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FS SHARE
FINANCIAL SECTOR KNOWLEDGE SHARING

SUB-SOVEREIGN BONDS

FS SERIES # 1: DIAGNOSTIC CHECKLIST

This diagnostic checklist is a tool for USG program officers to preliminarily evaluate if the fundamental legal and regulatory preconditions and market and local government-specific prerequisites are in place for developing a viable sub-sovereign bond transaction and bond market.

KEY QUESTIONS	YES	NO	COMMENTS/RESPONSES
1. Are sub-national entities legally authorized to borrow?			
If answer to 1 is NO, is it viable to change this situation?			
If answer to 1 is YES, what specific laws or regulations give local governments this authority?			List relevant laws and regulations:
If answer to 1 is YES, are there any legal limitations/restrictions in terms of the amounts, the sources, or the proposed uses of borrowed funds?			List what laws or regulations set out these restrictions:
2. Do the sub-national entities have adequate and transparent accounting, financial management, and reporting systems? <i>Note: Evaluate if sub-national entities' budgets readily available; if they provide adequate information on expenditures and sources of revenues; and determine if the entity's accounts and financial reports are audited on a regular basis.</i>			
3. Can the sub-national entity demonstrate a steady and predictable revenue stream (i.e. form taxes, government transfers, or fees/tariff revenues) to cover operating costs and service debt payments?			
4. Does the legal and regulatory framework allow credit enhancements*? <i>Note: Evaluate if sub-national entity can pledge revenues (i.e. user fees/tariffs; taxes; government transfers) as collateral; provide guarantees or obtain financial guarantees from financial institutions; create trusts, escrow and/or debt service reserve accounts; etc.</i>			List allowed credit enhancements:
If the Answer to 4 is YES, is the sub-national entity willing to provide/sponsor credit enhancements?			List possible credit enhancements:
5. Is there a domestic capital market to support bond financing?			
If answer to 5 is YES, who are the key players (e.g. pension funds, life insurance companies, etc.) and is there an adequate supply of long-term funding?			List key players and approximate size of market:
If answer to 5 is YES, are there any restrictions in the types of assets that institutional investors can invest in?			List restrictions in types and amounts of investment assets:
6. Are there credit rating agencies and a credit rating system in place to determine the creditworthiness of the sub-national entity?			
If answer to 6 is YES, does the sub-national entity have, or is willing to obtain, a credit rating?			
7. Is there a legal framework in place for concessions, leases, and other types of public-private partnerships?			
If answer to 7 is YES, is the sub-national entity willing to enter into a long-term PPP agreement with private sector operators/investors?			

* Credit enhancement is the process of reducing credit risk by requiring collateral, insurance, or other agreements to provide the lender with reassurance that they will be compensated if the borrower defaults. Credit enhancements not only help lower the risk premium but, in some cases, are essential to access capital markets.

RESOURCES FOR A DETAILED ASSESSMENT

If the results of the initial assessment indicate that the basic preconditions and prerequisites for viable sub-sovereign bond offering are in place, a more detailed analysis will be required before embarking on the design and implementation of a bond issue. To that end, there are a number of additional resources and existing toolkits to guide an in-depth analysis of key issues in municipal finance to determine the viability of long-term municipal bond offerings. Primary tools and resources identified in the research for this primer include the following, all of which may be accessed through the FS Share website.

Assessment and Implementation Toolkit for Municipal Finance. Developed by USAID's Making Cities Work program, this toolkit provides a format for preliminary and detailed assessments of the enabling environment for local government autonomy, management of municipal financial resources, trends in municipal finance, municipal performance in raising revenues, and municipal borrowing through instruments including sub-sovereign bonds.

Municipal Finance: A Guide for USAID Staff and Partners. This is a comprehensive resource developed by USAID's Cross-Sectoral Urban Training Project in 2006 with the objective of equipping USAID development professionals and their partners with the tools and background they need to design and oversee activities to help local governments finance infrastructure improvements.

Program Development Tool for Municipal Finance. Developed by USAID/EGAT as part of its Financial Sector Strategy, this tool offers detailed and systematic approach to exploring municipal finance initiatives through a decision tree process.

Water Finance Toolkit. Developed by USAID EGAT/DC, this innovative online toolkit is designed to be an online guide for program officers to evaluate potential water finance interventions including sub-sovereign bonds. The toolkit provides a number of entry points for brainstorming questions, ideas on integrating water finance with specific mission objectives, guidance on understanding the context and involving stakeholders, information on different water financing approaches and techniques, and resources for follow up. This toolkit will be available in the first quarter of 2009, and a link to the toolkit will be posted on the FS Share website.

Asian Development Bank's Public-Private Partnership Handbook. The handbook provides an overview of the role, design, structure, and execution of PPPs for infrastructure development, serving as a primer in the context of development finance. Its contents address a range of matters associated with PPPs, from policy considerations to implementation issues.

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