States and the Domestic Capital Markets

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19th May 2011

1. Introduction

New Dawn for Nigeria

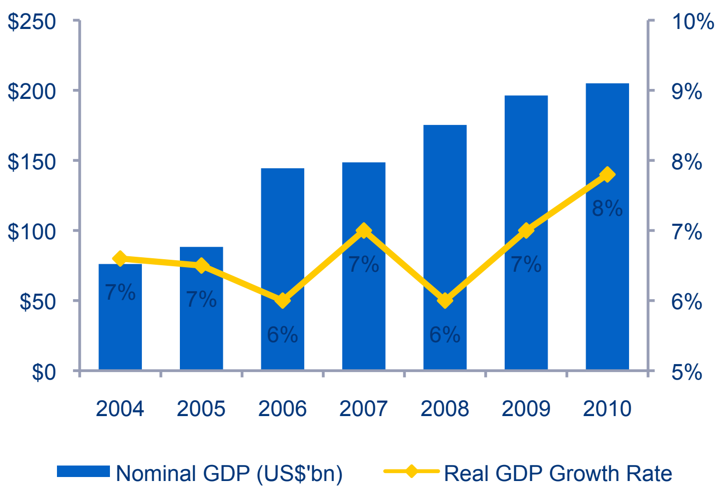
Key points

Nigeria is considered one of the fastest growing economies globally

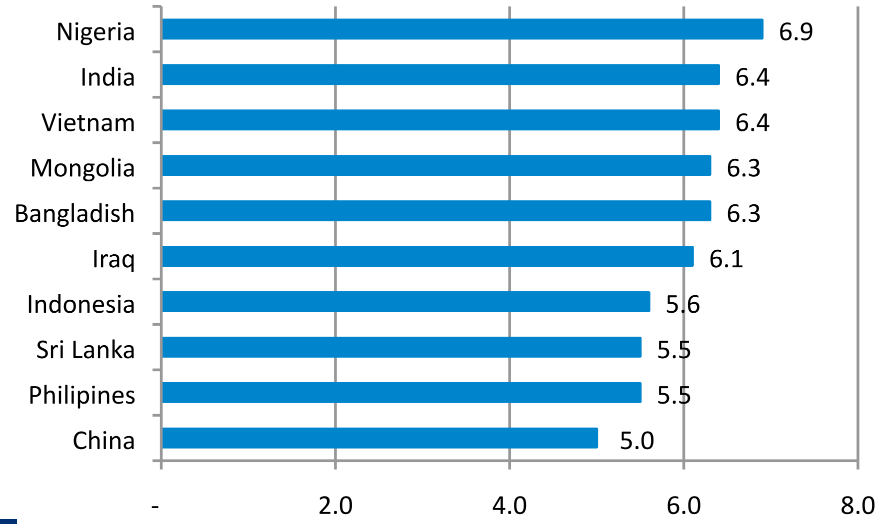
Successful elections

Sustained macroeconomic reforms

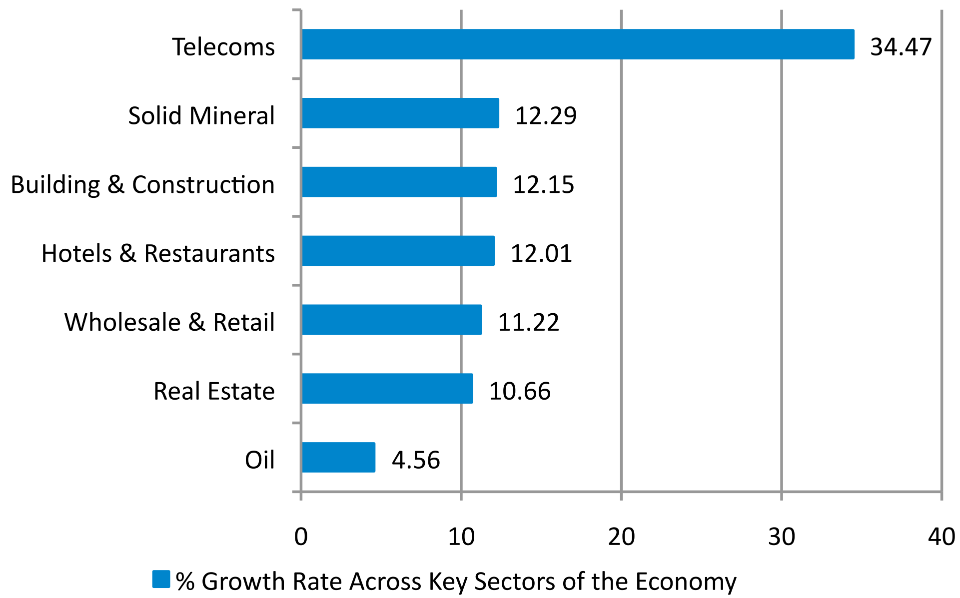
Strong economic growth



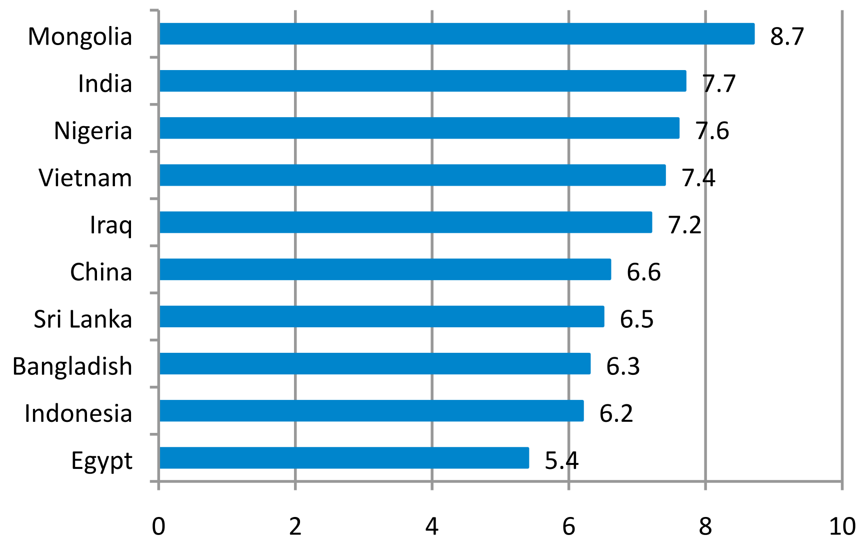
Citigroup GDP per Capita Forcast (%YoY): 2010 - 2050



Economic Growth by Sector



Citigroup GDP per Capita Forcast (%YoY): 2010 - 2030

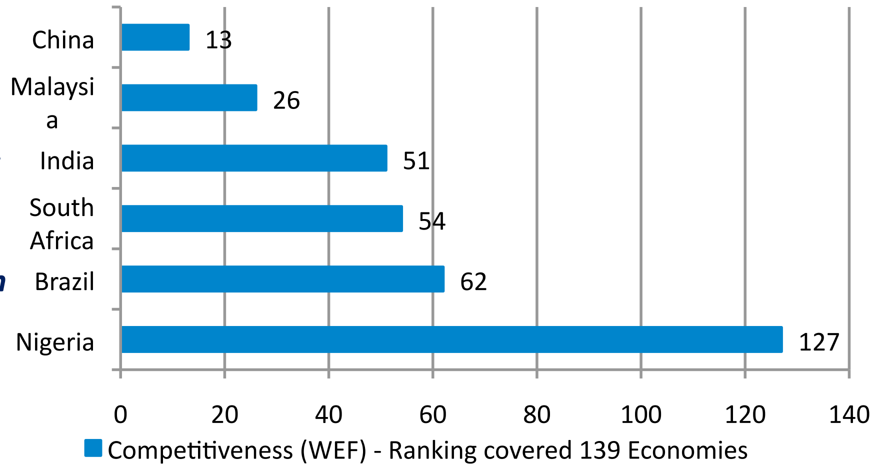


Competiveness and Social Indicators still weak

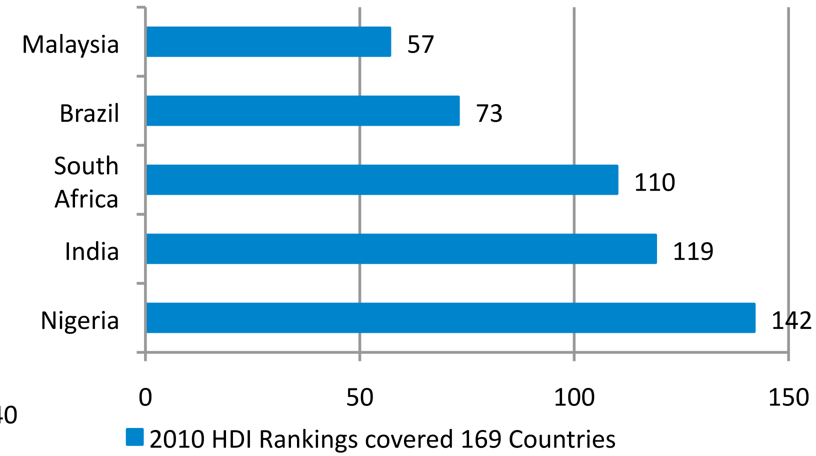
Key points

Nigeria is faced with huge developmental challenges as evidenced by its social and economic indicators which are compared with selected countries

Global Competitiveness Index



Human Development Index (HDI) Ranking



Components of the Competiveness Index - Nigeria

	Rank (out of 139)	Score (1–7)
• **Basic requirements**	**136**	**3.1**
1st pillar: Institutions	121	3.2
2nd pillar: Infrastructure	135	2.0
3rd pillar: Macroeconomic environment	97	4.3
4th pillar: Health & primary education	137	3.0
• **Efficiency enhancers**	**84**	**3.8**
5th pillar: Higher education and training	118	3.0
6th pillar: Goods market efficiency	87	4.0
7th pillar: Labor market efficiency	74	4.3
8th pillar: Financial market development	84	4.0
9th pillar: Technological readiness	104	3.0
10th pillar: Market size	30	4.6
•**Innovation &sophistication factors**	**83**	**3.3**
11th pillar: Business sophistication	76	3.8
12th pillar: Innovation	98	2.9

Component Indicators	Nigeria	SSA
Human Development Index (HDI) value	0.423	0.389
Life expectancy at birth (yrs)	48.4	52.7
Mean years of schooling (yrs)	5.0 b,q	4.5
Expected years of schooling (yrs)	8.9	9.0
Gross national income (GNI) per capita (PPP 2008 $)	2,156	2,050
GNI per capita rank minus HDI rank	-12	0
Non income HDI value	0.436	0.436

