

GOOD PRACTICE GUIDE

Creditworthiness

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C40 Cities Climate Leadership Group

The C40 Cities Climate Leadership Group, now in its 10th year, connects more than 80 of the world's greatest cities, representing 600+ million people and one quarter of the global economy. Created and led by cities, C40 is focused on tackling climate change and driving urban action that reduces greenhouse gas emissions and climate risks, while increasing the health, well-being and economic opportunities of urban citizens. www.c40.org

The C40 Cities Climate Leadership Group has developed a series of Good Practice Guides in areas critical for reducing greenhouse gas emissions and climate risk. The Guides provide an overview of the key benefits of a particular climate action and outline successful approaches and strategies cities can employ to implement or effectively scale up these actions. These Guides are based on the experience and lessons learned from C40 cities and on the findings and recommendations of leading organisations and research institutions engaged in these areas. The good practice approaches are relevant for cities engaged in C40 Networks as well as for other cities around the world.

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EXECUTIVE SUMMARY

A number of C40 cities do not have a credit rating or access to international capital and therefore face challenges in making climate-related and other investments that drive economic growth and sustainable development. The C40 Creditworthiness Network helps cities break through these barriers and realize their full potential to build a low-carbon and climate resilient future.

The creditworthiness of a city is a vital component of its ability to finance low-carbon, climate-resilient projects, particularly in terms of attracting investment and issuing bonds. Cities that have a low level of creditworthiness will struggle to raise the funds needed for new projects or for upgrading existing ones. An investment grade credit rating can help a city unlock access to a wide range of private investors, while the improvements in financial management required to achieve this are also likely to increase the city's revenue.

This Good Practice Guide focuses on the key elements for a city to successfully increase its creditworthiness with a goal of investing in sustainable infrastructure. These include:

- **Increase Own-Source Revenue (OSR) and manage expenditure**
- **Introduce best practices for financial management processes**
- **Develop a 'climate smart' long term capital investment plan**
- **Build a pipeline of public infrastructure projects**
- **Undertake a 'shadow' credit rating assessment**

The C40 Creditworthiness Network supports cities to overcome the major barrier that the lack of creditworthiness presents for financing sustainable infrastructure and delivering on city climate action plans.

The purpose of this Good Practice Guide is to summarise the key elements of creditworthiness good practice for global dissemination, highlighting the success of C40 cities in improving their creditworthiness.

1 BACKGROUND

1.1 Purpose

The C40 Cities Climate Leadership Group has developed a series of Good Practice Guides in areas critical for reducing GHG emissions and climate risk. The C40 Good Practice Guides provide an overview of the key benefits of a particular climate action and outline successful approaches and strategies cities can employ to effectively scale up these actions. These Guides are based on the experience and lessons learned from C40 cities and on the findings and recommendations of leading organisations and research institutions engaged in these areas. The following Good Practice Guide focuses on the key elements necessary to improve a city's creditworthiness in order to increase access to finance for low-carbon and climate resilient infrastructure. These approaches are relevant for cities engaged in C40's Creditworthiness Network as well as for other cities around the world.

1.2 Introduction

The creditworthiness of a city is a vital component of its ability to finance low-carbon, climate-resilient projects, particularly in terms of attracting investment and issuing bonds. Cities that have a low level of creditworthiness will struggle to raise the funds needed for new projects or for upgrading existing ones. An investment grade credit rating can help a city unlock access to a wide range of private investors, while the improvements in financial management required to achieve this are also likely to increase the city's revenue.

2 CREDITWORTHINESS AND CLIMATE CHANGE

2.1 What is creditworthiness?

Cities across the world are growing at an increasing rate, putting existing infrastructure and services such as transport, solid waste management and sanitation under extreme pressure. Many cities already require substantial investment to maintain current levels of services into the future, let alone expand to support the growing population. Investment needs are immense and traditional sources of financing from central governments and aid organisations will not be sufficient to meet them.

To attract additional investment from private sources, cities need to be creditworthy. Creditworthiness is essentially an assessment of the likelihood that a borrower (the city) will default on its debt obligations.ⁱ The assessment is carried out by an independent credit rating agency that will study a range of aspects of a city's financial management as well as the wider socio-economic-political environment and assign a score based upon the results. The score,

known as the credit rating, will be used by investors to determine whether or not they are interested in providing finance to a city and at what level of interest rate: the higher the rating, the more finance will be available at a lower interest rate.

