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**YEREL YÖNETİM REFORMU
PROJESİ (YJR III)**
LOCAL ADMINISTRATION REFORM
PROJECT (LAR III)

STRENGTHENING THE LOAN SYSTEM OF LOCAL AUTHORITIES IN TURKEY

Comparative Assessment and Recommendations

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Acronyms

ASKI	Ankara Water and Sewage Authority
BOT	Build Operate Transfer
DMO	Debt Management Office
EGO	Ankara Electricity Gas and Bus Authority
EU	European Union
GDP	Gross Domestic Product
GTZ	German Development Cooperation
IETT	Istanbul Bus, Transportation and Electricity Authority
ILBANK	Bank of Provinces
IMF	International Monetary Fund
ISKI	İstanbul Water and Sewage Authority
JICA	Japanese International Cooperation Agency
KfW	Kreditanstalt Für Wiederaufbau (German Development Bank)
LAR	Local Administration Reform
OECD	Organization for Economic Cooperation and Development
PPP	Public Private Partnerships
PWLB	Public Works Loan Board
RIO	Regional Audit Chamber
SIB	Social Impact Bond
SOE	State Owned Enterprise
SUKAP	Water and Sewage Infrastructure Projects
TBB	Turkish Municipalities Union
TCA	Turkish Court of Auditing
TRY	Turkish Lira
UK	United Kingdom
UMT	Union of Municipalities in Turkey
UNDP	United Nations Development Program

Executive Summary

1. The report on “Strengthening the local system of local authorities in Turkey” was prepared under the EU funded Local Administration Reform III. Project of the UNDP, Turkey office. This report aims to support the preparation of the draft legislation to be developed by the Ministry of Interior and Ministry of Environment and Urbanization and in coordination with Presidential Office on Strategy and Budget.
2. There were two specific tasks: (i) to evaluate the borrowing practices and loan systems in Turkey and (ii) to review the municipal borrowing practices in five European Union member countries.
3. In our report “debt” is defined in a broader way, including all financial liabilities that carry obligations to make future payments. So, it covers loans, deferred payments of municipalities and payables to suppliers, contractors and other public institutions, the municipal guarantees and contingent liabilities. This broader approach indicates municipal creditworthiness more properly, than the financial loans, only.

I. Municipal loan system in Turkey

Pressure for municipal borrowing

4. There are several external factors behind the pressure for municipal borrowing, such as rapid urbanization, migration to the metropolitan cities, social transfers, changes in municipal legislation, need for infrastructure and eco-friendly investments. While responsibilities grew, revenues remained same at the same level and they are dominated by central budget revenue shares. Under these vertically imbalanced local finances, majority of municipalities will soon lose their loan taking ability, might increase the unpaid liabilities to the private and the public sector.
5. Capital expenditures are significant in municipal budgets. Half of municipal shared revenues was spent on investments until 2015, then it started to increase. Metropolitan and province municipalities are more dependent on central budget revenue shares than the others.

Limits on municipal debt

6. Domestic and external borrowing follow different regulations. Article 68 of Municipal Law No. 5393 regulates domestic borrowing and the Law No. 4749 on Public Debt Management and Regulation of Debt Management for Foreign Borrowing. Municipalities are free to choose among loan taking instruments in domestic markets.
7. There is a numerical limit on domestic borrowing exceeding 10% of municipal budget revenues it requires Council decision with absolute majority and approval of the Ministry of Environment and Urbanization. The domestic and foreign debt stock cannot exceed the total amount of the latest year’s finalized budget revenues increased with revaluation coefficient (150% in the case of metropolitan municipalities). The same rules apply to the municipal affiliated administrations and the municipal companies with majority municipal shares. However, there are different calculation methodologies from three main institutions in the implementation such as Ministry of Urbanization and Environment, Ministry of Treasury and Finance and Turkish Court of Accounts.
8. Ministry of Treasury and Finance permission is needed for external borrowing and municipal bond issuance. Public Private Partnership schemes are permitted by the President.

Role of ILBANK

9. The municipality getting investment loan or cash loan from the ILBANK is obliged to submit the repayment plan to ILBANK. Treasury guarantee can be obtained for the projects included in the Annual Investment Program prepared by Strategy and Budget Office of the Presidency. ILBANK collects municipal interest and principal repayments into an escrow account and monitors the funds servicing foreign loans. ILBANK also uses the shared taxes as a collateral for the municipal loans (intercept mechanism up to 40% of shared revenues).

Increase in municipal loan taking

10. The total debt stock of local administrations was 12.1 billion TL in 2006 and reached 49.3 billion TL by the end of 2017. However, when broader debt definition is used total debt amount reaches to 107 billion TL by the end of 2017. Majority of municipal debt is long term debt. Following the debt restructuring in 2011, composition of municipal debt changed: relatively tax and public sector receivables decreased, and the bank loans increased significantly.

11. The ratio of total debt to municipal revenues presently is high again (48%). The largest ten metropolitan municipalities have more than 62% of the total local debt. Debt of the water and sewage administrations in the three major cities amounted to approximately TL 4.7 billion (one fifth of the total local debt accumulated by the three largest metropolitan municipalities).

Borrowing procedures

12. Turkey imports external saving to finance current account deficit. The annual average current account deficit, excluding crisis periods, varies between 3-5% of GDP. The total assets are 2.4 trillion TL (2017). It is relatively low compared the national income (76.3% of GDP) Significant portion of this amount consists of deposits (70% of total). 43% of deposits are in foreign currency. The financial sector does not have sufficient resources for lending: the loan to deposit ratio is over 120%. Compared to developed economies, the bond market is dominated by the Treasury, and it is relatively shallow. Both the Treasury and ILBANK support project finance of the municipalities and have a long-time experience on project financing with soring collaboration.

II. Loan systems in EU countries

13. Local government borrowing is widely used for financing municipalities: (i) it helps to allocate the costs of capital investments among the present and future users of infrastructure, (ii) with loans savings can be achieved by investing in modern technologies and (iii) short term loans are needed to balance seasonal municipal revenue inflow with the regular operational expenditure obligations.

14. In the period after the economic crisis of 2008/2009, both the local capital expenditures and local net borrowing declined. The European Union average of gross capital formation comprises app. 11% of total local expenditures (29% in Turkey!). The net borrowing was 2-3% of total budget, unlike in Turkey with significant increase in net borrowing, reaching 11% total municipal expenditures in 2017.

15. European Charter on Local Self-governments, ratified by Turkey, also claims the access to capital markets with some conditions. Borrowing is for capital investments and local access to the national capital market should be regulated law.

16. The five cases proved that following the 2008/09 financial crisis a fiscal re-centralization trend started in many countries. At the European Union level debt is regulated by keeping government deficit below 3% of GDP and the government debt under 60% of GDP. Countries above these limits should make proportional actions to reduce their debt.

17. Among the five countries discussed here the only country comparable in population size is Germany. The level of economic development (measured by GDP per capita) in Turkey is closer to the two Central European countries (Hungary, Poland). The other two countries (Denmark, UK) are among the most developed countries in Europe with 2.5 times higher GDP per capita.

Municipal borrowing practices

18. In the group of unitary countries local government borrowing is in line with the scope of decentralization. Municipalities in more devolved countries tend to accumulate more debt. Turkey belongs to the less decentralized countries compared to this group of countries: local expenditures are 3.6% of GDP and the local government debt is only 1.6% of GDP.

19. Sub-national borrowing is influenced by the level of economic development, the demand for infrastructure and the resources available for infrastructure and public services. The level of local government autonomy and the intergovernmental fiscal relations also have an impact on how loans are used for financing municipalities.

20. Development of the banking sector and the traditions in using diverse financial instruments are also critical factors. Beyond bank loans to finance local capital investments and budget deficit, among other forms, municipal bonds are also used in the studied countries. In European comparison the share of debt on accounts payable (arrears, unpaid bills, debt to suppliers) is rather high in Turkey (almost 39% of total municipal debt).

21. The local government loan systems are determined also by the guarantees issued by municipalities. They are parts of the local government liabilities, which are often categorized as direct and contingent (potential) liabilities on one hand and being explicit with straightforward legal obligation or as political (implicit) commitment.

Fiscal framework matters

22. The wider local government responsibilities and functions in many European countries create greater need for borrowing. Greater grant dependency combined with soft budget constraints does not support loan financing, as municipalities could have access to external funding at no costs. The less decentralized systems follow administrative control, usually with ex ante approval of all transactions by various government entities. While the decentralized systems rely more on the powers of local councils and other accountability mechanisms, which are supported internal control systems and ex post budget review.

23. The five countries discussed by the report represent rather different sub-national borrowing models: they range from a purely commercial bank based, liberal systems (Hungary, Poland) through the specific localized models of Denmark, Germany to the one single municipal lending channel under national government control in the United Kingdom. These five country cases prove the diversity of models, developed historically under different political and administrative systems.

Fiscal rules

24. Countries with extensive public sector and local government borrowing, developed both ex-ante regulations, such as the golden rule of borrowing, debt and borrowing limits, administrative permits, cooperative agreements between government tiers and the ex-post regulations (administrative or court-based rules for managing insolvency) to ensure debt sustainability.

25. Other local government borrowing regulations introduced some compulsory limits over municipal borrowing in the studied countries. The numerical limits are combined with administrative approval of borrowing (Hungary). The long-term approach to balanced budget is coupled with combined mechanisms of local accountability and national control: state audit screening (Poland), self-regulation

and limited ministerial discretion under the capped total debt (Denmark) to higher level approval (Germany, UK).

Managing insolvency

26. The defaulting regulations are different even under similar borrowing models and regulatory systems. Hungary is the only country with a court based preventive system of municipal insolvency. The others have no explicit default regulations (Poland) or offer specific interventions with diverse forms of financial help to municipalities with overdue debt (Germany, UK).

III. Recommendations for strengthening municipal loan system

27. The international examples discussed in this report do not offer any directly applicable solution for improving the loan system in Turkey. Adaptation of any technical methods require careful assessment of institutional conditions in the recipient country.

1. Reforming intergovernmental finances

28. For meeting enhanced municipal service needs the local revenue raising capacities should be matched with the enhanced municipal service needs. This vertical fiscal balance can be improved by re-assessing the devolved municipal functions and by re-designing the revenues assigned to local governments. Stable and significant local own source or shared revenues (with sound equalization mechanism) will limit the need for borrowing and will eliminate the risk of excessive debt. Public financial management reforms are needed to support medium term budget planning based on the development plan, capital investment strategy design, transparent management of arrears and overdue debt, with clear and strict local borrowing approval mechanisms

2. Improving debt regulations and practices

29. Broad issues of municipal debt should be in the focus of any future improvements of local loan systems. ILBANK loan supply scheme can be provided directly by the national budget and through foreign funding through the Treasury, similarly to the British model. If a scheduled public sector bailout is planned, then no across-the-board consolidation of highly indebted municipalities is recommended. Compulsory public procurement of financial services is proposed to open up the local borrowing market.

30. Alternative new forms of municipal borrowing will expand the financing opportunities for municipal capital investments. They are the municipal bond and the Public Private Partnership schemes. New regulations in these fields can promote Social Impact Bonds. Other proposed changes are the specification of municipal assets used as collateral, better monitoring and enforcement of debt limits and improved risk assessment methods. Development of these alternative forms requires improved technical capacities of municipal administration and decision makers.

31. Municipal debt regulations should be supplemented by limits on debt services. Gradually moving away from the simple numerical limits towards assessing long term net operating surplus against debt service will make creditworthiness analysis more reliable. It requires clear separation of current and capital budgets; gross approach to debt measurement, consolidation of all local expenditures and revenues.

32. Wider user of alternative forms to bank loan financing will raise need for domestic municipal rating organizations and capacities. Procedures for managing overdue debt should be developed by primarily targeting the process to be followed by the municipality with financial difficulties. They should also produce public information on municipal finances and transparency will improve local accountability.

3. Institutional capacity development

33. Local capital investment planning and strategy design with a debt management strategy is the key element of the effective public financial management system. Capital investment plans combined with the long-term financial plan is needed for balanced budget execution. Technical assistance and central professional support to municipal borrowing and sound debt management is needed both for the municipal staff and the elected officials. New organizational forms by separating loan taking and debt management are needed for more efficient local loan systems.

4. Legal Issues

34. Some changes in the Municipal Law Article 68 are needed such as excluding interest payments from stock definition and more clear defining of annual debt limit calculations.

Scope and methodology - an introduction

This report was prepared under the EU funded Local Administration Reform III. Project of the UNDP, Turkey office. In this third phase of the LAR project strengthening of municipal loan system is one of the first activities. It will be followed by several other closely related activities, such as improvement of own source revenue raising, management of municipal companies and affiliated service organizations.

The first draft report on local loan system aims to support the preparation of the draft legislation to be developed by the Ministry of Environment and Urbanization , PMinistry of Interior in cooperation with and in and coordination with Presidential Office on Strategy and Budget. The specific task under this contract was to review the municipal borrowing practices in five European Union member countries (sections prepared Gabor Peteri). In parallel the borrowing practices and loan systems were also evaluated (author is R. Hakan Özyildiz).

The two reports are connected, so the major problems identified by the analysis of the Turkish system are also targeted by the international comparison. Obviously, the section on Turkey is more detailed. In the other five countries we had limited access to data so mostly the information sources of international organizations (OECD, Eurostat) were used. The actual legislation, regulations and procedures on loan systems were studied through secondary information sources (with the exception of Hungary, where the author lives).

The recommendations formulated at the end of the report are preliminary proposals of the two authors. At this stage of our work they are indications of possible areas of future actions. We used the findings from the report on Turkey and the lessons learned from the practices in the studied five countries.

For preparing the combined report valuable support was provided by the LAR III. Project management. We are grateful for Mr. Ferhat Emil and Mr. H. Hakan Yilmaz to guide us during the project design and to help with the information and data on Turkish local governments. At the first stage of our work we received information from the two client ministries and the ILBANK. A workshop with the other stakeholders and selected municipalities also provided insights to municipal borrowing in Turkey. The first draft report was discussed with municipal representatives at two consultative workshops in June, 2019.

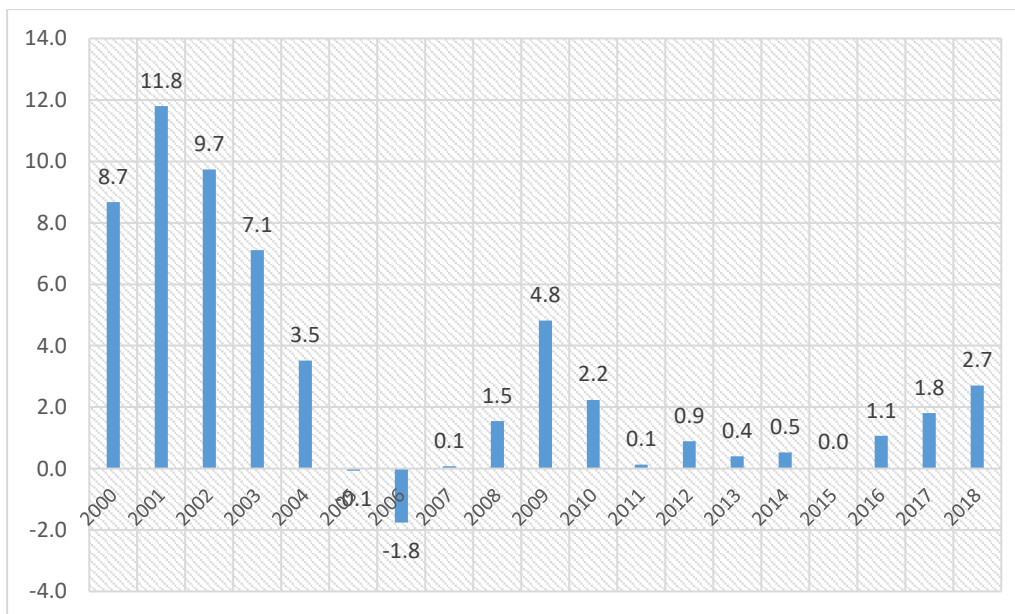
I. Municipal loan system in Turkey: structure and problems

Borrowing requirement

Turkey is an emerging market country suffering from chronic inability of generating sufficient domestic saving. Therefore, debt and debt payments affect all sectors of the economy. These topics influence the direction of development as the past experience demonstrated. Past experience. The external borrowing started to expand in the 1950s, accumulated over the years especially after 1980 under capital account liberalization coupled with growing fiscal deficits effected the economy negatively over the time due to foreign currency supply shocks

The public and private sector financial institutions lending money to the Treasury had encountered multi-dimensional financial problems which eventually contributed to the 2001 crisis in Turkey. In other words, the central problem was the pressure for borrowing in the public sector. Following to the widespread structural reforms implemented in those years, the need for overall public deficit central government (Treasury) borrowing requirement in general had decreased significantly.

Table 1 Public Sector Borrowing Requirements (As a Share of GDP, 2000-2018)



Source: SBO (Access Date: August 2, 2019)

However, these reforms were not geared towards solving the structural problems of local finances, as they predominantly focused on central government debt problem which was then a main cause for concern. In other words, local governments were not high on the reform agenda. The debt burden of local administrations, especially on metropolitan municipalities have become a problem relatively quiet recently. . Main factors behind this development are migration to the metropolitan cities, increasing social transfers and changes in the municipality legislations which assigns new duties but not supporting municipalities with sufficient resources. As the necessity for infrastructure and the eco-friendly investments cannot also be ignored under the quick urbanization process, this led the demand for capital investment of local governments, especially at municipalities, keeping the external financing (loan taking) a necessity of all ongoing projects.

On the other hand, while expenditures increased, revenues did not perform at the same pace. This, inter alia, can be attributed to two main factors: the inadequacy of the own revenue collection and the unwillingness of reduce some expenditures.¹ The result was the increase in the overall indebtedness of local governments.

Debt vs loan: clarifying the terminology

Local government loan taking and other forms of borrowing are now subject to various public discussions. Before we go further into the subject, it is useful to clarify the terminological difference between “debt” and “loan”. In the macroeconomic statistical system, the definition of “debt” is much broader. It includes all financial liabilities that carry obligations to make future payments. It goes beyond municipal borrowing of various types of loans taken by all local actors (municipalities, affiliated administrations, municipal companies). Debts cover loans, deferred payments of municipalities and payables to suppliers, contractors and other public institutions, municipal guarantees and contingent liabilities. IMF Governance Finance Statistics Manual 2014 also defines the same term as “Debt Instruments”, which encompasses loans (non-negotiable instruments)², unpaid liabilities, domestic and external bond issuances (negotiable instruments), etc.

Making such kind of differentiation between “debt” and “loan” may run the risk of overlooking the understanding of the degree of fiscal stance of any public institution from a broader point of view. This can be misleading for the public authorities to detect the risks and manage the loan taking activities properly with the least cost alternatives. Because lenders would take into consideration borrowers’ full financial position in any circumstances during credit evaluation processes in terms of measuring credit worthiness of public institutions including not only the Central Government Treasuries but also the municipalities.

It is therefore although the main thrust of the report would be on the loan taking and loan repayments of the municipalities, it should be kept in mind that these concepts are not separable from each other and references will be occasionally made to draw attention to the linkages between debt management and loan taking to assist the authorities to approach to the municipal loan issues from a broader perspective. Consolidation and restructuring of debts to other public institutions such as tax authority and Social Security Administration are well known practice in Turkey (see also Box 1.)

Table 1. below summarizes the present options of loan financing for both capital investments and operation, maintenance expenditures by three main local public actors. In this report on loan systems we focus on all the external financing options.

¹ Own revenue enhancement is another activity of LAR III project and elaborated in more detail over there.

² Negotiable debt instruments such as municipal bonds are those who have secondary markets while non-negotiable debt instruments such a project credits / loan does not have secondary markets.

<i>Loan financing</i>	<i>Municipality</i>	<i>Affiliated administrations</i>	<i>Municipal companies</i>
<i>1. Capital investment</i>	Domestic and foreign loans, bonds, PPP	Subsidies and guarantees of municipality and domestic and foreign loans	Owner's equity
<i>2. Current budget (liquidity)</i>	Deferred payments to utilities, tax authority	Deferred payments to utilities, tax authority, other public entities	Non-documented

Municipal budget trends - an overview

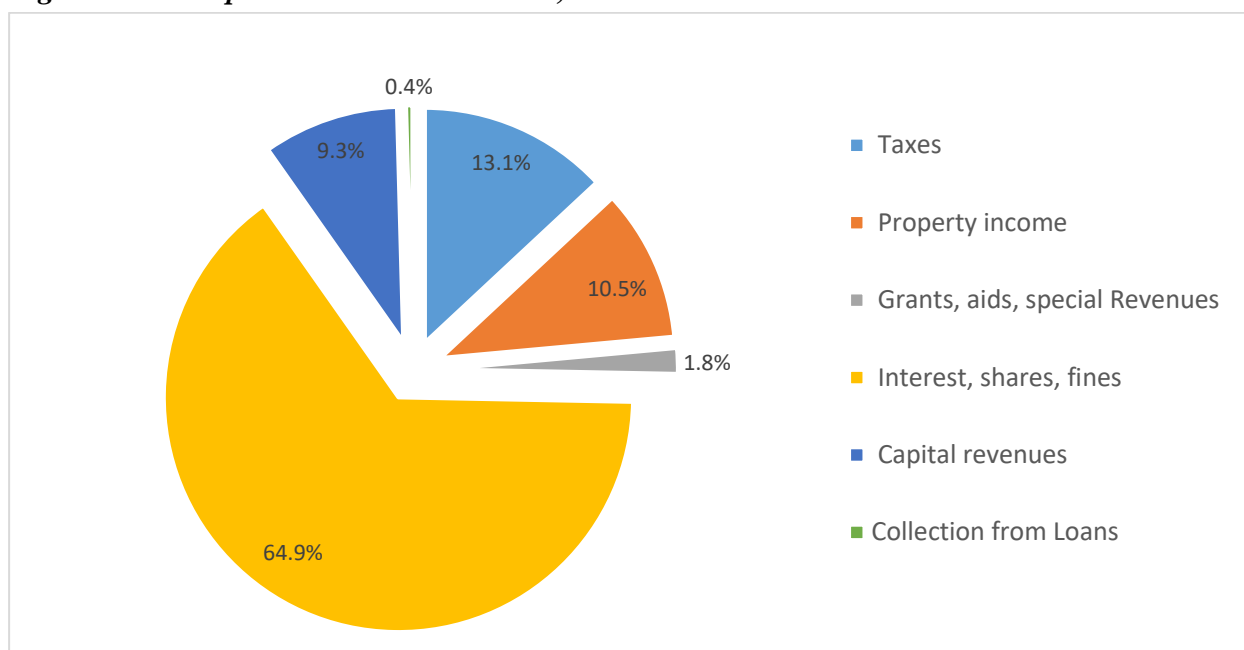
Municipal Budget Balance

The structural problems in revenue generation and culture of spending of the municipalities are the biggest factors producing pressures for loan taking. Beside fiscal management issues, new law code 6360 and migration from rural to urban areas and especially the Syrian migration in South Eastern Anatolia in the last five years further contributes to the financing bottlenecks.

Law no. 6360³ ratified in 2012, extended the area of responsibility of metropolitan municipalities to the provincial border. Service areas have expanded and investments have intensified as much as the social transfers.

However, two main matters of concerns need special attention. There are inequalities between central government and local governments primarily on social expenditures. First, vertical inequality: sharing roles and responsibilities between the two government tiers is challenging. For example, the central administration is responsible for schooling. However, it has been a common application that municipalities have cleaned up classes and maintains some interior maintenances. As municipalities also began to provide school sanitation services, their tasks have increased. The second aspect of vertical inequality is that revenue shares from the central budget is not distributed among municipalities in proportion to their enlarged tasks.

³ <http://www.mevzuat.gov.tr/MevzuatMetin/1.5.6360.pdf>

Figure 1 Municipal Revenue Distribution, 2018

Source: General Directorate of Accounting and Financial Control (Access Date: 2 August, 2019)

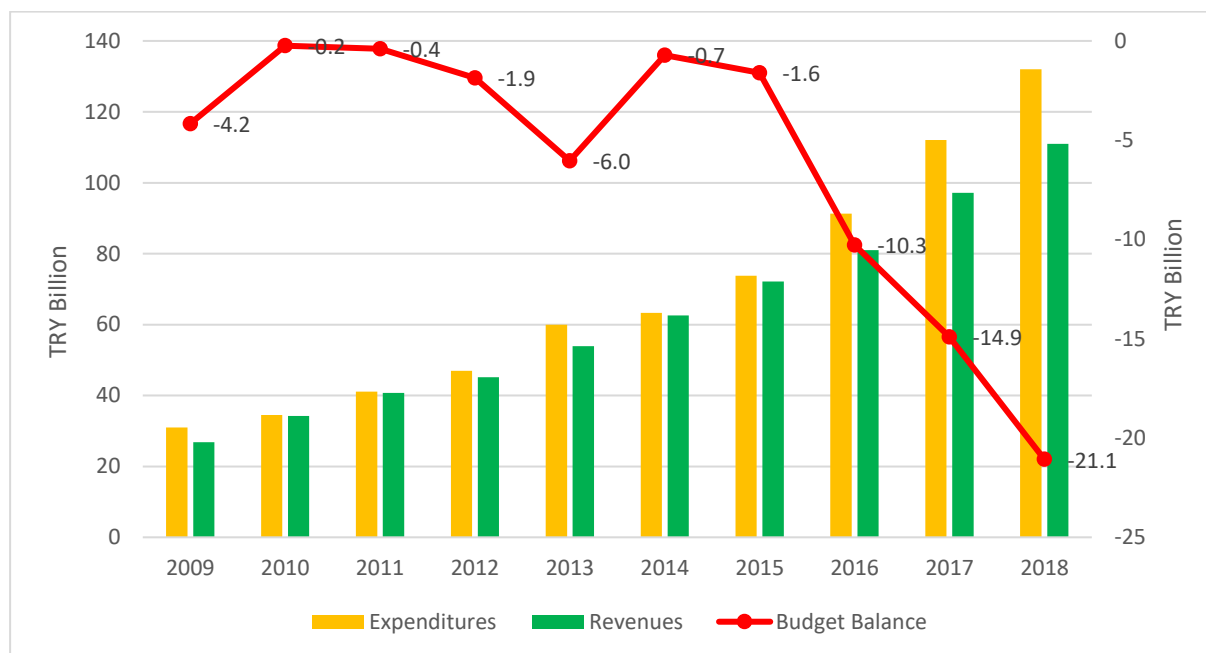
“Social state” is a mandate of constitution and this affects all public expenditures. With the effect of elections held in recent years, social spending has also increased. Between September 2010 - March 2019, elections were held nine times in Turkey, such as referendum, local elections, general elections and the presidential election.

While responsibilities grow revenues remained at the same level. The central budget revenue shares allocated to municipalities are almost two thirds of total municipal revenues. (Figure 1. above) Therefore, when central budget revenues start to decline in the times of economic recession or contraction, the borrowing burden tends to increase due to lessening revenue shares from central government.

As far as municipalities concerned, borrowing pressure would continue as long as their revenues and the central budget revenue shares remain unchanged. If the shares taken from the central budget are not increased, majority of municipalities will soon lose their loan taking ability and credibility. It will also force them to increase their unpaid liabilities to the private sector and to the public sector especially in forms of delayed payments to public utility companies, tax offices and social security institutions. Such occurrences further justify the continued pressure for increasing operating costs once the capital investments have been completed. Operation and maintenance expenditures are not considered sufficiently during capital investment planning. Small municipalities, in particular, are struggling with the higher operating expenditures.

The following Figure 2. shows the budget balance of municipalities for the period 2009-2018.⁴ The budget balances can be divided into two periods namely before and after 2011. (See more detailed data in Annex 1. Table A)

⁴ Budget data for municipalities are provided by two sources. First one is General Directorate of Accounting and Financial Control, other one is Presidency of Strategy and Budget. In this report first source is used for standardization budget and debt stock figures.

Figure 2. Municipal budget, 2009-2018

Source: General Directorate of Accounting and Financial Control (Access Date: 2 August 2019)

Between 2011 – 2015 the fiscal balances of municipalities were running moderate deficits. This was largely due to the legislative arrangements to restructure the unpaid tax debts of the municipalities. In 2011, Law No. 6111⁵, which was enacted in order to reduce the effects of the 2009 Global Crisis, restructured all economic entities', including municipalities' deferred tax obligations. With this restructuring, the interest rates of the penalties on deferrals were reduced and the instalments of the debts were reduced as much as possible and spread over time. This change partially relieved the expenditures of municipalities and reduced budget deficits. Thus, the budget balances of 2010, 2011 and 2012 have achieved to positive level.

However, especially after 2015, the situation rapidly distorted again. The budget deficits started to increase while the revenues did not show the same performance. At the end of 2018 budget deficit were TL 21,1 billion for all municipalities.

Compositions of municipal budget expenditures and revenues explain the changes in budget balances (Table 2.) Two items dominate expenditures: purchase of goods and services (41,3% in 2018) and investments (36,1%). The sum of these two items is close to 80% of the expenditure. The share of personnel expenditures in total expenditures is decreasing over the years: from 20.7% in 2009 they declined to 11,7% by 2018.

Box 1. Debt restructuring in 2011

The Law No: 6111 contains income, corporate, value added, special consumption taxes which must be affirmed until 31 December 2010. With this law, the debts of taxpayers who are paying tax liabilities by updating with the CPI have been terminated. Together with this, the collection of all the penalties due to the tax base with the late interest and late charge were deleted.

⁵<https://www.mevzuat.gov.tr/Metin1.Aspx?MevzuatKod=1.5.6111&MevzuatIliski=0&sourceXmlSearch=&Tur=1&Tertip=5&No=6111>

There is a similar structure in revenues. While in 2018 the property income is 10,5% of revenues, the revenue shares from the central budget are 59,7% of the total revenues. In the studied period the shared revenues range between 50.3% (2009) and 59.7% (2018) of the total municipal revenues. In other words, sources from the central budget are the main sources of municipal budgets, in metropolitan municipalities going up to almost 70 % of total revenues. (See Annex 1, Table B.)

