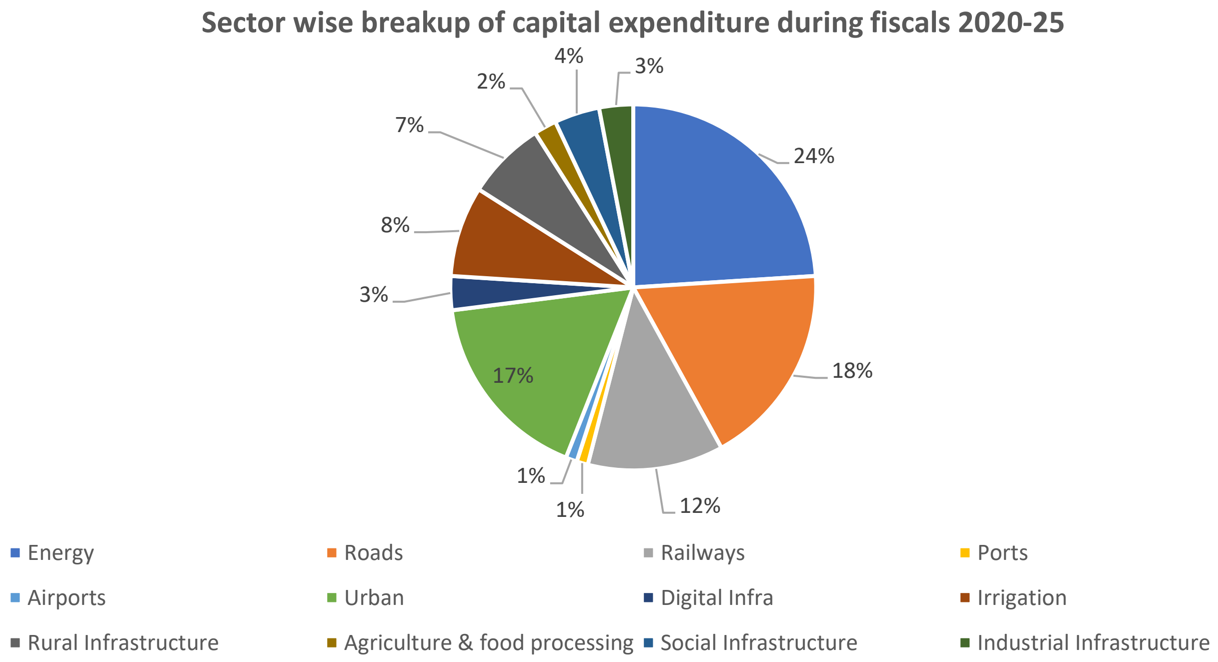
PRESENTATION

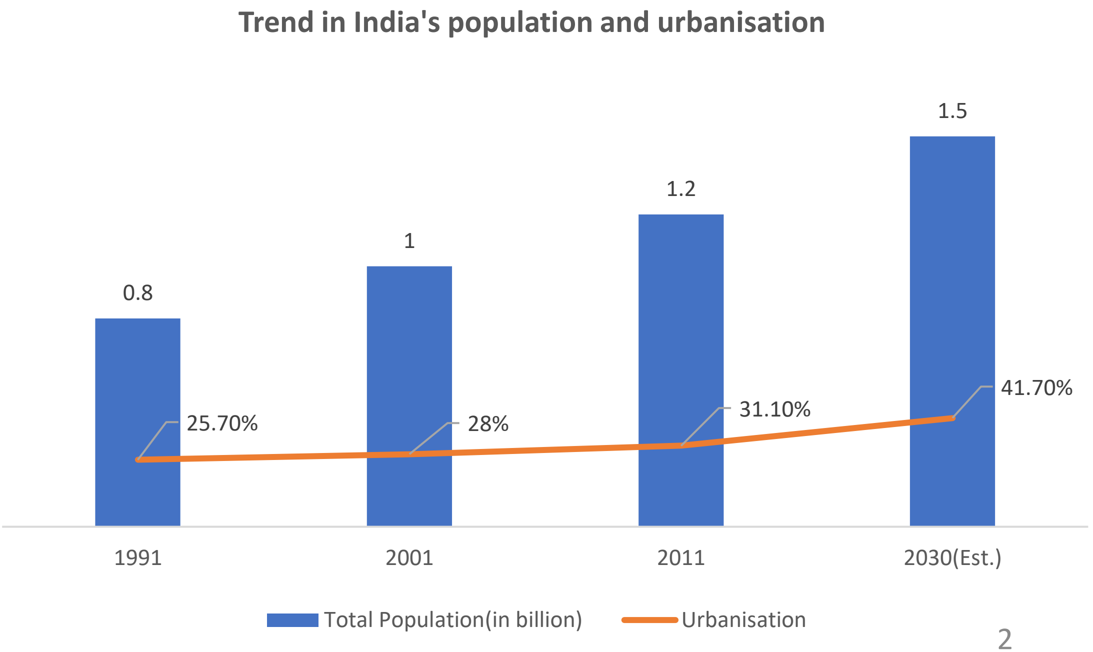
ON

MUNICIPAL BOND

INFRASTRUCTURE REQUIREMENTS FOR URBAN CITIES

- Global Infrastructure outlook estimates that India would need to spend US $4.51 trillion on infrastructure by 2030 to realize the vision of a US $5 trillion economy by 2025, and to continue an escalated trajectory until 2030.
- Infrastructure deficit is estimated to cost 4%-5% of GDP due to inefficiencies like the availability of funds, process of land acquisition, environmental concerns, time and cost overruns.
- India plans to spend US $1.4 trillion on infrastructure through National Infrastructure Pipeline between fiscals 2020-25 with an outlay of Rs. 2 lakh crores targeted for urban development.
- As on date, 40% of infrastructure projects are under implementation of National Infrastructure Pipeline 2025.





OVERVIEW OF GLOBAL MUNICIPAL BOND MARKET

- Local government finance has been a keenly debated issue in fiscal decentralization, with no specific model in the cross-country experience that can be regarded as a best practice.