The World Bank estimates that currently less than 20% of the largest 500 cities in developing countries are deemed creditworthy nationally, with just 4% having access to international markets.ⁱⁱ The lack of a credit rating severely constrains these cities' ability to provide basic services, let alone invest in low-carbon, climate resilient urban development.ⁱⁱⁱ This is because the revenues cities generate through taxation and other sources are usually only sufficient to cover operating expenditure (and in many cases not even that, with cities depending instead on national government or donor support), but not investments in new infrastructure and services.

However, cities that have been able to improve their creditworthiness significantly increased their access to finance and saw a general improvement in their own financial resources through better management processes^{iv}. Estimates from the World Bank indicate that “every dollar invested in the creditworthiness of a developing country city is likely to mobilize more than US \$100 in private sector financing for low-carbon and climate-resilient infrastructure”^v.

2.2 How can cities become creditworthy?

A city's creditworthiness is assessed by a credit rating agency against a wide range of criteria, which typically include:

- Institutional Frameworks
- Economy
- Financial Management
- Budgetary Flexibility
- Budgetary Performance
- Liquidity
- Debt Burden
- Contingent Liabilities

Each rating agency will have its own rating levels which will ultimately determine the availability of and cost of finance to a city from private investors.^{vi} These rating levels fall into two categories: **Investment Grade**, where a city is seen to have strong creditworthiness and therefore is attractive to investors and **Speculative Grade**, where a city is seen to be less creditworthy and therefore less attractive to investors, pushing up the cost of capital.

The rating categories of Standard & Poor's, one of the main global international rating agencies, are shown below:

Investment Grade	AAA	Extremely strong capacity to meet financial commitments. Highest rating
	AA	Very strong capacity to meet financial commitments
	A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances
	BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions
	BBB-	Considered lowest investment grade by market participants
Speculative Grade	BB+	Considered highest speculative grade by market participants
	BB	Less vulnerable in the near term, but faces major ongoing uncertainties to adverse business, financial and economic conditions
	B	More vulnerable to adverse business, financial and economic conditions, but currently has the capacity to meet financial commitments
	CCC	Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments
	CC	Currently highly vulnerable
	C	A bankruptcy petition has been filed or similar action taken, but payments of financial commitments are continued
	R	An obligor rated 'R' is under regulatory supervision owing to its financial condition. During the pendency of the regulatory supervision the regulators may have the power to favor one class of obligations over others or pay some obligations and not others

Source : Standard & Poor's Guide to Credit Rating Essentials

Cities can opt to apply for either a **national** credit rating or an **international** credit rating. National ratings are given by local rating agencies and provide information tailored for domestic investors. National ratings are generally easier for a city to achieve for a number of reasons and will allow cities to borrow from local investors, but may not be recognized by international investors. Although a national rating may limit cities to borrowing only in their local currency from domestic investors, it does remove the risks associated with fluctuating foreign currency exchange rates. It can also provide a useful assessment of a city's creditworthiness in the local context.

International credit ratings are recognized globally, providing a city with access to investment from the international capital markets, increasing the city's options and reducing the cost of capital. International credit ratings will depend on the ability of the city to service debt in foreign hard currencies (US dollar, British pound or euro), as well as on the sovereign government's creditworthiness and a range of other factors. As such, while an international credit rating may be more desirable, it is also significantly more difficult for a city to achieve. Additionally, borrowing in foreign currencies increases the risks associated with fluctuating foreign currency exchange rates.

2.3 Creditworthiness process

The first step is for a city on the path to becoming creditworthy is an assessment to evaluate its current level of creditworthiness^{vii}. A city can undertake an assessment either on its own or with an external agency (including a ratings agency) to identify where it may need to make improvements. If the city feels it performs well against all these criteria, it can then apply for credit rating from a credit rating agency.

