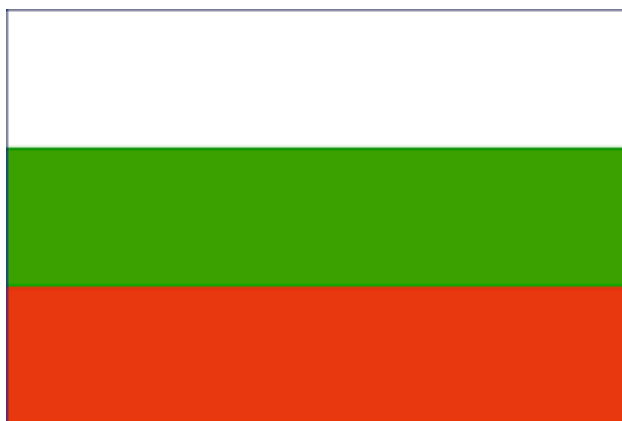


Municipal Pooled Financing in Bulgaria

- An initial study of the possibilities to introduce pooled financing for local authorities in Bulgaria

- Executive summery -



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Executive summary

The objective of this advisory assignment was to execute an initial desk study of the possibilities to introduce Pooled Financing Mechanisms (PFM) for local authorities in Bulgaria as a tool to finance local infrastructure investment.

Municipal PFM can be broadly defined as cooperation between local authorities with a focus on local infrastructure investments financing through market-based borrowing. PFM can be an efficient tool to address financing challenges at municipal level in countries where financial markets and municipalities are sufficiently sophisticated. A wide international experience validates that pooled financing has been successful in enabling market-based funding of local infrastructure investments, reducing costs of borrowing and supporting decentralisation. Implementation of PFM has been adjusted to political and public sector circumstances in the countries in question. It can range from execution of a single bond issue (club deal) by several municipalities to the creation of a platform for repeated club deals and a municipal funding agency (PFM-agency), which would be created by municipalities to aggregate their borrowing needs and issue bonds in the capital market on a regular basis.

Bulgaria and Bulgarian municipalities have extensive infrastructure investment needs. For example, only 18 percent of the municipal roads are considered to be in good condition. The investment needed in the water sector for the period of 2014 – 2023 is projected to €6.1bn. A part of the municipal investment program will be financed with EU funds. It is estimated that these funds will cover 30 – 40 percent of the investments needed in the water sector during the programme period until 2020. The remaining part has to be financed with own resources, transfers and borrowing. Given the financial standings of the municipalities and the amount of the transfers, borrowing is likely to account for a substantial part of the financing.

A key question related to borrowing and especially to PFM, is creditworthiness. The financial gap between municipalities in Bulgaria seems to be widening. While some municipalities received additional state grants in 2014 because of their difficult financial conditions, including structural deficits, the group of municipalities with above average economy seems to be improving.

Bulgarian municipalities have low levels of debt compared to most of the other EU-countries. There are many reasons for this, but the very restrictive borrowing rules are of course one of them. Within these borrowing restrictions, municipalities are free to use a number of different financing options, such as bond issues, loans from various financial institutions and foreign borrowing. The conclusion is that there is nothing in this regard that would hinder the use of PFM for municipalities in Bulgaria.

In chapter 8 of the Local Self-Government and Local Administration Act, the regulations for municipal cooperation are to be found. The conclusion is that applying PFM cooperation and establishing a PFM agency is perfectly feasible under Bulgarian law.

In conclusion, many of important prerequisites of PFM exist today in Bulgaria. It is recommended to:

1. **Start a process;** NAMRB is advised to take the initiative to discuss with their members with the object to form a core group of municipalities.
2. **Organise the process;** Appoint a Steering Group, Working Group and project leaders.
3. **Procure experts;** appoint experts with experience from PFM in other countries, alongside experts with extensive knowledge of the Bulgarian legal system.
4. **Produce a roadmap for the process;** planning a detailed organisation, budget, workload, deliverables and time-line.
5. **Conduct a creditworthiness study;** the aim is to answer the question about the level of creditworthiness that would be sufficient for applying PFM and to assess the extent to which the involved municipalities are able to reach this level. The study should also recommend a plan of how to improve municipal creditworthiness.
6. **Conduct a legal study;** this includes the legal framework for municipalities as well as the regulation of the capital markets. The study should answer detailed questions of how PFM could be introduced in compliance with Bulgarian laws. This includes questions about possible legal forms for a PFM-agency.
7. **Conduct a market review;** this includes studies of the domestic capital markets, determining which investors are present and how to attract their maximum interest for PFM bonds.
8. **Conduct a benchmark study;** this includes the study of PFM business models that are applied in other countries and an assessment of what elements could be used in the local context. It is advised to organise a study-trip to one or more existing European PFM-agencies.
9. **Structure a first club deal;** the primary aim of which is to gain real experience of municipalities working together and of how the capital market receives a PFM bond issue.
10. **Build a stable platform for future club deals;** using the experience of the first club deal, a stable platform should be built taking into consideration questions related to governance, creditworthiness, credit enhancement, etc.

If, after the steps recommended above, the creation of a PFM agency is deemed suitable and possible, detailed studies should be made into questions of legal set-up, ownership/stakeholders, capital structure, governance, creditworthiness requirements, internal policies, asset liability management, IT, HR etc.

NAMRB has a very important role to play as coordinator of the project to introduce PFM in Bulgaria and possibly as a minority stakeholder in a future PFM-agency. It should also be investigated if cooperation could be established between the Fund for Local Authorities and Governments (FLAG) and a future agency.