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Long-term debt control of local and regional authorities

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Introduction : the control of the debt in the missions of the French regional audit chambers

1. Audit of accounts and management

- Local authorities and inter-municipal structures, health and social structures
- Regularity of the acts of management, economy of the means implemented, evaluation of the results achieved in relation to the objectives; without being able to comment on the desirability of these objectives
- Every control involves a financial analysis, and therefore a debt analysis.

Introduction : the control of the debt in the missions of the French regional audit chambers

2. Budgetary control

- Three principles : 1) Budgets can't be adopted, nor in principle achieved, in imbalance. 2) The operating and investment sections must be balanced. 3) Borrowings must only finance investment expenditure and their repayment must be made from own resources
- At the request of the government representative (prefect) because of the absence of a real balance of the budget voted or realized, the Chamber makes (with 30 days delay) a notice proposing the necessary measures to the recovery balanced budget
- The new deliberation must take place within one month.

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Part I : The link between long term debt and local government investment

I. The link between long term debt and local government investment

1. Borrowing, instrument of local public investment

- The crucial role of the central government until the 1980s
- Decentralization Laws of 1982 :
 - freedom to borrow with market resources
 - Three principles of balance:
 - Obligation to present and vote the budget in balance;
 - Obligation to allocate borrowing only to finance investment expenditure;
 - Obligation to repay loan annuities with own resources
- Local authorities have become the first public investor (infrastructure and network works, cultural and sports equipment...) without massive debt :
 - 70% of the public investment (about 50 B €)
 - A debt contained, despite transfers of competence: € 150 billion; 9% of the public debt;...
 - and despite the crisis of 2008: indebtedness + 1.1 points of GDP 2007-2010 (State: + 15 points GDP)

I. The link between long term debt and local government investment

2. Since 2014, the relationship is more complex to understand

- Until then it was based on the "electoral cycle": increase in investment spending two years after the election then recourse to the loan
- This dynamic was halted in 2014, due to the decline in government allocations and the government's desire to generate 15-20 billion euros in financing capacity by 2022 (Public Finance Programming Act).
- Local authorities have offset this decrease in resources since 2014 by containing their operating expenses and by reducing their investment expenditure.
- A new borrowing dynamic in 2018 (€ 17.5bn in new loans, + 4.5%), due to new growth in investments (investments: € 54bn in 2018).

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Part II : The evolution and characteristics of local debt are an essential component of the work of the CRC

II : The evolution and characteristics of local debt are an essential component of the work of the chambers

1. The work of the chambers emphasized the risks of structured debt

a) The consequences of the 2008 financial crisis on local authorities

- The crisis has revealed the recourse of local authorities to "structured loans" or "toxic loans" to finance their investments, which may lead to an increase in the debt burden on their finances.
- A great freedom of choice of local authorities which has led to a variety of initiatives :
 - Conventional, fixed or floating rate loans
 - Banks granting financial derivatives

II : The evolution and characteristics of local debt are an essential component of the work of the chambers

1. The work of the chambers emphasized the risks of structured debt

b) Audits of the chambers and the Court of Auditors have shown the extent of the phenomenon

- The crisis of 2008 revealed the toxicity of the loans: *municipality of Saint-Etienne ; department of Seine-Saint-Denis*
- Outstanding structured loans subscribed exceed 30 billion euros, of which 10 to 12 billion euros represent a potentially high risk (21% of the local authorities' debt)
- Local authorities have made greater use of these products than other economic agents, especially businesses (Court of Auditors)
- These products corresponded to a commercial strategy of the banks, allowing opacity competition and restore margins (Court of Auditors)
- Measures were taken: December 2009, "Gissler" charter ; June 2010: ministerial circular

II : The evolution and characteristics of local debt are an essential component of the work of the chambers

2. The control by the chambers of the structure of the debt

a) Active debt management

During the review of this active management the Chambers noted the presence of structured products in the stock of debt :

→ the Chambers analyze the frequent renegotiations of borrowing that result : *municipality of Gourdon ; municipality of Charleville-Mézières*

→... and show the disadvantages of these renegotiations :

- Increase in the average life of the debt and its residual life : *municipality of Saint-Gaudens*
- High cost of these transactions : early redemption fees and financial expenses.

