MONGOLIA

Preparing for Debt Management in Ulaanbaatar: Issues to Consider

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Preparing for Debt Management in Ulaanbaatar: Issues to Consider

Contents

Acknowledgments ........................................................................................................................................... v
Abbreviations and Acronyms ............................................................................................................................... vii
Legal Framework .............................................................................................................................................. 3
   Establishing an Effective Debt Management Function for UB ................................................................. 9
   Formulating a Debt Management Strategy .................................................................................................. 14
   Ensuring Transparency and Good Governance in Bond Issuance ............................................................ 15
   Carrying Out Regular Audits ....................................................................................................................... 15
   Key Actions Required and Corresponding Outputs .................................................................................... 17

Boxes
   1: South Africa Regulatory Framework for Municipal Borrowing ............................................................... 4
   2: Transparency in Debt Management and India’s Experience ................................................................. 6
   3: National Debt Management Strategy .................................................................................................... 7
   4: Sinking Fund for Municipal Borrowing ................................................................................................ 8

Figures
   1: Debt Management Operations according to International Sound Practice ........................................... 9

Tables
   1: Fiscal Risks Matrix .................................................................................................................................. 10
   2: Key Actions and Associated Outputs for Prudent Debt Management ..................................................... 17
   A.1: Subnational Debt Management Performance Indicators ..................................................................... 19
   B.1: Borrowing Frameworks for Subnational Governments Worldwide ................................................ 21
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

Acknowledgments

This note is part of a broader technical assistance program designed to assist the City of Ulaanbaatar (UB) to improve its financial management system, assess the quality of municipal services provision, and mobilize resources from the capital markets to fund urban infrastructure. This note identifies key issues for UB to consider when putting in place an effective debt management framework prior to acquiring debt. It goes hand-in-hand with a separate “Financial Self-Assessment” that was carried out in preparation for a credit rating.

This work was carried out by a joint UB and World Bank team. The UB team received guidance from Mr. N. Bataa, Vice Mayor for Economy and Finance, and was led by Mr. Enkhmunkh Temuul in, Head of the Economic Development Agency (EDA). The Finance and Treasury Department (represented by Ms. Sandang Solongo), the Property Relations Department (headed by Mr. Tumurbataar Sharavdorj), and the Strategic Policy and Planning Department (headed by Mr. Bayaarbat) provided all the required information. Findings from the self-assessment and debt management assessment were presented at a workshop in UB convening a wide range of stakeholders, including the city administration, government agencies, and the press.

The World Bank team consisted of Meskerem Brhane (Task Team Leader and Senior Urban Specialist, EASIN), Hernando Garzón (Senior Public Finance Economist, Consultant), Huong Mai Nguyen (Urban Governance Analyst, EASIN), and Erdene Ochir Badarch (Operations Officer, EASCS).

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Vice President Axel van Trotsenburg
Country Director Klaus Rohland
Country Manager Coralie Gevers
Sector Director John Roome
Sector Manager Mark R. Lundell
Task Team Leader Meskerem Brhane
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

Abbreviations and Acronyms

BL  Budget Law
CG  Central Government
DeMPA  Debt Management Performance Assessment
EDA  Economic Development Agency
FRC  Financial Regulatory Commission
GDP  gross domestic product
IT  information technology
LDF  Local Development Fund
LG  local government
MED  Ministry of Economic Development
MFMA  Municipal Finance Management Act
MNAO  Mongolian National Audit Organization
MNT  Mongolian New Tugrik
MOE  Ministry of Economic Development
MoF  Ministry of Finance
MTDS  Medium Term Debt Management Strategy
PREM  Poverty Reduction and Economic Management
PRD  Property Relations Department
SNG  subnational governments
UB  City of Ulaanbaatar
WB  World Bank

CURRENCY EQUIVALENTS
(As of February 2014)
Currency Unit = Mongolian New Tugrik
MNT 1 = US$ 0.00057
US$1 = MNT 1,762.00
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

I. Background

The Government of Mongolia passed a Budget Law (BL) in December 2011 that for the first time allows local governments to borrow and to issue bonds. The City of Ulaanbaatar (UB) has therefore requested Technical Assistance from the World Bank to help put in place systems for issuing debt prudently. This note, drawing on the World Bank’s Subnational Debt Management Performance Assessment (DeMPA) Tool (World Bank 2012c), identifies the key areas that UB needs to focus on in order to manage future debt effectively. These include an appropriate legal framework, effective managerial structure, a debt management strategy and a borrowing plan, as well as timely and transparent financial reporting. (See Appendix A for a full description of the DeMPA tool and indicators). This note analyzes the current division of relevant functions in UB’s administrative structure along each of the key dimensions and offers recommendations for strengthening the current borrowing framework. It stresses the need to first build local institutional capacity for an effective and transparent debt management system before any borrowing is considered. Finally, the note concludes that given the macroeconomic context of massive levels of sovereign borrowing, new borrowing at this juncture would not be desirable and cannot be recommended by the Bank. Instead, UB should use this time to put in place a debt management system so that it is prepared for borrowing once it is ready and the macroeconomic conditions improve.

II. Ulaanbaatar City Government

The population of Ulaanbaatar has swollen from half a million in 2001 to approximately 1.32 million in 2012, accounting for over 40 percent of Mongolia’s total population. This trend is likely to continue as economic growth is increasingly concentrated in UB. Rapid urbanization is straining the city’s ability to provide services, especially infrastructure. Over 60 percent of the population lives in unplanned settlements—or ger areas—which spread more than 90 percent of the city’s urban footprint. Most residents lack access to basic services such as central heating, water supply, sewerage, and paved roads, and the low density and extremely cold climate make the provision of these services costly.

UB has the legal mandate to provide a wide array of services. The newly approved master plan calls for extensive investments to make up for the city’s infrastructure deficit to serve the

1 The services include urban planning, construction, and building new infrastructure; maintenance of the capital city’s constructions and buildings; establishing new property and making investments; social care and welfare services; employment generation and poverty alleviation; development of small and medium-sized enterprises;
Mongolia

bottom 40 percent of the population. Although the city is in relatively strong financial position, its own current resources are not sufficient to implement the investment plan within the projected timeframe. Therefore, the city needs to mobilize financing from the capital markets and through public-private partnerships to achieve its objectives. Moreover, with the passage of the Budget Law (BL), citizens now have the opportunity to participate in the budgeting process, as UB leaders are required to manage budgets in a more transparent and accountable manner. To prioritize investments on services expansion, the city intends to base its decisions on the transparent and effective management of its finances and the needs of its citizens.

