Deutsche Bank
Research

EU Monitor
European integration

Small is beautiful?

Capital market funding for sub-sovereign authorities on the rise

July 25, 2014

Authors
Stefan Vetter
+49 69 910-21261
stefan.vetter@db.com

Frank Zipfel
+49 69 910-31890
frank.zipfel@db.com

Jan Fritsche

Editor
Barbara Böttcher

Deutsche Bank AG
Deutsche Bank Research
Frankfurt am Main
Germany
E-mail: marketing.dbr@db.com
Fax: +49 69 910-31877

www.dbresearch.com

DB Research Management
Ralf Hoffmann

Bonds issued by sub-sovereign levels of government (regional and local authorities) are a segment that has attracted little attention to date. All the same, bonds are the dominant form of funding for Germany's Länder and are playing an increasingly important role in other European countries, too.

In Europe the market for sub-sovereign bonds is dominated by Germany's subordinate levels of government, which alone constitute 72% of the total volume. The lion's share of this is accounted for by the Länder, which benefit from Germany's excellent sovereign rating and comparatively low refinancing costs.

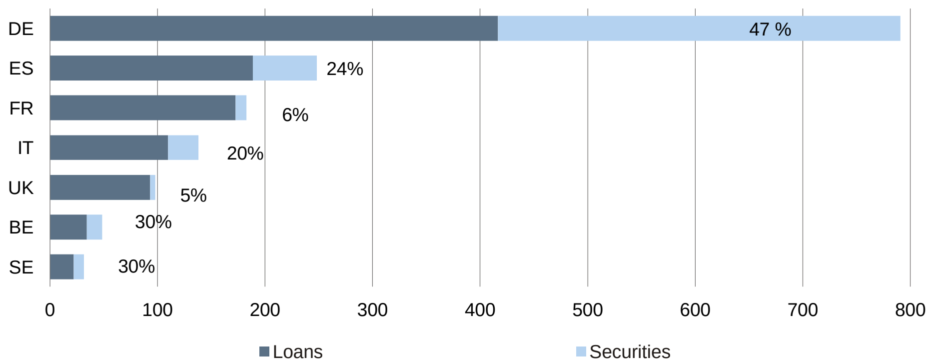
While the Länder ratings are the same or only slightly lower than the AAA sovereign rating for Germany, the ratings for the regions in Italy and Spain vary by up to five notches. A few regions with particularly low levels of debt currently have even better ratings than the central government.

From 2011 onwards many of Spain's autonomous communities were effectively cut off from the capital market and even more solvent regions could only obtain short-term, excessively costly funding. More than half of them had to be bailed out by the central government. Of late, however, they have benefited from falling risk premia. Regions that were not part of the bailout programme were already busy issuing bonds in the first few months of 2014 and had to offer yields that were scarcely higher than those for equivalent sovereign bonds.

In centralised France the importance of the regional level is relatively small, but issuance by the municipalities via the newly established Agence France Locale is likely to increase in the coming years. A local authority finance agency is also in the process of being introduced in the United Kingdom. Both countries are modelling their agencies on Sweden's Kommuninvest in particular. In Germany the debate is still very much in its infancy.

Debt of local and regional governmental authorities

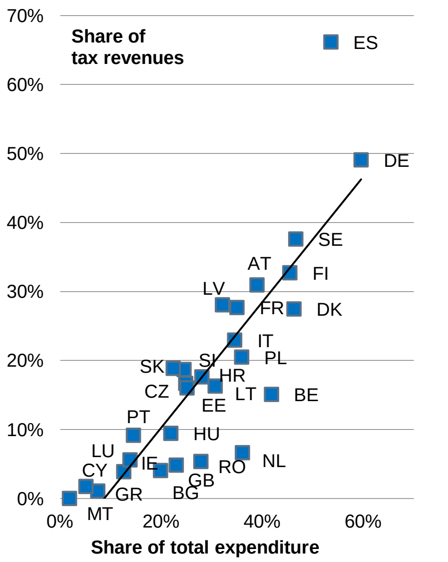
EUR billion; percentages indicate the proportion of total volume constituted by securities



Sources: Eurostat, ECB, Bundesbank, Department for Communities and Local Government

Fiscal significance of subsovereign authorities 1

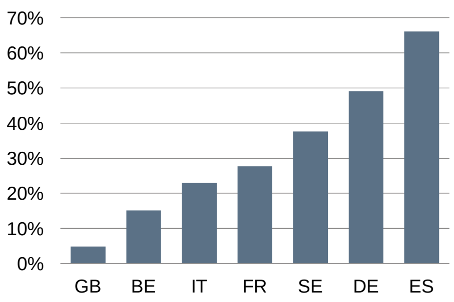
Respective shares, 2012



Sources: Eurostat, European Commission

Subsovereign share of total tax revenues 2

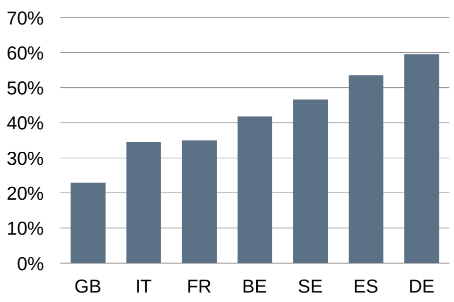
Excluding social insurance, 2012



Source: European Commission

Subsovereign expenditure as a share of total expenditure 3

Excluding social insurance, 2012



Source: Eurostat

Sub-sovereign bonds – a segment that has attracted little attention to date

In times of low interest rates and major macroeconomic uncertainty it is natural that the types of investment which become more appealing are those regarded as relatively safe and which at the same time offer higher yields than investment grade sovereign bonds. This phenomenon has recently benefited corporate bonds, for example, which were able to generate very high demand with comparatively moderate risk premia.[1]

Bonds issued by local and regional governments have the potential to become more significant in Europe going forward. In this segment Germany's Länder are among the trailblazers, along with the autonomous communities in Spain. The latter were virtually locked out of the market by the barely affordable risk premia on periphery bonds, but in the meantime the market environment has improved considerably. Moreover, the Scandinavian-inspired financial agencies created in France and planned in the UK will help local authorities there to tap the market for funding more easily and more cheaply in future.

Fiscal autonomy and debt of regional and local authorities in Europe

In the EU member states Germany, Austria, Belgium and Spain there is a distinct separation of government into the three levels of central, regional and local authorities. The most important entities at the regional level are the autonomous communities or Comunidades Autónomas (CAs) in Spain and the Länder in Germany. All activity below this level is assigned to the local level in the national accounts. In the other EU member states where regions either do not exist or are of comparatively minor importance (e.g. France and Italy), a distinction is mostly made between the local and the central government levels.

On a European comparison the regions in Spain and Germany can be adjudged to have the greatest autonomy, although it is not always possible to make such a consistent assessment. In terms of total tax revenues and public expenditure the importance of German and Spanish regions in their federal systems is, however, much greater than in the other EU member states (see charts 1-3).

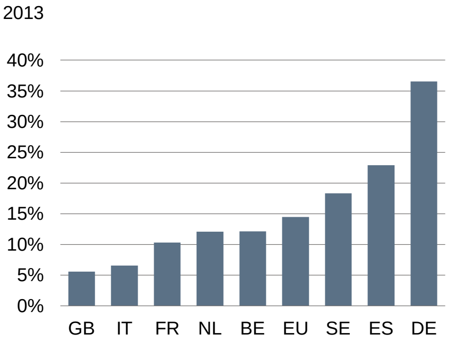
The sub-sovereign share of tax revenues is 66% in Spain and 49% in Germany. Government is highly centralised in the UK, where the sub-sovereign level collects only 5% of taxes. Italy and France occupy midtable rankings; their respective local government shares of tax revenue are 23% and 28%. The share of expenditure by the local and regional authorities of 35% for both France and Italy also ranks these countries between the UK (23%) and Spain (54%). Germany's subordinate levels of government top the rankings with a share of 60%.

The debt levels of the subordinate levels of government are also very mixed. On a EU-27 average, sub-sovereign debt represents 14.5% of total government debt. While the UK has a relatively low sub-sovereign debt share of 5.6%, in Spain the figure is 22.9% and in Germany it is no less than 36.6%. Local authorities account for 10.3% of total debt in France and for 6.5% in Italy.