The World Bank provides a helpful city creditworthiness self-assessment tool^{viii} that can be used by cities to develop a creditworthiness action plan: <http://www.citycred.org>. The tool has been used by cities such as Kampala in Uganda to achieve a credit rating in a relatively short amount of time (less than 3 years). The World Bank assessment tool has identified **19 key areas** in which cities may need to make improvements to obtain an investment-grade rating. Below is an example of the assessment tool highlighting two key areas for a city to start focusing on to improve their overall creditworthiness.^{ix}

No.	Challenge
1	Further Develop Local Currency Sub-National Debt Market
2	Clarify Legal Authority to Incur Multi-Year Liabilities
3	Improve Central Monitoring & Oversight of Sub-sovereign Operating & Capital Management
4	Create/Improve Multi-Year Operating & Capital Budget Development & Approval Processes
5	Improve Physical Development Planning
6	Create/Improve Comprehensive, Climate-Smart Capital Improvement Planning
7	Improve Project Preparation, Development, Operations, and Management Processes
8	Unstable/Unpredictable Intergovernmental Transfer Flows, Shared Tax, and Revenue Sharing
9	Improve Own-Source Revenue Collection and Management
10	Increase Sub-Sovereign Authority to Increase Tax and/or Fee Rates
11	Improve Transparency & Effectiveness of Local Governing Operations, Management, & Elected Leadership
12	Build 3+ Year Record of 'Clean' Independent Audits Accompanied by Management 'Reports' or 'Letters'
13	Improve Sub-National Entity Human Resource Management
14	Obtain a Credit Rating from an Independent Credit Rating Agency
15	Complete One or More Public Infrastructure Financing Transactions
16	Create/Improve Existing System for Capital Asset Valuation, Management, & Accounting Systems
17	Create or Improve Existing Green House Gas Inventory Systems & Use Them in Capital Improvement & Physical Development Planning
18	Create & Incorporate Climate Risk Assessment & Action Planning in Capital Improvement & Physical Development Planning
19	Insufficient Revenues to Pay for Central Government Mandated Services that are Full or Shared Responsibility

Most cities will only need to take action in two to five areas listed above, and many of the required actions will address challenges in multiple areas.

The C40 Creditworthiness Network^x has been supporting several cities to improve their performance in these areas. A number of C40 cities in East Africa and South Asia have been undertaking assessments of their own-source revenue (OSR) to identify opportunities for improvement, while two other cities in Africa have started to develop climate-smart capital investment plans. Two cities in Latin America and West Asia have been undertaking these activities as well as creating a pipeline of public infrastructure projects, such as BRT systems. One city is currently developing an Islamic ‘Sukuk’ bond to finance several public infrastructure projects, while another is currently applying for a ‘shadow’ credit rating assessment.

2.4 Main credit rating institutions

The majority of the world’s credit ratings are issued by three main companies:

- Standard & Poor’s (S&P)
- Moody’s Investor Services
- Fitch Group

However there are a number of regional and local agencies that work with municipalities. The ratings issued by these agencies are only recognized at the local or regional level, but often reflect a better understanding of the municipality than those provided by a global rating agency. Examples of regional and local agencies include:

South Africa / Africa Region:

- Global Credit Ratings Co. (GCR)

Brazil:

- SR Rating, Ltda

China:

- China Chengxin International Credit Rating Co. Ltd (CCXI)
- Dagong Global Credit Rating Co. Ltd (Dagong)
- Shanghai Far East Credit Rating Co. Ltd (SFECR)

India:

- CRISIL Limited
- ICRA Limited
- Credit Analysis and Research Limited (CARE)
- Brickwork Ratings India Pvt Ltd

Pakistan:

- JCR-VIS Credit Rating Co. Limited
- Pakistan Credit Rating Agency Limited

2.5 Benefits of creditworthiness

Credit ratings provide a wide range of benefits to municipalities. A regular formal assessment by an external agency will inspire confidence in municipalities from outside investors and provides them with an on-going report on a city's financial performance. This not only increases the pool of investors available to cities, but also allows cities better access to infrastructure finance at a lower cost. A good credit rating will also increase the speed at which a lender is prepared to come to a decision about whether or not to lend to a city.

Donors and national governments also value a municipal credit rating, as it indicates a well-managed municipality that can be relied upon to manage grants and other forms of support appropriately. The credit rating may also highlight any areas where a city might have issues and provide an indication as to where support should be targeted.

Having a credit rating allows municipalities to borrow to finance their infrastructure. This provides a number of advantages for cities:

Acceleration of infrastructure delivery - by borrowing, a city can deliver infrastructure much more quickly than it would be able to by building savings first.

Sharing costs with future beneficiaries - borrowing allows infrastructure costs to be shared with future users, rather than having current and past tax payers incur the total cost of long-lasting infrastructure.

