Guidance on use of Municipal Bond Financing for Infrastructure projects

September 2017

PPP CELL
DEPARTMENT OF ECONOMIC AFFAIRS
MINISTRY OF FINANCE
GOVERNMENT OF INDIA
Preface

The Government of India (GoI) has identified public-private partnerships (PPP) as an integral element of its strategy for developing infrastructure in our cities. The report of the High Powered Expert Committee on Urban Infrastructure appointed by GoI estimated an investment requirement of Rupees 39 lakh crore\(^1\) over the next two decades to develop infrastructure in Indian cities. The High-level Committee on Financing Infrastructure\(^2\) appointed by GoI also recommended creation of requisite regulatory and contractual frameworks to accelerate the pace of private participation in urban infrastructure, especially in water supply, sewerage, municipal solid waste and mass rapid transit systems.

Urban Local Bodies (ULBs) have tended to rely excessively on budgetary outlays which fall far short of their investment needs. Building capacity in ULBs to make them credit-worthy and to become capable of raising non-grant financing (through PPPs and through access to Capital Markets) therefore, assumes significance. Over the last decade or so, some ULBs have implemented PPPs in Water Supply, Waste-water Reuse, Municipal Solid Waste Management and Urban Transportation. Efforts to evolve robust replicable PPP models and enable wider mainstreaming of PPPs, building on these efforts, are underway.

Initiatives to scale-up PPPs in urban sector need to be complemented with capacity building initiatives to make ULBs bankable, creditworthy counterparties. This is particularly critical in implementing projects for which private investment may need additional financial support, which ULBs may not have ready access to. In such cases, the ability of ULBs to access Capital Markets through Municipal Bonds, which can be serviced through identified future cash flows, would enable them design and implement infrastructure projects with transformative service delivery impact. This ability to raise non-grant resources can help position ULBs as vibrant entities capable of honouring contractual commitments.

On the supply side, India’s corporate bond market has an entire ecosystem (comprising merchant bankers, arrangers, rating agencies, lawyers, stock exchanges, investors, etc.) functioning under a robust regulatory framework, and has enabled several aspirant issuers meet their funding needs. GoI believes that building capacity among ULBs to tap this ecosystem can help nurture a vibrant Municipal Bond market which can serve as an alternative financing channel for Indian cities.

Towards this objective, the PPP Cell, Department of Economic Affairs (DEA), Ministry of Finance has prepared this document to serve as a ready reckoner for cities aspiring to tap bond markets. While it was intended initially to address ULB sources of revenue to service PPP concessionaire payments/related Authority expenditure, it is evolved into a larger Guidance Manual which can serve as a handy reference for practitioners and policy-makers. It provides actionable step-wise inputs on preparatory actions, the regulatory framework and process of bond issuance. This document seeks to make Municipal Bonds a sustainable and alternative resource mobilisation channel by ULBs.

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\(^3\) This Reference Source Book can be accessed at [www.pppinindia.gov.in](http://www.pppinindia.gov.in) hosted by PPP Cell, Infrastructure Division, DEA
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1. **FINANCIAL DISCIPLINE AND INFORMATION DISCLOSURE:** Long term investors are particularly demanding on aspects like accounting discipline, quality of financial reporting and periodicity/level of information dissemination and disclosures. This entails (i) Threshold maturity of accounting systems incorporating accrual accounting principles, (ii) Timely finalisation and audit, and (iii) Transparent high quality information disclosure. SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 require ULBs to prepare accounting statements in accordance with the National Municipal Accounts Manual or an equivalent State Manual for at least three preceding financial years [Refer Sections 2.2.1 for salient features of SEBI Regulations and 3.1 for aspects related to the financial discipline and disclosure required by ULBs].

2. **RING-FENCED PROJECTS:** Well-prepared ring-fenced projects with approved DPRs are an important pre-requisite for successful bond financing of infrastructure. They help build investor confidence and signal that implementation modalities are clear and that financing mechanisms for capital investment and maintenance have been earmarked [Refer Section 3.3 for more details on project identification, structuring, and financing mix aspects].

3. **SHELF OF PROJECTS FOR SUSTAINABLE FINANCING:** In order to attract sustained investor interest in Municipal Bonds as a source of financing of infrastructure projects and services, ULBs would be expected to view the Bonds as an on-going alternative financing channel, rather than as a one-off initiative. Therefore, a ULB which presents a shelf of projects will help long-term investors identify potential investment avenues beyond the first issuance and incentivise them to allocate resources on a regular basis. As cities pilot an initial bond issuance, multi-year plans along with a prioritised shelf of projects to be financed through future bond issuances would be advisable [Refer Section 3.4 for more details on multi-year planning perspective towards creation of shelf of projects].

4. **THRESHOLD BOND ISSUANCE SIZE:** While the assessed debt capacity of a ULB is a primary determinant in sizing a bond issue, supply-side considerations and transaction costs also need to be factored in. Since bond issuance involves relatively higher transaction costs, a minimum threshold size of issuance is preferable. Further, since, long term funds are expected to be major players in the Municipal Bond market, it would be prudent to factor in market appetite while sizing up a bond issue [Refer Section 4.1.2 for more details on key considerations in designing and structuring bond issuance].

5. **ESCROWED REVENUES:** Addressing risk perception of investors is crucial. Setting up of an escrow mechanism is one of the key solutions for this. The objective of escrowing is to earmark specific revenue streams of the ULB for debt servicing to improve visibility and certainty of cash flows to Investors, thereby improving credit quality and issue rating of the Bonds. The identified revenue streams would have to be sufficient to meet the repayment obligations of the ULB [Refer Section 4.2.1 for more information on Escrow Account as credit enhancement structure].
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## Abbreviations and acronyms

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<td>AMRUT</td>
<td>Atal Mission for Rejuvenation and Urban Transformation</td>
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<td>CDP</td>
<td>City Development Plan</td>
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<tr>
<td>CIP</td>
<td>Capital Investment Plan</td>
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<tr>
<td>CoBoSAC</td>
<td>Corporate Bonds and Securitisation Advisory Committee</td>
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<td>CAG</td>
<td>Office of Comptroller and Auditor General of India</td>
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<tr>
<td>CFC</td>
<td>Central Finance Commission</td>
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<tr>
<td>CME</td>
<td>Corporate Municipal Entity</td>
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<tr>
<td>DEA</td>
<td>Department of Economic Affairs Ministry of Finance Government of India</td>
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<tr>
<td>DCB</td>
<td>Demand Collection Balance statement</td>
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<td>DSCR</td>
<td>Debt-Service Coverage Ratio</td>
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<tr>
<td>DSRF</td>
<td>Debt Service Reserve Fund</td>
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<tr>
<td>DPR</td>
<td>Detailed Project Report</td>
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<tr>
<td>FOP</td>
<td>Financial and Operating Plan</td>
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<tr>
<td>FSI</td>
<td>Floor Space Index</td>
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<td>GoI</td>
<td>Government of India</td>
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<td>HUDCO</td>
<td>Housing and Urban Development Corporation</td>
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<tr>
<td>LFA</td>
<td>Local Fund Auditor</td>
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<tr>
<td>LIC</td>
<td>Life Insurance Corporation of India</td>
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<td>MOUD</td>
<td>Ministry of Urban Development Government of India</td>
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<td>NMAM</td>
<td>National Municipal Accounting Manual</td>
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<td>NMATM</td>
<td>National Municipal Accounting Training Manual</td>
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<td>NMAVM</td>
<td>National Municipal Asset Valuation Manual</td>
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<tr>
<td>O&amp;M</td>
<td>Operations and Maintenance</td>
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<tr>
<td>OUIDF</td>
<td>Odisha Urban Infrastructure Development Fund</td>
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<td>PFDF</td>
<td>Pooled Finance Development Fund</td>
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<td>PPP</td>
<td>Public Private Partnership</td>
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<td>RBI</td>
<td>Reserve Bank of India</td>
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<td>RTI</td>
<td>The Right to Information Act 2005</td>
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<td>SEBI</td>
<td>Securities and Exchange Board of India</td>
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<td>TNUDF</td>
<td>Tamil Nadu Urban Development Fund</td>
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<td>ULB(s)</td>
<td>Urban Local Body(ies)</td>
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<tr>
<td>WSPF</td>
<td>Water and Sanitation Pooled Fund</td>
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About this document

This document is aimed at supporting Urban Local Bodies (ULBs) to tap Municipal Bond issuance as a sustainable resource mobilisation channel to meet their investment needs and for complementing Public Private Partnerships (PPPs).

The document is intended for use by Practitioners and Policy Makers, entrusted with responsibility of developing, financing and managing urban service delivery, and is organised along five chapters:

- **Chapter 1 Introduction** sets the context through a brief discussion on Municipal Bonds and the history of Municipal Bond issuances in India.

- **Chapter 2 Regulatory framework** provides an overview of desirable features in municipal legislation for providing an enabling environment for ULB-led bond issuances. It then discusses salient features of SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations 2015 (Last amendment on Feb 15, 2017) and its implications for bond issuances by ULBs. It introduces the option of bond issuance through a Corporate Municipal Entity (CME) and discusses factors guiding choice of issuance authority, i.e., by ULB directly or through a CME structure. Finally, it provides a summary of recent reform actions proposed for credit rating of infrastructure SPVs and projects.

- **Chapter 3 Readiness assessment and Preparatory actions** identifies pre-cursor steps and actions to be undertaken by ULBs to gear up for issuance of Municipal Bonds. These are identified and detailed in four areas: (1) Improving financial discipline and disclosure, (2) Improving financial performance and debt capacity and (3) Capital investment planning and (4) Project identification, PPPs and financing mix.

- **Chapter 4 Issuance roadmap and Market interfacing** provides an overview of type of Municipal Bonds, terms of bond issuance and credit enhancements that are typically employed to improve credit rating of bond issuances. It then details the steps in the process of Municipal Bond issuance and actions to be taken by ULBs, including approvals needed and the roles of various service providers to be engaged.

- **Chapter 5 Capacity Building** summarizes critical aspects of capacity development that need to be in place as ULBs gear up for Municipal Bond issuance. Apart from re-visiting critical building blocks and preparatory actions ULBs need to undertake, this section details the role and functions of dedicated cells for Debt Management and Project Management that can be set up by ULBs to drive early stage actions for bond issuance.

This document complements other policy, institutional and capacity building efforts underway and incorporates inputs from a variety of literature and reports on the subject (Refer Annexure I for a list of references and related links). It is intended to serve as an important and useful input to practitioners involved in urban development, financing and development of PPP projects. In the context of the dynamic and evolving nature of the urban financing landscape in India, this document is envisaged as a useful starting point and will be reviewed periodically to keep the content relevant.
1. Introduction

1.1. Background

The Government of India (GoI) has identified public-private partnerships (PPPs) as an important instrument to develop infrastructure in Indian cities and to enhance efficiency in urban service delivery. While financing of urban infrastructure has traditionally been reliant on budgetary outlays and grants from flagship programs of GoI (and that of State Governments), these are inadequate given the large investment needs in Indian cities.

In recent years, a number of Urban Local Bodies (ULBs) have implemented PPPs in diverse sub-sectors including water supply, waste-water reuse, solid waste and urban transportation. There is an opportunity to build on these experiences, and to evolve replicable PPP models for wider mainstreaming. However, projects in many of these sectors tend to require support from the ULB as a counterparty in the form of viability gap grants, which may be sizeable and required upfront (for instance during construction). Very often ULBs may not have upfront access to such funds and this constrains project implementation.

In such cases, an ability to access Capital Markets through issuance of Municipal Bonds that can be serviced with future ULB-level cash flows can potentially enable ULBs to design and implement PPP projects with transformative service delivery impact. This ability to raise non-grant financing would also enable ULBs to position themselves as vibrant entities capable of honouring contractual commitments. Building capacity within ULBs to tap capital markets therefore assumes significance both from resource mobilisation and institutional capacity strengthening perspectives.

On the supply side, the fixed income securities market in India has expanded in the past decade in terms of volume/value of debt issued diversity of issuers, and nature of instruments. The supply side is supported by an entire ecosystem (comprising merchant bankers, arrangers, rating agencies, lawyers, stock exchanges, investors, etc.) functioning under a robust regulatory framework. The bond market has enabled several aspirant issuers (including banks, financial institutions and corporate organisations) meet their funding needs. ULBs have an opportunity to tap into this ecosystem to help nurture a vibrant Municipal Bond market and to create an alternative channel to support their infrastructure financing needs.

Bond financing is not only important as a resource mobilisation channel; it also brings in a number of attendant benefits including greater financial discipline, rigour in project development, and accountability for services, even as it drives ULBs to unlock full revenue potential along each of their revenue streams.

GoI recognises the importance of mainstreaming Municipal Bonds as a complementary financing channel to develop sustainable PPP projects at the ULB level. Towards this objective, the Department of Economic Affairs, Ministry of Finance, Government of India (DEA) has initiated a pilot program for readiness assessment and model development for Municipal Bond financing in select Urban Local Bodies and the preparation of this document to serve as a ready reckoner for ULBs aspiring to tap bond markets.
This chapter sets the context by identifying the set of non-grant instrument options available for ULBs that are seeking to look beyond grant financing their infrastructure. It then provides an overview of Municipal Bonds (in terms of a conceptual foundation, history of transactions, challenges faced in issuance) and outlines initiatives taken by Government of India towards mainstreaming the Municipal Bond market. It concludes with a discussion on GoI’s flagship urban financing schemes and on the importance of leveraging these funds to create a vibrant Municipal Bond market in India.

1.2. Non-grant financing of urban infrastructure

Urban infrastructure projects in water and sewerage, roads and public transportation, municipal solid waste etc. tend to be capital intensive, because of the nature, size, technologies, materials, and geographic scope involved. Financing of urban infrastructure typically requires not only a large upfront capital investment, but also periodic replenishment expenditure and annually recurring operations and maintenance expenditures.

1.2.1. Instruments adopted

The following channels have been used to finance urban infrastructure:

- **Guaranteed lending**: In the past, borrowing by ULBs was typically through guaranteed instruments financed by government-owned institutions, such as the Housing and Urban Development Corporation Limited (HUDCO) and Life Insurance Corporation (LIC). Both HUDCO and LIC were mandated by Government of India directives to lend a certain amount to specific sectors, including the urban sector. However, financing under this route has reduced in recent years, as explicit State Government guarantees reduced in the context of fiscal pressures on State Governments.

- **State Urban Development Funds**: Some states created state-level urban development funds to channelize long-term concessional lines of credit from development institutions and multi-lateral agencies to ULBs. For instance, the Tamil Nadu Urban Development Fund (TNUDF) created to channelize concessional lines of credit available in a non-guaranteed manner, has accessed long-term lines of credit from World Bank, KFW etc. and has managed a good loan recovery performance for more than 20 years. Odisha recently created the Odisha Urban Infrastructure Development Fund (OUIDF) on a similar model. Several other states have tapped multi-lateral lines of credit, albeit on guaranteed mode for financing urban infrastructure programs.

- **Commercial finance (Municipal Bonds and term loans)**: Bank lending to local governments has increased in recent years. As of 2008, about 17% (Rs. 1,280 crore or US$285 million) of local governments’ share of capital costs were raised through term loans from banks and state-level funds. Till 2014, 23 Municipal Bonds had been issued for a total resource mobilisation of Rs. 1,353 crore (US$300 million). Tamil Nadu and Karnataka have also raised finance for small/medium ULBs through pooled bond financing.

- **Public-private partnerships**: During the decade of 2000-10, fund mobilisation through public private partnerships emerged as an alternative to augment municipal finances with a number of PPP transactions undertaken in municipal solid waste, urban transport, water supply and affordable housing. Although weak local capacity and the need for
stronger regulatory structures have limited wider mainstreaming, a number of cities have implemented PPP projects to successfully attract private capital in a range of sub-sectors including water supply, waste water reuse, solid waste management etc., which can serve as models for other ULBs to emulate.

1.3. Importance of Municipal Bonds

1.3.1. Definition

A bond is a marketable debt instrument in which one party (Issuer) borrows funds for a defined period of time at a variable or fixed rate of interest from another party (Investor). It is a contract between an Issuer and the Investor whereby an Issuer promises to pay a definite sum of money (as interest and principal) against the borrowing from the Issuer.

Municipal Bonds are marketable debt instruments issued by ULBs in India either directly or through any intermediate vehicle (Corporate Municipal entity/statutory body/special purpose distinct entity) with an objective to on-lend towards projects implemented by the ULB. The funds raised may be utilized towards implementation of capital projects, refinancing of existing loans, meeting working capital requirements etc., depending on powers vested with the ULBs under respective municipal legislation.

1.3.2. Rationale and benefits

The rationale for bond financing emerges from the following:

- **Leverage future cash flows to finance capital expenditure**: ULBs are often required to fund capital projects that require high upfront investment, which are typically larger than annually available resources. Bond issuances enable ULBs to leverage future cash flows to raise resources to meet these upfront capital expenditure commitments.

- **Attract new long-term investors and resources into urban projects**: Bond programs enable ULBs to attract long-term sources and resources from a variety of investors including insurance funds, retirement funds, mutual funds, and external funds. While commercial loans may also be tapped by ULBs to address this requirement, Municipal Bonds when structured well, typically provide greater flexibility in terms of tenure and repayment options. A vibrant Municipal Bond market can also potentially help attract new investors, both retail and institutional.

- **Build a credit profile and credit history**: Although initial bond issues may require extensive structuring to achieve a good credit rating, by doing regular issuances, ULBs can seek to build a credit profile and history that can bring down financing costs and credit enhancements needs in the medium term.

- **As a force multiplier for improving internal processes**: Exposure to capital markets requires a strong set of disclosure and reporting practices. A push to raise external resources will also push ULBs to implement stringent reporting and disclosure standards, which will in turn contribute significantly to the existing efforts to usher in greater transparency and accountability towards its citizens.
1.3.3. Summary of Municipal Bond issuances in India

The municipal financing market in India is dominated by grant funds from state and central Governments. The grants are devolved under state and centrally sponsored schemes or through direct transfer as per the directives of relevant Finance Commissions. The grants distributed are substantially lower compared to the investment requirements of the city, which has restricted cities’ capacity to services its citizens. In a bid to expand its funding sources, cities have tapped into the capital markets to raise long term loans for capital projects. Refer Exhibit 1.1 for year-wise value of issuance of Municipal Bonds till 2013.

Exhibit 1.1 Annual value of bond issuances - 1997-2013 (Rs. Crore)


Refer Annexure II for a list of reported bond issuances since 1997 and a brief review of the issuances.

1.3.4. Challenges in issuance of municipal debt

While Municipal Bond issuance transactions date back to the mid-1990s, the number and value of issuances has been relative small. While a number of ULBs have tapped capital markets with bond issuances, very few have succeeded in making bond financing a sustainable alternative channel for meeting their financing needs. This can be attributed to four demand-side factors:

- **Narrow revenue base coupled with inadequate revenue certainty and buoyancy:** ULBs often have a narrow revenue base coupled with inadequate buoyancy and certainty of revenue streams. Notwithstanding some sharp improvements by a few ULBs in property taxes and in user charges and fees, own revenue streams are often weakly exploited owing to regulatory and administrative capacity gaps. Most ULBs thus do not have adequate revenue surplus to effectively absorb and service debt.

- **Over-reliance on Grants for capital investments:** Capital investments tend to be excessively reliant on grants. While there has been a fairly sizeable increase in grant support both by Government of India and by State Governments, these are inadequately leveraged.

- **Under-developed financial management and accounting systems:** While double entry accrual accounting has been initiated in several ULBs as an urban reform initiative,
there is scope for improvement in overall accounting and financial management functions in most ULBs and follow-up actions including computerisation and MIS integration, staffing and training, and timely finalisation of accounts and audit.

- **Weak capacity to conceptualise, implement and manage bankable projects:** In view of the above constraints, the ability of ULBs to conceptualise, implement and manage bankable projects gets severely constrained and projects end up getting funded without adequate thought to sustainable financing of O&M and delivery.

The summary of key problems/constraints faced by the ULBs which restrict the capital market issuance are provided in *Exhibit 1.2*.

### Exhibit 1.2 Municipal Bonds: Constraints faced by ULBs

**Financial**

- Inadequate own revenue base
- Limited visibility on the buoyancy of own revenue
- Over reliance on capital grants for capital works
- Underdeveloped Financial management practices
- Higher Transaction costs

**Institutional**

- Weak institutional capacity for project designing and implementation
- Higher implementation risks for big ticket projects especially in a multi-institutional setup
- Delay in timely audit of accounts due to capacity constraints at ULB and local fund audit levels
- Weak information and reporting systems
- Weak institutional capacity to manage the incidental actions associated with Municipal bond issuance
- Underdeveloped financial and accounting system
- Lack of Stability in Top Management

**Governance**

- Multi-institutional coordination in Urban sector limiting ULB capacity as well as efficiency in project implementation
- Limited powers for ULB to implement revenue reforms
- Absence of a formulaic transfer of grants from State (in most of the ULBs)
- Short term planning horizon
- Ineffective ecosystem to promote municipal bond - Lack of incentives to promote bond issuances
- Presence of multiple channels/institutions for direct lending (vis-a-vis capital markets)

These constraints are reflected in credit ratings of ULBs (during 2006-11) initiated by MOUD, wherein less than a third of ULBs had a credit rating of ‘A’ or above. Thus creating a vibrant Municipal Bond market would require continued efforts in addressing the above constraints. While some supply-side incentives and push would no doubt also be useful, this document seeks to focus more on creating the demand-side fillip by enabling a systematic process for ULBs to improve their credit standing and to access the capital markets.
1.4. Initiatives to encourage non-grant financing of urban projects

1.4.1. Pooled Finance Development Scheme

In 2006, GoI approved the Pooled Finance Development Fund Scheme (PFDF) to provide credit enhancement to ULBs to access market borrowings through State-Level-Pooled Finance Mechanism. The broad objectives of PFDF were to:

- Facilitate development of bankable urban infrastructure projects through appropriate capacity building measures and financial structuring of projects.
- Facilitate Urban Local Bodies to access capital markets through Pooled Financing Bonds on behalf of one or more identified ULBs for investment in urban infrastructure projects, by providing credit enhancement grants to State Pooled Finance Entities (SPFEs)
- Reduce the cost of borrowing to local bodies with appropriate credit enhancement measures and through restructuring of existing costly debts.
- Facilitate development of Municipal Bond Market.

For implementing Pooled Finance Mechanism, an SPFE may be required to be set up in each State. Each SPFE is to be primarily State designed and could either be a Trust or a Special Purpose Entity, provided that the entity is only a pass through vehicle. The Pooled Finance Development Scheme sought to build on some of the early experience of Tamil Nadu and Karnataka which have successfully raised resources through pooled bonds. Refer Box 1.1 for a brief on the pooled bond experience of Tamil Nadu and Karnataka.

**Box 1.1 Pooled Bond financing experience in Tamil Nadu and Karnataka**

**Tamil Nadu**

The Water and Sanitation Pooled Fund (WSPF) was created in the 2002 as a trust wholly owned by Government of Tamil Nadu with the following objectives:

- Mobilize resources for urban infrastructure projects under pooled finance structure
- Provide financial assistance for setting up infrastructure projects
- Enable urban local bodies to access debt finance from market and
- Act as Nodal Agency on behalf of Central and/or State Government for water, sanitation and/or any other infrastructure projects

WSPF was created under the Indian Trust Act 1882 to mobilize resources from the capital market and to finance urban infrastructure projects. The Fund has been functioning on non-profit no-loss basis. This is the first entity in the country to mobilize resources on the pooled finance framework. GoTN designated WSPF as the State Pooled Finance Entity under Pooled Finance Development Fund Scheme and authorized to the guidelines issued by GoI. In 2003, the Government nominated the WSPF as the nodal agency for arranging funds (towards State Government’s Contribution) for implementation of the Under Ground Sewerage Projects under NRCP.

In 2010, the Government and KfW, the German funding agency have nominated WSPF as the agency for raising resources by way of issue of taxable pooled bonds under Sustainable Municipal Infrastructure Financing - TN (SMIF-TN) Program. Under SMIF-TN Program, KfW provided Rs. 65 crore (Euro 10 million) as subordinated loan to WSPF through Government of Tamil Nadu to facilitate the issue of taxable pooled bonds by WSPF.

A total sum of Rs. 222.3 crore has been mobilized by way of issue of bonds till date by WSPF.
1.4.2. Report on regulatory framework for Municipal Borrowing

At the request of the Ministry of Urban Development (MoUD) and Department of Economic Affairs (DEA), the World Bank undertook a non-lending technical assistance exercise to study the regulation of municipal borrowing in India in 2012\(^3\). The objective of this exercise was to develop a regulatory framework for Municipal borrowing in India. The study aimed at assessing the key regulatory and legal challenges to scale up of Municipal Bond market and suggest policy reforms.

Refer Annexure III for recommendations of this report.

1.4.3. CoBoSAC committee recommendations

The Government of India set up a committee, called the "Corporate Bonds and Securitization Advisory Committee" (CoBoSAC), to review the progress and implementation of the above recommendations. Among other things, SEBI placed an agenda item on formulation of framework for issuance of Municipal Bonds and disclosure norms for the same before the CoBoSAC committee. The committee decided that a sub-committee may be formed to specify disclosure and other requirements of Municipal Bonds. Refer Annexure III for a summary of recommendations of this report.

In July 2015, SEBI issued specific regulations vide the SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations 2015. Salient aspects of these regulations are discussed in Chapter 2.

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\(^3\)Report on Regulatory framework for Municipal Borrowing 2012
1.4.4. Credit rating under AMRUT

The Ministry of Urban Development has issued guidelines for the proposed credit ratings of Urban Local Bodies (ULBs) under the AMRUT and Smart Cities Mission. Credit rating of the ULBs is a key reform initiative under the AMRUT mission. As per the guidelines, the AMRUT cities will complete the credit ratings within 18 months of the launch of the mission. The ratings would be used to evaluate the credit worthiness of any particular ULB for raising additional resources from the market. Based on the approach for credit ratings the focus will be on the following:

- Undertaking credit worthiness and rating of ULBs using established methodology in order to provide pointers to potential lenders.
- Highlighting overall performance of ULBs in both financial and non-financial aspects.
- Identification of areas of strengths and weakness of ULBs in management of finances for a road map for Credit Enhancement Plan.
- Assessment of the 'Borrowing Capacity' of the ULB in the "Base Case Scenario" as well as the "Financial Improvement Action Plan" is implemented.

1.5. Current approach and strategy under GoI flagship schemes

Indian cities face significant service delivery pressures and large viability gaps at this point and hence the large capital investment needs will continue to be supported in the form of Capital Grants from State and Central Governments. This is reflected in the strong increases in outlay under the Government of India’s flagship urban development schemes especially Smart Cities Mission, and AMRUT. The Smart City Mission aims to promote cities that provide core infrastructure and give a decent quality of life to its citizens, a clean and sustainable environment and application of ‘Smart’ Solutions. The focus is on sustainable and inclusive development and the idea is to look at compact areas, create a replicable model which will act like a light house to other aspiring cities. The AMRUT Mission aims to provide basic services (e.g. water supply, sewerage, urban transport) to households and build amenities in cities which will improve the quality of life for all, especially the poor and the disadvantaged.

