Working paper

Bridging Africa's urban infrastructure gap

Financial intermediaries for facilitating cities' access to debt finance in Africa

Gundula Löffler and Astrid Haas
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Key messages

African cities play a pivotal role in addressing the continent's infrastructure gap and achieving the Sustainable Development Goals (SDGs). However, they struggle in accessing the necessary financing, in particular, in raising debt for capital investments.

Financial intermediaries are institutions, public or private, that facilitate access to capital investment finance for cities and local governments by way of creating better-than-market conditions for the debtor.

Financial intermediaries can come in many different legal and institutional forms. They may be owned by government, the development assistance community, the private sector, or co-owned by different combinations of these stakeholder groups. Their financing can come from a range of different public and private sources.

In Africa, government owned, publicly financed financial intermediaries dominate, many of which struggle with issues around mandate, capacity and resourcing. Development partner-owned intermediaries play an important role, but their institutional limitations hold them back from investing directly into cities at the required levels. The volume of blended and private financing flowing to cities through intermediaries is still greatly insufficient.

Policy recommendations focus on strengthening national legal and institutional frameworks for subnational lending, supporting cities and local governments in realising their investment portfolio, and revisiting the current lending practices of the development finance community.

FMDV

Supporting local authorities to access funding

FMDV – Global Fund for Cities Development is the unique international network of local and regional governments dedicated to designing financing and investment solutions for just, resilient, and sustainable urban development and transition. FMDV supports cities and regions, as well as central governments and development partners, to design innovative subnational financing strategies and mechanisms mobilising public and private finance and investment, aligned with global agendas, particularly the SDGs, the New Urban Agenda, and the Paris Agreement. FMDV has worked with more than 1,500 local governments from 100 countries, 150 public development banks, 250 companies, and investors and has contributed to mobilising more than $1.3 billion for urban development. FMDV also holds the Secretariat of the Alliances of Subnational Development Banks (SDBs) in Latin America and the Caribbean and in Africa that aim at reinforcing the capacities of financial intermediaries to fully deploy their potential, and develop partnerships based on peer-to-peer dialogues and multi-stakeholder cooperation.

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About this publication

This working paper has been prepared as part of the Africa-Europe Mayors' Dialogue. This platform, coordinated by ODI, brings together more than 20 cities in Africa and Europe to work on shared challenges, including how to improve cities' access to finance to rapidly scale investment in sustainable urban development.

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Acronyms

AFD	*Agence Française de Développement* / French Development Agency
AfDB	African Development Bank
CDCs	*Caisses des Dépôts et Consignations* (Gabon)
CDG	*Caisse de Dépôt et de Gestion* (Morocco)
DBSA	Development Bank of Southern Africa (South Africa)
DFLA	Development Fund for Local Authorities (Malawi)
EBRD	European Bank for Reconstruction and Development
EU	European Union
FEC	*Fonds d'Equipement Communal* (Morocco)
FEICOM	*Fonds Spécial d'Equipement et d'Intervention Intercommunale* (Cameroon)
FMDV	*Fond Mondial pour le Développement des Villes* / Global Fund for Cities Development
GCF	Green Climate Fund
GDP	gross domestic product
GIIF	Ghana Infrastructure Investment Fund
IGFTs	intergovernmental fiscal transfers
IMIF	International Municipal Investment Fund
KfW	German Development Bank
LGFV	local government financing vehicle (China)
OECD	Organisation for Economic Co-operation and Development
PIDG	Private Infrastructure Development Group
SDGs	Sustainable Development Goals
SDBs	subnational development banks
SDC	Swiss Agency for Development and Cooperation
SIDA	Swedish International Development Cooperation Agency
SPVs	special purpose vehicles
TNUDF	Tamil Nadu Urban Development Fund
TURF-IMIF	The Urban Resilience Fund-International Municipal Investment fund
UCLG	United Cities and Local Governments
UMDF	Urban and Municipal Development Fund
UNCDF	UN Capital Development Fund
USAID	US Agency for International Development
WAEMU	West African Economic Monetary Union

Executive summary

Urbanisation, climate change and other global challenges are putting cities and local governments in Africa, as in many other regions around the globe, under increasing pressure to provide more and better urban infrastructure and services to their growing populations. Their key role in achieving this and contributing to the Sustainable Development Goals (SDGs) and the Paris Agreement has long been recognised (United Nations, 2017). Yet, to date, most African cities and local governments remain severely under-resourced – leaving them unable to make the necessary investments.

This tension is further aggravated by the fact that cities and local governments in Africa struggle to get access to third party finance, including debt. The reasons are manifold and lie in the often poorly developed legal and regulatory framework governing municipal borrowing; the lack of creditworthiness of cities and local governments; in the paucity of mature, bankable investment projects; and in the underdevelopment of financial markets in the region. However, cities and local governments can overcome some of these challenges and gain access to debt finance through so-called financial intermediaries.

Financial intermediaries are institutions that facilitate access to capital investment finance for cities and local governments by creating better-than-market conditions for the debtor. Financial intermediaries can come from the public or private sectors and in many different legal and institutional forms. This paper proposes a typology for this diverse set of institutions based on two of their main constituting elements, namely their institutional setup, including ownership and legal and organisational structure; and their sources of financing. In terms of their institutional setup, the typology categorises financial intermediaries into those owned by government, the development assistance community or the private sector, or co-owned by different combinations of these stakeholder groups. In terms of their financing, the typology differentiates between several different public and private sources.

A review of the financial intermediaries facilitating cities' access to debt finance in Africa reveals that government owned, publicly financed financial intermediaries are most prominent, although many face challenges related to mandate, capacity and resourcing. Development partner-owned intermediaries can play an important role; this is even more the case with development partner financing channelled through financial intermediaries. However, many bi- and multilateral development institutions are prevented from investing directly into cities at the required levels by their own institutional limitations. Financial intermediaries owned by the private sector in Africa still constitute the exception rather than the norm, although a few promising examples indicate their potential. The volume of blended and private financing flowing to African cities through intermediaries is still greatly insufficient.

Given this current landscape of financial intermediaries in Africa, widespread access to debt financing for cities and local governments is still far from a reality. Smaller and less capacitated local governments, in particular, are unable to engage in municipal borrowing to address their infrastructure needs, even with the help of financial intermediaries. Thus, there is an important role for public financial intermediaries and the governments that own them to develop a broad financing offer with a range of different financing instruments that allow cities and local governments to use them strategically based on their borrowing capacity, as well on the nature and bankability of the investments to be financed.

In many countries, this also requires addressing the gaps in legal and regulatory frameworks to ensure that a reasonable balance can be struck between managing fiscal risks stemming from subnational borrowing and facilitating access for cities and local governments to needed infrastructure financing.

The paper concludes with policy recommendations for national governments, development partners, and cities and local governments that can help address some of these challenges and gaps. These focus on strengthening national legal and institutional frameworks for subnational lending, supporting cities and local governments in realising their investment portfolio, and revisiting the current lending practices of the development finance community. They can be integrated into a country's overall reform strategy to make effective use of financial intermediaries to facilitate access to finance for cities and local governments, enabling them to meet their infrastructure needs.

1 Why African cities need help with access to finance

The African continent and African cities, in particular, are faced with the tremendous challenge of addressing an infrastructure gap that has accumulated over decades. The African Development Bank has estimated that the current infrastructure needs of the continent will amount to $130–170 billion per year (AfDB, 2018). These numbers are only expected to increase as Africa's population is projected to grow by 1 billion by 2050 (UNDESA, 2022).

This situation is further exacerbated by several factors, among them conflict and protracted crises and climate change, which further accelerate already rapid urbanisation. Africa is currently the continent that experiences the fastest urban growth in the world, with a growth rate of 3.4%. The share of its population living in urban areas is currently 44% and is expected to increase to 60% by 2050 (UN Habitat, 2022). This rapid urbanisation is driven by population growth and by rural–urban migration. However, much of this migration is not aimed at the metropolitan areas, but at secondary cities and towns (Haas, 2023a; The Economist, 2023). As a result, cities and local governments of all sizes must cope with a continuously growing population, putting a strain on existing, often crumbling, urban infrastructure, while experiencing pressures to extend it at a large scale.

In light of these challenges, as well as the increasingly important role of cities and local governments in the provision of public services and urban infrastructure, not least to achieve the Sustainable Development Goals (United Nations, 2015) and align with the agenda of the Paris Agreement, cities and local governments have come under tremendous pressure to make substantive investments in their urban infrastructure. The New Urban Agenda, adopted in 2016 at UN Habitat III, recognises the crucial role of cities in achieving these global development objectives and highlights the opportunities of well-planned and well-managed urbanisation, including municipal finance, as a tool for sustainable development (United Nations, 2017).

Despite the huge investment demands that cities and local governments face (Cirola, 2020), their share of investment as a percentage of total public investment remains low. In 2020, subnational government investments worldwide amounted to 39.5% of total public investment, while for African subnational governments, that share was only 24%. In terms of share of gross domestic product (GDP), subnational public investment constituted, on average, only 1.5% globally and only 0.7% in Africa (OECD and UCLG, 2022). This is partly because most subnational governments are unable to access financing other than often insufficient central government transfers and their usually meagre own sources of revenue. In particular, debt financing from private investors or domestic or international financial markets is beyond the reach of most African cities and local governments. This is for a multitude of reasons, ranging from the absence of appropriate legal provisions to poor creditworthiness on the part of the cities, to a lack of potential investors that might be interested in financing urban infrastructure projects.

The enormous needs and multiple challenges described above have led to renewed attention on so-called financial intermediaries, a wide range of different types of institutions that facilitate access to debt finance for cities and local governments to allow them to address at least some of the extensive infrastructure demands they are facing. Given this unique facilitator role, financial intermediaries could become increasingly important for the development of urban infrastructure in the African context (FMDV and UNCDF, 2018). This paper takes stock of the diversity of financial intermediaries and gauges their current and potential role in facilitating cities' access to debt finance in Africa.

Box 1 Research methodology

The research for this paper relied on two main approaches for data collection. First, the authors conducted a thorough review of the existing academic and grey literature, as well as publicly available information about different financial intermediaries and urban investment projects. Second, they conducted key informant interviews (14 in total) with experts and practitioners in the field (see the Appendix for a list of key informants).

In addition, a small number of government-owned financial intermediaries were selected to develop in-depth case studies to illustrate some of the key characteristics of these institutions and demonstrate the breadth of institutional diversity and capacity that can be found on the African continent. Brief summaries of these case studies can be found throughout this paper, while the long versions are presented in a companion publication titled 'Subnational financial intermediaries in Africa - Case studies'.

The paper is organised as follows: the next section briefly describes the numerous obstacles that African cities and local governments face in accessing debt finance for infrastructure investments. Section 3 provides a tentative definition of financial intermediaries. Section 4 constitutes the heart of this paper, proposing a typology of financial intermediaries for cities' access to finance. The typology is composed of two dimensions, which are presented and illustrated with various examples in subsections 4.1 and 4.2, before combining into a typology matrix that provides an overview of the diverse landscape of African financial intermediaries in subsection 4.3. Section 5 discusses the gaps that exist in the financing offer to African cities by financial intermediaries, and Section 6 concludes with policy recommendations to expand the access to debt for cities and local governments in Africa.

2 Obstacles to cities' access to debt finance in the African context

This section will dig deeper into the obstacles that cities face in their quest to access debt financing in the African context. The obstacles are grouped based on the contextual factor they relate to: legal and regulatory framework, city and local government performance and practices, envisaged investment projects, and financial markets.

2.1 Obstacles related to the legal and regulatory framework

There are several obstacles related to the legal and regulatory framework that restrict cities' access to finance, both in terms of the ability to take on loans (demand side) and in terms of the ability and willingness of investors to make appropriate financial offers (supply side). One obstacle regarding the demand side that is frequently pointed to is that in many countries in Africa, cities and local governments are legally not allowed to borrow for capital investments or, if so, only under very specific circumstances (Smoke, 2022; Tyson, 2022; UN Habitat, 2015).

However, even in countries where municipal borrowing is permitted in principle, the lack of an appropriate legal and regulatory framework to enable cities and local governments access to debt finance effectively prevents them from going down that route. Here, the lack of clear rules and procedures that provide authorisation and safeguards (for example, regarding central government guarantees or bailouts) for local government borrowing activity acts as a deterrent by rendering such endeavours difficult and risky. Cities determined to acquire debt financing often have to forge their own path, usually with the support of external financial advisers, and without assurance that it will work out in the end.

These obstacles are particularly pronounced in countries with weak decentralisation, which also tends to further aggravate the issue. A limited decentralisation framework that does not grant local governments fiscal and administrative autonomy or does not devolve sufficiently productive revenue sources that would allow them to have adequate and reliable revenue inflows, for example, can be a major practical hurdle for cities and local governments wanting to access debt financing (Smoke, 2022; Habeau, interview, 2023). In such contexts, local governments have neither the authority nor the agency to borrow.

On the supply side, the absence of well-defined rules and regulations that quantify and mitigate risks and outline clear procedures and requirements to guide municipal borrowing tends to dampen investor confidence and makes the process difficult to navigate for all parties (Saxena, 2022; Machano, interview, 2023; Painter, interview, 2023). In many African countries, the legal requirements for reporting on local government finance tend to be narrow in scope and are often poorly enforced. Very few countries have a quantitative risk assessment framework in place that requires subnational governments to provide a regular and transparent overview of key financial variables that help determine the sustainability of their finances and look for signs of financial distress (Saxena, 2022).[1] Without such information, potential lenders find it difficult to accurately quantify the risk of lending to a particular city or local government.

