



Report of the State Comptroller of Israel |
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Systemic Issues

Loans and Credit Sources of Various Entities



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Background

Credit sources, such as loans and debt through bond issuance (Bonds), are crucial for any economic entity. On the one hand, proper and controlled leverage can bridge cash flow problems, maximize the entity's profits and enable its development and thriving. On the other hand, leverage at an unreasonable level holds many risks, such as economic instability and even, bankruptcy.

The Compulsory State Loan Law 1979 enables the government to borrow money for the state's needs and thereby maximize the benefits arising from the issuance of Bonds. Accordingly, the Accountant General's Division in the Ministry of Finance handles the process in a centralized manner. On the other hand, various entities – government companies, local authorities, municipal corporations, health funds, and statutory corporations – can issue Bonds and take loans within certain limits. Several financing options are available to the above mentioned entities: banks, the private loans market (institutional investors – pension funds, insurance companies, study funds, and provident funds), bonds issued to the institutional investors in a private offering, and bonds issued on the stock exchange in a public offering.

This report reviews the financing methods of government companies, local authorities, municipal corporations, health funds, and statutory corporations and presents the extent of change in the financing methods over the years and their adaption to the credit market changes.



Key Figures

**NIS 80
billion**

total corporate bond issued in the entire economy in 2021

**NIS 15
billion**

the burden of loans¹ of the local authorities as of December 31, 2019

2.01%

the ratio of local authorities' debt to GDP in Israel (low compared to most OECD member states)²

82%

of the local authorities loans approved by the Ministry of Interior, at about NIS 12.8 billion, are taken from four out of 15 banks

63%

the traded debt ratio of the total government companies bonds, compared to the traded debt ratio of corporate bonds, which is 92% as of 2021

only 4

local authorities issued municipal bonds before 2006. Compared to the municipal bond market in the United States at USD 4 trillion for 2021

100%

the financing sources of the health funds in 2020 are based on short-term credit facilities (NIS 709 million)

**NIS
2,076
million**

the financing expenses of government companies in 2020

Audit Actions



From July 2021 to March 2022, the State Comptroller's Office examined aspects of the various modes of financing of multiple entities: government companies, local authorities, municipal corporations, health funds, and statutory corporations. The examination included a review of the potential and competitive financing routes available to the entities above: bank credit, institutional credit, and non-bank credit, bonds issued to institutional investors in a private offering, and bonds listed on the stock exchange in a public offering. The examination was conducted in the following bodies: the Ministry of Interior – at the Municipal Corporations Division and the Budgets Division; The Ministry of Finance – at the Accountant General's Division and the Budgets Division; The Ministry of Health – at the Control over Health Funds and Additional Health Services Division

¹ The balance of the loans that each local authority must repay in the following years.

² Figures correct for 2018.



(Shaban); The Government Companies Authority, including the Listings Unit and the Airports Authority. Completion examinations were conducted at the Securities Authority and the Center for Local Government.

Key Findings



The Debt Ratios of the Local Authorities – the balance of the loans the local authorities must repay in the following years (the burden of loans) as of December 31, 2019, was about NIS 15 billion; most of the loans are bank credit. For the local authorities, credit is a source of financing for financial and operational efficiency and development projects contributing to the economic growth of the authority. The ratio between the local authorities' debt to the GDP in Israel (2.01%)³ is low compared to most OECD member states. The ratio between the local authorities' debt to the public debt in Israel (2.83%) is also low compared to most OECD member states.



The Approval and Control Procedure for Granting Credit Permits to Local Authorities by the Ministry of Interior – in 2019–2021, the Ministry of Interior granted local authorities permits for loans at about NIS 15 billion. The audit raised that (a) the Ministry of Interior's work procedure for credit approval was not distributed to the local authorities and is not published on the Ministry of Interior website; (b) the procedure has not been updated since 2010, despite the transformations and changes in the credit market; (c) the Ministry of Interior headquarters has not formulated a procedure for all the districts regarding the method of checking the application for credit permits – from the application submission by the local authority until its approval by the authorized body – and each district in the Ministry of Interior checks the permit according to its professional discretion; (d) the Ministry of Interior's examination of the loan is almost identical to the examination by the districts themselves and creates unnecessary bureaucracy.



The Time Required for the Ministry of Interior Approval of the Local Authorities' Requests for Loan – it was raised that the average time for the approval of such a request – from the submission date by the Northern District to the Ministry of Interior Administrative Headquarters until the approval date by the Ministry of Interior Administrative Headquarters – is 49 days. It should be noted that this period does not include the review duration of the loan application by the district itself. Furthermore, five cases (13%) were found where a request was approved after 100 days. Approval of a loan application after a prolong period of time delays the loan acceptance procedure. Moreover, in such periods, the loan terms offered by the banks can change

3 The figures are correct for 2018.



substantially, and the banks can even begin the loan approval process again, thus delaying the process.