Given the large financing requirements that Indian cities have, these grants and budgetary outlays alone are insufficient to bridge the growing service delivery demands on local governments and need to be complemented with access to non-grant financing. There is a need to tap alternative financing avenues (including Municipal Bonds and greater private sector investments) to meet the funding gap. Accordingly, flagship schemes of GoI seek to actively encourage City and State Governments to tap non-grant sources for meeting these financing needs. The Smart City Mission and AMRUT require co-financing arrangements from diverse revenue sources including Multilaterals/Institutional borrowings, and Municipal Bond financing which opens up the opportunity for cities to tap into the Capital markets in the near term. Refer Box 1.2 for a brief on the latest issuance of Municipal Bond by Pune Municipal Corporation.
Box 1.2 Issuance of Municipal Bonds by Pune Municipal Corporation

Pune Municipal Corporation (PMC) is the first municipal corporation in the country to raise funds under the Scheme detailed in this guidance document. PMC has identified the 24 x 7 Water Project to be funded through Bonds and proposes to raise Rs.2264 crore through private placement of bonds over the next 5 years. PMC as an organization is rated AA+ which is the highest credit rating any urban local body enjoys in the country. The bonds have a structured payment mechanism along with dedicated escrow account to ensure timely servicing of the bonds., and is based on the five key principles insisted on by DEA:

a. Financial discipline, information disclosure and credit rating,
b. Escrowed Mechanism for bond servicing
c. Ring fenced projects
d. Shelf of projects to justify cost of issuance and sustained investors interest
e. Threshold bond issuance size- The bonds have no special tax-breaks

2. PMC raised tranche 1 of Rs 200 crore at 7.59 per cent rate in June, 2017. The bonds are listed at the Bombay Stock Exchange. The issue was oversubscribed six times. Investors include domestic insurers, pension funds, and large state-owned banks.

Term Sheet:

<table>
<thead>
<tr>
<th><strong>Issuer</strong></th>
<th>Pune Municipal Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Security Name</strong></td>
<td>7.59% Pune Muni Bond 2027 Series I</td>
</tr>
<tr>
<td><strong>Issue Size</strong></td>
<td>Rs. 200 crore (Rs. 10 lakh per bond with minimum application of 5 bonds)</td>
</tr>
<tr>
<td><strong>Coupon &amp; payment freq.</strong></td>
<td>7.59% p.a fixed payable Semi-Annual (20th December and 20th June of each year)</td>
</tr>
<tr>
<td><strong>Type of instrument</strong></td>
<td>Unsecured, Listed, Taxable, Non-convertible, Redeemable Bonds in nature of debentures</td>
</tr>
<tr>
<td><strong>Seniority</strong></td>
<td>Senior</td>
</tr>
<tr>
<td><strong>Mode of issue</strong></td>
<td>Private placement</td>
</tr>
<tr>
<td><strong>Listing</strong></td>
<td>Wholesale debt market segment of BSE Ltd</td>
</tr>
<tr>
<td><strong>Credit rating</strong></td>
<td>CARE AA+; Stable by CARE rating agency ‘Provisional IND AA+/Stable’ by IRRPL</td>
</tr>
<tr>
<td><strong>Tenure and moratorium</strong></td>
<td>10 years Redemption date (20th June 2027)</td>
</tr>
<tr>
<td><strong>Deployment of proceeds</strong></td>
<td>Bond proceeds will be deployed towards Capex for implementation of 24*7 water supply project</td>
</tr>
</tbody>
</table>
| **Structured payment mechanism** | Under the structured payment mechanism, property tax collected by and due to PMC will be deposited every month in a separate no-lien escrow account for debt servicing. The salient features of the payment mechanism is summarized below:
  • At the beginning of every month, the funds lying in the escrow account (all property tax payments) may be used in the following priority
    o Firstly, transfer to Debt Service Reserve Account (DSRA) which has to be maintained at all times at an amount equivalent to 2 interest payments
    o Secondly, transfer to Interest Payment Account on monthly basis as per a detailed schedule
    o Thirdly, transfer to the Sinking Fund Account as per a detailed schedule
  • Any excess funds may be transferred to the PMC’s account for meeting O&M or other requirements |
| **Financial Covenants** | • DSCR not less than 1.5 times the operating surplus
  • Total amount collected in escrow account should be at least 1.25 times the annual debt service amount |
2. Regulatory framework

This Section captures the Regulatory framework for Municipal Bond issuances. It covers a review of salient features of municipal legislation necessary to encourage Municipal Bond financing followed by an overview of the Securities and Exchange Board of India (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 that provide the basic framework for capital market access. The regulation is applicable in case of issuances directly by ULBs or through Corporate Municipal Entity. The section concludes with an overview of proposed reform actions with respect to Credit Rating of Infrastructure projects.

2.1. Municipal legislation

2.1.1. Salient features

State-level municipal legislation typically provides the legal framework for powers and functioning of the ULBs. Municipal legislation varies across states, and in some cases, even across cities within a State. Critical legislative provisions for an enabling framework for borrowings by ULBs are summarised below:

1. **Powers to securitize assets/receivables:** The ULB Acts need to explicitly provide for allowing ULBs to securitize receivables or escrow its revenues. However, except for a few states (Gujarat, Madhya Pradesh etc.), many ULBs do not have enabling provisions for a charge on assets.

2. **Power to raise loans and the utilization of proceeds:** The Municipal legislation should provide explicit powers to ULBs to raise loans on its books. The applicable Municipal Act should also ideally specify the nature of loans that the ULBs may access i.e., Long term or short term and the objects of utilization of proceeds. Most Municipal Acts in India usually allow borrowings by ULBs only for Long term loans for project implementation, land acquisition, loan repayment etc. In several States cases, short term loans for payment of salaries and dues are prohibited under extant municipal legislation.

3. **Administrative procedures to raise loans:** These cover provisions dealing with the ease, transparency and efficiency of process as well as authority of ULB for bond issuance process. In most State legislation, ULBs require approval of the State governments for bond issuance or raising debt. Sometimes, multiple approvals may be required for example from the nodal department (say municipal administration) and Finance department (especially if there is a need for State Guarantees).

4. **Borrowing limits:** Municipal Acts may also specify a limit on borrowings by the ULB to ensure judicious spending by the ULBs and to diversify the sources of funds. In some states, the borrowing limits are fixed as a percentage of value of land as arrived at, in computing Property Taxes. With diversifying income sources of ULBs, it may be prudent to link borrowing limits with medium term operating surplus of ULBs.

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4 It should be noted that several municipal acts do not prohibit a charge on assets but an explicit enabling provision will help in providing clarity and certainty.

5 Recommended in the report on Regulatory framework for Municipal borrowings in India, World Bank 2011
5. **Credit enhancement structures:** Municipal legislation should also ideally provide for other structuring features including provision of a bond repayment fund/sinking fund into which funds towards servicing of debts (interest plus principal) may be transferred from the municipal fund of the ULB. This could facilitate creation of debt service reserve funds and other structures that could enable better structuring of bonds. Further it may be useful to have a clear policy position for State Government Guarantees/other credit enhancement support for Municipal Bonds. Eventually the goal should be to equip ULBs to raise resources on a non-guaranteed manner.

6. **Investor protection:** To address the relatively higher perceived credit risk, adequate provisions for attachment of municipal funds or assets have to be provided under the extant Municipal Regulations to ensure timely servicing of debt. Hence provisions in the Municipal legislation to attach the municipal fund/municipal assets in whole or in part by State Government (as provided in some Acts) would be useful. In case of debt raised through CME route, the regulations under the Debt Recovery Tribunal (DRT Act, 1993) and SARFAESI will be applicable.

*Box 2.1* below provides salient aspects of extant municipal legislation in Gujarat and Madhya Pradesh. Cities in both these States have successful Municipal Bond issuances in the past.

<table>
<thead>
<tr>
<th>BOX 2.1 MUNICIPAL LEGISLATION IN GUJARAT AND MADHYA PRADESH: Provisions for borrowings and debt</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GUJARAT - The Gujarat Provincial Municipal Corporation (GPMC) Act 1949</strong></td>
</tr>
<tr>
<td><strong>Section 109 Powers to borrow money:</strong></td>
</tr>
<tr>
<td>• Stipulates that approval of State Government is mandatory for borrowing including the method of borrowing and terms. Allows use of all own revenue streams to be used as security; security of any immovable property vested in the Corporation or proposed to be acquired by it</td>
</tr>
<tr>
<td>• No loan shall be raised for the execution of any work other than a permanent work. Borrowings cannot be used for payment of salaries/allowances to municipal officers or servants</td>
</tr>
<tr>
<td>• Maximum repayment period of sixty years is allowed. In case borrowing is for repayment of earlier loan, tenor cannot exceed that of previous loan</td>
</tr>
<tr>
<td><strong>Section 110 Powers to borrow from banks against public securities:</strong></td>
</tr>
<tr>
<td>• Allows the corporation to borrow money against deposits</td>
</tr>
<tr>
<td><strong>Section 110A Advances from banks and grant mortgages:</strong></td>
</tr>
<tr>
<td>• Allows ULB to mortgage its immovable assets especially land against borrowing in security of the payment subject to approval of the State Government. This section allows the ULB to provide for the asset cover mandated for bond issue under the SEBI guidelines</td>
</tr>
<tr>
<td>• ULB may also with the previous sanction of the State Government and on such terms and conditions as the State Government may lay down, mortgage any lands or property vesting in or belonging to the Corporation in security of the payment of the amount of such credit or of the sums advanced from time to time on such cash account with interest thereon</td>
</tr>
<tr>
<td><strong>Section 111 – When and How the loan will be paid:</strong> Lays out repayment method as follows: By payment from a sinking fund, by equal payments of principal and interest, by equal payments of principal, Refinance of loans</td>
</tr>
<tr>
<td><strong>Section 117 – Attachment of Municipal Fund or, Transport Fund in case of default:</strong></td>
</tr>
<tr>
<td>• Allows State Government to attach revenue of ULB in case of delays in payments</td>
</tr>
</tbody>
</table>
| • If any money borrowed by ULB or any interest or costs due in respect thereof is or are not repaid according
Guidance on use of Municipal Bond financing for Infrastructure projects

Section 126 – Annual statement to be prepared by Commissioner

This section lays out disclosure requirements in the form of a loan statement to be prepared by the Commissioner including outstanding loan, repayment track record, available balance in Sinking fund, etc.

MADHYA PRADESH – Madhya Pradesh Municipal Corporation Act 1956

Section 102 – Powers of Corporation to borrow money:

• Stipulates that approval of State Government is mandatory for borrowing.

• Act allows for application of immovable property vested in the Corporation or of all or any taxes, duties, tolls, cesses, fees and dues authorized by this Act or a combination of both to be utilized as Security.

• The loan proceeds may be utilized to fund Capital Projects, Land acquisition, Refinancing of loan

• No loan shall be raised for the execution of any work other than a permanent work. Borrowings cannot be used for payment of salaries or allowances to any municipal officers or servants

• Maximum repayment period of fifty years. In case borrowing is for repayment of earlier loan, tenor cannot exceed that of previous loan

Section 103 – Power of Corporation to open credit or cash accounts with a bank:

Government may grant mortgages of all or any property vested in the Corporation by way of securing the repayment with interest of amount of such credit or of sums advanced on such cash account.

Section 104 – Limit of Borrowing Power

Borrowing shall be limited such that the sums payable under this Act shall not at any time exceed together with the balances of all the outstanding loans and debts due by the Corporation in the whole, double the annual value of the lands and buildings in the City.

Section 113 – Repayment of loans: Lays out the repayment method as follows: By payment from a sinking fund, by equal payments of principal and interest, by equal payments of principal, by refinance of loans or a combination.

Section 121 – Attachment of Municipal Fund in default of repayment of loan; Section 122 – Attachment of Municipal fund or securing payments

The Act allows the State Government to attach the revenue of the Corporation in case of delays in payments. If any money borrowed by the Corporation, or any interest of costs due in respect thereof, is not repaid according to the conditions of the loan, the Government if it has itself given the loan may, and in other cases shall, on the application of the lender, attach the municipal fund in whole or in part.

Section 123 – Annual statement to be prepared by Commissioner:

This section lays out disclosure requirements in the form of a loan statement to be prepared by the Commissioner detailing the outstanding loan, repayment track record, available balance in the sinking fund, etc.
2.1.2. World Bank study: key recommendations on State-level Regulations

Recommendations from the World Bank study\(^6\) undertaken at the request of DEA and MOUD with respect to State-level Regulations are summarised below.

1. State regulations should define “debt” in terms broad enough to include those multi-year financial obligations whose repayment depends on the continuing existence of operational surpluses.

2. States should introduce a distinction between long-term and short-term debt. “Long term” debt is defined as (i) serving capital investment, (ii) repayable in over one year, and (iii) subject to state authorization. Short term debt must be repaid within the current fiscal year and not rolled over. A 5% limit on short term borrowing for liquidity purposes is in line with international practices where such borrowing is allowed at all.

3. Long-term borrowing may be limited to long-term capital investment. Long-term loans have over one year tenure and assets are created in water, sanitation, etc. service.

4. Retain state powers to grant or deny approvals, but shift to a rules-based system. Approvals should be directed at providing certification that the applicant is in compliance with stipulated regulations on debt service. The stipulated regulations should provide clear guidelines regarding the quantum and character of municipal borrowing.

5. States should introduce an annual debt service limit of 50% of the average net operational surplus of the ULB over the past three completed fiscal years.

6. The debt service test is applied only whenever a new debt is to be taken. It may be used by stakeholders to monitor the financial condition and statutory compliance of a given ULB borrower over time.

7. Municipal assets should be subject to mortgages, provided that the assets are non-essential for the provision of mandated services. State laws governing municipalities should provide for distinction between essential municipal assets and commercial/non-essential municipal assets.

8. State guarantees of municipal debts should be discouraged. Special situations, such as borrowing from international organizations or foreign lenders may be exceptions. In line with international practices, the borrower might pay a guarantee fee commensurate with the amount of public (state) funds at risk.

9. Maximum loan tenor limits should be stricken from state legislation. Tenor should instead be matched with the useful economic or accounting life of the asset being created.

10. Approved and realized borrowings and their terms should be in a public database maintained by each state. It will reduce risk and uncertainty, and offer a level playing field to all market participants. Data reported to MoUD should be published annually on an aggregate level and on ULB basis for transparency purposes.

Refer Annexure III for a full summary of recommendations made under this report.

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\(^6\) Developing a Regulatory Framework for Municipal Borrowing in India, World Bank 2011
2.2. SEBI Regulations

2.2.1. Salient features

In July 2015, SEBI notified a separate framework for issue and listing of Municipal Bonds namely Securities and Exchange Board of India (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015. The framework was evolved based on the learning from past issuances and recommendations from the report on Regulatory framework for Municipal Borrowing by World Bank and CoBoSAC sub-committee recommendations on Municipal Bonds. SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 is applicable in case of issuances directly by ULBs or through Corporate Municipal Entity.

Salient features\(^7\) of the regulations are summarised below:

1. **Eligibility criteria:** No issuer shall be eligible to issue debt securities to public under these Regulations, unless the following criteria are complied with:
   a. Accounts of Municipality shall be prepared in accordance with National Municipal Accounts Manual or in accordance with similar Municipal Accounts Manual adopted by respective State Government for at least three preceding financial years.
   b. Municipality shall have surplus income as per its Income and Expenditure Statement, in any of the immediately preceding three financial years or any other financial criteria as may be specified by the Board from time to time.
   c. Municipality shall not have defaulted in repayment of debt securities or loans obtained from Banks/Financial Institutions during the last 365 days.
   d. Where the issuer is a Corporate Municipal Entity, the requirements shall be complied by the Municipality which is being financed.
   e. The CME or its directors have not been restrained or prohibited or debarred by the Board from accessing securities market or dealing in securities and such direction or order is in force.

2. **General conditions for public issue:** An issuer making public issue of debt securities shall only issue revenue bonds. No issuer shall make a public issue of debt securities unless following conditions are satisfied, as on the date of filing of draft offer document and final offer document as provided in these regulations:
   a. It has made an application to one or more recognized stock exchanges for listing of such securities therein;
   b. It has obtained in-principle approval for listing of its debt securities on the recognized stock exchanges where the application for listing has been made;
   c. Credit rating has been obtained from at least one recognized credit rating agency registered with the Board and is disclosed in the offer document;
   d. In case of public issue of securities by the issuer, the debt securities intended to be issued shall have a minimum investment rating. Provided further that where credit

\(^{7\text{ Please refer http://www.sebi.gov.in/cms/sebi_data/attachdocs/1419931499189.pdf}}\)
ratings are obtained from more than one credit rating agencies, all the ratings, including the unaccepted ratings, shall be disclosed in the offer document;

e. It has entered into an arrangement with a depository registered with the Board for dematerialization of the debt securities that are proposed to be issued to the public, in accordance with the Depositories Act, 1996 and regulations made there under.

f. The debt securities shall have a minimum tenure of 3 years.

g. The issuer shall appoint one or more merchant bankers registered with the Board at least one of whom may be a lead merchant banker.

h. The issuer shall create a separate escrow account for servicing of debt securities with earmarked revenue.

i. The issuer shall appoint a monitoring agency such as public financial institution or nationalised bank to monitor the earmarked revenue in the escrow account.

j. Where the issuer is Corporate Municipal Entity, it shall appoint a Debenture Trustee registered with the Board in accordance with the provisions of the Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993, for compliance with this requirement.

In addition, the regulations provide for conditions pertaining disclosures in the draft offer document, filing of draft offer document, mode of disclosure of draft offer document, advertisements for public issues, abridged prospectus and application forms, minimum subscription, utilisation of proceeds and underwriting.

3. **Listing of Debt securities:** An Issuer may issue revenue bonds or general obligation bonds. An Issuer desirous of making an offer of debt securities to the public may make an application for listing to one or more recognized stock exchanges and the debt securities to be listed are to be in dematerialised form. For issuance by CME such an application may be made in terms of sub-section (1) of section 40 of the Companies Act, 2013. In case of private placement, the minimum subscription amount per investor shall not be less than Rupees twenty five lakhs or such amount as may be specified by Board from time to time. Credit rating of securities is to be obtained in respect of debt securities from at least one credit rating agencies registered with SEBI

4. **Asset cover and buyback:** An issuer, proposing to issue debt securities shall maintain 100% asset cover sufficient to discharge the principal amount at all times for the debt securities issued. The issuers may also provide an option to buy-back the debt-securities at their face value, from the investors, provided in such cases, appropriate disclosure shall be made in the offer document.

5. **Creation of security:** The debentures shall be secured by the creation of a charge, on the properties or assets or the receivables of the issuer, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon. Provided further, in case unsecured debentures are intended to be listed on stock exchange(s), then such debt securities shall either be backed by guarantee from State Government or Central Government or shall have a structured payment mechanism whereby the issuer shall deposit debt servicing amounts in the designated bank account at least 10 working days before due date of payment. The total value of debentures issued shall not exceed the market value of immovable property/other assets or
receivables of the Issuer, for which a charge shall be created. The issuer shall give an undertaking in the offer document that the assets on which charge is created are free from any encumbrances and if the assets are already charged to secure a debt, the permissions or consent to create second or pari-passu charge on the assets of the issuer have been obtained from the earlier creditor. The issue proceeds shall not be utilised until the documents for creation of security are executed.

Under SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 which provides a regulatory framework for Municipal Bond issuances, Municipal Bonds can be issued either by municipalities directly or through creation of a Corporate Municipal Entity (CME) The CME is envisaged as a conduit entity, set up as a Company under the Companies Act 2013 and as a subsidiary of the Municipality for issuance of Municipal Bonds on behalf of the Municipality. Box 2.2 summarises the rationale and definition of a CME as articulated in SEBI’s concept note and regulations. Refer Annexure V for guidelines for setting up a CME.

Box 2.2 Corporate Municipal Entity: rationale and definition

Municipalities may consider establishing a “Corporate Municipal Entity” (CME) which would borrow through issue of Bonds and lend it to the concerned Municipality. The objective is to create a conduit entity, which can access the market and which can lend it to the concerned Municipality based on its requirements. The Corporate Municipal entity shall not hold or carry out any projects of its own, in which cases it would create implementation, enforcement and hierarchical issues. Further, the transfer of projects of Municipalities to Corporate Municipal Entity in lieu of equity may require legislative amendment. The CME would be a going concern and disclosure would be the same as that prescribed under existing SEBI (Issue and Listing of Debt Securities of Municipalities) Regulations, 2015. Issuance through a CME set up by the ULB can particularly help in providing investor assurance where ULBs seek to tap capital markets with regular periodicity. In such cases, a CME structure can enhance credibility of issuer ULBs and help attract repeat investors.

SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 defines the Corporate Municipal Entity (CME) as a company as defined under Companies Act, 2013, which is a subsidiary of a municipality and which is set up for the purpose of raising funds for a specific municipality or group of municipalities.


Apart from these points, the SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 also provides conditions for continuous listing and trading and specify obligations of intermediaries and issuers. It also covers actions in case of violations of regulations and lays down the disclosure requirements to be complied by the issuers.

2.3. Issuance authority options

As per SEBI Regulations, the bond issuance authority could be (i) the Urban Local Body or (ii) a Corporate Municipal Entity (CME) as a Special Purpose Vehicle (SPV). The vehicle for bond issuance is context-specific and depends on a number of factors. From a medium-to-long term perspective, if a ULB is looking at municipal borrowings as a mainstream channel of financing and not just as a one-off issuance, a CME option appears appropriate in view of the following:
• A CME can potentially help build robust governance standards (through induction of specialists as Directors in the CME Board) and induction of operational and organisational expertise for resource mobilisation and fund raising function (including Risk Management, Treasury management, Asset-liability management, investor relations), which are not ‘core’ municipal functions that ULBs are otherwise equipped to handle. While ULBs have the option of outsourcing or getting hand-holding support for one-off issuances, a CME will help create threshold governance standards, specialisation and operational capacity needed to tap the scale of borrowings that ULB has the potential to tap.

• Through a CME structure, ULBs may be able to raise finances for portfolio smaller PPP projects, each of which may not be large enough to effectively raise resources from capital markets.

• Regular issuances through an independent CME and creation of a Master Financing Indenture (or a common structuring framework for issuances) can help minimise need for excessive credit enhancements and in bringing down borrowing cost.

Refer Annexure V for suggested guidelines for bond issuance through a CME route.

Notwithstanding advantages of the CME route, issuance by ULB directly would make sense under the following situations:

• When the issuance is supported by a fairly progressive clear and robust Municipal legislation which provides for (i) **strong investor protection** (especially in terms of credit structuring and provisions empowering State Government to deal with default situations) and (ii) **is reform oriented** with respect to delegation of powers. Several issuances in the past have been done directly by ULBs and validate the potential for ULBs to issue bonds directly without the need for a CME.

• If the ULB is looking at pilot bond issuance for a one-off project and is not necessarily yet equipped financially to mainstream bond issuances as a regular channel of financing. Pilot issues will require fairly extensive credit enhancements, irrespective of whether it is done by the ULB directly or through a CME.

• When States have state-level nodal financing institutions that are equipped to raise finances on behalf of ULBs or to provide hand-holding support to ULBs to tap capital markets through bond issuances. In the presence of such institutions, it may not be necessary for each ULB to set up a city-specific CME for issuance of Municipal Bonds.

While SEBI Regulations allow for a CME route to Municipal Bond issuance, these enabling provisions for CME may need further strengthening with additional clarity on applicability of other extant regulations including if the CMEs will fall under the ambit of RBI Regulations as an Non-Banking Finance Company (NBFC), in which case relaxation with respect to borrower concentration etc., may need to be sought. Therefore greater adoption of CME route will need to be preceded by clarity and further guidelines on some of these aspects.

### 2.4. New Credit rating system for Infrastructure sector

The Union Budget 2016-17 put forward the establishment of a new credit rating system for infrastructure projects in the country. The proposed system is intended to lay emphasis on
the value of the various in-built credit enhancement structures instead of relying upon a standard perception of risk which often result in mispriced loans. This will help infrastructure projects access long-term credit from multiple sources at competitive rates. A composite framework that integrates the probability of default of infrastructure projects with recovery prospects, thereby taking into account the unique features of infrastructure project SPVs, was considered as the guidance for the proposed credit rating system.

In January 2017, Credit rating agencies introduced the new credit rating system for rating of infrastructure projects and have initiated assigning ratings on a new scale to infrastructure projects. The new rating system will provide a comment on the expected loss of a project entity, while also factoring in probability of default and the recovery prospects. The new system is expected to help the Infrastructure sector find better funding options and enable better risk-based pricing in future. The Rating Scale is broadly envisaged on the lines presented below in Exhibit 2.1

Exhibit 2.1 Proposed Rating scale for infrastructure projects

<table>
<thead>
<tr>
<th>Proposed Rating</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>[INFRA] EL 1</td>
<td>Lowest expected loss – Instruments rated ‘EL 1’ are considered to have the lowest expected loss</td>
</tr>
<tr>
<td>[INFRA] EL 2</td>
<td>Very Low expected loss – Instruments rated ‘EL 2’ are considered to have very low expected loss</td>
</tr>
<tr>
<td>[INFRA] EL 3</td>
<td>Low expected loss – Instruments rated ‘EL 3’ are considered to have low expected loss</td>
</tr>
<tr>
<td>[INFRA] EL 4</td>
<td>Moderate expected loss – Instruments rated ‘EL 4’ are considered to have moderate expected loss</td>
</tr>
<tr>
<td>[INFRA] EL 5</td>
<td>High expected loss – Instruments rated ‘EL 5’ are considered to have high expected loss</td>
</tr>
<tr>
<td>[INFRA] EL 6</td>
<td>Very High expected loss - Instruments rated ‘EL 6’ are considered to have very high expected loss</td>
</tr>
<tr>
<td>[INFRA] EL 7</td>
<td>Highest expected loss - Instruments rated ‘EL 7’ are considered to have highest expected loss</td>
</tr>
</tbody>
</table>

The framework focuses on the Expected Loss (EL) of a project SPV over the life of the project, which would factor in the Probability of Default (PD) and the Recovery prospects (overall recovery of dues by the investor/lender over the lifecycle of the project). Thus the new scale will be a comment on EL from the underlying credit, where EL is calculated as the product of PD and Loss Given Default (LGD = 1 – Recovery Rate).

Further, in the context of growing interest of institutional and long-term investors in green finance and investments, DEA has also suggested that rating agencies can develop industry standards for ‘green-tagging’ projects through a robust evaluation mechanism. This could be of special significance for Green Bonds and/or infrastructure projects implemented by municipality after incorporating ‘green’ features in project design, construction and operations.
3. Readiness assessment and preparatory actions

This Section details the key actions to be undertaken by the ULB in preparing itself towards a capital market issuance. It starts off by providing the analytical framework for evaluation by the ULBs to gauge readiness to access capital markets. Based on the framework, it identifies the list of pre-requisite actions, strategies for strengthening credit quality as well as marketability of the issue, and provides guidance for structuring projects.

The ULBs need to rise up to the high standards of market discipline envisaged in capital markets. The Investors expect the Urban Local Bodies to be (1) financially disciplined (with requisite accounting controls, timely audits and capacity to disclose quality information with investors and regulators), (2) credit worthy (in terms of a stable and buoyant revenue surplus to honour and meet their debt obligations), and (3) capable of implementing bankable projects in a timely manner. Urban Local Bodies seeking to tap capital markets through Municipal Bond issuances therefore have to gear up to meet threshold standards with respect to each of these aspects prior to initiating the process of bond issuance.

3.1. Financial discipline and disclosure

Financial discipline and disclosure is an essential feature of the capital markets. External investors are particularly demanding with respect to accounting discipline, quality and credibility of reporting of financial information, in particular and level of information dissemination and disclosure standards in general. Actions pertaining to financial discipline and disclosure are discussed with respect to the following three pillars:

- Maturity of Accrual Accounting systems
- Timely finalisation and rigor in audit of accounts
- Credibility, Transparency and Quality of Information disclosure

3.1.1. Maturity of Accrual accounting system

Following the preparation of the National Municipal Accounting Manual (NMAM) by MOUD and the subsequent development of the National Municipal Accounts Training Manual (NMATM) and the National Municipal Asset Valuation Methodology Manual (NMAVM), most State Governments have adopted State-level Accounting Manuals to enable a transition of Urban Local Bodies to Accrual accounting. GoI has also mandated implementation of ULB-level Accrual accounting as a critical urban reform under its flagship urban development schemes including under AMRUT.

