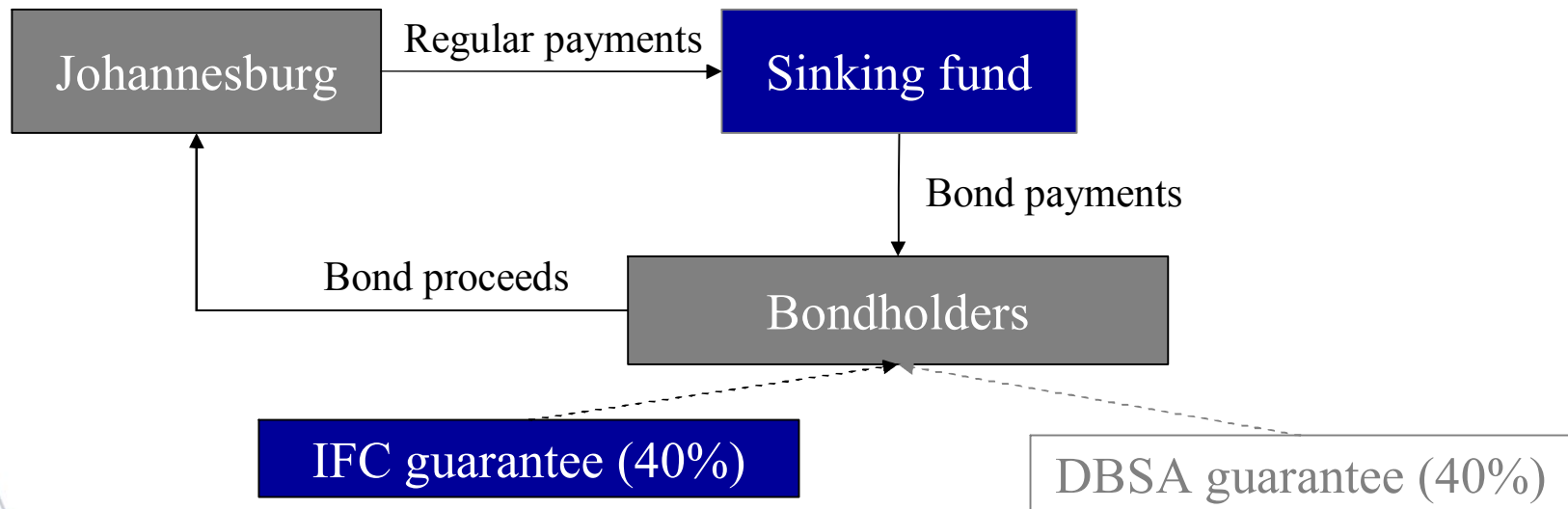
- **40 percent bond guarantee issued by IFC and Development Bank of Southern Africa**
- **Using a bond issued with support of IFC partial credit guarantee, the city could raise much-needed funds and balance debt financing with the useful life of the asset**
- **Bond improved enabling environment and market efficiency by allowing the city to access institutional bond investors as an alternative source of capital**
- **Long tenor improved city debt-service profile**
- **Borrower can obtain financing in the future without need for enhancement**



# Partial Credit Guarantee - Bond Issue

- **City of Johannesburg, South Africa**

Partial credit guarantee for a bond issued by the city



# South Africa – Buffalo City Loan Guarantee

## Partial credit guarantee for an existing loan for municipal services

### Highlights

- **Guarantee replaced zero-coupon bonds as the security for four existing loans to finance extension of basic infrastructure services across the city. Following financial close...**
  - ✓ **Water service extended from 739,000 to 860,500 for water**
  - ✓ **Sewer service extended from 683,000 to 810,000**
  - ✓ **Additional improvements made to electricity and road infrastructure**



