Municipal Finance Facility Ownership Structures: A SWOT Analysis

Provided under the Access to Credit Initiative – USAID/Ukraine

March 22, 2006

John E. Petersen

Background

The Government of Ukraine (GOU) is considering the establishment of a municipal finance facility or "bond bank." Such a bond bank would be established to provide a source of long-term capital to finance the infrastructure needs of Ukrainian local governments and their communal service enterprises. The possible ownership structures of a bond bank and how these might affect the scope and scale of a bond bank's operation are the subject of this report. Many models exist for municipal credit facilities around the world. These will be examined as illustrations of various ownership options, and as guidance on appropriate models for Ukraine.

Boundaries and Structure of this Report

As the following discussion will indicate, there are many forms that bond banks may take, and many services they may perform. This analysis of ownership structures is performed taking into consideration several preliminary boundaries regarding the establishment of a bond bank in Ukraine.

- May be capitalized by GOU and international finance institutions such as EBRD and IFC
- May raise lendable funds by borrowing in domestic financial markets
- Will not carry a GOU sovereign guarantee
- Will not on-lend donor funds (but such funds may be used for reserves)
- Will lend (and/or guarantee loans) to cities and communal service enterprises
- May have an indemnity fund to protect investors from loan defaults

This report provides a rapid assessment of the strengths, weaknesses, opportunities, and threats (SWOT) of several possible ownership structures for the bond bank. It considers four possible ownership structures:

1. Majority ownership by "private" non-governmental entities
2. Majority state (central) government ownership
3. Majority communal (city) ownership
4. Multiple owners (no single controlling owner)

These alternatives are examined after a general discussion of bond bank structure and operation providing international examples that offer lessons for Ukraine. The ownership and control alternatives are then subjected to a point-by-point SWOT (Strengths, Weaknesses, Opportunities, Threats) analysis. The report concludes with findings and a recommendation for the preferred ownership structure.

This report will not consider the legal format of the bond bank, except to note that the bank could either be formed under existing laws or by new legislation.

Rationale for Bond Banks and Bond Pooling

Bond banks are financial intermediaries that raise funds in the capital markets to finance local government capital spending. Bond banks can deliver a number of credit-related products, including the following:

- Long-term loans for infrastructure
- Short-term lending (debt due within one year)
- Loans matched by grants from GOU infrastructure programs
- Lease Financing
- Credit enhancements
- Technical assistance / oversight

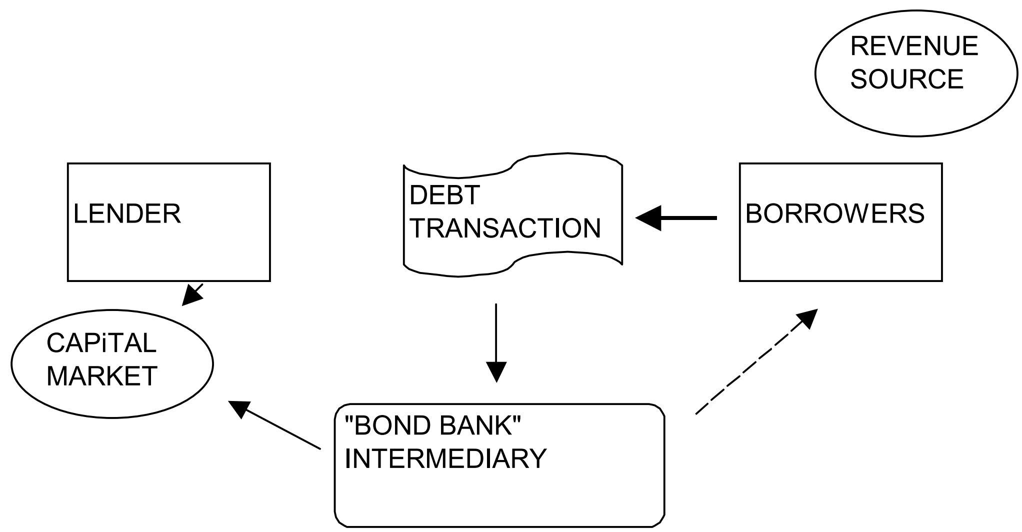
Bond banks can lend directly, or they can buy qualifying loans from local banks, thus acting as an apex (wholesale) bank.

A common characteristic in sub-national government borrowing is that local government borrowers and the individual loans they take are small, frequently too small to interest private capital markets that are oriented to larger (and fewer) borrowers. In Ukraine, almost all cities and communal enterprises are inexperienced in marketing debt obligations to the capital market. This typical emerging market situation suggests pooling small city or utility borrowings into larger, more efficient groups or "pools" in order to achieve various economies of scale that are possible with larger issues of bonds.

Pooling also brings a reduction in risk through portfolio diversification, resulting in reductions in the cost of borrowing to the participating local borrowers. The technique of bond banking – in which a financial intermediary pools together small loans, and itself borrows in the financial markets, pledging loan pools as collateral – has seen extensive use in developed markets, but only limited use in developing country financial markets.[1] Common impediments to broader adoption are 1) reluctance of central government on-lending agencies (including government-owned banks) to relinquish control over the borrowing by subnational governments and 2) limited capacity of local markets to finance longer-term debt transactions. The first factor is not now a limitation in Ukraine. However, at present, there is an effective five-year term maximum on Ukrainian city borrowings, which is a very short period for infrastructure finance. A bond bank might be able to quickly and effectively extend that maturity horizon.

[1] See John Petersen (2002). Given their small size and lack of market experience, local government issuers face high transaction costs in individual bond sales. Aside from just delivering economies of scale, the bond bank intermediary provides on-going oversight of loan performance and helps to establish uniform, transparent accounting and reporting norms at the local government level.

Figure 1: BOND BANK (POOLING)



The essential relationships in the bond bank approach are depicted in Figure 1 above. The bond bank in effect bundles the underlying sub-national debt and then sells its own bonds to investors in the capital markets.[2] The basic idea behind the pooling concept is to develop a portfolio of loans that can then be remarketed in bulk to the securities markets as bond bank obligations. Bond bank obligations almost always have one or more credit enhancements, such as added reserves, intercept provisions that grant creditors access to cash flows, or bond insurance.

Pooling also provides a number of inherent credit enhancements because of the size and diversity of the pool's portfolio, which protect it from both individual "event" risks and systemic risks. This means that with appropriate design, a debt service problem with one borrower (or even a class of borrowers) can be successfully handled with reserve funds and other credit supports, and by the pool's diversity. The loan pool itself mitigates credit risk. It has inherent financial stability.

The pooling intermediary also achieves economies of scale, which are especially important in financial markets. There are economies when the bond bank makes a sizeable borrowing in its own name (reducing legal, advisory, investment and trustee fees); and also when it monitors loan performance for its investors. The Tamil Nadu Urban Development Fund has pioneered a credit pooling approach in India and is a leading example in developing markets. The bond bank concept has seen great use in the developed financial markets of North America and Europe, as is illustrated below.