The development of sub-sovereign debt within the EU has been very mixed of late. While it roughly tripled in Spain compared with the pre-crisis phase, it

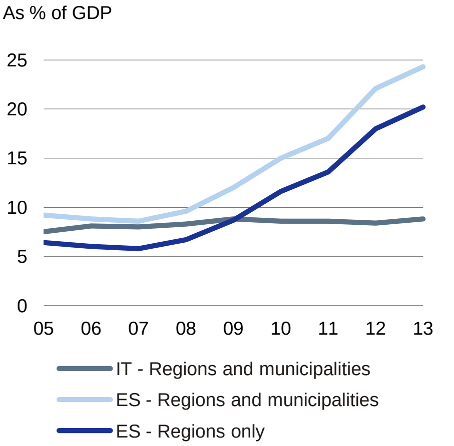
[1] See Kaya and Meyer (2013).

Subsovereign debt as a share of total debt 4



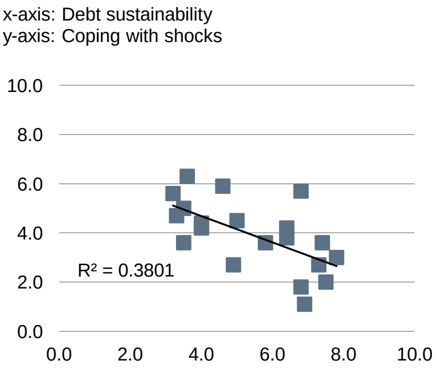
Source: Eurostat

Subsovereign debt in Spain and Italy 5



Source: Eurostat

OECD autonomy indicator: Negative correlation between subindicators 6



Source: OECD

remained largely constant in the Italian regions and municipalities (chart 5). The growth in sub-sovereign debt in Spain is mainly due to the new debt of the regions. This comparison on its own, however, is of little meaning as the Italian regions simply had no opportunity to take on the same level of debt because of their limited autonomy.

Such statistics are only of limited use for assessing the actual extent of a region's fiscal autonomy. On the one hand, a region appears to be largely autonomous if it generates most of its revenues from taxes that it levies – and sets – itself. This is, however, only the case if scope also exists for the appropriation of these taxes. If an explicit or implicit earmarking exists, e.g. for parts of the healthcare system or the transport network, then this autonomy is considerably reduced. The capacity to issue one's own debt is another aspect of the autonomy of a sub-sovereign authority. For the fiscal stability of the country as a whole it is desirable, on the one hand, that regions are only allowed to take on debt according to clearly defined rules. On the other hand, short-term new borrowing may be necessary to cushion the impact of temporary and regionally limited shocks.

Since 2005 the OECD has issued an indicator to assess the binding fiscal regulations that apply to sub-sovereign authorities which is comprised of four subcategories: (i) rules that restrain the overall size of the public sector, (ii) rules supporting allocative efficiency, (iii) rules on ensuring debt sustainability, (iv) rules concerning the discretionary scope in the event that a shock materialises. In aggregate form the indicator is, however, of limited informative value, as some subcategories are virtually irreconcilable. For example, a prerequisite for discretionary leeway in the event of shocks is that a region can independently decide to take on more debt during recessions. This stands in stark contradiction to a system with strict debt rules that is geared towards fiscal sustainability. It therefore comes as no surprise that these two subcategories are negatively correlated (chart 6). It is also striking that the sub-indicator of debt sustainability actually has a slightly positive correlation with the sub-sovereign share of total debt. The assessment of a region's fiscal autonomy thus needs to be complemented by a qualitative analysis.

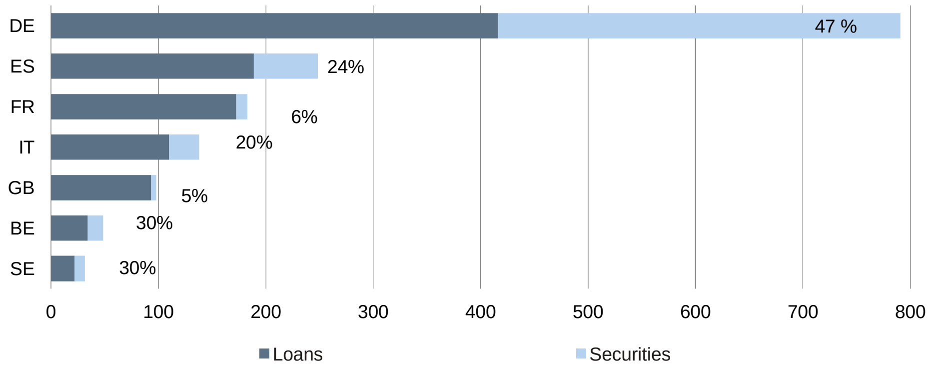
The role of bonds as regional debt instruments in Europe

In Europe there are big differences between the importance of securities (i.e. bonds) for regional and local authorities. While the Länder and local authorities in Germany raise 47% of their debt via the capital market, the securities share of debt for regional and local authorities is only 6% in France and only 5% in the UK. In Spain 24% of sub-sovereign debt is bond financed, while in Italy the figure is 20%.

Issuing own bonds brings with it fixed costs that only make financial sense above a certain volume. Bond issuance may, however, also be a necessity because of a lack of other alternatives, if previously established providers of credit are no longer as active in the market as before. A key factor in the appeal of bonds as a debt instrument is the rating of the respective local or regional authority. The institutional framework and the size of the region also play an important role. In countries with relatively small regional entities the subordinate levels of government have a greater imperative to join together in order to be able to place larger volumes in the capital market.

Debt of local and regional governmental authorities 7

EUR billion; percentages indicate the proportion of total volume constituted by securities



Sources: Eurostat, ECB, Bundesbank, Department for Communities and Local Government

One particularly important aspect of the institutional characteristics is the issue of the internal structure of the liability of the subordinate levels of government and whether thus, for example, a bailout by a higher-level entity is possible. However, this also includes the issue of how much financial autonomy (e.g. tax-raising power, fiscal equalisation system, debt legislation) municipalities and regions possess. What is desirable from an investor's point of view (e.g. the possibility of a bailout) may, however, be associated with negative incentives (e.g. unsound budgetary practices).

Fiscal equalisation schemes in Europe 8

Fiscal equalisation systems exist in many European countries and their objectives can be both vertical redistribution (between different levels of government) and horizontal redistribution between richer and poorer locations.

The characteristic features of Germany's federal system include not only the close financial ties between the different levels of government, but also the general “Bündisches Prinzip” (i.e. the principle of mutual support between the Federation and the Länder and between the Länder and the municipalities). The primary material reflection of this fiscal solidarity is the financial integration of the Federation and the Länder. Some 70% of tax revenues in Germany are shared between the different levels of government and a part of this is redistributed via the Länder financial equalisation system. This fiscal equalisation scheme ensures the practical anchoring of the solidarity principle and mutual support (and thus bail-outs) in the federal state.

Italy's subordinate levels of government are firmly intertwined. On the one hand, the central government redistributes some of the sub-sovereign tax revenues, while on the other hand a state fund has been established that provides support to regions whose tax revenues are low. This fund guarantees a minimum level of public benefits in the areas of healthcare provision, education and social services.** The transfers disbursed are geared to the costs of the most efficient region.

In France, too, vertical and horizontal equalisation mechanisms co-exist.*** In 2012 the vertical fiscal equalisation of EUR 7.34 bn was equivalent to some 3% of the expenditure at the local level. Four new funds were set up as part of a strategic shift towards increased horizontal equalisation. The most important detail is the national equalisation fund set up in 2012 (Fonds national de péréquation des ressources intercommunales et communales). This horizontal equalisation mechanism is intended to redistribute around 2% of receipts at the municipal level by 2016.

In Spain, several funds exit which support fiscal equalisation between the regions.**** The principal fund (Fondo de Garantía de Servicios Públicos Fundamentales) consists of 75% of fiscal revenue to which the autonomous communities are entitled and of additional contributions by the central government. The division is based on an expenditure-formula, which guarantees that the regions have access to the same per-capita resources. There is also a so-called sufficiency fund (Fondo de Suficiencia Global) which evens out remaining differences. Two convergence funds (Fondos de Convergencia) have been set up specifically for structurally weak regions. The Basque Country and the Navarre region are not part of the equalisation system; they must, however, pay a negotiated amount into the sufficiency fund.

The equalisation system in the UK has both a vertical and a horizontal component. The redistribution mechanisms are, however, of minor importance as most of the regional and local authority revenues are in any case transfers from the central government.

The fiscal equalisation systems ensure a high degree of redistribution of revenues at the sub-sovereign level. In 2012 redistribution mechanisms in Italy reduced the Gini coefficient (a measure of inequality of revenues between the regions) from 0.19 to 0.04. The transfer system in Spain brought down the Gini coefficient of the regions from 0.13 before the redistribution to 0.04.

