



Impact Capital
for Development



POLICY BRIEF

Local Government Finance is Development Finance

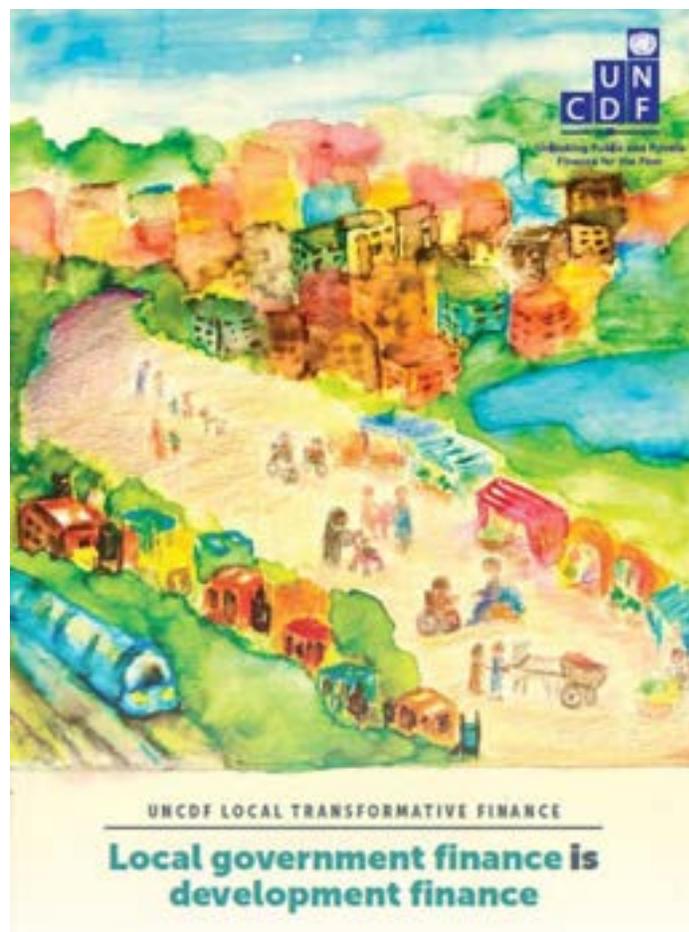


Why Local Government Finance is Development Finance

Development finance is about sustainably paying for social and economic transformation, which requires three types of transition: 1) **urban transition** from rural to sustainable urban spaces; 2) **green transition** from unsustainable to clean development; and 3) **productive transition** from low to high productivity level. Against the backdrop of urbanization trends worldwide, the urban transition requires sufficient investments to drive productivity and improvements in socioeconomic conditions.

However, this is the most underfunded transition, resulting in towns and cities that are neither environmentally sustainable, nor productive, nor advancing social progress. The climate crisis connected to the green transition makes it relevant for developing countries that have already reached 80% urbanization level, but still need to urgently upgrade their built environment to reduce emissions, adapt and build resilience

The productive transition requires a shift to more efficient public and private institutions, increased fiscal space, and deeper domestic capital markets. This is often characterized by agricultural processing, manufacturing and urbanization, and increases in fixed capital formation and in fiscal space as a proportion of gross domestic product (GDP) are indications of the transformation.



Therefore, it is key for all countries to consider planetary health alongside productivity and define development through a green transition by focusing on sustainability and recycling, alternative sources of energy to reduce emissions of greenhouse gases that fuel climate change, public transportation instead of private cars, preservation of water and soil resources, and biodiversity.

These three transitions are intertwined with one another, and without advancing them simultaneously, our home on the planet becomes a dangerous place for survival. This amplifies the urgency of a financial ecosystem that works for cities and local governments, so they can be not only a unit of analysis, but the essential unit of action toward a more productive, green, and inclusive future.



To this end, the Malaga Global Coalition for Municipal Finance led by UNCDF and the United Cities and Local Governments (UCLG) promotes a global financial ecosystem that works for cities and local governments.

The coalition aims to equip subnational governments with financial and technical support to realize their full potential in the provision of sustainable public services and infrastructures to drive the required transformation.

UNCDF's flagship publication, **“Local Government Finance is Development Finance”**, argues that the current global financial ecosystem is not working for cities and local governments, and therefore, it puts forward the Malaga policy agenda as a solution, which includes the following five elements:

Five Key Elements:

- 1 Intergovernmental fiscal transfers
- 2 Own source revenues
- 3 Domestic capital market for long-term debt financing
- 4 City-friendly investment funds
- 5 Global guarantee fund for cities



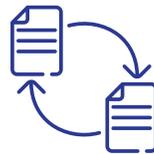
This policy brief aims to provide a high-level summary of this publication and its key findings, with a strong emphasis on the resulting policy and practical advice aligned with the Malaga Global Coalition agenda.

