AFRICAN REVIEW OF LOCAL FINANCE

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Towards an African Cities Development fund

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Africa currently has three cities with more than 10 million inhabitants (Cairo 17.7 million, Lagos 13.12 million, and Kinshasa 11.58 million): 4 cities where the population is between 5 and 10 million inhabitants: 49 cities with a population of 1 to 5 million; 53 cities with between 500,000 and 1 million inhabitants: and 85 cities counting a population between 300,000 and 500,000 inhabitants. These cities produce about 60% of the African GDP and host a growing middle class that should equal that of China in 2020. The economic weight of this middle class is currently valued at USD 700 billion and is expected to reach USD 1 700 billion by 2030. Experts estimate the annual added value of cities in Africa at around USD 51 billion, and their annual debt capacity at USD 8 billion. The annual turnover of the 200 main banks operating on the continent is valued at more than USD 1 000 billion, and their annual net income at about USD 45 billion. In other words, African cities are now operating in an environment characterized by growing and increasingly mature financial markets. The challenge of financing urban infrastructure and services in Africa is that to be and remain relevant to a new enabling environment.

United Cities and Local Governments of Africa (UCLG Africa) is the umbrella organization and the united voice for the representation of local governments throughout the African continent. It was created by the merger of the three pre-existing associations of local authorities, namely the African Union of Local Authorities (AULA), the Union of African Cities (UVA) and the African chapter of the Portuguese-speaking organization of local authorities União das Cidades e Capitais Africanas, Americanas e Asiáticas Lusófonas (UCCLA). UCLG-A brings together 40 national associations of local authorities from all regions of Africa, as well as 2000 cities of more than 100,000 inhabitants. UCLG-A represents no less than 350 million African citizens.

A 2012 report by the World Bank, AFD and Cities Alliance, Financing Africa’s Cities, estimates that USD 25 billion per year are needed to meet the municipal investment gap in Africa, while the current investment capacity of African local governments is estimated at not more than USD 10 billion over ten years – one billion per year, which is only 4% of the public investment needed for urban development. This figure is far below the two third of public investment managed by local authorities in OECD countries. This sustained gap was identified decades ago, but reducing it is regularly delayed for various reasons.

We will not discuss the amount of needed investments driven by the demographic growth. Indeed, it is expected that African cities will accommodate more than 30 million new inhabitants per year around 2030 (compared to 17 million per year currently). Furthermore, the relatively weak economic growth in many countries affects the capacity to finance urban investments, as well as other infrastructural needs. Fiscal revenues of States and Local Authorities are lagging, weakened among other factors by inefficient tax collection. In that context, weak management capacities and limited residual budget after payment of current expenditure hinder local investment, as well as simple maintenance.

Last but not least, the institutional environment of local authorities improves slowly and only a few countries support effectively local development agendas and autonomous financing. Decentralization is yet on the agenda of most of African countries, but...
there is still a long way to effective transfer of responsibilities. In average, the share of local budget in national GDP lags around 1%. Many urban public investments are managed and financed directly by the State or national entities, such as utilities companies or land development companies. However, management and maintenance of infrastructure and public equipment are often transferred to local government, without sufficient financial transfers and management capacities for the local administrations.

Under those circumstances, local authorities turn to a global strategy aiming to mobilize new resources. Improving creditworthiness and management becomes a supportive framework, dealing with technical issues that the local government has to endorse. Indeed, mobilizing local administration and partners and making decisions that could be unpopular (tariff increase or tax collection) require a shared and clear vision, but also a stimulating goal: put an end to the scarcity of resources.

Governments, along with development banks and agencies, design and implement various strategies aiming at that target. Those strategies are just as diverse as promoting public private partnership, improving public finance (PEFA program, sustained by the World Bank, AFD and many other agencies), support municipal development programs combining improvement of the institutional framework, support to local authorities and direct financing of investment programs, etc. However, these programs stay inside the global allocation of State budgets and the overarching limit imposed by its limited borrowing capacity. Improving transfers and transferring credit lines to local authorities appear to be in competition with all other national priorities. Therefore, Mayors and local managers look to diversify their resources.

2.2. Environment rating of Cities and Local Authorities

In 2012, UCLG Africa and Cities Alliance have come together to produce the study Assessing the institutional environment of local government in Africa, published in September 2013. The aim was to assess the enabling environment for well-functioning cities and local authorities in African countries. 50 countries were scored. The report analyses 10 criteria at national level, and rates each country on a four grades scale (1 to 4, highest score). That study does not evaluate individual cities, but the legal framework, common practices and ongoing improvements. Somewhere, it is the baseline from which each city will have to establish its own creditworthiness. Data were actualized in 2015 (on the basis of 2014' latest available data). Without forgetting that all components are linked, four criteria are more directly linked with creditworthiness evaluation and access to financial market. These criteria are the followings:

- Legislative framework (N°2),
- Financial transfers from the central government (N°4),
- Local government’s own revenues (N°5),
- Transparency (N°7).
In the study, the sixth item “Capacity Building of Local Governments Administrations” refers to the existence of a national framework of reference defining the qualification and responsibilities of local government staff, supported by a national training strategy. This item is too large to be really relevant for our purpose.

Table below presents the scores of all countries for these four indicators. For analyses, last columns give three global scoring:
- The global UCLGA’s scoring for the ten indicators
- The financial scoring by selection: that is the number of items scored 3 or 4 about the four financing criteria,
- The total of the 4 financial scores.

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<th>Financial transfer from the central government</th>
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Analysis by criteria

Table below totals scores for the four financing criteria.

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That global picture shows that it is a long way to before all local governments in Africa can access to financial markets. Nevertheless, that is a global picture than needs to be refined, in order to identify opportunities and fast result actions.

The legislative framework appears to be sufficient in 75% of the countries. That result appears of first importance. Indeed, it says that improving the overall rating depends on technical and administrative works that can be undertaken by the local level. However, national support would be indispensable in many countries, particularly French speaking ones, because local State’s administrations contribute to fiscal and treasury management of local authorities. The Central Government is also fully responsible for improving financial transfers, hat shall meet basic requirements: clear and predictable allocation, transparent distribution among local authorities, and absence of restrictions for the use of transferred funds.

Resources transfers from the central government appear as a serious concern. Indeed, only seven countries ensure predictable transfers. 85% percent do not meet the minimal requirements, and more precisely:

- 31 countries (2/3) does not ensure transfers of resource, or erratically and irregularly. External revenue should be secured only by own revenue (score 1 for “financial transfers”).
- 12 countries (1/4) transfer resources and distribute them among local governments, but annual amount and methods of distribution are not transparent, leading to low predictability for the recipient (score 2 for “financial transfers”).

Even though, financial markets could accept that the borrower relies only on its own revenue, the possibility that a share of expected revenue, transferred from the State, could be cut or not fully secured diminishes dramatically the creditworthiness.

The issue of local governments’ own revenues seems more complex. Four out five countries are badly rated on that item (rating of 1 or 2).

- 24 countries (1 half) define and collect local government revenue, and local authorities are prohibited from borrowing and/or accessing the financial market (score one for “own revenue”).
- 15 countries (1 third) give some latitude to local governments to determine rates for existing taxes, but the central government is responsible for setting tax bases, creating new taxes and accessing loans and financial markets.

However, further investigation might be recommended, as the definition of the criteria appears relatively strict. Indeed, it aggregates many important parameters when studying creditworthiness: determination of tax bases, setting of tax rates, tax collection management, accessing loans and financial markets. There is not a clear consensus on what defines financial autonomy of local governments. In many developed countries, the state government keeps the responsibility to set the list of possible local taxes, as well as the bases of local taxes, without undermining the creditworthiness and capacities of municipalities and other government to design and implement their own policies.

Although three out of four countries do not reach level 3 for the “Transparency” criteria, it doesn’t prevent a particular city to meet international requirements, such as Dakar which has met them while preparing its bond issue. Indeed, a local government has the power to commit itself for better transparency, beyond national regulations. Therefore, international guidelines and support would be useful to help cities to meet international standards and be able to borrow from the Fund.

Synthesis

A supporting national context for municipal finances will help to increase creditworthiness of each city. We will use the number of criteria that reach level 3 or 4 as a first proxy.

Only eight countries reach three or four times the scores 3 or 4 (Kenya, Morocco, Namibia, South Africa, Swaziland, Uganda, Zambia and Zimbabwe), a significant improvement of 5 countries compared with 2013. Six countries reach scores 3 or 4 for two criteria, a stable result. One country out of two (56
(€ 500 million since 2011 (ZAR 8 billion), about € 1,263 million of outstanding bond issues. Municipalities benefit from a deep market, and their emissions represent only around 1 % of the whole stock. Furthermore, only the biggest cities enter the bonds market, such as Johannesburg, Cape Town or Ekurhuleni. Nigerian cities have issued a similar volume of bonds (€ 1,186 million) in 23 emissions, also only in local currency (naira). It represents about 7 % of the sovereign emissions, a far larger scale of all emissions.

Other examples have not shown great success:
- The city of Nairobi succeeded in issuing bonds, but it failed to reimburse them.
- The city of Douala issued bonds in the early 2000, with the guarantee that the State will allocate the municipal tax income (collected by the Treasury) to reimbursement of loans in case of default. By the way, the State did not accept to pursue this policy after a few issuances.
- Dakar prepared a bond issue in 2014 with many supports, including USAID and the Gates Foundation. But the National government blocked the issuance a few days prior the launch.

In order to overstep those difficulties, the idea of pooling for better access to the bond market shall be studied further, building on the experience accumulated around the world.

2.4. Special financing vehicles around the world

36 Municipal banks or funds are still operating or prepared to operate in the world. Most of them are located in North America (8 in Canada, and 15 in the USA). 8 European and 3 Asian countries developed such a tool. In emerging countries, only local authorities in Mexico and in the Indian State of Tamil Nadu benefit from such a financial tool.

The majority of these funds have been set by states. In Europe, local authorities are more often associated to the governance, and even are the sole shareholders of the Fund (British Columbia, Denmark, France, Japan, Sweden, and the United Kingdom). Annex 1 summarizes the lessons learned from existing vehicles, including short descriptions of 12 funds, chosen for the diverse solutions given to the common challenges.

2.3. Issuing bonds, a new frontier

In that context, many local managers are looking for leeway, aiming to ensure better services and restore investment capacity. Mobilizing private funds shall support a strong increase of investment capacities, and invite/oblige the local administration to improve financial management, increase transparency, and enhance budget allocation and strong monitoring. The new frontier: accessing the national and international bond market.

At present time, only a few African cities have issued or prepared bonds issuances in the domestic or international capital markets. The door was opened two centuries ago by the city of New York, which issued in 1812 bonds to finance a new canal. Yet, supported by legal and fiscal incentives, the market of municipal bonds is worth $3.8 trillion, around 10% of the US bonds market. However, in Africa, only South African and Nigerian cities succeed to develop a municipal bond market in their country.

In South Africa, 17 municipal bond emissions have been registered since the first emission in Johannesburg, in 2004. However, after a pretty rapid growth until 2011, the development of this resource is now slowing down. South African cities have issued € 500 million since 2011 (ZAR 8 billion), about € 1,263
2.5. Backing the municipal fund, an opportunity for sustained local investments

Like in older urbanized countries in Europe and America, cities and countries of Africa must find efficient ways to increase investment in infrastructure and services, particularly in cities that will accommodate 450 million new inhabitants before 2030. As seen before, financial needs totalled $25 billion per year. Allocating a growing part of national public investment will not be easy, even if the main sectoral infrastructures such as universities or hospitals are located in cities. Indeed, national budgets are and will continue to be under constraint for a long time. Reduction of customs duty is a main condition to participate more actively in the world economy and will be difficult to replace. Debt management and other priorities such as agriculture, energy, forest, or education will not let many opportunities for new transfers to local governments. Therefore, national and international policies aiming to increase awareness and responsibilities of local governments appears as very critical. However, improving local governance, tax collection, and expenses quality represents a sea-change for local administrators. Obtaining support from the population and local economic actors might be difficult because such a new policy would impact acquired positions. Yet, many examples of quick win projects already demonstrate the shared benefit of better managed cities. However, filling the investment gap needs a bigger jump of local resources, which implies giving the possibility to municipalities and local governments to finance main investments that have sometime been identified for a long time. Therefore, backing local governments willing to work together and share risks for a better access to bond markets will offer many benefits for international financing institutions, and particularly the African Development Bank:
- Entering in such a process, municipalities would be encouraged to accelerate reforms and progress, aiming to reach minimal criteria set by the mutual fund that is their own community.
- As a risk management tool, the fund will reduce transaction costs for both municipalities and lenders, at first international development banks.
- As a new tool, well responsive to municipalities needs, the fund will facilitate growth of the overall volume of investment financed in Africa, boosting growth through induced activity and improvement of cities services.
- Designed to work with cities of all sizes, the fund will be a unique financing window for middle size and small cities.
- Embarking mayors and municipal executives, the governance of the fund is also an opportunity to disseminate the culture of financial responsibility among local governments and their administrations.

In addition, benchmark shows that international public financing institutions are interested to subscribe bonds issued by municipal funds. Last but not least, the management of African Development Bank and other active development banks in Africa should be interested to enter in a direct relation, in a real partnership with mayors and other chairpersons of local governments. In conclusion, backing a municipal pooled mechanism appears a promising answer for development banks in Africa willing to achieve the goals of the New Urban Agenda. Detailed possible provisions should be studied while preparing arrangements among local municipalities.

3. BUILDING THE DEVELOPMENT PROCESS OF THE ACDF

Creditworthiness remains the baseline issue when building a financing vehicle. It has to be tackled at the level of the vehicle, that will approach the market, and at the level of each local authority. Indeed, the first guarantee offered to investors is the quality of the portfolio of the vehicle, measured by the default rate. It appears that existing vehicles around the world does not suffer from default and, therefore, obtain very high rating even without any guarantee of the State (cf. annex 1).

All following proposals shall be understood, taking good account that this double level of creditworthiness is a main concern when designing the vehicle.

3.1. Keys parameters

Servicing Local Governments, owners of the Fund

3.1.1. Servicing all size of cities, but only cities at first

All cities, regardless their size, shall have access to the vehicle. The only condition is to reach the creditworthiness criteria that the fund will apply for its lending operations. They are many convergent reasons:
- Medium and small cities have more difficulties accessing financing, in regard of transaction costs,
- Political support will be reinforced,
- Experience, particularly in Europe, demonstrates the benefit of a large coverage.

Expansion of lending activities to other entities, such as public bodies managing utilities, social housing companies or other public companies owned by local government could be develop only after securing the first class of activity. Indeed, these entities constitute another category of risks that would need specific risk assessment.
3.1.2. Focusing on long term funding

The cities development’s need is to finance public infrastructure and utilities, including schools and other buildings. Amortisation of such investments is quite long, often over 20 years. Therefore, the goal is to provide long term financing to municipalities and local governments.

7 to 15 years commitments of the vehicle would probably be considered as pretty long, giving the current conditions of the financial markets in Africa – a maturity of 7 years would be considered as long, at least for the first issuances. Even if local government’s investments require longer terms, the vehicle will stick at the market maturities at the beginning of its operations. It’s only in a second stage that it would take the risk of maturity transformation, a more risky activity in regards of liquidity risk and refinancing costs. Finally, the issue of refinancing debt of local authorities would only be considered in a later stage.

It is also clear that the vehicle will not finance current deficits. Indeed, an annual surplus is a prerequisite to access the financial market, even through the vehicle.

3.1.3. Lending to municipalities only in local currency

Municipalities and other local bodies are not able to manage currency risks. Their revenues (taxes, revenue of assets, and State’s transfers) are in local currency and they do have no capacity to evaluate and manage such a risk. Some bad experiences of local authorities in other parts of the world invite to be very careful.

Therefore, loans of the vehicle to local authorities shall be denominated in local currency.

One sole exception could be accepted, when the currency is not convertible. In that case, the exchange risk shall be guaranteed by the state.

3.1.4. Local governments driving the vehicle

Working on a municipal pooled financing solution, African local government express their will to take ownership on access to international finance markets, opening a window that is not under the strict control of states and international financing institutions. Therefore, the vehicle governance shall reflect their effective ownership. The design of the process is of great importance to ensure success on that particular but central goal.

It implies a strong implication of local government in the preparatory process, including ensuring the financing of feasibility studies and other expenses. The designer of the vehicle shall also looks at innovative solutions, aiming to ensure political control (i.e. the majority of voting rights in the instance that decides strategy and control effectiveness), without weakening creditworthiness.

The diverse designs of existing vehicles around the world give a large basket of ideas. At that stage, it is possible to point out some specific arrangements. In Denmark, KommuneKredit is a cooperative society of cities. In Sweden and France, local authorities own a holding company (a cooperative in Sweden, an ordinary private company in France), which subsidiaries are financial institutions. That late scheme secures the double power of local authorities and financial specialist, aiming to ensure confidence to both elected people and bankers. The Tamil Nadu Urban Development Fund is a Trust, housed by a specific vehicle.

Other schemes used by private companies to ensure the power of specific shareholders have not been studied for municipal funds.

3.1.5. Getting an investment grade rating

The aim of the vehicle is to give access to the financial market at good conditions (maturity, interest...). Obtaining an investment grade rating (international market) is a prerequisite, albeit most of the cities in Africa would not obtain alone such a rating. In order to secure the first issuance, the selection of the first borrower’s basket should probably include some already rated cities at investment grade.

However, the full design of the vehicle shall take into account that extremely important objective when choosing a governance scheme or drafting the risk management framework...

3.1.6. Reaching quickly a sufficient volume of activity

Investors are looking for a good liquidity. An important parameter is the size of the bond emissions, allowing a minimal activity on the secondary market. It is accepted that an annual emission volume of M€ 750 is the minimal threshold to enter the international market in Europe. African national markets accept lower activity’s threshold, particularly from well-known entities – around M€ 100. However, as an international institution, a minimal size to be determined would participate to the Fund’s credibility.
3.1.7. Separating political governance & professional management

Investors and financial partners are very averse to the risk of political pressures on lending decisions and loans management. Indeed, disbursed loans are the sole asset of the vehicle and the quality of the portfolio would be ruined by the introduction of other criteria than the capacity to reimburse in decision making. Therefore, transparency and independency shall be at the heart of the institution. Ensuring the balance between political will of local authorities, technical capacities of high management, and implication of individuals recognized by the financial community, will need careful consultations and precise rules written in the status and the internal regulation. There are also many lessons to be learnt from other experiences, understanding the deep (and often hidden) reasons why some specific dispositions were adopted.

As a first step, owners of the vehicle, mayors have to give a strong signal to the financial community that they will not intervene in the daily management of loans and relations with local governments. They have to design an institutional framework, as well as procedures that ensure a strict independence of directors in charge of loans preparation, negotiation and decision.

3.1.8. Building a comprehensive and resilient guarantees package

Lenders will require strong guarantees prior any deal with the new vehicle. A large range of solutions is experienced around the world and the feasibility process will have to determine the best scheme. Classical solutions are the following: State guarantee, borrower’s guarantees, shareholder’s guarantees, reserve fund, one year liquidity buffer, legal provision, etc. The cost of those guarantees can be significant, particularly for institutions submitted to bank regulations. In addition, the project should look at external credit enhancement.

3.1.9. Organizing strict internal control

Like all banks, the Fund shall organize precisely internal control, relying on standard organizations and procedures: giving effective power to independent committees (operations, risks, quality, and audit), drafting precise but fluent and transparent procedures, auditing regularly operations and clients...

Managing a complex and innovative establishment process

3.1.10. Failing the 1st issuance is « lethal »

As a public owned entity, the vehicle will not have another chance to come to the market if the first issuance does not succeed. Indeed, matching political will and support and investor’s confidence is a long process. A failure will need a precise diagnosis: any change in the structure of the fund will need a new approval process, among all local authorities and involved public partners. The simple perspective of such a difficult negotiation would report the project for a long time.

In order to tackle that risk, precise preparation would include a cautious selection of first risks basket of cities, roadshows and also mobilizing banks and investors that will guarantee the issuance.

3.1.11. Building confidence as of today

Opening a new financing window for African local governments is a big deal for many partners in the development community, but also among investors. These potential shareholders will follow the progress made, make proposals and intervene in the decision making process. From today, lengthy processes, difficult political debates and incredible expectations will be reported and . The risk to weaken interest and support shall be considered and managed from now, as for any major project that needs to build a large consensus.

From now, managing communication and strengthening a first club of supports among local governments, national governments and the international financing community is part of the whole process.

3.2. Other issues to be tackled during the establishment process

3.2.1. Reaching a market share that benefits local authorities

The possible impacts of municipal funds on local government financing are numerous, depending on historical contexts and efficiency of local financial markets. Existing municipal funds demonstrate that various choices enable better access to large and cheap resources for municipalities.

-Covering the main financing needs of members (KommuneKredit covers 98% of municipal financing needs in Denmark) ensure a full access to the better resources. Indeed, following that strategy, the Fund is the main public issuer after the State, becoming an important asset for diversification of public risk in investor’s portfolios.
3.2.2. Choosing a supervision model or drafting a specific one

Delivering credit, all independent pooled financing agencies are submitted to bank regulations, except noticeable exceptions. In Europe, the two exceptions are the new UK Agency (by law) and in Denmark (exemption noted in the applicable EU directive). In the US and Canada, the majority of State Corporations and Crown Agencies are not specifically regulated, being part of the State administration, despite management autonomy and direct access to the financial market. Finally, international institutions are governed by their own rules, including internal but independent supervision.

The relation between ownership and supervision scheme needs probably more investigation. Indeed, the capacity of a group of African cities to supervise a financial institution could be discussed.

Being submitted to bank regulations imposes specific management arrangements that are costly and need minimal borrowing activity.

Therefore, careful attention is needed while tackling this sensitive issue. The choice of the model, then choosing the national applicable regulation will have large impacts on management and daily activity. The same attention is needed prior choosing fiscal regime and other applicable legislations. The choice of headquarter will have to take these issues into account.

3.2.3. Advising local authorities

Opening a new window for financing investment, the vehicle shall ensure that the creditworthiness of involved municipalities is increasing, reinforcing the overall solvency. In addition, support to municipalities which don’t meet minimal requirement is mandatory. Indeed, the perspective to open access to all municipalities and local authorities will increase local political support. Developing the lending activity is also critical for the vehicle, contributing to reduce margins and dilute residual risks in a larger portfolio.

3.3. Designing the vehicle

3.3.1. Business model

The business model of the vehicle is structured by three main choices, to be decided at an early stage of preparation, but after precise assessment of advantages and drawbacks. These choices are related to positioning the vehicle, targeting eligible governments, financing projects or credit lines. The final decision need to articulate strong political positions (from local and national levels) and tough technical issues related to risks, legal and currency management.

Positioning the vehicle

In the context of an African Fund, addressing the needs of cities in the whole continent, assessing different options of business model will be the first stage. Indeed, two main solutions could be considered: direct lending to local government or refinancing national entities, acting under national rules. It’s not time and place to conduct a deep analysis of advantages and drawbacks of each solution, and looking at other paths. The following presentation aims only to point the importance of that issue out.

Direct lender: the fund lends to each local government. The relation is clear: local government are shareholders, part of the governance, and benefit directly from the project. The Fund develops direct relationship with its members, reinforcing its knowledge of field realities. However, it has to manage the large diversity among cities and countries.

Refinancing national entities: in many countries, national development funds finance local governments. If distributing State’s subsidies is still their main activity, some of them develop credit lines, refinanced by international development agencies, as well as technical support. A scheme mobilizing these national tools would simplify the daily activity of the Fund. However, local authorities will lose the direct relation with the Fund as client, even they have the ownership. In addition, cities and local authorities are rarely associated to the management of the national entity.

Other hypotheses would probably appear while appraising this issue.

Targeting eligible local governments
Each country has its own categories of Sub-sovereign entities. At first, cities, districts, regions constitute the heart of the target. The Fund could consider, probably at a second stage, an extension of activities to other public entities, such as public companies controlled by local governments. Many existing vehicles have develop activities for this kind of bodies – public companies running utilities, managing public housing stocks, water authorities, etc.

Some specific issues shall also be analyzed and discussed. It’s the case, for example, of federated states in federal States. In the US, local government are ruled by each federated State, that are de facto not sub-sovereign for the purpose of local government financing.

Financing projects or credit lines
The design of the portfolio perimeter is a key issue for the Fund and for local governments. Many options can be considered: financing projects, as it is usual in Africa, currently, or financing the investment budget on the basis of multi-years investments plans.

The first option would build on well-known management capacities, on both sides of local governments and professional supports. However, the Fund will appear as an additional credit line for main projects – that are not too difficult to finance- on the disadvantage of the current investments activities that are the Achilles’ heel of cities. The need of a better financing of maintenance, infrastructure improvement, neighbourhood equipment is the real priority. Managing a large programme of local investments would also overload the preparation and control activities of the Fund that would be involved in project management and supervision.

Focusing on global financing of investment needs, the Fund would close a gap of financing. It will simplify the loan’s preparation, looking at the creditworthiness, the sustainability of the city’s debt, and the quality of financial management.

### 3.3.2. A prerequisite: accepting the primacy of ensuring the portfolio quality

The quality of the portfolio is a main concern to ensure sustainability. Indeed, this quality is the main criterion that will sustain a good rating, that is ensure the capacity of the vehicle to raise funds at an acceptable price.

A specific strategy shall be endorsed by all local participating local governments, as basis of the design of the Fund. Even when members of the Fund, cities and local authorities will be submitted to strong quality assessment and control of their creditworthiness, affecting the eligibility to borrow to the Fund, but also maturity, spread and other characteristic of the financing. The political acceptance of these rules by all municipalities and other local governments that enter in the process is a prerequisite for the project.

### 3.3.3. Business plan

Building on the business model, drafting the business plan would be a classical (but very innovative) exercise, tackling a long list of issues:

- **Market**: number and borrowing capacity of eligible local governments that are creditworthy, market share, acceptable spread... Perspective of future development, funding less creditworthy cities only after having secured access to financial market, rating, and capacity to manage risks;
- **Revenues**: fee based / fund based;
- **Currency management strategy**;
- **Applicable legislation for operations, including tax regime**;
- **Applicable legislation for management**;
- **Profitability**.

### 3.3.4. Risk management framework

Aiming to bridge the gap between local governments and the financial market, the Fund shall be designed to manage the existing risks that will not disappear at a foreseeable future. The Fund is not averse to risk: it manages risks through a well-designed risks policy.

Drafting a strong risk management framework shall therefore be undertaken at an early stage. Thorough the whole process, all proposals shall be challenged, taking into account impacts on risks.

At this stage, the first list of risks to be assessed would be the following:

- **Portfolio quality**: default risks, selection of borrowers...
- **Country risk assessment**: recognition as an pan African risk, not linked with the African worse case:
- **Funding costs**: rating, size of issuance, balance between African and other markets...
- **Market risks**: currency management and interest rates...
- **Funding and liquidity risks** (timely payment of debt, drawdown, working capital): refinancing capacity, liquidity buffer (at least 1 year of repayment and disbursements);
- **Guarantees given by shareholders for the whole activity (not only covering their own debt)**...
- **Credit guarantees schemes**.

#### Equity strategy comparison

Under banking regulation, the minimal leverage ratio under Basel III regulation is 3 % (tier core one capital related to all assets).

International financing institutions apply another scheme: they call only a small share of very large subscribed capital. The remaining amount, the callable capital, constitutes a strong guarantee. With 65.5 billion Unit of Account, AfDB capital is around four time 16 billion of outstanding loans. However, with 4.9 billion, called funds represent only 7.5% of the subscribed capital. In comparison, Basel III regulation would requires only €12 billion capital.

1. AfDB’s Unit of Account equal IMF’s Special Drawing Rights that is C 1.2
2. Not taking into account other requirement that may be demanding
3.3.5. Structuring the capital

The capital structure of the vehicle participates to the quality of the fund. At least two schemes shall be considered and assessed at the early stage of drafting the first business model. First, the vehicle is a limited company, owned by the participant local governments. Other members could be invited, such as States and International Financing Agencies, aiming to enhance the creditworthiness through their own excellent ratings. As a limited company, the Fund would be regulated by the legislation applicable in the headquarter State. Secondly, the Fund is an international institution, or is backed by an international institution – the African Development Bank would be first option. In that scheme, the Fund would be regulated by its own status, without references to national legislations, at least for business operations. Both schemes have advantages and disadvantages. For example, a large callable capital is a strong contribution for an excellent rating of an international institution. However, that callable capital is a strong tool aiming to collateralize risk among shareholders. Other schemes are possible, such as backing the Fund by AfDB, but adapted governance would be mandatory. Indeed, the backer should have enough control to ensure a sufficient guarantee. Ensuring ownership of local government could therefore be challenging.