Savings on infrastructure costs - in many regions, particularly Africa, building inflation (the rate of increase in building cost) can exceed the interest paid by municipalities on loans.

Improving the city's focus on financial sustainability - the process of borrowing and repaying loans (including meeting the lenders requirements and regular reporting) will help encourage cities to follow best practices and improve management practices.

The process of borrowing and repaying loans for infrastructure projects will also help further strengthen a city's creditworthiness, continuing to decrease the cost of capital and attracting outside investment to a municipality.

2.6 Challenges to becoming creditworthy

There are a number of challenges that local governments might face when seeking to increase their creditworthiness, including:

Cost - A municipality may feel the cost of achieving a credit rating is too high, particularly if the rating is likely to be a non-investment grade. However, the benefits a rating provides are

likely to outweigh the cost, and in some cases the national government or donors may cover the cost for the city.

Limited expertise and resources - Many cities, particularly those in developing countries, may be limited in the amount of time their staff have available to pursue a credit rating. They may also lack the knowledge and experience required. External support may be required in such a case.

Weak finances and financial management - The financial challenges, such as low revenue collection and poor management practices, faced by some cities may be significant. They may therefore feel it is unlikely they will be able to obtain an investment grade credit rating in the foreseeable future. Despite this, there is value in a city pursuing a credit rating, as the process itself will help address many of these challenges.

External factors and uncertainty (economic, social and political) - There may be a wide range of external factors beyond a city's control that limit its ability to pursue a credit rating. These could include an unstable wider economy, poor creditworthiness of the country, regulatory barriers and hurdles, regional conflict or political turmoil. In these cases, it may be more suitable for a city to pursue a national credit rating, as it assesses relative creditworthiness of cities within one country and subject to similar external factors, thus decreasing their relative effect.

Risk of decreased government and donor support - Many cities fear that with stronger finances and improved ability to borrow, national governments and donors will start to decrease the amount of support they provide to the municipality. This is unlikely, however, as well-run entities provide better value for money in the eyes of governments and donors.

Unfavourable peer comparison - A city's credit rating is public and so a weak rating may be perceived as reflecting badly on a city in comparison with its peers. Although this is a risk, it will also serve to highlight areas for improvement in a city's financial management and encourage improvements. To mitigate this risk, a credit rating assessment (or a 'shadow rating') can be conducted by a city in advance of applying for a formal rating, with the results being kept confidential by the city.

However, these challenges can often be overcome through inventive solutions, cooperation, coordination, and best practices listed in Section 3 below.

3 GOOD PRACTICE APPROACHES FOR ACHIEVING A MUNICIPAL CREDIT RATING

The steps a city will need to take to increase its creditworthiness will depend to a large extent on where it is starting from. It is important that cities initially concentrate on simple, achievable steps, such as identifying opportunities for increasing municipal revenues, before moving on to more complex steps, such as making changes in the regulatory or legislative environment.

For those cities with weak finances and management systems, their initial focus will be on general and wide ranging improvements to financial management practices and capacity building. For more advanced cities, it may be more appropriate to focus on building a pipeline of public infrastructure projects and establishing a track record of successfully managing such projects. For the most advanced cities with strong finances and track record of repaying debts, applying for a 'shadow' credit rating (a credit rating assessment) may be helpful in order to highlight any issues they may need to address before applying for a formal rating.

The main steps for a city to follow are:

- Understand its starting point by conducting an internal assessment;
- Set clear, realistic and ambitious objectives;
- Develop initiatives to address problem areas, particularly enhancing revenues and reducing costs;
- Create an action plan of initiatives;
- Allocate resources and implement the plan.

3.1 Creditworthiness Action Plans – key good practice components

Each city's action plan will need to be tailored to their specific challenges. The cities in the C40 Creditworthiness Network have identified a number of key areas of focus common to most of their plans:

- **Increase Own-Source Revenue (OSR) and manage expenditure**
- **Introduce best practices for financial management processes**
- **Develop a 'climate smart' long term capital investment plan**
- **Build a pipeline of public infrastructure projects**
- **Undertake a 'shadow' credit rating assessment**

We have identified case studies for each of these categories, which demonstrate good practices from C40 cities in the Creditworthiness Network and other cities around the world.