Renegotiations were sometimes accompanied by debt restructuring, with a greater share of structured products and increased exposure to interest rate risk

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2. The control by the chambers of the structure of the debt

b) The risk exposure

- Evaluation of the low interest rates exit : *municipality of Argenteuil (Ile-de-France)*
- Review of contract typology (underlying indices and structure)
- Measuring the relationship between the financial situation and the use of structured loans : *municipality of Caen (Normandy)*
- Fuzzy or illegible writing of loan agreements

II : The evolution and characteristics of local debt are an essential component of the work of the chambers

2. The control by the chambers of the structure of the debt

c) The organization of the local authority in terms of debt monitoring

- Relationships between lending organizations and local authorities
- transparency of procedures within the local community
- Information of elected councils on the debt situation
- Practical arrangements implemented within local authorities

II : The evolution and characteristics of local debt are an essential component of the work of the chambers

Conclusion about structured loans **(Report of the Court of Auditors September 2018)**

- A combination of responsibilities
- A first financial intervention of the French government in 2012
- After the judicial victories of some local authorities, the French government set up in 2013 a support fund (3 billion euros) over 15 years
- Law of 27 January 2014 : Accounting obligation to provision risks related to structured loans

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**Part III : Through the debt, all the financial risks are
analyzed by the audit**

III : Through the debt, all the financial risks are analyzed by the audit

*Chambers have deepened the analysis of the link
between local authorities' debt and their financial situation*

a) Objectives of the financial analysis of the Chambers

- Realization of the investment program without compromising the financial situation ?
- Commitments respected or carry forward charges or risks on the future ?

b) For this purpose, the Chambers proceed to five levels of analysis which all involve a thorough knowledge of the debt

III : Through the debt, all the financial risks are analyzed by the audit

*Chambers have deepened the analysis of the link
between local authorities' debt and their financial situation*

Five levels of analysis

- Thorough balance sheet analysis
- Analysis of the capacity of the local authority to reduce its debt
- External risks analysis
- Analysis of financial flexibility
- Debt function analysis

III : Through the debt, all the financial risks are analyzed by the audit

Chambers have deepened the analysis of the link between local authorities' debt and their financial situation

1) Thorough balance sheet analysis

- Working capital
- Self-financing capacity
- The link between working capital and self-financing capacity

Municipality of Chatenay-Malabry (Ile-de-France)

III : Through the debt, all the financial risks are analyzed by the audit

Chambers have deepened the analysis of the link between local authorities' debt and their financial situation

2) Analysis of deleveraging capacity

- The link between outstanding debt and gross savings
- The extinction profile of the debt
- The link between the repayment of the capital annuity and the new loans

Municipality of Gérardmer (Lorraine)

III : Through the debt, all the financial risks are analyzed by the audit

Chambers have deepened the analysis of the link between local authorities' debt and their financial situation

3) Financial risk analysis

- Consolidated debt
- Off balance sheet risks
- The balance sheet assets of the local authority

Municipality of Rueil-Malmaison (Ile-de-France)

III : Through the debt, all the financial risks are analyzed by the audit

*Chambers have deepened the analysis of the link
between local authorities' debt and their financial situation*

4) Analysis of financial flexibility : a relevant financial strategy?

- Debt feasible in view of the heritage situation ?
- Ability to continue using debt
- Possibility to use a working capital having reached a residual level ?

Municipality of Chatenay-Malabry ; municipality of Gérardmer

III : Through the debt, all the financial risks are analyzed by the audit

Chambers have deepened the analysis of the link between local authorities' debt and their financial situation

5) Debt function analysis

- Allow new tax revenues
- Valuing transferable assets
- Producing income
- Generate savings

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**Part IV : A new audit axis :
The participation of local and regional authorities
in the national debt reduction system**

IV : The participation of local authorities in the national debt reduction system is analyzed by the Chambers

1. The objectives set by the Public Finance Programming Act

- July 2017: national conference of territories : participation of local authorities in reducing public debt and controlling public spending
- Contract with the government on the evolution trajectory of their expenses
- Law of 22 January 2018 on the programming of public finances 2018-2022 :
 - Maximum evolution of operating expenditure: + 1.2% per year
 - Commitment to a target for changes in operating expenses and the need for financing
- 322 large communities involved (2/3 of local spending)
- Other local authorities may request the prefect to conclude a contract

IV : The participation of local authorities in the national debt reduction system is analyzed by the Chambers

2. The obligations to be provided by the agreements

- Binding goal with penalties: reducing operating costs
- Objective : reducing the need for financing local authorities
- Objective : Maximum individual debt capacity: Debt / self-financing ratio :
 - municipalities and intermunicipalities: 12 years
 - departments: 10 years
 - regions: 9 years

IV : The participation of local authorities in the national debt reduction system is analyzed by the Chambers

3. The audit of the new agreements negotiated between the government and the local authorities concerned

- In 2019, contractual process analysis:
 - Differential treatment of local authorities by State services ?
 - Are the calculation methods homogeneous ?
 - Consequences of the contractualization on the pooling of resources of the municipal-intermunicipal group
 - New type of indirect control by the government ?
- Next years : analysis of the achievement and effects achieved.

Thank you

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