### Market - Based Financing of Urban Infrastructure | ...

Chetan Vaidya

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#### INFRASTRUCTURE

Market-Based Financing of Urban Infrastructure

A market-A market-based approach to financing urban infrastructure linked with JNNURM with JNNURM will further strengthen ULBs and help achieve the decentralization objective of the 74th Constitutional Amendment

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have to look for alternative sources for financing their infrastructure costs. Market-based financing has emerged as a viable alternative to finance infrastructure investments. Market-Based Financing System

System Since 1994, the Indo-US Financial Institution Reform and Expansion (FIRE-D) project is working with national, state and local governments in India to develop a market-based bond market. Several ULBs and unitiy organizations have issued bonds: hat so far have mobilized over Rs.1,2349 million through taxable bonds, tax-free bonds and pooled financine (Table L).

Table 1: Municipal Bonds in India		
S. No.	Type of Bond	Amount (Rs in Million)
1.	Taxable bonds	4,450
2.	Tax-free bonds	6,495
3.	Pooled finance	1,304
	TOTAL	12,249

redit Kating In 1995, the Credit Rating nformation Services of India imited (CRISIL) to develop a tethodology for carrying out nuncipal credit ratings based on areful study of ULBs in India nd international experience. study of ternational experience. labad was the first city this methodology was in India. In February 1996, dabad received a rating RISIL for a bond offering. ng in

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gest urban population ... rld. The proportion of t sulation was 27.8% in the 01 and the decadal grow woi popt 2001 urban '9° The ur ed financi hip urban pooled mancing. The JNNORM, a flagship urban investment program of Government of India encourages ULBs to link the projects with market-based financing. The market and Rs. access is important the financing of urbar in the country. In 2001, about 286 million persons were living in urban areas of India and it was the second

system has come to be regarded by India's private financial community as a solid indicator of a city's performance and competitiveness. In the lass 12 years, all major rating agencies – CARE, PTCI, ICRA and CREIT. have provided enterprise bend offerings. Under DNNURM, about 52 cities have been credit rated and out of them about 42 have received investment grade rating. **Tachabe Municipal Bon5** system, strengtl workforce and fin and development capital improven to these measure ntofa turn around its a cash deficit to achieve a co Rs.2,140 mill These reform groundwor and the su of the wat project. Taxable Municipal Bonds

Tacabe Vandrigal Bonds The Government of India recognizing infrastructure's key roles in the process of economic development, set up the Expert Group on the Commercialization of Infrastructure, often kown as to be the set of the set of the location of the set of the set of the location of the set of the set of the committee recommended private sector participation in urban indicessing output bards: much indicessing output bards: much indicessing output bards: much indices in the set of the set of the location of the set of the set of the sector participation in urban indicessing output bards: much indicessing output bards in the set indices in the set of t The debt Ah cap guar cases, bon used to fun schemes or city gove mobilized a from the do through tax

accessing capital markets through issuing municipal bonds. The Ahmedabad Municipal Corporation (MAC) was the first ULB to access the capital market in *Lemmy* 1998. Insued Rs 1,000 million in bonds to partially functor in the second second second second second market and assering project. This was the first manicipal bond issued in hefts without a state guarantee and previously instituted significant functually instituted agenificant including improved its collection, computerization of its accounting To boost the municipal market, the Government of decided to provide municip speech of Minister of India to issue The Go guideli municip These g cipal bonds. Duri ch of 1999-2000. in Fe buy

