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# **Case Study Municipal Bond Development In India**

## **Ahmedabad Municipal Corporation**

Infrastructure Finance Regional Workshop  
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# **FINANCE AND CITIES IN THE 21<sup>st</sup> CENTURY**

## **Financing Municipal Infrastructure Through Bonds**

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Dy Municipal Commissioner  
Ahmedabad, INDIA**

### **STRUCTURE OF PRESENTATION**

- Section A : Municipal Services Overview**
- Section B : Municipal Financing**
- Section C : Meeting the Municipal Challenge**
- Section D : AMC Experience**
- Section E : The Way Forward**

## Section A

# Municipal Services-Overview

### SERVICE LEVELS - WATER SUPPLY

State	Population Coverage (%)
India	84.65
Andhra Pradesh	78
Assam	40
Gujarat	98
Haryana	100
Karnataka	96
Maharashtra	98
Punjab	71
Tamil Nadu	49
Uttar Pradesh	97

- Water supply requires major augmentation to meet future demand and existing deficiencies

## SERVICE LEVELS - SANITATION

Type of Toilet	% of Households
Flush	39.06
Septic System	37.49
Service System	17.01
Others	6.44
Total	100

- Most cities have no sewerage systems. Rapid implementation of such systems is required

## SERVICE LEVELS - ROADS

Size Class of Town/Cities	Per capita Road Length(Mts)
Above 10 lacs	0.36
1 to 10 lacs	0.72
0.5 lacs to 1 lac	0.93
upto 0.5 lacs	0.61

- In developed countries the per capita availability ranges from 5.25 mts for Italy to 25.69 mts in Australia

## **SERVICE LEVELS - SOLID WASTE**

<b>Size Class of Town/Cities</b>	<b>Collection Efficiency(%)</b>
Above 10 lacs	<b>80.0</b>
1 to 10 lacs	<b>63.5</b>
0.5 lacs to 1 lac	<b>55.5</b>
upto 0.5 lacs	<b>50.0</b>

- Most cities dispose of Solid Waste in uncontrolled landfills

## **Section B**

### **Municipal Financing**

## **THE SETTING**

- Urban population is likely to be twice its present level in the next two decades. The percentage of population living in urban areas by 2001 would be around 32%
- Urban centers represent high productivity and provide higher income but are characterised by poor living in slums
- Improvements in access to urban infrastructure and provision of a better service level will be the focal activity for urban local bodies in the future
- Given the existing pressures on finances from the traditional sources, it is apparent that new avenues need to be explored

## **MUNICIPAL GOVERNANCE**

- Municipal authorities are required to provide a large range of infrastructure services under the prevalent legislations. These are typically addressed as obligatory and discretionary functions
- Given the problems of a constraining legal framework, control of State Government and weak institutional capacity, providing infrastructure services have not kept pace with urbanisation and economic growth
- The poor market image of Municipal authorities makes it difficult for evincing any interest from both its constituents and non-budgetary financing sources

## MUNICIPAL REVENUES

State	Own Revenues as % to total Revenue
Andhra Pradesh	55.10
Assam	70.92
Gujarat	88.96
Kerala	76.79
Maharashtra	90.81
Punjab	87.85
West Bengal	27.89

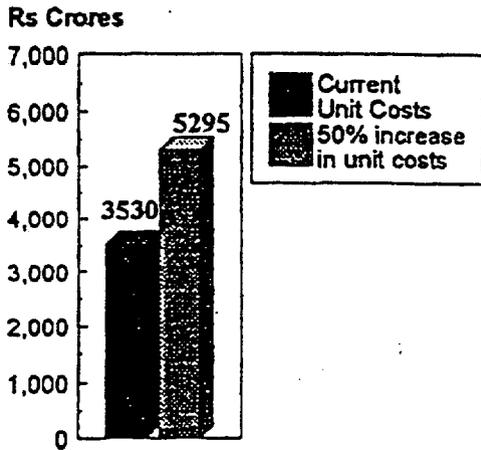
- Most Municipal entities have to sustain growth in infrastructure provision from their own sources

