DEVELOPMENT OF MUNICIPALITY BONDS MARKET IN THE WESTERN BALKAN COUNTRIES AND REPUBLIC OF SERBIA[1]

Aleksandra Bradić-Martinović[2]
Duško Bodroža[3]

Abstract:
Despite data showing that the impact of the crisis, which started in 2008, was completed funding to state and local governments is very difficult. Local governments need to develop and invest in large infrastructure projects for which they are not sufficient budgetary resources. Therefore, they had to find new ways to raise funds, and issuing municipal bonds proved to be one of the acceptable. In this paper we present the municipal bonds as one of the solution for funding of cities and municipalities in the Western Balkan region, with all its strengths, weaknesses, opportunities and threats. We also present the result of analysis of municipal bond markets in Croatia, Republika Srpska (Bosnia and Herzegovina), Montenegro and Macedonia, with special emphasis on Serbia. We consider that this way of financing can help municipalities to overcome the consequences of the last crisis and to provide a basis for future development.

Key words*: municipal bonds, cities and municipalities, regional development, debt, capital market*

INTRODUCTION

The developed countries have gone through major changes in recent decades of the twentieth century. During this period, with the support of the rapid development and expansion of information and communication technology, the globalization process has begun. The government has had to adjust its role to the new conditions. First was carried out privatization of certain services in the public service sector,

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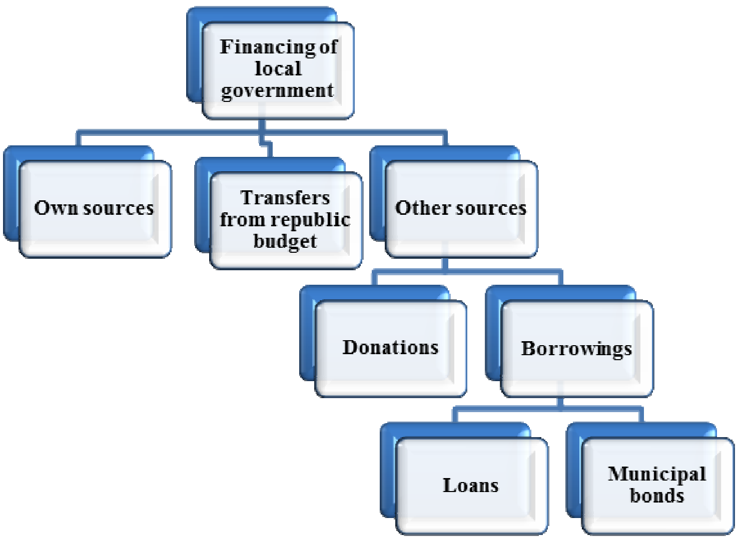
[2] Aleksandra Bradić-Martinović, Phd, Research Fellow, Institute of Economic Sciences, Belgrade, abmartinovic@ien.bg.ac.rs
[3] Duško Bodroža, MSc, Research associate, Institute of Economic Sciences, Belgrade dusko.bodroza@ien.bg.ac.rs

and then the reaffirmation of local government, as a second step (Krstić, 2006, p. 6).

Effective functioning of the local government is directly connected with the system of financing. To achieve this goal management of local government must provide sufficient funds and sustainable financing for all planned projects. They can provide it from: a) own resources, b) the central budget and c) other sources. Own resources available to local governments are revenue collected from its citizens, and it may be the fiscal and non-fiscal. Fiscal revenues from its own sources included various taxes, fees, contributions, fees and other fiscal revenues that are under the control of local government. Non-fiscal revenues are fees for use of public land, fee income, income from inspection and administrative services, income from rental of municipal property and others. Transfers from the state budget funds are used when local governments are unable to finance from its own resources. Other sources of funding local government are grants and bonds. Grants are resources that local governments receive as assistance from various national and international institutions, and individuals. Borrowed funds are funds that local governments borrow from other financial institutions or entities, with a commitment to them after a period of time back plus interest. There are two types of debt, loans and municipal bonds.