3.3.6. Containing processing costs

Members invest in the Fund in order to obtain competitive financial resources. If mutualisation will give access to good market conditions (and in some case simply give access to long term financial resources), the advantage in terms of rates will not be very large. Indeed, once the market open, investors will compete to finance local government. Therefore, keeping processing costs under control is a strategic issue, aiming to maintain margins at an acceptable level. On another hand, a high quality process of recruitments, organization and preparation will establish the accountability of the new vehicle. Attracting an experienced team with the goal of building and launching activities rapidly will need a precise preparation, including mobilizing in advance key managers. Balancing these two objectives is one of the difficult tasks of the management.

3.4. Owning and governing

On the basis of the business plan, drafting the legal set up and detailed organization will have to tackle a large set of issues, such as Corporate governance (general assembly, board, committees and advisory board...), independency of the main committees (particularly Investment committee), voting rights, as well as many issues that are specific at an international body (choice of applicable legislations, dispute resolution mechanisms, etc.)

3.5. Getting the local governments ready

Getting local governments ready aims to ensure that they will fulfill the conditions that will allow the Fund to approve and disburse loans. Accessing those new resources is a perspective that would undoubtedly encourage elected people and managers of the administrations to move forward and solve the numerous issues that local governments face in Africa. Identifying key actions and partners willing to support that movement shall begin at the early beginning of the preparatory process of the Fund. Three main axes are identified at this stage.

Drafting the lending policy

The fund’s creditworthiness is at the heart of the lending policy. Indeed, the quality of its portfolio and the management is critical: selection of borrowers, definition of borrowing ceiling, differentiation of interest among borrowers, follow-up and management of possible difficulties, etc. At an early stage, the main characteristic of that policy shall be drafted and discussed in the Initiators Club. That first dialog will help to measure progresses that members shall achieve for being members of the first deal.

The main items of that policy are the following:
- Assessment procedure of LG’s creditworthiness,
- Scoring scale,
- Lending rules, based on the scoring scale and other parameters of the borrower (size, budget...), such as borrowing ceiling, spread, maturity...
- Support to borrowers and candidates, aiming to ensure that criteria are fulfilled over time.

Improving local capacities to manage financing

As members, partners, and borrowers of the fund, cities will have to manage their different positions which also imply different interests. Therefore, entering in that complex international scheme is an entirely new experience for political responsible persons, such as for directors of finance. If increasing quality of budgeting and expenses management is a well identified challenge, other linked issues are pretty new: meeting international standard for borrowing, contributing to the definition of the strategy, investing capital in the fund, not to speak about accepting an external audit, even if conducted by the fund itself.

Director of Finance have a critical role to play, at both level of their municipality and of the African club that will prepare and finally join the fund. Indeed, they will be actively mobilized when designing the fund, particularly when assessing conditions to join the fund and to borrow, then defining borrowing conditions. In the meantime, they should be active to prepare their city, improving creditworthiness and drafting long term financial perspective. That should include in-depth work with other department, aiming to maintain current expenses at a reasonable level and to improve absorption capacity.
The latest shall not be underestimated. Mobilizing additional resources is an opportunity to increase investment. However, the lender will request effective disbursement and useful usages, contributing to a more efficient local economy and improving willingness to pay taxes. That risk of misuse of additional resources is well documented around the world.

The African network of Directors of Finance develops benchmarks, experience sharing, and training aiming to improve financial management of cities across the continent. Extending activities to creditworthiness, long term financial planning, and borrowing would be an important preparation step of the fund. These new activities would also give opportunity to extend partnerships around the network.

Partnering with programmes aiming to reinforce creditworthiness
Several programs aim to improve financial management and creditworthiness among local government in Africa. Identifying and partnering with those programmes will contribute to enlarge the support to the project, while improving local government capacities.

It is to know that the main institutions acting in that field around the world launched PEFAs program in 2001, and opened the programme to sub-sovereign entities in 2009. In Africa, 126 entities completed or will complete evaluation before the end of 2017. The programme encompasses all kinds of local governments (cities, districts, regions) and also 22 federated states in Nigeria. Cities which have issued or prepared issuance, have benefited from that assessment programme (Douala, Dakar, Johannesburg, Tshwane...).

Equity strategy comparison
Under banking regulation, the minimal leverage ratio under Basel III regulation is 3% (tier one capital related to all assets).

International financing institutions apply another scheme: they call only a small share of very large subscribed capital. The remaining amount, the callable capital, constitutes a strong guarantee. With 65.5 billion Unit of Account, AfDB capital is around four time 16 billion of outstanding loans. However, with 4.9 billion, called funds represent only 7.5% of the subscribed capital.

In comparison, Basel III regulation would requires only UoA 500 million capital.

1 AfDB's Unit of Account equal IMF's Special Drawing Rights that is € 1.2
2 Not taking into account other requirement that may be demanding

3.6. Mobilizing partners and at first, States

All local governments would need approval of States to take shares of an international vehicle, as well as, in many countries, to borrow at that vehicle. In some case, legislative changes might be necessary, allowing local authorities and government to enter in such a case. Therefore, building confidence among States and international partners is on the critical way.

The promoters of the Fund shall design a specific mobilization strategy at an early stage, including the followings (the list does not determine priorities at this stage):

- Forming a first club of cities, politically and technically involved in the preparation of the Fund,
- Establishing a relationship with AfDB, a reference partner for discussion with states and Ministers of Finance,
- Mobilizing a club of supporting states (10 members at least, including Ministry of Finance and Ministry in charge of Local Authorities),
- Informing and mobilizing national Associations of cities,
- Partnering with Development Banks active in Africa,
- Establishing good relations with institutional investors (mainly Africans), Pension Funds, Rating agencies and other members of the financial world,

In a second stage, valuating expected collateral benefits would contribute to a better understanding of mutual interests and help investors and their advisors to make decision to cooperate and finance the Fund.

At least, beginning at an early stage, managing relations with members / potential members and candidates is a key activity of the Fund that will need a dedicated person or team.

3.7. Prefiguring and launching

Contributing to confidence building, the preparatory process shall be transparent and visible, giving opportunity to all interested parties to make contact and engage discussion, as well as partnership. Therefore, specific decision is needed to organize the prefiguration and prepare the launch of the vehicle.

Some important steps are clearly identified:
- Inviting a 1st municipality club, whom president will organize the political dimension of the project. The club will also manage the technical preparatory process, probably with the support of a credible and existing institution,
- Funding the preparatory process (feasibility studies, communication, legal studies, roadshows...),
- Negotiating the legal arrangements with States and other involved institutions,
- Recruiting the first manager by anticipation,
- Designing the 1st issuance (selecting the first group of beneficiary, etc.),
- Roadshows and marketing, etc.
4. ROAD MAP AND RECOMMENDATIONS

4.1. A four years road map

The proposed road map aims to fulfill two contradictory objectives. The first one is to build properly confidence and support among local authorities, States and public financing partners, such as AfDB and bilateral financing institutions. In a more private approach, the second is to be able to put without delays a comprehensive business plan and issuance design on the table that would mobilize private partners and investors willing to take part of the process. At the crossroad between private financing and public management, the Fund has to face these contradictory injunctions.

Building confidence among public parties is a political process that should be managed by “The Club”, a first group of cities willing to benefit of the first issuances, supported by around ten African States opened to facilitate access for Cities to financial markets. Inviting and organizing the governance of that first club will prefigure the issues to be tackled at the time of the creation of the Fund itself. The club would aim to manage the prefiguration process of the Fund, mobilize financing (around USD 2 millions) and organize needed negotiations with States and other public partners.

Drafting a first business plan would need private investors and advisors to look under the bonnet, entering in preliminary discussions aiming to consolidate the model – business model, beneficiary, risk management framework... Recruiting a group of consultants that will complete a strong feasibility study comes therefore among the first steps of the roadmap. However, if finding the financing might not be too difficult, these studies shall be monitored by future beneficiaries, ensuring that the experts will keep doors open for future negotiation and help all stakeholders to move forwards. It is likely that revisions and adaptations of the business plan would be required along the process, taking into account changes of regulations, but also growing involvement of cities and theirs public partners.

Therefore, managing the roadmap and the probable stop and go process would require a strong management capacity, recruited by the Club.

4.2. Proposed road map

The road map combines different types of activities that are described below: managing the process and mobilizing local government and partners, conducting technical studies, negotiating agreements and legal issues...

The overall provisional scheme is built on the hypothesis of a fast track decision process, from the early beginning to the latest decision making: setting the fund and launching activities. At the early beginning, attention should be given to identifying a first pool of eligible municipalities and local government that will assume the responsibility to sustain and sell the project to States and all other partners. Political will and management capacities are prerequisite for a successful process.

4.2.1. The Club

10 to 20 local governments have to take the lead for establishing the Fund and benefit from the first issuances. The Club prefigures the Fund and its members have to make decisions, strategic choices, mobilize partners and negotiate the project with States and supporting institutions. Therefore, the Club should probably have a proper legal existence, aiming to manage funds needed for feasibility studies and advocacy activities. However, administrative task could be managed by an existing international institution. The club general assembly is expected to meet twice a year. Willing to demonstrate their commitment and capacities to set-up the Fund, participating cities and local governments will contribute to the financing of the Club: initial contribution, annual membership, as well as participating expenses.

4.2.2. Supporting states

The establishment and the development of the Fund will need specific authorizations of many states, allowing cities to invest in that new international institution, and later to borrow. In addition, support from international development institution would be a serious contribution to creditworthiness.

In order to convince a large majority of African states of the necessity to establish the Fund, a first group of supporting states shall be mobilized. They will contribute to the identification and resolution of bottlenecks and regulation difficulties.

Associated to the Club in a form which remains to be determined, their commitments could also include a financial contribution.

4.2.3. Advisory committee

An advisory committee would contribute to design a sustainable fund, taking into account the latest knowledge of the diverse worlds that have to deal with municipal finance in Africa. Made-up of 10 to 15 members, the advisory committee will contribute to the supervision of feasibility studies and advice the Club prior any decision making.

4.2.4. Feasibility studies

A comprehensive program of feasibility studies and technical assistance will progressively contribute to design the Fund and its
At this stage, the main identified tasks are described in the following table. When establishing the procurement plan, grouping some tasks could be considered. Delays are counted from the decision to launch the process (T0) and take into account efficient procurement procedures and funds mobilization (4 months between decision to start and first notification).
## Aim of the study

<table>
<thead>
<tr>
<th>Identifying eligible local governments</th>
<th>Building on assumption that enabling environment is not very favourable in many countries, the study aims to list cities and progress to be made prior borrowing to the fund. It would also set the minimum standard to be fulfilled for borrowing from the fund. It’s a prerequisite describing the market and accompanying actions that would ensure its growth. At least, around 50 borrowers should be identified and engaged in a preparatory process, aiming to join the borrower’s club.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assessing national tools financing LGs</td>
<td>Cooperating with existing national institutions lending to local governments is identified as a possible solution to manage currency risks and reduce processing costs. However, such a scheme will disturb loose the relation between cities and the Fund. Assessing national institution in regard of the goals of the Fund will nourish the debate on the business model.</td>
</tr>
<tr>
<td>Drafting the initial business model and plan</td>
<td>After a discussion on the preferred business model (for example, accepting or not to borrow to cities through existing national entities, or assigning loans to certain types of investments), the study will draft a detailed business plan.</td>
</tr>
<tr>
<td>Drafting the risk management framework</td>
<td>The risk management framework aims to identify all internal and external risks that could undermine activity and capacity to repay loans, and to propose detailed prevention or coverage scenarios. That early exercise will feed discussion and design work of the Fund: size, need for capital, guarantees...</td>
</tr>
<tr>
<td>Legal and fiscal advisory services</td>
<td>Building on recommendations of the two previous studies, these services aim to design and implement all legal framework: status, needed agreement or legislation changes aiming to authorized cities to enter the capital and borrow.</td>
</tr>
<tr>
<td>Technical assistance for seeking authorizations to run Bank operations</td>
<td>Unless the Fund is backed by an international institution, not submitted to any national Bank regulation, this technical assistance aims to seek all authorizations for Bank operation.</td>
</tr>
<tr>
<td>Preparation of first issuance</td>
<td>That is a classical mandate aiming to prepare an international issuance.</td>
</tr>
</tbody>
</table>
4.3. Financing the road map

The overall budget needed for the preparation of the Fund is estimated, at this stage, around M€ 2.8. That budget includes feasibility studies, specific applications and management processes aiming to obtain permissions to operate, etc. It does not cover establishing cost and initial losses prior break-even. As references, mobilization costs prior the creation of Agence France Locale reached € 600 000 (not included the cost of workforce covered by supporting entities that are estimated around the same amount). The mobilization costs of UK Municipal Bond Agency reached a comparable amount of £ 800 000. Preparing the African Fund will need specific tasks such as an in depth assessment of legal issues in the African context and a strong currency management strategy. The budget does not cover the specific programmes at city or national levels aiming to reinforce creditworthiness of cities and solve legal issues letting local governments subscribing the capital of the Fund and borrowing to that international institution. A very rough evaluation is given in Table 2.

<table>
<thead>
<tr>
<th>Prestations</th>
<th>Observations</th>
<th>Coût</th>
</tr>
</thead>
<tbody>
<tr>
<td>Etudes de faisabilité initiales</td>
<td>Plans d'affaires et de gestion des risques</td>
<td>800 k€</td>
</tr>
<tr>
<td>Services de conseil juridique et financier</td>
<td>3 ans</td>
<td>600 k€</td>
</tr>
<tr>
<td>Autre assistance technique</td>
<td></td>
<td>400 k€</td>
</tr>
<tr>
<td>Gestion de projet</td>
<td>250 k€/an</td>
<td>1 000 k€</td>
</tr>
<tr>
<td></td>
<td>1 gestionnaire avec tous les frais de déplacement et d'administration.</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>2 800 k€</td>
</tr>
</tbody>
</table>

This budget does not includes first loan issuance costs that will be supported by the vehicle, and are usually amortized over the loan term. Local governments, members of the Club, as well as supporting states will finance that program through initial contribution and annual membership. On the basis of a Club of 30 participating cities, supported by 10 states, revenue could reach 2.5 million Euros. International partners could probably contribute to the project, covering the gap.

<table>
<thead>
<tr>
<th></th>
<th>30 Cities</th>
<th>10 States</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial contribution</td>
<td>50 000 €</td>
<td>25 000 €</td>
<td>1 750 k€</td>
</tr>
<tr>
<td>Annual membership</td>
<td>5 000 €/year</td>
<td>10 000 €/year</td>
<td>250 k€/year</td>
</tr>
<tr>
<td>Other resources</td>
<td></td>
<td></td>
<td>300 k€</td>
</tr>
<tr>
<td>TOTAL over 4 years</td>
<td></td>
<td></td>
<td>2 800 k€</td>
</tr>
</tbody>
</table>
4.4. First steps

Building on experience, first steps should be the following:

- Establishing the Club, with a minimum of 15 members representing 7 to 10 countries of all regions of Africa. That task includes writing down objectives, governing rules, as well as status that would ensure a better recognition.

- Establishing the Advisory Committee, building on the group of participants to the Rabat workshop of November 2017.

- Making contacts with a first group of states that could prefigure the Supporting States Committee.

- Keep informed international partners, such as AfDB and other international development institution that promote decentralization and municipal finance improvement (AFD, USAID, Gates Foundation, World Bank...).

- Raise contribution for feasibility studies.
5. ANNEXE LIST

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Annexe 1 - Existing Vehicles

1. A large diversity of structures

Based on existing literature, 36 financing vehicles are operating in 14 countries. Most of them are located in North America (8 in Canada, and 15 in the USA). The oldest Municipal financing body was created in 1898 in Denmark. We can find entities in 8 European countries and 3 in Asia (Japan, Australia and New Zealand). In emerging countries, only local authorities in Mexico and in the Indian state Tamil Nadu benefit from such a financial tool.

The oldest Municipal financing body was created in 1898 in Denmark. If only three existing entities existed on 1950, one half were created between 1969 and 1986. A new impetus can be observed at the beginning of the century, with a new agency every two years.

However, the concept of municipal banks covers very different concepts. Indeed, many of them are small public bodies, notably in the US. The North Dakota Public finance authority is a single department of the State of Dakota, without any legal, administrative and financial autonomy. By the end of 2016, only 709 kS of municipal securities were recognized in the balance sheet.

<table>
<thead>
<tr>
<th>Name</th>
<th>Country</th>
<th>Creation</th>
<th>Legal status</th>
<th>Annual Lending volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newfoundland and Labrador Municipal Financing Corporation (NMFC)</td>
<td>Canada</td>
<td>1964</td>
<td>Crown agency with a primary mandate to provide long-term capital financing to municipalities</td>
<td></td>
</tr>
<tr>
<td>Kommunekredit</td>
<td>Denmark</td>
<td>1898</td>
<td>NonProfitAssociationofLocalGovernments Exempt from being a financial institution by the EU Directive.</td>
<td></td>
</tr>
<tr>
<td>Bank Nederlandse Gemeenten (BNG)</td>
<td>The Netherlands</td>
<td>1914</td>
<td>Financial institution under domestic and EU law Two-tier Company under Dutch law</td>
<td>2016- €87,576 million</td>
</tr>
<tr>
<td>Kommunalbanken (NKB)</td>
<td>Norway</td>
<td>1926</td>
<td>Financial institution under domestic and EU law KBN is a wholly Owned state company.</td>
<td>2016- €8,9 billion</td>
</tr>
<tr>
<td>Nederlandse Waterschapsbank (NWB)</td>
<td>The Netherlands</td>
<td>1954</td>
<td>Financial institution under domestic and EU law</td>
<td>2016- €7,1 billion</td>
</tr>
<tr>
<td>Alberta Capital Finance Authority (ACFA)</td>
<td>Canada</td>
<td>1956</td>
<td>Non-profit Corporation and provincial authority acting only as an agent of the Alberta Crown</td>
<td>2015-16 $21,9 million</td>
</tr>
<tr>
<td>Japan Finance Organization for Municipalities (JFM)</td>
<td>Japan</td>
<td>1957</td>
<td>Joint fund-raising organization for local governments.</td>
<td></td>
</tr>
<tr>
<td>Vermont Municipal Bond Bank (VMBB)</td>
<td>USA</td>
<td>1969</td>
<td>An instrumentality of the State of Vermont</td>
<td>2016- $94 260 000</td>
</tr>
<tr>
<td>Municipal Finance Authority of BC (MFABC)</td>
<td>Canada</td>
<td>1970</td>
<td>Independent authority - Under the Municipal Finance Authority Act</td>
<td>2016- $380 million</td>
</tr>
<tr>
<td>Maine Municipal Bond Bank (MMBB)</td>
<td>USA</td>
<td>1971</td>
<td>Public Corporation</td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td>Country</td>
<td>Creation</td>
<td>Legal status</td>
<td>Annual Lending volume</td>
</tr>
<tr>
<td>------</td>
<td>---------</td>
<td>----------</td>
<td>--------------</td>
<td>-----------------------</td>
</tr>
<tr>
<td>Puerto Rico Municipal Finance Agency (MFA)</td>
<td>USA</td>
<td>1972</td>
<td>Public corporation and governmental instrumentality of the Commonwealth</td>
<td></td>
</tr>
<tr>
<td>State of New York Municipal Bond Bank Agency (MBBA)</td>
<td>USA</td>
<td>1972</td>
<td>Public authority, managed by the State of New York.</td>
<td>Probably inactive</td>
</tr>
<tr>
<td>Alaska Municipal Bond Bank Authority (AMBBA)</td>
<td>USA</td>
<td>1975</td>
<td>Public corporation</td>
<td></td>
</tr>
<tr>
<td>North Dakota Public Finance Authority</td>
<td>USA</td>
<td>1975</td>
<td>Public Finance Authority</td>
<td></td>
</tr>
<tr>
<td>New Hampshire Municipal Bond Bank (NHMBB)</td>
<td>USA</td>
<td>1977</td>
<td>Public body corporate and politic</td>
<td>2016- $11,260,000</td>
</tr>
<tr>
<td>New Brunswick Municipal Finance Corporation</td>
<td>Canada</td>
<td>1982</td>
<td>Crown Agency</td>
<td></td>
</tr>
<tr>
<td>Illinois Finance Authority (IFA)</td>
<td>USA</td>
<td>1984</td>
<td>Public Authority</td>
<td></td>
</tr>
<tr>
<td>Virginia Resources Authority</td>
<td>USA</td>
<td>1984</td>
<td>Public corporation</td>
<td></td>
</tr>
<tr>
<td>Indiana Bond Bank</td>
<td>USA</td>
<td>1984</td>
<td>Quasi-governmental agency</td>
<td></td>
</tr>
<tr>
<td>Sunshine State Governmental Financing Commission</td>
<td>USA</td>
<td>1985</td>
<td>Public company, owned by counties</td>
<td>Not pursuing lending activities</td>
</tr>
<tr>
<td>Kommuninvest</td>
<td>Sweden</td>
<td>1986</td>
<td>Financial institution under domestic and EU law</td>
<td>2015: €24bn</td>
</tr>
<tr>
<td>Munifin</td>
<td>Finland</td>
<td>1990</td>
<td>Financial institution under domestic and EU law</td>
<td></td>
</tr>
<tr>
<td>New Mexico Finance Authority (NMFM)</td>
<td>USA</td>
<td>1992</td>
<td>Public Finance Authority</td>
<td></td>
</tr>
<tr>
<td>Idaho Bond Bank Authority (IBBA)</td>
<td>USA</td>
<td>2001</td>
<td>Public Authority</td>
<td></td>
</tr>
<tr>
<td>California Municipal Finance Authority</td>
<td>USA</td>
<td>2004</td>
<td>Public Authority</td>
<td></td>
</tr>
<tr>
<td>Ontario Infrastructure and Lands Corporation</td>
<td>Canada</td>
<td>2005</td>
<td>Crown Agency</td>
<td></td>
</tr>
<tr>
<td>First Nations Finance Authority (FNFA)</td>
<td>Canada</td>
<td>2006</td>
<td>non-profit Aboriginal government-owned and controlled institution</td>
<td></td>
</tr>
<tr>
<td>State of Hidalgo Bond Bank</td>
<td>Mexico</td>
<td>2007</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michigan Finance Authority</td>
<td>USA</td>
<td>2010</td>
<td>State administration</td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td>Country</td>
<td>Creation</td>
<td>Legal status</td>
<td>Annual Lending volume</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>----------------</td>
<td>----------</td>
<td>-------------------------------------------------------------------------------</td>
<td>-------------------------------------</td>
</tr>
<tr>
<td>Agence France Locale (AFL)</td>
<td>France</td>
<td>2013</td>
<td>Financial institution under domestic and EU law</td>
<td>€508 million</td>
</tr>
<tr>
<td>UK Municipal Bond Agency</td>
<td>United Kingdom</td>
<td>2014</td>
<td>Not considered by UK law to be a financial institution</td>
<td>inactive</td>
</tr>
<tr>
<td>Local Government Funding Vehicle (LGFV) of Victoria State</td>
<td>Australia</td>
<td>2014</td>
<td>Subsidiary of Municipal Association of the State of Victoria</td>
<td>One issuance of AUD 240 million (€ 150 million) in 2014.</td>
</tr>
</tbody>
</table>

Following forms presenting the main feature of around ten municipal banks illustrate the diversity of objectives, legal arrangement and activities. The sample retains autonomous vehicles. Indeed, municipal banks that are managed by the administration, benefiting from the signature of the State does not appear as useful benchmark for the African project.

2. LESSONS LEARNED FROM EXISTING VEHICLES

2.1 A large diversity of status and governance rules

Local authorities’ involvement is very diverse. Indeed, many vehicles are simple state departments or state companies, as the ancient Norwegian Kommunalbanken, created in 1927. In the US and Canada, State Corporations and Crown Agencies have very particular governance, financial schemes and guarantee issues. Indeed, the most common scheme is a special account, managed by a department inside the state administration. However, even if some members are civil servants, members of the board are personally responsible of the management. In those schemes, the state gives its guarantee to loans. Financing activities are also oriented by state’s priorities. Naturally, there are some exceptions in the American continent, such as the Alberta Capital Finance Authority.

(1) Dutch water boards have a status of local authorities.
(2) Danish KommuneKredit is an association of local authorities.
(3) France and Sweden agencies comprises two parts: a holding company holds by local authorities and a subsidiary, own by the holding and run by independent personalities, coming from the financial sector.

Therefore, these administrative tools have been taken out of the sample.

Among really autonomous entities, the main observation is the variety of legal arrangements and governance schemes, as described in following forms. The most common arrangement is the establishment of a limited company, owned by local governments (at least having the majority). Among other solutions, the following deserve attention:

- Danish KommuneKredit is a non-profit association, ruled by a specific Act.
- French Agence France Locale and Swedish Kommuninvest distinguish a holding, owned by local governments, a subsidiary, subject to banking regulation. The latest is a limited company, submitted to Bank regulations. Governance ensures a strict independence from political pressure in daily management and particularly decision making related to lending activities.

2.2 Challenging the market to market makers

Depending from historical context and objectives of public authorities, the municipal bonds vehicles tackles different goals:
- Covering the main financing needs of their members...
- Offering a competitive option for cities, covering specific needs...
- Making a new market reference, aiming to reduce rates and extending the maturity of debt lines.
Data on market share is available for a few institutions. The share varies from 100% (Danish KommuneKredit reaches a market share of 98%) to some percent (France: 2.5%, a share that should grow but without ambition to take over the market).

- The public vehicle contributes to reduce bank margins and improves credit conditions for all resource of all local governments, whether member of not of the Municipal Bank.

### 2.3 Largely submitted to Bank Supervision

Existing vehicles in Europe are submitted to Bank Supervision and all related rules, such as Basel regulations. Some exception are noticeable, following specific laws or mentions in EU directives: UK Municipal Bond Agency is exempted by the establishment law, while a specific exemption has been negotiated for the Danish KommuneKredit.

This supervision and all related obligation reinforce the creditworthiness of Municipal Bank. Indeed, this control by relevant institutions that are not related to local governments is an added guarantee that credit activities are professionally managed. However, these regulations affects the design and the structure of the vehicle.

**Impact on balance sheet**

In order to reinforce the capacity of the banking system to resist to main credit crisis, successive Basel regulations have imposed higher levels of the capital ratios. As other banks, Municipal Banks submitted to these regulations have to raise a significant capital, related to outstanding loans. At large, that ratio shall be higher than 3%.

Older institutions in Europe does not have too many difficulties to meet that requirement. Indeed, they have accumulated important reserve, not distributing profits. However, that requirement is costly for young institutions, because local government have to invest this important amount prior any activity.

**Impact on organization**

Such a submission implies strict organization and governance dispositions, aiming to ensure the quality of portfolio and of risk management. This dispositions depends from national applicable regulation. However, because rating includes management issues and lenders are accustomed to deal with structured banks and financial companies, the large majority of vehicles have adopted similar organizations.

The main layout are the following:

- Running specific committees appointed by the Board, as Audit Committee or Asset Liability Committee

---

**Audit Committee**

The Audit Committee is appointed by the Board to assist the Chair and Board of Directors of ACFA in monitoring the financial reporting, corporate governance, accountability processes and control systems in ACFA and is fully accountable to the Board. It does so by offering observation and objective advice on issues concerning ACFA’s risk, controls, quality of information, quality of management oversight and management assertions.

**Asset Liability Committee**

The Asset Liability Committee is a management committee with the purpose of managing ACFA’s key interest rate and market risks to minimize the risk that ACFA’s equity decreases due to a significant unexpected loss. These risks include (but are not limited to):

- risks due to unexpected changes in interest rates;
- the risk of higher floating rate borrowing margins;
- the risk arising from mismatches in the floating rate reset dates of assets and liabilities;
- financing and re-financing risks;
- loan prepayment risk; and
- loan pricing risk.