The brief defines the five elements of the Malaga policy agenda and their associated significance in achieving development finance, typical bottlenecks faced by subnational governments in the five policy areas, and concrete solutions followed by cases from different countries.

The policy brief calls local leaders, country-level decision makers, and international stakeholders for urgent action to leverage the Malaga agenda as a guiding framework for making the global financial system work for cities and local governments.



Unlocking the Potential of Intergovernmental Fiscal Transfers



I. Why Are Intergovernmental Fiscal Transfers Important?

Intergovernmental fiscal transfers (IGFTs) from the central to local government are the most important source of revenue for local governments in all countries, including rich and poor countries at both urban and rural levels. According to a review of 96 countries, IGFTs constitute over 50% of total revenues of local governments, which illustrates the significance of IGFTs for subnational governments (SNGs) and the associated development implications. Effective IGFTs allow SNGs to deliver efficient and equitable public services, respond to global challenges at local level, such as climate change, and achieve development goals. This is because SNGs have both the mandate and comparative advantages to determine solutions tailored to local circumstances and adapt to external changes. The COVID-19 pandemic was a clear example of how targeted but fungible, discretionary IGFTs can equip local governments with the power to effectively respond to an unexpected challenge. However, IGFTs remain as an untapped potential for development finance at the local level, especially in low-income countries.



II. What Are the Typical Bottlenecks?

Despite the importance of IGFTs, many developing countries face common challenges with designing and implementing effective IGFT systems, including:

Transfer size:



Transfers are often only \$1-\$2 per capita on average, which does not allow SNGs to deliver a meaningful level of local services. This is often exacerbated by the high costs of achieving service standards, salary increases, and unfunded or underfunded mandates. While there is no best practice for the size of transfers given it depends on a specific context, it is key to ensure predictability and security for regular transfers to local governments. For example, safeguarding grant size in the medium term or providing a clear framework for adjusting transfers against tasks could provide some level of predictability and stability for SNGs to plan accordingly. Another practice is to determine up-to-date expenditure needs and provide rough estimates based on reliable data, which was successfully carried out in Indonesia and the Philippines.

Distribution criteria



A lack of clear, transparent, and consistent systems for determining allocations can cause disparities across territories, reward poor performance in service delivery, and disincentives for local revenue mobilization and expenditure management.

It is important to base grants on a clear set of criteria by factoring in the revenue potential and expenditure needs and costs of local governments. Best practices from Viet Nam suggest that allocating transfers based on service delivery outputs can also lead to more positive incentives for better performance.

Transaction costs



Fragmentation of funding via multiple earmarked schemes can overwhelm SNGs and cause high transaction costs associated with grants management. These can be reduced by using a common reporting and monitoring system across national and subnational governments, and selecting a limited number of transfers by focusing on strategically important grant streams. For example, Denmark distributes a balanced combination of block grants and targeted earmarked grants in the areas of national priorities, which allows them to minimize transaction costs and increase efficiency.

Interference level



Excessive control by the central government will harm budget autonomy and flexibility at the local level, which would eventually harm the quality of public services being delivered to citizens. Finding the right balance between giving SNGs discretionary power and minimizing the risk of bailouts should be carefully planned by national governments. For example, in China, they use a combination of general and specific grants, which ensures local-level discretion while still pursuing national targets.

III. Examples of Effective IGFTs

Well-designed IGFT systems can help build trust in local governments, and shift from vicious cycles of deteriorating local governance to virtuous ones of performance improvement. The IGFT system should be managed efficiently in terms of predictability, timeliness, and transparency of fund allocations and be well-coordinated across government agencies. Here are success stories from the LoCAL global initiative with a spotlight on the country case of Solomon Islands, which promotes strategic use of IGFTs for development finance at the local level.

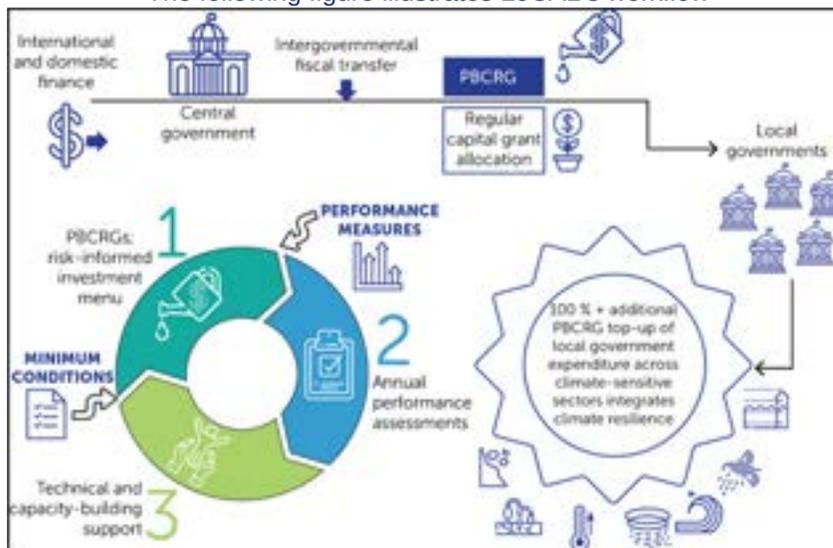
The Local Climate Adaptive Living Facility (LoCAL) was designed in 2010 and launched in Bhutan in 2011 by UNCDF to promote climate change–resilient communities and local economies. LoCAL serves as a standard and internationally-recognized country-based mechanism to channel climate finance to local government authorities in least developed countries.

