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LOCAL PUBLIC ADMINISTRATION AUTHORITY LOANS

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Abstract:

Local authorities within our country are facing an acute need for financial resources to meet the increasing local needs. This paper deals with the issue of local public administration loans for additional resources to finance the local public services and local investment projects. In the first part we focused our research on the concept and characteristics of local public administration loans and he conditions for contracting and guaranteeing them.

In the second part we brought arguments for the use of municipal bonds as an instrument of local public debt. These are debt securities issued by administrative territorial units in attracting such resources to finance certain objectives.

The main purposes for which municipal bonds are issued are: finance a new investment project, funding repair and maintenance of some assets held by the issuer, refinancing of bonds already in circulation and current expenditures.

Key words: . local budget, local public loan, municipal bonds, public debt

JEL classification: : H 72, H 83

INTRODUCTION

The local revenues represent the total financial resources that local authorities perceive and/or receive directly, either from government or other resources, to fulfil their duties in delivering public services. To establish the 'local' feature of a source of income, the main determinant is the fact that the authority has full power to set conditions for the mobilization of that income or has the power to decide on its use.

The local revenues express the financial resources acquired in administrative territorial units which are mobilized for local executive authorities to carry out activities within their jurisdiction. The local budget revenues are financial resources for local budgets based on legal provisions, they consist of revenues, income from amounts deducted from certain state income taxes, subsidies received from the state budget and other budgets, donations and sponsorships, and other financial operations[1].

In addition to the revenues collected in local budgets, local authorities have also at their disposal other extra budgetary funds (cash contributions, income for self-financed actions or income from special funds). Local revenues are broader in scope than the revenues of local budgets as they include other revenues that are mobilized and redistributed locally. There are mutual influences between local revenues and the economy of the local administrations, meaning that local revenues depend on the level of development of the local economy, and these revenues influence the local economy by ensuring the achievement of some economic and social activities.

Within Romania the administrative territorial units are in constant search of financial resources due to the low level of disposable funds and, on the other hand, to the impossibility to increase taxes and fees in order to raise their income. Resorting to loans[2] as extraordinary income of the local budget is often used by local authorities like a source of financing.

THE CONCEPT AND CHARACTERISTICS OF LOCAL AUTHORITY LOANS

The local public loan is an agreement of wills between local/county public authorities and an individual or a legal entity through which that individual or legal entity agrees to provide local/county public administration an amount of money, as a loan, for a certain period of time, and the local/county public authorities undertake to repay this amount within a certain period, and pay a proper interest (Leonte and Cioponea, 1999). This loan, unlike taxes and fees, is legal and reimbursable; it has a contractual character and involves counterpart (interest, fees and other expenses).

The local and county council and the General Council of Bucharest may approve the contracting and guaranteeing of internal or external loans on short, medium and long term to carry out public investments of local interest and refinance debt.

Contracting and guaranteeing loans by the local public authorities is approved by a vote of at least half plus one of the councillors in office. Local public administration authorities may contract and guarantee loans only on the advice of local borrowing authorization committee that operates under the Ministry of Finance. Also administrative territorial units are eligible for external loans contracted and guaranteed by the state and the Public Debt Law[3].

The public debt hired by deliberative authorities of the local public administration represents an obligation to be repaid from their own revenues of the administrative territorial units, and also from the revenues of the beneficiaries of loans guaranteed by local government.

The local public debt expresses the payment obligations at some point of the local public administration, resulted from agreements and contracts of internal and external borrowings, which stipulate the terms and conditions of the loans between the beneficiary and the creditor and shall be reimbursed from the own income of the administrative territorial unit.

CONDITIONS FOR CONTRACTING OR LOAN GUARANTEES

The total amount of debt contracted by the local public administration authorities is part of the register of local government debt that reflects information on local public debt and details the liabilities. The total amount of guarantees issued by local authorities is written in the register of local guarantees. After contracting and/or guaranteeing internal and/or external loans, local public administration authorities must deliver copies of each document to the ministry of Finance, within 10 days from the date of come into operation of the contract. During the usage and repayment of the contracted/guaranteed loan, local public administration authorities report to the Ministry of Finance data on public debt monthly, within 15 days from the end of the period.

Loans of administrative territorial units or those contracted by economic operators and public services subordinated can be guaranteed through their own revenues.

Administrative territorial units/subdivisions are denied access to loans or guaranteeing any kind of borrowing[4], if the total of the annual debt, representing due instalments on contracted and/or guaranteed loans, interest and fees, including the loan to be contracted and/or guaranteed in that year, exceeds the limit of 30% of the arithmetic mean of their own revenues, reduced by income from asset sale, over the last 3 years preceding the year in which is requested the authorization for reimbursed funding to be contracted and/or guaranteed.