The Asset Liability Committee will formulate and evaluate strategies within Board policy limits to manage ACFA’s interest rate and market risks. The Asset Liability Committee will also review the Board policies regarding interest rate risk management, funding, loan prepayment and loan pricing on an annual basis and, where appropriate, recommend changes in these policies to the Board.
Identifying inside the organization officers in charge of specific tasks, without any involvement in other activities opening the risk of conflict of interest. Notably, Credit Department (relation to client), Finance Department (financial resources) and Risk Management. That minimal organization implies pretty high minimal running cost, that have to be covert by the lending activity. Therefore, the vehicle shall reach a threshold activity in a short launch time period. Otherwise, sustained deficit will ruin the creditworthiness, without any chance to be restored.

2.4 Rating

Creditworthiness remain the baseline issue when building a financing vehicles. It has to be tackled at the level of the vehicle, that will approach the market, and at the level of each local authority. Indeed, the first guarantee offered to investors is the quality of the portfolio of the vehicle, measured by the default rate. It appears that existing vehicles around the world does not suffer from default and, therefore, obtain very high rating even without any guarantee of the State (cf. table).

<table>
<thead>
<tr>
<th></th>
<th>Canada - Alberta</th>
<th>Canada - Quebec</th>
<th>Germany</th>
<th>Denmark</th>
<th>France</th>
<th>Japan</th>
<th>Netherlands</th>
<th>FIN</th>
<th>New Zealand</th>
<th>Norway</th>
<th>Sweden</th>
<th>United Kingdom</th>
<th>Tamil Nadu</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rating</td>
<td>5/17</td>
<td>12/16</td>
<td>12/20</td>
<td>12/17</td>
<td>3/17</td>
<td>12/16</td>
<td>12/16</td>
<td>12/16</td>
<td>12/16</td>
<td>12/16</td>
<td>12/16</td>
<td>12/16</td>
<td>12/16</td>
</tr>
<tr>
<td>Moody's</td>
<td>Aa3</td>
<td>Aaa</td>
<td>Aaa</td>
<td>Aa3</td>
<td>Aa1</td>
<td>Aa3</td>
<td>Aaa</td>
<td>Aaa</td>
<td>Aaa</td>
<td>Aaa</td>
<td>Aaa</td>
<td>Aaa</td>
<td>Aaa</td>
</tr>
<tr>
<td>Standard and Poor</td>
<td>Aaa</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
</tr>
<tr>
<td>Fitch</td>
<td>--</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
<td>AAA</td>
</tr>
</tbody>
</table>

Client level

As pointed out in the Overview of municipal pooled financing practices, 2015, managing the client portfolio is also a critical issue, particularly when clients are shareholders! To tackle this difficulty, many funds develop advisory services for their members. However, all funds develop specific tools and internal regulation aiming to qualify their portfolio:

- Selecting members,
- Developing an internal rating tool, aiming to convince lenders of the quality of selection, help local authorities to move towards increasing creditworthiness, and sparing the burden of rating by international agencies (cost...)
- Diversifying risks by opening activities to diverse public entities managing public services,
- Advising local authorities for better financial management,
- Etc.

2.5 Activity

Besides lending activities, many vehicles aim to sustain increase quality of financial management of their members and client, as well as creditworthiness of local authorities.
### CANADA – ALBERTA CAPITAL FINANCE AUTHORITY

<table>
<thead>
<tr>
<th>ALBERTA - CANADA</th>
<th>ALBERTA CAPITAL FINANCE AUTHORITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation: 1956</td>
<td>Address: 2160, Sun Life Place</td>
</tr>
<tr>
<td></td>
<td>10123 - 99 Street NW</td>
</tr>
<tr>
<td></td>
<td>Edmonton, AB T5J 3H1</td>
</tr>
</tbody>
</table>

**Status:** The ACFA is a provincial authority, which status is regulated by special regulations: Alberta Capital Finance Authority Act, ACFA regulation and ACFA Allotment of Shares Regulation.

**Activities:** To provide shareholders within the Province of Alberta with flexible funding for capital projects on a prudent basis consistent with the viability of the Alberta Capital Finance Authority (ACFA). It includes all type of investments: airport infrastructure, parks and recreation projects, sewer and water infrastructure, schools, hospitals, roads and public spaces, etc.

**Shareholders:** The authorized stock of ACFA consists of the following shares with a par value of $10 each:

- 4,500 Class A – available only to the Crown;
- 1,000 Class B – available only to municipal authorities (includes improvement districts, Metis settlements, municipal districts, counties, special areas and specialized municipalities), regional authorities (includes drainage districts, irrigation districts, regional airport authorities and regional services commissions) and health authorities (includes non-profit corporations who own an approved hospital, a regional health authority and a provincial health board);
- 750 Class C – available only to cities;
- 750 Class D – available only to towns and villages; and
- 500 Class E – available only to educational authorities (includes school districts and divisions, colleges, technical institutes, universities and Northland School Division).

Only 1,827 shares among 3,000 authorized shares of class B to E were issued and fully paid on December 31, 2016.

**Corporate Governance:**

A/ ACFA Board of Directors (Board)

The Board is comprised of 12 members: 4 elected respectively by shareholders of class B to E, 5 appointed by the Lieutenant Governor of Alberta and three officers. Directors are appointed or elected for a fixed term of up to three (3) years, with the potential for reappointment.
B/ Audit Committee: appointed by the Board to assist the Chair and Board of Directors of ACFA in monitoring the financial reporting, corporate governance, accountability processes and control systems in ACFA and is fully accountable to the Board. It comprises 7 members, including the three officers, members of the Board.

C/ Asset Liability Committee: The Asset Liability Committee is a management committee with the purpose of managing ACFA’s key interest rate and market risks to minimize the risk that ACFA’s equity decreases due to a significant unexpected loss.

<table>
<thead>
<tr>
<th>ACTIVITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual lending volume:</strong> CAD 1,577 million for the financial year 2015-2016</td>
</tr>
<tr>
<td><strong>Annual repaid loans:</strong> CAD 1,110 million for 2015-2016</td>
</tr>
<tr>
<td><strong>Outstanding loans:</strong> CAD 15,567 million – 2016</td>
</tr>
<tr>
<td>Rate: 3.185% on December 31, 2016</td>
</tr>
</tbody>
</table>

The activity is organized on a quarterly base. Quarterly issuance is organized, at a fixed date. Shareholders should apply prior a deadline, giving sufficient delay for processing and legal work, if necessary (notably for Educational and Health Authorities).

<table>
<thead>
<tr>
<th>FINANCES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RATING</strong></td>
</tr>
<tr>
<td>Moody’s: Aa3</td>
</tr>
<tr>
<td><strong>Supervision</strong></td>
</tr>
<tr>
<td>ACFA is under the authority of the President of Treasury Board and Minister of Finance of the Province of Alberta (that guarantees the debt).</td>
</tr>
<tr>
<td><strong>Guarantees</strong></td>
</tr>
<tr>
<td>Obligations issued by ACFA are unconditionally guaranteed by the Province of Alberta</td>
</tr>
</tbody>
</table>

Sources
Annual report 2016
website: http://www.acfa.gov.ab.ca
## 4. DANEMARK – KOMMUNEKREDIT

<table>
<thead>
<tr>
<th>DENMARK</th>
<th>KommuneKredit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation: 1899</td>
<td>Address: 16 Kultorvet DK-1175 COPENHAGEN K</td>
</tr>
</tbody>
</table>

**Status:** KommuneKredit was established by a special Act in 1899 and is legally organized as an association (a membership organization) under Danish law. That act was abolished and replaced by Act 383, dated 3 May 2006.

**Focal areas:**
- Municipalities and regions - coverage of 100% of loan’s needs
- Companies with a municipal guarantee, such as utilities companies, including PPPs
- Considerable interest in green investment, but KommuneKredit do not define sector priorities

**Members:** Danish municipalities and regions. Membership is voluntary and 100% of Danish local governments are currently members.

**Corporate Governance:**
- Board of directors - 9 members elected by the general assembly - There are all members of municipal or regional councils, often the mayor or the chairman.
- The board has set an Audit Committee and a cycle of work, aiming to ensure a complete review of all activities and strategies over the year.
- Management: Chief Executive Officer, a managing director and six heads of departments. Management’s consensus is required for decisions regarding lending, funding and derivative financial instruments.

**Number of Employees:** 60

**Payroll:**

**ACTIVITIES**

**Other Activities:**
- Contributes to the development of green financing by on-lending funds from green investment mandates to Norwegian municipalities wishing to invest in ambitious environmentally friendly projects.
- Lends in a responsible way that will help to ensure that our customers have financially sustainable borrowing portfolios.
**Annual lending volume:** 3,564 new loans advanced in 2016.

**Total lending volume:**

**Outstanding loans:** 15,306 loans, for an amount of € 22.677 billion at 2016 year end

**Resources:** public bond issues among different market (USD, EUR…) and specific offers

Floating and fixed rate, structured bonds

Largest loan issued: DKK 170 million

Longest loan issued: 25 years

Smallest loan issued: DKK 8 million

**FINANCES**

<table>
<thead>
<tr>
<th><strong>RATING (end of 2016)</strong></th>
<th>Moody's: Aaa/P-1 (Stable)</th>
<th>Standard and Poor's: AAA/A-1+ (Stable)</th>
</tr>
</thead>
</table>

**Supervision:** Ministry for Economic Affairs and the Interior

**RISK MANAGEMENT**

**Credit Risk:**

- Members are directly jointly and severally liable for all KommuneKredit’s obligations.

- Municipalities in Denmark have unlimited right to levy taxes on income and property to fulfil their financial obligations Full coverage by a public guarantee

- KommuneKredit reports demonstrate a resilient economic model. Indeed, the Bank did not report any loan losses since it was established.

**Sources:** KommuneKredit documentation

Annual report 2016

Website: kommunekredit.dk/en
### 5. FRANCE - AGENCE FRANCE LOCALE

<table>
<thead>
<tr>
<th>France</th>
<th>Agence France Locale</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Creation:</strong> 2013</td>
<td><strong>Address:</strong> 10-12 Boulevard Marius Vivier Merle 69003 Lyon</td>
</tr>
</tbody>
</table>

**Status:** Governance is based on a dual company entity, separating the operations performed by the specialized credit institution from strategic management performed by member local authorities. That scheme ensures a greater accountability of stakeholders through a system of stakeholder’s checks and balance.

**Focal area:** Investment needs of local authorities and join local authorities. The outstanding debt of French local authorities amounts to 8% of the GDP; They contribute to the bulk of public investment, especially focused on infrastructures and 70% of their investment expenditure is self-financed.

**Shareholders:**

- *Overseas Communities*
- *Établissements Publics de Coopération Intercommunale.*

Agence France Locale - Société territoriale is fully owned by French local authorities.

The credit institution - Agence France Locale is owned at 99.99% by Agence France Locale – Société Territoriale.

To respect the French Banking Regulation, the City of Lyon holds a share.

**Corporate Governance:**

**AFL-SOCIETE TERRITORIALE:**

- **Board of Directors:** Determines the orientations of the agency’s activities. Between 10 and 15 members. The first ten were selected by the first ten shareholders for three years. The other ones are elected for 6 years renewable. Censors could be appointed by Board of Directors unrepresented shareholders. They can assist to the Board of directors’ meetings but do not have the right to vote.

Nowadays, it is composed of 6 Metropolises representatives, 2 Municipalities representatives, a region and a district.
- **Board of Directors Committees**: Audit and Risks Committee, Nomination Committee, Remuneration Governance Committee.

- **Executive Director**: in charge of effective management. He is appointed by the Board of Directors for 6 years renewable and work under Supervisory Board control.

**AGENCE FRANCE LOCALE:**

- **Supervisory Board**: 8 to 18 members with the mandatory inclusion of 4 financiers, the AFL Société Territoriale’s President, Vice-President and Executive Director and a government finance expert. The first members are elected for 3 years, the other ones for 4 years. There is actually 10 members.

- **Executive Board**: in charge of effective management. 2 to 5 members who can be selected out of shareholders and are appointed by the Supervisory Board for 6 years renewable. Its President is also chosen by the Supervisory Board.

- **Supervisory Board Committees**: Audit and Oversight Committee, Strategy Committee, Remuneration and Nomination Committee.

| Number of employees: 33 | Payroll: € 2 836 275 |

**ACTIVITIES**

- **Annual lending volume**: 2015- € 508 m
- **Outstanding loans**: €1,055 billion
- **Other activities**: Advices and awareness on toxic debt.

Creation of a digital funding platform available for local and regional authorities.

**Interest rate**: AFL provides rates under banks and emissions rates.

- **Biggest shareholder**: Pays de la Loire Region: 3 660 852 inhabitants
- **Smallest shareholder**: Grobois-en-montagne city council: 98 inhabitants

- **Biggest contribution to the capital**: Métropole Aix-Marseille → € 17 916 400 (13,44%)
- **Smallest contribution to the capital**: Grosbois en Montagne city council→ €300 (0,0003%)

As of March 2017

<table>
<thead>
<tr>
<th>Proportion of loans disbursed by the AFL / total of French local authority debt financing: 3,5%</th>
<th>Number of loans approved in 2016: 101</th>
<th>Loans range:</th>
</tr>
</thead>
<tbody>
<tr>
<td>The average proportion is 25% for members.</td>
<td>Average loans duration: 15.4 years</td>
<td>From € 15 000 to € 50 million</td>
</tr>
</tbody>
</table>

**FINANCES**

- **RATINGS**: Moody’s: Aa3 – A step down from French State rating
  - Common equity tier One > 12,5 %
  - Leverage: 3,5 %
  - LCR et NSFR > 150 %

- **Supervision**: Agence France Locale is a fully regulated specialized financial institution supervised by the French Banking regulator
Guarantees:

A/ A dual First call Guarantee system:
- Each member local authority provides an explicit and irrevocable first call guarantee to the financial creditors of AFL up to the amount of its outstanding debt received from AFL,
- AFL - Société Territoriale (the holding) also provides an explicit and irrevocable first call guarantee to the financial creditors of AFL up to an amount which is set annually by the Board

B/ A strong sub-sovereign risk of French local authorities:
- The regulatory framework governing French Local authorities is highly stringent: Local authorities are compelled to balance their budget, they can only borrow funds in order to finance their investments and must repay debt interests and capital on their own resources.
- French Local authorities cannot go bankrupt or undergo liquidation proceedings.

C/ AFL develops its own two-component scoring of local authorities:
- Firstly a financial scoring (from 1- best - to 7), based on solvency, budget sustainability and indebtedness is realized for membership application. A local authority which scores above 6 is not allowed to join AFL as a shareholder.
- Secondly, for the purpose of loan provision, a socio-economic scoring is performed in addition to the financial scoring, complemented by a qualitative analysis, taking into account parameters such as debt volume and the ratio requested amount / outstanding local debt.

Sources:
Agence France Locale’s documentation
Annual report 2016
web site: http://www.agence-france-locale.fr/
### 6. JAPAN FINANCE ORGANIZATION FOR MUNICIPALITIES

<table>
<thead>
<tr>
<th>JAPAN</th>
<th>Japan Finance Organization for Municipalities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Creation:</strong> 1957: Japan Finance Corporation for Municipal Enterprises, a central government’s institution 2008: Transformed into Japan Finance organization for Municipalities.</td>
<td><strong>Address:</strong> Shisei Kaikan, 1-3 Hibiya Koen, Chiyoda-ku, TOKYO</td>
</tr>
</tbody>
</table>

**Status:** Joint fund-raising organization for local governments

**Focal area:** Provide long-term funding at low interest rates to local governments and support Fund-raising of local governments in the capital markets. Public projects operated by local governments including social infrastructure renewal and disaster management and mitigation.

**Shareholders:** As of 31 March 2017, JFM’s capital was USD 148.2 million contributed by 1,789 Japanese local governments, i.e., all of the prefectures, cities, special wards of Tokyo, government designated cities, towns and villages, as well as some local government associations. The amount of capital contribution from each local government is based on outstanding JFM loans and the amount of revenue of each local government.

**Corporate Governance:**
- The board of Directors consists of 5 members.
- Committees: Supervisory Committee and Risk Management Committee

### ACTIVITIES

- **Annual lending volume:**
  - 2016 – USD 15,0 bn
  - 2015 – USD 16,5 bn

- **Outstanding loans:**
  - USD 211, 7 billion in 2016.

**Capital Contribution by Local Government Group**
- Towns, villages and local government associations: USD 9.3 mm (6.3%)
- Prefectures: USD 56.8 mm (38.4%)
- Government-designated cities*2: USD 25.7 mm (17.3%)
- Cities* and special wards of Tokyo: USD 56.4 mm (38.1%)

(As of 31 March 2017)
**Interest Rates:** JFM offers two types of loan interest rates:
- The standard lending rate: calculated in order to balance JFM’s funding cost with interest income from its lending.
- The special lending rate: The special lending rate is set at 0.35% per annum below the standard rate. The rate reduction is paid by proceeds from public races, allocated to JFM. At the end of fiscal 2015, approximately 99% of outstanding JFM loans consisted of special interest rate loans.

**Largest loan issued:** Osaka – USD 14,604 millions in March 2016. 7% of total lending volume (du volume de Prêt total)
**Longer loan issued:** long-term lending is maximum 40 years to Local governments
**Smallest loan issued:** Oita – USD 1,568 millions in March 2016. 0.8% of total lending volume. (du volume de prêt total)
**Biggest borrower:** city of Tokyo

### FINANCES

<table>
<thead>
<tr>
<th>RATING as of March 2017</th>
<th>Moody’s: A1</th>
<th>Standard and Poor’s: A+</th>
</tr>
</thead>
</table>

**Supervision:** JFM adopts an integrated risk management approach to respond to various risks, while pursuing for a higher level of risk analysis and management. Accordingly, JFM has developed a system for appropriate risk management, including the establishment of the Integrated Risk Management Committee, which supervises JFM’s overall risk management, and the Risk Management Office to ensure comprehensive risk management.

**Guarantees:**
- Local governments must receive the consent or approval of the Minister for Internal Affairs and Communications or their respective prefectural governors when they borrow from JFM. Within this structure, JFM has never had a default since its establishment.
- Revenue sources for the local governments are secured by the national government:
  - It allocates a part of national tax revenue to the local governments, in order to adjust revenue disparities among the local governments (Local Allocation Tax system).
  - It prepares the Local Government Borrowing Programme (LGBP) each fiscal year that set borrowing ceilings as well as funding sources.
  - It gives consent or approval to each specific borrowing operation.
  - It establishes a legal framework to monitor fiscal indices and can impose corrective measures.
  - Thus, none of the local governments has defaulted
  - Under the JFM Law, if JFM is to be dissolved and its obligations cannot be satisfied in full with its assets, local governments bear all costs necessary to satisfy the relevant obligations.

**Sources:**
Annual reports and company’s documentation
7. THE NETHERLANDS – BANK NEDERLANDSE GEMEENTEN

<table>
<thead>
<tr>
<th>NETHERLANDS</th>
<th>BANK NEDERLANDSE GEMEENTEN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation: 1914</td>
<td></td>
</tr>
<tr>
<td>Status: Two-tier Company under Dutch law</td>
<td></td>
</tr>
</tbody>
</table>

**Focus areas:** Housing associations, local governments, healthcare sector, education, public utilities, and other projects. Long-Term lending portfolio as of 31/12/15

**Shareholders:** Dutch State, Provinces and Municipalities.

**Capital Distribution:**
Dutch State own half of the shares. 95 % municipalities own 46 % of the capital. 11 about 12 provinces and a water board complete the ownership.

**Corporate Governance:**
Supervisory Board (9 members), Executive Board (3 members), and a Work Council (9 members).
Audit and Risk Committee
The Treasury of the Ministry of Finance exercise administrative supervision through review of Executive Board activities.

**Employees:** 292 as of December 31, 2016

**ACTIVITIES**

**Annual Lending:** 2016 – € 10,200 million
**Outstanding loans:** € 87,576 million

Activity for local governments is only around 1/3 of overall lending activities.
BNG develops a strong activity for housing institution (50 % of new loans, but only 1/3 of outstanding loans), healthcare institution and public utilities.
<table>
<thead>
<tr>
<th>NETHERLANDS</th>
<th>BANK NEDERLANDSE GEMEENTEN</th>
</tr>
</thead>
<tbody>
<tr>
<td>FINANCES</td>
<td></td>
</tr>
<tr>
<td><strong>RATING</strong></td>
<td>as of December 2016</td>
</tr>
<tr>
<td>Moody’s:</td>
<td>Aaa</td>
</tr>
<tr>
<td>Standard and Poor’s:</td>
<td>AAA</td>
</tr>
<tr>
<td><strong>Supervision:</strong></td>
<td>subject to Netherlands and EU banking regulations</td>
</tr>
</tbody>
</table>

**Guarantees**
- **Municipalities**: The financial relationship between central and local government in The Netherlands is structured in such a way, that the credit quality of Dutch municipalities is equal to that of the State of the Netherlands. Loans to Dutch municipalities are 0% risk weighted by the Dutch central bank.
- **Housing Association**: Liabilities of housing associations are supported by a Social Housing Guarantee Fund, Waarborgfonds Sociale Woningbouw (WSW). This fund is ultimately backed by the State of the Netherlands and the municipalities. WSW guaranteed loans are 0% risk weighted by the Dutch central bank.
- **Healthcare Institutions**: Liabilities of healthcare institutions are secured by a Healthcare Guarantee Fund, Waarborgfonds voor de zorgsector (WfZ). The Dutch central bank has given WfZ guaranteed loans a 0% risk weighting.
- **Public Utilities**: Dutch public utilities, owned by municipalities and provinces, still enjoy strong domestic market positions resulting in a high credit quality. Furthermore the major clients of BNG Bank in this sector have an external rating, which reflect their creditworthiness. The loans to public utilities carry a risk weighting for capital adequacy purposes.

**Sources**
Annual report 2016
website: https://www.bngbank.com
# 8. The Netherlands Water Board Bank

<table>
<thead>
<tr>
<th>Netherlands</th>
<th>Nederlandse Waterschapsbank N.V.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation: 1954</td>
<td>Address: Rooseveltplantsoen 3</td>
</tr>
<tr>
<td></td>
<td>2514 KR Den Haag</td>
</tr>
</tbody>
</table>

**Status:** Public limited liability company

NWB was created to finance Dutch water authorities. Dutch water authorities have the status of local authorities. A board is elected by landlords in the perimeter of the water authority. It is responsible to collect taxes and maintain water bodies, hydraulic, and retaining structures. It is also responsible for investment.

However, the bank develops its activities among all local governments and their subsidiaries in charge of social housing, healthcare, education, and activities related to water and environment.

**Loan activity by sector**

![Loan activity by sector chart]

**Shareholders by invested capital**

![Shareholders by invested capital chart]

Dutch public-sector parties: Water boards, 9 about 12 Provinces and Dutch State.

**Supervisory Board:** 5 to 9 members, appointed by the general meeting for a 4 years term, possibility of one reappointment. Age limit: 70 years

**3 committees:** Audit (4 members), Risk (4 members) and Remuneration and Appointment (3 members)

**Managing Board:** 3 members, 4 years term on nomination by the supervisory board, option of reappointment.
### ACTIVITIES

**Annual lending volume:** In 2016, NWB Bank granted €7.1 billion in new long-term loans, just €0.3 billion lower than the record lending volume achieved in 2015.

**Outstanding loans:** The total portfolio of long-term loans to clients, based on principal amounts, amounted to €48.3 billion at year-end 2016.

The Bank financed one third of the public investment agenda in Netherland.

The bank also plays a role in the financing of PPP projects. It is currently active in export financing.

**Other actions:**

NWB Bank is the arm wing of the Dutch state for implementing the water policy. Besides financing activities, it is also responsible for collecting data and controlling water quality, in accordance with the European Water Framework. It disseminate innovation in the field of water, advising its members and clients, the Dutch Water Authorities.

### FINANCES

<table>
<thead>
<tr>
<th>RATING</th>
<th>Moody’s: Aaa</th>
<th>Standard and Poor’s: AAA</th>
</tr>
</thead>
</table>

**Supervision:**

- Since the Dutch Water Authorities (DWA) are public entities, the financial and technical plans, as well as the annual reports are publicly available.

- The DWA are by law supervised by the Dutch provinces and regulated by both national and European legislations. Every 6 years a Water management plan is made, in which the progress of the ongoing works is reported.


**Guarantees:**

**Sources:** Annual report 2016
9. NORWAY – KOMMUNAL BANKEN

<table>
<thead>
<tr>
<th>NORWAY</th>
<th>KOMMUNAL BANKEN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation: 1927</td>
<td>Address: HAAKON VIIS GATE 5B</td>
</tr>
<tr>
<td>Status: KBN is defined as a state instrumentality, having a public policy mandate from the central government to provide low cost financing to the Norwegian local government sector. KBN is a wholly Owned state company.</td>
<td></td>
</tr>
<tr>
<td>Focal area: Welfare services - The Company’s objectives are to provide loans to local governments, counties, companies that carry out local government tasks against municipal guarantee, r government guarantee, or other satisfactory security.</td>
<td></td>
</tr>
<tr>
<td>Shareholders: 100% Kingdom of Norway</td>
<td></td>
</tr>
<tr>
<td>Corporate Governance:</td>
<td></td>
</tr>
<tr>
<td>The Norwegian central government controls the agency’s Annual General Meeting and elects members to its Supervisory Board. The state also elects members of the Board of Directors.</td>
<td></td>
</tr>
<tr>
<td>KBN’s Articles of Association cannot be altered save and except with the approval of the Government (the King). According to parliamentary tradition in Norway, material changes to the Articles of Association of a state instrumentality need to be presented to the Norwegian Parliament (Storting).</td>
<td></td>
</tr>
<tr>
<td>The Parliament is responsible for all decisions regarding KBN’s capital structure and dividend policy and also determining the target return on equity. The Government presents resolutions regarding KBN to Parliament in a separate chapter of the annual National Budget.</td>
<td></td>
</tr>
<tr>
<td>Supervisory Board (elected for a two years term): 12 members (Municipalities’ Mayors and CEOs), 5 alternates and 2 observers of the Local governments and modernisation Ministry. One member and one personal deputy member shall be elected by and from amongst the employees. The remainder of the members and deputy members shall be elected by the Annual General Meeting. The Supervisory Board should be composed of as broad a range of members as possible, so as to ensure that the various districts and interest groups affected by the Company’s business are fairly represented.</td>
<td></td>
</tr>
</tbody>
</table>
- **Board of directors**: 9 members with 2 employee representatives. The Company’s Board of Directors shall collectively exhibit diversity and breadth of qualifications, experience and background and consist of between five (5) and nine (9) members. If a majority of the employees should so decide, it can demand that a third and at least two (2) of the members of the Board shall be elected by and from amongst the Company’s employees. The other members shall be elected by the Annual General Meeting for two-year terms, so that at least two (2) shall be elected annually, but no more than four (4) of the elected members.

**ACTIVITIES**

Other Activities:

- Contributes to the development of green financing by on-lending funds from green investment mandates to Norwegian municipalities wishing to invest in ambitious environmentally friendly projects.

**Annual lending volume**: € 8.9 billion in 2016.

**Outstanding loans**: € 40.5 billion in 2016.

**Largest loan issued**: NOK 3 billion

**Smallest loan issued**: NOK 10 million certificate loan.

**FINANCES**

**RATING**

| Moody’s: Aaa | Standard and Poor’s: AAA |

**Supervision**: KBN is a financial institution, regulated by national and EU related regulations.

**Guarantees**:

- **Credit Risk**: Section 55 of the Norwegian Local Government Act states that «A municipality or county authority may not be declared insolvent or institute debt settlement proceedings». In theory, however, payments can be deferred until a solution is found to the situation that has arisen. In such cases, investors are compensated in the form of penalty interest, cf. the Act relating to Interest on Overdue Payments etc. and the associated Regulations.

Section 60 of the Local Government Act also contains provisions on the «State review and approval of financial obligations». Borrowing decisions taken by a municipality that is struggling to balance its budget and is on the Norwegian Register for Governmental Approval of Financial Obligations (ROBEK) are only valid once they have been approved by the County Governor.

- **Regulatory Risk**: Covered bonds were introduced into the Norwegian market in 2007, and have since then become a very important asset class for banks. They are firstly used as security for loans from Norges Bank, and secondly as an important part of the liquidity portfolios that banks are now required to hold to meet the liquidity coverage ratio (LCR) requirements.