Frameworks for mitigating risks, where they exist, tend to be basic, often relying on central government approval of all subnational borrowing activity. Other measures include requirements for balanced budgets, prudential limits on debt stock/flow, or debt service, etc. However, this approach can only create an enabling environment for subnational debt finance if it is strictly based on technical and financial considerations and analysis and does not allow politics to guide the decision-making. Other risk-mitigating measures or safeguards in case of default are rarely put in place by the legislator. These include, for example, clear rules about central government guarantees for city and local government lending (Machano, interview, 2023) or legislation that explicitly requires or permits local governments to ringfence certain revenue streams for securing debt repayment or to put up certain assets as collateral. Finally, few countries have clear insolvency or dispute regulations that articulate a course of action should a city or local government become unable to meet its financial obligations towards its lenders (Machano, interview, 2023; Painter, interview, 2023; see also Liu and Waibel 2008; Saxena 2022).

2.2 Obstacles related to the performance and practices of the city and local government

Few cities or local governments in Africa are considered creditworthy.[2] Lenders assess creditworthiness primarily based on cash flow and the availability of collateral, and cities often cannot sufficiently provide either (Smoke, 2022; Tyson, 2022; Machano, interview, 2023). In many cases, this is because cities cannot mobilise sufficient own-source revenue that provides an adequate and reliable stream of income to ensure debt service. In part, this is because central governments tend to keep the most productive revenue sources for themselves, devolving those sources with lower yields or that are more tedious to collect. However, many cities and local governments have yet to set up efficient and effective systems for local revenue collection (Haas, 2023a; Moore et al., 2018). Although several cities across Africa, such as Freetown (Sierra Leone), Kampala (Uganda) or Dakar (Senegal), have started to break this pattern, they remain in the minority. Meanwhile, most cities continue to struggle with numerous technical and political hurdles to increase their own-source revenue collection to expedient levels (see, for example, Moore et al., 2018; Fjeldstad and Heggstad, 2012). Recent studies (OECD and Lincoln Institute of Land Policy, 2022) have made the point that land value capture instruments can be used

1 According to Saxena (2022), a quantitative risk assessment framework should be built around the following five analytical dimensions: 1) fiscal capacity and flexibility; 2) operating performance; 3) liquidity management; 4) debt capacity; and 5) asset management.

2 While the term 'creditworthiness' in its popular use suggests a certain absoluteness of the concept – a city is either creditworthy or it is not – the assessment ultimately lies in the eye of the investor and is a function of their appetite for risk and their desired return on investment.

effectively to produce reliable revenue streams for local governments. However, to date, such instruments have not been widely established in Africa and may pose challenges and risks of their own (Paulais, 2012).

Debt repayment, in principle, can also be secured through intergovernmental fiscal transfers (IGFTs), especially unconditional transfers that allow cities and local governments to allocate them as they see fit. Unfortunately, local governments in many countries primarily receive IGFTs that are earmarked for specific purposes, making them unsuitable for debt service. In Uganda, for example, the use of almost all IGFTs is predetermined by the central government by specifying what local governments can spend them on. This effectively pre-empts any allocation decisions by local governments and prevents them from using the funds for any purpose other than the one intended. Furthermore, once they reach the city's general fund, IGFTs tend to be used quickly for other priority expenditure needs. Together, this means that relying on this revenue source for servicing debt is often not a viable option either (although it has been used in some contexts – see, for instance, international examples in Section 5).

Putting up appropriate collateral to secure a loan, such as land or other assets, can also be problematic for cities and local governments for a range of reasons (see, for example, Paulais, 2012). In particular, in less decentralised settings, public land and buildings, even if locally managed, might be owned by the central government. Even if the city owns the assets outright, poor local asset management, such as the lack of a basic asset registry that precisely identifies the assets and their value, can hinder effective employment of these assets as collateral. In addition, putting up land or buildings intended for public benefit as collateral could be controversial and create political problems down the line – in particular, if those assets end up being seized. Finally, land, especially outside of metropolitan areas, is often not worth enough to provide suitable collateral for more than just modest loans (Dahan, interview, 2023).

Given this situation, many cities and local governments are not financially robust enough to put potential investors at ease and give them credible assurances that the debt will be paid or can at least be secured. Therefore, it is not surprising that only a few cities in Africa have ever received a formal credit rating from one of the global or regional rating agencies.[3] Receiving such a rating, in many other regions of the world, tends to be one of the first steps for any institution, public or private, when seeking to access debt financing. A notable exception is South Africa, where a considerable number of its cities and municipalities have obtained credit ratings, although most of them do not rank at investment grade.

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3 A number of African cities, including Kampala, Windhoek, Arusha, Dar es Salaam, Gaborone, Lusaka, Maputo and Port Louis, have obtained 'shadow' ratings to get a sense of where they would land on a formal credit rating and on which aspects they would likely need to take corrective action (C40 Cities, 2016).

Box 2 Moody's sub-sovereign rating methodology

Subnational governments can request a credit rating from any global or regional rating agency. These ratings are called 'sub-sovereign' credit ratings. The methodology used for rating sub-sovereigns is similar across different agencies, although slight differences in ranking are always possible (Liu and Tan, 2009).

Moody's applies its methodology for rating sub-sovereigns globally to all regional and local governments except those in the United States, which are rated separately. The methodology entails two main components: the *baseline credit assessment* (BCA), which measures the intrinsic strength of a subnational government; and *extraordinary support,* which assesses the likelihood of a higher-tier government coming to the rescue of a subnational government at risk of default.

The BCA is determined by assessing a subnational government's *idiosyncratic risk* of default, its *systemic risk* of default, and several *additional factors*.

The key factors that determine the *idiosyncratic risk* score are:

- Economic fundamentals: economic strength; and economic volatility.
- Institutional framework: legislative background; and financial flexibility.
- Financial performance and debt profile: operating margin; interest burden; liquidity; debt burden; and debt structure.
- Governance and management: risk controls and financial management; investment and debt management; and transparency and disclosure.

The *systemic risk* score usually corresponds to the bond rating of the sovereign. The rationale for this lies in the macroeconomic and financial links between central and lower-level governments.

The *extraordinary support* component is assessed by considering the following:

- the supporting government's rating;
- an estimate of the default correlation between the two entities ('dependence');
- an estimate of the likelihood of extraordinary government support ('support').

To date, only a few subnational governments in Africa have requested a rating from a global or regional rating agency, and the majority are concentrated in South Africa.

Given that many rating factors relate to the national context, subnational government ratings tend to be heavily linked to those of their central governments (Liu and Tan, 2009). In fact, sovereign ratings tend to constitute the upper limit for sub-sovereigns. Only in exceptional cases can a subnational government obtain a rating that is above the one of its national government.

Source: Moody's Rating Methodology for Regional and Local Governments (2018)

2.3 Obstacles related to the investment projects proposed by cities and local governments

Another important set of obstacles to cities and local governments accessing investment finance is that cities often struggle to identify and formulate investment projects that are 'bankable' in the broadest sense, i.e., that will be successful in obtaining financing from a third party. Determining bankability and having a sense of what projects might be attractive for what types of investors is not trivial, as it requires, among other things, a level of understanding of the intrinsic motivations and incentive systems of the different financiers.

Once a potentially bankable project has been identified, the next challenge often lies in the quality and credibility of the technical and financial preparation of the investment. Large infrastructure projects frequently require highly specialised engineering and architectural expertise to conduct the preliminary studies and prepare detailed plans for the project. On the financial side, they need to be structured carefully to ensure the arrangement is financially viable for all parties and that inflows and outflows of cash are in line with project requirements and investor expectations. Cities and local governments around the world, even those with high levels of capacity, usually do not maintain this type of expertise in-house. Rather, they contract it out to specialised engineering and financial services firms. On the African market, these types of expertise are not widely available. So even if the cities or local governments could pay for them, which can be a considerable upfront investment for a project they may not be able to mobilise funding for, they might struggle to find suitable contractors to do the job. It has been estimated that 80% of infrastructure projects in Africa fail at the feasibility and business plan stage, partly due to this lack of expertise (Lakmeeharan et al., 2020). This issue is compounded by the lack of financial, physical, demographic and socioeconomic data needed to conduct all the related quantitative analyses. As a result, cities and local governments in Africa often present investment projects that are merely past the initial idea stage and still need work to determine feasibility, social and economic benefits, and sustainability (Habeau, interview, 2023).

Even in cases where investment is limited to the off-the-shelf acquisition of large machinery and equipment, such as a new electric bus fleet, city governments need to have the mandate and the capacity to adequately manage the procurement of such 'big ticket' items. However, this kind of mandate and capacity are often not present in many African cities, where the responsibility for high-value procurement rests with the central government and often within a specialised agency. Where that is the case, if and how procurement can be managed centrally on behalf of the city will need to be investigated, while the latter remains in charge of the overall deal.

Another obstacle relates to the financial viability of the investment project. Most of the investment needs in African cities are for basic urban infrastructure such as roads, bridges, water and sanitation networks, and public facilities such as schools and health centres. This type of investment seldom generates profit, which means that any debt taken on for their realisation would need to be repaid from other revenue sources. This is usually easier said than done.

However, some investment needs, such as ports and airports, public transport systems, markets and commercial centres, have the potential to be (at least partially) self-financing. This means that any revenue generated from their use can be put towards servicing the associated debt (see also Smoke 2019; 2022). The latter type of investments, if structured properly, can yield enough revenue to attract investors, even if part of the cost will need to be subsidised from other sources. For the former type of investments, it is usually much more difficult to make a convincing case for debt financing, unless a robust alternative revenue source can be secured. Such projects will likely continue to rely heavily on grant financing, even in the long run.

Although the pursuit of private financing for suitable infrastructure needs has become a necessity for most African cities, it holds the risk of drawing capacity and resources away from their responsibilities to provide basic services at an affordable level in favour of investments that are likely to generate a return. Cities can best address this challenge through strategic investment planning that helps to prioritise development needs and match projects to appropriate types of financing.

Finally, the scope of investment needs can also constitute an obstacle for cities' access to finance. Cities, in particular secondary cities and smaller local governments, tend to formulate projects in line with their needs and financial capacity – and these are too small to be interesting for most private investors. Most investors do not want to invest below a certain threshold, as overheads, such as costs for conducting due diligence, are usually relatively fixed and therefore become too expensive in proportion to a small investment. While these thresholds might vary from investor to investor, small investment projects (below $1 million is an often cited threshold) tend to have a harder time attracting financing than large ones (Dahan, interview, 2023).

2.4 Obstacles related to the financial markets

Despite considerable variation between countries, to date most financial markets in Africa are not sufficiently deep and mature to make suitable financial offers to cities and local governments for infrastructure financing. According to experts, the most developed financial markets on the continent are in South Africa and the West African Economic and Monetary Union (WAEMU), with its joint currency backed by the French treasury (Habeau, interview, 2023; Machano, interview, 2023; Painter, interview, 2023).

Emerging markets tend to be dominated by the banking sector, which, in such environments, gravitates towards low-risk, high-margin lending activities such as central government bonds, trade finance or lending to large corporations. Riskier clients such as small and medium enterprises – but also cities and local governments – often remain underserved (Dahan, interview, 2023). At the same time, commercial banks are generally more familiar with issuing loans with tenors between 30 days and 3 years (Painter, interview, 2023). They have little experience conducting due diligence assessments of cities and local governments, especially in the case of longer-term investments. Specialised banking services for infrastructure financing are still quite limited in emerging markets. This tends to leave cities and local governments with minimal private banking options for capital investments, as only a few banks are willing to lend to them, and particularly not loans with long tenors (Machano, interview, 2023).

Non-banking institutions such as pension funds, insurance companies, leasing companies, or other investment funds, which might be interested in investing with cities and local governments, are still less present in African markets than in other parts of the world. In principle, pension or insurance funds make quite suitable investors for infrastructure projects with investment horizons of 10 to 20 years or more, as they continuously receive contributions/premiums that they need to invest with a tenor that is in line with their pay-out schedule, either through bonds or direct lending. However, to date, there are few such funds in Africa and they tend to be heavily regulated, which restricts them in the investment portfolio. In Uganda, for example, discussions with these non-banking institutions have revealed that despite their growing appetite to invest locally, they struggle to find projects they consider suitable for investment.

Capital markets tend to be in their infancy in most of Africa. While sovereign and corporate bonds are becoming increasingly commonplace (Nzebo et al., 2021), municipal bonds are still rare outside of South Africa. In many countries, stock exchanges have not yet established formal rules and regulations for issuing municipal bonds. This requires first movers to spend a lot of time and resources exploring and negotiating a procedure that is acceptable to all stakeholders, including the finance ministry, the ministry in charge of local governments, the capital market regulator, and the underwriter of the bond, among others (Sarr, interview, 2023). And even when a city manages to navigate all these hurdles, there is still no guarantee that it will work, as in the case of Dakar, where the central government stopped the first municipal bond issue – a process that had taken the city over three years to prepare - the day before it went to market (Sarr, interview, 2023; Delbridge et al., 2022).

Even in places where clear rules and regulations are in place to issue a municipal bond, the cost of doing so is considerable. Cities need to hire transaction advisers to help structure the bond, obtain a credit rating from a reputable rating agency, cover the fees and expenses of the underwriter, and, where required, pay for a guarantor (Haas, 2023b).

Even if isolated cities or local governments manage to float a municipal bond, price discovery will remain a challenge – as potential buyers usually have no means of assessing the adequacy of the price and coupon rate by comparing it to similar bond offers. Hence, their purchasing decisions will need to be based on other considerations. Furthermore, without a large and diverse number of market participants, there tends to be no vibrant secondary market in which bonds can be traded. As a result, initial buyers might be stuck holding the bond until it reaches maturity, reducing the flexibility of the investment for the bond holder. Some experts have argued that these structural challenges constitute an important hurdle to developing municipal bonds as an effective financing mechanism for African cities on a larger scale, in particular in smaller countries that naturally have smaller capital markets (Dahan, interview, 2023). Others believe capital markets have great potential to transform the financing landscape for cities and local governments in Africa if those markets can be structured further and more investors, including from outside the continent, can be made aware and convinced of the opportunities they offer (Machano, interview, 2023).