LoCAL increases awareness and capacity to respond to climate change at the local level, integrates climate change adaptation into local government planning and budgeting systems in a participatory and gender-sensitive manner, and increases the amount of finance available to local governments for climate change adaptation. LoCAL combines performance-based climate resilience grants (PBCRGs) with technical and capacity-building support. PBCRG can be seen as a targeted cross-sectoral grant with conditions attached to the use of its funding for climate change adaptation beyond business as usual. Combined with regular allocations, PBCRGs enable investments in climate-sensitive sectors to become climate resilient over time.

The Local Climate Adaptive Living Facility (LoCAL)



The following figure illustrates LoCAL's workflow





• LoCAL's notable achievements so far include:

- LoCAL has engaged more than 320 local governments in 17 countries since 2014, representing over 12.5 million people. Another 15 countries have expressed interest in joining LoCAL, which brings the total number of country reach to 32. With these total engagements, the potential scale-up is half a billion people.
- Since 2014, LoCAL has mobilized more than US\$125 million from own resources, donors, and parallel funding from governments.
- The LoCAL Ambassadors' group was formed, comprised of Ministers of Environment from ten LoCAL member countries, who are committed to taking a lead role in advocating for the LoCAL mechanism.

Solomon Islands is a clear example of how LoCAL supports local governments to reform their IGFTs toward higher performance, shifting away from random, negotiated transfers to formula- and performance-based transfers. The system consists of two main grants: a recurrent grant and a capital grant, and in 2013, the annual capital transfers increased from around \$2 to around \$4–6 million in 2020.

LoCAL expansion map:





Leveraging Own Source Revenues to Realize the Power of Local Governments

I. Why Is Optimizing Own Source Revenues Important?



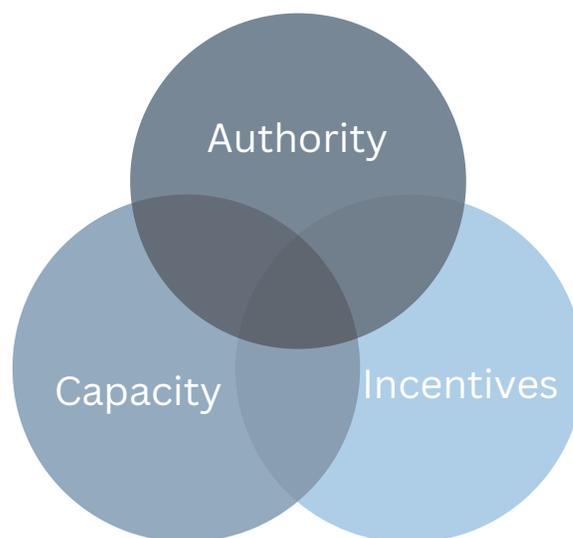
An essential element of local government finance is own source revenues (OSRs), which consists of taxes and fees that a local government is authorized to collect. OSRs are strategically important for transformative infrastructure development because they often support the operation and maintenance of local assets. Ensuring proper budget allocation for the financial, human, and material resources to manage assets over their lifespan is critical because it allows continued delivery of essential services for citizens, such as transport, water and sanitation, and solid waste management.

However, underinvestment on maintenance of infrastructure is often a financing gap and it is estimated to cause up to 2% loss in gross domestic product (GDP). Therefore, optimizing local OSRs is strategically important in ensuring day-to-day operations of local assets, delivering the promises of decentralization, and enhancing local governance and accountability, especially in low-income countries.

OSR also provides a means for local governments to collect information about the level and quality of public services that their citizens desire as local governments need to provide improved services in exchange for taxes. Increasing OSR can also provide funding to cash-strapped localities whose responsibilities often surpass funding received from the national government, which could help facilitate access to credit for more infrastructure investment at the local level.