## SOURCES OF FINANCE

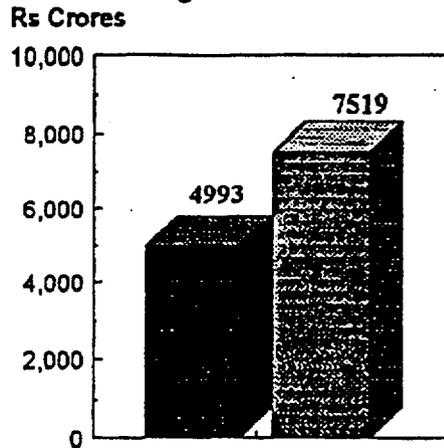
Sources	Amount per annum Rs (crores)
Plan allocation	
Central Plan	73
State Plan	1497
Institutional Sources	
HUDCO	250
Others	100
Internal Sources	80
<b>Total</b>	<b>2000</b>

# Investment Requirements at varying levels of service

LOW Scenario

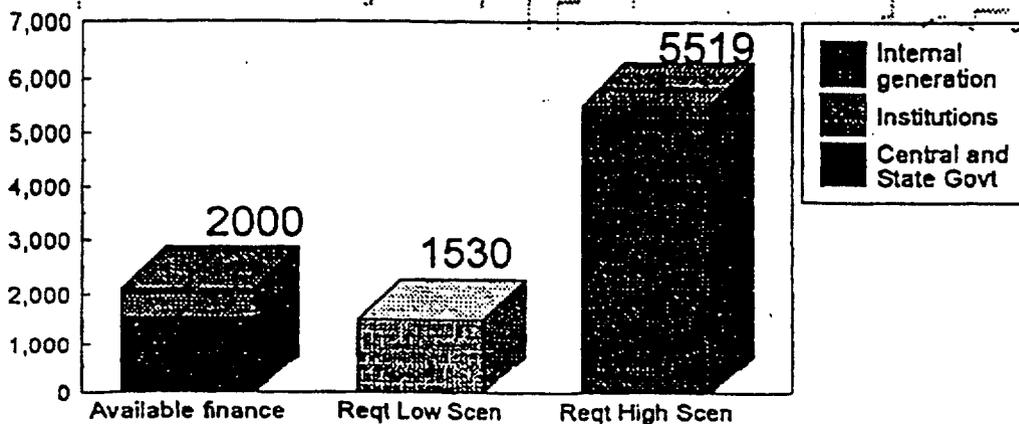


High Scenario



# INVESTMENT GAP

Rs crores





## Section C

# Meeting the Municipal Challenge

## THE CHALLENGE

- Keeping pace with economic growth in the cities it is essential that the infrastructure provision be upgraded rapidly. This would promote urban productivity and thereby the revenues of the Municipalities
- It would therefore be necessary for Municipalities to enhance their revenues and institutional capacity. Revenue enhancement would need to explore possibilities of enlarging and diversifying the resource base
- Municipalities would need to examine methods of improved and alternative service delivery mechanisms
- The expanded revenue base would capture value additions caused by improved efficiency in the economy
- Consequently, it would be possible for municipalities to leverage these resources and implement large programmes

## **URBAN INFRASTRUCTURE**

- It is estimated that the deficient gaps in Indian cities to provide the minimum standards of living is Rs. 1500 to 5000 crore per year
- Current status of most municipal entities renders them incapable of financing these needs on their own
- Although the 74th Amendment empowers them to raise resources and charge tariffs, lack of reputation precludes them from accessing funds
- Risk parameters do not make equity a viable option