3.2 Increase own-source revenue and manage expenditure

For almost all cities seeking to increase their creditworthiness, improving their fiscal and financial performance as well as cash and debt management is essential. In practice, this can cover a wide range of activities that include improving the collection of revenues, cash flow and reserves, and reducing unnecessary expenditure. These actions alone can make a major difference to a city's budget, particularly in cities where revenue collection rates are extremely low.

Case study: *Kampala, Uganda^{xi} - Strategic Plan*

Summary: The Kampala Capital City Authority (KCCA) has been working since 2012 to significantly improve the creditworthiness of the city. The economy of Uganda has been growing rapidly over the past decade, with the city of Kampala accounting for approximately 50% of GDP. The city has faced numerous problems, however, including poor revenue collection and management, weak governance, overdependence on government transfers, and disaffected residents. The city's finances were not particularly strong, partly due to a very low rate of collection of revenues such as taxes and fees (below 30%), which was limiting the city's ability to improve its services and infrastructure. These issues, combined with poor infrastructure and a rapidly increasing population, inspired the KCCA to create a Strategic Plan to restore good governance and service delivery, including improving the city's creditworthiness.

Results: The Strategic Plan targeted several areas, including human resource development and financial management, with the support of several external organisations, such as the World Bank and Public-Private Infrastructure Advisory Facility (PPIAF). In particular, the plan aimed to improve municipal revenues through better property record management, tackling inefficiencies in fee collections and billing processes, as well as stronger accounting and monitoring practices.

The Strategic Plan has been extremely successful in its implementation and results. In one year the city managed to increase its revenues by 86% through better collection of revenues and efficiency improvements. In 2011, prior to the implementation of the plan, the city's total income was UGX 98.8 bn. Following the implementation of the plan, revenues increased dramatically; by 2014 total city revenues were UGX 226.5 bn.

As the city started to make significant progress in improving its revenue generation and managing expenditure, grant funding from the national government and donors has also increased substantially to further support these changes. The city was able to double its debt capacity and improve its investment capacity. As a result, in April 2015, KCCA was awarded an **"A" (Investment-Grade) Rating** by Global Credit Ratings, with an "A, Stable" outlook for 2016 (ratings on the national scale).

Reasons for success: The KCCA was highly committed to the implementation of the Strategic Plan, which was a key factor in the award of a strong rating by GCR. Improvements made to revenue collection and financial management boosted the KCCA's finances substantially. The wide ranging improvements and the KCCA's clear commitment to the implementation of the strategic plan sent strong positive signals to the national government, donors, and investors, attracting further investment to the city in advance of and following the city receiving the rating.

When/why a city might apply an approach like this: Weak finances are a common problem facing many cities around the world. Often a city can substantially increase its income and financial position through better management and collection of revenues, rather than introducing new taxes or financial measures. In developing countries, where collection rates can be extremely low, relatively modest improvements can have a major positive impact on a city's finances.

3.3 Introduce best practices for financial management processes

Linked to improving own-source revenue, introducing best practices in financial management can significantly aid a city's creditworthiness by demonstrating the city has strong and robust systems in place. This will also improve efficiency and transparency, helping to identify opportunities for savings and increasing investor confidence in the municipality.

Case study: Kolkata, India^{xii} - Financial management best practices

Summary: The city of Kolkata is one of the wealthiest and most successful cities in India. The Kolkata Municipal Corporation has been making steady progress in improving the city's financial management over the past decade, which resulted in the city achieving an **A+ rating** from CRISIL (reaffirmed in December 2015), India's leading ratings agency. The city has been able to maintain this rating since 2005, providing it with the ability to issue bonds. This has been largely due to the city's commitment to continuous improvements in its financial management systems, including more efficient revenue collection systems and greater use of revenue-generating mechanisms. In particular, the city has been implementing measures to more effectively manage expenditure and improve the ratio of revenue to expenditure. Individual measures may be relatively minor in scale and impact, but cumulatively have had a significant effect on improving the city's creditworthiness.

Results: The city has consistently and steadily managed to improve both its revenue collection and expenditure through the introduction of financial management best practices. As a result, the city has demonstrated itself to be highly creditworthy, attracting significant external investment. This includes a USD 300 million support for the Environmental Improvement Investment Program, provided by the Asian Development Bank.

Reasons for success: The slow but steady improvements in the city's financial situation have been the result of significant and committed investment in building the expertise and capacity of staff. As the city has continued to make improvements, investment and funding to the city have increased, creating a positive cycle of improvements.