Table 3. Composition of municipal expenditures and revenues, 2009-2018

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Expenditures	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Compensation of Employees	20.7	20.2	18.4	17.5	15.1	15.6	14.7	13.5	11.5	11.1
Govern. Premiums to Social Security Agency	3.2	3.5	3.1	2.8	2.4	2.5	2.4	2.2	1.9	1.8
Good and Service Purchase	33.8	35.5	37.2	39.5	38.3	39.3	42.9	42.2	41.2	41.3
Interest Expenditures	3.2	3.0	2.6	2.5	1.9	2.4	2.3	2.1	2.6	3.4
Current Transfers	5.2	5.7	4.6	4.0	3.8	4.2	4.2	4.1	3.8	4.0
Capital Expenditures	27.9	27.7	27.7	29.5	33.9	32.4	30.2	32.5	36.5	36.1
Capital Transfers	1.7	0.3	2.1	1.1	1.1	1.3	1.4	1.0	1.0	1.0
Lending	4.3	4.1	4.3	3.1	3.4	2.3	1.9	2.5	1.5	1.3
Revenues	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Taxes	13.5	17.1	16.9	16.0	15.2	14.8	15.0	15.1	13.6	13.1
Property Income	15.4	14.1	13.2	14.4	14.8	10.8	10.4	10.4	11.9	10.5
Grants and Aids and Special Revenues	1.4	1.3	1.5	1.4	1.5	1.8	2.0	2.0	2.0	1.8
Interest, Shares and Fines	62.5	59.6	59.9	60.8	59.1	61.9	65.6	64.4	64.0	65.1
Revenue Shares	50.3	51.2	51.4	52.5	51.6	55.0	59.1	58.1	57.3	59.7
Capital Revenues	4.6	7.4	8.2	6.6	9.2	5.5	6.8	7.2	8.1	9.3
Collections from Loans	2.5	0.5	0.3	0.7	0.2	5.2	0.2	0.9	0.4	0.4

Source: General Directorate of Accounting and Financial Control (Access Date: 2 August, 2019)

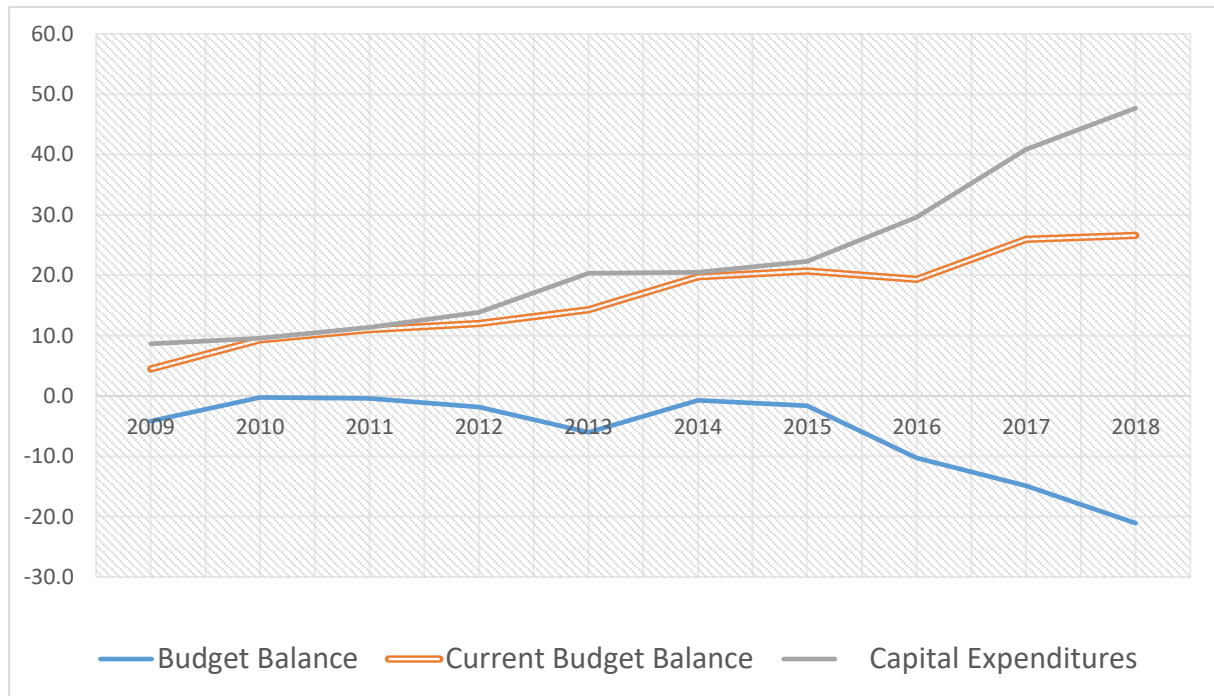
Table 4. Capital expenditures and budget balance, 2009-2018				
<i>TRY Million</i>	<i>Budget balance</i>	<i>Budget balance w/o capital expenditures</i>	<i>Capital expenditures in % total revenues</i>	<i>Capital expenditures in % of shared revenues</i>
2009	-4 167.2	4 482.9	32.2	51.5
2010	-241.1	9 307.1	27.9	46.8
2011	-392.5	11 006.1	28.0	46.7
2012	-1 856.6	11 992.9	30.7	50.5
2013	-6 033.2	14 313.6	37.7	63.8
2014	-721.4	19 757.5	32.7	52.9
2015	-1 597.1	20 701.9	30.9	47.1
2016	-10 275.6	19 359.8	36.6	56.8
2017	-14 899.1	25 959.6	42.1	65.7
2018	-21 071.6	26 618,86	43.0	72.1
Source: General Directorate of Accounting and Financial Control (Access Date: 2 August 2019)				

In order to understand the structure, we need to take a closer look at some items of the budget. For example, as seen in Table 4 and Figure 3. budget balance without capital expenditures is in surplus and increasing over the years. (See also Annex 1. Table A.-D.) Other ratio of capital

expenditures to revenue shares from central budget shows us that almost half of revenues shares was spent for investments until 2015, then it started to increase.

Taxes collected by municipalities themselves are not enough even for compensation of employees. In short, municipalities invest, produce services and pay staff compensation with the tax shares which they receive from the central government budget and mainly taking loans from ILBANK.

Figure 3 Budget Balance, Current Budget Balance and Capital Expenditures (billion TRY)



More data provided in the Annex 1. for further details concerning metropolitan, province municipalities and districts and also town municipalities.

Budget data of metropolitan and province municipalities shows that their dependency to central budget revenue shares bigger than others. They cannot pay wage and salaries with their own resources. Current budget balance is positive for all segments of the municipalities. Especially after Law 6360 there has been strong relation between capital expenditures and budget balance in municipalities as shown in the Figure 3. mainly resulting from the metropolitan municipalities capital expenditure increase.

Borrowing Rules and Practices

Rules and limits for loan taking

This type of municipal budget structure, explained in the previous section, generates pressure to borrow. Borrowing by municipalities in Turkey has been subjected to rules and limitations in the first years of the 2000s. When examining the loan taking, it is useful to address these legal regulations first. To make it easier, it is necessary to separate the legislative arrangements between domestic and external loan taking. The main reason for this separation is the fact that

both loans are subjects to different legislations. Article 68 of Municipal Law No. 5393⁶ mainly regulates domestic loan taking and draws the main boundaries of loan taking. On the other hand, Law No. 4749 on Public Debt Management and Regulation of Debt Management for Foreign Borrowing⁷ (hereinafter referred to as Law No. 4749) stipulates the rules and process for external loan taking of municipalities.

As per Article 68 of the Law No 5393, municipalities in Turkey rely on three main sources for loan taking: The Bank of Provinces, bank credits and issuing of bonds to finance projects under the investment program.

Domestic loan taking

First paragraph of article 68 of the Municipal Law regulates that “Municipalities may take loans and issue bonds in accordance with the following procedures and principles in order to cover the expenditures for realizing their duties and services”.

In short, domestic forms of loan taking can be summarized as the sum of Domestic Loan taking from Banks + İLBANK (Bank of Provinces) + Issuing Bonds into the Domestic Capital markets.

From this point of view, it is seen that municipalities have no limitations in selecting loan taking instruments in domestic markets. However, in sub-paragraph (b) of paragraph 1 of the same article, a municipality which secures an investment loan or cash loan from the İLBANK is obliged to submit the repayment plan to İLBANK. If İLBANK considers the repayment plan as insufficient, it rejects the municipality’s request for a loan.

However, the legislator, who does not limit its borrowing instruments, puts an upper limit on its amount.⁸

Municipal Law N. 5393 Article 68 First paragraph, subparagraph (e) states that; “By the decision of the Municipal Council, Municipalities can realize the domestic borrowing which does not exceed %10 of the amount which is determined by escalating the final total budget revenue by the revaluation rate which is determined regarding the Tax Procedure Law N. 213. In the case of internal borrowing’s exceeding %10 of this amount, the decision of the absolute majority of the total number of the members of the Council and the approval of the Ministry of Environment and Urbanization is needed”.

According to the provisions of sub- paragraph (d) of the first paragraph of article 68 of Law No. 5393, the amount of domestic and foreign debt stock, including interest payments, cannot exceed the total amount of the latest year’s finalized budget revenues which will be escalated by the revaluation rate determined according to the Tax Procedure Law no. 213. This escalated amount will be further increased by one and a half (1,5) times for the metropolitan municipalities.⁹

This is also applicable to the municipalities’ affiliates like (ASKİ, İSKİ, EGO, İETT¹⁰) and companies with more than fifty percent of municipal shares. The upper limit of the amount of

⁶ <https://mevzuat.gov.tr/mevzuatmetin/1.5.5393.pdf>

⁷ <https://ms.hmb.gov.tr/uploads/sites/2/2018/12/Law-on-Regulating-Public-Finance-and-Debt-Management-Law-no.-4749.pdf>

⁸ İLBANK, founded in 1933, is the bank of municipalities. Its main task is to provide technical and financial support to the projects of municipalities and affiliates. İLBANK, the main financier of municipal projects, provides long-term and low-interest cheap loans to municipalities.

⁹ As explained in the following examples this indicates that “normal” municipalities will have a maximum allowable debt limit will be Last year’s revenue amount multiplied by revaluation rate. Metropolitan municipalities’ maximum allowable debt limit will be last year’s revenue amount*(1+revaluation rate) * 1,5

¹⁰ Utility companies, water and sewerage, gas, public transport.

municipal companies' debts stock is calculated as the total of municipalities and their affiliates. Water and sewage administrations can lend to municipalities. However, this practice is not allowed for municipal economic enterprises. In other words, they cannot lend to their parent municipalities.

Although the law introduces limits on borrowing, the auditors of the Turkish Court of Accounts prepared very detailed report on metropolitan municipality debt management in 2018. In the time of writing our Report, TCA report has not been published and was still in draft form.. This draft report analyzed the debt and loan issues of metropolitan municipalities including accounting, reporting issues, implementation of debt limit and consistency of the accounts with the public institutions' accounts. In their 2017 General Evaluation External Audit Report,¹¹ (page 72) it is mentioned that municipalities continue to borrow without permission of Ministry of Interior despite the limit set for domestic borrowing¹². The permitting authority for the borrowing limit over-run is now the Ministry of Environment and Urbanism after the recent restructuring of the public administration system under the Presidential Government system.

External borrowing

Municipal Law N. 5393 Article 68 First paragraph, subparagraph (a) indicates that; "External loan taking can be effected in accordance with the rules set in the "Public Finance and Debt Management Law" N. 4749, only for financing the projects which are in the investment program".

It requires the permission of the Ministry of Treasury and Finance for the external borrowing regarding to the law and secondary regulation. In other words, the Ministry, which is the foreign borrowing authority of the public sector, limits the ability of municipalities to undertake liabilities in foreign currency, but for the capital investment projects.

Municipality should obtain first the municipal council decision before the approval of external borrowing request decided by the Treasury and the Ministry of Finance. The legal procedure is quite similar to issuing municipal Euro bond instead of getting credit from the external markets.

Municipal Law N. 5393 Article 68 First paragraph, subparagraph (c) is clearly states that; "Bonds are issued in accordance with the relevant legislation for financing projects which are included in the investment program". The principles and Procedures regarding foreign bond issuance by municipalities are regulated by the (External Finance Regulation)¹³ published in Official Gazette dated 25 December 2014.

Treasury guarantee

Treasury has been delivering guarantees for more than 30 years. To obtain guarantee, the projects should be included in Annual Investment Program prepared by Strategy and Budget Office of the Presidency. However, after the municipalities have long-lasting difficulty in repaying guaranteed debt, ILBANK was tasked with issuing the guarantee on behalf of the municipalities which are then counter guaranteed by the Treasury.

¹¹ <https://www.sayistay.gov.tr/tr/?p=2&CategoryId=97>

¹² This is despite the fact that Art. 68 stipulates punitive measures for the municipal mayor and staff if they exceed the borrowing limits without permission.

¹³ "Regulation on the Procedures and Principles for Obtaining Foreign Finance within the scope of Law No. 4749"

In other words, ILBANK is the only hub for the municipalities to secure loans from International Financial Institutions (World Bank, European Investment Bank, JICA, Islamic Development Bank, AFD, KfW) and to benefit the advantage of the Treasury Guarantee.

For couple of past years Treasury does not provide direct guarantee for the municipalities any more. Treasury looks for ILBANK commitment instead of providing direct guarantee to the municipality. By this way Treasury collects instalments directly from ILBANK.

The main reason for ILBANK's important role in external borrowing is to secure debt service; ILBANK allows municipalities to deposit the interest and principal repayments into an escrow account. ILBANK monitors the funds in the escrow account to service the foreign loans. And, ILBANK also uses the tax shares of the municipalities under revenue sharing scheme between the central government and the local governments as a collateral for the municipal loans. On the other hand, the municipalities which do not need to benefit from the advantage of the Treasury Guarantee can directly secure finance from other financial institutions such as EBRD, IFC or any International Bank. But they still need to acquire Treasury permission.

Bond issue

The Municipal Council's decision for foreign bond issuance is an obligation. According to the third paragraph of the Article 5 of the External Finance Regulation, Ministry of Treasury and Finance has the authority to approve the foreign bond issuance request of the municipality. Upon Ministry of Treasury and Finance approval, the municipality has to apply to the Capital Markets Board of Turkey to obtain the necessary approval for the bond issuance.

Municipal bond issuance in the domestic markets is also permitted. Domestic bond issuance is regulated by the Municipal Law N. 5393 Article 68 First paragraph, subparagraph (c); "Bonds are issued in accordance with the relevant legislation for financing projects which are included in the investment program". Bond issuance framework published in the Official Gazette of 15 December 2012 ¹⁴(Bond Issuance Regulation). It is regulated by a regulation issued by the Ministry of Treasury and Finance.

According to the Bond Issuance Regulation Article 4, Municipalities should apply to the Ministry of Treasury and Finance to issue bonds in the domestic markets. Bond Issuance Regulation Article 4 First paragraph also states that; "The bonds issued in the domestic markets within the scope of this Regulation are subject to the permission by the Undersecretariat¹⁵. The permission given by the Undersecretariat does not mean that a Treasury guarantee is provided".

To date, various attempts have been made to issue bonds by municipalities such as Ankara, Istanbul and most recently by Antalya metropolitan municipalities. Ankara metropolitan municipality issued bonds to Japanese and German capital markets in 1990 and 1991, but the Treasury had to undertake the responsibility of repayment of bonds due to the financial turmoil prevailing in 1994, despite the fact that there was no guarantee issued at the beginning. The Istanbul metropolitan municipality attempted to issue a bond but issue did not attract sufficient demand. Most recently in 2017, the municipality of Antalya decided to issue a bond for various capital investment needs, by the decision taken in the Municipal Council. Later however Municipality abandoned this decision due to difficulties of financial management and technical issues of the launching the bonds.

¹⁴ <https://ms.hmb.gov.tr/uploads/sites/2/2018/12/Regulation-on-the-Procedures-and-Principles-of-the-Permission-Process-of-Domestic-Market-Bond-Issuances-of-Local-Governments.pdf>

¹⁵ Ministry of Treasury and Finance, General Directorate of Public Finance

We will examine the review of bond issue attempts made by Turkish Municipalities in the coming sections

Public Private Partnerships

PPP is another financing model in public project finance. This method, which is generally preferred in projects of high revenue generating potential, demands intensive public guarantees to reduce the risks of long-term financing. In particular, in developed economies, taking into account the requirements of long-term capital investments of the country, the market risk of minimization the costs of the desired guarantees can sometimes be higher than the benefits obtained. In the short term, it is not easy to calculate such risks, therefore public decision makers also tend to give every required guarantee without making detailed risk assessment.

PPP model has been implemented since 1990's in Turkey. Energy projects were main targets of this financing model during the early years. Legal structure enacted in Law no 3996¹⁶ Pertaining Building of Some Investments and Services in the Framework of the Build-Operate-Turnover Model.

This law covers the projects mentioned below (inter alia):

- a- bridge, tunnel, dam, irrigation, drinking and utility water, treatment plant, sewage,
- b- communication, congress centre, cultural and tourism investments, commercial buildings and facilities, sports facilities, dorms,
- c- theme parks, fishing shelters, silos and warehouses,
- d- plants, geothermal and waste heat-based facilities
- e- environmental investments,
- f- gar complex and stations, ropeway and chair lift facilities,
- g- underground and ground car park,
- h- National park, Nature Park, nature conservation area and wildlife.

All public institutions, including municipalities must get permission of president for BOT financing. PPP is a long-term project financing scheme. However, as it is discussed several times in this report, long term funds are very scarce in Turkish financial system. On the other hand, there are some market and other risks calculation of which are usually not easy. To overcome this problem lenders asking all types of guarantees from public institutions. Options for guarantees might target inputs, price or purchase of the product.

Articles 11A of Law No: 3996 was emended as follows for providing guarantee for external borrowings of the PPP projects.

“In case the contracts for investments and services carried out by public institutions and organizations, subsidiaries and local administrations other than the general budget are terminated before the term of the contracts and the facility is assumed to be taken over by the related administrations, the financing provided for the financing of investments and services the administration is authorized to undertake the financial obligations, including those arising from the products”.

Against this background, municipalities can legally have access to PPP projects and it is known that some landfills of municipalities are being operated by private contractors under PPP project within the framework of generating energy from the waste. Old procurement Law N.2886 is known to be used for such projects through a legal instrument called “establishment of incorporeal rights on property (Mülkiyetin Gayri Ayni Hak Tesisi) However, so far, no complete list of such PPPs initiated by municipalities is available and contractual liabilities of

¹⁶ <http://www.mevzuat.gov.tr/MevzuatMetin/1.5.3996.pdf>

the parties and guarantee conditions, if any, are revealed to the public. So, it is necessary to establish a complete, transparent inventory of PPP projects initiated by municipalities and assess whether any risks are involved and pose a threat to the overall strength of municipal financial system.¹⁷

Municipal debt stock

Overall outlook

There is not any clear definition debt stock at the related Law. However Municipal Law 5393 Article 68 section (d) states a hinder definition such as; “Total domestic and foreign borrowings including interest payments of the Municipality, affiliated agencies and the companies more than fifty percent of the capital of which is owned by the municipality, may not exceed the total amount of final budget income subject to increase at the rate of revaluation specified in the Tax Procedural Law Nr. 213. This amount shall be applied as one and a half fold for great city municipalities.”

By this section, legislative authority states a kind of financial definition that covers total domestic and foreign borrowing of municipality and its affiliates and interest payment of total borrowing are included to debt stock. The Law defines borrowing such as funds obtained from financial markets. It is not clear that whether this general definition covers other sources of borrowing such as debts to tax authority and Social Security Institution.

Financial definition¹⁸ mainly covers the financial liabilities of the local administrations such as bank credit, fiscal debt to public administrations’ and external debt. On the other hand, there are different methodologies in calculating total debt stock applied by the different agencies in the practice. In this report we refer to the balance sheet data published by the General Directorate of Accounting and Financial

Control of the Ministry of Treasury and Finance, which is the largest data supply set available¹⁹. Other data are provided at the Annex 2. for comparison.

There are several debt stock definitions during application permission of overrun of debt limit. MEUB sample can be seen in Box 2. Box 3 provides Ministry of Treasury and Finance definition.

¹⁷ During the workshops, representatives of some municipalities argued that they had experienced no visible risk with this practice.

¹⁸ See detailed explanation in Güngör, 2015, p. 8

¹⁹ <https://en.hmb.gov.tr/local-government>

Box:2 Debt stock definition

As exposed in the meeting with the representatives of the municipality, the definition of “debt stock” should be clarified. Participant from Muğla Metropolitan Municipality highlighted that the issue is important: they prepared separate debt stock statements for the ILBANK, the Ministry of Environment and Urbanism and the Court of Accounts. As it turns out, the Ministry and the Court of Accounts prefer to have more extensive financial debt stock definition.

Below is the list of liabilities requested by the Ministry of Environment and Urban Planning, applying for according to the circular dated 2005.

Obligations included in the debt limit

1. Ministry of Treasury and Finance:
 - a. Current external debt situation
 - b. The state's current tax liabilities
2. Obligations to the Social Security Institution
 - a. Sourced from personnel (4.a, b, c)
 - b. Other
3. Debt to ILBANK
4. Debt to electricity administration
5. Personnel and market liabilities

Budget revenue (see the exact chart of accounts - net collection) and the balance sheet were recently requested from the municipalities.

Municipal council resolution (borrowing authority) is being taken. Related documents from associated institutions must be added:

Liabilities excluded from the debt limit

1. SUKAP
2. Loans from international organizations (ILBANK) with provisions placed in Budget Law (2019/13)
3. Severance payments
4. High-tech-requiring investments guaranteed by the Treasury are included in the stock in 2019. It was also being held out with article 68 of Law 5393.

Box 3: Debt stock definition of Ministry of Treasury and Finance.

A1- DEBT STOCK AMOUNTS OF MUNICIPALITIES

- 1- Municipal indebtedness of its obligations to the Treasury
- 2- Payables to other public institutions (the liabilities of each organization will be shown separately)
- 3- Payables to ILBANK
- 4- Payables to other domestic banks
- 5- Payables to the overseas creditors
- 6- Other debts

TOTAL MUNICIPALITY DEBT STOCK

- 7- The total amount of interest payments arising from the future years debts
TOTAL (Stock + Interest) (A)

A2- DEBT STOCK AMOUNTS OF AFFILIATES

- 1- Debt obligations of its subsidiaries the sum of the debt stock of affiliates (affiliates companies and shall be written separately)

TOTAL DEBT STOCK OF AFFILIATES

- 2- The total amount interest payments, of the debt stock resulting from future years (for affiliates) (affiliates and companies will be written separately)

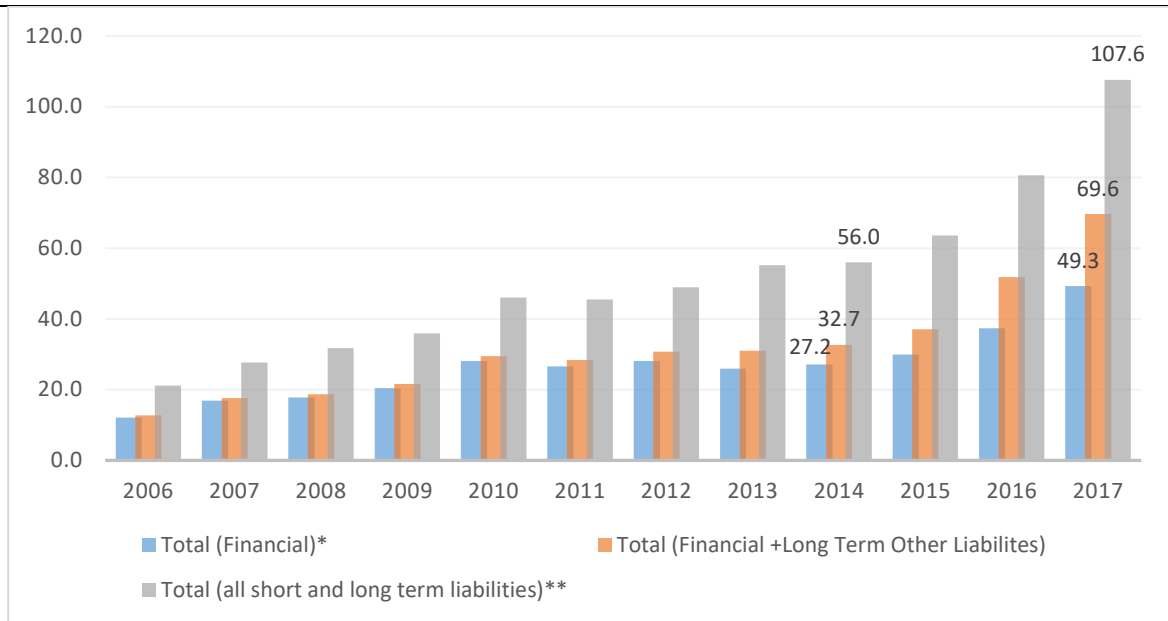
TOTAL (Stock + Interest) (B)

Sum of debt stock of municipal and affiliates, and companies more than fifty percent of their capital that they have, including internal and external debts.
(A+B)

On the other hand, Auditors of the TCA have used several debt stock definition during their periodic auditing. Some of them have used broader account codes such as 3 – Short term foreign liabilities and 4 – Long term foreign liabilities. All accounts are categorized under these two major accounts. It is interesting to see that in some TCA auditing reports have taken into account these two major accounts but omitted interest payments from debt stock calculations. A few of them using only 300 and 400 code numbered accounts as total debt.. However, latest auditing reports has shown that TCA uses the broader debt definition of the municipalities like Ministry of Treasury and Finance.

Within this understanding the data covering the years 2006-2017 are given Figure 4. and Annex 2. During our research for this report we found out that there is no common definition and data for total municipal debt. General Directorate of Accounting had published a data series for 2009-2015 period. These tables have a broad debt definition. They almost cover all liability accounts municipality balance sheet c. Therefore, it is easy to convert balance sheet figures to debt tables. In the last five years the average municipal debt made 95-96 % of total local administration liabilities (the rest was mainly the debt of water and sewerage administration).

Figure 4. Total Local Administration Debt (billion TRY)

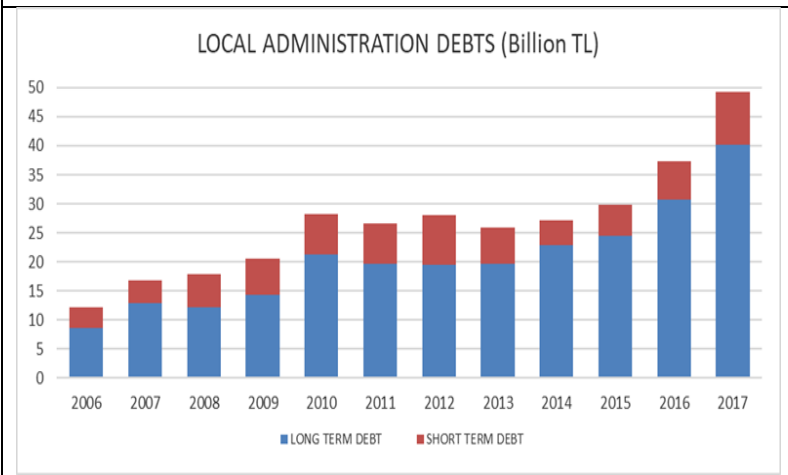


Source: MoTF, General Directorate of Accounting and Financial Control, own estimations, Access date May 2019

As the Figure 5. points out, the short-term debt of municipalities constitutes a very small share in the total debt stock. Majority of municipal debt is long term (i.e. more than one year and longer maturity).

According to these data the total debt stock of local administrations was 12.1 billion TL in 2006, but reached 49.3 billion TL by the end of 2017. The developments in the debt stock over the years gives us important messages. The first is the more than four times increase from 2006 to

Figure 5. Local administration short term and long-term debt, 2006-2017

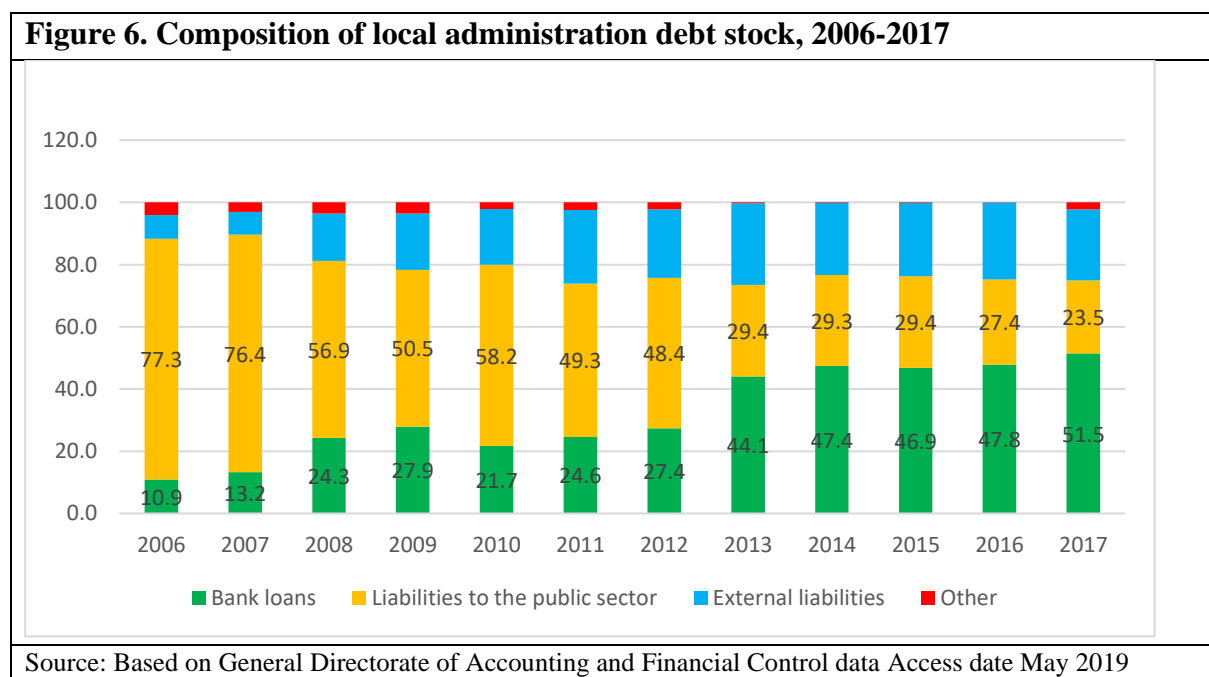


Source: General Directorate of Accounting and Financial Control Access date May 2019 and our calculations

2017. Within this period the moderate fall in 2011 stands out. As mentioned above, a very large restructuring of unpaid tax and SSI (Social Security Institution) premium liabilities of private and public institutions including municipalities took place with the introduction of the Law No. 6111 issued in the same year. In this way, local governments' debts to the public declined. Thus, total debt diminished by 5.4% in 2011. However, the debt problem of municipalities, started to increase again after 2015, as the structural problems of specifically revenue collection and spending tendencies as mentioned above. The local budget expenditures also increased significantly in this period (see Annex 1., Table A).

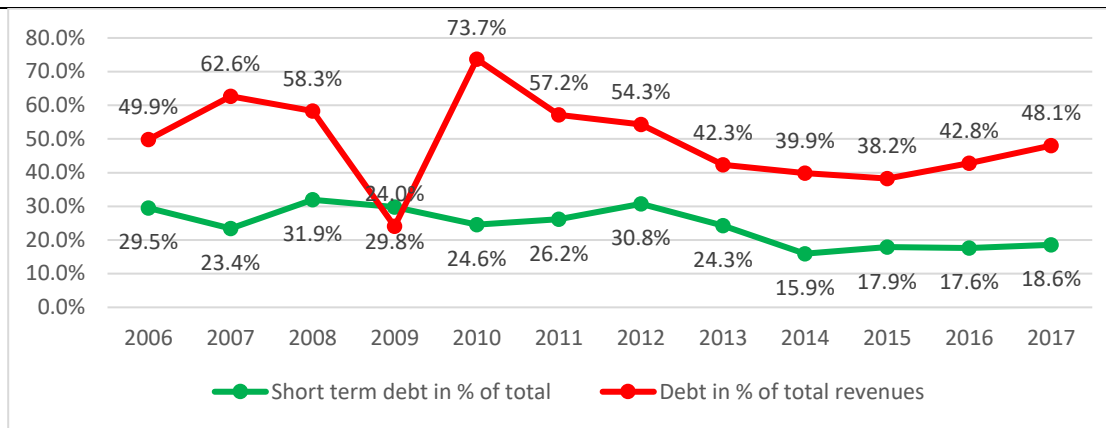
On the other hand, composition of municipality debt stock exposes an interesting shift in distribution. (Figure 6.) Following the restructuring of the aforementioned tax and public sector receivables, these debt items decreased and there was a significant increase in bank loans. We might conclude, that debt forgiveness neither encourages municipalities to rely on their own revenues nor urges central government to introduce more favourable revenue sharing schemes. Instead municipal debt consolidation further increases municipal bank debt to finance local budget deficits.

The ratio of debt stock to revenues is slightly decreasing in this period (see Figure 6 and 7) Local government expenditures were financed by loans in the period before 2011 so the accumulated debt reached 73.7% of total revenues by 2010. Following the debt restructuring program this ratio started to decline till 2015. However, in the following years the loan financing increased and the ratio of total debt to municipal revenues is again at the level of 48%.



However, the maturity structure of debt is more favourable, as the share of short-term debt within the total pool of municipal debt declined. In the pre-2011 period the ration was around 30, now it is below 20%. This positive development shows that less income will be used for short-term debt payments. If there is no pressure from loan instalments of long-term debts, it can be said that the effect of short-term debts on revenues is not significant.

Figure 7. Local Administration debt, 2006-2017



Source: General Directorate of Accounting and Financial Control, Access date May 2019 and our calculations

Debt stock at metropolitan municipalities

After looking at the debt stock of all local governments, it would be useful to separate debt by the size of metropolitan municipalities. For this purpose, data prepared by using the balance sheet data in the annual Audit Reports of the Court of Accounts will be used.²⁰ The reports have annual balance sheet data for each municipality.

It is natural that the three big cities, Istanbul, Ankara and Izmir have a high share in the stock. It is expected that these centres, which have approximately as much as 30% of the total population, will carry the majority of the debts. As can be seen from the Figure 8, (and Annex 1. Table B.) the debts of three major municipalities in the period 2016 -2017 account for approximately 40% of the total debts. At the end of 2017, total debts were TL 19.5 billion. If we consider the shares they receive from the budget and the size of their own incomes, it can be said that the debt size they carry would not be as big a problem as if they were managed well.

²⁰ Debt stocks are prepared by using the balance sheet data of the General Directorate of Accounting. Consistency between the municipal balance sheets of the Court of Accounts and the balance sheets of the General Directorate of Public Accounts is worth investigating.

