ODI

Case study

Case studies of subnational financial intermediaries in Africa

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Abstract

Financial intermediaries are institutions, public or private, that facilitate access to capital investment finance for cities and local governments by way of creating better-than-market conditions for the debtor.

This companion piece to the ODI publication, *Bridging Africa's urban infrastructure gap: Financial intermediaries for facilitating cities' access to debt finance in Africa,* provides case studies of four such institutions in Africa:

- Development Bank of Southern Africa (DBSA), a regional development finance institution with a city's portfolio.
- Development Fund for Local Authorities in Malawi, which was established through a partnership between the Government of Malawi and World Bank.
- Fonds d'Equipment Communal in Morocco, Africa's oldest subnational development bank

- Caisses des Dépôts et Consignations (CDCs) in Gabon, although this type of institution exists across several francophone African countries.

Although the case studies offer a limited snapshot of the diversity of subnational financial intermediaries that exist, the deep dive into these four provides more general lessons and policy recommendations.

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This case study has been prepared as part of the Africa-Europe Mayors' Dialogue. This platform, coordinated by ODI, brings together more than 20 cities in Africa and Europe to work on shared challenges, including how to improve cities' access to finance to rapidly scale investment in sustainable urban development.

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Contents

1 Introduction 7
2 South Africa: Development Bank of Southern Africa (DBSA) 8
2.1 Municipal borrowing in South Africa 9
2.2 Governance of the DBSA 10
2.3 Finances of the DBSA 11
2.4 Challenges for the DBSA 13
3 Malawi: Development Fund for Local Authorities (DFLA) 14
3.1 Municipal borrowing in Malawi 15
3.2 Governance of the DFLA 15
3.3 Finances of the DFLA 16
3.4 Challenges for the DFLA 16
4 Morocco: Fonds d'Equipment Communal (FEC) 18
4.1 Municipal borrowing in Morocco 18
4.2 Governance of the FEC 20
4.3 Finances of the FEC 20
4.4 Challenges for the FEC 23
5 Gabon: Caisses des Dépôts et Consignations (CDC) 24
5.1 Municipal borrowing in Gabon 25
5.2 Governance of the CDC 26
5.3 Finances of the CDC 26
5.4 Challenges for the CDC 28
6 Policy recommendations 29
Segmenting offers to the market 29
Developing municipal debt markets 30
Balancing development and financial objectives 30
Provision of technical assistance 30
Annual financial reporting and evaluations 31
Long-term capitalisation 31
References 32
DBSA – South Africa 32
DFLA – Malawi 32
FEC – Morocco 32
CDC – Gabon 32

Acronyms

CDC	Caisse de Dépôt et de Consignations (Gabon)
CDG	Caisse de Dépôt et de Gestion (Morocco)
CEO	chief executive officer
CFA	West African Franc
DBSA	Development Bank of Southern Africa (South Africa)
DFI	Development Finance Institution
DFLA	Development Fund for Local Authorities (Malawi)
FDCL	Local Community Development Fund (Morocco)
FEC	Fonds d'Equipement Communal (Morocco)
ICT	information communication technology
KfW	German Development Bank
MAD	Moroccan dirham
MK	Malawi kwacha
SADC	Southern African Development Community
SALGA	South Africa Local Government Association
SDGs	Sustainable Development Goals
SFI	subnational financial intermediary
ZAR	South African rand

1 Introduction

Africa is undergoing the fastest urban transition ever seen. With average urban growth of 3.4% across the continent, cities and local governments face increasing demands with respect to infrastructure and service provision. This is exacerbated by the complexities of the climate crisis, which require further investment in mitigation and adaptation.

Despite these huge demands, most cities and local governments in Africa are unable to access adequate financing. This is due both to insufficient central government transfers and usually meagre own sources of revenue. Long-term debt financing from domestic or international capital markets, including from private investors, is currently not possible. Appropriate legal and other institutional provisions are lacking, and unhealthy financial balance sheets that result in poor creditworthiness on the part of the cities.

In some contexts, so-called subnational financial intermediaries (SFIs) bridge the gap between capital markets and local governments, including municipalities, thereby facilitating access to debt finance. These SFIs have a variety of institutional structures, depending on their legal, historical, and economic circumstances.[1]

This brief looks at four very different African SFIs: the Development Bank of Southern Africa (DBSA) in South Africa, the Development Fund for Local Authorities (DFLA) in Malawi, the Fonds d'Equipment Communal (FEC) in Morocco and the Caisses des Dépôts et Consignations (CDC) in Gabon. As the case studies highlight, these SFIs have very different histories, legal foundations, and institutional set-ups. However, all of them, with varying levels of success, aim to bring financing for development-oriented projects to the lowest levels of government.

Each case study begins with a history and overview of the institution, followed by the legal basis on which municipalities can borrow from them. The next section focuses on these institutions' overall governance structure and a detailed analysis of their finances, where available. The final section highlights some of the challenges facing each institution. We conclude with some general policy lessons based on the experiences of these four institutions.

[1] For more detail see the companion paper to this case study, *Bridging Africa's urban infrastructure gap: financial intermediaries for facilitating cities' access to debt finance in Africa*.

2 South Africa: Development Bank of Southern Africa (DBSA)

The Development Bank of Southern Africa (DBSA) was established in 1983 by the National Treasury of South Africa on the premise that lack of infrastructure is a binding constraint to achieving economic growth and prosperity. The DBSA's mandate is to raise funding to channel into sustainable economic and social infrastructure, planning, and development, using its balance sheet and creditworthiness to crowd in funding for infrastructure. It sees itself as an innovative and catalytic mechanism to enhance the state's capacity to execute large development projects.

When it was established, its sole source of finance was the National Treasury. By 1994, with the fall of the apartheid regime, it had amassed assets of around 4.6 billion South African Rand (ZAR). As the country transitioned to democracy, DBSA's role also evolved and it became an important financier of municipalities. This was aided by the promulgation of the new Constitution in 1996, in which municipalities were granted their own legal status with full governance, service delivery and therefore financing authority over their respective territories. The DBSA inherited the total loan portfolio of subnational governments from the National Treasury, comprising around 390 loans at 900 million ZAR. It also underwent a rigorous and targeted process to recover overdue loans and instil borrowing discipline within municipalities.

During this period, DBSA transformed into a development finance institution (DFI), governed by its own Act, and expanded its geographical remit to all of Southern Africa. It also started financing social infrastructure, rather than just economic infrastructure, to accelerate post-apartheid development in South Africa. To support its development mandate, in 2001 DBSA added a knowledge component to its work. It also began to increase its portfolio in Southern Africa and expand to the rest of Africa as well. In South Africa specifically, due to increased pressure from the government and development partners, from 2007 DBSA ramped up its lending, including for infrastructure requirements for South Africa's hosting of the 2010 World Cup.