Municipal accounting reform is a critical pillar for overall financial discipline and effective financial management and is crucial to enable improved (i) asset-liability traceability and management, (ii) expenditure management and (iii) revenue stability and buoyancy. It helps overcome inherent limitations of cash-based accounting systems including lack of cognisance to timing of cash flow events, weak distinction between revenue and capital items and inadequate rigor in tracking and managing assets and liabilities.

NOTE: SEBI (Listing of debt securities by municipalities) Regulations 2015 require ULBs prepare their accounts in line with the NMAM (or an equivalent State-level Accounting
Manual adopted by State Government) for three years preceding year of issuance to be eligible for issuing bonds.

While many ULBs in India have initiated municipal accounting reforms and do prepare and audit their accounting statements as per the NMAM or equivalent State manual, this reform in many cases stops with implementing NMAM compliant formats. Implementation of NMAM should instead be complemented by a strong financial management improvement program (to enable revenue buoyance and expenditure control) along with implementation of e-governance architecture (to enable a seamless citizen interface and improved information disclosure). Exhibit 3.1 summarises foundations of a robust municipal accounting system and key contours of a phased approach to implementing accounting reforms at ULB level.

**Exhibit 3.1 Implementing a robust Municipal Accounting system**

<table>
<thead>
<tr>
<th>Foundations of Municipal Accounting Reforms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Success of municipal accounting reforms depend on three key building blocks:</td>
</tr>
<tr>
<td><strong>Supervision and monitoring structure for accounting reform</strong> covering (i) Institutional and legal arrangements, (ii) Right-sized staffing, (iii) Auditing arrangements and processes for finalisation of accounts.</td>
</tr>
<tr>
<td><strong>Robust Accounting system architecture</strong> covering comprehensive accounting modules, ring-fencing of utilities and services and reports/management information systems</td>
</tr>
<tr>
<td><strong>Computerisation and Information Technology</strong> including secure and stable enterprise applications, web-based e-governance modules and citizen interface and associated networking, hardware equipped with business continuity and disaster recovery management plans and protocols</td>
</tr>
</tbody>
</table>

**Phasing of municipal reform implementation**

Municipal accounting reform is rolled out in three phases.

- Phase 1 consists of establishment of a **double entry accrual-based accounting system**, which forms the foundation for creating the architecture of a robust accounting system.
- Phase 2 consists of a **financial management improvement program** based on the data available from the Phase 1 stage. This phase gives the scope for management reforms in achieving efficiencies both in revenues and expenditures.
- Phase 3 involves **participation of the citizens**, both internal and external, for interface with the municipal system through electronic governance mode.

3.1.2. Timely finalisation and audit of accounts

Audits of ULBs’ accounts are typically conducted on a regular basis by the Local Fund Auditor, State performance auditor, and State Auditor general. The office of the Comptroller and Auditor General (CAG) is also involved and undertakes ULB audits as per recommendations of Central Finance Commission. The CAG is entrusted with technical guidance and supervision for the maintenance of accounts and the audit of local bodies, including providing technical guidance to the Director of the Local Fund Audit. These audits highlight performance issues and the quality of decentralization.
With the adoption of the double entry accounting system, the auditor’s capacity also needs to be enhanced. In some states, a separate external audit is carried out by an independent panel of chartered accountants to certify the true and fair view of the financial statements. This is usually insisted upon by financial institutions and development agencies to avail an independent professional opinion of the financial position and performance of the ULB. Delay in finalisation of accounts and backlogs in completion of audits are viewed unfavourably by investors, rating agencies and other stakeholders and creates uncertainty and doubts about the veracity of the information put out by the ULB.

**NOTE:** ULBs seeking to tap capital markets should have finalised accounts and completed audit of accounts till the preceding financial year. For regular issuances, ULBs should necessarily build a track record of finalising accounts and completing audit of accounts within six months of financial year closing.

### 3.1.3. Credible, transparent and quality disclosure

ULBs in India are bound under the Right to Information Act (RTI Act) and under Public Disclosure Legislation enacted by respective State Governments, to ensure transparency and accountability in their functioning through publication of information pertaining to various facets of municipal governance, namely, personnel, particulars of administrative structure, finances and operations.

Disclosure on financial performance (Income and Expenditure, Balance sheet and Cash flow statements) and underlying drivers for financial performance (including cost recovery levels, collection efficiency) etc. are critical. Additionally information pertaining to procurement, service levels, details of subsidies released, etc., should also be ideally disclosed. All relevant information should be available for public access on a dynamically updated website maintained by the Urban Local Body. Additional steps including implementation of Open Data Standards, active presence on social media platforms, will also be good-to-have aspects with respect to information disclosure.

### 3.1.4. Summary checklist - Financial discipline and disclosure

Refer Exhibit 3.2 for a checklist of critical preparatory actions with respect to financial discipline and disclosure.

**Exhibit 3.2 Financial discipline and disclosure: a checklist of key actions**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accrual Accounting</strong></td>
<td></td>
</tr>
<tr>
<td>Does the ULB follow accrual accounting</td>
<td></td>
</tr>
<tr>
<td>Does the State have a duly approved State Municipal Accounting Manual</td>
<td></td>
</tr>
<tr>
<td>Is the State Municipal Accounting Manual in line with the scope and spirit of the NMAM</td>
<td></td>
</tr>
<tr>
<td>Does the ULB prepare a balance sheet and an income statement at the end of each year in accordance with the requirements of the State Accounting Manual/NMAM.</td>
<td></td>
</tr>
<tr>
<td><strong>Audit and finalisation of accounts</strong></td>
<td></td>
</tr>
<tr>
<td>Does the ULB have a computerised accounting system</td>
<td></td>
</tr>
<tr>
<td>Is data entry and accounting reconciliation done regularly</td>
<td></td>
</tr>
<tr>
<td>Are bank accounts reconciled periodically (Maximum periodicity to be one-month)</td>
<td></td>
</tr>
</tbody>
</table>
### Guidance on use of Municipal Bond financing for Infrastructure projects

**3.2. Financial performance and debt capacity**

City-level financial sustainability is crucial for ULBs to consistently invest in creation of urban infrastructure for seamless delivery of urban services and improved quality of urban living. This will require establishing a good level of financial autonomy, building strategic financial management focus, ensuring transparency and accountability in financial management, and sustainability in service provision. Many Indian cities face challenges with respect to their financial position and city level financial viability. Several of them tend to struggle with a low revenue income and poor collection efficiency while being saddled with a relatively large bottom-heavy work force. Further, transfers from State Government are often non-formulaic, and non-buoyant, creating challenges with stability and certainty of cash flows.

Entity-level credit rating undertaken during 2006-07 for 65 cities (that were supported under the JNNURM scheme) found that only 50% of these 65 cities could secure an investment grade rating (BBB- or higher). While cities are expected to have improved from then on, it is clear that many cities will need to significantly improve their financial capacity. Given that the Indian bond market is tilted towards higher rated issuances (over 80% of India’s bond issuances are AA and higher), improving financial performance and debt capacity is a critical hurdle that many Indian cities will need to cross to become ‘bond-financing ready’.

**NOTE:** For periodic access to debt financing or bond financing, a ULB should be in a position to consistently generate a stable and buoyant revenue surplus which is then available to service and honour its debt obligations in full and on time. To achieve this, a ULB should have recurring, stable and buoyant revenue streams sufficient to meet its Establishment costs, O&M costs, other recurring expenditure and debt servicing.

### 3.2.1. Improving stability, buoyancy and realisation of own revenues

A key yardstick for assessing and improving financial performance of a ULB is its access and ability to tap own revenue streams. These typically include Taxes (e.g., Property Taxes, Profession Taxes), User Charges (for water, sewerage services, door-to-door waste collection etc.) and other Fees and charges (Building permissions, FSI charges, Rental income etc.). Other things remaining same, a healthy share of own source income, a high buoyancy of the same (through legislative provisions for periodic revision and their enforcement) and consistent good collections (collection efficiency upwards of 80-85%) are
seen as credit positives. Exhibit 3.3 captures critical reforms under AMRUT scheme for revenue improvement.

- **Taxes:** Property taxes typically form an important own revenue stream for ULBs often comprising over 30% of a ULB’s revenue income. A number of ULBs in India also have access to Profession taxes. While Taxes in ULBs in India are to be revised periodically (quinquennial basis or once in 5 years in most states) actual revision is often not effected owing to lack of political will. Further, low coverage, under-assessments, and poor collection efficiency often constrain ULBs from maximizing the realization of tax revenues. In recent years, a number of ULBs are undertaking house-level surveys and creation of updatable and GIS-enabled property tax databases to improve coverage. Administrative improvements, multiple payment modes (online, mobile etc.,) and expeditious settlement of arrears are also instrumental in unlocking and improving coverage and revenue realizations.

**Exhibit 3.3 Reform requirements under AMRUT: Taxes and User charges**

<table>
<thead>
<tr>
<th>Municipal Taxes and Fees Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 90% coverage,</td>
</tr>
<tr>
<td>At least 90% collection</td>
</tr>
<tr>
<td>Make a policy to, periodically revise property tax, levy charges and other fees</td>
</tr>
<tr>
<td>Post Demand Collection Book (DCB) of tax details on the website,</td>
</tr>
<tr>
<td>Achieve full potential of advertisement revenue</td>
</tr>
</tbody>
</table>

**Improvement in levy and collection of user charges**

- Adopt a policy on user charges for individual and institutional assessments in which differential rates are charged for water use while placing safeguards to take protect the vulnerable
- Make action plan to reduce water losses to less than 20 % and publish on the website
- Separate accounts for user charges,
- At least 90% billing
- At least 90% collection.


- **User charges:** User charges are levied against services provided by ULBs. User charges for water supply and sewerage are typically the largest constituents of user charges. User charges for municipal solid waste management are also levied in a few ULBs especially for commercial establishments. ULBs are expected to levy and collect user charges at least to the extent of meeting their O&M cost obligations. However, most ULBs do not achieve 100% O&M cost recovery and the gaps/shortfalls are often met from taxes and other general revenue funds, which in effect ends up reducing the revenue surplus available with ULBs for capital investments and debt servicing. A key deterrent to user charge reform is often poor service levels which make citizens reluctant to pay. Therefore any efforts to improve user charge revenue realization need to be preceded by tangible improvements to service levels. Strong cost-recovery and collection efficiency performance on user charges are typically credit positives. Specific actions towards improving service levels, coverage and realizations (including metering and differentiated tariffs for water supply, levy of user charges for sewerage and solid waste services etc.) tend to improve credit standing of ULBs.
3.2.2. Certainty and stability of transfers from State Government and GoI

ULBs in States where there is a clear formulaic and timely transfer of devolution funds tend to have a greater certainty and stability of revenue flows. The acceptance of the increase in devolution recommended by the Fourteenth Central Finance Commission, from GoI to ULBs can potentially provide a spike in revenue realisation of ULBs across the country.

Other things remaining the same, States with a formulaic devolution (as in case of Tamil Nadu and Karnataka) linked to state government revenues are likely to experience better buoyancy and credit profile relative to states where the transfers are on the basis of adhoc grants and transfers. While some states provide for octroi compensation (e.g., Gujarat and Madhya Pradesh) which is often sizable, buoyancy and certainty of these transfers tends to be viewed conservatively vis-à-vis a formulaic devolution. Shifting to a formulaic transfer recommended by an independent State Finance Commission constituted in a timely manner will help improve timeliness, certainty and growth of transferred income to ULBs and hence will positively impact its credit profile.

3.2.3. Achieving a healthy level and composition of revenue expenditure

**Establishment costs** (manpower and social payments in the form of pensions/PF etc.) typically constitute the largest operating expenditure stream for ULBs, followed by **Operations and Maintenance** (O&M) expenditure. With respect to revenue expenditure, ULBs will need to ensure two critical aspects.

Firstly, a healthy level of well-directed revenue expenditure is actually necessary to meet service delivery commitments. Therefore short term revenue surplus achieved through depressed or extremely low levels of revenue expenditure below a minimum threshold level is not sustainable in the medium-to-long term. Secondly, a balanced composition of revenue expenditure is important. For instance, unbalanced staffing with vacancies in key supervisory, planning and engineering positions will constrain capacity to implement capital projects critical for long term service delivery improvements.

Similarly there is a need to provide adequate resources for upkeep of assets and regular maintenance. For instance, periodic shutdowns and planned maintenance in water supply and sewerage systems will ensure longevity of equipment. Similarly, pre-monsoon de-silting of drains which is a non-remunerative expenditure is crucial to prevent flooding. It is important that resources for such recurring activities are adequately provided for.
3.2.4. Healthy revenue surplus and incremental debt capacity

As highlighted at the start of this section, debt capacity of a ULB is a function of its cash revenue surplus generated annually over the medium-to-long term. Therefore, ULBs seeking to raise debt will need to demonstrate credible capacity to move to a healthy revenue trajectory. The debt capacity of a ULB is assessed based on the extent of revenue surplus that it can allocate towards meeting the principal and interest repayment. In other words, the debt capacity is actually the capital amount on market terms that can be supported with the ring-fenceable surplus available with the ULB over a medium term period (say 10-15 years).

3.2.5. Summary checklist - Financial performance and debt capacity

Refer Exhibit 3.4 for a checklist of review actions with respect to financial performance and debt capacity.

**Exhibit 3.4 Financial performance and debt capacity: a checklist of key actions**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improving stability, buoyancy and realisation of own revenues</td>
<td></td>
</tr>
<tr>
<td>Is the ULB adequately realizing its major revenue sources (Property tax, Profession tax, User charges etc) – Reflected in high coverage, billing and collection efficiency (Typically above 85%)</td>
<td></td>
</tr>
<tr>
<td>Does the ULB have the powers to revise tariffs in a periodic manner</td>
<td></td>
</tr>
<tr>
<td>Has the ULB done an assessment of its revenue potential and has a credible track record to achieve the same over the medium term</td>
<td></td>
</tr>
<tr>
<td>Certainty and stability of transfers</td>
<td></td>
</tr>
<tr>
<td>Is there a formulaic transfer of State Devolution funds to the ULB</td>
<td></td>
</tr>
<tr>
<td>Is there a formulaic transfer of Central Finance commission funds to the ULB</td>
<td></td>
</tr>
<tr>
<td>Is there a credible track record in transfer of State Grants</td>
<td></td>
</tr>
<tr>
<td>Healthy revenue surplus and debt capacity</td>
<td></td>
</tr>
<tr>
<td>Is the ULBs debt capacity adequate to meet the debt requirement on a business-as-usual basis (with per-capita revenue expenditure levels are in line with the MoUD norms)</td>
<td></td>
</tr>
<tr>
<td>If No, ULB should commit to specific financial reforms to meet the debt capacity requirements or revise project financing mix</td>
<td></td>
</tr>
</tbody>
</table>

3.3. Project identification, PPPs and financing mix

The availability of a shelf of commercially viable infrastructure projects that are ready for implementation (in terms of availability of Detailed Project Reports that identifies the project scope, details the specifications, identifies the environment and social impacts along with actions to address them, costing, options for implementation, including on PPP mode) is a critical pre-requisite for bond financing. Given that project preparatory stages often take time, it is important that cities translate the service delivery gaps and investment needs identified into bankable projects.

Project development is the process of turning broad planning concepts for infrastructure into implementable designs. Irrespective of whether a project is to be implemented through Public-Private Partnership (PPP) or on Engineering Procurement and Construction (EPC) mode, holistic project development is crucial, to avoid delays in implementation. Well-
developed projects identify risks up front, and then design the institutional arrangements, the financing package, and the contractual arrangements to best mitigate those risks.

### 3.3.1. Project selection, scoping and detailing

The project development process typically involves phased set of preparatory activities to move from a project concept to a well-fleshed out project document which will typically be a Detailed Project Report that will form the basis for project procurement and implementation. The process of developing and implementing a Project typically starts with identification of a project concept in terms of an intention to create an infrastructure and services based on citizen and ULB level needs followed by translating this intent into a well-defined Project.

**Feasibility report:** In case of new projects in non-familiar sectors with a large capital outlay with limited understanding of viability gaps, and where implementation modality is not yet finalised, DPR preparation may need to be preceded by one or two stage pre-feasibility/feasibility evaluation. Such a multi-stage preparatory approach also helps mitigate risks and optimise costs of project preparation.

**Detailed Project Report:** The detailed scoping of a project is usually in the form of a Detailed Project Report (DPR). This typically involves a detailed analysis of demand–supply gap, ascertaining the project scope, configuration and specifications, developing the detailed design and quantifying a detailed Bill of Quantities and cost estimates.

Further, in some PPP structures such as Design-Build-Operate (where the project is bid based on outcome and performance specifications and where the Design risk is transferred to the private operator) a DPR may not be prepared. The transaction may be initiated after feasibility report preparation, project structuring, financial approval and bid document finalisation. The extent of detailing of the preparatory document is contingent on the mode of implementation, precedence in terms of having done similar projects in the past, and nature of risk sharing during project implementation.

### 3.3.2. Mode of implementation and use of PPPs

While PPPs in urban sector are still evolving and the traditional EPC approach dominates, a number of different PPP arrangements have found their way into urban infrastructure creation across the continuum from Service Contracts to Investment-led concessions. Refer Annexure IV for a summary of PPP models in use in select sub-sectors. GoI’s HPEC report identifies PPP as an important instrument to enhance efficiency in urban service delivery. *Exhibit 3.5 summarises observations of this report with respect to PPPs in the urban sector.*

**Exhibit 3.5 PPPs in urban sector: observations from HPEC report**

The Committee views PPP as an important instrument for enhancing efficiency in the delivery of urban services and ensuring that controllable risks such as operations risks are transferred to the service provider. PPPs, which are structured around a robust revenue model and offer a good prospect of return on risk capital, can contribute to systemic gains and better urban management.

A distinction should be made between commercial PPP and ‘delivery partnership’ which is based on output-based contracts. It is entirely possible for the private sector in a PPP arrangement to provide specified services to constituencies that cannot pay for the services, if the government is...
Guidance on use of Municipal Bond financing for Infrastructure projects

subsidising the costs. There is a smooth continuum of PPPs from the public sector contracting service delivery to output-based contracts. It may well be prudent to begin with output-based contracts and gradually move to commercial contracts as private and public sectors build a working relationship.

With strengthened ULB capacity, PPPs also serve as an instrument of governance and service delivery improvement. This is achieved by committing ULBs to legally binding contracts and pricing rules which cover costs through user charges. The efficiency gains can be realised both in the process of entering the partnership through a competitive and transparent bidding process, and from operational efficiencies because of commercial orientation of such an entity.

A major deterrent to the entry of private firms in the urban sector in India is the commercial non-viability of projects. This is closely linked to the inability of ULBs to generate a strong internal revenue base. The relatively smaller size/value of projects also make projects unattractive for private companies. In cases where the underlying projects/sectors have the potential to be viable on a standalone basis but have operational costs and governance risks (such as collection of user charges), PPP structures may be opted for.

To create an enabling environment for the delivery of services through PPPs, the Committee recommends that state governments either amend their Municipal Acts or enact overarching Acts to facilitate PPPs. Gujarat and Karnataka have already done so. This must be supplemented by a robust regulatory environment. State financial intermediaries should take the role of guiding ULBs on PPPs.

Source: Report of India’s urban infrastructure. High Powered Committee on Urban Infrastructure. 2011

3.3.3. Financing mix, sustainability and bond issue sizing

Once the project scoping and mode of implementation are finalised, it is important to arrive at an appropriate financing mix taking into account the project’s lifecycle costs covering both the upfront capital costs and the recurring costs. The size of bond financing for a particular project is dependent on the debt capacity of the ULB and the incremental costs or revenues that the project will lead to.

- In case of non-remunerative projects (such as storm water drains where investments may not generate direct incremental revenue attributable to the project) financed through bond issuances, the debt repayment obligations will need to be met from general revenue surplus by an escrow of a earmarked revenue stream (such as property taxes)

- In case of remunerative projects (where a revenue surplus is available from project revenue streams E.g., user charge revenues for water supply), it may be possible to use a portion of project-specific revenue streams to meet debt servicing. However, often such direct revenues may be inadequate to meet all incremental recurring costs. For instance, if a ULB has a cost recovery of only 50% of its existing O&M costs, it may not be in a position to meet debt servicing and additional O&M obligations arising out of a new project for improving water supply solely from user charge revenues. Under such circumstances, earmarking additional revenue streams such as property taxes will be necessary to meet the recurring cost obligations and to ensure assurance and timeliness of debt servicing.

- In case of PPP projects (with future remunerative potential but with viability gaps), ULBs could consider tapping the capital markets with a bond issuance (to meet in part or full its own contribution and/or project viability gap funding of project costs) which can be serviced by its revenue surplus and with ring-fencing/escrow of select revenue streams
(such as property taxes or professional taxes). Many large scale urban PPP projects tend to have viability gaps which have to be provided for upfront and ULBs can possibly leverage their future cash flows in this manner to provide the required viability support early on.

- In case of **PPP projects (with future remunerative potential without viability gaps)**, In such cases, the private operator or SPV that is awarded the project can consider tapping the capital markets with a bond issuance which can be serviced by project revenue streams. While most urban service delivery projects tend to have viability gaps, projects of a commercial nature (for instance, development of land parcels) may be amenable to being financed fully by the concessionaire without any financing support by the ULB.

Thus, irrespective of whether a project has direct revenue streams or not, identifying and earmarking financial resources (for asset creation upfront, and for O&M and debt servicing during the operations) is important. The size of bond issuance in relation to the project cost is therefore limited by the extent of debt that can be serviced by earmarked project revenue streams. ULBs to therefore look at the Project in totality covering both capital and recurring cost obligations and accordingly identify and earmark financial resources to meet these obligations. Refer Exhibit3.6 for illustrative approaches for structuring the financing mix with a bond issuance built in for a remunerative and non-remunerative project.

**Exhibit 3.6 Project financing and bond issuance sizing: illustrative cases**

| Project Case 1 – Remunerative water supply project meeting incremental O&M obligations |
|---|---|
| **Sector** | Water supply |
| **Project and Project cost** | Distribution improvement for 24x7 water supply; Rs. 500 crore |
| **Project Cost** | Rs. 500 crore |
| **O&M cost recovery** | |
| - Existing | 50% from user charges |
| - Post project | 100% from user charges |
| **Property Tax Revenue** | |
| - Base year | Rs. 200 crore |
| - In 5 years | Rs. 350 crore |
| **Revenue Surplus** | |
| - Base year | Rs. 100 crore |
| - In 5 years | Rs. 175 crore |
| **Financing mix** | |
| - ULB own funds | : Rs. 50 crore |
| - Capital Grants | : Rs. 250 crore |
| - Bond financing | : Rs. 200 crore |
| - A 10 year tenure with 5 annual bullet payments from year 6 to 10 |
| **O&M sustainability** | Through user charges |
| **Debt servicing** | From revenue surplus through escrow of Property Taxes. |
### Project Case 2 – Non-Remunerative road project

<table>
<thead>
<tr>
<th>Sector</th>
<th>Roads and Transportation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project and Project Cost</td>
<td>Improvement and relaying of 300 km of interior roads; Rs. 300 crore</td>
</tr>
<tr>
<td>Mode of implementation</td>
<td>EPC</td>
</tr>
<tr>
<td>O &amp; M Cost</td>
<td>2% of project cost annually inflated at 5%</td>
</tr>
<tr>
<td>Project revenues</td>
<td>Nil</td>
</tr>
<tr>
<td>Property Tax Revenue</td>
<td></td>
</tr>
<tr>
<td>- Base year</td>
<td>Rs. 200 crore</td>
</tr>
<tr>
<td>- In 5 years</td>
<td>Rs. 350 crore</td>
</tr>
<tr>
<td>Revenue Surplus</td>
<td></td>
</tr>
<tr>
<td>- Base year</td>
<td>Rs. 200 crore</td>
</tr>
<tr>
<td>- In 5 years</td>
<td>Rs. 300 crore</td>
</tr>
<tr>
<td>Financing mix</td>
<td></td>
</tr>
<tr>
<td>- ULB own funds</td>
<td>Rs. 100 crore</td>
</tr>
<tr>
<td>- Bond financing</td>
<td>Rs. 200 crore</td>
</tr>
<tr>
<td></td>
<td>A 10 year tenure with annual interest payment and principal repayment in the form of 5 annual bullet payments from year 6 to 10</td>
</tr>
<tr>
<td>O&amp;M sustainability</td>
<td>From General Revenue fund</td>
</tr>
<tr>
<td>Debt servicing</td>
<td>From Revenue surplus through escrow of Property Tax proceeds</td>
</tr>
</tbody>
</table>

*Based on readiness assessment studies for bond issuance done in select cities as part of a pilot project initiated by DEA. However, the capital cost, and other amounts referred above and the other implementation details are only for illustrative purposes. Each ULB may structure the transaction based on the project size, borrowing capacity, and potential for co-financing.

### 3.3.4. Securing co-financing and other readiness aspects

Following completion of project preparation and arriving at the financing mix, the ULB should complete all other readiness requirements from a project implementation stand-point. Some of the crucial readiness requirements from an implementation stand-point are listed below:

1. The most critical requirement is to secure approvals for all co-financing arrangements, especially when State/GoI grants have been identified as part of the project financing mix. It is important to ensure that at the time of bond issuance, there is complete clarity on the overall financing mix, the share of project cost met by bond issuance and from other sources including ULB’s own funds and capital grants from State/GoI schemes.

2. Social and Environment impacts of the project are fully identified, and actions to address these impacts including compensation requirements etc., are fully provided for.

3. Land acquisition requirements are identified and a credible time-bound action plan to secure required land is in place.

4. A list of the clearances and approvals required for the project along with timeframes and concurrence of agencies involved is identified and clearly laid out. Wherever such clearances can be obtained prior to bidding to allow for plug-and-play implementation, they have been obtained.

5. Finalisation of bidding documents and transaction advisory process (in case of PPP projects), including approvals for initiating bidding including approvals for bid documents have been obtained. Initiation of project bidding at the time of bond issuance will be a positive.
3.3.5. Summary checklist - Project identification, PPPs and financing mix

Refer Exhibit 3.2 for a checklist of review actions with respect to Project identification, structuring and financing mix. The project identification and issue design is a multi-step process as follows:

1. Project selection – Which is/are the set of projects considered for bond issuance? Is it a single/few big-size project requirement or multiple small size projects? Are the projects remunerative or non-remunerative in nature?

2. Project Scoping and Detailing – What are the broad contours of the project? Defining the boundaries of the project scope including geographic, technical and demographic boundaries? What are the project specific revenue streams that can be leveraged?

3. Preparatory studies – Is the project backed by strong technical/social/environmental studies? Some of the preparatory studies include Feasibility study, detailed project report, Social impact assessment studies, Environmental impact assessment studies etc.

4. Mode of implementation – Which is the optimum mode of implementation PPP or EPC? If PPP, define the nature of PPP structure including DBO, DBOT, DBFOT, BOT etc.

5. Defining the financing mix – What is the realistic financing mix for the project (Grants/Loans including institutional, commercial, bonds/ULB contribution/Beneficiary contribution etc.) – including detailed bond structuring?

6. Securing co-financing and approvals – Are all the approvals required for project implementation in place? It is recommended that the co-financing arrangements are backed by enforceable commitments.

