



JANAAGRAHA CENTRE FOR CITIZENSHIP & DEMOCRACY

# MUNICIPAL BONDS

POLICY BRIEF #001

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In March 2015, the Securities & Exchange Board of India (SEBI) passed regulations to facilitate issuance of municipal debt and listing of debt securities by municipalities in India. This will enable investment in public infrastructure of the 100 Smart Cities that the Government of India proposes to build. Moreover, the 14<sup>th</sup> Finance Commission has allocated Rs 17,400 Crore to municipalities for the period 2016-20 as performance grants that are tied to conditions which, when complied to, will help municipalities raise money from the markets.

It is estimated that India's cities will require between \$800 Billion and \$1.2 Trillion of capital investment to cater to the growing demand for civic services over the next 20 years<sup>1</sup>. As only a part of the capital requirement can be met through the grant funds from central and state governments, municipalities should seek recourse through other means, including issuance of municipal bonds. The US municipal bond market, which raised \$ 303.66 Billion<sup>2</sup> in 2014, for local infrastructure development, provides a promising outlook on the prospects of municipal bonds.

Presently, municipal bonds in India have not been able to attract potential investors due to the opacity in finances and operational outcomes. Till date, municipalities in India have managed to raise only \$291 Million<sup>3</sup>, since 1997 through issuance of bonds. By taking advantage of the measures adopted by the central government, the 14th Finance Commission, and SEBI, municipalities will be able to fund infrastructure projects in their cities, and improve service delivery. Municipalities can raise money in the form of debentures that are traded across stock exchanges and use the money to invest in projects on water supply, storm water drains, roads and other public infrastructure.

To successfully raise money from bond markets, municipalities must ensure that their accounts are prepared on time, audit of accounts is carried out by an independent agency, financial and operational data is made public, and that they comply with all eligibility requirements put forth by SEBI and their state governments. Additionally, municipalities can comply with disclosure standards adopted by the private sector to boost investor confidence and bond subscriptions.

1. Report on Indian Urban Infrastructure and Services, High Power Expert Committee, Government of India, 2011; India's Urban Awakening, McKinsey Global Institute, McKinsey & Co., 2010

2. "Little respite seen for U.S. municipal bonds in 2014", Reuters, Dec 15 2014; <http://uk.reuters.com/article/2013/12/15/uk-usa-municipals-outlook-idUKBRE9BE06X20131215>

3. Issuance of Municipal Bonds in India, Janaagraha Centre for Citizenship and Democracy

## How to raise money through municipal bonds\*

- 1 Identify a project/function**  
↓ Identify a project or a function for which the municipality needs to raise money. It can be the construction of water supply network, storm water drains, roads et cetera.
- 2 Choose the issue type**  
↓ Choose the type of issue which fits the municipality's requirement. You can raise money through General Obligation Bonds or Revenue Bonds (see below to know more).
- 3 Evaluate project cost**  
↓ Do a cost analysis for the project. The municipality must contribute at least 20% to the total project cost.
- 4 Get credit rating**  
↓ Get a credit rating for the municipality from a recognised credit rating agency. Minimum rating for raising money through municipal bonds must be A+.
- 5 Open an escrow account**  
↓ Open an escrow account for the purpose of the project for which the money is to be raised. An escrow account is used for making debt payments to investors.
- 6 Disclose information**  
↓ Disclose Budgets and abridged Annual Accounts for the last five years, and other information as specified in the SEBI regulations.
- 7 Raise money**  
↓ Raise money either through private placement or public issue.

\*See full list of requirements in Annexure 1

# What are Municipal Bonds?

Municipal bonds are debt instruments issued by municipalities or other state agencies which use the money to build schools, water supply systems, sewer systems, and other projects for public good. When someone purchases a municipal bond, they are lending money to a state or local government entity, which in turn promises to pay a specified amount of interest and return the principal amount on a specific maturity date. Municipal bonds can be of two types, namely:

## Revenue Bonds

Revenue bonds are bonds supported by the revenue from a specific project, such as a water supply project or a sewer systems project. Such bonds finance income-generating projects and are secured by a specified revenue source. For example, if a revenue bond is issued to upgrade a water supply network, the water charges collected from users would be used to pay off the bond.

## General Obligation Bonds

General obligation bonds are issued in the belief that a municipality will be able to repay its debt obligation through taxation or revenue from projects. Unlike revenue bonds, general obligation bonds can be paid through a variety of tax sources. These therefore may not be for specific revenue-generating projects.