# South Africa, Buffalo City – Financial Structure

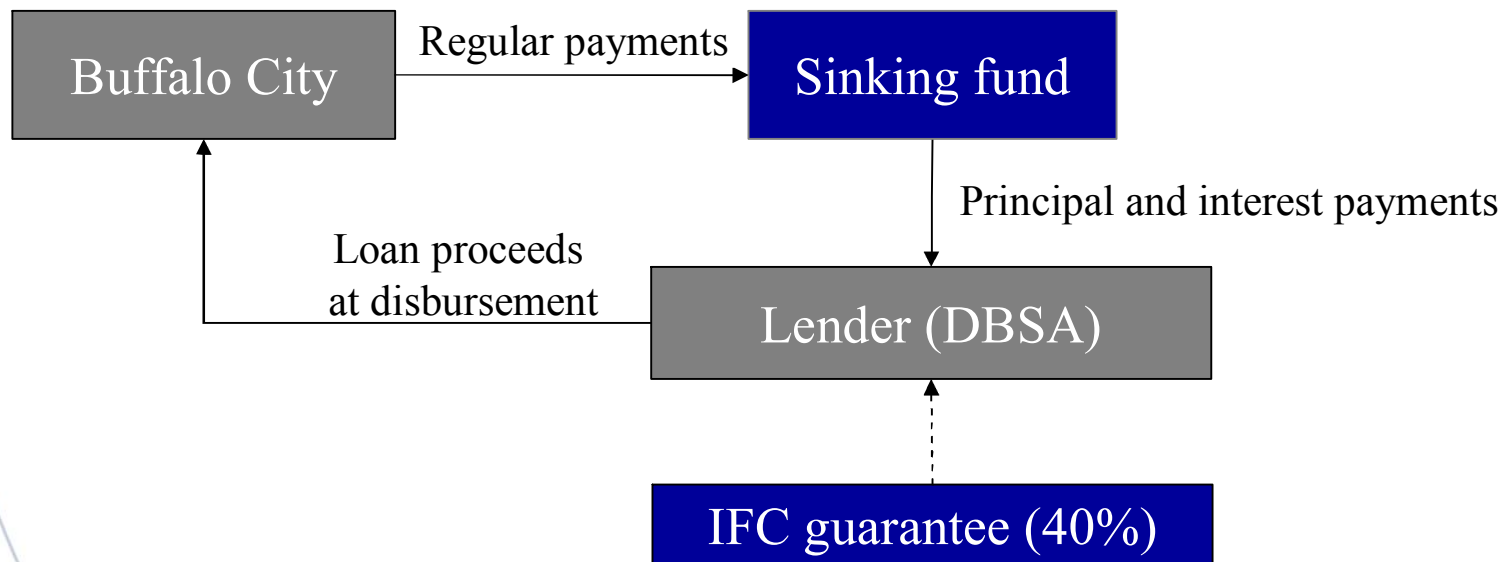
- **Buffalo City- the Development Bank of Southern Africa (DBSA) and IFC entered a tripartite agreement...**
  - **IFC agreed to issue a 40 percent guarantee in favor of DBSA**
  - **DBSA agreed to release existing security instruments in favor of the city and IFC in exchange for the guarantees**
- **Buffalo City sold the instruments for about ZAR 47 million (net proceeds ZAR 42 million).**
- **Transaction costs were lower than Buffalo City borrowing costs**



# Partial Credit Guarantee - Loan

- **Buffalo City, South Africa**

Partial credit guarantee for an existing loan



# Senegal – Dakar Street Lighting Risk-sharing

**Risk-sharing for local bank loan to the Municipality of Dakar.**

## Highlights

- **Will improve public lighting in low and middle-income neighborhoods of Dakar:**
  - **90,000 additional people will benefit**
  - **Over 50% reduction in kmh per km lighted**
- **Will support mayor's initiative to make Dakar safer and allow its residents to enjoy public spaces and carry out economic activities after dark**
- **Will enable a local commercial bank to gain its first experience and build capacity in the municipal finance market.**



# Senegal, Dakar - Financial Structure

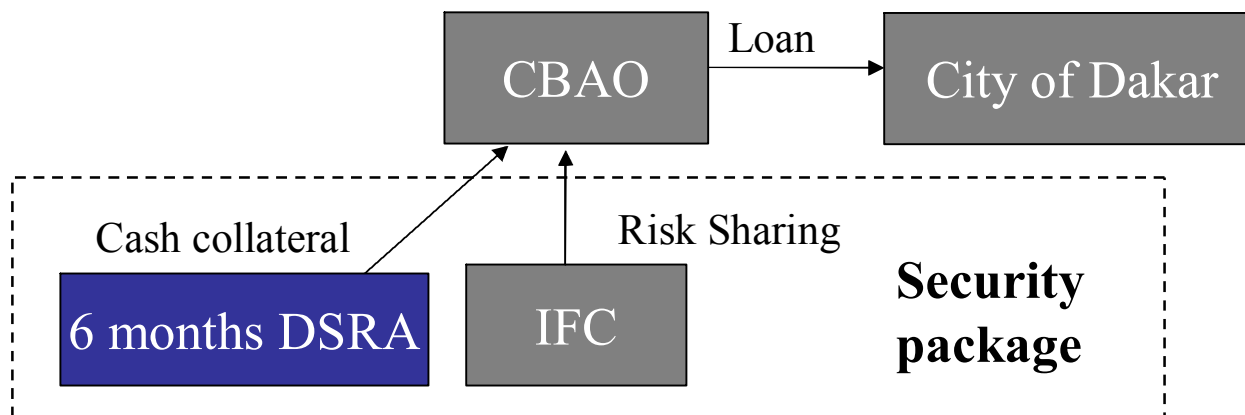
- **A 7-year local currency loan from CBAO for CFAF 4.1 billion (US\$8.7 million) to the Municipality of Dakar**
- **Risk-sharing agreement for single-credit exposure for 95 percent of the total bank exposure of CFAF 3.9 billion (US\$8.3 million)**
- **Loan Security Package** comprises the risk-sharing and a **Debt Service Reserve Account (DSRA)** with 6-months cash collateral



