Municipal Bond As a Commodity

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Photo by C.T.V

HCMC is a big economic center where the demand for infrastructure is very urgent but the public investment fails to meet it. The HCMC Investment Fund for Urbanization (HIFU) is an organization specialized in making investment by mobilizing all possible sources of finance from the public, and especially by issuing municipal bonds, which has achieved intended results in the past two years.

1. Municipal bonds in 2003

As directed by the HCMC government, HIFU, in cooperation with the Service of Finance, worked out a plan to issue municipal bonds in 2003 based on government bonds. The official issuer is the HCMC government.

As a pilot scheme, these bonds issued in 2003 were of two kinds, 2-year and 5-year ones. In the long run, these bonds would be of longer term to be more suitable to long-term development projects.

The interest rate of municipal bonds was based on the rate on government bonds of the same maturity plus a difference approved by the Ministry of Finance. The fixed rate is 8.25% a year for 2-year bonds and 9.00% a year for the 5-year ones. Bonds were issued through underwriters and agents, and the HCMC Securities Trading Center.

Up to Dec. 11, 2003, HIFU finished the issuance plan for 2003 with two issues that were worth VND2,000 billion.

2. Municipal bonds in 2004

HIFU and the HCMC Service of Finance made a plan to issue 2004 municipal bonds based on their past experience. The official issuer was the HCMC government. The total value of these bonds was VND2,000 billion. The bonds were of longer terms (5 and 10 years). The interest rate of municipal bonds was based on the rate on government bonds of the same maturity plus a difference approved by the Ministry of Finance. And they were also issued by underwriters, agents and Securities Trading Center.

On July 30, 2004, the first issue of 5-year bonds by underwriters was completed. Three banks and three brokerage firms acted as co-underwriters. The total value of bonds issued amounted to VND875 billion, equaling 87.5% of the planned target (VND1,000 billion).

On Aug. 17, 2004, VND125 billion worth of 5-year bonds was up for auction, and two concerns bought it up.

On Sep. 27, 2004, the first lot of 10-year bonds was issued by an underwriter and it brought in VND400 billion.

On Nov. 30, 2004, two concerns underwrote VND250 worth of 5 –year bonds.

On Dec. 15, 2004, one concern agreed to sell VND200 billion worth of 5-year bonds.

On Dec. 24, one concern underwrote a VND150- billion lot of 5 –year bonds.

3. Some suggestions on the issue of municipal bonds

a. According to current regulations (set by Decree 141/2003/NĐ-CP dated Nov. 20, 2003), the HIFU bond is a municipal one issued for raising funds for development projects approved by the HCMC government and these projects could, or couldn't, produce receipts. The HCMC budget must be responsible for paying debt and interest. Thus, the legal framework for municipal bonds must be based on ability to repay debt of local governments.

According to Decree 124/2004/ NĐ-CP dated May 18, 2004 on specific mechanism for budgetary control for HCMC, the total value of bonds issued shouldn't exceed the total public investment planned by the HCMC government. This regulation, however, could hinder the task of mobilizing funds for development when many development projects are of great urgency. Moreover, the growth rate of HCMC economy is more promising and in the long run it could repay huge debts without causing financial problems.

In fact, there are many projects in HCMC that could generate receipts to pay back investments. Besides allowing BOT and BT projects, the Government had better adjust current regulations with a view to facilitating the mobilization of money for income-generated projects. For example, the Government could allow the issue of income bonds – a kind of bonds that relies on future income earned by the projects instead of power or prestige of local governments. For this kind of bonds, it isn't necessary to limit it to the ability to repay debt of the local budget authority. For example, in the project to build the Thủ Thiêm residential area, the HCMC government could issue income bonds by employing various methods (such as putting the land use right up for auction) with a view to generate budget income. This project is very feasible and profitable but requires huge investments. If the mobilization of funds for this project is limited to the planned public investment, the project can't be carried out.

At present, the issue of this kind of bonds is under consideration.

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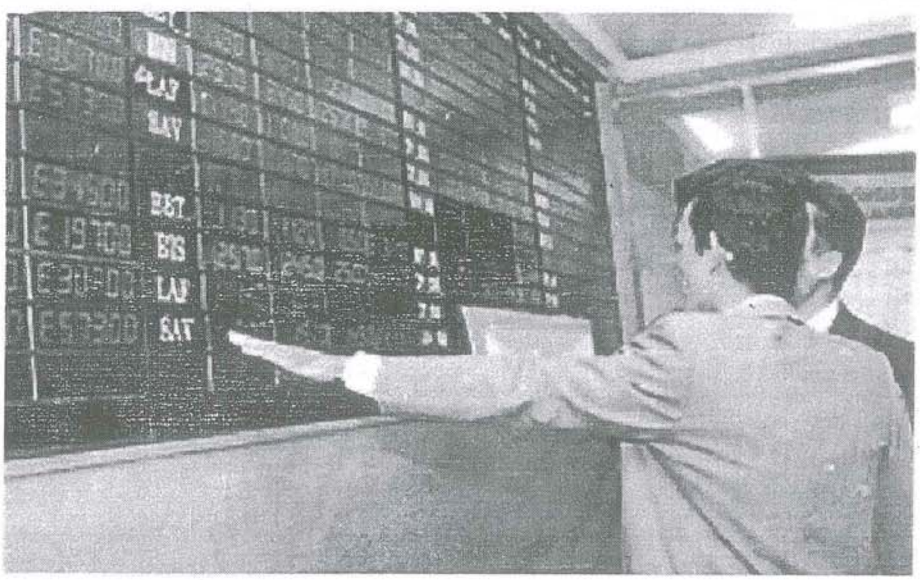
b. Income from municipal bonds could be exempt from tax. This suggestion originates from the following problems:

- In the case of government bonds that aim at mobilizing funds for the national treasury, the tax on income from these bonds is to be paid to the treasury. As for municipal bonds, however, only part of corporate income tax payment is sent to local budget, and the rest is sent to the national treasury. This regulation must be revised with a view to helping and encouraging local governments to raise funds on their own by issuing bonds instead of relying too much on grants-in-aid from the central government.

- Because municipal bonds are less trustworthy than the government ones, the interest paid by the former, on principle, must be higher than the latter. Exemption from the income tax will help reduce the interest rate on the municipal bonds, thereby reducing investment required by development projects, and making the production cost equal to the one of centrally-invested projects. Moreover, it could help reduce the difference in interest rates between municipal and government bonds on the market.

c. According to Circular 29/2004/ TT-BTC issued by the Ministry of Finance on April 6, 2004, "municipal bonds could be traded on the monetary market, discounted, re-discounted and mortgaged with state-owned banks as allowed by law." This means that, up to now, the SBV has only allowed government and HIFU bonds to be traded or exchanged with state-owned banks. To improve the liquidity of municipal bonds, the SBV had better allow them to be traded on the SBV open market, and put them in the list of paper assets to be in custody of state-owned banks.



d. To make the public trust debenture instruments issued by both central and local governments, necessary information must be disclosed. As for HCMC, the government should publicize its development projects and demand for funds every year; and disclose the detailed plan to issue municipal bonds (dates of issue, quantity, value, interest rate, etc.). At the year's end financial statement of these projects must be publicized along with report and analyses of performance and efficiency of the projects.

In addition, efforts must be made to help the public realize importance and benefits of investment in municipal bonds and consider them as a kind of stock for the good of both individuals and the society.

The issue of municipal bonds could help resolve the shortage of funds for development projects, and at the same time, provide a commodity of diverse characteristics in terms of maturity, interest rate and payment conditions, thereby attracting more investors to the infant stock market in Vietnam.■