Figure 1. Local government financing sources



Source: Authors' own research

Loans are usually granted by some financial institution; usually banks. Local governments do not use these sources for large investments. In the case of large capital investment the bonds are more suitable financing instrument.

In this paper we are presented the municipal bond market in Western Balkan countries with the special reference in Serbia. After the introduction we are offering a brief insight in municipal bonds as an option for local government financing with all its strengths, weaknesses, opportunities and threats. In this part of the paper we are also presenting the last tendencies in US municipal bond market, the biggest world market. The third part of the paper consist the analysis of municipal bond markets in Croatia, Republika Srpska (Bosnia and Herzegovina), Montenegro and Macedonia. At last, forth part, we are presenting the level of development of municipal bonds market in Serbia.

2. MUNICIPAL BONDS AS AN OPTION FOR LOCAL GOVERNMENT FINANCING

Municipal bonds are relatively low risk debt financial securities with possibilities of obtaining of large amounts of funds due to its broad-based investors. Purpose of municipal bonds may be very tight. Basically the raised money is used to fund capital projects or budget deficit. In addition, municipal bonds are important because they enable local people to invest their own money in their own city or municipality, and that it obtains a favorable interest rate. In addition, the yield of municipal bonds is also interested for institutional investors (mutual funds, insurance companies, banks, etc.).

The specific purpose of the funds raised through the issuance of municipal bonds could be: primary facilities for heat production, the capacities of water supply, capacities for waste recycling, main road or local road network, sports and recreation facilities, schools, market facilities, street lighting, improvement of the environment, etc.

Issuances of municipal bonds, local investors borrow the equity with accrued interest from the investors. Usually the interest is paid periodically, typically every six months. The principal is generally paid at maturity, but it is possible to have periodic payments.

In most states, municipal bonds, or more specifically their return is exempt from tax on income (tax-exempt municipal bonds). Also, there is a group of bonds whose yield is not tax-free income (taxable municipal bonds). Municipal bonds, other than tax incentives, offer investors many other advantages. First of all, as we point out the investor realizes an attractive interest rate, preferably free of tax. In addition, municipal bonds are issued by the local government in a public and transparent manner, and therefore the investors carry a high level of security of the receivables. Apart from interest, there is the possibility of capital gains if the bonds are sold on the secondary market (BMA, 2003, p. 346).

Municipal bonds investors can be divided into two main groups:

1. Individual investors (citizens) and
2. Institutional investors (banks, insurance companies, pension funds, mutual funds etc.).

The participation of individual investors in the municipal bond market in the last decade has grown to such an extent that today, individual investors own most of these financial instruments. Individual investors buy municipal bonds directly or through mutual funds. Institutional investors invest in these securities primarily due to returns that they can achieve, as well as relatively low risk.

In practice, there are several criteria for the division of municipal bonds. The basic division distinguishes:

1. General obligation municipal bonds and
2. Revenue municipal bonds.

General municipal bonds are issued by local units, cities or municipalities that have large fiscal capacity, relatively to debt size. These bonds are paid from the issuer's budget. Since the issuer gives guarantees with all its revenues, especially tax, a decision about the debt can be made only by representative body of local self-government or with the support of public referendum. Therefore such bonds are "approved by voters". For this reason, these bonds are the safest type from the perspective of the investors.

Revenue municipal bonds are named after income generated from the specific project for which they were issued, and implementation. These projects may be, for example, construction of roads, bridges, water supply, sports facilities, etc. The principal and interest are paid from the income generated from the object that is built on the basis of borrowing. A typical example is the toll which is base for bond debt return. This type of bond carries a slightly higher risk, and it is usually insured by some of the insurance company that agrees to pay the principal with accrued interest if the issuer or local government defaults.

According maturity municipal bonds are divided into: short-term (up to 1 year), medium (1-10 years) and long-term (over 10 years).

The advantages of borrowing through the issue of municipal bonds are lower interest rates compared to loans, tax breaks and increased accountability of government representatives expressed by transparency of the process. Building better infrastructure raises the standard of living at the local level and creates the conditions for more rapid development of the real sector through increased inflow of foreign investment.

