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MAYORS FOR ECONOMIC GROWTH

Ideas to Enhance Finance and Funding Capabilities for Municipalities

CASE

Mayors for Economic Growth (M4EG)
Supporting Local Level Financing
in Eastern Partnership Countries

UNITED NATIONS DEVELOPMENT PROGRAMME

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ARUP

Ideas to Enhance Finance and Funding Capabilities for Municipalities

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Ideas to Enhance Finance and Funding Capabilities for Municipalities

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Executive summary

Purpose of the research

Municipalities play a crucial role in funding local development, delivering essential services, and fostering community well-being. However, many municipalities encounter difficulties in securing the necessary funding and finance for the execution of infrastructure projects and sustainable development initiatives.

The Mayors for Economic Growth (M4EG) initiative, a joint effort by the EU and UNDP, supports local governments in secondary cities of Eastern Partnership (EaP) countries – made up of Armenia, Azerbaijan, Georgia, Moldova and Ukraine. While the network expands and the M4EG helps develop economic plans and transformative projects, attracting investment to implement these projects remains a challenge.

This report, conducted through a combination of desk-based research and interviews with stakeholders, sought to identify the primary obstacles faced by municipalities in the EaP in accessing a wider array of financial resources. Furthermore, it sets out solution pathways to unlock additional funding for municipalities, providing ideas for UNDP to help cities gain access to more funding for development programs in the region and beyond.

Understanding barriers to accessing funding and finance in EaP countries

The initial phase of the project involved conducting a baselining exercise to assess the current state of funding and finance at the municipal level, which included a review of existing funding mechanisms. Following the mapping of these mechanisms, we carried out a literature review and conducted interviews with EaP municipalities. The aim was to identify barriers / challenges commonly encountered in accessing finance and funding for municipal projects. We identified six such barriers:

Regulatory, legislative and governance barriers:

- Changing budgets (from central government) and raising local revenue is often difficult;
- Strict borrowing rules limit options; and
- Municipalities rely heavily on grants and national funding.

Information barriers:

- Poor communication between municipalities and funders hinders investment;
- Investors lack awareness of funding opportunities and projects; and
- Lack of project transparency discourages investment.

Economic barriers:

- Project size and return on investment make them unattractive to investors.

Financial barriers:

- Municipalities lack access to suitable financial tools for their projects;
- Project financing doesn't align with investor requirements; and
- Low investor interest in funding these types of projects.

Social and cultural barriers:

- Resistance to change and risk aversion within municipalities limit opportunities; and
- Fear of public backlash and lack of trust from citizens create obstacles.

Capacity barriers:

- Municipalities often lack the resources to effectively manage large projects and finances; and
- Municipalities often lack the capacity to effectively communicate with potential investors and promote the city's investment potential.

Recommendations

We drew on the insights obtained from the initial stage to propose ways to enhance access to funding and finance. We proposed a number of funding and financing solutions that best align with the needs of EaP municipalities, considering their respective country contexts. These solutions were presented to stakeholders, including municipal associations and the European Bank for Reconstruction and Development (EBRD), who have a deep understanding of the local contexts.

The key recommendations to be implemented include:

UNDP to develop guidance on local funding and finance best-practice and practical tools to improve project alignment with market demand attractivity and revenue streams as part of the local level programs. This action is a high priority;

UNDP to support project cohorts through seed funding. This could be used either to provide technical assistance or encourage private funding through blended finance mechanisms or risk mitigation. This could be developed in the short-term building on experience from other UNDP portfolios of programs;

UNDP to coordinate networks of cities for knowledge sharing and retention between local experts and for collaboration which could lead to project aggregation or collaborative procurement practices. Networks need to focus on local technical experts. This is a high priority action;

UNDP to develop local capacity to generate and implement sustainable and transformative projects by better knowledge of tools, revenue sources and project management practices. Building on the Urban Learning Centre Facility, UNDP can support collaboration, access to expertise and resources such as toolkits;

UNDP to support project aggregation to reach a critical size to an amount more attractive to IFIs and other investors. UNDP undertakes the role of the neutral enabling agent to broker relationships between stakeholders, and build consensus, trust and coordination. This is a high short-term priority underlined by IFIs; and

UNDP to support the creation of spatial clusters (economic growth corridors) to attract investment and foment collaboration and project aggregation. While the creation of the corridors would depend on the national government, UNDP could establish the evidence based to identify country spatial clusters and priority areas to attract investment at the local level. This is a longer term action but evidence base studies supported by UNDP could be conducted in the next 1 to 3 years.

Next steps

The recommendations outlined in this report serve as a set of ideas for UNDP. They are intended to guide the potential development of a programme that focuses on these aspects, rather than offering immediate, practical actions.

One common feedback across interviews conducted was that was the exception of municipalities with a high degree of authority legal barriers to financing or joint procurement of major capital investments remain a challenge.

The practicality and feasibility of these recommendations will require further exploration and refinement in collaboration with the relevant stakeholders and EaP national governments. This will be accomplished through the establishment of dedicated workstreams which will be spearheaded by UNDP. This iterative process is crucial to ensure that the proposed strategies are not only theoretically sound but also practically implementable.

Introduction to Mayors for Economic Growth (M4EG) Facility

The Mayors for Economic Growth (M4EG), a joint initiative by the EU and UNDP, supports secondary cities across the Eastern Partnership (EaP) region in achieving sustainable local economic growth and future-readiness. The M4EG network includes over 400 municipalities from Armenia, Azerbaijan, Georgia, Moldova and Ukraine, and fosters deep engagement with more than 60 cities through innovative approaches such as the mission-oriented Portfolio Journey, the Urban Imaginaries Programme, and the Response and Renewal Programme.

By employing a 'hyperlocal' and whole-of-place strategy, M4EG works closely with these cities to promote long-term, resilient urban development and aims to equip cities with the necessary tools to navigate and respond to evolving geopolitical, economic, and environmental challenges.

Despite the initiative's success in the work related to urban transformation, the municipalities in the EaP face considerable challenges in accessing the financial resources necessary for local development. Despite their central role in delivering essential services and promoting sustainable development, these municipalities often encounter significant barriers in raising funds. The reliance on national grants, restrictive borrowing regulations, and a lack of diversified revenue sources highlight the pressing need for innovative financial strategies.

In 2023, as a response to the finance related to challenges and local needs, as well as donor interest, the M4EG initiated a new work stream focused on diversifying resources and mobilizing additional funding and financing allocating EUR 100,000 for the 2023-2024 period. Throughout 2023, the Secretariat undertook several foundational activities to set the stage for expanded efforts in 2024 and beyond.

By providing targeted recommendations, this report outlines potential pathways to enhance the financial capacity of EaP municipalities. These include fostering better collaboration between local governments, international financial institutions, and private sector actors, as well as supporting capacity-building efforts to improve financial management and project planning at the municipal level. The insights derived from this research aim to guide stakeholders, including UNDP and M4EG, in refining their strategies to better support municipalities in securing sustainable financing for their development projects.

Introduction

Approach to the research

Arup was commissioned in December 2023 to support UNDP in identifying barriers to funding and finance at the local level and provide high level recommendations on how to better attract, retain and absorb funds locally. The M4EG municipal network in EaP countries with over 400 municipalities was selected as a case study and target group for the research.

This research had three objectives:

- To map EaP municipalities' available funding and finance resources depending on local contexts;
- Identify the main challenges to increase investment in local projects and absorbing funds; and
- Based on local contexts and barriers identified, conduct a gap analysis and propose practical recommendations for how UNDP can work with municipalities, national governments and IFIs to close the project investment gap.

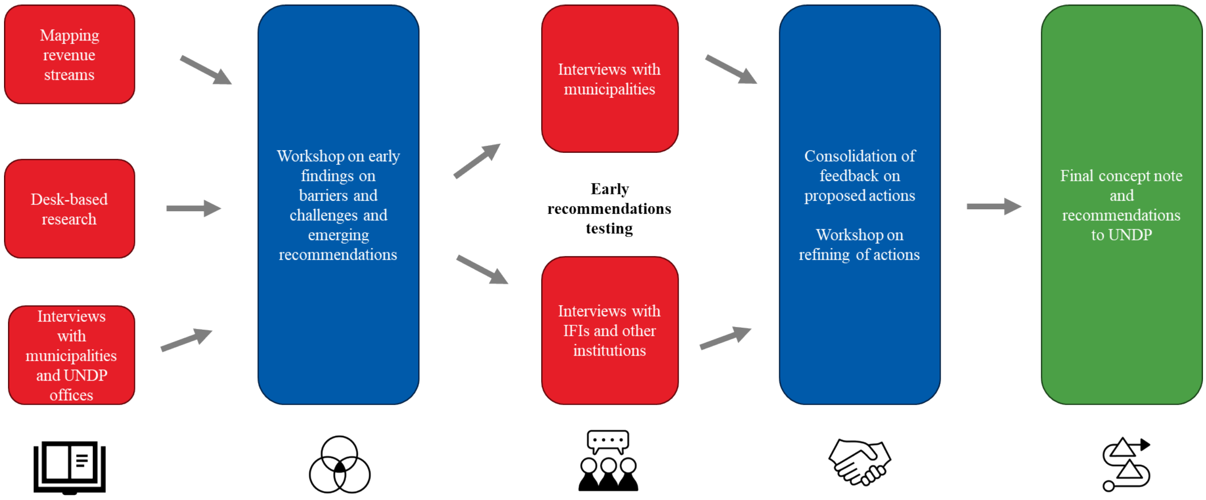
The adopted approach to identify barriers and challenges for municipal funding and finance and prioritise recommendations is set out in Figure 1.

The work comprised a blend of desk-based research and interviews with a diverse group of stakeholders (including municipalities, EBRD, and UNDP) to comprehend, test, and refine the proposed approach.

This report is structured according to the main stages of work:

- Understanding existing municipality revenue and funding streams
- Identifying barriers to funding and finance
- Setting out options to enhance access to funding and finance
- Targeting specific interventions

Figure 1 Methodology used for the identification of pathways of solutions for improving EaP municipal funding and finance



Existing municipality revenue and funding streams

Findings from literature review

THE CURRENT STATE OF FUNDING AND FINANCE

Available instruments to increase funding for investment

The first part of the research consisted of understanding how funding of projects currently works in EaP municipalities. Municipalities typically mobilise funding for local projects through the following set of interventions:

> Reorientate existing resources: using existing financial resources (e.g., budget from central government, local tax revenues etc.) by improved efficiency and allocation.

> Create new sources of municipal revenues: Municipalities can increase their revenues from both tax and non-tax sources, as well as receive revenue from grant sources and use this revenue to finance projects; and

> Undertake borrowing: using various financial instruments to increase project funding.

Figure 2 provides an overview of key municipality roles in accessing financial resources and corresponding instruments they can leverage.

Municipalities often face restricted access to funding instruments for local projects. This is primarily due to the highly centralised nature of many EaP countries, which grants limited autonomy to local governments.

Additionally, EaP municipalities typically have limited internal resources and manage smaller project sizes compared to their counterparts in other regions. These factors can significantly hinder their ability to utilise financial instruments like borrowing or private investment.