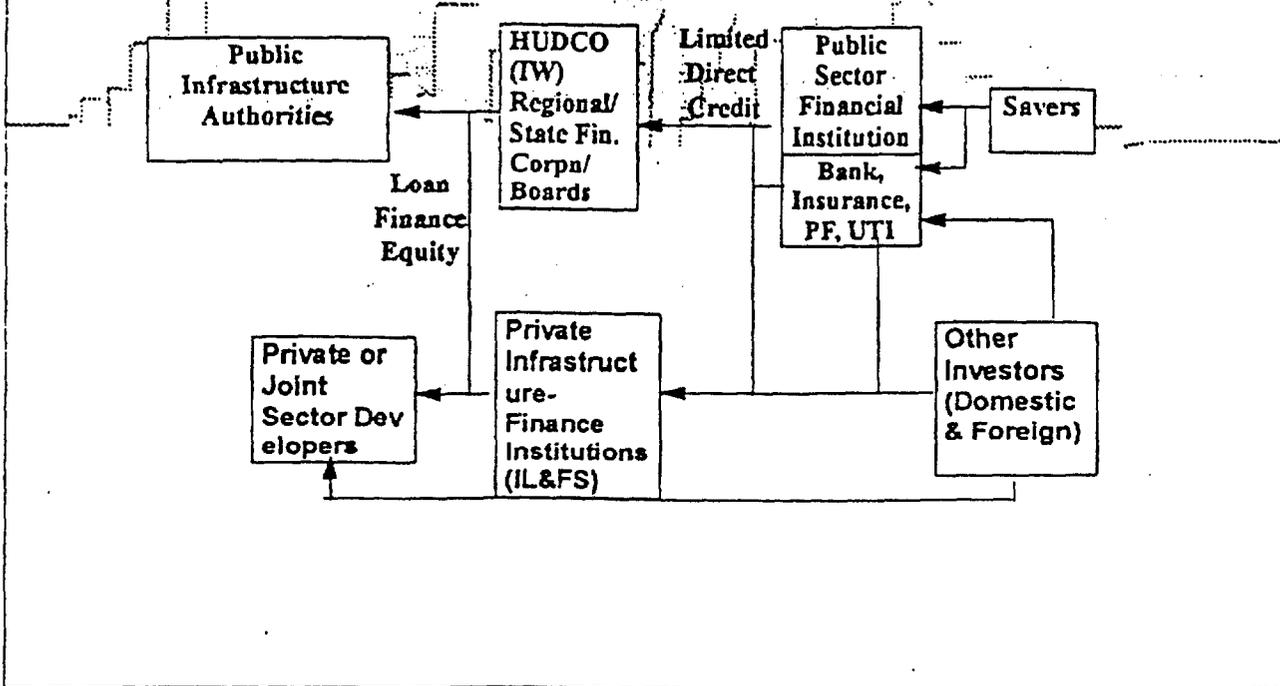
## **CASE FOR COMMERCIALISATION**

- Need for greater cost efficiency in construction and operation of infrastructure services
- Need for mobilising larger volume of funds
- Need to mobilise non-guaranteed finance from the market
- Technological development
- Need to create attractive investment climate
- Fiscal constraints on Government
- Growing disenchantment with public monopoly
- Innovative financing techniques and globalisation of financial markets

## EMERGING TRENDS

- Large amount of private finance could be mobilised for infrastructure projects, by structuring them to meet investor's requirements
- Private financing and management, could deliver better service performance than public sector management as well as provide rapid response and innovative solutions
- Capital market is the critical link to infrastructure financing
- Steps need to be taken to ensure access to domestic and international capital markets.
- Better environmental risk management could be a source of competitive advantage
- The first private projects are important to create replicable model