Variations in Bond Bank Financial and Managerial Structures

[2] There are legal distinctions between "pools" or "funds" that represent the resale of interests in the underlying portfolio and in bond banks that sell their own obligations that represent undivided shares in their "business." These distinctions can be important in matters of securities regulation and taxation.

This section reviews how the financial and managerial aspects of a bond bank interact. Figure 2 depicts several options for organizing bond bank operations. An important design question is which services will be provided by the Bank's permanent staff, and which will procured by contract. Most bond banks have very small staffs. Many banks contract with private sector asset managers for day-to-day operations.
Bond banks may approve individual loans, but contract with commercial banks for loan origination and servicing. In such cases, the bond bank acts as an "apex bank" selling its own securities and using the proceeds to purchase loans from originating banks.[3] Banks may be paid a fee, or may markup the interest rate. The bond bank may also use the contract to share risk with originators, either through partial guarantees from the originating bank, or by having the originator retain a fractional interest in the individual loans.[4]

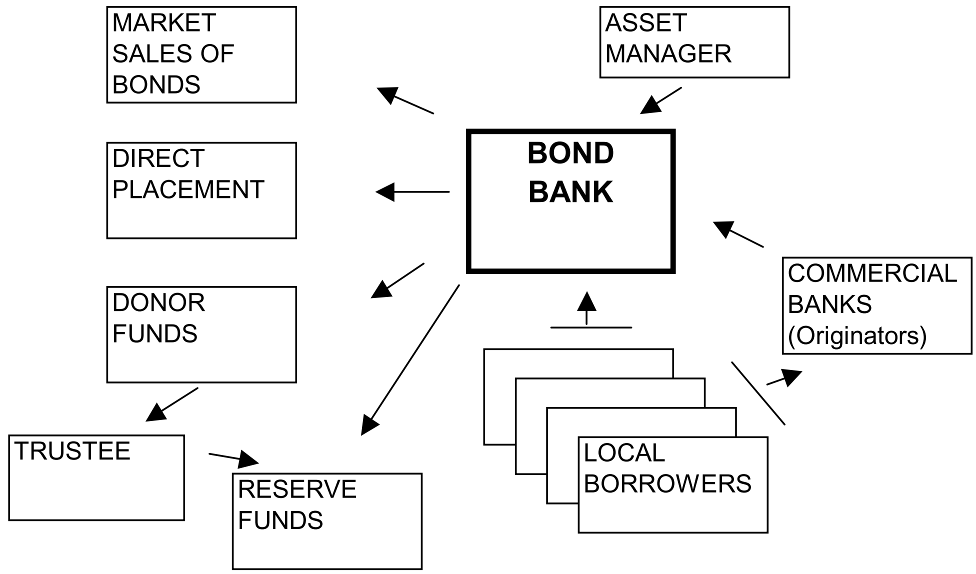
Generally, bond banks sell their securities publicly in the financial markets. However, there also can be direct (private) placements. For example, the Alberta (Canada) Financing Authority frequently places its bonds directly with the Provincial Public Employee Pension System, which holds about a third of its debt. The use of reserve funds, indemnity funds, and trustees to secure bond bank debt raises important design considerations. Adroit design of these funds can help to circumvent issues with international donor organizations that cannot (or will not) deal directly with public-sector institutions unless they carry a sovereign guaranty.

By and large, the ownership and control of the bond bank should not *per se* be the decisive issue, so long as the bank is operated for the public benefit. But the bank's ownership and control do of course influence how the bond bank operates, and ownership structure must support three major operational objectives:

- the bond bank must be *professionally and competently run*
- it must be *transparent and accountable*
- it must have *operational independence* to meet its policy goal of raising capital at low cost for legitimate public purposes.

[3] A common practice is for a bank to receive bond bank approval of a loan to a commune for inclusion in a bond issue. The bank can then provide short-term financing until such time as the bond bank is ready to sell the bonds and take the commercial bank out of its loan. Among others, this is done by the Maryland Bond Bank.
[4] This is the approach used by FINDETER, the Columbian municipal financing authority. See Kehew, Matsukawa, Petersen (2005) Appendix 1.

Figure 2: BOND BANK FINANCIAL AND MANAGERIAL STRUCTURES



The Ownership Structure and its Implications for Operations

At the outset, it was noted Ukraine can consider four major ownership models for bond banks:

1. Majority ownership by "private" non-governmental entities
2. Majority state (central) government ownership
3. Majority communal (city) ownership
4. Multiple owners (no single controlling owner)

Within these arrangements, there are a variety of ways to balance the various possible controlling interests and capital contributors that comprise "ownership" of the bond bank. It is important to understand that the "ownership" concept breaks into two separate issues: who provides equity capital, and who governs (sets policy for) the bond bank. The entities holding equity in the bond bank as a corporation will own it, but the purpose and profitability of equity ownership can vary greatly depending on the nature of the corporation and its chartered purposes.

Bond banks may be created as "special purpose vehicles" or "funds" that are dedicated to a public purpose, or they may be established under the general laws that cover financial corporations. Generally, their charters specify purposes, enumerate legal powers, and describe the bank's governance and initial capitalization.

To a large degree, the ownership structure will be driven by how the bond bank intends to finance its operations. Thus, a major concern is how the bond bank can be configured to tap into various sources of capital and, accordingly how the bank's operation and ownership may interlock. The bond bank can be funded in a variety of ways, but the predominant model is that the bank will serve as a *financial intermediary*, raising funds in the market by its own borrowing (or through the use of enhancements) in order to acquire the loans made to cities and their communal enterprises. As noted at the outset, in

Ukraine this activity is to be undertaken without a sovereign guaranty. The bank is to be self- sustaining. This places a great premium on its ability to act (and be perceived) as a prudent and creditworthy organization.

Among the four ownership models mentioned above, there is a broad range of international experience. In several bond banks, ownership structure has evolved over time.

There are few examples of wholly or predominantly private bond bank ownership, and these are both recent and special situations. A purely private, profit-making structure seems very unlikely for Ukraine, given the risk involved in new market development and the underlying public-purpose of the bank's operation.[5] (It is possible that a state-protected monopoly could induce creation of a private bank.) Both South Africa's INCA and Western Europe's Dexia are special situations.[6] On the other hand, a substantial minority private-sector participation is not unheard of, and this is found in some bond-bank funds India that are designed as special-purpose trusts.[7]

An alternative, represented by the Local Government Unit Guaranty Corporation (LGUGC) in the Philippines is to have predominantly private sector ownership as represented by a non-profit association (the Philippine Bankers Association, 51 percent owner) combined with a minority governmental ownership. The Philippine example is also of interest in that a development finance institution, the Asian Development Bank, now holds 25 percent equity ownership. (Similar structures are found internationally in associations of major banks that own bank clearing facilities, like Ukraine's MFS depository, or financial firms that associate to own and operate securities exchanges.)