Figure 8. Debt of the three largest metro municipalities, 2017

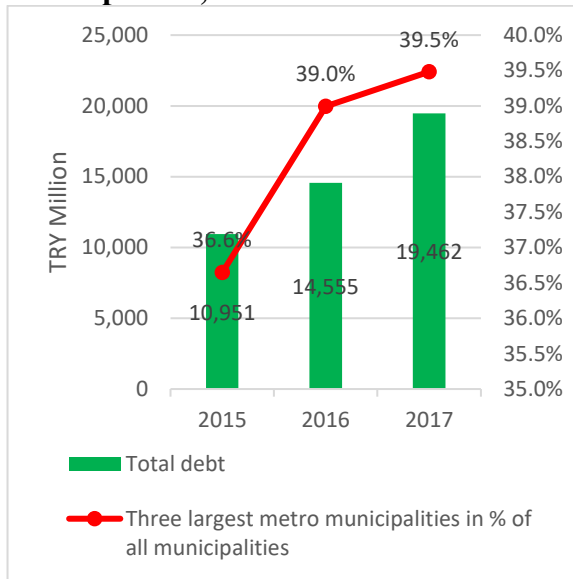
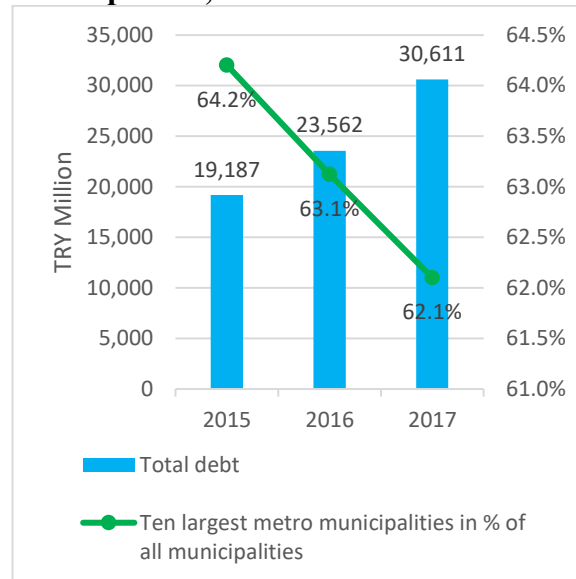


Figure 9. Debt of the ten largest metro municipalities, 2017



Source. Compiled from Turkish Court of Account Reports 2015, 2016, 2017

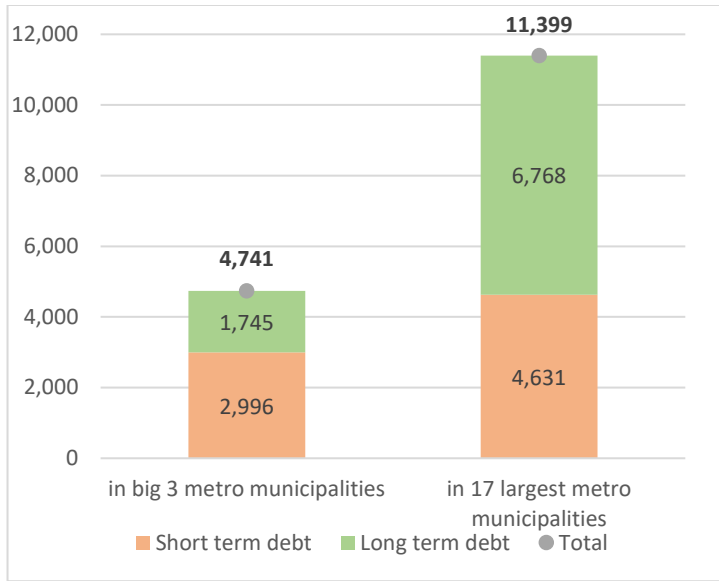
The data will be useful to look for the largest ten largest metropolitan municipality including big three. (Figure 9.) In this context, debt figures of the top ten major cities are over 62% of the total. The debt of the top ten major cities at the end of 2017 was TL 30.6 billion which points out a persistency of the concentration. As the size of the service area rises, borrowing pressure and demand are also increasing.

As for the total of 30 bigger municipalities, the debts of TL 22.2 billion in 2015 increased to TL 36.7 billion at the end of 2017. The three-year rate of increase is 65%. In addition, the ratio of the debt of the metropolitan areas within the total debt is as high as 74%.

In order to get a better and more comprehensive picture of metropolitan municipalities' debt situation of Water and Sewerage Administrations as well as large municipal affiliates such as IETT (Istanbul Bus, Transportation and Electricity Authority) and EGO (Ankara Electricity Gas and Bus Authority) should be added to this debt picture. For this, the balance sheet data attached to the audit reports of the Court of Accounts of 2017 will be used.²¹ (Figure 10.)

²¹ The last available year data is chosen since there is no standard reporting for each year.

Figure 10. Debt of affiliated administrations in large municipalities, 2017 (Million TL)



The water and sewage administrations of the first three major cities and IETT and EGO's debts amounted to approximately TL 4.7 billion. It is one fifth of the total local debt accumulated by the three largest metropolitan municipalities in 2017. For the 17 cities the stock figure is TL 11.4 billion.

The most significant problem of stock in this segment is that short and long-term debts are quite close to each other. Even short-term debts for three major cities are more than their long-term debts. Therefore, it is obvious that a special attention should be given to the debts of these organizations.

Borrowing procedures

It is well known practice that different markets and different intuitions have different procedures for lending. It would be very useful for municipalities prepare themselves for different applications before searching convenient type of loan for their project.

İLBANK

The most important factor for municipalities in credit management is cost. Naturally, they prefer the credits with the longest-term and low-interest. Therefore, options in the search for credit are also limited. İLBANK is the preferred lending agency for the municipalities: its interest rates and long-term credit facilities are more favourable.

İLBANK measures municipal creditworthiness only on the basis of the central budget revenue shares. The total indebtedness of the municipality is not considered.

Part of the İLBANK credits goes to water and sewage projects. In other words, it might be characterized as “a great water and sewage administration”. Many of them are standard projects. Consequently, İLBANK is the main source of financing of urban development. Other projects, especially transportation and solid waste projects are less preferred ones.

Project proposals are evaluated by the Regional Directorate and then by the relevant technical units at the General Directorate of İLBANK. If required by İLBANK, the applicant municipality should make the amendments to make the loan request more acceptable.

On the financial evaluation side;

- 1- The sole criterion of project assessment purpose is the Net Present Value of credit repayments. The logic behind this evaluation is whether the municipality's share of the central budget tax revenues is less than or equal to the amount remaining after deducting the debts.
- 2- During this process İLBANK does not pay much attention to revenues acquired from water, transportation, etc. A commitment is received from the municipality, but they are considered as

“main assurance” because it is considered that collecting money from central budget revenue shares would not be problematic in practice.

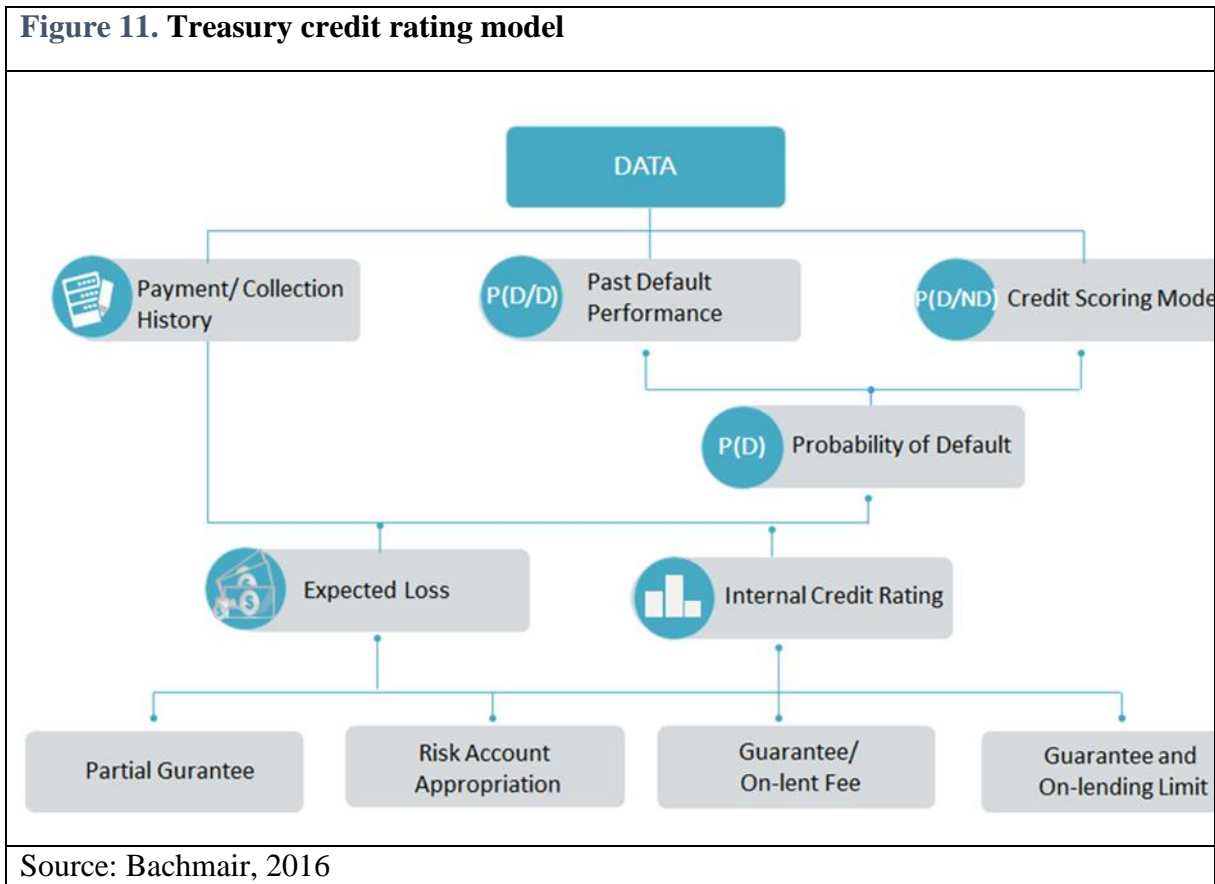
3 - ILBANK measures the credibility of the municipality only on the basis of the central budgetary revenue shares. In this manner the Bank is not interested in any other aspect as it guarantees its credit. And does not look at the total indebtedness of the municipality such as to other banks and other institutions.

Treasury

Public institutions do not share their internal credit evaluation procedures with the public. However, some of the reports and related studies published by the Treasury provides useful information to get some insights about the evaluation approach of the Treasury to the municipal loan taking requests

A section, in a report prepared and published by the World Bank experts in 2016 as a result of the meetings held in Treasury indicates Figure 9. (Bachmair, 2016) The chart is a summary of a credit rating model developed by Treasury.

Figure 11. Treasury credit rating model



In line with this flow chart, Treasury uses all kind of historic data for assessing the financial position of the municipality which applies for external credit guarantee.

Commercial bank

It is estimated that the share of commercial banks in total financial debts of municipalities is around 20% as of end-2018. In total liabilities, this ratio falls to the level of 11-12%. The borrowing from commercial banks started to increase as borrowing opportunities from İLBANK Bank contracted, especially in the last 2-3 years.

Based on the interview with the authorities and the commercial banks, issues underlined by the experts are summarized below:

Local governments do not administer their accounts in accordance with the requirements of financial management, so credit evaluations may be lacking. Since municipalities are not profit-making institutions it is difficult to evaluate debt / receivable situations, profit / loss conditions.

Allocation of own income / central budget share payments on income side, and the legal problems in sequestrating of municipal revenues makes the lending situation problematic.

Central budget shares are main revenue item for low income municipalities. In this case, their own revenue generation skills make it harder to reach credit.

Due to the Treasury regulations (Kamu Haznedarlığı), municipalities cannot hold deposits in private banks therefore the credit limits that can be established are restricted.

The degree of financial knowledge of local administration managers including mayors facilitates or does not facilitate the access to alternative financing sources.

Municipality's balance sheets are deteriorating when they are trying to adjust their tax / Social Security Institution payments to manage the cash flow in the current period. After that, it is more difficult for suppliers to apply for foreclosure.

Different decisions of the Supreme Court regarding the foreclosures are creating problems.

In common practice long-term loans are weighted the İLBANK credits. Whereas private banks maturities are linked to market conditions and funding power. This outcomes in shorter maturities in private banks.

If the mayor does not have a majority in the municipal councils, he is deprived of the credit facilities that can be reached by the municipality council decision.

Borrowing options

In various studies regarding financing models of public projects, it is commonly stated that the selection of financing model must be suitable with the project. Basic public investment financing principles suggest that a) projects with no financial revenues (road, drainage) should be financed by operating savings, development grants, or debts against the municipal budget; b) revenue projects with partial cost recovery can be also financed with general obligations, double-barrelled²² or with other special bonds; c) projects with full cost-recovery can be financed with revenue bonds, ring-fenced project financing, or project bonds. (Martell-Guess, 2006)

²² A double-barrelled municipal bond (also known as a *combination bond*) is a municipal obligation that combines a general obligation from the budget with a particular secured revenue source (e.g. water revenue) from outside the budget.

Domestic markets

As it was discussed, lacking sufficient savings, Turkey imports external saving to finance current account deficit. The annual average current account deficit, excluding crisis periods, varies between 3-5% of GDP. This structure leads the economy to resort to external borrowing. On the other hand, commercial bank dominates Turkish financial system. Bourse Istanbul (BIST) and other capital market instruments are mostly traded on company shares.

	<i>Total assets, TRY Billion</i>	<i>Total financial assets in % of GDP</i>	<i>Deposits in % of total assets</i>	<i>Public securities in % of total</i>	<i>FX deposits in % of total deposits</i>
2007	628	74,4	51,0%	83,0	33,7%
2008	746	78,4	54,6%	81,1	33,4%
2009	855	89,7	53,1%	82,4	32,3%
2010	974	88,6	55,2%	80,8	28,5%
2011	1 097	84,5	56,9%	78,0	32,3%
2012	1 203	84,9	57,4%	75,4	30,9%
2013	1 385	88,5	60,6%	73,9	34,6%
2014	1 510	86,3	62,4%	73,0	38,5%
2015	1 799	76,9	66,9%	74,0	41,4%
2016	2 031	77,8	68,8%	74,0	40,3%
2017	2 369	76,3	69,7%	74,5	42,8%

Source: Strategy and Budget Presidency, Accessed in May 2019

The distribution of assets is an important signal for better understanding the situation of financial markets. As seen in Table 5, there is a 2.4 trillion TL total asset as of 2017. This amount, which corresponds to 76.3% of the national income is very low compared to the developed economies. Furthermore, a significant portion of this amount consists of deposits (70% of total).

It is more crucial that 43% of deposits are in foreign currency. In other words, banking sector has been highly dollarized.

The share of bond assets within the total of 30% should be interpreted with caution. Because 75% of this market is dominated by Treasury's domestic borrowing instruments. The share of bonds in private sector assets is very limited.

	<i>Deposit, total TRY Billion</i>	<i>SIGHT and up to 3 months in % of total deposits</i>
2010	584.07	92.5
2011	659.56	86.9
2012	734.67	88.9
2013	903.76	87.4
2014	1 002.47	88.8
2015	1 210.45	87.6
2016	1 424.26	87.4
2017	1 655.64	87.2
2018	1 978.53	84.9
2019	2 104.96	88.6

Source: Banking Regulation and Supervisory Authority, Accessed in May 2019

The most important funding source is the deposits for banks to provide loans. However, demand side is crowded by the Treasury borrowing, the corporate sector and the households, as well as the municipalities. All these applicants for loans from banks increase demand and drives the credit prices up.

However, it can be stated, that the financial sector does not have sufficient resources. The most basic indicator of this is that the loan to deposit ratio is over 120%. In other words, banks distribute 120 units of loans against 100 units of deposits.

Even if it is possible to solve a problem for inadequate resource lending, we face the maturity problem of existing resources. As seen from Table 6. the maturity of deposits in the banking system is very short. Deposits and deposits up to 3 months constitute 89% of total deposits.

Providing long term loan to any borrower including especially municipalities would be very hard within this maturity structure of financial system.

Domestic bond market

The most obvious problem with the bond market in Turkey is the lack of long-term funding. Compared to developed economies, the market is dominated by the Treasury, and bond market is relatively shallow. The debt issuances of the municipalities in the domestic market have not succeeded. Inadequacy of basic structures in the market such as budget and accounting standards, and credit rating adversely affect the issuance of bonds.

One of the priorities of the healthy working of the main markets is the credit rating mechanism that works correctly and quickly. In developed economies, this system is the most important factor in the development of municipal bond markets. The practices in the world show that tax incentives are also important for the effective functioning of municipal bond markets.

The main problem of fixed income investment instruments markets is the increase of uncertainties and risks in the long term. Political and geo political risks, which are particularly difficult to calculate, make pricing difficult. More expensive. Fixed-return marketers who want to avoid such problems require various guarantees from the public.

Currently Treasury dictate country's bond market and the market has been dominated by Treasury since the mid-1980s. However, corporate bonds, especially those issued by banks, have started to be traded on the market in recent years.

As it is well known fact that, the secondary market is the sine qua none of long-term borrowing. Investors in the first markets often avoid tying their long-term money to a unique instrument. Due to the transaction logic of the money markets, the secondary markets with high liquidity are indispensable for the investor who wants to invest short-term low-interest funds into long-term higher-yield instruments.

For an attractive municipality bond market well-functioning secondary market is very critical. At the same time well-developed broker-dealer networks would affect the cost of bonds. It is also very well-known fact that lack of competition increases both the required yields and the transaction costs.

So far in Turkey, as said before two municipalities recently attempted for bond issuance ; Antalya municipality TRY 205 million TL bond, İstanbul 1 billion TL for Sukuk. At the last moment they stopped issuing. Although they have Treasury's supports for bond issue capacity of municipalities is insufficient. One reason of it that the costs are very high. There are some options such as environmentalist instruments - G Bond might be an alternative. For information purposes Box 4. below summarizes an assessment of the Islamic bond (Sukük) in Turkey.

Box 4. Sukuk vs Bonds

Another fixed income instrument alternative is Sukuk which is an Islamic choice. Similarities and differences can be summarized as follows:

Similarities: Islamic Sukuk deals replace the functions of conventional bond in:

- Mobilizing resources from financial institutions
- Injecting liquidities into a company or project
- Providing predetermined cash flow for Sukuk investors
- Furthermore, they have risk/return (cash flow) characteristics similar to conventional bonds
- Flexible issuance format: standard - alone or Medium Term Note program
- Rating agencies assess Sukuk risk profile similar to conventional (very often based on company credit risk if not securitized)
- Single or multi – currency
- Credit enhancement possible

Differences: However, Sukuk differs from conventional bonds in several ways:

- Investors earn profits compared to interest in conventional bonds
- They are either asset-based or asset-backed instruments
- Specific documentation is required depending on the structure such as Ijara, Wakala etc.
- Issuance of a Fatwa in consultation with Sharia scholars
- Require the incorporation of an Asset Leasing Company in Turkey
- Independent valuation is required for the valuation of the assets
- Taxation issues need to be considered to ensure the structure is workable under relevant jurisdiction
- Special agreement and legal framework might need to be drafted to protect the ALC against various risks including insurance and maintenance of assets etc.

The purpose of the intermediary vehicle which would be incorporated in Turkey an Asset Leasing Company is to ensure that the Islamically acceptable assets earn a profit either through their trading, leasing or other type of productive investments under Sharia guidelines. On the other side, ownership of the assets is required to earn full or partial profit income. It is known that cash flows generated from the assets belongs to the Sukuk holders/Investors throughout the tenure of Sukuk.

Main difference between Sukuk and conventional bonds is that Sukuk holder owns assets, bond owners owns cash flow only.

Sukuk as an Islamic finance instrument must have a principal contract accepted by Islamic Law. Commonly used underlying contracts for Sukuk are summarized at Annex 3.

Source: Oguz – Kopanyi, 2016

Foreign markets

External borrowing options are not too diverse and according to the legal requirements they are controlled by the Treasury. Borrowing of municipalities from foreign commercial banks is quite difficult and costly. External borrowing is not common by the lack of knowledge, experiences and organization of the hedging methods in Turkish municipalities according to the information received during workshops

Bond issue

The issuance of foreign bonds by the municipalities in Turkey began in the 1990s in the Samurai market in Japan for the construction of the Ankara metro. The Ankara municipality received an investment credit rating and made a successful bond issue for those days.

However, as mentioned previously, after the municipal elections held in 1994, the newly elected administration claimed that they were not responsible for the debt as it was extracted by the previous administration. In the same period the Turkish economy was in crisis due to external shock. Therefore, Treasury administration had was searching for options for new debt to finance the maturing debt of the central government under very hectic environment. Then, the debt of

as mentioned before Ankara Municipality, which under the risk of default became a main problem, first in Samurai market than in the other financial circles. And this possibility raised the concerns that non-payment of the municipal debt will contaminate the markets and whether the Treasury will be able to service its own debt has become an important risk factor for Turkish economy. In order to overcome this problem, the Treasury undertook a debt that was not guaranteed previously by a change in the budget law of that year. The Ankara municipality debt was paid with from the central government budget. Concerns of contamination were sedated and the Treasury was able to re-enter the foreign borrowing markets.

After this negative example, the Treasury had started to pay close attention to bond issuance by municipalities and other public institutions. Other side of the coin of such close attention was the concern by the Treasury that the Treasury were not very much willing to allow municipalities to tap into the same market that the Treasury was already tapping.

Project financing

It is known that the main borrowing reason of the municipalities is the financing need of infrastructure projects. Therefore, project financing is the main component of financing. Although the bond markets are limited, both the Treasury and ILBANK support project finance. Both institutions have a long-time experience on project financing.

Transactions in this area are relatively easier, due to the high number of investment banks that provide cheap loans for project financing in the world. For example, the institutions that ILBANK is in contact so far are the World Bank Group (including IFC), EBRD, European Council Development Bank, European Investment Bank, Islamic Development Bank, Black Sea Trade and Development Bank, Nordic Investment Bank. In addition, there are options for project financing funds from organizations such as the German Development Cooperation (GTZ) and the Japanese International Cooperation Agency (JICA).

Treasury guarantees

Foreign borrowing is a long-term option and it is too hard to calculate market risks, especially exchange risks, more accurately. Therefore, lenders are seeking appropriate collateral for credits. Foreign financial institutions usually seek to resolve this issue by seeking a Treasury guarantee.

Table 7. External municipal debt stock (Loans without Treasury guarantee), 2018, USD Million	
<i>LOCAL ADMINISTRATIONS. Total</i>	2,728
METROPOLITAN MUNICIPALITY OF İSTANBUL	2.121
METROPOLITAN MUNICIPALITY OF İZMİR	379
METROPOLITAN MUNICIPALITY OF ANTALYA	100
METROPOLITAN MUNICIPALITY OF BURSA	47
İZSU - İZMİR WATER & SEWERAGE ADMINISTRATION	34
İETT - İSTANBUL ELEC. TRAM. GEN. DIR.	18
MESKİ -MERSİN WATER & SEWERAGE ADM.	15
METROPOLITAN MUNICIPALITY OF GAZİANTEP	7
METROPOLITAN MUNICIPALITY OF KAYSERİ	6
MUSKİ - MUĞLA WATER & SEWERAGE ADM.	1
Source: Ministry of Treasury and Finance www.hmb.gov.tr , observed in May 2019	

Following the example of the bond issue of the Municipality of Ankara mentioned above, the Treasury had provided a lot of credit guarantee especially in the period until the crisis of 2001. Treasury supports the external borrowing of State Economic Enterprises and other public institutions as well as the municipalities.

Public Finance and Debt Management Law” No. 4749 has introduced valuable tightening rules with the lessons learned from the 2001 crisis. In recent years, however, some metropolitan municipalities have started external borrowing without Treasury guarantee for some projects. However, İLBANK provides proper collateral for these credits. As can be seen from the Table 7, the majority of the non-guaranteed debts are booked by Istanbul Metropolitan Municipality.

II. Loan systems in EU countries

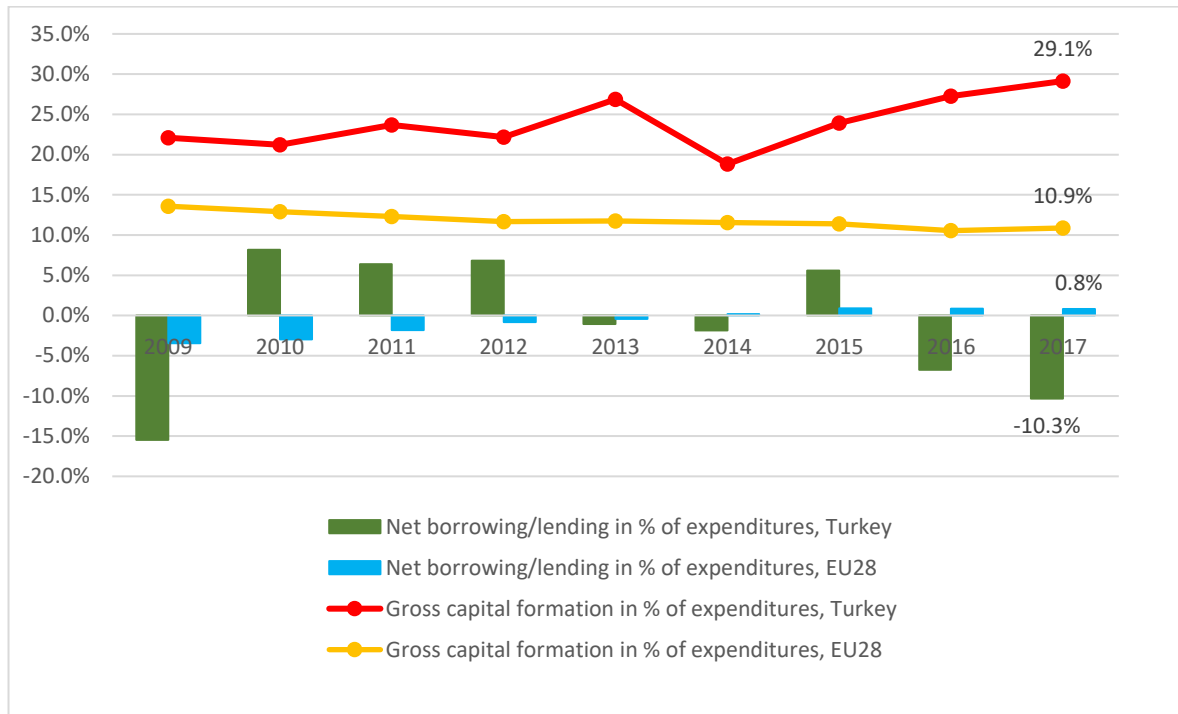
An overview

Similarly, to Turkey, local governments in the European Union use external resources for financing their mandatory functions and optional services. Some of these revenues are provided by higher tiers of government as grants, transfers or shared revenues, while the rest comes as loans or assets from other income owners. These revenues are needed for several purposes. Firstly, borrowing helps to allocate the costs of capital investments among the present and future users of infrastructure and other public services (pay as you use). With loans local budget savings can be achieved, when future operational costs are decreased through investing in modern technologies (classical example of these efficiency gains is the innovation in public lighting, which reduces operational and maintenance costs). Debt is used also for financing the current budget to balance seasonal municipal revenue inflow with the regular operational expenditure obligations. These are short term loans for financing the gaps in available cash and other liquid assets.

As local borrowing is predominantly used for financing capital investments, municipal borrowing is determined by the overall status of the economy. Figure 12. compares the capital expenditures and local net borrowing in the period after the economic crisis of 2008/2009. In the average of the European Union member countries gross capital formation (investments, acquisitions) comprises app. 11% of total local expenditures. This ration was slightly decreasing in this period, even with net borrowing of 2-3% of total budget. These external resources could not compensate the losses in national budget transfers and own source revenues.

Unlike in Turkey, where after 2009 the gross capital formation was kept at a two times higher level (21-27% of total expenditures) without relying on borrowed funds. This situation changed after 2015, when the increasing investments were coupled with significant increase in net borrowing (at 11% high ratio of total expenditures in 2017).

Figure 12. Local government capital investment and borrowing, 2009-2017



European Charter on Local Self-governments also claims the access to capital markets. In section on financing local governments (Article 9.), the paragraph 8. states, that “For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.” Turkey ratified the Charter in 1992 with some derogations, although they do not affect this provision. The statement on local borrowing specifies three important conditions of a good local government loan system.

Firstly, it emphasizes that municipal debt should be used for financing capital investments and not for supplementing current budget revenues. Loan is a receipt, which has costs and has to be repaid, so it should be used for investments which will bring future benefits (producing revenues or accelerating local development, access to services). Secondly, local governments as autonomous entities should be regulated in their borrowing actions by law. Within the given fiscal framework municipal borrowing should be controlled in order to maintain local financial sustainability and to minimize the risk of general government fiscal stability. These fiscal rules include the deficit and debt control. Finally, the Charter emphasizes that access to the national capital markets: it opens up the diverse options for borrowing (loans, bonds, leases, PPPs, etc.) and does not support borrowing in other currencies with locally uncontrollable exchange rate risks.

Excessive municipal borrowing and debt might be harmful for sub-national and for general government finances. The crisis a decade ago proved, that local governments’ *fiscal space is limited* to manage their debt when the external conditions are changing unexpectedly. The municipal tax autonomy is limited, the central governments prefer to transfer the fiscal burden to lower tiers and it is politically rather hard to cut the expenditures on basic municipal services. Debt management options of a particular local government is very much influenced by the position and actions of the other public actors. A defaulting municipality might have a “contaminating” effect on the entire local government sector. Sub-national governments have implicit contingent liability for the stable operation of the municipal enterprises and other service organizations.

However, their management and regulatory powers towards these entities are limited (e.g. they do not control user charges), which might create additional burden on an otherwise indebted municipality. All these problems might create expectations towards national budget guarantees and bailout, which often turns out to be unrealistic or costly. (Kim-Vammalle, 2012)

As the five country cases discussed below will prove, the 2008/09 financial crisis was a turning point in regulating sub-national government borrowing and debt management. In many countries a *fiscal re-centralization trend started* and the former fiscal autonomy in municipal borrowing was restricted. The former stable institutions ceased to exist (e.g. the French local government bank Dexia in 2012) or they were significantly transformed (e.g. the British Public Finance Initiative which used to support private sector participation in public service provision).

At the *European Union* level the balanced budget and the better coordination of member states fiscal policies became main priorities. The Stability and Growth Pact aimed to prevent future fiscal crises through better coordinated and medium term planning. It claims the member states to develop their own medium term budget targets and convergence towards the other EU countries.

Enforcement mechanisms were introduced through the Excessive Deficit Procedures. It is based on the simple numerical conditions of keeping government deficit below 3% of GDP and the government debt under 60% of GDP. Countries above these limits should make proportional actions to reduce their debt. Failure for meeting these fiscal targets might lead to revised European Investment Bank lending, fines or a compulsory deposit at the EU.

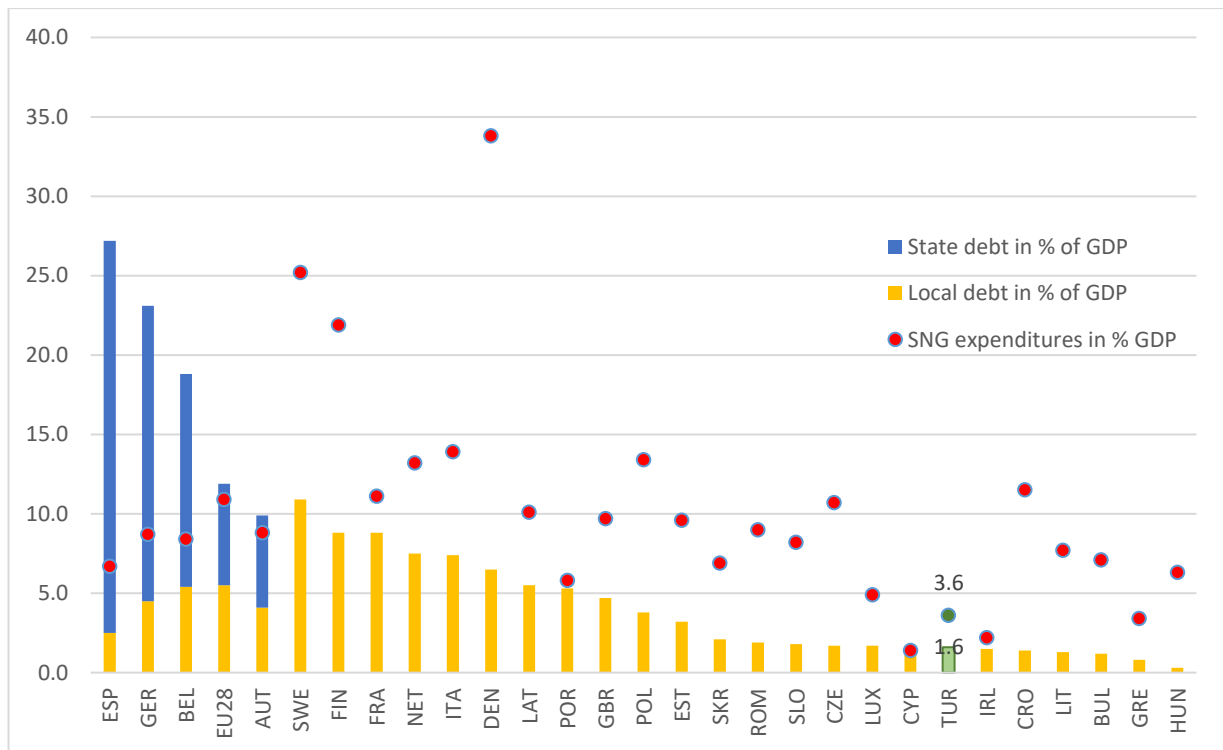
The European Union level regulations influenced sub-national government loan systems, as well. Local borrowing became more controlled and many countries applied rules similar to these Maastricht criteria for local government borrowing and debt limitations (e.g. Poland). There are several other European Parliament or European Council level directives and regulations, which set the rules of public sector borrowing, bond issue or the use of financial services.

