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A Study on Municipal Bonds as a Source of Revenue for Municipal Corporations in India

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RAMESH O OLEKAR**

ABSTRACT

Though the 74th Constitutional Amendment Act (CAA) gave autonomy to local governments, equivalent devolution of financial autonomy is absent. Municipal Finances in India are identified by the mismatch between the funds and functions of local governments. The investment requirement of urban infrastructure over the years is increasing with the increase in population. Prior to 1990, urban infrastructure was financed largely through grants and Plan funds of governments. After 1990, the concept of municipal bonds has evolved. The present study focuses on the overview of municipal bonds in India, trends, process of issuing municipal bonds using secondary data. And it concludes that the municipal bond market has grown drastically over the years.

Keywords: Credit Rating, Financial Autonomy, Municipal Finance, Municipal Bonds

INTRODUCTION

The confined means of income to the local bodies lead to fund developmental projects through issuance of municipal bonds in India. Municipal bond market in India is in a nascent stage where most of the developed countries, it is very vibrant (Devender Kumar Pant, 2001). The 74th Amendment paved the way for the issuance of municipal bonds in India. It mainly focused on decentralisation of funds to local bodies and gave them autonomy.

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Later in the year 1996, the Government of India had set up the Nakesh Mohan Committee for commercialisation of infrastructure in India which endorsed private sector participation and access of capital markets. Municipal bodies were permitted to issue tax-free municipal bonds through the amendment of Section 10(15)(viii) of the Income Tax Act, 1961, by the Ministry of Finance under certain specific guidelines in the year 2001. And again Ahmedabad Municipal Corporation was the first to issue tax-exempt municipal bonds in India.

In the year 2015, the Securities Exchange Board of India restructured the eligibility criteria for issuing and listing of municipal bonds. The municipal corporations which are planning to issue municipal bonds have to ensure that the following criteria is fulfilled: (a) It should have no negative net worth in the previous three fiscal years; (b) It should have no prior default in debt repayment in the previous year; (c) It must possess a minimum investment grade rating of Better Business Bureau (BBB); and (d) RBI's wilful defaulters list should have no mention of municipal entities, their group companies, promoters or directors.

Review of Literature

Brad Johnson & Chetan Vaidya (2001) described the groundwork prepared for the bond issue, the conception and financing pattern of the project and the issue of municipal bonds. The authors argue that the technical framework set up for the Ahmedabad Municipal Corporation bonds can act as a blueprint for future development initiatives.

Chattopadhyay (2006) delineated the problems and prospects related to the municipal bond market along with recent initiatives to propel the development of a viable and vibrant municipal bond system in India.

Chandrasekaran and Katayama (2012) stated that municipal development projects benefiting the public often get impeded by the political and institutional framework of the Central Government. In many cases in India, a major constraint is financing these projects. According to the 12th Finance Commission Report, most of the infrastructure initiatives have been stalled due to financial constraints. For instance, the shortfall in finances to achieve the water and sanitation sector goals in India's Tenth Plan is estimated at INR 179 billion. Without the discretion to issue municipal bonds, municipalities are often dependent on transfers from the Government of India (GoI). Chandrasekaran and Katayama described municipal bonds as an avenue

operation of Municipal bonds and highlighted the list of taxable and non-taxable municipal bonds. Lastly he concluded that municipal bonds can play the role of financing the development of infrastructure in smart cities. Nallathiga suggested for certain changes in the institutional capacity towards management of finances in Urban Local Bodies.

Objectives of the Study

- (i) To study the overview of municipal bonds in India;
- (ii) To understand the process of raising money through municipal bonds in India; and
- (iii) To analyse the trend of municipal bonds issuance in India.