Sources: *Zipfel (2011), **Blöchliger and Vammalle (2012); OECD (2013); Vallier and Boulanger (2012), *** Collectivités Locales (2014), ****Ministerio de Hacienda y Administraciones Publicas (2014)

Joint participation in the capital and credit markets becoming more popular also outside Scandinavia

The Scandinavian countries look back on many years of experience with so-called municipal finance agencies – Kommuninvest for example was already set up in Sweden in 1986. With the aid of these municipal finance agencies the local government authorities have managed to simplify their capital-raising and reduce their interest burdens. The municipalities in the Scandinavian countries are thus able to tap the capital market for between 40% and 90% of their debt via finance agencies.[2] Outside Scandinavia virtually no experience of joint bond issues has hitherto been gained elsewhere in Europe. This may be one reason why the issuance of local and regional bonds attracted little interest so far in many European countries.

In principle, municipal finance agencies are well suited to offer the subordinate levels of government new, favourable funding alternatives via the capital market. The bundling of demand for capital creates a series of benefits compared with a one-off funding exercise, these being fixed cost degression, higher volumes and liquidity, and product diversification. These can generate sizeable cost benefits for subordinate levels of government, enable them to tap the capital market in the first place and also attract international investors. The diverse range of possible features means, however, that there is no one single type of finance agency – key structural building blocks are the issues of mutual liability and the conditions for membership in an agency (this can for example be dependent on a credit-rating assessment).

In France the *Agence France Locale* was established in December 2013. The purpose of this finance agency is to provide support to French public-sector institutions in arranging their funding. The first bond issue with a volume of up to EUR 1 billion is planned for autumn 2014. The funds raised on the capital market will be passed on to members of the agency according to internal criteria for solvency and risk. In France there are also joint bonds issued by local and regional government authorities – albeit that most of them are unlisted. In the UK, too, work is currently underway to establish a Municipal Bonds Agency. This agency's job is to bring to market joint bonds issued by British municipalities regardless of the funding method via the Public Works Loan Board (PWLB) which is managed by the UK Debt Management Office. The first bond is to be issued in 2015, with the volume to usually range from GBP 250 m to GBP 300 m, while a higher volume is planned for the market launch.

No experience of municipal finance agencies has been gained in Germany to date. At the Länder level, however, so-called Länder jumbos have become established as a joint fundraising instrument. These jumbos often have a volume of EUR 1 bn and more and are therefore often more liquid than bonds issued by individual Länder, which results in the yield spread to sovereign bonds being narrower. As with the first jointly issued Federation and Länder bond in June 2013, the Länder bear only pro rata liability rather than joint or joint and several liability.

[2] See also Zipfel and Mann (2012).

Sub-sovereign bonds: Motivation, pros and cons

Whether issuing a bond is worthwhile for a region or a municipality is partly a question of relative prices. Since regions can take on debt via bonds in the capital market, as well as via bank loans the respective coupon determines the appeal of the bond issue. There are, however, also pros and cons arising from the ties between the levels of the federal system.

Issuing sub-sovereign bonds has a number of potential advantages:

— From a general government point of view the possibility for sub-sovereign entities to issue bonds on their own responsibility can have a positive impact on fiscal policy solidity. After all, regions that pursue irresponsible fiscal policy should see this reflected in a lower rating and a higher yield. Moreover, a bond issue increases the demands for financial transparency.

— Bonds are usually issued with a term of 3-10 years and can thus help to improve medium to long-term financial planning.

— Since bonds can be traded in the market, and a large range of potentially interested parties have access to them, the costs may be lower than for bank loans, where a relatively small number of financial institutions each grant a large loan.

There are nevertheless also potential risks:

— Without a credible “no bailout” clause the rating of the sub-sovereign entity is closely tied to that of the sovereign bonds. The implicit state guarantee gives rise to a moral hazard problem. Sub-sovereign entities can borrow more cheaply and assume bigger risks than is justified by their fundamentals, while the central government has to assume the risks for this.

— If no functioning debt rules exist, excessive indebtedness of sub-sovereign entities can jeopardise the solvency of the central government and make the latter's funding more difficult.

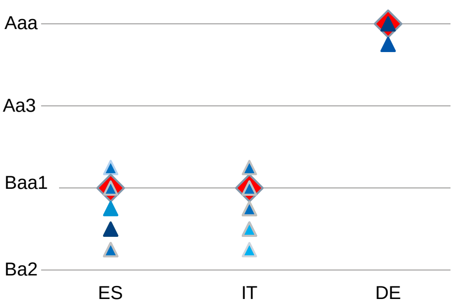
As sub-sovereign bonds often have to offer a higher return than an equivalent sovereign bond, the financing costs are normally higher. The spread can be attributed to higher credit risk and lower liquidity. Since the central government has a higher share of the overall budget, greater scope for making short-term tax changes and in most cases a lower fixed cost share, the credit risk tends to be lower. Moreover, sub-sovereign bonds are less liquid on account of the smaller issue volume, which means a liquidity premium has to be offered.

The rating of sub-sovereign issuers

If an explicit guarantee from the highest federal level exists for bonds issued by subordinate levels of government, then both have the same underlying risk and therefore also an identical rating. This is the case for example with public development banks (e.g. KfW in Germany or ICO in Spain). Between the highest level of the federal system and the lower levels the guarantee is in most cases only implicit. In the case of Germany this means that although the sovereign rating is AAA, only those Länder (which have a rating) regarded as particularly solvent enjoy the same rating. The ratings of the other Länder are one or two notches lower.[3] Besides the implicit shared liability of the Federation the existence of fiscal equalisation mechanisms leads to the rating agencies setting a ratings floor (a minimum level of rating) even for the regions with weaker fundamentals and high levels of debt.

[3] Only Fitch gives the AAA grade of the sovereign also to those Länder to which it assigns a rating.

Ratings of regions: Wide variation in Spain and Italy 9



Red = central government

Source: Moody's

In AAA-rated countries it is clear that a region cannot have a better rating than the central government, but in other cases such a situation is also somewhat unusual. There are exceptions, for example, in Spain and Italy. Some agencies have higher ratings for the Basque Country and Navarre than for Spain. Both regions have per-capita income that is well above average, relatively low debt and limited autonomy in setting taxes. For Italy, Moody's ratings of the autonomous provinces of Bolzano and Trento are two notches higher than for the central government, while for Lombardy the rating is one notch higher. Bolzano and Trento enjoy a special status with greater financial and legislative autonomy, they have an extraordinarily strong fiscal position and have a very low debt. Although Lombardy does not have a special constitutional status, it is not only the region with the biggest and most diversified economy but it also has the lowest debt-to-GDP ratio.[4]

What factors explain the ratings of the Spanish regions? 10

Every Spanish region has a rating from at least one of the big three agencies, most of them from several. It is interesting to note that the order of the regions at all the agencies is very similar, but the spreads differ considerably. While the difference between the regions with the best and worst ratings respectively at Fitch is only 2 notches, it is 4 notches at Standard & Poor's and no less than 5 at Moody's (as of Q1 2014).

To determine which factors explain the rating grades, we transform the ratings into an ordinal scale from 1 (C or DDD) to 22 (Aaa or AAA) and calculate the average rating for each region. This shows a very high negative correlation with the debt ratio as a percentage of GDP. A significantly positive correlation is seen with regional per capita income and a binary indicator for legal status with fiscal autonomy (Basque Country and Navarre). The correlation coefficients with the average rating are:

Regional debt (% of GDP): -0.7083 ***

Regional per capita GDP (EUR '000): 0.5954 **

Fiscal autonomy dummy (1 for Basque Country & Navarre, otherwise 0): 0.6351 ***

***, ** and * stand for significance to the 1%, 5% and 10% level. An OLS regression with heteroscedasticity-robust standard errors confirms these findings:

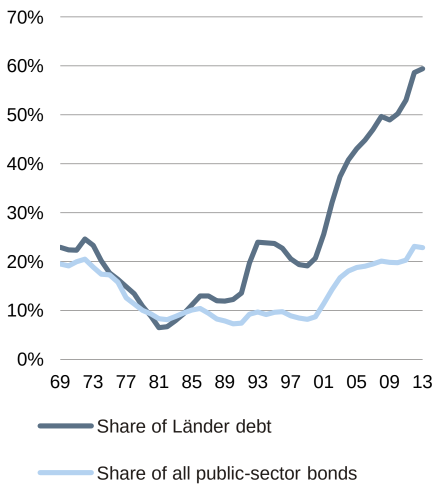
$$\text{Rating} = 13.230 - 0.092^{***}\text{Debt} + 0.076^{**}\ \text{GDP per capita} + 0.958^{**}\ \text{Fiscal autonomy} - 0.105^{*}\ \text{population}$$

10 percentage points less debt, a EUR 13,000 higher per capita GDP or a legal status with fiscal autonomy go hand in hand, ceteris paribus, with a rating improvement of one notch. (The marginal significance of the population in millions results from the fact that three of the four biggest regions had to borrow funds from the FLA. However, the influence is economically insignificant since it could not explain the rating at a higher or lower level in any region.) Even though this simple model only contains a small portion of the main criteria for the rating process it already has a high degree of explanatory power (R^2 = 0.84).