When/why a city might apply an approach like this: Low capacity and expertise are a common problem for many cities in both developed and developing countries. Investment in staff yields reliable results through general improvements across the city's financial management practices.

3.4 Develop a 'climate-smart' capital investment plan

A capital investment plan is essential for cities that are developing large capital projects as it allows them to plan strategically and holistically. Capital investment plans identify the priority projects for a city to pursue over a specific period of time in order to deliver the required services to its citizens, accompanied with cost estimates and options for delivering these projects.

Potential lenders will look favourably on a city that has a credible capital investment plan in place, as it reflects good governance and planning. A capital investment plan is essentially an attempt to estimate:

- The service delivery issues for a municipality in the present and future
- The priority projects to address these
- The costs of the projects
- The way in which these projects should be sequenced and delivered over time

With their long-term perspective, capital investment plans should also be made 'climate-smart'. This involves ensuring that mitigation and adaptation considerations are taken into account at the outset, prioritizing projects and designs that provide emissions reduction and resilience-building benefits.

Case study: Kampala, Dar es Salaam and Durban – Capital investment plans

Summary: In recent years, several cities such as Kampala, Durban and Dar es Salaam, started to develop '**Climate-Smart**' **capital investment plans** that look to integrate climate mitigation and adaptation more effectively into long-term capital investment planning. As a result, projects are designed from the outset to provide carbon reduction and resilience-building benefits to the municipality. These plans are currently under development by each city, but could help these cities more effectively mainstream mitigation and adaptation into their long-term development.

Kampala has been developing and implementing, with the support of the World Bank and other agencies, a new capital investment plan that takes into account the carbon and climate-impact risk aspects and implications of new projects. As a result, potential issues are identified while projects are still in initial stages of development, and preference is given to those projects that are more resilient and low-carbon. The city of **Dar es Salaam** is also implementing a similar system, but is at an earlier stage of development.

The city of **Durban** has identified the need to prioritise low-carbon and climate resilient projects in its budget planning. As of December 2015, the city is exploring the measures it can put in place in the annual budget planning process, with the intention of implementing these measures in the 2016 - 2017 budget cycle.

Results: A ‘climate-smart’ capital investment plan is a relatively new concept and as such, its results have yet to be fully demonstrated. The main benefit it provides is to help ensure that climate change implications (positive and negative) of projects will be considered extremely early in the process of their design and implementation, encouraging cities to more effectively achieve their climate change goals and avoid the need for costly retrofits in the future. In Kampala, observers have noticed a change in the types and designs of projects being put forward for consideration as a result of the new processes, with mitigation and adaptation being considered in their design. For example, greater consideration is being given to the location and vulnerability of new facilities such as hospitals and municipal buildings. Historically, only aspects such as the cost and availability of land would have been considered, though now, for example, the likelihood of flooding is also assessed.

When/why a city might apply an approach like this: The creation of capital investment plans is an extremely important part of a city’s move towards achieving an investment-grade credit rating. Integrating climate change into the planning process will also help cities to achieve their low-carbon, climate resilient goals more cost-effectively, as potential measures are generally cheaper and easier to build in at the design stage of a project than to retroactively introduce once the project has been built. It can also help avoid potentially costly mistakes by identifying potential risks early on e.g. building a project in a location that will become increasingly vulnerable to flood risk or erosion over time.

3.5 Build a pipeline of public infrastructure projects

A city’s credit rating will be influenced by its track record of borrowing and managing public infrastructure projects, including establishing public-private partnerships (PPPs) and issuing municipal bonds. A city that has a good record of repaying its loans in full and on time, as well as managing large infrastructure projects, will be deemed more reliable and trustworthy in the eyes of lenders. A city that does not have a credit rating may be limited in the options it has to finance particular projects, but it should be possible to attract finance for projects through innovative mechanisms and help build the city’s track record.

Case study: Lima^{xiii} - Infrastructure investment experience

Summary: Lima, a city of over 7 million people, is one of the fastest growing in Latin America and has been facing the challenge of rapidly increasing greenhouse gas emissions. Studies conducted on behalf of the city illustrated that investment in transport would reduce emissions by 15% by 2025, while saving citizens over US\$1.1bn per annum^{xiv}. To enhance its funding capacity and attract additional investments, Lima launched an effort to improve substantially its governance structure and operational performance. Starting in 2006, Lima introduced elements of corporate governance management policies and improved its fiscal and financial management, in particular through updating its tax collection strategies, improving quality of

accounting and adopting solid treasury and debt management practices. This resulted in improvements of credit ratings, in turn leading to higher attractiveness to investors, willing to finance infrastructure projects in the city at lower financial costs and longer-term maturities of loans.

