UNCDF MIF MUNICIPAL INVESTMENT FINANCE

Financing urban futures

in the world's Least Developed Countries

CHALLENGES

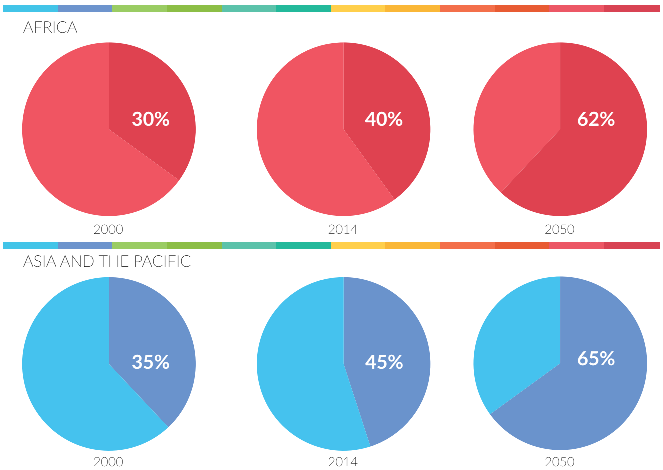
Demographic pressures, climate change and the promise for economic opportunity are driving **increased urbanization** in many parts of the world.

In 2000, 30% of Africans and 35% of Asians were city dwellers. By 2014, that proportion had increased to 40% of Africans and 47% of Asians and is expected to reach 62% and 65% by 2050 according to UN Habitat (see diagram below). Of the 2.5 billion people to be added to the urban population in the next 35 years, 90% will be in Africa and Asia.

Urban growth however, is not limited to capital cities – it is having a **profound impact on secondary cities** too. This is particularly the case in least developed countries (LDCs) where many of the world's fastest growing cities are located. 56% of the urban population in LDCs lives in secondary cities, which are growing rapidly. Of the 679 urban settlements with 300,000 to 500,000 inhabitants, 271 have grown at an annual rate of over 3% during the period 1990-2014, almost exclusively in the LDCs.

The accelerating rate of urbanization puts enormous **strains on urban resources**; there is increased demand for water, sanitation, education, transport, energy, housing and jobs.

URBAN POPULATION



Beyond the provision of basic services, disaster resilience is increasingly recognized as a key challenge in the post-2015 agenda.

The Ebola outbreak in West Africa has not only put big cities such as Monrovia and Freetown on lockdown, it has also revealed the weakness of key infrastructures (particularly health infrastructure) in smaller cities such as Kenema (Sierra Leone) and Gueckedou (Guinea). The earthquake in Nepal resulted in enormous damage in Kathmandu and beyond, whereas successive waves of refugees fleeing from wars and natural disasters are putting enormous pressure on cities worldwide. It highlights not only the lack of preparedness of many cities but also the **crucial role of the decentralization agenda** in putting cities firmly in charge of their own development.

The future economic development of LDCs now depends significantly on how well urbanization is managed. Cities harbor an enormous economic potential but unless this potential is maximized through adequate policies and the provision of the necessary support infrastructure, the development impact will be weak.

City governments need to have access to the necessary tools and capacities to manage urbanization, but crucially, they also **require a huge amount of investment capital to finance major infrastructure improvements**. Mobilizing these resources remains a considerable challenge for most cities, which depend heavily on government transfers for their development.

Given the scale of investments needed to provide an ever-growing amount of urban dwellers with the necessary services and infrastructures, the focus is starting to shift towards a **smart blend of financial mechanisms** that match transfers from central government with greater own revenue and sustainable borrowing. The critical challenge is to foster an **enabling environment for municipal financing**, in which local governments have the necessary capacities and rights to engage with financial markets, whilst at the same time managing the risks inherent in this type of arrangement.

OUR APPROACH

UNCDF has a unique mandate within the UN system. It provides seed capital to test out innovative financial mechanisms that address specific development challenges.

Over the last 30 years, it has built a specific expertise in local government finance, intergovernmental fiscal transfers and local investments. Whilst the responsibilities and powers of local authorities have expanded in that time - due to progress on decentralization, **increased demand for services and a greater role for local governments in crisis prevention** - the availability of funds to invest and offer services has not kept pace with these developments.

Yet, funding opportunities have increased due to national and international commitments on climate change, the increasing volume of remittances and the emergence of strong domestic financial markets amongst others. Local governments' ability to access these new funding sources now hinges on their capacities to mobilize them, as well as the existence of a favorable legal and regulatory national framework. This is the problem the **Municipal Investment Finance (MIF) programme** is trying to address.

The overall programme outcome is **to increase the ability of local governments and other sub-sovereign entities to address key urbanization challenges** (such as climate change adaptation, food security, adequate housing and access to utilities) through access to sustainable sources of capital financing. MIF will do this by capitalizing on UNCDF's core experience in capital development, public financial management and infrastructure finance in the private and public sectors.