Other regulations indirectly influence local borrowing. For example banking services, such as lending is subject to public procurement, although the bond issue is not covered by the procurement rules. Consequently it often made more convenient for the local governments to issue bond as it was faster and less complicated, despite its higher costs (e.g. large city borrowing was dominated by bond issue in Hungary in the period before the 2008 crisis).

Municipal borrowing practices

Within this overall fiscal framework the domestic legislation and traditions determine the level and form of local government borrowing. As Figure 13. below shows the sub-national government debt is the highest in the federal countries. It raises the EU average to 11.9% of GDP, with almost equal share of states/regions in the large federal countries and the municipalities, as local governments. (Spain is part of this group, because the regions as Autonomous Communities have extended powers.) It can be seen from this chart, that municipalities in the federal countries have relatively limited borrowing capacities.

Figure 13. State and local government debt, 2017



In the group of unitary countries local government borrowing is in line with the scope of decentralization. Municipalities in more devolved countries tend to accumulate more debt. The Scandinavian countries are good examples, although Denmark (discussed below), as one of the most decentralized countries in Europe is relatively less indebted. In the majority of the EU member countries local government debt is below 5% of GDP.

Turkey also belongs to this group of countries: local government debt is only 1.6% of GDP. However, compared to the level of decentralization (local expenditures are 3.6% of GDP), this ratio is relatively high. It reinforces the rule, that less decentralized countries with limited fiscal autonomy rely more on external resources, such as loans and other forms of debt. The other explanation is, that high grant dependency makes the budget constraint softer: lower sub-national budget discipline, less credible no-bailout policy, higher risk of moral hazard. (Herold, 2018). This is very much the case with Turkey, where ILBANK is the main lender to municipalities with dual (banking and treasury) functions. With its dominating role ILBANK finances municipal capital investments by using public funds, controlling municipal grants and capitalizing unpaid debt as future loans.

Differences among countries in using debt as sources for financing capital investments are determined by various factors. The level of economic development influences both the demand for infrastructure and the resources available for public services. There is a high need for basic services in less developed and emerging economies. The level of local government autonomy and the intergovernmental fiscal relations also have an impact on how loans are used for financing municipalities. Development of the banking sector and the traditions in using diverse financial instruments are also critical factors.

In this respect the differences between federal and unitary states are highly visible. (Figure 14.) Composition of sub-national government debt is dominated by bank loans (60% of all debt in the EU 28 countries average). However, in the four countries with federal structures in this sample of OECD members, accumulated app. one fifth of their debt by issuing bonds. It is typically the state (regional) government which is financed through bonds. Securities are also widely used in some Nordic countries, such as Norway, Sweden, Estonia. Denmark with is

unique credit association model is an exception among the Scandinavian countries (see country case below).

Comparing Turkey with these countries three characteristics can be identified. First, the overall weight of bank loans is comparable to the European country average, although with this ration (56% of total debt) Turkey belongs to the countries with lower share of bank loans. Secondly, there is no measurable bond issue in Turkey, as this debt instrument was exceptional and used only in large metropolitan cities. Thirdly, the share of debt on accounts payable is rather high in Turkey (39% of total). These arrears, unpaid bills, debt to suppliers might have been generated mostly by the affiliated administration or the municipal companies. Similarly, high ratio of this type of forced lending is in Denmark (but with it is regulated overdraft facility, see below), Czech Republic and Hungary (after the debt consolidation program with practically no municipal borrowing).

Figure 14. Composition of local government liabilities, 2016



Source: OECD, 2018

Alternatives to loan financing

As the chart above shows there are several other options beyond bank loans to finance local capital investments and budget deficit. In this brief overview we do not give a comprehensive assessment of all these financing instruments. The *municipal bond* is a financial obligation of the issuer, borrowing funds from the holders of the bonds with a promise of paying scheduled interest and the principal at the maturity (definition by Freire, 2014). It is a widely used financing instrument in the US, primarily because of income tax free status of municipal bond for its holder and the large secondary market of municipal bonds.

There are two basic types of municipal bonds: one which is paid by the revenue generated by the project (rents, user charges, tax increments), for which the creditors' funds were used and the general obligation bonds, which are repaid by all types of local revenues. Municipal bonds are usually with fixed rate and a long term maturity.

Bond issue has its costs for the issuer. First of all, the potential buyers should be convinced about the creditworthiness of the issuer, so rating is needed. The actual bond issue is organized by the underwriter, who will manage the entire process, which is also costly. The municipality should disclose credible information on its financial sustainability and the actual project financed by the bond. This information should be disseminated among the potential creditors. All these transaction costs might be minimized with private placement (one creditor, preferably the underwriter, purchases all the issued bonds), compared to the public placement, when there are several buyers of the municipal bonds. The bonds with large one-time repayment obligation at its maturity requires highly disciplined local financial management to accumulate these funds when the principal payment is due. A reserve fund or escrow account might be opened by the issuer for regular depositing these funds.

Careful and detailed overview of municipal bonds was prepared by the World Bank in Turkey (Oguz - Kopanyi, 2016). Following a thorough analysis of the local government debt and the special role of Iller Bank in lending to municipalities, this note formulates three sets of policy proposals for Turkey. The first one is about developing the municipal bond market by adapting the internationally tested mechanisms of mitigating the political and financial risks of municipal bond issue. The municipal bond-bank is an intermediary between the investors and the commercial banks' lending to municipalities. The master trust fund similarly connects the municipalities and the investors by authorizing the trust fund to use the local governments grant partially as guaranteed debt service payment. Other fund schemes might also enhance the credit rating of smaller municipalities or create guarantees. The tax-exempt status of bonds will increase the domestic savings.

The second set of recommendations targets local knowledge and capacity: all these mechanisms should be supported by municipal capacity development programs to familiarize the local decision makers with the bond issue.

The third proposal is to widen the use of *Sukük*, the municipal bond. (see Annex 3.) The various forms of *Sukük* combine the advantages of bonds and classical Public-Private-Partnership schemes. This asset based deferred payment mechanism goes beyond the typical bond by connecting the financial obligations to sale, lease agreements, joint ventures, etc.. The special purpose vehicles created through *Sukük* have tax advantages both for institutional and individual investors.

These proposals are in line with the recent global emergence of *impact bonds*. They are issued for achieving the set economic, social or environmental targets. The debtor entity takes an obligation towards the investors to achieve a specific outcome or performance with the funds borrowed with the impact bonds. The typical objectives are economic development, reduced unemployment, environmental protection and climate targets, achieved through energy saving, transformation of public transformation, municipal solid waste management, etc. (more about impact bonds among the recommendations).

Contingent liabilities

The local government loan systems are determined also by the guarantees issued by municipalities. They are parts of the local government liabilities, which are often categorized as direct and contingent (potential) liabilities on one hand and being explicit with straightforward legal obligation or as political (implicit) commitment (Kahkonen - Gooptu, 2015).

Among the municipal contingent liabilities guarantees represent an identifiable group of local responsibilities. Sub-municipal entities, such as locally owned companies or other service organizations or ventures can borrow often with a guarantee of the parent municipality. They represent the explicit contingent liabilities.

Denmark	68,3%	Latvia	19,1%
Czech Rep.	65,2%	Germany	18,6%
Sweden	53,4%	Poland	16,4%
Finland	38,5%	Spain	4,8%
Austria	28,5%	Hungary	0,3%
Netherlands	20,0%	UK	0,0%
Source: Eurostat			

Among the European countries the sub-national share of overall government guarantees is the highest in the most decentralized ones and in the federal countries. (Table 8.) In the more decentralized Scandinavian countries the municipalities manage a wide range of service organizations, which can borrow under more favorable conditions with local government guarantees. The special association form of municipal lending (see the case of Denmark below) also explains the high level of explicit contingent liabilities.

The other potential obligations of municipalities can be hardly quantified. Municipalities manage critical public services and they have ultimate responsibility for the service organizations delivering these services. The urban transportation company, the water or waste management companies should remain in business regardless of their economic performance. Municipal bailout costs might be shared with the national budget, but the local government bears the implicit liability for their legal claims, debt, and financial positions. Similarly, local governments have partial responsibility for managing natural disasters locally, and to pay for environmental recovery or clean-up costs in emergency situations.

Fiscal framework matters

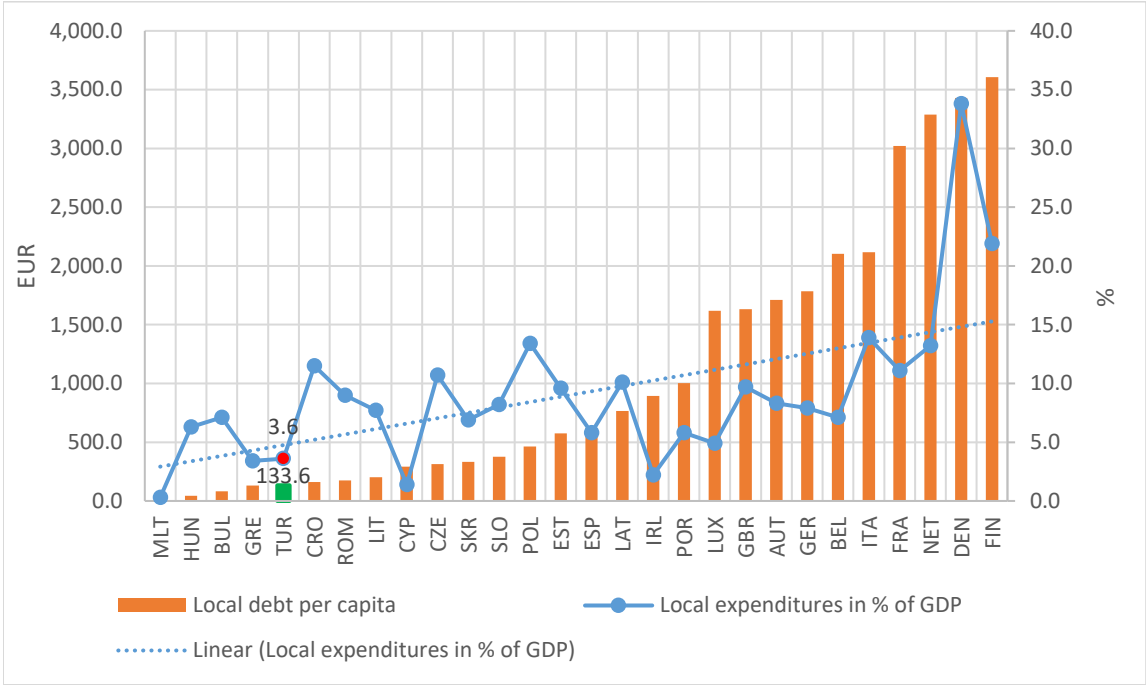
Loan and its alternatives are only one of the several components in municipal finances. The actual level and forms of municipal borrowing are influenced by other factors: the scope of decentralization, the intergovernmental fiscal relations, the composition of own source revenues and the public financial management. These elements of municipal finances determine the demand for loans, the incentives for borrowing, the repayment capacity and fiscal rules of debt.

The wider *local government responsibilities* and functions create greater need for borrowing. The sample of European countries shows, that the greater local government spending (measured in percentage of GDP) coincides with higher level of municipal debt (see Figure 13. and 15.). Beyond this general trend there are significant differences. The federal states are again exceptions, because they enjoy a special status within their countries.

All the Central-Eastern European countries are in the group with low level of debt, regardless of their scope of decentralizations. Countries with diverse local functions (above 10% of local expenditures in % of GDP) have higher debt in their respective reference groups: Poland, Czech Republic among the countries with lower level of debt and Italy, France, Netherland, Denmark in the other group. Perhaps there are other factors behind this trend, such as higher supply of investment funds or more developed financial infrastructure.

The *intergovernmental fiscal relations* determine the incentives for local revenue raising. The size of intergovernmental transfers within the local budgets and more the grant allocation methods provide the overall municipal motivation to search for resources, such as external funds through borrowing. Greater grant dependency combined soft budget constraints does not support loan financing. Access to public funds through grants or amended budgets does not create fiscal pressure on municipalities to raise debt.

Figure 15. Local government debt and decentralization, 2017



Within a given intergovernmental fiscal system, the *own-source-revenue raising capacity* and tax autonomy will have an impact on borrowing. The higher own source revenues are the bases of stable municipal finances, so in these countries the need for borrowing will be lower. Diverse, stable and significant local government revenues, will make municipal budgets more balanced, so there is lower need for borrowing. Local governments are forced to search for municipal taxes, user charges or capital revenues for financing their budgets, before they assess other alternatives, such as loans. (On the other hand, greater own revenues create a solid basis for debt financing, so the supply of loans might be greater in these countries.)

Countries with extensive public sector and local government borrowing developed diverse forms of *fiscal rules* to ensure debt sustainability. (Sutherland-Price-Joumard, 2005; OECD, 2013). They are both ex-ante regulations, such as the golden rule of borrowing²³, debt and borrowing limits, administrative permits, cooperative agreements between government tiers and the ex-post regulations (administrative or court-based rules for managing insolvency).

Conclusions from a large sample of country surveys proved that all these methods had a positive effect on fiscal performance. (Martinez-Vazquez - Vulovic, 2016) However, no overall superiority of any fiscal rules on local financial sustainability could have been identified. So finding of this 59 country research reinforced, that effectiveness of specific fiscal rule depends on the domestic public financial management system. The interaction of regulations,

²³ Golden rule of borrowing is, that governments must borrow only for investment purposes and not for financing current expenditures. This way future generations will not be overburdened by debt used for financing the consumption of the present public service users.

institutions and procedures shape the balanced budget and fiscal sustainability at local government level.

Successful transfer of fiscal rules between countries with different fiscal traditions need *careful adaptation of techniques and methods*. The supportive public financial management framework on municipal borrowing rules is based on the several conditions (Corbacho - Ter-Minassian, 2016). First, the fiscal rules have to be legally binding. It means they should be comprehensive covering all components of potential sources of debt (e.g. extra-budgetary entities, municipal enterprises, debt and guarantees of outsourced services). The data needed for assessing local government borrowing and indebtedness should be based on reliable accounting information. The municipal reporting system, staff has to be capable to produce and interpret this information. As local governments operate under public scrutiny, the indicators of municipal borrowing and debt has to be transparent and publicly available. Finally, the enforcement mechanisms have to be in place with sanctions on non-compliance.

At local government level the sound fiscal planning with a debt management strategy is the key element of the effective public financial management system. Capital investment plans combined with the long-term financial plan is needed for balanced budget execution for the borrowing municipality. The medium to long term debt management plans will ensure that the amount of loan repayment is available and the municipality has liquid assets in the period when the repayment is due.

The public financial management systems might follow different basic logics, which determine the fiscal framework of municipal borrowing. There are some common elements, such as the need for disciplined cash management, proper information produced by the accrual accounting system, external audit.

The Table 9. below summarizes the key components of different approaches to local public financial management. The less decentralized systems are based on administrative control, usually with ex ante approval of all transactions by various government entities. While the decentralized systems rely more on the powers of local councils and other accountability mechanisms, which are supported internal control systems and ex post budget review.

Table 9. Differences in public financial management systems	
<i>Decentralized, trust based</i>	<i>Controlled, less decentralized</i>
social, downward accountability towards electorates	administrative, upward accountability
internal monitoring, administrative control	closer oversight, authorization of transactions
ex post budget review	ex ante approval by budget controller
external audit, unified chart of accounts, budget classification	

The municipal borrowing and debt management practices will be also different under these two typical models. In the less decentralized, controlled systems local responsibility for stable financing is lower, so the decision on debt financing moves upwards to higher level of government. In the more decentralized systems where local decisions makers are faced with the consequences of borrowing, sustainability of local finances is the main target. So borrowing for capital investments and for financing the current budget will primarily controlled at the very local level. Countries are usually placed between these two extreme models of public financial management. The five country cases discussed below also operate with a mixture of these methods, which will determine their municipal borrowing and debt management practices.

Municipal loan taking and debt management

Local government loan systems compose of three main sets of institutions, rules and procedures. (See Table 10.). First one is the municipal *lending practice*. The five countries discussed here represent rather different models: they range from a purely commercial bank based, liberal systems (Hungary, Poland) through the specific localized models of Denmark, Germany to the one single municipal lending channel under national government control in the UK.

The local government *borrowing regulations* comprise the second set of rules. All countries introduce some compulsory limits over municipal borrowing, but their approaches are rather different. The rigid limits are combined with administrative approval of borrowing (Hungary). But the more realistic, long term approach to balanced budget is coupled with combined mechanisms of local accountability and national control: state audit screening (Poland), self-regulation and limited ministerial discretion under the capped total debt (Denmark) to higher level approval (Germany, UK).

The *defaulting regulations* are different even within the similar borrowing models and particular regulatory systems. Hungary is the only country with a court based preventive system of municipal insolvency. The others have no explicit default regulations (Poland) or offer specific interventions with diverse forms of financial help to municipalities with overdue debt.

Table 10. Municipal borrowing models ranging from market to centralized schemes			
	<i>Municipal lending</i>	<i>Borrowing regulations</i>	<i>Defaulting rules, practices</i>
Hungary	Open market, through dominating commercial bank	Debt, borrowing limits with administrative control	Court based, bailout exceptional
Poland	Open market, through dominating commercial bank	Gross savings for three years, current budget balanced requirement, state audit opinion	No default regulations, but forced ministerial loan
Denmark	Local lending association, one single local bank	Central loan approval with limited ministerial discretion	Financial help, administrative control
Germany	Specialized local, regional banks	Long term performance based, strong balanced budget requirement, state approval	Special federal and state interventions, but no bailout
United Kingdom	Centralized local lending, under government control	Administrative approval with detailed regulations on local prudential borrowing	Local responsibility to initiate, administrative control, option for financial help
Turkey	Mainly centralized municipal lending through state owned bank (İLBANK), commercial bank for short term loans	Diverse borrowing and debt limits, with state approval of loans	Soft regulations with implicit government bailout

Comparison of the selected five countries and Turkey should take into account the differences in economic conditions and local government systems. The basic indicators are summarized below in Table 11. The only country in this sample comparable in population size is Germany. However, the level of economic development (measured by GDP per capita) in Turkey is closer

to the two Central European countries, only. All the other three ones are among the most developed countries in Europe with 2.5 times higher GDP per capita.

This is reflected by the level of decentralization, which is well below the European average in Turkey. However, the limited scope of decentralization is combined with the high share of local capital spending in Turkey. This fact proves the importance of proper local loans systems, as borrowing is significant part of capital investment financing. The administrative structure of the studied countries is rather different: ranging from the fragmented system (Hungary, Germany) to the amalgamated models of Denmark and the UK. Measuring municipal size by the average population number, Turkey also belongs to this latter group.

	<i>Population (1,000)</i>	<i>Average municipality size</i>	<i>Sub-national expenditures in % of GDP</i>	<i>Sub-national in % of general government investment</i>	<i>GDP per capita (PPP international dollar)</i>
Turkey	76,619	53,940	4.0	35.9	16,610
Denmark	5.6	58,155	36.4	43.3	45,500
Germany	80,983	7,320	20.5 (7.6) ²⁴	67.9 (43.3)	46,394
Hungary	9,867	3,125	7.5	39.4	25,061
Poland	38,484	15,530	13.1	50.9	24,952
UK	64,597	166,060	11.6	35.6	40,210

Source: <https://www.oecd.org>

Overall municipal borrowing framework

Denmark

In the highly decentralized country local government associations play an important role in negotiating rules and regulations on intergovernmental fiscal relations and municipal finances. So the Local Government Denmark (KL), the municipal association acts as a quasi-national agency not only developing agreements with the ministries, but also enforcing the implementation of the negotiated arrangements.

This mechanism works in the case of the municipal debt limits, as well. The local government associations sign the agreement on the *total amount (ratio)* of municipal borrowing and debt annually. The individual permissions for borrowing is negotiated within this local government borrowing ceiling. Beyond this gross limit the level of municipal debt is also maximized in 30% of local expenditures (Mau, 2015)

The local government debt is *kept under control*, as it is only 6.5% of GDP (2017), whereas the local expenditures are among the highest in Europe exceeding one third of GDP. Sub-national government debt is primarily *financial debt* (65%) and the rest is accounts payable (35%).

In principle municipal borrowing is allowed only for capital investment purposes. It requires approval from higher government, although this permission is issued automatically for certain investments (e.g. utility projects, self-financed by user charges). These loans financed projects which easily authorized are usually are financed by user charges or have high political priority (energy savings, housing for refugees). These permits are issued only within the aggregate borrowing ceiling.

²⁴ Local (municipal) level

KommuneKredit: association for municipal lending

Municipal lending is dominated by the unique mechanism of a lending association in Denmark. The municipal credit organization (KommuneKredit²⁵) was established in 1898 with an exclusive mandate to lend to municipalities and their entities. Presently it is in a monopoly position with a market share of 95% in the local government sector. It is a special public entity, which is neither subject of the Danish banking law, nor the Danish financial supervisory authority regulations. It is supervised by the Ministry of Economic Affairs and the Interior²⁶. KommuneKredit is financed through large public bond issue. Banks, treasury departments and central banks, supranational institutions invest in KommuneKredit bonds, typically from Europe. The municipal credit association has a high credit rating (Aaa and AA+) (KommuneKredit, 2018)

Specialty of KommuneKredit is that municipalities and regions have a joint and several responsibilities for their obligations. KommuneKredit pays no dividend to the owners, so it is able to operate with low costs. The not-for-profit status makes the KommuneKredit competitive on the municipal market with relatively low interest rate. It provides loans and leasing to municipalities, regions, municipal associations and companies with municipal or regional tasks. Company loans (the principal) should be guaranteed by the municipalities.

In 2018 KommuneKredit lending targeted primarily the municipalities (47% of total), regional governments (12%) and the local companies, institutions (41%). The specific loan requests are evaluated by the Ministry of Economic Affairs and the Interior. Key criteria MoEAI consent are whether project qualifies for a loan under the municipal law and it is not against the European Union regulations prohibiting state aid in the private sector. All municipal loans are provided under equal terms and conditions for all municipal projects, regardless of their size and location. Due to credit association regulations there are no defaults on KommuneKredit loans.

Germany

In this federal country the three government tiers (federation, state/Land, municipalities, together their associations) represent rather independent also closely interwoven entities. The units of the federation, the *member states raise most of the government debt* (23.1% of GDP in 2017). However, the Länder as sovereign authorities have dual tasks. They are responsible for municipal finances within their territory and at the same time they are involved in the fiscal decisions of the federation. Through horizontal transfers and equalization schemes they exercise their duties in keeping the unity of the country and maintain the fiscal stability of the federal government.

The other specialty of the German system is network of local savings banks. They are organized on a territorial basis, so they are attached to a municipality or an association of municipalities and they also operate at member state level (although not in all Länder). Beyond these savings banks there are other specialized local banks. Their primary duties are the local small or medium size businesses and the public institutions, including the municipalities or the member states.

²⁵ <https://www.kommunekredit.dk/en/>

²⁶ Act No. 383, 3 May, 2006 on Credit Institution for Local and Regional Authorities

Local savings banks

The German savings banks, the Sparkassen (384) and the 5 Landesbanken create one financial group. Together with the other public savings banks (mortgage banks, special-purpose banks, such as KfW, etc.) they form an association. This is the largest financial group worldwide with assets of EUR 2.1 Trillion and a market share of 36% in deposits in Germany (DBRS, 2019).

The local savings banks operate under the public law. The main shareholders are the sub-national governments of a city or a region, although they are not state-owned banks. As public banks they are under municipal trusteeship and their legal form is similar to a public foundation (ESBG, 2017). Municipalities are represented in the banks' boards, but they are not liable for the savings banks' finances. The Sparkassen and the Landesbanken are independent business entities. The Landesbanken are usually jointly owned by the municipal banks and the federal government. At the same time Landesbank serves as a central bank of the Sparkasse in its territory.

Following the fiscal federalism logic of Germany, the savings banks have developed their own institutional protection scheme. They established a regional network of support funds, which will help out their members at the national scale, if their members' support fund is not sufficient. It is a rescue scheme combined with a mandatory deposit guarantee scheme.

Hungary

Starting from 1990 Hungary introduced a highly decentralized local government system and invented liberal regulations on municipal debt management. Before 2011 the two-tier local government structure was responsible for a wide range of public services, including public education and health care services, which comprised app. 12% of GDP. Local governments were equipped with a wide range of former state assets and they were financed primarily by municipal taxes, shared personal income tax and general grants. Local governments were allowed to borrow within the set national limits (debt service had to be below 70% of selected own source revenues) and the court-based consolidation procedures were introduced for defaulting municipalities since 1996.

Local government borrowing and the related regulations were significantly transformed during the past decade. The overall local government framework was changed with the political transformation after the 2010 parliamentary elections. (Péteri, 2012a, Péteri, 2014, Hegedüs-Péteri, 2015, Hajnal-Rosta, 2016) The middle tier (county) local governments were deprived of their major service functions and became only planning and coordination bodies. Former local services were nationalized, so by now local government budgets are less than 7% of GDP. Parallel to these changes the tax sharing system was abolished and the former general grants were transformed to a block grant system with stricter earmarking rules.

Together with this centralization program the local government borrowing rules were transformed. In addition, just before the next parliamentary elections, *all local government debt was taken over by the national budget*. The former modest share of municipal borrowing (in 2010 local debt was 4.6% of GDP) was decreased (in 2010 to only 0.3% of GDP). Now municipal borrowing requires central budget approval and the debt consolidation rules were partially changed.

The local government bailout, irrespective of the financial position of the "saved" municipalities had a deteriorating impact on local financial discipline: after two decades of municipal financial responsibility, no credible fiscal policy with hard budget constraint can be

developed in the future. This moral hazard was perhaps the biggest loss of this recent centralization-nationalization political program.

The Act on Local governments still excludes any potential bailout by stating, that the national budget takes no responsibility for any potential financial “deficiencies” of local financial management decision. However, the practice of the 2013/2014 consolidation program destroyed this rule, as the wide-scale takeover of municipal debt by the national budget introduced the implicit bailout policy.

The story of Hungarian local government debt had an interesting turn in the years before the financial crisis of 2008/2009. From 2006 to 2008, the stock of subnational debt increased 83 percent. In these years before the financial crisis, loans were easily available for local governments in various forms such as bank loans and bond issuance. But local governments kept the borrowing proceeds in reserve (rather than spending them) and they were not used for investments simply increased municipal savings as bank deposits. The main purpose of these funds were to accumulate resources for co-financing and pre-financing European Union investment projects (similar trend was identified in Poland, see Medve-Balint-Bohle, 2016).

During 2006–10, local government debt increased 2.5 times for all types of local governments (Liu-Peteri, 2015). But county governments’ debt grew tenfold and increased 3.5 times for other cities, and 2.7 times for cities with county rights. The capital city was the largest borrower before 2006, so increased its debt at a slower pace. These differences are partly explained by the fact, that political opposition-controlled counties and large cities. They expected to be left out from allocation of the national and European funds, so they focused on alternative sources.

This active period of local government borrowing during 2006–08 was characterized mostly by municipal bond issuance. The shift to bonds can be explained by favorable terms and conditions of the general obligation municipal bonds. Bond issuance was typically a private placement, when the underwriting banks purchased the issued bonds. Bond issuance was exempt from public procurement procedures, so despite the costly preparations, it was faster than the typical bank lending procedure. During 2007–13, foreign currency debt dominated local government borrowing so the ratio of foreign currency debt reached over 60 percent of local government debt by 2013. The Swiss franc or euro debt was favorable compared to domestic borrowing, until the Hungarian currency was devaluated and the costs of servicing and refinancing the debt significantly increased.

Poland

Municipal debt significantly decreased in Poland during the past decade (Table 12.). Municipal debt compared to local government revenues declined by one third to the manageable level of 22% of local revenues. That means the cost of municipal debt was halved, to 0.6% of local budget revenues. The stability of local finances also shows, that overdue payments are marginal within the total pool of municipal debt. It is dominated by loans, approximately being at the same, stable level during this period (PLN 25-26 Billion).

Table 12. Municipal debt in Poland		
	2011	2017
Debt as % of local revenues	34,3	22,3
<i>Composition of debt, %</i>		
Securities	1,0%	0,7%
Credits, loans	98,4%	99,1%
Liabilities due	0,7%	0,2%
Total	100,0%	100,0%
Cost of servicing debt, in % of revenues	1,4	0,6
Source: Ostachowski, 2019		

United Kingdom

Local government debt is at modest level (4.7% of GDP). Local authority borrowing is regulated and supported by professional standards and rules, procedures for capital investment financing. Local governments are obliged to follow the prudential code for capital financing. This approach of using common methods of technical bodies and recommendations by higher government entities is in line with the governance traditions of the UK. (see the capital financing part of Local Government Act in Annex 8.) The mandatory administrative methods on local borrowing, endorsed by the national government (Ministry of Housing, Communities and Local Government), were developed by the Chartered Institute of Public Finance and Accountancy. (CIPFA, 2017) Actually the code is a capacity development tool for local authorities to develop all components of a proper capital investment financing policy and local decision making.

This obligation to develop prudential codes by local authorities implies that the national government does not provide any guarantees to local loans and other liabilities. The short term borrowing is automatic as bank overdrafts without government approval. It cannot be repaid from future grants or asset sale. The local government property cannot be charged or mortgaged against local loans. The local authorities are liable for loan repayment with all their revenues.

The regulation of local capital investment planning and financing (including borrowing) is about clear separation of government responsibilities. In municipal capital financing and borrowing the national government departments are responsible for policy design, allocation of grants and local revenue regulations and they set the local borrowing limits. (NAO, 2016) The Treasury defines the borrowing rates of the Public Works Loan Board and approves local borrowing in foreign currency. National government agencies (departments) developed their own information system to collect and analyze data on local finances, monitoring policy implementation and local management.

Local authorities are autonomous within this framework controlled by diverse legal and administrative tools of laws, regulations, guidance issued by the ministries and their partner institutions (e.g. CIPFA). Negotiations in the preparatory stage, consultation, cooperation, respect and mutual settlements help to achieve the best results for both tiers of government. Local authorities are obliged to follow these rules and develop their own organizational and management practices to meet the requirements of the prudential code, determine minimum revenue for debt repayment, submit capital forecasts, publish financial management strategies, etc. Obviously all these actions are approved by the local councils and local budgets are externally audited.

Public Works Loan Board

The Public Works Loan Board (PWLB) is a specialized statutory institution, which issues loans to local authorities. It is the executive agency of the HM Treasury (the British ministry of finance). PWLB lending is implemented by the Debt Management Office (DMO). However, the conditions of municipal loans are defined by the HM Treasury within the framework of the law on national loans. The plan is to incorporate the PWLB in the HM Treasury structure, so even the present relative autonomy of the Board will be eliminated and local borrowing will be better controlled by the Treasury.

Public Works Loan Board	74.8
UK banks	9.2
Bonds, other securities	5.8
Other sources	10.2
<i>Total</i>	<i>100.0</i>
Total: GBP 100.2 Billion	
Source: https://www.gov.uk/government/statistical-data-sets	

In fiscal year 2018 PWLB provided loans to local authorities of GBP 74.5 Billion. It is the dominating source of local long-term borrowing (Table 13.).