[4] See press release from February 18, 2014: "Moody's changes outlook to stable on 19 Italian sub-sovereigns; ratings affirmed."

Significance of bond financing for Länder has increased dramatically 11

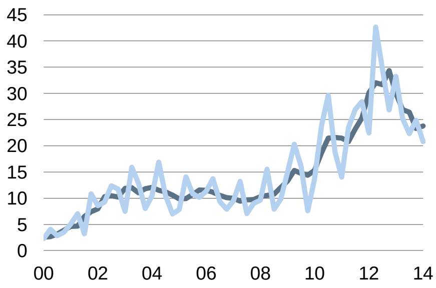
Länder bonds as a percentage of Länder debt and of total public-sector bonds



Sources: Deutsche Bank Research calculations, Bundesbank,Federal Statistical Office

Most bonds issued in Q1 12

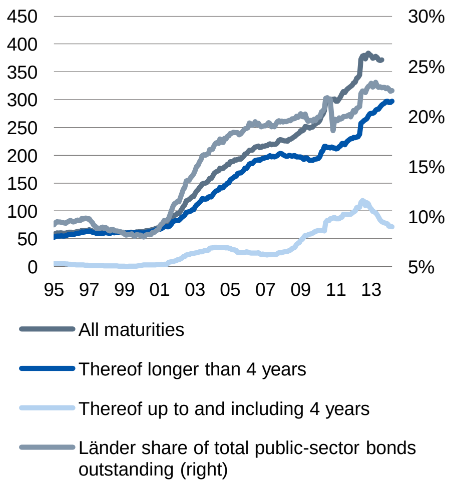
Gross sales of Länder bonds, EUR billion, moving average



Sources: Bundesbank, Deutsche Bank Research

Bonds increasingly popular 13

Nominal value of Länder bonds outstanding, EUR bn



Sources: Bundesbank, Deutsche Bank Research

Germany: Bonds remain by far the most important funding instrument for the Länder

Germany's Länder enjoy fundamental budgetary independence according to the Constitution. The autonomy on the revenue and expenditure sides is, however, de facto heavily restricted, since although the Länder are involved in tax legislation particularly concerning the revenue side via the Bundesrat, they cannot make any quantitatively significant autonomous decisions regarding the size of their own tax receipts. In addition, there is close financial integration and a comprehensive fiscal equalisation system between the different levels of government.[5]

The Länder and municipalities can make largely autonomous decisions about borrowing. The scope of the Länder in this respect will, however, be considerably curtailed from 2020 by the debt brake. At the municipal level there is no rule comparable to the debt brake. Instead, borrowing is closely linked with investment by the Municipal Code. Furthermore, debt-financed spending is subject to authorisation by overarching regulatory authorities. In the past this provision had proved to be stricter than the introduction of the debt brake at the Länder and Federation levels, so the debt level of the municipalities has risen far more slowly than that of the Länder. The financial situation between the municipalities is, however, even more mixed than between the individual Länder.

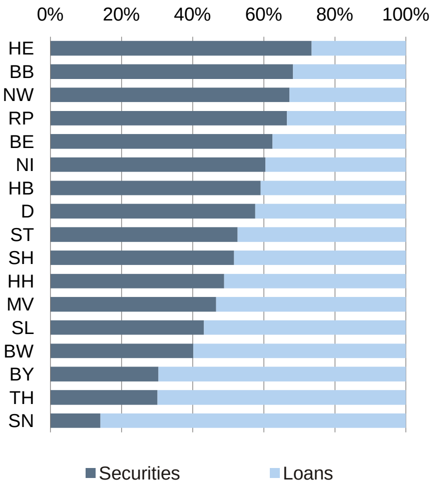
Länder debt is currently equivalent to some 24% of GDP (municipalities around 5%) and has been about half the size of the federal debt for quite a while. The breakdown of debt differs very markedly from Land to Land. The highest per-capita debt levels are found in the city-states and Saarland, Schleswig-Holstein, Saxony-Anhalt and Rhineland-Palatinate. Overall, it has been declining since peaking in 2010, but this does not apply to all the Länder. Around 60% of the debt is bond financed. This percentage has tripled since 2000, while the volume has more than quintupled to about EUR 370 bn at last count. This means the Länder currently account for some 22% of all public-sector bonds outstanding. Also, a series of municipalities have recently issued more bonds, though the significance of bond financing overall currently remains negligible (less than 1% of municipal debt). The most recent bond issues have mainly been joint issues by several cities, which with volumes of EUR 100 m and EUR 400 m respectively mean that comparatively large amounts were successfully generated.

In Q1 2014 the Länder gross bond issuance came to about EUR 27 bn – net sales were negative, however, meaning that aggregate repayments exceeded new debt in Q1. Given the positive budget trend – just 8 Länder reported deficits at end-2013 – it is partly the consequence of the consolidation course embarked upon by a series of Länder but also of course due to the continuing torrent of tax receipts. Despite the improved financial health of the public purse fiscally weaker and more heavily indebted Länder are pushing for joint bond issues with the Federation in order to benefit from the latter's credit rating and reduce their interest rate burden. After all, in some cases there are considerable yield spreads of more than 100 basis points between Länder bonds and comparable sovereign bonds.

[5] For a detailed discussion, see Zipfel (2011). The upshot of this equalisation system combined with the jurisprudence of the Constitutional Court is that de facto a bailout rule applies between the Federation and the Länder. There is no statutory provision made for an insolvency of the municipalities or Länder in Germany.

Scale of bond financing very mixed 14

Respective share of debt*, 2013, only core Länder budgets (excluding extra budgets)



*Securities debt (Landesschatzanweisungen) and loans

Sources: Deutsche Bank Research, Federal Statistical Office

In June 2013 the first joint bond was issued by 10 Länder and the Federation.[6] As with the Jumbo bonds issued jointly by a series of Länder, however, the sub-sovereign entities involved bear only pro rata liability and not joint liability. In the first month following issuance it also became clear that the Federation had to swallow a significant double-digit premium (basis points) relative to standard sovereign bonds, while the participating Länder were able to reduce their funding costs by 8-12 basis points.[7]

The main drivers of the spreads between Länder bonds and sovereign bonds are liquidity and the general risk aversion in the market and – to a lesser degree – the credit rating of the individual issuer. Generally, the greater the liquidity of Länder bonds, the lower the yield premia over comparable sovereign bonds. The greater the general risk aversion in the market, the wider the yield spread between sovereign and Länder bonds.[8] Against this background the implicit mutual obligation/joint liability of the different levels of government means that bonds issued by regional and local authorities in Germany constitute an alternative to pure sovereign bonds.

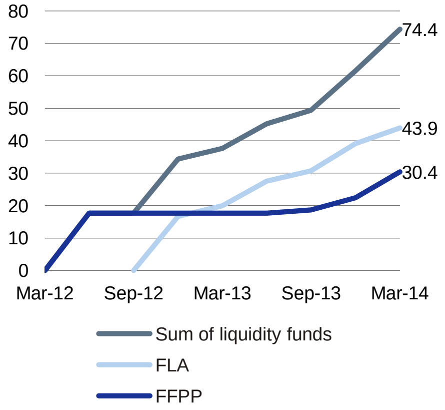
The Länder that currently have the largest volume of bonds outstanding are North Rhine-Westphalia, Berlin, Lower Saxony, Hesse, Baden-Wuerttemberg and Rhineland-Palatinate. In each case this figure runs into the significant double-digit billions. At end-2013 the securities share of debt was the highest in Hesse at over 70%, followed by Brandenburg, North Rhine-Westphalia, Rhineland-Palatinate, Berlin and Lower Saxony, which each have a share of more than 60%.[9]

Spain: Regions are returning to the market

The regional level – the 17 Comunidades Autónomas (CAs) – plays a comparatively important role in Spain. The CAs have over 40% of the total public budget in their remit, meaning they can achieve sufficient volumes for the issuance of bonds. While the debt of the regions was very low before the crisis at 6% of GDP, it increased threefold to 18% between 2007 and 2012 alone.