The calculation of accepted limit is done as follows:
The sum (Cc + Cn) must be less than or equal to 30% of:

$$\frac{[Vp(t-3)-Vc(t-3)]+[Vp(t-2)-Vc(t-2)]+[Vp(t-1)-Vc(t-1)]}{3}$$

Where:

- Cc - (Credit rate+ interest + fees) contracted credits;
- Cn - (Credit rate+ interest + fees) new credit;
- Vp(t-3) – revenues achieved in the third year preceding the year of requested contract/guarantee;
- Vp(t-2) – own revenues achieved in the second year preceding the year of requested contract/guarantee;
- Vp(t-1) – own revenues achieved in the year preceding the one of requested contract/guarantee;

- Vc(t-3) – revenues from asset sale, in the third year preceding the year of requested contract/guarantee;

- Vc(t-2) – revenues from asset sale, in the second year preceding the one of requested contract/guarantee;

- Vc(t-1) – revenues from asset sale, in the year preceding the one of requested contract/guarantee.

Administrative territorial units/subdivisions that registered arrears on 31 December of the previous year, unpaid until the request of the advice of the Committee for local borrowing authorization, or had deficit of the operating section at the end of the year previous to the request, are not entitled to contracting or guaranteeing loans. Are exempted from these provisions those administrative territorial units/subdivisions that are in procedure of financial crisis or insolvency and seek loans or guarantees for refinancing the local public debt, according to the recovery plan of financial crisis or insolvency, as appropriate.

Also are exempted the contracted and/or guaranteed loans by the administrative territorial units/subdivisions to provide pre-financing and/or co-financing of projects benefiting from reimbursable external funds previous and post accession of the European Union.

In order to calculate the limit for contracted and/or guaranteed loans with a variable interest rate is taken into account the amount of debt to interest rate, valid at the date of drawing up the documents, and for foreign currency loans is taken into account the currency exchange rate of National Bank of Romania, at the date of the calculation.

For framing in the annual consolidated budget deficit, at the proposal of the Ministry of Finance, no later than November 1 of each year, the Government approves the annual limits for reimbursable funding to be contracted by administrative territorial units/subdivisions, and withdrawals that can be made from contracted reimbursable funding or those to be contracted, for a period of 3 years, following the year in which the financing is approved. The setting of these limits do not include the reimbursable funds for pre-financing and/or co-financing the projects benefiting from external funds from European Union, including those comprised in the Hellenic Plan for Reconstruction and Economic Development of the Balkans - HiPERB, and the withdrawals from the reimbursable funds, contracted or to be contracted by the administrative territorial units/subdivisions.

The Committee for local borrowing authorization empowers the reimbursable funds to be contracted by the administrative territorial units/subdivisions, and also the withdrawals that can be made from repayable funding contracted or to be contracted, within which payment may be made, taking into account the annual limits approved by the government, for inclusion in the annual general consolidated budget deficit.

These regulations aim to eliminate those situations where local authorities would exploit unduly their leverage potential in the years when they obtained substantial income from assets sale, then not having the possibility of reimburse the contracted loans or guarantee obligations under the loans. We note that it was intended to limit access to local resources borrowed for local communities that register arrears or the increase of their debt because they are basic clue to assess financial situation and the solvency of the local budgets. Are exempted from these restrictions the contracted and/or guaranteed loans by the administrative territorial units/subdivisions to ensure the pre-financing and/or co-financing of those projects that benefit from the reimbursable external funds before and post accession to the European Union to encourage the access to such resources.

To cover the risk arising from the local authority guaranteeing of loans contracted by economic operators and public services subordinated locally, the risk fund is established, outside the local budget.

The risk fund consists of: amounts collected as fees from the beneficiaries of guaranteed loans, interest given by State Treasury units to fund availabilities, delay penalties similar to budgetary revenues, levied for not paying by borrowers at term, and respectively, due instalments, interest and commissions in addition of the local budget.

The risk fund shall be kept in separate accounts opened at the State Treasury territorial units and is made for internal loans guarantees, and respectively, for external loan guarantees.

The level of risk commission is determined by the authorizing officer and approved by deliberative authorities. The commission is applied on the value of the guaranteed loan.

The amounts found in the risk account at the end of the year shall be regularized with the local budget within sum limit received from this budget, and the difference shall be carried over the following year with the same destination.