**Sources**:

- Annual report 2016 and other KBN’s documentation
- Website: http://www.kommunalbanken.no/en
## 10. SWEDEN - KOMMUNENINVEST

<table>
<thead>
<tr>
<th>SWEDEN</th>
<th>KOMMUNEINVEST</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Creation</strong></td>
<td>In 1986, nine municipalities took the initiative to found what is now Kommuninvest. In 1992, the Kommuninvest Cooperative Society was set up as the joint owner organisation.</td>
</tr>
</tbody>
</table>
| **Status** | Kommuninvest consists of two parts:  
- The cooperative society Kommuninvest Cooperative Society, which owns the credit market company.  
- The limited liability company Kommuninvest i Sverige AB, which provides credit and financial advice |
| **Activities**: Support Swedish municipalities and county councils in their financial administration through stable and cost-effective financing, professional development and collaboration. This may involve new housing, recreational facilities, and schools, homes for elderly or hospitals. Sustainability and green loans. |
| **Shareholders**: Kommuninvest Cooperative Society owns the credit market company (100 % of shares). The Cooperative Society has 90 % of the local government sector as members. Consequently, Kommuninvest is owned and controlled entirely by member municipalities and county councils/regions. |
| **Capital distribution**: 100 % local authorities |
| **Corporate Governance**: |
| **A/ Kommuninvest Cooperative Society** | Administrates membership and the joint and several guarantees.  
- The Board of Directors consists of elected politicians from municipalities and county councils/regions with a Chairman, a Vice Chairman and 13 ordinary members. |
| **B/ Kommuninvest i Sverige AB** | The Board of Directors consists of eight experts in areas such as public administration, capital markets and business development and two representatives of the employees. |
| **C/ Group’s Committees** | **Election Committees**: There are two Election Committees within the Group. The Election Committee of the Society that bear the ultimate responsibility for the preparation of appointment decisions. The Election Committee of the Society’s Companies acts as a supervisory board of the operating company.  
**Analysis and Finance Committee**: The Board of Directors of the Society appoints an Analysis and Finance Committee responsible for monitoring the financial status of the member municipalities. |
| **Number of employees**: 85 |

### ACTIVITIES

**Other Activities**: Knowledge hub in the local government sector and an important interface between the state, municipalities, counties/regions, academia and financial sector. This manifests itself in Kommuninvest:  
- Representing municipalities and county councils/regions as the organisation to which they refer on issues of financing and debt management.  
- Financing and coordinating research on local government finance.  
- Providing advice to members on issues of financing.  
- Organising courses and seminars on financial matters for officials and politicians.  
- Promoting collaboration within the local government sector.
### Outstanding loans

At the close of 2016, lending totalled SEK 277 bn / € 27 billion

### FINANCING

<table>
<thead>
<tr>
<th>RATING</th>
<th>Moody’s: Aaa</th>
<th>Standard and Poor’s: AAA</th>
</tr>
</thead>
</table>

#### Supervision

Kommuninvest is monitored continuously by Finansinspektionen (the Swedish Financial Supervisory Authority) and is also an approved monetary counterparty to the Riksbank and a member of its risk payment system.

#### Guarantees

- When a municipality or a county council/region becomes a member of Kommuninvest, it undertakes at the same time to be jointly and several liable for Kommuninvest’s payment obligations in the event that Kommuninvest should ever fail to fulfil these.
- Owners who can never be declared bankrupt or cease to exist. By law, Swedish municipalities and county councils/regions can never cease to exist other than by merging.
- Owners entitled to levy taxes. Municipalities and county councils in Sweden have a constitutional right to charge taxes to finance their operations. The tax system, combined with stringent demands on a balanced economy, provides the local government sector with good income opportunities and secure finances.
- Lowest possible risk weighting. From the perspective of risk, securities issued by Kommuninvest are treated as equivalent to securities issued by the Swedish state.

### Sources

- Annual report 2016
- Website: [http://kommuninvest.se/en](http://kommuninvest.se/en)
# NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

<table>
<thead>
<tr>
<th>NEW ZEALAND</th>
<th>Local Government Funding Agency</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Creation:</strong> 2011</td>
<td><strong>Address:</strong> Level 8, City Chambers, 142 Featherston Street, Wellington Central, Wellington 6011.</td>
</tr>
<tr>
<td><strong>Status:</strong> The New Zealand Local Government Funding Agency Limited (LGFA) is a company registered under the Companies Act 1993 and is subject to the requirements of the Local Government Act 2002. LGFA is a limited liability company incorporated and domiciled in New Zealand.</td>
<td></td>
</tr>
<tr>
<td><strong>Focal area:</strong> LGFA is specialised in financing the New Zealand local government sector, the primary purpose being to provide more efficient funding costs and diversified funding sources for New Zealand local authorities. It can lend to all local authorities. As at June 30, 2017, 53 district councils are members, and 50 about them have borrowed. LGFA operates with two primary objectives: 1. Optimising the debt funding terms and conditions for participating local authorities. 2. LGFA will monitor the quality of the asset book so that it remains of a high standard by ensuring it understands each participating local authority’s financial position and the general issues confronting the Local Government sector.</td>
<td></td>
</tr>
<tr>
<td><strong>Shareholders:</strong> NZLGFA is owned 80 percent by local authorities and 20 percent by the central government. There are 30 shareholding local authorities; among these are Auckland Council, Christchurch City Council And Wellington City Council.</td>
<td></td>
</tr>
<tr>
<td><strong>Capital distribution:</strong> Share Capital: NZD 45 million NZD 20 million remain uncalled</td>
<td></td>
</tr>
<tr>
<td><strong>Corporate Governance:</strong> LGFA Shareholders Council acts as a supervisory board. It comprises 10 members (minimum 5), representing the members (9 local authorities and the state). Board of Directors, with 5 independent persons, recruited for their expertise in the field of financing, and the Treasurer of a local authority. Audit and Risk Committee</td>
<td></td>
</tr>
<tr>
<td><strong>ACTIVITIES</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Annual lending volumes:</strong> NZD 707 million bespoke long-dated lending and NZD 202 million of short term loans</td>
<td></td>
</tr>
<tr>
<td><strong>Outstanding loans:</strong> NZD 7,784 million as of June 30, 2017</td>
<td></td>
</tr>
<tr>
<td><strong>Annual bonds issuance:</strong> NZD 1,285 million</td>
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<tr>
<td>NEW ZEALAND</td>
<td>Local Government Funding Agency</td>
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</tr>
<tr>
<td><strong>Largest loan issued:</strong> June 2016 – December 2016 → NZD 2,382 million to Auckland Council</td>
<td></td>
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<tr>
<td><strong>Smallest loan issued:</strong> June 2016 – December 2016 → NZD 6,037 million to Opotiki district council</td>
<td></td>
</tr>
<tr>
<td><strong>Credit conditions</strong></td>
<td></td>
</tr>
<tr>
<td>Maturity up to 16 years, average term of 96 months.</td>
<td></td>
</tr>
<tr>
<td>LGFA offers also Short-dated lending, from 30 to 365 day terms, introduced in November 2015</td>
<td></td>
</tr>
<tr>
<td><strong>FINANCES</strong></td>
<td></td>
</tr>
<tr>
<td><strong>RATING</strong></td>
<td>Fitch Ratings: AA+</td>
</tr>
<tr>
<td></td>
<td>Standard and Poor’s: AA+</td>
</tr>
<tr>
<td><strong>Supervision:</strong> The Local Government Funding Agency (LGFA) funds itself through domestic and international wholesale and retail debt capital markets, with the funds raised on-lent to participating New Zealand Local Authority borrowers. LGFA activities are governed by the Local Government Borrowing Act 2011, the Local Government Act 2002, and the Companies Act 1993. In addition, the company is required to comply with ‘Foundation Policies’ outlined in the Shareholders Agreement. Any change to the Foundation Policies Require shareholders’ consent.</td>
<td></td>
</tr>
<tr>
<td><strong>Guarantees:</strong> Other than the New Zealand Government, each shareholder in LGFA must be a Guarantor. Any non-shareholder council that borrows in aggregate NZ$20 million or more from LGFA must be a Guarantor. Parties to the guarantee will be able to exit the arrangement but only after all the exiting council’s borrowings are repaid and all the LGFA’s borrowings, current at the time the council notifies of its withdrawal from the guarantee, are repaid.</td>
<td></td>
</tr>
<tr>
<td>LGFA work closely with Department of Internal Affairs, Office of the Auditor General and Local Government New Zealand on sector and individual council issues.</td>
<td></td>
</tr>
<tr>
<td><strong>Sources:</strong></td>
<td></td>
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<tr>
<td>Annual report 30 June 2016 and 30 June 2017</td>
<td></td>
</tr>
<tr>
<td>LGFA Guarantee and indemnity document, 2011.</td>
<td></td>
</tr>
</tbody>
</table>
### Tamil Nadu Urban Development Fund

**Creation:** 1996

**Address:** Tamilnadu Urban Infrastructure Financial Services Ltd. #19, T.P Scheme Road, Raja Annamalai Puram, Chennai - 600028

**Status:** TNUDF was established as a Trust under the Indian Trust Act, 1882. It is managed by Tamil Nadu Urban Infrastructure Trustee Company Limited (TNUITCL).

**Focus area:** TNUDF is a financial intermediary that supports urban infrastructure projects, giving financial assistance for setting up projects and mobilizing adequate financial resources.

Four settlers established the fund:
- Government of Tamil Nadu,
- and three financial institutions, namely
  - ICICI Bank
  - Housing Development Finance Corporation Limited
  - IL &FS Financial Services Limited (IL & FS).

1 crore = 10 million rupees = € 126,800

**Corporate Governance:**

The managing company of TNUDF, Tamil Nadu Urban Infrastructure Trustee Company Limited (TNUITCL) is managed by a Board of Directors (9 members) nominated by the four settlers of TNUDF. However, the weight of private partners reaches 51.35% and the State own only 48.66% of that company. This company is a legal vehicle.

Also, Tamil Nadu Urban Infrastructure Financial Service Limited, owned by the same shareholders, is the

Other funds have been set by the government, aiming to manage development policies: Water and Sanitation Pooled Fund, Project Sustainability Grant Fund, Project Development Grant Fund, Tamil Nadu Urban Road Infrastructure Fund, and Chennai Mega City Development Fund.

**ACTIVITES**

- **Annual disbursement on lending (2015-2016):** 145 crores / € 18.5 million
- **Annual recovery from previous loans (2015-2016):** 167 crores / € 21.4 million

**FINANCES**

**Rating:** Moody’s: Aa3

**Resources:** The Fund is financed by international development cooperation, including World Bank, JICA (Japan), and GIZ (Germany).
Guarantees:
State guarantees on account of ceilings on contingent liabilities.
The bonds are secured by borrower loan repayments, a debt service reserve fund, state finance commission devolution intercepts, cash collateral and a guarantee from the state or multilateral or Tamil Nadu Urban Development Fund (TNUDF) to cure deficiencies, if necessary.

Sources:
Annual report 2015-2016
website: http://www.tnudf.com/
### United Kingdom Municipal Bonds Agency

<table>
<thead>
<tr>
<th>United Kingdom</th>
<th>United Kingdom Municipal Bonds Agency</th>
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</thead>
<tbody>
<tr>
<td>Creation:</td>
<td>2013</td>
</tr>
<tr>
<td>Status:</td>
<td>UK Municipal Bond Agency is a public limited company. Under UK law, the agency is not considered to be a financial institution and is not subject to financial regulations.</td>
</tr>
<tr>
<td>Focal area:</td>
<td>helps local councils' to finance their investment in projects including infrastructure and housing, efficiently and cost effectively</td>
</tr>
<tr>
<td>Shareholders:</td>
<td>The UK Municipal Bonds Agency Plc is a public limited company, owned by local councils and The Local Government Association.</td>
</tr>
</tbody>
</table>

#### Corporate Governance:
- **Board of directors**: 8 members
- **Executive team**: 4 members

#### Contact:
Contact: Abrady@ukmba.org

#### ACTIVITIES
**Other Activities**: The UK Municipal Bonds Agency Plc brings together real expertise for the first time at the intersection of finance and local government. This expertise allows the creation of tailored products which meet investors’ needs and drive product innovation.

**Lending activities**: Lending operations has not started.

#### FINANCES
**RATING**: Moody’s: Aa3
<table>
<thead>
<tr>
<th><strong>Guarantees</strong></th>
<th><strong>Local authorities (‘LAs’) in the UK are subject to powerful controls through legislative Frameworks, to robust financial controls, and to the Local Government Act 2003.</strong></th>
</tr>
</thead>
</table>
| - The Local Government Act 2003 is central to local authority credit quality: | - All borrowing is secured against the revenues (and not the assets) of an authority  
- All debts are ranked pari passu  
- Removes vires ("beyond the powers") considerations of debt enforcement  
- Allows the High Court to appoint a receiver if debts are not paid  
- Creates the Prudential Code |
| - Enforces the role of Section 151 officers as responsible for budgets and reserves | - LAs can only take an action if a specific power enables them to do so and it is reasonable to do so.  
- Tax raising powers are not devolved  
- Government determines the majority of local authority funding |
| - In addition to legislative controls, LAs are subject to robust financial controls. | - Balanced revenue budgets must be set annually  
- Borrowing can only be for capital expenditure  
- The Prudential Code limits borrowing  
- The Minimum Revenue Provision (MRP) ensures that repayment of principal can be charged against council revenues |
| - Financial reporting/ accounting interpretation is limited by the Local Government Act 2003 Section 151 Officers are officers “suitably qualified” officers appointed to manage local authority affairs and who have ensured conservative financial management of local authorities. | |

**Sources**
UK Municipal Bond Agency documentation  
website: [https://www.ukmba.org/](https://www.ukmba.org/)
14. **DAKAR**

### CITY OF DAKAR

Establishment: 1887

<table>
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<tr>
<th>Legal status</th>
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</table>

**MAIN STEPS**

The project to issue municipal bonds was developed in full compliance with the Senegalese law governing local and regional authorities and their access to the stock market.

With its supporting partners (USAID and Gates Foundation), the municipality created a special control unit responsible for strengthen best practices and lead the programme.

**A/ Strategic phase:** stage of studies to determinate project feasibility (financed by Bill Gates foundation) -> retrospective and prospective analysis of Dakar funding. This made it possible to identify Dakar's debt capacity.

Institutional Diagnostic: understand what should be corrected so that the municipal system could integrate procedures which allow them to access to the stock market.

Information sharing with African municipalities that have already issued bonds.

**B/ The result was an operational phase in two parts:**

- **Capacity-building component:** 5 areas of the municipal administration were identified (Fiscal capacity valuation, development of a strategic planning document, communication, enhance Dakar heritage, strengthening participative process).

- **Structuring Debt Component:** inspired by public entities financial transactions made the last 3 years. Implementation of a “task force” composed of Dakar administration technicians and independent experts. They prepared the first Strategy Paper of the city of Dakar and identified a specific project to finance.

<table>
<thead>
<tr>
<th>rating</th>
<th>Moody's: Short Term: A3</th>
<th>Long Term: BBB+</th>
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</thead>
<tbody>
<tr>
<td>Guarantees</td>
<td>50% of the capital, by US AID</td>
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<tr>
<td>Loan structure</td>
<td>Amount: €30,4 million</td>
<td>rate: 6,6 %</td>
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<td></td>
<td>Loan maturity: 7 years</td>
<td>grace period: 2 years</td>
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<tr>
<td>Additional guarantees</td>
<td>Implementation of an escrow account, a contingency fund and a coupon to secure loan's incomes and give an additional guarantee to the investors. Dakar also fixed a partial guarantee provided by USAID and equal to 50% of the obligation principal amount.</td>
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<tr>
<td>Prior authorizations</td>
<td>Authorization of the Ministry of Economy and Finance and of the Ministry in charge of local and regional authorities and then an issuance permit of the CREPMF (the Subregional Regulatory Authority)</td>
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</tr>
<tr>
<td>Applicable law</td>
<td>CREPMF - Conseil Régional de l'Epargne Publique et des Marchés Financiers: Union monétaire Ouest Africaine</td>
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<td>Sub-national Entity</td>
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**ANNEXE 4 - SHELTER AFRIQUE**

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<th>SHELTER AFRIQUE</th>
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<tr>
<td><strong>Creation:</strong> 1982</td>
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<tr>
<td><strong>Legal Status:</strong> under the Constituent Charter agreed by shareholders at inception while in Kenya the company operates under the Shelter Afrique Act of 1995, an Act of the Parliament of the Republic of Kenya.</td>
</tr>
<tr>
<td><strong>Founders:</strong> Shelter Afrique was established by African governments, the African Development Bank (AfDB), African Reinsurance Corporation (Africa-Re) and UK’s Development Finance Institution.</td>
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<tr>
<td><strong>Focus areas:</strong> Shelter Afrique finances housing projects throughout Africa. It also offers practical advice and technical assistance to a wide range of industry stakeholders.</td>
</tr>
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</table>
| **Shareholders:** - “Class A” Shareholders: only countries -> 44 member countries  
| **Corporate Governance:**  
- **Board of directors:** 11 members - The African continent is divided in 7 groups corresponding to different geographic area. Each group have a representative in the Board of directors. Both of them are government’s members.  
- **“Class A” Shareholders:**  
  A Chairman: financier and representative of group 6  
  2 Independent Directors: development and management consultants.  
  Africa-Re President: African Reinsurance Corporation Class B shareholders  
  An African Development Bank representative.  
- **Class B shareholders:**  
  Divided in 3 committees: An Investment Committee with 4 members, an Administrative and Human Resources Committee with 3 members and an Audit Risk and Finance Committee with 3 members.  
  - **Senior Management:** 4 members: Acting Managing Director and its deputy, Director for Legal, Risk and Compliance and Chief Financial Officer |
| **Ending Partners:** made up of international development finance institutions -> the FMO (Dutch Development Agency), AFD (French Development Agency), and EIB (European Investment Bank).  
**Collaborating Partners:** International Union of Housing Finance, the Centre for Affordable Housing Finance in Africa and UN-Habitat. |
**Activities**

Actions: 3 types of clients:

**Financial Institutions Services** (such as housing finance institutions, banks, microfinance, and other intermediaries to promote home building and ownership)

- *Institutional Lending:* Shelter Afrique provides lines of credit, corporate loans and credit guarantees to financial institutions and specialised housing institutions for on-lending, in local and foreign currencies, to developers and individuals for new mortgages, refinancing of existing mortgages, and construction finance

- *Equity Investments and Joint Ventures:* Direct equity participations in financial institutions catalyze the development of the mortgage market across Africa through the provision of long term funding. Investments in joint ventures with developers enable the provision of affordable housing on a mass scale. In addition, it engage with private equity funds set up to invest in real estate development.

- *Trade Finance:* Help developers and financial institutions involved in the construction sector support the procurement cycle of building materials and equipment. Through our trade finance solutions, we support financial intermediaries, manufacturers and exporting and importing companies, by providing pre-export or import finance, medium term supplier and buyer credits, issuance and confirmation of short term letters of credit and guarantees.

- *Advisory Services:* Offer technical assistance such as housing policy advocacy to clients. This includes training and advisory services to structure project proposals, feasibility studies and project management services.

- *Social Housing:* Favor large-scale projects, which have government support (Public-Private Partnerships) and are environmentally sustainable.

**Private Sector Developers Services** (Housing developers and construction firms):

- *Project Finance:* Identify, appraise and finance projects for rental and outright sale. It provide support to small and medium size developers and encourage their involvement in housing stock delivery, including student hostels development projects. In addition, it support commercial and mixed-use developments that include office blocks, shopping centres and mining villages. Where the size of the project justifies it, SA has the capacity to raise additional funding through syndication with other financial partners.

- *Equity Investments and Joint Ventures; Trade Finance; Social Housing; Advisory services.*

**Public Institutions Services** (national housing agencies, cooperatives and other public institutions on a range of housing initiative):

*Project Finance; Trade Finance; Institutional Lending; Social Housing; Advisory Services.*

**2016 Loan Activities:**

- **Total loan amount:** US$ 89,929,194
  - **Client type:**
    - 14 private institutions
    - 1 Public Institution (Republic of Kenya)
    - 1 Financial Institution

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<td>- 14 debts</td>
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<td>- 1 joint venture</td>
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<td>- 1 line of credit</td>
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**FINANCES**

Cumulative approvals, disbursement and commitment since 2010
# SHELTER AFRIQUE

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**Main Financial partners:** FMO (Netherland Agency), AFD (French Development Agency), and European Investment Bank. International cooperation partners: UN-Habitat International, Union Of Housing Finance, and the Centre for Affordable Housing Finance in Africa.

**Sources:**
Annual report
Website: [http://www.shelterafrique.org/](http://www.shelterafrique.org/)

Andersson L., Overview of municipal pooled financing practices, IFC, FMDV, PPIAF, October 2015, 37p.
FMDV, Déclaration de Marrakech, Financer les Villes Africaines - Conference Resolutions Afrique, Marrakech, 11-12 Décembre 2014, 2p. Multigr.

Presse

Gorelick J., Financing Africa’s Cities, revue Bonds and Loans, 2017

Ressources en matière de données

Securities Industry and Financial Markets Association (SIFMA), Q1 2017
Cbond: http://cbonds.com/
Municipal Securities Rulemaking Board at http://www.msrb.org/EducationCenter.aspx
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<tbody>
<tr>
<td>Mr. ANDERSSON</td>
<td>Lars</td>
<td>Expert, local government funding vehicles</td>
<td>Mårten Andersson Production</td>
<td>Stockholm</td>
<td>Sweden</td>
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<tr>
<td>M. AWOUNOU</td>
<td>Côme</td>
<td>Deputy Director of Cooperation and Partnership</td>
<td>Fonds Spécial d'Equipement et d'Intervention Intercommunale (FEICOM)</td>
<td>Yaoundé</td>
<td>Cameroon</td>
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<tr>
<td>Mrs. BUKHRY</td>
<td>Rashna</td>
<td>Chief Financial Officer</td>
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<td>Port-Louis</td>
<td>Mauritius</td>
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<tr>
<td>Mr. COMWY</td>
<td>Ellis Nii Amor</td>
<td>Deputy Financial Officer</td>
<td>Accra Metropolitan Assembly</td>
<td>Accra</td>
<td>Ghana</td>
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<tr>
<td>Mrs. DIA SARR</td>
<td>Khady</td>
<td>Head of Dakar Municipal Finance Programme</td>
<td>City of Dakar</td>
<td>Dakar</td>
<td>Sénégal</td>
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<tr>
<td>Mr. DIOPI</td>
<td>Abou Khassim Mar</td>
<td>Head of County Senegal for the BRVM</td>
<td>Bourse Régionale des Valeurs Mobilières (BRVM)</td>
<td>Dakar</td>
<td>Sénégal</td>
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<tr>
<td>Mr. OZENGIWA</td>
<td>Siphiwe</td>
<td>Executive Director Municipal Finance</td>
<td>SALGA (South African Local Government Association)</td>
<td>Pretoria</td>
<td>South Africa</td>
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<tr>
<td>Mr. EXAM-DICK</td>
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<td>Managing Director</td>
<td>Iroko Securities LTD</td>
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<tr>
<td>Mr. HANSEN</td>
<td>Thomas</td>
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<td>NKS Kommunalsbanken (Kommunalsbanken Norway)</td>
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<tr>
<td>Mr. HOLENI</td>
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<tr>
<td>Mr. KRISHNASWAMY</td>
<td>Rajivan</td>
<td>Consultant, Former CEO of Tamil Nadu Urban Development Fund</td>
<td>Chennai</td>
<td>India</td>
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<tr>
<td>Mrs. BEMBA</td>
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<td>M. MILLADET</td>
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<td>Mr. NTSIMANE</td>
<td>Tshepo</td>
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<td>Mr. RADHAKRISHNA</td>
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Local authorities need to meet future challenges with their “affairs” in order - What is creditworthiness and how do municipalities achieve it?

Desislava Kalcheva & Lars M Andersson

The authors:
Desislava Kalcheva has worked for more than 10 years in the local finance field. She was a Director at the Fund for Local Authorities and Governments in Bulgaria, responsible for the assessment of fiscal conditions and debt profile of Bulgarian municipalities. Desislava holds a PhD in finance, and her PhD thesis is: Fiscal Decentralization and Investment Capacity of Bulgarian Municipalities. Currently she is doing research with the University of National and World Economy, Sofia on a project: "Systems for Financial Stability and Fiscal Discipline of Municipalities in Bulgaria."


Lars M Andersson has worked for more than 40 years with public sector finance. He started his professional carrier in municipalities and in 1986 he took the initiative to create Kommuninvest, the local government funding agency of Sweden. There he, as CEO, developed the activities during the first 15 years. In 2001 he joined the Swedish Export Corporation as the head of public sector activities and overall communication. In parallel with these positions, Lars has done a number of international advisory missions over the last twenty or more years. He has done a number of advisory assignments in many parts of the world, as, for example, South Africa, Senegal, Bulgaria, Romania, Colombia and Peru. Lars has been an advisor in the processes to create local government funding agencies in the UK and France. Agence France Locale was funding in 2013 and Lars is now serving as a member of the Supervisory Board and as chairman of the Strategy Committee. Lars is also a board member of the Fonds Mondial pour le déveoppement des villes (FMDV), an organisation created by United Cities and Local Government (UCLG) and Metropolis. Furthermore, Lars is a member of the City Finance Lab Committee.

Lars is the author of two books (in Swedish) about the future of Swedish local authorities and has recently co-written a chapter in UN Habitats Finance for City Leaders Handbook. Lars has also written a number of papers on the subject of local finance, as for example “Local Government Finance in Europe – Trends to create Local Government Funding Agencies” (2014), “Finance cooperation between local authorities in developing countries” (2014), “What the world needs now...is local infrastructure investments” (2014) and “Overview of municipal pooled financing practices” (2015). (2015).
Local authorities need to meet future challenges with their “affairs” in order - What is creditworthiness and how do municipalities achieve it?

Cities and other local authorities play an essential role in our societies. This role is projected to substantially grow in importance, according to, for example, United Nations1, UN-Habitat2, OECD3 and many others. This development comes with many challenges for the cities of tomorrow. The most pressing challenge is most certainly finance. This is true for all types of municipalities and the ongoing urbanisation has further emphasised this. Growing cities will face urgent needs to invest in infrastructure and to provide services to more and more people. Also, municipalities with shrinking population have to keep up the basic services, at the same time as the local tax-base is diluted. The question of finance is a huge one and it could be divided into two major issues: own-source revenues and state transfers. Within the category of own-source revenues there are local taxes and fees. Real-estate taxes in different forms and shapes are common. It is, however, important to realise that in order to tap this source the municipality has to have proper and up-to-date registers of the ownership of land and houses. The registers have to form the foundation for taxing. Even other local taxes need the proper information gathered by the municipality. Then it is, of course, a question of what local authorities are allowed to make use of it order to get income, within the national legal framework. Here we again come to the question of decentralisation, which needs to happen, first of all, because it is here that the public sector meets the citizens. Without proper local services, the national growth is inhibited, but, equally importantly, poor local services increase inequalities and give rise to conflicts and populist movements. Even with decentralisation happening, the national government should, of course, have a say on the overall strategies of the country. Transfers to local authorities are useful tools for this, but these transfers have to be stable and foreseeable. A local authority cannot carry out efficient activities without having a fairly good view of what the transfers would look like in one, two and three years from now. It is virtually impossible to do adequate budget prognosis when there is no clear vision about annual transfers. The question of municipal finance is the responsibility of both the local authority itself and the national government. The municipality has to put in place proper administrative processes, including budgeting, accounting, physical planning, public procurements etc. The national government should build sustainable systems for transfers, including equalisation grants. The latter is of outmost importance, since the success of a country depends on equal possibilities for all of its local authorities to produce public services of good quality. When a local authority approaches, for example, a bank to apply for a loan, the overall financial status is often referred to as creditworthiness. Basically, creditworthiness is about having the local authority’s “affairs” in order, which is, to say the least, desirable even when you do not intend to borrow money from anyone. For this reason, creditworthiness could in certain circumstances be renamed to “operational worthiness”. But, what is creditworthiness more precisely? The narrow definition is that the entity in question should be able to repay its debt in time and in full, which is not an unreasonable demand. The road to achieving this runs through sound financial management, including fully functional routines for budgeting, accounting, reporting and auditing. There has to be also a possibility to predict future income, not only from own-source revenues, but also from central government transfers.

