SEK

ADVISORY SERVICES

How can a Serbian Municipal Bank can help solve major challenges?

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Serbia’s economic challenges

- High unemployment, especially among young population
- Skilled and educated workforce emigrating
  Uneven regional development throughout country
- Need to invest in wastewater, water, district heating, landfills, biogas, efficient transport infrastructure
- Need to stimulate economic growth through FDI, tourism and exports

Efficient financial solutions drive economic growth

- Big infrastructure, exports and urban development need long-term funding
- Infrastructure in urban areas needs to be locally managed but based on national priorities
- Funding from IFI's & EU require efficient and transparent procurement skills
- Projects must be financially feasible and efficiently implemented
- Financial skills need to be learnt and best practices replicated
- Projects need skilled labor force and vitalize all sectors of economy

The Nordic countries are not well endowed

How is it possible to have a successful economy when the odds are stacked against them?

- Small populations
- Found in isolated and wide geographical areas
- At least 6 months of freezing weather
- High taxes…

So why are we successful?

- World class export companies that account for roughly half of GDP
- Excellent infrastructure - roads, rail, air, ports and power transmission
- Highly-rated schools and universities, excellent health care, functional social housing
- AAA-ratings even through the financial crisis
- Reasonable levels of public debt as % GDP

Good financial management at regional level is the key

- Good infrastructure produces economic growth and that needs capacity at the level of local government
- In all four countries, much of the basic infrastructure is provided by and mainly paid for by local governments (cities and municipalities) as opposed to the central government.
- Central government normally contributes to a minor part of the investment and operating costs through grants and subsidies
- The remaining costs must then be covered with tax revenues, user charges and by borrowing.

Local government must finance infrastructure

- Infrastructure requires professional procurement skills for works, supplies and financing these projects
- Finance must be cost-effective and long-term
- Financing must be easily available, secure and transparent
- Cities and government need cost effective access European development funding sources – EIB and COE Development Bank
- There must be open and strong competition for financing

Financial and procurement skills at local level

- Only a few large regional governments or cities in developed countries have good access to the bond markets like their central governments.
- Few local government entities in developed countries have the necessary resources, skills and volumes to operate in these markets.
- They have therefore innovated by creating their own surrogate agencies, LGFA to finance this infrastructure and by developing more efficient contractual arrangements for infrastructure procurement

What is a LGFA?

Local authorities set up a joint funding vehicle with or without central government to handle following:

1. Employs a small professional staff
2. Secures a sovereign-like rating – normally AAA/Aaa
3. Markets to investors at home and abroad
4. Issues debt on the capital markets
5. Intermediates European development funding programs
6. Makes long-term loans ONLY to its members
7. Manages all related risks professionally
8. Covers operating costs with profit cushion to sustain long-term development and high rating

Observed changes after when LGFA established

- Huge cost reductions in financing costs
- Competition is boosted and bank cartels are weakened
- Facilitates strong improvements in the municipal creditworthiness by replicating best practices
- LGFA is a knowledge centre
- Contracts for finance and for works/supplies are separated and thus more transparent
- LGFA is resilient in financial crisis – funding secure at all times

How can this be applied to Serbia?

- The government and the largest cities (Belgrade, Novi Sad, Niš etc) in Serbia need to take the initiative to consider establishing a LGFA
- A solution suitable to Serbia legal framework and special needs to be established but shareholders could include the largest cities, other parts of regional government and central government
- Such an endeavor could start with the regions and encompass the whole country over time
- Constitution could be based on law or on voluntary cooperation
- Need to work on a long-term plan together with strong banks located in Serbia and with International Financial Institutions

Developing urban infrastructure responds to the Serbian challenges

- Reduces unemployment, especially among young population
- Skilled and educated workforce emigrating
- Uneven regional development throughout country
- Need to invest in wastewater, water, district heating, landfills, biogas, efficient transport infrastructure
- Need to stimulate economic growth through FDI, tourism and exports

LGFAs have operated for over 200 years

- 1816 - French Caisse de Dépot, France
- Mid-19th century - Landesbanks established, Germany
- 1860 - Crédit Communal de Belgium, Belgium
- 1898 - KommuneKredit, Denmark
- 1914 - Bank Nederlandse Gemeenten (BNG), Holland
- 1926 – Kommunalbanken, Norway
- 1954 - Nederlandse Waterschapsbank (NWB), Holland
- 1957 - Japan Finance Corporation for Municipal Enterprises, Japan
- 1970 - The Municipal Finance Authority of British Columbia, Canada
- 1973 - Municipal Bond Banks of Maine, USA (one of many Bond Banks)
- 1986 - Kommuninvest, Sweden
- 1989 - Municipality Finance Plc, Finland

