PPIAF PUBLIC-PRIVATE INFRASTRUCTURE ADVISORY FACILITY

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PPIAF's Sub-National Technical Assistance Program: East Asia and the Pacific

The Sub-National Technical Assistance (SNTA) program was launched in 2007 to **help sub-national entities access market-based finance without sovereign guarantees**. The objective of the program is to improve the borrowing capacity of local governments and utilities by providing financing for credit ratings, creditworthiness enhancement programs, assistance in the preparation of financing without sovereign guarantees, and for knowledge generation and dissemination.

Since the creation of the program, countries in East Asia and the Pacific have requested its assistance due to their increasing need to find alternative financing sources for their growing infrastructure demands.

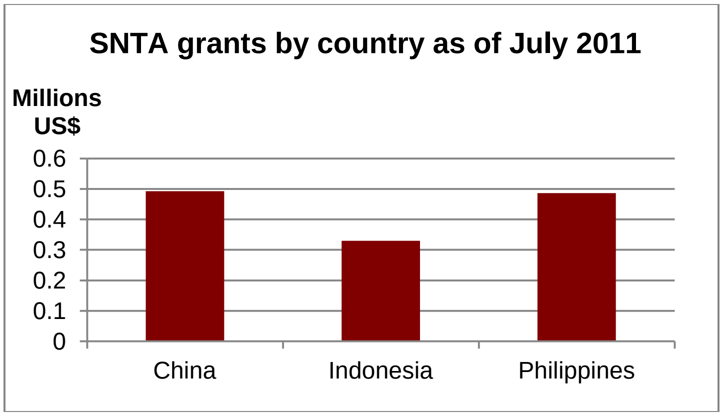
SNTA in East Asia and the Pacific

The main reason for the increasing demand for SNTA assistance is **decentralization**. In many developing countries, the responsibility for infrastructure financing and service provision is being transferred from central to sub-national governments. However, sub-national entities rarely have enough capacity to fulfill this new role due to weak policy frameworks, inadequate institutional capacity, evolving regulatory environments, and thin local capital markets. In addition, their traditional sources of financing, which consist of sovereign funding and guarantees, are either drying up or inadequate to meet the increasing service delivery responsibilities. This is due to the fact that many national governments are either unwilling or unable to provide further sovereign guarantees to sub-national entities due to pressing fiscal needs and a policy of promoting local financial autonomy. Sub-nationals often lack the creditworthiness to access markets directly, and thus programs such as SNTA enable them to "put their house in order" and facilitate their approach to the markets.

Rapid urbanization is another trend driving demand for SNTA. Almost half of the existing population in the world currently lives in cities; in the next 20 years nearly two billion new urban residents are expected. As a result, the need for basic infrastructure—such as transport, water and sanitation, waste disposal, and electricity—in rapidly expanding urban areas will grow exponentially.

Decentralization programs in East Asia and the Pacific are driving the demand for SNTA activities, particularly in countries such as China and the Philippines, with strong interest at the sub-national level in financing infrastructure improvements that are more directly under the control of local officials.

Several large credit rating activities have been supported in the region, particularly those making use of the new Financial Management Assessment tool, which provides more diagnostic information to clients than normal rating reports. Since the inception of the SNTA program in 2007, **SNTA has funded seven activities in East Asia and the Pacific** and **disbursed over US$1.3 million**.



SNTA-funded activities in East Asia and the Pacific since 2007

Country	Type of activity	Scope
China	Other (workshop)	Approaches to municipal finance
China	Credit rating	Urban Development Investment Corporations credit rating in China
China	Other (workshop)	Sub-national borrowing and debt management
Indonesia	Credit rating	Indonesia sub-national governments capital market
Philippines	Credit rating	Philippines Local Government Units
Philippines	Other (defining a program of priority investments for possible offering to the market for financing)	Financing strategy to implement various components of Marikina City's priority capital expenditure program
Philippines	Financing	Support for the development of financial product for small utilities

Selection of SNTA results in East Asia and the Pacific

The development value generated by the SNTA program can be viewed by the number and size of financings that result from the improved financial management resulting from the technical assistance provided by SNTA. These are mostly financings provided by international finance institutions or commercial banks, without reliance on sovereign guarantees.

Another indicator is the number of sub-national entities that have increased their capability to raise financing from non-governmental sources, because they have 1) obtained an appropriate local currency credit rating or 2) substantially improved a local currency credit rating.

