

Singapore International Water Week  
The Financing Forum

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***TALKING POINTS***

**Financial Sustainability and Development of Cities**

Mr Fumio Hoshi,  
Executive Director, Japan Bank for International Cooperation;

Mr Tan Yong Soon,  
Permanent Secretary, Ministry for the Environment and Water Resources  
(Singapore);

Fellow speakers;

Distinguished guests;

Ladies and gentlemen,

Thank you very much for this opportunity to speak to you at this important conference. On behalf of my colleagues, I would like to especially thank the

organizers of Singapore International Water Week for the warm hospitality that has been offered to our team.

I extend my warm greetings to all who have come here from around the world to discuss this important subject.

The evolution of cities, their productivity and service provision, are defining the success and the sustainability of development. The needs of infrastructure and how they are met set the path for the long-term development of cities. It is also important to note that the scale and quality of the infrastructure development in the cities is becoming a leading indicator of national economic growth.

As you all know, the WB-Singapore Urban Hub was officially launched yesterday. The focus of this conference on financing is an indication that a new phase of development in cities around the world has commenced, and that Singapore and the WB-Singapore Urban Hub are well positioned to play a key role in the transformation of cities in developing countries.

### **A new phase of development in cities**

It is clear that cities will need to go beyond the physical infrastructure development to pursue sustainable development paths. Those paths would need to embrace three things: an emphasis on regional balance and equity, the promise of environmental sustainability and an assurance of financial sustainability, the last of which is the central point I'll deal with today.

The need for transparent and predictable financing of urban infrastructure has become especially clear as the current global financial crisis has challenged market borrowing for cities worldwide. This time of crisis may be a good opportunity to review and refine the financing instruments and approaches.

In my remarks today I would like to bring in a few examples of the models which have been put in place around the world to help local governments mobilize capital for infrastructure finance. They provide some lessons from trying to tap into private markets to finance local infrastructure. Such an exchange of lessons could be useful for the local government leaders in the developing countries, many of whom are here in the audience.

### **International examples of local infrastructure finance models**

We know that municipal bonds and bank lending are common instruments which local governments utilize to raise capital. In some cases the central governments either do not allow local governments to engage in direct market borrowing – such as in China and Chile; or they put in place strict rules as a risk management measure to guard against ill-advised borrowing, as in Brazil.

The reason for the safeguards is the experience of unwise or unsustainable borrowing at the local level that can or has proven to result in (a) future financial difficulties for the local government and (b) increase in contingent liabilities for the central government. These types of government actions imply that the financial market is not always able to provide the necessary

checks and balances to control excessive borrowing by local governments. The current financial crisis has demonstrated that this type of market failure can take place in the developed economies as well.

The examples which I will list today involve financing models which countries have utilized to channel public and private savings into infrastructure development when the financial markets were not developed enough to provide a smooth flow of capital for infrastructure development. These examples show that successful development programs tend to be highly customized. When these models work, they tend to work for a specific country at a specific stage in its development.

Let me describe four models, all of which highlight certain key principles and also their application through customization.

1. Infrastructure Finance Corporation (INCA), South Africa. This first example shows the adaptation of financing mechanism to meet the acute need for service provision in a period of transition. It was useful immediately following the end of apartheid period when well run townships had to provide infrastructure services to a large segment of the under-served population. The model involved a private institution which (a) made loans to local governments, (b) bought municipal loans and municipal bonds from private banks and investors, and (c) refinanced municipal debt to longer maturities. *The key goal was to provide liquidity to the private market and extend maturity of municipal debt to improve affordability and access to infrastructure services for more people.*

2. Municipal Finance Company (MUFIS), Czech Republic. This second example shows a model when banking reforms in the Czech Republic in the early 1990s were helping in the transition out of the predominance of directed lending and weak appraisal standards. The model involved a long-term funds borrowing window for private lenders who were interested in making loans to local governments or their entities. MUFIS had no loan origination or underwriting functions, but it was able to dictate the format and guidelines which the banks had to adopt to participate in the program. *The key goal was to develop market standards for project appraisal and establish lending benchmarks.*
  