Volume of emergency funds for Spanish regions 15

EUR bn



Source: Banco de España

From 2011, as risk premia on Spanish government bonds started to climb relentlessly upward, the CAs' refinancing costs rose even faster than those of the central government. As a result, the regions were only able to issue bonds with short maturities (3 years or less) or else they lost access to the market altogether. As a consequence, the central government provided the CAs with emergency liquidity in several stages. In February 2012 the regions obtained a credit line of EUR 10 bn from Instituto de Crédito Oficial (ICO), the national public development bank. A fund set up in March with a volume of EUR 35 bn (FFPP – Fondo para la Financiacion de los Pagos a Proveedores) offered 10-year loans to the regions and municipalities. These loans were earmarked for servicing short-term liabilities to suppliers that were dated before January 1, 2012.

It was already apparent at this juncture, however, that the CAs which were deepest in debt would require additional financial aid since the refinancing costs in the market remained prohibitively high. At the same time, the central government had few effective options for controlling or influencing the budgets of the CAs. For this reason it created the Fondo de Liquidez Autonomico (FLA) in July 2012, a fund which offered the regions better financing conditions in return for greater rights of intervention. In 2012 and 2013, EUR 39.1 bn has

6 The bond has a 7-year term and the issue volume comes to EUR 3 bn.
7 See Jenkner and Lu (2014).
8 For a detailed discussion, see Zipfel and Zimmer (2013)
9 These figures only refer to core budgets (excluding extra budgets).

been disbursed from this fund. An additional volume of EUR 23 bn is earmarked for 2014, of which EUR 12.1 bn has been paid during the first half of the year. A description of how the FLA functions can be found below in box 16.

Creating the FLA was not a cheap solution for the central government, though, since it resulted in risk a transfer from the regions to the central authority. Jenkner and Lu (2014) estimate that this temporarily increased the risk premium for Spanish sovereign bonds by 70 basis points. With the decline in risk premia on the periphery, though, the premium for the transfer of regional budget risks shrank again appreciably.

Emergency financing for Spanish regions through the "Fondo de Liquidez Autonómico" 16

In order to provide the CAs with liquidity at short notice the Spanish government established the Fondo de Liquidez Autonómico (FLA) in 2012. This move centralised regional borrowing and helped to reduce their financing costs. However, access to the scheme was tied to fiscal conditionality and supervision via continuous monitoring of each region's budget adjustment plan.

In principle, participation in the FLA is "voluntary". Those CAs which were able to cover their funding needs without assistance – either because of low refinancing needs or relatively low costs for issuing bonds – did not join the FLA. In 2012 and 2013, a total of 9 out of 17 CAs borrowed funds via the FLA: Andalusia, Asturia, Balearic Islands, Canary Islands, Cantabria, Castile-La Mancha, Catalonia, Murcia and Valencia. Combined, these CAs account for 71% of Spanish regional debt and 58% of the country’s GDP.

At its inception in 2012, the FLA had a volume of EUR 18 bn. In addition to funding from a central government bond issue the FLA was additionally boosted by an extraordinary payment by the state-owned lottery of EUR 6 bn. In 2013, the volume of the FLA was raised by EUR 23 bn., of which close to EUR 20 bn have been disbursed. By mid-2014, the FLA regions have received another EUR 12 bn., 80% of which went to Andalusia, Catalonia and Valencia. While the volume of the FLA can be further increased, the recently much improved financing conditions for the regions should make assistance from the FLA less relevant over the medium term.

Participation in the FLA allows CAs to borrow long-term capital (10 years plus a 2-year grace period) at almost the same rate as the central government (10 basis points above Treasury bonds). At the peak of the sovereign debt crisis, this was equivalent to an advantage of well over 100 basis points for all the participating regions. In return, the CAs had to accept stricter fiscal conditionality and financial monitoring by the central government, which was a politically contentious issue especially in Catalonia.

Technically, the FLA works as follows:

— Regions which want to participate have to report funding needs for the following year before September 30.

— The central government adds the requested amounts to its own bond funding programme and lends the funds to the participating CAs through a credit agreement. This loan is backed by the CA’s claim on the regional financing system (participation in centrally collected tax revenues).

— Participating CAs are subject to fiscal and financial conditionality. Fiscal conditionality implies that CAs must set up and regularly update a rebalancing plan which must be approved by the central government. The CAs are obliged to perform monthly budgetary execution reporting. The central government has the possibility of direct intervention in the budget accounts if there is any risk of deviation from the rebalancing plan. Financial conditionality means that all new debt authorisations require the approval of the Treasury, even operations outside the FLA (e.g. short-term loans).

— The FLA is funded by the Treasury, monitored by the Ministry of Finance and managed by the public development bank Instituto de Credito Oficial.

Source: Ministerio de Hacienda y Administraciones Publicas (2014)

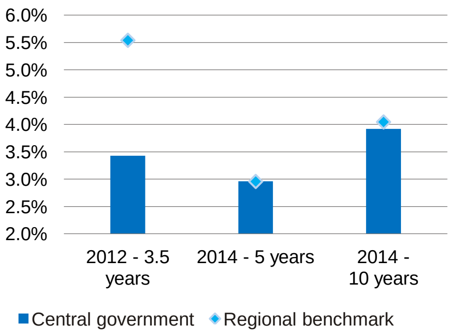
As part of the tightened debt rules under the EU's Fiscal Compact, Spain introduced its Ley Orgánica de Estabilidad Presupuestaria y Sostenibilidad Financiera (organic law for budget stability and financial sustainability) in April 2012. In this way the central government imposed both a budget rule (structurally balanced budget) and a spending rule (expenditure growth to remain below the medium-term rate of GDP growth) on the regions as fundamental principles. To implement the rules the government installed a series of preventive mechanisms, e.g. an early warning system and reduced financial latitude for the regions if they reach their budget limits prematurely.

Furthermore, it also enacted corrective mechanisms such as more stringent reporting requirements and the stipulation that authorisation be obtained from the central government before any new debt may be raised. In the event of continuing non-compliance, the CA even risks losing financial support and incurring financial penalties. In this respect the Spanish stability legislation is more far-reaching than the minimum requirements of the Fiscal Compact.[10]

Moreover, the central regions have set an upper limit on the costs of bond issues. If an autonomous region had to pay a premium of more than 75 basis points over Spanish government bonds with identical maturities it would only be allowed to raise future debt via the FLA.

2014: Spanish regions report successful issuance

Yields Central government vs. Autonomous Communities 17



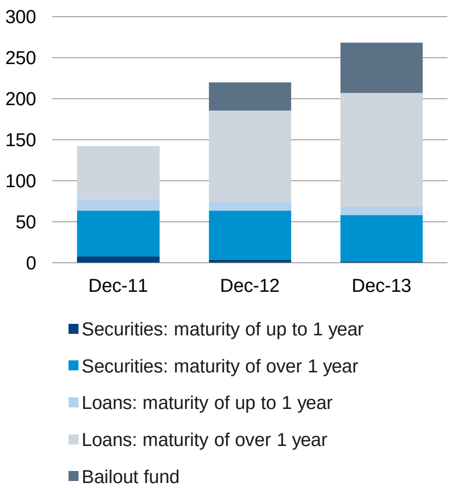
Source: Deutsche Bank Research, Banco de Espana

At the height of the sovereign debt crisis in 2012 the regions were compelled to offer much higher coupons than the central government if they still wanted to be able to place their bonds in the market at all. While government bonds with a maturity of 3.5 years yielded 3.4% in January 2012, comparable regional benchmarks had to offer 5.5% on average – a premium of more than 200 basis points (see chart 17).[11] There were also sizeable differences between the regions in 2012. Aragon in fact had to offer a yield of 6.1%, while the Madrid region needed no more than 4.6%.

Meanwhile, not only the yields of Spanish sovereign bonds have declined appreciably, but also the spreads to the regional bonds. At the end of April 2014, both Spanish 5Y sovereign bonds and the regional benchmark average yielded around 3%. With the 10Y bonds there was a minimal premium averaging 13 basis points over sovereign paper. This means that economically sound regions were able to obtain funding at roughly the same cost as the central government.

Debt structure of the Spanish regions 18

EUR bn



Source: Banco de España

The financial situation of the regions is mirrored in the debt structure. Since 2011, both the share of short-term bonds in total debt as well as their volume have plummeted. While this trend is also visible on short-term loans, it is much less pronounced than on bonds. In turn, the bailout funds now hold a substantial share of the regional debt (approx. 20%). A clear uptrend can be seen at the long end of the market. The improved financing conditions for the Spanish sovereign should also ensure in 2014 that the non-FLA regions can continue to place longer-term bonds.

