

Municipal Finance - Roadmap for Sustainable Borrowing to fund Capital Investments

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Setting The Municipal Finance Context : Constraints To Increasing Own Source

Factors Responsible
for the Tiny Size of
the Urban Sector

A Property Tax Dominated Municipal System

Low or Near Zero Productivity of Many Municipal Taxes

State Policies Towards Property Taxation

Inefficiencies in the Internal Management of Resources

Large Scale Subsidies in Service Provision

Irregular State Transfers

Current Fiscal Status of ULBs

- ▶ ULBs work in a complex and ever-changing fiscal policy environment; a significant portion of ULB receipts come through state and central government transfers and schemes.
- ▶ Own-source revenues are dynamic, changing from year to year
- ▶ There are financial and political impacts for all capital project decisions—there is never enough funding!
- ▶ For this reason key elements of fiscal planning are outside direct control of ULBs, but it is still possible to look at alternate mechanisms for resource mobilization and funding for urban infrastructure projects.

Funding Sources

- ▶ ULBs need to evaluate long-term financing goals and make sure they are maximizing all the funding sources that are available to them: this will mean taking full advantage of all revenue sources that the city controls.
 - ▶ Are essential services able to fund operations and maintenance from the user fees?
 - ▶ Can proposed projects or existing revenue sources generate additional revenues that can be used to finance projects that do not generate receipts from fees and charges?

Stronger “creditworthiness” improves a city’s ability to access different financing resources

- ▶ All lenders, domestic and international have criteria for lending to local governments to support capital projects; “credit quality” can mark a cut-off point.
- ▶ Creditworthiness is a positive quality, and it takes work and commitment to maintain it
- ▶ Look at available funding sources: own-source revenues, grants and subsidies from the state or central, and borrowing
- ▶ Borrow only what is needed and what the city can realistically repay

Commercial Sources Of Borrowing



Urban Infrastructure Term Loan Market

- Traditionally, ULBs borrowed from LIC and HUDCO backed by State Government guarantee
- Over time, LIC's incremental lending to this sector has come down
- HUDCO continues to lend to ULBs and urban infrastructure projects (Sabarmati Riverfront Project SPV), though the relative quantum of loans to this sector has gradually reduced.
- HUDCO has used revenue escrow arrangements as part of the security mechanism to support municipal debt repayments.
- However, HUDCO has preferred to rely on State Government guarantees as credit enhancement for loan repayment, in addition.
- Greater Hyderabad Municipal Corporation(GHMC) has upgraded all municipal roads during the pandemic shutdowns using a 4000 Cr. Term loan from State Bank of India(SBI) which had a State Government guarantee as credit enhancement. Recently, GHMC has raised additional 800 Cr. Term loan from SBI without State Government guarantee.

Borrowing Through State Level Financial Intermediaries

- ❑ **Tamil-Nadu Urban Development Fund (TNUDF)** was established in November 1996 as a trust fund by the Government of Tamil Nadu
 - ▶ TNUDF has borrowed from the World Bank and bilateral agencies such as KfW for on-lending to urban infrastructure projects implemented by ULBs as well as PPP projects in the sector.
 - ▶ TNUDF has funded more than 250 projects till date.
- ❑ **Karnataka Urban Infrastructure Development and Finance Corporation (KUIDFC)**
 - ▶ was incorporated as a public limited company in 1993.
 - ▶ KUIDFC procures funds from Government of Karnataka, Government of India, World Bank, ADB and from financial markets and provides financial and technical assistance in the form of loans and grants to ULBs, development authorities and water supply boards.
- ❑ **Madhya Pradesh Urban Development Company Limited (MPUDC)** - Assist ULBs in raising funding from development partners, future goal includes providing assistance in accessing capital markets.
- ❑ **Other State Level Intermediaries:**
 - Orissa Urban Infrastructure Development Fund(OUIDF),
 - Andhra Pradesh Urban Finance and Infrastructure Development Corporation Limited ,
 - Rajasthan Urban Infrastructure Finance & Development Corporation Limited,
 - Bihar Urban Infrastructure Development Corporation Limited etc.

