



**MARKET-BASED FINANCING OF URBAN  
INFRASTRUCTURE IN INDIA:  
OPPORTUNITIES FOR SUPPORT**

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Workshop on Issues before  
13<sup>th</sup> Finance Commission  
IRMA, Anand  
December 22-23, 2088



# OUTLINE OF PRESENTATION

- India Urban Context
- Market-Based Financing
- JNNURM: Project
- Opportunities for Support



# URBANBANIZATION IN INDIA

- Urban Population (2001): 285 Million
- % Urban Population to total
  - 2001 27.8%
  - 2011(projected) 30%
- Urban areas account for more than 60% of Gross National Product (GDP)
- Decadal Growth 1991-2001): 31.2%
- Total Urban Local Bodies: 4000 (About)
- 38% of urban population living in 35 metropolitan Cities (with more than 1 million population).



# URBAN CHALLENGES IN INDIA

- Weak Urban Governance
- Inadequate urban infrastructure and supply of serviced land
- High proportion of urban poor and slum population
- Weak financial base of urban local bodies
- Huge investment needed for urban infrastructure
- Thin staff capacity
- Inability to deliver urban services citywide to the poor.



# URBAN OPPORTUNITIES IN INDIA

- Urbanization is inevitable
- Urbanization and economic progress are concomitant
- Need to improve urban infrastructure, supply of serviced land and governance to maintain high economic growth and create jobs for the poor
- Several initiatives to improve urban governance and infrastructure:
  - a reform linked investment program, “Jawaharlal Nehru National Urban Renewal Mission (JNNURM)”
  - E-Governance in Municipalities
  - Market Based Financing
  - Special Economic Zones and Satellite Towns
  - New Urban Transport Policy



## **OPTIONS FOR HIGH INVESTMENT NEEDS**

### **HUGE INVESTMENT REQUIREMENTS IN URBAN SERVICES**

: Rs. 12702 billion during 2007-12

Accessing capital markets - municipal bond/tax free municipal bonds/pooled financing

- Borrowing from commercial banks/financial institutions
- Private sector participation



## **MUNICIPAL BONDS INDIA**

Taxable municipal bonds	:	Rs. 4,450 M
Tax free municipal bonds	:	Rs. 6,495 M
Pooled finance:	:	Rs. 1,304 M
<b>TOTAL:</b>	<b>:</b>	<b>Rs. 12,249M</b>



## **TAXABLE MUNICIPAL BONDS**

- The Ahmedabad Municipal Corporation (AMC) was the first ULB to access the Indian capital market
- AMC had first municipal credit rating in 1996
- AMC first municipal bond without state government guarantee in 1998 of Rs. 1000 m
- Annual interest of 14% and 7 year tenure.
- Credit enhancement measures included: Escrow account for octroi revenues (entry tax), a sinking fund for principal payment, and DSR of 1.5 for principal repayment
- Since 1997, twelve cities/utilities have issued municipal bonds without state government guarantees are Nashik, Nagpur, Ludhiana, and Madurai.



## **LOCAL REFORMS IN AMC**

- Mid-1994: Steps taken to Improve Revenue (Octroi and Property tax)
- 1996-97: Rs. 910 M Cash Surplus
- Computerization of Accounts
- Appointment of Professional Staff
- New Development Works
- Citizens and Staff Proud of AMC



## **CREDIT RATING**

- Provides investors independent evaluation of a bond issue
- It address ability and willingness of the local body to pay the debt
- Evaluation based on legal framework, economic base, existing operation, management capacity, project viability, financial structuring, etc.
- Major thrust on improving credit-worthiness of urban local bodies and development of capital market
  - Over 90 urban local bodies have been credit-rated
  - 58 JNNURM cities rated and 36 are investment grade.



## **TAX-FREE MUNICIPAL BONDS**

- To boost the municipal bond market, the Government of India decided to provide tax-free status to municipal bonds.
- Ahmedabad is first to issue a tax-free bond
- Hyderabad, Vizag, and Nasik, and HMWSSB issued tax-free bonds
- Municipal bond annual interest rates are 1.5 to 2% less than other loans for same credit enhancement structures



## **POOLED FINANCING**

- Only financially strong, large municipal corporations are in a position to directly access capital markets
- Most small and medium ULBs are not able to access capital markets simply on the strength of their balance sheets
- The cost of the transaction is a significant barrier
- Tamil Nadu and Karnataka issued pooled finance bonds.