Of course, in the absence of suitable offers in the domestic financial market, cities and local governments might be tempted to explore possibilities of borrowing from the international market. However, this comes with its own set of challenges. International investors might have higher minimum investment thresholds and be more risk averse, given the barriers to acquiring information on local conditions. This limits the types of investment projects that might be considered to large-scale projects that offer a solid profit margin. Furthermore, in many countries, borrowing from the international market for local governments is regulated more stringently or may not be permitted at all (Ter-Minassian and Craig, 1997).

Most importantly, borrowing from the international market means borrowing in hard currency. This carries a considerable exchange rate risk for cities and local governments, which generate revenue exclusively in domestic currency. Any substantive depreciation of the local currency, a risk that is difficult to assess given the long tenor of infrastructure debt, will effectively increase the cost of debt service, potentially to unsustainable levels. This can be so detrimental that some experts believe cities and local governments should be prohibited from borrowing in any other currency than their own (Painter, interview, 2023). Others have argued that with the right kind of support and a suitable framework in place to manage fiscal risk, foreign borrowing by subnational governments is feasible and should be encouraged (Machano, interview, 2023; Tyson, 2022).

3 Towards a definition of financial intermediaries

The previous section outlining the obstacles to borrowing paints a gloomy picture of the ability of cities and local governments to access debt financing for infrastructure development in Africa. Hence, it is not surprising that to date, not much borrowing activity has been observed at the local level. However, given the tremendous pressures on urban infrastructure created by fast progressing urbanisation on the continent, an increasing number of solutions have begun to emerge that can help cities overcome some of the obstacles to accessing debt. The solutions can be provided by so-called 'financial intermediaries' for a cities' access to finance.[4] Some of these financial intermediaries have been around for decades; others have only recently come into view. They come in many different legal and institutional forms and structures, and the financing sources and mechanisms on which they draw are manifold. Yet what they all have in common is that they help cities and local governments overcome some of the obstacles they face in accessing longer-term debt for infrastructure finance (Smoke, 2019; 2022; Tyson, 2022; Haas, 2023a; 2023b).

Given the diversity of institutions that can fall under this generic umbrella term, there might not even be a clear consensus across different communities of practice as to what types of institutions constitute financial intermediaries and under what conditions. For this reason, we believe that proposing a definition and typology of financial intermediaries – even a necessarily general and exploratory one – might be a fruitful contribution to the emerging debate.

To this end, we understand a financial intermediary for cities' access to finance to be an institution, private or public, that facilitates access to capital investment finance for cities and local governments by creating better-than-market conditions for the debtor. In that sense, financial intermediaries help correct a market failure that prevents the growing demand for subnational infrastructure financing from garnering an adequate supply.

> A financial intermediary for cities' access to finance is an institution, public or private, that facilitates access to capital investment finance for cities and local governments by way of creating better-than-market conditions for the debtor.

4 They are also sometimes referred to as 'special financial intermediaries' (see, for example, Smoke, 2022).

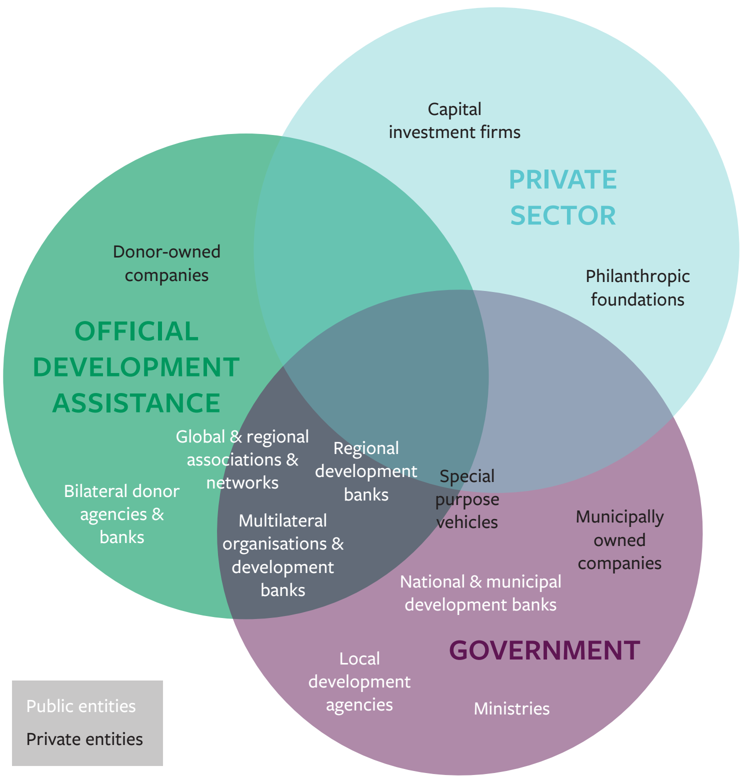
4 A typology of different models of intermediaries

At first glance, some of these financial intermediaries appear so different in nature and function that one might not recognise them as working towards the same overall objective. Therefore, it is useful to develop a typology of different models of financial intermediaries based on two of their main constituting elements. These elements are the institutional setup of the financial intermediary, including its ownership and legal and organisational structure, on the one hand, and the sources of financing the financial intermediary draws on, on the other. Each will form a key dimension of the typology. The following two sections present each of the key dimensions and discuss which of their manifestations can be most encountered across Africa, before combining them into a typology of financial intermediaries.

4.1 Key dimension one: institutional setup of financial intermediaries

As mentioned above, financial intermediaries can come in many different legal and institutional forms and structures. Figure 1 maps the ownership and legal status of the different types of financial intermediaries that facilitate access to infrastructure finance for cities and local governments.

Figure 1 Ownership structure and legal status of different types of financial intermediaries



Source: Authors

The figure shows that, broadly speaking, the financial intermediaries operating in this space are either owned by the governments of the countries whose cities and local governments are being targeted; the development assistance community (official development assistance contributors); the private sector; or are co-owned by a combination of these three groups. In terms of their legal status, financial intermediaries can be public or private entities, which is often a simple function of their ownership structure but can also constitute a deliberate attempt at exploiting specific advantages or incentives inherent to a particular legal form.

Financial intermediaries in government ownership

Government-owned financial intermediaries are usually public entities, such as ministerial departments or agencies, with the mandate to provide infrastructure and other capital investment financing to cities and local governments. Some of these agencies are banking institutions, which allows them to raise their own funds. These can be specialised municipal development banks or national development banks with a municipal lending window, and their main role is to provide debt financing to subnational governments at concessional or non-concessional rates. Others are non-banking institutions, such as local development funds or agencies that are primarily charged with on-lending or on-granting finance from the national budget and other sources to cities and local governments. These public agencies usually issue grants and concessional loans to subnational governments or municipally owned companies for investment projects. They might also provide them with guarantees or other types of credit enhancement for third-party loans. Many of these agencies also offer some form of technical assistance to subnational governments to support project preparation or implementation (Smoke, 2019; 2022; Habeau, interview, 2023; FMDV, 2022).

In large parts of the developing world, these public institutions play a critical role in enabling municipal debt financing, as they often are the only ones offering debt financing options to smaller, less capacitated cities and local governments. By combining technical assistance with a well-structured blend of grants and loans, for example, they can help local governments close financing gaps while building their capacity and incentivising them to increase their own-source revenue (Smoke, 2019; 2022). They can also provide technical and/or financial support to help cities formulate bankable projects and connect them with potential financiers, or pool smaller bankable projects to meet the investment threshold of larger investors. Furthermore, they can ensure that local investments are well aligned with national development policies or global commitments such as the Sustainable Development Goals (SDGs) or the Paris Climate Agenda (Habeau, interview, 2023).

In addition to directly facilitating the access of cities and local governments to debt financing, given their position within the government, these public institutions are well placed - at least in principle – to perform two functions that are crucial to improving conditions for municipal debt financing in the country. First, they can exploit their privileged access to policy-makers by using technical knowledge and experience to propose and advocate for improvements to the legal and regulatory frameworks that further enable local access to debt finance within reasonable safeguards. Second, they can collect data on local government finances, framework conditions and investment needs from different sources, compile and analyse them, and make them available to potential public or private financiers. These include other government bodies and development partners interested in supporting local infrastructure development. This second function will improve transparency regarding the creditworthiness of local governments and ultimately increase investor confidence, as it strengthens their ability to make an informed decision (Habeau, interview, 2023).

To give more weight and visibility to these types of agencies, the Global Fund for Cities Development (*Fond Mondial pour le Développement des Villes* – FMDV) has coined the catch-all term 'subnational development banks' (SDBs), defined as public development banks (PDBs) or public financing institutions supported by national governments or states, with the specific mandate to provide funding to local governments and support subnational urban investments. As noted above, not all of them are technically banks (see also Suchodolski et al., 2021).

Box 3 Supporting SDBs through the Finance in Common initiative[5]

FMDV, as part of the Finance in Common initiative – a global network led by the French Development Agency (AFD) and gathering more than 500 public development banks (PDBs) committed to finance the implementation of the Paris Agreement 2030 Agenda – has supported SDBs to organise into regional alliances that allow these institutions to network, exchange good practices, build their capacity and make their voices heard in international forums where they can lobby for their common concerns. A first alliance of SDBs in Latin America and the Caribbean was launched in 2020 (FMDV and FICS, 2022), followed by the alliance of SDBs in Africa in 2022. The SDB alliance in Africa currently counts 22 full and prospective members, the majority of which are in francophone countries (FMDV internal document).

As far as government institutions go, municipally owned companies, such as utility companies, can also function as financial intermediaries to facilitate subnational borrowing, but in a very different way from the institutions described above. Due to their corporate status as private entities, municipally owned companies tend to have more freedom to borrow from public or private investors than the municipalities that own them. They might not be concerned by local government restrictions on borrowing, or they may have easier access to loans from the banking sector, as commercial banks might be more familiar with conducting due diligence on corporate structures and therefore more comfortable doing business with them. Most importantly, their status as a separate legal entity isolates their finances from those of the associated local government. Therefore, as long as a company's balance sheet shows an adequate and stable

5 Finance in Common, Homepage (https://financeincommon.org/).

revenue stream – for example, from user fees or subsidies – or it can offer suitable collateral, it might be able to obtain a loan, even if the municipality that owns it is far from creditworthy. This approach can grant cities and local governments indirect access to debt financing for capital investments in infrastructure related to the company's service delivery mandate, such as the renewal or expansion of their water supply network.

Similar principles apply to another type of financial intermediary that cities or other government entities can set up to facilitate access to third-party finance for local governments, commonly known as special purpose vehicles (SPVs). SPVs are private legal entities established to insulate their owners from financial risk. They are widely used in the private and public sectors to separate certain assets or financial transactions from their parent institution. In this way, if either side experiences financial difficulties, the other side is protected. As financial intermediaries, SPVs can, in principle, be set up at any level and with any scope that suits the financial arrangement. This type of set-up, for example, can allow cities and local governments to issue a corporate bond to finance a particular project or set of projects. Depending on the risks associated with the project, the SPV is likely to obtain a better credit assessment than that available to the local government, allowing it to reduce the interest rate on the bond. SPVs are particularly useful for enabling blended finance, when one or more private investors and/or development partners want to join forces with a city or local government to finance a particular project or set of projects. Alternatively, a city can set up an SPV as an investment fund to mobilise private investment for a particular purpose, similar to the Paris Green Fund or the London Green Fund (Voges, 2018; Detter et al., 2020; Habeau, interview, 2023).

Financial intermediaries in development assistance ownership

The development assistance community also provides financial intermediaries that facilitate access to debt finance for cities and local governments in many parts of the world. These mainly come in the form of projects and programmes set up by one or several bilateral donor organisations and provide financial and/or technical assistance for the realisation of local infrastructure investments. These projects or programmes can be country-specific or can offer support at a regional or global scale. Their ability to mobilise substantive resources allows these financial intermediaries not only to invest large amounts into infrastructure finance at concessional rates, but also to buy in highly specialised expertise to provide technical advice and capacity-building to prospective and current borrowers.

One interesting characteristic of these bilaterals is that they can act both as a first-floor and a second-floor institution, meaning they can either provide direct support to cities and local governments through their own project structures, or they can channel their support through a government-owned financial intermediary. As a first-floor institution, they tend to have more control over the disbursement of funds and adherence to the conditions attached to their disbursement. As a second-floor institution, they incur fewer overhead costs while strengthening the financial and technical capacity of government-owned financial intermediaries to provide loans. This in turn might encourage these intermediaries or other financiers to focus their activities more on loan financing and less on grant financing in the future.

While crucial to the availability of debt financing for cities and local governments across Africa, this type of financial intermediary often links their financing commitments to a specific agenda in line with their current strategic objectives, such as the SDGs or the Paris Climate Agreement. Or they may have a particular sectoral focus, such as green transportation systems or flood mitigation infrastructure (FMDV, 2022; FMDV, 2021). These links or focus might or might not align well with national government strategies and the concrete needs and priorities of cities and local governments looking to borrow. Sometimes, achieving common ground requires lengthy, upfront discussions and negotiations to work out a set of conditionalities that ensures all parties can meet their respective objectives.

One challenge some of these financial intermediaries face in trying to facilitate cities' access to finance is that since they are themselves public institutions representing a donor country, they must – at least in principle – partner with central government bodies in the recipient country. Therefore, to be able to finance cities and local governments directly, they often need to establish a 'work around'. This can be achieved, for example, by establishing a trust fund at the central level that lends to local governments or, as mentioned above, by entrusting the financing to a government-owned intermediary for on-lending. Such approaches also deal with the fact that most city projects on their own would be too small to be funded by a donor organisation.

Finally, bilateral donor projects are usually time-bound interventions with a lifetime ranging from two to seven years, at the end of which support is often discontinued. Some projects aim to institutionalise the structures and practices by embedding them in new or existing government institutions, hoping that these will continue to function with government resources after support has ended. Other projects see their main contribution in the support they provide during their term – for instance, the urban infrastructure they financed, and the experience gained by the cities and local governments in managing their implementation.