"Among the factors driving investor interest in bonds issued by large municipalities are strong investment-grade ratings on the South African national scale, their large and diversified budgets and their above-average management expertise"

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# Highlights of Municipal debt issuance

- A total of Rs 1,747 Crores (\$291 Million)<sup>4</sup> of debt across 27 projects has been raised by municipalities in India since 1997.
- 16 of the 27 loans were secured for water supply and sewer system projects (Ref Annexure 2).
- Bangalore was the first city in India to issue municipal bonds (Rs 125 Crores) in 1997 followed by Ahmedabad (Rs 100 Crores) in 1998.
- Currently, municipal bonds with a yield of below 8%, and a maturity period of greater than five years, qualify for tax exemptions.
- South Africa recorded cumulative bond issuance of \$1.8 Billion in Q1 2011<sup>5</sup>. Their bond market has expanded five-fold between the years 2004 and 2011; and
- Local governments in China plan to issue \$17.8 Billion of municipal bonds for the year 2014<sup>6</sup>.

South Africa recorded cumulative bond issuance of \$1.8 Billion in Q1 2011 . In contrast India recorded cumulative bond issuance of \$291 Million as of 2014 .

Janaagraha Centre for Citizenship and Democracy (Janaagraha) is a Bengaluru based not for profit having the mission of transforming quality of life in India's cities and towns. It defines quality of life as comprising quality of infrastructure and services and quality of citizenship. Janaagraha, along with its sister organization - Jana Urban Space Foundation, operates 12 programs which are based on a robust City-Systems framework. To achieve its mission, Janaagraha works with both citizens and governments in advocating policy, creating platforms for citizen engagement and forging partnerships to attain scale.

4. Issuance of Municipal Bonds in India, Janaagraha Centre for Citizenship and Democracy

5. "Moody's: South African municipal bond market displays growth potential", Moody's Investors Services, Jun 06 2011: [https://www.moodys.com/research/Moodys-South-African-municipal-bond-market-displays-growth-potential-PR\\_220260](https://www.moodys.com/research/Moodys-South-African-municipal-bond-market-displays-growth-potential-PR_220260)

6. "China's Municipal Bond Issue", Reuters, Sept 05 2014: <http://www.reuters.com/article/2014/09/05/markets-china-debt-idUSL3N0R3ISR20140905>

## Annexure 1: Key regulations proposed by SEBI in its regulatory framework for issuance of debt securities by municipalities, 2015