Beside real effects, municipal bonds can have positive marketing effects on local government, since after the issuance of its own securities they come into the spotlight of general public and experts. It can bring them a comparative advantage over other local governments in the state and region. The following table shows the SWOT analysis of municipal bonds, i.e. the Strengths, Weaknesses, Opportunities, and Threats connected with these securities.

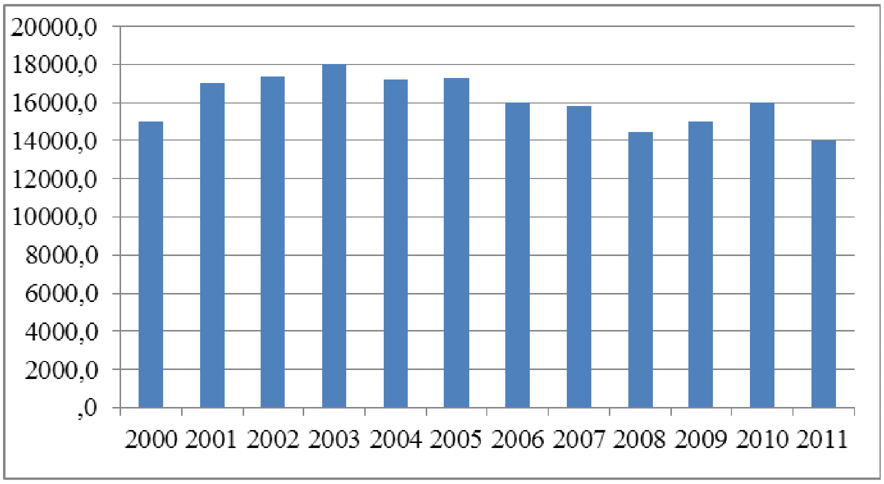
Table 1. Municipal bonds SWOT analysis

Strengths	**Weaknesses**
Stimulating the development of quality projects The possibility of obtaining funds under favorable conditions Diversification of risk Tax relief	Slightly higher risk than government bonds Instability institutions Country risk Lack of information
Opportunities	**Threats**
Encouraging the development of entrepreneurship Regional economic development	Risk of default Lack of deep capital market Resistance to change Legal restrictions

Source: Authors' own research

The importance of the municipal bond market is best seen in the example of the United States. According to the records (US SEC, 2012) in December 2011 this market has had over a million different municipal bonds, with total amount of $3.7 trillion. Size of engaged capital clearly indicates the huge potential of this market. Figure 2 represents the numbers of newly municipal bond issuer in the period of 2000-2011 in US market. Based on the presented values, we can conclude that the number of issuer years is quite balanced, around 16,000 issuers per year.

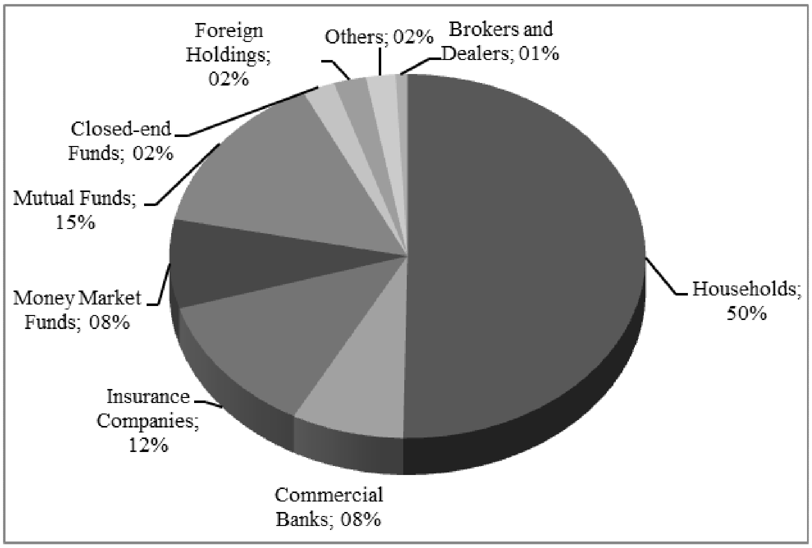
Figure 2. Newly issued municipal securities in US



Source: US SEC, 2012, p. according to Thomson Reuters' SDC Platinum, Global Public Finance module

On US municipal markets the main investors in municipal bonds are individual investors or households with over 50% of market share. Other major groups are Mutual Funds (14.5%), Insurance Companies (12.4%), Money Market Funds (7.9%) and Commercial Banks (7.6%) like presented on Figure 3.