1989 Municipality Finance, Finland

1987 Crédit Local de France

1954 Nederlandse Waterschaps-bank, Holland

1860 Crédit Communal de Belgique, Belgium

1898 Kommune-Kredit, Denmark

Over 15 Regional Bond Banks in US

1914 Bank Nederlandse Gemeenten, Holland

1986 Kommuninvest; Sweden

1926 Kommunal-banken, Norway

1970 Municipal Finance Authority of British Columbia, Canada

1957 Japan Finance Corporation for Municipal Enterprises, Japan

State Treasuries in all Australian States

Kommuninvest is huge success

- 25 years of operation with 1% cost reduction on loans has led to significant savings
- Total lending of SEK 135 billion saved the municipalities SEK 1.35 billion.

Government bond markets

- All government bond markets operate in the same way
- Bonds issued in standard form with lowest possible costs
- Governments issue general debt obligations
- Interest payments are taxable for investors
- Treasury responsible for debt management with requisite skills
- Large bond issues issued through primary dealers with active secondary markets providing liquidity

LGFA

- Do not seek to maximize profits – low margins
- Have potentially a near-sovereign rating
- Issue bullet bonds and on-lend with annual repayment structure
- Have skilled financial staff
- Create and maintains healthy competition

Start up problems

- Banks protect their ”own market position”
- Bureaucratic obstacles
- Initial unwillingness of local government to cooperate

LGFA works fine in AAA environment, but could it also work here?

Yes…

Especially in times of economic challenges and when development infrastructure is of high priority and the central government want to reduce grant funding and create financial discipline.

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SEK Advisory Services

- SEKAS has expertise, innovative solutions, experience and integrity to bring infrastructure projects from vision to bankable projects.
- Our advisors have international reputations and networks for infrastructure, energy, utilities, environmental, telecoms sectors.
- SEKAS has brought projects to successful implementation under the most difficult conditions, not only in the comfort zone of Europe.
- We can bench-mark and bring best practices adapt them for local conditions.
- Whatever know-how and expertise our projects and clients may require, we will find them.

Nicholas Anderson

Executive Director, SEK Advisory Services

- President & CEO of Municipality Finance Plc, Finland 1991 – 2000
- President of the European Association of Public Banks 1999 – 2000
- Leading expert on financing infrastructure for public and private sectors
- Some 40 years in banking and finance from London, New York, Paris, Singapore, Helsinki and Stockholm
- Published four books on banking and Investment
- Regular speaker at international Financial conferences for Euromoney

Innovations in Financing Public Services

Country Case Studies

Nicholas Anderson, contributed one chapter to this book.
Edited by Professor Stephen J. Bailey, **Glasgow Caledonian University**
Published in London by **Palgrave Macmillan**, August 2010

Local Government Funding Agencies in Ukraine and Romania

SEK Advisory Services appointed as an advisor to support the European Bank for Reconstruction and Development in starting up Local Government Funding Agencies in Ukraine and Romania

Client:	European Bank for Reconstruction and Development
Country:	Ukraine and Romania
Purpose:	To assess the transferability of the Local Government Finding Agency (LGFA) Concepts to Ukraine and Romania
SEK role:	Financial advisor
Period:	Apr – Oct 2005

Project Highlights:

- A Local Government Funding Agency (LGFA) is an innovative vehicle through which municipalities can access cost-effective funding in the capital markets by pooling risks.
- Great success for the concept in the Nordic countries, where local governments account for approximately 70% of public spending.
- SEK Advisory Services appointed as a financial advisor for the assignment which includes:
  - Determination of the specific success factors (operational, financial and legal) of the Nordic LGFAs, including explicit and implicit sovereign support;
  - Assessment of the operational, financial and legal parameters of other emerging markets for a local government funding approach;
  - Outlining of possible lessons learned from the Ukrainian and Romanian cases;
  - Review of the Ukrainian and Romanian local government context to assess which elements could be transferred and applied in Ukraine and Romania;
  - Outlining the legal, operational and institutional requirements for a start-up operation to set out the support needed from central government and from EBRD to ensure financial and operational success.