In North America, there is considerable precedent for bond bank ownership by provincial or state (oblast level) government. In Canada, local governments are "shareholders" that participate in bank governance, although the Province usually holds the majority of seats on the board. In the case of Alberta Province in Canada, the local governments, which are normally required to borrow through the bond bank, have a minority of seats on the Board and make minimal stock subscription payments. Since the bond bank is a Crown Corporation of the Province (and carries the Province's guaranty) it has very low borrowing costs.

In the United States, almost all bond banks are owned and operated by state (oblast-level) governments, usually as separate corporations or authorities. Their debt is usually not

---

[5] The question always is raised that were the bond bank as a private entity a good idea, why has not a private firm (or group of firms) created one? The answer is that without the needed governmental powers and financial "deep pockets," the bond bank business model is not profitable enough to offset the risks.

[6] INCA was created to restructure institutional portfolios and largely has acquired already outstanding debt in the context of South Africa's highly developed capital markets. Dexia was a privatization of state-owned and operated "specialized banks" that lent to local governments in Belgium and France. The state retains a minor interest in the firm, which now acts as a private underwriter and banker.

[7] The Indian trust structure, which is very flexible, allows for mixed ownership and the private firms are both members of the board and may serve as "asset managers." The International Finance Corporation, the private-financing arm of the World Bank, has served as a partial owner of an Indian asset management firm (ILFS).

directly guaranteed by the state.[8] In the United States, there are several legal and tax impediments to a mixed public private structure.[9] A specialized type of bond bank in the United States, the State Revolving Fund, also is prevalent for financing environmental and water supply projects.

In Scandinavian countries, bond banks are run by governmental "cooperatives," often with combined national and subnational government ownership, including ownership by local government insurance and pension institutions. In the case of Sweden, the local governments belong to a co-operative, which owns the bond bank. In Finland the localities and the local government employee pension system share ownership of the bond bank, which also carries a state guarantee. An association of local governments owns the bond bank in Denmark, whereas the central government has dominant ownership in Norway. In cases of majority local government ownership in the Scandinavian systems, for example in Sweden, the local government shareholders bear "joint and several liability". This means that any city's default must be absorbed on a pro rata basis by the members (usually up to a cap of each city's respective capital share). Joint and several liability reportedly creates a culture of creditworthiness and imposes peer pressure on borrowers.

Figure 3 sets out an array of actual ownership configurations. Given the differing definitions of public and private entities in the respective countries, it is difficult to formally divide the public and private sectors. In some cases, bond banks are owned by an association of private firms, like the Philippine Bankers Association. In other cases, some of the shareholders of a "for-profit" bond bank are themselves non-profit entities (as in the case of INCA in South Africa).

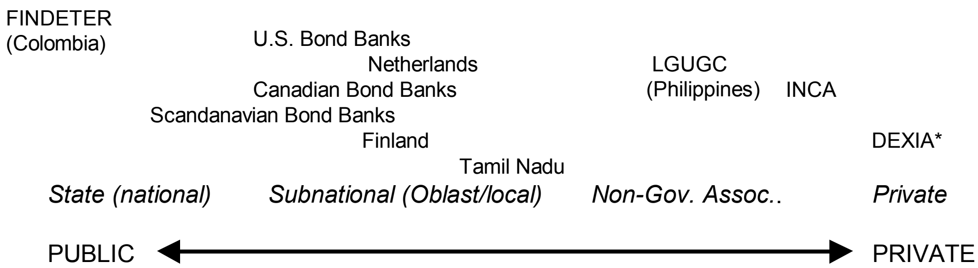
The point is that there are many possible ownership configurations that include private sector participation. Private participants may opt to subordinate profit maximization in the near term to build a viable mechanism for local government participation in the securities markets. In other words, private companies, acting in concert through an association and taking a longer-term view, may wish to promote the financial strength and independence of local governments apart from the possible profits achievable from bond banking in the near-to-medium term.

---

[8] There are a few examples of bond banks owned and operated at the local government level by consortias of local governments. The U.S. bond banks use a large range of credit enhancements to bolster security and typically carry ratings slightly lower than the respective sovereign states (oblast-level).

[9] A major factor in the United States is the tax treatment of securities, which if issued by subnational governments or their corporations, are exempt from federal and most U.S. state income taxes. This does not preclude having private firms work for such institutions, but private firms cannot have an equity interest in the institutions.

Figure 3: Bond Bank Ownership
Arrayed by Nature of Ownership:



*/ has minority government stock ownership

A final point has to do with the financial role of equity ownership in a bond bank. Normally, the role of equity (as opposed to debt and reserves) will be very limited in the capital structure of a bond bank. As a financial intermediary, the bond bank is designed to be a conduit to the financial markets. The major purpose of equity capital is to create a core of capital to "start the ball rolling" and to provide a cushion in case of financial difficulties. The creditworthiness of the bond bank will depend on the quality of its underlying portfolio of loans and whatever reserves it may hold or have access to. These sources provide the primary security to holders of its obligations.

Bond banks typically are highly geared or leveraged on their equity capital base. In the case of INCA in South Africa, the allowable gearing (borrowed funds to equity) is specified depending on the credit quality of the underlying loans. The Philippine bond insurer, LGUGC, has a maximum leverage specified in its trust agreement with the holders of the bonds it insures. In the Alberta Capital Financing Authority, local governments make small subscriptions known as "representational" equity. Annex B provides examples of the differences in equity gearing. Ratios vary greatly, depending on the nature of the bond bank and the degree to which it is run on a commercial basis.

The state (oblast level) revolving funds in U.S. use a combined Federal and state capitalization structure (80% and 20%, respectively).[10] The capitalization fund can be used either for leveraging market borrowings or as a source for loan funds (and therefore eliminating the need for borrowing by the bond bank itself). State revolving funds are wholly owned by the states, and the Federal contribution is a restricted capital contribution that carries legal requirements that restrict its use to environmental purposes.

The relative importance of equity in the overall capitalization of the bond bank and the concept of leveraging equity are discussed in Annex B.

A SWOT Analysis

A SWOT Analysis deals with the "**S**trengths, **W**eaknesses, **O**pportunities and **T**hreats" faced by an institution in accomplishing its mission. Such an analysis needs to cover a broad range of concerns. Many key issues of bond bank design are operational ones that

[10] The revolving fund means that any repayments of interest and principal must be repaid to the fund and may only be used for its purposes. Since administrative expenses are permissible, and under federal law there is no need to repay the capital contribution and no prohibition on lending at zero interest rates, the fund can ultimately fade away.

are unrelated to ownership structure, *per se*. Crucial issues are: 1) the degree to which bank operations are accountable to the owners, and 2) whether bank owners are executing a core strategy of preserving capital, and earning an adequate return on capital. Possible ownership structures range from private (unlikely as a sole source), to mixed ownership (some private ownership in conjunction with management contracts, etc.), to a mixture of local and central government ownerships.