In terms of fiscal management, while Mongolia remains a unitary state, the government is making greater efforts at fiscal deconcentration. First, UB’s capital revenue base has been improving significantly, which is allowing it to respond to the deficit in municipal services and infrastructure, as well as the concerns over rising inequality. UB’s largest source of revenue, the income tax, is stable and expected to continue to grow. The recent establishment of the Local Development Fund under the Budget Law provides UB with predictable central government transfers for capital investments, and a newly introduced regulation allows the city to retain its budget surpluses. Additionally, some new revenue sources are currently under discussion, such as the “capital city tax.”

Second, UB intends to borrow from the capital markets to meet its enormous capital investment financing needs. In preparation for future borrowing, it plans to obtain a credit rating, assess its actual credit needs, determine its absorption and debt carrying capacity, and put in place a transparent and accountable system for managing future debts. The importance of a strong debt management system is illustrated by the experiences of several U.S. cities and municipalities that have filed for bankruptcy, including Detroit, Michigan; Vallejo, California; and Jefferson County, Alabama. Municipal bankruptcies are often the result of over-indebtedness of utilities (such as the sewer system in Jefferson County and an incinerator plant in Harrisburg, Pennsylvania) or pension and labor contracts (as in Vallejo and Detroit) that were in excess of their revenues (De Angelis and Tian 2013). To come out of their bankruptcy status, many of these cities have had to significantly cut back on service provision and staffing. Lessons from Hungary show that municipal bankruptcies were primarily due to accounting and internal regulatory shortfalls (Jokay 2013). Therefore, a key lesson for UB is that ineffective debt management can put the finances of the city at great risk.

pasture management; water supply, sewerage, and drainage; housing and public utility services; public transportation services; pest eradication and control; disaster prevention, including flood protection; environmental protection and rehabilitation; roads, bridges, and public lighting; solid waste removal; and operation and maintenance of high voltage and electricity lines (Budget Law).
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

III. Core Areas of Debt Management

Legal Framework

A sound legal framework for local government borrowing and debt management allows for successful management of public finance, promotes economic stability, and avoids debt distress and insolvency. Good international practice shows that such frameworks clarify roles and responsibilities, clearly designate the authorities responsible for incurring and managing debt, and establish actions designed to promote transparency and accountability. These frameworks may vary widely across countries in terms of the degree of their dependence on the national government and the range of financing methods that they use to meet their financing needs. (Appendix B presents a summary of possible variations.) Measured against international experiences, how effective is the coverage and content of Mongolia’s legal framework for public borrowing and debt management operations? What are its strengths? What are the areas that need improvement? What needs to be developed?

Mongolian Law establishes the right of UB to issue bonds and sets debt limits. There is no legal constraint on UB’s ability to borrow on international markets or specifications on the currency of the debt, as is found in the legislations of other countries/subnational governments. However, there are limits to how much UB can borrow. First, “public debt” cannot exceed the previous fiscal year’s base revenue. Also, yearly debt service obligations cannot exceed 15 percent of base revenue of the previous year (BL Article 62.3). Second, the Fiscal Stability Law (FSL) makes it clear that “public debt” comprises of all internal and external borrowing, and any obligation that is payable in the future by central and local governments, including the debts of legal entities fully and partially owned by the state and the local governments (FSL Article 4.1.8). UB debt is therefore subjected to the total public debt limit of 40 percent of gross domestic product (FSL Article 6). Third, the debt can only be issued for a term of up to 4 years (BL Article 62). Finally, the law prohibits UB from using its budget revenues and assets required in the performance of its legal mandate as collateral (BL Article 62.4.2).

There are several legal constraints pertaining to these borrowing limits that need to be addressed for UB to make effective use of the capital markets. First, the Mongolian government has undertaken massive borrowing and there is intense parliamentary debate as to whether or not the debt limit has been breached. In December 2013, the Mongolian Parliament rejected a motion to increase the debt limit for FY13 to 50 percent. The issue may be debated again if the new Debt Management Law is introduced. This still leaves very little or no scope for UB to borrow further. Good international practice suggests that in order to ensure accountability and fiscal prudence, subnational borrowing and debt payment obligations should be independent of
the central government. Furthermore, subnational governments should borrow out of their own volition and rely on their own resources to repay debts. This said, subnational borrowing needs to be subject to appropriate oversight by the central government, which should play a facilitating role. Central government should only intervene when well-established rules of borrowing are neglected, or when subnational government mismanagement threatens to trigger a fiscal crisis (see Box 1). Second, the Budget Law does not clearly define “base revenue”\(^2\) (BL Article 4.1.29) and the term does not appear in the financial statements of the city. This causes confusion for UB administrators in determining the appropriate debt level for a given year. In order to remove any ambiguity, the regulations on UB's borrowing that are currently under preparation should clearly define “base revenue,” aligned with the current budget reporting system. Third, the maximum four-year borrowing term is too short for UB to benefit from issuance of long-term and generally lower-cost bonds. This is fairly limiting, as it will not allow for extending the debt maturity profile. Fourth, it would be useful for UB to specify in the regulations what assets can be used as collateral.\(^3\) The only collateral that can be used is city property that is not associated with any of the core services provided (see BL Article 62.4).

### BOX 1
**South Africa Regulatory Framework for Municipal Borrowing**

South Africa enacted the Municipal Finance Management Act (MFMA) in 2003. The MFMA is comprehensive legislation created to ensure the sound and sustainable management of the financial affairs of local governments and their institutions. It regulates the preparation of municipal operational and capital budgets, and the management of revenue, expenditure, and debt. To enhance political and managerial accountability, the MFMA clearly specifies the roles and responsibilities of the mayors and accounting officers. It also provides a framework for municipal borrowing and mechanisms to avert financial crises and debt distress. Finally, the MFMA sets conditions for intervention by higher-level governments through a fiscal adjustment and debt restructuring process.


This is especially important since the Securities Markets Law (SML) specifically states that the Prospectus for a borrowing proposal must specify the collateral being used (SML Article 10.5.15). UB can learn from the Hungarian Municipal Act, which requires municipalities to categorize their assets based on their functions as follows: (i) core assets needed for public service delivery that therefore cannot be sold or collateralized; (ii) essential but negotiable; and (iii) nonessential and fully negotiable (Jokay 2013). Finally, the Budget Law states that the

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\(^2\) Article 4.1.29 states that “base revenue” is defined as the sum of nontax revenues and revenues estimated at the minimum rate and the amount of taxes to be collected for the budget of the respective level. It is unclear if this includes transfers from the central government and if there is any distinction between capital and recurrent revenues.

\(^3\) The Budget Law states that assets to be used in implementing functions on behalf of the central government cannot be collateralized. Such functions include preschool education, general education, cultural services, primary health, land relations and cadaster, child development and protection, and public fitness (BL Article 61.1.1 to 61.1.7).
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

capital city’s budget revenues and transfers from the central government cannot be used as collateral; however, UB’s revenues can indeed be used to cover debt service obligations, including repayment of principal. The draft Debt Management Law could try to address these legal issues.