<b>Eligibility</b>	<ul style="list-style-type: none"> <li>The municipality (issuer) should be allowed to raise money under the laws that govern it</li> <li>The municipality should not have negative net worth for the last three financial years</li> <li>The municipality should not have defaulted in repayment of debt securities or loans</li> </ul>
<b>General requirements</b>	<ul style="list-style-type: none"> <li>The municipality will issue only revenue bonds in case the issue is a public issue, and it may issue general obligation bonds or revenue bonds in case of private placement</li> <li>Minimum tenure of the debt securities issued will be 3 years</li> <li>The municipality's contribution for each project shall not be less than 20% of the project costs, which shall be contributed from their internal resources or grants</li> </ul>
<b>Minimum subscription</b>	<ul style="list-style-type: none"> <li>The minimum subscription limit shall not be less than 75% of the issue size</li> </ul>
<b>Credit Rating</b>	<ul style="list-style-type: none"> <li>Minimum credit rating of A+ is required from at least one of the recognized credit rating agencies</li> <li>Every rating obtained by an issuer shall be periodically reviewed by the registered credit rating agency</li> </ul>
<b>Listing of debt securities</b>	<ul style="list-style-type: none"> <li>The issue will have to be listed on one or more recognized stock exchanges</li> <li>The issuer shall maintain 100% asset cover sufficient to discharge the principal amount at all times for the debt securities issued</li> <li>The issuers may provide an option to buy-back the debt-securities at their face value, from the investors</li> </ul>
<b>Security of debt</b>	<ul style="list-style-type: none"> <li>The debentures shall be secured through the properties or assets or the receivables of the municipality.</li> <li>The total value of debentures issued shall not exceed the market value of immovable property/other assets or receivables of the municipality</li> <li>In case unsecured debentures are intended to be listed on stock exchange(s), then the debt securities shall either be backed by guarantee from state government or central government or shall have a structured payment mechanism</li> </ul>
<b>Utilization of funds</b>	<ul style="list-style-type: none"> <li>The proceeds of the issue shall be clearly earmarked for a defined project or a set of projects as specified in the offer document</li> <li>The municipality or Corporate Municipal Entity (CME) will obtain a "viability certificate" from a chartered accountant certifying the financial viability of the project for which the money is raised. It will also maintain a separate bank account where the money raised from the issue will be transferred and utilized for the specific projects as specified in the offer document</li> </ul>
<b>Monitoring of project</b>	<ul style="list-style-type: none"> <li>The municipality shall establish a separate project implementation cell and designate a project officer</li> <li>The municipality shall disclose the schedule of implementation of the project in the offer documents and the funds raised by the issuer shall be utilized in accordance with the disclosed schedule</li> </ul>
<b>Accounting, Auditing and Reporting</b>	<ul style="list-style-type: none"> <li>The accounts of municipality shall be prepared in accordance with the National Municipal Accounts Manual or similar standard approved by state government</li> <li>In case of a CME, the accounts shall be prepared in accordance with section 129 and 134 of the Companies Act, 2013 and the rules made thereunder</li> <li>In case of the issuer being a municipality, 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</li> <li>In case of a CME, the accounts of the issuer shall be audited by an auditor, in terms of section 139 of the Companies Act, 2013 and the rules made thereunder</li> </ul>
<b>Monitoring of debt</b>	<ul style="list-style-type: none"> <li>A public finance institution or nationalized bank will be appointed to monitor the revenues in the escrow account</li> <li>The monitoring agency shall inspect on half yearly basis, the utilization of issue proceeds in accordance with objects of the issue as specified in the offer document</li> </ul>
<b>Inspection</b>	<ul style="list-style-type: none"> <li>SEBI may appoint one or more persons to undertake the inspection of the books of accounts, records and documents of the issuer or merchant banker or any other intermediary associated with the public issue, disclosure or listing of debt securities</li> </ul>
<b>Disclosure</b>	<ul style="list-style-type: none"> <li>The municipality will disclose information as provided in the regulations. In case the issuer is a CME, information will be disclosed as specified in the Companies Act, 2013 and Companies (Prospectus and Allotment of Securities) Rules, 2014</li> </ul>

Source: Proposed regulatory framework for issuance of debt securities by Municipalities, Securities and Exchange Board of India, March 2015

## Annexure 2: Bond Issuances in India

City	Issue Year	Issue size (Rs Cr)	State Guarantee	Escrow	Purpose
Ahmedabad	1998	100	No	Octroi from 10 Octroi collection points	Water Supply and Sewerage
	2002	100	-	-	Water Supply and Sewerage
	2004	58	-	-	Water Supply, Storm water drainage, roads and bridges
	2005	100	-	-	Roads and water supply
Bengaluru	1997	125	Yes	State govt. grants and property tax	City roads and drains
Chennai	2003	42	Yes	-	Chennai water supply augmentation project- Chennai Metropolitan Water Supply & Sewerage Board
	2005	50	Yes	-	Water Supply- Chennai Metropolitan Water Supply & Sewerage Board
	2005	45.8	-	-	Roads
Hyderabad	2003	82.5	Yes	-	Road construction and widening
	2003	50	Yes	-	Drinking water- Hyderabad Metropolitan Water Supply and Sewerage Board
Ludhiana	1999	10		Water and Sewerage taxes and charges	Water Supply and Sewerage
Nashik	1999	100	No	-	Water Supply and Sewerage
	2002	50	-	-	Underground sewerage scheme and storm water drainage system
Indore	2000	10	Yes	-	Improvement of City roads
Nagpur	2001	50	No	-	Water supply
	2007	21.2		-	Water Supply and Sewerage
Madurai	2001	30	No	-	City roads
Vishakhapatnam	2004	20	No	-	Water supply
	2004	50	-	-	Water supply
	2010	30	-	-	Water supply
Tamil Nadu Water and Sanitation Pooled Fund	2002	30.2	USAID	-	Refinancing loans for water and sanitation projects of 13 ULBs
	2008	6.7	-	-	-
	2010	83.19	-	-	-
	2012	51	-	-	-
Karnataka Water and Sanitation Pooled Fund	2005	100	USAID	-	Water supply component of a greenfield project for 8 ULBs, Greater Bangalore Water Supply and Sanitation project (GBWASP)
	2010	300	-	-	Lending to ULBs through Directorate of Municipal Administration
<b>Total Amount</b>		<b>1746.59</b>			