



# national treasury

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National Treasury  
REPUBLIC OF SOUTH AFRICA

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## BRIEFING NOTE

### The Role of Development Finance Institutions in Municipal Infrastructure Investment ('DFI Day')

#### in partnership with the Association for Savings and Investment South Africa (ASISA)

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#### BACKGROUND

1. The forthcoming update to the Policy Framework for Municipal Borrowing notes that a robust legal framework for municipal borrowing is now in place, and that municipal authority over land use decisions have been strengthened. Since the original policy framework was issued in 2000, additional municipal investment priorities have emerged, including expanding infrastructure to support economic and population growth, rehabilitating and replacing aging infrastructure, and promoting densification and spatial transformation to improve access to jobs, education, services and opportunities. In this context, the policy update notes that:
  - The identified need for investment in local infrastructure has grown significantly.
  - Public sector lending has grown faster than private sector lending.
  - National resources are under stress.
2. Government remains committed to the principles underlying the original Policy Framework. These include the following:
  - Creditworthy municipalities should borrow responsibly to finance capital investment and fulfil their constitutional responsibilities.
  - Municipal access to private capital, based on investors' evaluation of municipal creditworthiness, is a key to efficient local government and fiscal discipline.
  - Municipalities should borrow in the context of long-term financial strategies, which reflect clear priorities and the useful life of assets.
  - A sustainable municipal credit market includes the proper pricing of risk. Government does not support "soft" or subsidised loans to municipalities.
  - Investors whose funds are at risk have both the incentive and the means to limit or deny credit if there is doubt about the sustainability of proposed borrowing.
  - Neither national nor provincial government will underwrite or guarantee municipal borrowing. There will be no bailouts by national or provincial government.
3. To address questions that have arisen since the original *Policy Framework* was developed, the *Update* proposes the following policy decisions and clarifications;
  - a) **Government will remove DORA limitations on municipal pledges.** In recent years, the Division of Revenue Act (DORA) has contained language requiring the approval of the National Treasury to pledge conditional transfers for the purpose of securing a loan. This provision will be removed, so that municipalities may pledge grant streams, subject to the specific conditions of these grants.

- b) Project finance, revenue bonds and tax increment financing are all explicitly permitted,** subject to the terms of the *MFMA*. A municipality may find that it is useful or appropriate to pledge specific revenue streams to repay debt obligations, either to improve the creditworthiness of a particular debt issue, or to mitigate risks associated with general obligation borrowing. A municipal council considering ring-fenced financing or spatially targeted investments should solicit public input on the potential impacts, including impacts related to inclusiveness.
- c) Government encourages public and private efforts to support a liquid secondary market.** Approaches that may have merit include the following:
- Metros may want to position their bonds as similar to sovereign bonds, given that municipalities have permanent existence and taxing powers. In these respects, municipalities differ to corporate issuers. Debt payment structures that replicate RSA bond issues may be most attractive to investment managers.
  - Financial institutions may want to explore standardisation of municipal debt instruments and supporting documentation. This could reduce transaction costs and increase liquidity.
  - All lenders, including commercial institutions and DFIs, should consider originating new municipal lending in the form of bonds. These bonds can be held or sold as capital and liquidity needs evolve.
- d) The role of DFIs be clarified.** Public-sector lenders, both domestic and foreign, should be guided by a social and developmental investment approach, in which demonstrable social outcomes are considered alongside potential financial returns. One or more development objectives, and appropriate indicators, must be agreed in advance of DFI lending, with National Treasury and any proposed municipal borrower. This can be done on an annual or programmatic basis. Credible metrics and independent annual reviews will be required throughout the term of any loan.
- e) Pooled finance arrangements are explicitly addressed.** Any pooled financing mechanism must be structured to avoid assumption of credit risk by one municipality on behalf of another. Correctly structured, pooled finance and intermediation can help small creditworthy municipalities access affordable credit. Poorly structured, pooling can create inappropriate risks. Two principles should therefore guide any proposals for pooled finance: first, the mechanism must not be used to make credit available to municipalities that are not creditworthy; and second, no municipality should be at risk of becoming responsible for any debts of another entity.

## **PURPOSE OF THE DAY**

4. A Municipal DFI Day has now been planned, building on the success of the Urban Investment Partnership Conference (August 2015) that launched the Policy Update and led to the formation of the Urban Finance Working Group,. This will also provide an opportunity for DFIs and private financiers to learn about progress made by cities in developing their strategic (or “catalytic”) investment programmes - aimed at guiding and stimulating a change to the spatial form of cities
5. The purpose of the DFI Day is to:
  - **Clarify the developmental role of DFIs**, in the context of the proposed revisions to the Policy Framework for Municipal Borrowing and Financial Emergencies;

- **Provide a platform for DFIs**, both local and international, to showcase the specific financial products and services (preparation support, credit enhancement and first risk positions, technical assistance, etc.) they have on offer to support of investment in municipal infrastructure in South Africa, in order to enable both private financiers and municipalities to:
  - Identify potential partnerships with DFIs in funding municipal investment programmes; and
  - Fully understand the pre-conditions DFIs require to qualify for funding, be it of a grant, concessional or commercial nature.
- **Workshop strategies for preparing and funding programmes or projects that “crowd-in” private sector investment**, ensure sustainable project development across the value chain, and / or assist in developing the overall market for municipal borrowing, including:
  - Identifying potential pilot projects between municipalities, DFIs and the private sector.
  - Setting the scene for bi- and trilateral meetings to follow on from this event.