The current legal framework for subnational borrowing includes many key provisions to ensure transparency and accountability that are consistent with good international practice. The Budget Law requires public consultation and information sharing on the purposes and amount of the debt (BL Article 62.6.1), as well as approval and oversight by the Ministry of Finance (MoF) for issuance of local government bonds as MoF is responsible for monitoring total public debt (BL Article 62.6.2). In addition, a no-objection of the Ministry of Economic Development (MOE) is also required, since it is responsible for overseeing public investment as a whole. The prevailing laws do not require a central government guarantee of UB city debt, although this can be issued as necessary (BL Article 51.1). Consistent with good international practice, the legislation identifies the signatory for debt-related transactions, which in UB city is the Capital City Governor (BL Art 62.2). Furthermore, the BL allows debt instruments issued by UB to be traded in the securities market (BL Art 5.1.3). The purposes for borrowing are to be clearly established and are limited to the core functions of UB as outlined in the Budget Law (BL Art 58.1). In order to ensure adequate information to the public, the Securities Markets Law 2012 also highlights the need to prepare a Prospectus six months prior to the bond issuance (BL Art 10.1). The Prospectus is to explain the rationale for the investment (the business plan), its management, revenue generation, liabilities, and other financial information. UB may borrow on a short-term basis from the central government to make up for any seasonal shortfalls, as long as the loan is repaid within the same fiscal year.

The legal framework for the preparation of a national debt management strategy follows good international practice, but it is unclear if these requirements apply to local governments (see Box 2). Mongolia’s central government is expected to prepare a debt management strategy based on financial needs and acceptable levels of risk, set the debt management objective and amount, and establish a database on government debt that will also support transparency (BL Article 53.1.1) (see Box 3). Given the complex process of amending laws, the UB City Council should introduce regulations (i) that spell out responsibilities for authorizing borrowing, (ii) for the preparation of debt management objectives and strategy, and (iii) for standard annual reporting to the City Council on debt management activities and issued loan guarantees (where applicable). In addition, the debt management operations need to be subjected to periodic external audits. These points should also be included in the draft Debt Management Law.

Prevailing laws do not require a central government guarantee for UB’s borrowing. This means that the city would need to back its debt with its own creditworthiness based on its net revenue flow. It would be advisable for UB to make corresponding yearly budgetary appropriations to
The IMF’s “Code of Good Practices on Transparency in Monetary Financial Policies” (IMF 1999) outlines two key premises. First, the effectiveness of financial policies can be strengthened if the goals and instruments of policy are known to the public (financial markets) and if the authorities can make a credible commitment to meeting them. Second, transparency helps enhance good governance through greater accountability of central banks, finance ministries, and other public institutions involved in debt management. More specifically, transparency in the mandates and clear rules and procedures in the operations of central banks and ministries of finance can help resolve conflicts between monetary and debt management policies and operations, help issuers reduce transaction costs, and help issuers meet their portfolio objectives. Transparency also helps reduce uncertainties among investors, encourages their participation, and over time helps governments lower their debt servicing costs.

In India, one crucial element of the subnational debt restructuring and fiscal reform process towards the passage of the fiscal responsibility legislation was wide stakeholder consultations and coordination. Bringing together the different parts of the government—the Finance Commission, the Ministry of Finance, the states themselves, the Planning Commission, and the Reserve Bank of India—created shared urgency about addressing the fiscal stress and debt repayment pressures faced by many states in the late 1990s. The priority of fiscal consolidation was to reverse the fiscal decline, institute structural reform of the taxation system, to develop a rule-based institutional framework to ensure the sustainability of the debt readjustment, and to move from central government on-lending to states toward market-based financing, with an emphasis on strong subnational market discipline. The coordination and consultation among all engaged parties ensured consistency of approach and moved the reforms forward.


cover debt service obligations, pledge revenues to a reserve fund, and make mandatory deposits to a sinking fund to be able to periodically redeem its bonds (Box 4). Investors in bonds, in contrast to bank lenders, pay more attention to stability in revenue sources for servicing debt than to a city’s own commercial assets serving as collateral. Since UB would be expected to be fully responsible for the payment of its future financial obligations, including annual interest and principal redemption upon maturity, it is advisable that credit rating be a standard legal or regulatory requirement.

The “Traffic Light” approach adopted in Colombia to control subnational debt is illustrative. Even though all municipalities in the country are legally allowed to borrow, only those that demonstrate the capacity to acquire debt and cover debt service obligations are allowed to do so. The Ministry of Finance carries out periodic financial assessments of each municipality and classifies them into three groups. The first group of creditworthy municipalities is given a “green light” to borrow. The second group of municipalities with poor fiscal management is given a “red light” and not allowed to borrow. The third group comprises municipalities that fall between the other groups and have some debt-carrying capacity; they require a “no objection” from MoF before they can borrow and are given a “yellow light.”
## BOX 3
### National Debt Management Strategy

The public debt management strategy is the fundamental document that guides debt managers in their decisions and operations. The strategy is built upon foundations (goals) stated in the government’s debt management objectives. One objective is to ensure that the government’s financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risks. Other debt management objectives typically address the government’s involvement in the domestic bond market and coordination of its actions with fiscal and monetary policies, which contain various interdependencies.

A debt management strategy is typically proposed by the debt management authority to the minister of finance. It usually presents specific guidelines and benchmarks for the optimal government debt portfolio. The guidelines provide directions for future debt management operation, while the strategic benchmarks state specifically the desired risk characteristics of the debt portfolio in a quantitative manner, including three basic types of risks: foreign currency risk, interest rate risk, and refinancing (rollover) risk.

A document outlining this strategy should include the following issues:

- a description of the market risks being managed (currency, interest rate, and refinancing or rollover risks) and the historical context of the debt portfolio
- a description of the future environment for debt management, including fiscal and debt projections
- assumptions about interest and exchange rates and constraints related to portfolio choice, including those relating to market development priorities and the implementation of monetary policy
- a description of the analysis undertaken to support the recommended debt management strategy, clarifying the assumptions used and the limitations of the analysis
- a recommended strategy and its rationale.

The strategy should be guided by an analysis of the major risk indicators, including the following:

- total debt service under different scenarios, particularly sensitivity to interest and exchange rates
- the maturity profile of the debt under different scenarios
- strategic benchmarks, such as the currency composition of the debt portfolio.

*Sources:* Melecky 2007; World Bank 2009a and World Bank 2009b.