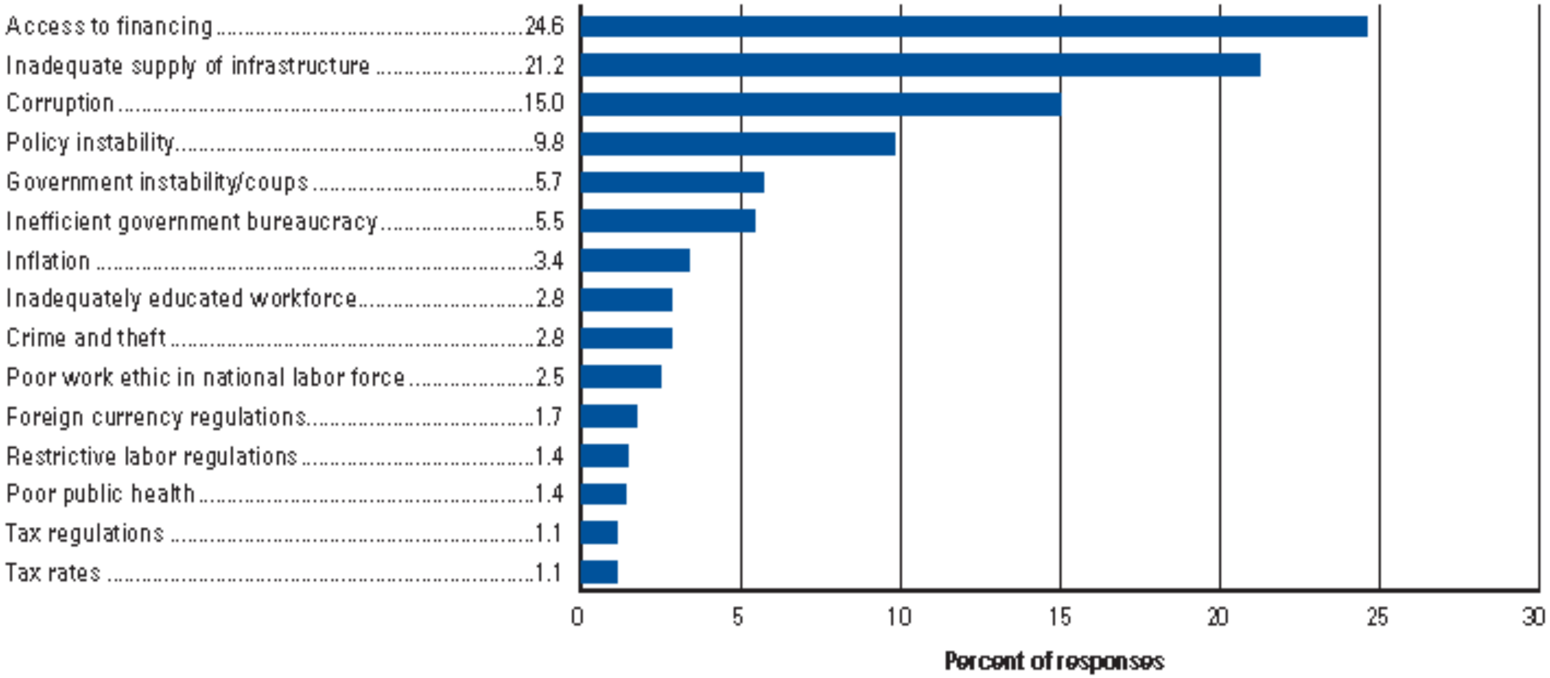
Sources: World Economic Forum and UNDP

Infrastructure is key for competitive business

Key points

Access to finance and infrastructure inadequacy are still major constraints for business development in Nigeria

The most problematic factors for doing business



Comparison with other Countries

Indicator	Nigeria	China	Brazil	India	South Africa	Malaysia
Access to Financing	24.6	13.2	6.3	6.5	4.1	10.5
Inadequate Infrastructure	21.2	8	15	18.5	7.8	6.3