## EMERGING SYSTEM FOR LATE 1990's



## Section D

# AHMEDABAD EXPERIENCE

## BACKGROUND

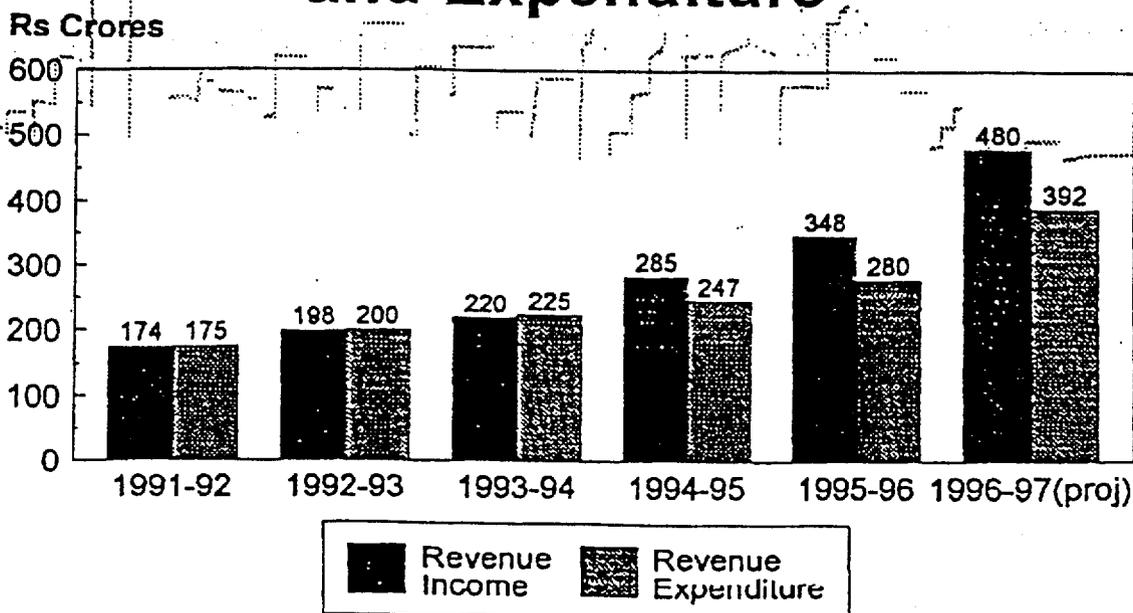
- Ahmedabad Municipal Corporation (AMC) is one of the six Municipal Corporations in the State of Gujarat. The services it offers includes Water supply, sewerage, primary education, public safety and public works. In addition, it also runs Hospitals and Medical college
- AMC is governed by the provisions of the Bombay Provisional Municipal Corporations Act which allows for collection of Octroi and Property tax. Any addition to this needs Govt approval
- The Act also specifies the borrowing powers of the corporation and the manner in which loans would be deployed and serviced by the corporation
- Concomitant with the upsurge in the Industrial activity in Gujarat, Ahmedabad has witnessed rapid growth of population and economic activities

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## BACKGROUND

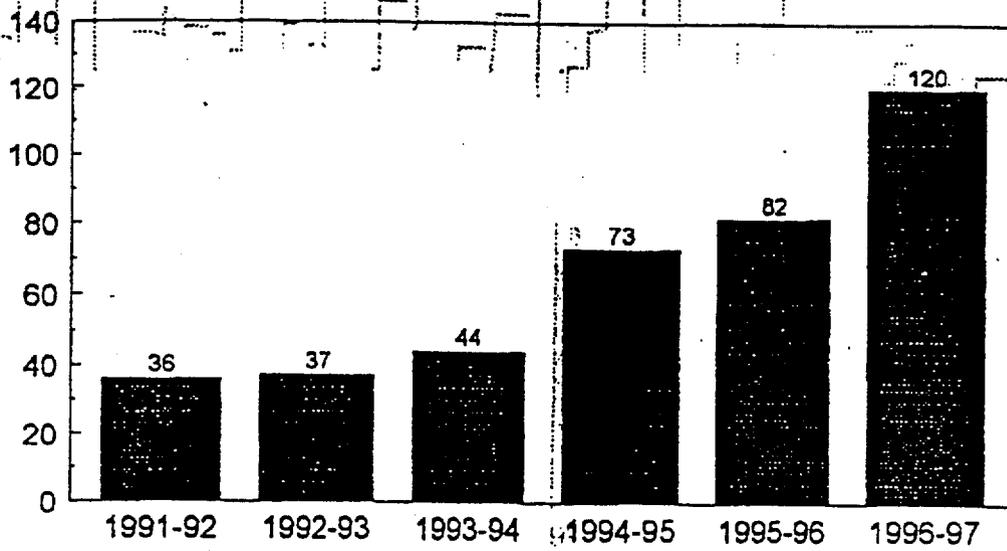
- Ahmedabad Municipal Corporation(AMC) has a jurisdiction covering an area of 191 sq kms. The population residing in the corporation limits is 31 lacs
- Like most other local bodies ,AMC also was in dire financial straits till about three years ago. It had a deficit of Rs 35 crores. In the last financial year, AMC registered a surplus of Rs 68 crores
- Revenue enhancement measures through plugging of leakages and bulk enforcement for recoveries were the major focus of the local body during this period
- The revenues of the corporation increased from Rs 220 crores to Rs 350 crores between 1993 and 1996. This was on account of a large number of factors. Prime among them being the sense of accomplishment inculcated by the employees

