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Mobilizing Local Capital: Creating & Accessing Local Public Capital Markets for Urban Infrastructure

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Decentralization : That Unstoppable, Inexplicable Train

- Changes in the roles, mandates of different levels of government
- Changes in the taxation and fiscal transfer systems
- Ability to maintain operating flexibility for the unexpected
- Infrastructure lending shifting to state and local units of government

Decentralization : That Unstoppable, Inexplicable Train

- Newness of Real Decentralization
- Relative Insecurity of Local Government Taxes
- Relative Security of Intergovernmental Transfers

Credit Implications of Decentralization

- Credit Enhancement (transfers, oversight) vs. Credit Substitution (explicit guarantee)

- General Obligation in U.S. (Full Faith & Credit) vs. General Obligation Rest of World (Unsecured Counterparty)

Credit Implications of Decentralization

- Ratings Migration as Decentralization Proceeds
- Greater Significance of Local Credit Considerations
- Greater Importance of Local Managerial Response

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Creating Efficient & Sustainable Capital for Infrastructure

New financial model combines:

- Pooling of project risk with
- Layers of credit enhancements

Resulting in:

- Enhanced investment vehicles for domestic capital market

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Private Funds Are Available

- But Need:
  - Certainty of repayment
  - Timeliness of repayment
  - Market rate interest
  - Liquidity

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Benefits of Pooled Project Risk

The State Revolving Fund (SRF) Model:

- Stronger credit with cross-collateralization of loans
- Concern shifts to repayment capacity of portfolio instead of individual loans
- Reserves mitigate cashflow concerns

Benefits of Pooled Project Risk

Cost of Capital Advantages:

- Collateralized cash flows result in stronger credit and lower interest costs
- greater liquidity leads to lower interest costs

Retooling the SRF Model for Emerging Markets

- U.S. state revolving fund model assumes full ultimate recovery and low default rates (investment grade clientele)
- In emerging markets, assume higher default rates and variable ultimate recovery (non-investment grade clientele)
- Traditional SRF reserves not enough

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Credit Enhancements

Building layers of credit enhancement:

- Initial project user fees or taxes
- Portfolio cash flow supplemented by reserve
- Reserve supplemented by intercepts
- Intercepts supplemented by external partial risk guarantee or line of credit
- In investment grade countries, possible to introduce monoline wrap

Credit Enhancements

- Multi-lateral lines of credit / partial risk guarantee products in local currency, local market
- Repayment obligation subordinate to bank debt
- Multi-laterals or national development banks take the role of patient investor
- Pooled recovery rates for subordinated debt may vary by economic and policy considerations
- Reserve interest income can supplement subordinated debt repayment

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Credit Enhancements

Goal : Improved performance over time

- Administrative and service efficiency standards gradually improve subordinate ultimate recovery
- Bank interest income gradually freed to provide lower cost of capital to project loans

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Benefits of Credit Enhancement

- Stabilize project portfolio revenue streams
- Capitalize on ultimate recovery value of projects
- Achieve high national scale investment grade ratings
- Extend infrastructure debt maturities
- Engage domestic capital markets
- Diversify local investment portfolios

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Summary

"Public-public partnerships, armed with

- Pooled project risk and
- Supplemented by layers of credit enhancement
- Engages local private capital and

Provides the best shot for a sustainable supply of capital for global infrastructure needs."

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