# Risk-sharing Agreement

- **Dakar, Senegal**

## Risk-sharing for a local loan to the municipality of Dakar



# Guatemala - Municipality of Guatemala City

## Risk-sharing agreement for single-credit exposure in the transport sector

### Highlights

- **Financed critical urban transport infrastructure that reduced travel times and congestion in one of the largest cities in Central America.**
- **Improved lives of some 180,000 daily users, many from the poorest segments of the population who depend on public transportation to reach their employment.**
- **Introduced to municipalities in Central America, a new source of commercial funding that does not rely on sovereign guarantees.**
- **Enhanced municipal financial management practices and diversified funding sources through WBG technical assistance.**
- **Created an entry point for a leading Guatemalan bank to participate in the municipal financing business.**



# Guatemala – Financial Structure

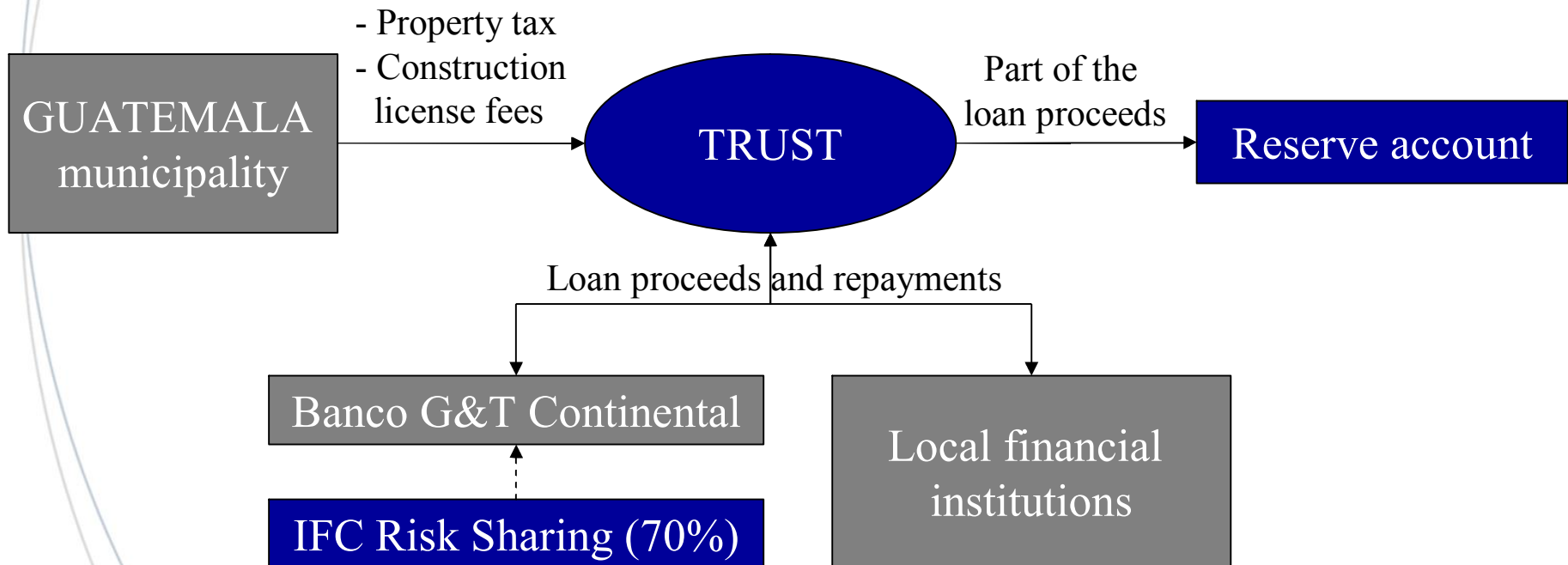
- **A 10-year syndicated loan** for Q279 million (US\$36.7 million) secured by a mechanism that aggregated property taxes and construction licenses in a separate trust account to service specific Municipality of Guatemala City debt.
- **A local currency loan** from Banco G&T Continental for Q72 million (US\$9.5 million)
- **Risk-sharing agreement** for single-credit exposure for 70 percent of the total bank exposure of Q72 million (US\$9.5 million).