Project Results and Innovations:

- Groundbreaking work with the aim of ensuring that important municipal investments can be carried out through accessing low-cost funding in the capital markets.
- SEK Advisory Services recommended a number of tangible steps to be taken in forming a successful LGFA in Romania.
- Due to the political climate prevailing in Ukraine at that time, it was deemed too early to take the next steps in establishing an LGFA.

Local Infrastructure Financing through Commercial Banks, Croatia

SEK Advisory Services appointed as lead consultant by the European Bank for Reconstruction and Development to advise commercial banks in Croatia for financing local infrastructure projects

Client:	European Bank for Reconstruction and Development
Country:	Croatia
Purpose:	To support Croatian municipalities in gaining access to funding for investments in local infrastructure projects
SEK role:	Financial advisor
Period:	Sep 2003

Project Highlights:

- The assignment is a part of an initiative by the European Commission to support Croatian municipalities in gaining access to funding for investments in local infrastructure projects.
- Envisaged infrastructure investments include water supply, wastewater treatment and sewerage, solid waste management, district heating systems, roads, parking, traffic management, public transport and rolling stock.
- SEK Advisory Services was appointed lead consultant for the assignment to provide technical assistance to Croatian commercial banks in strengthening their expertise in municipal lending operations.
- Work includes:
  - Specialist assistance in reviewing municipal lending operations;
  - Drafting of municipal credit strategy;
  - Processing borrower credit applications;
  - Appraisal of investments projects;
  - Credit-worthiness assessment;
  - Training.

Project Results and Innovations:

- Challenging financial environment: small municipalities and undeveloped banking standards.
- A EUR 20 million municipal finance facility through Zagrebacka Banka was established by EBRD.

Debt Management Programme for the City of Kazan, Russian Federation

SEK Advisory Services appointed to assist the City of Kazan in introducing debt management policies and procedures based on international best practice and forecast the city's future financial performance

Client:	City of Kazan & EBRD
Country:	Republic of Tatarstan, Russian Federation
Purpose:	Introducing international best practice debt management
SEK role:	Financial advisor
Period:	Sep – Dec 2007

Project Highlights:

- During the refurbishment of the City of Kazan, with a population of 1.1 million, the City's borrowing capacity reached its ceiling, limiting its future borrowing capability.
- In order to improving its creditworthiness and borrowing capacity, the City wishes to introduce debt management policies and procedures based on international best practice, while considering local legal and other statutory requirements.
- SEK Advisory Services has been appointed to assist the City in reaching its debt management objectives. Specific tasks include:
  - Developing a financial model for the City budget;
  - Forecasting the financial performance and the financial debt of the City for a 10-year period;
  - Reviewing the City's system of managing debt and contingent liabilities;
  - Developing the borrowing capacity profile of the City;
  - Developing recommendations on forecasting and funding cash gaps;
  - Training the City staff in the use of the financial model and debt management systems;

Project Results and Innovations:

- A comprehensive but flexible and easy to use financial model was developed for the City;
- A debt management policy was established which will greatly enhance the city's debt management and improve its creditworthiness;
- Staff were extensively trained through workshops and a debt management handbook.

Creditworthiness Enhancement Programme, Ivano-Frankivsk, Ukraine

SEK Advisory Services appointed to develop and implement a Creditworthiness Enhancement Programme for the City of Ivano-Frankivsk, Ukraine

Client:	City of Ivano-Frankivsk
Country:	Ukraine
Purpose:	Creditworthiness Enhancement Programme to enable modernisation and rehabilitation of municipal district heating infrastructure
SEK role:	Financial Advisor
Period:	April – July 2010

Project Highlights:

- SEK Advisory Services has been contracted to assess the City of Ivano Frankivsk's current financial standing and develop and implement a realistic Creditworthiness Enhancement Programme (CEP).
- The aim of the CEP is to improve the City's financial and capital budgeting management, so as to improve its creditworthiness, and therefore improve its ability to attract and manage investment finance in the future, as well as provide meaningful financial guarantees to its subsidiary companies.
- The City needs to improve its creditworthiness in order to secure financing needed to support the rehabilitation and modernisation of the municipal district heating infrastructure.
- The assignment is divided into two phases:
  - Phase 1: Assessment of the City's financial standing and development of the CEP, including:
    - Assessment of the current financial standing of the City and its financial planning;
    - Treasury and debt management;
    - Budget management and financial reporting;
    - Capital investment planning;
    - Asset management;
    - Municipal service delivery;
    - Management information system.
  - Phase 2: Implementation of the CEP

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