On the other hand, there is a growing appetite from donors and private investors to support sustainable and green infrastructure projects, which represents an opportunity to access finance for development.

This research prioritises the exploration of solutions to enhance the availability of funding for EaP municipalities, rather than merely focusing on reallocating existing, often limited, resources. By pinpointing the specific barriers that hinder municipalities in EaP countries from accessing these financial instruments, it aims to pave the way for new financing avenues for local projects.

The subsequent step, therefore, centered on understanding context-specific barriers by conducting interviews with municipalities of varying sizes, from different countries, and with diverse priorities. A literature review supplemented this baseline analysis of barriers.

Figure 2 Instruments to mobilise resources and funding

Reorientate existing resources	Improving efficiency of existing resources
	Public Private Partnerships
Enhance municipal revenues	Taxation
	Alternative revenue
	Levies and charges
	Municipal enterprises
	Grants (intergovernmental and international)
Access to borrowing and investment	Debt
	Municipal bonds
	Loans
	Blended Finance
	Crowd Funding
	Equity

Barriers to funding and finance

Consultation with municipalities and secondary research

ACCESSING CAPITAL CAN BE COMPLEX FOR CITIES IN THE EAP

Insights from literature and interviews

The second phase of the research focused on a review of existing studies and tools on practice regarding funding and finance at the municipality level and identification of barriers and challenges to investment in the EaP context.

This was progressed through desk-based research, as well as interviews with relevant stakeholders from EaP countries (municipalities of different sizes and countries, municipal associations, UNDP country officers and International Financial Institutions (IFIs, Table 1).

We identified six primary barriers to accessing funding and finance at the municipal level, as outlined in Figure 3.

Each of these has several sub-categories of barriers that were explored to understand the potential importance of each, the power of influence different actors might have on them and first identified steps to unveil solutions to address them.

It is stressed that these barriers and constraints will vary with the type of projects, and with the risk and sector. Barriers also vary with the local country context as legislation, availability or capacity may differ between countries.

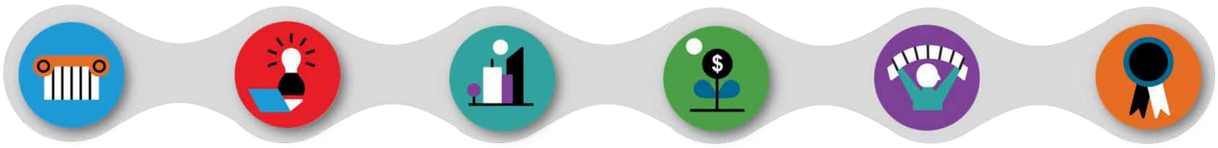
The following section of the report provides a summary of the barriers identified, illustrated by examples taken from interviews and literature review. Figure 4 sets out a Problem Tree summarising the analysis. The Figure sets out the core problem (ability to attract funding and finance), its drivers and barriers. The figure provides and overview and awareness of the problem by identifying the fundamental causes and their most important effects.

Capabilities are threefold: (i) Institutional capacity, referring to the policies and structures that enable local governments to function and lead; (ii) Human capacity, the experience and knowledge of local government employees that allow them to respond to people's needs; and (iii) Societal capacity, the empowerment of communities and NGOs. Recognizing these capabilities is crucial for targeting interventions.

Table 1 List of organisations interviewed as part of the research

Organisation	Type	Country
Kapan	Municipality (small)	Armenia
Dusheti	Municipality (small)	Georgia
Zugdidi	Municipality (medium)	Georgia
National Association of Local Authorities	Municipal association	Georgia
Stăuceni	Municipality (small)	Moldova
Strășeni	Municipality (medium)	Moldova
Association of Ukrainian Cities	Municipal association	Ukraine
Kharkiv	Municipality (large	Ukraine
Nizhyn	Municipality (small)	Ukraine
European Bank for Reconstruction and Development (EBRD)	IFI	Regional

Figure 3 Main typologies of barriers identified



Unpacking barriers identified

Regulatory, legislative and governance barriers

Municipalities in EaP countries often have limited fiscal powers, heavily rely on grants and national government funding and have limited capacity to self-generate revenues.

Even in countries with a more advanced decentralisation process such as Ukraine or Georgia, municipalities mentioned that centralised revenue ownership and fiscal policies limited their ability to take responsibility or initiative for some projects, while bureaucracy and processes caused delays and challenges in accessing funding. This made it difficult to track and manage revenue generation and create more entrepreneurial approaches to raise revenues. Additionally, sector-specific approaches to development from central governments (e.g. infrastructure, governance, or social programs) lead to mismatches at the local level where a more holistic approach is needed.

Many municipalities mentioned strict laws that make it difficult for them to borrow money. This makes it harder for them to get funding from private investors and banks. Consequently, IFI and private investor funding are centralised at the national level, which leads to mismatch in funding due to local versus national needs and lack of responsiveness and accountability to regional disparities.

Finally, there is a need to support for establishing municipal owned enterprises to better grow and manage revenues. Municipal-owned enterprises, which would be responsible for service provision and would have more freedom to take on finance, are not common in all EaP countries.

Information and communication barriers

There is poor communication between municipalities and funders which limits awareness and hinders investment.

Many municipalities, especially small and medium ones, highlighted that they would benefit a lot from getting consolidated and official system in place for how IFIs are engaged allowing equal access to available opportunities.Information channels are unclear which leads to funders lacking information about the existence of projects, while municipalities lack knowledge about available funding for the types of projects they are looking to implement. In Moldova and Armenia, municipalities mentioned a need for support or information sessions on available funding and screening of projects. This was also perceived as leading to a misalignment between smaller municipalities' needs and available funding.

When looking for opportunities to fund projects, IFIs value evidence-based local plans and transparent projects. Having a structured vision and strategy, and detailed rationale for selected projects for funding helps start the conversation. This is often missing from municipalities. Additionally, municipalities either don't provide sufficient and easily accessible information about their financial health and bond offerings or their local context to inform decision made by donor governments and international organisations.

Finally, there needs to be early engagement with the IFIs and national governments to match local projects and funding needs. Equally, in the context of heavily centralised funding mechanisms, limited collaboration and information sharing between different government agencies can hamper financial administration.

Economic barriers

There are two main components of economic barriers identified at the municipality level: the very nature of municipal projects which are often public goods with low or no financial return, and the size of municipalities and projects which are unattractive to financial markets.

The nature of public goods makes them unattractive to financial markets, albeit providing high value for society and often creating enabling conditions for further private sector investment, and reliant on funding from other revenues such as taxes and levies, or grant funding. However, government or IFI grant funding is often conditioned on the ability to demonstrate wider benefits (social, environmental, health etc.). Due to their size and limited resources available, municipalities often lack these abilities and fail to demonstrate public value, leading to constrained access to funding.

The size of municipalities in the network was also pointed as a challenge for funding, especially around capital investment such as infrastructure (e.g. transport networks, waste collection etc.). This in turn limits the Benefit Cost Ratio, of people benefitting from the investment (or “use to the society”) compared to its size of investment required. Collaboration and pooling with other municipalities could help improve scalability and critical size of projects as well as de-risk the investments, however several municipalities notably in Moldova and Georgia mentioned trust issues between cities and reluctance to collaborate unless coordinated by the central government or external actors.

Financial barriers

Identified financial barriers to municipal finance consist of the limited or non-existent financial instruments available to municipalities, criteria matching with investor requirements and market appetite for municipal projects.

Many municipalities in highly centralised contexts (e.g. Azerbaijan) or of small or medium sizes reported that they operate with very limited financial instruments. Their borrowing capacity is limited due to either regulatory constraints or very low credit rating resulting from small market size, limited municipal finance resources, and failure to demonstrate budget and operational effectiveness.

There is also a lack for “market readiness” of municipal projects, which fail to demonstrate alignment with requirements and Key Performance Indicators (KPIs) from IFIs and private investors. Moreover, it was underlined that these criteria vary by IFIs or investors, further complicating access and application for these funds. Projects need to demonstrate transparently sound financial plans and forecasts, mitigation strategies, operational arrangements and governance to be able to speak to investors. Additionally, local capacity and resources limits the ability to implement innovative financial instruments such as municipal enterprises, crowd funding or blended finance.

Second, private investors, including IFIs, look for bankable projects. A bankable project should have a reliable and sufficient revenue stream to cover operating costs, debt service, and other financial obligations. Strong cash flow projections contribute to the project's attractiveness to lenders. Municipal projects are often small, with individual actors, low cash flows and limited scalability and replicability. They are highly context specific and bespoke, which provide little comparison or reassurance to private investors and institutions with high barrier of entry to “de-risk” the investment. Major IFIs and investors are highly risk averse and have specific frameworks or typologies of projects they finance, looking for “bankable”, easily replicable projects, but little space for innovative, “outside of the box” projects. Municipalities struggle to demonstrate mitigation strategies, track record and action planning to provide reassurance to the markets.

Risk aversion and coordination barriers

Literature review and interviews underlined the institutional inertia and risk aversion of municipalities which restrains opportunities for additional revenues. Many interviewees indicated that municipalities (mostly small and medium) may be hesitant to adopt alternative funding sources that deviate from traditional budgeting and financing methods due to risk aversion, uncertainty of these revenue streams and lack of experience or relatable successful examples.

Some stakeholders also pointed to short-term budget pressures leading to prioritising short-term financial stability over the potential benefits of alternative funding sources, while local governments may be disincentivised to increase tax burdens out of fear of political backlash.

Finally, in many EaP countries, the lack of an effective mechanism or modality for inter-municipal collaboration has financial repercussions, limiting the potential for aggregation of projects and the ability to reach critical sizes for project investments.