7. Procurement readiness – Has the procurement of vendors for project implementation completed as per the extant regulations?

Exhibit 3.7 Project identification, PPPs and financing mix: Summary of approach
3.4. Multi-year Planning perspective

3.4.1. City Development Plan/Capital Investment Plans

A key input for systematic capital investment planning is the preparation/updation of a Multi-year Capital Investment plan/City Development Plan (CDP), which outlines the vision and development goals, is prepared in consultation with a wide range of stakeholders, identifies priority actions and interventions to realise the city’s vision and goals. The CDP thus provides a framework within which individual projects are then identified. The CDP is a medium term plan for the ULB aimed at bringing an outcome based approach to infrastructure investment and also brings in financial discipline to the ULB’s planning process.

The CDP takes a strategic view and seeks to align infrastructure development and service delivery to the City’s development vision in a consultative and participatory manner. It may be prepared based on a quantitative assessment of the service level gaps of the ULB, building on the city’s strengths and in line with the aspirations of the citizens. These projections are critical in assessing expenditure commitments, revenue trends, and the affordability of new capital investments. It is also recommended that the annual budget of the ULB may be aligned in line with the proposed capital investment plan which reflects the commitment of the ULB to stick to its long-term growth plans.

The CDP typically cover all sectors that make a difference to the quality of life experienced by urban citizens. Although projects/initiatives in sectors outside the mandate of ULBs and other urban institutions typically are not detailed, the impact of these sectors is factored. For e.g. sectors such as power supply, rail transport, or higher education are outside the ambit of urban sector institutions. While the CDP itself may not plan for the growth and development of these sectors, the needs, demands and requirements from these sectors are typically factored into the plans for land use, urban services etc. Refer Exhibit 3.8 for pointers for CDP preparation and updation.

Exhibit 3.8 Pointers for CDP preparation

- State Governments should seek to encourage ULBs to prepare CDPs by either making it a statutory requirement or make it a pre-requisite for seeking capital grants. CDPs should ideally be reviewed and updated once every 5 years.

- The preparation of CDPs should involve a wide consultative process to ensure views of all stakeholders (especially urban poor) are taken on board, to build consensus and local ownership.

- Service performance studies and demand surveys should be used to strengthen city assessments and complement city information baseline, especially when data on services available with the ULB is sketchy.

- A CDP should complement existing spatial plans or inform their revisions. The CDP is not a substitute for spatial planning exercises. While spatial plans concentrate on land use, building codes, and aesthetic characteristics, CDPs focus on investment needs and service delivery. CDP analysis can support Master Plans by refining the scopes, by suggesting changes based on the ground realities, and by prioritizing implementation. Conversely, CDPs can incorporate findings from more detailed studies as important inputs into the process (e.g., doing-business surveys or slum profiles).
The time it takes to conduct CDPs varies by city. Cities that have already undergone management reforms can conduct the CDP process more easily, since they will likely have better organized databases and regularly collect information on urban indicators.

Cities should conduct “shadow” credit ratings. Credit ratings provide good insight into a local government’s financial performance and management practices. Analysis of revenue generation and expenditures over the last several years reveals a local government's ability to meet its financial commitments on a timely basis, including debt service (creditworthiness). It also provides an indication of how much market borrowing a municipality will qualify for and can safely sustain. Consequently, it also pinpoints necessary reform initiatives or potential revenue-generating activities as precursors to approaching private capital market.

Source: Adapted from Developing Sustainable and Inclusive Urban Infrastructure Services A Guidebook for Project Implementers and Policy Makers in India. FIRE-D and MOUD. 2011.

3.4.2. Investment prioritisation, CIP and FOP

Indian cities typically require far higher capital investments than what they can typically afford, even after factoring budgetary transfers and grants that they expect to receive from State Governments and GoI schemes such as AMRUT and Smart Cities Mission. Therefore it is important that the process of CDP preparation also enables and leads to an effective prioritisation of financial investment demands and opportunities. In this regard, a Capital Investment Plan (CIP) is a valuable tool for prioritizing infrastructure investments, budgeting resources, planning fund utilization, and urban management. It is typically the final part of the CDP process and provides ULBs with a strong mandate to move into detailed project design, and then financial mobilization and implementation. The CIP is the stage where programmatic and financial convergence occurs for city development projects.

Preparation of a CIP is typically done in an iterative manner, complemented by preparation of a Financial and Operating Plan (FOP). An FOP is a tool used in (1) sizing investments, given limited resources, or (2) setting levels of resource mobilization required for a desired level of investment. In the first case, there is a set level of resources from grants, internal own-source revenue, or debt capacity. This becomes a deciding factor for prioritizing projects. In the latter case, recommendations for additional resource mobilization will need to be identified (including tax revisions, increasing user charges for services and leveraging alternative financing and PPPs). Although resource mobilization (e.g., financial strengthening) is paramount for making cities financially viable, it involves an on-going reform process that takes place over many years. Changes in user charges as well as willingness-to-pay studies should be completed at detailed project structuring stages.

3.5. Internal readiness for bond issuance: a summary

As described above, the steps in internal readiness assessment will enable an Urban Local Body to establish clarity on the extent and direction in which proceeds from bond financing are to be deployed. A summary checklist for the ULBs to review its readiness is provided in the Exhibit 3.9 below.
### Exhibit 3.9 ULB readiness Checklist

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Readiness</strong></td>
<td></td>
</tr>
<tr>
<td>Accrual accounting system in line with National standards</td>
<td>Mandatory</td>
</tr>
<tr>
<td>Timely audit and finalization of accounts</td>
<td>Mandatory</td>
</tr>
<tr>
<td>Credible, Transparent and Quality information disclosure</td>
<td>Mandatory</td>
</tr>
<tr>
<td><strong>Financial performance and debt capacity</strong></td>
<td></td>
</tr>
<tr>
<td>Is the ULB’s debt capacity on business-as-usual basis (at per-capita RE levels in line with norms) is adequate to service bond issuance</td>
<td>Mandatory</td>
</tr>
<tr>
<td>If the Debt capacity is lower, Does the ULB commit to undertake reforms to improve stability, buoyancy and realisation of own revenues</td>
<td>Recommended</td>
</tr>
<tr>
<td>Certainty and stability of transfers from State Government and GoI</td>
<td>Recommended</td>
</tr>
<tr>
<td><strong>Capital Investment planning</strong></td>
<td></td>
</tr>
<tr>
<td>City Development Plan/Multi-year capital Investment plan</td>
<td>Recommended</td>
</tr>
<tr>
<td>Investment prioritisation, CIP and FOP</td>
<td>Recommended</td>
</tr>
<tr>
<td><strong>Project Identification, PPPs and Financing Mix</strong></td>
<td></td>
</tr>
<tr>
<td>Project preparatory studies in place</td>
<td>Mandatory</td>
</tr>
<tr>
<td>Project implementation modalities finalized – PPP/EPC</td>
<td>Mandatory</td>
</tr>
<tr>
<td>Project financing mix finalized</td>
<td>Mandatory</td>
</tr>
<tr>
<td>Securing the co-financing commitments</td>
<td>Recommended</td>
</tr>
</tbody>
</table>

To summarise, the key is to establish clarity on gaps and actions required on four building blocks namely, (i) Financial discipline and disclosure, (ii) Financial performance & debt capacity, (iii) Project identification & financing plan, and (iv) Shifting to a multi-year cycle of Capital Investment Planning.
4. Issuance Roadmap and Market Interfacing

4.1. Bond issuance basics

A bond is a marketable debt instrument in which one party (Issuer) borrows funds for a defined period of time at a variable or fixed interest rate from another party (Investor). It is a contract between an Issuer and the Investor whereby an Issuer promises to pay a definite sum of money (as interest and principal) against borrowing from the Issuer.

When bonds are sold, the market assesses the risk that the Issuer ULB issuing bonds will fail to make payments, and prices the bonds according to that perceived risk. Investors and market participants closely analyse the ability of the Issuer to repay, especially new Issuers. Risks that cannot be eliminated or minimized by legal, structural or other procedures will be priced into the issue. The cost to the Issuer of the financing, as reflected in the bond’s yield at issuance, will reflect the market’s perception of the bond’s risk, as well as country region and currency risk, where applicable. In determining whether or not to enter the fixed income market and issue bonds, an Issuer ULB must make a series of decisions, often with assistance from external advisors. The Issuer ULB should also seek to reduce cost of debt issuance through actions that reassure the market of its creditworthiness.

4.1.1. Type of bonds

As per the extant regulations, Municipal Bonds can be issued as Revenue bonds and General obligation bonds. It may be possible to structure a third category, Hybrid bonds which reflect characteristics of both these bonds. General obligation bonds are raised on the strength of a ULB’s Balance sheet and Revenue Surplus and Revenue bonds are typically serviced from identified surplus cash flows and revenue streams of a specific project.

- **General obligation (GO) bonds** are issued on the backing of the ULB’s finances. The bonds are raised against the power of the ULBs to raise resources backed by the respective Municipal legislation and supporting provisions under Central and State legislations. GO bonds are typically issued against taxation powers of ULBs (property taxes) wherein a portion of the ULBs tax proceeds is earmarked for debt servicing and are usually issued to finance non-remunerative projects (that not have a direct attributable revenue stream or cash flows). Examples of such projects include roads and storm water drains, where provision does not generate direct revenues. Key factors to determine credit quality of GO bonds include a) Economic strength and sustainability of the city, b) Financial track record and debt position of the ULB, c) Organizational efficiency and track record in project execution, and d) Legal and Institutional framework.

- **Revenue bonds** are loans backed by Revenue streams from projects financed with the issuance. Generally, Revenue bonds are issued to finance remunerative projects (that have a specific attributable revenue stream). Examples include water supply and sewerage (where user charges are levied) and toll roads (where toll revenues can be used to service bonds) etc. Debt servicing in these bonds is typically done from project-specific revenues earmarked for bond servicing. Hence, implementation risks, demand risk and pricing risk associated with the project impact the bond’s repayment profile. Most bondholders evaluate project surplus (net revenue pledge) as a defining criterion
for arriving at bond value. The project should therefore be able to service the O&M obligations in addition to debt servicing for long-term sustainability.

As explained above, the choice of whether a ULB should consider a Revenue bond or a GO bond is contingent on the nature of the project (remunerative or non-remunerative) and the track record and experience of the ULB in actually being able to implement projects with a strong revenue profile. Historically, most ULBs in India face challenges in immediately translating project implementation with a robust user charge or revenue regime especially in sectors like water supply and sewerage, where viability gaps tend to be high and there is often an ‘unwillingness to charge’. ULBs where cost recovery and collection efficiency track record is poor would thus be constrained to structure a Revenue Bond purely on the basis of the project level revenues. Therefore, in the initial stages, ULBs with a reasonable overall revenue surplus only may be able to manage securing a good investment grade rating, even if there is a project with strong revenue potential. Thus when a ULB starts exploring bond issuances, even Revenue Bonds will need to be structured with strong credit enhancements with the backing of the overall revenue surplus of the ULB including for instance, escrow of property tax proceeds.

**Special Initiatives – Green bonds:** India has embarked upon an ambitious target of building 175 Giga Watt of renewable energy capacity by 2022 and this requires a massive estimated funding of US$ 200 billion. A significant portion of the urban infrastructure investment is linked to the implementation of renewable energy and green solutions to the urban problems. Green bonds have been a recent initiative in the capital market space and are issued to support financing of “green infrastructure” projects. In case of Green bonds, the issuer publicly states it is raising capital to fund ‘green’ projects, assets or business activities with an environmental benefit, such as renewable energy, low carbon transport etc. Some of the indicative broad categories as noted in SEBI’s Draft Disclosure requirements for issuance and listing of Green Bonds include the following:

1. Renewable and sustainable energy (wind, solar etc.)
2. Clean transportation (mass transportation)
3. Sustainable water management (clean and/or drinking water, water recycling etc)
4. Climate change adaptation
5. Energy efficiency (efficient and green buildings)
6. Sustainable waste management (recycling, waste to energy etc.)
7. Sustainable land use (including sustainable forestry and agriculture, afforestation etc.)
8. Biodiversity conservation

Green Bonds as an instrument started only in 2007, and the estimated global market size was US$ 46 bn in 2015. India issued green bonds worth US$ 1.1 bn in 2015 behind USA, Germany and Netherlands. In India, a handful of big ticket issuances have happened over the last 2 years including Yes Bank (Rs. 1000 crore and Rs. 315 crore), CLP India (Rs. 600 crore), Exim Bank of India (US$ 500 mn) and IDBI Bank (US$ 350 mn).

Apart from leveraging on the visibility and positive public relations associated with such projects, ULB may also be able to access specific global pool of capital, which is earmarked
Guidance on use of Municipal Bond financing for Infrastructure projects

4.1.2. Elements of a bond structure and bond issuance design

Refer Exhibit 4.1 for a summary of key elements of a bond structure.

**Exhibit 4.1 Bond structure: A typical term sheet for bond issuance**

| **Issuer** | [Name of the ULB/CME] |
| **Type of Instrument** | [Public/private] placement of [General obligation/Revenue bonds] with details of Eligible and non-eligible investors [Secured/Unsecured] [Redeemable] [Taxable/Tax free] Bonds |
| **Listing** | Bonds are proposed to be listed on [Name of the Stock Exchange] |
| **Issue Size, Face Value, Issue price and Number of Bonds** | [Number of bonds] with a [Face value per bond] and [Issue price per bond] to raise [Issue Size] |
| **Tenure and Redemption** | Term of [Number of years] redeemable at the end of [Year 1], [Year 2] etc. with a principal moratorium of [Number of years] and interest moratorium of [Number of years] |
| **Credit Rating** | [Brief of the Credit Rating of the issuance] |
| **Coupon** | [Coupon Rate – Fixed/Floating] payable [quarterly/semi-annually/annually etc.] |
| **Deployment of proceeds** | [Brief profile of project] |
| **Credit Enhancement** | Escrow of [Tax revenue/user charges etc.]. Additional support structures, if applicable |
| **Security** | Charge on [Corporation Assets]/[Receivables] as per Trustee Agreement |
| **Trustee** | [Name of the Trustee] |
| **R&T agents** | [Name of the R&T agent] |
| **Depository** | [Name of the Depository] |
| **Listing** | Bonds are proposed to be listed on [Name of the Stock Exchange] |
| **Other features and details** | Deemed date of allotment, Form of issue, Settlement date, Transferability, Minimum subscription, Conditions precedent, Transaction documents to be submitted and any additional covenants |

Key considerations in designing and structuring bond issuance are discussed below:

**Size of Bond Issue**

While the assessed debt capacity of a ULB is a primary determinant in sizing a bond issue, supply-side considerations and transaction economics also need to be factored. While average size of Corporate Bond issues has been over Rs. 1000 crore during FY 06 to FY 14 (Refer Exhibit 4.2), average issuance size in the Municipal Bond market, was Rs. 50 crore (during FY 1996 and FY 14). Typically, Banks, insurance companies, PFs, pension funds and Mutual funds are expected to be major players in the Municipal Bond market. Therefore it is important to factor the market appetite as well while sizing up a bond issue.

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*Trustee or Debenture Trustee or Bond Trustee are used interchangeably in the document*
Guidance on use of Municipal Bond financing for Infrastructure projects

Exhibit 4.2 India’s bond market: year-wise no. and size of issuances FY 06-FY 14

Given that bond issuance involves transaction costs (Legal fees, Project preparatory fees, Accounting fees, Regulatory filing fees, Trustee and paying agent fees, Depository fees, Rating agency fees and any administrative costs), a minimum threshold size of issuance is necessary. Therefore very small issues may be rendered unviable due to high transaction costs of issuance. At the same time, very large municipal issuances (upwards of Rs. 500 crore) may be limited by debt capacity at ULB level.

In general, medium size ULBs (with population of between 1 and 2 million) with a reasonably good credit profile could look at a bond issuance size of Rs. 200-250 crore while larger ULBs (with population greater than 5 million) could possibly target a Rs. 400-500 crore issue size for their first bond issuance. It should be noted that this is only a ball-park range suggested based on a review of financial position of select ULBs, past bond issuances and interaction with merchant bankers/investors. Actual size of bond issuance is project and context specific and will need to be determined on a case to case basis.

Instrument type

Refer Exhibit 4.3 for considerations in deciding the type of instrument.

Exhibit 4.3 Bond instrument type: Considerations

<table>
<thead>
<tr>
<th>Factors</th>
<th>If Yes</th>
<th>If No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project has direct revenue streams that are sufficient to meet debt servicing after meeting O&amp;M cost obligations.</td>
<td>Revenue bonds, public issue or private placement⁹</td>
<td>GO bonds through private placement</td>
</tr>
<tr>
<td>Municipal Act prohibits charge on municipal assets</td>
<td>Unsecured</td>
<td>Secured¹⁰</td>
</tr>
<tr>
<td>Expectation of interest rates during project term is either (i) steady and increasing or (ii) High volatility</td>
<td>Fixed Rate</td>
<td>Floating rate</td>
</tr>
<tr>
<td>Expectation of fall in interest rates in the medium term</td>
<td>Callable bonds</td>
<td>No call option</td>
</tr>
<tr>
<td>High appetite for tax-free structures</td>
<td>Tax-free</td>
<td>Taxable bonds</td>
</tr>
</tbody>
</table>

⁹ Depending on appetite, size of issue and administrative ease, Revenue Bonds can also be privately placed
¹⁰ In case the ULB does not want to create a charge on the municipal assets it may issue unsecured bonds
Where bond servicing is expected to be done from project specific revenues, a Revenue bond issuance through either public or private placement is possible. A General Obligation bond issuance is done when debt servicing is envisaged from non-project specific funds.

Although the endeavour should be to adopt sustainable taxable Municipal Bond structures in the medium-to-long term, there is sometimes a felt-need for continuing tax-free status to Municipal Bonds, in view of large viability gaps or to reduce the cost of financing for ULBs at least in the early stages. The Government of India through the Ministry of Urban Development had earlier issued guidelines for support to tax-free Municipal Bonds in 2001 and for pooled tax-free bonds in 2006\textsuperscript{11}, whereas the current guidelines are for regular taxable bonds as well.

The appetite for tax-free issuances and the nature of investors targeted for the issue are also consideration factors in deciding between taxable and tax-free bonds. Institutional investors that have pre-existing tax shields typically tend to prefer investing in taxable bonds while retail investors often tend to show a preference for tax-free issuances.

Government of India appreciates the importance of creating a sustainable and vibrant Municipal Bond market by laying stress on promoting issuances of taxable bonds through non-guaranteed mode. However, considering the weak credit profile of the issuing entities and the limited impact of tax-free issuances, the Ministry of Urban development has recently announced the creation of a Rs. 400 crore fund\textsuperscript{12} to provide interest subsidy to issuing entities. Under the proposed plan, MoUD may offer the municipal corporations a 2\% interest subsidy on the size of bonds which will improve bankability of the issue.

**Coupon rate and Issue pricing**

The coupon rates will be contingent on the credit rating of the issue and the average spreads against the G-Sec for the particular rating category. The spreads vis-à-vis the 10 year G-Sec rates vary with the rating category. As of March 31, 2017, the yields on AA rated security varied 109 basis points over the benchmark G-Sec rates\textsuperscript{13}. The 10-year benchmark interest rate as on March 31, 2017 was around 6.69 percent.

**Repayment terms and Maturity**

The maturity of bond issue is dependent on the demand factors like the ULBs credit rating, debt capacity, and project IRR (in Revenue bonds) and supply side factors like the investor appetite. Given that ULBs seek to raise resources for long-gestation capital projects, a maturity period of at least 10-12 years should be targeted for Municipal Bond issuances.

The repayment terms cover the frequency of repayment of Interest and principal. Typically interest payments are done on an annual basis with back-ended principal repayments (either bullet payments in the last five years or a balloon payment involving payment of principal at maturity).

\textsuperscript{11}http://moud.gov.in/upload/uploadfiles/files/POOLED%20FINANCE%20DEVELOPMENT%20FUND04.pdf
\textsuperscript{13} Yield to maturity (YTM) 5 year AA rated TataMotors ~ 7.91 percent. YTM 5 Year G-Sec ~6.82 percent
The choice of fixed and floating rate bonds will be contingent on prevailing interest rate regime and the expectations of interest rate movement during the bond term. The repayment terms may be determined by the ULB based on a realistic estimate of cash flows generated by the ULB annually so as to maintain a comfortable DSCR levels (at least 1.5) over the project period.

In case the ULB expects to face constrained cash flows in short term, it may choose to opt for a principal moratorium with bullet/balloon repayment. Also, yield on annual repayment structures is expected to be higher than balloon repayments due to reinvestment risk.

4.2. Credit rating, structuring and credit enhancement

Of the standalone credit rating of 65 ULBs done in 2006 and 2007, only 20 ULBs had a credit rating of A and above (10 cities each in A and AA). Refer Exhibit 4.4.

Exhibit 4.4 Entity Credit Rating of ULBs

<table>
<thead>
<tr>
<th>Rating of Cities under JNNURM- 65 Nos.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>1</td>
</tr>
<tr>
<td>B</td>
<td>10</td>
</tr>
<tr>
<td>BB</td>
<td>16</td>
</tr>
<tr>
<td>BBB</td>
<td>16</td>
</tr>
<tr>
<td>A</td>
<td>10</td>
</tr>
<tr>
<td>AA</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: ULB Rating, MOUD 2006 and 2007

However, the Indian debt market reflects a sharp preference for higher credit quality assets with rating categories (AA and above) accounting for over 80% of the debt issuances in the past decade. Investment in this segment is dominated by Insurance funds and pension funds that have a regulatory requirement to invest in higher quality assets. In light of this, ULBs should target a credit rating of AA or above (and preferably above AA+) for successful bond issuance. Since most ULBs are likely to secure a relatively lower intrinsic rating on a standalone basis, at least the early stage issuances of ULBs will require significant credit structuring and enhancements to attract investors for successful bond issuance.

4.2.1. Credit enhancements

Considering the demand-supply mismatch in the bond market (due to the average credit profile of the issuers), the ULBs need to put in additional credit enhancement structures provide assurances to the investors that the debt repayments will made on a timely manner irrespective of any challenges in accessing the basic revenue stream. For example, property tax collections may be impacted by an adverse socio-political environment. In such cases, the credit enhancement structures will provide for necessary liquidity and provide alternative resource streams to ensure timely debt servicing, reduces the cost of issuance and improves marketability of bonds. Any additional features which improves the visibility and certainty of cash flow to Investors, could improve credit quality (issue rating) and marketability of bond issue. The potential credit enhancement structures can be categorized as follows:
1. Project/ULB level Interventions – This provides details on the credit enhancement structures that may be implemented at a project level/ULB level to improve the credit quality of the issue. The interventions may be project level (in case of Revenue bonds) or ULB level (in case of GO bonds) or both (in case of Hybrid bonds). The objective may be to identify and earmark key revenue streams for the project/ULB and ensuring stability, visibility and effectiveness of the fund transfer. The ULB may look at the following structures for improved effectiveness:

   a. No-lien escrow account for transfer of identified revenue streams for repayment – (usually the primary source of revenue - Project revenue/Property tax)
   b. Creation of debenture redemption reserve (in case of issuance via CME)
   c. Debt service reserve funds
   d. Charge of ULBs assets/mortgage of assets

2. State/Central Interventions – This provides details on the credit enhancement structures that may be implemented at the State/Central level by leveraging on the credit strength of the State/Centre to improve the credit quality of the issue. The interventions under the same include:

   a. State/Central government guarantees (Complete/Partial)
   b. Tax free status or Interest subvention
   c. Devolution/Grant intercept for repayment
   d. Special Grants towards meeting Cash credit, DSRF

3. External Institutional interventions – This provides details on the credit enhancement structures that may be facilitated through the financial institutions/State/Central government bodies by leveraging on the credit strength of the State/Centre to improve the credit quality of the issue. The interventions under the same include:

   a. Subordinated debt or Cash credit to improve the overall cost of capital
   b. Cash credit support through credit enhancement funds
   c. Partial credit guarantee of ULB bonds provided by financial institutions
   d. Interest subvention supported by Multi-laterals/Financial Institutions

The credit enhancement structures suggested above are indicative in nature and the ULB may look at whole other ranges of options to strengthen the stability, visibility and effectiveness of bond.

Refer Exhibit 4.5 for an illustrative chart showing fund flows with credit structuring.
A brief note on each of the credit enhancement structure is provided below:

1. **Escrow Account**: No-lien Escrow Account for transfer of identified revenue streams for repayment (usually the primary source of revenue) may be set up by the ULB as a separate bank account (or one each for Interest payment and Principal repayment). The Escrow Account would be managed by the ULB bankers for meeting the debt repayment obligations. The account would be managed as per the Escrow Agreement entered into between ULB and the Bank. The ULB would setup a Collection Account and transfer the requisite amounts on a timely basis into the account, or structure the transaction such that the primary revenues as in user charges are deposited directly into the Escrow Account by the consumers. This ensures stability of cash flows. This process of collection and subsequent transfer of funds to the designated Escrow Accounts and payments of dues to the bond holders may be supervised by the Trustee.

2. **Devolution/Grant intercept**: This is one of the major untapped revenue sources for the ULB which is likely to have a significant impact on issue rating especially due to perceived stability and reliability of state transfers (vis-à-vis ULB’s own revenue stream). Under this arrangement, any short fall in the payments into the designated bond service account would be made up from State/Central Finance Commission Devolutions or Revenue grants to the ULB. Since the stability of the fund flow is an important indicator, such structures are more effective when there is a formulaic transfer of funds from the State government to the ULB).

3. **Debt service reserve funds**: ULB from its Revenue sources (including Own source revenue or State/Central grants), may set apart a sum into a Debt Service Reserve Fund DSRF, for meeting the debt obligation. This may be maintained typically as a separate fix deposit account with a Scheduled Commercial Bank. The DSRF is usually structured as an additional layer of comfort (for investors) in case the primary revenue stream is inadequate to meet the debt obligation. The DSRF funds may be accessed there is shortfall in servicing the debt obligations from the primary revenue stream. In the event DSRF is accessed for repayment, ULB may ensure that the same is replenished. The
quantum of sum to be earmarked depends on a multitude of factors including annual debt obligation, stability of primary revenue stream etc.

4. **Charge on ULBs assets/mortgage of assets:** ULB may secure the Bond principal, bond interest and any other incidental expenses by Mortgage/Charge on the Corporation’s properties as may be agreed to in consultation with the trustees subject to minimum asset cover requirement as per the SEBI Regulations 2015. The security is usually created in consultation with the Trustee after the bond allotment (typically in 6 months to 1 year period).

5. **Cash Collateral account:** Similar to DSRF, the Cash collateral account can be structured as an additional layer of security to the primary revenue stream. It's a separate account, funded at the time of bond issue, which can be accessed to cover shortfalls in interest, principal, or incidental expenses in the primary account. The account can be funded by the ULB funds, Grant from Centre/State/Multilaterals or as a short term bank facility. The amount is typically deposited (as term deposit) in Scheduled Commercial banks/financial institutions. The quantum of sum to be earmarked depends on a multitude of factors including annual debt obligation, stability of primary revenue stream etc.

6. **Partial credit guarantee of ULB bonds provided by financial institutions:** A partial credit guarantee (PCG) represents a promise of full and timely debt service payment up to a predetermined amount based on agreement between the ULB and Financial institutions. The guarantee is provided against a fee. The impact of the PCG is both from a probability of default as well as the expected loss perspective and may reflect positively on the issuer rating.

### 4.2.2. Dimensions for assigning credit rating

Refer Box 4.1 for a list of dimensions that are analysed as per methodologies of select rating agencies. Also refer *Annexure VI* for detailed methodology.