The interest rates of on-lending by PWLB cannot be lower than the interest on borrowed funds. PWLB provides fixed and variable interest rate loans with set options for repayment. For fixed interest exclusively half, yearly payments with three options: (i) interest with single principal repayment at the end; (ii) equal principal payment with interest calculated on the remaining amount; (iii) fixed principal and interest. Interest rates are the same for all loans with similar maturity period (calculated by bands). For fixed rate loans the maximum maturity period is 50 years. Variable rate loans can be repaid in shorter intervals either with principal repayment at the end of the term or in equal instalments of the principal (interest calculated on the outstanding amount).

Sources of PWLB on-lending are provided by the National Loan Fund. The costs of local borrowing are regulated by the margins on government treasury bonds. The margin is specified by type of loan, so in the case of local infrastructure loans it is lower than the standard rate. PWLB is government funded, so all the interest, the principal are paid to the National Loan Fund.

Local loan requests are assessed at DMO only from financial administration point of view. The purposes and the circumstances of local borrowing are not subject to review, they are under the sole responsibility of the local councils. This borrowing decision cannot be delegated to a committee or an officer. Municipal loans are provided against all local budget revenues without earmarking special revenue type or local assets as collateral. When the local authority meets the loan application requirements, set by the government circular, then the funding is provided automatically.

As the DMO and the PWLB have detailed information on municipal budgets, the loan applications are decided in very short time, usually in two days after the local authority's request was submitted. As PWLB is a public body, it is subject to freedom of information law, so the data on municipal loans are accessible by the public.

PWLB is often criticized of lending with interest above the market rate. Despite the smooth and fast decision on loan requests, local authorities are looking for borrowing options below the interest rate set by the government. As an alternative the local government association established the UK Municipal Bonds Agency (UKMBA). Similar to the Scandinavian model the Agency is owned by the local councils and the Association. It can reach favorable conditions for bond issues by pooling borrowing to larger bonds, having joint and several guarantees, introducing careful credit assessment practices. By 2017 it signed a framework agreement with 23 municipalities, but its impact on the local lending market is not visible, yet.

Local authorities can invest their surplus funds. Security and liquidity of financial investments are the two main criteria for finding the right financial institution. Investing abroad is protected up to a certain limit when local authorities choose among the eligible depositors.

Local borrowing control

Denmark

Local governments have diverse and significant own source and shared revenues. So the general approach of financial regulation is that there is no need for municipal borrowing, neither for liquidity nor for capital investment financing purposes. Due to the funding available from KommuneKredit, local governments are not allowed to issue bonds. However, it is recognized,

that municipalities need external funding for large investment projects and for proper management of cash flow.

The three key mechanisms of local debt control are the (i) balanced budget requirement, (ii) the aggregate limit of municipal borrowing (loan pool) with a strong monitoring role of the relevant ministry and (iii) the overdraft facility.

The total amounts of local government expenditures and revenues are regulated and they are strictly monitored by the Economic Council. The Council is an independent advisory body of the government, with influential membership of unions, the central bank, etc. (Niemann, 2018).

The loan pool covers all forms of bank credit, leasing contracts and PPP schemes. The special regulations on leasing requires to deposit the cash equal to the leased asset to ensure the liquidity of the municipality. This amount is gradually released during the term of lease. This deposit requirement is softened when the municipality has automatic access to loans (Ministry of Economic Affairs and Interior, 2014)

The short term borrowing is regulated by the overdraft facility rule (“kass kreditregel”). That means the local government (municipality or region) liquidity over a year should be positive: daily balance of the overdraft for the past 12 months should not exceed the average total balance of the liquid (financial) assets. If this limit cannot be met, then the municipality should agree with the ministry and develop its consolidation plan. The early warning mechanism of the ministry is the indicator on the liquidity level, showing a downward trend and falls below the level of USD 150/person.

The enforcement mechanisms are rather effective such as withholding the national block grants and other specific grants. It is regulated at the aggregate level for the entire local government sector, so municipalities should agree among themselves how to keep the set national limits on expenditures, revenues and debt.

Germany

German sub-national governments are subject to strong balanced budget rules. The current and capital budgets, off-budget special funds should have approved balanced budgets separately. The balanced budget requirement is set by the constitution (Basic Law, Art. 109), amended after the financial crisis a decade ago. The Federal government deficit can be financed by borrowing, up to 0.35% of GDP. (see Annex 5.)

This federal structural deficit limit is accompanied by the balanced budget requirement of the Länder, although credits are not allowed “in principle”, that is under normal economic circumstances. This provision will be introduced from 2020, when 16 different (plus one at the federal level) debt brakes might be used. Until then the five most indebted states (including Berlin) were obliged to decrease their debt by 10% annually. Even after this statutory deadline the deficit can be carried over or it can be offset by the budget year surplus.

Special funds are exempt from the borrowing limits and regulation, in the case which were established before the constitutional changes. There are 50 different types of special funds, the largest still existing ones are financial market stabilization, investment and repayment fund. They are important borrowing mechanisms at the state level. The state special funds are not parts of the debt brake mechanism (Reischmann, 2015).

The constitution does not set the regulations on municipal borrowing and debt. It is the member state government’s legislation which allows municipal borrowing to finance capital investments and to reschedule debt. Overall amount of municipal loans is approved by the state regulations. State governments are not obliged to guarantee municipal loans. Borrowing for financing current budget is not possible and cash credits are not subject to these regulations.

Following the fiscal crisis, the intergovernmental fiscal relations were modified in the federal republic. The constitutional court obliged the federal government to help two Lander (Bremen, Saarland) in financial distress. The revenue sharing mechanism was also modified and new equalization mechanism were introduced. Five member states, including Berlin, received consolidation aid.

The financial position of the states is assessed and monitored by the Stability Council. It is a joint body of the member states' and the federal government's finance and economic ministers. Decisions are made with qualified majority (federal representative and two thirds of the Lander) The Stability Council at federal level will monitor and control member state level borrowing. The key ratios observed by the Council are the structural financial balance per capita, ratio of net borrowing to net expenditures, debt to revenue ratio, interest to tax ratio. In the case of financial distress, the states are obliged to develop a recovery plan to balance their finances.

The Stability Council exercises its soft powers through benchmarking, peer review, exchange of good practices. (Thöne-Bullerjahn, 2018) Sanctions do not come in the first round of monitoring, solidarity-based bailout and strong fiscal equalization is the basis for managing state level default risks. The same principles are followed in the case of municipal insolvency.

The government debt regulations are often criticized, as the rather strict "debt brake" does not have a counter-cyclical effect. (Truger-Will, 2012) It supports public investments in the period of economic boom and the contracting GDP will cause further expenditure cuts during economic slowdown. The constitution does not exclude the possible deviation from this debt brake, so under exceptional circumstances (e.g. dealing with natural disasters) borrowing might exceed the limits both at federal and member state level. (Pünder, 2016)

Municipal borrowing is permitted if "long-term performance capability" guaranteed. According to the current regulation, each German municipality is granted a credit refinancing margin of a maximum of € 750 per inhabitant. State government approval is needed on municipal borrowing for major capital investment projects in infrastructure. Introduction of accrual accounting modified the actual assessment of municipal debt, because explicit contingent liabilities should be reported, as well. So civil service pensions, depreciation of investments are also to be covered by municipal revenues.

Hungary

In the period of 1996 to 2011, local government borrowing was limited by two types of regulations. First, the ex-ante regulation specified that in the next budget year debt service of a local government should not exceed 70 percent of a subset of the municipal own (recurrent) revenues. No specific permits were needed for local government borrowing.

Second, the ex-post court-based local bankruptcy procedures set the rules for restructuring local government debt in the event of insolvency. Implementation was largely successful. The main challenge was to make the pre-bankruptcy negotiated restructuring more transparent so that the pre-negotiations are fairly and transparently conducted among all creditors and the municipal debtor (Jokay 2013).

Hungary is the only country among the five cases studied here, which has introduced court based municipal default regulations. (see Annex 6.) It successfully prevented excessive borrowing for two decades. Following the political changes in 2010 local government insolvency regulations were modified. Some of the procedures were redesigned (for example, more time was left for developing the program for debt restructuring), and the personal financial responsibility of the mayor was specified by the new amended law.

The legislative limits on local government borrowing were amended in 2011 by making them stricter. Some provisions of the new rules tried to correct the past pitfalls of the previous legislation. After 2014, the obligations of municipal enterprises must be included in the obligations of the municipality itself (but loopholes remained: only debt of 100 percent publicly-owned companies is taken into account).

The new legislation requires balanced current budget and prohibits borrowing for operational purposes. This provision aimed to halt the practice of rolling short-term debt over between fiscal years.

Local government borrowing and issuance of guarantees should be approved by the national government. However, some borrowing activities are exempted from the new rules: (a) short-term borrowing for liquidity, (b) borrowing for co-financing and pre-financing projects funded by grants from the national budget, the EU, or other international funds; and (c) borrowing below minimum thresholds (app. US\$450,000 for the capital city and US\$45,000 for other municipalities if the borrowed amount is below 20 percent of their own revenues).

The national government authorization procedures are set by law. So, the responsible ministry does not have full discretion in supporting or rejecting local borrowing requests. The operational budget surplus as a measure of local government borrowing capacity is used for evaluating local governments' long-term financial stability. However, the ministry has discretionary powers in projecting current budget revenues and expenditures.

The limit for debt service was reduced from 70 percent of a subset of the municipal own (recurrent) revenues to 50 percent. However, this limit is extended to the entire borrowing period, not just the actual fiscal year per the previous regulations. No new capital investment projects can start if the local government reaches the 50 percent limit on debt service. Although specification of own revenues was modified by including some of the capital receipts. So the limit was decreased, but the basis of calculating local government debt service became larger. Beyond the 50 percent limit on debt service, the other important criterion is that the local government intending to borrow is obliged to levy either the local business tax, one of the property taxes, or the communal tax on private persons.

In the case of municipal default, the debt consolidation must not incorporate the assets which are not owned, but only managed by the municipality and the capital grants provided by the national and European Union budgets. In the period of debt consolidation only those capital expenditures can be made, which are specifically authorized by the competent ministry and only they might be included in the municipal reorganization plan.

The municipal reorganization plan can be supported by subsidized loans if the responsible minister approves it. The list of mandatory, core local government services was supplemented by the cultural services; the county local government services, which are eligible for national budget transfers; and with the payment for contracted local employers of handicapped people.

The new regulation did not solve all the problems of the previous regulation and created several new issues. The debt stock is not limited. The obligations under public-private partnerships are not reported under guarantees, nor are other future obligations (for example, capital payment obligations under leading, buyback obligations, delayed payments).

Poland

Local government loans and securities are subject to opinion of the Regional Audit Chamber (RIO) regional office (Legutko, 2018). RIOs as audit institutions are supposed to control the legality of municipal finances and financial management, but at the same time they exercise supervisory powers and also provide consultation services to local governments. In practice

RIOs decides on municipal creditworthiness, so lenders take into account their opinion on the municipal borrowing capacity.

As the multiannual financial forecast is mandatory to local governments, it serves as an important controlling instrument of RIO. When a local government is not able to approve the multiannual plan or does not meet the debt limits, then a corrective action plan should be developed. It is subject to RIO approval. RIOs also give their opinion on municipal borrowing. The practice shows that these decisions are made almost automatically, negative opinions on local government are issued only in a very limited number of cases: below 0.3% of loans and below 20% of corrective action plans.

The regulation on local government borrowing went through a radical transformation in Poland. The method introduced in 2005 was in line with the typical debt limitation rules introduced in many European countries. According to these regulations both municipal debt stock and the annual debt service (flow) were limited in percentage of local budget revenues. The total amount of local liabilities during the year should be lower than 60% of total budget revenues. The special liabilities for pre-financing European Union grants were excluded from this ratio. The debt service should be lower than 15% of planned local government revenues. In order to control new municipal loan in the case of high general government indebtedness, this ration was only 12% when the general government debt is above 55% of GDP²⁷.

This traditional method of debt limitation had two basic problems. Firstly, there are high differences in municipal revenue raising potential, so these two regulatory limits do not really reflect the local creditworthiness and seriousness of municipal indebtedness. Secondly, these simple ratio-based limits can be easily met by the municipalities by sale of property in the year of borrowing or by collecting any other one-off revenues in a particular year.

So, the approach to limit the local government borrowing was modified in 2011. The “Individual Debt Ratio” (Art 243, Public Finance law) was introduced since 2014 and municipalities were obliged to prepare long term financial forecasts. (see Annex 7.) The new borrowing limit was a unique local debt control mechanism: *the debt service should not exceed the average of operating surplus and privatization receipts of the preceding three years*. Debt service was defined broadly, so it included the principal and interest payment of loans, the securities payment and the potential payment of guarantees issued by the municipalities. The municipalities are obliged to prepare multi-year financial plans, so the forecasted borrowing limits are presented for a longer period.

The indicator was defined as follows: debt service to revenue should be lower than the net operating surplus compared to budget revenues ((current revenues + asset sale - operating expenditures)/total revenues). In addition, the balanced current budget requirement was introduced, so the current expenditure should be lower than the current municipal revenues, plus the surplus from the previous year and the cash available. The debt limit ration defined by this method was 9.99% in the year 2018, while the debt service ratio was 3.47%, well below the regulatory ceiling (Czekaj, 2018)

This regulation reflected the municipal revenue raising capacity more precisely than the simple ratios of debt limitation. However, the narrow fiscal focus of municipal debt had some problems. Certain debts services are excluded from the formula, such as redemption of securities, loan service of projects financed with 60% of EU funds, loans from other quasi banks. Municipal enterprise debt is not included in the indicator. According to the estimates the consolidated financial liabilities are higher than the debt in the fiscal reports by one third.

²⁷ Public debt is limited to 60% of GDP by the constitution, so local governments are also affected by this overall debt limit. Beyond the lower debt limit, they should decrease their budget deficit by one percent and no municipal guarantees can be issued.

(Czekaj, 2018) With this aggregate figure the Polish municipalities would be still below the statutory limit.

Municipalities can find other channels of borrowing. Beyond municipal company loans the other forms of unregistered debt such as revenue bonds, sale and lease back, repurchase agreements, subrogations, extending loan repayment periods will also increase the overall municipal debt. These “unconventional” forms of debt are 22% more expensive than the regular bank loans (Poniatowicz-Wyszkowska-Piekarska, 2016). So according to the Polish experts the individual debt ratio should incorporate these alternative forms of municipal borrowing.

Municipalities can bypass the borrowing limitations by transferring debt to municipal companies and budgetary organizations, such as hospitals. Health care services are funded through central financing channels, the local (regional) governments have limited influence on the deficit accumulated by these health care institutions. However, as owners of hospitals they are fully liable for the debt issued by these health care institutions.

United Kingdom

Local governments decide on their borrowing limits autonomously. However, they should meet the general standards set by the prudential code and the treasury limits. As it was discussed the rules and practices set by the prudential code provide the overall framework of local borrowing. The prudential code aims to ensure that (i) capital expenditures are affordable, (ii) the liabilities are at a sustainable level and the related (iii) local finances are managed at high professional standards.

The key element of the code are the prudential indicators, which will help decision makers to control the local capital investment and borrowing. They include the capital expenditure limits, sources of financing, the borrowing limits, gross debt in the coming three years, debt affordability (ratio of financing costs to net revenue), and maturity structure of borrowing.

Regulations on defaulting municipalities

Denmark

Municipalities cannot be declared bankrupt. However, when the overdraft facility rule is broken, then the local government has to launch formal negotiations with the partner ministry. The aim of these negotiations is to develop a sound financial plan for stabilizing municipal finances. It fits into the Scandinavian culture of consensus building, when local government elected and administrative officials start the technical discussion with the ministry staff (civil servants). The competent national government agency has a combined portfolio of economic and local government matters (Ministry of Economic Affairs and the Interior).

Germany

No municipal defaults are possible according to the Bankruptcy Act and the states have no formal bailout duties. However, the combined, joint liability of the states supports the implicit bailout expectation at the expense of the state budgets.

In some states municipalities with fiscal problems can apply for conditional grants as part of the fiscal equalization scheme. They are allocated on an individual basis with the requirement for consolidation. This plan is approved by the state government (e.g. balanced budget

requirement in three years), although the Land government decision might be challenged at the court. Consolidation plan can be combined with stricter fiscal oversight, when a state commissioner is appointed. He can overwrite the council financial decisions in the case of municipal bankruptcy, when the municipality is under forced administration.

Municipal debt enforcement options are limited, because no insolvency proceedings are possible against federal and state assets. In the case of municipal assets it is also prohibited, unless the state legislation regulates differently. Usually assets of basic municipal services are exempt from debt enforcement.

Hungary

The Hungarian debt adjustment law for local governments, enacted in 1996, focuses on the procedure of debt restructuring. It has seven major steps.

1. *Initiation of debt adjustment procedure.* The debt settlement process should be initiated by one of the interested parties (that is, the local government debtor or the lender). The insolvency criteria are set as the deadline for delayed payments and outstanding debt (60 days).

2. *Court review of the petition.* The court decree is published and all creditors (for example, banks, the national tax authorities, the health insurance fund, the national budget information service, and the government's administrative office) should announce their claims within 60 days. Appointed by the court, a certified debt manager (trustee) takes over control over the financial decisions of the local government. The mortgages, liens, and other potential legal actions by the lenders should be suspended until the debt settlement process is completed.

3. *A debt adjustment committee* is established by the local government, which prepares all the financial decisions under the guidance of the appointed debt manager. A crisis management budget is also drafted by the committee for the approval of the local council.

4. The *budget developed for managing the financial crisis* should be adopted within 60 days. As the trustee authorizes the payments from the local budget, the basic services (for example, core municipal administration, the mandatory public services, and the key utility services) are specified by law and have priority. If this emergency budget is not approved by the council, then the court will decide on the local government assets.

5. Formulating the *financial reorganization plan* and the proposed agreement. Based on the approved crisis budget, the debt manager prepares the financial recovery plan and the proposals for debt settlement with the creditors.

6. *Debt agreement negotiations* are launched and the signed agreements are approved by the court. Once all the negotiations are closed, the debt settlement procedure is terminated by court decision.

7. *Asset liquidation if no agreement is reached.* If there is no approved local crisis management budget and financial recovery plan, the debt manager prepares a proposal on the liquidation of municipal assets for debt settlement, which is submitted to the court for approval. If no agreement is reached during this 270-day procedure, the council is dissolved by the Parliament and new municipal elections are held.

The formal debt consolidation procedures had to be implemented in Hungary only in 75 cases at 69 municipalities between 1996 and 2017 (out of more than 3,000 municipalities). Usually smaller municipalities with limited own source revenue base, lacking proper financial management and audit practices or venturing with private businesses were subject of the law. Despite the legal obligation, municipalities with unpaid bills beyond 90 days do not tend to initiate the formal debt consolidation process (according to the National State Audit report in 2012-2016, there were 514 municipalities with arrears, ASZ, 2018)

The rather straightforward and manageable local insolvency procedure was made weightless by the consolidation of local government debt. This highly political process was implemented in three stages. First, the county local government debt was taken over by the national budget in 2012. It coincided with the nationalization of hospitals, polyclinics formerly operated by the county governments.

This was followed by the second stage in 2013, with the full restructuring of the debt of municipalities with population under 5,000, and a partial debt consolidation of the larger municipalities. Approximately 60 percent of the smaller municipalities were subject to debt bailout. For these smaller municipalities, the actual amount of debt was only 6 percent of total local government debt, and the foreign currency exposure was also lower (31 percent of total debt). This was not a serious burden on the national budget. Finally, in February 2014, two months before the national elections, the remaining debt of the larger municipalities was either paid off or taken over by the national budget.

Throughout the three stages, the following debt was excluded: the loans for co-financing and pre-financing the EU-funded projects; guarantees issued by local governments, the liabilities toward nonfinancial institutions and the delayed payments. The former loans for liquidity purposes were also transformed to bank loans and became part of the consolidation packages.

Debt consolidation was implemented in two ways: (a) local governments received national budget grants for loan repayment; or (b) a tripartite agreement was developed when the Hungarian State Treasury replaced the former debtor local government in its contract with a bank lender.

There were 1,176 municipalities that had no debt and that did not benefit from the debt consolidation program. They were, however, compensated by a special national government grant program in 2014.

Poland

There are no bankruptcy regulations in Poland. Two municipalities with extremely high debt were reported in 2013. Their debt increased at the uncontrollable rate of 2.5 times of their annual budget. They could not repay, even if some of the borrowed amount was deposited in “para-banks”. To keep their debt under control the municipalities had to apply for central government loans. (Ostachowski, 2019)

United Kingdom

The Local Government Finance Act (1988) obliges the local finance officer to initiate the insolvency process. The responsible finance officer should report any unlawful activities and when it “appears” the expenditures in a financial year is likely to exceed the available resources (including borrowed funds). In the period after the financial crisis this provision was used only in the case of one local authority (Northamptonshire County Council in 2017).

The council had to develop a consolidation plan to manage the overspending. Emergency spending limits were introduced for all expenditures beyond the statutory local services. A property rationalization plan was approved and the newly built council building was proposed to be put up for sale. Later an independent commissioner was appointed who took over the council’s powers in governance, appointment of officers and for making strategic financial decisions.

In the case of PWLB loans, the Board’s operational rules sets the management of overdue payments. The amount paid with delay are charged with an interest of official Bank rate, as it

is defined by late payment regulations. The relevant government agency might reduce local authority payments to compensate PWLB directly or can reduce local debt to other creditors.

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Annexes

Annex 1. Municipal budgets in Turkey

Table A: Municipal expenditures and revenues

Municipality Total	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	000 TL
Expenditures	31 012 132	34 474 935	41 132 755	46 988 113	59 964 440	63 266 220	73 756 957	91 269 961	112 048 078	136 127 444	
Compensation of Em	6 429 912	6 961 389	7 579 178	8 212 752	9 083 774	9 895 429	10 879 060	12 290 220	12 917 332	14 588 451	
Govern. Premiums to	978 137	1 191 385	1 289 262	1 329 199	1 465 719	1 611 617	1 742 152	1 970 590	2 076 175	2 329 674	
Good and Service Pu	10 486 169	12 247 627	15 296 432	18 552 457	22 969 162	24 852 967	31 665 780	38 479 212	46 216 373	54 197 775	
Interest Expenditures	1 004 952	1 043 586	1 074 701	1 189 199	1 129 888	1 497 643	1 663 875	1 949 798	2 896 520	4 321 565	
Current Transfers	1 619 737	1 967 553	1 887 236	1 861 478	2 269 259	2 650 298	3 118 339	3 721 403	4 249 003	5 188 102	
Capital Expenditures	8 650 100	9 548 125	11 398 589	13 849 438	20 346 776	20 478 879	22 299 065	29 635 313	40 858 656	52 624 219	
Capital Transfers	519 968	115 196	849 903	527 250	671 802	849 497	1 012 287	933 785	1 121 681	869 343	
Lending	1 323 157	1 400 074	1 757 454	1 466 340	2 028 060	1 429 890	1 376 399	2 289 640	1 712 338	2 008 314	
Revenues	26 844 961	34 233 863	40 740 227	45 131 525	53 931 284	62 544 796	72 159 838	80 994 408	97 148 981	111 996 855	
Taxes	3 631 028	5 854 566	6 878 140	7 232 437	8 196 251	9 283 644	10 839 017	12 225 548	13 217 357	14 034 228	
Property Income	4 123 985	4 824 058	5 365 883	6 505 295	7 997 458	6 739 057	7 474 956	8 426 757	11 585 675	13 837 845	
Grants and Aids and	375 120	444 597	626 713	645 662	817 549	1 109 552	1 475 922	1 621 091	1 981 842	2 238 588	
Interest, Shares and f	16 787 113	20 408 332	24 391 216	27 437 036	31 879 490	38 709 149	47 302 390	52 173 000	62 144 191	72 562 074	
Capital Revenues	1 243 331	2 533 815	3 351 272	2 988 174	4 954 769	3 448 302	4 908 445	5 838 798	7 879 786	8 669 842	
Collections from Loan	684 384	168 495	127 003	322 921	85 767	3 255 092	159 108	709 214	340 130	654 278	
Budget Balance	-4 167 171	-241 072	-392 528	-1 856 588	-6 033 156	-721 424	-1 597 119	-10 275 553	-14 899 097	-24 130 589	

Table B: Metropolitan municipalities' budget

Metropolitan Municipalities	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	000 TL
Expenditures	13.662.594	13.836.250	15.570.973	16.837.380	22.681.953	30.376.234	35.130.964	45.389.187	56.690.752	67.728.370	
Compensation of Employees	1.300.164	1.369.619	1.585.518	1.811.987	1.969.819	3.082.843	3.473.337	3.902.741	4.019.313	4.594.514	
Govern. Premiums to Social Security Agencies	215.795	251.325	273.531	287.130	308.463	483.625	546.592	615.872	634.460	730.108	
Good and Service Purchase	3.195.186	3.397.423	4.100.762	4.764.440	6.097.047	8.691.878	11.830.744	14.918.046	17.757.246	19.496.621	
Interest Expenditures	710.389	725.174	669.269	746.285	593.749	889.864	902.409	1.094.178	1.797.241	2.791.102	
Current Transfers	839.004	1.007.278	990.042	928.984	1.270.381	1.606.878	2.063.199	2.409.467	2.716.755	3.355.013	
Capital Expenditures	5.639.049	5.704.227	5.469.735	6.406.341	9.715.562	13.586.856	13.983.178	19.545.401	27.326.047	34.434.638	
Capital Transfers	466.575	20.827	757.579	486.796	722.447	672.174	1.020.101	691.376	850.510	457.941	
Lending	1.296.432	1.360.377	1.724.537	1.405.417	2.004.485	1.362.116	1.311.404	2.212.106	1.589.180	1.868.434	
Revenues	11.335.294	13.322.111	15.560.584	17.228.427	20.719.833	29.823.555	33.181.095	37.911.916	46.170.934	55.535.605	
Taxes	249.378	286.067	333.122	256.984	325.508	446.920	488.616	601.396	660.227	667.418	
Property Income	1.348.917	1.397.509	1.302.592	1.893.212	2.906.943	2.913.070	3.444.479	3.530.230	5.613.741	7.659.141	
Grants and Aids and Special Revenues	37.992	58.613	120.000	159.071	137.647	147.761	281.443	256.516	237.347	511.902	
Interest, Shares and Fines	8.554.912	10.006.684	11.928.431	13.663.037	15.729.870	22.003.872	26.954.911	30.457.024	36.277.814	43.107.294	
Capital Revenues	465.096	1.405.948	1.750.415	934.480	1.535.329	1.057.348	1.867.612	2.365.579	3.050.374	2.935.572	
Collections from Loans	678.999	167.290	126.024	321.643	84.536	3.254.584	144.034	701.171	331.431	654.278	
Budget Balance	-2.327.300	-514.139	-10.389	391.047	-1.962.120	-552.679	-1.949.869	-7.477.271	-10.519.818	-12.192.765	
Borrowing Limit	17.002.941	19.983.167	23.340.876	25.842.641	31.079.750	44.735.333	49.771.643	56.867.874	69.256.401	83.303.408	
Budget Balance without capital expenditures	3.311.749	5.190.088	5.459.346	6.797.388	7.753.442	13.034.177	12.033.309	12.068.130	16.806.229	22.241.873	
Compensation of Employees / Taxes (%)	521,4	478,8	476,0	705,1	605,2	689,8	710,9	648,9	608,8	688,4	
Capital Expenditures / Revenue shares (%)	65,9	57,0	45,9	46,9	61,8	61,7	51,9	64,2	75,3	79,9	

Metropolitan Municipalities											% Distribution
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
Expenditures	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Compensation of Employees	9,5	9,9	10,2	10,8	8,7	10,1	9,9	8,6	7,1	6,8	
Govern. Premiums to Social Security Agencies	1,6	1,8	1,8	1,7	1,4	1,6	1,6	1,4	1,1	1,1	
Good and Service Purchase	23,4	24,6	26,3	28,3	26,9	28,6	33,7	32,9	31,3	28,8	
Interest Expenditures	5,2	5,2	4,3	4,4	2,6	2,9	2,6	2,4	3,2	4,1	
Current Transfers	6,1	7,3	6,4	5,5	5,6	5,3	5,9	5,3	4,8	5,0	
Capital Expenditures	41,3	41,2	35,1	38,0	42,8	44,7	39,8	43,1	48,2	50,8	
Capital Transfers	3,4	0,2	4,9	2,9	3,2	2,2	2,9	1,5	1,5	0,7	
Lending	9,5	9,8	11,1	8,3	8,8	4,5	3,7	4,9	2,8	2,8	
Revenues	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	
Taxes	2,2	2,1	2,1	1,5	1,6	1,5	1,5	1,6	1,4	1,2	
Property Income	11,9	10,5	8,4	11,0	14,0	9,8	10,4	9,3	12,2	13,8	
Grants and Aids and Special Revenues	0,3	0,4	0,8	0,9	0,7	0,5	0,8	0,7	0,5	0,9	
Interest, Shares and Fines	75,5	75,1	76,7	79,3	75,9	73,8	81,2	80,3	78,6	77,6	
Capital Revenues	4,1	10,6	11,2	5,4	7,4	3,5	5,6	6,2	6,6	5,3	
Collections from Loans	6,0	1,3	0,8	1,9	0,4	10,9	0,4	1,8	0,7	1,2	

Table C: Province Municipalities other than Metropolitan municipalities' budget

Province Municipalities Other Than Metropolitan Municipalities											000 TL
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
Expenditures	3.262.669	3.872.080	4.901.245	5.607.952	7.078.819	4.358.653	5.153.172	6.364.938	8.089.462	10.326.472	
Compensation of Employees	982.900	1.042.198	1.101.478	1.117.844	1.256.888	914.346	1.005.802	1.139.026	1.191.333	1.387.083	
Govern. Premiums to Social Security Agencies	147.871	183.788	199.726	195.582	218.461	156.457	168.603	198.384	203.102	234.204	
Good and Service Purchase	1.302.278	1.627.621	2.036.898	2.473.867	3.049.785	1.987.198	2.400.309	2.904.236	3.545.871	4.387.764	
Interest Expenditures	97.067	90.368	108.175	112.416	149.661	141.133	232.640	192.897	207.404	301.584	
Current Transfers	135.713	166.234	138.018	161.481	190.224	119.990	157.776	237.387	235.470	258.679	
Capital Expenditures	581.203	720.345	1.280.962	1.515.781	2.182.838	1.012.800	1.156.816	1.645.416	2.638.306	3.693.116	
Capital Transfers	12.060	36.243	25.420	18.505	19.521	17.780	31.191	35.042	67.198	58.558	
Lending	3.577	5.283	10.568	12.476	11.441	8.949	35	12.550	778	5.485	
Revenues	2.917.161	3.872.328	4.518.688	5.183.880	6.412.220	4.362.365	5.315.121	6.006.549	7.213.268	8.296.437	
Taxes	400.010	587.048	595.026	661.356	744.814	514.808	576.961	625.577	707.924	748.989	
Property Income	853.257	1.068.781	1.237.736	1.448.565	1.593.223	978.124	1.132.689	1.346.568	1.514.379	1.642.658	
Grants and Aids and Special Revenues	41.877	51.810	92.869	72.561	72.400	80.211	113.772	159.818	270.662	279.278	
Interest, Shares and Fines	1.507.771	2.038.648	2.412.481	2.742.717	3.534.739	2.610.923	3.210.586	3.579.638	4.377.536	5.122.247	
Capital Revenues	113.287	125.658	180.576	258.681	467.044	178.249	281.113	294.948	342.767	503.265	
Collections from Loans	959	383	0	0	0	50	0	0	0	0	
Budget Balance	-345.508	248	-382.557	-424.072	-666.599	3.712	161.949	-358.389	-876.194	-2.030.035	
Borrowing Limit	2.917.161	3.872.328	4.518.688	5.183.880	6.412.220	4.362.365	5.315.121	6.006.549	7.213.268	8.296.437	
Budget Balance without capital expenditures	235.695	720.593	898.405	1.091.709	1.516.239	1.016.512	1.318.765	1.287.027	1.762.112	1.663.081	
Compensation of Employees / Taxes (%)	245,7	177,5	185,1	169,0	168,8	177,6	174,3	182,1	168,3	185,2	
Capital Expenditures / Revenue shares (%)	38,5	35,3	53,1	55,3	61,8	38,8	36,0	46,0	60,3	72,1	