- The vertical division of functions and responsibilities among various tiers of governments vary across countries. The sources of revenue for Local governments vary across countries but generally include taxes, user fees and charges and intergovernmental transfers.
- Other revenues include investment income, property sales, licenses and permits. Property tax is regarded as one of the most important tools for raising revenue at the Local government level around the world (UN Habitat, 2009; McMillan and Dalby, 2014).
- In many countries, the decentralization of responsibilities from the national and subnational governments to Local governments has not been accompanied by a commensurate decentralization of financial power.

Top 4 countries with Outstanding Municipal Bonds:

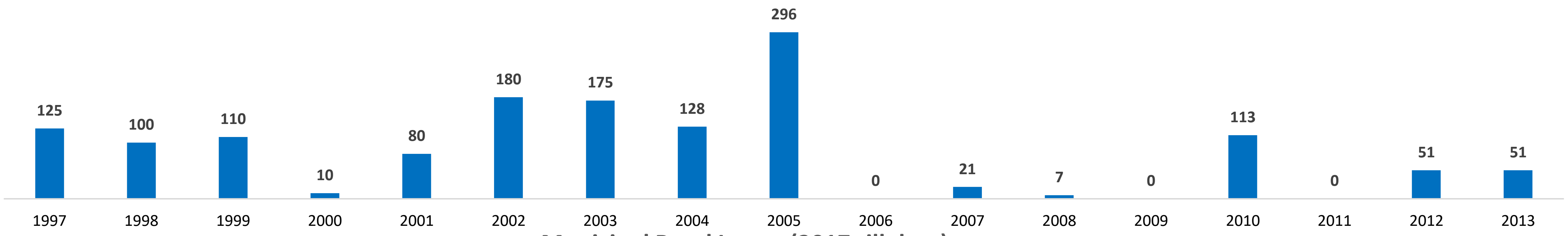
Countries	Outstanding Amount (Rs. Crs.)
USA	2,61,85,956.78
Puerto Rico	4,45,113.30
Guam	18,986.95
United States Virgin Islands	10,987.40
Total Outstanding Amount	**2,66,61,044.43**