Financial analysis is the most important part of the process of determining the level of creditworthiness of a local authority. It should encompass the following:

Revenue streams
The stability and predictability of local revenue, revenue diversification, tendencies, system of tax collection and possibility to impose taxes and fees have to be assessed. Assessment of creditworthiness includes an analysis of different revenues of the local authorities. High level of creditworthiness suggests significant and stable own revenues and good level of tax collection. The revenue from shared taxes is a part of the local budgets in many countries. Local and regional authorities in twenty countries of the European Union receive revenue from shared taxes. The sum represents around 43% of the local and regional revenue and 20% of the total local and regional revenue4. These revenues significantly increase the total own revenue base and imply fiscal autonomy and a higher level of access to the debt market. During the assessment of income flows, the local fees and taxes policy has to be analyzed, including the amendments and trends as regards the amount of local taxes. In some countries, sub-national authorities have a right to introduce new fees and taxes (Austria, Belgium, France). For instance, in Bulgaria, the municipalities determine the amount of local taxes within the limits set by the law and may determine the amount of local fees and to introduce new ones at their discretion.

Cost-structure
The costs for separate functions (education, healthcare, residential construction etc.) and according to intended use (for wages, for current maintenance) are analyzed. Their distribution
and dynamics are assessed. Costs-flow studies assess and analyse which expenditures are made with funds from own revenues and which are made with funds from transfers. It is important to consider capital and operating costs separately. Equal treatment of costs is achieved when capital and operating costs are considered separately, in particular investment costs are reported specifically, financial stability is maintained. Often, in the event of financial crises and temporary financial instability, local authorities give priority to current expenditures. It is important to maintain the balance between different types of expenditures and not give priority to the current expenditures.

**Balance**

The net operational balance represents a difference between current revenue (own revenue from local taxes and fees and total equalization subsidy) and current/operational costs (costs for employee’s salaries, social costs, interest costs and others). Under good financial management, favourable economic conditions, and a stable revenue base, local authorities should be able to achieve a positive net operational balance each year. The net operational balance can be used for financing of local public investments as well as for repayment of debt liabilities. The ability of local authorities to generate operational surplus influences considerably both the investment capacity and the debt financing opportunities.

The operational balance can be negative (deficit) when the local spending exceeds local revenue. If local authorities report deficit annually, it is possible to observe substantial under-financing of local costs. The deficits show a deteriorated financial condition and a risk of delay of the debt payments.

Regarding local budgets, the theory recommends that a balanced operating budget be maintained, and the financing of current/operating costs is done from local revenue sources. Balanced budget recommendations are associated with the so-called “Golden Rule”. The “Golden Rule” of the balanced budget prescribes that local authorities should never take on debt to cover current costs, but it allows and, in some formulations, even promotes prudent borrowing for capital purposes5.

The Golden Rule implies that the operating and capital budgets are differentiated and separated. It is recommended that debt financing be used for financing of investment costs only. Debt financing of operating costs hides a number of risks, incl. an uncontrollable increase in debt burden, and the likelihood of a “Rollover Effect” and the creation of a fiscal illusion. The Golden Rule is observed in a number of Western European countries such as Austria, Denmark, France, Germany, Norway, Italy, Spain, Switzerland and the United Kingdom6. In these countries, the assumption of debt to finance current expenses is only possible in the short term.

In Sweden, it is also a legal requirement to balance the budget, but it is a general view that this is not enough. The vast majority of municipalities comply with the principle of having a 2% surplus. It is viewed that a mere balance is not sufficient for two reasons: a surplus is needed for the self-financing part of local investments and, also, to have a leeway to cope with cyclical fluctuations. There is a debate as to whether the surplus should be not 2% but 3 or 4%.

The separation of capital and operating budgets is lacking in some countries of Central and Eastern Europe, for instance, in Bulgaria. Revenue and expenditure of local authorities in Bulgaria are reported as such for local activities, state activities and for financing of state activities with local revenues. A one-year capital program is set up and presented for capital expenditure; yet often it is not implemented due to a shortage of funds. There is no stability regarding long-term investment programs.

At the same time, we should note that the Golden Rule is breached in Bulgaria. It is formally allowed to take on long-term debt to finance operational costs according to the amendments to the Municipal Debt Act of 2018. According to the changes, long-term debt can be assumed for payment of arrears and for payment of temporary interest-free loans at the expense of the central budget under the Public Finance Act (Article 4, item 8 and item 9 of the Municipal Debt Act). Arrears’ structure analysis shows that most of them are arrears for operating costs. Pursuant to the Public Finance Act, temporary non-interest-bearing loans are provided to finance cash disruptions (Article 103 of the PFA).

Amendments to the Act imply creation of a fiscal illusion and prerequisites for a Rollover Effect and debt overhang. The municipalities’ budgets may be burdened with deferred payments of current costs through debt for a long-term period. This limits the financial opportunities for implementation of debt financing of investment costs. However, the law only allows for the possibility of long-term financing of current costs. The Municipal Councils decide whether they will use this option and whether they will burden the municipal budgets with debt financing of current costs.

**Assets**

The municipal assets have to be analyzed in the assessment of the creditworthiness of a municipality. The assets can be used as collateral for debt financing and substantially reduce credit risk. In some countries like Sweden, using assets as collateral is not possible. This legal restriction derives from the thesis that municipal property should not be put at risk. Furthermore, it is viewed that creditworthiness will not be compromised by this, since other legal features ensure a secure financial situation to be upheld.
The composition of assets, the trends related to increase or decrease, incl. sale or purchase of new assets, depreciation method, market and book prices have to be assessed.

Liabilities
Short-term and long-term liabilities have to be assessed. The overdue liabilities have to be analyzed, attention should be paid to the composition of the arrears. Historically, overdue liabilities are assessed and the causes for delayed payments are explored. Current arrears suggest a deteriorating financial condition and reduced liquidity.

Debt
The debt exposure and the annual debt payments are an important element of the financial assessment. In practice, there are different indicators assessing the debt profile of local authorities, but the most significant of them is the total debt value at year-end compared to annual municipal revenues, annual debt servicing costs compared to annual own revenues and debt per inhabitant. The central government often imposes limits on annual debt payments or on the total debt exposure at the end of the fiscal year concerned.

For instance, in Bulgaria, annual debt servicing costs should not exceed 15% of the average annual amount of own revenues and the total equalizing subsidy for the last 3 years. In the event of a breach of the rule, the Ministry of Finance sends letters with instructions to cease the assumption of new debt. The National Audit Office and the State Financial Control Agency also monitor the municipal debt.

In the analysis of the debt profile, account is taken of the diversification of the debt, annual interest payments, fees, commissions and principals, interest, currency and operational risks are assessed, and the maturity of individual loans is examined. It should be said that debt in itself is neither good nor bad; whether it is one or the other depends on the purpose of taking on the debt. Three categories can be envisaged:

- Taking on debt for the purpose of financing investments that will lower the expenditure of the city in the future. Investments in this category should be encouraged even if it gives rise to increased debt, but, of course, the result related to expenditures has to be beyond doubt.

- Taking on debt for the purpose of financing investments that improve the conditions for the local economy. Here again, the certainty of the outcome is of outmost importance. The clear aim should be to make local companies flourish and the local tax base grow.

- Taking on debt for other purposes. Prudence is recommended! But, also additional factors play a role when it comes to creditworthiness. These are:

Sound long-term planning
Long-term planning can be conducted on the basis of a trend analysis. The analysis includes tax base research and assessment, diversification of individual revenue streams, possibility of raising tax revenues, assessment of average annual change in the individual budget items in previous years, as well as assessment and forecasting of costs and transfers. It is advisable to avoid unrealistic predictions.

Often, in order to balance the budget, local authorities plan significant revenues from the sale of assets. In a number of cases, these sales transactions do not take place and the forecasts have to be updated. It is recommended to prepare a conservative long-term prognosis.

Institutional and structural issues at the national and regional level
This factor implies the assessment of central government policy regarding the revenues and expenditure responsibilities and obligations of sub-national authorities. Here we can also include the transfer relations between local and central government, state decisions on additional financial support and special transfers, decisions on investment policy, and other factors. A number of countries have institutionalist recurrent talks between the central government and local authorities, often represented by their associations. This provides a good platform for resolving outstanding questions.

Capacity development of local authorities
Demographic trends, local economic and business development, future prospects, income level of the local inhabitant’s solvency of the local population, natural resources, efficiency and productivity of municipal investments are assessed and analyzed. Well-built and maintained public infrastructure is a very important prerequisite for attracting new inhabitants and investors to the region.

Institutional issues
The organization of local government, the accounting and audit system, the reputation of the municipal leaders, as well as the composition and role of staff and its level of preparedness are very important points for an overall assessment of creditworthiness.

Management
The elements for assessment and analysis are the continuity and stability of governance and local government decisions, the transparency of local decisions and local spending, the publicity of local policies and decisions, the quality of local administration, investment policies, development plans, indicators for the implementation of development plans, etc. Lately, another area that should be added to the list is IT
security. More and more local authorities have computerised systems for their service provisions. Moody’s Investor Service has discussed cyber risks in two reports7. “Cyber risks encompasses a broad range of threats, from web-based denial of service to data theft and disruption of critical infrastructure services” according to Moody’s. The rating agency notes the following: “As providers of critical infrastructure services, a cyber attack on one or more utilities would cause major disruptions to these companies’ service territory and result in material economic costs to the region and the affected companies”. It should be noted that many local authorities provide utility services themselves or are the owners of utility companies.

The cornerstone of a well-functioning local administration

A good financial situation is reliant on a well-functioning local administration. This requires well-educated and well-trained employees. Now, we can see at least two problems in this regard, and these are more or less common in most countries, at different stages of development.

Problem №1: Most countries lack specific education and training for future employees of local authorities. Few countries have designated schools and universities for future civil servants. It is totally necessary to acknowledge that the skills needed to work in a local administration are very different from what is required in many private companies producing goods or offering services. The fundamental flaw of the neoliberal view is not seeing that a democratically governed authority is driven by altogether different principles than a private profit-maximising company and therefore requires a different set of skills. There are, nevertheless, some countries that have created their own education facilities for future high-position civil servants. In France, the Institut National des Études Territoriales (INET) has provided a university-level education for over 25 years. Students are admitted to INET after very competitive exams and only a small part of the applicants are accepted. This is an example worth studying for a vast majority of countries around the world.

Problem №2: Local authorities have a hard time retaining their high-quality administrators. Working in the public sector means in most countries lower wages than working in the private sector, especially for people in high positions in, for example, a city administration. In smaller municipalities this is even more accentuated, and the private sector is constantly looking for bright people. Brain drain from local authorities to private companies is a fact in most countries. If local authorities are to properly assume their important role for the future, the people working there must be paid accordingly.

Creditworthiness and corruption

Corruption can be classified as grand, petty and political, depending on the amounts of money lost and the sector where it occurs. Grand corruption consists of acts committed at a high level of government that distort policies or the central functioning of the state, enabling leaders to benefit at the expense of the public good. Petty corruption refers to everyday abuse of entrusted power by low and mid-level public officials in their interactions with ordinary citizens, who often are trying to access basic goods or services in places like hospitals, schools, police departments and other agencies.

Transparency International is an organization that works with governments, businesses and citizens with the purpose to stop abuse of power, bribes and secret transactions. The organization prepares and presents annual indexes of the level of corruption in a given context. The index, which ranks 180 countries and territories by their perceived levels of public sector corruption according to experts and businesspeople, uses a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean.

Review of the ratings for 2017 shows that the countries of the Balkans and Central and Eastern Europe have more significant corruption indices than Western European countries. For example, Romania’s index is 48, Bulgaria’s - 43, Macedonia’s - 35. Countries with an index of corruption at the opposite end are Germany - 81, France - 70, Sweden - 84, Switzerland -85. There is a correlation between the level of corruption and the level of well-being in the country concerned. A higher level of corruption is reported in poor countries with low wages for public sector employees. Corruption can have a major negative impact on public spending, including in the implementation of European projects and access to the debt market. Lack of transparency and accountability can seriously undermine the confidence of investors and creditors and therefore central, local and regional authorities can reduce dramatically their creditworthiness.
Implementing a monitoring system and corresponding strict penalties when irregularities are detected can limit corruption. Increasing the remuneration of public sector employees can also be used as a measure against corruption. Anti-corruption measures can lead to increased creditworthiness and to the gradual growth in confidence in public institutions.

How is creditworthiness analyzed?
What first comes to mind is of course the worldwide operating rating agencies such as S&P, Moody’s, Fitch. Apart from these there are a number of regional and national rating agencies.

Just to mention a couple of examples: BCRA, in Bulgaria and Bloomfield Ratings, located in Abidjan, have both rated local authorities and related entities. The rating agencies’ ways of analysing local authorities is fairly well known, so we want to look into how some other entities are working, that is to say central governments and local government funding agencies.

Local authorities are an integral part of the public sector, for which the central government bears the main responsibility. For that reason, a government authority, usually the Ministry of Finance, supervises the local public sector. This supervision could consist in all from very elementary estimates to elaborate analyses. It is very difficult to get precise information about the details of these systems, but a few examples could be mentioned.

In France, the Treasury has an updated list of local authorities that have a vulnerable financial situation (le réseau d’alerte) and in Sweden the Ministry of Finance has done specific studies of which financial information helps to detect future problems in individual local authorities.

In Bulgaria, the Ministry of Finance assesses and publishes on a quarterly basis, basic financial indicators on the fiscal conditions of municipalities, including information about municipal debt by a municipality. There are regulatory constraints on maintaining sound public finances in the Public Finance Act. The Ministry of Finance contacts the specific municipalities when they deviate from the legal restrictions, sends recommendations and monitors their financial status/municipal debt. There is a procedure in Bulgaria for financial rehabilitation of municipalities. In case of violation of fiscal rules, municipalities should improve their financial position. In certain cases, interest-free loans for financial rehabilitation are offered.

Since the local government funding agencies are conducting their operations based on the creditworthiness of their members/customers, it is essential that they have an updated and comprehensive view of the same. Let us take two examples: Kommuninvest of Sweden and the French Agence France Locale. Both have systems for supervising the financial situation of the local authorities that are involved in their financial activities. These systems have to be viewed in relation to the general financial situation of local authorities in Sweden and France. This means that questions related to, for example, tax collections are not addressed since this is not a responsibility for local authorities in these two countries.

In the 1990s, Kommuninvest introduced a system of risk analysis of new members and semiannual checks on each of the existing members. The following areas are analyzed by this system:

- **Liquidity**: the flow of revenues and the ability to cover payments, both taking short and long-term views.
- **Balance**: the result of the profit-and-loss-account over time. Analysis of trends, the ability to adjust costs to revenues in order to reach a satisfactory result.
- **Capacity**: long-term financial resilience. Analysis of solvency, debt, assets, tax-levels and the local authority’s finance policy.
- **Commitments**: activities with inherent financial risks. This could be, for example, entities owned by and/or guaranteed by the local authority.
- **Internal and external factors**: internal factors include questions regarding governance, organisation and staff. Population development, local economy, unemployment etc., are among the external factors.

Agence France Locale has, in turn, put in place a scoring system with a scale from 1 to 7 (1 being the best). Local authorities that apply for membership and have a financial scoring from 1 to 6 are admitted. The scoring is based on three criteria:

- **Solvency**
- **Budget sustainability**
- **Indebtedness**

For the purpose of loan provision, a socio-economic scoring is performed in addition to the financial scoring, complemented by a qualitative analysis if:

- The financial score is > 5
- The debt ratio is > 120%
- The local authority debt volume with AFL is > 50 M euro
- The requested loan maturity is > 26 years.

The qualitative analysis includes governance stability, quality of management, off-balance sheet items and financial outlooks.

The supporters of local creditworthiness

In most countries, the national local government associations are crucial in developing standards.
for their members and for exchanging experiences between members. In conferences and written information “best practices” are shared. As noted above, local government funding agencies, in the countries where they exist, could play an important role in keeping the local authorities financially healthy. Here it is most of all a question of peer-pressure since the success of the agency is based on the creditworthiness of its members. Indeed, peer-pressure seems to be one of the most efficient ways of pushing the local authorities in the right direction.

A special network operates in Central and Eastern Europe - The Network of Institutes and Schools of Public Administration in Central and Eastern Europe (NISPAcee). The network is a professional network of more than 120 institutions from almost 40 countries (from the NISPAcee region and beyond) and hundreds of individuals sharing the organisation’s mission, established in 1995. The members of the organization may be individuals, associated and institutional representing the central, regional or local authorities, NISPAcee region involved new EU member countries (Czech Republic, Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia); non-EU member countries in Eastern Europe (Belarus, Ukraine, Republic of Moldova, Russian Federation, Turkey); countries in the West Balkans (Macedonia, Bosnia and Herzegovina, Serbia, Albania, Montenegro); countries of Central Asia (Kazakhstan, Kirghizstan, Uzbekistan, Turkmenistan, Tajikistan); countries in the Caucasus (Armenia, Georgia, Azerbaijan). Members of the organization are public institutions, associations and universities, as well as representatives of regional and local authorities12.

NISPAcee activities are to promote the development of public administration disciplines and training programmes in post-Communist countries. This means increasing the quality of instruction and research and assisting in school/institute development on international, regional and national levels. Part of the mission is also to foster the development of civil service human resources by spreading the practices of good professional public management, public policy and governance and assisting in the overall political and economic transition through effective public service. Most important is the creation of conditions for increased professionalism of the civil service especially through the facilitation of contact between government representatives responsible for public service and representatives and consultants from member institutions. In addition to the advantage this will give the countries involved, it will also help strengthen the position of schools and institutes in these regions as well as NISPAcee as an organisation.

NISPAcee unites experts from different countries, and the main activity is to strengthen and improve public administration, to promote the transparency of public decisions and to explore and incorporate good practices.

In post-Communist countries, we observe many universities with programs in Public Finance and Public Administration (Bulgaria, Greece, Romania). Nevertheless, in these countries we observe a high level of corruption and inefficient management of public resources.

The importance of self-diagnosis. As noted above, the creditworthiness of local authorities is analyzed by a number of different entities, but the responsibility for a well-functioning administration, whether it is about to take a loan or not, lies solely with the local authority itself. To be clear, this is the responsibility of the members of the local council and cannot be delegated to the staff of the local authority. To supply the elected local politicians with sufficient information to assume that responsibility, it is very important for the local authority to perform a self-diagnosis. This should be done at least semi-annually, in conjunction with the decision of the budget for next year and at the time when the annual report is being produced.

To conclude, it is always important for local authorities to have “their affairs in order”. This is the responsibility of the local authority itself, but in order to take this responsibility the national government must provide appropriate conditions to do so.

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FRENCH LOCAL AUTHORITIES AND BORROWING: FROM AUTONOMY TO FRAMEWORK

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I – From supervision to autonomy: the first stages of the recourse to borrowing by local and regional governments

A- The initial supervision by “Caisse des Dépôts et Consignations” (CDG)

In France, the financial strategy of local governments has developed with decentralization. Until the beginning of the 1980s, their action took place in a managed and protected environment. The formal institution, beginning in 1956, of a link between the subsidization by the Central government of an investment project and the parallel allocation of a preferential rate loan by the Caisse des Dépôts et Consignations, introduced a quasi control of appropriateness of local investment. In this context, the leeway of elected officials was relatively low. To loosen this constraint, heavily felt by the latter, a more flexible procedure was introduced as of 1966: the local governments could find with the Equipment Fund of Local Governments (CAECL) - an administrative institution managed by the Caisse des Dépôts - the additional financing needed for their projects. Loans were granted on terms relatively close to those of the financial market.

Secondly, the so-called “globalization” procedure for loans allowed each local government to negotiate annually the funding budget needed to carry out its entire equipment program. In return, the local government had to take full responsibility for the management of its finances by taking into account certain global financial constraints such as the level of indebtedness and of the tax burden.

B- The consequences of decentralization: the risks of the trivialization of the financing circuits

However, it was in the 1980s that the most important changes occurred under the double effect of the March 1982 law on decentralization and trivialization of financing circuits from 1986 onwards. Decentralization led to the abolition of prior authorization from the prefect for the loan as well as of the link between the loan and the allocation of equipment grants. The Law of 1982 recognizes the ability of local governments to freely borrow at the rates and conditions they have negotiated with any lender of their choice.

All that remains is an ex post review of the legality of the decision to resort to borrowing. The trivialization of the financing channels is reflected in the fact that local governments are now financed by resources provided on the financial markets. The creation of Crédit Local de France in 1987, through the transformation of CAECL and its privatization in 1993, is one of the consequences of this development.

Credit to local governments has gradually become commonplace and diversified. Local governments have thus acquired the opportunity to subscribe to more and more complex products.

In this new context, some have feared the worst and have denounced in advance “the explosion of local debt” or “unbridled recourse to borrowing”. In fact, the twenty years following decentralization stood out as a period of perfectly controlled dynamism of local investment. Far from favoring a new resource without quotas, local governments have preferred to limit the call for loans by mobilizing their own resources and, in particular, taxation.

In the course of the 2000s, however, there was the emergence of so-called structured products based on short and long-term interest rate spreads, or on currency parities such as the Euro-Swiss Franc, most of which are offered by Dexia, and made attractive by the fact that they allowed the borrower to benefit in the first years of the contract from a rate much lower than the market conditions. Even if the borrower knew he was at risk, he may have missed out on the intensity and likelihood of it actually happening.

The onset of the 2008 financial crisis led to the activation of the clauses of some of these structured products, which until now had been generally favorable to borrowers, sometimes leading to double-digit interest rates. After 2010, various reports have measured the size of the so-called sensitive outstanding loans, estimating it at the amount of ten billion Euros in the debt of a thousand local governments.

In an attempt to avoid the repetition of a similar crisis, various measures were taken between 2012 and 2014 to secure the conditions for future bond subscriptions and to make accounting regulations more demanding.

In addition to the regulation of the use of loans, the law of July 26, 2013 on the separation and regulation of banking activities has defined a strict framework for borrowing by local governments, to prevent the reconstitution of a stock of sensitive outstanding loans.

1-Report of the commission of inquiry of the French National Assembly on “the risky financial products taken out by the local public actors” of November 2011, report to the Parliament, the structured loans of the local governments and public organizations involving either a foreign exchange risk, or cumulative structural effects or whose rates change based on high-risk index, July 2012.
II- The principles of the recourse to borrowing: respect for the free administration of local governments

A- Borrowing and the terms of subscription

- The legality check exercised by the Central government representative

Since the loan contract is essentially a private law contract, it does not fall under the legality check\(^2\) and does not have to be transmitted to the representative of the Central government to be enforceable\(^3\). The prefect may not therefore oppose himself to loans whose conditions appear unfavorable to the interests of the local government if no illegality is noted. Only loan agreements that assume the character of an administrative contract are subject to the obligation of transmission to the prefectoral services\(^4\).

However, the Central government representative may request the transmission of any additional documents necessary for the assessment of the legality of the acts carried out by the local governments\(^5\). Thus, when controlling the deliberation of a local government authorizing the use of the loan, the representative of the Central government can usefully request the transmission of the draft loan agreement.

In case of illegality of the deliberations or decisions to resort to the loan, the Central government representative may appeal to the local executive branch to ask it to modify or withdraw these acts. In the absence of a response, within two months, the prefect may refer the act to the administrative court, possibly accompanied by a request for suspension against administrative acts alone.\(^6\) In this respect, it should be noted that the annulment by the administrative court of the deliberation or the decision does not directly affect the validity of the loan agreement.

- The terms of subscription of a loan

According to Articles L.2337-3, L.3336-1, L.4333-1 and L.5211-36 of the CGCT (French General code of local and regional governments), communes, departments, regions and EPCIs (Public Establishments for Intercommunal Cooperation) can resort to borrowing. The proceeds of borrowings constitute one of the non-tax revenues of the investment section of the local government budget (Article L. 2331-8 of the CGCT). Borrowings correspond to the overall volume of debts taken out for more than one year during the fiscal year.

The recourse to borrowing falls within the competence of the deliberative assembly. However, this power may be delegated to the Mayor (article L.2122-22 of the CGCT), to the standing commission or to the President of the Departmental Council (L.3211-2 of the CGCT), to the standing commission or to the President of the Regional Council (L.4221-5 of the CGCT and to the office or to the President of the EPCI (Public Establishment for Intercommunal Cooperation) (Article L.5211-10 of the CGCT).

When the deliberating assembly delegates its borrowing power to the executive branch of government, it must determine precisely the duration and scope of the delegation, in particular the essential characteristics of the contracts that the executive branch is authorized to enter into to finance the investments planned by the budget.

The deliberation or the decision to take out loans or financial products in case of delegation, is a unilateral act which precedes the signing of the contract, under penalty of nullity of this latter. Their content must be sufficiently precise for the loan agreement to constitute an enforcement measure and for the Central government representative to be able to assess the legality of the loan.

On the other hand, the delegations granted to the executive branch of government regarding the use of the loan expire at the beginning of the electoral campaign aiming at renewing the deliberative body. Finally, in the context of the report accompanying the debate on the budgetary guidelines, information on the structure and management of the outstanding debt taken out and the outlook for the draft budget as well as the profile of outstanding debt for the end of the financial year must be presented (Articles D.2312-3, D.3312-12 and D.4312-10 of the CGCT).

- Borrowing, a budgetary resource

Borrowings are exclusively intended to finance investments, be they specific equipment, a set of works relating to this equipment, or acquisitions of durable goods considered as fixed assets. Borrowings need not be explicitly allocated to one or more investment transactions specifically designated in the contract. They can be globalized and match the entire funding requirement of the budgeted investment section.

The control of local government borrowing made is exercised through the principle of balanced budgets provided for in Article L.1612-4 of the CGCT. Under no circumstances should the loan cover a deficit of the operating section or a shortage of own resources to ensure the amortization of the debt. In addition, unforeseen expenses included in the investment section of the budget may not be financed by the loan (article L. 2322-1 of

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2- Articles L. 2131-4, L. 3131-5, L. 4141-5 of the CGCT (General code of local and regional governments).
3- EC, 12 February 2013, No. 234917, Ministry of Finance.
4- Articles L. 2131-2 (4 *) L. 3131-2 (4 *) L. 4141-2 (3 *) of the CGCT (General code of local and regional governments); EC, December 29, 1995, SA, in “Nato Energy”, No. 143861.
5- CE, 13 January 1988, N. 68166, General Mutual company for the staff of the local authorities and of their establishments.
the CGCT. Subject to this reservation, the proceeds of the loans provided for in the original budget may ensure the balance of the investment section.

Article L.1612-1 of the CGCT provides that the executive branch of the local government may, between 1 January of the financial year and the date of adoption of the budget, “collect the revenues”, which authorizes the drawing of the loans taken out before December 31. However, this provision does not allow a new loan contract to be established on the basis of the revenue forecasts of the previous budget, which would constitute a new commitment and not merely the collection of revenues previously legally incurred.

Article L.1612-1 also states that “until the adoption of the budget, or until April 15, in the absence of adoption of the budget before that date, the executive branch of the local government may, with the authorization of the deliberative body, engage, liquidate and mandate the capital expenditures, within the limit of one quarter of the appropriations opened in the previous financial year, excluding the credits relating to the repayment of the debt”. These provisions do not concern borrowing, which is a revenue of this section. The deliberation deciding to take out new loans could be referred to the administrative judge, even if this decision was to be regularized in the next original budget. It is only after the adoption of this one that the mayor will be able to take out the loan.

In the context of budgetary control (articles L. 1612-1 to L. 1612-20 of the CGCT, the prefect ensures compliance with these rules. The prefectural authority or any person having an interest to act may challenge the legality of the acts relating to the loan before the administrative judge.

- Charging of expenses in the budget

The credits necessary to repay the annuities of the loan, interest and capital, are assessed in the budget in a sincere manner.

Repayment of capital is charged to account 16, in expenditures of the investment section. It must be covered by own resources, which is an essential condition for a balanced budget (Article L.1612-4 of the CGCT).

The financial expenses, whether interest or related financial expenses, are charged to account 66 in the expenses of the operating section.

The payment of the debt is a mandatory expense, whether it is a repayment of capital or of the financial expenses. The lender is therefore entitled to use the ex officio registration and entrustment procedures to obtain the payment of annuities in case of default of the local government (articles L. 1612-15 to L. 1612-17 of the CGCT code). On the other hand, enforcement measures under ordinary law (mainly seizures of assets) are not applicable to a local government or to a local public institution.