Source: World Economic Forum - Global Competitiveness Report

Job creation key for Nigeria

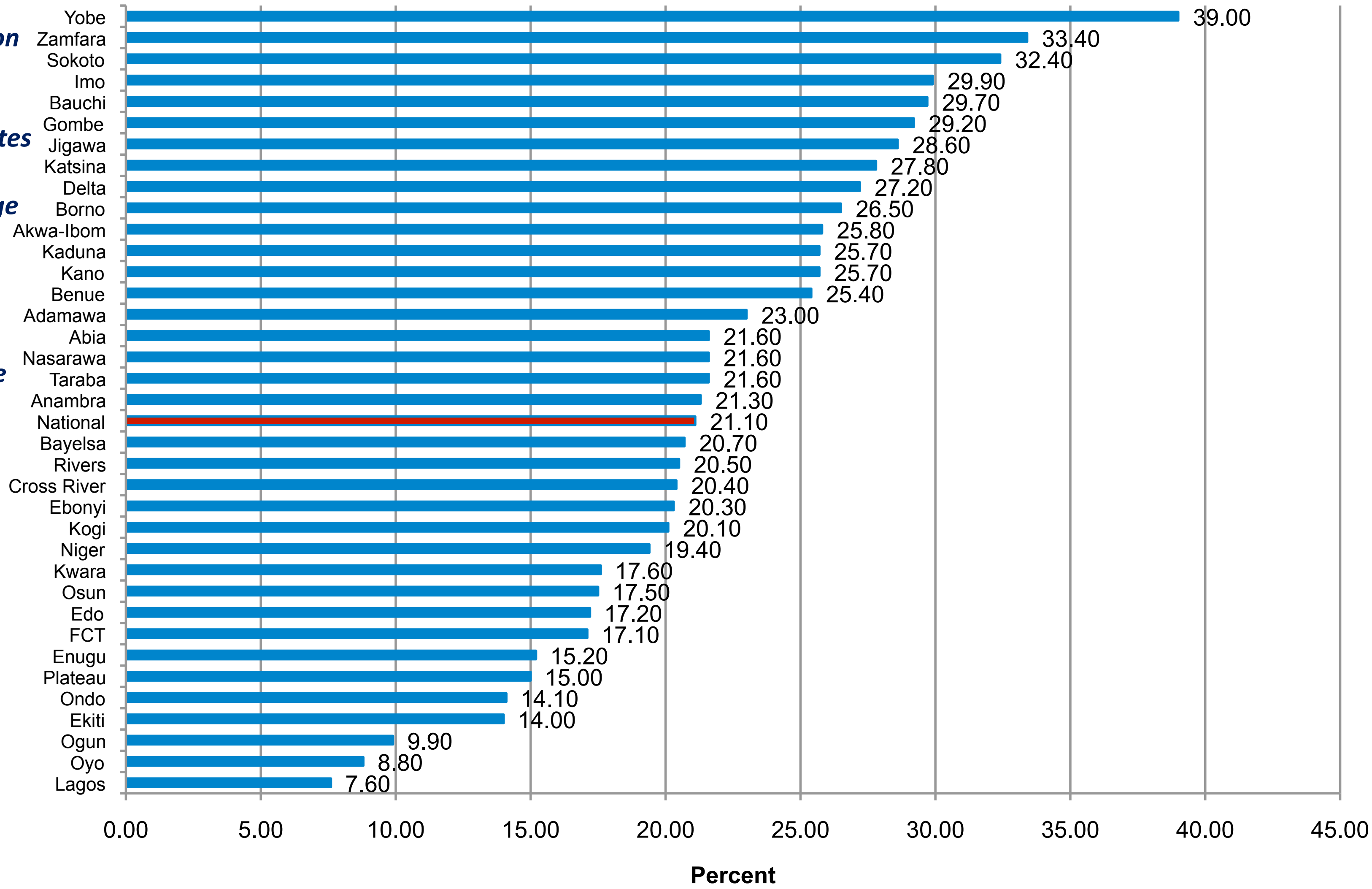
Key points

Unemployment is a key concern across the nation

19 States have employment rates above the national average of 21%

Highest Unemployment Rate among the youth

Distribution of Unemployment Rates at the subnational level as at March 2010



Sources: National Planning Commission

II. Rationale for Accessing the Capital markets

Rationale for Accessing the Capital Markets

Key points

Raising finance via the capital markets presents a compelling proposition due to regulatory reforms, amounts and tenors achievable, tapping new funding sources and overall cheaper funding costs

- Raising finance within a secure and well defined regulatory framework (ISA 2007, Section XV/ SEC Rules covering state bond issuance)
- Ability to immediately access significant lump sums, on the back of pledged stream of anticipated future cash flows (e.g., FAAC allocations)
- Diversification of funding sources (away from traditional bank credit) to include pension funds, insurance companies and other asset managers
- Cheaper funding costs now (lower coupon or interest rates) and in the long run (issuance costs spread over tenor), compared to rolling over short term bank facilities
- Obtain long term funding - bond issues by state governments currently up to 7 years in tenor, and expected to extend to even longer maturities
- Encourages strong financial management, including audited financial statements, and credit ratings
- Capital markets disclosure regime encourages transparency, accountability, thereby promoting credibility of a state's administration
- Promotes private sector visibility of investment opportunities in the State

Supportive Environment for Bond Issuance

Key points

The Nigerian capital markets are rapidly developing and increasingly viewed as a source of long term development finance.

- The Nigerian capital markets is increasingly viewed as a viable source of long term finance for infrastructure and other social development initiatives
- Traditionally, state governments have relied primarily on federal statutory allocations, internally generated revenue and short to medium term bank credit for financing their development activities
- Following recent introduction of certain fiscal and regulatory incentives aimed at boosting competitiveness of the domestic capital markets, a number state governments have successfully raised long term finance from the domestic bond market, with several others also considering
- Ongoing regulatory reform by both SEC and The NSE to streamline the issuance process and reduce overall costs of issuance have contributed towards creating an enabling environment
- The results of the above reforms are self evident, and the regulatory authorities remain committed to supporting evolution of our capital markets towards achieving world class standards