Province Municipalities Other Than Metropolitan Municipalities											% Distribution
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
Expenditures	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Compensation of Employees	30,1	26,9	22,5	19,9	17,8	21,0	19,5	17,9	14,7	13,4	
Govern. Premiums to Social Security Agencies	4,5	4,7	4,1	3,5	3,1	3,6	3,3	3,1	2,5	2,3	
Good and Service Purchase	39,9	42,0	41,6	44,1	43,1	45,6	46,6	45,6	43,8	42,5	
Interest Expenditures	3,0	2,3	2,2	2,0	2,1	3,2	4,5	3,0	2,6	2,9	
Current Transfers	4,2	4,3	2,8	2,9	2,7	2,8	3,1	3,7	2,9	2,5	
Capital Expenditures	17,8	18,6	26,1	27,0	30,8	23,2	22,4	25,9	32,6	35,8	
Capital Transfers	0,4	0,9	0,5	0,3	0,3	0,4	0,6	0,6	0,8	0,6	
Lending	0,1	0,1	0,2	0,2	0,2	0,2	0,0	0,2	0,0	0,1	
Revenues	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	
Taxes	13,7	15,2	13,2	12,8	11,6	11,8	10,9	10,4	9,8	9,0	
Property Income	29,2	27,6	27,4	27,9	24,8	22,4	21,3	22,4	21,0	19,8	
Grants and Aids and Special Revenues	1,4	1,3	2,1	1,4	1,1	1,8	2,1	2,7	3,8	3,4	
Interest, Shares and Fines	51,7	52,6	53,4	52,9	55,1	59,9	60,4	59,6	60,7	61,7	
Capital Revenues	3,9	3,2	4,0	5,0	7,3	4,1	5,3	4,9	4,8	6,1	
Collections from Loans	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	

Table D: Town and Borough Municipalities' budget

Towns and Boroughs Municipalities	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	000 TL
Expenditures	14.123.326	16.801.958	20.716.418	24.663.322	30.480.918	28.971.669	34.489.640	39.658.165	47.381.358	58.072.601	
Compensation of Employees	4.146.848	4.549.572	4.892.182	5.282.921	5.857.067	5.898.240	6.399.921	7.248.453	7.706.686	8.606.854	
Govern. Premiums to Social Security Age	614.471	756.272	816.005	846.487	938.795	971.535	1.026.957	1.156.334	1.238.613	1.365.362	
Good and Service Purchase	5.988.705	7.222.583	9.158.772	11.314.150	13.822.330	14.173.891	17.434.727	20.656.930	24.913.256	30.313.389	
Interest Expenditures	197.496	228.044	297.257	330.498	386.478	466.646	528.826	662.723	891.875	1.228.880	
Current Transfers	680.977	824.584	810.548	821.586	896.439	1.290.198	1.600.517	1.124.383	1.349.719	1.574.409	
Capital Expenditures	2.429.848	3.123.553	4.647.892	5.927.316	8.448.376	5.879.223	7.159.071	8.444.496	10.894.303	14.496.466	
Capital Transfers	41.833	62.936	71.413	91.917	119.299	233.111	274.661	299.862	264.526	352.844	
Lending	23.148	34.414	22.349	48.447	12.134	58.825	64.960	64.984	122.380	134.396	
Revenues	12.592.506	17.039.424	20.660.955	22.719.218	26.799.231	28.403.020	33.761.172	37.224.648	43.922.940	48.164.812	
Taxes	2.981.640	4.981.451	5.949.992	6.314.097	7.125.929	8.321.916	9.773.440	10.998.575	11.849.206	12.617.821	
Property Income	1.921.811	2.357.768	2.825.555	3.163.518	3.497.292	2.847.863	2.897.788	3.549.959	4.457.555	4.536.046	
Grants and Aids and Special Revenues	295.251	334.174	413.844	414.030	607.502	925.724	1.144.766	1.300.963	1.547.330	1.447.408	
Interest, Shares and Fines	6.724.430	8.363.000	10.050.304	11.031.282	12.614.881	14.094.354	17.170.384	18.188.837	21.573.505	24.332.533	
Capital Revenues	664.948	1.002.209	1.420.281	1.795.013	2.952.396	2.212.705	2.759.720	3.178.271	4.486.645	5.231.005	
Collections from Loans	4.426	822	979	1.278	1.231	458	15.074	8.043	8.699		
Budget Balance	-1.530.820	237.466	-55.463	-1.944.104	-3.681.687	-568.649	-728.468	-2.433.517	-3.458.418	-9.907.789	
Borrowing Limit	12.592.506	17.039.424	20.660.955	22.719.218	26.799.231	28.403.020	33.761.172	37.224.648	43.922.940	48.164.812	
Budget Balance without capital expenditures	899.028	3.361.019	4.592.429	3.983.212	4.766.689	5.310.574	6.430.603	6.010.979	7.435.885	4.588.677	
Compensation of Employees / Taxes (%)	139,1	91,3	82,2	83,7	82,2	70,9	65,5	65,9	65,0	68,2	
Capital Expenditures / Revenue shares (%)	36,1	37,3	46,2	53,7	67,0	41,7	41,7	46,4	50,5	59,6	

Towns and Boroughs Municipalities	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	% Distribution
Expenditures	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Compensation of Employees	29,4	27,1	23,6	21,4	19,2	20,4	18,6	18,3	16,3	14,8	
Govern. Premiums to Social Security Agencies	4,4	4,5	3,9	3,4	3,1	3,4	3,0	2,9	2,6	2,4	
Good and Service Purchase	42,4	43,0	44,2	45,9	45,3	48,9	50,6	52,1	52,6	52,2	
Interest Expenditures	1,4	1,4	1,4	1,3	1,3	1,6	1,5	1,7	1,9	2,1	
Current Transfers	4,8	4,9	3,9	3,3	2,9	4,5	4,6	2,8	2,8	2,7	
Capital Expenditures	17,2	18,6	22,4	24,0	27,7	20,3	20,8	21,3	23,0	25,0	
Capital Transfers	0,3	0,4	0,3	0,4	0,4	0,8	0,8	0,8	0,6	0,6	
Lending	0,2	0,2	0,1	0,2	0,0	0,2	0,2	0,2	0,3	0,2	
Revenues	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	
Taxes	23,7	29,2	28,8	27,8	26,6	29,3	28,9	29,5	27,0	26,2	
Property Income	15,3	13,8	13,7	13,9	13,0	10,0	8,6	9,5	10,1	9,4	
Grants and Aids and Special Revenues	2,3	2,0	2,0	1,8	2,3	3,3	3,4	3,5	3,5	3,0	
Interest, Shares and Fines	53,4	49,1	48,6	48,6	47,1	49,6	50,9	48,9	49,1	50,5	
Capital Revenues	5,3	5,9	6,9	7,9	11,0	7,8	8,2	8,5	10,2	10,9	
Collections from Loans	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	

Annex 2: Debt figures used by General Directorate of Accounting and Financial Control between 2009-2017

Data for 2016 and 2017 is generated from balance sheet data for same period.

	MUCIPALITIES DEBTS											000 TL
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
SHORT-TERM LIABILITIES												
SHORT-TERM DOMESTIC FINANCIAL LIABILITIES	3.521.183	3.839.342	5.489.711	5.895.647	6.643.522	6.519.578	8.065.019	4.976.382	3.483.534	4.303.993	5.413.065	7.805.753
300 BANK CREDITS	505.079	1.062.692	1.507.081	1.573.217	1.969.977	1.812.416	1.958.590	2.452.478	2.481.562	3.066.027	3.871.564	4.745.989
303 FINANCIAL DEBTS TO PUBLIC ADMINISTRATIONS	3.003.360	2.765.242	3.965.168	4.297.984	4.650.463	4.681.050	6.009.976	2.499.635	982.995	1.222.220	1.529.152	2.037.261
309 SHORT-TERM OTHER DOMESTIC FINANCIAL LIABILITIES	12.744	11.407	17.463	24.446	23.082	26.113	96.454	24.269	18.978	15.746	12.349	1.022.503
OPERATING LIABILITIES	2.948.380	4.230.379	5.560.957	5.762.399	6.130.405	6.097.897	6.716.402	8.718.668	9.867.970	11.450.412	13.224.574	18.655.829
320 BUDGET ESCROW ACCOUNT	2.927.650	4.226.860	5.554.812	5.754.626	6.105.832	6.067.165	6.690.296	8.660.431	9.837.124	11.404.819	13.165.621	18.544.552
322 PAYABLES TO BE BUDGETED	20.730	3.519	6.146	7.773	24.572	30.732	26.106	58.237	30.845	36.669	53.886	106.991
ESCROW FOREIGN RESOURCES	913.287	1.111.952	1.404.980	2.060.609	2.109.533	2.361.970	2.298.566	2.594.277	3.017.038	4.305.484	5.874.568	7.989.089
330 DEPOSITS AND PROVISIONS	309.042	356.971	479.426	596.698	639.747	793.730	919.418	1.103.009	1.163.529	1.308.916	1.659.505	2.186.985
333 ESCROWS	604.245	754.982	925.553	1.463.371	1.469.786	1.568.240	1.379.147	1.491.268	1.853.509	2.996.569	4.215.063	5.802.104
ADVANCES RECEIVED	168	23	32.758	34.397	33.327	33.822	1.687	47.451	57.615	61.850	56.275	61.391
340 RECEIVED ORDERS ADVANCES	83	21	31.389	32.260	33.303	33.821	1.661	47.445	57.487	61.716	53.763	60.495
349 RECEIVED OTHER ADVANCES	85	2	1.369	2.136	24	1	26	7	128	134	2.513	896
OTHER OBLIGATIONS TO BE PAID	3.986.372	4.006.318	5.258.591	5.530.796	6.695.054	6.542.128	6.837.183	7.407.639	8.030.217	9.237.196	7.831.150	8.354.005
360 TAXES AND FUNDS PAYABLE	738.510	917.038	1.168.928	1.287.032	1.586.110	1.241.534	1.204.147	1.326.664	1.317.897	1.577.549	1.267.402	1.426.513
361 SOCIAL SECURITY PREMIUMS PAYABLE	1.102.199	1.210.865	1.782.006	1.534.410	1.961.672	1.725.192	1.736.940	1.809.923	1.772.448	2.022.930	1.484.669	1.420.678
362 COLLECTIONS OF FUNDS MADE ON BEHALF OF OTHER PUBLIC	183.835	277.944	360.306	407.595	512.975	524.357	690.447	791.082	930.227	1.091.840	1.018.086	1.072.122
363 SHARE OF PUBLIC ADMINISTRATIONS	580.428	508.225	490.316	477.738	409.054	392.893	416.467	406.248	472.261	414.557	385.658	565.574
368 PAST DUE DEFERRED OR INSTALLED TAX AND LIABILITIES	1.381.400	1.092.245	1.457.036	1.824.022	2.225.243	2.658.153	2.789.182	3.073.722	3.537.384	4.130.321	3.675.334	3.869.118
DEBT AND EXPENSE PROVISIONS	11.022	20.521	26.261	30.991	57.686	65.190	146.157	189.868	267.656	434.918	556.532	689.327
372 PROVISION FOR SEVERANCE PAY	8.057	16.477	21.427	26.138	32.452	36.255	111.415	180.886	261.940	407.850	516.456	633.022
379 OTHER LIABILITIES AND EXPENSE PROVISIONS	2.965	4.045	4.835	4.853	25.234	28.935	34.742	8.982	5.716	27.068	40.075	56.304
FUTURE INCOME AND EXPENSE ACCOUNT	47.862	112.915	106.640	166.652	93.149	115.021	159.767	1.607.923	299.288	661.629	1.095.746	2.172.548
380 INCOME ACCOUNT FOR COMING MONTHS	180	1.633	2.663	4.930	4.566	6.019	4.322	5.647	4.193	73.398	154.422	222.662
381 EXPENSE ACCRUALS ACCOUNT	47.683	111.282	103.976	161.722	88.584	109.002	155.445	1.602.276	295.095	588.231	941.324	1.949.886
OTHER SHORT-TERM LIABILITIES	14	20	2.554	5.778	2.278	2.672	125.061	186.091	236.123	365.449	160.244	85.216
397 COUNTING SURPLUS	4	10	2.544	5.768	2.278	2.668	22.906	19.524	15.824	209.132	103.279	27.287
399 OTHER VARIOUS SHORT-TERM LIABILITIES	10	10	10	10	0	4	91.505	133.722	184.923	156.317	56.964	57.929
SHORT TERM DOMESTIC DEBTS TOTAL	11.428.288	13.321.470	17.882.452	19.486.729	21.764.954	21.738.279	24.349.841	25.728.299	25.259.439	31.717.236	45.265.705	60.451.427
LONG TERM DOMESTIC FINANCIAL PAYABLES	7.657.918	11.742.240	9.489.923	10.665.461	14.971.371	12.209.956	12.167.131	13.279.299	17.066.962	18.524.356	22.699.918	30.233.007
400 BANK CREDITS	803.130	1.125.188	2.705.073	3.942.711	3.906.362	4.451.012	5.403.414	8.397.733	10.070.439	10.940.831	13.976.624	20.627.338
403 FINANCIAL LIABILITIES TO PUBLIC ADMINISTRATIONS	6.374.100	10.115.364	6.166.769	6.027.216	10.483.013	7.134.916	6.234.967	4.831.516	6.969.818	7.559.310	8.696.573	9.524.443
409 LONG TERM OTHER DOMESTIC FINANCIAL LIABILITIES	480.688	501.687	618.081	695.534	581.996	624.028	528.750	50.050	26.705	24.215	26.721	81.236
OTHER DEBTS	355.290	506.296	631.897	779.265	887.401	1.160.145	1.359.320	1.352.869	1.629.591	1.986.045	5.116.061	5.856.228
430 DEPOSITS AND WARRANTS RECEIVED	16.326	18.639	22.338	22.776	23.444	20.026	31.630	32.300	27.019	29.684	61.503	98.880
438 DEFERRED OR INSTALLED DEBTS TO PUBLIC SECTOR	338.964	487.657	609.560	756.490	863.957	1.140.118	1.327.690	1.320.570	1.602.572	1.947.880	5.054.558	5.757.349
ADVANCES RECEIVED	74.724	78.756	25.000	32.102	47.665	74.118	71.967	97.916	25.547	25.337	32.341	34.746
440 RECEIVED ADVANCES	27.783	29.981	25.000	32.102	47.665	74.118	71.967	97.916	25.547	25.337	32.341	34.746
449 OTHER ADVANCES	46.941	48.775	109.606	140.832	184.172	185.024	513.119	97.386	25.002	25.002	32.007	34.746
DEBT AND EXPENSE PROVISIONS	54.961	94.424	102.581	134.728	178.394	179.149	506.729	630.101	958.727	1.522.160	3.421.487	3.977.729
472 PROVISIONS FOR SEVERANCE PAY	46.267	87.274	7.025	6.105	5.778	5.875	6.390	623.367	935.247	1.491.923	3.381.420	3.920.011
479 OTHER DEBT AND EXPENSE PROVISIONS	8.694	7.149	143.543	178.029	172.167	317.618	661.849	6.733	23.480	30.237	40.066	57.718
CURRENT INCOME AND EXPENSE ACCOUNTS	122.648	124.539	10.241	9.927	10.119	14.331	14.512	2.831.886	2.812.599	3.604.253	5.413.610	9.696.994
480 INCOME FOR THE FUTURE YEARS	2.245	3.789	133.302	168.101	162.049	303.286	647.337	37.271	36.156	332.864	521.099	970.060
481 EXPENSE ACCRUALS	120.402	120.750	370	505	508	8	23.558	2.794.615	2.776.443	3.271.389	4.892.511	8.726.935
OTHER LONG-TERM LIABILITIES	0	370	370	505	508	8	23.558	61.012	40.568	38.336	101.448	115.033
499 OTHER LONG-TERM LIABILITIES	0	370	370	505	508	8	23.558	61.012	40.568	38.336	101.448	115.033
LONG TERM DOMESTIC DEBTS TOTAL	8.265.541	12.546.625	10.400.340	11.796.194	16.263.284	13.946.868	14.796.945	18.253.083	22.533.995	34.091.385	50.974.938	67.370.179
DOMESTIC DEBT TOTAL	19.693.829	25.868.094	28.282.792	31.282.923	38.028.238	35.685.147	39.146.786	43.981.382	47.793.434	65.808.621	96.240.644	127.821.606
SHORT-TERM FOREIGN CURRENCY FINANCIAL LIABILITIES	59.366	101.532	164.293	163.841	231.216	396.622	527.166	852.721	788.322	1.039.600	1.171.681	1.362.567
310 FOREIGN CURRENCY PAYABLES TO BE PAID IN CURRENT YEAR	59.366	101.532	164.293	163.841	231.216	396.622	527.166	852.721	788.322	1.039.600	1.171.681	1.362.567
SHORT TERM FOREIGN CURRENCY DEBT	59.366	101.532	164.293	163.841	231.216	396.622	527.166	852.721	788.322	1.039.600	1.171.681	1.362.567
LONG TERM EXTERNAL FINANCIAL LIABILITIES	869.367	1.129.127	2.535.670	3.545.971	4.806.611	5.899.312	5.657.817	5.960.267	5.496.437	6.016.749	8.041.839	9.890.883
410 EXTERNAL FINANCIAL LIABILITIES	869.367	1.129.127	2.535.670	3.545.971	4.806.611	5.899.312	5.657.817	5.960.267	5.496.437	6.016.749	8.041.839	9.890.883
LONG TERM FOREIGN CURRENCY DEBT	869.367	1.129.127	2.535.670	3.545.971	4.806.611	5.899.312	5.657.817	5.960.267	5.496.437	6.016.749	8.041.839	9.890.883
EXTERNAL DEBT TOTAL	928.733	1.230.659	2.699.963	3.709.812	5.037.827	6.295.934	6.184.983	6.812.989	6.284.759	7.056.349	9.213.520	11.253.449
TOTAL DEBT	20.622.562	27.098.753	30.982.755	34.992.736	43.066.065	41.981.080	45.331.769	50.794.371	54.078.193	72.864.970	105.454.163	139.075.056
TOTAL BANK CREDITS	1.308.209	2.187.880	4.212.154	5.515.928	5.876.339	6.263.427	7.362.003	10.850.211	12.552.001	14.006.858	17.848.187	25.373.317
BANK CREDITS / TOTAL DEBT (%)	6,3	8,1	13,6	15,8	13,6	14,9	16,2	21,4	23,2	19,2	16,9	18,2
FINANCIAL DEBT TO PUBLIC INSTITUTIONS	13.363.832	16.886.925	15.390.529	15.855.996	21.828.530	18.358.094	19.082.126	14.738.790	15.983.030	18.018.726	18.056.875	19.915.708
FINANCIAL DEBT TO PUBLIC INSTITUTIONS / TOTAL DEBT (%)	64,8	62,3	49,7	45,3	50,7	43,7	42,1	29,0	29,6	24,7	17,1	14,3

Annex 3. Commonly used underlying contracts for Sukuk

Excerpts from Oguz - Kopanyi, 2016

Ijarah refers to a lease or commission contract that involves an exchange of usufruct or benefits of an asset or a service for rent or commission for an agreed period. In the context of Islamic finance, the Ijarah concept is usually applicable in financing contracts such as in real property financing, vehicle financing, project financing and personal financing. It can also enable customers to lease assets from the Islamic financial institutions with an option to acquire the leased assets at the end of the lease tenure based on the concept of Ijarah muntahia bi al-tamlik or al-Ijarah thumma al-bai`

Istisna` is a contract of sale and purchase involving manufacturing, producing or constructing a particular asset according to certain terms and specifications as agreed between the seller, the manufacturer/developer and the customer. In the current context, istisna` is normally applied in the construction and manufacturing sectors.

Mudarabah is a contract between two parties to conduct a particular joint venture. It involves the rabbul mal as the investor who provides the capital, and the Mudarib as the entrepreneur who manages the joint venture. Any profits generated from the joint venture will be shared between the investor and the entrepreneur based on the agreed terms and ratio, whereas any losses will be solely borne by the investor.

Musyarakah is a contract of partnership between two parties or more to finance a particular business joint venture whereby all parties contribute the capital either in the form of cash or others. Any profits incurred from the partnership will be shared amongst them based on an agreed ratio, whereas any losses incurred will be borne by them according to their ratio of respective capital contribution.

Musyarakah mutanaqisah (Diminishing Musyarakah) is as follows: i. A customer who wants to buy a real property applies for financing from the Islamic financial institution; ii. The Islamic financial institution and the customer will jointly purchase the real property based on a determined share (for example 90:10) depending on the amount of financing requested; iii. The deposit paid by the customer is deemed as his initial share of ownership; iv. The Islamic financial institution's share of ownership will be leased (based on Ijarah) to the customer; and v. The monthly installment by the customer will be used to gradually purchase the share of the Islamic financial institution until the entire share of the Islamic financial institution is fully purchased by the customer.

Tawarruq refers to a mu`amalah with two stages of transactions. At the first stage, the buyer will purchase an asset on credit from the original seller, and at the second stage, the buyer will then sell the asset on cash basis to a third party. It is named as tawarruq because the buyer purchased the asset on credit with no intention of utilizing or benefiting from it, rather to sell it to obtain cash. Tawarruq, which is also known as commodity Murabaha, is widely used in deposit products, financing, asset and liability management as well as risk management.

Wakalah is an agency contract in which a party mandates another party as his agent to perform a particular task. In the current context of Islamic finance, the customer normally appoints a financial institution as his agent to conduct a particular mu`amalah transaction and in return, the financial institution will receive a fee for the service.²⁸

²⁸ Bank Negara Malaysia- BN

Annex 4. Treasury info

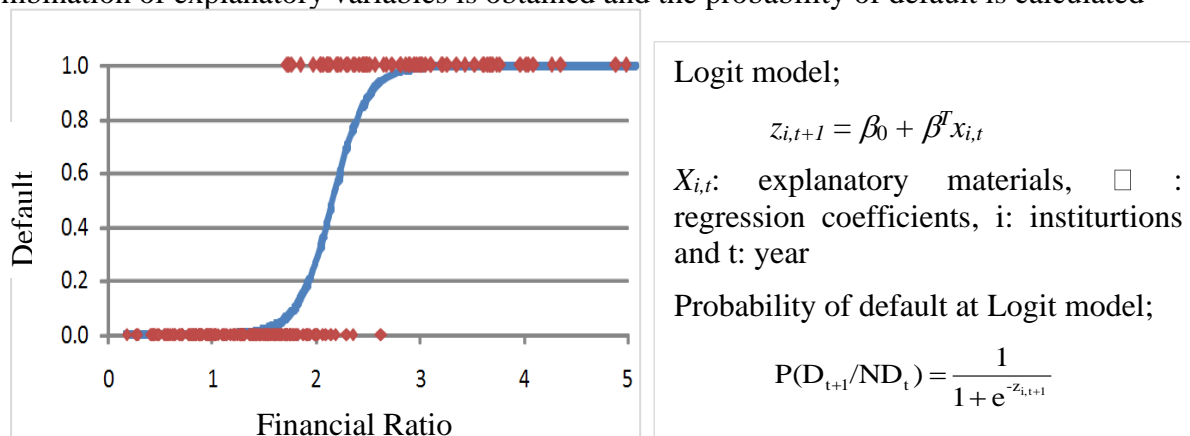
2011 Public Debt Management Report

Credit Rating Model

“Internal Credit Rating Model” has been used in order to effectively manage the credit risks of Treasury arising from Treasury guarantees, on-lent credits and receivables since 2006. The model covers four major types of beneficiaries: SOEs (State Owned Enterprises), municipalities, municipal administrations and banks.

The model estimates the default probabilities of institutions by using their financial ratios and past payment performances. The model is based on the combination of two definitions of default probability. The first one is the probability of default at time t given that the subject entity has defaulted during time $t-1$ ($P(D/D)$) and this probability is calculated using past payment performances for each institution. The second one is the probability of default at time t , given the entity has not defaulted during time $t-1$ ($P(D/ND)$). It is calculated by score models based on financial information of the respective institutions. The credit score models are recalculated with new financials regularly (every five years). In this context, the coefficients of the model were updated in 2015.

Logistic regression, which is developed for situations when the dependent variable is a binary response, is used to explain default probabilities using financial variables. The logistic regression uses the Maximum Likelihood Estimation (MLE) for calculating the optimum solution. Using the results of the logistic regression, a score which is a weighted linear combination of explanatory variables is obtained and the probability of default is calculated



Using the estimates for probability of default given default and probability of default given non-default, the combined probability of default for a beneficiary through the life of the loan is determined. Collection and recovery rates are then embedded in the model to reach the expected losses from each loan of the respective beneficiary.

Above mentioned model outcomes support the decision on the setting of credit risk management tools: guarantee and on-lending limits, the setting of guarantee fees, the degree of risk coverage, and appropriations to the risk account.

2011 Public Debt Management Report
Credit Rating

Credit ratings are assigned according to the institution's probability of default that is calculated by Credit Rating Model. Credit ratings form A to D are assigned to the institutions that didn't default during the previous two years, whereas the institutions that were defaulted in at least one of the last two years take E or F rating.

Credit Rating	Description	Default Status in last Two Years	Probability
A	Minimum Risk	Non-Defaulted	$P(D/ND) \leq 5\%$
B	Very Low Risk	Non-Defaulted	$5\% < P(D/ND) \leq 15\%$
C	Low Risk	Non-Defaulted	$15\% < P(D/ND) \leq 30\%$
D	Medium Risk	Non-Defaulted	$P(D/ND) > 30\%$
E	High Risk	Defaulted	$P(D/D) < 100\%$
F	Very High Risk	Defaulted	$P(D/D) = 100\%$

Consistent with the model results, past performance of the credit ratings indicates that 2 percent of the A rated institutions and 97 percent of the F rated institutions are defaulted in the consecutive year.

Annex 5. Germany: Excerpts from the Basic Law

Article 109

[Budget management in the Federation and the Länder]

(1) The Federation and the Länder shall be autonomous and independent of one another in the management of their respective budgets.

(2) The Federation and the Länder shall jointly discharge the obligations of the Federal Republic of Germany resulting from legal acts of the European Community for the maintenance of budgetary discipline pursuant to Article 104 of the Treaty Establishing the European Community and shall, within this framework, give due regard to the requirements of overall economic equilibrium.

(3) The budgets of the Federation and the Länder shall, in principle, be balanced without revenue from credits. The Federation and Länder may introduce rules intended to take into account, symmetrically in times of upswing and downswing, the effects of market developments that deviate from normal conditions, as well as exceptions for natural disasters or unusual emergency situations beyond governmental control and substantially harmful to the state's financial capacity. For such exceptional regimes, a corresponding amortisation plan must be adopted. Details for the budget of the Federation shall be governed by Article 115 with the proviso that the first sentence shall be deemed to be satisfied if revenue from credits does not exceed 0.35 per cent in relation to the nominal gross domestic product. The Länder themselves shall regulate details for the budgets within the framework of their constitutional powers, the proviso being that the first sentence shall only be deemed to be satisfied if no revenue from credits is admitted.

(4) A federal law requiring the consent of the Bundesrat may establish principles applicable to both the Federation and the Länder governing budgetary law, cyclically appropriate budgetary management and long-term financial planning.

(5) Sanctions imposed by the European Community on the basis of the provisions of Article 104 of the Treaty Establishing the European Community in the interest of maintaining budgetary discipline shall be borne by the Federation and the Länder at a ratio of 65 to 35 per cent. In solidarity, the Länder as a whole shall bear 35 per cent of the charges incumbent on the Länder according to the number of their inhabitants; 65 per cent of the charges incumbent on the Länder shall be borne by the Länder according to their degree of causation. Details shall be regulated by a federal law which shall require the consent of the Bundesrat.

Article 109a

[Budgetary emergencies]

(1) To avoid a budgetary emergency, a federal law requiring the consent of the Bundesrat shall provide for:

1. the continuing supervision of budgetary management of the Federation and the Länder by a joint body (Stability Council),
2. the conditions and procedures for ascertaining the threat of a budgetary emergency,
3. the principles for the establishment and administration of programs for taking care of budgetary emergencies.

(2) From the year 2020, oversight of compliance with the provisions of paragraph (3) of Article 109 by the Federation and the Länder shall be entrusted to the Stability Council. This oversight

shall be focused on the provisions and procedures regarding adherence to budgetary discipline from legal acts based on the Treaty on the Functioning of the European Union.

(3)The decisions of the Stability Council and the accompanying documents shall be published.

....

Article 115

[Limits of borrowing]

(1)The borrowing of funds and the assumption of surety obligations, guarantees or other commitments that may lead to expenditures in future fiscal years shall require authorisation by a federal law specifying or permitting computation of the amounts involved.

(2)Revenues and expenditures shall in principle be balanced without revenue from credits. This principle shall be satisfied when revenue obtained by the borrowing of funds does not exceed 0.35 per cent in relation to the nominal gross domestic product. In addition, when economic developments deviate from normal conditions, effects on the budget in periods of upswing and downswing must be taken into account symmetrically. Deviations of actual borrowing from the credit limits specified under the first to third sentences are to be recorded on a control account; Debits exceeding the threshold of 1.5 per cent in relation to the nominal gross domestic product are to be reduced in accordance with the economic cycle. The regulation of details, especially the adjustment of revenue and expenditures with regard to financial transactions and the procedure for the calculation of the yearly limit on net borrowing, taking into account the economic cycle on the basis of a procedure for adjusting the cycle together with the control and balancing of deviations of actual borrowing from the credit limit, requires a federal law. In cases of natural catastrophes or unusual emergency situations beyond governmental control and substantially harmful to the state's financial capacity, these credit limits may be exceeded on the basis of a decision taken by a majority of the Members of the Bundestag. The decision must be combined with an amortisation plan. Repayment of the credits borrowed under the sixth sentence must be accomplished within an appropriate period of time.

Annex 6. Hungary: Local debt settlement procedures (1996-2011)

Effective: January 1st 2000

Amendments in 2011 are not included!

Act XXV of 1996

on the Procedure of Settlement of Local government Debts²⁹

In order to restore the solvency of local governments, settle creditors' claims in proportion to the assets (abatement of debt) and ensure the uninterrupted accomplishment of local government duties during the debt settlement period, the Parliament enacts the following Act:

Chapter 1

General Provisions

Section 1: The goal of this Act is to regulate the debt settlement procedure aiming to restore the local governments' solvency, protect the creditors' rights, and, as a result of the procedure, to facilitate the creation of an increasingly responsible and judicious local government financial management system.

Section 2: For the purposes of this Act:

- a.) *local government*: local governments defined in Subsection 1 of Section 1 of Act LXV of 1990 on Local governments (henceforward: Loc. gvt. Act);
- b.) *settlement of debts*: that part of the debt settlement procedure which starts with the promulgation of the court's debt settlement commencement order in the Company Gazette (Subsection 1 of Section 10).
- c.) *creditor*: Up to the point of the commencement of the debt settlement process, that who has a pecuniary claim against the local government or its budgetary organ; after the date of commencement of the debt settlement procedure, that who has declared a creditor's claim by the deadline set for the declaration of such claims, and the claim has been approved by the Receiver, or that, until a non-appealable judgement is made, whose claim is contested.
- d.) *assets*: those local government assets - existing assets and ones which are obtained by the local government during the procedure - which are categorised as invested and current assets by Act XVIII of 1991 on Accounting.
- e.) *assets which may not be calculated towards debt settlement*: flats and non-housing premises which have been transferred from state ownership to local government ownership;
- f.) *assets which may be calculated towards debt settlement*: that portion of assets which is over and beyond the non-marketable registered assets as defined by law, and is over the assets necessary for the provision of basic services for the citizens. Assets which may be calculated towards debt settlement are marketable.

²⁹ Promulgated as of 12th April 1996

Section 3 (1) The debt settlement procedure is a non-adversarial procedure coming under the jurisdiction of the county (Budapest) court which is competent according to the registered office of the local government.

(2) Unless it follows differently from this Act or from the non-adversarial nature of the procedure, the provisions of Act III of 1952 on Civil Procedure (hereinafter: Cp.) are applicable in the course of the procedures, with the proviso that no suspension or stay of proceedings will lie in the procedure. Deferment will only lie at the joint request of the parties participating in the process, and only before the commencement date of the debt settlement. The termination of the procedure will only lie before the commencement date of the debt settlement.

(3) Application for the review of a non-appealable order made in the course of the debt settlement procedure will not lie.

BH³⁰ 1999. 222. II. It is incumbent on the court to forewarn the party of the consequences of default, prior to levying a financial penalty for behaviour exhibited in the course of the debt settlement procedure. In the absence of such a notice the levy of a penalty will be in breach of the rules of law. (Subsection 2 of Section 3 of Act XXV of 1995; Subsections 1 and 2/a and Subsections 3-4 of Section 5 of the Code of Civil Procedure)

Chapter II

Starting the debt settlement procedure

Section 4 (1) The debt settlement procedure can be initiated by the local government or its creditor. The starting date of the procedure is the day on which the application is received by the court.

