



IFC

**International
Finance Corporation**
World Bank Group



THE WORLD BANK



The Municipal Fund
GLOBAL FINANCING
FOR LOCAL NEEDS

The Municipal Fund

The Municipal Fund, an initiative of the World Bank Group, provides financing and credit enhancement to sub-national public sector entities for development projects. It acts as a catalyst to enhance their capacity and creditworthiness without central government guarantees.

Scope. The Municipal Fund is building an investment portfolio in all emerging regions. It will consider projects in a wide range of sectors (water, wastewater, transport, electricity, solid waste, district heating, and any other essential public services) and with a wide range of sub-national entities (local, provincial, or state governments, enterprises, financial intermediaries). Local governments can manage the investments directly or in the context of public-private partnerships. The Municipal Fund will typically look at investments in the range of \$5–50 million. Larger or smaller investments can be considered for particularly sound projects with significant development impact.



Skills. The Municipal Fund draws upon the combined sectoral, credit, and structuring expertise of the World Bank and International Finance Corporation. Its appraisal processes are modeled on private equity funds, allowing for a flexible and rapid response to client requests.

Products. The Municipal Fund invests from IFC's AAA-rated balance sheet and has access to IFC's full line of financial products. Our *lending instruments* include long-term senior, subordinated, and convertible loans, as well as a selection of loan types: fixed rate or variable rate. Loans are issued at commercial rates and provided in major currencies as well as in local currency in several countries. The Municipal Fund uses loan and bond *guarantees* to broaden its clients' access to capital markets. Credit enhancement structures help clients attract new sources of financing in their currency of choice, reduce borrowing costs, and extend maturities beyond what lenders would otherwise provide. Where appropriate, the Municipal Fund can make *equity* investments in project companies, financial institutions, or other entities. *Quasi-equity* products include convertible debentures, subordinated loans, income warrants, and other hybrid instruments. The Municipal Fund can also help local governments access *technical assistance* managed by the World Bank Group and other development partners for capacity building and for sustainable development.

Market Context. Decentralization in many countries has brought the transfer of service responsibilities from central to local governments. These sub-national entities face large investment needs as they strive to improve the quality and coverage of the infrastructure and basic services that are essential to support economic growth and reduce poverty.

However, the regulatory environment in which they operate is still evolving, and their own institutional capacity is uneven. Few local governments in emerging economies are able to fund their investments from market sources, even if they provide services that meet an economic demand. At the same time, central governments that have devolved significant revenue authority are increasingly reluctant to guarantee sub-national borrowings. This results in a growing mismatch between the traditional central government focus of external aid programs, which often require the intermediation or guarantee of the sovereign, and the increasingly local nature of the development process. The Municipal Fund aims to help address this mismatch.

IFC's Experience in Local Water, Sanitation, and Transport Projects

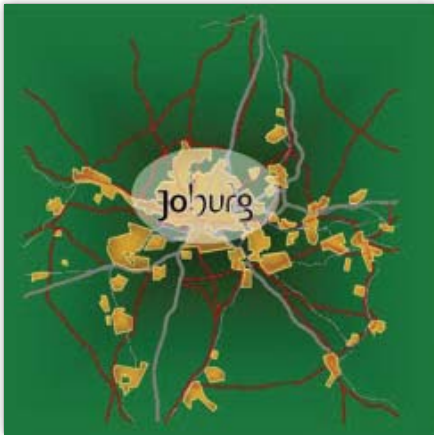
- *Sociedad Acueducto, Alcantarillado y Aseo de Barranquilla S.A (AAA), Colombia.* A partial credit guarantee from IFC enhanced a local currency long-term bond issue by AAA, the water and wastewater concessionaire for the District of Barranquilla. The District of Barranquilla has a 35.1 percent share in the ownership of AAA.
- *Aguas Provinciales de Santa Fé (APSF), Argentina.* APSF holds a concession granted by the Province of Santa Fe for provision of water and sanitation services to about three quarters of the population of the province.
- *Puerto Vallarta, Mexico.* IFC financed the first build-operate-transfer wastewater treatment plant in Mexico operated under a sub-national concession.
- *Autoban, State of Sao Paulo, Brazil.* The State of Sao Paulo awarded a group of local sponsors a 20-year concession for the expansion, rehabilitation, and modernization of an existing highway system.
- *Shanghai Midway Infrastructure Co., China.* Midway is a local Chinese private holding company that operates a series of road concessions in the Zhejiang Province of China, in partnership with county and provincial government agencies.
- *Buga-Tulua-La Paila Highway, Colombia.* This project is a 20-year concession awarded by the Colombian Province of Valle del Cauca to refurbish a 56 km section of the road connecting Cali, Bogota, and Medellin.
- *Bangkok Transit System, Thailand.* This mass transit project, supported by IFC under a concession granted by the Bangkok Metropolitan Authority, helped alleviate traffic congestion in Bangkok.
- *Sepetiba Container Terminal, Brazil.* The project involved the development of a container and steel products port terminal in the State of Rio de Janeiro under a 25-year lease awarded by the Port Authority of Rio de Janeiro.