Institutional and human capacity barriers

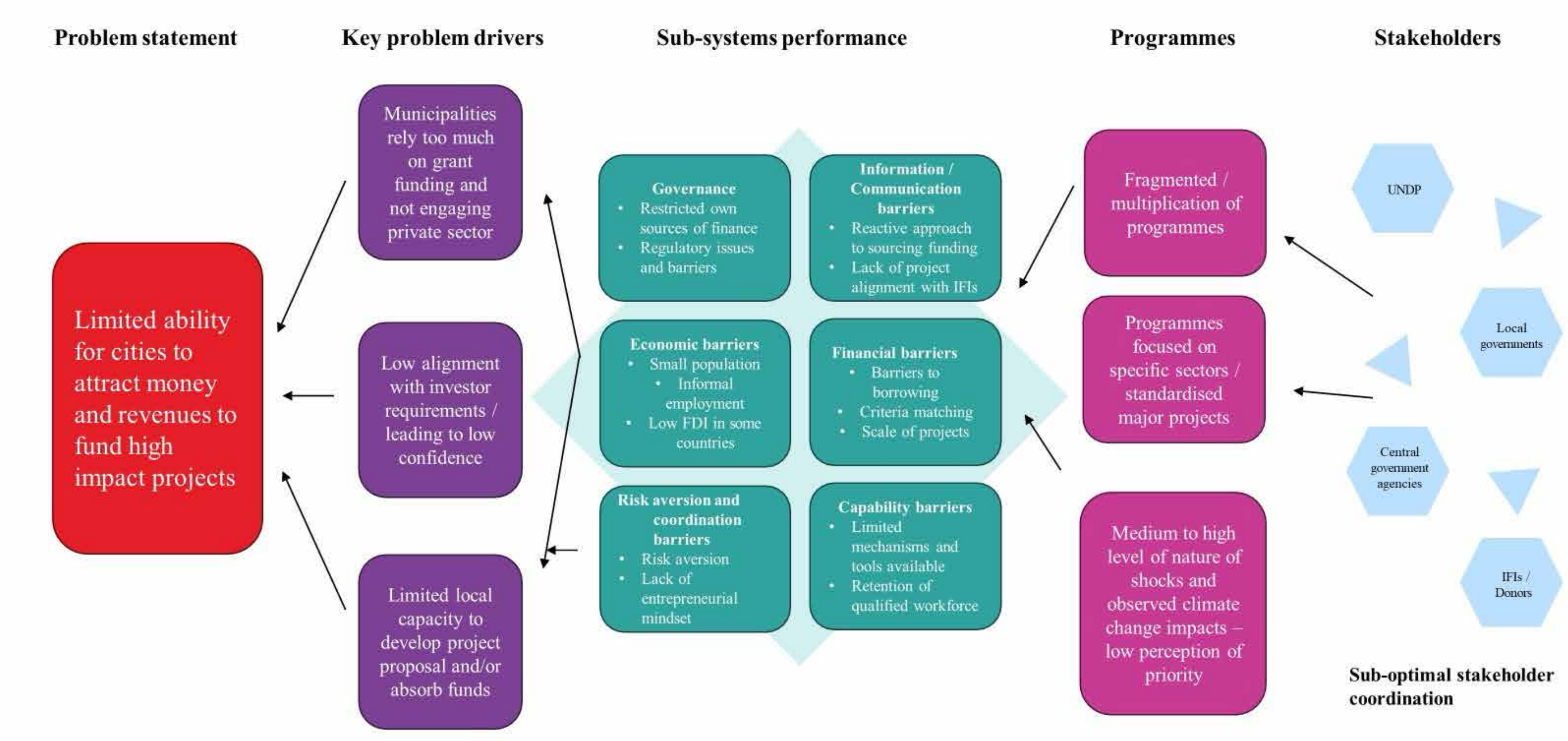
In secondary cities in the EaP, municipalities are often affected by insufficient skills, expertise or resources to effectively implement the projects and manage the municipality's funding and finances.

These gaps in capacity can pertain to areas of human capital, such as financial knowledge and pitching capacity , and technological capital, for example outdated data collection resources. Emphasis on upskilling or sub-contracting and providing necessary resources could help rectify these issues.

Municipalities, especially smaller ones, need substantial guidance in developing and capturing revenue systems and navigating standard budgetary processes. Pathways for funding / financing traditional green infrastructure are not always clearly set out, which can blur the message or fail to demonstrate eligibility for investment.

Municipalities also flagged that they do not have the right managerial and technical staff to plan and implement projects with success, and notably that staff retention was difficult. This was particularly mentioned in Ukraine where both municipalities underlined competition from the private sector and donor organisations for qualified staff. In Moldova, municipalities also highlighted language skills as a barrier for application to international funds.

Figure 4 Problem tree for funding and finance in EaP countries



Ideas to enhance access to funding and finance

Contributions towards better access to funding and finance at the municipal level

Setting objectives

We identified 3 key objectives to address the challenges identified:

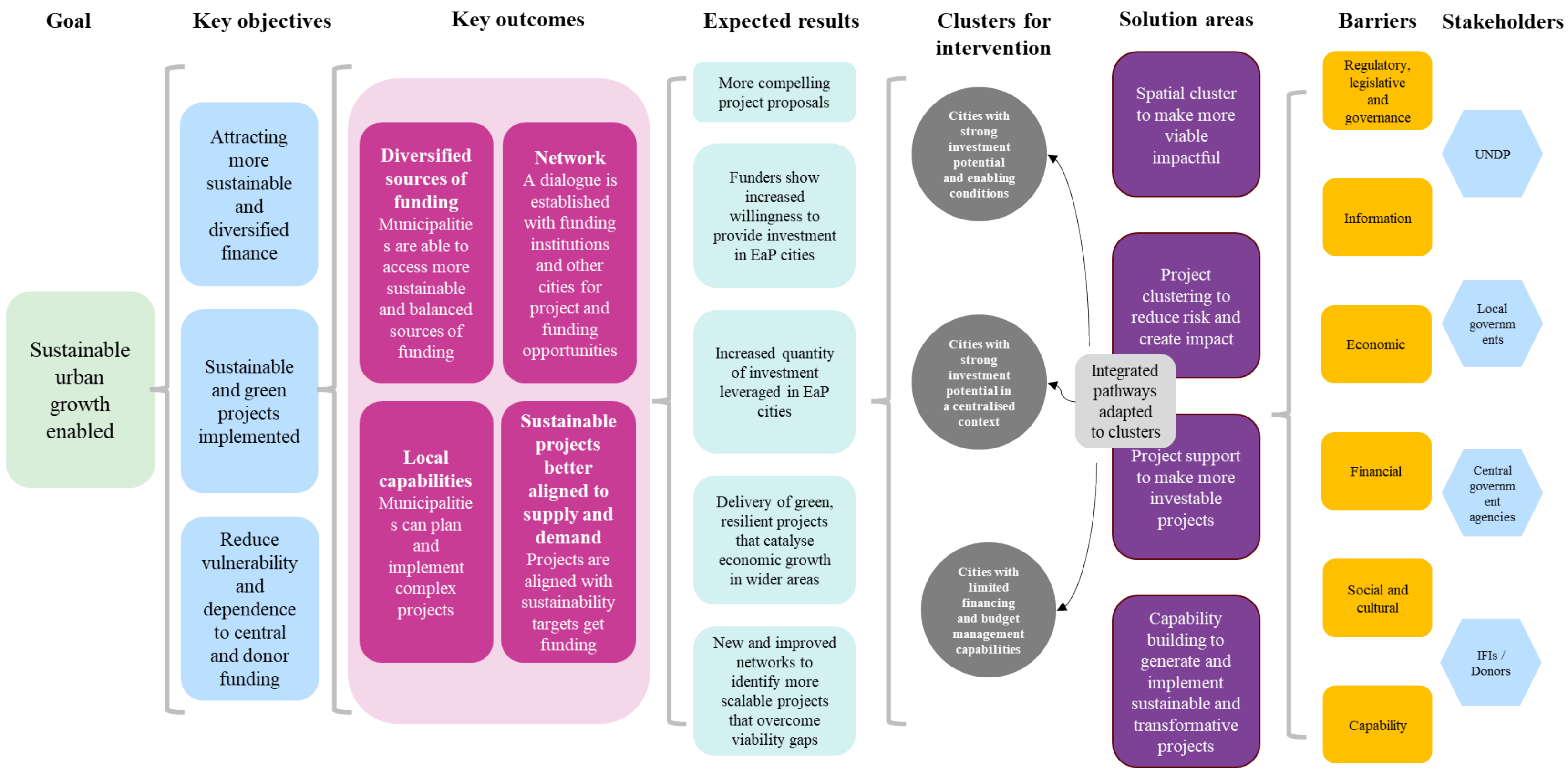
- Attract more finance;
- Deliver more green projects; and
- Reduce dependence on grant funding.

Each objective is tied to a specific outcome we want to see including:

- More diversified sources of funding, more innovative sustainable funding streams for green projects including a mixture of revenue based and financing measures;
- Greater use of peer networks of cities, increased coordination between layers of government for decision making and funding of projects, improves capacity at the city level regarding ability to identify pipelines of projects and share knowledge and best-practice;
- Improving local government's ability to attract funding from donors, and improve budgeting approaches to implement funding; and
- Integrating the sustainability dimension in all projects to align with financial markets supply and demand.

The gap analysis between expected results and barriers identified in Figure 5 resulted in 4 solution areas, detailed in the following section.

Figure 5 Pathways towards improved funding and finance in EaP countries



Identifying solutions

Four solutions were identified regarding their ability to address barriers and increase access to funding and finance:

- Capacity building to generate and implement sustainable and transformative projects;
- Project support through guidance, funding and networking'
- Project aggregation to access more diversified sources of funding; and
- Spatial aggregation to attract investment and foment collaboration and project aggregation.

We further elaborated on these solutions by breaking them down into specific actions.

Ensuring solutions are relevant to the local context

Cities within EaP are distributed across various countries, each possessing its unique context. As such, the solutions proposed must be tailored to suit the specific circumstances of each city, especially considering their level of autonomy in funding and financing at the national level. In contemplating the application of these solutions across the EaP, we have classified cities into 3 categories set out below.

Cities with Strong Investment Potential and Enabling Conditions: typically, medium-sized cities with strong capabilities, and situated in countries with a conducive regulatory context. Enabling conditions include the ability to borrow, generate self-revenues, and well-developed procurement processes.

Cities with Strong Investment Potential in a Centralised Context: usually large or medium-sized cities. They showcase mature projects ready for investment and possess capabilities but operate within a highly centralised context. This often means they have limited fiscal powers and are heavily dependent on the central government for funding and project approval.

Cities with Limited Financing and Budget Management Capabilities: typically, smaller cities or cities within centralised contexts, with limited ability to access funding and heavily reliant on central government or donor funding, through grants. The size of projects in these cities is usually too small to attract investors or donors.

Expected results

The following section sets out prioritised actions for each of the four solution areas:

- Each solution family;
- Associated action;
- Benefit of each action; and
- Applicability of each action to each of the 3 city categories.

Appendix 6 outlines the sifting criteria we have used to prioritise actions and determine which actions are relevant to each city category.

Municipalities' ability to take actions forward

Actions listed in the following section can be classified into two categories depending on the ability of municipalities to take them forward:

Actions within reach of municipalities: these are actions that municipalities can do on their own, without need to change regulation, validation from central government or involvement of external parties

Actions that require partnerships: actions that require partnership and further external support to be implemented. Municipalities will often require national level agreement, change of legislation or support from M4EG or similar initiatives to put them forward.

Throughout the next section, actions are signposted with corresponding icons to indicate level of complexity and support needed for implementation.