<table>
<thead>
<tr>
<th>Box 4.1 Credit rating – Dimensions of analysis as per methodologies of select rating agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CARE</strong></td>
</tr>
<tr>
<td>1. Economic factors</td>
</tr>
<tr>
<td>2. Legal set-up</td>
</tr>
<tr>
<td>3. Administrative factors</td>
</tr>
<tr>
<td>4. Accounting and Auditing Practices</td>
</tr>
<tr>
<td>5. Debt Factors</td>
</tr>
<tr>
<td>6. Financial Indicators</td>
</tr>
<tr>
<td>7. Finances of state government</td>
</tr>
<tr>
<td>8. Project Viability</td>
</tr>
<tr>
<td>9. Credit enhancement structure</td>
</tr>
<tr>
<td><strong>CRISIL</strong></td>
</tr>
<tr>
<td>1. Legal and administrative issues</td>
</tr>
<tr>
<td>2. Economic base of the service area</td>
</tr>
<tr>
<td>3. Current financial position</td>
</tr>
</tbody>
</table>
4. Managerial assessment
5. Project specific issues
6. Credit enhancement structure

**ICRA**

1. Credit Quality of the State and Inter-governmental Fiscal Relationship
2. Economy of the Municipal Area
3. Operational Efficiency
4. Municipal Finances
5. Management Quality
6. Credit enhancement structures

*Source: Respective websites of credit rating agencies*

### 4.3. Agencies to be engaged and their roles

**4.3.1. Merchant Banker**

Bond issuances are to be anchored by Merchant bankers who act as a financial intermediary to hand-hold ULBs through the bond issuance process and are regulated by SEBI under the SEBI (Merchant Bankers) Regulations, 1992. Merchant Bankers perform a variety of activities including Raising funds for clients, Project counselling, Assistance in Mergers & Acquisitions, Corporate restructuring, etc. Assistance in bond issuance is an important service offering of Merchant bankers and typically covers the following activities:

1. Design and structuring the bond issue
2. Structuring the Debt
3. Advise on size and timing of public issue.
4. Acting as manager to the issue
   a. Prepare Term sheet/Information Memorandum
   b. Marketing the issue and shortlisting of investors/subscribers
   c. Appointing underwriters and bankers to the issue
   d. Co-ordination with trustees, rating agencies, depositories, R&T agents and stock exchanges
   e. Assistance in Listing of shares on the stock exchange

**4.3.2. Credit rating agency**

In India, any bond issuance (except for Government bonds, T-bills which carry the sovereign rating) has to be necessarily rated by a Credit Rating agency before accessing the market. Additionally, the rating agencies may also undertake regular surveillance of credit profile of issues and review the credit rating on outstanding bonds every year after issuance.

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14 In October 2016, MOUD had empanelled a set of transaction advisory firms to provide technical assistance to ULBs for issuance of Municipal Bonds for implementing smart city projects.
Credit ratings reflect the likelihood of default of the proposed bond and therefore are crucial to pricing of bonds. The rating of a Bond is correlated to the risk premium associated with the bond and hence the required bond yield/coupon interest of the bond issue and also the eligible investors that may buy the issue.

Ratings nomenclature for long-term debt ratings are alphabetical with the best credit quality being typically denoted as “AAA” down to “C” denoting substantial risk and “D” denoting a defaulted security. Refer Annexure VI for a summary of frameworks and key indicators identified in Municipal Bond rating approaches of select rating agencies. Typically, the following parameters are evaluated by assigning a Municipal Bond credit rating:

1. Economic profile and potential for the city
2. Financial profile and revenue potential for the ULB
3. Debt position
4. Organizational capability reflected in project implementation track record, and management information systems, Accounting and audit practices etc.
5. Fiscal autonomy and ULB powers
6. Project viability and stability of co-financing arrangements

### 4.3.3. Bankers and Trustees

**Bankers:** The capital market transaction involves exchange and management of funds across multiple parties. To facilitate the transactions, the issuer/ULBs are expected to appoint a recognized bank registered with SEBI as Bankers to the Issue, with whom the Escrow Accounts and/or Issue Accounts and/or Refund Accounts will be opened. The banks are registered under SEBI (Bankers to an Issue) Regulations, 1994 as amended. The banks are required to collect application money against the debentures from investors and also refund of application money to un-allotted debentures.

**Debenture Trustee:** A Debenture Trustee ( interchangeably referred to as Trustee/Bond trustee) is a SEBI-registered financial entity appointed in case of bond issue to safeguard the interest of bondholders. The Trustee would serve as a liaison between Issuer and Debenture holders and may ensure that debt servicing is done in a timely manner. The Issuer needs to appoint a Trustee, and enter into an agreement (called Debenture Trust Deed or Trustee Agreement) with the Trustee detailing the roles and responsibilities of each party. The Trust Deed would have the details of roles and responsibilities of Trustees, power of Trustees, financial and operational covenants, etc. It would also carry the details of the security created by creating a charge on the assets in favour of the Trustee. The Trustees would hold the security on behalf of the Issuer and for the benefit of debenture holders. The Trust Deed would also lay out actions for liquidating the asset, in case of default.

Under Section 7 of the SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations 2015, “The issuer shall appoint a monitoring agency such as public financial institution or a scheduled commercial bank to monitor the earmarked revenue in the escrow account under sub-regulation (6): Provided that where the issuer is corporate municipal entity, it shall appoint a debenture trustee registered with the Board in accordance with the
provisions of the Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993 and Companies Act, 2013.”

Although in case of Municipal Bonds by ULB, SEBI Regulations 2015 require the appointment of a monitoring agency to monitor the earmarked revenue in the escrow account, appointing a Debenture Trustee with a specific Trust Deed including escrow account monitoring may provide better comfort to the Investors. The Issuers are expected to provide timely disclosures to Trustees with respect to the operational and financial aspects of the ULB which has a material impact on the credit profile of the ULB. The mandatory disclosures as per Schedule V of SEBI Regulations 2015 are provided below.

It is to be noted that the issuers are also expected to provide all the relevant information sought by the Debenture Trustees on demand. The list of mandatory disclosures include (i) Utilization of funds for the projects, (ii) A report containing status of implementation of project(s), (iii) Project development, along with certifications from the Project Engineer should be furnished on Half Yearly Basis (iv) Material adverse changes affecting ability to service bonds (v) Proposal for pre-payment, valuation of bond in case of sale/purchase before maturity etc. (vi) Important ratios like Debt Equity Ratio, Debt Service Coverage Ratio, Interest Service Coverage Ratio, Half Yearly return on servicing of bonds, maintenance of Asset Cover, Credit enhancement facilities.

4.3.4. Registrar and Transfer agent and Depositories

Registrars to an issue are intermediaries in charge of maintaining detailed records of bond issuance transactions. They would keep a record of all applications and funds received from investors, assist the issuing companies in determining the basis of allotment, assist in finalization of allotment and dispatching refund orders, etc. The R&T agents would work closely with the merchant bankers in finalization of eligible allottees and ensure that the same is reflected in the investors’ dematerialised accounts. The unallotted debentures would be dispatched and the refund orders are communicated to the bankers to the issue. Considering the need to liaison with multiple investors it is advisable that the R&T agent has a strong national presence.

The Issuer should also make necessary depository arrangements with National Securities Depository Limited (NSDL)/Central Depository Services Limited (CDSL) for issue and holding of Bonds in dematerialized form. Investors who hold the bonds in dematerialized form can deal with the same as per the provisions of Depositories Act, 1996 as amended from time to time. The applicant must have at least one beneficiary account with any of the Depository Participants (DPs) of NSDL/CDSL prior to making the application. The Bonds issued in electronic (dematerialized) form will be governed as per the provisions of The Depository Act, 1996, Securities and Exchange of India (Depositories and Participants) Regulations, 1996 and rules notified by NSDL/CDSL/Depository Participant from time to time and other applicable laws and rules notified in respect thereof.
4.4. Issuance process

4.4.1. Pre-requisites

Before embarking on bond issuance, a ULB should check compliance on the following pre-requisites:

1. Does the ULB have an active ULB standalone rating? (It is expected that ULB has an outstanding entity credit rating)

2. Does the ULB have audited accounts till the last financial year? (It is expected that ULB should have completed audit of accounts within 6 months from close of financial year)

3. Does the ULB regulation been amended to allow for issuance of bonds along with provision for escrow of receivables, creation of charge on assets/receivables, debt protection etc?

4. Does the ULB qualify for the eligibility criteria set out under the guidelines:
   a. Accounts prepared in accordance with NMAM for at least 3 years
   b. Municipality shall have income surplus in last 3 years;
   c. Municipality shall not have defaulted in the last 1 year
   d. No order or direction of restraint, prohibition or debarment by SEBI and
   e. No wilful defaults by the corporate municipal entity or its directors;

5. Does the ULB have a strong MIS system for reporting information as per Schedule I and Schedule V of the SEBI Regulations 2015

4.4.2. Project selection, financing plan and preliminary bond issue size

Once a ULB meets the pre-requisite requirements and eligibility conditions as per extant regulations, the first step is to identify and define the contours of project(s) against which bond issuance proceeds are sought to be deployed. The specifics of the steps involved in project identification and selection are dealt with, under section 2.4 and key points are reiterated below for continuity.

1. **Project selection, scoping and detailing:** The project development process typically involves phased set of preparatory activities to move from a project concept to a well-fleshed out project document which will typically be a Detailed Project Report that will form the basis for project procurement and implementation.

2. **Finalizing mode of implementation:** The approach for implementation of the project in terms of the nature of contracting (EPC vs. PPP) including the extent of private involvement and risk sharing, needs to be finalized. A wide range of options exists with respect to the extent and nature of private sector involvement.

3. **Project financing mix, sustainability and sizing of bond issue:** Once the project scoping and mode of implementation are finalized, the appropriate financing mix (taking into account the project’s lifecycle costs covering both the upfront capital costs and the recurring costs) needs to be finalized. The level of bond financing for a particular project is dependent on the debt capacity of the ULB and the net incremental costs or revenues that the project will lead to. At this stage it is also critical to identify the specific revenue streams and cash flows from which the debt obligations will be met. In non-remunerative
projects, the debt will need to be serviced typically by non-project cash flows and revenue streams such as property taxes, while in case of remunerative projects, it may be possible to service the debt either fully or in part through project specific revenue streams such as toll or user charges.

4. **Securing co-financing arrangements and other project readiness aspects:**
Following completion of project preparation and arriving at the financing mix, the ULB should complete all other readiness requirements from a project implementation standpoint. Key among this is securing co-financing arrangements and approvals. Other aspects including actions to address Social and Environment impacts, land acquisition requirements and other statutory clearances and approvals. Approvals of bidding documents and initiation of project bidding prior to bond issuance are other aspects that will reflect positively in terms of advanced state of readiness for project implementation.

4.4.3. **Engagement of a merchant banker**

Once the preliminary project contours and financing mix has been finalised, the ULB may appoint a merchant banker to facilitate the bond issuance process. The ULBs may procure the services of the Merchant banker based on the extant tender rules of the City/State. Refer Box 4.2 for typical Scope of work for a Merchant Banker.

<table>
<thead>
<tr>
<th>Box 4.2 Scope of Work for engaging a Merchant Banker</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Successful bidder shall mobilise/subscribe the funds for the bonds up to its committed amount within stipulated time by arranging to remit the sum through Real Time Gross Settlement (RTGS) at designated bank branch of the ULB. The Merchant Banker(s)/Arranger(s) shall ensure that as per the relevant provisions of the Companies Act 2013, the payment to be made for subscription to Bonds shall be made directly from the bank account of the person subscribing to such securities.</td>
</tr>
<tr>
<td>2. The Merchant Banker(s)/Arranger(s) are required to consider, ensure compliance and apprise the issuer of all the relevant statutory provisions for issue of Bonds including latest amended relevant regulations/provisions of SEBI, Municipal Act, the Companies Act 2013 and the related Rules thereunder, Stock Exchanges, other applicable laws/regulations etc. in connection with the said issue of bonds.</td>
</tr>
<tr>
<td>3. The Merchant Banker(s)/Arranger(s) are required to provide the issuer the checklist for ensuring compliance under various applicable provisions of the laws and regulations. stipulated deadlines for filing with SEBI, Ministry of Corporate Affairs (MCA), Stock exchanges and other regulators/authorities.</td>
</tr>
<tr>
<td>4. Advise issuer on timing of the bond issue and the date of opening of issue and closure of issue depending upon the prevailing market conditions in such a way that the issues receives healthy response from investors.</td>
</tr>
<tr>
<td>5. Assist issuer in preparation of Disclosure/other documents as per the extant regulations.</td>
</tr>
<tr>
<td>6. Preparation of Offer document (as per SEBI guidelines) or any other document as required under SEBI guidelines, and other applicable laws/regulations.</td>
</tr>
<tr>
<td>7. To liaise with Stock Exchange for obtaining In-Principle approval for listing the bonds with BSE/NSE and also assist issuer in accomplishing the requisite documentation for listing of the Bonds.</td>
</tr>
</tbody>
</table>

Refer Annexure VII for detailed Terms of Reference
4.4.4. Bond structuring, obtaining a credit rating and final approvals

Bond structuring involves detailing of the terms of the issue in a manner that supports the ULB to achieve a threshold credit rating and in raising resources under the most competitive terms. A key objective of effective structuring is to minimize credit risk to Investors and involves identification and ring-fencing of revenue streams in a manner that provides assurance of timely repayment of interest and principal payments to investors.

Given the nascent stage of evolution of Municipal Bonds, this may involve incorporating some of the credit enhancement features (discussed in section 4.2.1) and designing the bond issuance as a Structured Obligation. Once the terms and structure of the proposed bond issuance are finalised, a credit rating should be obtained from recognised credit rating agency. Refer Annexure VIII for Terms of Reference for engaging a Credit Rating Agency.

4.4.5. Final approvals, issue documentation and filing

Following the completion of structuring and credit rating, the ULB must obtain all the final approvals from its Elected Council and State Government. Concurrently, the Merchant Banker will work with the ULB in completing necessary documentation towards engaging investors and towards completing regulatory and statutory formalities for bond issuance including the following

- **Information Memorandum**: The Merchant Banker works with the ULB to prepare an Information Memorandum, which is typically a ‘pitch’ document, providing details of the Issuer and the salient features of the issuance. The Information Memorandum typically the base document to facilitate marketing of the issue with prospective investors. This is typically an abridged version of **Issue Prospectus** which is required to be filed as a regulatory requirement. Typically an Information Memorandum provides the following information:
  - Detailed profile of the issuer (ULB) and the services provided
  - Financial and Operational review of the issuer
  - Capital Investment plan for the city
  - Project details and financing plan
  - Project Implementation plan and timelines
  - Proposed bond issuance and utilization
  - Financial projections of the ULB as well as the standalone project

- **Prospectus, application form and related documentation**: The Draft Shelf Prospectus, Shelf Prospectus, Application Form, and Abridged Prospectus are key transaction documents prepared by the Merchant bankers on behalf of the Issuer. The Shelf prospectus is a medium whereby the subscription to debt securities invited by the Issuer. It provides detailed information on the issuance and needs to be filed with SEBI. The Issuer and Merchant banker are also required to share an abridged prospectus along with every application form shared with prospective investors. The Prospectus is both a legal and a marketing document. This provides a detailed financial and operational profile of the issuer along with full and accurate information about the issue to facilitate informed choice by the investors. A prospectus usually includes the following information:
4.4.6. Investor engagement

Given that the Municipal Bond market in India is nascent, a pro-active Investor engagement process to create awareness and interest among potential investors is crucial for successful issuance and the role of the Merchant banker in this regard is crucial. As discussed, effective structuring and preparation of high quality issuance documentation are crucial ingredients. However, they need to be complemented by preparation and roll-out of an appropriate investor engagement plan. The Merchant Banker will need to hand-hold the ULB in driving this process while the ULB will need to ensure timely availability of information and availability of senior personnel to participate in investor interactions.

The nature of investor engagement tends to be different depending on the nature of the issue as to whether the issuance is done on private placement route or through a public issue. In case of private placement, the engagement is typically institution centric where the Merchant banker engages with a wide range of institutional investors primarily.

The role of the Merchant Banker would be to identify Investor-Issuer fit for the proposed Issue (given the issue design, credit structure and enhancement) and ensure targeted communication and engagement to maximise investor interest and eventual subscription. A combination of investor meets, road shows, research coverage and press meets may be used to achieve these objectives.

In case of Public Issues, Issuers needs to reach across a wider retail investor community and hence would need to plan for an advertising campaign. This will require engagement of an Advertising agency to design and implement a public outreach campaign across appropriate media (including print, television and social media). Further, there is a need to ensure that the issue receives wide awareness across all stakeholders (including Institutional investors, High Net-worth Individuals, Stock Exchanges, Rating Agencies, Brokers, Regulators etc.) to ensure investor interest not only in the initial issuance but also for future trading of the bonds to progressively enable development of vibrant secondary market for the bonds.

4.4.7. Issue pricing

The issuer may choose among two different methods to determine the price of the bond issue: Fixed price or through book building method.
In case of fixed price, the issue price and the coupon interest rates are fixed beforehand based on realistic assumption of the risk premium and discussions with the prospective investors.

The Issuer may also decide the basis of allotment through book building route. In case of a book building approach, the Issuer may seek bids on the coupon rate and subscription size subject to a ceiling and floor rate and allotment would be made at the price bid.

4.4.8. Execution of agreements

The Issuers need to undertake the following documentations/agreements with various stakeholders which are essential to the bond issuance process. Typical documentation at the stage of bond issuance includes the following:

1. **Debenture Trust Deed (DTD):** A Trustee is a SEBI registered financial entity appointed in case of bond issue to safeguard the interest of the bondholders. A brief background of the role of Debenture Trustee is provided in Section 2.2.4. The Debenture Trust Deed is an agreement between the Issuer and Debenture Trustee (mandatory in case of issuance by CME) which details out the roles and responsibilities of the Trustees. The Trust Deed would have the details of roles and responsibilities of Trustees, power of Trustees, financial and operational covenants etc. It would also carry the details of the security created by creating a charge on the assets in favour of the Debenture Trustee. The draft terms of trust deed is provided in Annexure IX.

2. **Tripartite Agreement with Depository and R&T agent:** The issuance requires the execution of a tripartite agreement between the issuer, depositories (NSDL or CDSL) and Registrar and Transfer Agents (RTA) for holding/transfer of debentures in the dematerialized form. It also lays out the roles and responsibilities of each stakeholder (Issuer, Depository and R&T agents) with respect to the issuance and covers aspects like timely furnishing of information, reporting and transaction protocols, documents to be submitted, indemnification, nodal persons in charge etc. A sample tripartite agreement is provided in Annexure X.

3. **Listing Agreement with stock exchange:** The Listing Agreement is entered into between the issuer and the relevant stock exchange(s) in connection with the listing of the debt securities. It would lay out the roles and responsibilities of issuers and the stock exchanges with respect to timely furnishing of information, commitment to meet the listing requirements, list of disclosures, reporting formats etc.

4. **Escrow agreement:** The Escrow agreement entered into amongst the Issuer, Registrar to the Issue, the Lead Managers and the Escrow banks. It serves as an important tool to protect both investor as well as issuer interest during issuance as well as during debt servicing. Generally a separate escrow account is created with the bankers for timely servicing of bonds. The escrow accounts are held by the bankers on behalf of the issuer towards debt servicing. The escrow account receives the funds earmarked for bond servicing like property tax (preferably the escrow should be structured so that payments are made directly into the account rather than routing it through the issuers). During issuance, the Escrow Banks, for and on behalf of the Applicants, may maintain the monies in the Escrow Account until the creation of security or any terms approved by the issuers under the Trust Deed.
4.4.9. Issuance formalities and transaction completion

The actual bond issue is effected after all the above processes have been competed which usually takes around 30-60 days. The timelines for the above is subject to the effectiveness of credit structuring, demand from investors and a suitable interest rate environment. The issuer would then finalize an issue opening and closing date and communicate the same to the Stock exchange. The issuers would also intimate the details of issuance to the Trustees, Bankers to the issue and R&T agents. After closure of issue, the applications received are evaluated for final allotment. The basis of allotment may be on first come first serve basis or proportional allotment. The basis of allotment may also look into providing adequate representation for each category of investors. The Issuer may indicate the basis of allotment under each category beforehand. The category of investors include Category I (“Qualified Institutional Buyers”) (“QIBs”), Category II (“Domestic Corporates”), Category III (“High Net-worth Individuals”) (“HNIs”) and Category IV (“Retail Individual Investors”) (“RIIs”)

Hence, the level of oversubscription against category ratios are calculated and proportionate allocation of bonds is undertaken. Subject to the completion of all legal formalities, the issuer may issue the Bond Certificates (in case of Physical option) or Bonds may be credited to the depository account of the applicant. The excess amounts may be refunded back to the applicant. The issuer may also build in an option to retain over-subscription up to a particular amount.

- **Listing**: The issue may be listed in stock exchange within the mandated time frame provided under the SEBI Regulations. Post allotment, the issuer would share with the stock exchange the listing application, compliance certificate, credit rating letter, consent letters from Trustee, RTA etc. for listing the security. The exchange would review the application and approve listing subject to the fulfilment of listing conditions.

- **Execution of security**: The issuer may also identify the assets/receivables which may serve as the security. The Bonds would be secured by a legal mortgage over the assets (including immovable property or revenue streams). The Bonds would generally rank pari-passu with other creditors secured against the said asset. Upon creation of security as disclosed in the Debenture Trust Deed, the Escrow Bank(s) would transfer the principal amounts to the Issue account of ULB.

4.4.10.Post issuance formalities

The ULB will need to perform a number of actions during the term of the Bond post issuance

- The Bond servicing procedure starts with finalizing the record date which is intimated to the R&T, Exchange and Depositors. Request is then sent to the R&T agents for the list of bond holders in the market as on the finalized record date. If applicable, adjustments for TDS is done from the bondholder payment and remitted to the Government

- The bond holders are paid (as per the terms of bond issue) from the dedicated escrow account and confirmation of receipt is received.

- The successful payment of bond service should be intimated to relevant stakeholders such as Bondholders, Stock Exchange, Depositories, Registrars, Rating agencies and
Trustees. After intimation of successful payment, a prompt payment certificate (PPC) will be issued by the Trustees.

- Certification from the Chartered accountant confirming bond servicing in a timely manner would be obtained every time the payment is done. The PPC and the certificate from CA would be filed with the rating agency.

Refer Exhibit 4.6 for a summary term sheet of a Municipal Bond issuance done by Visakhapatnam Municipal Corporation (VMC) in 2004 and Ahmedabad Municipal Corporation (AMC) in 2005. Structuring of Bond issuance with credit enhancement features as illustrated below helps in providing assurance and comfort to investors on timely servicing of debt servicing payments. In case of AMC 2005, the bonds rating was supported by creating a charge on AMC assets (~1.25 times the loan value) and by channelling the ULB funds into a Trust & Retention Account. In case of VMC, an Escrow account of entire collection on Account of Property Tax, including General tax and 30% of Water tax/charges of VMC was created.

**Exhibit 4.6 Term sheets: Past Municipal bond issuances – Ahmedabad (2005) and Vizag (2004)**

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Secured Redeemable Non-Convertible Tax Free Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Rating</td>
<td>AA+ (SO) by CARE, AA(SO) by CRISIL</td>
</tr>
<tr>
<td>Minimum Subscription</td>
<td>Rs.100 lakh and in multiples of Rs.10 lakh thereof</td>
</tr>
<tr>
<td>Issue Price</td>
<td>Rs.10,00,000/- per bond</td>
</tr>
<tr>
<td>Tenor</td>
<td>10 years</td>
</tr>
<tr>
<td>Coupon</td>
<td>6% p.a. payable semi-annually on outstanding principal</td>
</tr>
<tr>
<td>Put/Call Option</td>
<td>At the end of 5 years from the deemed date of Allotment</td>
</tr>
<tr>
<td>Coupon Payment</td>
<td>Semi Annually</td>
</tr>
<tr>
<td>Redemption</td>
<td>Semi-annually in the 8th, 9th &amp; 10th year in a ratio of 33:33:34% from the deemed date of allotment</td>
</tr>
<tr>
<td>Security</td>
<td>Pari-passu charge/mortgage of the corporation’s assets/properties with a minimum asset cover of 1.25 times</td>
</tr>
<tr>
<td>Credit Enhancement</td>
<td>Trust &amp; retentions account with a bank for collating the revenues from specified revenues receivables.</td>
</tr>
<tr>
<td>Listing</td>
<td>The corporation proposes to list the bonds on the wholesale Debt Market Segment (WDM) of the NSE</td>
</tr>
<tr>
<td>Trustee</td>
<td>Indian Bank has been appointed as Trustee to the Issue</td>
</tr>
</tbody>
</table>
Visakhapatnam Municipal Corporation 2004

(Private Placement of 7000 Secured Redeemable Non-Convertible Bonds of Face Value Rs. 1,00,000/- each aggregating to Rs. 70 crore divided between (SERIES A of 5000 Secured Redeemable Non-Convertible Tax-free Bonds aggregating to Rs. 50 crore and SERIES B of 2000 Secured Redeemable Non-Convertible Taxable Bonds aggregating to Rs. 20 crore for cash at par)

<table>
<thead>
<tr>
<th>Series A</th>
<th>Series B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue amount</td>
<td>Rs 50 crore</td>
</tr>
<tr>
<td>Bond type</td>
<td>Secured, Non-Convertible, Redeemable Tax-free</td>
</tr>
<tr>
<td>Number of Bonds</td>
<td>5000</td>
</tr>
<tr>
<td>Face Value</td>
<td>Rs 1,00,000/- per bond</td>
</tr>
<tr>
<td>Credit rating</td>
<td>AA - (so) by CARE. ([Double A Minus (Structured Obligation)])</td>
</tr>
<tr>
<td>Coupon rate</td>
<td>Coupon rate will be arrived at by book building process with the following indicative band; 6.75% to 7.25% p.a.</td>
</tr>
<tr>
<td>Interest</td>
<td>Computed annually and paid semi-annually</td>
</tr>
<tr>
<td>Tenor</td>
<td>7 years</td>
</tr>
<tr>
<td>Redemption</td>
<td>30% at the end of 5th year; 30% at the end of 6th year; 40% at the end of 7th year; From the deemed Date of Allotment</td>
</tr>
<tr>
<td>Security</td>
<td>Pari-passu first charge/mortgage on properties of Godavari Drinking Water Supply Project only.</td>
</tr>
<tr>
<td>Credit enhancement</td>
<td>Escrow account of entire collection on Account of Property Tax, which includes General tax and 30% of Water tax/charges of VMC</td>
</tr>
<tr>
<td>Listing</td>
<td>Proposed to be listed with the WDM Segment of NSE</td>
</tr>
<tr>
<td>Trustee</td>
<td>IL &amp; FS Trust Company Limited, Mumbai</td>
</tr>
</tbody>
</table>

Source: Offer documents of AMC and VMC

Refer Exhibit 4.7 for a term sheet with key elements of a bond structure, incorporating principles outlined in this document including an illustrative 3-layer credit enhancement structure for pilot issuance by ULBs.