Strengths Related to Various Ownership and Control Structures

- *Promotes high standards of borrower creditworthiness:*

  This relates both to the lending criteria used by the bond bank and the strength of its own security. The ability to achieve creditworthiness of the bond bank is dependent upon the independence, integrity and prudence of its lending criteria. Essentially, the bond bank must lend only to those borrowers that will pay debt service (principal and interest) in full and on time. This is not to say that credit assistance or even subsidies cannot be used, but that they must be explicit, transparent, dependable and carefully designed not to be politically motivated or predatory. The institutional focus of the bond bank will provide technical resources to support improvements to local government financial management. as is discussed below.

- *Financial sustainability*

  This relates to the ability of the bond bank to maintain its capital base and, to the degree necessary, to earn a sufficient return of it. That should be a product of its properly charging for risk, its diversification, and the depth of its reserves.[11] Dividend policies, for example must be such as required to build up reserves. This militates against an initial "profit motive" in the operation of the bond bank. [12]

- *Facilitates high credit rating*

  This question runs to two levels: rating of the bond bank, and ratings of the cities and communal enterprises that it lends to. First, at the level of the bond bank itself, the credit rating will be determined by the bank's capital structure, its portfolio and other characteristics of its organization and operation. In the domestic Ukrainian market, the bank's credit rating should be as close to the sovereign ceiling as possible in the absence of a sovereign guaranty. At the local government and communal enterprise level, the bond bank will need to have its own "credit scoring" system to assess loans and bonds. This will attach internal scores (or ratings) to borrowers. That system of internal reporting and scoring

[11] An initial problem is lack of diversification in the early years of operation. Risk assessments rely on some experience and on probability distributions of "events" occurring for given periods. In the first few loans there is necessarily high-concentration. In the beginning, reserves (or recourse to added capital) must be at higher levels.

[12] INCA has been able to pay out competitive dividend rates to its equity holders. It is a special case however in that it bought out institutional portfolios of already existing South African municipal bonds. The banks and insurers were anxious to unload the bonds, which lost their ratings when the sovereign guaranty was withdrawn were believed to be too difficult to monitor. By creating INCA and selling off the bonds (and buying the INCA bonds), the South African financial institutions were able to "swap" un-rated bonds for the more secure ones represented by INCA. This process was helped because INCA has been the recipient of helpful donor-based capital injections.

will prepare borrowers to report information that will meet requirements of the private capital markets.

- *Promotes positive perception of local government credits by capital markets*
  The bond bank, by bundling and overseeing local credits, to some degree obviates the need of the financial market participants themselves to obtain that information from the underlying governments. However, the successful operation of the bond bank will no doubt enhance the reputation of local governments in the markets. As the credit markets deepen and governments mature, there is the likelihood that larger municipal borrowers may elect to enter the financial market directly.[13] This depends on the policies of the bond bank and the success of its operation.

- *Improves access to capital (core capital and lendable funds)*
  The bond bank, for a variety of reasons, will improve access to capital. That is an essential part of its rationale. Attracting loan capital is the more important consideration since bond banks typically rely on high leverage to be successful. A commercially-oriented ownership and governance structure that understands and protects the quality of the bank's underlying assets (loans to cities and communal service enterprises) will best serve this purpose.

Possible Weaknesses of Various Ownership and Control Structures

- *Creates obstacles to efficient management*
  Public ownership always raises the issue of efficient and objective operation as opposed to politically motivated, self-serving and subjective activity. In other words, loans may be lent on weak projects at favorable rates, staff may be too large, and facilities may be extravagant. Although these problems can also occur in private sector operations, they are mitigated by the imperatives to make profit and earn a market-competitive return on capital. More fundamental than ownership structure in either case are the integrity and independence of bond bank management, and the transparency and accountability of its operations. Above all, the ownership structure must provide strong incentives for efficient management. Standard tools in corporate management are independent external audits that are publicly released, public reporting of audited accounts, and boards of directors that are independent of day-to-day management and effectively oversee it. Another approach is to hire a private-sector asset manager that reports to the bond bank's governing board. Last, and very important, is the fact that the bond bank will itself be entering and reporting to the private capital market. Its securities will be rated and scrutinized by prospective bondholders.

- *May inhibit bond bank's access to capital (core capital or lendable funds)*
  A weakness of state government control is that some private investors (such as IFC) will not invest in state government-controlled entities. (IFC will consider

[13] Eligibility to borrow through the bond bank (by size or type of governmental or communal enterprise unit, purpose of loan, size of loan) will be a design issue. At inception, it appears best to apply a broad net and apply strict credit quality standards that all deals that are financially viable can be considered for inclusion. Individual loan terms may be tailored to reflect variations in risk and size and, therefore, promote wider use of the bond bank.

investing in municipal finance facilities that include both state and city ownership, as well as private ownership, so long as the facility operates on a commercial basis.)

- *Increases city/utility costs of borrowing*
  A weakness of private sector ownership is that the bond bank must satisfy private sector targets for return on equity invested. In an unsubsidized bond bank, these higher costs will be passed on to borrowers as higher spreads over the bank's cost of funds. The weakness may be less significant when the private investors have a public purpose orientation (like IFC, EBRD, or Dexia) and when the investors' own cost of funds is low, as with AAA-rated international finance institutions.

- *Creates regulatory problems or uncertainty*
  The exact legal structure of the bond bank is beyond the scope of this report. The type of ownership of the bond bank itself, if properly constituted, should not create regulatory problems or uncertainties. It is presumed that it will have appropriate legal powers to conduct its business. However, the legal nature of its ownership may pose important issues as regards the regulatory and tax treatment of its own securities and its interest earnings. For example, will it be deemed as a not-for-profit entity, and be able to use tax-free interest income from loans to pay interest on its own debt? What will be the requirements for registering and selling its own securities? How will its own securities be treated for purposes of legal investment by banks (capital adequacy requirements) and other institutional investors (prudential portfolio restrictions and requirements). It can be presumed these issues can be solved by appropriate clarifying legislation and regulation. However, that may be more difficult where there is a private sector involvement in the ownership that necessitates the payment of dividend or other returns on private investment.

Possible Opportunities Related to Ownership Structures

- *Increasing leverage of capital over time*
  A bond bank must have the capacity to borrow by issuing its own securities in the financial markets. The term "bank" infers that it has the capacity to create liabilities for purposes of acquiring assets, so long as it meets certain prudential and liquidity requirements. In private sector operations, this is essentially the requirement that after adjusting for the quality of its earning assets, it must hold a certain level of equity or subordinated debt and reserves. Government operations, backed by various governmental powers, often have less stringent requirements, although liquidity and financial condition of the sponsoring/parent government can be of concern.

  Leveraging refers to the ability to reduce the share of paid-in equity in the capital structure in relationship to borrowed funds. A non-leveraged bank essentially lends only up to the amount of equity and contributed capital (such as government appropriations or donor grants and loans). Leveraging means that the entity borrows funds and then lends those funds to grow its asset base. As a bond bank grows, it is likely to see its leverage increase if it does not make claims on its reserves to cover bad loans and expenses. For the bond bank the most meaningful measure of leverage will be the volume of its lending in relationship to reserves, equity, and subordinated debt. Many credit programs begin with low levels of leverage. A capital grant or donor loan may simply be on-lent. Leveraging in the domestic credit market increases as experience is gained and/or effective demand for loans picks up. The degree of acceptable leverage depends on the credit quality of the assets (the underlying loans made), the presence of adequate reserves, and the bond bank's ability to match cash flows between its assets and liabilities.

