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Executive Summary

# Municipal Bonds as an Alternative to Bank Loans – The Case of the Jerusalem Municipality

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מכון ירושלים למחקרי מדיניות  
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## About the Milken Innovation Center Fellows Program

The Milken Innovation Center Fellows Program accelerates Israel's economic growth through innovative, market-based solutions for long-term economic, social, and environmental challenges. Our goal is to accelerate Israel's transition from a Start-up Nation to a Global Nation with solutions that others can replicate.

The Program awards annual fellowships to outstanding Israeli graduate students. We train and deploy some of Israel's best and brightest young professionals to create pragmatic financing and economic policy solutions. Our applied research and Financial Innovations Labs® are a launching pad for transformative change, using innovative financing mechanisms, programs and policies to bridge social, regional, economic and productivity gaps within Israel and between Israel and the world.

In addition, Fellows craft their own projects during their internship aimed at barriers to job creation and capital formation in Israel. The Fellows' research, carried out under the guidance of an experienced academic and professional staff, support business and policy makers to shape economic reality in Israel. The program offers the ultimate training opportunity, combining real-life work experience with applied research.

Throughout the year, Fellows receive intensive training in economic and financial analysis, public policy and research methods. They acquire tools for communication and presentation, policy analysis, leadership and project management. The fellows participate in a weekly research training workshop where they work with senior economic and government professionals, business leaders, and top academic and financial practitioners from Israel and abroad. They also participate in an accredited MBA course, taught at the Hebrew University School of Business Administration by Prof. Glenn Yago.

Fellows Program alumni can be found in senior positions in the public and private sectors. Some serve in key positions in government ministries while others work at private-sector companies or go on to advanced graduates studies at leading universities in Israel, the United States and Great Britain.

The Fellows Program is a non-partisan. It is funded, in part, by the Milken Institute and other leading philanthropic organizations and individuals in the United States and Israel.

Over the past decade, Jerusalem has positioned itself as a significant player in Israel's high-tech industry, aiming to become a national and global hub for technological innovation. The city's growth in this sector has been marked by ambitious plans, such as those outlined in the 2021 article "The New High-Tech Capital? A Million Square Meters of Employment Planned in Jerusalem" (Globes). However, this growth presents challenges, particularly in ensuring that all residents benefit from the city's economic expansion, and that the city can support this growth.

The Jerusalem Municipality, like most local governments, faces the challenge of balancing its budget to maintain city operations and fund future development. Despite its efforts, the municipality's revenue streams struggle to keep pace with expenditures, creating a risk for its financial stability. This issue is compounded by the city's socio-economic challenges, including high poverty rates and low economic participation among certain communities. The 2019 State Comptroller's report highlighted that the municipality is heavily reliant on supplemental government grants to balance its budget. By 2017, these grants accounted for 13% of the municipality's budget, up from 6% in 2007.

This growing reliance on external funding exposes Jerusalem to significant economic risks. Should these government grants diminish, the city could face severe financial instability, jeopardizing its ability to repay debts, maintain infrastructure, and invest in necessary development projects. The State Comptroller's report recommended that the municipality, in collaboration with the Ministry of Interior and the Ministry of Finance, explore ways to increase its independent revenue streams and establish a sustainable financial framework to reduce the government's supplemental "capital grant."

One proposed solution is to diversify the municipality's sources of financing, particularly for long-term development projects. Traditionally, the municipality has relied on project-specific grants from the Government, fees or limited development budgets with high competition among basic activities for essential services, or loans from banks, often under conditions that may not be the most favorable. The municipality's structural budget weakness and the commercial banks' aversion to risk, limits the municipality's bargaining power, leaving it with few alternatives and potentially higher costs for project financing. To address these challenges, the Jerusalem Municipality has begun exploring innovative financial instruments and strategies to secure funding for long-term projects. Among these

strategies is the consideration of municipal bonds, a tool widely used by local authorities around the world, particularly in the United States. Municipal bonds, including general obligation bonds and revenue bonds, offer municipalities a way to raise new capital for infrastructure and development projects, improve the financial viability of these development projects, and reduce financing costs.

General obligation bonds are backed by the full faith and credit of the municipality, making them a relatively secure investment. Revenue bonds, on the other hand, are secured by specific revenue streams generated by the projects they finance, such as tolls from a new highway or fees from municipal services. By diversifying its financing tools, Jerusalem could strengthen its financial position, increase its bargaining power, and access a broader base of investors.

The adoption of municipal bonds in Israel has been limited, despite their potential benefits. The topic has been discussed for over two decades, with a detailed document on municipal bond issuance submitted to the Israel Securities Authority as early as 1991. However, regulatory challenges and the perceived complexity of the bond issuance process have hindered their widespread adoption. Nonetheless, the 2022 State Comptroller's report recommended that the Ministry of the Interior, in cooperation with other relevant stakeholders, examine a framework for municipal bond issuance to diversify funding sources for local governments, to relieve budget pressures on the Government, and accelerate and enable local development projects.

In 2022, the Municipality and its development agencies convened a Financial Innovation Lab through the Milken Innovation Center at the Jerusalem Institute for Policy Research. Among the recommendations in their report, the use of revenue bonds for tourism, infrastructure, and commercial activities would accelerate developments that would add important real estate taxes and development fees to Jerusalem's tax base.

For Jerusalem, introducing municipal bonds could be a significant step toward financial independence and sustainability. By leveraging this tool, the municipality could secure the funding necessary to support its ambitious development goals, ensuring that Jerusalem continues to grow as a leading city in innovation and technology while maintaining its financial stability.



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