Initial Phase of Municipal Bond market Development in India

- ▶ Historically, Urban Local Bodies issued bonds backed by state government guarantees which were treated as state government securities by the banking system.
- ▶ The fiscal stress faced by the Government of India and state governments in the early 1990s led to a move away from this form of state government guaranteed borrowing to support municipal urban infrastructure investments.
- ▶ In this context, the concept of issuance of municipal bonds without recourse to state government guarantees was proposed by the USAID FIRE-D project and subsequently elaborated by the Rakesh Mohan Committee on Commercialization of Infrastructure Projects.
- ▶ The FIRE-D project engaged CRISIL to develop a framework for credit rating of municipal bonds which led to the first municipal bond issuance without state government guarantee in 1998 by Ahmedabad Municipal Corporation.
- ▶ This was followed by a spate of municipal bond issuances, though small in number and size.

Leveraging Through Municipal Bonds

Promoted by Government of India and governed under the SEBI Issue & Listing of Debt Securities by Municipalities, 2015

Debt instruments issued by a civic body to finance capital with fixed amount of principal with interest to be repaid over a time

Just like other bonds, municipal bonds are also given credit rating, showcasing their investment worthiness, ranging from AAA to D,



Bonds are mostly secured with well- defined timelines for meeting interest and principal repayment obligations

Money raised generally used to fund city development, including the Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and smart cities and other infrastructure projects

These bonds are listed on the Stock Exchange i.e. NSE or BSE and are tradeable

Recent Municipal Bond Issues - 2013 Onwards

S.No.	Issuer	Issue Opening Date	Issue Amount (Rs. in crore)	Tenure (in years)	Put/ Call Option (in years)	Coupon Rate	Interest Payment	Credit Rating
1.	Pune MC	20/06/2017	200.00	10 years	None	7.59%	Semi-annual	AA+
2.	GHMC	16/02/2018	200.00	10 years	None	8.90%	Semi-annual	AA
3.	Indore MC	28/06/2018	139.90	10 years	7 years	9.25%	Semi-annual	AA(SO)
4.	GHMC	14/08/2018	195.00	10 years	None	9.38%	Semi-annual	AA
5.	APCRDA	16/08/2018	2000.00	10 years (5 STRPPs)	None	10.32%	Quarterly	A+(SO) & AA- (SO)
6.	Bhopal MC	25/09/2018	175.00	10 years	7 years	9.55%	Semi-annual	AA(SO)
7.	GVMC	21/12/2018	80.00	10 years	None	10.00%	Semi-annual	AA(SO)
8.	Ahmedabad MC	11/01/2019	200.00	5 years	None	8.70%	Semi-annual	AA+(SO)
9.	Surat MC	27/02/2019	200.00	5 years	None	8.68%	Semi-annual	AA+(SO)
10.	GHMC	20/08/2019	100.00	10 years	None	10.23%	Semi-annual	AA
11.	Lucknow MC	13/11/2020	200.00	10 years	None	8.50%	Semi-annual	AA & AA(CE)
12.	Ghaziabad MC(2021)	08/04/2020	150.00	10 years	None	8.1%	Semi-annual	AA & AA(CE)
13.	Vadodara MC (2022)	24/03/2022	100.00	5 years	NA	7.15%	NA	AA+ & AA
14.	Indore MC (2023)	10/02/2023	244.00	9 years	NA	8.42%	Semi-annual	AA+
15.	Pimpri Chinchwad MC (2023)	28/07/2023	200.00	5 years	NA	8.15%	Semi-annual	AA+

Municipal Bonds - Major Benefits

Financial incentive by Government of India

Government of India has come out with an incentive scheme wherein financial incentive is being provided to the ULBs amounting to Rs 13 Crores for every Rs 100 Crores of bond issued and the incentive to each ULB is limited to Rs 26 Crore.