# Risk-sharing Loan and Trust Arrangement

## • Guatemala City

Risk-sharing facility for 70 percent of exposure amount to a local bank to finance municipal urban transport infrastructure



## Risk-sharing agreement for multiple-credit exposure in the municipal sector

### Highlights

- **Created an entry point for a leading Peruvian bank to reach the underserved municipal financing market.**
- **Will enable subnational governments to access long-term local currency commercial financing for critical infrastructure projects.**
- **Will leverage WBG expertise to improve the quality and sustainability of local infrastructure and public services.**
- **Will benefit over 75,000 people through accelerated investments in critical local infrastructure.**



# Peru – Financial Structure

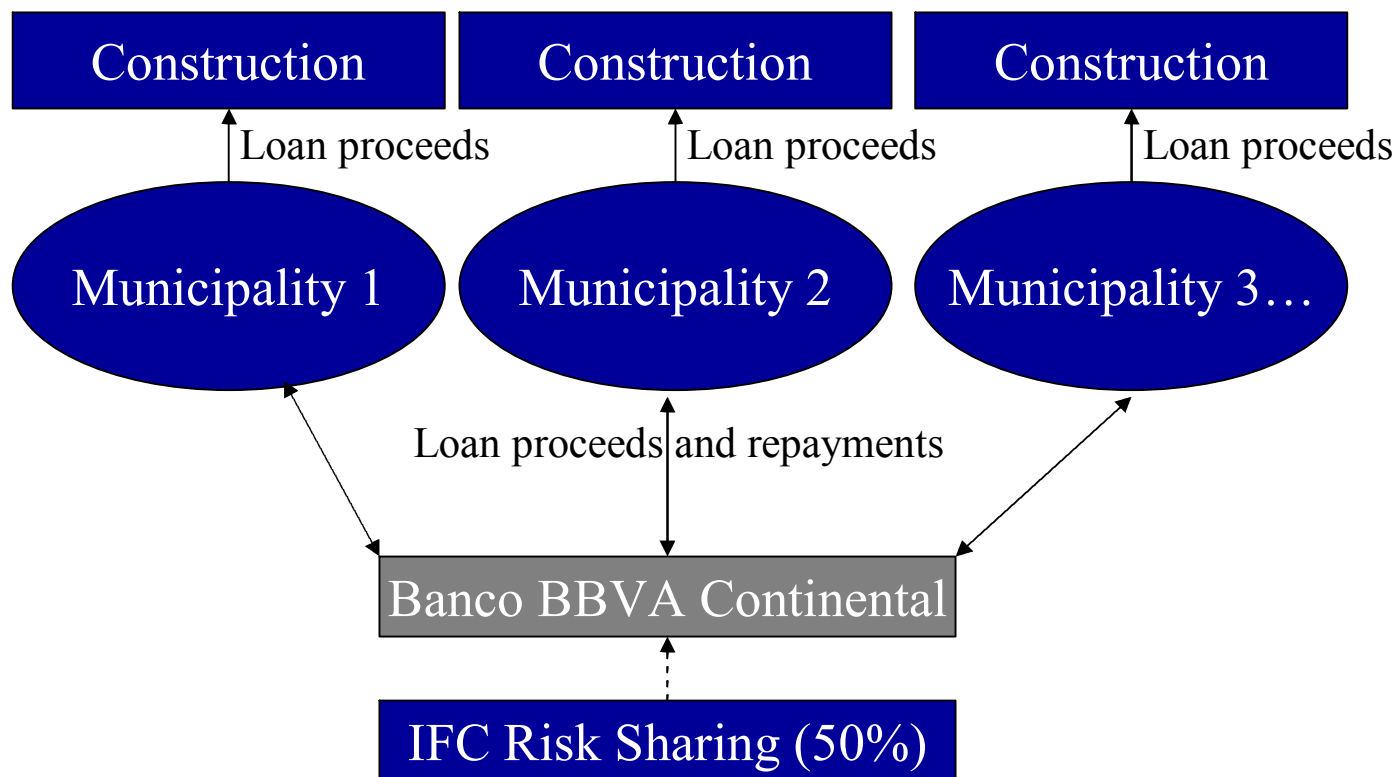
- **A risk-sharing program** of up to PEN 112.5 million (US\$40 million) whereby WBG would risk-share up to 50% of the loans originated by BBVA to subnational governments for infrastructure project finance.
- **Local currency loans** from Banco BBVA Continental.
- **Risk-sharing agreements** for single-credit exposure for up to 50 percent of the total bank exposure.