Source: RBI Report on Municipal Finances, Bloomberg

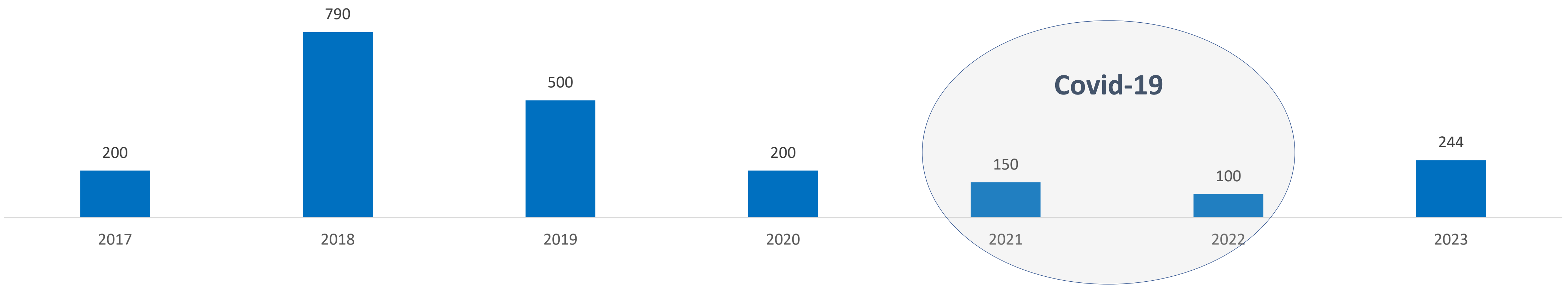
OVERVIEW OF MUNICIPAL BOND MARKET IN INDIA

The Indian municipal bond market has seen a total issuance of ***INR 1,447 crores till 2013 & post 2017*** *till date , the total issuance has been* ***INR 2,184 crores by 10 ULBs crores through 13 municipal bond issuances.***

Municipal Bond Issues (1997-2013) (1447 Cr)



Municipal Bond Issues (2017 till date)