B- The framework of the recourse to borrowing: the novelties introduced by the law of July 26, 2013 on the separation and regulation of the banking activities

In terms of financing of local governments and in order to secure the conditions for future subscriptions to loans, Law No. 2013-672 of 26 July 2013 on the separation and regulation of banking activities introduced two major changes in the CGCT (General code of local and regional governments):

- Article L. 1611-3-1 of the CGCT sets the legal framework for the use of loans for local governments, their groupings and the departmental fire and rescue services;
- Article L. 1611-3-2 of the CGCT authorizes the creation of a local government financing agency.

- The legal framework for the use of loans for local governments

Article 32 of Law No. 2013-672 of 26 July 2013 on the separation and regulation of banking activities, codified in article L.1611-3-1 of the CGCT, now defines the loans that local governments, their groupings and the departmental fire and rescue services can take out from credit institutions, by limiting access to the simplest products.

In order for their taking out to be authorized, the loans must have the following characteristics:

- borrowings may be denominated in Euros or foreign currencies provided that they are hedged against currency risks. In this case, a currency exchange agreement against Euros must be entered into for the total amount and the total duration of the loan concerned;
- the interest rate of the loans that have been taken out can be fixed or variable. For all variable rate loans, indexes and index deviations allowed for interest rate indexation clauses are determined by Decree No. 2014-984 of August 28, 2014, codified in Articles R.1611-33 and R.1611-34 of the CGCT. The formula for indexing variable rates must meet criteria of simplicity or predictability of the financial charges of the entities concerned.

In addition, local governments may use debt-based financial contracts (swap) as part of their debt management in order to hedge the risk taken by the entity concerned.

Local governments may, however, derogate from these rules when the subscription of a loan or a financial contract, by means of an addendum or a new contract, has the effect of reducing the risk associated with a loan or a financial contract that is
The creation of a local government financing agency: Agence France Locale

Article 35 of Law No. 2013-672 of 26 July 2013 endorsed the creation of a public funding agency for local governments aimed at contributing to the diversification of access to financing by local governments, by offering them a shared access to the bond market.

Thus, a new article L1611-3-2 of the CGCT Code authorizes the local governments and the public institutions of inter-municipal co-operation with own taxation systems to create a state-owned company (Territorial Company) taking the form of public limited company of which they hold the entire capital and whose purpose is to contribute, through a subsidiary (the Operating Company) to their financing.

Created in October 2013, Agence France Locale secured the approval of the French Prudential Control and Resolution Authority (ACPR) on December 22, 2014 as a credit institution. It launched its first bond issue in March 2015, allowing it to begin its operational activity, which was deployed during 2015. At the end of 2016, 173 local governments were members of Agence France Locale. 191 loans were granted for a total amount of 1.055 billion Euros.

III- Current conditions of borrowing by local and regional governments: controlled freedom

A- Toxic debt about to become extinct

The years 2015 to 2017 saw the extinction of most of the subprime loans taken out in the 2000s by local governments and whose outstanding amount was estimated at around ten billion Euros. These products, more than 80% of which were marketed by Dexia Bank, were based on attractive rate conditions at the outset.

These conditions subsequently turned out, in particular as a result of the financial crisis of 2008, to be unfavorable for the finances of local governments due to the inclusion in loan contracts of variable rate formulas depending on macroeconomic developments.

Not all local governments are in the same boat when it comes to the cost of credit. With an average borrowed amount of 198.5 million Euros, the regions obtained an average credit rate of 0.77%, well below the average rate for other governments (1.02% for example for the “departments”, who borrowed, on average, 40 million Euros on average last year). For their part, municipalities and EPCIs with less than 10,000 inhabitants benefited from both historically low market interest rates and declining bank margins. Municipalities and EPCIs (Public Establishments for Intercommunal Cooperation) of more than 100,000 inhabitants and their counterparts of less than 10,000 inhabitants are the structures that have benefited the most from these favorable conditions.

The subprime crisis is based on a combination of responsibilities: that of local governments that have exercised their power to borrow freely in the name of the principle of self-government, and presidents of local executive branches of government who have taken ill-considered risks for short-term benefits without properly informing their deliberative assembly; the responsibility of the banks, and in particular Dexia, which designed these structured products and encouraged their underwriting, especially for small municipalities; and lastly, the responsibility of the Central government who did not take the measure of the risks incurred at the time of the appearance of these new loans and did not quickly put in place the legal and accounting devices which would have avoided their propagation.

At the end of 2017, the cost to public finances of the exit of risk loans exceeded € 3 billion, of which nearly € 1 billion for the Central government and € 2 billion for the local governments concerned.

Begun in December 2011, the decline in the average rate of local government debt continued in 2016. Like the rest of the economic players, local governments have benefited in recent years from exceptional borrowing conditions, with an average rate of 1.18% in 2016, according to the 2017 edition of the Local Government Debt Observatory. Local governments benefited from both historically low market interest rates and declining bank margins. Municipalities and EPCIs (Public Establishments for Intercommunal Cooperation) of more than 100,000 inhabitants and their counterparts of less than 10,000 inhabitants are the structures that have benefited the most from these favorable conditions.

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The local public debt has become very safe. The implementation in 2015 of the support fund for local governments that took out toxic loans has accelerated the “desensitization” of these high-risk loans. These account for only 2.3% of the total debt of the local public sector.

9- In 2014 and 2015, the local authorities had obtained conditions of loans described at that time as “competitive”, respectively of the order of 2.40% and 1.75% on average. But 2016 was a record year.
Thanks to the support fund set up in 2014, the threat posed by toxic loans is now almost completely ruled out for local governments and their local public institutions, while nearly 1,500 of them were facing difficulties in 2012.

The Court of Auditors also estimated in its 2018 annual report that the exit of local governments from toxic loans is now “under control”, except for a dozen of them. This crisis will cost 3 billion Euros, including 2 billion to local governments: however, the financial jurisdiction refers the responsibility to banks as well as to the Central government.10

B- State-owned banks: Still major players of local borrowing

According to the 2017 study of the Local Government Debt Observatory (built on a set of more than 1,300 local governments, representing a total debt outstanding of more than 100 billion Euros), the local public sector has borrowed an average of 17.3 years to cover its financing needs. 73% of the loans were subscribed for terms of between 15 and 25 years. In 2016, banks financed a bit more than 57% of new long-term borrowing needs of local governments. The rates offered by the institutions were extremely competitive (1.20% on average). Nonetheless, nearly 10% of bank contracts have interest rates higher than 2.5%.

With 42% of bank loans granted to local governments last year, the French Postal Bank confirmed its position as market leader, attained in 2015. It is ahead of Groupe BPCE (21.3%, Crédit Agricole (16%), and Société Générale (7.3%). In total, about fifteen banks lent money to the sector.

“Alternative” financing helped meet the remaining needs (almost 43%). In this context, bond issues, launched mainly by large local governments, covered 11.5% of the long-term financing needs of local governments, on very favorable terms (1.09%). The European Investment Bank (10.7%) and Caisse des Dépôts (13.9%) were the main public lenders. As for the Agence France Locale, recently created at the initiative of the large local governments, it financed 4% of the needs in 2016. In total, the public banks remain the partners who finance the longest investments (22 years on average and up to 50 years for Caisse des Dépôts), says the study.

C- The contribution of local governments to the reduction of public deficits

The French Finance Law for 2018, the first of president Emmanuel Macron’s five-year term, lays the groundwork for an in-depth reform of local finances and relations between the Central government and local governments. On the one hand, this Finance Law initiates the progressive assumption of the housing tax by the Central government, through adjustment, for 80% of the households, and transfer to the regions of a fraction of the VAT. On the other hand, the Law inaugurates the contractual mechanism of supervision of the expenditures of the 319 largest local governments in order to save 13 billion Euros by 2022. Finally, after four years of decreases in endowments, the financial contributions of the Central government become stable (+ 0.4%).

Above all, Law number 2018-32 of January 22, 2018 on public finance programming for the years 2018 to 2022, puts in place a policy of deleveraging of 2.6 billion Euros per year that is an incentive policy and no longer a binding one, aimed at local governments.

Indeed, though the weight of local governments in the French public debt in 2016, according to the French National Statistics Institute (INSEE) is only 9.3%, this reality, which was stable for several years, did not deter the government from presenting a range of tools to ensure that local governments have a consistent budget surplus in the years to come, so that they contribute actively and continuously to the sacrosanct reduction of the public deficit.

In accordance with the guidelines presented at the launch of the National Territorial Conference of July 17, 2017, the maintenance of state allocations is accompanied by a commitment by local governments to gradually reduce their operating expenses (minus 13 billion Euros expected by 2022). This slowdown should allow greater self-financing and deleveraging of the local governments. The effort required is primarily based on the 319 largest local governments, which account for two-thirds of the local governments’ total operating expenditures.

Local governments have nonetheless obtained the deletion of article 24 of the programming law introducing the deleveraging ratio as the new prudential financial ratio of the local governments Since its introduction in the draft Finance Law (PLFI), local elected officials have been trying to suppress this “reinforced golden rule” which provided for the launching of a procedure of surveillance of the local governments whose ratio between the stock of debt and the gross saving exceeds 11 to 13 years. This measure, which they describe as “useless, dangerous and vexatious”, presents, according to many financial experts, problems of volatility, unpredictability, and did not integrate the assets of the local governments.

All in all, according to the government’s forecasts, local governments and their groupings will have to generate almost one point of budget surplus (0.8%) by 2022 to participate in

the overall consolidation of the public deficit in order to tend towards balance. Based on the estimated GDP for 2018, this represents almost 19 billion Euros of budget surplus in 2022.

At the same time, it is expected that the Central government will reduce its own deficit from -3.2 to -1.8 points of GDP ... but without ever regaining the balance that it imposes however in an increasingly restrictive manner to local governments. It should be noted that, according to a May 2017 Senate report, the contribution of local governments to the growth of the public debt since 1990 has been continuous but only represents 3% of the overall increase.

Today there are two philosophies of free administration that clash: the first one, resulting from Act III of the decentralization resulting from the reform of 2004, favors an integrated reform of the public finances where the Central government guides the big macroeconomic balances while leaving, according to the principle of subsidiarity, the management of proximity to the most appropriate level of government. The second philosophy is based on tax autonomy as a double lever of democracy and efficiency\(^{11}\). With the vertical participation of local governments in the control of government deficits, it seems that we have entered a new era of decentralization moving away from the spirit of full responsibility of local governments and local democracy desired since 1982.

**Conclusion: towards an active and enlightened treasury management of local governments**

Cash-flow credits are different from loans in that they are not intended to finance investments and do not provide any budgetary resources. They finance only the temporary lag in time between the payment of expenses and the receipt of revenue. Therefore, Cash-flow credits are not subject to the legal loans regime. In order to meet one-off cash needs, the local government can then open a line of credit with a bank: it is a credit whose ceiling and duration are determined. Cash management must, however, be effective enough: indeed, the funds available must cover all expenses reaching maturity; therefore, a cash surplus in excess can be a sign of inappropriate management.

Unlike loans, local government treasury management is marked by two strong rules: the obligation to deposit funds with the Public Treasury on one hand, and the absence of remuneration on the other hand. The rule of obligation of deposit of the “free funds” of the local governments was laid for the first time by an imperial decree dated February 27, 1811. In the same spirit, obligation is made to “départements” to deposit all their funds available under the Law of July 18, 1892, thus matching, therefore, the principle of non-remuneration of deposits – a principle extended to municipalities by the law of September 18, 1941. At present, the legal basis of the filing obligation results from section 26 of the LOLF (Organic Law on Finance Laws). This principle obey the logic of unity of the treasury of all administrative public services: whether or not they have legal personality, public services must deposit their funds with the Central government. With regard to the specific case of local governments, these obligations are the counterpart of two services rendered by the Central government. As an example, the Central government calculated the tax base, then carries out the liquidation and the collection of the local taxes on behalf of local governments; in addition, the Central government pays to the local governments, by twelfth monthly, the proceeds of local taxes in the form of unpaid advances.

Although they fall under two different logics, cash management and borrowing are, however, in fact often associated. Contracts combine long-term financing with cash flow requirements. Local governments are then offered by financial institutions mixed products, which can result, on the basis of the same contract, in a certain articulation between cash loans and budget borrowing. These complex debt products provide a broad investment financing objective, while seeking maximum adaptation to the local government’s cash flow situation. The main mixed or complex products offered to local governments make it possible to consolidate cash lines in loans or to take out a loan offering active debt management facilities.

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\(^{11}\) O. WOLF: “Le début de la fin pour la libre administration” (“The beginning of the end for free administration”), Published in: “La Gazette des communes”, issue n°72403, February 19, 2018, page 22.
TAX DECENTRALIZATION AND THE MOBILIZATION OF LOCAL REVENUE: THE CASE OF RENTAL INCOME TAX IN THE CITY OF BUKAVU

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Based on data from the Directorate General of Taxes and the Provincial Directorate for the Mobilization and Revenue Supervision in South Kivu area for ten years, from 2006 to 2016, this article verifies, using the Student’s t-test on the comparison of averages, the impact of tax decentralization on the mobilization of revenue. The results show that the average revenue from the Rental Income Tax after decentralization is significantly higher than the average of those collected before decentralization. However, these revenues are still low compared to the tax potential. They could be mobilized more if the quality of the institutions were improved and if the urbanization standards were respected.

Keywords: Tax decentralization, Rental Income Tax, Student’s t-test.

1. Introduction

Grassroots development implies certain autonomy of action by local governments. Local development and tax decentralization go hand in hand. How to speak of local or endogenous development without local governments having their own financial resources of which they have perfect control?

Decentralization is defined as “a mode of management of public services which translates into the transfer of powers of the central governments to institutions (whether territorial or not) that are legally distinct from it and benefiting, by virtue of an organic law, of a certain autonomy” (Toengaho, 2009, p.217). Decentralization distributes resources and powers by organizing financial relations between the central government and local governments (Yatta, 2000).

Thus, the Congolese Constitution as amended by Law 11/002 of January 20, 2011 in its articles 201 to 206 specifies the exclusive powers of the central governments, i.e. in total 36 powers (Art. 202), those shared between the central government and the provinces, representing 25 powers (Art. 203) and those belonging exclusively to the provinces, i.e. 29 powers (Art. 204). The Constitution states in its Article 171 that “the finances of the central government and those of the provinces are distinct “.

Law number 08/012 of July 31, 2008 establishing the fundamental principles relating to the free administration of provinces specifies, in its Articles 45 to 55, that the resources of provinces include: (i) the own resources, (ii) the resources from national revenues with a 40% withholding tax to the provinces, and (iii) the exceptional resources. The effectiveness of this withholding tax still suffers from a lack of enforcement5.

This Law states in section 48 that the province’s own resources include: taxes, levies, provincial and local taxes, and participation revenues. The tax on Leasing Income (IRL) is part of the own revenues of the province.

Based on the provisions on public finances in the Constitution contained in Articles 171, 203 and 204, as well as in the abovementioned Law 08/012 of July 12, 2008 in Article 35 paragraph 4 thereof, the provincial legislature has endowed, through Edit 09/05 of 12/12/2009, the province of South Kivu with an institutional instrument called Provincial Directorate for the Mobilization and Management of Revenue / for the South Kivu area, called DPMER in short. Indeed, Organic Law number 11/011 of July 13, 2011 relating to public finances (LOFIP), is the consecration of the principle of the tax autonomy of the provinces. Its Articles 145, 148 and 149 establish the principle of tax autonomy and that of resources in favor of provinces and Decentralized Territorial Entities (ETDs).

Taking as a starting point Liégeois (2008)’s idea that decentralization may not be reduced to the sole transformation of institutional structures in some Developing Countries, this article seeks to answer the question: Does tax decentralization contribute to the maximization of public revenue, in this case the Rental Income Tax (RIT) in South Kivu?

2. Decentralization and Maximization of Revenue

On average, tax revenues represent around 20% of the Gross Domestic Product ( GDP ) in developing countries, leading to a low pooling of resources. For example, Africa is indeed the region of the world where the levies on the national economy for public action are the lowest. They represent 10 to 17% of GDP, compared to 20 to 25% in Latin America, and 40 to 50% in the countries of the Organization for Economic Cooperation and Development ( OECD ), according to the World Bank (2011). Though tax revenues have improved in Africa, they kept standing at proportions that are insufficient for the economic potential of the continent (World Bank, 2001- 2011).

5According to François Yatta (2016), in a number of countries, the legislative provisions organizing the decentralization processes, particularly with regard to its financial aspects, are struggling to be implemented. Indeed, the decentralization orientation texts voted by the Parliament are not applied because the taking of the implementing decrees and ordinances can often take a decade. The situation is even more concerning in some countries where these implementing texts even when they exist are often not applied. This situation puts the central state in total illegality with respect to the law, thus putting it on the margins of the rule of law. The increase of these cases where compliance with Law by the central government itself is less and less a reality, is a further concern which limits the efficient management by the local authorities of the transferred powers.
In a study on local public finances in the Democratic Republic of Congo (DRC), Balyahamwabo and Ntagoma (2009) show that “not only does the enormous weight of the informal sector in the economy lead to a weak tax base but the people have lost the culture of taxation and are disappointed to find that the amounts of taxes paid end up partly in the pockets of some individuals, including those of the political elite, which leads to a lack of trust in managers”. Local governments suffer even more from tax incivism than the central government.

In spite of this fact, in order to avoid excessive reliance on the external financing often generated by budget deficits, developing countries need to rely mainly on the mobilization of domestic revenues to support economic growth. (Gupta, 2007).

Laws 08/012 of July 31, 2008 on fundamental principles relating to the free administration of the provinces and 08/016 of October 07, 2008 on the composition, organization and functioning of the Territorial Dedicated Entities (ETDs) and their relations with the Central government and the provinces explain the content of taxation and resources that the Central government transfers to the provinces and ETDs, and the resources that should be under the responsibility of the Central Government and those to be shared with the provinces and ETDs.

The financial aspect of decentralization is such that it is an issue that affects the sensitivity of economists only since the 1950s. In terms of public finances, provincial autonomy has two parts according to Dafflon (2005, p. 43): financial autonomy concerning the resources of local governments, and budgetary autonomy concerning expenditures. Financial autonomy is mentioned when a community is able to obtain the financial resources it needs without using or relying on other communities that are at a higher level or at the same level of government. However, financial autonomy should not be confused with tax sovereignty. The latter corresponds to the right to invent taxes, that is to say the tax bases, the taxable persons, the method of calculation and the rate schedule, as well as the right to levy taxes.

Decentralization can lead to failures or to the strengthening in revenue mobilization. On the one hand, local elected officials may not submit citizens to the obligation to pay taxes, a way to be benevolent and to attract voters in order to increase the chance of being re-elected soon. Yet in terms of public spending, each elected official will want to make an investment in his constituency to be re-elected. In this context, financial decentralization, especially in the developing countries, can increase the budget deficit. Also, sometimes local governments do not have the same possibilities to collect the taxes as the central bodies, and this can lead to the reduction of public revenues when local governments are entrusted with the responsibility of levying certain taxes.

On the other hand, in order to pay taxes, taxpayers may more easily cooperate with local government officials than with central governments that are distant from them. This is the point of view of Wasylenko (1987). Knowing that taxes will be used locally to maintain roads, or to finance garbage collection services, people often do not hesitate to pay local taxes because they know the needs to be financed. In addition, populations also have the possibility to control the use of taxes since the leaders are close to them, due to decentralization.

Finally, since financial decentralization has conferred the power of decision and control on local authorities, the latter can oblige taxpayers to fulfill their duty: the central government having a monopoly of coercion, especially in tax matters (Balyahamwabo, 2012).

To verify these assumptions, the graph below traces the evolution rate of implementation of the Rental Income Tax (RIT) before and after decentralization.

![Figure 1: Evolution of the achievement rate of the Rental Income Tax revenues](image)
This graph shows a tendency to an increase in revenue due to decentralization until the end of 2015, the year when DPMER workers have begun to experience delays in the payment of wages. Maximum revenues at DPMER were achieved in February 2015, reaching $383,321. In a study of mining companies in Katanga, Kalenga and Balyahamwabo (2016), it is explained nevertheless that in order to fulfill their social responsibility, companies should properly motivate their employees to expect a better performance from the latter.

3. Rental Income Tax

The tax base of the Rental Income Tax (RIT) consists of the net income from the rental or subletting of the buildings and lands located in the DRC, or even from the rental of furniture, materials, tools, and of any object attached to said land and buildings. In the event of the transfer of all the property rights of the taxable person, this latter must pay a special levy on the income that has been collected from the first of January of the year of that transfer.

The proliferation of rented properties in the city of Bukavu offers huge tax opportunities at the local level. Indeed, there are two sources of values based on the occupation of urban land. On the one hand, there is the gain deriving from the urbanization mechanism which increases the value of a land because of its urban character. On the other hand, there is the gain linked to the agglomeration economy, which is related to the decline in transaction costs when people live close to each other on a territory but also because of the decline in the overall cost of access of populations to different services (Elong Mbassi, 2014). Thus, like other tax bases, the Rental Income Tax (R.I.T.) has the virtue of being particularly effective.

According to Ordinance-Law number 69/009 of February 10, 1969 establishing schedular taxes on income, the net rental income comes from the accumulation of:

- The rental proceeds;
- The taxes of any kind paid by the tenant to the lessor;
- The expenses, other than rental repairs, borne by the tenant, on behalf of the lessor, and resulting or not from the conditions imposed by the lessor for the rental of the building. The burden consisting in an expense once made is distributed over the years not yet completed of the lease term.

In principle, the rental guarantee does not constitute a rental income. However if it reveals the character of a rent paid in advance, it is taxable under the rental tax.

The doctrine of jurisprudence considers that when a building is requisitioned in exchange for the payment of compensation, such compensation is comparable to the rent to the extent that it does not represent compensation for damage. In addition, the compensation for occupation without title or right is considered as a taxable rent if the owner has not suffered any prejudice other than the deprivation from rent.

The real person liable for the payment of tax or the taxpayer is the owner, possessor or holder of a real estate right, the beneficiary of the net profit of the subletting of the buildings and of the lands. On the other hand, the legal persons liable for the payment are required to pay the tax by way of withholding tax. These persons are the tenants and subtenants, and the de jure and de facto middlemen who are active in the management of the buildings rented to individuals. In the case of a lease of an apartment building belonging to a real estate company whose purpose is the rental of houses, the rental tax is not due but the professional tax is.

The taxable period is the entire calendar year and the basis of taxation varies depending on whether it is the flat tax system or the tax system resulting from the taxpayer’s return. With respect to the flat-rate tax system, the flat-rate basis takes into account several factors of comfort, including the built-up area of more than 200 square meters, the water and electricity connection, the possession of a closed garage or of an independent and furnished cellar or garden, the number of floors being greater than two. In the event of a presumption of inaccuracy, the taxable rents are determined for each taxable person by taking into consideration the normal rents of one or more similar taxpayers.

Article 4 of the Ordinance-Law of 1969 provides that “is taxable the income from the rental of buildings and land located in the DRC regardless of the country of residence or residence of the beneficiary; are considered as rental income the housing allowances granted to the occupants of their own home or that of their spouse”.

The rental income tax is levied on the income beneficiary, that is to say, when one is a legal person or a physical owner of a

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building rented out. The rate of the income tax on the rental of buildings and land but also the profit on subletting is set at 22%. The tenant withholds 20% of the rent that he pays to the property manager before paying the rest of the rent to the landlord. On February 01\textsuperscript{st} of the year following that of the realization of the taxable income, the landlord who is the true taxpayer pays to the tax authorities 2% of the rent that his landlord has not retained throughout the budget year. In total, the latter bears a tax burden of 22%.

According to Article 13 of Law No. 83/004 of February 23, 1983 as such Article has been amended to date, over a year, the deduction is paid to the tax administration as many times as there are payments of rents to the lessor. The tax must be declared and paid by the landlord, on behalf of the landlord, within 10 days of each rent payment. It should be noted that the lessor is obliged to make an annual tax return concerning his rental income by including the gross amount of rent which consists of the actual amount of rent to be cashed and that of the withholding amount.

4. Methodology

We will mainly use the comparative method on the revenues of the Rental Income Tax (RIT) collected by the DGI before decentralization, particularly the 48 months from January 2006 to December 2009, and the Rental Income Tax (RIT) revenues recovered by DPMER after decentralization, specifically for 72 months from January 2010 to December 2016. To do so, we shall use the Test on two averages with variances of the two populations that are unknown and supposedly unequal.

Thus, we use the hypothesis test based on Student’s distribution, instead of the reduced centered normal distribution. (Anderson, 2010).

Data were collected from DGI and DPMER.

In any hypothesis test, one establishes two mutually exclusive hypotheses and only one of them will be accepted.

The null hypothesis is noted as follows:

\[ H_0: \bar{x}_1 \leq \bar{x}_2 \]

This is the hypothesis that will be rejected only if there is enough evidence against it. This hypothesis does not bring about a positive and significant impact of decentralization on local tax revenues (R.I.T.).

The counter- hypothesis or the alternative hypothesis is

\[ H_1: \bar{x}_1 > \bar{x}_2 \quad \text{or} \quad \bar{x}_1 > \bar{x}_2 \]

This hypothesis makes it possible to reject H0 (Bernard Grais, 1998). It means that the Rental Income Tax (RIT) after decentralization is significantly higher than the RIT before decentralization. It is the hypothesis that brings change.

As part of our work, we use Student’s t-test for a right unilateral test to check if the Rental Income Tax (RIT) resulting from the DPMER (after decentralization) is significantly superior to the Rental Income Tax (RIT) from the DGI (before decentralization). The goal is to measure the impact of decentralization on the mobilization of tax revenues.

Manually, we should use:

\[
t_c = \frac{\bar{x}_1 - \bar{x}_2}{\sqrt{\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}}}
\]

where \( t_c \) is the calculated value, \( \bar{x}_1 \) et \( \bar{x}_2 \), \( s_1 \) et \( s_2 \), \( n_1 \) et \( n_2 \) the standard deviations on a sample r of the revenues of the Rental Income Tax (RIT) after and before decentralization, and \( T \) go s the sample revenues Rental Income Tax (RIT) after and before decentralization, and, \( n_1, n_2 \) the sample sizes of the revenues of the RIT after and before decentralization.

In this work, we set the threshold at

The value of the table \( t_{\alpha, n_1 + n_2} \) is read in the table. This statistic follows approximately a Student’s law with K degree of freedom: \( n_1 + n_2 - 2 \). Since K is greater than 30 we could also use the Normal law (Doucouré, 2010).

Figure n° 3: The Gauss curve.

If \( t_c < t \) read: acceptance of \( H_0 \), which means that there is no significant impact of decentralization on the Rental Income Tax (RIT): the average of the Rental Income Tax (RIT) revenues of DPMER is not significantly higher than the average of the revenues of the Rental Income Tax (RIT) of DGI.

However, we use the Stata software for data processing. Thus, Student’s t probability, aimed at comparing two subpopulations, will enable us to accept or reject the null hypothesis. The first subpopulation is made up of the Rental Income Tax (RIT) revenues after decentralization and the second subpopulation consists of the Rental Income Tax (RIT) revenues before decentralization. The latter subpopulation is here marked by the presence of DPMER.

DPMER needs to be dynamic so that revenues increase as it is the purpose of its creation to justify its presence and the merits of decentralization.

\footnote{The RIT data for 2014 were not available.}
5. Results and discussions

The results in Table 1 show that the average revenue from the Rental Income Tax (RIT) collected by the DMER (after decentralization) is significantly higher than the same revenue collected by the DGI (before decentralization) at the error threshold of 5% given the probability of zero for a right unilateral test. The null hypothesis is thus rejected.

In addition, the revenues of the Rental Income Tax (RIT) for the DPMER are more scattered (coefficient of variation being equal to the standard deviation on the mean = 62825/72 = 873) than those of the DGI (coefficient of variation = 2869/48 = 60) as also shown in the graph below.

The analysis below relates to the achievement rate it complements that of the revenues seen previously.

At the moment when the maximum achievement levels are almost the same for the DGI as for DPMER, the medians and minima of these rates are lower for DPMER.

These results are similar to those of Balyahamwabo (2013), Neyapti (2010) and Thiessen (2002) who also claim a link between the quality of the institutions, including the decentralization and mobilization of tax revenues.