Figure 3. Municipal-securities holdings by investor category in US (Forth quarter 2011)



Source: US SEC, 2012, p. 14, Data source Forth Quarter Flow of Funds Data.

Municipal bond market in the U.S. has three key features (Lee, et al, 2010, p. 1673):

- it is organized as over-the-counter market,
- it is highly concentrated and
- it has a relatively low liquidity and lack of price transparency.

According to SEC analysis (2012, p. 133-145) there are several recommendations for improvement of US municipal bond market. The main are: a) Municipal market participants should follow and encourage others to follow existing industry best practices and expand and develop additional best practices guidelines in a number of areas to enhance disclosures and disclosure practices in the municipal securities market; b) The Commission could consider amendments to Regulation ATS to require an alternative trading system (ATS) with material transaction or dollar volume in municipal securities to publicly disseminate its best bid and offer prices and, on a delayed and non-attributable basis, responses to “bids wanted” auctions; c) The MSRB could consider requiring municipal bond dealers to report “yield spread” information to its Real-Time Transaction Reporting System (RTRS) to supplement existing interest rate, price and yield data and d) The MSRB should promptly pursue enhancements to its EMMA website so that retail investors have better access to pricing and other municipal securities information.

3. MUNICIPAL BOND MARKET IN WESTERN BALKAN COUNTRIES

Due to traditional bank-centric system, credit markets in the WBC is highly developed, particularly loans supply. In those countries, as a result of the need for better sources of capital the municipal bond markets began to develop. To ensure the further development of this market it is necessary to strengthen the financial position of local governments, especially in the field of fiscal decentralization. Fluctuations in global financial market, especially after the global financial crisis in 2007, are characterized by high variability of interest rates and high volatility of exchange rates. This situation is very challenging for local government borrowing, as entered high risk in financial projections.

Local governments have a number of options that they can use to finance their needs: revenues, state or European Union grants (or other funds), long term debts, private sector (through Public Private Partnership), etc. Possibility of local authorities to borrow is connected with its general financial condition, i.e. solvency. This is particularly important because of the direct link between financial conditions and the interest rate at which it will be granted a loan. It is very important to point out that state and legislation cannot provide stability per se, but it can provide a general framework for the local government, in this area. In order to understand the situation in each of the selected countries (Croatia, Macedonia, Montenegro, Republika Srpska - BiH) we will first give an overview of income and the level of autonomy of local governments.

According to *NALAS Guidelines* (2011, p. 129) in *Croatia* local government revenues are consist of a) most important local taxes/fees and average share in the annual budget: income tax and surtax on income tax, income from non-financial asset and property tax; b) share taxes: income tax (34% until 2006; 52% as of 2007) and profit tax (20% until 2007) and tax on real estate (60%) and c) central government transfers which implies transfers for decentralized functions – primary education, secondary education, health care, social welfare and fire protection and equalization grants for general purposes and for capital purposes. The expenditures assignments are: a) management of the local road infrastructure, water supply, sewage, waste and pluvial water treatment, public lightning, sanitation/waste collection, local public transportation and district heating supply; b) shared local with central governments are energy saving projects and c) shared region with central governments are social housing and houses for youth (exclusive competence of regional government).

In *Macedonia* local government revenues are consist of a) most important local taxes/fees and average share in the annual budget: property tax (6%), real estate transfer tax (17%) and communal fee (29%); b) share taxes from local governments receive 3% of personal income tax and c) central government transfers which implies a general purpose transfer from VAT, earmarked/block grants for the areas of education, culture, social policy and child protection. The expenditures assignments are: a) management of the local road infrastructure, water supply, sewage, waste and pluvial water treatment, public lightning, sanitation/waste collection and local public transportation; b) shared local with central governments are social housing as well as houses for youth.