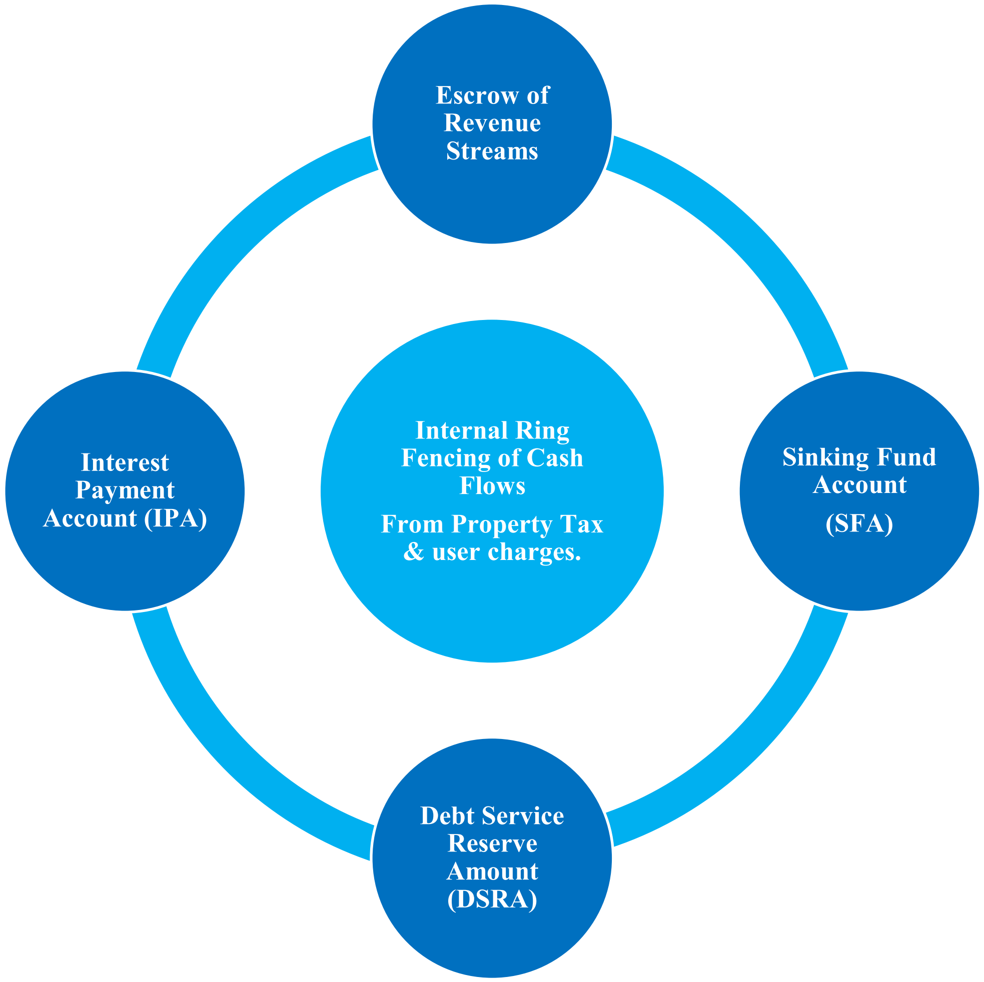


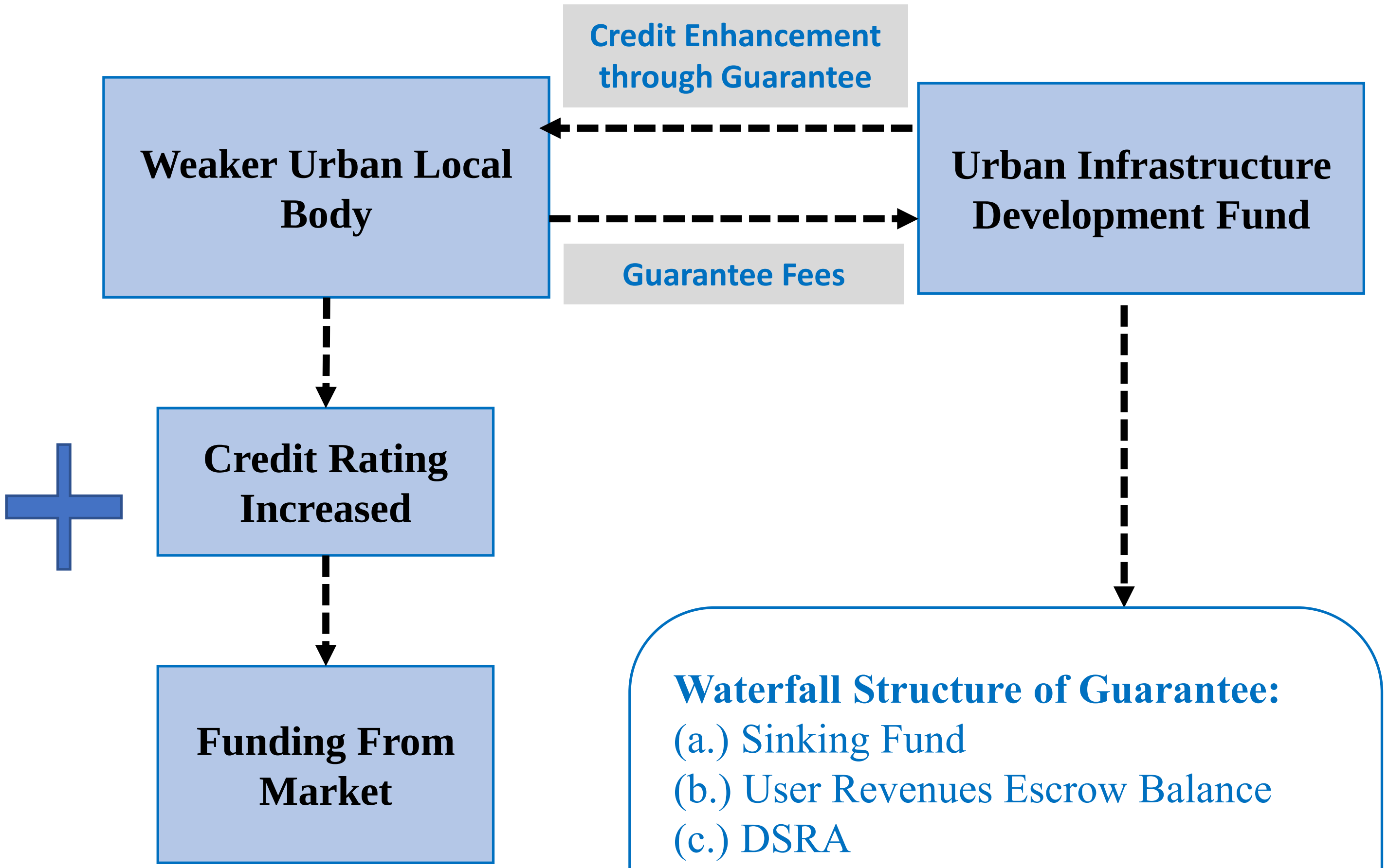
INNOVATIVE STRUCTURING - MEASURES & CHALLENGES