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To ensure that UB has the necessary fiscal capacity for providing services, servicing debt, and to protect it from future insolvency, the Hungarian Municipal Act is again a useful reference. In Hungary, state transfers, the personal income tax, and other shared taxes cannot be used for debt servicing; and the local value added tax—which accounts for 84 percent of all taxes—serves as the main source of debt financing (Jokay 2013: 271). Likewise, Hungarian restrictions on the use of revenue in debt service illustrate the good practice of carefully considering specific revenue sources for debt service. This practice ensures that the municipality has sufficient resources to carry out its mandate to delivery current services while also making investments for the future.
In order to enhance UB’s debt-carrying capacity, the City Council could consider introducing a resolution establishing a reserve fund to service the debt of short- and long-term bonds. Such a fund could be financed from UB’s operational surplus and could be designed to cover debt service obligations for no less than six months. This would enable the city to continue to pay its debt obligations even in the event of an unexpected drop in city revenue. The regulation should also require the city to invest such funds in highly liquid assets, such as fixed-term deposits and/or central government treasury bills. However, in cases where municipal revenue sources are fairly predictable and provide adequate coverage for debt service payments, there may not be a need for a reserve fund. Likewise, consideration should be given to establishing a sinking fund for repaying the debt upon maturity. A sinking fund assures investors of the ability of the city to comply with debt service obligations. In addition, UB city government could structure its debt to level annual debt service payments by issuing serial bonds maturing at equal time intervals. Furthermore, term bonds could be issued and gradually redeemed on a yearly basis from a mandatory annual sinking fund (through mandatory sinking fund deposits) to level debt service over the entire term of the debt.

**BOX 4**

**Sinking Fund for Municipal Borrowing**

A *sinking fund* is an account set up by a municipality to set aside bond interest payments and redemptions on a periodic basis so as to repay the securities at maturity. By having a sinking fund, a municipality can reduce its debt burden over time, avoiding the need to finance a large lump sum when the bond reaches maturity. Typically, a municipality is required to put a forecasted amount in the sinking fund every year, as described by the bond offering statement. The positive feature is that the sinking fund reduces a municipality’s chance of defaulting on its debt obligations by enforcing fiscal discipline over the term of the bond issuance. This, in turn, has been known to influence creditors to offer lower interest rates on government bonds and thereby reduce debt service burden.

In Morocco, establishing a sinking fund to pay for interest and redemptions is part of a broader strategy to minimize risk, enhance creditworthiness, and protect creditors’ rights. The Communal Infrastructure Fund limits eligibility for borrowing to subnational governments whose debt service (i) does not exceed 40 percent of their combined own-source and central government transfers from the value-added tax revenues, and (ii) is estimated at 20–25 percent of total local budgets. Under clear regulations, the borrowing entity (i) determines the types and classes of assets pledged as security for borrowing, (ii) sets up independent trusts to handle the recurrent revenues of projects, and (iii) has a transparent accounting system in place for transfers into the sinking fund. The assets of this fund need to be reported in the yearly municipal balance sheet. Annual debt service payments associated with municipal borrowing must be treated as obligatory expenditures recorded in the local budget, and debt service is priority expenditure. Although such budgetary commitment does not guarantee against default, it does make default much less likely and is a measure of fiscal discipline. Meanwhile, municipal bankruptcy also needs to be governed by clear regulations on debt adjustments, bankruptcy initiation, debt workout plans, and allowed expenditures during bankruptcy proceedings.

*Source: Authors and Freire and Peterson (2004)*
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

To overcome current constraints in the legal framework, UB could prepare a comprehensive set of regulations to be approved by its council as well as by the MoF and the Fiscal Regulatory Commission. Such regulations are the responsibility of the central government, according to the Securities Market Law (SML Article 8.1 and 8.2). Another option is to include these regulations in the draft Debt Management Law currently under preparation; or a combination of these options could be used.

Establishing an Effective Debt Management Function for UB

An effective debt management structure requires clear division of tasks. On the one hand, political-level decision makers (including the City Council, the Mayor/Governor, Vice Mayors, and General Auditor of the City) review, approve, and oversee the overall volume of indebtedness. They set debt management objectives and the medium-term debt management strategy, including acceptable risk levels. Political officeholders also address the fiscal implications of the debt on the budget, set taxes, and designate UB’s spending programs. On the other hand, technical-level officers are responsible for formulating the key elements described above and for implementing the strategy as a whole. (See Figure 1 for an illustration of these roles.)

FIGURE 1
Debt Management Operations According to International Sound Practice

Technical experts will also be responsible for implementation and for seeking optimal risk-adjusted outcomes within those parameters. A clear division of responsibilities between the political and technical levels will minimize the risk of fiscal or budgetary policy dominance over prudent debt management.

Under the present structure of UB’s city government, the technical functions associated with borrowing are fragmented and shared across different agencies and departments. The Economic Development Agency is responsible for securing financing for the city’s investments, including coordinating the bond issuance process. The Finance and Treasury Department is responsible for revenue collection, expenditure execution, overall financial management, as well as budget preparation and reporting. The Strategic Policy and Planning Department is responsible for preparing the city’s capital investment plans along with the estimated costs of the investments. The Property Relations Department (PRD) is responsible for recording assets and liabilities (that is, for preparing key parts of the city’s balance sheet). As part of this function, the PRD keeps records of outstanding UB debts and also oversees the debt liabilities of the city enterprises. Some municipally owned companies hold debts that are guaranteed by the municipality, the central government (MoF), or their own assets. There is a risk that over borrowing by city-owned enterprises could become a liability for UB. Table 1 illustrates a fiscal risk matrix to identify potential liabilities. For example, it is fundamental that PRD’s reports make explicit who is the owner of these liabilities (and their assets) and who is therefore responsible for the associated debt-service obligations. As these entities are all independent of each other, debt management operations will be fragmented and ineffective unless appropriate coordination and debt management mechanisms are put in place.

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>DIRECT LIABILITIES</th>
<th>CONTINGENT LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>EXPLICIT</td>
<td>E.g., debt (loans contracted and debt securities issued)</td>
<td>E.g., loan guarantees</td>
</tr>
<tr>
<td>IMPLICIT</td>
<td>E.g., social security schemes and future public pensions not mandated by law</td>
<td>E.g., default on loans from financial institutions by public enterprises</td>
</tr>
</tbody>
</table>


International experience suggests that it is best for UB to streamline and consolidate these functions under one Principal Debt Management function. It should have the mandate and skills to transact in the markets operating within the parameters established by the UB’s decision makers. At the central government level, for example, the debt management function is
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

housed in the MoF. Many subnational governments have such a function within their finance and treasury departments, as is the case of Johannesburg and Pretoria in South Africa. Hence, UB may consider establishing a Debt Management function within its Finance and Treasury Department. This function can be carried out by staff already in place at the Finance and Treasury Department. Alternatively, one of the entities involved in the borrowing process may also be assigned the lead role in coordinating among all the technical departments responsible for different elements of the borrowing process. This would be a more challenging approach for UB, given the high level of coordination needed to work across an already fragmented institutional structure. The roles and responsibilities of each of the entities would need to be clearly defined, preferably through a formalized operational manual. The coordinating entity will be responsible for ensuring that information is shared effectively, regular meetings among all take place, and their activities/tasks are well coordinated. It is also important that a single entity be responsible for formulating a medium-term debt management strategy and that such entity have access to the complete debt database.