Increasing demand for State Government Bonds

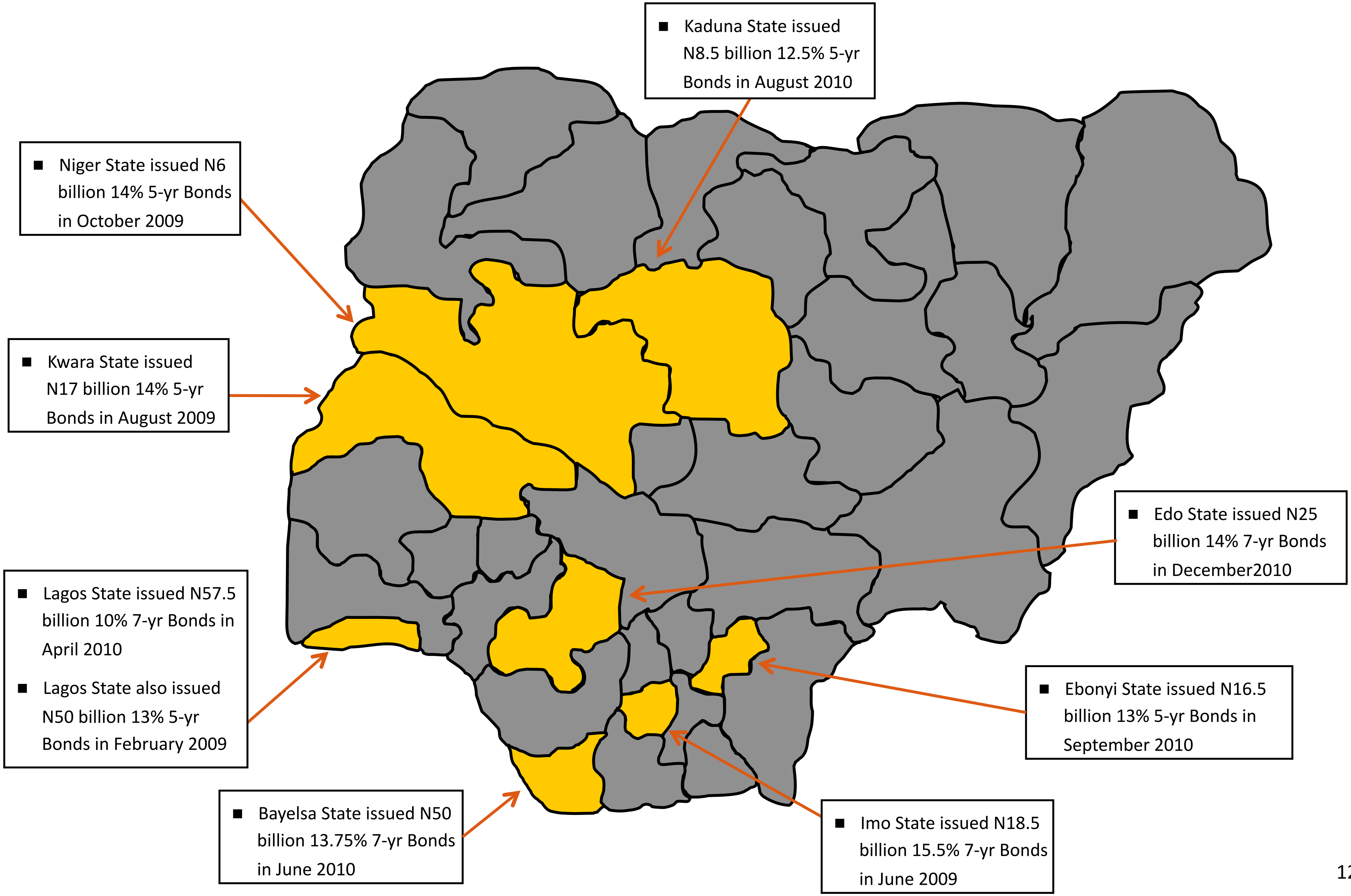
Key points

N400bn available from domestic pension funds for investment in state government bonds

- A number of market factors have supported an increasing demand for domestic state government bonds by institutional investors. One of the most significant factors is the phenomenal growth in pension fund assets.
- The growing institutional investor demand for state government bonds is a structural shift in the domestic capital markets.
- Market research suggests that pension funds have the capacity to allocate N400 billion to state government bonds.
- Pension Funds are allowed to allocate up to 20% of their funds to state government bonds. Total assets under management by pension funds is estimated to have be N2.0 trillion.
- Currently, Nigerian pension funds are estimated to have less than 5% of their assets in corporate bonds and state governments compared to a combined limit of 55%.

Sources: National Pension Commission, Stanbic IBTC Research

State Government Bond Issuance in 2009 and 2010



Sub-National Bond Issuance in Nigeria

S/N	State	Coupon Rate (%)	Tenor	Amount (N')	Use Of Proceeds
1	Bendel State Loan Stock	7.00 (above MRR)	1978 - 1988	20mm	Developing of Housing Estate
2	Ogun State Revenue Bond	12	1986 - 1996	15mm	Developing of Water Project
3	1st Lagos State Revenue Bond	19.0 (above MRR)	1987 - 1999	30mm	Development of Lekki Peninsula Scheme Phase 1
4	2nd Lagos State Revenue Bond	19.0 (above MRR)	1988 - 1999	60mm	Development of Lekki Peninsula
5	1st Lagos Island LGA FRRB	24.75	1992 - 1996	100mm	Development of Sura Shopping Complex
6	1st Oyo State Revenue Bond	16.50 (above MRR)	1987 - 1999	30mm	Adamasingba Shopping Complex Gbagi Market development
7	1st Kaduna State Revenue Bond	17.00 (7% above MRR)	1989 - 1996	30mm	Development of Ginger factory
8	2nd Kaduna State Revenue Bond	21.00 (2.5% above MRR)	1993 - 1996	30mm	Development of Ginger Factory
9	Edo State Revenue Bond	21	2000 - 2006	1bn	Development of Ogba River Side Housing Estate
10	Delta State Revenue Bond	16.05	2000 - 2006	5bn	Market, Health Care, Water and Education.
11	Yobe State Revenue Bond	23	2002 - 2005	2.5bn	Urban Road and Housing Drainage improvement.