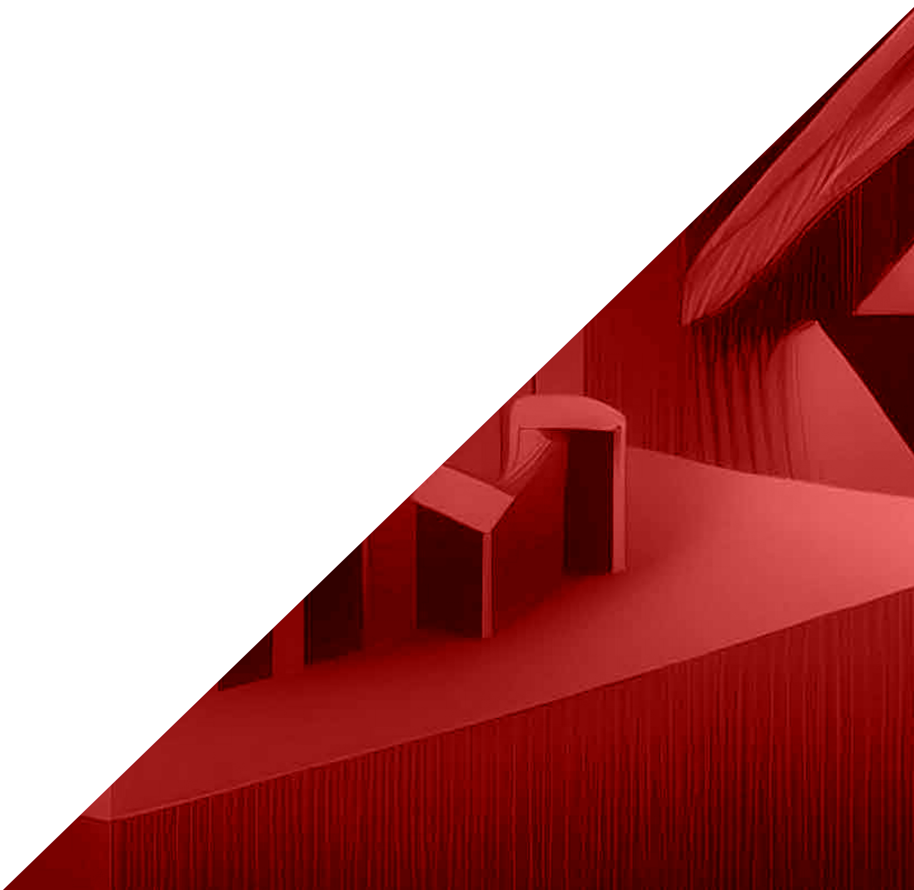
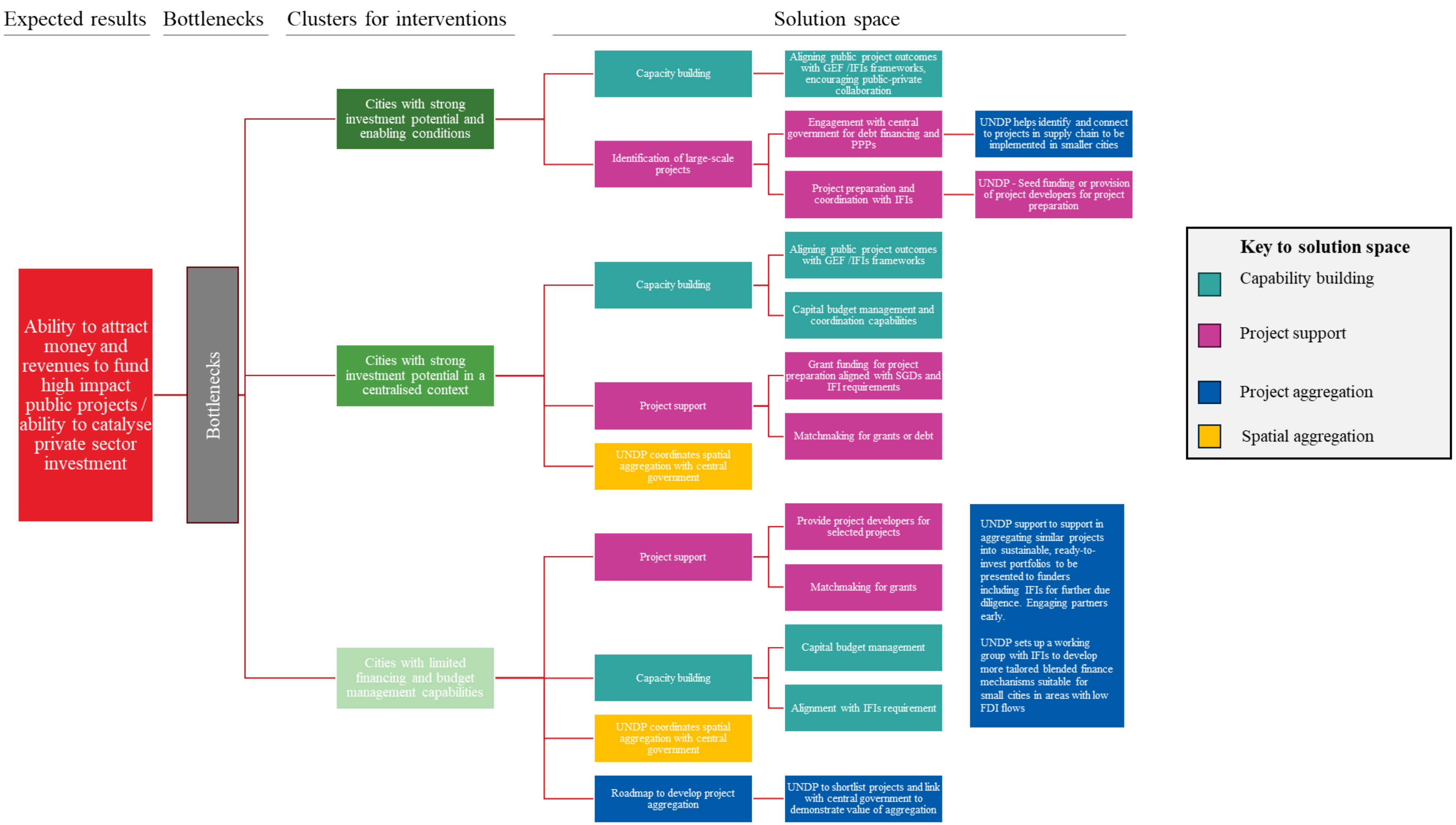


Figure 6 Pathways of solutions related to specific clusters



Targeting specific actions

Solutions space

(A) Capacity building

Targeted actions

Municipal finance toolkit

Barrier identified: Many municipalities need substantial guidance in developing and capturing revenue systems and navigating standard budgetary processes. Pathways for funding critical local services is not always clear.

Proposition: Prepare municipal finance toolkit (e.g. mini- city financial advisor course) for cities to lift capacity in the most needed cohorts of cities, across a range of areas including public investment management, private sector engagement, SME engagement, and creation of knowledge management platforms. This could include developing a funding road map for different types of projects or determining top 5 remedial actions to improve local revenue generation that can be taken by municipalities on their own (such as more frequent property valuations to support tax take). Alongside this, for reforms that require national level support, undertake policy dialogue with central governments. Consider embedding themes as part of existing UNDP public services delivery programs (such as the UNDP Supporting Public Administration Reform Program In Georgia) by adding a sub-program on reforms to reduce reliance on intergovernmental transfers (see UN Habitat policy paper).

Expected benefits

- Improved engagement with private sector
- Credibility and ability to leverage climate finance
- Greater opportunity for diversification or risk and benefits
- Potential to achieve public sector efficiency

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities.

Establishing a multi-partner investment forum

Barrier identified: The planning process creates obstacles to investment and cities feeling limited in their ability to raise revenues.

Proposition: Seek opportunities for central governments to incentivise to local authorities' revenue generation through performance-linked grant systems. Coordinate a multi partner investment forum with higher levels of government to target:

- Development of municipal enterprises that can seek capital for investment programming in ways municipal governments cannot
- Top barriers / blockages for planning systems in small cities
- Enhancing clarity on the roles of municipal v federal regarding revenue collection
- Tacking specific reasons for poor revenue collection in cities
- Reviewing barriers to service charges, property rates

Expected benefits

- Strengthen financial stability
- Increase revenue base to support economic growth

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities;
Cities with strong investment potential in a centralised context.

Municipal collaboration platform

Barrier identified: Municipalities are not working in a joined-up way in relation to cross boundary investments

Proposition: Leverage the M4EG collaboration platform to drive greater collaboration for neighbouring municipalities that have similar opportunities and challenges. This collaboration need not involve integrated governance platforms, which can be challenging to achieve in some countries. Instead, softer forms of collaboration, such as bringing together regional institutions like universities, and the regional city network during Local Economic Development Planning (LEDP), can anchor discussions on regional priorities and visions. Think of these as mini versions of EU Sharing Cities, where capital cities and municipalities share knowledge and experiences with other cities interested in replication and scale-up, embedding this knowledge in LEDPs.

Expected benefits

- Improved dialogue with other cities
- Increased engagement with the community
- Improved understanding of data
- Ability to have more control over expenditure

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities.

Support access to expertise and resources

Barrier identified: Many municipalities do not have the right managerial and technical staff to plan and implement projects with success, and staff retention is difficult.

Proposition: Develop a collaboration and partnership platform for municipalities that struggle to access expertise and resources – this could include developing role terms of references for cities to ensure the skill base is correct in relation to investments need in green transition sectors. Networks are particularly relevant to deal with skill retention issues, allowing municipalities to continuously have access to project support and shared knowledge rather than relying on individuals holding all the knowledge. This was specifically underlined by the Georgian Municipality Association (NALAG). An additional UNDP in country resource could be considered for a more in need cohorts of municipalities, to help with shape organisational abilities and strengthen local government institutions and attract skilled professionals.

Expected benefits

- Improved dialogue with other cities
- Increased engagement with the community
- Improved understanding of main skills and roles involved in resourcing and funding activities
- Ability to have more control over expenditure

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities.

CASE STUDY
URBACT Toolbox

Since 2002, URBACT (funded by the EU) has been enabling the cooperation and idea exchange amongst cities within thematic networks, by building the skills of local stakeholders in the design and implementation of integrated and participatory policies, and by sharing knowledge and good city practices, notably on municipality finance. URBACT has developed a series of processes and tools, as a part of the URBACT Method. It encourages cities to re-think centralised governance structures and shift towards more inclusive and holistic models. URBACT funds and supports networks of cities.
The URBACT toolbox provides guidance, tools, templates, prompts, explainers and much more to help municipalities find their way when tackling urban challenges. The Toolbox is organised into the five stages of the action-planning cycle and the crosscutting actions of engaging stakeholders and sharing knowledge.
Activities include guidance on coordinating the funding search, checklists of key skills, experiences and responsibility of a funding coordinator or funding mux and option appraisal for municipality projects. All include guides, exercises and case studies

Source: https://urbact.eu/toolbox-home/

(B) Project support

Targeted actions

Smart investment indicators

Barrier identified: Feedback from IFIs is that cities small cites lack compelling investment theses and the borrowing entity is not often clear

Proposition: Prepare smart investment indicators to embed in project screening to ensure projects have cross-cutting effects. This would include (i) tighter focus on indicators of interest to investors such as SDGs (jobs, gender, carbon reduction potential). Indicators would need to be applied in screening of projects with a tighter focus on development themes in each country in terms of projects such as connectivity, digital infrastructure, improved land use, community infrastructure, adaptation to climate change. This could be facilitated by developing an investment support database giving access to libraries of tools and pro formas for cities to cost/payback during project planning, allowing identification of obstacles and strategies to mitigate them (as this is a key concern for IFIs) like IFC Apex tool (see case study box).

UNDP could provide links to other tools to help build evidence bases and inform project investment theses. One such tool is the UN Green Jobs Assessment Model (GJAM), a macro-economic modelling framework that aids countries in identifying the employment impact of green policies. Cities in countries with access to this model can leverage it to assess the job and economic impacts of projects, thereby aiding the development of project proposals that align with investor needs.