# Risk-sharing Program

- **Peru, BBVA Continental**

Risk-sharing facility for up to 50 percent of exposure amount to a local bank to finance critical municipal infrastructure



**To sum up – benefits  
and more**



# Comparative Advantages of Subnational Product

## **Faster processing ... more flexible product ... greater borrower control**

### **Subnational financing terms are “commercial”, but:**

- ✓ Faster processing – concept to disbursement typically 3-6 months
- ✓ Does not need National/Federal Government guarantee → gives subnational borrowers greater control over investment choices and borrowing terms
- ✓ Flexible use of proceeds. Can be used by borrower to finance general capital investment plans, as well as specific projects.
- ✓ Uses local procurement laws but requires prudent procurement practices.
- ✓ Safeguards principles are the same – but application is more flexible - builds on and strengthens country systems where possible
- ✓ Upfront disbursements – no need for statement of expenditure, replenishment requests, etc. Disbursements can be staggered to meet borrower’s needs.
- ✓ Can also invest in equity (IFC as a shareholder)

### **May be suitable for:**

⇒ **Relatively urgent investment needs in revenue generating assets**

⇒ **Initial phase of larger investments**



# Other Motives to consider Subnational Finance

- **Diversify funding sources** – move from sole reliance on own source revenues, higher government transfers and multilateral loans → to use of capital market instruments
- become a more **well managed, commercially oriented entity.**
- Use WBG presence as a strategic partner/shareholder, to improve transparency and corporate governance, E&S practices → **improve brand image**
- Investments to Complement WB Loan/Project
- Potentially access TA, such as corporate governance, PPIAF-SNTA



# WBG Subnational Program

- **Joint teams.** Investments appraised by joint teams of CSF and regional sector staff, led by staff from the Bank or IFC. TA activities are normally run by Bank TTL. SDN VP on IFC corporate investment committee (CIC) for subnational projects.
- **Regional resource.** Annual budget available for regional participation. Distribution of budget subject to business demand by each Bank region.
- **Recognition of deliveries.** Loans are booked on IFC's balance sheet, but SN "product type code" enables shadow-booking of deliveries in Bank country and sector unit scorecards, and SAP.
- **Future role of SN in WBG Operations.** Upcoming Board meeting to decide on future structure of SN.



# Sample Transactions

- **Colombia** – Bogota (urban streets, senior loan \$50m)
- **South Africa** – Johannesburg (general infra, bond guarantee \$30m)
- **China** – Guangzhou (power, RMB loan \$50.1m)
- **Guatemala** – Guatemala City (busway, risk share \$6.6m)
- **South Africa** - Buffalo City (gen'l infra, loan guarantee \$6.4m)
- **Russia** - Chuvash Republic (gen'l infra, bond guarantee \$8.3m)
- **Hungary** – OTP (energy efficiency in schools, risk sharing \$130m)
- **Philippines** – PNOC-EDC (geothermal power SOE, equity \$50m)
- **Russia** – Chuvash Republic Roads (rural roads, Ruble loan \$50m)
- **Russia** – Petropavlovsk Kamchatsky Muni (st. rehab, gen'l Infra Rub loan \$28.6m)
- **Morocco** – RADEEJ (sanitation, risk sharing, \$21m)
- **Panama** – Panama Canal (waterways, senior loan, \$300m)

*Exposure US\$700m, investment mobilized > US\$1bn*



# Subnational Finance staff based in the Regions

**Sumeet Thakur**

Head (Hong Kong based)

[sthakur@ifc.org](mailto:sthakur@ifc.org)

**Valentino Bagatsing**

Investment Officer (Manila based)

[vbagatsing@ifc.org](mailto:vbagatsing@ifc.org)

**Rajesh Sinha**

Sr. Investment Officer (New Delhi based)

[rsinha@ifc.org](mailto:rsinha@ifc.org)

**Serguei Kojoukhov**

Investment Officer (Moscow based)

[SKojoukhov@ifc.org](mailto:SKojoukhov@ifc.org)

**Gaetan Tiberghien**

Sr. Investment Officer (Bogota based)

[GTiberghien@ifc.org](mailto:GTiberghien@ifc.org)

**Rogério Pilotto**

Investment Analyst (Sao Paulo based)

[RPilotto@ifc.org](mailto:RPilotto@ifc.org)



For more information...

**Website**  
**[www.ifc.org.subnationalfinance](http://www.ifc.org.subnationalfinance)**

**Thank you**



The World Bank