In *Montenegro* local government revenues are consist of a) most important local taxes/fees and average share in the annual budget: utility fees (23%), real estate tax (7.5%) and surtax on income tax (5.5%); b) personal income tax (10%), real estate transfer tax (50%) and concession and fees for using natural resources (30%) and c) central government transfers which implies equalization grants (comprise 11% of personal income tax and 20% of real estate transfer tax) and conditional grants for financing investment projects. The expenditures assignments are: management of the local road infrastructure, water supply, sewage, waste and pluvial water treatment, public lightning, sanitation/waste collection, local public transportation and social housing – social welfare.

In *Republika Srpska - BiH* local government revenues are consist of most important local taxes/fees and average share in the annual budget: property tax (35%), turnover tax – up to 20% and rent – up to 15%. The expenditures assignments are: a) management of the local road infrastructure, water supply, sewage, waste and pluvial water treatment, sanitation/waste collection and local public transportation; b) shared local with central governments: sewage, waste and pluvial treatment, public lighting, district heating supply and building of social houses as well as houses for youth.

The second determinant of borrowing potential is municipal authority. Each country has procedures for subnational borrowing, and in all selected countries central government must give an approval for local debt issue. The third factor is ability to guarantee and give a pledge (collateral) for the loan. For that purpose local government can use physical assets (land or buildings), general revenues (taxes and transfers) and project- generated revenues.

Table 2. Type of allowed guarantees and collaterals

	Allowed	**Not allowed**
Own revenues	Croatia, Macedonia, Montenegro, Republika Srpska - BiH	
Physical properties	Macedonia, Montenegro	Croatia, Republika Srpska – BiH
Reserve funds	Croatia, Macedonia, Montenegro	Republika Srpska – BiH
Private insurance		Croatia, Macedonia, Montenegro, Republika Srpska – BiH
Others	Macedonia[4]	

Source: NALAS Guidelines, p. 35

The development of municipal bond market development is closely connected with the level of discipline in local government. It is very important because the disorder in this segment can cause serious problem at macroeconomic level. *Ter-Minassia & Craig* (1997) concluded that each country should have some mechanism for ensuring stability in municipality. They made distinction between: market discipline, direct loans, rule-based approach and co-operative approach.[5]
According to *NALAS report* the situation in selected WB countries in 2011 has been presented in Table 2.

[4] Credit enhancements (guarantees by USAID through Development Credit Authority)
[5] Further on this subject in Ter-Minassian, Craig. 1997, pp. 156-172

Table 3. Controlling mechanisms in selected WB countries

	Market discipline	Co-operative control	Rule based	Direct controls
Croatia			●	●
Macedonia			●	●
Montenegro			●	●
Republika Srpska – BiH				●

Source: NALAS Guidelines, p. 66

It is obvious that in selected countries the market discipline and direct controls as controlling mechanisms do not exist. These countries rely on rule-based and cooperative approaches. The selected mechanisms are more restricted and imply a stronger state control over local government.

The experience in these selected WB counties is different. Most of them have municipal bond market at some extent of development.

Municipal market in Croatia had six issues of municipal bonds, for cities of: Koprivica, Zadar, Rijeka, Split, Osijek and Vinkovici. The detailed data about these bonds are: [6]

- City of Koprivnica 2004 8,000,000[7]
- City of Zadar 2004 2,500,000
- City of Rijeka 2006, 2007, 2008[8] 24,600,000
- City of Split 2006 4,000,000
- City of Split 2007 8,100,000
- City of Split 2008 8,200,000
- City of Vinkovci 2007 5,700.000
- City of Osijek 2007 3,400.000

All municipal bonds issued by local government in Croatia were listed on Regulated market in The Zagreb Stock Exchange.

Macedonia does not have municipal bonds yet, but in 2011 over sixty municipalities can make borrowing for their capital projects by issuing bonds. The city of Skopje had prepared primary issue with total amount of 4,9 mil EUR but until today they did not realized it[9].