**Exhibit 4.7 Illustrative Term sheet incorporating a 3-layer credit enhancement**

<table>
<thead>
<tr>
<th>Issuer</th>
<th>&lt; Urban Local Body&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Size/Date</td>
<td>Rs. 200 crore, subject to timely completion of actions</td>
</tr>
<tr>
<td>Tenure and moratorium</td>
<td>A 10-12 year issue with a minimum 5-year principal moratorium is envisaged, during which no repayment or redemption will be made to bond holders. Post the moratorium period, repayments/redemptions of bonds are envisaged on an annual basis.</td>
</tr>
<tr>
<td>Deployment of proceeds</td>
<td>The Bond proceeds will be deployed in water supply distribution strengthening, service delivery improvement and provision of 24x7 supply. The contours of the project would be finalized during the DPR stage. Functionally, the Project would involve creation of District Metering Areas, expansion of water storage (ground and elevated), SCADA-based monitoring and universal metering with focus on delivery of continuous water supply city-wide, while reduction in Non-Revenue Water in the network. The ULB would finalize the geographic scope during the DPR stage and it may choose to implement project zone in a phased manner, starting with West Zone. The project cost for West Zone is estimated at Rs 500-600 crore and will be financed by converging grants from GoI and GoG schemes, proceeds from the bond issuance and ULB’s own funds. Implementation shall be through a Performance Management Contract by inducting a private operator</td>
</tr>
</tbody>
</table>
Guidance on use of Municipal Bond financing for Infrastructure projects

| Credit Structuring and Rating | ULBs revenues (Through Water Tax and user charges) could be insufficient to cover O&M costs and debt servicing obligations fully. Therefore, debt servicing is envisaged from Property Tax proceeds and surplus funds of ULB’s general budget. The exact structure of credit enhancement would be finalized during the course of issuance process. Debt servicing would be from Property tax proceeds and surplus funds of ULB. Credit structuring support to secure high investment grade rating (at least AA level) and ensure competitive terms. A three layer credit enhancement is envisaged:
- Layer 1: Escrow of Property tax proceeds
- Layer 2: A Replenishable Debt Service Reserve Fund (DSRF) equivalent of 1 year’s principal plus interest payment
- Layer 3: Cash Collateral (estimated at 25% of issue size) |
| Other features of bond issuance | • Secured Redeemable Non-convertible General Obligation Bonds
• Dematerialized form
• While preference is for a Tax-free bond, this is contingent on interest rate scenario and demand scenario for Tax-free bonds at the time of issuance.
• Pricing to be finalized at the time of issuance. |
| Trustee | A Scheduled Commercial Bank would be appointed as a Trustee to Issue. ULB and the Trustee will enter into a Trustee Agreement, inter alia, specifying the powers, authorities and obligations of the Trustee and Issuer. |

*Based on a readiness assessment exercise in a large ULB conducted as part of a pilot project initiative of DEA.*
5. Capacity building

5.1. Need for wider reform orientation

This Section provides guidance on the institutional and capacity building actions to support Municipal Bond issuance in the ULBs. It covers aspects like training, administrative reforms, financial reforms, e-governance initiatives etc. It also lays out the institutional interventions to support issuance (IIPDF facility for preparatory actions) and to ensure sustainability of the Municipal Bond initiative (Project implementation cell, and Debt management cell). While the focus of this section is on specific requirements pertaining to Municipal Bond issuance, the requirement of wider reform and capacity building, for sustainable financing, within Urban Local Bodies cannot be understated. External Investors tend to be demanding and a threshold level of improvement with respect to wider urban reform both at the level of State Governments and at the level of Urban Local Bodies is critical for sustainable financing of urban infrastructure.

The Reform program under GoI’s AMRUT scheme outlines a set of reforms required to be undertaken. Grouped into 11 areas, this reform agenda provides a fairly comprehensive set of areas that ULBs and State Governments should put in place. While developing a comprehensive set of capacity building is beyond the scope of this document, this chapter seeks to capture some of the critical aspects of capacity building that are crucial for sustainable and consistent access of ULBs to alternative financing. While some of these actions are to be done at the level of the ULB, others would require concerted action on the part of State Governments of which they are part of.

5.2. Organisation strengthening, training and upskilling

A recent report of the Ministry of Urban Development observes that States with well-established municipal cadre in core functions evidently made significant progress in terms of urban governance initiatives, progress on reforms, attracting external funding and technological innovations. In contrast, states which do not have exclusive municipal cadres, performance in terms of reform implementation, innovations, revenues, attracting investments is lagging behind. The report observes that while staffing norms existing in most states, these have been arrived at in most cases without adequate scientific study on the nature of work flows and requirements, even as more than one-third of positions lay vacant. Further, major critical expertise like Urban Planning, Transportation, IT and Public Finance etc. are still unavailable for urban development with talent for such critical functions being drawn from open market on consultancy, outsourcing or on PPP mode.

Given this context, it is critical for State Governments to ensure a threshold level of capacity upgradation in line with the recommendations of the above referred exercise undertaken by MOUD including the following:

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15 The detailed list of reforms identified under AMRUT can be accessed at http://amrut.gov.in/writereaddata/List%20of%20Reforms.pdf
16 Approach for establishing municipal cadres in India. Capacity Building for Urban Development project. MOUD India. 2014.
1. Creation/strengthening of municipal cadre at the State level in line with the recommendations of this report which calls for creation/strengthening of municipal cadres in three areas namely **Administration, Technical Services and Financial Management**.

2. Creation/updation of Service Rules for the various cadres

3. Implementation of a Staff Augmentation Plan to address the prevailing staffing gaps in a time-bound manner.

Further, given the dynamic and evolving nature of the urban sector, it is critical that a sound training framework be established covering

1. Identification of training and up-skilling requirements among existing staff

2. Creation/strengthening of state-level training institutions while creating a collaborative network of institutions to meet impart training and up-skilling requirements

3. Creation of an active performance management system to ensure that training needs and gaps are continually assessed and a plan for skill upgradation is put in place.

### 5.3. Financial management and disclosure

While this has been dealt in a fair bit of detail under chapter 2, the importance of prudent financial management and transparent disclosures cannot be understated when ULBs seek to tap the bond markets. Some of the critical areas needing utmost attention by ULBs as well as by State Governments are re-emphasised here.

#### 5.3.1. Revenue reforms

Facilitating buoyancy in revenues and enabling sustained growth in operating surplus is critical for sustainable borrowings and reforms to enable revenue stability and growth is critical in the early stages when ULBs seek to pilot bond issuance. While ULBs with a strong financial position will have an edge initially, sustaining a borrowings program will require more than that. It will require (as detailed in chapter 2) ULBs to consistently seek avenues to improve revenues from its existing as well as new streams. State Governments will have to play their role here by ensuring a stable financial devolution regime and putting in place independent and autonomous regulatory frameworks to aid improvements in own revenues of ULBs.

#### 5.3.2. Accounting discipline and transparent disclosure

Rigor in accounting discipline in terms of timely finalisation of accounts and audit is crucial for success in raising external finance. External investors tend to be extremely picky about the nature and level of information disclosures. ULBs will need to also step up their capacity with respect to leveraging technology, internet and social media to ensure seamless communication with not just investors but also to its wider set of stakeholders and citizens.

#### 5.3.3. Cash management

Prudent cash management is a critical cornerstone for raising debt. Tapping the bond market by ULBs especially in the initial stages will call for stringent cash collateral and credit enhancement structures (Debt Services Reserve, Escrow accounts etc.). ULBs seeking to
access bond markets need to therefore incorporate good cash management practices to ensure that they are ‘bankable’ and credit worthy.

This not only involves creating an adequate buffer in the form of monetisable assets and cash reserves, but also putting in place mechanisms to ensure liquidity and efficient working capital management. Improvements to make collection of revenues efficient and payment to contractors/vendors timely and transparent tend to be looked at favourably by Investors and rating agencies.

5.3.4. Multi-year planning and budgeting

Many states statutorily require ULBs to prepare only a one-year budget which is most often prepared on a cash basis. Rigor in variance analysis is often missing and actual accounts tend to deviate from budgets in many ULBs. Given that ULBs are called upon to plan and commit resources on capital projects that get implemented over several years and are in operation over a much longer period, it is critical for ULBs to shift to a multi-year planning mode. While this has to some extent started with the preparation of City Development Plans and with preparation of Smart City Proposals (accompanied by creation of SPVs) in several cities, the larger frame of thinking continues to be on the basis of the annual budget which needs to be changed. While the requirement of schemes such as the Smart Cities Mission and the need for preparation of Service Level Improvement Plans (SLIPs) and State Annual Action Plans (SAAPs) seek to trigger this change and is a positive, it needs to be backed up with comprehensive multi-year Capital Investment Plans and Financing Plans.

5.4. Specific Institutional interventions

5.4.1. Independence in project management

Project Implementation and O&M of infrastructure projects has been one of the major challenges faced by the ULBs. The multitude of activities including planning, project implementation, service delivery, O&M and public administration is one of the major reasons for inefficiencies in project management by the ULBs especially during implementation of big ticket projects. Hence, there is a need to align the institutional structure to facilitate efficient project management. This may be addressed by undertaking implementation through a separate SPV (registered under the Companies Act) preferably under the PPP model. PPP model in project management aims to address the institutional challenges, by allowing the ULB to focus on its core strengths like planning, policy, regulation and monitoring while leveraging on the private sector experience in project implementation and delivery. It also transfers significant portion of the project viability risks on the private sector.

Some of the key benefits of a PPP implementation mode in Municipal Bond financing are as follows:

- PPP structure brings down the project implementation risks considerably allowing the project to access funds at competitive rates
- It allows the ULB to act as a regulator while the private sector can focus on the day-to-day delivery of the services
It brings in efficiencies in project tracking and monitoring and provides regular up to date information disclosure to the investors on the project progress. This is particularly relevant for investors in taking a periodic call on value of assets under management.

PPPs are typically long-term contracts which allows for greater innovation and efficiency in project planning and execution by the private sector thereby bringing down the life cycle cost of project.

Private sector participation in project implementation and O&M also provides a comfort to the investors that the demand risk associated with the project is manageable.

Incentivises the private sector to deliver projects on time and within budget.

It helps in extracting long-term value-for-money through appropriate risk transfer to the private sector over the life of the project – from design/construction to operations/maintenance.

5.4.2. Leveraging Project Development funds

The ULB implementing Municipal Bond financing for PPP projects may access the “India Infrastructure Project Development Fund” (IIPDF) facility under the Department of Economic Affairs, Ministry of Finance, Government of India. The funds may be utilized towards meeting the project preparatory and transaction costs associated with the PPP project. The Fund will assist ordinarily up to 75 per cent of project development expenses to the Sponsoring Authority. The IIPDF facility was setup with an initial corpus of Rs. 100 Crore for supporting the development of credible and bankable PPP projects.

The IIPDF is available to the Sponsoring Authorities for PPP projects for meeting the project development costs which may include feasibility studies, environment impact studies, financial structuring, legal reviews and development of project documentation, including concession agreement, commercial assessment studies (including traffic studies/demand assessment, capacity to pay assessment), grading of projects etc. required for achieving Technical Close of such projects, on individual or turnkey basis, but would not include expenses incurred by the Sponsoring Authority on its own staff.

5.4.3. Project Management Cell: Role and functions

SEBI Regulations Section 12 Sub-section (4) require the creation of a Project Implementation Cell and reads as follows: “The issuer shall establish a separate project implementation cell and designate a project officer who may not be below the rank of deputy commissioner, who shall monitor the progress of the project(s) and shall ensure that the funds raised are utilised only for the project(s) for which the debt securities were issued: Provided that where the issuer is a corporate municipal entity, such requirement shall be complied by the Municipality which is being financed.”

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17 Scheme and Guidelines of IIPDF, DEA
18 DEA Website URL: https://www.pppinindia.gov.in/......
**Role and structure**

The intent underlying this clause is to ensure that the ULB has created accountability towards preparation and implementation of the project(s) for which the proceeds of bond issuance will be applied towards. The team may be set up under the Deputy Commissioner (Works) ULB with operating responsibility vested with a senior Engineering official (Superintending Engineer in charge of Special projects/Roads) supported by a 3-member team.

**Functions**

The PIC would be responsible for project management, co-ordination and technical support for implementation of the Project (for which bond proceeds are to be used). Its functions would include the following:

- Preparation of project implementation plan including necessary reform actions, administrative approvals etc. and preparing a detailed timeline of actions. The PIC would review and update the project plan on a quarterly basis with detailed reasons for revision in timelines.
- Preparation of MIS for reporting, compliance and monitoring of project progress. Monthly reports on usage of funds as well as project implementation would be prepared by the PIC.
- Engaging and managing service providers and external experts for implementation of projects and reforms; staying abreast with latest developments in the area of expertise and facilitate transfer of relevant information and best practices to staff for use in ULB functioning

**5.4.4. Debt Management Cell: Role and functions**

**Role and structure**

Though not a regulatory requirement, we recommend that a Debt Management Cell be created within ULB to ensure sharp accountability and effective management of the multiple tasks needed to be performed with respect to the bond program, prior to, during and post issuance. The DMC would serve to build institutional capacity to plan and manage the process of bond issuance, and post issuance, manage investor relations, information dissemination and statutory requirement on behalf of ULB.

The DMC may be set up under the Head (Revenue & Finance) and would be supported by a two member team with experience in municipal finance, information management and investor relations.

**Functions**

The functions of the DMC would include the following:

- Work with audit agencies for timely finalization, audit and dissemination of ULB’s accounts.
- Manage the process of bond issuance starting with issuance planning and putting in place internal and external preparedness actions.
Guidance on use of Municipal Bond financing for Infrastructure projects

- Work with other lines department to finalize project financing arrangements including bond issue size and terms

- Appoint service providers (including Merchant Banker, Credit Rating agency, Registrar, Trustees and Stock Exchanges, Depository etc.) for bond issuance as per statutory requirements.

- Manage post-issuance actions including
  - Maintain an database on Municipal Finances ULB wise(historical and current)
  - Prepare revenue enhancement plans and cash flow projections.
  - Liaison with Credit Rating agencies/Merchant bankers/Trustees/Stock exchanges/Auditors etc
  - Manage Investor relations, information dissemination and compliance reporting

- Upgrade MIS to ensure rigor in capture and disclosure of key financial information including the following (and other regulatory filings as required)
  - Annual audited financial statements
  - Project implementation status - Half yearly (Monthly would be preferable)
  - Fund utilization against project - Half yearly (Monthly would be preferable)
  - Project development - Details with respect to the development of the Project along with certifications from the Project Engineer should be furnished to the Trustee, Rating Agencies and stock exchanges on Half Yearly Basis and should be publicly disseminated
  - Key financial ratios
  - Half Yearly return on servicing of bonds, maintenance of Asset Cover, Credit enhancement facilities and Investors Grievances & Redressal
  - A CA/Bank certificate for timely servicing of bonds.

- Build institutional capacity within the DMC to support ULB’s in future resource mobilization and borrowings program
Annexure I. Related links and reference documents

1. Securities And Exchange Board Of India (Issue And Listing Of Debt Securities By Municipalities) Regulations, 2015
2. Developing a Regulatory Framework for Municipal Borrowing in India, World Bank 2011
3. Recommendations of The Corporate Bonds and Securitization Advisory Committee (CoBoSAC) on Municipal Bonds
4. Developing Sustainable and Inclusive Urban Infrastructure Services A Guidebook for Project Implementers and Policy Makers in India, MOUD USAID
5. Credit Rating Methodologies for urban local bodies – CRISIL, CARE and ICRA websites
7. Bond issuance tool kit For emerging market corporate issuers, USAID 2005
8. Reforms under JNNURM and Credit rating information (http://jnnurm.nic.in/wp-content/uploads/2012/12/Current-credit-rating-v-final-.pdf)
Annexure II. Municipal Bond – Indian and Global experience

Global Experience

The Route taken by countries in Municipal Bond financing are based on a multitude of factors including the vibrancy and maturity of capital markets, the extent of devolution of powers to local government, and socio-political legacy of the countries. While some nations have created specialized institutions to facilitate bond financing by local governments, a few other like USA and South Africa scaled up bond financing by individual ULBs on the strength of the local government. The following section provides a brief on the Municipal Bond financing routes across specific countries (while detailing the USA Municipal Bond financing context). The list of Local government bond financing institutions is given below:

- Canada Provincial Municipal Finance Corporations
- Norway KommunBankan
- Sweden Kommuninvest
- Netherlands Bank of Netherlands Municipalities
- Denmark KommunKredit
- France Agence France Locale
- UK UKMunicipal Bonds Agency (Local Capital Finance Company)
- Finland Municipality Finance PLC
- Japan Finance Corporation for Municipal Enterprises
- Columbia Findeter
- Tunisia Caisse des Prêts et de Soutien des Collectivités Locales
- Sri Lanka Local Government Loans Fund

The presence of institutional structures to support bond issuance has been multifold including improved rating (through effective structuring and continuous issuance), optimum issue sizing, diversified funding and competitive rates. Although the underlying approach to issuance is similar in all the institutions, some of the unique factors specific to the institutions are summarized below:

- “Joint and Several” obligation of Local governments – The Institutional structures for Municipal Bond financing in Sweden, Denmark, Canada and France is supported by a legal arrangement wherein each of the member municipalities under the agreement is liable to support the debt issued by all local governments.
- Institutional obligation – In case of Municipal Finance Authority of British Columbia, the authority has been empowered with necessary taxing powers (in case local government fails to meet its due) to ensure the replenishment of the debt service reserve and timely repayment of debt obligations
- Guaranteed borrowings – Credit guarantee of Municipal Bonds is one of the major tools for improving the credit rating as well as marketability of the issuance. The guarantee may be issued by National Government (For example: Japan Finance Corporation for Municipal Enterprises and Norway’s Norges Kommunalbankan), or by State Governments (New Hampshire Municipal Bond bank, mostly before 2005) or by specialized institutions (For example: Finland’s MGB, a public institution that guarantees issuances by Municipality Finance Plc)
• Devolution intercept – Some US bond banks employ this additional mechanism as a credit enhancement feature which allows the state to withhold and “intercept” state aid payments to municipalities, towards debt repayment.

South Africa
South Africa is one of the oldest proponents of Municipal Bonds in the world. The Municipal Bond issuances in SA are dominated by directed issuances by local governments. The South African Municipal Authorities have been issuing debt securities as early as 1920 (Rand Water Board) and still do so, with maturities extending beyond 25 years. There is however, immense scope of development as a majority of this existing debt was issued under the then Apartheid Government’s “Prescribed Investment Regime” which required institutional investors to hold 54% of their investment portfolios in government or Government backed securities, including Municipal Bonds. This coerced the institutional investors to hold the Municipal bonds till Maturity. In the Post-apartheid Era, Such “Prescribed” investment mandates have been done away with, and Government & Municipal Bonds now enjoy far more tradability than before.

The issuance in the Municipal Bond market are mostly non-guaranteed in nature and is generally issued by the Country’s largest cities including Johannesburg, Cape Town and Ekurhuleni. The annual issuance was close to 1 billion rand (US$ 71 million). The South Africa’s Municipal Bond market revived over the recent years driven by tapering of capital transfers from central-government leading to increased issuances.

United States of America
The Municipal Securities Rulemaking Board was established in 1975 by Congress to develop rules regulating securities firms and those banks involved in underwriting, trading, and selling municipal securities, bonds and notes issued by states, cities, and counties or their agencies to help finance public projects. The Municipal Bonds are generally classified as General obligation bonds or Revenue bonds. General obligation bonds are backed by the taxing power and/or “full faith and credit” of the issuing entity. Revenue bonds may be backed by specific project revenue stream. USA stands apart as a major model for sustainable Municipal Bond issuances by cities. As of Q2 2016, the total outstanding Municipal Bonds were around US$ 3.8 trillion in principal (Out of total bond market of US$ 40 trillion).
A detailed “Report on the Municipal Securities Market” was published by US Securities and Exchange Commission in 2012. From the supply side perspective, it is seen that a major bondholders in the municipal securities market are retail investors who hold more than 50 per cent of the outstanding debt. The rest are held by Banks, Insurance funds, Mutual funds etc. This is unlike the Indian debt market scenario, wherein the retail participation has been quite low. The chart below provides a summary of the supply side dynamics.

**Municipal Bonds for Private sector projects “CONDUIT REVENUE BONDS”**— In certain cases, Municipal entities also issue bonds (mostly revenue bonds) on behalf of a third party (often called a “conduit borrower” or “obligated person”). Conduit revenue bonds would also be tax-exempted, subject to meeting the regulatory requirements of IRC and IRS. Conduit bonds allow private entities/projects to access low-cost debt to undertake infrastructure projects which have significant socio-economic benefits. The local governments are paid a fee for the same. The bond would be serviced by the conduit borrower based on the project specific revenues. It was estimated that conduits accounted for more than 20% of all Municipal Bonds prior to the financial crisis.
## Taxable Municipal Bonds in India

<table>
<thead>
<tr>
<th>City</th>
<th>Amount Rs. mn.</th>
<th>Placement</th>
<th>Guarantee</th>
<th>Annual Interest</th>
<th>Escrow</th>
<th>Purpose</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangalore Municipal Corporation (1997)</td>
<td>1,250</td>
<td>Private</td>
<td>State Govt.</td>
<td>13.00%</td>
<td>State Government grants and property tax</td>
<td>City roads/street drains</td>
<td>A- (SO)</td>
</tr>
<tr>
<td>Ahmadabad Municipal Corporation (1998)</td>
<td>1,000</td>
<td>Public &amp; Private</td>
<td>No</td>
<td>14.00%</td>
<td>Octroi from 10 octroi collection points</td>
<td>WS&amp;S project</td>
<td>AA- (SO)</td>
</tr>
<tr>
<td>Ludhiana Municipal Corporation (1999)</td>
<td>100</td>
<td>Private</td>
<td>No</td>
<td>13.50% to 14.00%</td>
<td>Water &amp; Sewerage taxes and charges</td>
<td>WS&amp;S Project</td>
<td>LAA- (SO)</td>
</tr>
<tr>
<td>Nasik Municipal Corporation (1999)</td>
<td>1,000</td>
<td>Private</td>
<td>No</td>
<td>14.75%</td>
<td>Octroi from four collection points</td>
<td>WS&amp;S project</td>
<td>AA- (SO)</td>
</tr>
<tr>
<td>Indore Municipal Corporation (2000)</td>
<td>100</td>
<td>Private</td>
<td>State Government</td>
<td>13.00%</td>
<td>Grants/property tax</td>
<td>Improvement of city roads</td>
<td>A (SO)</td>
</tr>
<tr>
<td>Nagpur Municipal Corporation (2001)</td>
<td>500</td>
<td>Private</td>
<td>No</td>
<td>13.00%</td>
<td>Property tax and water charges</td>
<td>WS project</td>
<td>LAA- (SO)</td>
</tr>
<tr>
<td>Madurai Municipal Corporation (2001)</td>
<td>300</td>
<td>Private</td>
<td>No</td>
<td>12.25%</td>
<td>Toll tax collection</td>
<td>City road project</td>
<td>LA+(SO)</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>4,450</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


While the Bangalore Municipal Corporation was the first municipal corporation to issue a Municipal Bond of Rs.1250 million with a state guarantee in 1997, the first non-guaranteed Municipal Bond issuance was undertaken by Ahmedabad Municipal Corporation in January 1998.

In 2000-01, the GoI inserted clause (vii) in Section 10(15) of the Income Tax Act, 1961, exempting interest income from bonds issued by local authorities. Funds raised from Tax Free Municipal Bonds are to be used only for capital investments in urban infrastructure for providing one or more of the following: i. Potable Water Supply; ii. Sewerage/Sanitation; iii. Drainage; iv. Solid Waste Management; v. Roads, Bridges and Flyovers; and vi. Urban Transport (if this is a municipal function under respective state legislation).

Here, the “local authority” refers to “a municipal committee, district board, body of port commissioners or other authority legally entitled to, or entrusted by the Government with the control or management of a municipal or local fund”. Although a cap on interest rate and availability of other tax-shields for investors had dampened the enthusiasm for tax-free bonds in the interim, they are expected to find favour with ULBs and investors again when overall interest rates trend lower.
Tax-free Municipal Bonds in India

<table>
<thead>
<tr>
<th>Name of the municipal corporation</th>
<th>Year of issue</th>
<th>Purpose</th>
<th>Amount INR mn.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahmedabad Municipal Corporation</td>
<td>2002</td>
<td>Water supply and sewerage project</td>
<td>1000</td>
</tr>
<tr>
<td>Nashik Municipal Corporation</td>
<td>2002</td>
<td>Underground sewerage scheme and storm water drainage system</td>
<td>500</td>
</tr>
<tr>
<td>Hyderabad Municipal Corporation</td>
<td>2003</td>
<td>Road construction and widening</td>
<td>825</td>
</tr>
<tr>
<td>Hyderabad Metropolitan Water Supply and Sewerage Board</td>
<td>2003</td>
<td>Drinking water project</td>
<td>500</td>
</tr>
<tr>
<td>Visakhapatnam Municipal Corporation</td>
<td>2004</td>
<td>Water supply system</td>
<td>500</td>
</tr>
<tr>
<td>Chennai Metropolitan Water Supply &amp; Sewerage Board</td>
<td>2003</td>
<td>Chennai water supply augmentation project</td>
<td>420</td>
</tr>
<tr>
<td>Ahmedabad Municipal Corporation</td>
<td>2004</td>
<td>Water supply, storm water drainage, road, bridges and flyovers</td>
<td>580</td>
</tr>
<tr>
<td>Chennai Metropolitan Water Supply &amp; Sewerage Board</td>
<td>2005</td>
<td>Chennai water supply project</td>
<td>500</td>
</tr>
<tr>
<td>Chennai Municipal Corporation</td>
<td>2005</td>
<td>Roads</td>
<td>458</td>
</tr>
<tr>
<td>Ahmedabad Municipal Corporation</td>
<td>2005</td>
<td>Roads and water supply</td>
<td>1000</td>
</tr>
<tr>
<td>Nagpur Municipal Corporation</td>
<td>2007</td>
<td>Nagpur water supply and sewerage project</td>
<td>212</td>
</tr>
<tr>
<td>Greater Vishakhapatnam Municipal Corporation</td>
<td>2010</td>
<td>Greater Vishakhapatnam water supply project</td>
<td>300</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>6795</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


In all, there have been over 20 Municipal Bond issuances reported during this period under which around Rs. 1500 crore have been raised cumulatively. Issuances by ULBs dropped sharply after 2005 with issuance in 2011, 2012 and 2013 corresponding to pooled bond issuance through the Water and Sanitation Pooled fund (WSPF) in Tamil Nadu. Key trends from Municipal Bond issuances in the past are summarised below:

- **Issuer profile:** The issuances tracked here have been made by 11 ULBs. Of these only 4 ULBs have made more than 1 issuance. Large non-metro cities (with population of 1 million to 5 million) dominate issuances; Bangalore, Hyderabad and Ahmedabad between them raised over Rs 500 crore or over a third of total issuances.

- **Size of issuance:** The smallest issue size was by Ludhiana Municipal Corporation (Rs. 10 crore in 1999) and the largest issue was by Bangalore Municipal Corporation (Rs. 125 crore) in 1997. Average size of issuances during this period was around Rs. 50 crore.

- **Taxable vs Tax-free bonds:** 30% of issuance (by value) was in the form of taxable bonds and 46% of issuance (by value) was in the form of tax-free bonds. Rest were issued as pooled bonds.

- **Credit rating and structuring:** All issuances had a rating above A and 80% of issuances had at least AA rating. Except for one bond issue by Ahmedabad Municipal Corporation, all other issuances were structured obligations with credit enhancements.