Need of Credit Enhancement (CE) in Structuring

- ✓ Most of the Municipal Corporations are rated low, requiring innovative measures of structuring of the bonds for credit enhancement.
- ✓ Out of the 500 (approx) rating of AMRUT cities only 36 cities rated A(-) or above.
- ✓ Only 163 cities have Investment Grade Rating (IGR) of BBB- and above.
- ✓ As per most of the Investment guidelines prescribed by the regulators, investors such as Banks, Mutual Funds, Insurance Companies, PF Trusts, etc. generally invest in either dual “AA” rated bonds or bonds which are Government Guaranteed/credit enhanced.

INNOVATIVE CREDIT ENHANCEMENT MEASURES





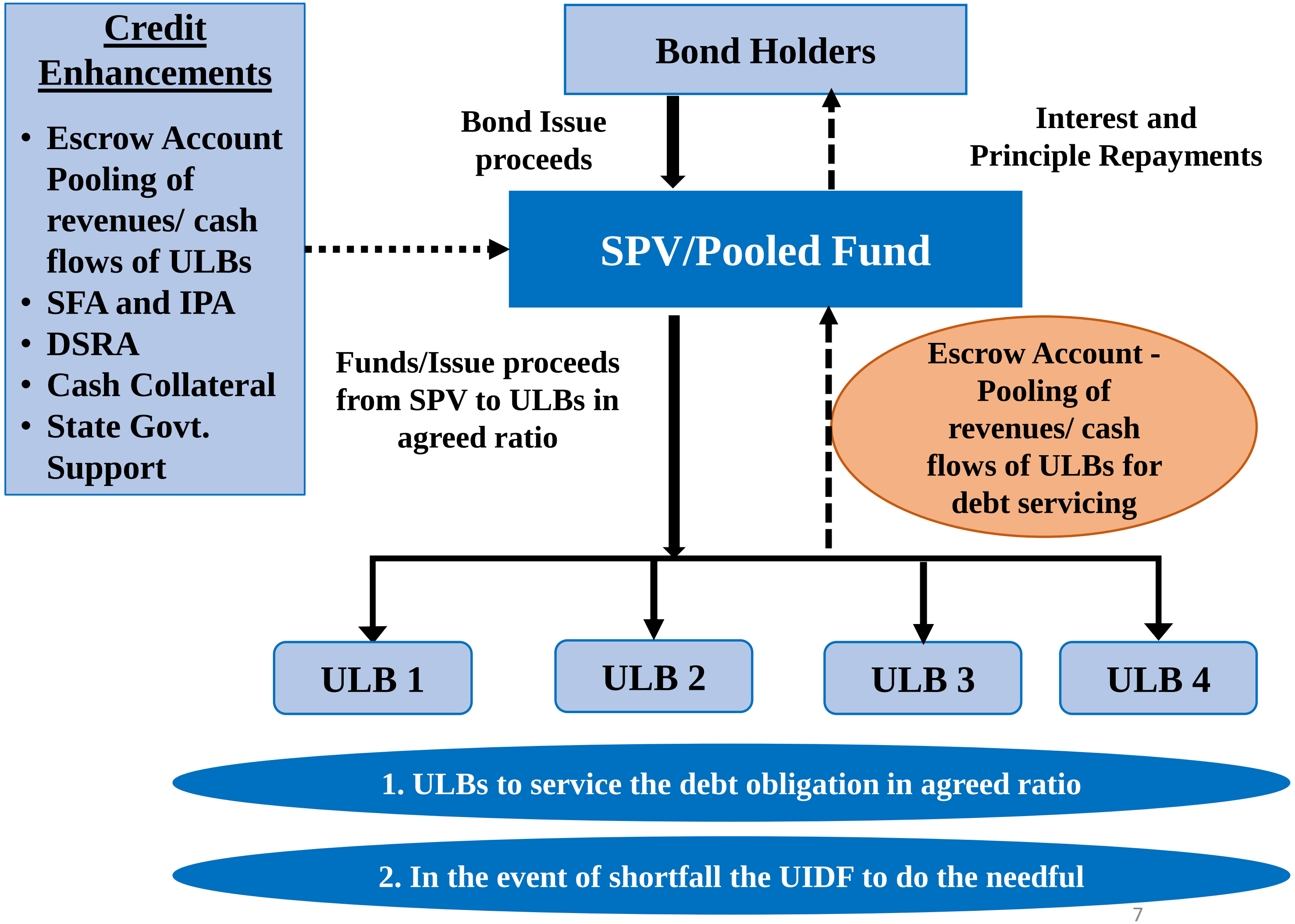
Waterfall Structure of Guarantee:
(a.) Sinking Fund
(b.) User Revenues Escrow Balance
(c.) DSRA
(d.) Guarantee
(reducing basis amount escrowed in above manner. i.e. **Guarantee = Amount Outstanding – (a)- (b) - (c)**

Additional Cash collateral may be created as additional security to service the debt obligations

INNOVATIVE CREDIT ENHANCEMENT MEASURES

Pooled Municipal Bond

- **Can be done by forming a separate SPV for Urban Infra projects.**
- **Facilitate capacity building of ULB's by providing access to domestic capital markets for small and medium Urban Local Bodies (ULBs)** who are unable to issue municipal bonds on their own to finance the projects.
- **Helps in achieving the high grade credit rating** by pooling of revenues/cash flows of multiple ULBs of strong & weaker one together.
- Reduces the transaction costs and mobilize funds through a single bond issuance
- Multi-layered credit enhancement structure increases the investor confidence



INNOVATIVE CREDIT ENHANCEMENT MEASURES

Pooled Finance Development Fund (PFDF)

- ✓ **Launched in the year 2006 by Central Government**
- ✓ **Included in Municipal regulations by SEBI in Sept-2019**
- ✓ Provide credit enhancement facilities to ULBs for market borrowings via State Level Pooled Finance Mechanisms
- ✓ State Pooled Finance Entity (SPFE) shall be setup which is responsible for availing the Credit Rating Enhancement Fund (CREF) support facility which serves as a separate security layer
- ✓ Scheme helps in accessing the capital markets and reducing the cost of borrowings

Under PFDF scheme the contribution amount for Credit Rating Enhancement by the Central Government shall be:

