

# BONDS OF LOCAL GOVERNMENT IN MONTENEGRO

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**Abstract**—General market characteristics of Montenegro are weak development and insufficient transparency, which greatly reflects on a number of achievable capital investments in the previous period. Lately, local government is forced to join emission of bank notes property, which will suffice needs for the missing fund.

**Keywords**— bonds, capital investments, bank notes market

## I. INTRODUCTION

**P**UBLIC policy (interest) and capital investment decisions are among the most important (in terms of long-term impact and influence in general) that local governments can adopt. In the past, capital investments are funded on the basis of current income, not on the loan basis. The reason for this was that infrastructure investments are financed either from direct subsidies from the central government or by the current revenue of certain municipalities.

However, based on the lack of investment during the nineties and the decentralization of various responsibilities to the local government in Montenegro, it is not longer possible to finance the necessary infrastructure investments based on the current income only. Thus, local governments in Montenegro are forced to raise revenues from their own resources and access domestic and international financial markets.

Montenegrin law has enabled an environment in which the municipal loans are possible. The general framework is defined by the Bonds Law 1, which emphasizes that the bonds issue can be a municipality in Montenegro, while the Budget Law 2 shows that local government units may take long-term loans and guarantee, with the previous consent of the Government, and at the same time it is defined that the Government may take into consideration the overall macroeconomic situation while giving consent for these requirements.

The system for municipal borrowings is determined by

the Law on Financing Local Governments (Chapter VI, Articles 60-65). The law is in concord with the European Constitution and it states that the municipality may be indebted by issuing bonds or taking loans. The law clearly outlines the difference between short-term (whose purpose is to meet short-term liquidity needs, while payments program should not exceed 12 months - Article 61) and long-term loans (Article 62 defines this as any loan with repayment program which exceeds 12 months). At the same time, the law sets limits on loans - a municipality may be indebted in a way that the total payments of principal and interests, lease contract payments, payment obligations for the previous period, and any other obligations that are in the form of debt cannot exceed 10 % of the realized current income in the year preceding the year of the loan, and only with a prior approval of the Government.

## II. THE FRAMEWORK OF BONDS ISSUANCE BY LOCAL GOVERNMENTS IN MONTENEGRO

Municipal bond (bond of local governments) is a loan that allows the local governments to borrow money from bond buyers. The most flexible mechanism for funding is municipal bonds issuance. Municipalities gain necessary capital by selling / issuing bonds for a few days period up to a period of 30 or 40 years [1]- [3]. The municipality (issuer) signs a contract to the compensation to borrowing party (bondholders) through periodic interest payments in the form of coupons. But also to pay off the original sum (amount) on a specified date, which is also known as the bonds maturity. Approximation of time series presented later in the paper was made using the methodology from [4].

The advantages and disadvantages of a municipal bond are shown in Fig. 1.

Municipalities in Montenegro have to explore, facilitate and support new mechanisms for financing public infrastructure and one of the options are bonds.

<b>The advantages of municipal bond</b> <b>Competition among investors may reduce interest rates</b> <b>The municipality builds a direct relationship with investors</b> <b>Timely payoffs help the municipality have a public record of a credit rating</b> <b>By issuing detailed disclosure of financial state municipality promotes transparent management</b> <b>A number of issued bonds gives the investor access to the credit rating of municipalities</b>	<b>Disadvantages of municipal bonds</b> <b>Credit rates and other costs of broadcasting can be significant, particularly for broadcasting small bonds.</b> <b>Issuance of bonds is not suitable for small loans</b> <b>Detailed financial disclosure requires a lot of time</b> <b>Preparations for issuance may take a long time</b>
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Fig. 1. The advantages and disadvantages of municipal bond

The main legal provisions that allow municipalities to issue bonds are incorporated in the Montenegrin legal system. As indicated in national legislation, municipalities in Montenegro are authorized to issue/offer bonds offered through public or private offerings.

The primary legislation defines a standard procedure for the issuance of municipal bond through Rules on the conditions, Regulation for issuance, recording and trading with short term and indebted securities. Other key elements of the legal framework are: Republic's Instructions for creating a special list for trading, Bonds, Bonds of local governments and Rules on content, terms and manner of publication of financial statements of issuers of securities.

On the basis of such regulations, the Securities Commission has begun an intensive implementation that leads to a large number of sanctions that are imposed on issuers which didn't establish an obligation to provide reports within the deadline prescribed by these regulations. These activities resulted in an increase in the discipline of the market players and the development of public information booklet which contains more than 8,000 pages of financial statements and is subject to constant updates that will contribute to greater reserving information about market players [5]- [9].

However, this mechanism is a novelty for Montenegro and it should be clarified quickly and carefully to all stakeholders - municipalities, investors, those who mediate or regulate it in public. Development of a functioning market for municipal bonds is part of a wider development of the capital markets/securities market in Montenegro, which is not at full speed.

### III. CURRENT SITUATION AND PROSPECTS

Similar to other capital markets in the region, the structure of the Montenegrin market is characterized by the dominant existence of shares. In addition, different types of debt securities were present in the early stages of its establishment, and only short-term securities were available, which served to increase liquidity. The buyers

of these securities were only commercial banks.

Outside shares and short-term securities, capital market in Montenegro are engaged in so-called "old-saving-by-currency" securities, with the ability to be used as currency in the privatization process. The Government of Montenegro has put securities for the reconstruction of roads and road infrastructure in the country with a total value of EUR 1.2 million. These are long-term securities, with an annual interest rate of approximately 3% and three-year grace period to pay. In all the above cases, it was known that customers come from existing management structures.