Expected benefits

- Project economic credentials more demand driven
- Improved engagement with private sector
- Greater opportunity for diversification or risk and benefits

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities.

Municipal convening platform

Barrier identified: Municipalities not working in a joined-up way in relation to cross boundary investments

Proposition: Organise a municipal convening platform to combine initiatives with neighbouring municipalities that have similar opportunities and challenges (see project aggregation) this would connect public / or private projects that have mutually reinforcing benefits (for example combining Waste Management and Drinking Water supply projects to amplify impact). This platform could also include providers of finance (IFIs or local commercial lenders) to match projects with of sources of capital for sound business investment that helps grow local economies.

Expected benefits

- Project economic credentials more demand driven
- Improved engagement with the private sector
- Credibility and ability to leverage climate finance
- Financial viability potential and project size
- Greater opportunity for diversification or risk and benefits

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities.

CASE STUDY
Urban Performance Tool

The Urban Performance Tool is an online platform that allows stakeholders and city decision makers to assess their city's present and future performance by creating multiple growth scenarios that include investment projects, public policies and land regulations. The results are evaluated in a set of indicators related to the Sustainable Development Goals that can be easily visualised, communicated and shared with investors. The tool can capture up to 35+ indicators, visualise data in maps and compare results across 5 scenarios. It is also accessible in multiple languages and has been applied in developed and developing countries. This tool was developed by the World Bank and City Planning Labs and its use is based on a case-by-case application.

Source: Urban Performance - https://www.urbanperformance.in/about

Investment advisory call down services

Barrier identified: Many cities lack the resources and capacity to advance promising projects beyond the planning stage for public infrastructure and services

Proposition: Establish a call down investment advisory and facilitation service in country to support high potential cities. UNDP to take to central government and IFIs a cohort of top cities in each country to seek interest in supporting investment programs. Cites would have strong need for either municipal infrastructure / and or have high potential for PPPs. The call down would support on project development activities to ensure more compelling project ideas (innovation competitions or incubator programmes), supporting on TA type activities, steering co-benefits around greening and resilience to support building a high potential set of projects in each city. The Municipal Infrastructure Investment Unit set up in South Africa provides a good example of such supporting structure (see case study box).

Expected benefits

- Project economic credentials more demand driven
- Improved engagement with private sector
- Credibility and ability to leverage climate finance
- Financial viability potential and project size
- Greater opportunity for diversification or risk and benefits
- Alignment with government objectives
- Potential to achieve public sector efficiency

Target municipalities: Cities with strong investment potential and enabling conditions ; Cities with limited financing and budget management capabilities; Cities with strong investment potential in a centralised context.

CASE STUDY
Municipal Infrastructure Investment Unit (MIIU)

Setting up municipal infrastructure partnerships typically is expensive and requires considerable technical expertise. The South African government realised that, in order to facilitate such partnerships, something was needed to guide the process of preparing and negotiating public-private partnerships (PPPs) at the municipal level across the country and set up the Municipal Infrastructure Investment Unit (MIIU) to do this. The MIIU managed a grant fund capitalised by the South African national government and a small contribution from the US Agency for International Development. Local government budgets typically cannot cover the necessary but often costly investigations on the viability of PPP projects. Without such investigations local officials cannot structure bankable projects or negotiate effectively with potential private partners. MIIU's fund provided resources for local governments to carry out feasibility studies, develop project specifications and contract negotiations. Using an extensive array of decision making criteria drawn from similar work in other countries, the MIIU provided grants to PPPs that it considered had greatest potential for success. The projects were selected from a nationwide list of projects proposed, on a demand-driven basis, by any of South Africa's towns and cities.

Source: The Municipal Infrastructure Investment Unit: The Government's PPP Enabling Strategy https://www.clgf.org.uk/default/assets/File/Publications/reports/2006%20Municipal%20Finance%20Paper.pdf

Private sector engagement guidance

Barrier identified: Often public investments are being proposed without considering co-financing and partnership opportunities

Proposition: Develop private sector engagement guidance. This would focus on adequate private engagement and competition-based processes for expressions of interest with private sector (calls for ideas) to ensure all avenues are explored for private sector participation in in project development. UNDP could provide guidance in a form of case study repository or assistance in engaging with the private sector in the context of smaller municipalities and relevant to EaP countries contexts (see C40 Cities Public-Private Collaboration Guide for Global South Cities repository as an example of guide to illustrate a set of models of collaboration and the tactics needed to best use these models -

https://www.shiftcities.org/sites/default/files/2023-09/public-private_collab_guide_24092023.pdf).

Private sector engagement guidance

Expected benefits

- Improved engagement with private sector
- Credibility and ability to leverage climate finance
- Financial viability potential and project size
- Alignment with government objectives
- Potential to achieve public sector efficiency

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities; Cities with strong investment potential in a centralised context.

Guidance on collaborative procurement

Barrier identified: Often public investments are being proposed without considering co-financing and partnership opportunities

Proposition: Provide guidance on collaborative procurement. By pooling resources and working together, cities can more easily finance and manage expensive and complex climate action projects, increase their bargaining power, reduce transaction costs, improve access to leading experts and technologies, and enhance delivery times. Collaborating can also have wider benefits for local climate action, particularly by driving the market for new technologies and services.

The implementation of pooled procurement requires robust public procurement processes and strong coordination between public sector entities and departments. UNDP can play a role with central governments in reforming procurement processes to be aligned with international or EU procedures, which would simplify procurement and collaboration. This was suggested notably in the context of Georgia procurement processes where all municipal procurements currently have to go through a centralised procurement agency. An example of collaborative procurement benefits is provided in the case study box.

Expected benefits

- Improved engagement with private sector
- Credibility and ability to leverage climate finance
- Greater opportunity for diversification or risk and benefits
- Potential to achieve public sector efficiency
- All this leads to better unit costs, stronger value for money and better ability to deploy low-carbon and resilient infrastructure and services.

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities.

CASE STUDY

Building retrofit programmes for building energy efficiency in the UK

In the UK, 14 local authorities in the county of Lancashire partnered to create Cosy Homes in Lancashire (CHiL). By pooling members' resources, CHiL is improving the energy efficiency of privately owned and privately rented homes, addressing the shared problems of fuel poverty and low-quality housing, and making a whole-house approach to retrofitting possible. CHiL has a managing agent, Firefly Energi, which advises on technical issues and surveys homes to determine what energy efficiency measures could be beneficial, while local authorities' energy officers contribute time to CHiL's work. CHiL has secured an Energy Company Obligation contract with a large energy supplier, which provides funding linked to expected CO2 savings from home upgrades.

Source:
https://www.chil.uk.com/about-cosy-homes

Establishing a working group with governments, IFIs and donors

Barrier identified: Small nature of cities in the network create intractable challenges for investors and lenders regarding risk and reward payoff.

Proposition: Establish a working group with governments, IFIs and donors, to explore mechanisms to attract new types of investors and use future revenue streams as collateral. Where borrowing is considered necessary, explore specific sustainability linked mechanisms, including central government 'soft' loans for high impact initiatives, sustainability linked products. This could help to broaden the class of project, risk profile, and time horizon. Sustainability bond issues from municipal efforts through off balance sheet vehicles such as municipal enterprises should be encouraged.

Expected benefits

- Improved engagement with private sector
- Credibility and ability to leverage climate finance
- Financial viability potential and project size
- Alignment with government objectives
- Potential to achieve public sector efficiency

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities; Cities with strong investment potential in a centralised context.

(C) Project aggregation

Targeted actions

Pooled finance

Barrier identified: Economic and financial barriers. For small cities, generally only small-scale single sectors public sector projects are economically viable (if the project is used only by residents), unless they have demand by residents outside of the city boundary (for example a solar energy centre).

Proposition: Pool grants and financial support for joined-up initiatives for projects that are likely to increase project size to an amount more attractive to IFIs and other investors. Pooled financing mechanisms support local governments that are too small to undertake debt structuring and negotiations on their own, or at least to achieve a lower cost of funds than they could achieve alone. These funds usually come with specific eligibility criteria and may have a particular sector focus. Governments also often channel grant funds for project development and subsidies to specific activities through such entities. This usually requires building consensus, trust and strong coordination between stakeholders. A neutral enabling agent (e.g. UNDP) is often important to broker such relationships.

Aggregating small scale initiatives can help achieve scale up (for example, aggregate electrification bus network through a public–private partnership structure in city pair regions, for examples Baghdati and Kutaisi where there is a commuter flow). This model has worked in some small municipalities in the region, for developers to obtain capital from EBRD for private sector projects in the transportation sector.

Note in some countries, project aggregation might be difficult to implement due to legal constraints as municipalities are not allowed to fund projects in another municipality even if benefits their own citizens (e.g. a hospital). This was mentioned in the Georgia context.

Expected benefits

- Overcoming high upfront costs.
- Increased investor interest and confidence due to higher returns and greater stability than financing individual entities.
- Improved dialogue with other cities
- Increased engagement with the community
- Greater opportunity for economic gains
- Alignment with national government policy objectives
- Increased investment in community
- Sufficient depth budget and financial management

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities; Cities with strong investment potential in a centralised context.

CASE STUDY

Carbon financing for energy efficiency in Indian SME clusters

This project developed by REEP aimed to improve energy efficiency in Indian rice mill clusters through pooled financing. Its goals were to involve the local trade association or the Chamber of Commerce and the Indian Renewable Energy Development Agency (IREDA) to explore options for financing energy efficiency equipment by pooling the cluster's demand, to use a carbon financing mechanism.

Challenge: Many small rice mills lacked access to financing for energy-efficient equipment.

Solution: The project explored using the cluster's combined demand for better loan rates and involving relevant organisations like the Chamber of Commerce and the Indian Renewable Energy Development Agency (IREDA)

Key Learnings:

- The neutrality of the implementing partner was crucial.
- Carbon trading wasn't feasible due to the small size of the companies.

Outcome: The project created a model for bulk procurement of energy-efficient equipment in the rice mill sector. A handbook was developed to share this model for wider adoption.

Source:
https://reeep.org/projects_programmes/carbon-financing-for-energy-efficiency-in-indian-sme-clusters/

Municipal aggregation platform

Barrier identified: In complex urban setting, it is rarely a single intervention that will unleashes economic transformation.

Proposition: Identify projects within the city and (possibly) surrounding municipalities that have systemic effects, and have mutually beneficial links, and can be bundled. There would need to be strategic linkages between two or more investments into the covenants of an investment instrument. Aggregation platforms can support the bundling and potential securitisation of multiple small investments. They address the key issue of scale that blocks private finance interest in certain new markets and markets defined by the perceived or actual small size of the project or asset. Distributed renewable energy and energy efficiency investments are prototypical markets that would benefit from aggregation. Aggregation can also be achieved by setting up city-focused funds or structuring a bond or other asset-backed instruments that can help increase transaction size. Setting up a facility focused on building urban climate finance projects allows economies of scale and project aggregation to make projects economical. For example, combining Waste Management and Drinking Water supply projects to amplify impact.