II. What Are the Typical Bottlenecks?

While OSR benefits are widely accepted, using OSR systems in an adequate, effective, and efficient manner remains a challenge for many local governments in developing countries. For example, local governments in low-income countries generate only \$12 per capita per year from OSR, compared to \$2,944 per capita per year in high-income countries. Some of the key bottlenecks that explain these drastic differences include the following:





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Authority:

While local governments can influence national-level legislation on using and administering revenue sources, they do not possess sufficient OSR authority. This is because taxation is a key component of the national government's power, and it is not always easily or sufficiently devolved, compared to decentralizing functional responsibilities. Because local governments do not have the necessary OSR authority, low compliance rates become another challenge, which leads to decreased revenue at the local level. This structural challenge needs to be tackled by creating an enabling environment for local governments to possess the appropriate level of OSR authority for effective decentralization and regional equality.

Capacity

Developing the right OSR policies and building effective administrative systems to implement those policies require significant capacity from local governments, including on asset management. However, many localities in developing countries are often small and underfunded, lacking the human resources needed to develop OSR systems. These challenges are compounded by the fact that the nature of taxes and fees devolved to local governments is often not the easiest to administer or control politically. For example, taxes on land or property require costly, complicated, and contentious valuation rolls and are politically difficult to enforce against the will of local landowning elites. To address this bottleneck, capacity-building efforts are needed for local civil servants to devise and implement improved policies and practices, such as diagnostic tools or data systems for better OSR administration.

Incentives:

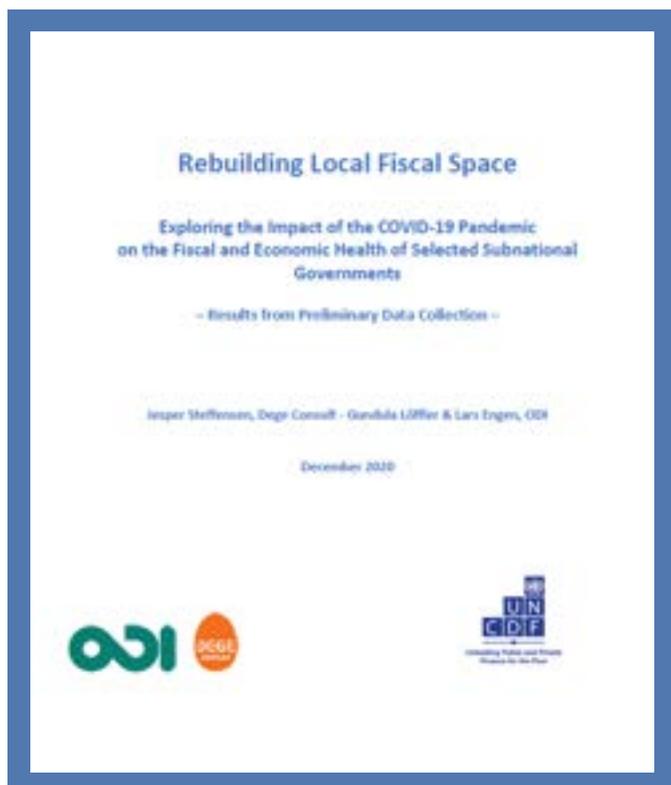
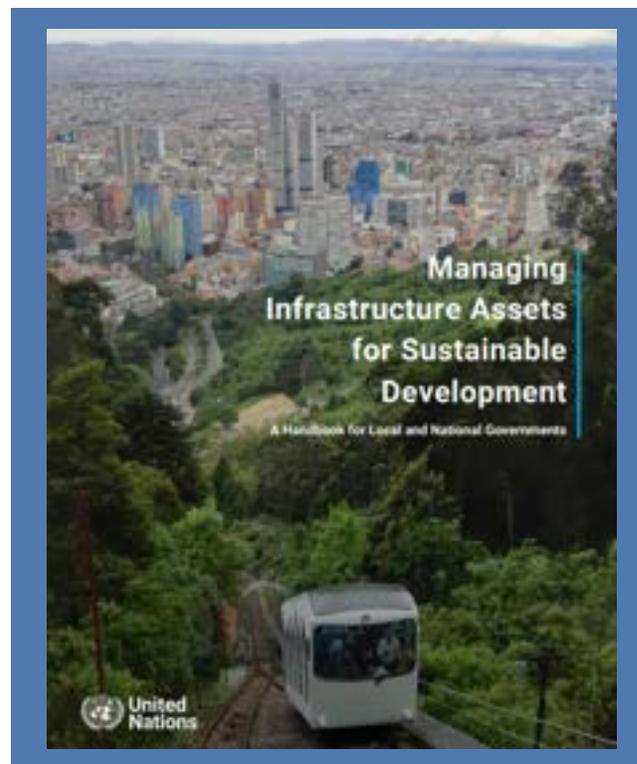
Effective OSR policies and systems are often not in the interests of tax collectors, politicians or economic elites, all of whom benefit from tax loopholes, lack of enforcement, or reduced business or property tax rates. Since raising taxes is generally politically unpopular, local governments are often unlikely to optimize OSR, especially when they have access to politically 'cheaper' sources of funding, such as IGFTs. Such incentive challenges could be addressed by making information more readily available through adequate data management, reporting, and control systems to hold government officials accountable. Another solution is to make OSR optimization a precondition for local governments to receive funding, such as intergovernmental transfers and external credits from development partners.