While most bilateral donor projects acting as financial intermediaries for city financing are public entities, there are a few examples where donors have created companies with that mandate. An example is the Private Infrastructure Development Group (PIDG), which is a private limited company incorporated in England and Wales. PIDG was created in 2002 (originally as a trust) and is currently owned and funded by the governments of the UK, the Netherlands, Switzerland, Australia, Sweden, Germany and the International Finance Corporation (IFC), with the aim to demonstrate the commercial viability of infrastructure development in sub-Saharan Africa and South and South-East Asia. Although its main focus is on supporting access to finance for the private sector, it has effectively facilitated municipal debt financing on numerous occasions. However, its scope remains limited.

Financial intermediaries in private sector ownership

On the private sector side, philanthropic foundations have also acted as financial intermediaries for city financing around the world. Their methods and approaches are like those of other development partners, although their internal governance structure and accountability mechanisms are, of course, quite different. Over the past decade or two, foundations have become increasingly important in the international development sector, due to the volume of resources they provide and the wide range of different stakeholders they support (OECD, 2020). This also includes considerable support for urban development. In 2018, for example, the overall commitment of private philanthropy to SDG 11 on sustainable cities and communities reached $1.9 billion, second only to its commitment to SDG 3 on good health and well-being (Ibid.).

More recently, some private capital investment firms have started to explore possibilities for financing city investments in developing countries. One of them is Meridiam, a private international infrastucture investment and asset management firm with the mission to 'deliver sustainable infrastructure that improves the quality of people's lives'.[6] Meridiam set up a capital investment fund called the The Urban Resilience Fund – International Municipal Investment Fund (TURF-IMIF), which is intended to make long-term equity and quasi-equity investments in urban resilient and sustainable infrastructure projects for cities outside Organisation for Economic Co-operation and Development (OECD) countries, and mainly for African cities. To mitigate some of the challenges related to such investments, Meridiam has partnered with the UN Capital Development Fund (UNCDF), along with United Cities and Local Government (UCLG) and FMDV (Nasse Bridier, interview, 2023). This partnership is a valuable source for early-stage pipeline identification and development. The fund is a blended finance fund attracting concessional and commercial capital with a targeted amount of €350 million (Nasse Bridier, interview, 2023). The first close raised around €290 million (Habeau, interview, 2023). In addition to the TURF-IMIF, Meridiam also manages several other funds that invest in urban infrastructure in African cities. These are the Meridiam Infrastructure Africa Funds (MIAF) I and II. It is from the experience with these funds that Meridiam took the strategic decision to implement an investment strategy dedicated to city projects in Africa (Nasse Bridier, interview, 2023).

Financial intermediaries co-owned by government and the development assistance community

In terms of ownership, there are also a considerable number of hybrid institutions, i.e., institutions co-owned by two or more groups, that function as financial intermediaries for cities' access to finance. Among those co-owned by government and the development assistance community, the most prominent ones are the multilateral development banks and organisations, as well as the regional development banks. In principle, due to the multitude and diversity of their owners, these institutions might be slightly more consistent in adhering to their long-term objectives and less exposed to shifts

6 Meridiam, Homepage (www.meridiam.com/about-us/our-mission-values).

in priorities of any one government. In practice, however, the types of support instruments and modes of delivery provided by these institutions are quite similar to the ones offered by the bilateral donor community. They facilitate access to urban infrastructure financing through programmes and projects that provide grants and loans (both concessional and non-concessional), guarantees and other credit enhancement instruments, and technical assistance and capacity-building – for example, for project preparation and implementation to cities and local governments.

The World Bank, for example, has a large urban development portfolio through which it supports cities and local governments around the developing world to meet the critical demands of urbanisation. One of the key priorities of its urban strategy is to strengthen the fiscal and financing systems of cities, by expanding their access to finance for infrastructure development from multiple sources, including private finance, while also strengthening their fiscal systems and capacities.[7] This includes the provision of grant and loan financing to cities and local governments, as well as technical assistance to strengthen the institutional, fiscal and regulatory systems at both the city and national levels. The aim is to put cities and local governments on a more solid financial footing while creating an enabling environment for private sector participation and financing.

In addition to its regular lending programme, the World Bank hosts a few specialised facilities and mechanisms that enable access to finance for cities and local governments. The Public-Private Infrastructure Advisory Facility (PPIAF), for example, is a multi-donor technical assistance facility managed by the World Bank that supports governments in developing countries in their efforts to strengthen policies, regulations and institutions that enable private sector investments in public infrastructure.[8] It has a special Sub-National Technical Assistance programme (SNTA) aimed at subnational governments, which provides grants for capacity development in critical areas of urban infrastructure development, ranging from establishing reliable revenue streams to designing bankable capital investment plans. It also assists subnational governments and other entities in accessing financing without sovereign guarantees. In the past, for example, PPIAF has helped improve the commercial viability of Lusaka Water and Sewerage Company in Zambia or supported a Public Expenditure and Financial Accountability (PEFA) assessment of Nouakchott, Mauritania, to identify measures to improve the city's creditworthiness.

Under the umbrella of the United Nations, there are also institutions well placed to facilitate access to finance for cities. The UNCDF, for example, under the heading of 'Local Transformative Finance', has committed to:

> promot[ing] and support[ing] transformative investment through local governments and domestic banks in LDCs [least developed countries] by piloting and scaling up innovative financing mechanisms and policies in the public and private sectors.[9]

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7 World Bank, 'Urban Development': Strategy (www.worldbank.org/en/topic/urbandevelopment/overview#2).
8 PPIAF, Homepage (https://ppiaf.org/).
9 UNCDF, Homepage (www.uncdf.org/ltf).

To this end, UNCDF works on five building blocks to strengthen the financial ecosystem for local infrastructure finance, among them, the development of local capital markets.

The Green Climate Fund (GCF),[10] established by the United Nations through its Framework Convention on Climate Change (UNFCCC), also has potential to be quite transformative as a financial intermediary for cities' access to finance. GCF is a multi-stakeholder trust fund that has been raising funds from countries, regions and cities around the world, currently adding up to $10.3 billion in pledges. It acts through the World Bank as its trustee. The financial instruments it offers include grants, contingent grants, concessional loans, equity, guarantees and results-based finance.[11] Following a country-driven approach, GCF finances the implementation of country programmes that outline the respective climate adaptation and mitigation policies, strategies, and projects of the countries. Funding for their implementation can be accessed by a wide range of institutions, including cities and subnational development banks, provided they obtain GCF accreditation. *The Fonds Spécial d'Equipement et d'Intervention Intercommunale* (FEICOM) in Cameroon, for example, is currently working through the accreditation process with assistance from the FMDV, which will allow the agency to access financing for green local investments (Zo'obo Belinga, interview, 2023).

Among the hybrid institutions, there are also a number of global networks and associations that can effectively take on the role of financial intermediaries to facilitate cities' access to finance. They tend to act less as financiers and more as providers of technical assistance and capacity-building for cities and local governments. However, their active role in connecting cities with suitable investors and brokering financing deals for urban infrastructure development can make all the difference in whether a project gets financed or shelved. Furthermore, the technical and financial advice they provide for project preparation that helps cities turn an idea into a ready-to-finance investment proposal not only effectively lowers the project cost for the cities, but also mitigates the risk of making an upfront financial investment into a project that might not proceed. Project preparation facilities that operate at arm's length from the investor financing the project have become more common place, as experience has shown that these project proposals are generally evaluated more objectively by the lender, often resulting in better loan performance (Smoke, 2019; 2022).

The Global Fund for Cities Development (FMDV), for example, is a global network of local and regional subnational governments with more than 50 members around the world. Their core mission is to develop and promote investment and financing solutions for urban development. To that end, FMDV often acts as a broker between institutions seeking financing for infrastructure development and potential public and private investors. Through their efforts to activate a wide range of stakeholders and resources around this issue, FMDV has helped to mobilise more

10 Green Climate Fund, Homepage (www.greenclimate.fund/).
11 Climate Funds Update, Green Climate Fund (https://climatefundsupdate.org/the-funds/green-climate-fund/).

than $1 billion in investment financing since 2017.[12] Other global networks that focus on project preparation are the C40 Cities Financing Facility or ICLEI – Local Governments for Sustainability. C40 Cities, for example, is an alliance of close to 100 cities aimed at catalysing climate action. Their membership is granted based on the cities' demonstrated commitment to counteracting the climate crisis.[13] C40 Cities works with cities to develop green investment proposals and help them identify suitable financing for implementation (Tyson and Kumar, 2022).

Financial intermediaries co-owned by government and the private sector (and some development assistance involvement)

SPVs that function as financial intermediaries can also be hybrid institutions co-owned by government and the private sector. In these arrangements, the role of the private sector can be limited to providing financing, including equity investment, or can play a more active managerial role in the implementation of the SPV's mandate. The latter case will likely give the private sector more control over the use of the funds. Donor organisations might also be interested in setting up or joining such arrangements as a way to protect some of their riskier investments.

4.1.1 The institutional setup of financial intermediaries in Africa

After outlining the different types of institutional setup that exist for financial intermediaries in principle, this section provides an overview of how these different types have manifested across the African continent to date. Rather than trying to be exhaustive, it provides an indication of their prevalence and gives several illustrative examples.

Financial intermediaries in government ownership

In Africa, a considerable number of countries have established a type of government-owned financial intermediary to facilitate subnational access to capital finance, such as national or municipal development banks or local development agencies. These public institutions constitute the (admittedly, often weak) backbone of subnational lending across the continent. They vary greatly in their size, lending portfolio, organisational structure, capacity and financial sustainability (for a discussion on the diversity among national development banks, see Attridge et al., 2021). Among the larger and more functional ones are, for example, the Development Bank of Southern Africa (DBSA) in South Africa (see case study on page 23), the *Fonds d'Equipement Communal* (FEC) in Morocco (see case study on page 25), and the *Fonds Spécial d'Equipement et d'Intervention Intercommunale* (FEICOM) in Cameroon.

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12 FMDV (www.fmdv.net/Propos).
13 C40 Cities, Homepage (www.c40.org/about-c40/).

Box 4 South Africa: Development Bank of Southern Africa (DBSA)

The Development Bank of Southern Africa (DBSA) was established in 1983 by the South African National Treasury under the premise that the lack of infrastructure is a binding constraint to achieving economic growth and prosperity. Therefore, the mandate of DBSA is to raise funds to channel into sustainable economic and social infrastructures, planning, and development and, through this, unlock economic growth and prosperity. It does this by using its balance sheet and creditworthiness to crowd-in funding for infrastructure. It sees itself as an innovative and catalytic mechanism to enhance the state's capacity to execute large development projects.

In 1997, DBSA transformed into a development finance institution (DFI), governed by its own Act, and expanded its geographical remit to all Southern Africa. It also started to finance social infrastructures, rather than just economic infrastructures, to accelerate post-apartheid development in South Africa.

To support its development mandate, in 2001, DBSA started to transform part of its work to become a knowledge institution and produce knowledge impact. It also started to expand its portfolio in southern Africa, and to expand to the rest of Africa as well. Furthermore, from 2016, rather than just providing financing, DBSA started becoming involved in the full project life cycle, providing direct technical assistance from project identification onwards.

Depending on the classification of the respective municipality in South Africa, the work of DBSA in this area is different. For metros and other creditworthy cities, the role of DBSA is to invest in the municipal debt market, through supporting the expansion of the market, improving secondary market liquidity, encouraging the development of innovative lending instruments, supporting these municipalities to float bonds, including underwriting the bond, helping attract project finance, and other methods of enhancing the expansion of private finance for municipal infrastructure investment.

For under-resourced municipalities that are not creditworthy, DBSA focuses on how to develop and maintain basic household infrastructure, which it classifies as water and sanitation, electricity, and investments around human settlements. To do this, DBSA provides development subsidies in the form of grants and other non-lending instruments to enhance the infrastructure, but also the capacities within these municipalities. Furthermore, since 2016, DBSA has provided targeted technical assistance to help municipalities develop municipal and specific sectoral plans, together with capacity-building for municipal personnel.

Box 4 South Africa: Development Bank of Southern Africa (DBSA) continued

Within its portfolio, DBSA classifies economic infrastructure as information and communications technology (ICT), transport, water, sanitation and energy, while social infrastructure comprise health, education and human settlements. In 2022, the distribution of funds across sectors was as follows:

- Social infrastructure: ZAR 5.6 billion
- Transport and logistics: ZAR 13.9 billion
- Education: ZAR 1.6 billion
- Energy and environment: ZAR 45.5 billion
- Water and sanitation: ZAR 3.4 billion
- ICT: ZAR 2.7 billion

In 2010, the mandate of DBSA expanded further to support regional integration in the Southern African Development Community (SADC) region and then later in the rest of Africa. However, South Africa still comprises 70% of DBSA's balance sheet and it is the only country where the bank provides municipal lending.

Other government-owned intermediaries are considerably smaller and struggle to establish a solid lending portfolio to local governments. The Development Fund for Local Authorities (DFLA) in Malawi (see case study on page 27), for example, has grappled with extremely poor repayment rates. Others, such as the now defunct Local Government Loan Authority (LGLA) in Kenya, were a successful revolving fund before being politicised and decapacitated.

Again, other financial intermediaries of this type, such as the *Agence Nationale d'Investissement des Collectivités Territoriales* (ANICT) in Mali, have the principal ability to issue loans and guarantees to local governments, but have never effectively done so. In fact, many of the local development agencies in Africa focus mainly on deploying intergovernmental transfers, including capital grants to local governments, rather than facilitating their access to debt finance. From case to case, this can be for several reasons, some of which relate to the political will to make municipal borrowing a reality. However, the main obstacles appear to lie primarily in a lack of ability. This is both on the part of the cities and local governments to take on debt and on the part of the financial intermediaries to objectively assess the financial viability of projects and loan applicants, and to structure the financing accordingly, e.g., through a combination of grants and loans. Many local development agencies lack the appropriate tools and capacity – and sometimes political autonomy – to make sustainable lending decisions. They are also not able to provide technical assistance and oversight to cities and local governments to ensure that they prepare and implement projects that yield the desired socioeconomic benefits while allowing them to service their debt. Considerable investment must be made, in many African countries, to build the skills of these institutions in these areas, so that they can effectively play their vital role in helping to build the borrowing capacity of these cities and local governments.