- *Attraction of new capital by the Bond Bank*

  The ownership of the bond bank can influence its ability to raise new capital. In the absence of a sovereign guaranty, donor organizations, at least initially, have been reluctant to provide loans directly to local governments. This policy has been changing in the last few years, but still follows the general principal that until experience is gained, there is reluctance to deal directly with the local governments on the basis of their own credit standing. There are significant exceptions. The EBRD will enter into direct loans to local governmental bodies and enterprises if it is satisfied as to creditworthiness and the enforceability of contracts. The IFC division of the World Bank will enter into loans (and equity) with private institutions dealing with local governments. USAID's Development Credit Authority is restricted to dealing only with private institutions, but can assist subnational governments through them. It is important to recognize that in all the above cases, it is the *financial soundness and integrity of the underlying projects and the borrowing governments* that condition their participation. An ownership and governance structure that assures these donor organizations of the credibility and creditworthiness of the bond bank's operations will increase access to capital, and access to terms that make long-term investments possible.

- *Creativity and financial innovation*

  The ownership structure is not directly relevant to creativity and innovation except as it may have bearing on the management and "culture" of the bond bank's operation. To the extent that qualified individuals and efficient procedures are believed to be inconsistent with government ownership and operation, then the services of technically qualified and innovative personnel may be secured through personal contracts or the hiring of an "asset manager" firm from the private sector. In such a case, the bond bank's governing body (whatever its capital structure) will have policy and operations oversight, and the technical work can be carried out by the contracted party. While this relieves the Board of managing and staffing day-to-day operations, it does require writing appropriate contracts and effectively overseeing them. When contracting for asset management, it is imperative that the board have access to its own experts independent of the contract. Contracts must be negotiated professionally.[14]

- *Maintain lean organization by contracting for services*

[14] Contracting out raises several other issues such as the tenure of a contract and how often to bid it out.

One difficulty in a free-standing, self-contained bond bank structure is that the volume of loans may not justify the employment of the skilled persons needed to evaluate and process loan transactions and to handle the bond bank's own interface with the private credit markets. Bond banks in the United States, Canada and Scandinavia tend to be small, specialized organizations that have a few highly skilled staff and contract out for many services. (The bond bank may also handle a number of credit programs, so as to maximize efficiency)[15] A great advantage of a lean bond bank organization is reducing administrative costs (while paying competitive compensation) and building a results-oriented culture. This means keeping the size of the organization small by outsourcing many skilled activities. This outsourcing of activity also helps "seed" the private sector with skills that will help broaden the market for local government securities.

- *Develop expertise in specialized credit evaluation of cities and utilities*
  As has been noted, the bond bank must have its own internal credit evaluation system (credit rating or scoring) in order to achieve an objective basis for making loans and deciding on loan terms and conditions. Typically, the bank will require borrowers of a minimum credit quality, below which the bank will require contributions to its own reserves and make requirements on borrowers to mitigate risks.[16] As a creditor, the bond bank requires continuously updated information about borrower finances, conducts ongoing oversight, and has a creditor's rights to require remedies that will cure or, preferably, prevent default. One of the major strengths of the bond bank is its on-going familiarity with local government and company finance. The ownership structure that is strongest on this score is likely to be mixed, comprising both national and local governments, and, if possible, private sector lenders.

- *Provide focal point for identifying and acting on obstacles to or opportunities for city and city enterprise borrowing*
  One of the most useful attributes of the bond bank is to act as a focal point for collecting and assessing information about how local governments and communal service enterprises finance their operations, and about their borrowing capacity. This is for three reasons: first, as a creditor, it has a business interest in national and local developments that affect its portfolio of loans and the market for its own securities. Second, it has both focus on and expertise in the local government sector. Third, as an institution with national coverage, it has knowledge of and access to a large number and variety of local governments and enterprises.
  Aside from these positive attributes, which are independent of its ownership structure *per se*, it is possible that the ability of the bond bank to express opinions and disseminate information and its viewpoints may be inhibited

[15] The Bond Bank in the U.S. state of Virginia, the Virginia Resources Authority, has a staff of five professionals that handles the bond bank's loan programs (there are three), as well as that state's State Revolving Loan Program (environmental projects) and a couple of smaller loan programs. Maryland's smaller bond bank program has two staff persons and hires outside legal counsel and relies in part on the local commercial banks to administer its loans.
[16] These requirements are written into the loan agreements with the underlying local borrowers. For example, a local borrower may be prohibited from taking additional loans without the Bond Banks' prior permission or may do so only if they are subordinated to the Banks obligations. Likewise, disposal or sale of collateral may be prohibited, as may be minimum balances in the debt service fund, and so forth.

if it is a government line agency or under government ownership without a clear mandate to act (and speak) with independence.

- *Aggressively monitor borrowers and help resolve borrower financial problems*
  The bond bank is a creditor, and under most configurations will rely on capital market acceptance of its portfolio of assets, the underlying city and communal enterprise loans. Simply as a matter of financial survival, the bond bank will need to have good security on its loans and act to protect that security. There must be ongoing monitoring of borrowers' finances and financial operations. Monitoring will trigger enforcement of security provisions in loan contracts. The bond bank will need to take steps to gain as much assurance as possible of the viability of activities funded and its ability to access funds needed for debt repayment. The fruits of this will be improved local government financial management and financial reporting practices. A bond bank ownership structure that promotes on-going internal and external monitoring of operations is best. Exposure of the bond bank to market investor scrutiny is the best way to accomplish this objective.

Possible Threats Related to Ownership Structures

- *Avoiding Corruption*
  Corruption can invade all forms of ownership structures, but the question, is, which ownership structures resist corruption? Corruption is ultimately a societal issue that legal and ownership structures can make more or less likely, but it is either endemic to a political and financial system, or it is not. Corruption is acknowledged to be a major problem in Ukraine, which ranks low on the corruption perception index worldwide. Fundamental tactics to combat bond bank corruption include making the dealings of the entity as transparent and accountable as possible. These tactics will of course be directed by the bank's owners, and their effectiveness can be enhanced by designing the ownership structure to be corruption-resistant. An ownership structure that comprises multiple owners from different organizations and different sectors can induce owners to exercise oversight on one another. Private, international investors would bring extremely valuable discipline and oversight to the governance of a Ukrainian bond bank. Independent and qualified "public" governing board members who do not represent a particular ownership stake can also be considered.

  The fact that the bond bank will issue securities held by institutional investors is also an important deterrent to corruption. Bondholders invested in the bond bank's securities will be outside parties who depend on honest and efficient operation of the bank. Standard reporting processes and independent audits will help guard against corrupt behavior, and the lack of a sovereign guaranty should reinforce those requirements. If the bank eventually achieves sufficient sophistication to tap longer-maturity debt in the Eurobond market, it will have to meet international disclosure and credit rating norms.

