

# **Legal Framework Analysis for Municipal Financing**

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# LEGAL FRAMEWORK ANALYSIS

## Introduction

- Much like the laws of physics, the principles of municipal finance have universal application
- Investors in Mozambique are just as concerned about risk and rate of return as investors in Manhattan
- Similarly, financial structures and credit enhancements designed to reduce investor risk should result in reductions in cost of capital regardless of location of investment
- Attempts to cut corners or design sub-standard financial programs in developing countries will fail to raise capital or result in unintended consequences

# PROFESSIONAL AND INDEPENDENT JUDICIARY

- All debt instruments, including loans, bonds and debentures, are contractual agreements
- Capacity of the judiciary to effectively and fairly resolve disputes between contracting parties is a factor considered by investors
- This analysis goes beyond the scope of legal audit
- Highly professional, independent judiciary will enhance development of municipal finance system
- Enforcement of contractual obligations of parties by an impartial judiciary is essential to viable municipal finance system

# THREE PHASES OF LEGAL ANALYSIS

- **Legal Audit** – review all relevant laws for municipal finance and identify barriers to efficient and effective mobilization of private capital for public infrastructure development
  - Should be conducted by experienced bond counsel and local legal advisor
  
- **Remediation Strategy – address impediments on a triage basis –**
  - Stipulation of parties
  - Financial structures
  - Administrative orders
  - Legislative initiatives
  
- **Draft Standard Legal Documents**
  - Bond Resolution
  - Trust Indenture
  - Disclosure Document

# LEGAL AUDIT

## Laws to be Reviewed

### Constitution

- U.S. bond market is predicated on specific provisions in the U.S. Constitution
- Constitution does not need to authorize municipal debt, however, the federalism section may contain language that will have a direct impact on municipal finance
- Provisions defining local governments' entitlement to percentage of nationally collected revenues (Colombia, Argentina and Brazil)
- Certain provisions of the Constitution that do not address federalism issues may nevertheless have an impact on municipal finance (U.S.)

# LOCAL GOVERNANCE LEGISLATION

- Legislation granting specific powers to sub-national government entities
- Authority to incur debt and specific limitation on such authority, e.g. debt caps (Europe) state approval (Mexico)
- Authority to raise revenue
- Authority to pledge assets (Zimbabwe)
- Authority to contract with the private sector for the provision of public services – PPP, concession, joint venture (Zimbabwe)
- Monitoring and oversight of local government financing
- Terms of office

# LOCAL GOVERNANCE LEGISLATION

## (Continued)

- Power of national or regional government to suspend actions of lower level of government (India)
- Power of national or regional government to dissolve municipal corporation or government (India)
- Public notice and hearings
- Duties levied by the national government but collected and appropriated by the states
- Tax levied and collected by the national government but assigned to the states

# LOCAL GOVERNANCE LEGISLATION

## (Continued)

- Registration of borrowing
- Registration of collateral
- Municipal accounting standards
- Budget standards
- Audit procedures and requirements
- Foreign currency borrowing (Mexico)



# FINANCIAL DISCLOSURE LEGISLATION

- Will govern public bond offerings not private placements
- Most countries' disclosure laws cover the issuance of stock and debt for private companies only (India)
- Very few countries have specific disclosure requirements for municipal securities
- Modification to disclosure laws to accommodate municipal securities will streamline financing process

# MUNICIPAL ENTERPRISE LAW

- Governs activities of municipal utilities (Water Districts, Philippines)
- May have specific debt limit and other restrictions independent of local finance laws.
- Will generally govern the issues of revenue bonds
- Will define powers of utility to contract with the private sector for delivery of public services
- Provides procedures for tariff setting and adjustments

# TRUST ACT

- Municipal bond financing structures utilize trust and trustees
- Trust Act will specify what qualification an entity must meet to serve as a trustee
- Some legislation provides trustees with much broader authority than trustees are willing to assume (India).

# MUNICIPAL CHARTER

- Elections and terms of office
- Provisions regarding validity of proceedings
- Obligatory and discretionary duties
- Power to execute contracts
- Acquisition and disposal of property

# MUNICIPAL CHARTER (Continued)

- Municipal funds
  - deposits
  - draw against
  - restrictions on expenditures
- Audit of accounts
- Borrowing powers
- Taxing powers - taxes to be imposed and manner of recovery

# BANKRUPTCY LAW

- Does it cover municipal bankruptcy?
- Who can file? Debtors and/or creditors?
- Remedies and procedures
- Inability of creditors to take local authorities into bankruptcy or insolvency proceedings is not fatal to a vibrant municipal finance system