- **10% of the proposed amount of bond issue; or**
- **50% of the CREF requirement as determined by the Credit Rating Agency; whichever is less**
- **Balance amount shall be contributed by the respective State Government**

Partial Credit Enhancement

- ✓ RBI allows banks to offer Partial Credit Enhancement (PCE)
- ✓ **Objective** is **to enhance the credit rating of the bonds** issued so as to enable entities to access the funds from the bond market on better terms
- ✓ Banks can provide PCE as **a non-funded subordinated facility** in the form of an irrevocable contingent line of credit which will be drawn in case of shortfall in cash flows for servicing the bonds
- ✓ **Aggregate PCE** provided by banks - **50% of the bond issue size** (up to 20% for an individual bank)
- ✓ **Pre-enhanced rating** of the issuer should be **BBB minus or better**

INNOVATIVE STRUCTURING – CASE STUDY

Major Credit Enhancement Measures Adopted – Lucknow & Ghaziabad

Escrow of main revenue streams

Creation of Sinking Fund Account & Interest Payment Account for timely Bond Servicing

Creation of additional reserve in the form of DSRA

Backup from Infrastructure Development Fund of Government of UP.

Government of India incentive kept as additional collateral

26 crores for every 200 crores raised

By innovative structuring, Credit Enhancement Measures & Central Government of India support, the rating can be upgraded by 2 notches or AA

Similar measures were also adopted in other Municipal Bond issuances such as PUNE, SURAT, BHOPAL, INDORE, etc.

SURAT & PUNE bond issuances are also taken to US department study as a Case study based on the Standalone cash trap mechanism.

The Water and Sanitation Pooled Fund (WSPF) – Tamil Nadu

WSPF issued a pooled bond to facilitate access to long-term domestic capital markets for 13 small and medium ULBs to finance water and sanitation services

Credit Enhancement Mechanism adopted

- Debt Service Reserve Fund capitalized by the state Govt.
- Creation of individual ULB Escrow Accounts
- Local Debt Service Reserve Fund
- Partial credit guarantee from USAID (United State Agency for International Development)

INVESTOR APPETITE : PREVIOUS MUNICIPAL BOND ISSUANCES

Details	Indore	Vadodara	Ghaziabad	Lucknow	Greater Hyderabad	Surat	Ahmed-abad	Greater Vishakhapatnam	Bhopal	Greater Hyderabad	Indore	Greater Hyderabad	Pune	Total
Issue Date	14-Feb-23	24-Mar-22	31-Mar-21	13-Nov-20	20-Aug-19	27-Feb-19	11-Jan-19	21-Dec-18	25-Sep-18	13-Aug-18	28-Jun-18	16-Feb-18	20-Jun-17	-
Amount (Rs. Crs)	244	100	150	200	100	200	200	80	175	195	139.90	200	200	**2,184**
Tenure (years)	6 (Effective)	5	10	10	10	5	5	10	10	10	10	10	10	-
Rating	IND AA+/CARE AA	IND AA+/ CRISIL AA	IND/BWR AA	IND/BWR AA	IND/CARE AA	CRISIL / IND AA+	CRISIL/ IND AA+	CARE/IND AA	ACUITE/ BWR AA	CARE/ IND AA	ACUITE/ BWR AA	CARE/ IND AA	CARE/ IND AA+	-
Coupon (%) (semi-annual)	8.25	7.15	8.10	8.5	10.23	8.68	8.7	10	9.55	9.38	9.25	8.9	7.59	-
Spreads (over G-Sec par curve)	90	82	87	268	349	150	135	274	147	157	119	134	110	

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005 -2013	Total
Amount (in Rs. Crs.)	125.0	100.0	110.0	10.0	80.0	180.0	174.5	128.0	539	**1447**

Approximately Rs. 2,184 crores have been raised by ULBs across 13 issuances in the past 5 financial years

Challenges faced by Investors

Availability of updated financial information

Limited credit enhancement for Municipal Bonds

Few municipals with high credit quality

Municipal laws do not prescribe any uniform accounting standard rendering their accounts largely incomparable