The municipal bond market in Montenegro is making a large number of controversies: according to some authors, the overall strategy for establishing a market for municipal bonds was misleading and led to the de facto its nonexistence.

The market is under the control of the Development Fund; who in their portfolio has a number of other bonds and securities (e.g. from the Restitution Fund; Securities saving the old currency; securities issued by the Ministry of Finance, etc.). The total number of municipal bonds in its portfolio is 11.5 million Euros, but secondary market is not functioning.

Hence it follows that after the initial work on establishing a municipal bond market in Montenegro, there is a need for further development and improvement. The main challenges for the establishment of the functional municipal bond market are those relating to human resources and the establishment of a secondary market.

Municipal workers have limited knowledge and understanding of the general aspects of municipal bonds and opportunities that arise from the functional municipal bond market [10]- [14]. All municipalities in Montenegro are facing difficulties in preparing documents for the issuance of municipal bonds; creditworthiness of the municipality is low and needs to be considered. As indicated in Table 1, municipal bonds, which have already been issued, were sold to a known buyer - Fund for development, which resulted in a lack of real secondary market for bonds.

Municipalities in Montenegro which are issuers of bonds are shown in Fig. 2.

TABLE 1.  
 MUNICIPALITIES OF MONTENEGRO AND A NUMBER OF BONDS ISSUED

<i>Municipalities</i>	<i>The total number of issued bonds</i>	<i>Nominal</i>	<i>Date</i>	<i>Secondary trade</i>
<b>Andrijevica</b>	435.407	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Berane</b>	622.125	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Bijelo Polje</b>	1.249.255	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Cetinje</b>	965.531	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Danilovgrad</b>	812.000	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Kolasin</b>	995.400	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Niksic</b>	1.306.452	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Podgorica</b>	1.244.243	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Pluzine</b>	622.613	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Plevlja</b>	1.244.243	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Rozaje</b>	746.410	1 EUR	Series from 2009 to 2015	Bonds included in the market – there is no secondary trading
<b>Savnik</b>	400.001	1 EUR	Series from 2010 to 2016	Bonds included in the market – there is no secondary trading
<b>Zabljak</b>	392.000	1 EUR	Series from 2010 to 2016	Bonds included in the market – there is no secondary trading
<b>Bar</b>	599.998	1 EUR	Series from 2010 to 2016	Bonds included in the market – there is no secondary trading

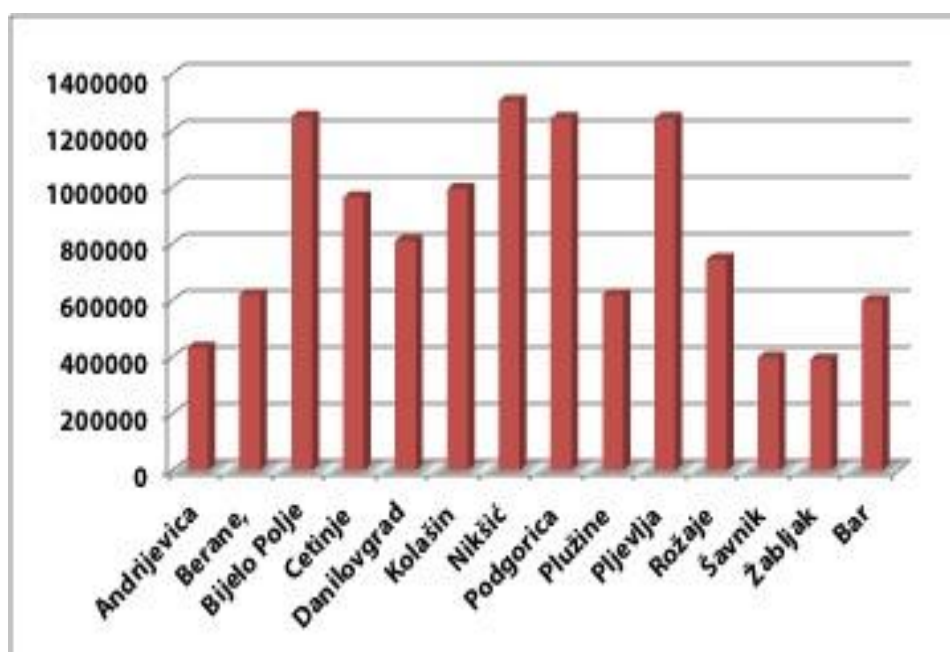


Fig. 2. Municipalities in Montenegro which are issuers of bonds

The entire mechanism and the concept are relatively unknown and it needs to be clarified to the municipalities and to all stakeholders - municipalities, investors,

intermediaries and the public [15]- [19]. Development of a functional municipal bond market should be seen as part of a wider development of the capital markets /

securities market in Montenegro. The further development of secondary markets and open trade with municipal bond is especially important.

The municipalities in Montenegro have to work on the preparation of mature and fully functional capital investment projects that can be funded through municipal bonds broadcasting. One of the main prerequisites for the broadcasting of municipal bonds is financial reporting, particularly municipal balance sheet [20-24].

#### IV. CONCLUSION

Following the example of the lack of investment in the nineties and the decentralization of various responsibilities to local governments in Montenegro, it is not longer possible to finance the necessary infrastructure investments based on current income. That is why today the local governments in Montenegro are forced to raise revenues from their own resources and approach to domestic and international financial markets.

Local government of Montenegro have been given the legal possibility of issuing its own securities.

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