Specifically, the programme will focus on:

- building the necessary capacities for local governments to gain access to alternative sources of municipal financing, including municipal bonds;
- strengthening and developing municipal finance markets and intermediaries;
- creating the enabling policy environment to improve the capital financing process.

The MIF programme also responds to a number of core challenges and opportunities of the post-2015 agenda, in particular with regard to **Sustainable Development Goal (SDG) 11** (Making cities inclusive, safe, resilient and sustainable), the Financing for Development agenda and the associated question of widening sub-national entities' access to domestic and international sources of private and public finance.

The key tool proposed under the MIF programme is the use of blended finance to contribute to the narrowing of the financing gap in LDC cities. In practice this involves **the use of grants and non-grant financing instruments such as loans, bonds or equity**. The exact 'blend' will be determined by the country-specific circumstances but the MIF programme will also actively work towards creating the enabling environment to allow local governments to access a greater number of funding sources for their investment needs.

PROGRAMME STRATEGY

4 STEP APPROACH

Addressing the issue of local governments' access to sustainable sources of financing

1. **Promote the municipal financing agenda nationally and internationally** by enhancing understanding of how municipal finance can address development challenges and building support, nationally and internationally, for creating the enabling conditions for the emergence of municipal finance markets.

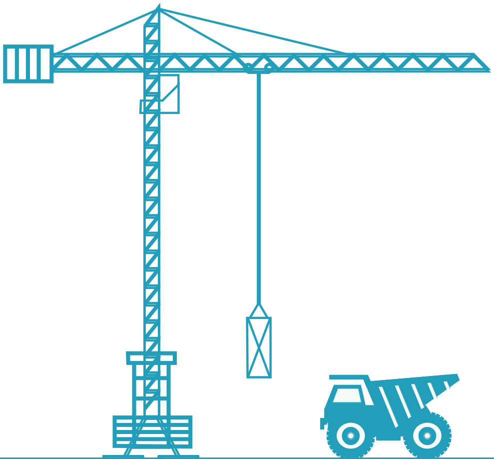
2. **Supports complementary efforts to make cities more resilient** by linking up different resilient cities initiatives (from the World Bank, ADB or AFD) and serving as a coordination platform.

3. **Bridge the gap in funding** by leveraging municipal grant funding with sub-sovereign credit, building on UNCDF's unique expertise in using grant funding to unlock domestic and international private finance.

4. **Put an emphasis on risk mitigation measures** through objective market assessments, improving financial information, adequate credit rating systems and credit guarantees.

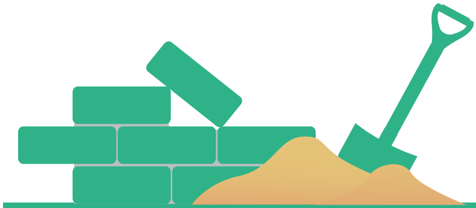
The MIF programme will provide assistance to at least four LDCs and support financing transactions for at least 12 local governments. The objective is to create platforms and models that will enable greater access to capital finance for municipalities in each country.

OUTPUTS AND PHASING



01 PHASE I: **Project Inception**

- Finalizing project tools and methodologies
- Establishing the monitoring system for the project
- Engaging partners and mobilising resources



02 PHASE II: **Project Implementation**

- Establishing government and private sector working groups
- Assessing financial intermediation options
- Agreeing on policy and legal reforms required
- Evaluating and selecting the initial cities in each country
- Implementing policy and legal reform
- Conducting training and institutional capacity building
- Preparing and updating municipal investment plans
- Preparing and carrying out financing transactions

03 PHASE III: **Project Consolidation and Sustainability**

- Completing policy and legal reforms
- Evaluating and selecting additional cities
- Preparing or updating investment plans in additional cities
- Analyzing additional intermediaries and engaging these entities
- Continued training and institutional capacity building in government and private sector
- Preparing and carrying out additional financing transactions

UNCDF is the UN's capital investment agency for the world's 48 least developed countries (LDCs). With its capital mandate and instruments, 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. This last mile is where available resources for development are scarcest; where market failures are most pronounced; and where benefits from national growth tend to leave people excluded.

UNCDF's financing models work through two channels: savings-led **financial inclusion** that expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives; and by showing how **localized investments** - through fiscal decentralization, innovative municipal finance, and structured project finance -- can drive public and private funding that underpins local economic expansion and sustainable development. UNCDF financing models are applied in thematic areas where addressing barriers to finance at the local level can have a transformational effect for poor and excluded people and communities.

By strengthening how finance works for poor people at the household, small enterprise, and local infrastructure levels, UNCDF contributes to SDG 1 on eradicating poverty with a focus on reaching the last mile and addressing exclusion and inequalities of access. At the same time, UNCDF deploys its capital finance mandate in line with SDG 17 on the means of implementation, to unlock public and private finance for the poor at the local level. By identifying those market segments where innovative financing models can have transformational impact in helping to reach the last mile, UNCDF contributes to a number of different SDGs and currently to 28 of 169 targets.

CONTACT US

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Unlocking Public and Private Finance for the Poor

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