  Competitive wages for bank employees and independence of operation will combat corruption, but at the end of the day, avoidance of corrupt behavior will depend on the culture of the bond bank and the character of its employees. However, there is no *a priori* reason to believe that corruption is more or less likely as a result of the ownership structure, since both private sector and public sector employees are equally liable to seduction.

- *Systemic investment risks (tariffs set by local radas; all cities rely heavily on Inter-governmental transfers)*

  An inherent problem in securing communal enterprise debt is that tariff policy is subject to local political decision, making it difficult for enterprises to react quickly to changes in their costs. A systemic risk for cities is that most local revenue sources are effectively beyond the control of the local government and local governments are heavily reliant on shared revenues and grants from the central government that are beyond their control. The danger is that changes at the national level will affect all local governments at the same time, causing a systemic risk that defies effective diversification. There can be some protections against this, the major one being to limit the proportion of transfers that can be pledged to debt service. In many counties (including the United States) transfer payments or a limited share of transfer payments that can be pledged to debt service is limited to 20 per cent or so of the total payments.[17]

- *Politicization of lending decisions*

  There may be a higher risk of politicizing lending decisions and terms where there is controlling government interest in the bond bank. This has not been the case on the United States, Canada or Western Europe, in large part because of the transparency of the institutions and the fact that subnational governments borrow in well-developed private capital markets.[18] Government institutions elsewhere that do not borrow in the private markets and are not accountable to them have succumbed to the "political imperative."[19] Private-sector involvement as an equity holder or asset manager will help insulate bond bank decisions from politics, but this is by no means assured. Involvement of an international financial institution can bolster the independence of the bond bank operation to avoid undue pressure. A foreign institution could participate as a partial owner of the bond bank, or as an asset manager, perhaps in co-operation with a Ukrainian bank. The risk of politicization may be reduced where different levels of government represented on bond bank governance have different perspectives on local borrowing. For example, the Ministry of Finance has a

[17] In the Philippines, no more than 20 percent of shared taxes in the form of transfer payments can be devoted to debt service. In the United States this is often expressed as a coverage ratio, which the number of times that debt service is covered by pledged revenues. A "five-times" requirement is fairly standard. The longer that a shared revenue/ grant program goes without major modification, the more it is accepted as a dependable source of revenues, as the coverage factor may be lowered. State payments to school districts have a long history of no severe cutbacks, which makes them very highly rated backing for local school bonds.

[18] Especially in the United States and Canada (and increasingly in Europe), the need to raise capital in the private markets and the role of the rating agencies has been critical to the transparency of the process, accountability, and lack of scandal in the markets. The threat of downgrading and the loss of a rating can be financial (and political) disasters. The privately owned rating agencies, meanwhile, have retained autonomy and credibility. Subnational governments are forced to face a hard budget constraint because of the rating system and their need to borrow in the private capital markets.

[19] This is a problem noted by international donor organizations that have supported on-lending operations that have not encouraged either private-market access or hard budget constraints. See Petersen (2005A)

strong interest in ensuring that local borrowing and guarantees are carefully controlled, while cities could be expected to favor relatively more permissive controls.

- *Changes in GOU political and legal environment adverse to local government creditworthiness*
  A potentially important role of the bond bank is to act as a sentinel for possible changes in national or local laws and regulations that would either diminish communal enterprise or city creditworthiness, or erode the quality of the bank's own obligations. So long as the bond bank is itself borrowing in the markets, it must abide by its debt contracts with investors. And so long as its own ability to live up to its own debt contracts is dependent on the quality of the underlying loans in its own portfolio, then it must be mindful of the quality of the underlying credits. This perspective will be reinforced by the lack of a sovereign guaranty and, also, by independence from dominant ownership by any single governmental level.

- *Reliance on market interest rates and maturities may make loans unaffordable*
  A risk for any institution that enters the domestic markets is that there may be times and circumstances that will make the loans it extends unaffordable to its market, in this case cities and their enterprises. This risk is largely unavoidable and has to do with the volatility of the domestic markets as opposed to any particular ownership structure. Although a state-controlled bank might have better access to subsidies to restore affordability and maintain its lending activity, the remedy is likely to be short-lived. High interest rates and unreceptive markets are a signal to shut down further growth in credit. This is applicable to both private and public lending. A bond bank per se cannot assure that markets will be accommodative or interest rates low. However, bond banks, because of their scale and sophistication, typically do have more options available to weather the storm and to sell debt instruments that can accommodate higher interest rate environments.

Summary Findings & Conclusions Regarding Bond Bank Ownership Structure in Ukraine

The above SWOT analysis has provided a detailed discussion of the various factors that enter into decisions regarding the ownership structure of a bond bank.

Following is a summation of these SWOT findings on what should be the general operating policies, powers and ownership structure of a Ukrainian bond bank:

- A key role for bond bank owners will be to invest sufficient core capital to enable the bank to build capital market confidence and borrow efficiently in its early years, while building a sound track record of prudent lending to cities and communal enterprises. It should increase leverage of equity over time.

- The bond bank's own creditworthiness and its transparent, objective lending criteria will be *critical*. The more creditworthy the underlying cities and utilities to which it lends, the more successful the bond bank can be in raising long-term funds at lower cost.

- The bond bank will be a focal point for local government financial expertise and for promoting reform in communal enterprise and city finance.

- A reserve or indemnity fund can protect investors who buy the bank's bonds. If the bond bank is properly and credibly designed and is itself creditworthy, then donor organizations can be counted upon to help fund such reserves.

- The bond bank structure must promote professional management, transparent operations, and its operation must be insulated from political pressure at both the national (state) and subnational (city) levels.

- The bond bank could be structured, if possible, to enable city governments and communal enterprises to make equity investments in the form of land holdings transferred to the bond bank.

- Special legislation would be highly desirable to establish the creation of the bond bank in order to clarify its public purpose, to establish the basis of its ownership, to provide it with appropriate corporate powers, and to create the required regulatory and tax treatments to facilitate its businesslike operation. Such legislation should be liberal in giving the bond bank powers to evolve over time as the Ukrainian governmental and financial structure evolves.

Recommendations

The bond bank's primary mission will be to lend on a financially sustainable, businesslike basis to communal service enterprises and cities for infrastructure. It would borrow in its own name in the capital markets without a sovereign guarantee.

1. These bond bank objectives can best be achieved with a mixed ownership model, with a balance of ownership shares distributed among 1) the state (national) government; 2) city governments and communal service enterprises that choose to invest in the bank; and 3) one or more private entities, most probably international finance institutions or European commercial banks with municipal finance expertise. A desirable ownership structure would be roughly one-third ownership: each by the state, by cities and communal enterprises, and by private banks/international finance institutions. This balance would incorporate state support and financial strength; city and communal enterprises, the bank's customer base; and private sector business discipline. Multiple owners from these three different sectors will create a counter-balance of different interests in bank governance. Checks and balances in governing authority will promote competent operation, transparency, and independence from political influence.