I. Examples of Effective OSR Practices

In many local government contexts, old assets are often neglected and new ones are built without putting in place an asset management framework for proper maintenance over time. This hinders the economic and social sustainability of public infrastructure investments, leading to loss of OSR that could have been used for other purposes.



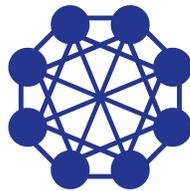
To help address this challenge, UNDESA and UNCDF have developed a **UN handbook for local and national governments on infrastructure asset management**. The toolkits include a diagnostic tool, asset management action plans, emergency response plans, climate vulnerability assessment, and a tool for building enabling environment. Many developing countries participated in the pilot phase, including Tanzania, Uganda, Nepal, and Bangladesh, by engaging their local government staff in capacity-building and assessment activities to understand their current status quo and determine a framework for future actions. Such asset management practices can help local governments to better plan the allocation and spending of OSR across local expenditures in economically and socially sustainable ways.



Another example of UNCDF’s work in promoting effective OSR reforms is its collaboration with ODI on the “Rebuilding Local Fiscal Space Initiative,” which aims to provide tools and recommendations on improving local fiscal space in light of the challenges caused by COVID-19, including loss of OSR, non-conductive intergovernmental fiscal transfer systems, increased costs of service delivery, and loss of local economic development. The diagnostic phase resulted in a report assessing the impact of the COVID-19 pandemic on the fiscal and economic health of the six pilot subnational governments (Chandpur, Bangladesh; Kumasi, Ghana; Gulu, Uganda; Telita, Moldova; Chiapas, Mexico; and Harare, Zimbabwe). Based on the initial findings, concrete workplans on enhancing OSR were developed for each government.

Bridging the Local Infrastructure Financing Gap through Domestic Capital Markets

I. Why Are Domestic Capital Markets Important?



Investing in city infrastructure is integral to most development strategies, and it is well recognized that such investments contribute to economic growth and human well-being. For example, improved roads and transportation allow for greater mobility of people, goods and services; cleaner water and sanitation lower morbidity; and green spaces improve sustainability.

However, the current level of traditional financing mechanisms alone cannot deliver the necessary volume of local investments due to growing populations and the associated high demand for public services, increasing land values, and expanding local fiscal space. Reforms to improve both assigned and own sources are important if local governments are to be empowered to take proactive decisions on infrastructure rather than continue as passive responders to scattered grants.

These reforms are a first step towards empowering local governments to blend public sources of finance with private sources, so local public goods, such as infrastructure projects, can be created on a scale that lifts the city to higher growth in an equitable and environmentally responsible manner. Given the gaps between the investments needed and the available public sources of finance, blended finance becomes critical, and a key component of the package is access to capital markets by cities and local governments. In particular, local government borrowing and the issuance of municipal bonds would play a key role in achieving sustainable and transformative infrastructure finance by attracting investments at scale.

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Authority to borrow

For example, cities must have the legal authority to borrow, create and pay for the use of the assets over time; however, many cities and local governments do not have this level of authority, and if they do, the direct borrowing is highly regulated with specific formulas that limit the amount of debt.

Despite the inherent value proposition of investing in municipal infrastructure, domestic capital markets remain significantly underdeveloped in most parts of the world due to a number of challenges.



Clear revenue stream

Cities also have to be able to demonstrate a clear revenue stream to repay the borrowings for potential lenders to assess, which depends on the rationality of intergovernmental fiscal rules and the stability of own source revenues, including powers to levy and raise user charges.



Excess borrowing at the national level

Another challenge is excessive borrowing at the national level, which reduces fiscal space for cities to borrow locally and invest in infrastructure. Such lack of domestic savings increases borrowing costs for cities and stimulate capital flight, making long-term funding scarce for local governments.

III. Examples of Effective Domestic Capital Market Development

Cities and local governments need a holistic support of national and municipal policies that strengthen own source revenues, intergovernmental fiscal rules, and municipal borrowing frameworks to expand access to capital for cities of all sizes. In particular, below is the summary of best practices for promoting domestic capital markets, followed by different country cases that illustrate the successful practices of creating enabling conditions that linked capital markets with municipal finance.