From 2010, its mandate further expanded to directly include the promotion of regional economic integration, opening up the possibility of funding regional infrastructure projects. From 2016, DBSA started becoming involved in the full project lifecycle, providing direct technical assistance from project identification onwards.

2.1 Municipal borrowing in South Africa

There are 278 municipalities in South Africa, classified by DBSA into metro, secondary and under-resourced municipalities. According to a 2021/2022 Auditor General report, only 17 municipalities had approved borrowing plans. In just over a quarter of municipalities expenditures far outpace revenues and debt, particularly short-term debt, is so unsustainable that there is concern that they may become unviable.

The most common challenges include:

- Lack of skills at municipal level.
- High population growth.
- Low capital spending.
- Poor supply chain management.
- Poorly managed municipal audits.
- Weak revenue management.
- Irregular, fruitless, and unauthorised expenditure.
- Poor operation and maintenance of infrastructure.

For metros and other creditworthy cities, the DBSA's role is to invest in the municipal debt market through supporting the expansion of the market, enhancing secondary market liquidity, encouraging the development of innovative lending instruments, and supporting these municipalities to float bonds, including underwriting the bond and helping attract project finance and expand private finance for municipal infrastructure investment. The DBSA has been key in the development of the municipal debt market, bringing municipalities to the capital market and helping to crowd-in private lenders.

According to the National Treasury, in 2020 53.2% of total South African municipal debt was held by financial institutions and 26.1% by institutional investors, including pension funds and insurance firms. The rest were held by individuals, other government institutions and miscellaneous organisations. When municipalities started to borrow, the DBSA was the most important issuer of municipal debt, but now it makes up just over 10% of total debt outstanding. Four metros, Johannesburg, Cape Town, Tshwane and eThekwini, account for 50% of all municipal debt.

For under-resourced municipalities that are not creditworthy, the DBSA focuses on developing and maintaining basic household

infrastructure – water and sanitation and electricity – as well as investments around cities and other human settlements. DBSA provides development subsidies in the form of grants and other non-lending instruments to enhance infrastructure and capacity within these municipalities. Since 2016, it has provided targeted technical assistance for the development of municipal and sector-specific plans, as well as capacity-building for municipal staff.

In 2021/2022, support between these different types of municipalities was allocated as shown in Table 1.

Table 1 DBSA support for municipalities, 2021/2022 (billions of rands)

	Target	Actual
Top 5 metros	3.5	4.5
Small metros and intermediary cities	0.7	0.04
Under-resourced municipalities	1.4	2.1
Total	**5.6**	**6.64**

Source: DBSA 2022

The DBSA intends to take a more integrated approach to working with smaller metros and intermediary cities to accelerate the pace and scale of infrastructure service delivery. To do this, it will work closely with the South Africa Local Government Association (SALGA) to identify municipalities where this may be possible. In these municipalities, it aims to take an integrated approach by front-loading municipal grants, as well as supporting them in pursuing project finance opportunities. It also uses municipal guarantees and development subsidies to unlock the potential of municipal projects.

2.2 Governance of the DBSA

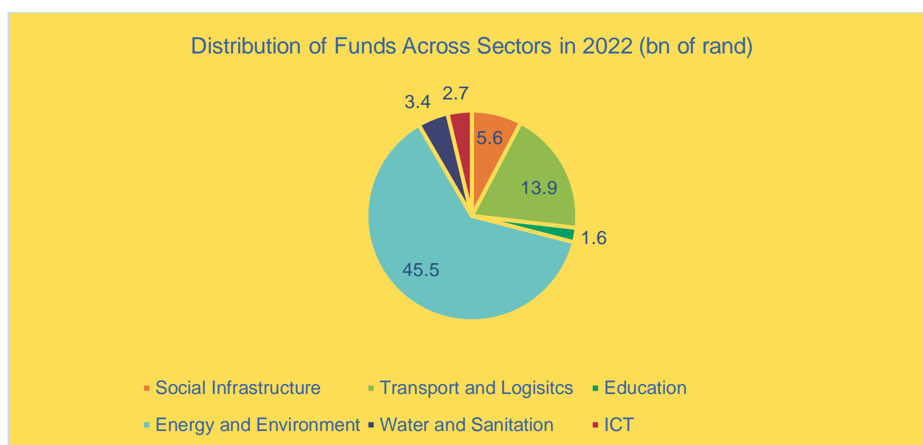
The DBSA is governed by the 1997 DBSA Africa Act and the 1999 Public Financial Management Act. The President of South Africa appoints the Chair of the 12-member Board as well as two other members from the Southern African Development Community (SADC) region, in consultation with their respective heads of state. The Chair serves a three-year term, while all other Board members are appointed for two years. For all members, the term is renewable once. The Board provides recommendations to the Minister of Finance for the appointment of the Chief Executive Officer.

The sole shareholder of DBSA is the South African National Treasury. The management of loans and technical support for municipalities sits under the Chief Investment Officer in the Directorate of Climate Coverage. Here there are two separate departments, one for Metros and Bankable Cities and a second for Local Government Support, the latter handling all other municipalities.

2.3 Finances of the DBSA

Within its portfolio, the DBSA classifies economic infrastructure as Information and communication technology (ICT), transport, water and sanitation and energy. Social infrastructure comprises health, education and human settlements. The distribution of funds across sectors in 2022 is shown in Figure 1.