- **Deployment of proceeds:** Nearly 80% of proceeds were used for Water supply, sewerage and sanitation projects, while the rest were towards road projects.
Annexure III. Recommendations of recent reports on Municipal Bond issuances

Report on Regulatory framework for Municipal Borrowing 2012

At the request of the Ministry of Urban Development (MoUD) and Department of Economic Affairs (DEA), the World Bank has undertaken a non-lending technical assistance exercise on the regulation of municipal borrowing in India. The objective of this exercise was to develop a regulatory framework for Municipal borrowing in India. The study aimed at assessing the key regulatory and legal challenges to scale up of Municipal Bond market and suggested policy reforms for improving the same. Key recommendations of this report are summarised below:

Recommendations on Central Regulations

1. Stakeholders should be informed at state level that direct lending to ULBs is allowed under the circular. In addition, state instructions on borrowing by municipalities should cross-reference the appropriate RBI document for clarity’s sake.

2. RBI should consider adding direct lending to ULBs for capital investments in obligatory functions to the list of lending defined as “infrastructure project lending”. It could happen even though the borrower is not an SPV, but rather a ULB. This no cost reclassification will reduce confusion as to the status of direct lending to municipalities. It will reinforce, directly, the link between legitimate purposes of borrowing and the asset classification system in use by RBI and banks that report to RBI. RBI should consider adding direct lending to ULBs for capital investments in obligatory functions to the list of lending defined as “infrastructure project lending”.

3. Eliminate the interest cap and treat tax-free Municipal Bonds in the same manner as other tax-free instruments. A Union-wide annual volume limit should be used. In addition, approval should be valid for 12 months, not just within the fiscal year in which it was granted.

4. SEBI should publish disclosure guidelines for public issues of Municipal Bonds. They should be in line with the GoI MOF tax-free standards and incorporate current international practice. This step would anticipate future public issues of bonds, and would be in congruence with requirements that provident funds and other institutional investors invest only in publically offered and traded instruments. International practices offer two options for India. It is appropriate to follow EMMA in the United States, where the SEC has no specific disclosure requirements and relies instead on the voluntary industry standard, though after suitably adapting it to the Indian context. For instance one thing to note in the Indian context is the protracted litigation process. Conversely, some transition economies have developed specific municipal disclosure standards, as a part of their securities regulation. In addition, the investor base for Municipal Bonds should start including retail investors as well going forward.

5. Add a new asset class called “rated municipal securities” to both IRDA and PFRDA’s guidelines. This class should have the same allowed proportion as corporate bonds, i.e. asset Class C, and should be substitutable for investments in Class C. This means
essentially that Municipal Bonds are not government bonds, but may be substituted one for one against corporate bonds. Therefore an investor may replace riskier but higher yielding corporate paper with rated municipal securities. Thus, depending on an investor’s risk and maturity preferences, this recommendation would allow them to diversify into a recognized asset class without any disadvantage in terms of permitted allocations among classes. Other studies have recommended reducing the rating requirement for approved municipal securities from A+ to A – this too can be considered as the regulatory environment improves.

6. The state procurement laws should be extended to cover services offered by both private and publically owned financial firms. Applicable and exempted financial services should also be specifically defined. Bids for banking and financial services should be required using simple standard formats, with full costs easily defined on a comparable basis.

Recommendations on State Regulation of Borrowers: Ex ante Rules

1. State Regulations should define “debt” in terms broad enough to include those multi-year financial obligations whose repayment depends on the continuing existence of operational surpluses. All future monetary obligations27, such as guarantees issued by ULBs, financial leases, promissory notes and such should be subject to the State’s review and approval procedures by being defined as “debt”.

2. States should introduce a distinction between long-term and short-term debt. “Long term” debt is defined as (i) serving capital investment, (ii) repayable in over one year, and (iii) subject to state authorization. Short term debt must be repaid within the current fiscal year and not rolled over. A 5% limit on short term borrowing for liquidity purposes is in line with international practices where such borrowing is allowed at all.

3. Long-term borrowing may be limited to long-term capital investment. Long-term loans have over one year tenure and assets are created in water, sanitation, etc. services, as defined by the Govt Guidelines for Tax Free Municipal Bonds. Allow refinancing of earlier long-term capital investment loans only if the new terms are significantly more advantageous to the borrower, if all costs such as prepayment penalties are considered.

4. Retain state powers to grant or deny approvals, but shift to a rules-based system. Approvals should be directed at providing certification that the applicant is in compliance with stipulated regulations on debt service. This would rule out arbitrary judgments about the other merits of the project. The stipulated regulations should provide clear guidelines regarding the quantum and character of municipal borrowing. They should include clearly defined allowable purposes, stock and flow limits as appropriate, allowable security, etc. Project-related approval can be part of a separate process of administrative sanction, if this is regarded as necessary.

5. The authorizing role should be played by a standing Inter-Departmental Committee. Its members should be recruited from the urban and finance sectors. This Inter-Departmental Committee should have a clear mission and simple, time-bound operating procedures (including “deemed approval”) and standard approval request forms.

6. Regulations should clarify that approvals do not constitute state underwriting of municipal loans. Bailouts and unauthorized debt do not constitute a legitimate claim so the courts
will not accept a request of this type that has not been duly authorized under the appropriate state laws.

7. States should introduce an annual debt service limit of 50% of the average net operational surplus of the ULB over the past three completed fiscal years. This limit is often used internationally. Financial institutions certainly project these surpluses into the future and such calculations could be a part of the state approval process. The average operational surplus includes all revenue funding, but excludes one-off capital receipts such as those stemming from sales of assets. Debt service includes current payments of principal and interest on outstanding debt (including financial leasing), as well as anticipated additional payments of principal and interest regarding the new borrowing. The implicit annuity of given guarantees at 1/tenor need be added on a current basis. It creates a cushion for the contingency of paying out a guarantee. If the new borrowing has a grace period, then anticipated new debt service must include not only interest, but also a level annuity of principal that is to be set aside in a sinking fund.

8. The debt service test is applied only whenever a new debt is to be taken. It may be used by stakeholders to monitor the financial condition and statutory compliance of a given ULB borrower over time.

9. Municipal assets should be subject to mortgages, provided that the assets are non-essential for the provision of mandated services. State laws governing municipalities should provide for the distinction between essential municipal assets and commercial/non-essential municipal assets. Rules should be made to provide for the tests to determine which particular category a municipal asset falls under. State laws should then provide clearly that commercial/non-essential municipal assets will be subject to general debt enforcement laws and can be attached by lenders in whose favor security was validly created for loans taken in accordance with the relevant municipal law.

10. State guarantees of municipal debts should be discouraged. Special situations, such as borrowing from international organizations or foreign lenders may be exceptions. In line with international practices, the borrower might pay a guarantee fee commensurate with the amount of public (state) funds at risk. Were state guarantees borrowing to continue, clear criteria should be established, along with published approval procedures and forms. As stated above, municipal-SPV guarantees may be accounted for and treated as debt until the guaranteed debt is repaid.

11. Maximum loan tenor limits should be stricken from state legislation. They have little effect on creditworthiness and are not to be used in approval decisions. Tenor should instead be matched with the useful economic or accounting life of the asset being created; but this is not a formal recommendation, rather a basic principle that all stakeholders should follow.

12. Approved and realized borrowings and their terms should be in a public database maintained by each state. It will reduce risk and uncertainty, and offer a level playing field to all market participants. Data reported to MoUD should be published annually on an aggregate level and on ULB basis for transparency purposes.
**Recommendations on State Regulation of Borrowers: Ex post Procedures**

1. Legislation at both Union and state levels should ease the enforcement of both security and collateral against ULBs. In the short and medium term, the role of DRT in enabling enforcement of debt against municipal authorities should be extended by suitable amendment to the DRT Act and formulation of corresponding rules in light of the existing framework, so as to provide clarity on the rights of lenders against municipal assets. The rules should classify municipal assets as “essential” and “commercial” and allow for enforcement through DRT against “commercial/non-essential” municipal assets. This step would have to be undertaken by the GoI and Union Parliament in consultation with state governments. Recommendation 20: In the short to medium term, municipal insolvency situations will need to be dealt with in the current state administrative structure. This requires the creation of a formal, institutionalized Administrator at the state level responsible for municipal insolvency resolution within existing laws. The Administrator should have clear functions and powers relating to intervention in a municipality and the assumption of its financial affairs in instances of insolvency, and should operate within a set of consistent and transparent rules regarding events that trigger intervention and procedures during the intervention period (including negotiations between the municipality, its creditors and other stakeholders and the development and implementation of a financial recovery plan). The overall objective of any such intervention should be to balance competing imperatives, specifically addressing the legitimate claims of lenders and creditors while maintaining critical public services, without encouraging moral hazard.

2. In the long term (by which is meant anything after about five years from the implementation of recommendations 19 and 20, depending on how conditions develop), and assuming that municipal borrowing activity has expanded to the point that such measures are justified, it would be advisable to create an entity within each state that focuses specifically on issues related to municipal default and bankruptcy. In essence, this would involve shifting some of the functions which, in the short-medium term are proposed to be undertaken by an expanded DRT and Administrator in Recommendations 19 and 20 above, to a properly and formally constituted Municipal Debt Tribunal (MDT). This would work with, but with substantial autonomy from, the state government in order to enforce contracts and security, and oversee municipal insolvency interventions in a way that is more systematized and institutionally objective than is possible with interventions run entirely under the state government. In this model, the MDT would take over the municipal-related functions of the DRT with expanded powers, not only to enforce security and collateral, but also to “force” debt adjustment and to impose settlements if the voluntary negotiations do not succeed. At the same time, the state government would retain certain key obligations regarding the institution of an Administrator in cases of municipal insolvency, but with certain oversight and triggering roles to be played by a semi-autonomous MDT, to minimize the politicization of any intervention and to ensure balance in the way that competing imperatives and stakeholders are dealt with.
CoBoSAC sub-committee recommendations on Municipal Bonds

The MoUD set up a committee to review the progress and implementation of the above recommendations called the "Corporate Bonds and Securitization Advisory Committee of SEBI" (CoBoSAC). SEBI placed an agenda item on formulation of framework for issuance Municipal Bonds and disclosure norms for the same before the CoBoSAC committee which decided that a sub-committee be formed to specify disclosure and other requirements of Municipal Bonds. The sub-committee deliberated on the issue and inter-alia, proposed four different structures for municipalities:

1. Issuance of securities or Municipal Bonds directly by the ULBs Municipal Body: The Municipal Corporations may issue general bonds or revenue bonds subject to the condition that general bonds may not be made available for public offering and may be issued only on private placement basis to institutional investors. It stemmed from the fact that in case of revenue bonds, projects could be identified and the revenue stream can be escrowed, thus providing certain safeguards to the investors. However, in the case of general bonds, the cash flows from the project for which the bonds are issued become part of general revenues of the municipality and thus there are no identifiable resources, which are specifically earmarked to repay such bonds.

2. Issuance of securities or bonds through Corporate Municipal Entity (CME) (Subsidiary) created by the Municipality: Municipalities may consider establishing a “Corporate Municipal Entity” (CME) which would borrow through issue of Bonds and lend it to the concerned Municipality. The objective is to create a conduit entity, which can access the market and which can lend it to the concerned Municipality based on its requirements. The Corporate Municipal entity may not hold or carry out any projects of its own, in which cases it would create implementation, enforcement and hierarchical issues. Further, the transfer of projects of Municipalities to Corporate Municipal Entity in lieu of equity may require legislative amendment. The CME would be a going concern and disclosure would be the same as that prescribed under existing SEBI (Issue and Listing of Debt Securities) Regulations, 2008. In addition, however, it would carry additional information on the Municipal Corporation structure and hierarchies.

3. Creation of a statutory body or a 100% Govt. owned undertaking, which can borrow from market through issue of bonds for onward lending to ULBs or Municipal bodies: Government may consider establishing a statutory body or a 100% Govt. owned undertaking (in the lines of India Infrastructure Finance Company Limited). The objective of such undertaking may be to borrow from the market or from financial institutions for onward lending to Municipal Bodies. Such an undertaking may be capable of assessing/appraising the viability of each project of the Municipality and their Governance level, before meeting their financing requirements. Rather than each investor subscribing to Bonds assessing/appraising the risks and viability of various projects proposed to be undertaken by various Municipal Bodies, if such task could be...

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19 As reflected in SEBI Concept paper on proposed regulatory framework for issuance of debt securities by municipalities. December 2014.

20 This Terms of Reference for this exercise focuses on option 2 and seeks to develop a framework for issuance of Municipal Bonds through structuring of a CME by ULBs. Under the SEBI concept paper,
taken care or assigned to an expert body set-up in this regard, it would yield better
assessment and funds may flow to the suitable projects. Further, such an undertaking
could be central or state government owned and since the body will be engaged in
financial intermediation, may have to be registered with RBI as an NBFC. Such a
statutory body can make such borrowings under the SEBI (Issue and Listing of Debt

4. Issuance of securitized debt instruments by a special purpose distinct entity (Trust)
created by one or more municipalities by securitizing the receivables: The guidelines
prescribed by the MoUD, under the Pooled Finance Development Scheme (PFDF)
Scheme, provides that each State/Union Territory has to designate either an existing
state entity or create a new entity as State Pool Finance Entity (SPFE) for execution of
the PFDF Scheme. Such a SPFE could be either a Trust or a Special Purpose Entity. As
per section 2(h) of the SCRA 1956, the term securities include "shares, scrips, stocks,
bonds, debentures, debenture stock or other marketable securities of a like nature in or
of any incorporated company or other body corporate". Also as per the SEBI Debt
Regulations, "debt securities" means non-convertible debt securities which create or
acknowledge indebtedness, and include debenture, bonds and such other securities of a
body corporate or any statutory body constituted by virtue of legislation. The committee
observed that trusts are pass through entities and they cannot acknowledge any
indebtedness in itself and thus, can issue pass through certificates. The committee
observed that as PTCs are Securitized Debt Instruments and are specifically included
under "Securities" under the SCRA and can be issued by Trust and can also be listed.
Such a trust or SPFE can make a public issue or private placement of securitized debt
instruments which are proposed to be listed, under the extant PFDF scheme by
complying with SEBI (Public Offer and Listing of Securitized Debt Instruments)
Regulations, 2008. However, the suitability of the existing SDI framework to the SPFE
created by the Government needs further examination.

a) The recommendations of CoBoSAC are as under which provided for four ways under
which Municipal Bond financing can be done: Issuance of securities or Municipal
Bonds directly by the ULBs Municipal Body

b) Issuance of securities or Bonds through Corporate Municipal Entity (CME)
(Subsidiary) created by the Municipality

c) Creation of a statutory body or a 100% Govt. owned undertaking, which can borrow
from market through issue of bonds for onward lending to ULBs or Municipal bodies

d) Issuance of securitized debt instruments by a special purpose distinct entity(Trust)
created by one or more municipalities by securitizing the receivables

The SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 which
notified in July 2015 provides that the municipalities can raise funds either directly from the
market or through the Corporate Municipal Entity. The salient features of the regulations are
summarized below:

PPP Cell, Infrastructure Division, Department of Economic Affairs, Ministry of Finance, Government of India September, 2017
a. No municipality shall issue debt securities to public under these Regulations, unless the following criteria are complied with:

   o Municipality, whether proposing to issue debt securities itself or through Corporate Municipal Entity, should be eligible to raise funds under its constitution.
   o Accounts of Municipality shall be prepared in accordance with National Municipal Accounts Manual or in accordance with similar Municipal Accounts Manual adopted by the respective State Government for at least last three preceding financial years.
   o Municipality shall have surplus in any of the last three preceding financial years.
   o Municipality shall not have defaulted in repayment of debt securities or loans obtained from Banks/Financial Institutions, during the last 365 days.
   o The Corporate Municipal Entity or its directors should not have been restrained or prohibited or debarred by the Board from accessing the securities market or dealing in securities and such direction or order is in force.

b. An issuer making a public issue shall only issue revenue bonds. In case of private placements, an issuer shall issue general obligation bonds or revenue bonds.

c. The issuer shall create a separate escrow account for servicing of debt securities with earmarked revenue and appoint a monitoring agency such as a Scheduled Commercial Bank or a Public financial institution for its monitoring.

d. In case of public issuer, the funds raised shall be used only for projects that are specified under objects in the offer document.

e. Issuer’s contribution for each project shall not be less than 20 per cent of the project costs, which may be contributed from their internal resources or grants.

f. Mandatory credit rating, which has to be investment grade rating in case of public issuances.

g. In the event of credit rating being downgraded by two or more notches below the rating at the time of issue, the issuer shall present to all bondholders, the reasons for fall in rating and the steps, if any, they intend to take to recover the rating and cash flows.

h. The offer document shall not omit disclosure of a material fact which shall make the statements made therein, in light of the circumstances under which they are made, misleading.

i. Minimum tenure of 3 years and maximum tenure of 30 years.

j. In the case of private placement, the minimum subscription amount per investor shall not be less than Rupees twenty five lakhs or such amount as may be specified by SEBI from time to time.

k. The accounts of the issuer shall be audited by the persons appointed by the municipal corporations, as permissible under its constitution/state legislation governing the municipality.
## Annexure IV. PPP in urban sector: Models and experience in select sub-sectors

### Water supply – PPP models adopted in the past

<table>
<thead>
<tr>
<th>TYPE</th>
<th>ILLUSTRATIVE PROJECTS</th>
<th>MODEL/FEATURES/ISSUES</th>
</tr>
</thead>
</table>
| City wide concessions with capital grants | Khandwa, Shivpuri, Aurangabad | - 20 + years. Capital Grants + investment by Operator  
- Demand/Revenue risk on operator  
- Tariff spikes, protests, weak communication, delays in financial closure |
| Concessions - Bulk Treatment | Chennai Desalination, Kolhapur STP, Nagpur WTPs | - 10 year + contracts with assured off-take commitment  
- Grants crowded out several projects  
- Strong State Government support necessary given bankability concerns and counterparty credit risk |
| Management Contracts - Distribution pilots | Nagpur and KUWASIP (Belgaum, Hubli-Dharwad, Gulbarga) | - 3-5 Years, Investment by Public Authority  
- Performance linked fees model  
- Demonstrated proof of concept for 24x7 supply  
- Challenges in scaling up city-wide |
| Management Contracts - City water supply | Mysore | - 5+ years. Performance linked O&M Fee  
- Unrealistic performance target setting  
- Improved collections/willingness to pay |

### Water supply PPPs: stress points on awarded projects

<table>
<thead>
<tr>
<th>PROJECTS</th>
<th>STRESS POINTS</th>
</tr>
</thead>
</table>
| Tiruppur Water Supply | - Sharp fall in water demand vis-à-vis projections  
- Loan default scenario; Transition support funding inadequate  
- Project operational with State Government bailout |
| Haldia water supply | - Fall in water demand  
- Private operator exits after incurring heavy losses |
| Khandwa and Shivpuri | - Changes in scope and increase in project cost  
- Projects under attack/protests for tariff spikes despite sizeable grant support |
| Aurangabad | - Open-ended investment obligation on private operator  
- Ambiguity in payment security mechanisms  
- Delays in financial closure; Project yet to start 2 years after award |
| Mysore management contract | - Ambiguity in scope of rehabilitation in Contract along with a cap on investment allowed under the Project  
- Unrealistic performance targets  
- Poor post-award monitoring and management |
Guidance on use of Municipal Bond financing for Infrastructure projects

### Municipal Solid Waste – PPP models adopted in the past

<table>
<thead>
<tr>
<th>MODEL</th>
<th>ILLUSTRATIVE PROJECTS</th>
<th>FEATURES/CHALLENGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrated city wide</td>
<td>Hyderabad, Kanpur, Guwahati</td>
<td>• 20 year + Concessions with Tipping Fee/JNNURM funding</td>
</tr>
<tr>
<td>Projects</td>
<td></td>
<td>• Protests from existing employee base,</td>
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<tr>
<td></td>
<td></td>
<td>• Financial stress faced by ULBs in paying tipping fees</td>
</tr>
<tr>
<td>Processing/Landfill</td>
<td>Rajkot, Bangalore</td>
<td>• 15 year + Concessions with Tipping fee/ton;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Over-estimation of revenues from processing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Poor post-award monitoring</td>
</tr>
<tr>
<td>Collection and Transport</td>
<td>Chennai</td>
<td>• 7-10 year concessions with tipping fee</td>
</tr>
<tr>
<td>only</td>
<td></td>
<td>• Weak definition/enforcement of door-to-door collection and source</td>
</tr>
<tr>
<td></td>
<td></td>
<td>segregation obligations</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Lack of focus on other components (Processing/Landfill etc.)</td>
</tr>
</tbody>
</table>

### Urban Transport: PPP models adopted in the past

<table>
<thead>
<tr>
<th>TYPE</th>
<th>ILLUSTRATIVE PROJECTS</th>
<th>MODEL/FEATURES/ISSUES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Facilities</td>
<td>Bus terminals in Ludhiana, Amritsar, Multi-level car parking etc.</td>
<td>• BOT with Revenue share or minimum annuity grant</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Revenues: Parking, Advertising, Commercial development</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Weak Parking policy/enforcement and unclear land titles</td>
</tr>
<tr>
<td>Bus Transit – Rolling stock</td>
<td>Ahmedabad, Raipur, Surat, Jabalpur etc.</td>
<td>• JNNURM funding for buses. O&amp;M Contracts</td>
</tr>
<tr>
<td>(Buses)</td>
<td></td>
<td>• Revenue from fare box collections or fixed fee per km</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Pre-designated routes; Limited route optimisation</td>
</tr>
<tr>
<td>Bus Transit – Full city bus</td>
<td>Indore city bus services</td>
<td>• JNNURM funding under an SPV</td>
</tr>
<tr>
<td>services</td>
<td></td>
<td>• Although successful in Indore, hasn’t seen replication elsewhere</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Subsidized public services through State Transport Corporations (STCs) a dampener for PPPs</td>
</tr>
<tr>
<td>Rail Transit</td>
<td>Mumbai, Hyderabad, Delhi (Airport express)</td>
<td>• Viability Gap Funding model</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Hyderabad ~45% revenue from property dev., 5% from advertising</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Delhi Airport link - ridership was only 11,000 vs. 40,000 projected</td>
</tr>
</tbody>
</table>
Annexure V.  Suggested guidelines for setting up a Corporate Municipal Entity

Structure of the CME

The City level CME will be established as a Limited Company under the Companies Act, 2013 and will be a subsidiary of the Corporation. The State level State Pooled Finance Entity (SPFE) promoted by the State/UT may also take an equity stake with the ULB jointly, both having 50:50 equity shareholding.

Raising and utilization of funds by the CME

The objective is to create a conduit entity, which can access the market and which can lend it to the concerned Municipality based on its requirements. The Corporate Municipal entity may not hold or carry out any projects of its own, in which cases it would create implementation, enforcement and hierarchical issues. Further, the transfer of projects of Municipalities to Corporate Municipal Entity in lieu of equity may require legislative amendment. The CME would be a going concern and disclosure would be the same as that prescribed under existing SEBI (Issue and Listing of Debt Securities) Regulations, 2008. The CME would remain a conduit entity for raising funds and on lend it to the ULB for project purpose. It would also be a vehicle to channel project specific grant funds. The CME may also access funds from other sources such as debt, user charges, taxes, surcharges, etc.

Board of Directors and Staffing

The Board of Directors will have representatives of State Government (Municipal Administration and Finance Department), State Pooled finance entity, ULB and Independent Directors, in addition to the CEO and Functional Directors. Additional Directors (such as representative of parastatal) may be taken on the Board, as considered necessary. The Company and shareholders will voluntarily comply with the provision of the Companies Act 2013 with respect to induction of independent directors. The Independent Directors will be selected from the data bank(s) maintained by the Ministry of Corporate Affairs and preference will be given to those who have served as independent directors in the Board of Companies fulfilling Clause 49 of the listing agreement of Securities and Exchange Board of India (SEBI).

The CME may be headed by a financial officer, not below the rank of Deputy Commissioner – for a fixed term. The Detailed staffing requirement for the CME may be decided based on the size of ULB and size and number of proposed issues. The CME should have staff with expertise in project appraisal and monitoring, General Administration and Finance & Accounts. A CME can potentially help build robust governance standards (through induction of specialists as Directors in the CME Board) and induction of operational and organisational expertise for resource mobilisation and fund raising function (including Risk Management, Treasury management, Asset-liability management, investor relations), which are otherwise not ‘core’ municipal functions that ULBs are otherwise equipped to handle.

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21Suggested guidelines for setting up a CME. As a corporate entity, the CME would need to comply with the Companies Act 2013 and other extant legislative and statutory requirements at the State and local levels.
Possible roles and responsibilities that can be handled under a CME

The key functions and responsibilities of the CME are to:

1. Mobilize resources within timelines and raise funds on behalf of the ULB, subject to approval of a Borrowing plan or on a case to case basis

2. Creation of a Master Financing Indenture (or a common structuring framework for issuances) can help build credit profile, minimise the need for excessive credit enhancements and bring down cost of borrowings.

3. Act as a liaison between the ULB and Investors, Regulatory agencies and other stakeholders

4. Co-ordinate with ULB and investors/other stakeholders to ensure timely redressal of grievance

5. Work with audit agencies for timely finalization, audit and dissemination of IMC’s accounts.

6. Manage the process of bond issuance starting with issuance planning and putting in place internal and external preparedness actions.

7. Work with other lines department to finalize project financing arrangements including bond issue size and terms

8. Appoint service providers (including Merchant Banker, Credit Rating agency, Registrar, Trustees and Stock Exchanges. Depository etc.,) for bond issuance as per statutory requirements.

9. Manage post-issuance actions including
   a. Maintain an database on Municipal Finances ULB wise(historical as well as current)
   b. Prepare revenue enhancement plans and cash flow projections.
   c. Liaison with Credit Rating agencies/Merchant bankers/Trustees/Stock exchanges/auditors etc
   d. Manage Investor relations, information dissemination and compliance reporting
   e. Keep abreast of the developments in municipal finance, capital markets and related areas.

10. Upgrade MIS to ensure rigor in capture and disclosure of key financial information including the following (and other regulatory filings as required)
    a. Annual audited financial statements
    b. Project implementation status - Half yearly (Monthly would be preferable)
    c. Fund utilization against project - Half yearly (Monthly would be preferable)
    d. "Project development - Details with respect to the development of the Project along with certifications from the Project Engineer should be furnished to the Trustee, Rating Agencies and stock exchanges on Half Yearly Basis and should be publicly disseminated."
    e. Key financial ratios
f. Half Yearly return on servicing of bonds, maintenance of Asset Cover, Credit enhancement facilities and Investors Grievances & Redressal

g. A CA/Bank certificate for timely servicing of bonds.

11. Build institutional capacity within the CME to support ULB in future resource mobilization and borrowings program

12. Undertake timely review of project activities and reporting the same
Annexure VI. Rating frameworks of select credit rating agencies

This section is a summary of the criteria and indicators featuring in the rating methodologies of rating agencies and has been compiled from websites of respective rating agencies.

**CARE**

1. Economic factors
   a. Nature of local economy;
   b. Local employment and income characteristics;
   c. Development indicators and current availability of urban services.

2. Legal set-up
   a. Borrowing powers and limits;
   b. Pending litigation’s or disputes;
   c. Powers of taxation;
   d. Powers to levy user charges;
   e. Actual control over revenue sources considering the political implications of tax and user charge hikes;
   f. Collection enforcement mechanisms under the Act and restrictions on operations;

3. Administrative factors
   a. Organizational structure;
   b. Division of responsibilities between the Administrative and Political wings;
   c. Quality and continuity of management, extent of delegation;
   d. Depth of management, extent of delegation;
   e. Tax billing, collection and enforcement mechanism;
   f. Track record in project implementation;
   g. Degree of autonomy enjoyed by the local body;
   h. Management Information System;
   i. Industrial relations.

4. Accounting and Auditing Practices
   a. Systems of accounting;

5. Debt Factors
   a. Composition of current debt burden;
   b. Interest and debt service coverage ratios;
   c. Past debt service performance;
   d. Evaluation of credit enhancement mechanisms, if any;
   e. Commitments/encumbrances on cash flows;
   f. Degree of reliance on short term borrowings;
g. Maturity matching profile;
h. Recourse available to lenders, in case of default, as per the Act.