[6] Source: Zagreb stock exchange, http://zse.hr/default.aspx?id=26476
[7] These are rounded figures.
[8] Bonds issued by the City of Rijeka had three tranches.
[9] Formal decision for issue of municipal bonds for City of Skopje can be found at this URL: http://ipserver.skopje.gov.mk/e-

Municipal bond market in Montenegro is very specific. According to some criteria it cannot be consider as a market. In Montenegro municipalities make primary issue of municipal bonds to known buyer, which is always Investment Development Fund. It is a form of state financial aid for local governments for project of infrastructure and ecological importance, established in 2006. Montenegro exchange only registers the primary issues of these bonds, but Investment Development Fund buy them at the same day. There is not secondary market for these bonds. These municipalities had been financed until now (in EUR):[10]

• Mun. Bijelo Polje	28/09/2006	1,250,000[11]
• Mun. Nikšić	28/09/2006	1,300,000
• Cap. Cetinje	08/12/2006	965,000
• Mun. Pljevlja	28/12/2006	1,250,000
• Mun. Rožaje	08/12/2006	746,000
• Mun. Andrijevica	20/02/2007	435,000
• Mun. Berane	20/07/2007	622,000
• Mun. Žabljak	20/02/2007	392,000
• Mun. Plužine	16/05/2007	622,000
• City of Podgorica I	16/05/2007	1,000,000
• Mun. Danilovgrad	13/06/2007	812,000
• Mun. Kolašin	18/07/2007	995,000
• Mun. Šavnik	18/07/2007	400,000
• Mun. Bar	21/12/2007	600,000
• Mun. Plav	21/12/2007	311,000
• Mun. Budva	25/07/2008	750,000
• City of Podgorica II	24/09/2009	1,071,000

In Republika Srpska[12] transition to a market economy and dealing with the increasing pressure of urbanization and decentralization, local governments are forced to find new ways to finance the growth and development communities. A new era in the development of financial markets and local communities began in 2007 with the adoption of the Low of debt and guarantees in Republika Srpska, this law enabled the cities and municipalities, with the approval of the Ministry of

skopje/sluzben%20glasnik%20so%20konverzija.nsf/f0bffbc54d86a5a080256a22004f4875/da5a4f2d4b51c763c1257a7f0025e9b8?OpenDocument

[10] Official web page of Investment Development Fund, http://www.irfcg.me/upravljanje-porteljom-hov-a/portfelj-irf-a/obveznice, visited on 26th February 2013

[11] We used round figures for the purpose of this paper, original figures can be found at the web page referenced at the previous footnote

[12] Federation of Bosnia and Herzegovina does not have municipal bonds issues until 2013.

Finance to borrow by issuing bonds. The following cities and municipalities had emissions (in million EUR):[13]

• Mun. Laktaši – first issue	23/06/2008	5,000,000
• Mun. Gradiška – first issue	03/03/2009	1,350,000
• City of Bjeljina	03/08/2009	5,500,000
• Mun. Šamac	18/09/2009	230,000
• Mun. Istočni Stari Grad	04/06/2010	250,000
• Mun. Kotor Varoš	10/06/2010	2,250,000
• Mun. Brod	11/06/2010	2,000,000
• Mun. Srbac – first issue	04/10/2010	750,000
• Mun. Gradiška – second issue	31/11/2010	3,500,000
• Mun. Srbac – second issue	18/01/2011	500,000
• Mun. Kneževo	20/01/2011	2,800,000
• Mun. Laktaši – second issue	29/04/2011	4,500,000
• City of Banja Luka	18/07/2011	3,500,000
• Mun. Osmaci	23/09/2011	170,000
• Mun. Kostajnica	29/09/2011	350,000
• Mun. Zvornik	07/10/2011	150,000
• Mun. Lopare – first issue	08/10/2011	210,000
• Mun. Petrovo	26/01/2012	200,000
• Mun. Lopare – second issue	07/02/2012	130,000
• Mun. Trnovo	12/04/2012	420,000
• Mun. Šipovo	20/06/2012	80,000

Regarding to the presented data we can conclude that Croatia, Montenegro and Republika Srpska, BiH recognized municipal bonds as appropriate capital market mechanism for funding the development of their regions through infrastructure projects. Macedonia had several attempts to issue their first bonds for City of Skopje, but did not finish the first issue until now.