## AMC - Revenue Income and Expenditure



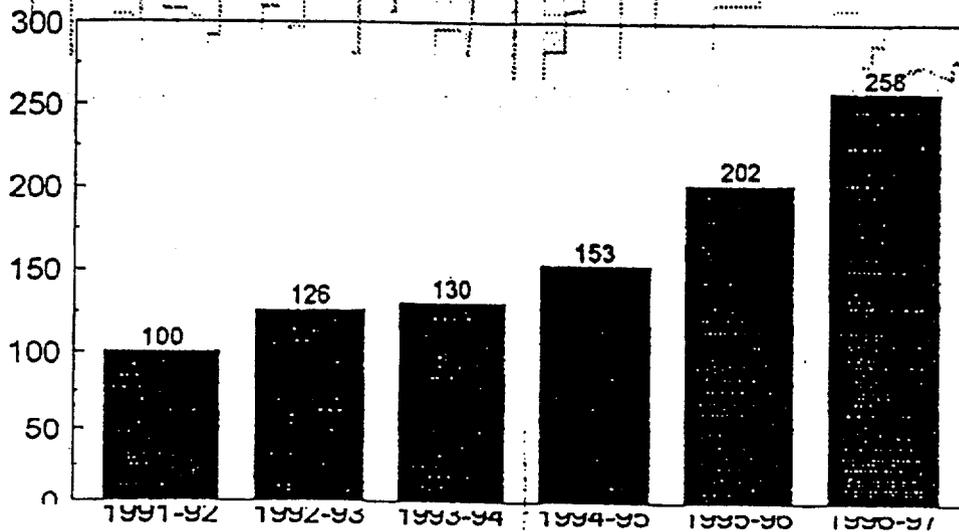
# AMC-Income from Tax

Rs crores

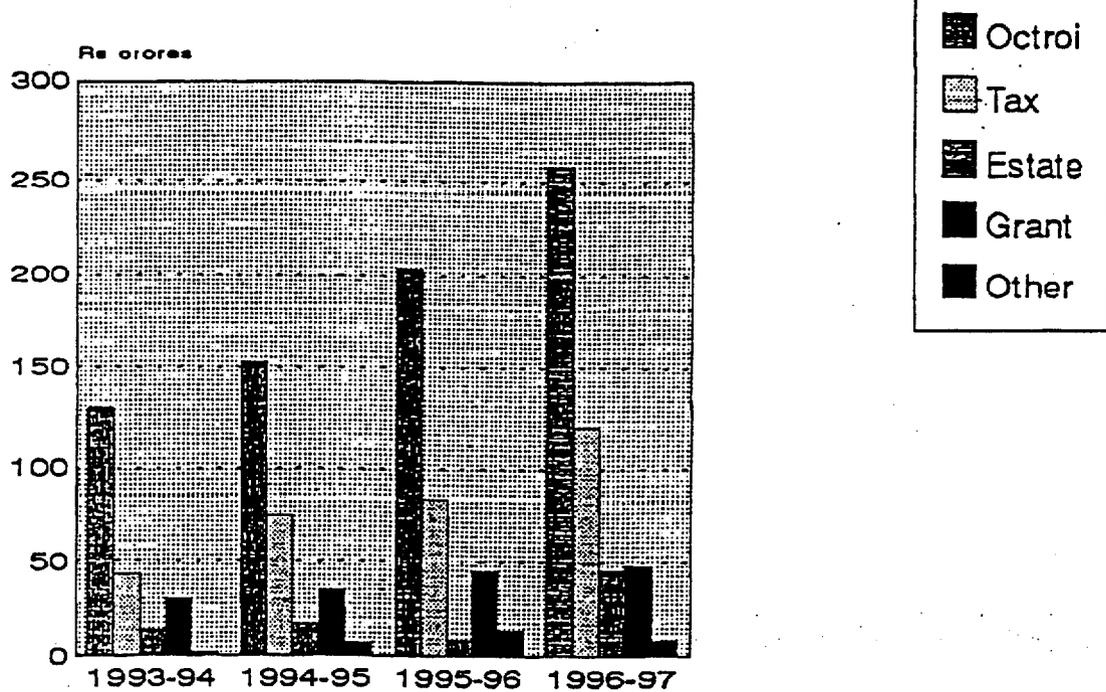


# AMC-Income from Octroi

Rs crores



# AMC-Sources of Revenue



## REVENUE BUOYANCY

Rs Crores

ITEM	1992-93	1995-96
Octroi	123	203
Other Taxes	37	82
Grants	27	45
Others	12	21
Total	199	351

## **FACING THE CHALLENGE**

- Traditional sources of Financing Urban Infrastructure Projects, is becoming increasingly difficult to access given the competing demands on it
- Internationally especially in the United States the domestic capital market has been the major sources of financing projects by local Govt's
- In fact in the US the Municipal bond market is much larger than the corporate debt market. This was facilitated by constitutional amendments in the 1970s which shifted the burden of financing from state to the local levels
- In India too, the 74th constitutional amendment has created the environment similar to the ones made in the US

## **AMC INITIATIVES**

- AMC prepared a infrastructure improvement plan, to rapidly upgrade the level and coverage of services in the city
- Realising the need for additional resources, other than what was available through normal sources, AMC embarked on examining the possibility of accessing the capital market
- As a first step, AMC appointed a leading credit rating agency to assess the inherent strength of the institution and its financial position