*It is important to clarify the segregation of duties between those officials who have the power to authorize payments and those responsible for debt data recording.* Strong operational controls and well-articulated responsibilities for staff members will reduce the risk of errors, policy breaches, and fraudulent behavior. The negotiation of loans and signing of loan agreements will reside with the UB City Governor and the authorization to borrow will need to be approved by the City Council. This provision is also now being included in the draft Debt Management Law. Officials with power to authorize the payments (in accordance with the agreements) are typically those who have the authority to directly supervise and oversee the principal debt management function (potentially in UB, the Director of Finance and Treasury). Officials who can authorize payments should not have the license to also record debt data into the debt recording system. The entry of data into the debt recording system should be by dedicated staff within the principal debt management function, and subsequently all data entered into the system should be checked by a different official. In short, clear job descriptions and terms of reference for all those involved in debt management functions need to be prepared. This should be supplemented with a code of ethics and conflict of interest guidelines. Given that this is UB’s first experience in managing debt, a training program should also be prepared and implemented.

Some of the key tasks of the principal debt management function include the following:

**Preparation of an Annual Borrowing Plan**

Drawing on the five-year capital investment budget, the medium-term debt management strategy, and annual budget cash flow forecasts, a detailed plan for borrowing is prepared. Annual borrowing should only be undertaken for capital investment projects that are shovel-ready. A financial analysis should be carried out taking into account all of the city’s current financial obligations together with the implicit future costs associated with borrowing. It should
include assessments of the most cost-effective terms and conditions for available borrowings and the risks inherent in each of these options. Such an analysis should also consider whether the borrowings should be placed on international or domestic markets. The interest rates in the domestic market would be higher; however, there would be no foreign exchange risk. In contrast, interest rates on the international market would be lower, but the risk associated with debt service costs would be considerable due to potential devaluation of the tugrik as reflected in significant increases in the exchange rate.\textsuperscript{4} In addition, the effective rate on the domestic market may also be lower, when the inflation rate is discounted. Short-term loans (from banks or the central government) should also be considered, along with short-term bonds to finance projects during the summer construction season and refinanced with longer-term debt in the fall. The Borrowing Plan should also include the schedule of the borrowings and the amounts in both wholesale and retail markets. Simulation models will need to be prepared to define different options. This is an internal document that should be updated regularly and presented to decision makers, such as the City Council and the Mayor, to make evidence-based and informed decisions.

**Leading the process of borrowing transactions**

Once the annual investment projects have been identified, the Principal Debt Management unit determines the financial sources (either domestic and/or international bond markets, as well as concessional loans from bilateral and/or multilateral institutions) that offer the most beneficial or cost-effective terms and conditions, including maturity periods for long-term bonds. In the case of loans, UB would negotiate the terms and conditions of the loans with the creditor (including the currency, interest rate, and fees) and would finalize the loan documentation. When loans are the financing source, the entity is also responsible for coordinating with the creditor to ensure that disbursements are completed in accordance with the loans terms and conditions.

**Maintaining debt records and debt forecasting**

A key function of the debt management unit is to maintain a complete, accurate, and timely record of all forms of UB’s debt issuances and loan guarantees. Clear differentiation should be made between the debt of the city, the debts of its enterprises, and the associated debt service obligations. UB needs to ensure that these records are stored in a secure electronic registry with adequate securities (against theft, fire, and so forth) to mitigate operational risks. Key debt data include the total value of debt sold and the corresponding dates, total value of monthly interest on the bonds sold, and expected yearly obligations upon maturity for rolling periods of four years (the maximum allowable term for debt). Debt records are critical for estimating the additional debt that could be acquired considering the legal debt limits, preparing the Borrowing Plan, cost/risk analysis of the debt portfolio, and estimating the cost of debt service.

\textsuperscript{4} Foreign-currency-denominated debt exposes UB to the risk of tugrik devaluation, because the city collects all of its revenue in MNT.
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

Therefore, when loans are disbursed, it is critical that this is recorded immediately. This information will be used in forecasting debt and debt service obligations to provide a basic input into the budget process, thereby ensuring that the yearly budgetary appropriations include interest and principal payments, subject to sensitivity analysis for changes in interest and exchange rates. Debt data as recorded in the terms sheet should include the following information.

- Effective or start date
- Borrowing instrument
- Maturity date
- Interest rate
- Currency
- Fees
- Interest payment frequency
- Disbursement start date
- Any complementary benefits
- Disbursement end date
- Principal amount
- Interest calculation basis
- Principal repayment start date
- Lender or creditor
- Principal repayment end date
- Disbursement schedule
- Principal repayment amount (or principal repayment schedule)

Cash flow forecasting and cash balance management

UB needs to also establish an appropriate range for its cash balance so that it borrows only when the funds are needed. Therefore, the Principal Debt Management unit needs to manage the cash balance by maintaining a reasonably reliable forecast of UB’s cash balance needs. UB would need to know with complete certainty that it can retain its surplus without being required to transfer it back to MoF as has been the case in the past. To develop a reliable forecast, comparisons of actual outcomes against forecasts needs to be undertaken on a monthly basis to identify any variance. An annual analysis should also be carried out, identifying the number of instances where the aggregate cash balance fell below a minimum or generated excess funds that were not anticipated and why, including assessing the seasonality of such forecasts. For example, it is fundamental for UB to know with full certainty whether or not the city will receive capital transfers from the Local Development Fund and the exact amount. These forecasts are a critical input to the preparation of the Borrowing Plan discussed above.

Reporting on debt management activities

In order to ensure accountability and transparency to investors and UB citizens alike, regular reports on debt management activities need to be produced. There are two types of reports that need to be produced regularly and made available to the City Council, investors, and the public at large. First, a detailed Annual Report on UB’s debt management activities should be prepared. It should assess the outcomes of borrowing against the stated debt management objectives and evaluate the extent to which these activities have complied with UB’s Debt Management Strategy. Secondly, a “Debt Statistical Bulletin” should be produced on a quarterly or semiannual basis, depending on the level of borrowing. The bulletin should describe:
• the debt stock—by creditor, instrument, currency, interest rate basis, and residual maturity
• debt flows—principal and interest payments
• debt ratios or indicators
• basic risk measure of the debt portfolio.

**UB needs to also put in place a separate risk monitoring and compliance function for debt management.** This could potentially be housed under UB’s Office of the General Auditor (internal auditor). This function is to monitor whether all debt management operations are within the authorities and limits set by central government policy, UB’s approved debt management strategy, and the Borrowing Plan. It is also important to prepare written and documented procedures for all such transactions and operations undertaken in the debt office (for example, recording data, validation, processing payment orders, and so forth).