4. REPUBLIC OF SERBIA

Capital market in Serbia has not been developed enough and its main characteristics are lack of liquidity, small depth and with and symbolic volume of operations in compare to developed world stock exchanges. The initial good start, after changes in the social structure was not used in the right way (IPF, 2013), so now our capital market is at the bottom, compared with the countries in the region. Therefore, it is necessary to follow good experience of others and to establish best market in the domestic financial market. One way was to enable local governments

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[13] Official web page of Banjaluka Exchange, http://www.blberza.com/v2/Pages/securitylist.aspx?tier=om%3a12%2cfm%3a9%2cfm%3a13, visited on 26th February 2013

to issue and trade bonds on the stock exchange and we already point out that countries in the region recognized the opportunity before us.

According to Law on financing local government in Republic of Serbia (2006, p. 2) local government can collect on its own territory: property taxes, excluding taxes on the transfer of rights and inheritance tax and gift; Local administrative fees; The local utility charges; Local taxes; The fee for the use of land; Charges for construction land; Charge for the protection and improvement of the environment; Revenue from the concession fees for municipal; Income from operations and other concession that local governments concluded in accordance with law; Fine imposed in misdemeanor proceedings for offenses prescribed by the council of local governments, and confiscated assets in such proceedings; Income from rentals and the use of state-owned property used by local governments and indirect beneficiaries of its budget; Income from the sale of items used by local governments and indirect beneficiaries of its budget; Income through the activities of agencies and organizations of local governments; Income from interest on funds from the budget of the local government; Income from donations to the local authority; Income from self-contributions and other revenues stipulated by law. Beside these, local government can also use shared revenues, transfers, income from *borrowing* and other revenues and income.

The current legal framework (*Law of public debt*) also allows local governments to borrow at home and in a foreign country, in domestic and foreign currency or by issuance of securities. The raised funds could be used for financing the liquidity deficit, which is caused by imbalances between revenue and expenditure, as well as for long-term financing or refinancing capital investment expenditures which were planned by the local government budget. Local governments can borrow money from financial institutions (through open competitive procurement of loans and finance lease) or from investors in the capital market through issuing municipal bonds. Decision on borrowing had to be made by the competent authority of local government, upon the prior opinion of the Ministry of Finance.

There are, however, certain legal restrictions on long-term local borrowing for capital investment projects: the amount of outstanding long-term debt cannot exceed 50% of total operating revenues of the budget of the local government in the previous year; the amount of principal and interest in any particular year on all outstanding long-term debt cannot exceed 15% of total operating revenues of the budget of the local government in the previous year and the total public debt of the Republic of Serbia must not be greater than 45% of gross domestic product.

In the Republic of Serbia first local government which made steps toward emission of municipal bonds was the City of Novi Sad, whose experience in the process of issuing bonds was more than positive. As the first local government, the City of Novi Sad met with many challenges. For instance, in order to provide the first bond issue it was necessary to change and adapt to certain legal regulations: The SEC had to change several secondary legislation (Tariff code, which reduces the fees of the Commission to a maximum of 500 thousand RSD; Rulebook on the content and form of the prospectus and other documents submitted for the purpose of issuing securities; The National Bank of Serbia is due to the adoption of the new Law on Pension Funds has adopted a new Decision on conditions and investment of pension funds, which allowed pension funds to participate in the purchase of municipal bonds and The Ministry of Finance has expressed an opinion in which he accepted the International Finance Corporation (IFC) can invest in municipal bonds).

Issuance of municipal bonds of the City of Novi Sad has raised interest of all participants in the financial market. On the side of local investors six banks and one broker&dealer company gave a quote for the underwriter. Pension funds have also expressed an aspiration to participate in this process, as well as several insurance companies. Table 4 contains the list of bonds underwriters with amount of emission and interest rate.