City of Johannesburg

Highlights

- Rand 1bn (\$153 million equivalent) 12-year bond issue by the City of Johannesburg (South Africa).
- Partial credit guarantee for 40 percent of principal shared equally by IFC and the Development Bank of Southern Africa (DBSA).
- Achieved a national scale rating of AA-, three rating levels above the City of Johannesburg's stand-alone rating.



The City

The City of Johannesburg, with a population of 3.2 million, is South Africa's main business center and contributes more than 16 percent of the national gross domestic product. The City of Johannesburg provides the full range of municipal services, from power distribution to waste management. Its revenues come from property and business taxes and from utility tariffs.

Financing Objectives

The City of Johannesburg's financing objectives were threefold: extend the maturity of its debt to match better the life of its infrastructure assets; refinance existing high-cost bank debt; and diversify

its funding sources. It used a partial credit guarantee to raise its credit rating, extend the maturity of the bond, and tap the institutional investor market.

The Structure

The rand 1 bn bond matures in 2016, amortizes over the last three years, and pays a coupon of 11.90 percent. IFC and DBSA assisted in structuring the transaction and provided a partial credit guarantee. The guarantee, sized at 40 percent of the principal outstanding, was shared equally with DBSA. It can be used to repay up to the full amount of principal and interest falling due and payable to bondholders on any given payment date, subject to guarantee limits, and may also be called upon if the bonds have been accelerated.

Outcome

The enhanced bonds were rated AA-.zaf by FitchRatings. The issue was oversubscribed 2.3 times, reflecting a strong endorsement by the market of the credit-enhanced structure and allowing for spread tightening to 164 basis points above the Treasury benchmark—71 points below the pricing achieved for the City of Johannesburg's inaugural six-year bond (rated A-.zaf) issued in April 2004 without enhancement. The transaction, IFC's first partial credit guarantee in South Africa, has laid the groundwork for further long-term municipal bond issuance.

Tlalnepantla Municipal Water Conservation Project

Highlights

- Mexican pesos 95.9 million (\$9.2 million equivalent) 10-year bond issue by a trust established to raise funds and on-lend to the Tlalnepantla Municipal Water Company and the municipality of Tlalnepantla as joint obligors, to finance a wastewater treatment plant.
- Partial credit guarantee for 90 percent of principal shared by IFC and Dexia Crédit Local.
- Achieved a local scale rating of AAA, two rating levels above the municipality's stand-alone rating.
- First municipal bond issue in Mexico without direct access to federal transfers.

The Municipality and the Company

The municipality, with around 800,000 habitants, accounts for 2.9 percent of the country's GDP. The primary source of repayment of the credit is the water company's water fee revenues. Should these be insufficient, the municipality would have to make up the difference through its own resources. The municipality is currently rated by S&P (A-.mx) and Moody's (A2.mx). For 2004, its overall budget was \$127 million equivalent.

The water company, established in 1991 as a municipal utility, is in charge of providing water and sanitation services within the municipality. In 2004, its revenues were around \$40 million equivalent. In May 2004, the company obtained its first rating from Moody's (Baa1.mx).

Financing Objectives

The municipality's financing objectives were twofold: to better match the maturity of its debt with the long-term nature of its infrastructure investments; and to diversify its funding sources. The enhanced bond issue enabled the municipality to achieve these objectives by accessing long-dated savings in the institutional investor market.

The Structure

The \$9.2 million equivalent bond matures in 2013 and pays a coupon of 5.5 percent on inflation adjusted units. IFC and Dexia assisted in structuring the transaction and provided a partial credit guarantee. The guarantee was sized at 90 percent of the principal outstanding, shared between IFC (\$3.0 million equivalent) and Dexia (\$5.2 million equivalent). The guarantee can be used to repay up to the full amount of principal and interest falling due and payable to bondholders on any given payment date, subject to guarantee limits.

Outcome

The credit enhancement from IFC and Dexia allowed the bond to achieve a local scale rating of triple A, two rating levels above the municipality's stand-alone rating. The bonds were oversubscribed and sold to local institutional investors. The traditional financing structure used to fund states and municipalities in Mexico gives banks recourse, through an intercept, to the state or municipality's allocation of federal transfers. IFC supported the first municipal bond issue in Mexico without direct access to federal transfers.



Technical Assistance

Depending on the needs of the sub-national entity, varying forms of technical assistance can be designed to enhance its capacity and creditworthiness and assist in the project implementation:

- Financial improvement plans, including measures to strengthen revenue generation, the efficiency of expenditures, and the quality of financial controls.
- Training of key officials.
- Independent reviews of existing feasibility and engineering studies.
- Communication, public information, and stakeholder consultation.
- Financial advisory services for project structuring.
- Obtaining credit ratings.