Determining Parameters or Limitations by the Ministry of Interior Regarding Loan Routes Taken by Local Authorities

– differences were found between the terms of loans approved for the local authorities; thus, the maximum interest rate on loans not based on a prime-based variable interest rate is 7%, and the maximum interest rate for a prime-based variable rate loan is 3.38%. However, the Ministry of Interior did not set parameters or limits regarding the loan routes taken by the local authorities. The loan route (indexed, variable interest rate, etc.) may affect the financial resilience of the local authority and the risk it is exposed to. For example, development loans are often considerable volumes of loans for long periods. During the loan period, many changes in the market are expected, such as changes in the Bank of Israel interest rate, inflation rates, or government bond yields, and they may directly affect the pricing of the loans.



Diversification of Banks' Credit Taken by Local Authorities and Loan Recycling

– 82% of the local authorities loans are from four out of 15 banks: Bank A, Bank B, Bank C, and Bank D⁴. It was found that there are no Ministry of Interior instructions to local authorities to compare the various banks loans before taking the credit, and a local authority may contact one bank only and take a loan from it without getting price offers from other banks. Moreover, out of about NIS 15 billion in loans taken by the local authorities, 48 authorities recycled debts of about NIS 2.1 billion (approximately 15% of the total volume of loans taken) in 2019–2021. The Ministry of Interior did not recently organization-wide instruct local authorities regarding options to save in financing expenses by recycling a loan due to a low-interest rate environment.



Issuance of Bonds by Local Authorities

– since 2006, no municipal bonds have been issued by local authorities. Only four out of 257 local authorities issued municipal bonds, only in 2005–2006. The total par value issued was about NIS 470 million, compared to the municipal bond market in the USA of about USD 4 trillion in 2021. Moreover, to issue bonds, the local authority must publish a prospectus, including financial statements prepared according to generally accepted accounting principles. However, the local authorities' financial statements are not prepared according to generally accepted accounting principles, and therefore they cannot be submitted to publish a prospectus for the issuance of bonds.



Credit Permits for Municipal Corporations

– 59% of the total loan permits granted to municipal corporations in 2020 are for Tel Aviv-Yafo Municipality. It was also found that four resilient municipal corporations were required to apply to the Ministry of Interior for credit permits to issue guarantees in immaterial amounts (between NIS 9,000 to NIS

⁴ It should be noted that Bank D provides loans to the local authorities that are in the recovery plans, and against these, it is given assignment of rights at the rate of 25%–45% of the balancing grant of the local authorities receiving the loan.



47,000) compared to the scope of their financial activity, which is tens to hundreds of millions of NIS, and this is for participation in official calls for bids and government tenders.



The Financing Methods of the HMOs – the HMOs do not use additional financing alternatives other than the arrangement of short-term credit facilities for a total of NIS 709 million as of December 31, 2020. Maccabi Health Services is the only HMO that presents long-term loans in its financial statements, as companies held by it take long-term loans, and on December 31, 2020, the balance of these loans was about NIS 461 million. These differences in the loans in the long run can create a difference between the health services provided to the public since a fund that takes long-term loans will be able to carry leveraging and expand health services to its insured. In contrast, a fund that does not take long-term loans will have more difficulty constructing long-term projects.



The Financing Methods of the Airports Authority – although the Airports Authority's Finance Committee recommended in September 2020 to issue institutional bonds for the long term, until May 24, 2021, the Authority had utilized NIS 465 million from the short-term credit facilities. It should be noted that after the audit completion date, at the end of June 2022, the Authority issued bonds to institutional investors.



Costs of Issuing Bonds in Government Companies Compared to Issuing State Bonds – on December 31, 2021, the scope of government companies' bonds was about NIS 32 billion. By analyzing issuances by government companies (Israel Ports Company, Israel Electric Corporation, Mekorot, Rafael, Israel Natural Gas Lines, Energy Infrastructures Ltd., and Israel Railways) in 2019–2021, their average margin compared to the government bond yield is 0.73%. Hence, the financing cost of government companies' debt and not of the state is estimated at millions of NIS.



Procedure for Distributing a Shelf Prospectus of Government Companies – one of the means to increase the accessibility of corporations to the capital market and to ease restrictions is the publication of a shelf prospectus that allows the corporation to offer securities to the public at any time during 24 months from its publication date. According to the Securities Regulations (Period for Placing Orders for Securities Offered in a Prospectus), 2005, when expanding a series of securities, a company can make an issuance in seven hours, of which five hours are trading hours, i.e., this procedure is meant to be short. However, the Government Companies Authority does not have a procedure regarding the entities to whom the shelf prospectus and all relevant documents must be distributed. Furthermore, the Government Companies Authority does not set a time limit for receiving responses from the relevant government ministries, and the approval process can be prolonged. Therefore, the additional time for issuance based on the shelf prospectus for government companies is in practice about ten days to two weeks, and even more so in cases where comments are received from the relevant ministries.



The Rate of Tradable Bonds of Government Companies – at the end of 2021, the rate of bonds issued by government companies to the public is 52%, while 36.59% are issued on Tact-institutional. This is compared to the traded debt rate of corporate bonds, which was 92% in 2021. However, it should be noted that in the last seven years, the traded debt rate of government companies increased by 3.25 times, from a rate of 16% to a rate of 52%.