Results: Between 2006 and 2011, Lima managed to substantially increase its creditworthiness and achieve an investment-grade credit rating (BBB- from Fitch, Baa3 from Moody's), which was recently improved to BBB+. ^{xv} In order to get the process started back in 2006, the city worked with the World Bank to create a series of investment projects through innovative financing mechanisms, such as pooling financing opportunities and improving tax revenue collection. Lima was able to obtain a \$190 million bank loan (Banco del Credito de Peru and BBVA), ^{xvi} the largest market-based financing ever obtained by a municipality in Peru. This has then also helped Lima to apply for a credit rating by demonstrating the city's ability to borrow and repay loans. The funds made a significant contribution to the Metropolitan Bus Rapid Transit Corridor Project ^{xvii}.

Reasons for success: Lima worked with several external organisations, including donors and international finance institutions, to explore the range of different finance options available for projects in the city. This allowed the city to identify those that were most appropriate and cost-effective for their project needs. Despite initially not having a credit rating, the city was able to introduce innovative financing mechanisms that helped the city create a track record of successfully raising funding for projects.

When/why a city might apply an approach like this: Cities without an existing credit rating should adopt this approach to set out to improve their fiscal management, secure initial investment projects and improve their creditworthiness. The process of pursuing creditworthiness itself is beneficial to the city's financial attractiveness and can drive the strengthening of underlying fiscal and financial management practices.

3.6 Undertake a 'shadow' credit rating

A credit rating assessment, or 'shadow rating', is a useful tool for a city to understand how creditworthy it may be and where it might need to take further action before applying for a formal credit rating. A 'shadow rating' assessment is not essential for a city to obtain a credit rating, but it can provide an initial assessment by a rating agency of a city's creditworthiness at a lower cost than a full rating. It can also send a strong signal to the financial markets that a city is actively seeking to increase its creditworthiness, peaking potential investors' interest. This may be particularly valuable for cities which may not currently be in a position to pay for a full credit rating, as even a positive shadow rating will be viewed favourably by the investment community.

‘Shadow ratings’ can be kept confidential by cities and are considerably cheaper than a normal rating as a rating agency will only conduct a limited examination of a city’s creditworthiness, rather than an in-depth analysis. If the results indicate a good rating is likely, a city can then proceed to a full rating, with the shadow rating comprising only a small fraction of the total cost. If the results indicate a low level of creditworthiness, a city can then decide to take corrective action.

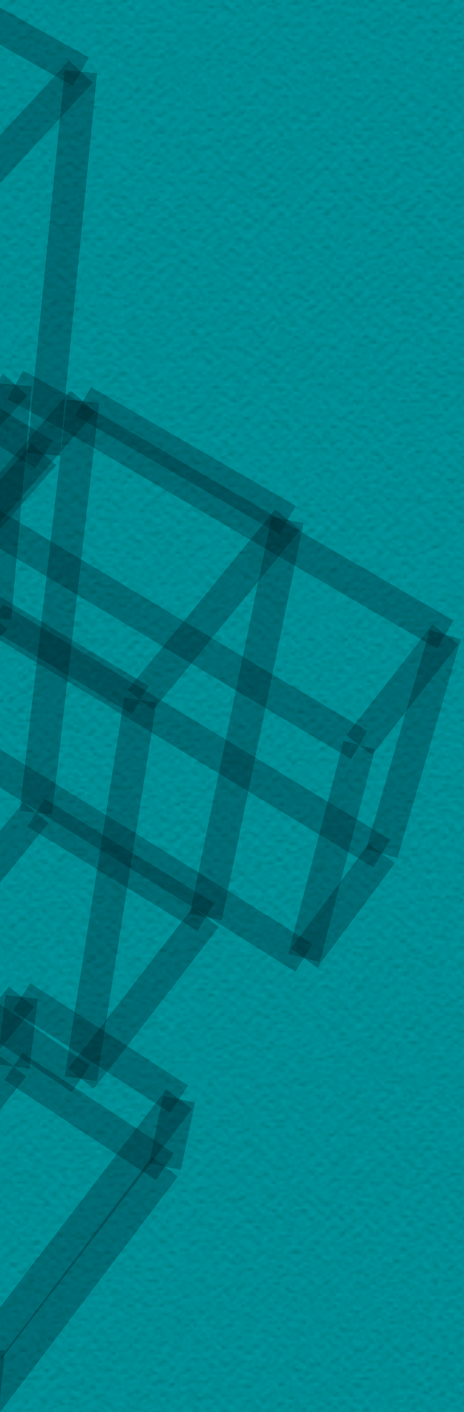
Many cities around the world have undertaken an initial shadow rating, including a number of cities in Africa, such as Kampala, Windhoek, Arusha, Dar es Salaam, Gaborone, Lusaka, Maputo, and Port Louis.^{xviii} Many more cities will have undertaken a shadow rating, but as these are not publicly disclosed by the rating agencies (though may be by the municipality), information is limited.^{xix}