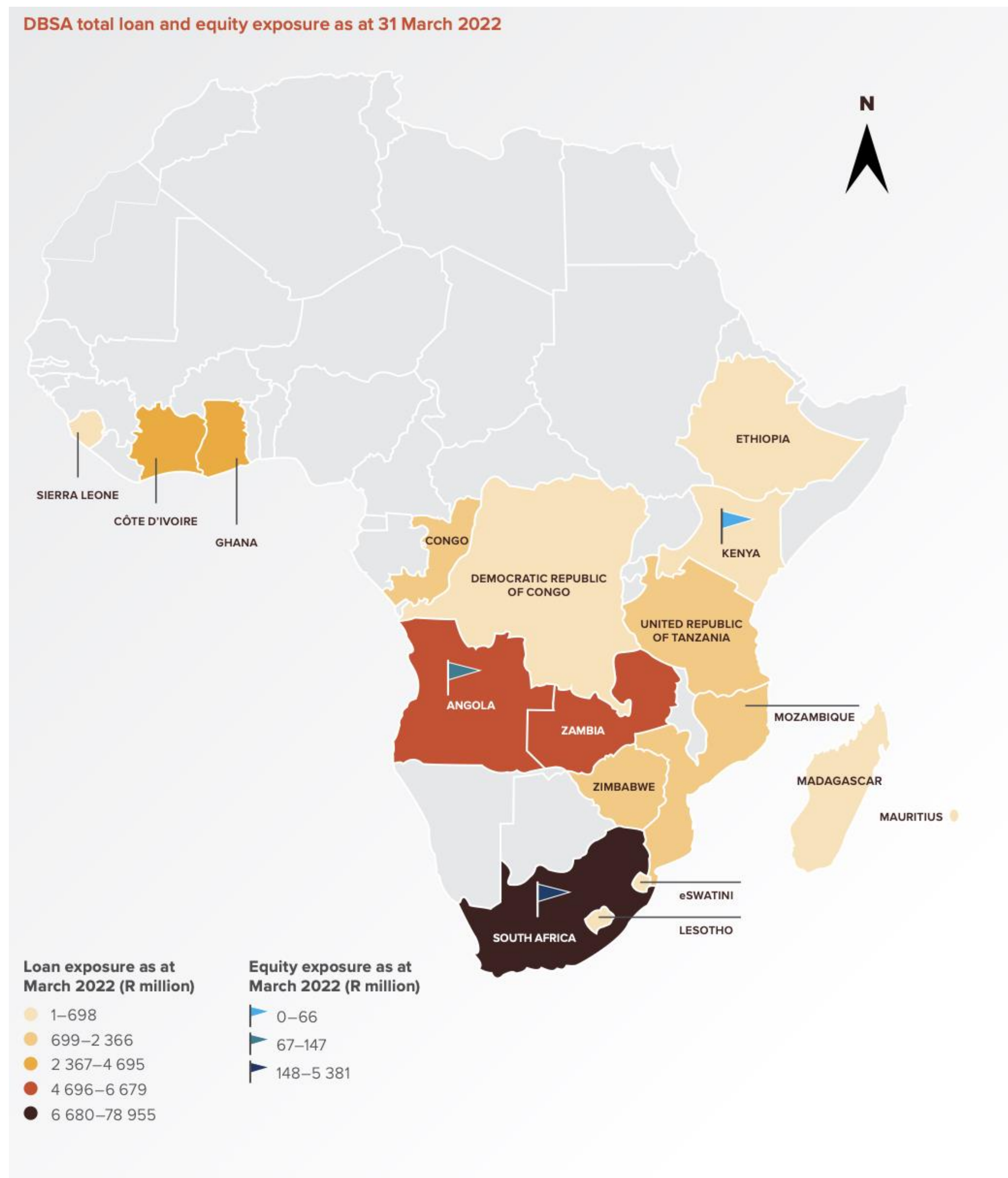
Figure 1 DBSA distribution of loan portfolio, 2022



Source: DBSA 2022

In 2010, the DBSA's mandate expanded to support regional integration in the SADC area, and then later the rest of Africa. However, South Africa still comprises 70% of the DBSA's balance sheet. Its further loan and equity exposures across Africa are shown in Figure 2.

Figure 2 DBSA loan and equity exposure across Africa



Source: DBSA 2022

As its aim is to raise funds at the lowest cost and lowest possible price volatility, the DBSA has increasingly focused on diversifying its funding sources. It is now raising money from a variety of local and international financial institutions, as well as institutional investors and funds. It also has bilateral loan facilities from banks and development finance institutions. The DBSA's current rating is a Ba3 foreign currency rating, awarded by Moody's, and an AA rating.

The DBSA has been accredited by the Global Environmental Facility and the Green Climate Fund; it can now extend green financing and is working to establish further climate facilities. It issued its first green bond in 2022 through a private placement with the French Development Agency. It is also establishing frameworks so that it can tap into so-called ‘use-of-proceed’ bonds, such as sustainable development bonds.

2.4 Challenges for the DBSA

The DBSA faces two main challenges when it comes to lending to cities. The first is a perceived tension between its development objectives and the requirement to function as a self-sustaining financial institution. This is a particular challenge in relation to lending to municipalities, where larger metros provide higher yields on loans, while under-resourced municipalities may be more in need. Over time, the DBSA has tried to refocus its portfolio so that loan repayments from larger metros cross-subsidise grants to underperforming municipalities. It has also instituted a technical assistance programme to enhance creditworthiness and improve project preparation in these cities.

The second challenge is with respect to DBSA as a player in the municipal debt market. DBSA lending is on concessional terms. As such, it can offer cheaper interest rates than the private sector. There is a concern that, particularly for larger and more creditworthy metros, it is crowding out private sector loans, instead of complementing them. Although the private sector views this as unfair competition, municipalities welcome this more favourable lending. There is a view that, rather than focus on creditworthy municipalities, the DBSA should reorient its lending to smaller and under-resourced municipalities. In other words, DBSA should focus on having an exit strategy when municipalities are mature enough to raise finance from capital markets directly.

3 Malawi: Development Fund for Local Authorities (DFLA)

The Development Fund for Local Authorities (DFLA) was established in 1993 by the government of Malawi in partnership with the World Bank under the Local Government Development Project. The World Bank provided the DFLA with an initial $8.5 million in capital through the Ministry of Finance, in the form of a 50% loan and 50% grant, to be on-lent to local governments in the form of investment finance.

In its initial lending rounds between 1994 and 1998, the DFLA lent to 31 local governments to finance infrastructure and equipment, ranging from urban roads to vehicles for waste management. While initially the DFLA only disbursed in the form of indirect loans, which paid service providers directly, from 1996 onwards it started providing direct loans to local governments as well. In 1999 the Board of DFLA decided to capitalise all the accrued and unpaid interest, amortising these over the remaining loan period. In addition, the government decided to lower the interest rate to a fixed 15% rate. In April 2000, the Ministry of Finance amended the credit provisions to make all future allocations fully grants.

This period was characterised by increasingly adverse macroeconomic conditions for Malawi overall. This meant that the real value of the World Bank loan fell significantly, due to a combination of rising inflation and depreciation of the currency, the Malawi kwacha (MK). Although the national government, which took on the initial loan from the World Bank, bore the overall cost of the depreciation, the monies available to the DFLA for on-lending were reduced. Poor repayment rates, at an average of under 25% annually, combined with recurrent debt cancellations for local governments and the frequent conversion of loans to grants, meant that, by the mid-2000s, the DFLA had no money left to issue any finance to local governments at all. A World Bank assessment of the Fund in 2001 concluded that it was dormant and illiquid, and unlikely to ever resume lending.

In 2010, the government decided to recapitalise with an injection of $1.4 million. In 2017, management of DFLA was transferred from the World Bank fully to the government of Malawi. Although the recapitalisation was extremely small in relation to the needs of local

governments, it rejuvenated the DFLA and enabled it to resume lending, albeit to a much smaller degree. In recent years, only one or two loans have been awarded per year with an average value of $170,000. As before, these are paid out directly to service providers, rather than to local governments. The conditions of these loans are with a tenor of up to 10 years, and at a fixed interest rate of 14.5%, the same as the Malawi Reserve Bank rate, and highly favourable compared to commercial bank rates that hover around 26%.

3.1 Municipal borrowing in Malawi

Under Article 49 of the Local Government Act (2017), local governments are allowed to borrow funds for long-term investments with the approval of the Minister of Local Government in consultation with the Minister of Finance, and subject to the provisions of the Finance and Audit Act (2014). Local governments can also obtain bank overdrafts to address short-term expenditures, without seeking further approval. Therefore, in theory, they can borrow not only from the DFLA but from other institutions as well. In practice, however, local governments have to date borrowed only from the DFLA given the challenges they have faced with respect to creditworthiness and the small size of their loan requests.