## TAMIL NADU POOLED FINANCING II

- The Tamil Nadu WSPF, a trust, set by state government and Tamil Nadu Urban Development Fund
- WSPF issued a tax-free bond (Rs. 300M) by pooling 14 municipalities' proposals for infrastructure projects
- Annual interest 9.2% and 15-year tenure
- Private placement
- Proceeds financed water supply and sanitation projects
- Credit enhancements measures included: escrow accounts funded by municipal revenues, state-funded debt service reserve service fund, and USAID guarantee 50% of principal



## **GREATER BANGALORE POOLED FINANCE FEATURES OF THE BOND**

- Water Supply for 1.5 M people from 8 Urban Local Bodies around Bangalore.
- Water supply Project of Rs. 3400 M and Citizen Contribution of 35% in terms of connection charges.
- Karnataka Water and Sanitation Pooled Fund (KWSPF) Trust set up
- KWSPF borrows from capital market and lends to ULBs
- Tax free status from Government of India
- Rs. 1000 M
- 15-year tenure at 5.95% coupon rate
- USAID DCA guarantee for credit enhancement



## **POOLED FINANCE DEVELOPMENT FUND**

- The GOI decided to create a market-based vehicle that facilitates capital market access to small and medium size ULBs
- GOI set up a Pooled Finance Development Fund (PFDF).
- The objective of this fund is to support state initiatives to establish pooled financing structures, provide technical support and credit enhancements, and leverage urban reforms
- PFDF will support project development cost Rs. 0.25 to 10 M (based on size of ULBs).
- PFDF will contribute to State Level Credit Enhancement Fund.



## **DEMAND FOR MUNICIPAL BONDS**

### **Constraints**

- Too few creditworthy issuers seeking bond financing.
- Limited financially viable projects seeking bond financing.
- Lack of intermediation support to help issuers achieve bond structures that respond to investor needs
- A variety of “administrative and managerial” constraints
- Need for clarity on how the Government will operationalize the sanctioning mechanism for Tax-Free Pooled Finance Development bonds.

**Improve financial sustainability of urban local governments**



## **SUPPLY OF CAPITAL THROUGH MUNICIPAL BONDS**

### **Constraints**

- Banks, Insurance Companies and Pension Funds face regulatory constraints on purchasing municipal bonds
- Lack of credit enhancement on so investors perceive the bonds to be risky
- Fixed cap on tax-free interest from municipal bonds so are unattractive when market rates exceed the cap.
- Municipal bonds are relatively illiquid investments for lack of exit opportunities for institutional investors.



## **SUPPLY OF CAPITAL THROUGH MUNICIPAL BONDS**

### **Suggestions**

Insurance and Pension Fund Regulators should change regulations to facilitate investment in the bonds by Insurance companies and Pension Funds, etc.

RBI Central Bank should change regulations to facilitate investment in the bonds by Banks.

Fixed cap on tax-free interest on municipal bonds should be linked to prime lending rate of SBI.



## **JNNURM: Jawahar Nehru National Urban Renewal Mission**

- Mission provides reform linked investment for urban infrastructure for cities undertaking reforms.
- Total project cost Rs. 1000 billion (US\$ 25 billion) over seven years 2005-12
- Cities and the state governments signed Memorandum of Agreements (MOAs) with National Government for introducing reforms
- Cities have to prepare City Development Plans (CDPs) and Detailed Project Reports (DPRs)
- 62 CDPs approved, 254 Detailed Project Reports with total cost of Rs. 300,000 million approved



## REFORMS UNDER JNNURM

### FINANCIALLY SUSTAINABLE ULBs

- Improved Accounting Systems
- E-Governance Applications (using IT, GIS and MIS)
- Property Tax Reform
- User Charges
- Administrative and Structural Reforms
- Encouraging Public Private Partnership
- Public Disclosure Law



## **KEY CONSTRAINTS**

- Insufficient political consensus at state and municipal levels for the reform agenda for water and sanitation, particularly regarding private sector participation and proper pricing of services
- Few examples of comprehensive state-level policy, institutional and legal frameworks for sustainable replication of commercially viable projects.
- Constant transfers of administrative “champions” undermine promising reform initiatives.
- Thin staff capacity, particularly at municipal level.



## **URBAN INDIA: OPPORTUNITIES FOR SUPPORT**

- ULBs should be further supported to improve revenue mobilization and manage expenditure. Grant could be linked to revenue enhancement measures.
- Capacity Building support needed for Urban Officials and Elected Leaders
- Support state level funds set up to help small and medium ULBs to access market-based financing.