- Promote **debt** that can lend to local and regional governments for transformative projects
- Implement **equity partnerships** that crowd in investment to local projects from domestic and international investors and build confidence through replicable projects
- Create **specific budget lines for technical assistance** for local and regional governments to build their capacity to structure transformative financeable projects

- Establish and increase intermediary instruments that **channel climate finance** to local and regional governments for effective public and private investment
- Create non-sovereign regional or global **guarantees** for local transformative investments
- Develop **blended finance** instruments and **public-private alliances** for city investments
- **Advocate for local infrastructure investment** as a prerequisite for national development

While connecting cities and local governments to capital markets may seem difficult at first glance, there have been many examples of success. For instance, UNCDF worked with the **Government of Bangladesh** to develop a framework that aimed to expand the use of direct debt financing for municipal investments from domestic financial institutions, followed by an initiative to expand access to capital markets through municipal bonds.



During the process, a key challenge was a lack of municipal creditworthiness, which led the banking sector to see municipalities as a risk. Interest rates were another issue, and banks seek guarantees for such lending. To address this situation, the Government of Bangladesh set up several specialized financial institutions for infrastructure financing with its own funds that can be used to lend to municipalities within that institution's legal-administrative framework.

For example, the Infrastructure Development Company Ltd. (IDCOL) was set up to finance green energy projects, and the Bangladesh Infrastructure Finance Fund Ltd. (BIFFL) was established to finance multisector infrastructure. International financial institutions were another source for indirect municipal borrowing – the World Bank loaned funds to the Government of Bangladesh backed by sovereign guarantee, which has then been on-lent to municipalities.

Another example of effective domestic market development practices is the ongoing work of first-ever water infrastructure green revenue bond in **Tanga, Tanzania**. Due to population growth and expansion of service areas and economic activities, water demand increased yearly in Tanzania, and the water production level does not match installation capacity and the required demand/supply gap increase.



The loss of revenue is still high due to dilapidated water supply infrastructure, which posed an opportunity for UNCDF to help scale up water investment projects. Since government funds were limited, UNCDF provided technical support to the Tanga Urban Water Authority and Sanitation (UWASA) to issue a 15-year water revenue bond amounting to US\$23.1m as part of project investment cost, with third-party credit guarantees from development partners, including UNCDF and other local and international organizations. The revenue raised from water bills would be used to service the debt, including principal and interest payments. This example illustrates the feasibility of meeting dire infrastructure needs by leveraging domestic capital markets with the required technical assistance and credit guarantees.

Mobilizing City-Friendly Investment Funds to Achieve Local Transformative Finance

I. Why Are City-Friendly Investment Funds Important?



City-friendly investment funds increase the ability of local governments and other sub-sovereign entities to address key urbanization challenges, such as local infrastructure gaps, through sustainable sources of public and private financing. In particular, this type of solution can work for certain infrastructure investments with dedicated revenue streams, such as mass transit systems. Such funds open up the local market for further investments by promoting policy and regulatory reforms, strengthening domestic capital markets for subnational finance, expanding international capital deployed to subnational finance, and building the capacity of local governments to access finance.

In these investment funds, risk is mitigated by an investor owning the asset and managing it privately while producing the transformative outcome required.

When these funds are designed and implemented through the “city-friendly” perspective, they can demonstrate the potential of municipal and local government finance to national regulatory authorities and international investors to deploy public and private capital for infrastructure needs of cities and local governments.

II. What Are the Typical Bottlenecks?

Cities and local governments lack the necessary capacity to tap into investment funds and receive external credits. For example, they need coordinated support on conducting economic analysis and planning for capital investments, business plan development for investment projects, and tools for financial modeling and other projections.

They also need an enabling environment from policy, legislative, and regulatory perspectives, including technical support to financial mechanisms, such as project finance and domestic bond markets. Another area of support is on the pipeline of revenue-generating investments, such as support to projects in catalytic sectors that address the urbanization and climate imperative, value add to local economies, and proof of concept to market regulators and domestic financial institutions. However, at the root of these bottlenecks is the lack of transformative investments that are financeable.

Many investment funds are focused on finding bankable projects, which could preclude transformational impact by restricting revenues to be ringfenced to create a commercially bankable structure and adjusting risks to repay commercial finance, but the same project may not meet transformation objectives



Instead, cities and local governments need an investment fund that promotes transformative and financeable projects that improve local productivity levels, contribute to planetary health, and impact local economic development.

III. Example of Effective City-Friendly Investment Funds



One clear example of this solution is the creation of the **International Municipal Investment Fund (IMIF)** that has been designed as a ‘city-friendly’ fund. In alignment with the Malaga Coalition agenda, UNCDF launched the IMIF in October 2019 to serve as an instrument of the Coalition to support local SDG-oriented projects in developing countries. The IMIF is a unique, bespoke investment fund that raised over 350 million EUR to exclusively help cities and local governments leverage concessional and commercial capital in domestic and international markets.

The Fund aims to finance urban resilient and sustainable infrastructure projects by investing in equity and quasi-equity securities to accelerate the achievement of the SDGs. In November 2019, UNCDF appointed Meridiam, a private infrastructure investment and global asset manager, to manage the IMIF.