If during the budgetary execution there is a temporary lack of cash due to the gap between income and expenditure of the local budget, it can be covered by loans from the Ministry of Finance, the availability of the Treasury General Account, only after using surplus from previous years[5].

The local authority loan is subject to the following limits:

- It shall not exceed 5% of total revenues estimated to be received during the fiscal year in which the loan is contracted;
- Local authority cannot engage loans that exceed repayable funds during the same fiscal year;

Reimbursement of borrowed funds is guaranteed with revenues estimated to be received within the same fiscal year. In a situation where the loan from the Treasury General Account cannot be paid at maturity, The General Directorates of public finances are authorized to execute the administrative unit account in question.

The activity of the local public administration authorities may be subject to an exceptional verification of the Court of Auditors in the following situations:

- If the local government authority fails to repay all short-term payment obligations until the end of the fiscal year in which the loans were engaged;
- If, at some point, during the fiscal year, the short-term debts of the local public administration exceed the established limit;
- Upon motivated notification of at least third of the members composing the deliberative authority.

The Court of Auditors will require local public administration authority found in one of the referred situations, to draw up and submit a recovery plan to the Court of Auditors and General Directorate of public finances through which undertakes to comply with the limits for loan within 12 months.

The Ministry of Finance is authorised to grant from the availability of the Treasury General Account loans to local authority in the recovery plan, if they pledge to redeem funds in a set time limit, not exceeding two years.

MUNICIPAL BONDS-ALTERNATIVE FINANCING OF LOCAL COMMUNITIES

The local community contracts public debts through the following instruments: securities, loans from the commercial banks, credit provider, financial leasing, and local warranty.

The issuance of securities can be done directly by the local public administration authorities or through agents or other specialized institutions.

Within local government debt instruments that local public authorities may use the municipal bonds present some peculiarities. These are 'debt securities issued by the administrative territorial units to attract resources to finance certain objectives.' (Moşteanu, 2008)

The main purposes for which municipal bonds are emitted are: finance a new investment project; funding repair and maintenance of assets held by the issuer; refinancing the bonds already in circulation; current expenditure.

Municipal bonds have the advantage of attracting a large number of investors who are passive because they do not engage in surveillance the activities of the loan. Municipal bonds can also be traded on the stock market. The option for this instrument of local public debt arises also from the fact that it avoids the costs involved in taking out a bank loan and legislative obstacles in access to it.

The access to such funding source requires assuming management of guarantee bond issues, risks for the municipality, legislative instability and the evaluation of bonds. (Lăcătuş and Văduva, 2009)

Municipal bonds are not guaranteed by the state but they are guaranteed solely by revenues of local budgets. For this reason some municipalities[6] were sometimes unable to pay on debentures and had to resort to assets and new issuances. This gave an alarm regarding the need for efficiency and effectiveness in predicting and local public spending, and also balancing both in volume and time with the term of local revenue collection.

Municipal bonds involve certain risks for municipality, namely liquidity risk, default risk and market risk. Therefore, municipalities might not have on time the necessary resources to bond redemption or for the payment of coupons, or even not creditworthy. Regarding market risk, the variability rate of coupon given as payments for municipal bond loan can be problematic. This is dependent on the interbank market interest changes that are in constant change. If taking into account the growing of issuance maturities, the uncertainty about the future payment responsibilities on behalf of the bonds increases. Launch and management of municipal bonds is hampered by legislative instability that changes their attractiveness.

As regards the assessment bonds, there was a need for municipalities issuing ratings to reflect, in a synthetic way, the types of risks assumed by the investor and their size. Ranking of local authorities in terms of their financial credibility, as public information, would help the primary market and the secondary one for municipal bonds. So far, only a listing of municipal bonds on Bucharest Stock Exchange represents a guarantee of reliability of local community concerned.

The issuance of municipal bonds in Romania started in October 2001 when the municipality of Predeal decided to acquire five billion lei for setting up a slope by issuing 50000 municipal bonds, for a period of one year and a half, which paid investors with a coupon that exceeded by 3% average interbank interest. The example of this municipality was followed by Breaza, Zalău, Alba Iulia, Bacău sau Târgu Mureş municipalities that found in municipal bonds a source to finance local investment projects easier and cheaper than bank loans (Lăcătuş and Văduva, 2009). In subsequent years increased the number of issued bonds, so far we have listed on Bucharest Stock Exchange 70 such securities of which 35 are still on going[7].