4 FURTHER READING

For more detailed information and additional case studies, refer to:

- World Bank (2014). *Municipal Finance: A Handbook for Local Governments* - <https://openknowledge.worldbank.org/handle/10986/18725>
- *Handbook for Municipalities: Creditworthiness, Credit Ratings and Borrowing to Fund Municipal Infrastructure*, PPIAF 2009 - <http://www.ppiaf.org/sites/ppiaf.org/files/publication/Creditworthiness-Handbook-for-Municipalities.pdf>
- *City Creditworthiness Self-Assessment & Planning Toolkit* - www.citycred.org
- *The City Creditworthiness Initiative* - <http://www.worldbank.org/en/topic/urbandevelopment/brief/city-creditworthiness-initiative>
- Urban Landmark (2013). *The financing of city services in Southern Africa*. Shadow rating focus - http://www.urbanlandmark.org.za/downloads/tm2013_02.pdf

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- ⁱ <http://www.lboro.ac.uk/gawc/rb/rb115.html>
- ⁱⁱ World Bank (2013). *Planning and Financing Low-Carbon, Liveable Cities*. Available at: <http://www.worldbank.org/en/news/feature/2013/09/25/planning-financing-low-carbon-cities>
- ⁱⁱⁱ World Bank (2015). *City Creditworthiness Initiative: A Partnership to Deliver Municipal Finance*. Available at: <http://www.worldbank.org/en/topic/urbandevelopment/brief/city-creditworthiness-initiative>
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- ^v World Bank (2013). *Planning and Financing Low-Carbon, Liveable Cities*. Available at: <http://www.worldbank.org/en/news/feature/2013/09/25/planning-financing-low-carbon-cities>
- ^{vi} <http://siteresources.worldbank.org/INTDSRE/Resources/389451-1250785355895/WPS5013.pdf>
- ^{vii} <http://www.clgf.org.uk/userfiles/1/File/Municipalcreditrating.pdf>
- ^{viii} http://www.citycred.org/user_guide.pdf
- ^{ix} Anonymous example of city creditworthiness priority mapping. For more information, see www.citycred.org.
- ^x http://www.c40.org/blog_posts/c40-launches-creditworthiness-academy-network-to-unlock-city-access-to-capital
- ^{xi} For more information, see *PPIAF Helps Kampala Capital City Authority Improve its Creditworthiness* (2015). Available at: <http://www.ppiaf.org/sites/ppiaf.org/files/publication/Uganda-Kampla-SNTA-Credit-Rating.pdf>
- ^{xii} <http://www.clgf.org.uk/userfiles/1/File/Municipalcreditrating.pdf> - p.8
- ^{xiii} https://www.moody.com/research/Moodys-upgrades-Lima-to-Baa1-stable-outlook--PR_303110
- ^{xiv} <http://2014.newclimateeconomy.report/cities/#section-170>
- ^{xv} Business Wire (2015). Fitch Affirms Metropolitan Municipality of Lima's Ratings. Available at: <http://www.businesswire.com/news/home/20150722006208/en/Fitch-Affirms-Metropolitan-Municipality-Limas-Ratings>
- ^{xvi} Cities Today (2014). *Plugging the infrastructure gap: How can cities attract private investment?* Available at: <http://cities-today.com/plugging-the-infrastructure-gap-how-can-cities-attract-private-investment/>
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