Sub-National Bond Issuance in Nigeria

S/N	State	Coupon Rate (%)	Tenor	Amount (N')	Use Of Proceeds
12	1ST Tranche Ekiti State Revenue Bond	24.5%	2002 - 2005	2.5bn	Road Construction, Water, Electrification and Palm Plantation projects
13	2nd Tranche Ekiti State Revenue Bond	24.5%	2002 - 2005	2.5bn	Road Construction, Water, Electrification and Palm Plantation projects
14	Lagos State Bond	4% above T-Bills	2002 - 2009	15bn	Refinancing developmental projects
15	Cross River State Tourism Dev. Bond	20.5%	2004 - 2007	15bn	Upraging and expansion of Obudu Ranche
16	1st Akwa Ibom State Revenue Bond	19.5%	2004 - 2007	6bn	To finance infrastructural development.
17	Kebbi State Revenue Bond	14.00%	2006 - 2009	3.5bn	Kebbi State University of Science and Technology and Zauro polder irrigation.
18	Lagos State Bond	13%	2008 - 2013	50bn	To refinance loans on ongoing infrastructural project
19	Imo State Bond	15.50%	2009 - 2016	18.5bn	Road; Water Schemes; Equity Investments (Imo Wonder Lake and Conference Centre Oguta);
20	Kwara State Bond	14%	2009 - 2014	17bn	Truck Plaza, Aviation College, ASA Dam, New Secretariat, Agriculture Project (phase II), State University, Irrigation Projects

18. Lagos State Bond-Series 1 (under the N275billion Debt Issuance Programme)
19. Imo State **N18.5bn 15.5%** Bond Series 1 (under the 40bn Debt Issuance Programme)
20. Kwara State **N17billion 14%** Bond Series 1 (under the 30bn on Debt Issuance Programme)

Sub-National Bond Issuance in Nigeria

S/N	State	Coupon Rate (%)	Tenor	Amount (N')	Use Of Proceeds
21	Niger State Bond	14%	2009 - 2014	6bn	Road Projects (Minna Metropolis, Kutigi-Faizi, Minna Industrial Layout, Mokwa-Rabba, Luma-Banbanna & Bonu-Gurara)
22	Bayelsa State Bond	15.50%	2009 - 2016	50bn	Yenagoa Galleria, Roads, Schools, Gas turbines (Imiringi & Etelebou); Repayment of existing obligations
23	Lagos State	12%	2009 - 2016	50bn	Ongoing projects and refinance outstanding loans.
24	Ebonyi State	13%	2010- 2015	16.6bn	Construction of State Secretariat, Roads, Bridges, water projects and debt refinancing
25	Kaduna State	12.50%	2010 - 2015	8.5bn	Zaria Regional Water Supply (150 MLD treatment plant) and Construction of specialist hospital.
26	Edo State	14%	2010 - 2015	25bn	Power Plant and Road projects.

21. Niger State **N6bn 14%** Fixed Rate Redeemable Infrastructure Development Bond
22. Bayelsa State Bond **N50bn** Fixed Rate Development Bonds
23. Lagos State Bond-Series 2 **N50bn** (under the N275billion Debt Issuance Programme
24. Ebonyi State **N16.6bn** Fixed Rate Development Bonds
25. Kaduna State **N8.5bn** Fixed rate bond under the N15 billion Debt Issuance Programme
26. Edo State **N25bn** Fixed rate Infrastructural Development Bond

III. Issuance Process and Regulatory Framework

Terms and Conditions

Key points

There have been significant changes to the regulatory framework to facilitate the issuance of state government bonds and stimulate investor interest

	Current terms & conditions	Prior terms & conditions
Significant reduction in regulatory fees	▪ SEC Registration Fee reduced to 15bps ▪ NSE Application Fee reduced to 10bps ▪ For unsecured bond issues, registration and stamping of the Trust Deed can now be effected at a nominal fee of N500 ▪ All-in regulatory costs for a state government bond issue is approximately 30 bps	▪ SEC Registration Fee was 100 bps, then reduced to 30bps ▪ NSE Application Fee was fixed at 100bps regardless of issue size, then reduced 60bps, then reduced to 15bps ▪ All bond issues (secured or unsecured) were subject to fees of 250bps for the registration and stamping of the Trust Deed ▪ All-in regulatory costs for a sub-sovereign issue was over 300 bps
Removal of mandatory firm underwriting	▪ Public offerings are no longer required to be underwritten	▪ Underwriting was mandatory for all public offerings, which increased issue costs by at least 100-300bps
Tax waivers granted for 10 years	▪ All state government bonds are now exempted from taxation ▪ Investors in state government bonds are no longer subject to taxation in Nigeria	▪ Only Federal Government bonds enjoyed automatic tax exemptions ▪ Investors were subject to taxes including withholding tax and company income tax
Viable secondary market and improved liquidity	▪ A number of electronic secondary market trading platforms are being developed which should facilitate the effective trading of sub-sovereign bonds	▪ There was no secondary market trading platform and sub-sovereign bonds were viewed and priced by investors as illiquid securities
Cash settlement risk eliminated	▪ Cash settlement for secondary market trades can now be effected through the CBN, thus eliminating settlement risk	▪ No formal platform for cash settlement