2. The bond bank will likely fall under the regulatory jurisdiction of the State Commission for Financial Services Markets Regulation. Appropriate regulations should be formulated as needed to accommodate its mission.

3. The bond bank should be designed to allow the contractual utilization of a private-sector asset manager.[20] Strong consideration should be given to using commercial banks as loan originators and loan servicers.

4. Bond banks usually have small staffs, and contract for legal services, loan servicing, and so forth. The design should reflect the need to hire a few very capable full-time staff to run its operations, market its services to local governments, and perform recurring loan administration services.

[20] An example of a contract oriented structure would parallel the mortgage bond structure now being developed by GOU with ATCI assistance

References:

Alberta Capital Finance Authority. *Annual Report 2003*. Edmonton, Alberta Canada

Genz, Richard. "USAID Access to Credit Initiative: Rapid Assessment of the Municipal Bond Component." Urban Institute (2004).

Kehew, Robert , Tomoko Matsukawa, and John Petersen. *Local Financing For Sub-Sovereign Infrastructure in Developing Countries* Infrastructure, Economics and Finance Department World Bank (February 2005)

Pascual, Alfredo *Promoting Private Finance of Local Government Infrastructure.* Remarks at Second International Conference on Financing Municipalities and Sub-national Governments Washington D.C. (October 1, 2004)

Petersen, John "*Municipal Bond Banks: Why they should be used in Transitioning Markets"* Paper presented at Subsovereign Finance in the New Europe Conference, Prague Czech Republic June 2002.

Petersen, John, and Mila Friere. "*Subnational Credit Markets in Developing Countries*." World Bank and Oxford University Press, Washington, DC. 2004.

Petersen, John. "Decentralized Credit Financing of Infrastructure in Developing Countries: An Assessment of Techniques" Report for the Urban Division. The World Bank, Washington DC July 2004.

Peterson, George "*Building Local Credit Systems*" International Studies, The Urban Institute, Washington, D.C. May 1997.

Peterson, George and Priscilla Phelps "*Municipal Credit Enhancement in South Africa: Strategic Opportunities for USAID*" (Task Order No. 800) USAID/South Africa. (Revised) April 1997.

Peterson, George. (2005) *Local Credit Systems for Municipal Environmental Infrastructure in Russia, Ukraine, Kazakhstan, and China.* A report to the OEDC (April 2005).

World Bank. "*Municipal Development Projects: Financing Local Development and Building Institutions*." Operations Evaluation Department, Washington, D.C. Number 178, Spring 1999.

World Bank, *Improving the Lives of the Poor through Investment in Cities*, Operations Evaluation Department, Washington, D.C. (June 24, 2002)

ANNEX A: Legal Format and Ownership Structures of Local Funding Agencies

Name of Bond Bank of Local Gov. Funding Agency	Legal Format	Ownership Structure
Credit Communal de Belgium	Bank (Public limited company)	Cities
KommunKredit Denmark	Credit Association	Cities and counties
Bank Nederlandse Gemeenten Holland	Statutory two-tier company	50% central gov't 50% cities
Kommunalbanken Norway	Special law since 1999; has government guarantee	80% central gov't 20% KLP (mutual pension and life ins. company for local gov't)
Nederlandse Waterschapsbank Holland	Bank which can lend only to public sector clients, or to clients whose loans are guaranteed by a public entity	81% local water boards 17% central gov't 2% provinces
Japan Finance Corp. for Municipal Enterprises	Government financial institution, has gov't guarantee	Government of Japan
Municipal Finance Authority of British Columbia Canada	Special law-"corporation without share capital;" independent organization operates like credit union; has power to tax property anywhere in the province	Governed by all regional districts of province; board members have votes proportional to district population. Regional districts have joint and several liability for each other's borrowings.
Kommuninvest Sweden	Joint stock company	Cities and counties own Kommunivest via a cooperative society; cities have "joint and several obligation" to pay loans.
Credit Local de France*	Specialized financial institution	8% Central gov't 12% Caisse des depots* 80% Private shareholders (*state-owned financial institution)
Municipality Finance PLC Finland	PLC; shareholding restricted to public entities; debts are guaranteed by state-created Municipal Guarantee Board	57.5% Cities and Ass'n of Local and Regional Authorities 42.5% Local Gov't Pension Fund Institute

*/ Replaced by the formation and privatization of Dexia in 1996.

Dexia- Europe	Bank focusing on municipal finance in several countries	Formed from Former state-owned systems. Private shareholders (including Caisse de Depot and some cities in Belgium)
Inca-South Africa	Special Purpose Vehicle	Private shareholders, as follows: 2% Chanson Investment 4.42% Dexia 17.68% FirstRand Bank Ltd. 4.95% INCA Share Inventive Trust 43.96% Kagiso Financial Svcs Ltd 26.98% Momentum Group
Tamil Nadu (India) Urban Development Fund	Trust created under India Trust Act of 1882	51% Tamil Nadu State Gov't 49% three private investors (asset managers)
Bond Banks in United States	Most US bond banks are independent authorities created by special state laws; some provide for state guarantee; some are part of a state agency or commission with other responsibilities.	Most are state-owned, and self-supporting with revenues from operations; and usually independent of state government
Local Government Unit Guaranty Corporation-Philippines	Private financial services corporation organized under Trust Act; does not lend, but guarantees municipal loans. USAID DCA program reinsures the company.	51% Association of Philippine Banks 49% public and private investors (including 25% ($1.3 million) from Asian Development Bank)

Sources: Bank websites; Moody's Investor Service reports; SEK Advisory Services/EBRD *Assessment of Transferability of Local Government Funding Agency Concepts to Ukraine and Romania,* 2005. John E. Petersen, *Analysis of State Bond Banks*. 1997. Table Provided by Richard Genz, March 15, 2005

ANNEX B: Illustrative Equity Gearing Ratios

Ownership and control of a corporation is usually evidenced by "equity," which is the residual interest in its assets and income after liabilities and the interest due on them have been accounted for. In a profit-making activity, increasing the value of equity and the income derived form it are the motivating factors in ownership. In governmental and non-profit activities, the "equity" interest has a public-purpose rationale. Control of management and policy decisions are associated with equity ownership. But, the nature of the organization, as well as limitations placed on the ownership by creditors, can limit the discretion of the equity owners. By the same token, the equity interests may be divided among various parties and itself by subject to limitations. Generally, majority ownership vested in a particular class of stock will determine operational and policy control. Thus, the majority owner will have control, but this control may itself be limited, depending on the details of the articles of incorporation.

Bond Banks can have several ownership structures (corporate forms). These can have a bearing on the significance of the equity component, which is typically a minor fraction of the overall capital raised. Below are illustrated some capital structures of bond-bank type organizations. The degrees of leverage (debt in proportion to equity) are illustrated.