3.2 Governance of the DFLA

The DFLA was set up as a Trust Fund with a separate bank account from which the DFLA could then approve loans to local governments. The legal basis for establishing a Trust Fund of this kind is outlined in the Finance and Audit Act (Public Financial Management Act) from 2014. Article 40 stipulates that money paid to the state can be held in a trust for any purpose as approved by the Secretary to the Treasury. Trust money shall be held and accounted for separately from other public money. Article 41 states that the Secretary to the Treasury may establish a trust account fund to receive trust monies, and all such monies shall be paid into accounts constituting the Trust Fund established for that purpose. Finally, Article 58 provides for a mechanism by which the Minister of Finance may on-lend a loan to another body including a statutory body, under a written subsidiary loan agreement, where the terms and conditions are specified.

The Board of the DFLA is chaired by the Permanent Secretary of Local Government with other Ministries represented. One of the governance challenges consistently noted by the World Bank in its review reports is that the Board is made up only of government officials, usually without any direct experience of financial management.

The DFLA is managed by a Chief Executive Officer (CEO) appointed by the Minister of Finance. Aside from the CEO, there are only three other staff, the Director of Operations, who also is responsible for credits and loans, the Director of Finance, and an assistant accountant.

At local government level, the entire council must approve the loan before it can be taken on. This is intended to ensure political support for the projects being pursued.

3.3 Finances of the DFLA

The DFLA does not publish annual reports, thus there are no public financial records of its lending.

3.4 Challenges for the DFLA

Chronic undercapitalisation is an ongoing problem. It was envisaged that the initial capitalisation of the DFLA would be provided by the World Bank, and that the government of Malawi would inject other direct sources of finance into it. This eventually happened, but only nearly a decade after the World Bank loan had been depleted. Furthermore, the DFLA was supposed to function as a revolving fund, with loan repayments providing sufficient finance for future local government borrowing. However, poor repayment and the shift from loans to grants meant that the DFLA ceased to function as a revolving fund.

Poor management structures, including outdated operational systems, have deterred investment from other development partners. Fundamental information, such as annual reports detailing the financial position of the fund, have never been issued. Loan allocation is not transparent, and it is unclear why certain local governments receive loans as this does not seem to be linked to their overall creditworthiness or the merits of the project.

Most, if not all, local governments in Malawi are not creditworthy. They are also often indebted based on deficits in recurrent activities and the overdrafts they obtain from commercial banks to cover these. The DFLA has no inbuilt technical assistance to support the upstream activities involved in project preparation. Although this is understandably challenging with a staff of four, it is critical in ensuring that the projects that are financed not only meet economic and social objectives, but also have an associated financial plan that will allow for repayment in the future.

There remains a lack of clarity from the national government as to how the DFLA should evolve. Although the fact that it was recently recapitalised with a further $545,000 is a positive sign that the government does not want the institution to fully collapse, the lack of technical, operational, and overall capacity investment in the fund to allow it to attract higher levels of financing remains concerning. Furthermore, there is ongoing unease about potential political interference given the nature of the DFLA’s governance structures.

Finally, any support to the DFLA would have to be mirrored by support to enable local governments to take on loans. A positive sign in this respect is a recent loan to Blantyre City to update its property

valuation roll, which would help to generate more own-source revenue.

4 Morocco: Fonds d’Equipment Communal (FEC)

The FEC is the oldest subnational development bank on the African continent. It was established in 1959 as an autonomous financial agency managed by the Caisse de Dépôt et de Gestion (CDG – Deposit and Management Fund). The CDG is responsible for managing the government’s public funds, deposits, and long-term savings, including from national insurance and pension schemes, mutual societies and cooperatives. In 1980, the FEC became a separate department of the CDG, and in 1997 it became a credit institution, albeit still within the CDG’s structure.

The general mandate of the FEC is to finance projects that aim to improve living standards for Morocco’s citizens. As such, the variety of projects it can finance are manifold. Examples include the following types of infrastructure:

- Drinking water.
- Solid and liquid waste purification.
- Electricity.
- Specialised equipment (including hammams and slaughterhouses).
- Urban development and transportation (including public buildings, roads, industrial zones, and green spaces).
- Public roads.
- Sports, tourism, and other recreational development.
- Commercial structures (including markets and shopping malls).

4.1 Municipal borrowing in Morocco

Morocco is divided into 12 regions, 63 provincial (rural) and 12 prefectural (urban) governorates and 1,503 communes (municipalities). The provincial and prefectural levels are led by governors, as the head of provincial assemblies. The provincial level

is responsible for social development and is highly reliant on intergovernmental fiscal transfers.

Municipalities have extensive revenue-raising and expenditure powers, as per the constitutional principle of subsidiarity. This is further outlined in Law 113-14 on Communes (2015). Municipalities' budgets are developed on an annual basis and approved by the Ministry of Interior. The allocation of the various sources of funding are also proposed by the municipalities when they submit their budgets. A large portion of the municipality's budget is funded by intergovernmental fiscal transfers managed by the Local Community Development Fund (FDCL).

Following constitutional changes in 2015, municipalities can also raise financial resources themselves, including through borrowing, although they are only mandated to borrow from the FEC. The FEC can also co-finance local municipalities and public utility infrastructure projects through medium- and long-term loans. Resources from the FEC can only be allocated to projects that have a cost-recovery or revenue-generating element, such as from user fees, and that are not otherwise financed. The FEC's financing cannot be used to cover operating expenditures, which need to be met within permanent budget resources.

To be eligible, the borrowing entity needs to be able to generate savings that cover the entire reimbursement annuity. They also need to contribute at least 20% of the total project funding costs, although this can also be done through an in-kind equivalent. The borrowing entity must also be able to demonstrate that it has the human, material, and organisational capacity to carry out the project, as well as manage the loan. This can be done internally, or another entity can do this on their behalf.

The FEC's overall project pipeline is drawn from the municipality's annual budgets and requests for financing. To be selected, a project must demonstrate social merit, as the FEC is meant to support the overall development objectives of the government. The project must also be a demonstrated priority of the entity requesting the loan and reflect the economic and planning priorities of that municipality. For commercial projects financial viability is assessed, while social projects must be both economically and socially justified and meet least-cost conditions. Technical criteria are assessed to ensure that the project is executed in the most efficient way. Environmental and social impact assessments are carried out to demonstrate that the project will have no adverse effects; or that, where it does, sufficient mitigation measures have been put in place.