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project, compulsory stellir rating, and external monitoring of the taxofree municipal board. Tax-free local powerments to improve their local powerments to improve their neutron of the stellar stellar stellar community. Abancelabased was the first municipal corporation in fadia to first water and severage projects. In 6pr42 1002, ARC issued a tax- free (By-per boad with an annual first (By-per boad) with an annual first (By-per boad) with an annual first (By-per boad) with an annual boad issue anored water stellar stellar boad issue anored water skellar boad issue anored water skellar boad issue anored with a stellar boad was and for providing urban boards beam the stocod of the issue tax- free manicipal boads. The money boards boards of the stellar boards was also for providing urban boards was also for providing urban boards was also for providing urban independent stellar stellar stellar boards was also for providing urban interest of s.50 percent.	A special purpose vehicle, the where and Sentator Nodel Fanal Ware and Sentator Nodel Fanal Ware and Sentator Nodel Fanal Ware and Sentator Nodel Fanal Sentator & R. 304 Sentator Nodel Sentator Sentator & R. 304 Sentator Nodel Sentator Nodel Sentator Sentator Nodel Sentator Sentator Nodel S	and Sanitation Pooled Fund (KWSP) was established under (KWSP) was established under (KWSP) was established under (KWSP) was established to the observation of the the the stablished of the participating (LBL: The KWSPF) was established (LBL: The KWSPF) borrowed from the market and observation of the the KWSPF) borrowed from the market and observation of the the the the stablished observation of the million taken by the the the stablished observation of the million taken by the the stablished observation of the million taken by the the stablished observation of the stablished observation of the stablished observation of the bord observation of the stablished to similar credit enhancement the bords tenure to 15 years.
	water supply schemes, and provide	The success of the pooled
Pooled Financing	underground drainage and solid waste management schemes. The	finance model as demonstrated in the States of Tamil Nadu and
Only financially strong, large municipal corporations are in a	issue demonstrated a successful	Karnataka subsequently led the Government of India to create a
position to directly access capital markets. Most small and medium	model of pooled financing in India.	central fund that enables capital investments to be pooled under
ULBs are not able to directly access capital markets on the strength of	Subsequently, the Government	one state borrowing umbrella.
their own balance sheets. Also, the	of Karnataka used the concept of pooled financing to raise	The objective is to provide a cost- effective and efficient approach for
cost of the transaction is another barrier. In the United States and	debt from investors for the Greater Bangalore Water	smaller- and medium-sized ULBs and to reduce the cost of borrowing.
elsewhere, small local bodies pool their resources and jointly	Supply and Sewerage Project (GBWASP). This project covers	FIRE-D project supported GoI's MOUD in formulating the Pooled
access the capital market. Based on this model, the Governments of Tamil Nadu and Karnataka	eight municipal towns around	Finance Development Fund (PFDF)
	Bangalore and has a total project cost of Rs.6.000 million. These	Guidelines to help small- and medium-sized ULBs access market
issued municipal bonds by pooling municipalities.	cost of Rs.6,000 million. These eight municipal towns were merged with the Bangalore	funds for their infrastructure projects and to encourage municipalities
In 2003, the Tamil Nadu Urban	Municipal Corporation. A debt	undertake fiscal, financial and institutional reforms required to
Development Fund issued a bond	tunu carreu me Karnataka water	
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create efficient and equitable urban	· Commercial banks,	bond structures that respond t
centers.	governed by the RBI's asset and liability management	investor needs while providir the issuer with the longe
Linkages with JNNURM The Government of India has	governed by the RBI's asset and liability management (ALM) requirements, prefer to lend over the short- to	investor needs while providir the issuer with the longe possible tenor, lowest possib interest rate, and lowest possib
Linkages with JNNURM The Government of India has attempted to meet the challenge	governed by the RBI's asset and liability management (ALM) requirements, prefer to lend over the short- to medium-term as their assets	investor needs while providir the issuer with the longe possible tenor, lowest possib interest rate, and lowest possib cost of issuance.
Linkages with JNNURM The Government of India has attempted to meet the challenge of inadequate urban infrastructure through a flagship program, the	governed by the RBI's asset and liability management (ALM) requirements, prefer to lend over the short- to medium-term as their assets and liabilities are short- to medium-term in nature.	investor needs while providin the issuer with the longe possible tenor, lowest possib interest rate, and lowest possib cost of issuance. • There are a variety of "administrative and manageria
Linkages with JNNURM The Government of India has itempted to meet the challenge of inadequase urban infrastructure through a flagbid program, the through a flagbid program, the Reaseway Mission (JNNURM) JNNURM must complete a value JNNURM must complete a value to 22 reforms, some mandatory and some optional, during the INNURM anterULB under INNURM governance and enpowering has located backs, introduction	governed by not RHI start and Liability management (ALM) requirements, prefit to lend over the short- to main the short- to main and liabilities are short- to mediam-fermi in nature. Further, bracks cannot lake coportex to ULB financing in bonduinstruted instruments that and the origination of the second start of the short to the second start of the seco	investor needs while provide the issuer with the longe possible tenor, lowest possib- interest nice, and lowest possib- cost of issuance. There are a variety v "administrative and romagerize constraints that inhibit an discourage potential issuers municipal bonds. Though, no efforms initiated by the Minist of Urban Development shall be change the situation. Front et al. (Urban Development shall be change the situation. Front of the Ulban Therefore, the mini- gencies many start of the situation of the optimal and the equity an fet Ulban. Therefore, the mini- serveice many start of the situation of the second start communicate the second start communicate the situation of the situation of the situation of the situation of the situation of the second start communicate the situation of the situation of the situation of the situation of the situation of the second start communicate the situation of the situation of the second start communicate the situation of the situation of the second start start of the situation of the situation of the second start start of the situation of the situation of the second start start of the situation of the situation of the second start start of the situation of the situation of the situation of the second start start of the situation of the situation of the situation of the second start start of the situation of the second start start of the situation of the situa