This incentive scheme was first brought in FY 2018-19. In FY 2020-21, the incentive will be given to first 7 ULBs coming out with its bond issuance

Timely completion of projects

The immediate availability of funds shall help in timely completion of projects for which funds are being raised which may otherwise get delayed due to delay in availability of funds

Benefit to public at large

The timely completion of the projects shall also benefit the general public at large who will be the main beneficiaries from completion of the projects for which funds are being raised by getting better and improved facilities.

Generation of incremental revenues

The timely completion of projects may also help the Corporation to generate incremental revenues either directly or indirectly.

Improvement in financial discipline

The process of issuance of Municipal Bond increases the financial discipline and also improves the professionalism in delivering services by the Municipal Corporations.

Municipal Bonds - Major Challenges

Poor Financials and unstreamed

In debt capital markets, majority of investors consider financial position of any issuer as one of the key factor for investment. In case of ULBs, quite a few have strong financial position. However this challenge may be overcome by creating proper bond servicing structure where in escrow of strong revenue streams may be done.

Lack of regulatory framework

Pre July 2015, there were no specific regulations regarding issuance of Municipal Bonds in terms of various disclosures, eligibility criteria etc. this challenge is addressed by SEBI through specific guidelines for issuance of Municipal Bonds in January 2015 (addressed)

Lack of Demand

Due to lack of initiatives, these bonds were not able to create demand or particular appetite in the debt capital Markets. Major investor for such bonds are QIB's. However during last 4 years, due to Government initiatives, Various ULBs have raised Rs 3689 Crs approx. in bond issues as compare to total of Rs 1695 Crs raised by various ULBs till 2016.

Others

Preparation of A/Cs as per regulations, Market Making, Disclosures and continues compliance etc.

Other Potential Issues In Bond Financing

Enabling Bond Financing

- ▶ Regulatory framework
- ▶ Perception issues

General Obligation	Structured Debt Obligation
Revenue	Pooled Finance Scheme Bond

Preparedness pointers

- ▶ Credit enhancement is no substitute to project development at ULB level
- ▶ If bonds issued, but project is delayed, payment clock already started
- ▶ Proceeds kept in Treasury/ permissible assets: would earn less than Bond payment obligations

- Efficient project development & management at core
- Bond finance could otherwise end up being high cost option

Other Potential Issues In Bond Financing

Enabling Bond Financing: Municipality focus

- ▶ Double entry accrual accounting in place
 - ▶ Computerised accounts
- ▶ Audit and disclosures in place
- ▶ Property tax coverage and current collection efficiencies ideally > 90%
- ▶ Ringfencing mechanisms in place supporting projects & repayment
 - ▶ Ideally with clear cost recovery models from designated project portfolio
 - ▶ Credit enhancement/escrow mechanisms: support the framework: should not be seen as constituting the framework



Case Studies of First Green Bonds Issued by Ghaziabad Municipal Corporation and Indore Municipal Corporation

Ghaziabad Nagar Nigam (GNN) - First Green Bonds Issued in India

Green Bonds in India

Green bonds are the bonds issued by any sovereign entity, inter-governmental groups or alliances and corporates with the aim that the proceeds of the bonds are utilized for projects classified as environmentally sustainable.

GNN is the first ULB to launch Green Municipal Bonds in India

India started issuing green bonds since 2015. As of February 12, 2020, the outstanding amount of green bonds in India was US\$16.3 billion India issued green bonds of about US\$8 billion since January 1, 2018, which constituted about 0.7 per cent of all the bonds issued in the Indian financial market.