Loans from the FEC are provided on a medium- to long-term basis as required by the project, with an average tenor of around 15 years. The FEC can also provide credit lines for multi-annual investments that require more than one disbursement. The disbursements are done on planned or committed expenses for the implementation of

the project. The interest rate on loans from the FEC can be fixed or variable. Fixed rates are calculated on a weighted six-month average based on information from the Bank Al-Maghrib. For variable rates, data from the date of disbursement is used. Loans from the FEC have first repayment priority and the central government may intercept intergovernmental fiscal transfers for repayment.

4.2 Governance of the FEC

The FEC is managed by a Board of Directors, chaired by the Minister of Interior. The board has two arms, one representing the national government and one for elected representatives from the municipalities. The national government side comprises:

- Two members from the Ministry of Interior.
- Two members from the Ministry of Economy and Finance.
- One member from the Ministry of Health and Social Protection.
- One member from the Ministry of Equipment and Water.
- One member from the Ministry of Energy Transition and Sustainable Development.

On the municipalities side, eight members are selected by the Ministry of Interior from an initial list compiled by the municipalities themselves.

As of 2022, the FEC has 91 employees across Morocco. The Executive Director of the FEC is the General Manager of the CDG, who is also represented on the Board. The Secretary General is responsible for internal audit and compliance. There are four main divisions: operations, finance, risk and control and sustainable development.

4.3 Finances of the FEC

Since its establishment in 1959, the FEC has provided 58 billion Moroccan dinar (MAD) in loan commitments and 48 billion MAD in loan disbursements, financing more than 5,500 local development projects in municipalities and by public utilities. In 2020, the year of the latest Annual Report, loans were approximately 3.335 million MAD. An additional 100 million MAD were provided to the government’s Covid-19 appeal.

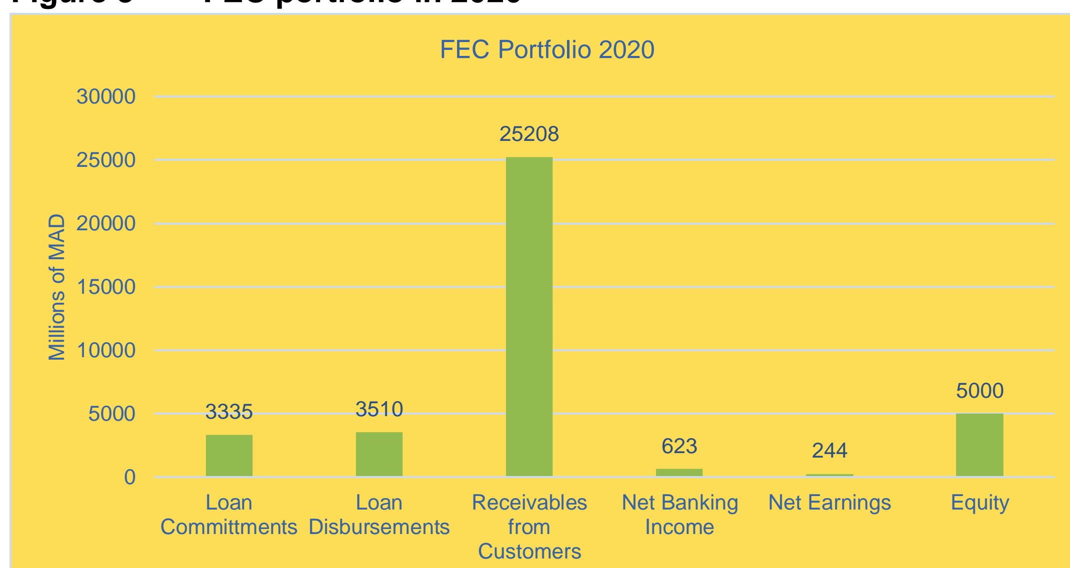
The primary capital base for the FEC is public subsidies from the CDG. Other resources include rediscounts from the Moroccan Central Bank and borrowing that the FEC can undertake on national and international markets, but this must be guaranteed by the government. For example, in 2020 it floated a 2 billion MAD bond on Moroccan capital markets, accounting for the largest part of its resources that year. The FEC’s creditworthiness as an institution is derived from that of the CDG. Outside these main areas of financing,

the FEC also derives a small part of its financing from the interest paid on its loans.

The FEC is seeking to diversify its funding base particularly through concessional loans from development finance institutions (DFIs). For example, in November 2019, after operationalisation of the African Development Bank's (AfDB) Subnational Financing Guidelines, the AfDB Board approved a €100 million line of credit to the FEC to support financing of subnational entities. To date, this was the first and only loan the AfDB has made to support financing subnational entities, which was made easier, and perhaps only possible, as the FEC was a national financial intermediary managing the overall loan.

According to its 2020 Annual Report, the most recent publicly available, the following were the main activity areas for the FEC as illustrated in Figure 3:

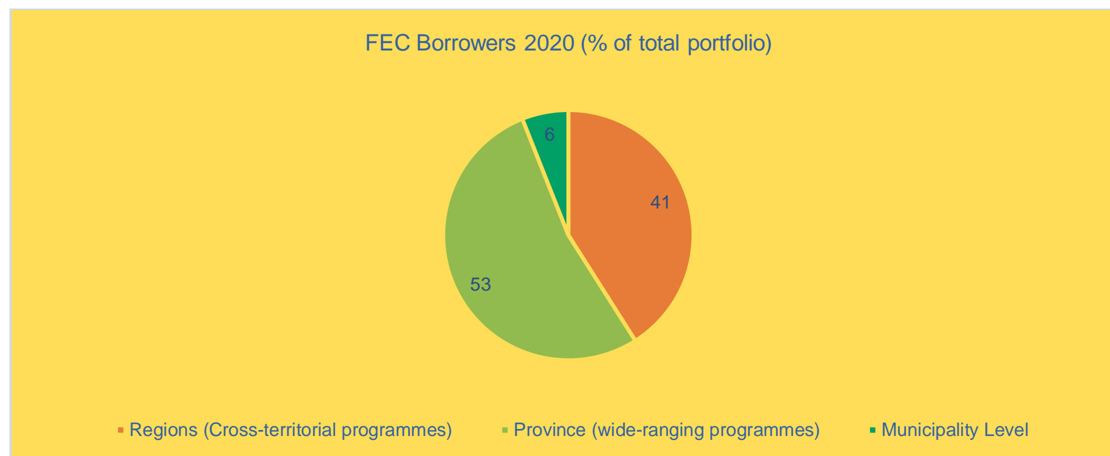
Figure 3 FEC portfolio in 2020



Source: FEC 2020

Figure 4 highlights the nature of borrowers from FEC, with municipalities making up the smallest proportion at 6%:

Figure 4 Proportion of loan portfolio to different borrowers (2020)



Source: FEC 2020

Overall, the risk profile of the FEC has improved, with non-performing loans making up 0.03% of its overall portfolio.

Investments

Projects financed by the FEC increasingly focus on infrastructure in urban areas. In 2020, of the 158 ongoing projects in its portfolio, 53% were to support urban development, and 82% of all loans were invested in road infrastructure, particularly in urban areas.