The IMIF features city-friendliness through its Technical Assistance Facility (IMIF-TAF) that was created and managed by UNCDF. The TAF provides capacity strengthening and policy support to cities and local governments by helping them finalize investment projects to access credit and with relevant policy and regulatory reforms at the national level.

The TAF harnesses the **UNCDF Dual Key system** to support local governments in developing a pipeline of revenue generating investments that ensures both development impact and financial sustainability. Support is targeted toward developing and emerging countries in particular sectors, including solid waste, water management and sewerage, urban development, transportation, and energy (renewable source and efficiency).

In 2020-2021, UNCDF has provided technical assistance and granted funding for over 15 municipal investment projects through the TAF process, and one such project is the Bus Rapid Transit (BRT) system to address congestion in Kumasi, Ghana.

Kumasi is the second largest city in Ghana, with over 2 million residents, and the over-concentration of investments in the city centre, segregation of land uses, and urban sprawl among others are causing the core areas to become congested, especially during peak hours.





This has been compounded by the absence of an efficient and scheduled public transport system, increased car ownership, and overreliance on low occupancy vehicles.

Therefore, Kumasi Metropolitan Assembly (KMA) submitted a proposal for the introduction of a seamless system that integrates a localized BRT system with the current operations of the privately operated TroTro system at designated locations in the city. The total project cost is approximately US\$125 million via equity and debt. After the project passed the initial eligibility screening, UNCDF has been providing technical assistance on pre-investment phase, including business case development, assessment of the development impact and financial impact additionality, and sustainability, as well as project structuring and de-risking.

This project is not only financially sustainable, but will also contribute to improved access to safe, environmentally responsive, affordable, accessible and sustainable transport systems for all. Following the pre-investment support, UNCDF will also assist KMA with the investment process, post-investment business development, and monitoring and reporting of SDG-responsive impact and results.

Successful financing and implementation of this project will achieve multiple anticipated benefits, such as an environmentally responsible, reliable and affordable transport system that enhances physical accessibility and connectivity intra-city and inter-city, enhanced road safety and reduced congestion, as well as improved quality of life and environment.

Empowering Cities & Local Governments through Guarantee Mechanisms

I. Why Are Guarantees for Cities & Local Governments Important?



Guarantees are a financial instrument to unlock public and private funding for local infrastructure by mitigating risks, increasing investor confidence in cities and local governments, and bringing down the cost of capital for municipal borrowing. In particular, concessional or publicly-funded guarantees for subnational governments can significantly accelerate transformative investments at the local level.

The COVID-19 pandemic has presented a new, unprecedented source of investor risk that is depressing business confidence to historic lows. According to the World Bank, global foreign direct investment fell by 42% in 2020, from \$1.5 trillion in 2019 to an estimated \$859 billion—the lowest level since the 1990s. Against the backdrop of the COVID-19 pandemic and declining investments, it is critical now more than ever to unlock private financing for developing economies by mobilizing a diverse set of instruments, including guarantees.

II. What Are the Typical Bottlenecks?



In developing countries, the current level of local government lending and the associated financial mechanisms is not sufficient to enhance development finance and address critical infrastructure gaps. While there are some guarantors that operate a business model similar to insurance by collecting a premium for a guarantee and providing either a full or partial guarantee to the lender in the event of default, this type of scheme is not conducive to cities and local governments given their weak fiscal positions.

There are some public guarantors, such as the World Bank Group’s Multilateral Investment Guarantee Agency (MIGA), but it operates at the sovereign level for priority projects of national governments by mitigating political and other risks for high-value transactions. Such lack of public or private guarantors in the sub-sovereign infrastructure space is due to the limitations of sovereign and private finance, a small market of transactions to guarantee, and the policy and regulatory restrictions on sub-sovereign finance. In order to facilitate credit access for cities and local governments, partial or full guarantees from the central government or international development partners are required.

I. Why Are Guarantees for Cities & Local Governments Important?

At the global level, the **European Fund for Sustainable Development Plus (EFSD+) Guarantee – Sustainable Cities Window** was established to support cities through guarantees for infrastructure investments that address the demographic, climate/environmental, and economic challenges.

The objective is to contribute to the mobilization of additional finance for investment in sustainable urban development, and support the wider strengthening of the ecosystem for subnational finance. In particular, the guarantee mechanism aims to increase the role of the private sector as a technology provider and co-financier in addressing investment needs and maintenance of municipal infrastructure, such as in the areas of water, sanitation and waste water management, solid waste management, air pollution and green urban areas, urban residential rehabilitation, district heating and lighting, affordable and green social housing.

The EFSD+ guarantee will be structured in a way to lower investment risks for long-term financing and create enabling conditions for the delivery of quality municipal services. The EFSD+ will also support capacity building to systematize risk-sharing mechanisms and promote public-private partnerships in subnational finance.