Examples of "Bond-Bank-Type" Capital Structures and Leverage

INCA (effective gearing 22.8 to 1)
3,400 R assets
3,200 R. market debt
60 R. subordinated debt
140 R. equity and retained earnings

LGUGC (effective gearing: 6.3 to 1)
1,900 million Peso outstanding insured debt (contingent liability)
300 million P. paid in capital and retained earnings
250 million P. subscribed uncalled

Alberta Capital Finance Authority (effective gearing: 25.66 to 1)
4.00 billion C$ assets
3.85 billion C$ debt
0.15 billion C$ in equity and retained earnings

Tamil Nadu Fund (effective gearing: 3.7 to 1)
3500 Crore Rps. assets
2750 C. Rps debt (including World Bank loan)
750 C. Rps. in equity

Source: Kehew, Matsukawa, Petersen 2005

As may be seen, the leverage varies dramatically. Where there is a direct or de facto sovereign guaranty, there is high leverage (Alberta) where the underlying creditworthiness of the sovereign is very high quality. INCA, a private corporation, carries a high leverage, which is geared to the quality of underlying assets (it carries no sovereign guaranty). The developing country funds (India and Philippines) carry lower leverage ratios. The leverage will depend on the quality of the underlying loans and what reserves can be assembled to support the Bond Bank's debt.

Annex C: *Assessment of GOU Actions and Decisions Required to Establish Bond Bank*

(Prepared by the Access to Credit Initiative/USAID-Ukraine)

1. ESSENTIAL ACTIONS FOR IMMEDIATE STARTUP

A. Develop Consensus on Bond Bank Strategy

The Ministry of Construction, Architecture and Housing and Communal Economy, the Ministry of Finance, the Ministry of the Economy, and the Association of Ukrainian Cities will comprise the core group of key stakeholders in bond bank formation. With leadership of the Minister of Construction, this core group should agree on a broad action plan for bond bank development, beginning with agreement on an ownership structure as recommended in the John Petersen SWOT report.

B. Develop Business Plan

A detailed business plan should be prepared that addresses bond bank capitalization, financial management, lending and loan monitoring operations, marketing, staffing, contracting for services. The Access to Credit Initiative/USAID-Ukraine is available to provide technical assistance to the GOU in developing its business plan.

C. Evaluate Options for Immediate Formation of the Bond Bank Under Current Law

Because of the unique nature of the bond bank, special legislation and regulation should be the goal. However, it will be possible for the bank to begin operations on an interim basis under current law. A legal evaluation of the options should be undertaken as soon as the GOU makes a political decision to proceed with establishing the bank.

With the recommended mixed state/city/private ownership, it appears that the following interim legal structure for the bond bank might be appropriate:

Legal Status Under the Civil Code:	Legal Entity
Legal Status Under the Financial Services Law:	Financial Institution
Organized Under:	Company Law (Law on Business Associations) as Joint-Stock or Limited Liability Company
Founded by:	Decision of founders meeting (equity investors)
Regulated by:	State Commission on Financial Services Markets Regulation

D. Amend 2006 Law on Budget to Raise GOU Capital Stake in Bond Bank

Amend the 2006 State Budget Law, Line 54, and the related Cabinet of Ministers Resolution, and use a portion of the UAH 1 billion that is now earmarked for modernization of infrastructure as GOU equity investment in the bond bank.

E. Seek Equity Participation by International Finance Institutions, and Commercial Banks Specializing in Municipal Finance

Based on the interim legal structure agreed upon by the core group of stakeholders, and after securing firm investment commitments from the GOU and cities, the next step will be to secure additional equity investments or lines of credit from international finance institutions and commercial banks. Candidates include IFC, EBRD, Dexia, and Raiffeissen.

2. NECESSARY STEPS FOR OPERATIONAL SUCCESS

A. Enact Special Legislation for the Bond Bank

Lending exclusively to communal service enterprises and cities entails special and unique risks. There is no other financial institution in Ukraine that lends exclusively to communal service enterprises and cities, as the bond bank will do. The bond bank must be astutely regulated if it is to maintain the confidence of capital markets and accomplish its infrastructure finance mission in decades to come. Although the bank can start operation immediately under existing law, this should be considered an interim solution. Effective bond bank operations should be enhanced and protected by a legal and regulatory framework that fits the specific operational demands and risks of a prudently managed municipal finance facility.

Special legislation should be enacted to define the powers and fundamental operating principles of a bond bank, including: preservation of capital; earning market returns on capital; strong and transparent creditworthiness standards; financial sustainability; annual external audit; full operational independence; and authority to contract for services.

The State Commission for Financial Services Markets Regulation should enact special supervisory regulations for the bond bank in accordance with the special legislation, and taking account of the bond bank's unique business.

B. Enact the Law on Local Borrowings and Guarantees

The Ministry of Finance has formally asked for comment on the draft Law on Local Borrowings and Guarantees. Comments are due by April 6, 2006, and the draft law will probably be introduced into the Verhovna Rada in May 2006.

The law should promote and simplify responsible use of municipal guarantees for city-owned communal service enterprises. The current draft makes it doubtful whether such guarantees could practically be made.

The annual Law on State Budget should not prohibit cities from guaranteeing debts of creditworthy communal enterprises.

The law should provide GOU assurance to creditors that an approved local borrowing is valid under Ukrainian law for the full term of the borrowing. The enforceability of local loans and guarantees should be incontestable after the GOU has approved them.

There should be no pre-election bans on local borrowing, such as the current draft law's 12-month ban on local borrowing before any local election. A lending ban would require a bond bank to suspend operations. (Super-majorities to approve local borrowing in pre-election periods may be desirable.)

Provisions in the draft law that obligate local governments to repay debt and that give repayment of local borrowings legal priority over other expenditures should be retained.

Provisions removing the Ministry of Finance from evaluating creditworthiness should be retained.

A borrowing application should be deemed approved in the event that the Ministry of Finance fails to respond to an application within 10 days.

C. Change Legal and Regulatory Framework to Promote Creditworthiness of Communal Service Enterprises

To promote creditworthiness of communal service enterprises, implement full cost-recovery tariffs that automatically adjust for operating cost changes. GOU should allocate funding to pay debts incurred by state-owned enterprises to communal enterprises. Develop a mechanism to facilitate enforcement of the Law on Communal Services (2004) that requires cities to compensate communal enterprises for the difference between approved tariffs and full-cost recovery tariffs. GOU should initiate introduction of annual, external audit reviews of communal service enterprises.

D. Change Legal and Regulatory Framework to Promote Creditworthiness of Cities

To promote creditworthiness of cities, modify city revenue structure so as to increase the share of city revenue that can be modified by local radas. Stabilize the proportions of shared taxes. Restore the Budget Code's incentives for cities to promote economic development, increase local tax revenues, and retain the revenue increases generated by economic growth. Make equalization transfer grant formulas transparent. Suspend the State Treasury's practice of making medium-term loans to cities. Allow cities to maintain debt service reserve accounts in commercial banks. Institute transparent financial reporting standards and regular external audits for cities.