Apart from public entities under government ownership, private entities functioning as financial intermediaries for city access to finance are becoming increasingly common. Municipally owned companies have existed in many African countries for decades and frequently serve as a way to access debt financing for the development of urban infrastructure. In Kenya, for example, county-owned water companies have a long track record of taking on concessional and domestic loans to finance infrastructure investments, unlike their parent counties, which are only slowly beginning to venture into long-term debt finance (for example, Laikipia was the first county to receive parliamentary approval to issue an infrastructure bond in June 2022 (Mutai, 2022)). However, an increasing number of county-owned water companies are heavily indebted, which is also due to liabilities handed down from central government, and this has significantly reduced their fiscal space to take on new debt (PIAFF, 2020).

Box 5 Morocco: *Fonds d'Equipement Communal* (FEC)

FEC is the oldest subnational development bank on the African continent. It was established in 1959 by Law-1-59-169, as an autonomous financial agency with legal status managed by *La Caisse de Dépôt et de Gestion* (CDG – the Deposit and Management Fund). CDG is a public institution responsible for managing government public funds, deposits, and long-term savings, including national insurance and pension schemes, mutualist societies, and cooperatives. These are also the funds that the Government of Morocco uses to guarantee its national borrowing. In 1980, FEC became a separate CDG department, and in 1997, it became its own credit institution, although still within the structures of CDG.

The municipality is the lowest level of the Moroccan subnational government. It legally has extensive revenue-raising and expenditure powers, as per the principle of subsidiarity emphasised in the Constitution. However, until a constitutional change in 2015, municipalities did not have independent authority to raise financial resources. Since then, they have been able to do this, including through borrowing; however, they are only mandated to borrow from FEC. FEC can also co-finance infrastructure projects of local municipalities and public utilities through medium- and long-term loans. In all cases, resources from FEC can only be allocated to projects that have a cost-recovery or revenue-generating element, such as from user fees, and that are not otherwise financed by another stream of financing. These resources cannot be used to cover operating expenditures for the infrastructure, which need to be covered by permanent budget resources.

Box 5 Morocco: *Fonds d'Equipement Communal* (FEC) continued

The general pipeline of FEC projects is drawn from the municipality's annual budgets and requests for financing. Each selected project must demonstrate its social merit, as FEC is meant to support the overall development objectives of the government. The project must also be a demonstrated priority of the entity requesting the loan, by ensuring it reflects the economic and planning priorities of that municipality. For commercial projects, financial viability is assessed. Social projects need to be economically and socially justified while also meeting least-cost conditions. Technical criteria are also assessed to ensure this is the most efficient way to execute the project. There are environmental and social impact assessments that need to be carried out to demonstrate that the project will have no adverse impacts, or that where it does, there are sufficient mitigation measures in place to take these into account.

FEC loan terms are provided on a medium to long-term basis, as required by the project, with the average tenor of the loan being around 15 years. In certain cases, FEC can also provide credit lines for multi-year investments that thus require more than one disbursement. The disbursements themselves are done on both planned and committed expenses for the implementation of the project. Interest rates on FEC loans can be fixed or variable. Where they are fixed, they are based on a weighted six-month average based on information from the Bank Al-Maghrib. For variable rates, they use data from the date of disbursement. Loans from FEC have first repayment priority, and the central government may even intercept intergovernmental fiscal transfers for repayment.

The primary capital base for FEC is from public subsidies from CDG. Other resources include rediscounts from the Moroccan Central Bank and borrowing that FEC can undertake on national and international markets, but that must be guaranteed by the government. For example, in 2020, FEC floated a MAD 2 billion bond on the Moroccan capital markets, which made up the most significant part of its resources that year. FEC's creditworthiness as an institution is derived from that of CDG. Outside these main areas of financing, FEC also derives a small part of its financing from interest paid on the loans it provides.

Special purpose vehicles (SPVs) as financial intermediaries are a more recent and less common phenomenon in Africa. They are still mostly set up at the project level to separate the balance sheet of the project from the one of the implementing local government. This has the important advantage that any revenues generated by the project are automatically ringfenced and provide a reliable source for servicing the debt. As a result, investors can focus primarily on the creditworthiness and profitability of the project and its business model, and not worry about the financial situation and associated risks of the local government – even though these should still be taken into consideration for the financial structure of the transaction (Habeau, interview, 2023).

Furthermore, since SPVs are usually set up as private entities, they are governed by the regulatory framework for corporates, which, in many African countries, tends to be much better developed and tested than corresponding regulations for the public sector. Due to these advantages, SPVs have increasingly gained in popularity across the continent (Machano, interview, 2023), even though important challenges remain. This is especially true with regard to the appropriate structuring of the SPV and the underlying analysis and financial modelling.

The city of Freetown in Sierra Leone, for example, with the assistance of UNCDF and the Swiss Agency for Development and Cooperation (SDC), is in the process of exploring the setting up of an SPV with the aim of issuing a corporate bond to finance the city's Blue Peace Initiative, a water and sanitation infrastructure project that plans to build up to 40 water kiosks and 15 public toilets in Freetown. The bond is intended to be serviced from the user fees charged for these services. However, the city aims to keep these user fees below those currently charged by private water providers, to improve affordability of and access to water and sanitation for its citizens. The project's business model is currently being tested to determine its expected rate of return. Freetown had initially explored the possibility of issuing a municipal bond to finance the initiative, but a feasibility study advised the city to opt for a corporate financing model after identifying several important constraints to successfully issuing such a bond. These included legal and political challenges and the city's poor prospects of obtaining a sufficiently high credit rating.

Box 6 Malawi: Development Fund for Local Authorities (DFLA)

The Development Fund for Local Authorities (DFLA) was established as a trust fund in 1993 by the Government of Malawi in partnership with the World Bank, in a project (the 'Local Government Development Project') to support the overall decentralisation objectives of the country. Initially, the World Bank provided the DFLA with $8.5 million in capital, through the Ministry of Finance, in the form of 50% loan and 50% grant, with the objective that it would be on-lent to local governments in the form of investment finance.

Due to poor repayment at an average of less than 25% annually, combined with recurrent debt cancellation for local governments and frequent conversion of loans to grants, by the mid-2000s, DFLA had no money remaining to issue to local governments. In an assessment of the fund in 2001, the World Bank concluded that it was dormant and illiquid and unlikely to ever resume lending.

Box 6 Malawi: Development Fund for Local Authorities (DFLA) continued

However, in 2010, the Malawi government decided to recapitalise DFLA with an injection of $1.4 million. Then, in 2017, the management of DFLA was transferred from the World Bank to be fully under the Government of Malawi. Therefore, although the recapitalisation was extremely small with respect to the needs of the local governments, it did rejuvenate the activities of DFLA and allowed it to resume lending - although to a much smaller degree. In recent years, only one or two loans have been awarded annually with an average value of $170,000. Furthermore, these are again paid out directly to selected service providers, rather than to local governments. The conditions of these loans are with a tenor of up to 10 years, and at a fixed interest rate of 14.5%, which is the same as the Malawi Reserve Bank rate and highly favourable compared to commercial bank rates, which hover around 26%.

The Board of the DFLA is chaired by the permanent secretary of local government, while other ministries are represented accordingly. One of the governance challenges the World Bank has consistently noted in its review reports of DFLA is that its board is made up only of government officials, usually without any direct experience in financial management. DFLA is managed by a technocratic chief executive officer (CEO) appointed by the minister of finance. Under the CEO, there are only three other staff, namely, the director of operations, who is also responsible for the credits and loans, the director of finance, and an assistant accountant.

At the local government level, one of the interesting aspects of the lending carried out by DFLA is that the entire council must approve the loan before it can be taken on. This is supposed to ensure there is political and technical support for the projects being pursued.

DFLA does not publish annual reports and therefore does not have any publicly available financial records of its lending. There remains an ongoing lack of clarity and, therefore, commitment, by the national government on how DFLA should evolve. Although the government's recent recapitalisation of the fund with another $545,000 is a positive sign that it does not want the institution to fully collapse, the lack of investments in technical, operational and overall capacity in the fund – which would allow it to attract higher levels of financing – remains concerning. Furthermore, there is ongoing unease about the level of potential political interference, given the nature of the governance structures of the DFLA.

Despite these numerous advantages, the use of SPVs by cities and local governments also holds several risks and disadvantages that should be considered. Ceding municipal responsibilities to corporate structures that may or may not be under the full control of local governments can potentially affect local autonomy. This might weaken effective coordination between sectors and any attempts at an integrated territorial development. Furthermore, using this approach to circumvent the poor creditworthiness of local governments might solve the immediate financing issue at hand, but does not do anything to address the underlying problem regarding the financial position of the local government.

Financial intermediaries in development assistance ownership

Regarding financial intermediaries in Africa, the contribution of the bilateral development assistance community is essential and will likely remain so for many years to come. This is because it helps alleviate the enormous lack of resources for urban infrastructure development that currently neither the public nor the private sector in many African countries is able to adequately address. At the same time, donors are still reluctant to set up full lending programmes to cities due to their lack of creditworthiness, and prefer to offer a mix of grants and loans or provide sovereign loans for on-granting. Some of the key stakeholders acting as financial intermediaries for city financing across Africa are the French Development Agency (AFD), the German Development Bank (KfW), the European Union (EU), the US Agency for International Development (USAID), and the Swedish International Development Cooperation Agency (SIDA), among others.

Box 7 Development partners acting as financial intermediaries in Cameroon

In Cameroon, the EU, AFD and KfW are the main development partners acting as financial intermediaries for facilitating cities' access to finance. The EU and KfW funnel their funding through FEICOM, the country's local development agency and itself a government-owned financial intermediary. The EU financing managed by FEICOM, is focused on financing basic infrastructure in 15 secondary cities in the border regions of the country that are affected by conflict and migration.[14] KfW's financing provides a mix of grants and loans for urban infrastructure development to 14 secondary cities, alongside a capacity-building component for the recipient cities in the areas of project planning and implementation, own-source revenue generation, and infrastructure maintenance.[15] FEICOM, as the fund manager, also benefits from some technical assistance to strengthen its own implementation capacity. In addition, AFD and the EU have programmes through which they directly finance the development of large infrastructure in the two main cities, Yaoundé and Douala. Here, the role of FEICOM is limited to helping cities mobilise their own contribution (Zo'obo Belinga, interview, 2023).

14 The EU financing is provided through the Programme for the Economic and Social Development of Secondary Cities Exposed to Instability Factors (PRODESV).

15 The KfW financing is provided through the *Programme de Décentralisation FEICOM-Villes Moyennes* (PDFVM).

AFD has been one of the pioneers in lending to African cities. One of its first loans was issued to Ougadougou, Burkina Faso, in 2007 for the rehabilitation of the central market, Rood Woko, and other secondary markets. The total amount of €5.15 million consisted of €3.15 million in grants and €2 million in loans (PEFA, 2010). Repayment of the loan, which was issued without sovereign guarantee, was secured by ringfencing the city's own revenues from market fees and rents and was successfully completed. Currently, however, AFD considers direct lending to cities feasible only in Senegal, Burkina Faso and South Africa, as it considers these its only partner countries where the legal and regulatory framework is sufficiently developed and favourable. Partner countries that are close to reaching that level of legal/regulatory development are Kenya, Tanzania and Togo (de Dianous, interview, 2023).

In addition to exploring ways to increase its direct lending to cities, AFD has established a number of other mechanisms that function as financial intermediaries for cities' access to finance, such as a guarantee mechanism and a project preparation support unit. Numerous other development partners, including SIDA and USAID, have offered similar mechanisms to facilitate lending by African cities.

Box 8 AFD's intermediary support to cities' access to finance

With co-financing from the EU and the Swiss Cooperation, AFD has established a project preparation unit called Cities and Climate in Africa (CICLIA) that provides technical assistance grants to around 25 cities across Africa for the preparation of resilient, low-carbon urban projects. However, financing to implement these projects is still provided through sovereign loans, which are usually granted on to cities and local governments.

Furthermore, AFD is in the process of developing a guarantee mechanism that will secure 50% of loans to cities issued by selected domestic banks for green projects, reducing the risk to lenders and allowing them to provide loans with longer tenors. This support will be accompanied by technical assistance for banks to strengthen their capacity to evaluate the creditworthiness of cities and perform due diligence on proposed projects (de Dianous, interview, 2023).

With regard to private entities owned by development partners, there are currently not many examples of intermediary activity in Africa. One example is GuarantCo, a subsidiary of PIDG that acts as one of the guarantors helping to secure a green bond to be issued by the Tanga Urban Water Supply and Sanitation Authority (Tanga UWASA), a public company serving the city of Tanga, Tanzania.

Financial intermediaries in private sector ownership

Foundations have acted as financial intermediaries in Africa on numerous occasions, although only a fraction of the resources goes towards facilitating cities' access to debt finance. The Bill and Melinda Gates Foundation, for example, provided a $5 million grant to the city of Dakar, to pay for financial advice and all other costs associated with the preparation of a municipal bond, the first one to be floated in West Africa (Sarr, interview, 2023; Siddique, 2019). This contribution considerably lowered the effective cost of the bond to the city and absorbed the financial risk of the preparation being for nothing, a risk that unfortunately materialised.