The Municipal Fund provides access to World Bank Group administered technical assistance targeted to sub-national entities involved in development projects:



- Grant funding to finance feasibility studies, sector studies, capacity building, policies to strengthen the business environment, and assessments of environmental and social impacts of investment projects.
- Assistance tailored to the needs of small and medium enterprises, with a focus on business-enabling environments, access to capital, and access to business development services.
- Programs designed around selected IFC investments that increase participation of local firms in the project and bring additional benefits to the surrounding communities.
- Initiatives to improve the business environment and attract foreign direct investment.
- Grants for the improvement of utility services to the poorer sections of communities.
- Grant funding and advisory support to local governments, including assistance in preparing city development strategies to assess the economic development prospects, define actions for sustainable growth and poverty reduction, prioritize investments, and identify financing options.
- Technical assistance grants to develop strategies and identify options for private participation in infrastructure and to build capacity and share knowledge on the design, procurement, and regulation of public-private partnerships.

Technical Assistance in Action

Simplifying Local Business Regulations

Experience has shown that heavy regulation often works against the economic and social interests it seeks to protect. Local government is often the first point of interaction for businesses and where the highest administrative burden is concentrated. The Municipal Fund can help local governments obtain technical assistance to simplify business regulations.

In Latin America IFC has identified simplifying business regulations as one of its principal areas of focus and is giving a high priority to projects at the local government level. The business simplification program began as a pilot in La Paz, Bolivia, and has already grown to encompass municipal and national initiatives in four countries (Bolivia, Peru, Honduras, and Nicaragua) over the course of just a year.



La Paz was selected as a pilot for a number of reasons: demonstrated need, potential impact, institutional support, and political will. The project focused on the administrative procedures required for obtaining a business operating license.

The results were rapid and significant. On average, the number of steps required to obtain a license was reduced by over 70 percent, and the number of visits made by entrepreneurs to the city decreased from six to two—resulting in a 90 percent reduction in the time it took to open a business. The program created a simplification culture within the city, and over 30 administrative processes are now being reviewed and simplified. The use of information technology for tracking applications and capacity building for civil servants has greatly increased transparency in the processes.

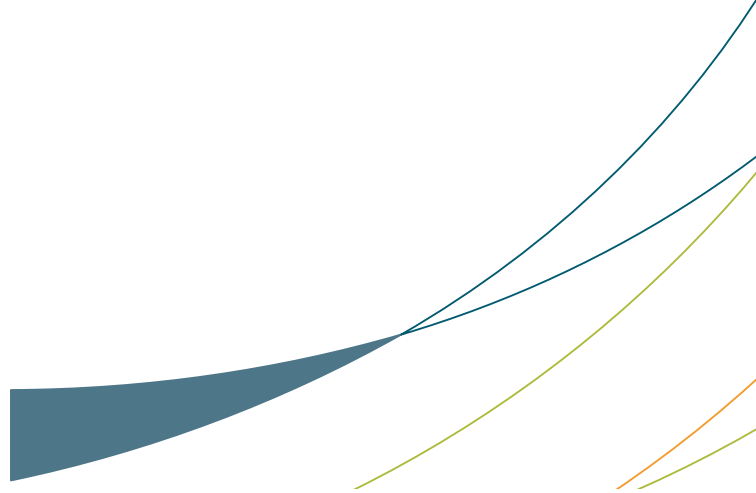


Carbon Credits

Carbon credits are created when a project reduces or avoids the emission of greenhouse gases, such as carbon dioxide or methane. The Municipal Fund can assist sub-national entities in augmenting their revenues by selling carbon credits through IFC or World Bank carbon credit facilities. The Municipal Fund's due diligence process for its investments generates much of the information needed by these facilities to assess a client's potential for carbon credit offtakes, saving them the need to undergo a separate appraisal process. The Municipal Fund could also help sub-national entities raise financing against the expected revenue from carbon credits.



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Contact the Municipal Fund

If you have a project in mind or you have questions regarding the Municipal Fund, please send us your business proposal for evaluation or contact us.

Municipal Fund

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The World Bank

The World Bank consists of the International Bank for Reconstruction and Development and the International Development Association. IBRD aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, and advisory services. In the year up to June 2004, IBRD committed \$11 billion for 87 new operations in 33 countries. IDA enables the World Bank to provide highly concessional financing to the world's 81 poorest countries. In the year up to June 2004, IDA committed \$9 billion for 158 new operations in 62 countries.

The International Finance Corporation

IFC promotes economic development by providing equity, long-term loans, structured finance and risk management products, and advisory services to sustainable projects in developing countries without accepting government guarantees. In the year up to June 2004, IFC committed \$4.8 billion for 217 projects in 65 countries.