Expected benefits

- Overcoming high upfront costs.
- Increased investor interest and confidence due to higher returns and greater stability than financing individual entities.
- Improved dialogue with other cities
- Increased engagement with the community
- Greater opportunity for economic gains
- Alignment with national government policy objectives
- Increased investment in community
- Sufficient depth budget and financial management

Target municipalities: Cities with strong investment potential and enabling conditions; Cities with limited financing and budget management capabilities; Cities with strong investment potential in a centralised context.

CASE STUDY

The Warehouse for Energy Efficiency Loans (WHEEL) – USA

WHEEL is a public-private partnership designed to accelerate investment in residential energy efficiency upgrades in the United States. It functions as a financing platform for existing government and utility-sponsored loan programs. WHEEL operates by:

Aggregation: WHEEL acts as a central platform that aggregates unsecured residential energy efficiency loans from various participating state and local programs.

Securitisation: These aggregated loans are then bundled together and transformed into financial instruments called "green bonds." These bonds are attractive to institutional investors seeking a steady return on investment with a positive environmental impact.

Funding: The proceeds from selling these green bonds are then used to recapitalise WHEEL, allowing it to purchase more loans from participating programs. This creates a continuous cycle of funding for energy efficiency upgrades.

Overall, WHEEL aims to achieve two key goals:

Increase Investment: By providing access to a larger pool of capital, WHEEL helps state and local programs offer more low-cost financing options.

Environmental Benefits: By encouraging energy-efficient upgrades.

Source:
https://www.greenfinanceplatform.org/policies-and-regulations/warehouse-energy-efficiency-loans-wheel

EXAMPLE OF PROJECT AGGREGATION – EBRD

Energy Efficiency Initiatives in Sarajevo and Belgrade

Both Sarajevo and Belgrade are undertaking significant projects aimed at improving the energy efficiency of public buildings, supported by the European Bank for Reconstruction and Development (EBRD) and the European Union (EU). These initiatives are part of broader efforts to promote sustainability and reduce carbon emissions in urban environments.

Sarajevo Project Overview

In Sarajevo, the EBRD and EU have committed a €10 million financing package for the refurbishment of 40 public buildings, which includes 29 schools, 6 kindergartens, 3 student dormitories, and 2 outpatient clinics. The EBRD is providing an €8 million loan, while the EU contributes a €2 million grant. This project is a priority under the Green City Action Plan for the Sarajevo Canton. The anticipated energy savings from the project are estimated at 13.7 GWh, leading to a reduction of approximately 4,774 tonnes of CO_2 emissions annually. Energy efficiency improvements will include cleaner heating systems, better insulation, improved lighting, and overall building enhancements.

Belgrade Project Overview

In Belgrade, a senior loan of up to €5 million from the EBRD is designated for the energy efficiency renovation of four public buildings: the Emergency Medical Institute, City Library, Student Healthcare Centre, and Student Hospital. This project, which has a total cost of €15.52 million—including over €10 million in EU grants—aims for a 42% reduction in energy consumption and a decrease of 517 tCO_2eq in annual emissions. Renovations will focus on thermal insulation, building envelope repairs, and upgrades to heating, ventilation, and lighting systems.

Funding Structure

Both projects exemplify the EBRD's commitment to enhancing energy efficiency in public infrastructure as part of its Green Cities initiative. A noteworthy innovative aspect of these projects is the pooling or spatial clustering of local government buildings. By focusing on clusters of facilities within close proximity, these initiatives can leverage economies of scale, streamline the renovation process, and maximize the impact of energy efficiency improvements.

In Sarajevo, refurbishing multiple schools and facilities in a coordinated manner allows for a comprehensive approach to energy management, ensuring that improvements in one building complement those in others. This spatial clustering enhances operational efficiency, simplifies project management, and allows for better sharing of resources and expertise among facilities.

Picture Belgrade Public Buildings Project - EBRD

Picture Sarajevo - EBRD

Similarly, in Belgrade, the renovation of nearby public buildings as part of a cohesive strategy facilitates the implementation of standardized energy efficiency measures. This not only optimizes costs but also creates a more significant cumulative effect in reducing emissions and energy consumption across the cluster of buildings.

The funding structures highlight the importance of combining loans and grants to ensure successful project execution. In Sarajevo, the EBRD's loan complements the EU's grant, enabling comprehensive renovations across multiple facilities. Similarly, in Belgrade, the EBRD's investment closes funding gaps while working alongside EU contributions to facilitate significant environmental improvements.

The EBRD's role extends beyond financial support; it also provides expertise in risk management, climate resilience, and capacity building. By establishing long-term relationships with cities like Sarajevo and Belgrade, the EBRD fosters innovation and enables clients to undertake necessary energy transitions, aligning with global climate goals. Both projects serve as important steps toward sustainable urban development, aiming not only to improve public infrastructure but also to enhance the quality of life for residents through reduced energy costs and lower pollution levels.

Read more about the Belgrade project:

- GrCF2 W2 - Belgrade Public Buildings (ebrd.com)
- EBRD and EU finance energy efficiency improvements in Belgrade

Read more about the Sarajevo project:

- Public buildings in Sarajevo to become energy efficient (ebrd.com)
- Public buildings in Sarajevo to become energy efficient (ebrd.com)
- EU helps energy efficiency in public buildings in Sarajevo Canton (wbif.eu)

Picture
Sarajevo Public Buildings Project – WBIF EU

(D) Spatial Clustering

Targeted actions

Develop spatial development framework

Barrier identified: Economic size of municipalities and projects is too small for IFIs to deploy resource and economic opportunities and areas of interest are not clearly identified. Limited expertise and practice from governments around spatial clustering and establishment of growth corridors.

Proposition: Establish evidence base. Conduct spatial framework that identifies the natural economic clusters that emerge from the country spatial clusters. Bringing cities together could have the option to join forces. This approach could work particularly well-suited to neighbouring cities or cities in the same territorial area. Even if cities are not geographically close, collaborating on action planning helps to raise ambition, establish common standards, and share ideas and experiences.

Provide technical assistance to governments in developing spatial development plans that identify priority areas for investment based on factors such as population density, infrastructure availability, economic potential, and environmental sustainability. Provide technical assistance using investment planning methodologies (for example using C40 action planning framework) examining interlinkages between various sectors (e.g., infrastructure, agriculture, education, healthcare) and their spatial implications, to identify synergies between different cities intra and inter nationally.

Expected benefits

- Improved dialogue with other cities
- Credibility and ability to leverage climate finance
- Financial viability of investment
- Greater opportunity for economic gains
- Alignment with national government policy objectives
- Increased investment in community
- Sufficient depth budget and financial management

Target municipalities: Cities with strong investment potential and enabling conditions ; Cities with limited financing and budget management capabilities ; Cities with strong investment potential in a centralised context.

CASE STUDY

Identifying Economic Growth Corridors in Indonesia

This study aimed to identify economic growth corridors in Indonesia to inform national development strategies.

Methodology: Researchers used spatial data like locations of firms, employment figures, infrastructure (roads, ports), and economic indicators (GDP, wages) at a regional level. Other techniques used included Spatial Cluster Analysis, Hotspot Analysis, Spatial Econometrics.

Outcomes: The study identified several economic growth corridors across Indonesia, characterised by high concentrations of businesses, infrastructure development, and strong economic performance. This information informed national development plans by:

- **Prioritising Investments:** The government could target investments (infrastructure, skills training) towards identified growth corridors to accelerate their development and create spillover effects for surrounding regions. This in turn attracted private investment and provided confidence to the market.

- **Developing Targeted Policies:** National policies could be tailored to the specific needs and opportunities of each growth corridor, fostering innovation and attracting further investment.

- **Promoting Regional Collaboration:** The study encouraged collaboration between regions within a growth corridor for joint projects and knowledge sharing.

Source: Master Plan Acceleration and Expansion of Indonesia Economic Development 2011-2025

Conclusion

Available instruments to increase funding for investment

Ideas to improve municipality funding and finance

Municipalities play a crucial role in driving local development, delivering essential services, and fostering community well-being. However, despite their significance, many municipalities in Eastern Partnership countries (Armenia, Azerbaijan, Georgia, Moldova and Ukraine) face significant challenges in accessing adequate funding and finance. Insufficient financial resources hinder their ability to invest in crucial infrastructure projects, address social needs, and implement sustainable development initiatives.

This research aimed to improve the ability of municipalities in the EaP to sustainably enhance funding opportunities, within the framework of the M4EG.

In order to achieve this goal, our work consisted of identifying and reviewing challenges and barriers for finance and funding at the municipal level through a literature review and interviews with municipalities representative of the EaP context (in terms of countries and municipality sizes) and identifying practical ways to address these challenges.

Key barriers identified through the research

The research identified six broad categories of barriers for better funding and finance in EaP municipalities:

Regulatory, legislative and governance barriers:

- Changing budgets (from central government) and raising local revenue is often difficult.
- Strict borrowing rules limit options.
- Municipalities rely heavily on grants and national funding.

Information barriers:

- Poor communication between municipalities and funders hinders investment.
- Investors lack awareness of funding opportunities and projects.
- Lack of project transparency discourages investment.

Economic barriers:

- Project size and return on investment make them unattractive to investors.

Financial barriers:

- Many municipalities lack access to suitable financial tools for their projects.
- Project financing doesn't align with investor requirements.
- Low investor interest in funding these types of projects.

Social and Cultural barriers:

- Resistance to change and risk aversion within municipalities limit opportunities.
- Fear of public backlash and lack of trust from citizens create obstacles.

Capacity Barriers:

- Many municipalities lack the skills and resources to effectively develop business cases, manage complex projects and finances (business cases, ROI, CBA).

Recommendations

Key recommendations to take forward this work include:

UNDP to develop guidance on local funding and finance best-practice and practical tools to improve project alignment with market demand attractivity and revenue streams as part of the next round of M4EG programmes. This action is a high priority.

UNDP to support project cohorts through seed funding. This could be used either to provide technical assistance or encourage private funding through blended finance mechanisms or risk mitigation. This could be developed in the short-term building on experience from other UNDP portfolios of programmes.

UNDP to coordinate networks of cities for knowledge sharing and retention between local experts and for collaboration which could lead to project aggregation or collaborative procurement practices. Networks need to focus on local technical experts. This is a high priority action.

UNDP to develop local capacity to generate and implement sustainable and transformative projects by better knowledge of tools, revenue sources and project management practices. Building on the Urban Learning Centre Facility, UNDP can support collaboration, access to expertise and resources such as toolkits and potentially technical assistance to municipality 'cohorts' to enable peer to peer learning through a framework offered by UNDP.

UNDP to support project aggregation to reach a critical size to an amount more attractive to IFIs and other investors. UNDP to undertake the role of the neutral enabling agent to broker relationships between stakeholders, and build consensus, trust and coordination. This is a high short-term priority underlined by IFIs.

UNDP to support the creation of spatial clusters (economic growth corridors) to attract investment and foment collaboration and project aggregation. While the creation of the corridors would depend on national governments, UNDP could establish the evidence base to identify country spatial clusters and priority areas to attract investment at the local level. This is a long term action but evidence based studies sponsored by UNDP could be conducted in the next 1 to 3 years.

