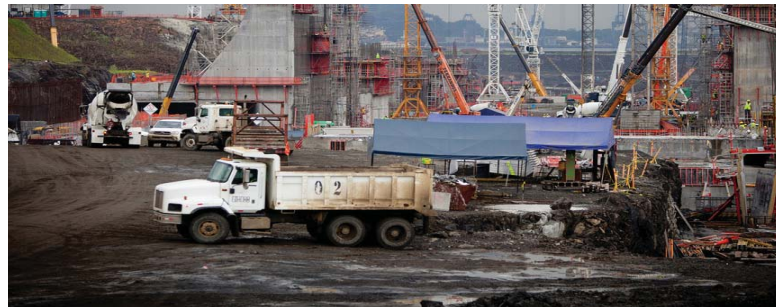




PPIAF

Enabling Infrastructure Investment

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PPIAF Helps Peruvian Sub-Nationals Tap Financial Markets

PPIAF's Sub-National Technical Assistance (SNTA) program is helping sub-national government entities in Peru raise market-based financing for much needed infrastructure investment. Since 2008, SNTA has assisted eight regional and municipal entities by facilitating credit ratings, implementing financial assessments and coaching, supporting transaction preparation, and helping the central government monitor and evaluate the financial health of local authorities.

As a result of SNTA support, the Municipality of Lima has signed two significant financings for investment: a \$70 million commercial bank loan with BBVA Banco Continental in April 2010—and a subsequent \$120 million (local currency PEN\$360 million) loan with BBVA and Scotiabank, signed in November 2013. The SNTA technical assistance also helped the Regional Government of Arequipa obtain a \$10 million commercial bank loan in January 2011 to finance a regional road rehabilitation project.

Until 2002, Peru was one of the more centralized countries in Latin America. The government's approach to fiscal decentralization was a cautious and gradual one. However, a policy shift in 2002 led to the passage of the Decentralization Framework Law, which established the guiding principles of a political and fiscal decentralization process.

Because of the limited authority of sub-national governments to raise tax revenues and the absence of a sub-national debt market, local governments in Peru rely heavily on government transfers for both operating and capital expenditures. Regional governments, in particular, have no authority to levy taxes and hence rely almost fully on central government transfers for both operating expenditures and investments. Municipalities finance a higher percentage of their expenditures from their own sources (e.g., property tax, real estate transaction tax, various fees, sale of goods and services, etc.), but have no authority to set local tax rates and rely heavily on government transfers for capital expenditures.

Local governments are exploring options to better leverage their resources in order to meet large infrastructure investment needs. Currently, borrowing accounts for only 1% of such investment funding, with virtually all of that in Lima. Commercial banks restrict their activities to financing working capital for a small number of local governments. To date, the only sub-national bonds issued securitized Lima's toll road revenues, allowing for greater investment in roads.

PPIAF SUPPORT

In 2008 and 2009 PPIAF's SNTA program funded two technical assistance grants designed to facilitate Peruvian sub-national governments access financing from commercial banks and capital markets, as a way to complement existing government transfers and revenues, diversify funding sources, lengthen the maturity of available commercial bank financing, create and strengthen credit histories, and introduce financial discipline. The objective was to strengthen financial standing and management capacity and help sub-nationals prepare infrastructure projects for commercial financing.

A workshop on sustainable development plans for provincial and regional governments was held in April 2010, and used international examples to demonstrate how access to market-based finance can result from fiscal discipline, sound financial management, and investment planning. The first SNTA grant helped the Municipality of Lima obtain a credit rating from an international credit rating agency, identify potential sources of finance for new infrastructure investments, and assess ways of replacing existing short-term debt with sustainable longer-term financing. This work resulted in compliance with sub-national fiscal prudence rules and helped Lima make a significant contribution to the Metropolitan Bus Rapid Transit Corridor Project, also supported by the World Bank and the Inter-American Development Bank. The second SNTA grant helped the Regional Governments of Arequipa and Cuzco, the Provincial Municipality of Santa (Chimbote), the Municipality of Piura, and Arequipa's water utility SEDAPAR prepare for and obtain credit ratings from a local credit rating agency. In the case of the Regional Government of Arequipa, SNTA's technical assistance also included support in navigating the sub-national borrowing approval process, financial coaching, and a review of technical documentation.

The program with Lima is a good example of the impact a sustained technical assistance can bring and the importance of flexibility in the designing tailored support to our clients. The most recent activity with Lima was related to the structuring of a sizeable bond issuance for the municipality. PPIAF-SNTA provided assistance with a market sounding exercise and recommendations on the optimal structuring of the security, using property tax revenues as a lien to attract international investors to a local currency bond. Unfortunately when the municipality went to the market with the instrument in the summer of 2013 there was a sudden volatility related to the perceived likelihood of withdrawal of quantitative easing policies in the United States. As a result, Lima was not able to get the terms it required from the investor base. The municipality then proceeded to access the local banking market for a PEN\$360 million loan, using a similar structure as security and achieving a favorable interest rate of 6.7% on the facility. The proceeds were allocated to debt consolidation (\$92 million) and socially inclusive infrastructure projects (\$268 million).

Footnote

¹ This is an update of a story published in November 2011.

OUTCOMES

SNTA's technical assistance, and close collaboration with key partners, facilitated two significant loans: a \$70 million commercial bank loan to the Municipality of Lima by BBVA Banco Continental, signed in April 2010, and the \$120 million (local currency PEN \$360 million) facility with BBVA and Scotiabank signed in 2013. The \$70 million loan was partially backed by a \$32 million IFC guarantee. Both transactions represented the largest market-based financings ever realized by a sub-national government entity in Peru. Both loans also achieved record tenors (5 year) in Peruvian municipal lending and low interest rates.

As a result of the second phase of SNTA support, the Regional Government of Arequipa signed a \$10 million loan with a local commercial bank - the first time a Regional Government in Peru borrowed without a sovereign guarantee. As happened in Lima in 2010, the loan was backed by another IFC guarantee. All other banks invited to arrange the financing (without IFC's guarantee) declined interest in the transaction. With the help of this loan, Arequipa will finance its regional road rehabilitation program.

Other Peruvian authorities supported by PPIAF's SNTA program are also advancing steadily toward creditworthiness and additional transactions are expected in the coming years.

IMPACT

By extending the tenors and reducing the interest rate risk premiums, the Municipality of Lima's monthly debt service payments are much more affordable and left more city revenues available to cover critical operating expenses. Important milestones were also reached in improving Lima's financial management, such as the consolidation of the accounts of the Municipality of Lima and the 19 public companies and other entities it controls.

DONOR COORDINATION

SNTA activities complemented on-going work in Peru by several donors and international finance institutions, including work by the United Nations on water utility financing, successful efforts by the International Finance Corporation (IFC) to establish a sub-national guarantee facility in 2008, and funding from the World Bank to the central government for projects executed by regional authorities.

RELATED PPIAF-SNTA ACTIVITIES IN PERU

- 2008-2009: Access to Commercial Banks and Capital Markets (Phase I and Phase II), \$855,072
- 2010: Strategic Plan for the Universal Service Fund, \$75,000
- 2011: Technical Assistance to the Metropolitan Municipality of Lima, \$350,000
- 2011: Technical Assistance to Peruvian Water Utilities, \$75,000
- 2011: Creditworthy Municipal Public Banks, \$275,000