Between January and April 2014 Spain's regional authorities raised close to EUR 6.5 bn in the bond market. The bonds issued have maturities ranging from three to 30 years, and over 50% of the volume is accounted for by the region of Madrid. The CAs are expected to be able to continue issuing debt on similar conditions as the central government for the foreseeable future. This applies in particular to regions with sound financials that did not need to tap the FLA for emergency funding. A further increase in financial aid from bailout funds cannot be ruled out since the regions can only gradually transform their short-term maturities into longer-term debt. All things considered, though, obtaining support from the FLA seems to be becoming an increasingly unattractive option for the regions.

[10] See also: presentation of the Spanish finance ministry on the contents of the Ley Orgánica de Estabilidad Presupuestaria y Sostenibilidad Financiera. http://www.thespanisheconomy.com/stfls/tse/ficheros/2013/agosto/120524_Budgetary_Stability_and_Financial_Sustainability.pdf

[11] The regional benchmark is derived from bonds of similar maturities that were issued within a few weeks of a central government bond. For 2012, the bonds used were issued by Navarre, Madrid and Aragon. For 2014, the selection was based on bonds from Madrid and Aragon (5Y maturities) as well as Navarre, Madrid and Extremadura (10Y).

Spain: Regional bond issues from January to April 2014 19

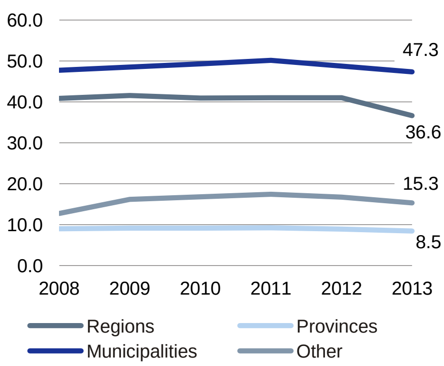
Issuer	Volume (m)	Coupon (%)	Issue date	Maturity in months
Aragon	24.20	4.420	23.01.2014	171
Aragon	625.00	2.875	10.02.2014	60
Aragon	75.00	5.150	14.02.2014	275
Aragon	50.00	4.000	20.02.2014	104
Basque Country	350.00	2.000	18.03.2014	52
Castile and León	650.00	4.000	06.03.2014	121
Extremadura	300.00	3.875	14.03.2014	120
Extremadura	27.50	3.800	15.04.2014	132
Galicia	500.00	1.890	12.02.2014	34
Madrid	1,400.00	2.875	06.02.2014	62
Madrid	131.30	5.000	12.02.2014	264
Madrid	1,600.00	4.125	19.02.2014	123
Madrid	21.60	5.250	26.02.2014	360
Madrid	59.00	5.125	03.03.2014	348
Madrid	424.00	3.875	28.02.2014	102
Navarra	88.80	3.950	14.02.2014	120
Navarra	140.00	3.587	14.02.2014	96
Total volume	6,466.40			

Source: Banco de España

Italy: Role of bonds declining

Italy's local debt gradually receding 20

EUR bn



Source: Banca d'Italia

Politically, Italy is organised along very strong central government lines and the sub-sovereign levels of government enjoy only limited autonomy. While transfers to the sub-sovereigns have been falling as a share of their total revenues since the 1980s and are now at a level of 40%[12], the regions are nevertheless heavily constrained by a complex set of national rules. While there is greater latitude on trade tax at the regional level – from a strictly legal perspective – since the relevant legislation was amended in 2008, it is hardly ever used. With other types of tax, too, there have been efforts to devolve more competences to the regions, but mostly with only modest success.[13]

Italy's sub-sovereign debt totalled about EUR 108 bn in 2013, or 6.5% of the total general government debt, with roughly 34% accruing to the regions, 8% to the provinces, 44% to the municipalities and 14% to other local institutions. Since 2011, debt has fallen at all levels, a fact which is partly to be explained by one-off interventions by the central government and partly by new budget constraints. In principle, the regions and municipal authorities have no right to engage in anti-cyclical borrowing and must present a balanced budget.[14] Over the past few years numerous laws meant to reduce (sub-sovereign) public debt have been passed or amended, e.g. the internal stability pact (*Patto di Stabilità Interno*) and the health pact (P*atto per la Salute*; box 21).[15] The stability pact focuses on debt outside the health sector and contains a raft of tools to monitor and sanction the local governments. Every year, the government adopts a stability pact for the next three years that contains numerous plans for cutting

---

[12] OECD Fiscal Decentralisation Database. http://www.oecd.org/ctp/federalism/oecdfiscaldecentralisationdatabase.htm
[13] See Longobardi (2013).
[14] See Gagliano (2013).
[15] Fore more on this and what follows see Gagliano (2013) as well as Dipartimento del Tesoro (2013). Economic and Financial Document – Italy's Stability Programme: http://www.dt.tesoro.it/en/analisi_programmazione_economico_finanziaria/documenti_programmatici/sezione3/def_assistenza.html

The health pact 21

Close to half of public spending at the sub-sovereign level is on healthcare. Healthcare is funded via the redistribution of regional tax revenues. Trade tax, levied at the regional level, is aggregated at the national level and divided up as ring-fenced transfers among the regions, which deploy the funds as specified by the central authorities.[16] In this context, the central government specifies the minimum requirements for primary health services; beyond this the regions have some latitude in how they structure the services.

As part of the health pact, several measures were adopted for 2013-2015 to secure balanced funding of the healthcare system:

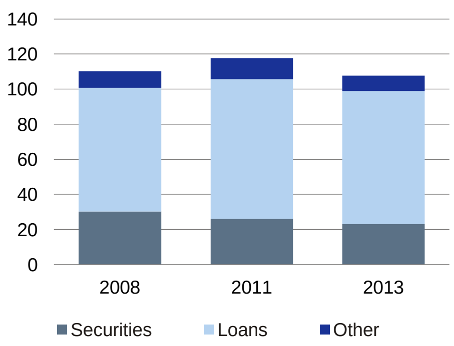
— A mechanism which leads to automatic tax hikes if the health budget is not in equilibrium.

— A plan to handle government transfers more efficiently.

— A plan for spending cuts and a fund for temporarily covering the deficits of the structurally weak regions.

Debt structure of local authorities in Italy 22

EUR bn



Source: Banca d'Italia

expenditures as well as setting targets for the regions' debt levels. In 2013, expenditures on new and old debt will probably account for not more than 6% of total spending; in 2014, the figure shall be down to only 4%. If the authorities fail to comply with the targets the regions risk facing restrictions, e.g. hiring freezes, cutbacks on public salaries and/or other spending.

Given the stable regional debt development and the minor (budgetary) significance of the regions and provinces there was no need, unlike in Spain, to set up a permanent support fund for the regions. However, the Italian development bank Cassa Depositi e Prestiti, which is 80.1% owned by the finance ministry,[17] has provided support loans to the regions that are earmarked for the settlement of accounts payable. They have an interest rate of only 3% on a maturity of 30 years and are amortisation free for one year. In 2013, a total of EUR 10 bn was provided for all the sub-sovereign levels. In 2014, a further EUR 5 bn will be made available for the regions, EUR 9 bn for the regional health insurance schemes and EUR 2 bn for other local institutions.[18]

The local authorities are raising less and less debt in the capital market. The volume of securities in circulation has been declining since 2008 (chart 22) and the regions have not launched any significant new issues since 2007. The volume of loans outstanding had swollen to EUR 80 bn by 2011, and since then has contracted again to EUR 76 bn. Therefore, bonds are not expected to regain significance as funding instruments for sub-sovereign units in Italy in the medium term. The rather complex and occasionally changing set of rules for fiscal discipline appears to narrow the degree of transparency for investors on the one hand and reduce the scope for new issuance on the other. At the same time, the emergency loans provided are attractive enough to be able to waive the option of procuring short-term, more expensive liquidity in the capital market.

France: Credit financing dominates – aim to increase bond financing

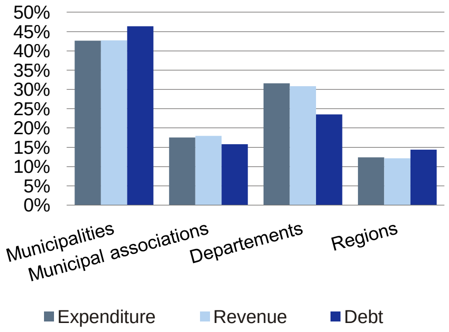
Despite its strong tradition of centralist decision-making, France is fundamentally governed on a decentralised basis with three sub-sovereign levels of government – municipalities (*communes*), departments (*départements*) and regions (*régions*). Since 1981 there have been several decentralisation reforms (1982/83, 2003, 2010, 2013f) which have brought greater autonomy to the sub-sovereigns on the income and the expenditure side.[19] Since then, these have been allowed to act independently on their own responsibility and take out loans – albeit only for investment activity.[20] With the abolition of the *taxe professionelle* in 2010 limitations were resumed on tax autonomy; however, the reforms sought since 2013 are meant to repeal this step.