The Activity of the Listings Unit at the Government Companies Authority – the State Comptroller's Office commends the Listings Unit activity to encourage government companies to diversify their credit sources. The inherent advantage of this unit is the counsel it gives to government companies in the pursuit of maximum returns and at few restrictions as possible.

Key Recommendations



It is recommended that the Ministry of Interior consider checking the loans both by the district itself and by its headquarters; hence the loan approval procedure will be efficient and will not result in an excess bureaucratic burden on the authorities. It is also recommended that the Ministry of Interior headquarters examine from time to time the loans approval policy and the parameters for their approval, publish a relevant procedure for all districts and authorities, and monitor the policy implementation by the districts.



It is recommended that the Ministry of Interior consider formulating a loan mix policy for the local authorities and their exposure to changes in the interest rate and the index (similar to the restrictions established by the Bank of Israel in the mortgage sector).



It is recommended that the Ministry of Interior consider instructing all local authorities to obtain a price quote from several credit providers to get the best credit terms. It is also recommended that the Ministry of Interior ease the requirements for municipal corporations that request permits for loans or credit, especially for low amounts, and establish criteria, such as the amount of the loan and the type of Municipal Corporation (as is done with the local authorities, which are divided into resilient and non-resilient authorities).



It is recommended that the Government Companies Authority and the Ministry of Finance examine models to reduce the excess costs of government companies raising capital through the state. It is further recommended that the Government Companies Authority continue to encourage government companies to issue bonds to the public in the appropriate cases and formulate a work procedure to streamline approvals obtaining from

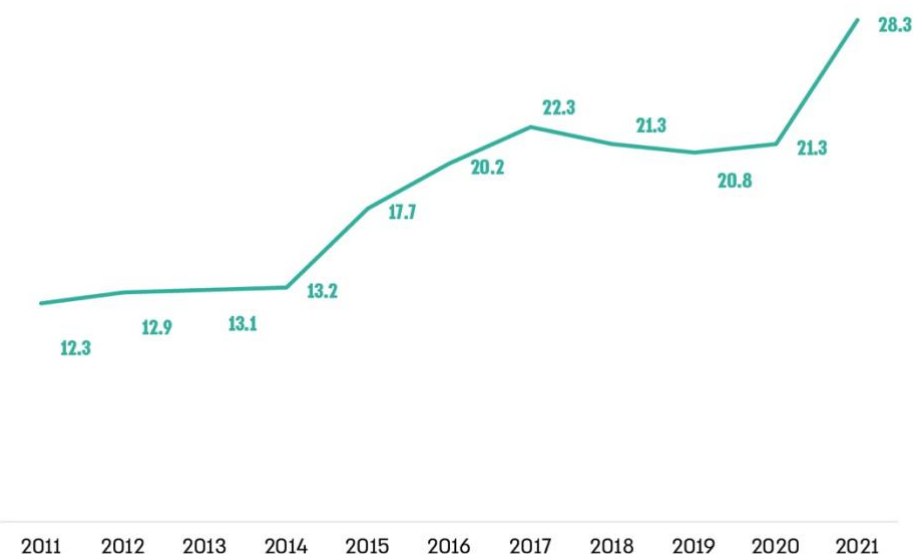


the relevant government ministries when issuing government companies bonds concerning misleading details.



It is recommended that the Ministry of Interior – in cooperation with the Accountant General, the Budget Division, and the relevant local government agencies – consider an outline for local authorities bond issuances, diversifying their financing sources. It is also recommended that the Ministry of Interior consider the transition of local authorities to report on a government accounting standard basis and present the data in the financial statements on an aggregated basis. This, among other things, will enable the authorities to meet the conditions required for listing securities on the stock exchange. Alternatively, it is recommended that the Securities Authority consider, in cooperation with the Ministry of Interior, issuance of municipal bonds regulation, considering the currently accepted accounting in the local authorities.

The Development of Local Authorities' Debt and Other Public Corporations Whose Debts are Included in the Public Debt, 2010–2021 (in NIS billions)



According to data from the Ministry of Finance, processed by the State Comptroller's Office .



Summary

The expansion of the financing sources of the various government entities and their diversification is significant to strengthen economic growth, encouraging and refining the tradable and non-tradable capital market, and creating alternatives to bank financing. Refinement and development of the capital market in Israel are expected to promote liquidity in the Israeli capital market, increase trading turnover on the stock exchange and improve the level of attractiveness of the local capital market for investors. All government entities usage of financing sources, such as funding from institutional bodies and the public investing in the capital market, can create an alternative to bank financing and thus increase competition in the debt markets and improve the process of interest rate determination in the banking channels as well.

The audit raised various barriers and bureaucracy imposed on the government entities, which brought most of the government entities (apart from the government companies) to choose the classic financing alternative – bank loans. In addition, some of the authorities responsible for the government entities do not encourage finding other financing solutions besides taking loans from the banks.

It is recommended that the Ministry of Finance, the Government Companies Authority, the Ministry of Interior, and the relevant authorities of the various government entities jointly find additional financing alternatives for the government entities and locate the barriers preventing these entities from turning to other financing channels (the size of the government entity, excessively high threshold requirements, incompatibility of the existing regulatory costs to the size of the government entity, etc.).