**Formulating a Debt Management Strategy**

UB should prepare a medium-term debt management strategy document based on the longer-term debt management objectives. This strategy should be set within the context of UB’s macroeconomic assumptions and budget framework. It is to serve as a decision-making tool for city leaders (Mayor, Vice Mayors, and the City Council) and will help identify the city’s level of risk tolerance. The strategy should be updated periodically (preferably annually) in order to reflect changes in circumstances the city may be facing. Good international practice suggests that this strategy should be prepared by the technical entities responsible for debt management, with input of key stakeholders, and then approved by the political body of the city. In UB’s case, it could be presented by the Mayor for approval by the City Council. The document should also be made public.

The following information is needed to formulate a strategy:

• total debt service under different scenarios, paying particular attention to interest rate and exchange rate variations
• maturity profile of the debt under different scenarios
• strategic benchmarks such as
  o share of foreign currency to domestic debt
  o currency composition of foreign currency debt
  o minimum average maturity of the debt
  o maximum share of the debt that is allowed to fall due during one and two budget years
  o maximum share of short-term (up to one year) to long-term debt
  o maximum share of floating-rate to fixed-rate debt
  o minimum average time to interest rate re-fixing
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

- maximum and minimum interest rates
- ratio of concessional versus semi-concessional loans
- repayment profile chart.

Ensuring Transparency and Good Governance in Bond Issuance

When UB decides to issue debt securities in either short-term bills or longer-term bonds through auctions in the domestic market, it should consistently present market participants and investors with details of an auction calendar well in advance. This can lead to lower costs by providing investors with greater certainty, increasing liquidity, broadening the investor base, and creating a level playing field for all investors. However, if the first debt issuance is relatively small, UB could consider negotiating the sale of long-term debt with underwriters annually, and move towards competitive sales as its credit standing becomes better known and its debt better accepted in the marketplace.

UB’s legal advisors need to be actively involved in the loan negotiation and/or bond issuance process to ensure that all documentation meets all legal and contractual requirements. The legal advisor needs to alert UB government whenever there is a risk that a certain action will breach any of the loan conditions, or bond issuance terms, and to provide a legal opinion for each borrowing action. In the United States, for example, subnational debt issuers rely almost exclusively on the opinion of private attorneys (“bond counsel,” paid from bond proceeds and not by the issuer or underwriter) that debt being issued is legal, valid, and binding under all applicable laws.

UB government needs to prepare clear procedures for every step of the borrowing process. This would include the initial negotiations of the terms and conditions, signing of contracts, preparation of the term sheets, disbursement procedures, and debt recording. If auctions are being used, procedures should also address announcement of the auction, bid opening and closing time, processing, approval of auction cutoff, announcement to successful bidders and the market, and settlement of the auction. The auction procedures should be made available to potential participants through the prospectus.

Carrying Out Regular Audits

UB city leaders need to ensure that the debt management activities, policies, and operations are subject to oversight by the Mongolian National Audit Organization (MNAO) through an annual audit and that the findings and recommendations of the auditors are used to take corrective action as needed. The current rule is that UB government’s financial statements are

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5 In terms of international sound practice, at a minimum, the subnational debt issuer should prepare and publish an auction calendar for planned issuance of domestic debt securities at least one month ahead on a rolling basis that contains issue dates and instruments to be issued at those dates.
already subject to an external audit by MNAO. UB’s debt management operations should also be subject to a performance audit. The audit will include three key aspects. First, *performance effectiveness* will assess achievement of the borrowing objectives and the impact of the borrowing activities against the intended impact. Second, the *efficiency audit* assesses the efficient use of resources by examining information systems, performance measures, and monitoring arrangements. Finally, *audit of the internal control system* assesses the extent to which the control system is adequately designed to ensure the debt management objectives can be reached and fraud has been prevented. Ensuring segregation of debt management duties, sound IT security, and a monitoring unit to promote adherence to internal rules can help prevent fraud. This audit needs to be shared with the City Council and needs to be made publicly available.

**Conclusion and Recommendations**

A key lesson learned from international experience on subnational borrowing is the importance of laying a solid foundation for prudent management of debt. There are many examples from around the world of municipal fiscal indiscipline. Fiscal indiscipline is especially pervasive in situations where national governments offer guarantees. The benefits of possible lower interest rates due to a central government guarantee do not seem to offset the risk and associated moral hazard of such guarantees. UB can tighten its budget discipline by carefully estimating its infrastructure financing needs, modeling the cost of borrowing and then making the corresponding annual budgetary appropriations for debt service obligations, and setting aside reserves to ensure that it has the required funds for repaying its debt at maturity, through the implementation of a sinking fund. Such detailed financial planning requires close coordination among the many different departments who will play a role in the borrowing exercise: the Finance and Treasury Department, Strategic Planning and Policy Department, Economic Development Department, and the specific departments providing the services for which the debt will be issued. It is therefore critical to establish a Debt Management Unit and an effective institutionalized coordination mechanism among all of these.

In addition to internal coordination for debt management, coordination and close collaboration with the central government is critical on any borrowing UB might undertake. Given the city’s large share of the national economy, any large-scale development spending will have a significant impact on the overall economy and national-level fiscal management. For this reason, proper alignment of any UB borrowing with the medium-term debt management strategy at the national level would be important.
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

The key elements for a practical and comprehensive approach in debt management have been outlined in this note. This note strongly recommends that UB’s leadership consider the implementation of these principles and processes in order to set up a successful debt management framework. (Appendix C includes a checklist of key decision points in formulating a debt management framework.) A detailed explanation of each of these key elements may be consulted in the *Guide to the Subnational Debt Management Performance Assessment*, prepared by the World Bank (World Bank 2012a).

**Key Actions Required and Corresponding Outputs**

Drafting laws is a complex undertaking, but the current draft Debt Management Law provides an opportunity for addressing many of the gaps in the current legal framework. As a second-best option, UB also has the power to draft regulations that will clarify ambiguities in the various laws. Table 2 summarizes the key short- and medium-term actions and associated outputs that UB should consider for prudent debt management.