Research Methodology

To study the overview of municipal bonds and understand the process of raising money through municipal bonds, descriptive research method is employed. Analytical research method is used to analyse the trend in municipal bonds issuance in India. Secondary data is collected from sources such as Government of India and other institution(s) or agencies reports such as CARE, Indian Urban Infrastructure and Services, Working papers and websites such as National Stock Exchange (NSE), Bombay Stock Exchange (BSE), city finance, C bonds, INDmoney were used to collect the relevant data for undertaking this study. Trend of municipal bonds issuance in India is analysed using Bar graph. The present article confines to study municipal bond market in relation to Indian municipal corporations and their bonds.

Overview of Municipal Bonds in India

Municipal bonds are the debt instruments and issued by the local bodies to raise funds for their developmental projects that would require huge capital expenditure. Municipal bonds can be termed as the loan taken by the local body from the investors. The investors get interest which is tax free as return on their investment. The categorisation of municipal bonds is done in two ways – The General Obligation bonds (used for funding general infrastructure projects) and Revenue Bonds (used for funding specific projects and are repaid through revenues or taxes generated by these specific projects). Until 2017, the only issuances in India have been of general obligation bonds and as per the 73rd Amendment, these bonds have been sold via private

Risks involved in Investment of Municipal Bonds

- **Call Risk** - It is a risk associated with interest rates. If interest rates decline, the potential to repay bond before maturity date by the issuer increases and vice-versa.
- **Credit Risk** - It is a risk associated with financial problems of the issuer that may make it difficult to repay interest and principal amount.
- **Interest Rate Risk** - It is a risk relating to the inverse relationship between the bond's market price and the interest rates.
- **Inflation Risk** - Municipal bonds are not suitable to overcome inflation.
- **Liquidity Risk** - It is a risk associated with lack of market for municipal bonds which doesn't enable the investors to buy and sell bonds.
- **Political Risk** - The fund raising project may get affected due to change in the political scenario of the State government and the local government.

Process of Raising Money through Municipal Bonds in India

Generally the projects for which municipal corporations tend to raise money through bonds are infrastructure projects that require huge capital expenditure. The municipal corporations can choose between the general obligation bonds and revenue bonds. Total project cost is evaluated considering various factors. Any municipal corporation wishing to raise funds through bonds have to obtain investment grade rating from any of the recognised credit rating agencies (Credit Rating Information Services of India Limited (CRISIL), Investment Information and Credit Rating Agency of India (ICRA) and others) in India. An Escrow Account has to be opened in order to make debt payments to the investors which acts as a third party between the municipal corporation and the investors until the completion of a Project/Plan. Financial and other information is disclosed as per the Securities Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. Completion of all these requirements enables a municipal corporation to raise money either through public issue or a private placement.

Interpretation: The highest amount of Rs. 412.10

Trend of Municipal Bonds Issuance in India

TABLE 1: MUNICIPAL ISSUANCES IN INDIA SINCE 1997

(Rupees in crores)

Sl. No.	Name of the Municipal Bonds Issued	Year of Issue	Purpose of Issue	Amount Raised
1	Bengaluru	1997	City Roads/ Street Drains	125
2	Ahmedabad	1998	Water Supply and Sewerage	100
3	Ludhiana	1999	Water Supply and Sewerage	10
4	Nasik	1999	Water Supply and Sewerage	100
5	Indore	2000	Improvement in City Roads	10
6	Madurai	2001	City Road Project	30
7	Nagpur	2001	Water Supply	50
8	Ahmedabad	2002	Water Supply and Sewerage	100
9	Nasik	2002	Underground Sewerage scheme and storm water drainage	50
10	Tamil Nadu Water and Sanitation Pooled Fund	2002	Water and sanitation projects of 13 ULBs	30.41
11	Hyderabad	2003	Road Construction and Widening	82.5
12	Hyderabad Metropolitan Water Supply and Sewerage Board	2003	Drinking water	50
13	Chennai Water Supply and Sewerage Board	2003	Water supply augmentation project	42
14	Ahmedabad	2004	Water Supply, Storm water drainage, roads and bridges	58
15	Vishakhapatnam	2004	Water supply Project	20
16	Vishakhapatnam	2004	Water supply	50
17	Karnataka Water and Sanitation Pooled Fund	2005	Water supply Project of a Greenfield project for 8 ULBs	100
18	Chennai Metropolitan Water Supply & Sewerage Board	2005	Water Supply	50
19	Chennai	2005	Roads	45.8
20	Ahmedabad	2005	Roads and water supply	100
21	Nagpur Metropolitan Water	2007	Water Supply	21.2