Next steps

The broad scope of the research and significantly challenging issues identified means that the recommendations of this report provide a general way forward for UNDP, aiming to inform the potential development of a larger programme focusing on these aspects rather than practical actions.

The principles of these recommendations were tested and validated with relevant stakeholders from municipal associations and IFIs. However, the feasibility and practical implementation of these will need to be further tested and refined with these stakeholders and EaP national governments as part of dedicated workstreams or taskforces to be implemented by UNDP.

Appendix 1

Detailed review of desk-based research on barriers to municipal funding and finance

INFORMATION BARRIERS

UNDERSTANDING CURRENT PRACTICE AND CHALLENGES

Barrier	Unpacking barrier	Evidence in literature	Municipality power of influence
Small market size	Municipal bond markets are often smaller than other capital markets, making them less visible to large institutional investors. Smaller markets may be perceived as less attractive due to limited liquidity.	Staff working document accompanying the communication from the Commission on capital market union: Progress on building a single market for capital for a strong economic and monetary union (europa.eu)	Low
Asymmetric information	Municipalities either may not provide sufficient and easily accessible information about their financial health and bond offerings or their local context to inform decision made by donor governments and international organisations	CLNEA2022007.pdf	Medium
Lack of access to information	A lack of awareness about opportunities may result in missed chances for securing funding, or developing projects that will never get funded because outside of scope of external funders.	WEF_C4IR_GFC_on_Cities_Finance_2022.pdf (weforum.org)	High
Complexity of municipal finance	Municipal finance can be complex, with various types of bonds, structures, stakeholders, and risks involved. Investors, especially those less familiar with the intricacies of municipal finance, may be hesitant to participate due to perceived complexity	World Bank Document	Medium
Inadequate collaboration and information sharing	Limited collaboration and information sharing between different government agencies can hamper financial administration.	PLD_Improving-cross-government-data-and-information-exchange.2021_EN.pdf (europa.eu)	Medium
Lack of public awareness of education	Inadequate public awareness and education about tax obligations can contribute to non-compliance. Taxpayers may be unaware of their obligations or the consequences of non-compliance, leading to weak tax administration	Microsoft Word - MANAGING AND IMPROVING TAX COMPLIANCE SEPT 04.doc (oecd.org)	High

POLICY, INSTITUTIONAL AND GOVERNANCE BARRIERS

UNDERSTANDING CURRENT PRACTICE AND CHALLENGES

Barrier	Unpacking barrier	Evidence in literature	Municipality power of influence
Centralised fiscal policy	The central government retains significant control over revenue collection and allocation, limiting capacity for municipal spending.	1732The Challenge of Local Government Financing in Developing Countries _3.pdf	Low
Legal constraints	Strict regulations governing municipal debt issuance can limit municipalities from accessing capital markets	Supporting the future of municipal bonds in sub-Saharan Africa: the centrality of enabling environments and regulatory frameworks (sagepub.com)	Low
Lack of transparency and accountability	Regulatory bodies may require a high level of transparency and accountability in financial reporting. Municipalities with inadequate financial management practices or a lack of transparency may face difficulties meeting regulatory standards	Phase2.fm (oecd.org)	High
Siloed approach to development	Donor governments and international organisations may adopt sector-specific or siloed approaches to development, focusing on areas such as infrastructure, governance, or social programs. This can lead to mismatches if integrated, holistic development is needed at the local level	the-governance-of-inclusive-growth.pdf (oecd.org)	Low
Centralisation of IFI and private investor funding at the central government level	Investment through central government can undermine access to finance, due to: mismatched local vs. national needs and lack of responsiveness and accountability to regional disparities.	Home | OECD iLibrary (oecd-ilibrary.org) 1732The Challenge of Local Government Financing in Developing Countries _3.pdf	Low

ECONOMIC BARRIERS

UNDERSTANDING CURRENT PRACTICE AND CHALLENGES

Barrier	Unpacking barrier	Evidence in literature	Municipality power of influence
Public goods	Nature of public goods makes it difficult to collect revenue to finance the investment. This would disincentivise investment from private sector and adds importance on proving value for society	Draft_revision_v2 (core.ac.uk)	Medium
Informal economy	The lack of formalisation makes it challenging for tax authorities to track economic activities and enforce tax regulations	Informal economy (Central and Eastern Europe) (ilo.org)	Low
Market and economic conditions	Shifts in market dynamics or economic downturns may cause investors to reassess their priorities, leading to mismatches with municipal development plans.	IPCC_AR6_WGIII_Chapter15.pdf	Low
Divergent objectives of central governments and private investors	Disincentives for investment and grants where the municipalties' missions are not aligned. This includes the projects' output and time frame of its returns	Investing in nature-based solutions (eib.org) 1732The Challenge of Local Government Financing in Developing Countries _3.pdf	Medium

FINANCIAL BARRIERS

UNDERSTANDING CURRENT PRACTICE AND CHALLENGES

Barrier	Unpacking barrier	Evidence in literature	Municipality power of influence
Project "bankability" – excessive debt levels relative to revenue generation **Project scale / aggregation**	A bankable project should have a reliable and sufficient revenue stream to cover operating costs, debt service, and other financial obligations. Strong cash flow projections contribute to the project's attractiveness to lenders. Municipal projects are often small, with individual actors, low cash flows and limited scalability.	C40-Good-Practice-Guide-Creditworthiness.pdf	High
Risk aversion and return expectation for investors	Major IFIs are highly risk averse and have specific frameworks or typologies of projects they finance but little space for innovative, "outside of the box" projects	Private Finance for Development: Wishful Thinking or Thinking Out of the Box? in: Departmental Papers Volume 2021 Issue 011 (2021) (imf.org)	Medium
Insufficient contingency planning	Failure to establish adequate contingency plans for economic downturns or unexpected events can contribute to poor credit ratings. Resilient financial planning is crucial for maintaining creditworthiness.	C40-Good-Practice-Guide-Creditworthiness.pdf	High
Currency risk	Fluctuations in local currencies can pose risks for both municipalities and investors. If municipal debts are denominated in foreign currencies, currency exchange rate volatility can impact the cost of servicing the debt	Currency Risk in Project Finance (iisd.org)	Low
Low project replicability	Private investors are risk averse and look for projects that have a track-record or can be replicable. Municipal projects are highly context specific and bespoke, which provide little comparison or reassurance to these institutions with high barrier of entry to "de-risk" the investment	Barriers to financing adaptation actions in the UK	High
Interest rates	An increase in interest rates by the National Central Bank increases the cost of debt management for the municipality, which result in a constraint on further funding.	Higher-for-Longer Interest Rate Environment is Squeezing More Borrowers	Low

UNDERSTANDING CURRENT PRACTICE AND CHALLENGES

Barrier	Unpacking barrier	Evidence in literature	Municipality power of influence
Financial liabilities	Increasing financial liabilities can significantly affect the city's credit rating and result in the reallocation of debt management funds in the budget during the financial year.	Improving asset and debt management in developing cities	High
Lack of the inventory and strategic capacities	Cities have a large pool of wealth in their public assets, However they lack the inventory and strategic capacities required to untap the potential revenue.	Improving asset and debt management in developing cities	High
Unknown sources of revenue	Once new infrastructure is in place, it is also important to tap into a range of non-tax sources.	Improving asset and debt management in developing cities	High
Lack of funds over capacity building	The sheer multitude of programs associated with funding institutions, in which cities are involved, creates a scenario where limited internal resources—both human and financial—prevent the achievement of high-quality work on each individual program.	Bridging the SDG funding gap in cities	Medium
Lack of EU-wide standards	Lack of EU-wide standards segments a market, reducing the market size available for a financial product. Meeting alternative standards to access neighbouring markets tends to mean higher costs for investors.	Breaking Down Investment Barriers at Ground Level	Low

SOCIAL AND CULTURAL BARRIERS

UNDERSTANDING CURRENT PRACTICE AND CHALLENGES

Barrier	Unpacking barrier	Evidence in literature	Municipality power of influence
Institutional inertia of municipalities	Municipalities may be hesitant to adopt alternative funding sources that deviate from traditional budgeting and financing methods.	168076cf16 (coe.int)	Medium
Institutional inertia of donor governments and international organisations	Donor agencies are usually slow to change, due to the weight of accumulated common knowledge and cognitive short-cuts informing how a development organisation should work	Barriers to Political Analysis in Aid Bureaucracies (thepolicypractice.com)	Low
Short-Term Budget Pressures	Municipalities facing immediate budget pressures may prioritise short-term financial stability over the potential benefits of alternative funding sources.	13-05-08-Ways-and-means-Money-management-and-power-in-local-government.pdf (centreforcities.org)	Medium
Uncertain revenue streams	Alternative funding sources often involve revenue streams that are less predictable than traditional funding sources like taxes or grants	13-05-08-Ways-and-means-Money-management-and-power-in-local-government.pdf (centreforcities.org)	High
Political backlash	Both central and local governments may be disincentivised to increase tax burdens in order to retain political support.	1732The Challenge of Local Government Financing in Developing Countries _3.pdf	Medium
Lack of trust in local government	A lack of trust can have financial repercussions (e.g. reduced creditworthiness, borrowing costs), and investment potential (e.g. interest in engaging in PPPs or donor funding)	Trust in public institutions: Trends and implications for economic security | DISD (un.org) 395819 (moodys.com)	Medium

CAPACITY BARRIERS

UNDERSTANDING CURRENT PRACTICE AND CHALLENGES

Barrier	Unpacking barrier	Evidence in literature	Municipality power of influence
Lack of modern technology	Outdated or insufficient technological infrastructure for tax administration can impede efficient data collection, processing, and enforcement	Supporting the Digitalisation of Developing Country Tax Administrations (oecd.org)	Medium
Financial and logistical expertise	Sufficient expertise is needed to organise the projects in a financially viable way, e.g. risk allocation & mitigation, project strcuture and financing model, technical and operational capacity , CBA, debt structure and fiancing terms, insurance and hedging strategies, stakeholder engagmenet	Investing in nature-based solutions (eib.org) 1732The Challenge of Local Government Financing in Developing Countries _3.pdf	High
Writing and communication/ pitching capacity	Ineffective communication/pitching skills may limit the attraction of private investment in municipal infrastructure projects or persuasion of enabling grant funding		High