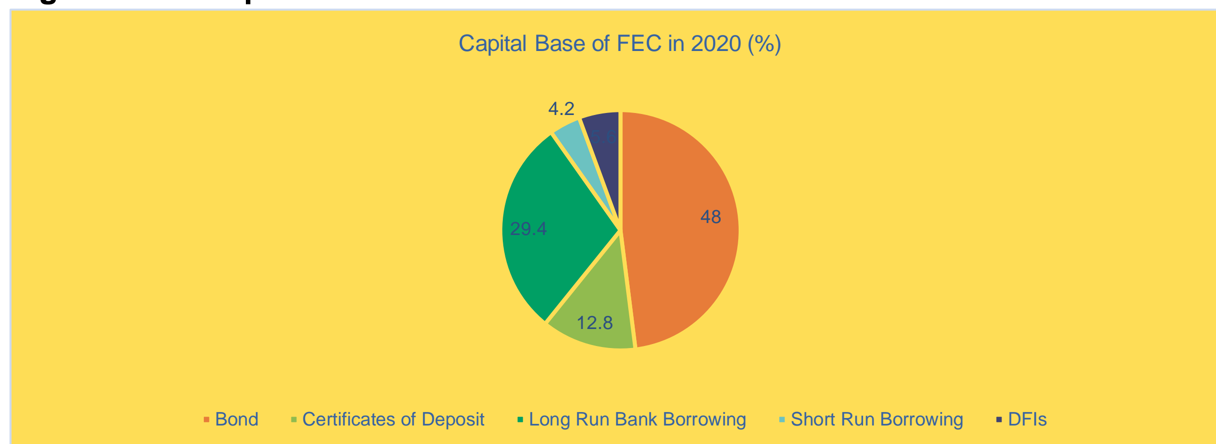
Overall, 60% of the FEC's resources went to disbursement of loans for projects, including operational expenses to manage them, and 31% were used to repay its own borrowing. The remaining components were for budgetary expenditures and to pay various forms of tax.

Capital base

The vast majority of loans (94.6%) were medium- and long-term loans mobilised on the domestic financial market, with the bond issue in 2020 making up the majority of the FEC's resources that year. At 5.4%, external loans from DFIs make up a small but slowly growing proportion of financing as the FEC seeks to diversify its capital base.

The overall profile of financial resources was as follows (Figure 5):

Figure 5 Capital base of FEC



Source: FEC 2020

Variable interest rate sources predominate, although fixed interest rate resources are increasing, from 26% in 2018 to 32% in 2020. The aim of the FEC is to increase this further to preserve balance sheet integrity by better matching assets and liabilities.

4.4 Challenges for the FEC

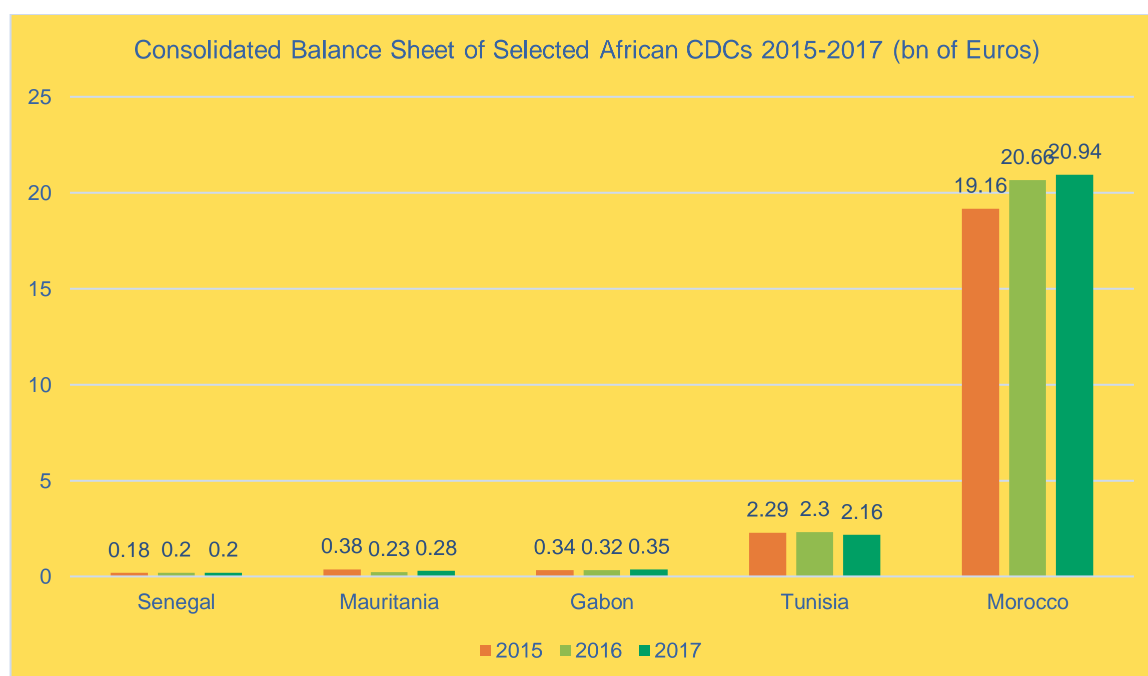
The project preparation abilities of municipalities are still very weak. Although the FEC provides some technical assistance to borrowers, this is very limited. This is reflected in the smaller number of loans that go to the municipalities, as well as the fact that, at times, the projects selected are poor. For example, a project evaluation carried out by the German Development Bank (KfW) following a credit line issued to the FEC in 1995 found that only about 60% of projects increased the availability and/or quality of municipal services.

Although all municipalities in Morocco have access to the FEC, many smaller municipalities have little or no creditworthiness and limited capacity to manage loans, and thus have not been able to borrow. As such, the proportion of loans to municipalities in the FEC's portfolio is declining. This was exacerbated by the Covid-19 pandemic, which impacted the borrowing capacity of municipalities even further.

5 Gabon: Caisses des Dépôts et Consignations (CDC)

Caisses des Dépôts et Consignations (CDC), which loosely translates to Deposit and Consignment (Savings) Funds in English, are public entities governed under the French civil code. Eight African countries have a legal structure based on this code and have adopted similar institutions. Morocco's is the oldest, established in 1959, and has the largest balance sheet (see Figure 6).

Figure 6 Balance sheet of selected African CDCs



Source: African Development Bank 2021

In general, CDCs are mandated to manage the regulated long-term savings of the government, and to transform them into investments for the public interest. In other words, they invest these long-term savings into domestic markets to catalyse productive and social investments. Unlike traditional development banks, they primarily mobilise private savings within the economy, and they are meant to have a more independent management and governance structure to

remove them from political interference. In addition, CDCs can act as the guarantor agency for government investments, as well as undertake specific banking and other financial market activities, depending on local laws.