(2)³¹ A debt settlement procedure can be initiated if the local government or a budgetary organ of the local government

- a.) has not contested or made payment against the invoice sent by the creditor, or in the event of a creditor that is not required to issue an invoice, the dunning letter, and neither has it contested the reception of these documents within 60 days of the due date;
- b.) has not paid their acknowledged debt within 60 days of the due date;
- c.) has not fulfilled its payment obligations set forth in a non-appealable and enforceable court (authority) resolution.
- d.) has not fulfilled its payment obligations, and did so in breach of the agreement made in the course of a debt settlement procedure conducted earlier.
- e.)³² has not paid its public debts to other subsystems of the state budget within 60 days of the submission of the immediate collection order as defined by Subsection 7 of Section 63 of Act XXXVIII of 1992.

³⁰ *Bírósági határozatok*: a monthly periodical containing significant decisions of Hungarian courts (rulings and orders) [translator's comment]

³¹ The preamble defined by Subsection (1) of Section 61 of Act CXLVI of 1997. Effective: from December 1st 1998.

³² An amendment included in Section 71 of Act CXXV of 1999. Effective: from 1st January 2000.

Section 5 (1) The mayor (chief mayor) or the chair of the county general meeting (hereinafter generically: mayor) informs the financial committee - provided the representative body has created such a body earlier - without any delay about the situation which corresponds to the circumstances defined by Subsection 2/a-d.) of Section 4, and convenes the -representative body or the general meeting (henceforward generically: representative body) within 8 days. The representative body shall pass a resolution to meet the payment obligations or authorises the mayor to initiate the debt settlement procedure immediately.

(2) If the situation described under Subsection 2/a-b.) of Section 4 still prevails on the 90th day following the due date, or the situation described under Subsection 2/c-d.) of Section 4 still prevails on the 30th day following its occurrence, the mayor - irrespective of the representative body's decision - must initiate the debt settlement procedure within 8 days. Concurrently the mayor shall inform the public by using the locally customary communication means.

(3) The following are to be attached to the application for the commencement of the debt settlement procedure:

- a.) a copy of the mayor's letter of engagement;
- b.) the deeds pertaining to the unsettled claim, which reflect the title and due date (expiration) of the claim as well as the receipt of the payment of the fee to be paid for promulgation in the Company Gazette.
- c.) the minutes of the representative body meeting convened as per Subsection (1) as well as the related motions and representative body resolutions;

(4) If the mayor fails to discharge any of his/her duties stipulated in this Act the court may levy a financial penalty of not more than HUF 100,000 per instance.

(5) Concurrently with the initiation of the debt settlement procedure at court, the mayor shall inform the head of the county/Budapest public administration office about the commencement of the debt settlement procedure.

BH1999. 222. I. If, in breach of the legal requirements, the mayor fails to initiate the so called debt settlement procedure with the local government within 8 days of the conclusion of a non-appealable and enforceable court procedure, a financial penalty can be levied to the mayor's debit (Subsections 2 and 4 of Section 5 of Act XXV of 1996)

Section 6 (1) If the creditor initiates the commencement of the debt settlement procedure, their application must indicate the title and expiration date (due date) of the local government debt. The documents verifying the claim shall be enclosed in the application.

(2) If the creditor requested conducting the debt settlement procedure, and the court has not rejected the application without investigating the case on its merits (as per Section 8), the court shall inform the local government about the submission of the application without any delay by sending them a copy of the application.

(3) The mayor must declare to the court within 15 days of receiving the notification whether the situation described in the application is acknowledged by the local government. In the absence of such a declaration it shall be assumed that the existence of the debt is a fact.

Section 7 A creditor who could have enforced their outstanding (maturing or overdue) claim in the debt settlement procedure conducted earlier may not initiate conducting a debt settlement procedure within two years of the procedure concluding order coming into force which follows the compromise in bankruptcy made in the course of the debt settlement procedure or the partition of assets (Subsection 3 of Section 25; Subsection 4 of Section 32).

Section 8 The court dismisses the case without investigating it on its merits if

- a.) if it has not been submitted by an entitled party;
- b.) if the application which has been returned to the applicant for completion of the included information has either not been completed by the applicant within 8 days or has been submitted again containing incomplete information;
- c.) the mayor has acted without the authorisation of the representative body, except if the procedure was initiated as per Subsection 2 of Section 5.
- d.) the creditor has initiated the procedure prior to the expiration of the period defined by Section 7.

Section 9: (1) If the court finds that any of the conditions stipulated by Subsection 2 of Section 4 is met it ordains by virtue of a decree the commencement of the debt settlement procedure, or else shall terminate the debt settlement procedure.

(2) In its decree ordaining the commencement of the debt settlement procedure the court shall also appoint the Receiver.

(3) The following may not be appointed as receiver:

- a.) the mayor of the local government, a member of the representative body, a head or employee of a local government budgetary institution and their relatives [Section 685/b of Act IV of 1959 on the Civil Code of the Hungarian Republic, (hereinafter Cc.) while they are in this status or within three years of the cessation of this status.
- b.) who are creditors of the local government or whose creditor is the local government or those regarding whom the local government has the owner's powers. These rules shall also govern the engagement of those who work for the receiver;
- c.) who is an auditor or internal auditor engaged by the local government;
- d.) who is a non-representative member of a committee of the representative body;
- e.) the notary or an employee of the mayor's office.

(4) If the local government initiated the commencement of the debt settlement procedure or was one of the initiators thereof no appeal against the decree ordaining the commencement of the debt settlement procedure will lie. If the procedure started at the initiative of the creditor the creditor may not appeal against the decree, and the mayor may only submit an appeal in accordance with a pertaining decision of the representative body.

Commencement of the debt settlement

Section 10 (1) The court shall promulgate its non-appealable decree on the commencement of the debt settlement in the company gazette without any delay as a first priority.

(2) The promulgation should include

- a.) the name of the court and the reference number of the case,
- b.) the local government's name and registered office,
- c.) the commencement date of the debt settlement procedure,
- d.) the information that the date of commencement of the debt settlement procedure coincides with the date of the publication of the decree in the Company Gazette,
- e.) a notice addressed to creditors to the effect that they should report to the receiver their outstanding claims (maturing and overdue claims), the amount of which is either known, unknown or variable, against the local government or its budgetary organ within 60 days of the promulgation of the decree ordaining the commencement of the debt settlement,
- f.) a warning of the conclusions of law included under Subsection 4/b of section 11,

- g.) the receiver's name, address or registered office,
- h.) other circumstances of importance.

(3) The mayor makes sure that the notice addressed to the creditors shall also be published in at least two national newspapers within 15 days of the promulgation of the decree in the Company Gazette. This notice is also to be announced in the locally customary way. The deadline for the registration of creditors' claims shall be determined precisely in the notice in accordance with the provisions of Subsection 2/e. The fact of publication is to be verified at the court within three days.

(4) The mayor (in his/her absence the receiver) informs the following entities about the commencement of the debt settlement within 8 days of the promulgation of the decree in the Company Gazette:

- a.) the head of the county/Budapest public administration office;
- b.) the director of the county regional state finances and economic information service, or in Budapest, the director of the Budapest State Finances and Economic Information Service (hereinafter: TÁKISZ)
- c.) the financial institution with which the local government's mayor's office has its budget accounting account, as well as the financial institutions with which the budgetary organs of the local government have their bank accounts and accounting accounts;
- d.) the appropriate tax and customs authorities, office of public fees and dues and the administrative agencies of the pension insurance and health insurance self-governments
- e.)³³ the heads of the National Health Insurance Fund and the health care institution with respect to the appointment of their representatives in the committee defined by Subsection 1 of Section 16, if the debt settlement procedure started because of the insolvency of the local government's health care institution.

(5) After the date of the commencement of the debt settlement, the banker may only debit the local government's or its budgetary organ's account with liabilities deriving from financial institution activities on the countersigned instruction of the local government's receiver, and disbursements and remittances may only be made against transfer and payment orders if they are countersigned by the receiver.

Conclusions of law regarding the date of the commencement of the debt settlement

Section 11: (1) Subsequent to the commencement date of the debt settlement, claims against the local government can only be enforced under the debt settlement procedure in ways stipulated in this Act. On the date of the commencement of the debt settlement, the local government's and its budgetary organ's pecuniary liabilities reported by creditors that have claims which are not overdue shall also become overdue.

(2) Subsequent to the date of the commencement of the debt settlement, contractual or default interest (fee, penalty) on the reported and accepted (contested or non-contested) liabilities is enforceable only until the proposal for the partition of assets as per Subsection 1/b of Section 30 is drawn up.

³³ An amendment included in Subsection 2 of Section 61 of Act CXLVI of 1997. Effective: from 1st December 1998.

(3) Only claims which were generated before the debt settlement may be included in a set-off arrangement. Claims against the local government are valid only if they were reported by the creditor to the receiver before the deadline stipulated by Subsection 2/e of Section 10.

(4) In the event of failing to comply with the 60 days' notice period for the statement of creditors' claims (Subsection 2/e of Section 10)

a.) no application for justification will lie;

b.) creditors may enforce their outstanding claims (overdue and maturing claims) through the submission of a collection order, distraint or initiation of a debt settlement procedure only when two years have elapsed after the non-appealable conclusion of the debt settlement procedure.

(5) No default interest is enforceable on claims defined under Subsection 4/b for the period following the date of the commencement of the debt settlement. The limitation of such claims is governed by the provisions of Subsection 2 of Section 326 of the Civil Code.

Section 12: (1) Execution procedures which are underway at the time the debt settlement procedure starts to enforce pecuniary claims against the local government or its budgetary organs shall be discontinued by the court conducting the execution, and the court shall hand over to the local government the distrained assets and the amounts raised but not paid off, and concurrently informs the receiver thereof. The right of execution over the real property of the local government ceases on the date of the commencement of the debt settlement procedure. The necessary land registry office procedure shall be initiated by the mayor.

(2) At the date of the commencement of the debt settlement, mortgages on the real properties and other assets of the local government, furthermore the prohibition of encumbrance and alienation stipulated in contracts, as well as the right of redemption and option to purchase ceases. The necessary land registry office procedure shall be initiated by the mayor. The termination of the mortgage right or lien does not affect the priority ranking of the claim (Subsection 1/b of Section 31) secured with mortgage or lien.

(3) Litigious and non-adversarial proceedings instituted against the local government before the date of the commencement of the debt settlement will be continued by the courts which are originally in charge.

(4) Procedures started in order to enforce the claim before the date of the commencement of the debt settlement shall not relieve the creditor of the fulfilment of the duty set forth under Subsection 2/e of Section 10.

Section 13: (1) From the date of the commencement of the debt settlement onwards the local government may not:

a.) make decisions through which it incurs additional pecuniary liabilities,

b.) found businesses,

c.) acquire ownership in businesses in commutative contracts

d.)³⁴ fulfil its financial obligations assumed earlier, except for liabilities defined under Subsection 1/a of Section 31 and obligations included in the crisis budget and crisis plan as per Subsection 1 of Section 11 and Subsections 2-3 of Section 18 of this Act.

(2) The mayor shall hand over to the receiver within 30 days of the date of the commencement of the debt settlement:

³⁴ Stipulated by Subsection 3 of Section 61 of Act CXLVI of 1997. Effective: from 1st January 1998

- a.) his/her report on financing and the locally adopted ways of implementing mandatory or optionally assumed local government duties and exercising mandatory or optionally assumed local government powers;
- b.) the inventory of and annual report on the local government assets prepared as of one day before the date of the commencement of the debt settlement which includes, with adequate justification, the following categories separately: registered assets, assets necessary for performing and exercising duties and powers required by law, and assets which can be used to meet creditors' claims,
- c.) the draft crisis budget by-law,
- d.) a detailed summary of proceedings in progress at court and state authorities and a detailed summary of execution proceedings in progress,
- e.) contracts regarding local government assets which were concluded within a year before the date of the commencement of the debt settlement procedure together with statements, made any time, incurring liabilities with regard to the assets,
- f.) detailed information on business organisations operating with the involvement of the local government,
- g.) detailed information on the financial situation, debts and accounts receivable of local government institutions,
- h.) other documents which are needed by the receiver to perform their responsibilities.

The responsibilities and remit of the receiver

Section 14: (1) The receiver shall monitor the local government's financial management as well as its performing mandatory duties and exercising mandatory powers, from the date of the commencement of the debt settlement. The receiver's comments on the motions regarding the budget and submitted to representative body meetings are to be enclosed with the motions.

(2) The receiver

- a.) reviews the financial management of the local government and reveals the reasons underlying the commencement of the debt settlement procedure;
- b.) may inspect all documents pertaining to the assets of the local government;
- c.) attends public and closed sessions of the local government and the committees - which have bearing on local government assets - in the capacity of advisor;
- d.) may make motions regarding debt settlement, which are to be deliberated by the representative body or the committee as a first priority on the agenda;
- e.) initiates the collection of the local government's matured claims;
- f.) informs the creditors, at their request, about the local government assets and the debt settlement procedure;
- g.) informs the head of the county/Budapest public administration office if the representative body does not meet its obligations stipulated by this Act;
- h.) within 90 days of the commencement date of the debt settlement, the receiver may, by filing a claim on behalf of the local government at the court exercising general jurisdiction, contest contracts and legal statements made by the local government or its budgetary organ within 1 year before the commencement date of the debt settlement if the subject of the contract or the statement is gratuitous alienation of local government assets, or a gratuitous compromise in bankruptcy encumbering local government assets, or a transaction which constitutes an onerous contract. The calculation of the deadline for contestation is governed by the provisions of Subsection 3 of Section 236 of the Civil Code.

(3) The aggrieved party may raise objections against a measure taken by the receiver in violation of the rules of law or the receiver's nonfeasance at the court conducting the proceedings within 8 days of being informed thereof. No objection may be raised if more than 30 days have elapsed since the nonfeasance or the measure.

(4) In view of the objection, the court may ordain the suspension of the measure. If the court regards the objection as well-founded, it will proceed to nullify or modify the measure taken by the receiver, or requires the receiver to take the appropriate measures, or else it will dismiss the objection.

(5) If the receiver fails to meet their obligations stipulated by this Act, or does not fulfil the non-appealable court order sustaining the objection, the court may, *ex officio* or at request, relieve the receiver of its position and may require the receiver to bear the related costs or may reduce the receiver's fee.

Section 15: (1) The receiver registers the creditors reporting by the deadline set forth in Subsection 2/e of Section 10, investigates their claims and informs the creditors within 15 days of the expiration of the deadline for the registration of claims, whether their claims and the justification of the claims are accepted by the receiver.

(2) If the receiver contests the creditor's claim which has not yet been adjudicated by virtue of a court resolution (decision of an authority), the creditor can enforce the claim at the court exercising general jurisdiction by instituting proceedings within 15 days of the reception of the dismissal. The creditor informs the receiver about it, concurrently with filing the statement of claim (warrant for payment). In the event of judicial proceedings in progress, and simultaneously with filing the claim, the creditor shall also enclose the deed(s) in verification thereof.

(3) If the deadline referred to in Subsection (2) is missed no application for justification will lie, and the creditor may not enforce their claim in the course of the ongoing debt settlement procedure.

Section 16: (1)³⁵ Within 8 days of the commencement date of the debt settlement, a debt settlement committee is set up the membership of which includes the mayor, the notary, the chair of the financial committee (in the absence of a financial committee a local government representative) and a local government representative. The receiver shall serve as the committee's chair. The local government representative member(s) of the debt settlement committee is elected by the representative body by a simple majority vote. If none of the representatives undertakes membership in the committee the debt settlement committee shall be constituted notwithstanding - without a local government representative. If the debt settlement procedure started because of the insolvency of the a health care institution of the local government the representatives of the National Health Insurance Fund and the health care institution shall also be committee members.

(2) The committee has a quorum if the receiver and half of the members are present. Committee decisions are made with a majority of votes, and if a tie vote occurs the vote of the receiver shall be decisive. The receiver may request the representative body to review committee decisions.

(3) Except for matters stipulated by Section 10 of the Municipality Act - matters which fall exclusively within the remit of the representative body- all financial issues related to the performance of mandatory local government responsibilities and exercising mandatory local government powers shall be decided upon by the debt settlement committee.

³⁵ The last sentence added by Subsection 4 of Section 61 of Act CXLVI of 1997. Effective: from 1st December 1998.

Section 17 (1) If the representative body does not convene to meet its obligations stipulated in this Act within 30 days of the notice of the head of the county or Budapest public administration office, its dissolution may be initiated.

(2) If the representative body becomes inoperative, or its dissolution has been initiated (Subsection 2 of Section 93 of the Local Government Act) the provisions of Chapter IV of this Act shall be immediately applicable to the debt settlement procedure conducted against the local government.

Section 18: (1) The notary, the chief notary (henceforward generically: the notary) shall prepare the draft crisis budget by-law within 30 days of the commencement date of the debt settlement procedure.

(2) The crisis budget includes - in view of the conditions set by Subsection (3) - the operating costs of the basic residential services and authority duties listed in the Annex of this Act.

(3) The local government may not finance in its crisis budget health care, social, and educational institutions where the utilisation of the total capacity is below 50 %, and where the per-unit-cost of the public services exceeds the national average per-unit-cost of the last year by over 30% - except if the community operates only one single institution of a given type in its area.

Section 19: (1) The debt settlement committee discusses the draft crisis budget by-law within 8 days of it being handed over to the receiver. After its approval the mayor shall send the draft crisis budget by-law to the representatives, and simultaneously convenes a representative body meeting which is to take place within 8 days.

(2) If the representative body approves the crisis budget the local government's financial management shall be based on the crisis budget until an agreement is reached with the creditors, or the assets are partitioned by the court. If the debt settlement procedure does not finish in the fiscal year of the crisis budget a new crisis budget is to be prepared for the next fiscal year.

(3) Between the commencement date of the debt settlement procedure and the approval of the crisis budget by-law, duties are to be discharged in accordance with the earlier by-laws of the local government - at the same time the provisions of Subsection 1 of Section 13 are to be adhered to. Debts which have not been repaid and were generated during this period in relation to the continued provision of the basic residential services and discharge of administrative duties are to be entered in the crisis budget as expenses.

(4) If the representative body does not approve the crisis budget by-law within 60 days of the commencement date of the debt settlement it is incumbent on the receiver to report this fact to the court which shall ordain the continuation of the debt settlement procedure according to the provisions of Chapter IV of this Act.

Chapter III

Negotiating a compromise in bankruptcy

Section 20 (1) When the representative body has approved the crisis budget by-law, the debt settlement committee draws up a reorganisation programme and drafts an agreement for a compromise in bankruptcy.

(2) In addition to a detailed description of the financial situation of the local government, the reorganisation programme includes proposals regarding the utilisation of the assets which may be involved in the debt settlement as well as proposals for taking various measures to expedite the debt settlement effort (e. g. through taking loans), also indicating the level of income each of these measures yields to the local government.

(3) In the compromise proposal, the debt settlement committee groups the creditors of the local government into groups by the amount of the creditors' claims, the original maturity date of the claims or by other categories, and the committee may propose different types of compromise for the different groups with adequate justification.

(4) As the compromise in bankruptcy is drafted, creditors with contested claims - inasmuch as judicial proceedings are in progress in order to enforce the claim - are taken into account by the debt settlement committee according to the claim reported by the creditor.

Section 21: Subsequent to their preparation, the receiver shall submit for approval the reorganisation programme and the compromise proposal to the representative body which has been convened by the mayor with no more than eight days' notice. The representative body shall pass a decision at a closed session, with a qualified majority and voting by name. If the representative body turns down the reorganisation programme and the compromise proposal the debt settlement committee shall revise them.

Section 22 (1) If the debt settlement committee does not prepare the reorganisation programme or the compromise proposal, or if they are not approved by the representative body within 150 days of the commencement date of the debt settlement procedure, the receiver informs the creditors thereof.

(2) The creditors may prepare a creditors' compromise plan/compromise plans regarding the settlement of the local government debts within 30 days of receiving the receiver's notification. This intention of theirs shall be communicated by the creditors to the receiver within 8 days of the notification.

(3) The receiver, at the request of the creditors, shall provide all the information and data necessary for the preparation of the compromise plan.

(4) The creditors deliver the compromise plan to the receiver who shall submit it, with the addition of the observations of the debt settlement committee, to the representative body through a procedure stipulated by Section 21. If the representative body approves the plan from that point on it shall be regarded as the compromise proposal.

(5) If the creditors fail to inform the receiver, by the deadline set forth by Subsection (1), about their intention to draw up a compromise plan the receiver reports to the court that no compromise proposal is in the making.

Section 23 (1) The receiver shall send the reorganisation programme and the compromise proposal approved by the representative body to all the creditors, and at the same time the receiver invites them to a conference to negotiate the compromise. The receiver shall forward the invitation complete with its attachments to the creditors at least 8 days prior to the

meeting. Depending on the number of creditors, creditors may be invited in separate groups to negotiate a compromise in bankruptcy.

(2) The proceedings of the compromise negotiations shall be recorded in the minutes. Creditors may attend the compromise conference either personally or through their representatives. The representatives must verify their capacity of attendance - even without request. Creditors who are absent may consent to the compromise in bankruptcy in writing, too. If the minutes contain the compromise in bankruptcy, too, in addition to the two attestors the minutes shall also be signed by those listed under Subsection 1 of Section 25.

(3) A compromise in bankruptcy may be concluded if more than half of the creditors having extant claims at the time the debt settlement procedure starts consent to it, provided that the total claims of these creditors amount to at least two-thirds of all the reported and uncontested creditors' claims. If the creditors were divided into groups in the compromise proposal then at least half of the creditors in a group should consent to the compromise in bankruptcy.

(4) The compromise in bankruptcy concluded as per Subsection (3) is also applicable to those who have not consented to it, or have not attended the conference in spite of being duly notified thereof. The compromise in bankruptcy may not stipulate different conditions for these creditors than for those who have consented to the compromise in bankruptcy. If the local government has divided the creditors in groups already in its compromise proposal the conditions set by the compromise for a group may not vary within the group.

(5) Amounts, as adjusted to the settlement level provided for the given group, which are due to creditors who at the time of the conclusion of the compromise have contested claims are to be handled separately. Such creditors may not participate in the conclusion of the compromise in bankruptcy, and their claim is not to be taken into account when the calculations defined by Subsection (3) are made; nevertheless, depending on the adjudication of their claims, the compulsory compromise in bankruptcy will also affect such creditors.

(6) The proceeds of the share of assets to which a creditor with contested claims is entitled as per Subsection (5) are to be handled separately with the given share of assets until the legal dispute has a non-appealable conclusion, and are to be issued together with the share of assets when a non-appealable judicial resolution has upheld the claim. Costs arising from the management of the share of assets are to be defrayed from the share of assets. As the assets are issued the creditor shall be given an account of expenses and revenues related to the assets. If the creditor's claim is not found justified, the share of assets handled separately shall be divided between the other creditors in proportion to their claims up to the amount of their entire claim. The notary in office at the given point of time is responsible for such division of the assets.

Section 24: The compromise in bankruptcy is to be put down in writing and must contain the following in particular:

(a) the compromise proposal approved by the creditors, and ways of its implementation and monitoring;

(b) ways of satisfying the creditors;

(c) possible modification of the deadlines, cancelling claims or assuming other creditors' claims, and everything that is held necessary by the local government and the creditors for the restoration or preservation of the solvency of the local government;

(d) the unanimous act of will of the local government and the creditors consenting to the compromise .

Section 25 (1) The compromise in bankruptcy shall be signed by the mayor, the notary and the creditors or their lawful representatives or proxies, and it shall be countersigned by the receiver.

(2) The receiver submits the deed containing the compromise in bankruptcy to the court within 3 days, to which the receiver shall attach the following:

- a.) the compromise proposal,
- b.) the reorganisation programme,
- c.) minutes recorded in the course of the compromise in bankruptcy procedure, and
- d.) and a report demonstrating that the compromise in bankruptcy meets the conditions set forth by Subsection 3 of Section 23,
- e.) a report on the contested creditors' claims and pertaining documents demonstrating that meeting these claims is ensured as per Subsection 5-6 of Section 23.

(3) If the compromise in bankruptcy complies with the provisions of this Act, the court concludes the debt settlement procedure and ordains that the court order be published in the Company Gazette. Or else it shall ordain the continuation of the procedure as per Section 29 of Chapter IV. No appeal against the order concluding the procedure will lie.

(4) Simultaneously with the conclusion of the debt settlement procedure, the court shall relieve the receiver in its special order and shall establish the receiver's fee as per Section 33.

(5) Inasmuch as no compromise in bankruptcy is made within 210 days of the commencement date of the debt settlement, the receiver shall report it to the court in 3 days.

Section 26 The local government and the creditors may agree that they wish to commission the receiver to supervise the execution of the compromise in bankruptcy. In this case the receiver's responsibilities and remit for the period following the court order concluding the procedure must also be determined, and an agreement is to be reached on the remuneration of the receiver for the supervision.

Section 27 If the local government does not fulfil its obligations assumed in the compromise in bankruptcy the creditor may initiate a new debt settlement procedure in which the creditor may claim the payment of the yet unsettled portion of their claim.

Section 28 The court may extend the deadlines defined by Subsection 1 of Section 22 and Subsection 5 of Section 25 by 30 days at the justified request of the receiver and the representative body or the majority of the creditors (computed in terms of the totality of claims), provided such an application is submitted before the expiration of the deadline in question.

No appeal against such an order will lie.

Chapter IV

Partition of the assets by the court

Section 29 (1) In the cases defined by Subsection 2 of Section 17, Subsection 4 of Section 19, Subsection 5 of Section 22, Subsection 3 of Section 25 and Subsection 5 of Section 25 the court shall determine the continuation of the debt settlement procedure according to the rules of the partition of assets by court. No appeal against such an order will lie.

(2) Until the assets are partitioned by the court the obligations of the local government shall be met in compliance with the crisis budget by-law. If there is no crisis budget by-law

the receiver shall develop an operational crisis plan along the principles laid down in Subsections 2-3 of Section 18, within 8 days of receiving the order defined in Subsection (1), and after consulting the debt settlement committee. The operational crisis plan shall be sent by the receiver to the court and the representative body for their information. The local government shall operate in accordance with the crisis plan until the conclusion of the debt settlement procedure.

(3) The receiver

- a.) determines the locally applicable forms of how the local government discharges duties and exercises powers which are required by law;
- b.) determines which local government assets and which kinds of support allocated centrally from the central budget are necessary for discharging the duties described under heading a.),
- c.) determines the range of assets which may be involved in the debt settlement procedure (Section 2/e) .

(4) The receiver submits their report, with adequate justification, on what is included in Subsection (3) to the court within 30 days of the delivery of the order defined in Subsection (1) and shall also send it to the local government and all the creditors.

(5) The local government and the creditors may make observations on the receiver's report at the court within 15 days of the reception of the report. The court shall send the observations to the receiver, and gives the receiver 8 days' notice for responding. At the same time the court sets a date for a personal hearing as an urgent priority to which it summons the receiver, those who made the observations and if the observations were not made by the local the government, the local government, too. The receiver may modify their report in view of the observations received,

(6) In view of the receiver's report and the comments made by the local government and those who submitted the observations, the court approves the receiver's report in an order or requires the receiver to write a new report.

(7) The local government and/or creditors who submitted observations may appeal against the order defined in Subsection (6). The appeal is to be sent for comments to the receiver and besides the receiver only to those who have the right to appeal.

Section 30 (1) After the approval order defined in Subsection (6) of Section 29 taking effect, the receiver shall:

- a.) within 30 days prioritise the creditors' claims as per the priority order stipulated by Section 31, and notifies the creditors thereof,
- b.) within 60 days attempt the public sale of those assets of the local government which may be involved in the debt settlement procedure at the possible highest market price. The creditors shall have the right of first refusal in the course of the sale of assets. The 60 days' period may be extended in accordance with the provisions of Section 28 on one occasion.

Within 30 days after the expiration of the deadline the receiver shall propose the partition of the assets available for the debt settlement procedure among the creditors. Settling the creditors' claims can take place by virtue of money or through the transfer of unsold assets to the creditors. In the latter case it is to be established - corresponding to the priority order of settling the claims and the ratio of creditors' claims - in what proportion the creditors shall share the local government assets.

(2) The acquisition of assets through the partition of unsold assets among the creditors is not liable to dues or value added tax.

(3) The provisions of Act XXXIII of 1991 on the transfer of certain state owned assets to the ownership of local governments are applicable to the alienation of historic monuments

and buildings and nature conservation areas as well as the transfer of the right of management or use thereof.

(4) When the asset partition proposal is submitted, creditors' contested claims are to be taken into account as if the receiver had approved the full amount claimed by the creditors and the share of the assets (calculated correspondingly) of the creditor that has a contested claim is to be handled separately until a non-appealable ruling concludes the legal dispute. If the non-appealable ruling establishes that the creditor's claim was not rightful the share of assets handled separately is to be divided among the other creditors in view of the priority order set forth by Section 31, in proportion to their claims and up to the settlement of their entire claim. The notary currently in office is responsible for such division of assets.

(5) The proceeds of the share of assets to which a creditor with contested claims is entitled as per Subsection (4) are to be handled separately but together with the share of assets until the legal dispute has a non-appealable conclusion, and are to be issued together with the share of assets when a non-appealable judicial resolution has upheld the claim. Costs arising from the management of the share of assets are to be defrayed from the share of assets. As the assets are issued the creditor shall be given an account of expenses and revenues related to the assets.

Section 31 (1) (The assets which may be involved in the debt settlement procedure must be divided among the creditors in the following way (priority order of settling the claims):

- a.) regular emoluments including severance pay for the termination of civil servant or public employee status;
- b.) claims secured with lien, mortgage or caution money up to the value of the pledge, mortgage or caution money, provided that the security was stipulated at least 6 months prior to the commencement date of the debt settlement procedure. This constraint is not applicable to the security of a credit provided in relation to a compromise in bankruptcy concluded in the course of a previous debt settlement procedure. If the pledge or asset is encumbered by several liens or mortgages the priority order of settling the claims shall be determined by the provisions of Subsection 3 of Section 251 of the Civil Code;
- c.) the state's claims arising from interest payment support provided for a compromise in bankruptcy concluded in the course of a previous debt settlement procedure, and the amounts of reimbursable targeted support and further reimbursable central budget support;
- d.) social security debts, taxes and public debts which may be collected like taxes;
- e.) other claims;
- f.) interest claims defined under Subsection 2 of Section 11, furthermore default penalties and fees on claims listed under heading d.) and charged during the debt settlement procedure;

(2) The claims of lower priority group creditors shall be settled after the claims of higher priority group creditors are fully settled.

(3) The amount available for settling the claims of creditors grouped under the same heading of Subsection (1) shall be divided among the creditors in proportion to their claims, however, the social security debts coming under heading d.) of Subsection 1 must first be fully settled and subsequently the claims of the rest of creditors under the same heading shall be settled in proportion to their claims.

Section 32 (1) The receiver submits the report on the processes assets to be involved in the debt settlement procedure have undergone as well as the asset partition proposal defined

under Subsection 1/b of Section 30 to the court, and shall also send them to all the creditors and the mayor, who will present them to the representative body.

(2) The local government and the creditors may raise objections against the report and the asset partition proposal within 15 days of their reception, or the creditors may relinquish their claims in view of the said documents.

(3) The court shall decide about the asset partition proposal after having heard those who raised objections as well as the receiver and the mayor.

(4) When the court approves the asset partition proposal it shall require the receiver to execute the asset partition. The receiver must report the accomplishment of the asset partition to the court without any delay. Subsequently the court concludes the debt settlement procedure with an order, and no appeal against the order will lie.

(5) Simultaneously with the order concluding the procedure, the court shall relieve the receiver of its position and shall determine their fee. The receiver and the minister of the interior have the right of appeal against the fee determination clause of the order.

(6) The conclusion of the debt settlement procedure is promulgated by the court in the Company Gazette.

Chapter V.

Miscellaneous provisions

Section 33 (1) The receiver's fee is determined, depending on the actual circumstances, by the court. The actual sum is determined by the annual act on the government budget; in 1996 it amounts at least to HUF 300,000 but does not exceed HUF 2 million.

(2) The receiver's fee will be financed from the central government budget, line item: supplementary support for local governments which have been rendered inoperative. Based on the non-appealable order of the court, the minister of the interior shall take measures to remit the amount of the fee through TAKISZ.

(3) The receiver's justified expenses and the fees of consultants used by the receiver shall be paid by the local government at the time they fall due. Together with the compromise in bankruptcy and the asset partition proposal, the receiver submits to the court an itemised account of expenses and consultant fees, with justification of the use of consultants.

BH1998. 500. Principles of setting the fees of receivers involved in the debt settlement procedure of local governments. (Subsection 1 of Section 33 of Act XXV of 1996; Section 3/c of Annex No. 6 of Act CXXIV of 1996).