Investors should consider **green bonds** as part of their portfolio because this type of **bonds** carries lower risk than other **bonds**. The salient feature of **green bonds** is that though proceeds are raised for a declared **green** project, repayment is tied to the issuing company and not the success or failure of the projects

Case Study of Ghaziabad Nagar Nigam Green Bonds

Transformation of GNN

Since the work began for the bond issue of GNN, during the past more than 2 years, there has been a complete transformation in the functioning and financial discipline of GNN

Credit enhancement from A- to AA

The credit rating assigned to GNN around three year ago under AMRUT mission of Government of India was 'A-'. However, there has been a major turnaround and rating is upgraded by five notches to 'AA' due to transformation in functioning, financial discipline, innovative structuring and Government keenness to develop the municipal bond market

Improvement in financial discipline

There has been vast improvement in the financial discipline of GNN in the past 2 years. Financial systems and accounting practices have improved a lot and time lag for completion of audit has also reduced to a great extent

Innovative structuring

The structure of GNN bonds is very innovative with high cash liquidity and support of the State Government

Initiative of the State Government

State Government took the initiative to develop municipal bond market and formed a policy to promote municipal bonds in the State of UP

Various Green Initiatives Taken by GNN

Revival of 46 water bodies in the city.An amount of Rs. 1 crore is already granted for the project **GNN** has undertaken this task to revamp all those water bodies of which 5 have been restored in its natural state.

City forest development – GNN is establishing 2 city forest with own resources. **GNN** has allotted funds to make a botanical park

Dust free Ghaziabad –To make road sides dust free by use of cut stones.**Additionally,** for open patches of dust, steps like grassing and new green belt restorations being undertaken.**An amount of Rs.20 crore** has been allocated as per the approved budget for this purpose.

Development of 1300 parks-GNN has undertaken the task of development and maintenance of 1300 parks in the city, of which 900 parks are developed and tendering has started for development of additional 200 parks started.**An amount of INR 20 Cr.** has been allocated as per the approved budget for this purpose.

GNN has undertaken the initiative of conversion of all diesel based vehicles to **CNG**. Further **GNN** has decided to buy in future any new procurement in **CNG** taking into consideration the pollution and falling air quality index.

Air filters- Plan to install 30 air filters at various places of severe air quality conditions.**Work sanctions** have been given by the committee.

GNN has also taken the initiative of **Plastic waste recycling** and making different usable products from the same. **MoU** has been signed with local artists for this purpose

Underlying Green Project

Ghaziabad Nagar Nigam proposes to undertake the project for setting up a Tertiary Sewage Treatment Plant ("TSTP") to further treat secondary-treated sewage water.

The Issuer has entered into a Memorandum of Understanding ("**MoU**") dated February 17, 2021 with Sahibabad Industries Association ("**SIA**") for the purpose of achieving various goals and objectives relating to the water supply to all the industrial units of the Second Party for their industrial use

Uttar Pradesh Pollution Control Board vide letter dated February 17, 2021 has certified the Project as appropriately covered under sub-clause (f) of Clause 2.1 of SEBI Circular on Disclosure Requirements for Issuance and Listing of Green Debt Securities issued via CIR/IMD/DF/51/2017 dated May 30, 2017

The Eligible Green Project is of a revenue generating nature and is expected to yield revenues after 30 months from the project work start date.

This project would enable GNN to reduce pressure on ground water resources in the city and free up the supply of potable water to Sahibabad industrial area.

Financial Snapshot of Ghaziabad Nagar Nigam

Particulars	FY 2017-18 (Audited) (INR in Crores)	FY 2018-19 (Audited) (INR in Crores)	FY 2019-20 (Audited) (INR in Crores)
Total income	398.51	425.26	474.62
Total expenditure (excluding depreciation)	276.35	294.57	341.29
Surplus (before depreciation)	122.16	130.69	133.33
Depreciation	30.74	32.56	34.53
Surplus (after depreciation)	91.42	98.13	98.80