SEC - Securities & Exchange Commission; NSE - The Nigerian Stock Exchange; CBN - Central Bank of Nigeria

Legal and Regulatory Requirements

Key points

State governments will be required to comply with the legal and regulatory requirements for issuing bonds in Nigeria

House of Assembly and Executive Council Approvals	▪ The State House of Assembly's approval will need to be obtained to create a State Bond Law and authorise the Programme ▪ The Executive Council's approval is required for each issuance under the Programme
Regulatory Approvals	▪ All bonds issued by state governments in Nigeria are regulated by the Securities & Exchange Commission, the apex regulator in the capital market ▪ Bonds to be listed must also be approved by The Nigerian Stock Exchange ▪ Formal applications must therefore be filed with SEC and The NSE and the necessary approvals obtained before any State can issue bonds to investors
Credit Ratings	▪ The National Pension Commission requires that the State and the Bond Issue are rated by two SEC-registered rating agencies ▪ A "BBB" Bond Issue rating will ensure that it qualifies as an investment instrument in which Pension Fund assets can be invested. However, the higher the rating, the larger the size of the Issue that Pension Fund Administrators can take up ▪ Agusto & Co. Limited and Global Credit Rating Co. are the leading rating agencies
Validity of audited financial statements	▪ SEC and The NSE require the audited financial statements of a State Government undertaking a public offering to be less than 12 months during the offer period ▪ The State's audited financials is valid for twelve months
Bond Issue Proceeds	▪ SEC requires that the Issue proceeds be kept and maintained in a bank account separate from the other operating accounts of the State ▪ All documentary evidence supporting the utilization of the Issue proceeds must be categorised according to appropriate expenditure heading and kept properly until SEC's verification inspection of the utilisation of the proceeds is concluded

Key Documentation Requirements

Key points

These are the key documentation items required to obtain regulatory approvals and successfully execute the bond issue

Classification	Description
Documentation	■ History, State profile, future prospects, risk factors, consents, etc.
Legal approvals	■ State House of Assembly to create Bond law and to authorise Bond Issue ■ State Executive Council resolutions
Offering documents	■ Shelf Prospectus ■ Supplementary Shelf Prospectus or Pricing Supplement
Trust Deed	■ Legal agreement between the State and the Trustees which regulates the obligations of both parties in respect of the bond issuance
Legal Opinion	■ Summary of any claims and litigations involving the State ■ Legal opinion on the effect of these claims and litigation, if any
Agreements	■ Vending Agreement
Financials	■ 5-year audited financial state financial information ■ Validation by Reporting Accountant
Rating	■ Rating Reports

Parties to a Bond Transaction

Key points

All the professional parties to the Issue are required to possess a valid registration with the SEC

- The State Government
- Auditors
- Solicitors to the Issue / Issuer / Trustees
- Issuing House(s) / Advisor(s)
- Registrars
- Rating Agencies
- Trustees
- Stockbrokers
- Reporting Accountants

Post Issue Considerations

Key points

- *Rigorous onsite inspection and offsite reviews to ensure compliance with Bond covenants*

- **Ensure proceeds are used as disclosed in the prospectus**
- **Modifications to the terms of the Bond must be duly approved by the SEC, and communicated to investors**
- **Ensure timely payment of Coupons**
- **Ensure timely repayment of Principal**
- **Ensure good financial, risk and debt management**
- **Ensure all bond covenants are fulfilled**

IV. Case Studies

Lagos State Government: N57.5 bn 10% Bonds

Key points

Lagos State Government has leveraged the SEC's shelf registration to establish a N275bn debt programme and manage debt issuance more effectively.

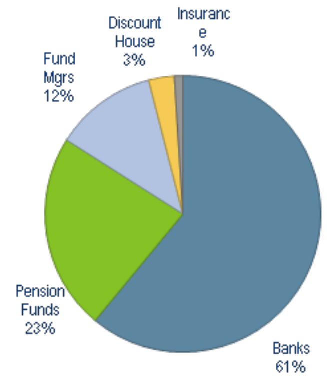
Key Terms and Conditions

Issuer:	Lagos State Government of Nigeria
Issuer Rating:	A+ (Domestic - Agusto & Co) BB- (International - Fitch)
Amount:	NGN 57.5 billion
Issue Date:	19 April 2010
Coupon:	10% (semi-annual)
Issue Rating:	A+ (Domestic - Agusto & Co)
Tenor:	7-year
Maturity:	19 April 2017
Format:	Domestic bonds
Listing:	The Nigerian Stock Exchange
Tax Consideration:	Exempt from taxation in Nigerian
Law:	Nigerian Law

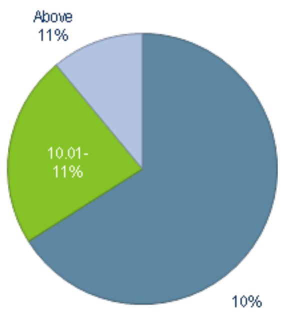
New Issue Commentary

- The Lagos State Government ("the Issuer") marked a very successful return to the domestic bond markets by undertaking a NGN 50 billion (USD 333 million) 7 year fixed rate bond issue, which attracted an extraordinary high level of investor demand.
- This bond issue was the second bond issuance under the Issuer's NGN 275 billion (USD 1.83 billion) Debt Issuance Programme.
- The Issuer conducted several institutional investor meetings in March 2010, and book building for the transaction commenced on 07 April 2010. A price guidance of 10-12% was provided to the market for an expected deal size of NGN 50 billion
- The order book built quickly on the back of the price guidance and by the end of the book building on 13 April 2010 had reached NGN 174 billion worth of orders from 176 investors which included a broad mix of domestic institutional investors. NGN 141 billion of orders from 117 investors were at 10%. The Issuer increased the size of the transaction to NGN 57.5 billion and the bond priced at a coupon of 10%.
- The transaction is the largest sub-sovereign bond issue in the history of the Nigerian bond market.