Table 4. List of municipal bonds underwriters in the case of City of Novi Sad

The name of underwriter	**Emission amount (mil EUR)**	**Effective interest rate**
Bank consortium: Banca Intesa , Societe Generale Bank, Komercijalna Banka i Hypo Alpe-Adria-Bank	35	6.44%
UniCredit Bank	35	6.25%
Consortium: Citadel Securities & Renaissance Capital	35	7.79%
Bank consortium: Erste Banka ad Beograd i Erste Group Bank AG Wiena	35	6.87%

Source: Internal documentation of the City of Novi Sad

On the side of international investors, as already mentioned, the IFC has expressed an aspiration to be a part of the customer programs, while USAID has provided a guarantee of the U.S. Treasury for guaranteeing one share of the principal municipal bonds.

By issuing municipal bonds the City of Novi Sad got funds under favorable conditions in compare to banking loans. In fact, in the public procurement of loans, the best offer that met all the requirements of the public invitation had fixed the effective interest rate of 7.5% for 12 years (2 year grace period and 10 years of debt repayment) and was offered the consortium comprised: Banca Intesa, Hypo Alpe-Adria-Bank and Societe Generale Bank. On the other hand, the offer submitted by the underwriter, UniCredit Bank, the implied guarantee the issuance of bonds by the maximum effective fixed interest rate of 6.3%, with the same maturity as the bond was a loan. The effective interest rate for the bond consisted of coupons in the amount of 6.2% and fees for underwriting. As a result of comparison of these two options for financing projects the following conclusions can be made:

- The City of Novi Sad will be charged with the effective interest rate, which is 1.3% less because they chose a more flexible way of borrowing through the issuance of municipal bonds,
- Savings, in absolute terms, is over 3 mil EUR, which is significant.

Another city in Serbia that took the opportunity of borrowing through issuing municipal bonds is City of Pančevo. They made the bond issue on 20th June 2012. The first series of municipal bonds was at amount of 1 mil. EUR, with a maturity of 7 years (1 year grace period) and an interest rate of 9.5%. The underwriter of entire issue was Komercijalna banka and Banca Intesa. With issuance of municipal bonds, the city of Pančevo has saved few thousands of euros, because they provided lowest interest rate on submitted bids for the loan - 9.9%. The raised funds will be invested in the five capital projects. They are using funds for the design and begin construction of two industrial zones, the reconstruction of one street in the city, building battlements in the barrack "Rastko Nemanjić" and create documentation for the construction of the first town the Olympic pool.

In close future we are expected new borrow by issuing municipal bonds in the city of Užice, Aranđelovac, Kikinda, Beograd, Požarevac, Pirot, Ruma and Valjevo. All cities and municipalities reported issuance of bonds worth more than 100 million euros.

5. CONCLUSIONS

The time of crisis force each country to find an optimal balance between borrowings and stimulate economic growth. The problem is significantly compounded in cases when government needs to provide adequate funding for balanced regional development. One way to overcome this problem is to create the conditions for the issue of municipal bonds through which the cities and municipalities could finance themselves, according to own plans and budgets. The main reason for this is the advantages of municipal bonds: stimulating the development of quality projects, the possibility of obtaining funds under favorable conditions, diversification of risk, tax relief, encouraging the development of entrepreneurship and regional economic development. In countries with highly developed financial markets this type of financing is widespread while the other countries follow the good example.

Market of municipal bonds in the Western Balkan is relatively new and undeveloped. Croatia and Republika Srpska, BiH have the most developed market in the region and Montenegro has specific use of these securities, while Serbia started with first issue in 2011. Macedonia started, but did not finish first emission of municipal bonds for City of Skopje until March 2013.

The tendency that has been observed in the capital markets of WB countries, especially in the last few years, indicates that municipal bonds are very attractive way to finance local governments. This way cities and municipalities in the region have a scheme to finance their projects, run regional economic development, to mitigate and overcome the consequences of the last crisis.

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