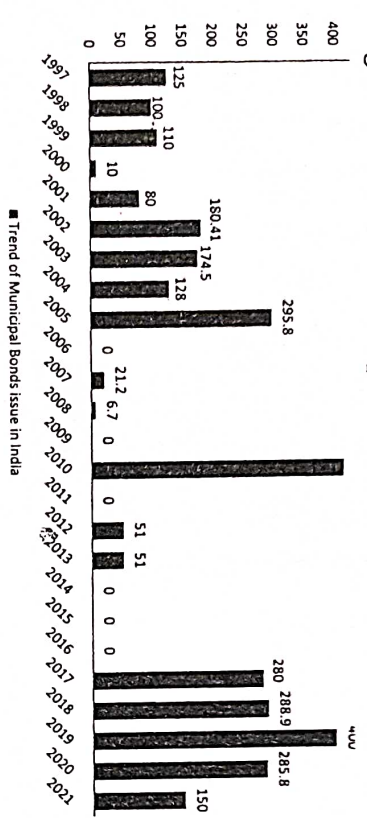
(Table 1 contd.)

22	Tamil Nadu Water and Sanitation Pooled Fund	2008	-	6.7
23	Vishakhapatnam	2010	Water Supply	30
24	Tamil Nadu Water and Sanitation Pooled Fund	2010	-	83.19
25	Karnataka Water and Sanitation Pooled Fund	2010	Lending to ULBs through Directorate of Municipal Administration	300
26	Tamil Nadu Water and Sanitation Pooled Fund	2012	-	51
27	Tamil Nadu Water and Sanitation Pooled Fund	2013	Municipal Administration and Water Supply	51
28	Pune	2017	Water metering project	200
29	Tamil Nadu Water and Sanitation Pooled Fund	2017	-	80
30	Indore secured	2018	Development of infrastructure	113.90
31	Bhopal	2018	Implementation of projects defined under AMRUT	175
32	Ahmedabad	2019	Development projects under AMRUT	200
33	Hyderabad	2019	Strategic Road Development Plan	200
34	Lucknow	2020	Infrastructure project	285.80
35	Ghaziabad	2021	Sewage Treatment plant	150

Source: <https://cityfinance.in/borrowings/municipal-bond>, <https://cbonds.com/bonds/>, <https://www.indmoney.com/bonds>

of Rs. 200 crores each. The years 2005, 2017, 2018 and 2020 witnessed the municipal bond issuances of more than Rs. 200 crores while the years 1997 to 2004 and 2021 except 2000 and 2001 had more than Rs. 100 crores municipal bonds. Less than Rs. 80 crores bonds were issued in the years 2000, 2001, 2007, 2008, 2012 and 2013 while the years 2006, 2009, 2011 and 2014-2016 had no municipal bond issues. Ahmedabad Municipal corporation has raised highest amount of Rs.558 crores in the form of municipal bonds since 1997-2021. And Bengaluru Municipal

Diagram 1 - Trend of Municipal Bonds issue in India (Rs in crore)



CONCLUSION

Raising finance through municipal bonds for financing the infrastructure projects of Municipal Corporations in India assumed greater importance in the recent times. Some of these bond issues are backed by the Government guarantee and while others are not. Municipal bonds act as an important source of finance for municipal corporations in India and can have a vast market when backed by government guarantee and are offered with handsome interest making them tax-free.

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