Allocation by Investor Type



Distribution by bid



Overview

Key points

South Africa has a vibrant municipal bond market backed by a robust framework

- The South African municipal bond market operates within the framework of the ***Municipal Finance Management Act No. 56 of 2003***
- The object of this Act is to encourage sound and sustainable management of the fiscal and financial affairs of municipalities by establishing norms and standards for their borrowing activities
- Key objectives of the Law is to ensure, inter alia:
  a) transparency, accountability and appropriate lines of responsibility in the fiscal and financial affairs of municipalities and municipal entities;
  b) the management of revenues, expenditures, assets and liabilities and the proper handling of financial dealings;
  c) budgetary and financial planning processes and the co-ordination of those processes with the processes of organs of state in other spheres of government; and
  d) prudent borrowing and proper handling of financial matters in municipalities;
- The law also sets conditions for contracting of short and long term debt, acceptable security, disclosure requirements and use of municipal, national or provincial guarantees
- Adherence to the principles by all stakeholders have helped to transform the South African municipal bond market into a world class platform

City of Johannesburg ZAR 850 mm 10 year Bonds

Key Terms and Conditions

Issuer:	City of Johannesburg Metropolitan Municipality
Amount:	ZAR 850 million
Issue Type:	Senior Unsecured
Issuer Rating:	Aa3.za/AA-.zaf
Coupon:	10.78%
Issue price:	par
Coupon dates:	23 March and 23 September
Benchmark Bond:	R 208
Tenor:	10yrs
Maturity:	23 March 2021
Listing:	The Bond Market of the JSE
Governing Law:	South African
Lead Manager:	Standard Bank

Transaction Overview

OVERVIEW

- The City of Johannesburg is the most populous of South Africa's nine metropolitan municipalities and remains the financial hub of the country
- The City contributes approximately 16 % of National GDP and approximately 15% of national employment
- Joburg has set its sights on becoming a World-Class African city in which all residents can enjoy the fruits of economic growth and job creation and lead prosperous and healthy lives
- The key drivers of the City's economy are the construction, tourism, retail and property sectors

BACKGROUND

- City of Johannesburg is the largest municipal bond issuer in the South African market. This is the City's first new bond since December 2008
- SBSA has acted as an arranger for 2 of the 3 municipal issued in the market
- The bond was marketed to a wider range of investors, in addition to the big players, the arranging team focused on the inclusion of some of the smaller investors. This assisted in broadening participation in the transaction and also saw the return of investors that have not actively participated in the bond market
- Priced at R 208 + 195 (10.78%) which was within the price guidance. This represented a significant spread tightening and is expected to assist in re-pricing the City's curve
- In addition this pricing was very attractive when compared to the City's alternative sources of funding

City of Cape Town ZAR 2bn 15 year Bonds

Key Terms and Conditions

Issuer:	**City of Cape Town**
Amount:	**ZAR 2 billion**
Issue Type:	**Senior Unsecured**
Issuer Rating:	**Aa2.za**
Coupon:	**11.16%**
Issue price:	**par**
Coupon dates:	**15 March and 15 September**
Benchmark Bond:	**R 186**
Tenor:	**15 yrs**
Maturity:	**15 March 2025**
Listing:	**The Bond Market of the JSE**
Governing Law:	**South African**
Lead Manager:	**Standard Bank**

Transaction Overview

OVERVIEW

- 15 year benchmark bond issue
- The bond was significantly oversubscribed with over R 3bln in bids received. The City issued R 2bln making this the largest single bond ever to be issued by a Municipality in the SA market
- The enormous amount of interest shown by the investors resulted in spread tightening of over 50bps from the previous bond.
- Distribution was diverse in investor terms, with 18 investors participating in the transaction and over 15 being allocated paper.
- Priced at R 186 + 208 (11.16%) which was within the price guidance. This represented a spread tightening of over 50bps from the previous bond issued by the City.

BACKGROUND

- The City of Cape Town is the third largest metropolitan municipality generating approximately 11% of the national GDP.
- The City's key objective is to drive the development and promotion of solid infrastructure led economic growth through:
- creating a solid platform of urban infrastructure and support services; streamlining regulation to provide an enabling environment ensuring that the City operates at high levels if governance, service and ethics
- The key drivers of the City's economy are the construction, tourism, retail and property sectors

V. Conclusion

Conclusion

- Realizing the aspirations of Nigerians for economic and social development depends on the quality of leadership at all tiers of government.

- The capital markets provide long term funding, promote good governance and support sound financial management

- Leveraging the capital markets will enable balanced development across the country and a harmonious society

- Capital markets facilitates your plan to "harness the resources of the nation to promote national prosperity and an efficient and self reliant economy"-- Section 16 (I) Chapter II, Constitution of the Federal Republic of Nigeria

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