Enlages with JNNURM The Government of India has tempote lo more the challenge through a Ingahi program, the challenge and the second second through a Ingahi program, the NNURM must complete a wall NNURM must complete a wall NNURM must complete a wall NNURM must complete a wall nundatory and goingten Herms of sates 400 LUBs under the NNURM include decentification of urban when focus ballengi. Introduction of improved accounting systems improved revenue hase, reform of rent control acts, delivery of service property and the NNURM international systems in the NNURM of rent control acts, delivery of services in proceed. The NNURM	<ul> <li>governed by not RHII start and liability management (ALM) requirereast, prefer medians-error is their avers and liabilities are short-to medians-error is their avers and liabilities are short-to medians-error is their avers in the exposure to ULB financing is buoki-intraction interaction and the or bunch- leading by backs in the form endoacement, hedging took for relative transferred and the requirements.</li> <li>Since there is lack of credit enhancement, hedging took for interaction and subject to sub- requirements.</li> <li>The financing on such set interac- tion manicapies to be risky.</li> <li>The financing on such set interac- from manicapies boards does not such as the subject to be does not present to implement to be risky.</li> </ul>	investor needs while provide the issuer with the longe possible trans, hence possible cost of issuers and the second second cost of issuers and manageric constraints that inhibit a discourage potential issuers manifold long. Theogen, is discourage potential issuers manifold longers and the second cost of the second second second second second cost of the second second second second second cost of the second second second second second second cost of the second second second second second second cost of the second second second second second second second cost of the second second second second second second second cost of the second second second second second second second cost of the second second second second second second second second second sec
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Charace with PNUEME The Supervised of the Labelenge interprete in one with the Labelenge interprete in one with the Labelenge interprete interpr	govened by the RHI same and Liability imagement (ALM) requirereas, prefer median-server in the same and the same shows and the same median-server is used as the same and the same same same and the same same same same and the same same same take exposures to ULB financing by backs in the ferm of loase in a object to such requirements. Since there is lack of credit enhancement, heights to lot of the same same same same and limited critically of credit information, investors perceive municipal backs are shared by the enhancement of the same same and limited critical same same same response to the resky. The face capo nature same same response to the resky. The face capo nature same same response to the resky. The face capo nature same same response to the resky. The same same same same response to the resky. The same same same same response to the resky. The same same same same same response to the resky. The same	investor needs while provide the issuer with the longe possible town, however possible cost of issuers, however possible cost of issuers, however possible cost of issuers, however, however administrative and momentaria constraints that inhibit a discourage potential issuers maticipal books. The obtain of Udan Development shalt bechange the situation, Present of Udan Development shalt here is divergeness of opini- er (Uda, Theorefore, hor mit agreesis matter and the situation of the situation of the situation of the opinicate by Udas. There is need for further clar on how the Covernment Inda will operationalized in the RBI approv- ced training agreesy carry the same that the tower books. There is need for further clar on how will the RBI approv- finance Development Books. The for an effort the tower books interactive the situation of the situation of the same that the tower books interactive the situation of the situation of the same that the tower books interactive the situation of the situation of the same that the tower books interactive the situation of the situation of the same that the situation of the situation of the same that the situation of the situat
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Charace with PNUEME The Supervised of the Labelenge interprete in one with the Labelenge interprete in one with the Labelenge interprete interpr	<ul> <li>governed by the RHI sear and Liability management. ACM Jo requirements, performents, performance and the search of the search of</li></ul>	investor needs while provide the issuer with the longer possible term, lowed possible cost of issuers in the longer possible term, lowed possible cost of issuers and mongerin constraints that inhibits and discourage potential issuers runnicipal bonds. Theogh, the Charge be situation, Present and Charge becomes and the situation of the optimal debt equity ratio optimal debt equity ratio potential debt equity ratio projects by ULBs. There is need for further call on how the Covernment India will operationalized tancicioning exclusions. The situation optimal debt equity ratio the situation of the situation optimal debt equity ratio projects by ULBs. There is need for further call on how the Covernment India will operationalized tensor of the ISA Free Pool Finance Development Bonds The funding and refo Finance Development Bonds The funding and refo be addressed by the instituti- de addressed bloods. Of uspoyl-side constraints can be addressed by the instituti- de development I for the institu- de development Bonds. Of uspoyl-side constraints can be addressed by the instituti- de development Bonds of the institution of the institu- development Bonds. Of uspoyl-side constraints can be addressed by the institution address. Therefore a Work