Financings obtained/to be obtained	Shadow credit ratings obtained
• **Marikina City, Philippines:** US$6.4 million loan from a government-owned bank to undertake infrastructure projects • **Bohol, Philippines:** Antequera Waterworks received a Php1.5 million (US$33,000) loan from Landbank for a new water source	• **China:** Shadow credit ratings of 6 Urban Development Infrastructure Companies in China • **Philippines:** Shadow credit ratings of 8 Philipino municipalities (Iligan, Malabon, Mandaluyong, Marikina, Naga, Quezon, Tacloban, Taguig)

Sub-national entities use the proceeds from the financing raised as a result of SNTA assistance to provide and extend access to basic infrastructure services such as water and power; as such, the program contributes to improving the living standards of populations and to the reduction of poverty.

Selection of SNTA activities

Financing

These activities are designed to help sub-national entities **secure capital for infrastructure development**, i.e., raise money for infrastructure investments from banks or bond markets. The range of assistance includes feasibility studies, market sounding exercises, targeted policy diagnostics, and transaction support for the actual structuring and implementation of financial operations.

Small Water Utilities Improvement and Financial projects in the Philippines

Small local government-run water utilities and cooperatives play a major role in providing water in rural areas in the Philippines. For these entities, financial accounts of water-related activities are often not separated or **"ring-fenced" from the general financial reports** of Local Government Units (LGUs) or multi-purpose cooperatives. This practice makes it **difficult to establish the true performance of the water utility** or to determine the appropriate tariff to ensure the utility's sustainability. It also makes it very **hard for financing institutions to determine the financial position of a water utility**, much less be encouraged to consider extending credit for service improvement and expansion if accurate financial data is lacking. Small water utilities are therefore unable to present bankable projects.

In collaboration with the Water and Sanitation Program's Small Water Utilities Improvement and Financing projects, SNTA contributed to "ring-fencing" financial accounts to help LGUs and cooperatives generate accurate and reliable financial information that can be used to inform decisions on resource allocation, management, tariffs, and operational changes and improvement. A ***Guide to Ring-Fencing of Local Government-Run Water Utilities***, a simple yet practical manual—applicable to typical LGU-run water utilities and flexible enough to adapt to the varying conditions in a utility—was produced. The Philippine Water Revolving Fund further piloted the guidebook in six other LGUs and three cooperatives. One of the mayors indicated that it "opened our eyes to unnecessary subsidies that we are providing." National government counterparts—the Cooperative Development Authority and the Department of Interior and Local Government—plan to advocate and roll-out ring-fencing to other LGUs and cooperatives, integrate ring-fencing in their capacity building programs, and work for its institutionalization at the national level.

Credit ratings

Credit ratings are designed to **indicate the relative creditworthiness of potential borrowers**. In the case of "shadow" credit ratings—unpublished, unofficial ratings done for diagnostic purposes—the rating exercise is usually followed by technical assistance to make improvements with the objective to go for a formal rating. East Asia and the Pacific had specific interest in credit ratings and especially in the Financial Management Assessment tool, which provides more detailed diagnostic information. **SNTA provided funds for three such activities in India, China, and the Philippines.**

PPIAF Helps the Chinese Government Move Toward Credit-Based Borrowing by Sub-National Entities

SNTA support:

Chinese budget law prohibits sub-national governments from borrowing, but many do so indirectly by using Urban Development Investment Corporations (UDICs). In the poor areas of northern and western China, UDICs are of particular concern because they rely heavily on bank loans backed by guarantees rather than by assets or expected project revenues. SNTA helped by co-sponosring an international forum on sub-national debt management in Zhuhai, China, attended by government officials, then by **supporting central and municipal officials in better understanding the financial situation of UDICs by funding six shadow credit ratings**. It was concluded that UDICs often borrow more debt than they can service with their own revenues, and that they rely on guarantees from parent municipalities to finance projects that do not generate enough cash flows to cover the borrowed amount. **A key recommendation of the work was to move UDICs from open-ended guarantees by parent municipalities to credit-based borrowing practices.**

Outcomes:

SNTA helped curtail an extremely risky form of borrowing, and an important sub-national finance reform process begun. The Ministry of Finance announced its intention to prohibit local government guarantees for UDIC borrowing, as a way of restricting local non-credit-backed borrowing until a comprehensive regulatory framework is put in place. Prime minister Wen Jiabao also announced that the **central government would sell 200 billion Yuan (US$30 billion) of bonds** for a second year to on-lend to local governments for infrastructure projects.

Performance improvement

SNTA's performance improvement activities are designed to address problems that weaken the credit standing of sub-national entities in the eyes of potential lenders. They focus on helping sub-national entities build financial sustainability plans, strengthen or identify potential revenue flows, diagnose current financial management practices, improve transparency, and strengthen financial monitoring mechanisms.