The sub-sovereign levels of government account for 35-40% of total government expenditure, depending on how it is broken down. The lion's share (close to 60%) is attributable to municipalities and municipal associations, just over 30% to the departments and approx. 10% to the regions. The breakdown is similar for the share of the respective level in the total debt of the sub-sovereigns. Only about 6% of the total debt is funded via securities – the total slightly exceeded EUR 10 bn in 2013. Since 2011 the sub-sovereigns have

[16] See Thomson et al. (2013).
[17] For details see http://www.cassaddpp.it/en/company-profile/facts-and-figures/shareholding.html
[18] See Angelelli et al. (2013).
[19] See French National Assembly (2014). http://www2.assemblee-nationale.fr/decouvrir-l-assemblee/role-et-pouvoirs-de-l-assemblee-nationale/les-institutions-francaises-generalites/l-organisation-territoriale-de-la-france (June 12, 2014). While tax autonomy was restricted in 2010, this legislation was recently rolled back.
[20] See OFL (2013) and http://www.collectivites-locales.gouv.fr/finances-locales

Municipalities: France's most important sub-sovereign level of government 23

Share in total sub-souvereign expenditures, revenues and debt; 2012



Source: DGFiP

been confronted with both a decline in credit supply and higher margins as well as shorter maturity terms.[21] This is a general consequence of the financial crisis as well as of the sharply reduced activity of established providers such as Dexia. However, it emerged in 2013 that on account of the activity of state-controlled banks such as the CDC (Caisse des Depots et Consignations) and the European Investment Bank (EIB) the scope for funding has improved again, at least on a short-term horizon.[22] However, a substantial portion of these funds is from France's central government and thus will not be available on a permanent basis.

Bond financing is gaining in importance for the sub-sovereign levels of government. At the end of 2013 a municipal finance agency was established which at end-2014 is set to place its first bond in the market and this will ease the way for the sub-sovereigns hoping to tap the capital market.[23] Now, Francois Hollande's government wants to follow up with a further reform aimed at giving the regions still more autonomy and funding. At the same time, though, the structures are to be streamlined and competences are to be defined more clearly. In this framework there are also plans to significantly decrease the number of regions.

The Agence France Locale in detail 24

The French model of a municipal finance agency borrows from the model of the Scandinavian finance agencies. The "Agence France Locale" (AFL) consists of a parent company (Société Territoriale, a joint stock company) in which the government authorities hold 100% of the capital and of a subsidiary (Société Opérationelle). The subsidiary, a bank in principle, assumes the operational role, that is, it issues bonds in the capital market and turns over the funds raised to the respective government authorities. The parent company focuses on the AFL's strategic thrust.

Not only municipalities but also departments and regions may participate in the AFL's activities. The size of their stake in the parent company's capital is partly geared to their economic clout and debt load. Participation is voluntary. The prerequisite is a sound financial situation and/or internal rating. In case of a negative assessment, the government authorities are not allowed to borrow funds via the agency.

The AFL may only grant the government authorities plain vanilla loans. Structured products are not permitted. Not more than 50% of the funding requirement may be covered by the AFL. No participant may hold more than 5% of the company's capital. If an authority decides to participate in the AFL and obtains shares in the parent company it has to hold them for at least 10 years. The stakes of all the sub-sovereign authorities are to increase to about EUR 605 m by 2025.

The subsidiary is to be funded via bond issuance – the target is a broad maturity spectrum spanning 3 months to 10 years. The average maturity should be over 6 years, though. There are to be 3-4 issues launched per year. These are to be primarily euro-denominated but may also be effected in other currencies. It should be possible to hedge against risks (e.g. interest rate changes) via countertrades. The first issue is planned for November or December 2014. This time frame also applies to the initial disbursement of loans to government authorities. There are plans for a bond issue ranging from EUR 750 m to EUR 1 bn in volume.

Currently, about 50 government authorities hold stakes in AFL. In ten years' time, some 25% of all the sub-sovereigns are to meet part of their capital needs via the AFL, with participation in the scheme climbing to 50% in the long term and thus 50% of the French authorities' total funding requirements (EUR 4 bn) being covered by this facility.

One key element is the structuring of liability. There are two different guarantees applicable under the AFL. One is a member guarantee and the other is a parent-company guarantee. The former exists in the amount of all of the loans extended to the members, with each member being liable up to the amount it borrowed itself. The guarantee pledged by the parent company is equal to the total debt incurred by the subsidiary. Hence, the participating government authorities are ultimately jointly and severally liable for the debt, with the liability for the individual sub-sovereign being limited to the level of its individual loan.

Source: AFL (2014)

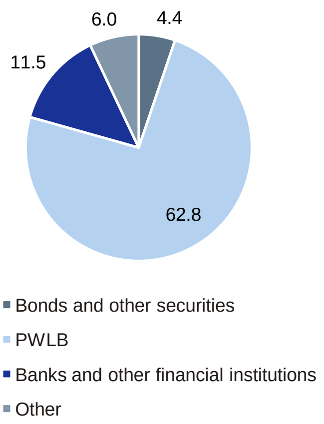
[21] For more on this and what follows see OFL (2013).
[22] See S&P (2014a).
[23] Back in 2012 there was a joint issue with a total volume of EUR 600 m launched by 44 sub-sovereigns – without any joint agency. Standard & Poor's expects the share of bond financing to increase threefold to about 15%. See S&P (2014a).

United Kingdom – virtually no credit or capital market funding to date

The United Kingdom is relatively centralised – even though there are three levels of sub-sovereign government – local authorities, counties (with separate police and firefighter units) as well as the three countries of Scotland, Wales and Northern Ireland. Only Scotland has come to enjoy a considerable degree of autonomy. The UK's local authorities – 400 or so altogether – have only very little revenue-generating power – and expenditures are heavily regulated too.[24] Lately, over 70% of revenues consisted of grants – a much higher level than in many other OECD countries. The most important local tax is council tax, but it raises only about 5% of total tax revenue and roughly 17% of the sub-sovereign authorities' revenues. However, its importance has increased steadily over the past few years. Roughly 25% of all government expenditure is at the sub-sovereign level – mainly in the areas of education, social services and housing.[25]

Sub-sovereign government funding in the UK 25

As of Q1 2014; GBP bn



Source: DCLG

At the latest reading, sub-sovereign debt totalled approximately GBP 85 bn.[26] Some 99% of the total is long-term liabilities (20-year maturities on average). For all intents and purposes it is only possible to raise revenue for investments (in infrastructure). Until 2004 the debt was limited by specific targets set out by the central government. Since that date it has no longer been necessary to obtain authorisation; rather, loans may be taken up for investments as long as the sub-sovereign is able to service the debt.[27] 75% of the sub-sovereign borrowing requirement is currently funded via the Public Works Loan Board (PWLB), a body operating within the UK Debt Management Office, an agency of HM Treasury. Some 15% is covered by banks and other financial institutions and only slightly more than 5% via the capital market. The latter equalled about GBP 4.5 bn at last reading and applies nearly exclusively at present to sub-sovereigns in England. The PWLB is funded via the capital market and it passes on the funds to the local authorities as loans. The lending rates are set by the PWLB. The yield of British government bonds (gilts) plus a premium serves as the benchmark. This premium is currently in the range of 60-100 basis points.

In the UK, too, work is currently underway to establish a Municipal Bonds Agency.[28] The agency is to issue bonds on behalf of the local authorities and then pass on the thus generated funds to the participants as loans. The main objective is to achieve greater independence from the PWLB and, above all, to improve the conditions, that is, to reduce the spread to gilts as far as possible. A further goal though, too, is to boost investment in infrastructure. Participation would be voluntary here, too. The individual sub-sovereigns would only have to subscribe to shares in an agency. The current state of planning provides that the first bond be issued in 2015. As a rule, the target volume would be about GBP 250-300 m; however, for market entry it should be much higher. A recent survey identified a market potential of roughly GBP 5 bn in the next three years. There are plans to offer joint and several liability or a guarantee from the participating authorities in order to obtain a triple-A rating. However, the agency is yet to be established.