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Linkages with JNNURM inkages with JNNURM The Government of India hass ttempted to meet the challenge f inadequate urban infrastructure rrough a flagship program, the awaharlal Nehru National Urban interes and ULBs accessing the attempt of inad mal Urban NURM). essing the ete a total mandatory luring the 5-12). The reforms of er the JNNURA , delivery of The JNNURM s to poor, etc. The JNNURM ages ULBs to access market-financing and PPP for urban tructure projects that are by the Mission. The Nagpur ipal Corporation issued a : million municipal bond in 2007 to fund a WSS project JNNURM.

raints for Municipal Supply-side Constraints are:

tional investors with rm funds face regulatory aints on purchasing pal bonds: n

utional investors such

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Institutional investors such as the insurance companies are constrained because of restrictions imposed by the investment guidelines of the Insurance Regulatory Development Authority (IRDA).

exceed the cap. Given the poorly developed government securities market, municipal bonds are relatively illiquid investments for lack of exit opportunities for institutional investors. Further, there is an inefficient clearing and settlement mechanism. and side constraints are: agendas of the JNNU PFDF will help to There are too few creditworthy issuers seeking bond financing. There are too few financially viable projects seeking bond financing.
 There is a lack of intermediation support to help issuers achieve

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Commercial banks, governed by the RBI's asset and liability management (ALM) requirements, prefer to lend over the short- to medium-term as their assets and liabilities are short- to medium-term in nature. bond structures that respond to investor needs while providing the issuer with the longest possible tenor, lowest possible interest rate, and lowest possible cost of issuance. There are a variety of "administrative and managerial"

medium-term in nature. Further, banks cannot take exposures to ULB financing in bonds/structured instruments due to 'mark-to-market'' requirements. Lending by banks in the form of loans is not subject to such resolutions. "administrative and managerial" constraints that inhibit and discourage potential issuers o municipal bonds. Though, the reforms initiated by the Ministry rgence al debt on the optima for ULBs. The

requirements. Since there is lack of credit enhancement, hedging tools for investors to mitigate credit risk, and limited reliability of credit information, investors perceive municipal bonds to be risky. optimal debt equity projects by ULBs. There is need for further on how the Governm India will operational The fixed cap on tax-free interest from municipal bonds does not respond to market conditions. Municipal bonds become unattractive when market rates exceed the cap. sanctioning mecha Tax-Free Pooled Development bonds.

There is need for furth on how will the RB1 a credit rating agency of the surveillance throug tenor of the Tax Free Finance Development

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address the key supply-side constraints that impede further development of India's long-term municipal bond market. Recommendations to the responsible institutions regarding the supply-side constraints are:

- Expand the range of "approved investments" for insurance and pension organizations to include municipal bonds of investment grade or higher. General Purpose bonds may also be included in the list of 'infrastructure' category.
- Municipal bonds to be classified under 'hold to maturity' category rather than in 'marked-to market' category.
- Specify municipal bonds under the 'priority sector' category for investment/lending purposes.
- Provision of "bond insurance" as credit enhancement may be explored as a security against default by municipal bodies.
- Review the 8% cap on interest rate for tax-free municipal bonds and prescribe a benchmark market rate linked to State Bank of India-Prime Lending Rate rather than an absolute percentage.
- Provide investment opportunity in municipal bonds to individual/retail investors, CBDT to include municipal bonds in the list of eligible investments/ subscriptions for the purpose of claiming deduction under section 80C of the Income Tax Act, 1961.
- Include municipal bonds in the list of eligible investments for Employee Provident Fund Organization.

Great progress has been made in developing the policy and legal framework for local governments to access the capital market to finance urban infrastructure. However to routinely access capital markets, ULBs will have to have the capacity to develop commercially viable projects. The most critical factor for obtaining market finance will be a healthy municipal revenue base. A market-based approach to financing urban infrastructure linked with JNNURM will further strengthen ULBs and help achieve the decentralization objective of the 74th Constitutional Amendment.

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