In many cases, CDCs are also legally able to lend to local authorities to support their social and economic needs. This is the case in Gabon, where the CDC was established in 2010. It became operational in January 2012 after the law underpinning its governance mechanisms was passed. As with all CDCs, its primary funds come from savings deposits from government institutions, including pensions. It is also allocated resources in the form of grants from the National Treasury. Institutions and individuals operating in the legal profession and public accountants are also required to keep savings accounts with the CDC.

The establishment of the CDC in Gabon was directly related to the passage of the *Emerging Gabon 2025* Strategic Plan. The main aims of the CDC are to contribute to overall national economic development by mobilising financing that can, in turn, be transformed into productive activities to create jobs and economic growth. Although the CDC pursues a public mission, it does so with a focus on profitability and high-quality performance, enabled by the fact that it is managed under private law. Financially, the CDC in Gabon aims to be the benchmark investor for the public sector.

5.1 Municipal borrowing in Gabon

Law 12/82 passed in 1983 allowed the Gabonese state to establish public enterprises, semi-public enterprises, and companies with public and private financial participation. This was the foundation law that permitted the establishment of a CDC. The CDC was established in 2010, with the primary law underpinning its governance structures, namely Presidential Decree No. 0657/PR/MECIT, subsequently issued on 21 April 2011. This decree, which constitutes law, includes the following provisions:

- Establishing the CDC as a public establishment under private law for an initial period of 99 years with the Gabonese state contributing an initial 10 billion CFA.
- Entrusting it with responsibility for regulating deposits from the legal profession and public accountants, all income from state holdings and sovereign wealth funds, resources allocated by the treasury, managing local authorities' equalisation funds, and the protection and management of pension funds, postal accounts and reinsurance funds.
- Allowing the CDC to provide financing, including counterpart funding for public projects and programmes, as well as being the institution responsible for centralised management of local and external financing for these programmes. It is also the institution

entrusted with ensuring financing for local authority-initiated projects.

- Establishing the CDC's structure and the Board of Directors.

Gabonese local governments are allowed to borrow only from the CDC.

5.2 Governance of the CDC

The CDC is overseen by the Ministry of the Economy but governed by an independent Board of Directors. There are 11 members on the Board, including a representative of the Presidency, Prime Ministry, Ministry of Justice, Ministry of Budget, Ministry of Economy, Ministry of Local Authorities, the legal professions, Bank of Central African States, Finance Commission of the National Assembly, Senate Finance Committee and Economic and Social Council. None of the positions is remunerated, although expenses for meetings are reimbursed.

All representatives are nominated by their respective institutions for a three-year term, and can be renewed once. The Chair is appointed by the Council of Ministers, on the recommendation of the Minister of the Economy. The Director General of the CDC, who is responsible for day-to-day management as well as the chief authorising officer of the budget, is also appointed by the Council of Ministers, on the recommendation of the Minister of the Economy. CDC staff are public officials specifically seconded from their appointed place of work and their appointments are governed by Labour Law.

5.3 Finances of the CDC

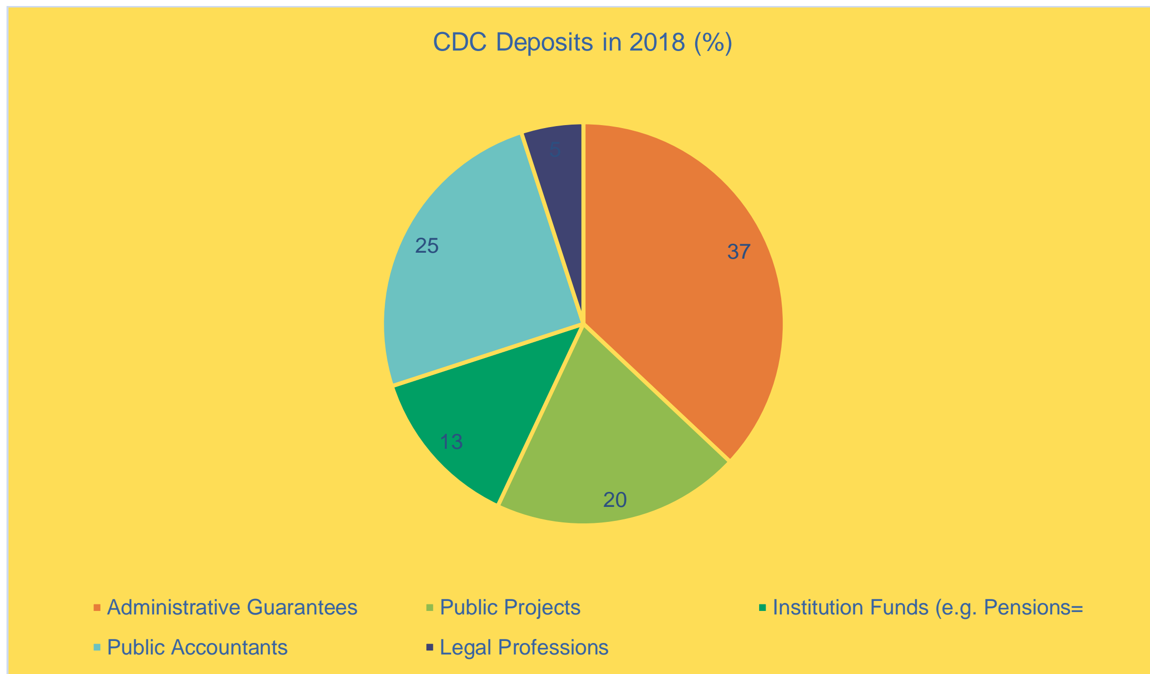
The CDC is mandated to maintain a high level of equity and, accordingly, to develop financial instruments that can mobilise other finance by leveraging government savings. Currently, equity finance comprises approximately 52% of its balance sheet. The CDC also aims to optimally allocate its resources, according to loan maturity, and through this maximise yields.

As the CDC does not issue public annual reports, the most recent data with respect to its portfolio comes from 2018, when the breakdown of finances was as follows:

- Balance sheet total: €454 million.
- Own funds: €105 million.
- Funds managed on behalf of Government: €276 million.
- Asset portfolio: €160 million.