With regards to capital investment firms, Meridiam has four offices in Africa – that is, in Dakar, Senegal, Addis Ababa, Ethiopia, Libreville, Gabon and Johannesburg, South Africa – through which it manages its investments on the continent (Nasse Bridier, interview, 2023). To date, Meridiam has invested in different urban infrastructure projects, such as a rapid transit bus system in Dakar, which provides an all-electric bus service connecting Dakar with some of its growing hinterland, or flood protection for the city of Nouakchott to protect its inhabitants from rising sea levels. Further investments through TURF-IMIF will likely focus first on the cities where Meridiam and its partners already have a working relationship, expanding from there to more cities across Africa (Nasse Bridier, interview, 2023).

Financial intermediaries co-owned by government and the development assistance community

Multilateral and regional development banks play an important role in facilitating access to finance for cities in Africa. While most World Bank financing, for example, is still provided as concessional loans to central government, which is then on-granted to local governments, e.g., in the form of performance-based grants, some projects aim specifically at providing debt financing to cities. Given the difficulties of the World Bank and similar institutions in lending directly to cities and local governments, it needs to employ institutional workarounds to do so. The DFLA in Malawi, for example, started as a World Bank project aimed at providing debt finance to local governments for infrastructure investments. To this end, the World Bank and the Government of Malawi established a trust fund to administer a lending programme to local governments, which the World Bank capitalised with $8.5 million (50% as a grant, 50% as a loan to the central government). Only in 2017 did the DFLA management completely pass from the World Bank to the Government of Malawi, making it a fully government-owned local development agency (see case study on page 27).

Another hybrid institution co-owned by government and the development assistance community that is starting to take on a key role as financial intermediary for cities' access to finance, with a focus on Africa, is the African Development Bank (AfDB). While, like other multilateral development banks (MDBs), the AfDB is primarily partnering with central government institutions, there is a strong interest in expanding its support directly to subnational entities, including cities and local governments. One clear indicator of this is that the AfDB has developed formal guidelines for subnational lending, making it the first and so far, only MDB to have done so, even though these guidelines have yet to be applied much to date (Stubdrup, interview, 2023).

Box 9 AfDB's Urban and Municipal Development Fund (UMDF)

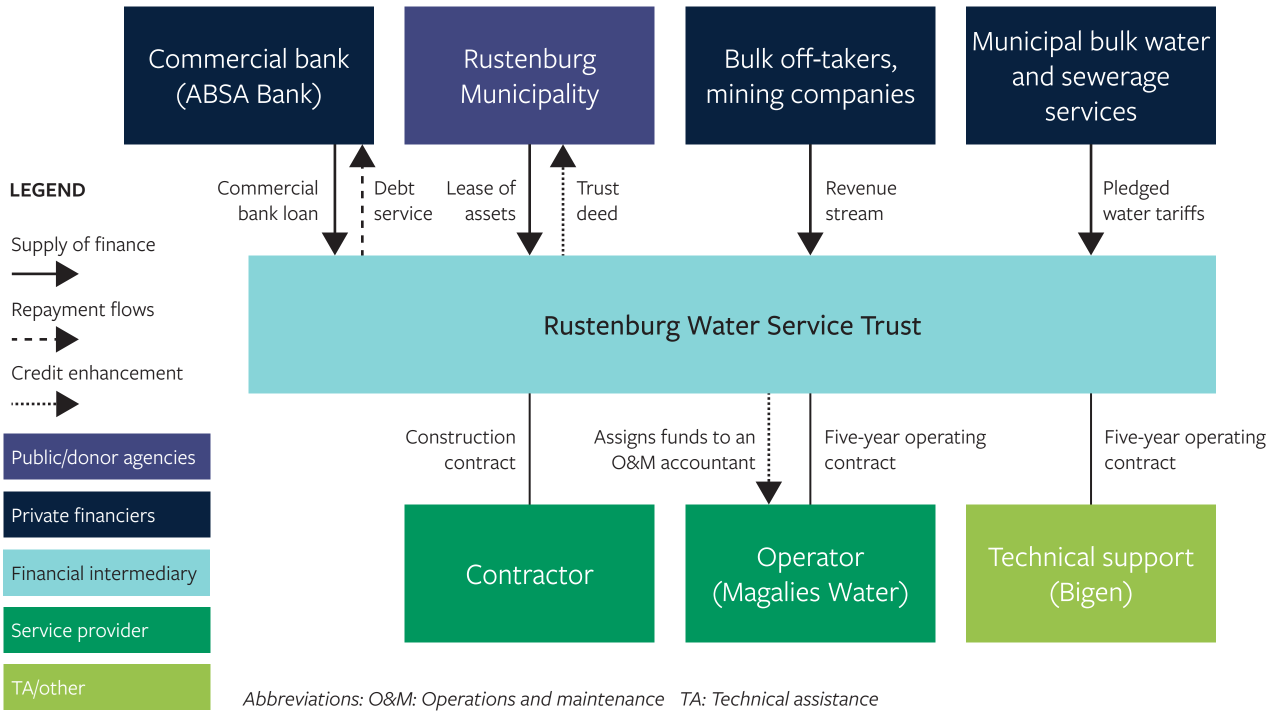
The AfDB also manages the Urban and Municipal Development Fund (UMDF), a multi-donor technical assistance facility aimed at strengthening the ability of cities, in particular secondary cities, to develop a strategic and integrated investment portfolio with a viable pipeline of projects and to attract investment. This support ranges from strengthening subnational financial governance structures and the broader regulatory framework to facilitate access to private capital to helping cities develop urban action plans that identify priority investment opportunities. The core of its support is on the preparation of concrete development projects and the identification of suitable investment capital within and outside the African Development Bank. While for the majority of projects, the UMDF approaches other concessional funders for co-financing, some projects might allow for more substantive private sector engagement, which the fund seeks to explore where possible. However, while the projects are conceived and prepared under the cities' direction, their financing is still intended to be channelled mostly through central government institutions (Stubdrup, interview, 2023) and requires no objection from the Ministry of Finance.

Among the membership organisations, United Cities and Local Governments (UCLG), a global association of local and regional governments, is in the process of creating its own financial intermediary for cities' access to finance. Its Africa chapter has been working on setting up the Africa Territorial Agency (ATA), a financial institution for financing infrastructure, equipment and urban services. The ATA is intended to be a cooperative institution, of which cities and local governments will be the shareholders along with regional and international financing institutions and other interested parties. It aims to pool the financing needs of local governments across Africa, allowing them to access debt at lower interest rates, e.g., through bonds. This will ensure all cities can access investment financing on the same terms, regardless of their size or the size of their projects (UCLGA, no date; Yatta, interview, 2023).

Financial intermediaries co-owned by government and the private sector (and some development assistance involvement)

As mentioned above, financial intermediaries co-owned by government and the private sector usually come in the form of SPVs. However, despite some of their beneficial features, which can mitigate a number of obstacles for cities and local governments accessing debt finance, the use of SPVs is still not common in many countries in Africa. However, there are some cases, in particular in South Africa (Voges, 2018). The municipality of Rustenburg, for example, together with its consortium partners, established the Rustenburg Water Services Trust (RWST), an SPV aimed at upgrading the municipal water infrastructure, including expansion of the wastewater treatment plant to enhance water quality and refurbishment of the pipeline system to improve water provision reliability. The consortium partners included ABSA Bank, a commercial bank that financed the project through a $37 million loan with a 20-year tenor; Magalies Water, the water service provider responsible for operation and maintenance; and Bigen Africa, which provides technical support to RWST. Repayment of the loan was ensured by securing two stable revenue streams, one from water tariffs in exchange for the supply of bulk water and sewerage services to the municipality, and the other from a long-term off-take agreement for treated wastewater from two local platinum mines (World Bank, 2016). Figure 2 illustrates the financial structure of the SPV and its relationship with various stakeholders.

Figure 2 Financial structure of the RWST



Source: World Bank, 2016

In addition to the caveats mentioned above, SPVs, like any other institution, require sound and diligent governance and management over their lifetime to achieve their intended results (Voges, 2018). This is something that cannot be bypassed like a sub-par balance sheet, so the responsibility is on all owners to make it work.

Box 10 Gabon: *Caisses des Dépôts et Consignations* (CDC)

Caisses des Dépôts et Consignations (CDC), which loosely translates to 'Deposit and Consignment (Savings) Funds' in English, are public entities governed by private law that can be established under the French civil code. As such, there are several African countries that have a legal structure based on this code and that have adopted similar institutions. These include Benin, Burkina Faso, Côte d'Ivoire, Gabon, Niger, Senegal and Tunisia. In general, CDCs are institutions mandated to manage regulated long-term savings from the government and then transform them into investments for the public interest. In other words, they invest these long-term savings into domestic markets to catalyse productive and social investments. In addition, CDCs can act as the guarantor agency for government investments, as well as undertaking specific banking and other financial market activities, depending on the local laws in place.

In many cases, CDCs are also legally able to lend to local authorities to support their social and economic needs. This is the case in Gabon, where the CDC was established in 2010, as a public institution of industrial and commercial value under private law. It became operational in January 2012, after the law underpinning its governance mechanisms was passed. As with all CDCs, their primary funds come from the savings deposits of government institutions, including pensions. It is also allocated resources, in the form of grants, from the national treasury. In the case of Gabon, institutions and individuals operating in the legal professions and public accounting are also required to maintain savings accounts with the CDC.

In Gabon, the establishment of the CDC was directly related to the passing of the *Emerging Gabon 2025* Strategic Plan, which required financing. As such, the main aims of the CDC are to contribute to the overall national economic development by mobilising financing that can, in turn, be transformed into productive activities to create jobs and economic growth. Although it pursues a public mission, it does so with a focus on profitable and high-quality performance, which is enabled by the fact that it is managed under private law. Financially, CDC Gabon aims to be the benchmark investor for the public sector.

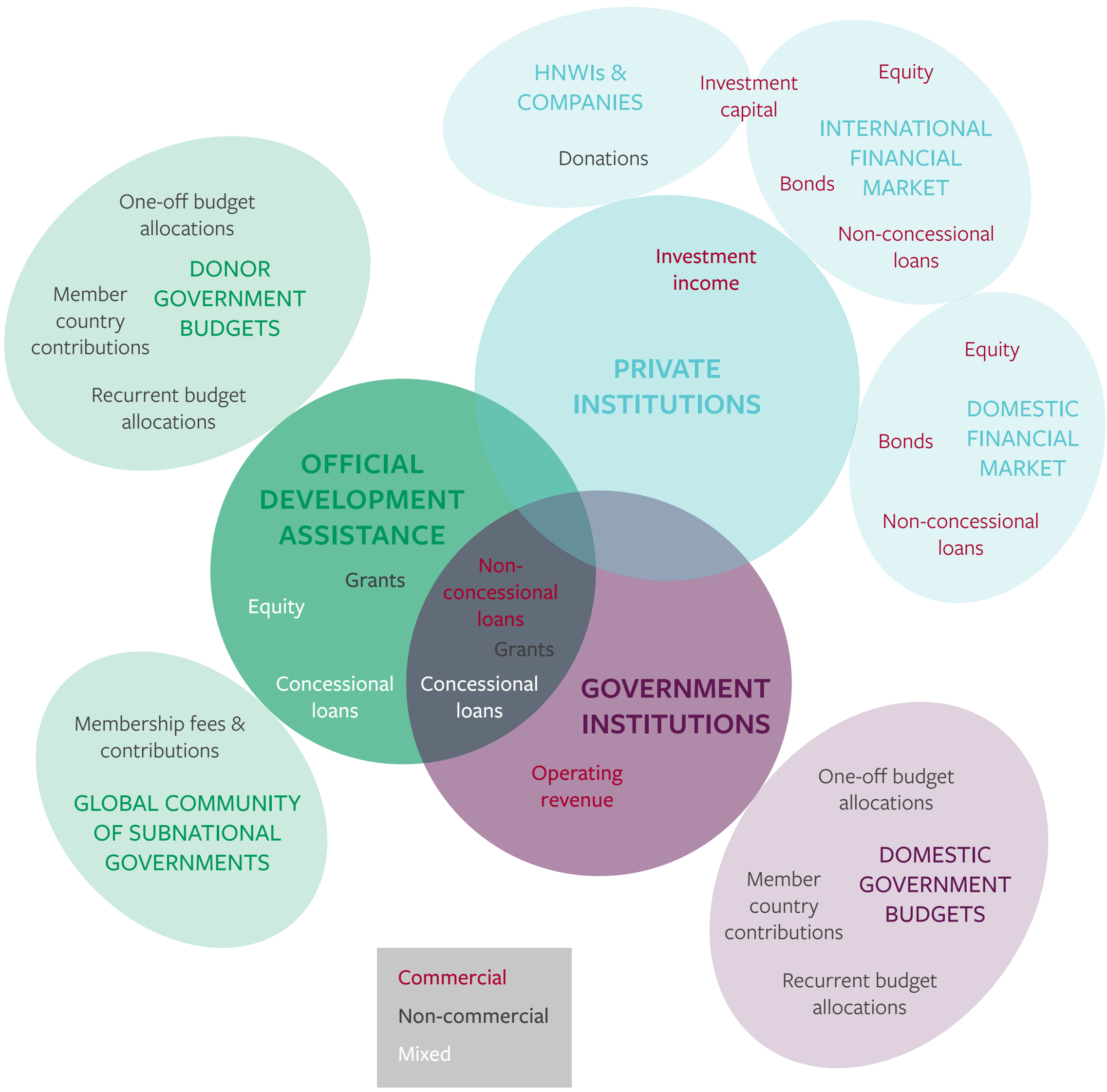
The governance structure of CDC Gabon is based on achieving viability over the long run, by avoiding short-run liquidity constraints and asset volatility. Therefore, it is mandated to maintain a high level of equity and, accordingly, to develop financial instruments that can mobilise other finance by leveraging government savings. Currently, equity finance comprises approximately 52% of its balance sheet. CDC Gabon also aims to optimally allocate its resources, according to loan maturity, and through this maximise its yields.

As CDC Gabon does not issue public annual reports, it was not possible to determine how much of the portfolio went to financing local government versus national government projects.