For the first of these authors, when financial decentralization is accompanied by other measures to improve institutional quality (political stability, control of corruption, good regulation and the efficiency of the public authorities), financial decentralization becomes a source of increase in tax revenue because it has a positive and significant impact on tax revenues. The second author concludes that financial decentralization is more likely to be unfavorable to economic performance if it is not accompanied by other good governance policies. As far as the third author is concerned, he supports the existence of a level of financial decentralization, below which its effect is positive on the macro-economic performance.

Ahmad and Stern (1987) says the same concerning India, Zee (1995) concerning Bangladesh, the World Bank (1998) concerning the Latin American countries, and Engel et al. (1999) concerning Chile, who confirm the impact of tax reform on taxation. Indeed, as is the case for most developing countries, local taxation in the DRC is unprofitable and relies on taxes that have not been revised recently and are particularly difficult to collect (Rota Graziosi, Caldeira, and Chambas, 2015).
Like Yatta (2015), we propose that financial auditing bodies at the central level (court of auditors and general financial inspectorates) should also be allowed to carry out regular financial audits within local governments, particularly in the provinces.

6. Conclusion

Our study focuses on the impact of tax decentralization on the rental income tax in the city of Bukavu. The purpose of this research was to verify if tax decentralization contributes to the maximization of public revenues, based on the case of the province of South Kivu.

Based on our results, there has been a significant improvement in the rental income tax revenues since the inception of the DMPI compared to the DGI. Thus, tax decentralization contributes to improved revenues from Rental Income Tax (RIT): it is an innovative practice in the tax area.

These results can however be nuanced by the increase in rented apartments which can also explain this improvement in local public finances. In addition, relative to the potential of the province, the revenues of the Rental Income Tax (RIT) are far lower than those that should be mobilized. The lack of competent and motivated staff within the DPMER, as well as fraud and tax evasion, are among the factors that lead to this weakness. The improvement of institutional quality such as the fight against corruption, influence peddling or insecurity, could further facilitate the collection of the rental income tax.

The collection of tax revenues by local authorities remains a major concern in countries such as the DRC, which has accumulated only a few years of experience in the decentralization process.

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Ladies and Gentlemen

It is a real pleasure for me to speak at this forum to share with you the reflections of the Network of African Local Finance Professionals, AFRICA FINET, on African municipal bonds. I am also pleased to introduce the theme: “New era of borrowing: local representatives and development partners”, a theme that the organizers have kindly entrusted to me.

Before continuing, let me thank, on behalf of my fellow Chief Financial Officers of the Africa Finet Network, the organizers of this forum, in particular Mr. Khalifa Ababacar SALL, Mayor of the City of Dakar, and Mr. Tomas PAQUETE, for their invitation. By associating us with the participants of this forum, they have measured the interest that not only African cities than dedicate a subject like this one, but also, and above all, the authorising officers for the local budget, and the communal Chief Financial Officers, for whom budget limits are a constant headache.

One can understand, in view of the objective of the forum devoted “on the one hand, to the exchange between issuers and investors, and, on the other hand, to the creation of a platform to promote the development of a market for African municipal bonds”, the fact that the organizers of this forum deemed it appropriate to invite the players, the investors, the brokers, the lawyers, the rating agents, and the lawmakers. Nevertheless, the Africa-Finet Network is of the opinion that the analysis on the situation of the African municipal financial market requires a strong participation of a partner who is not expressly mentioned among the participants, namely the Central governments. Indeed, as we will see later, a new era of municipal borrowing remains dependent on this privileged partner that is the Central government. Therefore, it seems to us imperative that after the present phase of the forum of exchange of views with local representatives that one should consider to make a plea with the Heads of Central governments in order to overcome the supreme the obstacle represented, as we will see, by the collateral.

Taking into account these brief introductory elements, my presentation will be made according to the structuring hereafter :

E a reminder of some concepts ;
E a brief overview of the current situation of African municipalities in relation to the financial market;  
E the new era of municipal borrowing: the ambition of municipal officials.
I- Reminder of some concepts related to the objective of the Forum

The concept of municipal bonds is essentially based on the mechanism of intervention of African municipalities on the financial market.

This forum on African Municipal Bonds, which brings together the potential issuers of African municipalities and potential buyers, aims to encourage the various players in the financial market to form strategic and productive partnerships with the aim of boosting local development.

Indeed, the goal is for municipalities to resort to public offerings in the form of bonds to facilitate the financing of investments, that is to say the development of their city.

It is important before any development to recall some concepts:

The Financial Market:
It can be defined as the market of long term capital that is mobilized by the recourse to public offering for the financing of investments. It includes a primary market, the issue of securities and a secondary market, the resale of securities, called “Stock Exchange”.

The primary function of the financial market is to attract part of the savings in order to contribute to the financing of the real economy. In this sense, it participates in the financing of business investments, provides the Central governments and public administrations with the financial means necessary for the implementation of investment projects and the regulation of public finances by financing budget deficits.

Bond loan:
It is a financial instrument issued by a legal person represented either by the Central government, a public authority, or a public or private company receiving a loan, a certain amount of money from the subscribers of the securities. It is thus a debt representing a debt repayable on a given date and for an amount set in advance bearing an interest.

However, the bonds may be guaranteed by the Central government, a bank or a banking pool, by specialized guarantee bodies with regional or international dimension

Examples:
- Gari Fund : Private Investment Guarantee Fund in West Africa ;
- FAGACE : African Guarantee and Economic Cooperation Fund ;
- FSA : African Solidarity Fund ;
- BOAD : West African Development Bank ;

Bond:
A bond is a marketable debt instrument, which corresponds to a fraction of a long-term loan issued by a company, by the Central government, or by a public authority and which is repayable at the due date and bearing interest.

Bond issuance is therefore carried out by public or private joint-stock companies, which are at least two years old and are authorized by the Central government and local governments to resort to initial public offerings.

We distinguish first class bonds which are those issued by the Central government or a public sector (public authority) and guaranteed by the Central government, then the bonds of the second category which are issued by private sector companies or local or infranational governments to which the Central government has not granted its guarantee.

The financial market, as an organized market, includes supply from investors and demand expressed by issuers without forgetting the entities responsible for its operation, that is to say the supervisory authorities, the market companies and
the stock market intermediaries. These are the players in the financial market.

Potential issuers, initiators of the demand for capital: They are public or private economic agents, in search of resources intended to finance their investments. These are:

Ø companies;
Ø Central governments;
Ø Local and Infranational Governments.

Unlike businesses, public administrations (Central governments and public authorities) cannot finance themselves by issuing shares because they have no capital. Apart from the methods of financing that are specific to their nature (mainly taxes), they can only resort to borrowing in the form of bonds and treasury bills. Also these securities issued by the Central governments are sought by investors, because deemed to have almost a zero risk.

Suppliers or potential buyers, the investors: The supply of capital comes from different categories of economic agents. These are:

Ø individuals, either directly through the holding of an individual portfolio of securities, or indirectly through the collective investments of the investment club type, through the Open-ended Mutual Fund (SICAV), or the Closed-ended Mutual Fund (FCP);
Ø institutional investors, i.e. insurance companies, pension funds and other provident societies, savings banks, Undertakings for Collective Investment in Transferable Securities (UCITS), or the Caisse de Dépôt et Consignation (CDC) (the investment of the French State);
Ø companies that are structurally or occasionally creditors, the banks ...

The bodies responsible for the functioning of the market:

Ø the regional supervisory authority; the Regional Council of Public Savings and Financial Markets (CREPMF);
Ø the market operators, whose regional is the Regional Stock Exchange (BRVM), the Central Depository / Settlement Bank (DC / BR);
Ø and the commercial players, mainly management and intermediation companies (SGIs).

II- Brief overview of the current situation of African municipalities in relation to the financial market

In general, the presence of African municipalities in the financial market is very weak. This situation is mainly due to an unfavorable legal context.

There is, in fact, communes are not much attracted to borrowing, while they suffer from a blatant lack of resources. It should be recalled that these resources consist mainly of tax revenues and meager transfers or repayments of the Central government.

2.1 Insufficient traditional resources

The situation is not the same from one region to another, depending on whether you are in North Africa, sub-Saharan Africa or South Africa. It also varies according to whether one is in the presence of Francophone or Anglophone Africa, or other.

In most countries South of the Sahara, it is recognized that traditional revenues do not always cover the operating costs of local budgets. Much of this expenditure is covered by the contribution of external financial partners, sometimes with a matching contribution from the beneficiary municipalities. A contribution that is often difficult to meet with delays that impose heavy threats on the investments made for this method of financing because, from now on, the cost of maintaining new projects becomes a new burden for municipalities.

To compel local officials in many of these cities to think about investments instead of allocating all resources to operations, the agreements signed with the World Bank contain clauses that set a percentage of the city’s own resources each year that must
be reserved for the investment component of the budget. In the absence of such conditionality, many municipalities south of the Sahara will only provide allocations to budget items intended essentially for operations.

The financing needs in terms of investments are so huge that, compared to the current own resources of the municipalities, they barely cover one-tenth of the requirements for all administrative expenditures, expenditures for the reorganization of socio-community infrastructures, and so on.

The insufficiency of the own financial resources that could finance the investments of the communes should lead the local authorities to widen the sources of financing by opting, inter alia, for the recourse to borrowing authorized by most laws on decentralization which unfortunately have not always been implemented.

2.2 The low attractiveness of borrowing

African municipalities should therefore resort to borrowing to supplement their own resources and finance their investments. Unfortunately, direct access to the bond market is little or not at all experienced in many of these countries.

Yet in these countries, regulatory texts (often written in the form of decrees) set the terms of borrowing by municipalities and their guarantees for those countries that are member of WAEMU²: Regulatory texts draw inspiration from instruction No. 36/2009 of the CREPMF (Regional Council of Public Savings and Financial Markets) amending and repealing Instruction No. 33/2006 on public offering in the WAEMU area.

In these conditions marked by the existence of legislation and therefore by the existence of procedures in this field, what is it that blocks the use of borrowing by communes in these countries? ?

A survey at the level of management and intermediation companies (SGIs) shows that they attribute the cause to the lack of information from municipalities. This is possible, but not enough. The real blocking point must, from our point of view, be sought elsewhere, especially in terms of approval that the legislation obliges municipalities to obtain from the Central government before resorting to borrowing on the financial market.

For example, Instruction No. 36/2009 of the CREPMF states, in its Article 10 of Chapter 4 dealing with the due diligence to be carried out by local or infranational public authorities, the following: “Local or infranational public authorities that intend to make a public offering must secure authorization from the Regional Council. To this end, they submit a file including:

1- Joint approval of the operation by the Minister of Finance and the Ministry in charge of Local Governments;
2- Etc.

In accordance with this Instruction No. 36/2009 of the CREPMF, WAEMU member countries have issued decrees laying down the terms of borrowing by communes, as well as the related guarantees. It follows that the Central government must give its approval before a municipality resorts to borrowing in the financial market.

Though the guarantee required from the communes is understandable, the fact remains that the authors of this decision have not sufficiently measured the weight of the bureaucracy of the African administrations and that of excessive politicization. Early on, this instrument became in the hands of many African heads of state a means of political pressure, discrimination and settlement of accounts. Thus, depending on whether the Mayor is from the governmental movement or not, the approval given or refused under false pretexts..

Some examples of African cities show enough this deplorable state of things:

Ø In Benin, two cities have tried to access the financial market. First, the municipality of Parakou, which has begun a process of public offering (see "Le Municipal" newspaper No. 293 of May 05 to May 11, 2008). The municipality requested
a loan of 5 billion CFA francs on the regional WAEMU market, for, inter alia, the construction of a five-star hotel, a modern bus station, a cereal processing food chain, a business center, a parking lot for large trucks, and an international conference center. The application complied with the approval procedure and had already received a favorable first reading from the Regional Council of Public Savings and Financial Markets (CREPMF) and even the agreement of the National Savings Commission before being later abandoned because the Beninese Central government refused to give its approval for political reasons.

Then, there is the city of Porto-Novo that tried to go to the market to finance for up to 2 billion CFA Francs the construction of a large shopping center. This project did not succeed because of the change of the management team of the Municipality, which did no longer get along with the government in place for political reasons.

In Cameroon, the city of Douala also resorted to the bond loan with the support of CUD Finances SA which played the role of intermediation. For this purpose, two issues were achieved to raise 16 billion FCFA, whose first tranche that started on March 21, 2005 amounts to 7 billion FCFA.

This loan is part of a strategy aiming at diversifying the sources of financing of the CUD, will serve among other things to finance the program for the rehabilitation and maintenance of roads in the economic capital.

In Senegal, the city of Dakar took steps for three years aiming at accessing a bond loan on the financial market in order to acquire land for the construction of a major commercial equipment. Finally, ten (10) billion out of the 20 billion requested got the guarantee of USAID and of the Gates Foundation.

Although the municipality of Dakar had been rated BBB + and had got an initial positive opinion from CREPMF, the Senegalese government suspended the said operation on the grounds, among others, that it did not respect the debt / GDP ratio nevertheless tolerated for up 70% according to the WAEMU criteria. This experience of Dakar which was supposed to be a reference for the surrounding municipalities and, why not, for the WAEMU member countries of UEMOA, was unfortunately short-lived.

Lessons drawn from these few experiences of Benin, Cameroon and Senegal:
The attraction for this mode of bond financing will remain weak, even nil as long as the guarantee of the Central government will be required. It is therefore essential to put in place a mechanism that, while not losing sight of the guarantee sought by the financial partners, could give municipalities more opportunities to fully face local development, one of their cardinal missions. It is essential to open a new era of borrowing, because it is clear from the experiences reported above that the predominance of Central governments over municipalities is manifest although they have a legal personality that is distinct from that of the Central government and from financial autonomy.

III-The new era of borrowing: the ambition of municipal officials

In order to meet the challenges of decentralization, and considering the modest resources and low commitment of the Central government, local elected officials are now turning their eyes towards a new era, that of borrowing.

This new era of borrowing should lead to the opening of better prospects for the financing of local territorial investments.

3.1 The foundation of this new era

Very favorable factors for the emergence of the new era of borrowing exist and do consolidate, as days go by. Among other things, one can mention the system of ratings, the proliferation of management companies and intermediation (SGIs), the sub-sovereign lending opportunities available today, and other factors.
3.2 The use of rating agencies

The Central government no longer holds the monopoly of rating which gives it the guarantee which it sells so dearly to local authorities. Decentralization of this scoring system which has already been adopted by many African municipalities is an important parameter with which the municipalities must count among other things to break down the barrier that the Central government and offer themselves, as is the case for the Central government, the guarantees necessary for the recourse to the financial market.

In West Africa, the cities of Dakar, Cotonou, Parakou, Porto-Novo, Yaoundé, Douala, Ouagadougou, Bamako, Lomé, Nouakchott and many others have already been subjected to the exercise of ratings and do have the so-called PEFA tool that complies with its recommendations, should favor the conditions required to obtain the approval of the financial partners. Local and infranational governments must therefore pay special attention to the improvement of financial management.

3.3 The expertise and advocacy of management and intermediation companies (SGIs) are increasingly visible

Today, throughout Africa, management and intermediation companies are getting mobilized to help municipalities to move towards bond financing by offering their expertise and sometimes making pleas with Central governments so that the legislation giving access to borrowing no longer requires the compulsory guarantee of these Central governments.

3.4 Transfer of resources by the Central governments to strengthen the capacity of municipalities to borrow

All the financial regimes in the collection of laws on decentralization state that the Central government must transfer the resources to the municipalities in return for transfers of powers. The general observation made in this area shows that the Central governments did not comply, thus turning this decision of the lawmakers into wishful thinking, with no future.

In state of these transfers, many Central governments are hiding behind “gimmicks” such as FAST TRACK, the FADeC, the PMIL, the PSDCC, etc. essentially fueled by foreign financial partners, and give free rein to the wasting of the portion of the general budget of the Central government that should be transferred.

There is here also a battle to be fought for compliance with the legal provisions on the transfers of resources from the Central governments. This will greatly enhance the capacity of municipalities to take on debt, and therefore their recourse to borrowing.

3.5 The grouping together of African local governments for the issue of bonds

Like the current experience in France, one is tempted to propose to local authorities to group themselves together, for example per region, to issue a bond. In this system, the rating is done not on the local authorities but rather on the issue, which can increase the chances of completion of the operation, provided one imposes and observes the rules of budgetary discipline and good management required by PEFA and other rating agencies, the management and intermediation companies (SGIs), and all other financial partners.

All in all, this forum will achieve its goals if the organizers, in addition to the current exchanges of views, decide to go further, in order to conduct advocacy with the Central governments who, in the last analysis, have the key of the recourse of the local or infranational governments to the financial market.

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3. Public Expenditure and Financial Accountability

4. Fast Track: program funded by a group of development partners including the World Bank to rapidly strengthen the educational and socio-communal domain of the Central governments in terms of infrastructure.


7. Project of Deconcentrated Services Conducted by the Communities.
It is indisputable that the current access conditions imposed on local authorities are not attractive and direct them towards more expensive modes of financing, including the public-private partnership (PPPs) that is very fashionable these days.

One must resolutely turn the page and open a new era of borrowing with the support of new instruments such as PEFA, the expertise of the SGIs, and the sub-sovereign loans which constitute a system in which loans are granted directly to municipalities on the own guarantee offered by themselves, but provided that the municipalities do comply with the good management procedures and adopt behaviors that are compatible with a rigorous budgetary discipline.

Finally, I would like to recommend that the activities of this forum be forwarded to UCLGA, which will make use of such recommendations at its next meeting so that advocacy towards Heads of Central government is undertaken at a high level.

Thank you!
“Grain by grain, does the hen fill the gizzard?”
Evidences of the municipal personal tax from thirteen Mozambican cities

Eduardo Jossias Nguenha
National Association of Municipalities of Mozambique
Executive Summary

The municipal personal tax (IPA) is one of the taxes for which the tax effort of Mozambican municipalities is low, varying between 0.1% and 21%, with a relative weight in the structure of own revenues ranging from 0.6 % to 2%. This study examined at which level thirteen major cities in Mozambique are exploiting the potential of the existing IPA to improve the collection of own revenue. To guide the research, the following questions were asked: a) what is the revenue potential of the IPA that the thirteen municipalities can mobilize? (b) What are the factors that influence current levels of municipal personal tax revenue mobilization?

In order to answer the first question, it was necessary to collect financial information from the balance sheets from 2009 to 2016, including the IPA amounts invoiced. Based on the IPA values updated in accordance with legislation, the IPA’s revenue potential has been calculated for at least 40% of a population per municipality, assuming that the remaining 60% are exempt for a number of reasons. In order to answer the second question, two questionnaires were completed, one for municipal officials (municipal councilors and technicians) and the other for municipal residents. The data collected made it possible to evaluate the legal and institutional and technical and administrative aspects that determine the performance of the thirteen cities in the IPA collection.

The research concludes that, over a long period, the municipality collected IPA revenues that ranged between 1% and 35% of potential, with differences in levels of variation between municipalities, ranging between 2% and 26% of the municipalities. The annual growth rate of revenue was invariable and unstable in the range of -79% to 2317%. This reality is the result of a combination of factors including non-compliance with the calculation criteria and non application of the legislated annual value of the IPA, the lack of efficient collection methods, the poor institutional coordination between municipalities and government, and the underutilization of lower administrative structures of municipalities to stimulate tax collection, namely in neighborhoods.

As a result, the IPA tax collection performance levels are left to chance and out of the control of municipalities, with revenues from the municipal expenditure structure accounting for only 0.1% to 5.3% of payroll expenditures (salaries and other staff costs), thus perpetuating the financial dependence vis-à-vis other sources when in optimal conditions, this source could cover between 2% and 27% of the same expenses. Therefore, “grain by grain, the hen cannot fill its gizzard”, not because the grains do not exist, but because the chicken does not go properly to look for them. The research recommendations include, exceptionally, the possibility of assigning and improving intra- and inter-institutional coordination in the tax collection.

Key words: Personal taxes, municipal personal tax, own revenues, municipality, and financial sustainability, Mozambique.

JEL codes: H71

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Finally, a special thank you to the African Forum on Tax Administration (ATAF) / African Taxation Research Network (ATRN) who funded the author’s participation in the workshop on scientific research methodologies April 2018 in Dar-es-Salaam, during which the first draft of this article was presented and commented.

Abbreviations and Acronyms

ANAMM - National Association of Municipalities of Mozambique
INE - National Statistics Institute
IPA - Municipal Personal Tax
IRN - National Reconstruction Tax
ISPC - Simplified tax for legal entities
UEM - Eduardo Mondlane University
1. Introduction

The lack of financial resources to finance the competences and attributions of municipalities in Mozambique is a recurring fact. This is due, on the one hand, to the misalignment of the system of intergovernmental fiscal relations and, on the other hand, to the technical and administrative constraint of municipalities to mobilize their own resources (UN-Habitat, 2000; Weimer, 2012; Nguenha et al., 2012; Weimer, 2016; MAP, 2016; MAP, 2017; Dialogue, 2017; National Association of Municipalities of Mozambique, 2017).

The municipal funding system, which includes intergovernmental tax transfers, the municipal tax system, access to credit, and public-private partnerships, is regulated, making it difficult to influence their change, at least in the short and medium terms. In this condition, only the technical-administrative and organizational aspects of municipalities can be easily influenced to improve municipal revenues, especially own revenues.

The self-financing levels of Mozambican municipalities vary between 20% and 50%. Most municipalities have more than half of their expenditures financed by transfers from the Central Government (Weimer, 2012; Nguenha et al, 2012; MAP, 2016). The Municipal Personal Tax (IPA), one of the about thirty municipal own revenue sources, is one of the least exploited by municipalities. The level of effort provided by municipalities for the collection of the IPA varies between 0.1% and 21%, and the relative weight in the structure of the revenues themselves varies between 0.6% and less than 2%. The tax for economic activities and the market fees are the most significant own revenue sources (Weimer, 2012 National Association of Municipalities of Mozambique, 2017).

This research investigates the factors explaining the performance of the municipalities in the collection of IPA in thirteen municipalities in Mozambique, namely the ten provincial capitals of Mozambique and the cities of Matola, Maxixe and Nacala, from 2009 to 2016. All thirteen municipalities have existed since the beginning of municipalization in Mozambique (1997), and in four of them (Beira, Nampula, Quelimane and Nacala), their governance has experienced political changes to opposition. According to the 2017 population census, the thirteen municipalities represent 20.8% of Mozambique’s total population (INE, 2017). This represents 1.5 percentage points more than the forecasts of the 2007 census (INE, 2016).

This tax has been deliberately chosen for two reasons: the first reason is of a technical and administrative nature, namely its simplicity in the incidence and determination of the tax base, which will make it possible to evaluate the extent to which municipalities large and technically mature, in the Mozambican context, are facing a simple tax such as the IPA: and the second reason is the fact that it is a highly sensitive tax from the sociopolitical point of view, which will help people understand how, in these politico-geographical spaces where there is a relatively educated and economically diversified population, municipal governments deal with a politically sensitive, namely IPA. This latter is also considered as a “massive” tax because it is usually a tax that is payable by the majority of the population.

The IPA is the minimum contribution to public expenditure required of the national or foreign citizens having their tax domicile in the municipality (such citizens being designated by the term “constituents”). Since IPA is a minimal contribution required for every citizen, its role must be considered from an educational perspective, not just in terms of funding, although this latter factor is important. The educational perspective can enable citizens to develop or own the concept according to which the municipality only works with the contribution of its residents. The educational perspective of the tax obviously makes sense when it can generate sufficient resources for the municipality to respond to residents’ demands with the provision of the services to which they are entitled.

The choice of the title of the article is due to the fact that the value of the IPA is somehow a minimal contribution required from citizens but one which can make a significant contribution to the financing of municipal expenditures. Hence the question: “Grain by grain, does the hen fill the gizzard?” which is tantamount to asking whether municipalities collect a sufficient share of this tax.

The text includes, in addition to this introduction, seven sections: (i) the research questions; (ii) the objectives; (iii) the review of the literature; (iv) the methodology; (v) the results of research; (vi) the recommendations; and (vii) the conclusions.

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1. The current Municipal Tax Code establishes five taxes, nineteen fees for licenses granted and economic activities, and six levies and charges for the provision of municipal services (see details in Decree No. 63/2008 of 30 December approving the Code of Municipal Taxes).


3. The Municipal Finance Law provides for exemptions (Article 53) that only produce effects when they are recognized by the mayor of the municipality at the request of the interested parties. The persons exempted from the IPA who will have to apply for the exemption to the president of the municipality are: (i) the persons unable to work temporarily or permanently due to weakness, illness or physical deformity; (ii) the persons performing compulsory military service; (iii) the students, including those abroad, in full-time work at the intermediate level or above until the age of 21 or 23, respectively; (iv) the State pensioners, when they have no income other than their pension; and (v) the foreigners serving the country of their nationality, where there is reciprocity.
2. Research questions

The research is guided by two questions it intends to answer, namely:

a) How much of the revenue potential of the Municipal Personal Tax the thirteen municipalities do manage to mobilize?

b) What factors do affect the current levels of the IPA revenue mobilization?

3. Research objectives

The general objective of the research is to contribute to the debate on the financial sustainability of Mozambican municipalities as an important condition for achieving the broader objective for which municipalities have been created, namely: promoting local development. In specific terms, the research intends to evaluate to what extent the thirteen important cities of Mozambique do avail of the potential of the existing IPA to improve the collection of own revenues.

The general objective of the research is to contribute to the debate on the financial sustainability of Mozambican municipalities as an important condition for achieving the broader objective for which municipalities have been created, namely: promoting local development. In specific terms, the research intends to evaluate to what extent the thirteen important cities of Mozambique do avail of the potential of the existing IPA to improve the collection of own revenues.

4. Literature review

IPA is a direct tax, usually of a fixed amount defined per individual, evenly applied to each individual or group of individuals having the common characteristics of a specific territorial constituency (Smith & Fowler, 2008). Depending on the historical period, the space and the political circumstances, the taxes with characteristics of the IPA do have or will have various designations.

In Mozambique, the IPA collected by the municipalities corresponds to the National Reconstruction Tax (IRN) created shortly after the national independence and now collected by the Local entities of the State (Provinces and Districts), in representation of the Central Government under Decree 2/78 of 16 February, in all spaces that are not municipalities (Weimer, 2012).

From a theoretical point of view, the IPA seems to have more elements in its favor to qualify a “good tax” from the perspective of the four maxims (principles) of Adam Smith published in 1776 in his book “The Wealth of Nations”. The four maxims (principles) of Smith state that for a tax to be “good” must (i) make it possible to with certainty what must be paid and how much, in order to avoid evasion and manipulation or arbitrariness in their calculation; (ii) be convenient to facilitate payment by the taxpayer with the least cost of compliance; (iii) be economical or low cost in terms of tax collection and administration of the tax, so as to extract the least money possible from the pocket of taxpayers in addition to what they already give to the Treasury; and (iv) the tax must be fair and equitable so that everyone can contribute to the operations of their governments, as far as possible in proportion to their respective capacities, i.e. in proportion to the revenues that the taxpayers draw respectively under the protection of the State (Pereira and, Smith & Fowler, 2008; Smith, 2010: 485-489). In fact, by comparing the IPA and its variants with other more sophisticated taxes, one can note that IPA is simple and clear in terms of the contribution base and in terms of calculation method, is relatively cheap, and its administrative costs are also low, although these tend to increase in case of circumvention. It is in the fourth maxim, in a way, that the IPA and its variants relative to others lose in comparison with other taxes because of their regressivity, because they do not take into account the tax capacity of taxpayers, thus provoking more severe effects on people with low income than people belonging to middle and upper brackets. This is one of the main reasons that make the IPA and its tax variants unpopular in the modern world (Smith & Fowler, 2008).

Throughout the history of civilization of nations, IPA or its variants were applied for several purposes, including the financing of wars (e.g. England and Portugal), immigration control, (restriction / conditioning of the) political participation, funding for local services (Province of Nelson in New Zealand and in Margaret Thatcher’s United Kingdom), and the supply of labor by Africans inside and outside their regions (Hedges & Rocha, 1999: UEM, 2000: Tarus, 2004; Fjeldstad and Therkildsen, 2008, Smith and Fowler, 2008).