6. Financial Indicators
   a. Fiscal data on the issuer;
   b. Budgetary and planning processes;
   c. Tax base and past trends;
   d. Composition and timing of revenue and expenditure, past trends;
   e. Trends in tax rates and user charges;
   f. Extent of cost recovery on various urban services;
   g. Financial flexibility to meet unforeseen contingencies;
   h. Revenue surplus/deficit;
   i. Extent of State budgetary support;
   j. Operating and collection efficiency;
   k. Sources and allocation of capital expenditure, trends;
   l. Extent of borrowings, if any, from non-governmental sources and the degree of compliance with the credit discipline imposed by such lenders.

7. Finances of state government
   a. Trends of revenue surplus/deficit, revenue deficit/Gross Fiscal Deficit;
   b. Interest payment/Revenue expenditure; Debt servicing/Gross transfers;
   c. Non-development exp./Aggregate disbursement; Tax revenues/Revenue exp.;
   d. Gross transfers/Aggregate disbursements;
   e. Trends in overall deficits and Gross Fiscal Deficits.

8. Project Viability
   a. Constitution of the project as a departmental project or an SPV;
   b. Sources and uses of funds for project being financed;
   c. Analysis of projected revenues and expenditure for the tenure of the instrument as well as the underlying assumptions;
   d. Revenue flow pattern from the project and extent of cost recovery;
   e. Committed budgetary support and other credit enhancement measures;
   f. Sensitivity analyses to user charge hikes, cost of borrowing etc.;

9. Credit enhancement structure
   a. Escrow of specific tax revenues
   b. Supporting structures like Mortgage of assets, DSRF, Devolution intercept
   c. Partial guarantee or Full guarantee
1. Legal and administrative issues
   a. Municipal function domain
   b. Taxing powers
   c. Tax-collection track record
   d. Transfer of State government grants
   e. Borrowing powers
   f. Ability to pledge revenues for servicing debt

2. Economic base of the service area
   a. Demographics and the area covered
   b. Level of industrial and commercial activity
   c. Diversity and elasticity of tax-base
   d. Prospects of widening tax coverage
   e. Per capita income levels

3. Current financial position
   a. Accounting quality
   b. Analysis of surplus/deficits
   c. Growth in tax and non-tax revenue streams
   d. Collection efficiency, debtor analysis
   e. Dependence of State government Grants
   f. Expenditure on core services
   g. Past/projected debt servicing needs and debt service coverage
   h. Liquidity
   i. Projected revenue and expenditure growth

4. Managerial assessment
   a. Organization structure and responsibility division
   b. Systems and procedures; Level of computerization
   c. Project management capabilities
   d. Initiatives taken for enhancing resources
   e. Level of control on expenditure

5. Project specific issues
   a. Proposed projects
   b. Project tenure and funding pattern
   c. Debt servicing requirements
   d. Existing service levels and improvements envisaged

6. Credit enhancement structure
Guidance on use of Municipal Bond financing for Infrastructure projects

a. Escrow of specific tax revenues
b. Supporting structures like Mortgage of assets, DSRF, Devolution intercept
c. Partial guarantee or Full guarantee/Mortgage of assets

ICRA

ICRA’s rating methodology addresses the inter-governmental fiscal relationship between a ULB and the next higher tier of government—the State—as one of the key determinants of the credit quality of the ULB. Given the role of States in determining the operational and financial autonomy of a ULB, ICRA’s rating methodology also recognises the linkage between the credit quality of a ULB and the State it belongs to.

Overall credit quality determinants under ICRA’s rating framework include:

1. Credit Quality of the State and Inter-governmental Fiscal Relationship
2. Economy of the Municipal Area
3. Operational Efficiency
4. Municipal Finances
5. Management Quality
6. Credit enhancement structures
Annexure VII. ToR for engaging a merchant banker

Background of the issuer
1. Brief profile of the issuer including its structure, functions and the services provided
2. Overview of the legal and regulatory frameworks associated with the ULB/CME
3. Overview of financial position covering profit and loss and capital structure
4. History of debt or bond issuances

[Name of issuer] invites Merchant Banker(s)/Arranger(s) for the proposed Bond issue.

Brief profile of the project
1. Project context and relevance
2. Financing mix

Bond issue details

[Name of the ULB] proposes to issue [General obligation/Revenue bonds] [Secured/Unsecured] [Redeemable] [Convertible/Non-convertible][Taxable/Tax free] Bonds through [private placement/public issue] towards the [Name of the project].

Tentative Bond structure

The Tentative structure of bond issue is as follows:

<table>
<thead>
<tr>
<th>Issuer</th>
<th>[Name of the ULB]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of Instrument</td>
<td>[Public/private] placement of [General obligation/Revenue bonds] with details of Eligible and non-eligible investors [Secured/Unsecured] [Redeemable] [Convertible/Non-convertible][Taxable/Tax free] Bonds</td>
</tr>
<tr>
<td>Issue size and face value</td>
<td></td>
</tr>
<tr>
<td>Credit Rating of issue</td>
<td></td>
</tr>
<tr>
<td>Issue price (at par/discount/premium)</td>
<td></td>
</tr>
<tr>
<td>Tenor and Coupon</td>
<td>Term of [Number of years] redeemable at the end of [Year 1], [Year 2] etc with a principal moratorium of [Number of years] and interest moratorium of [Number of years]</td>
</tr>
<tr>
<td>Coupon</td>
<td>[Coupon Rate – Fixed/Floating] payable [quarterly/semi-annually/annually etc]</td>
</tr>
<tr>
<td>Minimum application</td>
<td></td>
</tr>
<tr>
<td>Deployment of proceeds</td>
<td>[Brief profile of project]</td>
</tr>
<tr>
<td>Credit Enhancement</td>
<td>Escrow of [Tax revenue/user charges etc]. Additional support structures, if applicable</td>
</tr>
</tbody>
</table>

Eligibility criteria

1. The bidder shall be a SEBI registered category I Merchant Banker. The registration shall be valid during the bond mobilisation period. In case the registration has already expired or is due for expiry any time before the closure of the issue, the Merchant banker has to produce the proof of application submitted in SEBI for renewal of registration. The

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22 This is a suggested framework and seeks to cover key points of scope of work. The RFP issued by ULB will incorporate provisions to comply with State and Local requirements under State-level procurement practices.

23 The details of bond structure are tentative and need to be finalized as per the ULB’s requirements.
Merchant Banker is required to furnish copies of the above documents issued by SEBI, duly certified by its Statutory Auditor.

2. The Merchant Banker(s)/Arranger(s) should have mobilised/invested as a sole arranger of a minimum size of issuance° during the last 5 years.

3. Merchant banker should have experience in mobilization of Municipal Bonds, and/or issuances of State Government agencies, State Governments or Public Sector Undertaking.

4. The Merchant Banker(s)/Arranger(s) should not have been disqualified or blacklisted by any Regulatory Authority and/or by any bond issuer for non-fulfilment of any of its commitments in the Bond issue and such disqualifications etc. are not continuing at the time of submitting bid application as well as at the time of award of mandate

Scope of work and roles and responsibilities of the bidder

1. Successful bidder shall mobilise/subscribe the funds for the bonds up to its committed amount within stipulated time by arranging to remit the sum through RTGS at designated bank branch of the ULB. The Merchant Banker(s)/Arranger(s) shall ensure that as per the relevant provisions of the Companies Act 2013, the payment to be made for subscription to Bonds shall be made directly from the bank account of the person subscribing to such securities, the proof thereof has to be provided by the Merchant Banker(s)/Arranger(s).

2. The Merchant Banker(s)/Arranger(s) are required to consider, ensure compliance and apprise the issuer of all the relevant statutory provisions for issue of Bonds including latest amended relevant regulations/provisions of SEBI, Municipal Act, the Companies Act 2013 and the related Rules there under, Stock Exchanges, other applicable laws/regulations etc. in connection with the said issue of bonds.

3. The Merchant Banker(s)/Arranger(s) are required to provide the issuer the checklist for ensuring compliance under various applicable provisions of the laws and regulations. Stipulated deadlines for filing with SEBI, MCA, Stock exchanges and other regulators/authorities.

4. Advise issuer on timing of the bond issue and the date of opening of issue and closure of issue depending upon the prevailing market conditions in such a way that the issues receives healthy response from investors.

5. Assist issuer in preparation of Disclosure/other documents as per the extant regulations and legislations.

6. Preparation of Offer document (as per SEBI guidelines) or any other document as required under SEBI guidelines, and other applicable laws/regulations.

7. To liaise with Stock Exchange for obtaining In-Principle approval for listing the bonds with BSE/NSE and also assist issuer in accomplishing the requisite documentation for listing of the Bonds.

°This may be decided in line with local procurement guidelines and issue size.
8. Assist Issuer in conducting road shows, identify the potential investors, interact with them, prepare and supply them the Information memorandum and other necessary documents, reply to investors’ queries, furnish information, etc.

9. Design the Bond Application Forms to be filled by the investors, subject to approval of the issuer

10. Collect the Application Forms from the investors with necessary documents and arrange to remit the application money with the collecting Banker under intimation to the issuer.

11. Liaise with the Depositories, for making all formalities/compliances in connection with issuing the bonds in dematerialised form.

12. Liaise with Collecting Banker, keep track of the collection of funds and report to the issuer.

13. Follow up with various intermediaries including Credit Rating Agency, Registrar to issue, Collecting banker, Trustee etc. on behalf of the issuer to ensure the successful completion of the bond issue.

14. Finalise subscription list with all necessary details and documents as per the requirement of all applicable laws and regulations to enable the issuer in allotment of bonds.

15. Complete all other formalities, which are not specified hereinabove, as per all the applicable laws and regulations required for completion of the issue process, receipt of money, allotment, filing of all required documents with regulators like SEBI, Registrars, and Stock Exchanges etc.

16. The scope is not limited to the above. It shall be the responsibility of the Merchant Banker(s)/Arranger(s) to ensure that the entire Issue amount as mentioned in the bid document is fully subscribed after complying with all the applicable laws, regulations and Statutory Provisions.

**Evaluation of bids**

The evaluation of bids will be as follows:

1. Bidders eligible as per the eligibility conditions mentioned in above will be shortlisted

2. Commercial bids of the shortlisted bidders will only be opened

3. Evaluation of the financial bid will be based on the IRR calculated, computed on the basis of coupon rate and arranger’s fees quoted by the Merchant Banker(s)/Arranger(s).

4. Issuer reserves the right in the appointment of either sole arranger or more than one arranger.

5. If Issuer chooses to appoint a second arranger, the arranger quoting the second lowest fee computed in the manner described in point (3) above, will be selected and will be asked to match the fee quoted by the lowest bidder. If the bidder does not agree to match the price of the lowest bidder, the next lowest bidder will be asked to match the price of the lowest bidder.

6. Issuer reserve the right to negotiate other terms and conditions with the selected Merchant Banker(s)/Arranger(s)
Other conditions

1. EMD as per norms.

2. The coupon rate and fee shall be valid for at least 30 days from the date of opening of the bid and further, if appointed as Arranger, until the closure date/extended closure date of the issue.

3. The Arranger has to quote single coupon rate, any range/multiple rates quoted may be rejected.

4. The fees quoted in financial bid should be inclusive of all Taxes and out of pocket expenses. No additional charges shall be payable. Tax will be deducted at sources as per the provisions of Income Tax Act, 1961.

5. Conditional bids will be rejected forthwith.

6. Issuer reserves the right to request any further/additional information from any of the bidders.

7. The offer received without Earnest Money Deposit will be summarily rejected.

8. The arrangers shall mobilise the entire quantum of the issue within stipulated time from the date of opening of issue on firm commitment basis.

9. Non-fulfillment of any of the pre-qualification criteria will attract disqualification.

10. Issuer may disqualify the selected Arrangers at any stage, if it comes to its notice at a later date that any information/certificate(s) furnished by the Arrangers were factually incorrect or false.

11. Issuer at its sole discretion can reject all or any of the bids.
Annexure VIII. ToR for engaging a credit rating agency

Background of the issuer
1. Brief profile of the issuer including its structure, functions and the services provided
2. Overview of the legal and regulatory frameworks associated with the ULB/CME
3. Overview of financial position covering profit and loss and capital structure
4. History of debt or bond issuances

Brief profile of the project
5. Project context and relevance
6. Financing mix

Bond issue details

[Name of the ULB] proposes to issue [General obligation/Revenue bonds] [Secured/Unsecured] [Redeemable] [Convertible/Non-convertible][Taxable/Tax free] Bonds through [private placement/public issue] towards the [Name of the project].

Bond structure

The Tentative structure of bond issue is as follows:

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<th>Issuer</th>
<th>[Name of the ULB]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of Instrument</td>
<td>[Public/private] placement of [General obligation/Revenue bonds] with details of Eligible and non-eligible investors [Secured/Unsecured] [Redeemable] [Convertible/Non-convertible][Taxable/Tax free] Bonds</td>
</tr>
<tr>
<td>Issue size</td>
<td>&lt;To be mentioned&gt;</td>
</tr>
<tr>
<td>Tenor and Coupon</td>
<td>Term of [Number of years] redeemable at the end of [Year 1], [Year 2] etc with a principal moratorium of [Number of years] and interest moratorium of [Number of years]</td>
</tr>
<tr>
<td>Coupon</td>
<td>[Coupon Rate: Fixed/Floating] payable [quarterly/semi-annually etc.]</td>
</tr>
<tr>
<td>Rating fee</td>
<td>Initial Rating Fees – Surveillance fees –</td>
</tr>
<tr>
<td>Deployment of proceeds</td>
<td>[Brief profile of project]</td>
</tr>
<tr>
<td>Credit Enhancement</td>
<td>Escrow of [Tax revenue/user charges etc]. Additional support structures, if applicable</td>
</tr>
</tbody>
</table>

Scope of work

The scope of work includes carrying out the credit rating for the bond issue of [Amount of issue] raised via [private placement/public issue] by [Name of the issuer]. The rating shall be utilized by the ULB/CME at the time of raising of funds.

The Credit rating agency shall also undertake the surveillance of the proposed bond issue during the term of the bond.

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25 The details of bond structure is tentative and the issue may carry minimum information like issue size, and type of bonds
Qualification requirements

Credit Rating Agency, which responds to this tender, must have been registered with SEBI under SEBI (Credit Rating Agencies) Regulations 1999 (and as amended) should produce a copy of the valid registration certificate.

The Credit Rating Agency should have experience in having rated the debt instrument for a value (not less than a threshold level26) in Municipal Bonds, and/or issuances of State Government agencies, State Governments or Public Sector Undertaking.

Time period

The Credit Rating Agency will intimate the ULB about all the required information within [Number of days] from date of order. The time period of completion of proposed rating of [Name of issuer] and [Issuance] will be five (5) weeks from the date of submission of all required information by the [Name of the Issuer].

[Name of the Issuer] reserves the right to not to appoint the 2nd Credit rating Agency for the facility.

Financial proposal 27

The Credit Rating Agencies are requested to quote firm price only. Rates may be in both figures and words. Taxes as applicable will have to be quoted, separately. The offer should be valid for acceptance for a period of at least 90 (ninety) days from the date of opening of the offer. (Format for quoting fee may be annexed as follows)

Annexure – Fee (Indicative Structure)

<table>
<thead>
<tr>
<th>Sl no</th>
<th>Particulars</th>
<th>Unit</th>
<th>Amount in INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Initial rating</td>
<td>Lump sum</td>
<td></td>
</tr>
<tr>
<td></td>
<td>fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Surveillance</td>
<td>Lump sum</td>
<td></td>
</tr>
<tr>
<td></td>
<td>fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Selection

The selection would be based on the financial bid and L-1 bidder would be selected on the basis of least cost.
Annexure IX. Indicative contents – Trust Deed

DEBENTURE TRUST DEED

This Debenture Trust Deed is made at ______ on this_______ day of ________________, by and between: __________________________________________________________, an
Urban Local body established in ____ under provisions of the _________ Municipal Act, _________ having its Registered Office at
_________________________________________________________________________ _____________
______________________ (hereinafter called the “Issuer”)

AND

________________________________________________, a Company incorporated and registered under the provisions of the Companies Act, 2013 (or a Trust established under Indian Trust Act 1882) and having its Registered Office at ________________________________

Schedule IV to SEBI Regulations lists some of the clauses which are to be included in the Debenture Trustee Agreement.

1. Preamble,
2. Description of the Instrument,
3. Details of charged securities
   a. nature of charge,
   b. examination of title,
   c. rank of the charge, i.e., whether first, second, or pari-passu charge, etc.
   d. charging of future assets,
   e. time limit for creation of charge,
   f. minimum security cover required,
   g. valuation of security,
   h. circumstances in which security becomes enforceable,
   i. method and preservation of secured property etc.
4. Events of default.
5. Rights of Debenture Trustee.
6. Obligations of the body corporate (i.e., Issuer of debentures).
7. Apart from the above, the Agreement will have to include the following provisions :
   a. Definition and Interpretation,
   b. Appointment of Debenture trustee and its powers,
   c. Remuneration of Debenture Trustee,
   d. Appointment of debenture Trustee as Attorney,
   e. Negative pledge i.e. not to create additional encumbrances on the secured asset,
f. Description of Events of Default, which may arise due to Non-payment to debenture holders, breach of any undertaking, avoidance or repudiation, etc.
g. Notice of exercise of Trustee powers,
h. Indemnity of Trustee,
i. Retirement of Trustee & appointment of new Trustee,
j. Reimbursement of expenses incurred by the Trustee,
k. General covenants etc.
Annexure X. Indicative contents – Tripartite agreement

TRIPARTITE AGREEMENT BETWEEN THE ISSUER, REGISTRAR AND THE NATIONAL SECURITIES DEPOSITORY LIMITED

This Tripartite Agreement made and entered into on this_______ day of ___________________, at Mumbai between ____________________________, a Company incorporated and registered under the provisions of the Companies Act, 2013 and having its Registered Office at ____________________________ (hereinafter called the “Issuer” which expression shall unless it be repugnant to the context or meaning thereof mean and include its successors in title) and ____________________________, its Registrar and Transfer Agent and having its Registered Office at ____________________________ (hereinafter called the “R & T Agent” which expression shall unless it be repugnant to the context or meaning thereof mean and include its successors in title) and the National Securities Depository Limited, having its Registered Office at Trade World, 4th Floor, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai 400 013 (herein after called the “NSDL”)

WITNESSETH AS FOLLOWS

WHEREAS The Issuer and or its Registrar and Transfer Agent has furnished, to the NSDL an application dated _______________ for its Equity shares bearing ISIN _______________ being admitted as an ‘eligible security’ in the depository system and whereas the second undersigned is working as the R & T Agent of the Issuer.

NOW THEREFORE in consideration of the NSDL having agreed to admit the securities of the Issuer as being eligible for being admitted on the depository system, the parties to this Tripartite Agreement hereby covenant and agree as follows:

1. The Issuer and/or the R & T Agent agree and undertake to comply with the provisions of the Bye Laws and the Business Rules of NSDL, wherever applicable.

2. The Issuer, it’s R & T Agent and NSDL hereby agree that the Bye Laws and Business Rules of NSDL shall be part of the terms and conditions of every agreement, contract or transaction between the parties to the agreement.

3. The Issuer and/or its R & T Agent shall be bound by any amendment to the Bye Laws and Business Rules of NSDL with respect to any transaction occurring subsequent to the time of such amendment. Such amendment shall take effect as if it were originally a part of the Bye Laws and Business Rules of NSDL.

4. The agreement and all contracts and transactions effectuated by the Issuer and/or its R & T Agent under the Bye Laws and Business Rules of NSDL or through the facilities of NSDL shall be governed by and be construed in accordance with the provisions of the relevant laws as well as the rules and regulations of the Regulatory Bodies having jurisdiction in respect of the same from time to time.
5. The Issuer and/or R & T Agent shall furnish a list of authorized officials who shall represent and interact on behalf of the Issuer and/or R & T Agent with NSDL within fifteen days of the execution of this agreement and any changes including additions/deletions thereof shall be communicated to NSDL within fifteen days of such change.

6. The Issuer shall send to NSDL copies of the letters approving listing and commencement of trading issued by the relevant stock exchanges in respect of securities held in dematerialised form with NSDL.

7. NSDL shall allocate unique identity codes to both the Issuer and/or its R & T Agent.

8. The Issuer and its R & T Agent shall establish continuous electronic means of communication with NSDL and NSDL shall provide necessary manuals & procedural guidelines to the Issuer and/or its R & T Agent, as is necessary for effective and prompt conduct of the business of the Depository. The Issuer and/or its R & T Agent shall maintain such systems, procedures, means of communication, adequate infrastructure, hardware, software security devices and back-up facilities as shall be prescribed by NSDL.

9. The Issuer and/or its R & T Agent shall strictly follow the backup procedure recommended by NSDL. A copy of the latest back-up of database and subsequently incremental backup shall be maintained at a designated remote site.

10. The Issuer and/or its R & T Agent shall comply with all the systems and procedures recommended by NSDL and shall allow access to their systems by NSDL designated EDP Audit Team for periodic assessment of compliance with systems and procedures.

11. The Issuer and/or its R & T Agent agree that NSDL shall not be liable to the Issuer and/or its R & T Agent for any loss arising out of any failure of the Issuer and/or its R & T Agent to keep full and up to date security copies (backup) of computer programme and data it uses in accordance with the best computing practice.

12. The Issuer shall inform NSDL on the next day on which the information is being sent to the stock exchanges in which the eligible securities are listed, about the dates from which new shares arising out of conversions, further issues, final call payments, etc. become pari-passu with its existing shares.

13. The Issuer shall furnish information to NSDL of any further issues such as rights, bonus, public offerings with details viz.; opening and closing dates, issue size, issue price, record date, book closure, proportion, along with a copy of the offer document.

14. The Issuer shall give information to NSDL about book closures, record dates, dates for the payment of interest or dividend, dates for annual general meetings and other meetings, dates for redemption of debentures, dates for conversion of debentures and warrants, call money dates, amalgamation, merger, reduction of capital, reconstruction scheme of arrangement, sub-division, consolidation, and conversion of debentures/loans and such other information relating to any corporate action, on the next day it is being communicated to the relevant stock exchanges, where the eligible security is listed.

15. The Issuer and/or its R&T Agent undertakes that the dematerialisation and rematerialisation requests are processed within fifteen and thirty days respectively.
However, it is agreed that in case of bulk dematerialisation requests, this period may be extended to thirty days.

16. The Issuer and/or its R & T Agent undertakes that no dematerialisation requests shall be accepted when there are any prohibitory order, stop transfer, attachment order, or disputed title, on the day of such request. It is agreed that where a court order has been received by the Issuer and/or its R & T Agent or where there are court orders against any transfer request, if such a request is entertained, the Issuer and/or its R & T Agent shall be entirely responsible. The Issuer and/or its R & T Agent agrees to be fully responsible for destruction, mutilation and cancellation of certificates received and accepted by it for dematerialisation.

17. It is agreed that the Issuer and/or its R & T Agent will continue to be responsible for corporate actions. The NSDL undertakes to provide the list of beneficial owners with suitable details to the Issuer or R & T Agent as of the record date. This list shall be provided by the NSDL fifteen days after such request has been received by the NSDL. In the event of any loss caused to the Issuer and/or its R & T Agent, in respect of any incorrect information relating to the Client, furnished by NSDL or its Participant, NSDL shall indemnify such losses.

18. The Issuer and/or its R & T Agent shall indemnify NSDL in respect of any loss or liability incurred, or any claim arising in respect of any incorrect information furnished by the Issuer and/or its R & T Agent in respect of the operations of the Depository.

19. Any claims, disputes or liabilities arising in respect of any securities which have been rematerialised under intimation from the Issuer and/or its R & T Agent to NSDL after the dispatch of such securities’ certificates in the manner laid down under the Bye Laws shall be settled between the Issuer and/or its R & T Agent and the owner of such securities.

20. In the case of securities that have been dematerialised and electronically credited to the accounts of the Clients in NSDL under intimation from the Issuer and/or its R & T Agent in the manner laid down under the Bye Laws, any claims, disputes or liabilities or cause of action from a third party arising in respect of such securities pertaining to any fake or forged securities shall be settled between the Issuer and/or its R & T Agent and such third party.

21. NSDL shall authorise persons who, shall have the right to enter during the regular business hours, on any working day, the premises of such Issuer and/or its R & T Agent where the records relating to the depository operations are being maintained and inspect, and take copies thereof.

22. NSDL shall provide reports updating details of Beneficial Owners on a fortnightly basis to the Issuer and/or its R & T Agent.

23. NSDL shall provide the details of the list of Beneficial Owners as well as the pending requests for dematerialisation and rematerialisation that may be required by the Issuer and/or its R & T Agent from time to time on the payment of such charges as may be provided in the Business Rules. Such information shall be provided within fifteen days from the date of making such request and where the list of Beneficial Owners is required as on a particular record date, the same shall be provided within a period of fifteen days.
after such date or fifteen days from the date of receipt of such request by the NSDL whichever is later.

24. NSDL shall in its discretion provide any other details that may be required by the Issuer and/or its R & T Agent from time to time on the payment of such charges as it may deem fit.

25. The Issuer and/or R & T Agent shall inform NSDL of any proposed changes in the address of the Registered Offices, Corporate Office, or of the location where the equipment for communication with NSDL is situated not less than thirty days before the date of such change.

26. NSDL shall inform the Issuer and/or its R & T Agent of any proposed changes in the address of its Registered Office or Corporate Office not less than thirty days before the date of such change.

27. The Issuer shall not change, discontinue or substitute its R & T Agent unless the alternative arrangement has been agreed to by NSDL.

28. The Issuer and/or its R & T Agent shall not assign to any other person/entity its functions & obligations, relating to transactions with the Depository, without the approval of NSDL.

29. All parties to this Agreement shall resolve the grievances of the Beneficial Owners within a period of twenty-one days, from the date of receipt of the complaint, concerning NSDL, the Issuer and/or its R & T agents.

30. All parties to this Agreement shall abide by the arbitration and conciliation procedure prescribed under the Bye-laws of NSDL and that such procedure may be applicable to any disputes between the NSDL and the Issuer and/or R & T Agent.

31. All parties to this Agreement further agree that all claims, differences and disputes, arising out of or in relation to dealings on the Depository including any agreements, contracts and transactions made subject to the Bye Laws or Business Rules of the NSDL or with reference to anything incidental thereto or in pursuance thereof or relating to their validity, construction, interpretation, fulfillment or the rights, obligations and liabilities of the parties thereto and including any question of whether such dealings, transactions, agreements and contracts have been entered into or not, may be subject to the exclusive jurisdiction of the Courts at Mumbai only.

IN WITNESS WHEREOF THE PARTIES HERETO HAVE HEREON TO SET AND SUBSCRIBED THEIR RESPECTIVE HANDS TO THIS AGREEMENT IN TRIPlicate ON THE DAY, MONTH, YEAR AND PLACE FIRST MENTIONED.

SIGNED, AND DELIVERED

By the within named ........................................................................through its authorised representative

___________________________

Designation___________________________

in the presence of ___________________________ : ______________
Guidance on use of Municipal Bond financing for Infrastructure projects

SIGNED, AND DELIVERED

By the within named …………………………………………………through its authorised representative

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Designation ______________________

in the presence of ____________________________ : __________________

SIGNED, AND DELIVERED

By the within named National Securities Depository Limited through its authorised representative

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Vide Board Resolution dated __________

in the presence of ____________________________ : __________________