Major Terms of Ghaziabad Nagar Nigam Green Bonds

Rating of Instrument	AA by India Ratings and AA(CE) by Brickwork Ratings
Issue Size	Rs.150,00,00,000 (Rupees One Hundred and Fifty Crore only)
Objects of the Issue	Incurring capital expenditure in respect of the project of Tertiary Sewage Treatment Plant of 40 MLD net output capacity at Indirapuram to generate industrial grade water under GNN for reuse of treated waste water from existing 56 MLD Indirapuram STP in Ghaziabad
Tenor	10 (Ten) years from the Deemed Date of Allotment
Redemption Amount	Principal repayment to happen annually, from the expiry of 4 (Four) years from the Deemed Date of Allotment, in 7 (Seven) annual instalments (STRRP Structure)
Security	<ul style="list-style-type: none"> • Legally enforceable and tenable exclusive first charge over specific Fixed Asset of the municipal Corporation with minimum cover of 1.25 times of the total amount borrowed • First and exclusive charge over the Escrow Account and the account(s) where the 'Tax Revenues and Revenue Grants' (which are free from all charges) are collected and/ or pooled by Ghaziabad Nagar Nigam in each case to the extent of the 'Tax Revenues and Revenue Grants' (which are free from all charges) collected and/ or pooled in each of such accounts; • First and exclusive charge over Escrow account, Interest payment account (including the DSRA Amount) and Sinking fund account and all permitted investments made through these accounts and investments made by utilising the AMRUT Incentive
Structured Payment Mechanism	<ul style="list-style-type: none"> • Transfer of collections from 'Tax Revenues and Revenue Grants' (which are free from all charges) in a separate escrow account • Monthly funding of Interest payment account (20% of half yearly interest payment for 5 months) • 4 half year DSRA Amount (For interest) • Sinking fund (1% each month for 10 months every year until redemption i.e. 10% annually) • Replenishment of DSRA Amount and/or funding the shortfall in sinking fund account from Infrastructure Development Fund (IDF) of GoUP as per the timelines of structured payment mechanism
Gol Incentive	<ul style="list-style-type: none"> • Gol incentive of Rs.19.5 Crores to be deposited in fixed deposits which shall be lien marked in favour of the trustee in the form of security until maturity

Government of Uttar Pradesh Policies to Promote Municipal Bonds

- ▶ Government of Uttar Pradesh, in July 2019, came out with a policy to promote Municipal bonds in the State of UP wherein the amount of Infrastructure Development Fund (IDF) maintained at State Govt. Level for Urban Local Bodies may be utilized for credit enhancement/structuring of bonds. The State Govt. has issued a G.O. in this regard on 30th July 2019.
- ▶ Out of the 2% additional stamp duty collected by the State Govt. on transfer records of immovable properties located under Urban Local Bodies, 0.5% is made available in IDF for Urban Local Bodies. The said amount of 0.5% comes out to approx. Rs. 600 Crores annually.
- ▶ The benefit of this policy can be availed by first 5 ULBs of UP State which comes out with its bond issue. LMC became the first ULB in UP to avail benefit under this policy for its bond issue .
- ▶ In order to achieve the desired credit rating/enhancement, this policy provides for utilization of funds available in Infrastructure Development Fund at State Govt. level in specific pre-defined circumstances for repayment obligations of bonds raised by ULBs on priority basis.
- ▶ The benefit of this policy can be availed by those ULBs which issues Municipal Bonds in accordance with SEBI guidelines.

Prospects for City Credit Rating and Municipal Bond Issues

- ▶ The process of going in for a municipal bond issue involves a paradigm change in municipal functioning, outlook and attitudes.
- ▶ This is the reason why many cities in India have preferred to wait and rely on grant funds from higher levels of government rather than accessing the bond markets.
- ▶ The whole process demands substantial improvement in governance, planning and financial management, which is feasible only through substantial hand-holding and sustained capacity building.
- ▶ Therefore, exposure to the idea of credit rating / creditworthiness and municipal bonds alone will not create the climate for substantial participation by cities in municipal bond markets and the concomitant climate change initiatives.

Prospects for City Credit Rating and Municipal Bond Issues

- ▶ IFIs and governments need to put in the right incentives in the form of funds (for use as credit enhancement tools) and technical assistance for hand-holding cities to take this initiative forward.
- ▶ Hand-holding assistance would entail support for preparation of relevant projects, a financing plan and the gap which needs to be met through municipal bonds/municipal borrowing and help in preparing information dossiers needed by Rating Agencies and capital markets.