Section 34 (1) If the local government raised money through taking loans from financial institutions in order to conclude a compromise in bankruptcy, the central budget provides interest free, reimbursable support for the local government to finance that part of the payable interest on the loan which the local government is unable to finance from its own resources. This interest payment central support will not correspond to more than the central bank interest rate + 1%. The provisions which constrain the local governments' liabilities (Subsection 2 of Section 88 of the Act on Local Governments) are not applicable to such cases.

(2) In cases defined in Subsection (1), the mayor initiates the allocation of the reimbursable interest support with the minister of the interior. The attachments of the application shall include: the deed of compromise in bankruptcy concluded by the local

government and its creditors, the reorganisation proposal, the court's order concluding the procedure, and the local government's statement about its resources and solvency together with documents providing evidence thereof, as well as the documents made on the loan with the financial institution.

(3) After the full payment of the loan provided by the financial institution, the local government is required to repay the interest support to the state based on an agreement reached with the minister of the interior.

Chapter VI.

Closing provisions

Section 35 (1) This Act comes into force on the 60th day after its promulgation.

(2) The government shall issue a decree to lay down the rules of implementing this Act.³⁶

(3) Local governments which receive the per formula government contribution and personal income tax as per Subsection 3 of Section 30 of Act CXXI of 1995 on the 1996 Budget of the Hungarian Republic may initiate the debt settlement procedure within 8 days of the Act coming into force, and simultaneously the minister of the interior must be informed thereof. In such cases the local government is entitled to the financing available in accordance with Subsection 3 of Section 30 of the State Budget Act until the debt settlement process is launched.

Section 36 During the debt settlement procedure the provisions of the Local Government Act are applicable to the given local government with deviations stipulated by this Act.

Section 37 (1)³⁷

(2)³⁸

Section 38³⁹

Section 39⁴⁰

Section 40⁴¹

³⁶ see. Gvt. decree 95/1996 (July 4th)

³⁷ Incorporating Subsection 3 of Section 59 of Act LXXVII of 1993.

³⁸ Incorporating Subsection 6 of Section 60 of Act LXXVII of 1993.

³⁹ Incorporating Subsection 1/l. of Section 57 of Act XCIII of 1990.

⁴⁰ Incorporating Subsection 2/f of Section 46/a of Act LXIX of Act 1991.

⁴¹ Incorporating Subsection 3 of Section 90 of Act LXXV of 1990.

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Annex to Act XXV of 1996

Basic services provided to the population

1. Creation, extension, maintenance, closing, elimination, evacuation, and re-opening of public cemeteries, and operation of crematories (§ 18 of Act XX of 1991)
2. Providing chimney sweeping services (§ 19 of Act XX of 1991)
3. Specifying a location for the community's liquid waste drain-off site, operating a public chemical neutralising site (§ 20 of Act XX of 1991)
4. Keeping public areas clean, collecting solid waste of communities, delivering it to the disposal site, providing services related to the regular collection of worn-out/useless items of households accumulated over a period [point *b* of section (1) of § 85 of Act XX of 1991, and section (1) of § 1 of Act XLII of 1995]
5. Safeguarding, protecting, maintaining, promoting, and restoring the local natural values [point *b* of section (1) of § 85 of Act XX of 1991]
6. Water supply, building/operating a sewage system, cleaning the sewage water collected, draining off rainwater, local water management, preventing damage caused by water, and preventing/fighting floods and inland waters [section (1) of § 4 of Act LVII of 1993]
7. Ensuring that local public roads are safe for traffic and kept clean, that snow is cleared away and slipperiness is prevented, and any situation compromising safe traffic on local public roads is eliminated (§ 34 of Act I of 1988)
8. Operating public lighting equipment [section (3) of § 65 of Act XX of 1991]
9. Neutralising carcasses, capturing, keeping, selling or destroying stray dogs within the area inhabited by the community, destroying with no compensation dogs or cats medically dangerous for humans and jeopardising the health of the total animal stock, or just showing symptoms of some disease, or suspicious of medical problems, and arrange for the obligatory inoculation of dogs against rabies. (point *d*) of § 40 of Act XX of 1991)
10. Ensuring and controlling that plants on public areas of the community are properly maintained (point *d*) of § 40 of Act XX of 1991)
11. Ensuring that rodents are kept outside the community [section (3) of §129 of Act XX of 1991]
12. Ensuring that firefighting and technical rescue services are available (§ 5 of Decree of effect equivalent to an Act No. 13 of 1973)
13. Operating kindergartens, providing primary school education and teaching, operating kindergartens, providing primary school education and teaching to members of the national or ethnic minority in communities partly inhabited by national or ethnic minorities [section (1) of § 86 of Act LXXIX of 1993]
14. Providing treatment to children suffering from physical, sensory deficiencies or from light mental disabilities or speech impediments who can still be educated and taught together with other children and pupils [section (2) of § 86 of Act LXXIX of 1993]
15. Providing dormitory services, providing dormitory services to members of the national or ethnic minority groups, providing secondary school and technical school education, providing secondary school and technical school education to members of the national or ethnic minority groups, adult education, basic art education, schooling/career counselling, education consulting, speech therapy services [section (3) of § 86 of Act LXXIX of 1993]

16. Providing education required by children under permanent medical treatment in medical institutions to meet their schooling obligations, kindergarten, schooling, and dormitory services to children and pupils suffering from physical, sensory deficiencies or from mental disabilities or speech impediments who cannot be dealt with and educated together with other children in the case of those at the permanent residence of whom schooling and education is not ensured until the end of the schooling age; ensuring the conditions to meet schooling obligations, including changing schools without differential examinations or repeating a year, early-age counselling and care services, examining learning aptitudes, offering rehabilitation, conductive pedagogy, information provision related to entrance in secondary and technical schools, local professional pedagogical services [section (1) of § 87 of Act LXXIX of 1993]
17. National services to determine the fact of disability, and related rehabilitation services [section (2) of § 87 of Act LXXIX of 1993]
18. Preventing a situation of threat for minors, eliminating threat already present, financial and in-kind provision for minors under threat, and ensuring education, care, and upbringing to those boarding in reformatory institutions, educated at a reformatory institution or state operated children's home, and those minors who require children's or youth protection services for some other reason [section (2) of § 129 of Act XX of 1990]
19. Primary medical care (family doctor, family child doctor, dentist), and nursing [section (1) of § 129 of Act XX of 1991]
20. Out-patient and in-patient care, and various tasks to be provided by medical institutions providing care [section (4) of § 129 of Act XX of 1991]
21. Social primary care that belongs under personal care (day-care for children, feeding, assistance at home, family assistance) [section (1) of § 57 of Act III of 1993]
22. Specialised care that belongs under personal care: various tasks to be provided by institutions providing nursing/care, rehabilitation institutions, institutions providing day-care, institutions providing temporary care [section (2) of § 57 of Act III of 1993]
23. Ensuring access to specialised care for those impossible to treat in the framework of primary care (point *b*) of § 86 of Act III of 1993)
24. Means tested financial and in-kind social assistance (income subsidy for the unemployed, housing maintenance support, nursing allowance, temporary support, funerals in public cemeteries, public health care, entitlement to medical services) (§ 33, 38, 40, 45, 48, 49, 54 of Act III of 1993)
25. Certain tasks of preparation for national defence, and national alert [section (1) of § 66 of Act CX of 1993]
26. Performing services of civil defence [section (2) of § 66 of Act CX of 1993]
27. Operating the board of representatives and the mayor's office, and remunerating the employees of the office (wages and public contributions, in-kind remunerations), except for the honorary fees of the local government representatives and committee members [section (2) of § 9 of Act LXV of 1990]
28. Organising employment of public benefit (related to the continuous operation of the public service and tasks of public administration) for recipients of income subsidy [point *a*) of section (4) of § 8 of Act IV of 1991, and sections (1)-(2) of § 79 of Act XLVIII of 1995]

Annex 7. Poland: Act on public finance, Part II. State Public Debt

Annex Act on public finance

Issued on 27 August 2009⁴²

Excerpts!

**Part II
State Public Debt
Section 1
General Provisions**

Article 72.

1. State public debt shall include public finance sector obligations in respect of:
 - 1) issued debt securities;
 - 2) incurred credits and loans;
 - 3) accepted deposits;
 - 4) outstanding liabilities:
 - a) resulting from separate acts of law and legally binding court rulings or final administrative decisions,
 - b) regarded as non-contestable by the relevant debtor unit of public finance sector.
2. Minister of Finance shall specify, by the way of a Resolution, a detailed manner of classifying debt titles categorized as state public debt, including State Treasury debt, with due consideration for basic subjective and objective debt categories and maturity periods.

Article 73.

1. State public debt shall be calculated as the nominal value of obligations of public finance sector units, after eliminating mutual obligations between units within the sector.
2. Nominal value of obligations shall be understood as the nominal value of:
 - 1) issued securities;
 - 2) incurred loan, credit or other obligation, i.e. the principal amount due on maturity date.
3. Nominal value of indexed or capitalized obligations shall be equivalent to the initial nominal value including the increase in capital resulting from indexation or capitalization, calculated as of the end of the reporting period.
4. Provisions set forth in paragraphs 1-3 shall apply to the calculation of amounts of unmatured obligations in respect of sureties and guarantees not classified as state public debt, and - respectively - to the calculation of State Treasury debt and the amounts of unmatured obligations in respect of sureties and guarantees not classified as State Treasury debt.
5. Minister of Finance shall specify, by the way of a Resolution, the detailed manner of defining:
 - 1) the value of obligations classified as:
 - a) state public debt,
 - b) State Treasury debt,
 - 2) the value of obligations in respect of sureties and guarantees

⁴² Journal of Laws of the Republic of Poland, 2009, no 157, item 1240, 2010, no 28, item 146.

– having regard to the classification of debt titles included in state public debt and the need to correctly calculate the relationship between state public debt and gross domestic product.

Article 74.

1. Minister of Finance shall exercise oversight over the public finance sector from the standpoint of compliance with the principle stating that state public debt cannot exceed the level of 60% of the value of annual gross domestic product.
2. Minister of Finance shall exercise oversight over the status of State Treasury debt to ensure compliance with the principle referred to in paragraph 1 above.
3. Minister of Finance shall exercise oversight referred to in paragraphs 1 and 2 above in particular by verifying the performance of duties ensuing from Article 86.
4. Minister of Finance, in connection with the oversight referred to in paragraphs 1 and 2 above, has the right to request from public finance sector units additional information with respect to the current and projected debt status of those units and their debt structure.
5. In the case of improper performance of duties ensuing from Article 86, Minister of Finance shall notify the organs that supervise public finance sector units about the irregularities.

Article 75.

1. Minister of Finance shall prepare a four-year strategy of State Treasury debt management and state public debt impact, taking into account, in particular:
 - 1) debt management conditions related to macro-economic stability of the economy;
 - 2) analysis of the level of state public debt;
 - 3) projections pertaining to state public debt and State Treasury debt levels;
 - 4) projections pertaining to the cost of service of State Treasury debt;
 - 5) debt structure development;
 - 6) projection and analysis of unmatured obligations in respect of State Treasury sureties and guarantees.
2. The document referred to in paragraph 1 above shall be submitted by the Minister of Finance to the Council of Ministers for approval.
3. The Council of Ministers, having approved the document referred to in paragraph 1 above, shall submit it to the Sejm together with draft budget law explanatory statement.

Section 2

Financing state budget borrowing needs

Article 76.

State budget borrowing needs shall be defined as the demand for financial resources indispensable for the financing of:

- 1) the deficit of:
 - a) the state budget,
 - b) European funds budget;
- 2) state budget expenditures.

Article 77.

Minister of Finance, in order to finance state budget borrowing needs and in connection with State Treasury debt management, shall be authorized to:

- 1) incur financial obligations on behalf of the State Treasury, in particular by issuing securities and incurring loans and credit on domestic and foreign markets;
- 2) repay incurred obligations referred to in point 1 above;
- 3) carry out other financial operations related to debt management, including the operations related to financial derivative instruments;
- 4) manage the surplus of European funds.

Article 78.

1. Minister of Finance shall perform the tasks related to State Treasury debt management in particular by:

- 1) taking legal and factual steps connected with:
 - a) obtaining repayable funds to finance state budget borrowing needs,
 - b) servicing State Treasury obligations in respect of issued securities and incurred credit and loans;
- 2) managing state budget available resources, as well as managing financial liabilities and financial assets of the State Treasury, including public resources earmarked in connection with State Treasury debt management.

2. Management of available resources, referred to in paragraph 1, point 2 above, shall include in particular placing those resources on the financial market.

3. Managing financial liabilities and financial assets, referred to in paragraph 1, point 2 above, shall include in particular such operations and actions made on financial markets which affect the structure of State Treasury debt with the purpose to:

- 1) increase financial security of state budget borrowing needs;
- 2) reduce the risk or service costs of State Treasury debt;
- 3) execute other tasks related to State Treasury debt management, set forth in the document referred to in Article 75, paragraph 1.

Article 79.

1. At the point of redemption, treasury bonds shall be written off.
2. Treasury securities purchased by the State Treasury with the purpose to manage State Treasury debt are exempt from a write-off.

Article 80.

1. State Treasury may take loans and credit only and exclusively with the purpose to finance state budget borrowing needs, subject to Article 81.
2. Only the Minister of Finance may take loans and credit on behalf of State Treasury, subject to paragraph 3.
3. When a loan or a credit is taken by the way of an agreement, including an international agreement, which requires that the Council of Minister should be the organ acting on behalf of the Borrower, the Council of Ministers shall authorize the Minister of Finance to sign the agreement and it shall define the terms and conditions of execution of the agreement.

Article 81.

1. Upon the motion from Monetary Policy Council, State Treasury may incur mid-term loans and credit from the European Union and EU member states with the purpose to improve the balance of payments.
2. Upon the motion from the Council of the European Union, State Treasury may be involved in granting a loan with the purpose to improve the balance of payments in another EU member state, according to the principles set forth in the budget law.

Article 82.

The amount of incurred loans and credit, referred to in Article 80, paragraph 1, and Article 81, paragraph 1, shall not exceed the thresholds specified in the budget law.

Article 83.

1. Minister of Finance shall make deposits in Polish currency and in foreign currencies, and shall carry out other financial operations in the National Bank of Poland or other bank.
2. In the case of transactions involving derivative instruments for which a collateral agreement was executed, Minister of Finance may open in the National Bank of Poland or other bank a separate bank account for the collateral contributed in monetary terms. Minister of Finance shall return the collateral contributed in monetary terms, together with interest, in the amount and on the dates stipulated in the collateral agreement.
3. Funds placed on the account referred to in paragraph 2 herein may be deposited by the Minister of Finance in the National Bank of Poland or other bank.

Article 84.

Provisions set forth in Article 35 and Article 49 herein and public procurement provisions shall not apply to loans and credit incurred by State Treasury, treasury bonds issue and other operations directly related to state public debt management.

Article 85.

The National Bank of Poland shall provide the Minister of Finance with the data, including individual data as well as specifications and evaluations, referred to Article 23 of the Act on the National Bank of Poland, issued on 29 August 1997 (Journal of Laws 2005, no 1, item 2, with further amendments ⁷⁾), required for the execution of tasks referred to in Article 77 and Article 78.

⁷⁾ Amendments to the consolidated text of the Act in question were promulgated in the Journal of Laws, 2005, no 167, item 1398, 2006, no 157, item 1119, 2007, no 25, item 162, and no 61, item 410, 2008, no 209, items 1315 and 1317, 2009, no 69, item 589 and no 143, item 1164.

Section 3

Precaution and remedial procedures

Article 86.

In the event when the value of state public debt to gross domestic product ratio, referred to in Article 38, point 1, letter a, announced in accordance with Article 38:

1) is greater than 50%, and not greater than 55%, for the subsequent year the Council of Ministers shall adopt draft budget law in which the ratio of state budget deficit to state budget revenue shall not be higher than the ratio of state budget deficit to state budget revenue in the current year, as stipulated in the budget law.

2) is greater than 55%, but smaller than 60%, then:

a) for the subsequent year, the Council of Ministers shall adopt draft budget law in which:

– state budget deficit is not anticipated, or such a gap between state budget revenues and expenditures is projected which guarantees that the ratio of State Treasury debt to gross domestic product anticipated as of the end of the budget year described in the draft budget law shall be smaller than the ratio referred to in Article 38, point 1, letter b, announced in accordance with Article 38,

– no compensation increases for the staff of state budget institutions are anticipated, including staff employed in entities referred to in Article 139, paragraph 2,

– valorization of disability pensions and retirement pensions shall not exceed the level equivalent to the increase in prices of consumer goods and services, announced by the Chief Statistical Office (GUS) for the previous budget year,

– a ban on the provision of loans and credit from the state budget is introduced, with the exception of installments of credit and loans granted in previous years,

– no increase in expenditures at the level higher than in the government administration is anticipated in the entities referred to in Article 139, paragraph 2,

b) Council of Ministers shall review state budget expenditures financed with resources obtained through foreign credit, and it shall review multi-year programs,

c) Council of Ministers shall present to the Sejm a remedial plan aiming at reducing the ratio referred to in Article 38, point 1, letter a,

d) expenditures of a local or regional self-government unit specified in the budget law for the subsequent year may be higher than the revenues of such a local or regional self-government unit increased with budget surplus from previous years and available resources only by the amount related to the execution of tasks from resources referred to in Article 5, paragraph 3;

3) is equal to or greater than 60%, then:

a) provisions set forth in point 2, letters a and b herein shall apply, accordingly,

b) Council of Ministers, not later than within a month from the date of announcement of the ratio referred to Article 38, point 1, letter a, shall present to the Sejm a remedial plan aiming at reducing such ratio to the level below 60%,

c) expenditures of a local or regional self-government unit specified in the budget law for the subsequent year cannot be higher than the revenues of such budget,

d) starting on the seventh day from the date on which the ratio referred to in Article 38, point 1, letter a, was announced, public finance sector units shall not issue any new sureties and guarantees.

Article 87.

Remedial plan shall include:

- 1) indication of the reasons behind the development of state public debt ratio referred to in Article 38, point 1, letter a;
- 2) action plan aiming at the curtailment of the ratio referred to in Article 38, point 1, letter a, including in particular proposed legal solutions that affect the level of expenditures and revenues in public finance sector;
- 3) a three-year forecast of the ratio of state public debt to gross domestic product, together with expected status of macroeconomic situation in the country.

Article 88.

Provisions set forth in Article 86 and Article 87 shall not apply should any of the following be introduced:

- 1) martial law;
- 2) state of emergency throughout the entire territory of the Republic of Poland;
- 3) the state of natural disaster throughout the entire territory of the Republic of Poland.

Section 4

General principles governing obligations incurred by public finance units other than the State Treasury

Article 89.

1. Local and regional self-government units may take credit and loans and issue securities with the purpose to:

- 1) cover temporary deficit of a local or regional self-government unit occurring during the year;
- 2) finance planned deficit of a local or regional self-government unit;
- 3) repay previously incurred obligations in respect of issued securities and incurred loans and credit;
- 4) pre-finance projects financed from European Union budget resources.

2. Credit and loans incurred and securities issued with the purpose referred to in paragraph 1, point 1 herein, shall be repaid or redeemed in the same year in which they were incurred or issued.

Article 90.

To finance capital investments and capital purchases included in the projects referred to in Article 226, paragraph 3, local and regional self-government units may take loans from state earmarked funds, provided that this is allowed by the law upon which the fund was established.

Article 91.

1. The aggregate sum of incurred credit and loans and liabilities resulting from issued securities, referred to in Article 89, paragraph 1, and Article 90, shall not exceed the amount specified in the budget law of the local or regional self-government unit.
2. In the event when a local or regional self-government unit is applying for credit or loan for the purpose referred to in Article 89, paragraph 1, points 2-4, and Article 90, and in the event when a local or regional self-government unit intends to issue securities for the purpose referred to in Article 89, paragraph 1, points 2-4, and Article 90, the Board of such a unit is obliged to obtain an opinion from the regional accounting chamber on the potential for repayment of a credit or loan or redemption of securities.

Article 92.

1. Local and regional self-government units may only incur such financial obligations, with the purpose referred to in Article 89, paragraph 1, points 2-4, and in Article 90, in the case of which the cost of service is incurred at least once a year, and:
 - 1) the discount on securities issued by a local or regional self-government unit shall not exceed 5% nominal value;
 - 2) interest rate capitalization is prohibited.
2. The restriction referred to in paragraph 1 herein shall apply accordingly to public finance sector units other than the State Treasury.

Article 93.

1. Public finance sector units, except for the State Treasury, shall not take credit or loans, issue securities or provide sureties and guarantees whose nominal value due for payment on maturity date, expressed in Polish currency *zloty*, was not determined on transaction date.
2. The Council of Ministers shall define, by the way of a Resolution, the cases when the restrictions referred to in paragraph 1 shall not apply, taking into account in particular the unique character of credit and loans from international institutions or from sovereign lenders, and taking into consideration the potential for meeting the obligations resulting from incurred liabilities and constraining the level of growth of state public debt.

Article 94.

1. Local and regional self-government units may provide sureties and guarantees, subject to provisions contained herein. Total amount of sureties and guarantees is specified in the budget law.
2. Sureties and guarantees referred to in paragraph 1 herein are time-bound and provided up to a certain specified amount.

Article 241.

When the Council of Ministers adopts a draft law on interim budget, the constituting organ of a

local or regional self-government unit, upon the motion of the board, may pass the resolution on the interim budget of the local or regional self-government unit for the period covered by the interim budget.

Article 242.

1. Constitutive organ of a local or regional self-government unit cannot adopt a budget in which current expenditures planned are higher than current revenues planned increased by budget surplus from previous years and available resources referred to in Article 217, paragraph 2, point 6.
2. As of the end of the budget year, actual current expenditures cannot be higher than actual current revenues increased by budget surplus from previous years and available resources, subject to paragraph 3.
3. Actual current expenditures may be higher than actual current revenues increased by budget surplus from previous years and available resources only by the amount related to the execution of current expenditures involving the resources referred to in Article 5, paragraph 3, in the case when those resources were not transferred in a given budget year.

Article 243.

1. Constitutive organ of a local or regional self-government unit shall not adopt a budget the execution of which would mean that, in the budget year and in each year following the budget year, the ratio of the total amount of the following items, due in a given budget year:
 - 1) repayment of credit and loan installments, referred to in Article 89, paragraph 1, points 2-4, and in Article 90, together with the interest due in a given year in respect of credit and loans, referred to in Article 89, paragraph 1 and in Article 90,
 - 2) redemption of securities issued for the purposes referred to in Article 89, paragraph 1, points 2-4 and in Article 90, together with due interest and discount on securities issued for the purposes referred to in Article 89, paragraph 1, and in Article 90,
 - 3) potential repayment amounts resulting from provided sureties and guarantees, in relation to overall planned budget revenues, would exceed the arithmetic mean of the ratios, calculated for the last three years, of its current revenues increased with revenues from the sale of property and decreased by current expenditures, to total budget revenues, calculated according to the formula below:

$$\left(\frac{R+O}{D}\right)_n \leq \frac{1}{3} * \left(\frac{Db_{n-1} + Sm_{n-1} - Wb_{n-1}}{D_{n-1}} + \frac{Db_{n-2} + Sm_{n-2} - Wb_{n-2}}{D_{n-2}} + \frac{Db_{n-3} + Sm_{n-3} - Wb_{n-3}}{D_{n-3}} \right)$$

where individual symbols stand for:

R – planned for the budget year, total amount in respect of repayment of installments of credit and loans, referred to in Article 89, paragraph 1, points 2-4, and in Article 90, and the redemption of securities issued for the purposes referred to in Article 89, paragraph 1, points 2-4, and in Article 90,

O - planned for the budget year, interest in respect of credit and loans, referred to in Article 89, paragraph 1, and in Article 90, interest and discount on securities issued for the purposes referred to in Article 89, paragraph 1, and in Article 90, and the repayment of amounts resulting from provided sureties and guarantees,

D – total budget revenues in a given budget year,

Db – current revenues,

Sm – revenues from the sale of property,

Wb – current expenditures,

n – budget year for which the ratio is determined,

n-1 – a year preceding the budget year for which the ratio is determined,

n-2 – a year two years prior to the budget year,

n-3 - a year three years prior to the budget year.

2. For the calculation of ratios referred to in paragraph 1 herein, for the year directly preceding the budget year, planned values reported in the local or regional self-government unit budget execution reports covering three quarters of the year are taken into account. For the calculation of ratios for the two previous years, values reported in annual report are taken into account.

3. Restriction set forth in paragraph 1 shall not apply to:

1) redemption of securities, repayment of credit and loans incurred in connection with an agreement concluded for the execution of a program, project or task involving the resources referred to in Article 5, paragraph 1, point 2, with the exception of interest on those obligations,

2) sureties and guarantees provided to self-government legal persons who perform the tasks bestowed upon a local or regional self-government unit within the framework of programs involving the resources referred to in Article 5, paragraph 1, point 2,

– within the period up to 90 days from the completion of the said program, project or task and the receipt of reimbursement from those funds.

4. In the event when the resources specified in the agreement, referred to in Article 5, paragraph 1, point 2, are not transferred or, upon the transfer, their return will be required, a local or regional self-government unit shall not issue securities, take credit, loans, or provide sureties and guarantees until the ratio referred to in paragraph 1 is achieved.

Article 244.

1. Total amount of repayments and redemption due in a given budget year, referred to in Article 243, paragraph 1, shall be increased with the amounts of obligations, due for payment in the same budget year, incurred by the association established, among others, by the local or regional self-government unit in question:

1) in the amount proportionate to its share in the joint investment co-financed with a credit, loan or issuance of bonds repaid or redeemed in a given budget year;

2) in the remaining cases - in the amount proportionate to its share in contributions for the benefit of the association in which it is a member.

2. Total amount of repayments and redemption for a local or regional self-government unit referred to in Article 243 shall not include obligations of the association established, among others, by the local or regional self-government unit in question, for which the self-government unit provided sureties and guarantees.

Article 245.

The board of an association of local or regional self-government units notifies the boards of local or regional self-government units which form the association and the relevant regional accounting chamber about the amounts of obligations of the association, within 15 days from the date on which such obligations were incurred.

Article 246.

1. Regional accounting chamber, on the basis of draft budget resolution, presents the opinion on the feasibility of financing deficit presented by a local or regional self-government unit.
2. The opinion referred to in paragraph 1 is published by a local or regional self-government unit within 7 days from the date of receipt from the regional accounting chamber, pursuant to the principles set forth in the Law on Access to Public Information, issued on 6 September 2001 (Journal of Laws no 112, item 1198, with further amendments ¹⁰⁾).
3. Provisions set forth in paragraphs 1 and 2 shall apply to the budget resolution, accordingly.



Local Government Act 2003

2003 CHAPTER 26

An Act to make provision about finance, and other provision, in connection with local and certain other authorities; to provide for changing the dates of local elections in 2004; to amend the Audit Commission Act 1998; and for connected purposes.
[18th September 2003]

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

PART 1

CAPITAL FINANCE ETC AND ACCOUNTS

CHAPTER 1

CAPITAL FINANCE ETC

Borrowing

1 *Power to borrow*

A local authority may borrow money—

- (a) for any purpose relevant to its functions under any enactment, or
- (b) for the purposes of the prudent management of its financial affairs.

2 *Control of borrowing*

- (1) A local authority may not borrow money if doing so would result in a breach of—

- (a) the limit for the time being determined by or for it under section 3, or
 - (b) any limit for the time being applicable to it under section 4.
- (2) The Secretary of State may, in relation to specific borrowing by a particular local authority, by direction disapply subsection (1)(b), so far as relating to any limit for the time being applicable under section 4(1).
 - (3) A local authority may not, without the consent of the Treasury, borrow otherwise than in sterling.
 - (4) This section applies to borrowing under any power for the time being available to a local authority under any enactment, whenever passed.

3 *Duty to determine affordable borrowing limit*

- (1) A local authority shall determine and keep under review how much money it can afford to borrow.
- (2) In the case of the following authorities, namely—
 - (a) the Greater London Authority, and
 - (b) a functional body,
 the Mayor shall determine and keep under review how much money the authority can afford to borrow.
- (3) Before making any determination under subsection (2), the Mayor shall consult the London Assembly.
- (4) Before making a determination under subsection (2) for a functional body, the Mayor shall consult that body.
- (5) The Secretary of State may by regulations make provision about the performance of the duty under subsection (1) or (2).
- (6) Regulations under subsection (5) may, in particular—
 - (a) make provision about—
 - (i) when a determination under subsection (1) or (2) is to be made,
 - (ii) how such a determination is to be made, and
 - (iii) the period for which such a determination is to be made;
 - (b) make provision about the monitoring of an amount determined under subsection (1) or (2);
 - (c) make provision about factors to which regard may be had in making a determination under subsection (1) or (2) or in monitoring an amount determined under that subsection.
- (7) Regulations under subsection (5) may include provision requiring a person making a determination under subsection (1) or (2) to have regard to one or more specified codes of practice, whether issued by the Secretary of State or another.
- (8) A local authority's function under subsection (1) shall be discharged only by the authority.
 - (9) Section 38(1) of the Greater London Authority Act 1999 (c. 29) (delegation by Mayor) does not apply in relation to functions under subsection (2).
- (10) The power under subsection (7) is not to be read as limited to the specification of an existing document.
- (11) In this section—

“functional body” has the same meaning as in the Greater London Authority Act 1999 (c. 29);

“local authority” does not include the Greater London Authority or a functional body;

“Mayor” means Mayor of London.

4 *Imposition of borrowing limits*

- (1) The Secretary of State may for national economic reasons by regulations set limits in relation to the borrowing of money by local authorities.
- (2) The Secretary of State may by direction set limits in relation to the borrowing of money by a particular local authority for the purpose of ensuring that the authority does not borrow more than it can afford.
- (3) Different limits may be set under subsection (1) or (2) in relation to different kinds of borrowing.
- (4) A local authority subject to a limit set under subsection (1) may transfer any headroom it has in relation to the limit to another local authority subject to a corresponding limit.
- (5) The Secretary of State may by regulations make provision about the exercise of the right under subsection (4) and may, in particular, make provision about—
 - (a) the circumstances in which a local authority is to be regarded as having headroom for the purposes of that subsection, and
 - (b) the amount of headroom which it has for those purposes.
- (6) Where an amount is transferred under subsection (4), this Chapter shall have effect—
 - (a) in relation to the transferor, as if the limit in relation to which the headroom exists were reduced by that amount, and
 - (b) in relation to the transferee, as if the corresponding limit to which it is subject were increased by that amount.

5 *Temporary borrowing*

- (1) Subject to subsection (2), any limit for the time being determined by or for a local authority under section 3, or applicable to it under section 4, shall be treated for the purposes of this Chapter as increased by the amount of any payment which—
 - (a) is due to the authority in the period to which the limit relates, but
 - (b) has not yet been received by it.
- (2) In the case of a limit determined under section 3, or set under section 4(2), subsection (1) shall not apply to any payment whose delayed receipt was taken into account in arriving at the limit.

6 *Protection of lenders*

A person lending money to a local authority shall not be bound to enquire whether the authority has power to borrow the money and shall not be prejudiced by the absence of any such power.

Credit arrangements

7 *“Credit arrangements”*

- (1) For the purposes of this Chapter, a local authority shall be taken to have entered into a credit arrangement where—
 - (a) it enters into a transaction which gives rise to a liability on its part, and
 - (b) the liability is a qualifying liability.
- (2) A transaction entered into by a local authority is to be taken for the purposes of subsection (1) as giving rise to a liability on the part of the authority if—
 - (a) it falls in accordance with proper practices to be treated for the purposes of the authority's accounts as giving rise to such a liability, or
 - (b) it falls in accordance with regulations made by the Secretary of State to be treated as falling within paragraph (a).
- (3) The reference in subsection (1)(b) to a qualifying liability is to any liability other than—
 - (a) a liability to repay money,
 - (b) a liability in respect of which the date for performance is less than 12 months after the date on which the transaction giving rise to the liability is entered into, and
 - (c) a liability of a description specified for the purposes of this provision by regulations made by the Secretary of State.

8 *Control of credit arrangements*

- (1) A local authority may not enter into, or vary, a credit arrangement if doing so would result in a breach of—
 - (a) the limit for the time being determined by or for it under section 3, or
 - (b) any limit for the time being applicable to it under section 4.
- (2) In applying those limits for the purposes of subsection (1)—
 - (a) entry into a credit arrangement shall be treated as the borrowing of an amount of money equal to the cost of the arrangement, and
 - (b) variation of a credit arrangement shall be treated as the borrowing of an amount of money equal to the cost of the variation.
- (3) The Secretary of State may by regulations make provision about the calculation for the purposes of subsection (2) of the cost of a credit arrangement or a variation and may, in particular, make provision about the treatment of options.



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