<table>
<thead>
<tr>
<th>TABLE 2</th>
<th>Key Actions and Associated Outputs for Prudent Debt Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strengthening the Regulatory Framework</td>
<td></td>
</tr>
<tr>
<td><strong>Debt limits</strong></td>
<td>Define “base revenue” as current actual revenues minus actual capital budget revenues and contributions. By clearly linking the definition to the budget reporting classification, the ceiling will be clarified.</td>
</tr>
<tr>
<td></td>
<td>Set an internal limit of UB’s debt-carrying capacity based on a financial assessment of the city’s ability to repay (taking into account all its financial obligations).</td>
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<tr>
<td></td>
<td>Clarify which parts of UB’s revenues can be used in debt service and repayment of principal (for example, capital revenue should be for investment financing only).</td>
</tr>
<tr>
<td></td>
<td>Lengthen the current debt term limit of four years to ensure that UB can benefit from long-term and lower-cost borrowing.</td>
</tr>
<tr>
<td><strong>Collateral, debt service, and debt repayment at maturity</strong></td>
<td>Specify the remaining assets that can be used as collateral for loans since the law protects those assets that are used for the purpose of carrying out the city’s legally mandated responsibilities. In parallel, consider exempting bond issuance from collateral requirements and instead require pledging revenues to debt service obligations and the implementation of a sinking fund to fully cover debt repayment at maturity.</td>
</tr>
</tbody>
</table>

(Continued next page)
Table 2 (continued)

<table>
<thead>
<tr>
<th>Special Account</th>
<th>Require the establishment of a Special Account for the management of bond proceeds, with well-defined recording rules for transparency in the usage of these financial resources.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishing a Debt Management Function</td>
<td></td>
</tr>
<tr>
<td>Designate the administrative unit in charge of the debt management functions</td>
<td>Recruit staff, prepare job descriptions, and conduct training as needed.</td>
</tr>
<tr>
<td></td>
<td>Define a coordination framework and approach among all key stakeholders.</td>
</tr>
<tr>
<td>Prepare debt management objectives and strategy</td>
<td>Make strategy document available to the public through UB’s website.</td>
</tr>
<tr>
<td>Borrowing</td>
<td></td>
</tr>
<tr>
<td>Borrowing Plan</td>
<td>Identify the investments that will be financed through borrowing and other capital sources, and prepare simulations to select most appropriate financing.</td>
</tr>
</tbody>
</table>
Appendix A: Subnational Debt Management Performance Indicators

The subnational DeMPA tool assesses 33 dimensions of subnational governments’ debt management activities (and closely related areas), organized into 14 debt performance indicators (DPIs). The tool aims to capture sound practices that are indispensable to debt management (Table A.1). The assessment is incorporated into a Debt Management Performance Report.

<table>
<thead>
<tr>
<th>Number</th>
<th>Title</th>
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</thead>
<tbody>
<tr>
<td>DPI-1</td>
<td>Legal Framework</td>
</tr>
<tr>
<td>DPI-2</td>
<td>Managerial Structure</td>
</tr>
<tr>
<td>DPI-3</td>
<td>Debt Management Strategy</td>
</tr>
<tr>
<td>DPI-4</td>
<td>Evaluation of Debt Management Operations</td>
</tr>
<tr>
<td>DPI-5</td>
<td>Audit</td>
</tr>
<tr>
<td>DPI-6</td>
<td>Coordination with Fiscal and Budgetary Policy</td>
</tr>
<tr>
<td>DPI-7</td>
<td>Borrowing Planning</td>
</tr>
<tr>
<td>DPI-8</td>
<td>Borrowings</td>
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<tr>
<td>DPI-9</td>
<td>Loan Guarantees, On-Lending, and Derivatives</td>
</tr>
<tr>
<td>DPI-10</td>
<td>Cash Flow Forecasting and Cash Balance Management</td>
</tr>
<tr>
<td>DPI-11</td>
<td>Debt Administration and Data Security</td>
</tr>
<tr>
<td>DPI-12</td>
<td>Segregation of Duties, Staff Capacity, and Business Continuity</td>
</tr>
<tr>
<td>DPI-13</td>
<td>Debt and Loan Guarantee Records</td>
</tr>
<tr>
<td>DPI-14</td>
<td>Debt and Loan Guarantee Reporting</td>
</tr>
</tbody>
</table>


This appendix is adapted from the World Bank’s Subnational Debt Management Performance Assessment (DeMPA) Tool. (World Bank 2012c: 9).
The subnational DeMPA does not specify recommendations for reforms, staff capacity, or institution building. However, the performance indicators for each dimension do stipulate a minimum level of performance that should be met under all conditions. Consequently, an assessment showing that the subnational DeMPA minimum requirements are not met indicates an area that normally would be considered a priority for reform or capacity building or both.
Table B.1 presents a wide range of borrowing frameworks for subnational governments (SNGs) around the world. It illustrates variations in terms of their dependence on the national government and the range of financing methods that they use to meet their financing needs.

<table>
<thead>
<tr>
<th>SNG borrowing activities are (at least partially) regulated by the rules imposed by central (or upper-level) government</th>
<th>Constraints on purpose of borrowing</th>
<th>Numerical constraints on new debt, debt level, and debt service</th>
<th>SNG is eligible for borrowing with prior approval of central (or upper-level) government</th>
<th>SNG is not eligible for borrowing except on-lending through central government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada province</td>
<td>Australia state</td>
<td>Germany region</td>
<td>Germany local</td>
<td>Japan local (above certain limit)</td>
</tr>
<tr>
<td>Japan local (up to certain limit)</td>
<td>Austria local</td>
<td>Austria local</td>
<td>Italy state and local</td>
<td>Republic of Korea local</td>
</tr>
<tr>
<td>Switzerland state</td>
<td>Belgium local</td>
<td>France local</td>
<td>Spain local</td>
<td>Germany local</td>
</tr>
<tr>
<td>United States state</td>
<td>Germany region</td>
<td>Brazil local</td>
<td>Brazil local</td>
<td>Spain region and local (outside EMU)</td>
</tr>
<tr>
<td>Argentina province (domestic)</td>
<td>Spain region</td>
<td>Columbia local</td>
<td>Peru local</td>
<td>Turkey local</td>
</tr>
<tr>
<td>Czech Republic local</td>
<td>Indonesia local</td>
<td>Lithuania local</td>
<td>Lithuania local</td>
<td>United Kingdom local</td>
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<tr>
<td>Zimbabwe local</td>
<td>South Africa local</td>
<td>Latvia local</td>
<td>Latvia local</td>
<td>(external)</td>
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<td></td>
<td></td>
<td>Poland local</td>
<td>Poland local</td>
<td>Argentina province (external)</td>
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<td>Russian Federation local</td>
<td>Russian Federation local</td>
<td>(external)</td>
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<td>Serbia local</td>
<td>Serbia local</td>
<td>Brazil local (external)</td>
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<td>Slovak Republic local</td>
<td>Slovak Republic local</td>
<td>Colombia local (bond issuance)</td>
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<td>Philippines local</td>
<td>Philippines local</td>
<td>Peru local (external)</td>
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<td>Thailand local</td>
<td>Thailand local</td>
<td>Serbia local</td>
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<td>Nigeria state</td>
<td>Nigeria state</td>
<td>Slovak Republic local</td>
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<td>(above certain limit)</td>
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<td>Indonesia local (domestic)</td>
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<td>Thailand local</td>
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<td>Vietnam local (external)</td>
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<td>Mexico state (external)</td>
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<td>Kazakhstan local</td>
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<td>(external)</td>
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<td>Russian Federation local</td>
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<td>Cambodia local</td>
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<td>India state (external)</td>
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<td>Indonesia local (external)</td>
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<td></td>
<td>Nigeria state (external)</td>
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</tbody>
</table>