4.2 Key dimension two: financing sources of financial intermediaries

After exploring the different legal and institutional forms and structures that financial intermediaries for cities' access to finance can take, this section looks at the different sources of upstream financing these institutions draw on to finance their activities. These are not to be confused with the financial and non-financial instruments, such as loans, grants, guarantees and technical assistance, for project preparation and other measures to strengthen cities' borrowing capacity, which financial intermediaries provide to facilitate cities' access to finance. Figure 3 maps the different sources of financing of financial intermediaries based on their provenance; that is, the stakeholder groups responsible for providing them with finance. The figure shows there is a wide range of commercial, non-commercial and mixed financing sources that different financial intermediaries draw on.

Figure 3 Sources of financing based on their provenance



Source: Authors

Financing from government budgets – domestic and international

Two key stakeholder groups here are domestic governments, i.e., the governments of the countries where cities are receiving support, and donor governments providing official development assistance. From their respective budgets, both groups finance different institutions acting as financial intermediaries, either through recurrent and one-off budget allocations or through member country contributions to multilateral development institutions. With their budget allocations, domestic governments provide funding to government-owned financial intermediaries, such as municipal development banks or agencies, while donor governments funnel those budget allocations to their international development agencies. Member country contributions from both domestic and donor governments go towards financing multilateral development institutions.

In cases where the bi- and multilateral development institutions utilising these financing sources act as second-floor financing institutions to other financial intermediaries, rather than acting as intermediaries themselves, they can provide them with grants, concessional loans, non-concessional loans and, in rare cases, equity for on-lending. Most of these financing sources are non-commercial, with only a few having a commercial aspect.

The nature and relevance of financing from government budgets in Africa

In Africa, to date, these financing sources, essentially government and donor funds, provide by far the most important share of the resources through which financial intermediaries facilitate access to debt finance for cities and local governments. This means the vast majority of urban infrastructure in Africa continues to be financed by the public sector (see, for example, Cirola, 2020).

Furthermore, much of the public sector financing for urban infrastructure in Africa continues to be provided in the form of grants rather than loans. Most central government funding for infrastructure investments by cities and local governments, whether disbursed directly or through local development agencies, is provided as grant payments. This holds true even in cases where government-owned financial intermediaries are able to make some of their government allocations available as loan financing to cities for certain types of projects. This also means that financial intermediary funds need to be regularly replenished with fresh resources if they are to continue to provide financing for city and local government investments.

At the same time, as mentioned above, bilateral and multilateral development institutions lending directly to cities is still uncommon, despite growing interest. Most of their financing earmarked for urban infrastructure investment goes to central government institutions, which usually either on-grant the funds to local governments or implement the investments themselves on behalf of local governments. This is primarily due to national government frameworks or legal requirements, as is the case, for example, in Uganda, as well as to the charters of international agencies, none of which are particularly easy to change. Furthermore, given that in recent years this type of development partner financing has been shifting progressively from grants to loans, this also means that the burden of repayment normally remains with central government rather than being passed on to cities or local governments.

As previously discussed, development partner financing also often comes as part of their own programming, which commonly prescribes certain thematic priorities, as well as specific disbursement and reporting conditions. This can work well, when the financial intermediary or the national government negotiating on its behalf has the capacity to ensure that these programmes are aligned with their own policies and strategies, or with the established engagement procedures of cities and local governments. But this is not always the case. This is especially true when financing needs are high: countries are often not in the position to say 'no' to 'free' or 'cheap money', even if accepting it might end up disrupting their own policies or procedures (Habeau, interview, 2023).

Financing from the private sector

The other possible sources of financing for financial intermediaries derive from the private sector, i.e., from the domestic and international financial markets and from high-net-worth individuals (HNWIs) and companies. Domestic and international financial markets can provide commercial financing in the form of non-concessional loans, bonds and equity. HNWIs and companies, through generous donations, provide endowments to some institutions (such as foundations) that can act as financial intermediaries. All these stakeholder groups could also provide investment capital for capital investment funds that invest in urban infrastructure. In addition to this, financial intermediaries in private sector ownership might also fund some of their city financing activities from their own investment income.

The nature and relevance of private sector financing in Africa

Although it has become increasingly clear over the past decade that private investment will be crucial in addressing the massive infrastructure gap in African cities, financial intermediaries that draw on these types of private financing sources are still uncommon. Apart from a general reluctance on the part of the private sector to invest in public infrastructure in Africa, the main obstacle appears to be the poor visibility of bankable projects, as bankability and solid returns are key to attracting private investment. However, according to some experts, while lending to cities might be risky, there is considerable potential for developing urban projects that in themselves are fairly low risk and can offer a decent return to their investors. With the help of financial intermediaries, these projects could be insulated from broader risks and further secured through guarantees or other credit enhancement, to convince private investors to engage while making the debt more affordable to the cities. The challenge then is to identify these types of projects across the continent and to prepare them to the point where more commercially minded investors will take them on (Machano, interview, 2023). This will also free up resources in the form of grants and concessional loans to go towards projects for basic services that, due to their nature, will always require subsidies.

Of the private financing sources, some experts consider the African bond market to be among the ones with the greatest potential. According to them, an increasing number of capital market actors – in particular insurance and pension funds in Ghana, Tanzania, Kenya, Uganda, Cameroon, Senegal and the WAEMU region more broadly – are starting to consider infrastructure bonds as an area of investment. In the few instances where bonds were prepared by municipal actors, they were usually fully subscribed or even oversubscribed before issuing. However, given the current lack of regulatory processes for municipal bonds in most stock exchanges on the continent, this market is only in its infancy (Gorelick, 2018; Machano, interview, 2023).

Financing from the global community of subnational governments

Finally, the global community of subnational governments can also provide a source of financing for financial intermediaries through membership fees and contributions. However, in terms of its financial impact, this financing source has been quite limited to date, both in Africa and beyond, primarily financing the basic operations of certain financial intermediaries such as different global and regional associations and networks. These intermediaries also continue to rely heavily on donor funding to finance most of their technical assistance activities. Overall, the global community of subnational governments, apart from signalling their commitment, cannot be expected to make a significant contribution to supporting financial intermediaries for cities' access to finance.

4.3 A typology of financial intermediaries along two dimensions

After exploring the different models of financial intermediaries for cities' access to finance based on two of their main constituting elements, this section combines the two dimensions into a single typology of financial intermediaries. Table 1 presents this two-dimensional typology, displaying financial intermediaries grouped by their ownership structure in the first and second columns and their corresponding sources of financing in the third and fourth columns. The sources of financing are presented separately based on their use of financial instruments, such as loans, grants and guarantees for urban infrastructure financing, or non-financial instruments, such as technical and financial advice on project preparation and other capacity-building measures. The last column provides a summary of the current state and significance of each of the types of financial intermediaries in Africa.

Table 1 Typology of financial intermediaries by ownership structure and source of financing

Ownership structure	Type of financial intermediary	Source of financing by type of instrument		Current state and significance in Africa
		Financial instruments	Non-financial instruments	
Financial intermediaries owned by government	Units providing project financing to local governments for capital investments within national ministries, such as ministries of finance, infrastructure, or local government	Recurrent budget allocations; one-off budget allocations; bonds; non-concessional loans; concessional loans; grants	Recurrent budget allocations; one-off budget allocations; bonds; concessional loans; grants	Some ministries provide loans to local governments, while most financing is provided in the form of grants. To this end, they draw both from their own budgetary resources and from donor financing.
	National and municipal development banks	Recurrent budget allocations; one-off budget allocations; bonds; equity; non-concessional loans; concessional loans; grants; customer deposits	Recurrent budget allocations; one-off budget allocations; bonds; concessional loans; grants	Where they exist, these institutions still depend on budget allocations and donor financing. Only a few draw on alternative financing sources, such as bonds, customer deposits, or private debt or equity.
	Local development agencies	Recurrent budget allocations; one-off budget allocations; concessional loans; grants	Recurrent budget allocations; one-off budget allocations; grants	These institutions rely heavily on allocations from the national budget and donor funding.
	Municipally owned companies under specific circumstances	Recurrent budget allocations; one-off budget allocations; bonds; non-concessional loans; concessional loans; grants; operating revenue	n.a.	Only a small number of municipally owned companies are sufficiently creditworthy to draw on private sector financing, such as bonds and loans, thus functioning as financial intermediaries. Most rely on their operating revenue, substantial subsidies from the national budget and some donor funding to maintain their core operations.
	Special purpose vehicles	Equity; bonds; non-concessional loans; concessional loans; grants	n.a.	To date, SPVs exist primarily at the project level to access private finance in the form of bonds or loans. Local governments often draw on technical assistance for their setup.
Financial intermediaries owned by the development assistance community	Certain projects managed by bilateral donor agencies and banks (acting as first-floor institutions)	Recurrent budget allocations; one-off budget allocations; bonds	Recurrent budget allocations; one-off budget allocations	Bilateral donor institutions continue to receive large allocations for assistance to Africa. There is a growing interest in investing directly in cities, although challenges remain.
	Certain projects by donor-owned companies	Equity; grants; concessional loans; non-concessional loans; bonds	Equity; grants; bonds	These institutions are rare and less focused on Africa than on other regions of the developing world. They also mostly focus on financing the private sector, although they have supported city financing in the past.

Ownership structure	Type of financial intermediary	Source of financing by type of instrument		Current state and significance in Africa
		Financial instruments	Non-financial instruments	
Financial intermediaries co-owned by government and the development assistance community	Certain projects managed by multilateral organisations and development banks (acting as first-floor institutions)	Member country contributions; bonds	Member country contributions; bonds; grants	Multilateral development institutions continue to commit a large share of their resources to Africa. There is a growing interest in investing directly in cities, although challenges remain.
	Certain projects managed by regional development banks (acting as first-floor institutions)	Member country contributions; bonds; non-concessional loans; concessional loans; grants	Member country contributions; bonds; grants	Regional development banks complement their member country contributions primarily with financing from bi-and multilateral donors, but also some private sector financing.
	Global and regional associations and networks with a particular mandate	n.a.	Membership fees and contributions; grants	Although these organisations are membership institutions, they tend to depend heavily on donor funding to finance their programming.
Financial intermediaries owned by the private sector	Certain projects managed by philanthropic foundations	Endowments; investment income	Endowments; investment income; grants	Foundations continue to focus most of their funding on Africa, although it tends to be concentrated on a small number of countries. Direct support to cities constitutes only a fraction of their activities.
	Capital investment firms	Investment capital; investment income	n.a.	Capital investment funds focused on infrastructure investments in Africa are still in short supply and investment volumes tend to be modest.
Financial intermediaries co-owned by government and the private sector (with some development assistance involvement)	Special purpose vehicles	Equity; bonds; non-concessional loans; concessional loans; grants	n.a.	To date, SPVs exist primarily at the project level to access private finance in the form of bonds or loans. Local governments often draw on technical assistance for their setup. The private sector can also get involved in their management.

Source: Authors

By examining the previous sections summarised in Table 1, in particular with a view to the situation and significance of the various types of financial intermediaries in Africa, several observations can be made about the access to debt finance by African cities and local governments and the role of different financial intermediaries in facilitating that access.

First, and most obviously, most city infrastructure financing is still provided through public sector institutions with public sector funding. The central government still has responsibility for financing most urban investments. This goes hand in hand with a high dependency on financing from bi- and multilateral donors and other development partners, most of which continue to be accorded to central government. However, the volume of this financing is far from sufficient to address Africa's urban infrastructure gap.

Second, most approaches to urban infrastructure investment are still quite conventional and risk averse with most financing, especially those to smaller cities and local governments, provided in the form of grants and only a small share in the form of loans or a mix of grants and loans. This continued practice reinforces the reliance of cities and local governments on central government, prevents them from gaining borrowing experience in a low-stake environment, and fails to provide incentives for cities to improve their creditworthiness. In addition, in many cases, cities and local governments are offered the same financing conditions for the same types of projects, regardless of their size or their capacity to borrow. This runs the risk of overcharging weaker local governments, which could result in their default and potential loss of borrowing privileges, while wasting 'cheap money' on stronger municipalities that could take on more commercially minded debt.

Third, there is a clear appetite and willingness on the part of many bi- and multilateral development partners to directly engage with cities in supporting their provision of urban infrastructure. An increasing number have opened lending windows for local governments and integrated city financing into their strategies and instruments. Putting this intention into practice – in addition to overcoming some internal governance challenges – requires these institutions to identify a suitable investment portfolio with projects that meet their desired risk profile, investment threshold, and environmental, social and governance (ESG) criteria (Habeau, interview, 2023). For this approach to have broad impact and not just 'cream off' the few high-potential cities and projects that are likely to be able to access private financing as well, they may need to increase their risk tolerance (Attridge and Engen, 2019; Colenbrander et al., 2023). They may also need to develop projects that combine soft lending with capacity-building and a clear performance framework that incentivises cities to strengthen their systems and processes.

Fourth, there are some promising experiences with blended and private finance for urban infrastructure investment, but they still constitute the exception rather than the norm, and their connection to cities and local governments can be ambiguous. Most cases where private finance has been mobilised rely on corporate financing models such as SPVs (see, for example, OECD, 2020). This approach is still quite new to most cities and local governments in Africa and, therefore, usually requires some technical assistance to ensure these entities are set up and secured appropriately to ensure no party is exposed to hidden risks. Private financing that goes through the city's balance sheet is still quite rare. However, a few examples, such as the city of Dakar in Senegal, demonstrate that it is possible, at least in principle, albeit with a lot of technical assistance.

All in all, this analysis has clearly demonstrated that, with some rare exceptions, almost no city or local government in Africa would be able to access debt finance for infrastructure investments without the support of some type of financial intermediary. The challenging framework conditions outlined in Section 2 make direct access for African cities to financial markets close to impossible. This makes financial intermediaries essential for the development of urban infrastructure led by cities and highlights the importance of ensuring that these institutions are as effective as they can be in facilitating the access of cities to debt finance in Africa and beyond.