Such guarantees have an inherent value of reducing a variety of risks for local governments, including commercial, political, legal and regulatory, and environmental risks. The indicative target volume of guarantees is EUR 723 million and it is open for all countries in the scope of international partnerships of the EU. This Fund is a strong example of how non-sovereign guarantee mechanism can complement sovereign and private finance in funding urban infrastructure gaps.

At country level, since many local governments operate in different contexts with different intergovernmental frameworks and have uneven levels of experience in subnational investment, guarantee structures need to be designed in line with the specific characteristics of localities. For example, in the Philippines, the Local Government Unit Guarantee Corporation (LGUGC) was founded as a private financial entity by the Bankers Association and the Development Bank of the Philippines.



It offers financial guarantees for local governments and other public and private entities, such as water districts, electric cooperatives, renewable energy projects, and medium or large enterprises seeking to develop infrastructure with private and public capital. The basic approach of LGUGC is to provide guarantees to partner financial institutions in case of borrower default, and in return, the partner lends to or underwrites bond issuances. Borrowers pay a guarantee fee, depending on the risk assessment, and LGUGC also rates local governments' creditworthiness.

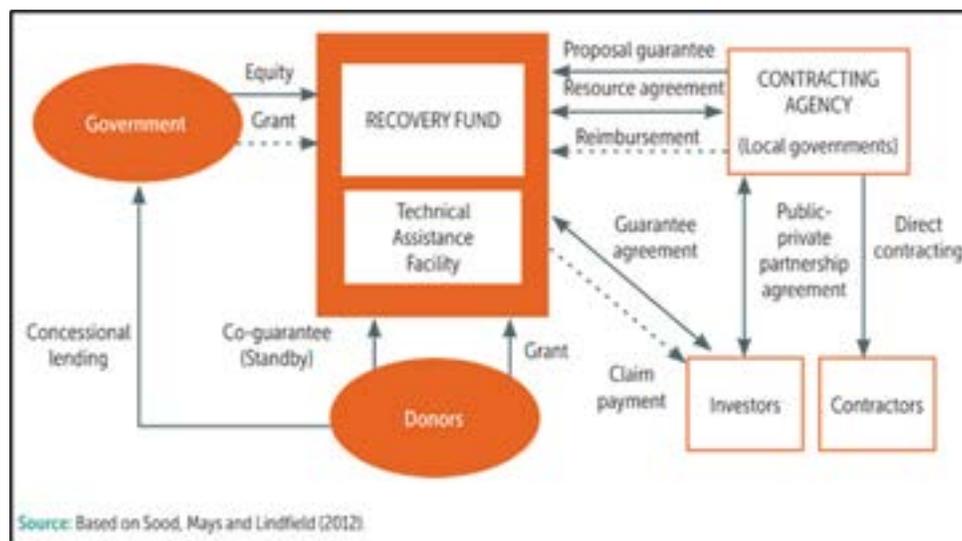
Only local governments with a minimum investment grade rating are eligible for its guarantees. As a result, local governments in the Philippines have borrowed a fair amount through special financial intermediaries with public and private funding that serve different types of local projects.

While the Philippines' guarantees are run by a private financial entity, many countries design and implement a diverse set of financial mechanisms to conduct guarantees.

For example, Cameroon has a public body financed from the national government budget, which provides loans, grants, cash advances, guarantees, and technical assistance to local authorities, and in Nepal, they have an autonomous agency that is primarily financed from loans and grants from international financial institutions and development agencies.

Additionally, guarantees can be combined with other types of financial instruments as a component of blended finance, such as public-private partnerships, direct grants, and concessional lending from international or multilateral organizations, to support local infrastructure or other needs.

A local government revolving recovery fund is an example practice of providing short-term liquidity to local governments for response and recovery. Such funds are usually co-financed by the central government, with the participation of local governments as contracting agencies and supported by donors through a combination of various financial instruments. The following graph showcases a feasible model of such recovery fund:





Impact Capital for Development



This policy brief's content directly comes from the UNCDF's flagship publication – Local Government Finance is Development Finance. For more information about the book, download [here](#) or via + QR code

For more information on the work of the Local Transformative Finance Practice, visit <https://www.uncdf.org/local-development-finance>



The UN Capital Development Fund makes public and private finance work for the poor in the world's 46 least developed countries(LDCs).

UNCDF offers “last mile” finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development.

UNCDF's financing models work through three channels: (1) inclusive digital economies, which connects individuals, households, and small businesses with financial eco-systems that catalyze participation in the local economy, and provide tools to climb out of poverty and manage financial lives; (2) local development finance, which capacitates localities through fiscal decentralization, innovative municipal finance, and structured project finance to drive local economic expansion and sustainable development; and (3) investment finance, which provides catalytic financial structuring, de-risking, and capital deployment to drive SDG impact and domestic resource mobilization.