Appendix C: Checklist for Reviewing a Borrowing Framework

<table>
<thead>
<tr>
<th>Decision points</th>
<th>Standard options for consideration in a debt management framework</th>
<th>Current status of the borrowing framework in Mongolia and action areas</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Setting the terms of borrowing</strong></td>
<td>The borrowing framework should specify the permitted term of borrowing. Options include a set number of years, a time period tied to the useful life of the asset being financed, or whatever the market will bear.</td>
<td>The law sets a four-year limit on borrowing; no other terms are included. Consider extending the term to allow for long-term (and lower cost) borrowing.</td>
</tr>
<tr>
<td><strong>2. Form of borrowing</strong></td>
<td>The framework should specify any limits on the form of borrowing instruments. Options might include loans from banks, financial institutions, or other entities; tradable securities; or financing leases.</td>
<td>The Budget Law states that “debt instrument” means all types of loans, securities, and any agreements that incur debts. However, this definition remains general and the regulations should provide more specific guidance on the form of borrowing that is appropriate for UB.</td>
</tr>
<tr>
<td><strong>3. Pledges, intercepts, and other security interests</strong></td>
<td>The framework should specify whether and to what extent specific revenue streams or assets may be pledged to secure creditors’ right to repayment.</td>
<td>The Budget Law does not specify how debt service obligations would be met (examples include pledging general revenues to secure debt service obligation and repayment of principal, or securing associated revenue streams in the case of revenue-generating projects). However, it does specify that local government revenues cannot be used as collateral in case of default. Amending the Budget Law or including a provision in the draft Debt Management Law to allow for a pledge of revenues for debt service would provide greater assurance to bond investors. In addition, consideration should be given to a fiscal intercept of transfers from the central government to enforce debt payment compliance.</td>
</tr>
<tr>
<td><strong>4. Reporting requirements</strong></td>
<td>The framework should specify the information to be reported to the Ministry of Finance, the City Council, and/or disclosed publicly. Examples include the term and amount of the debt, interest rates, loan origination or brokerage fees, repayment schedules, and any pledges, intercepts, security interests, or credit enhancements.</td>
<td>The provisions of the Budget Law on “Property and Government Debt Management” are not specific enough and reporting requirements are still fairly broad. A detailed reporting requirement (recommendations for which have been included in this note) should be elaborated and integrated into the borrowing regulations/framework.</td>
</tr>
</tbody>
</table>
### Preparing for Debt Management in Ulaanbaatar: Issues to Consider

<table>
<thead>
<tr>
<th>Decision points</th>
<th>Standard options for consideration in a debt management framework</th>
<th>Current status of the borrowing framework in Mongolia and action areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>5. Monitoring, government intervention, and creditor remedies</td>
<td>The framework should specify early warning systems to alert the MoF or other agency to developing liquidity issues. It should specify any interventions or controls that may be imposed by government, and the conditions under which these would be appropriate. The framework should specify the remedies and procedures available to a creditor in the event UB defaults.</td>
<td>The framework does not yet provide any guidance on early warning systems in the event of developing liquidity issues. This note and the “Financial Self-Assessment” have highlighted the importance of upgrading current reporting formats. An accurate, relevant, and timely reporting system should significantly assist in the monitoring function. This note also recommends that the draft Debt Management Law (or regulations to be developed) explicitly include the legal procedures available to creditors in the event of defaults.</td>
</tr>
<tr>
<td>6. Ratios and limits</td>
<td>The framework should specify any limitations in terms of either aggregate debt or annual debt service, which may be stated in absolute or proportional terms.</td>
<td>Current legislation has established that public debt (including local government debt) should not exceed 40 percent of GDP. Furthermore, the absolute amount of debt cannot be larger than UB’s previous fiscal year base revenue; debt service obligations cannot be greater than 15 percent of base revenue. A revision is needed to make the definition of base revenue operational and consistent with the financial reporting system.</td>
</tr>
<tr>
<td>7. Purpose of borrowing</td>
<td>The framework should specify the purpose for which funds may be borrowed. Examples might include authorization for infrastructure investment, or other property, plant, and equipment, and refinancing (with limitations). Additionally, there may be prohibitions—for example, on investments for arbitrage or investment in derivatives.</td>
<td>The current framework does not specify the purpose of borrowing, beyond restricting it to the provision of the 18 functions of the city and short-term intergovernmental loans for budget shortfalls to be repaid during the same fiscal year. Specific regulations for UB’s borrowing, including the purpose of borrowing, need to be prepared by MoF and approved by the government.</td>
</tr>
<tr>
<td>8. Borrowing limitations and or prohibitions</td>
<td>The framework should specify any limitations on terms and conditions of borrowing. These might include prohibitions on zero coupon structures in the absence of a sinking fund, or prohibitions on borrowing in foreign currency or in structures dependent on the value of foreign currencies.</td>
<td>Consideration should be given to the explicit inclusion of establishing sinking funds and reserve funds. Empirical evidence of good international practices strongly suggests that UB should focus on debt issuance in the domestic rather than the international markets, particularly considering the relatively high foreign exchange risk in still volatile economies. International investors should be encouraged to invest in bond denominated in tugriks in the domestic market.</td>
</tr>
<tr>
<td>9. Borrowing authorization</td>
<td>The framework should specify the processes by which debt is authorized, which may include a vote by the City Council, a referendum by the electorate, and/or certification of financial statements or projections by an independent auditor.</td>
<td>Current legislation requires public consultation and the explicit authorization of MoF, the Financial Regulatory Commission (FRC), and the City Council. It also requires implicit approval of the Ministry of Economic Development (MED) as they are responsible for overseeing investments. Nevertheless, to facilitate the borrowing process, the regulations should include a summary of the authorization steps required and provide a clearer role for public input (such as through a referendum or clarification of the steps for consultation).</td>
</tr>
</tbody>
</table>
## Decision points

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<thead>
<tr>
<th>Standard options for consideration in a debt management framework</th>
<th>Current status of the borrowing framework in Mongolia and action areas</th>
</tr>
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<tbody>
<tr>
<td><strong>10. Short-term borrowing</strong></td>
<td>The framework should specify limits on the use of short-municipal borrowing, for example, to bridge operating cash shortfalls in anticipation of specific and realistic revenues to be realized within the fiscal year. The framework may also require that short-term debt be paid off annually, to prevent accumulation of unserviceable debts.</td>
</tr>
</tbody>
</table>
Preparing for Debt Management in Ulaanbaatar: Issues to Consider

References


