STORKEY & CO

MANAGEMENT CONSULTANTS

LOCAL GOVERNMENT FUNDING AGENCIES

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SUBNATIONAL OR LOCAL GOVERNMENT FINANCING

With a global push for fiscal decentralisation, central or federal governments are requiring subnational or local governments to have more autonomy and are being given the role of meeting some of the country's infrastructure development requirements, particularly if it falls within the jurisdiction of the subnational or local government. This has necessitated the need to finance infrastructure projects, primarily in the domestic market due to prohibition or restrictions on external borrowing. The dilemma this presents to subnational or local governments is the resources and capacity needed to access the local market, particularly where borrowing costs can be lower through issuing securities rather than taking loans or credits from commercial banks.

Establishing a government securities or bond program can be time-consuming, particularly if it is necessary to maintain a credit rating and for maintaining an investor relations program with frequent contact with financial institutions and end investors. For large and well-established subnational or local government treasury or finance operations, there are more resources that are more likely to have the skills and expertise to manage a bond issuance program. Moreover, the financing requirement may be larger necessitating more frequent and regular bond issuance in the market. The smaller subnational or local governments will find it more difficult and the cost may be higher. To overcome these difficulties, some countries have established a Local Government Funding Agency (LGFA). This note provides details of LGFAs that have been established with links to their respective websites.

WHAT IS A LGFA?

A LFGA is a financial institution that serves as a vehicle for local and regional authorities such as municipalities, local and regional governments to access capital markets for the purpose of jointly procuring credit for public investment projects. The local and/or regional authorities of a country own the LGFA, sometimes with a minor ownership by the state or central government. It works as a co-operative agency where the participating authorities come together in order to ensure low interest rates on loans, based on the creditworthiness of the participating members. This co-operation can also help the local authorities to achieve a higher credit rating than if they act independently. The LGFA normally does not seek to make profits and any surplus is usually reinvested in the activities. LGFAs exist and operate within the borders of the respective countries where they are based.[1]

Although the term 'Local Government Funding Agency' is often used, these agencies have also been called 'Local government collective agency' and 'Municipal bond bank' as well as 'Agence de financement des collectivités locales' (French) and 'Kommunalen Finanzagentur' (German). LGFAs work solely (with lending) within the borders of their respective countries.

[1] Refer to http://en.wikipedia.org/wiki/Local_Government_Funding_Agency

Why Create a LGFA? [2]

An issuer of bonds in the financial markets needs to have a large borrowing requirement in order to:

- digest the transaction costs related to each bond issue, such as marketing, rating and legal support.
- supply the markets with liquid or benchmark bonds, which means that each issuance must be of a significant amount.
- be able to be a frequent borrower in the market, so that the markets will be acquainted with the issuer and price the bonds appropriately.

Furthermore the borrower needs to have considerable knowledge of the functions of the market and of the different financial instruments.

The rationale behind establishing LGFA's are:

- Local authorities are by matter of definition small entities. Small borrowers – like small and medium sized municipalities – get less attention from banks and capital markets than big borrowers. This means that a large part of the financial markets are closed to small borrowers, whether they are public or private entities.
- A LGFA is potentially better equipped to market local government risk to the investors in the capital markets.
- Processing costs for pooled financing are considerably lower than if the local entities borrow on their own.
- Local governments often play crucial roles in the public sector of a country and has the potential of having high creditworthiness, especially if they cooperate in a LGFA.
- Financial expertise is often low in local authorities since their primary focus is on providing appropriate basic services to the public. The administrative staff of a local authority is often of a rather modest size.

LGFAs Worldwide

The following provides information on LGFAs or similar entities that have been established worldwide along with their respective websites.

- Municipality Finance of Finland (*link*)
- Kommuninvest of Sweden (*link*)
- Kommunekredit of Denmark (*link*)
- Nederlandse Waterschapsbank of Holland (*link*)
- Emissionszentrale der Schweizer Gemeinden of Switzerland

[2] Refer to http://www.maproductions.se/?page_id=479

- Cassa del Trentino of Italy (*link*)
- Municipal Finance Authority of British Columbia, Canada (*link*)
- The Alberta Capital Finance Authority, Canada (*link*)
- Municipal Bondbanks of the US (*such as Maine Municipal Bond Bank, Vermont Municipal Bond Bank, Sunshine State Governmental Financing Commission and others*)
- New Zealand Local Government Funding Agency Ltd (*link*)
- Japan Finance Organization for Municipalities (JFM, *link*)
- KBN (Kommunalbanken Norway, *link*) could also be placed in the category of municipal funding agencies although it is owned by the state.
- BNG (N.V. Bank Nederlandse Gemeenten, *link*) has many of the characteristics of a municipal funding agency, but there is one mayor deviation; they are engaged in lending to project outside of the Netherlands. This means that they are involved in business that can be compared to ordinary banking business.

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