Appendix 2

Sifting and prioritisation of recommendations

PROJECT SUPPORT (1)
Solution areas

Problems	UNDP project support activities	Benefits for municipal governments: Project economic Credentials more demand driven	Improved engagement with private sector	Credibility and ability to leverage climate finance	Financial viability potential and project size	Greater opportunity for diversification or risk and benefits	Alignment with government objectives	Potential to achieve public sector efficiency	Relevant cities: Cities with strong investment potential and enabling conditions	Cities with limited financing and budget management capabilities	Cities with strong investment potential in a centralised context
Feedback from IFIs is that cities small cites lack compelling investment theses and the borrowing entity is not often clear	Prepare **smart investment indicators** to embed in project screening to ensure projects have cross-cutting effects. This would include (i) tighter focus on indicators of interest to investors such as SDGs (jobs, gender, carbon reduction potential. Indicators would need to be applied in screening of projects. Tighter focus on development themes in each country in terms of projects such as connectivity, digital infrastructure, improved land use, community infrastructure, adaptation to climate change. **Develop investment support database** giving access to libraries of tools and pro formas for cities to cost/payback during project planning, allowing identification of obstacles and strategies to mitigate them (as this is a key concern for IFIs) like IFC Apex tool.	Relevant now	Relevant now	Relevant with reform	Relevant with reform	Relevant now	Relevant with reform	Relevant with reform	Relevant now		
Municipalities not working in a joined-up way in relation to cross boundary investments	Organise municipal **convening platform** to combine initiatives with neighbouring municipalities that have similar opportunities and challenges (see project aggregation) this would connect public / or private projects that have mutually reinforcing benefits (for example combining Waste Management and Drinking Water supply projects to amplify impact). This platform could also include providers of finance (IFIs or local commercial lenders) to match projects with of sources of capital for sound business investment that helps grow local economies.	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant with reform	Relevant with reform	Relevant with reform	Relevant with reform	Relevant with reform
Many cities lack the resources and capacity to advance promising projects beyond the planning stage for public infrastructure and	Establish **a call down investment advisory and facilitation** service in country to support high potential cities. UNDP to take to central government and IFIs a cohort of top cities in each country to seek interest in supporting investment programs. Cites would have strong need for either municipal infrastructure / and or have high potential for PPPs. The call down would support on project development activities to ensure more compelling project ideas (innovation competitions or incubator programmes), supporting on TA type activities, steering co-benefits around greening and resilience to support building a high potential set of projects in each city.	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now
Often public investments are being proposed without considering co-financing and partnership opportunities	Develop **private sector engagement guidance**. This would focus on adequate private engagement and competition-based processes for expressions of interest with private sector (calls for ideas) to ensure all avenues are explored for private sector participation in in project development. Example project could include a drinking water treatment and supply plant catering to all city residents. This could follow PPP model in collaboration with local municipalities. For example Public /Private collaboration models see here.	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant with reform	Relevant with reform	Relevant with reform

Key to colour coding for cities typologies Relevant now | Relevant with reform | Not relevant

PROJECT SUPPORT (2)
Solution areas

Problems	UNDP project support activities	Benefits for municipal governments: Project economic Credentials more demand driven	Improved engagement with private sector	Credibility and ability to leverage climate finance	Financial viability potential and project size	Greater opportunity for diversification or risk and benefits	Alignment with government objectives	Potential to achieve public sector efficiency	Relevant cities: Cities with strong investment potential and enabling conditions	Cities with limited financing and budget management capabilities	Cities with strong investment potential in a centralised context
Often public investments are being proposed without considering co-financing and partnership opportunities	**Provide guidance on collaborative procurement.** By pooling resources and working together, cities can more easily finance and manage expensive and complex climate action projects. Collaborating can also have wider benefits for local climate action, particularly by driving the market for new technologies and services. Building retrofit programmes for building energy efficiency. In the UK, 14 local authorities in the county of Lancashire partnered to create Cosy Homes in Lancashire (CHiL). By pooling members' resources, CHiL is improving the energy efficiency of privately owned and privately rented homes, addressing the shared problems of fuel poverty and low-quality housing, and making a whole-house approach to retrofitting possible. CHiL has a managing agent, Firefly Energi, which advises on technical issues and surveys homes to determine what energy efficiency measures could be beneficial, while local authorities' energy officers contribute time to CHiL's work. CHiL has secured an Energy Company Obligation contract with a large energy supplier, which provides funding linked to expected CO_2 savings from home upgrades.										
Small nature of cities in the network create intractable challenges for investors and lenders regarding risk v reward payoff	Establish **a working group with governments, IFIs and donors**, to explore mechanisms to attract new types of investors and use future revenue streams as collateral. Where borrowing is considered necessary, explore specific sustainability linked mechanisms, including central government 'soft' loans for high impact initiatives, sustainability linked products. This could help to broaden the class of project, risk profile, and time horizon. Sustainability bond issues from municipal efforts through off balance sheet vehicles such as municipal enterprises should be encouraged										

Key to colour coding for cities typologies Relevant now · Relevant with reform · Not relevant

CAPACITY BUILDING / FOR READINESS (1)
Solution areas

		Benefits for municipal governments							Relevant cities		
Problems	**UNDP project support activities**	Strengthened financial stability	Ability to have more control over expenditure	Increased engagement with the community	Increase revenue base to support economic growth	Improved understanding of data	Improved dialogue with other cities	Needs of SMEs and skills	Cities with strong investment potential and enabling conditions	Cities with limited financing and budget management capabilities	Cities with strong investment potential in a centralised context
Many municipalities need substantial guidance in developing and capturing revenue systems and navigating standard budgetary processes. Pathways for funding / financing traditional green infrastructure is not always clear (See Baghdati LEDP)	Spearhead **municipal finance toolkit** (e.g. mini- city financial advisor course) for cities to lift financial literacy in the most needed cohorts of cities, across a range of areas including public investment management, private sector engagement, SME engagement, and creation of knowledge management platforms. Develop a funding road map for different types of projects. Determine top 5 remedial actions to improve local revenue generation that can be taken by municipalities on their own (such as more frequent property valuations to support tax take). Alongside this, for reforms that require national level support, undertake policy dialogue with central governments. Consider embedding themes as part of existing UNDP public services delivery programs (such as the UNDP Supporting Public Administration Reform Program In Georgia) by adding a sub-program on reforms to reduce reliance on intergovernmental transfers (see UN Habitat policy paper).	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant with reform
Planning process creating obstacles to investment and cities feeling limited in their ability to raise revenues	Seek opportunities for central governments to incentivise to local authorities' revenue generation through **performance-linked grant systems**. Establish a **multi partner investment forum** with higher levels of government to target: • Development of municipal enterprises that can seek capital for investment programming in ways municipal governments cannot • Top barriers / blockages for planning systems in small cities • Enhancing clarity on the roles of municipal v federal regarding revenue collection • Tacking specific reasons for poor revenue collection in cities • Reviewing barriers to service charges, property rates	Relevant now	Relevant with reform	Relevant with reform	Relevant now	Relevant with reform	Relevant with reform	Relevant with reform	Relevant now	Relevant now	Relevant now

Key to colour coding for cities typologies Relevant now | Relevant with reform | Not relevant

CAPACITY BUILDING / FOR READINESS (2)
Solution areas

Problems	UNDP project support activities	Benefits for municipal governments: Strengthened financial stability	Ability to have more control over expenditure	Increased engagement with the community	Increase revenue base to support economic growth	Improved understanding of data	Improved dialogue with other cities	Needs of SMEs and skills	Relevant cities: Cities with strong investment potential and enabling conditions	Cities with limited financing and budget management capabilities	Cities with strong investment potential in a centralised context
Municipalities are not working in a joined-up way in relation to cross boundary investments	Organise municipal **collaboration platform** for neighbouring municipalities that have similar opportunities and challenges. This collaboration need not involve integrated governance platforms, which can be challenging to achieve in some countries. Instead, softer forms of collaboration, such as bringing together regional institutions like universities during Local Economic Development Planning (LEDP), can anchor discussions on regional priorities and visions. Think of these as mini versions of EU Sharing Cities, where capital cities and municipalities share knowledge and experiences with other cities interested in replication and scale-up, embedding this knowledge in LEDPs.										
Many municipalities do not have the right managerial and technical staff to plan and implement projects with success, staff retention is difficult	**Develop a collaboration and partnership platform for municipalities struggle to access expertise and resources** – this could include developing role terms of refences for cities to ensure skill base is correct in relation to investment need in green transition sectors. An additional UNDP in country resource could be considered for a more in need cohorts of municipalities, to help with shape organisational abilities and strengthen local government institutions and attract skilled professionals.										

Key to colour coding for cities typologies Relevant now Relevant with reform Not relevant

PROJECT AGGREGATION (PORTFOLIOS)
Solution areas

		Benefits for municipal governments							Relevant cities		
Problems	**UNDP project support activities**	Improved dialogue with other cities	Credibility and ability to leverage climate finance	Financial viability	Greater opportunity for economic gains	Alignment with national government policy objectives	Increased investment in community	Sufficient depth budget and financial management	Cities with strong investment potential and enabling conditions	Cities with limited financing and budget management capabilities	Cities with strong investment potential in a centralised context
For small cities, generally only small-scale single sectors public sector projects are economically viable (if the project is used only by residents), unless they have demand by residents out side of the city boundary (for example a solar energy centre)	Pool grants and financial support for joined-up initiatives for projects that are like increase project size to an amount more attractive to IFIs and other investors. Achieve scale up by aggregating small scale initiatives (for example, aggregate electrification bus network through a public– private partnership structure in city pair regions, for examples Baghdati and Kutaisi where there is a commuter flow). This model has worked in some small municipalities in the region, for developers to obtain capital from EBRD for private sector projects in the transportation sector.	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant with reform
In complex urban setting, it is rarely a single intervention that will unleashes economic transformation	Identify projects within the city and (possibly) surrounding municipalities that have systemic effects, and have mutually beneficial links, and can be bundled. There would need to be strategic linkages between two or more investments into the covenants of an investment instrument. For example, combining Waste Management and Drinking Water supply projects to amplify impact.	Relevant now	Relevant with reform	Relevant now	Relevant with reform	Relevant with reform	Relevant now	Relevant with reform	Relevant now	Relevant now	Relevant with reform

Key to colour coding for cities typologies Relevant now Relevant with reform Not relevant

CLUSTERING GROWTH CORRIDORS
Solution areas

		Benefits for municipal governments							Relevant cities		
Problems	**UNDP project support activities**	Improved dialogue with other cities	Credibility and ability to leverage climate finance	Financial viability of investment	Greater opportunity for economic gains	Alignment with national government policy objectives	Increased investment in community	Sufficient depth budget and financial management	Cities with strong investment potential and enabling conditions	Cities with limited financing and budget management capabilities	Cities with strong investment potential in a centralised context
Economic size of municipalities and projects is too small for IFIs to deploy resource and economic opportunities and areas of interest are not clearly identified	Establish evidence base. Conduct spatial framework that identifies the natural economic clusters that emerge from the country spatial clusters. Bringing cities together could have the option to join forces. This approach could work particularly well-suited to neighbouring cities or cities in the same territorial area. Even if cities are not geographically close, collaborating on action planning helps to raise ambition, establish common standards, and share ideas and experiences.	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now	Relevant now
Limited expertise and practice from governments around spatial clustering and establishment of growth corridors	Provide technical assistance to governments in developing spatial development plans that identify priority areas for investment based on factors such as population density, infrastructure availability, economic potential, and environmental sustainability. Provide technical assistance using investment planning methodologies (for example using C40 action planning framework) examining interlinkages between various sectors (e.g., infrastructure, agriculture, education, healthcare) and their spatial implications, to identify synergies between different cities intra and inter nationally.	Relevant with reform	Relevant with reform	Relevant with reform	Relevant now	Relevant now	Relevant with reform	Relevant with reform	Relevant now	Relevant now	Relevant now

Key to colour coding for cities typologies Relevant now Relevant with reform Not relevant

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