In terms of deposits, the breakdown is as follows (Figure 7):

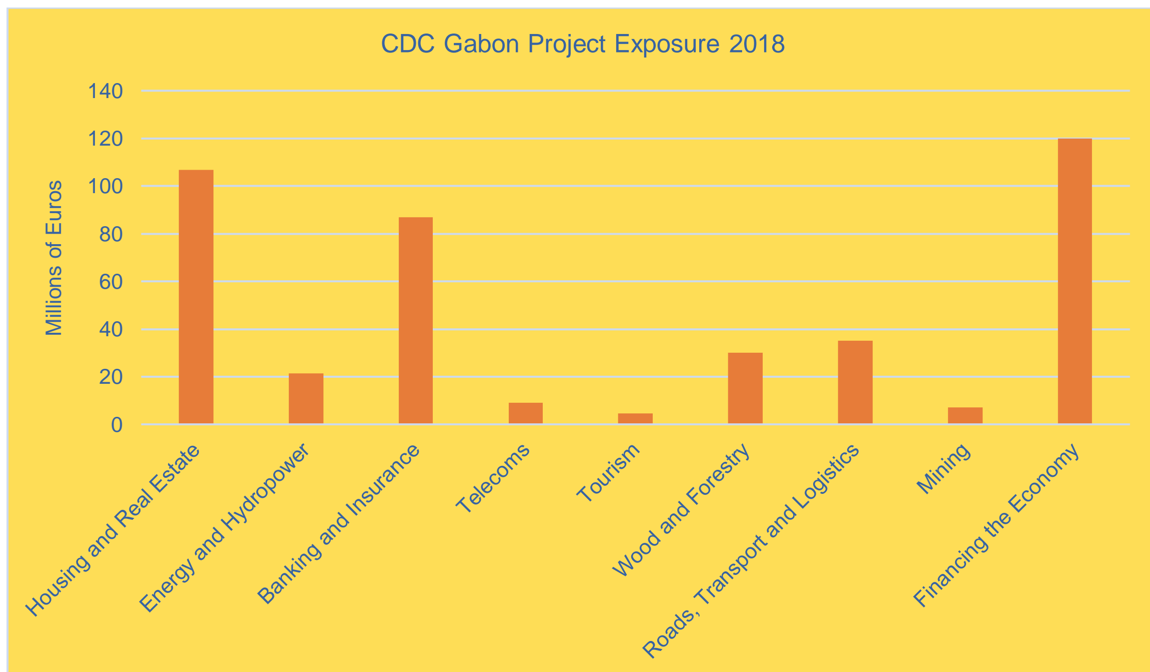
Figure 7 CDC Deposits



Source: CDC Gabon 2019

From a project perspective, exposure in 2018 was as follows (Figure 8):

Figure 8 CDC Project exposure



Source: CDC Gabon 2019

It is not possible to determine how much of the portfolio went to financing local government versus national government projects.

5.4 Challenges for the CDC

There does not seem to be a publicly available evaluation of the CDC highlighting current operations and ongoing challenges.

6 Policy recommendations

The case studies show that lending to municipal governments is working, albeit with differing degrees of success and not without its challenges. Even institutions like the DBSA and FEC, which have a longer history of lending to local governments, and a more solid institutional framework under which to do this, are not able to meet all the demands placed on them, particularly regarding smaller, less-resourced municipal governments. There is a set of recommendations that relate to the municipalities and local governments themselves, such as improving their creditworthiness and developing a pipeline of projects, and a set of broader recommendations around improving the legal and institutional framework, the final section of this brief looks solely at recommendations for the SFIs themselves. The four case studies offer a limited snapshot of the diversity of institutions that exist, but the deep dive into these four provide some more general lessons and policy recommendations.

Segmenting offers to the market

As with any successful financial institution, SFIs should have a portfolio of different products and services they offer their clients because municipalities and local governments can differ significantly in both their needs and their capacities. By segmenting their markets, SFIs will be better able to target their products and services. For example, DBSA provides different types of loans, with different concessionality, based on the municipality or the metros it is lending to. However, as an institution it needs to do this better, because of concerns that it is crowding out other potential lenders to those municipalities that have the capacity to access capital markets.

Being able to offer a wide portfolio of loan products also requires the SFI to diversify its funding sources to ensure different tenors at different interest rates. A major opportunity here are multilaterals that may only be able to lend to national institutions. There is also an increasing pool of specialised financing, such as green financing or 'use-of proceed' bonds, for example, those related to achieving the Sustainable Development Goals (SDGs). Both the FEC and the DBSA are actively trying to access more diversified sources of financing, with the FEC being the only entity so far to have received a line of credit under the African Development Bank's Subnational Financing Guidelines.

Developing municipal debt markets

SFIs have an important role to play in helping municipalities, particularly the smaller ones, become creditworthy. This is both from a technical assistance point of view, to be able to stabilise their balance sheets, but also to help them borrow and repay so that they can develop a credit history. To a limited extent, this is what DFLA has been doing with municipalities in Malawi, although to date none has been able to access the wider capital market. In South Africa, DBSA has been very successful in this endeavour, both by bringing municipalities to the capital market and helping develop municipal debt markets overall, including crowding in private lenders.

Balancing development and financial objectives

If they are going to be successful in unlocking financing for sustainable urbanisation across Africa, subnational financial intermediaries are necessarily going to need a public development objective. This is the case for all the SFIs analysed in these case studies. These objectives, however, are at times likely to be incompatible with having to run a self-sustaining financial institution that can borrow from capital markets on favourable terms. This is particularly the case where the SFI may want to lend to more under-resourced municipalities.

A further challenge is when the governance structure of the SFI is not politically independent. In these cases, it is important to consider the potential for political influence that could divert funds towards less creditworthy but politically prioritised projects or undercut adequate due diligence or scrutiny of projects. SFIs must develop institutional set-ups that potentially allow them to cross-subsidise loans or provide different kinds of services, such as technical assistance (see next section). Again, as mentioned previously, they will have to understand the needs of their markets and provide services and products accordingly.

Provision of technical assistance

Having in-built technical assistance mechanisms, both in terms of helping municipalities improve their credit worthiness and to support upstream activities, particularly with respect to project preparation, should be a key activity of SFIs in order to generate the necessary demand for financing. For example, even the FEC, the oldest subnational financial intermediary on the continent, only engages to a very limited extent in supporting project preparation. As an alternative, where the SFI does not have the ability or expertise to provide this technical assistance, it can partner with other institutions that do. This can in turn help foster complementarities. For instance, where one institution helps support project preparation, it can target the SFI's requirements for subsequent lending.

Annual financial reporting and evaluations

For many of the SFIs examined, very little public information is available. Yet, like any other financial institution, in order to attract financing, for SFIs at a very minimum, having a public financial and audited record of finances is critical and thus building institutional capacity to enable this is key. This not only fosters transparency and accountability but will also be a key requirement in attracting further finance in the future. Information with respect to transparency for SFIs also needs to include information in terms of on-lending. The DFLA, for example, is chronically undercapitalised. However, the lack of financial data means there is no evidence and therefore confidence for those institutions that may want to invest in it in the future. Aside from audited public financial information, external evaluations should highlight both opportunities and challenges with respect to the organisation’s operations. This is important information to encourage confidence in the overall management of these institutions.

Long-term capitalisation

Although SFIs can be set up through initial support, including capitalisation from development partners, as was the case with the DFLA in Malawi, in the longer term the public sector needs to run the institution and capitalise it, and a strategy needs to be in place for this. The experiences from both Morocco and Gabon, as well as CDCs established in other countries, are very interesting as these are institutions able to mobilise nationally long-term public savings for investments. This is an important source of domestic financing that in many other countries is not yet aptly channelled to national or local investment.

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