---

[24] See Lockwood (2013).
[25] For more on this and what follows see DCLG (2014). The information in this section only applies to England.
[26] For further information, see Brady et al. (2014) and the related statistics at https://www.gov.uk/government/statistical-data-sets/live-tables-on-local-government-finance
[27] There are specific assessment guidelines for this purpose.
[28] For more on this and what follows see Brady et al. (2014).

The way has been paved for Scottish bonds – regardless of the independence issue

Irrespective of the independence referendum to be held in September 2014, Scotland will have the option from 2015 of issuing its own bonds. The legal basis for doing so was created with the Scotland Act 2012 which guarantees Scotland more fiscal autonomy from 2015. Thanks to greater tax sovereignty (including its own income tax that will replace part of the current national income tax) the share of budget revenue that the Scottish Parliament can raise itself will climb to about 30% from 15% at present.[29] Taken together, Scotland can then issue debt of up to GBP 2.2 bn in bonds. This limit can be increased in future as required, but may no longer be reduced.

From a purely financial perspective, however, this is unlikely to result in any advantages for Scotland. The current arrangement provides that Scotland can borrow from the British government for a premium averaging 20 basis points (depending on the term to maturity) over gilts. The economists and capital market participants who expressed their opinion on the Scotland Act in May 2013 in a consultation round initiated by the British government expect future Scottish bonds to carry a premium of 30-120 basis points.[30]

The consultation took place on the premise that Scotland remains a part of the United Kingdom. If a majority votes in favour of independence in the upcoming referendum, some rating agencies have already announced that Scotland could count on obtaining a similar rating to the United Kingdom in the long run, but initially it would probably have to accept a slight downgrade.[31] Just how high the effective funding costs would prove to be in this case cannot be reasonably predicted without knowing the terms and conditions of secession (division of sovereign debt between London and Edinburgh, currency arrangement, temporary loss of EU membership). Compared with the United Kingdom, however, the costs will probably be somewhat higher if only because of the much lower overall volume and hence lower liquidity. The lack of data on record as bond issuer could also prove to be a disadvantage, at least at first.

Outlook

The European sub-sovereign bond market has been dominated by German government authorities to date. Given the sheer size of the German Länder and their comparatively high degree of fiscal autonomy this is unlikely to change in the foreseeable future. After all, the biggest Länder – North Rhine-Westphalia, Bavaria and Baden-Wuerttemberg – have a higher GDP than countries such as Belgium or Poland.

However, the German authorities' share of total sub-sovereign issues in Europe, still at 72% in 2013, is likely to decrease on a medium-term horizon. Thanks to the relatively healthy finances of most of the Länder at present and to the debt brakes anchored in the Länder constitutions that have to be complied with from 2020 at the latest, the net borrowing level is set to fall over the next few years. By contrast, the Spanish regions will have high refinancing requirements over the next decade and beyond; at the same time, they currently enjoy beneficial conditions for bond issuance. Even those regions which had depended on FLA loans over the past few years should be able to return to the capital market for funding on better terms and conditions.

---

[29] See HM Treasury (2012).
[30] See HM Treasury (2013).
[31] See S&P (2014b).

For another thing, various countries (such as France) have either set up municipal financing agencies or they are in the process of establishing them in order to more strongly diversify the funding requirements of local units. It remains to be seen how the importance of these agencies will develop and how the municipalities will tap their resources over the next few years. However, not only the Swedish counterpart that has existed since 1986 suggests that this should give municipal bond issuance a considerable boost.

Stefan Vetter (+49 69 910-21261, stefan.vetter@db.com)
Frank Zipfel (+49 69 910-31890, frank.zipfel@db.com)
Jan Fritsche

Bibliography

AFL (2014). Agence France Locale. http://www.agence-france-locale.fr/accueil.aspx

Angelelli, C., Conio, E. and Lombardo, F. (2013). New Italian decree 'unlocks' € 40 bn of state debt. Freshfields Bruckhaus Deringer.

Blöchliger, H. and Vammalle, C. (2012). Reforming Fiscal Federalism and Local Government: Beyond the Zero-Sum Game. OECD Fiscal Federalism Studies.

Brady, A.; Andersson, L.; Breedon, F. (2014). The UK Municipal Bonds Agency, Establishment of a Local Government Collective Agency for the issue of Local Authority Bonds, Report to the Executive Board of the Local Government Association. http://www.local.gov.uk/documents/10180/11531/MBA+Report+Final.pdf/037bbcf0-e7f5-4f06-946e-98e7e824ce49

Collectivités Locales (2013). http://www.collectivites-locales.gouv.fr/perequation

[DCLG] Department for Communities and Local Government (2014). Local Government Financial Statistics England, N. 24, 2014. https://www.gov.uk/government/publications/local-government-financial-statistics-england-2014

Jenkner, E. and Lu, Z. (2014). Sub-National Credit Risk and Sovereign Bailouts – Who Pays the Premium? IMF WP/14/20.

Gagliano, A. (2013). The Introduction of the "Balanced Budget" Principle into the Italian Constitution: What Perspectives for the Financial Autonomy of Regional and Local Governments? Centre for Studies on Federalism. Perspectives on Federalism, Vol. 5, issue 1. http://www.on-federalism.eu/attachments/155_download.pdf

HM Treasury (2012). The Scotland Act 2012: A consultation on bond issuance by the Scottish Government. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81566/condoc_scotlandact2012_bond_issuance.PDF

HM Treasury (2013). Summary of responses to the consultation on Scottish Government bond issuance. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198225/summary_of_responses_to_consultation_on_scottish_bonds_issuance.pdf

Kaya, O. and Meyer, T. (2013). Corporate bond issuance in Europe – Where do we stand and where are we heading? Deutsche Bank Research. EU Monitor, Global financial markets. http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000300834.pdf

Lockwood, B. (2013). Federalism in the UK: How Free is Local Government? The CAGE–Chatham House Series, No. 9, September 2013. http://www2.warwick.ac.uk/fac/soc/economics/research/centres/cage/onlinepublications/briefing/ch_gage_bp_9_web.pdf

Longobardi, E. (2013). From transfers to tax "co-occupation": The Italian reform of intergovernmental finance. OECD and Korea Institute of Public Finance, Measuring Fiscal Decentralisation: Concepts and Policies, OECD Publishing;

Ministerio de Hacienda Y Administraciones Publicas (2014). http://www.minhap.gob.es/en-gb/areas%20tematicas/financiacion%20autonomica/paginas/financiacion%20autonomica.aspx

Moody's (2014). Rating Scenarios for an independent Scottish Sovereign.

OECD (2013). Fiscal Federalism 2014: Making Decentralisation Work. OECD Publishing.

OFL – Observatoire des finances locales (2013). Rapport de l'observatoire des finances locales, Les Finances des collectivités locales en 2013. http://www.collectivites-locales.gouv.fr/files/files/OFL_2013(2).pdf

S&P – Standard & Poor's (2014a). French LRGs' Stable New Borrowings Mask Rising Pressure On Public Finances.

S&P – Standard & Poor's (2014b). Key considerations for rating an independent Scotland.

Thomson, S., Osborn, R., Squires, D. and Jun, M. (2013). International Profiles of Health Care Systems. The Commonwealth Fund. http://www.commonwealthfund.org/~/media/Files/Publications/Fund%20Report/2013/Nov/1717_Thomson_intl_profiles_hlt_care_sys_2013_v2.pdf

Vallier, F. and Boulanger, A. (2012). Subnational public finance in the European Union. Dexia. http://www.eetaa.gr/enimeroseis/17-01-13/Note_CCRE_Dexia_EN.pdf

Zipfel, F. (2011). German finances: Federal level masks importance of *Länder*. Deutsche Bank Research. Current Issues. http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000273969.PDF

Zipfel, F. and Mann, S. (2012). Einer für alle, alle für Einen? Kommunale Finanzagentur – ein Überblick. Deutsche Bank Research. Aktuelle Themen. http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000292227.PDF

Zipfel, F. and Zimmer, J. (2013). Länder bonds: What drives the spreads between federal bonds and Länder bonds? Deutsche Bank Research. Current Issues. http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000324840.PDF

Deutsche Bank
Research

EU Monitor

Our publications can be accessed, free of charge, on our website www.dbresearch.com You can also register there to receive our publications regularly by E-mail.

Ordering address for the print version:
Deutsche Bank Research
Marketing
60262 Frankfurt am Main
Fax: +49 69 910-31877
E-mail: marketing.dbr@db.com

Available faster by E-mail:
marketing.dbr@db.com

Printed by: HST Offsetdruck Schadt & Tetzlaff GbR, Dieburg

Print: ISSN 1612-0272 / Internet/E-mail: ISSN 1612-0280