From a theoretical point of view, the IPA seems to have more elements in its favor to qualify a “good tax” from the perspective of the four maxims (principles) of Adam Smith published in 1776 in his book “The Wealth of Nations”. The four maxims (principles) of Smith state that for a tax to be “good” must (i) make it possible to with certainty what must be paid and how much, in order to avoid evasion and manipulation or arbitrariness in their calculation; (ii) be convenient to facilitate payment by the taxpayer with the least cost of compliance; (iii) be economical or low cost in terms of tax collection and administration of the tax, so as to extract the least money possible from the pocket of taxpayers in addition to what they already give to the Treasury; and (iv) the tax must be fair and equitable so that everyone can contribute to the operations of their governments, as far as possible in proportion to their respective capacities, i.e. in proportion to the revenues that the taxpayers draw respectively under the protection of the State (Pereira and, Smith & Fowler, 2008; Smith, 2010: 485-489). In fact, by comparing the IPA and its variants with other more sophisticated taxes, one can note that IPA is simple and clear in terms of the contribution base and in terms of calculation method, is relatively cheap, and its administrative costs are also low, although these tend to increase in case of circumvention. It is in the fourth maxim, in a way, that the IPA and its variants relative to others lose in comparison with other taxes because of their regressivity, because they do not take into account the tax capacity of taxpayers, thus provoking more severe effects on people with low income than people belonging to middle and upper brackets. This is one of the main reasons that make the IPA and its tax variants unpopular in the modern world (Smith & Fowler, 2008).

IPA is a direct tax, usually of a fixed amount defined per individual, evenly applied to each individual or group of individuals having the common characteristics of a specific territorial constituency (Smith & Fowler, 2008). Depending on the historical period, the space and the political circumstances, the taxes with characteristics of the IPA do have or will have various designations.

According to Smith and Fowler (2008), Canada and New Zealand applied the tax to control Chinese immigration by imposing barriers to avoid massive influxes, while the United States, for their part, have used tax to condition access to voting, rather than restricting African Americans and poor whites from the right to vote. England and Portugal have used the personal tax both as an important source of funding for wars, of administrative mechanisms in their colonies, and the exploitation of Africans (Hedges & Rocha, 1999; UEM, 2000; Tarus 2004; Fjeldstad and Therkildsen, 2008).

In some African countries, the personal colonial tax was an important source of financing, but the brutality with which it was collected led to negative connotations with repercussions on the financing and construction of the young democratic African nations today. Fjeldstad and Therkildsen (2008) have studied the effect of direct taxation, by analyzing personal taxation in relations between society and the Central government, and the reasons why it took a long time to abolish it in Tanzania and Uganda. The authors found that in Tanzania, the personal tax in 1948 “represented 15% of the national income, i.e. an income tax with a weight of 10% and in 1961/62 the personal tax accounted for 83% of the total local government revenues” (Fjeldstad and Therkildsen, 2008: 119-120, citing IBRD, 1961: 49 and Due, 1963: 64). In Uganda, the personal income tax accounted for 91% of the revenues collected in 1961 (ibid: 123). In both countries, even after independence, the personal income tax remained a major source of funding. After its abolition in 1969, it was reintroduced in 1982 under the new development tax nomenclature and was abolished in 2003 without consultation with local governments (Fjeldstad and Therkildsen, 2008). The authors conclude that “the intensification of political competition has increased the political cost of the coercive force of the personal tax which does not compensate for the financial advantage (revenues) in the rules of the current political game” (ibidem: 131), namely that collecting the personal tax in a coercive manner meant abdicating the political choices.

In Mozambique, the personal tax that existed in the colonial era was the “mussoco” (or “head tax” “In English), which accomplished many functions for the benefit of the colonial administrative machinery. According to Hedges and Rocha (1999), the tax has contributed significantly to the financing of the expenses of the new colonial administrative network in terms of payment of wages, the construction of buildings, roads, etc. Similarly, the head tax, through the use of physical and administrative aggression, was used to influence the supply of labor of Mozambicans to cash crop producing companies because the only way to raise funds for the payment of taxes was to sell their workforce (Rocha and Hedges, 1999). The colonial administration was very repressive, managing to employ armed tax brigades to collect taxes, especially in border areas and clandestine passageways (ibid.). The “non-payment of the entrance fee was punished by forced labor for a specified number of days for which, at the local official salary value, the amount of the additional tax of 50% was added” (Eduardo Mondlane University, 2000: 318).

The abuse committed in the collection of the Mussoco head tax and other taxes caused “ulcers” in African societies whose consequences have so far eroded their tax systems. Both the rulers and the citizens are suspicious of tax collection.

Shortly after independence was introduced in 1978 the first personal tax, the IRN for state funding purposes intended to secure resources for the reconstruction of the country which was then devastated by the colonial war and natural disasters. In 1997, with the creation of municipalities, IPA was established in substitution of the IRN, which is not cashed in municipalities.

In 2009, an election year, the December 21, 2009 edition of the news bulletin reported that the Government, through the Mozambique Tax Agency, conducted a study to assess the “relevance of IRN, account given of the new forms of taxation: IPA and Simplified Tax for Legal Entities”, and concluded that there was the need to abolish the tax due to (i) the contextualization of the reasons behind its creation (individual contribution to the reconstruction of the country devastated by the national war of liberation); (ii) the high administrative costs of tax collection (26% of the revenues collected); (iii) the weakness of the control system and absence of an organized cadastre, which leads to losses ; and (iv) the insignificance of income in relation to global tax revenues (0.00001%). Despite these findings, the fact is that the IRN is still part of the national tax system, perhaps because, by taking the argument of “the decontextualization” of the tax designation (national reconstruction), the other arguments reflect the public administration’s inefficiency and not necessarily a problem of the tax itself. As a result, all of this suggests that the personal income tax, whether under the form of the IRN or the IPA, is a politically sensitive tax.

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5 The new administrative network can be understood as the form that Portugal was forced to adopt in the regions under its direct and exclusive administration, namely the region of the present province of Nampula and Zambezia which were jointly administered by the majestic enterprises and the Portuguese State (ibid).
There are places where personal taxation has worked at the local government level, and where experiences were replicated at the national level. Smith & Fowler (2008) examining the history of personal taxation in New Zealand’s Nelson Province to understand the reasons for its success while in most parts of the world this type of tax leads to revolts that undermine the state of governance, came to the conclusion that the factor contributing to success, among other factors, was the allocation of tax revenues to an important and necessary service for the local community, namely early childhood education. The authors are of the opinion that:

“The main factor that seems to have influenced the acceptance of the tax was the assignment of the tax revenues to specific purposes (education), which the community of the Province of Nelson considered important. Another factor that seems to have contributed to the acceptance of the tax has been the adoption of the user-payer method of the public school system, so that residents without children do not pay for the entire education system. In addition, as the system intensified in the hinterland and legislative changes were made, there was less resistance as more people benefited directly. However, for a personal tax to be acceptable in a modern society, it must be sufficiently progressive to meet the requirements of equity.” (Smith & Fowler, 208: 27-28)

The conclusion reached by these authors is important in the African context, particularly in Mozambique, where the level of service delivery is still debatable. The experience of the Province of Nelson shows that the leadership of public managers is important in defining a social purpose to which the community truly identifies, and therefore it is important to clearly define the source of funding. The lesson is just as important for opinion makers who want to convey the idea that the regressive nature of the IPA is a fundamental issue, without further examining how this outweighs the gains of communities actually having adequate public services.

The last reading concerning the sources is that personal taxes, as mass taxes, have been favored throughout history, almost everywhere, to achieve public policy objectives, be they socioeconomic (financing utilities) or political (financing of wars, control of migration, and restriction of voting rights). Although personal taxes respond favorably to three of Adam Smith’s four maxims, they are not easily accepted, which leads to their abolition. In some cases, as in Margaret Thatcher’s England, governments that have removed personal taxes have offset the loss by increasing the tax burden on other consumer taxes (Smith, 1991, Smith and Fowler, 2008). However, personal taxes can finally be successful, as Smith & Fowler’s (2008) study of the Nelson Province experience in New Zealand shows.

5. Research Methodology

In order to meet the objectives of this research, namely to demonstrate that the IPA can also be an important source of funding, and to contribute to the academic debate on the financial sustainability of municipalities, the case study of thirteen Mozambique using panel data was adopted. The municipalities were chosen intentionally according to three criteria: seniority, size and economic importance.

As mentioned earlier, the first municipalities were set up in 1997 and the first municipal elections were held in 1998. This is the historical context, assuming that in these municipalities, there is better technical and administrative capacity than in others created later, and assuming that the respective citizens are more familiar with the IPA. In this case study, all municipalities were put in place in 1997. In terms of size, one has adopted the official classification of municipalities in Mozambique which ranks them in categories A, B, C, D and Cities, in descending order of population size, level of economic development and financial capacity. In this order, the thirteen municipalities under study include one municipality of the A category (Maputo, capital city of Mozambique), three of the B category (Beira, Nampula and Matola), eight of the C category (Xai-Xai, Inhambane, Chimoio, Quelimane, Tete, Nacala, Lichinga and Pemba), and one of the D category (Maxixe). The size criterion using the official classification encompasses all municipalities in categories A to D and inherently contains the third criterion, of economic importance. A World Bank study on urbanization in Mozambique considered the 23 Mozambican cities as the engine of development in the country (World Bank, 2017). The IPA study covers Mozambique’s main urban centers, namely the country’s capital city and the provincial capitals. Finally, the city of Matola is the municipality with the largest industrial park in Mozambique and according to the INE (2017) is the most populated in the country with 1,616,267 inhabitants. The city of Nacala is the economic and tourist capital of the province of Nampula, and Maxixe the economic capital of the province of Inhambane with a population 1.5 times larger than the political capital of the province, the city of Inhambane (idb). Thus, the three criteria adopted can provide sufficient results that demonstrate that the IPA can generate significant resources. 

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The questionnaire for municipal officials sought to identify the institutional arrangements and challenges associated with the collection of the IPA, and the questionnaire applied to citizens was designed to understand the factors that discouraged them from paying the IPA. The results of the questionnaires help to make a more in-depth analysis of the results in the first stage of the study as they focus on the behavioral aspects of both sides, that is to say, of municipal officials and citizens. Appendices 1 and 2 present the individual results of each questionnaire.

To ensure representativeness, the questionnaire for municipal managers was applied to people with the same characteristics, the numerical value not necessarily being taken into account. It is understood that people with the same characteristics tend to provide the same answers. Thus, the questionnaire received answers from the administration and finance specialists and councilors of each municipality. In the city of Maputo, five people were interviewed, in the town of Matola two, in the town of Maxixe two, in the city of Nacala two, and in each of the other nine municipalities of the provincial capitals, four people. The second questionnaire was applied electronically using the “Survey Monkey” tool, to which 184 people living in municipal spaces responded. The possibility of indicating the municipality of residence was eliminated to ensure a significant number of respondents.

Collection of responses through the “Survey Monkey” was an important limitation of this study, but did not affect the achievement of the expected goals because even so it was possible to demonstrate that the municipalities under study do not exploit enough the source of income analyzed, and the answers from citizens provide important elements denouncing significant factors of constraint.

6. Results

6.1 Legal provisions and institutional arrangements for the collection of IPA

Law 1/2008 of January 16 states that the value of the IPA of each municipality must be determined annually in function of the highest minimum wage recorded until June 30 of the previous year applying rates of 4%, 3%, 2%, 1% according to the categories of municipalities which are A, B, C and D, respectively. In Mozambique, the minimum wage is adjusted each year by taking into account the factors of economic performance and of productivity of the economic sectors, which means that, therefore, the value of the IPA in each municipality must be adjusted each year upward. The method of
calculation for the IPA gives it characteristics that are similar to those of a direct income tax, with the particularity of being a unique value for all salary levels, an unusual characteristic for direct taxes. Regressivity, as we have seen above, has been, throughout history, the main cause for the rejection of personal taxes under the argument that these taxes weigh more in the structure of expenditure of the low-income or poor social strata than in the structure of the rich, and do not guarantee social justice which is one of the basic principles of taxation. In these circumstances, and given the high rates of poverty, unemployment and dependence for survival on urban areas (INE, 2016), the IPA becomes one of the municipal taxes that are the most politically and socially sensitive, forcing municipal managers to an annual tax adjustment.

Under the same legal framework, the forms of collection of the IPA include (i) the withholding of the share deducted from the wages by employers through the signing of agreements with these, for the individuals subjected to the personal income tax, which constitutes a national tax levied by the Central government also in the form of withholding tax: ii) mobile stations, in which case the President of the municipality must indicate, by order of service, the dates and places of collection: and (iii) the collection agents to be designated by order of service of the President of the municipality concerned. It was found that all thirteen municipalities surveyed do collect the IPA via the neighborhood offices - the neighborhood being the municipal administration structure that is closest to the citizens below the municipal district in the case of the city of Maputo, and municipal locality in the case of other municipalities under study - identified as collection agents in the spirit of the law in question and through the withholding tax for employers. Two municipalities, Nampula and Maputo, adopt the mobile stations. The municipality of Nampula launched the method in 2014 and 2015, which enabled it to increase IPA revenues by 67% and 42% respectively. In fact, the IPA revenues of this municipality have not changed until the establishment of mobile stations in 2014. The municipality of Maputo adopted the method from 2016 onwards, after experiencing for the first time, a decline in the revenues from this negative tax rate of 16% in 2015. The fact that the mobile stations were adopted by the two municipalities, and the circumstances in which they were adopted, suggests that the method is hardly considered to be residual to solve the specific problems encountered in tax collection and is not a common practice. However, the mobile collection point method cannot be a definitive solution until it becomes a practice, let alone as long as problems persist with the other two methods adopted by all municipalities.

The method of withholding IPA at source by employers is not effective, first of all, because municipalities do not have information on the number of workers of all private enterprises in their jurisdictions and make no effort in this regard, if at all. On the other hand, the withholding tax values made by State institutions (with most of the existing IPA taxpayers located in municipalities) are not always channeled to municipal coffers because, on the one hand, the legislation does not provide for institutional coordination mechanisms for their delivery, although the withholding tax is indicated by law as a method to be adopted by municipalities. On the other hand, a receipt of the revenue by the State institutions (constituting an outflow of resources) which should be planned by these institutions, with a strong coordination of the municipalities interested in the previous exercise, does not occur, with the exception of the Maputo city, and again without the desired aggressiveness. The fact is that in all public institutions conduct an annual IPA withholding and few of them deliver the respective values. This problem was identified by the National Association of Municipalities of Mozambique (2017) in its study entitled “Commitment and Tax Potential of Municipalities in Mozambique: Case Studies of Nampula and Quelimane.”

The method of collection of the IPA by the Neighborhood Offices confuses the tax with a levy and since there is no explicit service perceived by the citizens as a community, this generates discomfort and the mistrust from citizens in general as to the best use of their contributions. Since neighborhoods are not well organized to collect taxes, as administrative structures representing the districts or localities, the collection of IPA is made through a neighborhood entity, and it is common practice (a) to issue a declaration of confirmation of residence, whether for marriage, the opening of a bank account or the request for another service outside the municipality, to mention only these: (b) to claim the right to use and develop land (a plot for housing or other purposes); (c) to grant licenses for economic activities; and (d) to make a transfer of ownership between living beings (inter vivos). This raises the idea that the IPA is a levy and not necessarily a tax. However, all citizens, including those who pay by other methods of collection (withheld or mobile), would like better coverage and better quality of services that do not currently exist. A lack of services with better coverage and the lack of quality associated with the lack of adequate administrative organization of the neighborhood headquarters (often the Neighborhood Office has only the secretary as an
employee) generate resistance and mistrust from citizens as to a better use of the taxes they pay, including the IPA, as confirmed by the survey conducted among citizens, with 91% of respondents saying they "suspect that their money is misused". This confirms that the association of personal income taxes with the services provided by municipalities or local authorities becomes an important aspect to consider, sometimes more important than that of tax regressivity, and, as we have seen, there are indeed countries that have solved this problem by allocating revenues to specific services, which makes the collection of personal taxes a success, contrary to the idea that personal taxes are always bad taxes (Smith & Fowler, 2008).

6.2 Performance of municipalities in the collection of the IPA

This sub-section presents the results of the performance of the thirteen municipalities concerning the collection of the IPA. The behavior of the revenues collected over a long period is then compared to its relative weight in the potential revenues of the projected IPA, assuming that at least 40% of the population of each municipality would be able to pay the tax, and finally the contribution of tax revenue to staff costs recorded in 2016 is assessed.

In general, Table 1 reveals that, over time, IPA's revenues have behaved inconsistently with inconsistent variations, in the form of a "zigzag". In these circumstances, the behavior of IPA revenues is consistent with the lack of properly structured collection methods. Well-structured methods include, among other things, the existence of taxpayer files, as provided for in legislation, clarity in the institutional coordination in the delivery of revenue collected by withholding tax by employers, and neighborhood administrations organized and equipped with means and resources. The absence of structured methods exposes the municipalities and conditions the evolution of the income of the IPA to factors of chance, as is the case for example of a citizen wishing to benefit from a service, at which time would take place the collection of the tax from the citizens, the spontaneous willingness of the citizens to pay, or the employer who carries out the withholding to deliver the revenues.

Table 1: Percentage Change in Annual Revenues of the IPA, 2009-2016

Other important factors affected municipalities' performance in collecting IPA revenues. The first factor is the application of tax rates that are lower than those established by the legislation in force, namely not updating the value of the IPA in function of the minimum wage, or even the absence of criteria for the calculation of this tax. During the eight-year review period, 38% of municipalities, namely Beira, Quelimane, Inhambane, Tete and Nampula, did not update the value of the tax collected. The municipality of Maxixe did not adjust the value of the tax for six years, while the municipalities of Pemba and Xai-Xai did not do so for five years. An expressive example of non-alignment on the legislation is the municipality of Beira - second important political city after Maputo and important economic city with the port serving the countries of the hinterland - which today collects only 8% of the IPA that it should collect per citizen, which means that for more than eight years it receives 20,00 MT per year out of the 263.00 MT which it should receive in 2016. Maputo and Matola are the only municipalities of the sample characterized by a certain regularity in the readjustment of the annual value of the IPA.

The second factor is the conflict between the IPA and the IRN. Both taxes are levied on individuals and only the taxpayer's place of residence is the distinguishing factor. If a person resides in a local community, he or she must pay the IPA and if he or she resides outside, they must pay IRN. There is, however, a perception by municipal managers (68% of respondents) that the fact that both taxes have similar tax bases and that the value of the IPA is, in most cases, higher than IRN, makes the latter preferable to taxpayers to the detriment of the former. For citizens who are not well informed about differences between municipalities and districts, the IPA and the IRN appear to be the same tax paid twice to the same state.

Thus, the only substantive justification for the positive variations in IPA revenues in Table 1 may be the increased demand for municipal services by citizens, which is also a consequence of the ongoing urbanization process, as noted by the World Bank (2017). Although it was not possible to delve deeper, it is interesting to note that a bigger number of municipalities with positive income changes (ten) was observed in the only election year of the time series studied (2013). This reinforces the IPA's revenue-raising argument because of increased demand for municipal services, as during the election years citizens fear the change of political leadership in municipalities which actually
took place in five of the ten municipalities - aim to ensure the legality of their properties such as plots and real estate where, as we have seen, the process begins with the declaration of residence spent in the neighborhood, is the moment utilized for tax collection.

Table 2 compares revenue collection efforts over time with potential determined assuming that a municipality could bill at least 40% of its residents. The result found reveals that municipalities collect revenues ranging from 1% to 35% of the potential. On the one hand, the municipalities of Nacala, Lichinga and Tete are among those that are the most below their potential in decreasing order of the deterioration of their performance, ranging from 2-3%, 3-9%, 3 -11% and 7-12%, respectively. The municipalities of Beira and Tete are those that have not updated the IPA values in the last eight years; IPA's revenue growth rate in the Lichinga municipality has dropped significantly, from 37 percent in 2009 to -33 percent in 2011, and has remained virtually unchanged in recent years. On the other hand, the cities of Inhambane, Maputo, Matola, Maxixe, Pemba and Quelimane, are among the best performing cities, with a variation of revenues compared to potential revenues of 14-33%, 15-30 %, 9-28%, 14-35%, 9-20% and 7-31%.

Table 3 presents the corollary of the issue of IPA revenue mobilization difficulties for the IPA by municipalities. A primary destination for municipal revenues should be to ensure the functioning of the municipal administrative machinery, namely guaranteeing minimum services by paying salaries to employees and spending on goods and services so that Central government transfers can strengthen the rest of revenues for the financing infrastructure and basic services. The IPA, which is one of the taxes whose revenue is expected to cover the financing costs of the municipal administrative machinery, is almost insignificant, covering less than 1% of staff costs in five municipalities, namely Beira, Lichinga, Nacala, Tete and Xai-Xai, and less than 2% in seven municipalities, namely Chimoio, Inhambane, Maxixe, Nampula, Pemba and Quelimane. Matola and Maputo presented the highest potential, with 7-12% and 7-31%, respectively.

Table 2: IPA Revenue Contribution to the payroll costs in 2016

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Source: Author’s calculations based on data from municipalities, 2009-2016 and projection of IPA potential.

IPA could, however, make a significant contribution to municipal expenditures. If municipalities are able to collect the tax corresponding to at least 40% of the population once the IPA value has been updated, the income from this tax could represent up to 27% of the payroll charges in Matola, 22% in Nampula, 18% in Maputo and 16% in Beira, thus freeing up some of the resources that are now paying salaries for other expenses. Indeed, a simple measure consisting in the updating of the IPA value can revolutionize own revenues, as can be seen in Table 3. If other structural measures, such as improved collection methods, are taken, it is certain that the IPA can make a significant contribution to the financial sustainability of these municipalities.

As a result, the low use of the possibility to improve IPA revenues by municipalities results in perpetuating their reliance on central government transfers. With improved IPA revenues, at least 10% the resources of the Municipal Compensation Fund coming from the Central government would be freed up to cover operating expenses that are currently used only to pay employees’ salaries.

Table 2: IPA Performance in function of the Potential based on 40% of the Population and Coverage Rate in 2016

Source: Author’s calculations.
7. Recommendations

The results of the study resulted in recommendations at three levels: policy, coordination and operation.

a) Political level

The literature indicates that personal taxes combine most of the features needed to be good taxes, which is why they have been used throughout History to achieve various goals. However, regressivity, which is the only problem with these taxes, may be offset if there is a reciprocity between the contribution and the benefit of a service that is useful to taxpayers (Smith and Fowler, 2008). Under the current conditions of need for the financing of Mozambican municipalities, IPA is an important source of revenue if it is properly implemented. Therefore, it is recommended that the law should assign IPA to a service or services of municipal responsibility and of extreme public interest, such as, for example, preschool education, primary education, and water supply. The assignment may, among other advantages, increase the level of responsibility and transparency of public managers on the one hand, and strengthen the redistributive function of taxes, on the other hand. Similarly, the fact that the result of taxation is applied to a service that is specific and important for citizens can facilitate the education of the generations on the role of taxation, for which, unfortunately, since Independence, generations of people have developed negative connotations.

b) Level of coordination

The fact that the IPA can be collected through the withholding tax on individuals makes it more certain with less likelihood of fraud and manipulation, which are important features of good taxation. Under Mozambican conditions, where income taxes are levied by the Central government, withholding IPA at the source requires better coordination between levels of government so that the revenues collected by this method actually reach the municipal coffers. This requires that in the annual planning the Provincial Governments (Provincial sections of the Ministry of Economy and Finance) and / or District (District Offices), as the case may be, as well as the municipalities, provide the technical conditions for the transfer of the IPA revenues once the withholding tax has been deducted in the financial year in question.

Likewise, the municipalities and the Central government, including the local chapters of the National Social Security Institute, coordinate their efforts to ensure that they have the same level of information on employers and their respective employees in the same fields of municipal jurisdiction.

c) Operational level

The result of this study reveals that municipalities simultaneously lose (i) a significant share of the revenues they could mobilize from the municipalities to finance the operation of the administrative machinery and/or a share of the services; and (ii) the possibility of using a mass tax, such as the IPA, to pedagogically introduce aspects of education to citizens.

Without prejudice to their responsibility concerning the recommendations at the level of institutional coordination, it is recommended that municipalities should take measures at the neighborhood level and at the level of the municipal organic structure.

The neighborhood, as a municipal administrative unit, must be endowed with powers and capacities to mobilize revenues, in addition to the political powers it already holds for the mobilization and organization of the citizens. This involves rethinking the District Offices with a certain minimum number of structures to provide services and support the central municipal level in term of mobilization of revenues, especially of the IPA. Neighborhood Offices must have the technical skills to compile taxpayers’ registers, learn about processes and apply revenue collection and recording procedures. This necessarily implies a minimum investment in each Office in terms of equipment and training. This will facilitate the necessary monitoring and evaluation of the activities of the Offices.

At the municipal central level (municipal organic structure), it is recommended that the determination of the value of the IPA should comply with the criteria set out in Law 1/2008 of January 16 and in the Municipal Tax Code in force. The survey conducted in this study showed that citizens were more concerned about the lack of transparency in the use of IPA earnings than the magnitude of its value which they did not consider high. One also recommends a better functional, sectoral and taxpayer cadastres articulation for a better payment of IPA and other taxes. Finally, the adoption of mobile tax collection stations should be established as a practice and not an ad hoc solution because in addition to facilitating contact with groups of taxpayers, the adoption of this system of mobile tax collection stations makes it possible to optimize the time it would take taxpayers to travel to the tax office or to the municipal tax collector’s office.
8. Conclusions

The study entitled “Grain after grain, does the Chicken feed the Gizzard?: Evidences of the Personal Municipal Tax in thirteen cities in Mozambique” tried to determine to which extent thirteen major cities in Mozambique - the capital city of the country, nine provincial capital cities and three economically important cities - do exploit the existing potential of IPA to improve the collection of own revenues. To guide the research, the following questions were asked: (a) What is the revenue potential of the IPA that the thirteen municipalities can mobilize? (b) What are the factors that affect current levels of municipal personal tax revenue mobilization?

In order to answer the first question, it was necessary to collect financial information from the balance sheets from 2009 to 2016, including the collected IPA values. Based on the IPA values updated in accordance with the legislation, the potential for IPA revenues for a minimum of 40% of the population per municipality has been calculated, assuming that the remaining 60% is exempted for several reasons. In order to answer the second question, a survey was conducted using two questionnaires, one for municipal officials (municipal councilors and technicians) and the other for municipal citizens. The data collected made it possible to evaluate the legal and institutional, technical and administrative aspects that determine the performance of the thirteen cities in terms of IPA collection.

The research concludes in the long term that municipalities will collect IPA revenues ranging from 1% to 35% of the potential, with differences in levels between municipalities, and reaching between 2% and 26% of the citizens. The annual growth rate of revenues was invariable and unstable in the range of -79% to 2317%. This situation is the result of a combination of factors, including non-compliance with the criteria for the calculation criteria and enforcement of the annual IPA established by law, the lack of efficient collection methods, the weak institutional coordination between municipalities and Government, and the poor performance of lower administrative structures in terms of strengthening tax collection, especially in neighborhoods.

As a result, the performance levels of the IPA levies are left to chance and out of the control of the municipalities, with revenues from the municipal expenditure structure accounting for only 0.1% to 5.3% of staff charges (salaries and other staff costs), thus perpetuating the financial dependence on other sources when, in optimal conditions, this source could cover between 2% and 27% of the same expenses. Therefore, “grain after grain, the chicken cannot feed the gizzard”, but not because there are no grains.

The study suffered from two limitations that did not, however, invalidate its results, namely the small number of respondents who answered the questionnaire and the impossibility of explaining the real reasons behind not updating the IPA values of the survey as provided in the legislation. This last limitation opens up prospects for future research.

References


Annexe 1: Results of the questionnaire applied to municipal officials

1. The fact of the IRN being paid by the State in each district, how do you think municipalities prefer to pay IRN in each district, in the detriment of the IPA in the municipality?

2. The collection of the IPA is difficult and administrative costs in its collection are also high, so would it be better to abolish it?

3. The tax collection of the IPA is still low compared to the potential of the existing population, because:

4. Politically advisable to collect IPA through the administrations of the neighborhood?

5. Do you think that the annual adjustment of the IPA in terms of the salary minimum and more, according to the law, is in the best interest of the citizens, or would you recommend a renewal of the mandate of the PCM and of your political party?
Annexe 2: Results of the questionnaire applied to the administered
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