Table no. 1 the evolution of municipal bonds listed on Bucharest Stock Exchange

Year	No. of Trading sessions	No. transactions	No. of traded bonds (volume)	Value (RON)	Daily average value (RON)	No. of issuers	No. of new listed issuances
2001	17	5	45	481,42	28,32	2	2
2002	247	10	59.050	782.679,31	3.168,74	4	2
2003	241	39	187.870	17.135.351,82	71.101,04	10	8
2004	253	1.116	530.466	289.794.851,55	1.145.434,20	22	16
2005	247	394	397.101	127.369.058,79	515.664,21	19	6
2006	248	570	3.917.457	985.517.592,79	3.973.861,26	19	5
2007	250	268	6.652.467	794.335.510,65	3.177.342,04	22	11
2008	250	552	1.214.353	231.929.950,72	927.719,80	50	33
2009	250	965	2.892.920	1.284.618.844,77	5.138.475,38	60	16
2010	255	543	3.014.375	2.571.065.247,01	10.082.608,81	55	7
2011	255	248	1.857.248	545.978.257,20	2.141.091,20	60	6
2012	250	409	245.238	1.431.115.737,72	5.724.462,95	68	8
2013	55	114	12.040	41.863.725,48	761.158,65	64	1

Source: http://www.bvb.ro/TradingAndStatistics/GeneralStatistics.aspx?tab=1&m=0

Data in the table show that during 2001-2012 the municipal bond market grew very much, all indicators with predominant rising trend. The number of traded bonds in 2012 was 245.238 worth 1.431.115.737, 72 lei, incomparably a greater value to those registered in 2001-2002.

We believe that in order to improve the local budget process is necessary as this form of attracting funding resources of local investment objectives to be used in a larger scale, especially for those municipalities that have their own income and assets to guarantee municipal bonds.

CONCLUSIONS

Administrative territorial units/subdivisions are denied access to loans or guaranteeing any kind of borrowing, if the total of the annual debt, representing due instalments on contracted and/or guaranteed loans, interest and fees, including the loan to be contracted and/or guaranteed in that year, exceeds the limit of 30% of the arithmetic mean of their own revenues, reduced by income from asset sale, over the last 3 years preceding the year in which is requested the authorization for reimbursed funding to be contracted and/or guaranteed.

These regulations aim to eliminate those situations where local authorities would exploit unduly their leverage potential in the years when they obtained substantial income from assets sale, then not having the possibility of reimburse the contracted loans or guarantee obligations under the loans.

We note that it was intended to limit access to local resources borrowed for local communities that register arrears or the increase of their debt because they are basic clue to assess financial situation and the solvency of the local budgets.

We believe that supplementing the resources for financing certain local investment objectives could be achieved through extending the use of the municipal bonds, especially from those municipalities that have income and assets to guarantee them.

Municipal bonds have the advantage of attracting a large number of investors who are passive because they do not engage in surveillance the activities of the loan. Municipal bonds can also be traded on the stock market. The option for this instrument of local public debt arises also from the fact that it avoids the costs involved in taking out a bank loan and legislative obstacles in access to it.

ENDNOTES

[1]*Law no. 273/2006 on local public finances, published in Of. M, Part I, no. 618 of July 18, 2006, annex 1*
[2] *Law no. 273/2006 on local public finances with amendments, art. 61-65*
[3]*Law no. 109/2008 approving G.E.O. no. 64/2007 on public debt, published in Of. M. no. 369 of May 14, 2008*
[4]*G.E.O. no. 63/2010 amending and suplementing Law no. 273/2006 on local public finances, and establishing financial measures, published in Of.M. no. 450 of July 2, 2010, art. I, para. 32*
[5]*G.E.O. no. 63/2010 on amending and suplementing Law no. 273/2006 on local public finances, and establishing financial measres, published in Of. M.no. 450 of July 2, 2010, art. I, para. 36*
[6]*The municipality means an administrative territorial unit: commune, town, city See*
[7]*htpp://www.kmarket.ro/emisiuni/emisiuni.php, accessed on March 20, 2013*

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***Law no. 109/2008 approving G.E.O. no. 64/2007 on public debt, published in Of. M. no. 369 of May 14, 2008

***G.E.O. no. 63/2010 amending and supplementing Law no. 273/2006 on local public finances, and establishing financial measures, published in Of. M. no. 450 of July 2, 2010, art. I, para. 6, aproved with amendments by Law no. 13/2011 published in Of. M. no. 179 of March 14, 2011

***Law no. 69/2010 on fiscal and budgetary responsability published in Of. M. no. 252 of April 20, 2010

*** htpp://www.kmarket.ro/emisiuni/emisiuni.php