



BUILDING DOMESTIC PUBLIC CAPITAL MARKET INSTRUMENTS

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INDIA

Urban Infrastructure Financing & Development Options

PROJECTS



SOURCES OF FUNDS



INTERVENTIONS



CAPACITY REQUIREMENTS

ACCOUNTING & OPERATIONAL REFORMS, PRIVATE SECTOR MANAGEMENT, PROJECT DEVELOPMENT & PLANNING, TARIFF REFORMS, CAPITAL MARKET MGT.



EMERGING TRENDS IN URBAN SECTOR

- ◆ Urban sector is at the cross roads
- ◆ Availability of resources in the financial sector is not a constraint
- ◆ Channeling these resources to the urban sector is crucial
- ◆ Flow of resources to the urban sector will be facilitated by enhanced perception of credit quality of these entities in the financial markets and well structured projects
- ◆ Few municipal entities with high stand alone credit quality
- ◆ Sharp distinctions in credit quality between octroi and non - octroi levying bodies.



EMERGING TRENDS IN URBAN SECTOR

- ◆ Improving the credit/fiscal profile of Urban Local Bodies in the crux of Urban Sector Reforms
 - Financially sound entities would be in a position to invest in civic infrastructure
 - They would also be in a position to attract private sector capital - both through capital markets as well as PSP



MUNICIPAL BONDS (MBs)

- ◆ Concept of MBs as an additional mechanism for raising resources for urban infrastructure sector first presented at an USAID seminar in 1995
- ◆ Later recommended for Commercialization of Urban Infrastructure in India by the Rakesh Mohan Committee
- ◆ Would open new vistas for attracting private capital to the urban infrastructure sector



WHAT ARE MUNICIPAL BONDS

- ◆ MBs are debt obligations issued by cities, and urban sector related governmental entities to raise money in order to finance urban infrastructure
- ◆ Through MBs, investors lend money to an issuer who promises to pay the investors a specified amount of interest (usually paid semiannually) and return the principal on a specific maturity date



TYPES OF MUNICIPAL BONDS

- ◆ **General obligation bonds.** Principal and interest are secured by the full faith and credit of the issuer and usually supported by either the issuer's unlimited or limited taxing power. General obligation bonds are also voter-approved.
- ◆ **Revenue bonds.** Principal and interest are secured by revenues derived from tolls, charges or rents paid by users of the facility built with the proceeds of the bond issue. Public projects financed by revenue bonds include toll roads, bridges, airports, water and sewage treatment facilities, hospitals and housing for the poor.



MUNICIPAL FINANCING IN INDIA

- ◆ Traditionally financed through mix of
 - budgetary allocations from Municipality's own revenues
 - grants from state government
 - borrowing from insurance companies and specialised national level institutions like HUDCO and state level financial institutions
 - limited borrowings from banks/FIs
- ◆ Capital Market access yet at a nascent stage – only 4 years since first municipal bond issue
- ◆ Total Value of Municipal Bonds so far - Rs 7.5 bn
- ◆ Strong interest from several municipal bodies to issue similar bonds
 - a dozen have already accessed capital markets
 - 40 Urban Local Bodies have sought rating

Bond Issuance provide alternate sources of Institutional finance not conventionally available to municipalities

MUNICIPAL BOND ISSUANCES THUS FAR



Municipality / Local Body	Year	Rating	Amount (Rs crore)	Coupon (%)	10 yr G-sec yield
Ahmedabad	Jan 1998	AA(SO)	100.00	14.00	13.3
Bangalore	Nov 1998	A(SO)	125.00	13.00	12.2
Ludhiana	Sept 1999	LAA(SO)	17.80	14.00	11.6
Nashik	May 1999	AA(SO)	100.00	14.75	11.7
Bangalore Water Supply Bd.	Aug 2000	Not Avail.	10.00	12.90	11.4
Kanpur	Dec 2000	LA+(SO)	50.00	13.50	10.9
Madurai	Mar 2001	LA+(SO)	30.00	12.25	10.3
Ludhiana	Jun 2001	LAA-(SO)	2.00	13.50	9.3
Tamil Nadu Urban Dev. Fund	Aug 2001	LAA+(SO)	106.10	11.85	8.9
Nagpur	Nov 2001	LAA-(SO)	31.10	13.00	7.8
Ahmedabad	Mar 2002	AA(SO)	100.00	9.00	7.4
Hyderabad	Mar 2002	AA+(SO)	82.50	8.50	7.4



KEY FEATURES OF AMC BOND ISSUANCE

- ◆ First Municipality Bond Issuance in India
- ◆ Issue Size of Rs 1000 mn
 - Rs 750 mn privately placed with 13 banks and institutional investors
 - Balance Rs 250 mn by way of public issue in January 1998
- ◆ Standalone rating of A+ enhanced to AA(SO) based on Escrow of Octroi collections from 10 identified points (nakas)
- ◆ Credit enhancement (escrow) provided prioritisation of cash flows for payments to bondholders
- ◆ No State / Local Government Guarantee / Support for debt servicing
- ◆ Funds utilised for pre-identified Water Supply and Sewerage Schemes
- ◆ Process took over a year to develop and deliver “first time in India”