Investors do not have easy access to Disclosures

Lack of frequent and sizeable issuances hence, no pricing guidance and liquidity

Implementable Solution to address the challenges of resource crunch in ULBs

Sr. No.	Proposal	Time Lines	Stakeholders
1	Innovative Structuring of Municipal Bonds for wider acceptability by Markets (Investors, Rating Agencies, Intermediaries etc) To create template of some model structures which can be used by ULB's to structure their debt This template to be created through consultation with ULB's who have borrowed, Investors, Rating Agencies, Arrangers etc Such standard template structures will have the benefit of easier & faster evaluation by investors, rating agencies & other market participants	4 to 6 weeks for suggesting first standard template Termsheet/ Structure which can be modified basis dynamics of market (evolution of accounting norms, SEBI Regulations, introduction of any new structure in market etc) This Template will serve as just a standard and ULB's and market will be free to develop their own Termsheet and Structure as well	ULB's with history of borrowing + Existing as well as potential Investors + Merchant Bankers + Rating Agencies
2	Formulate UIDF Credit Shortfall Support Scheme/ Guarantee, to aid borrowing by weaker Tier II & Tier III ULB's	2 months	NHB, MoUHA, SEBI, ULB's, Rating Agencies
3	Revival of Pooled Finance Development Fund		MouHA
4	Uniform Accounting Standards under IND AS for ULB's	2 Years	NFRA, ICAI, MouHA, …

Implementable Solution to address the challenges of resource crunch in ULBs

Sr. No.	Proposal	Time Lines	Stakeholders
5	Instead of project specific borrowing as under SEBI ILMDS 2015, allow borrowing for pre-qualified/filtered pool of projects (projects already evaluated by government under some scheme example AMRUT, Smart City Mission etc)	4 to 6 months	SEBI, MoUHA
6	Reforms in Application of User Charges on ULB Services	Ongoing	MoUHA, Central & State & Municipal Governments
7	Development of Municipal Bond Markets		SEBI, MoUHA, PFRDA, IRDAI, Rating Agencies, Merchant Bankers

SUGGESTIONS TO DEVELOP MUNICIPAL BOND MARKET IN INDIA

- ✓ **Demand and supply for Municipal Bonds:**

  Demand for Municipal bonds may be increased through modification in investment guidelines of Mutual funds, PF Trust, Insurance companies etc. for compulsory investing some share in municipal bonds.

- ✓ **Hand holding support to strengthen the capacities to engage with the market:**

  Presently, 163 cities have Investment Grade Rating (IGR) of BBB- and above, which can be enhanced to A+ by strong structuring. Hand-holding Transaction advisors should be appointed for achieving such ratings and for guidance in issuing municipal bonds.

- ✓ **Empowerment:**

  ULBs need powers over municipal borrowings. Currently, any form of borrowing generally requires state government approval. Authority for approving Municipal borrowings should be given at Municipal Commissioner level.

- ✓ **Grants and assigned revenues from the Central and State Governments need to be predictable in quantum and timing.**
- ✓ **ULB's share in MoHUA approved project under AMRUT 2.0 can be raised through Municipal bonds.**
- ✓ **Other innovative mode of raising funds such as Pooled Fund, InvIT, etc. may be used by ULBs.**

SUGGESTIONS TO DEVELOP MUNICIPAL BOND MARKET IN INDIA

- ✓ **Incentivize Investors:**

  Bonds issued can be made tax-efficient for increasing retail participation.

- ✓ **Regulatory Incentives**:

  Constitution of pooled finance development fund; that allows smaller ULBs to pool assets and issue bonds backed by pooled assets.

  Constitution of a state level body to monitor the accounting and budgeting processes of ULBs, thereby allowing uniformity in measuring ULB's performance.

- ✓ **Issuers:**

  Plan a pipeline of projects and regularly issue bonds so that investors have some incentive for creating limits.

Thank you