5 Gaps in the current access to finance offer for cities and local governments through financial intermediaries in Africa

After an in-depth exploration of the landscape of financial intermediaries facilitating cities' access to finance in Africa in the previous sections, this section summarises the most important gaps that exist in the current access-to-finance offer to cities and local governments. Here, the most glaring one is certainly the fact that, overall, the volume of financing made available for cities and local governments is much too small to allow them to address their enormous infrastructure needs. As a result, the financing gap continues to persist and risks growing even larger over time due to the demographic and migration dynamics on the African continent. Public investment, which continues to dominate in this area, is insufficient to meet demand. While this may not be surprising, it shows that despite global efforts to mobilise private finance to accelerate sustainable development and achieve the SDGs, these efforts have not yet shown the desired results in the development of urban infrastructure in Africa.

Another important gap in the African landscape of financial intermediaries, in particular with respect to government institutions that facilitate access to finance for cities and local governments, is their indiscriminate reliance on grants at the expense of expanding their lending offer. In some cases, this is due to the legal environment, which would need to be addressed. Yet for some institutions to transform into fully fledged lending organisations, they will need to strengthen their capacity to give appropriate technical advice and guidance to cities on project formulation; adequately manage credit lines from their investors; and effectively monitor and report on their loans. However, institutions reinforcing their technical capabilities might not be enough. To allow themselves and their clients to become full market participants, they need to fundamentally change their institutional behaviours and practices to ones guided by a more commercially oriented mindset. This will require them to start responding to market incentives rather than bureaucratic incentives (Machano, interview, 2023). To date, there are only a few institutions in Africa that fit this description, among them FEC (see case study on page 25), DBSA (see case study on page 23) and the Ghana Infrastructure Investment Fund (GIIF).[16] This kind of transformation can drive market growth and, in turn, the maturation of the legal and regulatory framework surrounding it. Here, development partners can act as catalysts by providing these financial intermediaries with technical assistance and capacity-building, as well as by setting pertinent incentives for them to access credit lines.

16 The GIIF does not provide lending to cities and local governments to date, but is considering doing so in the future.

Another critical gap with regard to subnational lending is that most local governments continue to have no access to debt finance. These institutions find themselves in a 'catch-22' situation, where they have no credit history, but without being able to demonstrate their ability to successfully manage debt, lenders are reluctant to lend, preventing them from building a credit history. Thus, they become caught in a low-capacity trap, with no incentive to develop their creditworthiness because this still might not enable them to access debt financing. The default response by most funders, be it central government or development partners, has been to offer them grants instead of loans, even for potentially profitable projects. But this does not provide any incentive for poorly performing local governments to change their behaviour. While capacity-building programmes for local government finance are widely available, too few actively seek to link this support to improving creditworthiness and access to lending. Government-owned financial intermediaries should structure their lending programmes in a way that treats each local government based on its level of creditworthiness and sets incentives for building their borrowing capacity over time. This should also include discouraging high-functioning municipalities from accessing concessional loans for bankable projects. These types of loans, possibly in combination with grants, should be reserved for weaker local governments and/or projects that do not yield enough revenue to be attractive to private investors.

One example of a simple but effective way to categorise local governments based on their creditworthiness can be found in Colombia. The Colombian financial intermediary *Financiera de Desarollo Territorial* (FINDETER) applies a so-called 'traffic light' system (see Table 2), which was established by Law 358 in 1997. This system determines under what conditions local governments can borrow, with the criteria becoming more stringent if the local government is less creditworthy. As such, in the Colombian context, this combination of factors means that while local governments can access a wide variety of loans from different lending institutions, the type and conditions of the loans primarily depend on the creditworthiness of those local governments.

Table 2 Colombia's traffic light system used by FINDETER to determine a local government's creditworthiness

Rating	Indicator	Restrictions on borrowing
Green	Interest as a % of operational savings < 40% AND Debt stock as a % of current revenues is ≤ 80%	No restrictions
Yellow	Interest as a % of operational savings < 40%–60% AND Debt stock as a % of current revenues is ≤ 80%	Lending with Ministry of Finance authorisation
Red	Interest as a % of operational savings > 60% OR Debt stock as a % of current revenues is ≤ 80%	No lending unless the local government agrees to an adjustment plan

Source: Kehew et al., 2005

Another gap in the current offer of African financial intermediaries is the lack of investment vehicles for blended and private finance, especially at the state and national levels. Setting up a financial intermediary as an SPV that takes the structure, governance and financing mechanisms of a corporate entity, will allow for a much smoother, more effective engagement with private investors, as the latter will be more comfortable partnering with an entity that looks and acts in a way they are familiar with. At the global level, IMIF could be a good example of this approach, but many more of these types of institutions will be necessary to attract and accommodate the private investment necessary to address urban infrastructure needs across the continent.

One such example of a state-level SPV in India is the Tamil Nadu Urban Development Fund (TNUDF). TNUDF emerged from the state-owned Municipal Development Fund in 1996. It was established as a trust fund with private equity participation, with the aim of increasing the volume of financing to municipalities in the form of blended finance. TNUDF undertakes project financing through loans with tenors of up to 20 years. Any municipality can apply for a loan for up to 60% of the project cost, with the conditions of the loan depending on the economic characteristics of the project. However, all projects must demonstrate a projected cash flow sufficient to service the debt and cover the operation and maintenance of the infrastructure. TNUDF also helps municipalities structure their projects and can pool projects from different municipalities to raise financing in bulk on the capital markets. An example of this is the Water and Sanitation Pooled Fund launched in 2002, with the participation of 13 municipalities.

Another gap exists regarding the support available to cities and local governments to realise their potentially bankable project ideas. At present, it is mainly the most entrepreneurial city leaders that actively seek out assistance from interested development partners, who are benefiting from this type of specialised support. Their cities then receive help to structure the project financially, secure revenue streams for repayment, and obtain guarantees to reduce the cost of debt. However, there are many more project ideas out there that could be made a reality. This type of support is often crucial to launch these projects and avoid cities making potentially expensive mistakes while trying to emulate existing flagship examples. However, a word of caution is needed to reiterate that not all urban investments, especially those providing basic services, can be turned into bankable projects. Trying to force such projects in the face of fiscal pressures can have disastrous consequences. These projects should be given priority for grant financing.

One example to illustrate this need for caution is the challenge currently faced by many Chinese municipalities. After 2008, many Chinese municipalities established a local government financing vehicle (LGFV) to help them boost urban investment. As municipally owned development and investment corporations, LGFVs were independent legal entities from the municipalities themselves and able to raise finance from domestic and international financial markets. However, with their financial models based on optimistic growth projections, China's recent economic downturn has resulted in many of these investment projects no longer generating sufficient revenue to repay the associated debt. This is pushing LGFVs into riskier, often offshore refinancing, which is associated with significantly higher interest rates, further weakening their financial position and ultimately risking default and bankruptcy.

Finally, there is a gap in the legal and regulatory framework to facilitate municipal borrowing. To date, corporate financing models have been offering solutions in the absence of appropriate subnational government debt regulations. For example, where no municipal bond process is in place, an SPV can be set up to issue a corporate bond. Ideally, however, mechanisms should be put in place that allow cities and local governments to carry their debt themselves, both for transparency and accountability reasons, as well as for creating incentives for good financial performance, so strengthening local autonomy. This also includes establishing mechanisms that can secure the repayment of project debt directly from the municipality's balance sheet, for example, by explicitly allowing the ringfencing of certain revenue streams or legally prioritising certain payments over others. This requires the amendment of local public financial management (PFM) or debt legal frameworks or a broader set of financial market regulations. In Morocco, for example, national regulation requires local governments with FEC loans to serve their debt obligations before they are even allowed to pay salaries.

6 Policy recommendations

Based on the gaps in the African landscape of financial intermediaries identified above, this final section proposes some potential avenues for reform aimed at expanding cities' and local governments' access to debt finance through financial intermediaries by making concrete policy recommendations for different key stakeholders operating in this space. The first set of recommendations aims to strengthen the overall legal and institutional framework for subnational lending, while the second set seeks to support cities and local governments in realising their investment portfolio. The final recommendation proposes revisiting the current lending practices of the development finance community.

Strengthen the overall legal and institutional framework for subnational lending

- Advance the development of national legal and regulatory frameworks across the continent that strike a healthy balance between managing risks of subnational borrowing and creating an enabling environment that allows cities and local governments to access debt finance to address their infrastructure needs. While national governments need to lead these reforms, consulting with local governments, potential investors, finance experts and other stakeholders will be key to achieving the multiple objectives. Development partners can support this process by identifying gaps in the framework, sharing experiences from other jurisdictions, and initiating pilots for experimentation and demonstration purposes.
- Strengthen the capabilities of municipal development institutions as financial intermediaries and support them in their transformation towards becoming effective lending institutions. This should include building their technical capacity as lenders, advising them on their governance structure, and setting incentives that help them transform into market participants, e.g., when providing them with credit lines for on-lending. This can be spearheaded and/or supported by central government, development partners or the financial intermediaries themselves. Once the transformation becomes palpable, these institutions should be encouraged and possibly assisted in broadening their portfolio of financing sources, including mobilising private funding to further reinforce their market orientation.
- Establish different types of lending programmes for different levels of local government fiscal capacity. The design of such programmes could be devised by the central government or the financial intermediary itself. This not only allows for the most efficient use of resources, but also challenges local governments of all capacities to maintain and improve their fiscal performance. Weaker local governments should be offered a mix of grants and soft loans, while high-performing cities and municipalities should be encouraged to access commercial-type loans for their bankable projects. Their placement in the different lending categories should be monitored and adjusted based on their loan performance. A system of rewards and sanctions should be set up to ensure cities comply with their debt obligations, while being encouraged to become better borrowers.

- Support cities and local governments without a credit history to gain borrowing experience. Helping them establish a track record of successful debt management will break through the vicious cycle and give future lenders reassurance. In combination with the above recommendation, this process can be conceived and managed by financial intermediaries. It can start small, by issuing a mix of grants and loans with only a minor loan component for first-time borrowers. Then it can gradually increase the share of that component for subsequent finance, depending on the local government's fiscal performance and the nature and expected return of the project. This can be initiated even with weaker governments, as long as they are adequately supported to manage the loan properly and procedures and safeguards are put in place that allow them to do this – even when they are no longer being closely monitored.
- Support the establishment or strengthening of corporate entities at the national or regional levels that allow for the mobilisation of blended and private finance. These institutions can provide lending under quasi-commercial conditions while still offering technical assistance or credit enhancement support. They can also be used to pool investment projects from several municipalities to meet the minimum thresholds for mobilising finance from larger investors. Such efforts should be led by government in collaboration with the private sector and development partners, where expedient.

Support cities and local governments to realise their investment portfolio

- Link technical assistance and capacity-building programmes on strengthening local PFM processes and local revenue mobilisation more explicitly and systematically to improving the creditworthiness and borrowing capacity of local governments. This approach, which could be pursued by central government, development partners and even local governments themselves, might mutually benefit all support areas. This is because the prospects of gaining access to debt might help overcome some of the inertia and political obstacles to effective local revenue mobilisation, while establishing stable revenue streams will certainly increase the chances of qualifying for debt financing.
- Develop capital investment strategies and plans for cities and local governments. Ideally, every local government should have a medium-term capital investment strategy and plan based on needs assessments and empirical data and analysis that provides a comprehensive picture of the cities' investment needs and priorities over the next five to ten years. Although led by the city, this exercise can be supported by the central government or development partners. These capital investment plans should include, among others, a sound analysis of the revenue potential and bankability of each investment project, as well as a clear identification of potential financing sources and a strategy on how to access them. Such an analysis will allow the city to determine which projects to prioritise for grant financing, which projects only require partial subsidies, and ones that could be attractive for private investors. This will result in a more efficient use of resources.
- Expand the offer of on-demand assistance to local governments that have ideas for potentially bankable projects. Development partners can play a key role here by financing this specialised expertise. The advantage of this type of support is that it can be tailored to the specific

characteristics and business model of the project, as well as to the management capacity of the local government. The approach could be further enhanced by developing a simplified rating approach for projects that provides an objective indication of their bankability. This will allow potential investors to decide more easily whether they are interested enough to do their own due diligence before making an investment decision.

- Help match infrastructure projects with suitable investors. There are many technical assistance facilities that support strengthening local finances and the development of city investment plans and projects. In conjunction with the previous recommendations, these valuable efforts can be made more effective by helping the project proactively seek investors. Bringing in potential investors early in the process to ensure that proposed projects meet their investment criteria could further increase the chances of mobilising financing.

Revisit current lending practices of the development finance community

- Initiate a debate about risk. Bilateral and multilateral development institutions tend to be risk averse in their lending decisions (Attridge and Engen, 2019; Colenbrander, 2023), which might limit their ability to engage with cities on a larger scale. While there are many things to consider in determining the appropriate risk level to adopt, these institutions might benefit from having an open debate about whether they should consider accepting more risk when lending to certain borrower groups, to achieve their mission.

While implementing any one of these recommendations might have some positive effects on the overall situation, a more effective approach could be to combine and/or sequence some or all of them, depending on the starting point and context of the respective country. The more coordinated and modulated the different interventions are in an overall reform strategy, the greater the chance of reaping synergy effects and avoiding gaps, discrepancies and conflicting signals.

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Key informant interviews

Name	Organisation, position	Interview date
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O'GRADY, Lin	EBRD, Deputy Head Sustainable Infrastructure Group	02/03/2023
PAINTER, David	Independent Development Finance Adviser	01/03/2023
SARR, Khady Dia	City of Dakar, Advisor to the Mayor of Dakar	10/03/2023
STUBDRUP, Ole Pilgaard	AfDB, UMDF City Diplomacy and Urban Development	14/03/2023
VISCONTI, Massimo and colleagues	Moody's, Vice President/Senior Credit Officer/Manager Core Europe, Central and Eastern Europe (CEE), Africa	15/02/2023
YATTA, Francois Paul	UCLG Africa, Head of Programmes	27/02/2023
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