KEY TERMS OF ISSUE

- ◆ Issue Size : Rs 1000 mn
- ◆ Purpose : To part finance Water and Sewerage projects
- ◆ Interest : 14% p.a. (G-Sec yield 13.35%)
- ◆ Tenor : 8 years
- ◆ Redemption : At end of 6, 7 and 8th years
- ◆ Security : - First mortgage and charge on corporations property subject to minimum 1.25 times cover
- Structured Payment Mechanism by way of Escrow
- ◆ Listing : National Stock Exchange
- ◆ Credit Rating: CRISIL AA(SO)



AHMEDABAD MUNICIPAL CORPORATION BOND – 2ND ISSUE

- ◆ Arranger for AMC City 2002 Tax-free Bonds in March 2002

Issuer	Ahmedabad Municipal Corporation
Instrument	Tax Free Bonds
Rating	AA(SO) by Crisil
Yield	9% payable semi-annual (10 yr G-Sec yield 7.45%)
Tenor	10 years with put/call at end of the 5th Year
Issue Size	Rs 50 Crore, greenshoe option to retain additional Rs 50 Crore
Issue Open & Close	March 16, 2002 & March 31, 2002
Amount Mobilised	Rs 108 Crore
Amount Retained	Rs 100 Crore



KEY HIGHLIGHTS

- ◆ Nashik – AA(SO)
 - Escrow of octroi
 - Inability to implement security structure led to rating downgrade - subsequently restored
- ◆ Ludhiana – LAA-(SO)
 - Escrow of non-tax revenues like water charges
- ◆ Hyderabad – AA+ (SO)
 - Combination of escrow and cash collateral
 - Replicable model for corporations with substantial revenue surpluses
- ◆ Bangalore - Guaranteed by State Government; Rated A+(SO)
 - Non-utilisation of proceeds resulted in negative carry on bond interest
- ◆ Madurai – LA+(SO) credit enhancement by GoTN's guarantee
 - Escrow of Toll collections on Madurai Inner Ring Road
- ◆ Nagpur – LAA-(SO)
 - Escrow of property tax and water charges



MUNICIPAL BOND ISSUES - KEY LEARNINGS SO FAR

- ◆ Implementation of commercial accounting framework
- ◆ Institutional preparedness to identify, implement and profitability operate projects and schemes
- ◆ Important to position municipality on stand alone basis without state government cover
- ◆ Development of appropriate payment security mechanisms to raise investor confidence and rating
- ◆ Stagger resource raising to align with projected spend profile and in present context also take advantage of softening interest regime



LESSONS FROM MUNICIPAL BOND EXPERIENCE

- ◆ Urban local bodies are open to new concepts and ideas
- ◆ Number of Local bodies have attempted to improve their finances and quality of civic services through administrative measures
 - Ahmedabad, Surat, Ludhiana, Vijaywada, Vizag.....

While initiative for these administrative reforms may have come from pro - active CEO's there is a broad based acceptance at both political and employee level of the need to change



LESSONS FROM MUNICIPAL BOND EXPERIENCE

- ◆ Ahmedabad, Surat have had a demonstrative effect on other cities, this competitive spirit needs to be encouraged
- ◆ While actual number of municipal bond issuances have been few, credit rating has now become widely accepted as a self evaluation tool and a feedback for reform initiatives taken
- ◆ Credit rating, fiscal incentives now offered on municipal bonds, Proposed “Challenge Fund” need to be judiciously used to sustain the momentum of reforms in the urban sector



IMPLICATIONS FOR THE URBAN SECTOR REFORM AGENDA

- ◆ Administrative reforms at the local level need to be pushed to improve financial profile under existing legal framework
 - Accounting and MIS improvement
 - Tax assessment and collection processes
 - Enhancing own revenue base in existing tax structure
 - Expenditure control, manpower rationalization need to be looked into
 - Norms for expenditure also need to be evolved, particularly R&M
 - Commercialization of operations
 - Professionalism in management



IMPLICATIONS FOR THE URBAN SECTOR REFORM AGENDA

- ◆ Training and technical assistance should focus on the following to maximize the impact of reforms
 - Project conceptualization and development, financing and management
 - Financial Accounting and MIS, Computerization
 - Treasury management
 - Costing and pricing of services
 - Public Private Partnerships including familiarity with Bid Evaluation, Bid process management



IMPLICATIONS FOR THE URBAN SECTOR REFORM AGENDA

◆ Policy level issues

- Is municipal bond driven financing of urban projects more workable than private sector investments in projects at this juncture
- Should smaller private sector projects be encouraged first?
- Improving creditworthiness hinges on enhancing revenues through property tax reforms, levy of user charges, rationalizing costs, improving MIS and facilitating private investment, wherever feasible



POLICY ISSUES

- ◆ While some municipal entities may be able to achieve an improvement in financial profile, structural changes involving higher levels of government may be necessary in other cases
- ◆ The City Challenge Fund seeks to provide incentives to cities to embark on reforms that will lead to sustainable improvement in financial profile and quality of services delivered to the residents
- ◆ In order to ensure sustainability of municipal finances and service delivery, cities would need to choose a comprehensive and far reaching reform agenda which needs to be developed to meet specific local requirements. Further, local ownership of the same is critical in order to facilitate its implementation



THANK YOU