## MAIN EVENT TOPICS

6. The main topics will include:
  - a) An introduction on the need for new approaches to urban infrastructure investment and partnerships, with a focus on a new role for DFIs as intermediaries in crowding in private sector;
  - b) A review of the Local Government Fiscal Framework and updates to the Policy Framework for Municipal Borrowing and Financial Emergencies;
  - c) An opportunity for DFIs to outline their country strategies and specific existing or new product lines / instruments and services they have available that would support this;
  - d) Sharing of any Green Finance initiatives or possible areas of intermediation, and potential for product standardization and or blended finance;
  - e) An opportunity for cities to showcase their strategies and particular programmes or projects with potentially relevant financing needs;
  - f) An opportunity for participants to seek to apply product lines to specific programmes or projects under consideration by municipalities; and
  - g) Commentary on best practice and new trends in financing instruments.
7. Discussions from the Day will be recorded and disseminated, with a particular focus on (i) mapping the strategies and instruments available from DFIs and (ii) facilitating discussion between private financiers, DFIs and municipalities on a bi and trilateral basis.

## PROVISIONAL AGENDA

8. The provisional agenda for the Day is as follows:

Time	Item	
09h00	Welcome and objectives for the day	Adré Smit (ASISA)
09h30	Setting the scene and explain the day	Malijeng Ngqaleni (NT)
09h45	Municipal Borrowing: progress and prospects	Judy Mboweni (NT)
10h00	The role of DFIs	David Savage (NT)
<b>10h45</b>	<b>Tea (foyer area)</b>	All
11h00	Plenary Panel Discussion (IFC, AFD, EIB, KFW, DBSA on facilitated panel discussion)	David Savage (Facilitator) and

	<ul style="list-style-type: none"> <li>Participants to note specific question to ask in DFI Speed dating</li> </ul>	Camille Chastagnol (AFD) Jan Martin (Kfw) Tom Anderson (EIB) Soumya Banerjee (IFC) Mohan Vivekanandan (DBSA)
12h00	<b>DFI speed dating (5 tables)</b> 1 <sup>st</sup> DFI visit (30 mins) 2 <sup>nd</sup> DFI visit (30 mins) 3 <sup>rd</sup> DFI visit (30 mins)	All
13h30	<b>Lunch</b>	
14h00	<b>Metro speed dating (8 tables)</b> 1 <sup>st</sup> municipal visit (40 mins) 2 <sup>nd</sup> municipal visit (40 mins) 3 <sup>rd</sup> municipal visit (40 mins) 4 <sup>th</sup> municipal visit (40 mins)	DFIs and financiers visit metro tables
17h00	Closure and networking	NT / ASISA

## PREPARATION REQUIREMENTS

### DFI preparations

9. Participating DFIs are requested to make the following preparations prior to the Day

**a) Plenary answers to be prepared:**

- Outline the top 5 challenges you have encountered with municipal funding and how you would like to see this addressed
- Do you have any target programmes or funding product lines that can be applied to municipalities to address these challenges
- Make reference to a case study to outline how you have crowded in private finance which could also include past or current projects being supported
- Explain any innovative products and new ideas that you have or are going to use to facilitate blended finance or credit enhancement in the sector (including any green finance initiatives)

**b) Finalise a brochure/hand-out that addresses:**

- Strategies
  - Internal Strategy(ies) and policies for municipal funding
  - Strategies to "crowd in" of private sector
- Products/Instruments
  - Existing programmes or products in the municipal funding space
  - Target programmes/ funding product lines
  - Innovative products and new ideas - approach to blended finance/credit enhancement
  - Green finance initiatives
  - Project preparation funds
  - Non-financial support (example – Technical/advisory support)
- Other

- Primary interest/mandate clarification
  - Funding limits (term, amounts etc.) and Application procedures
- c) **Review municipal snapshot of pilot projects in order to facilitate discussion in speed dating events. After receipt of municipal pilots, indicate by 28 February 2018 which metros they want to go see on the day.**

### **Metro/municipal preparations**

10. Participating metropolitan municipalities are requested to make the following preparations prior to the Day:

- a) **Prepare a planned project snapshot to be handed in by 24 February 2018 addressing at least:**
- Brief programme or project description (including strategic context, size, area, technical specifications, structure, etc.)
  - Outline the funding strategy (internal and external sources in detail)
  - How you plan to address maintenance and rehabilitation to decrease high replacement costs and ensure sustainability
  - Outline repayment strategies
- b) **Prepare names of 3 DFIs you want to visit on the one-on-ones and list questions or discussion points for purposes of the one-on-ones (speed dating) with the DFIs. To be submitted by 24 February 2018.**