3. FINDETER, Colombia's local development fund. This third example illustrates the case of Colombia where local governments had taken on a lot of short-term debt which had to be refinanced to longer maturities via a market-based financing mechanism. The FINDETER model involves a facility which helps the private banks -- who lend to local governments -- by refinancing their municipal loans at a discount. FINDETER therefore takes only bank risk, i.e., it does not take any direct local government risk and is backed by the balance sheet of participating banks. This model can only work if the participating banks have the institutional capacity to lend to local governments, and local government credit risks are known and cities have their own credit ratings. Local governments also took out new longer-term loans to finance infrastructure, but their unwillingness to assume more debt slackened the demand for funding via this facility. Local government caution itself meant that demand for credit was far from excessive. *The key goal is to provide for longer term financing on the part of local governments through market based mechanisms.*

4. Tamil Nadu Urban Development Fund (TNUDF) of India. This fourth example shows an effort to directly fund local governments. As part of the apparatus of the southern state of Tamil Nadu, the TNUDF was launched to provide funding directly to local governments to finance priority infrastructure projects. TNUDF started well. It acquired a corporate status and reported a profit. Loans repayments were good. Pooled financing by several local governments and municipal bond issues occurred for the first time in India. Perhaps most importantly, TNUDF was able to demonstrate that smaller cities in developing countries can pool together and borrow from the market under a well structured program which can also offer them technical assistance. While TNUDF successfully financed many local government projects throughout the state, the biggest constraint upon the expansion of this model was limited local government capacity. Too few were able to prepare convincing proposals for project finance and the creditworthiness of some was in doubt. *The key goal again was to not only provide financing for local governments, but to also establish a pooled financing framework for small and medium sized cities to raise capital.*

### **What lessons can be learned from these experiences?**

So what can be learned from these and other experiences? Let me list three important lessons.

1. Efficient and sustainable avenues for market borrowing: Local governments or local government entities will increasingly and rightly

show great interest in borrowing funds from the market. There are important gains from supporting such borrowing that draws on local governments as they are close to their constituents and they feel the pressure of infrastructure demand from the citizens directly. At the same time, this effort needs to be efficient and sustainable. And so it is important that policy makers provide the right mechanisms for access to market borrowing by local governments and that their entities are appropriately supervised and monitored within sound regulatory frameworks.

2. Mix of tools to ensure performance: The financial performance of an entity which borrows funds from the market is a crucial consideration. This is a fundamental issue for government entities who undertake market transactions, such as borrowing or public-private contracting. Market-based tools and mechanisms are vital in monitoring, feedback and follow up, and they can complement public sector administrative rules. The appropriate use of market-based tools is essential to monitor the market's perception of the financial performance of the public entity. Some common examples of market-based tools include:
  - a. Credit rating – which will be discussed later vis-à-vis the UDICs
  - b. Market valuation (stocks or bonds) of listed public entities
  - c. Public tender valuations of projects (e.g. sale of toll roads)
3. Innovation and adaptation: Innovation and continuous refinements of the financing model are not only advisable, but essential. It is important to note that best knowledge and expertise can be more relevant than best

practices. Knowledge and know-how can lead to customized solutions. Adopting best practices from elsewhere without adapting to relevant conditions does not always produce best results. This is particularly true when the scale of operations or institutional arrangements vary enormously from one situation to another. For example, it will be difficult to translate the financial viability parameters of a metro system from a medium sized city to a mega city.

### **The way forward for the WB-Singapore Urban Hub**

The global trends towards urbanization present both extraordinary challenges and opportunities for improving people's lives. Financing development efforts with efficiency and sustainability is vital to that outlook. I hope that this forum will set the stage for how the public and private sector in Singapore can best support the sustainable development of cities in developing countries. As I mentioned earlier, we expect the WB-Singapore Urban Hub to play a key role in helping to leverage Singapore-based experience, expertise and investment interest to help cities in developing countries develop efficient financing models for sustainable growth.

Thank you.