- AMC obtained an "A+" category credit rating signifying adequate safety for timely payment of interest and principal for raising resources from the capital market

## INFRASTRUCTURE PROGRAMME

PROJECT	COST (Rs.Crores)
Water Supply Augmentation	387
Sewerage Project	46
Bridges, Flyovers, Under passes	67
Widening and Strengthening Roads	85
Pay and use Toilets	15
Slum Networking	100
National River Conservation Plan	30
Solid Waste Management	12
TOTAL	742

Implementation Period : 2 - 4 yrs.

## ATTITUDE TO AMC BOND ISSUE

Surveyed Attributes	Percent to total Respondents
Willingness to invest	72
AMC has done good work	79
Participate in city welfare	83
AMC is a profit making Organisation	3
Credit Rating is good	38

## AMC BOND ISSUE

■ The objective of the current debt raising exercise is twofold:

— To create a sound basis for sustained fund raising by the corporation

— to structure suitable financial instruments for mobilisation of upto Rs 100 crores

■ In the process of raising commercial resources, it is also the intention of AMC to clearly map out the raising of resources with its deployment and subsequent repayment obligations

■ AMC recognises that the interest rates being higher than what it has been used to so far AMC will have to self inflict a large dose of commercial discipline. This is being put in place

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## AMC BOND ISSUE

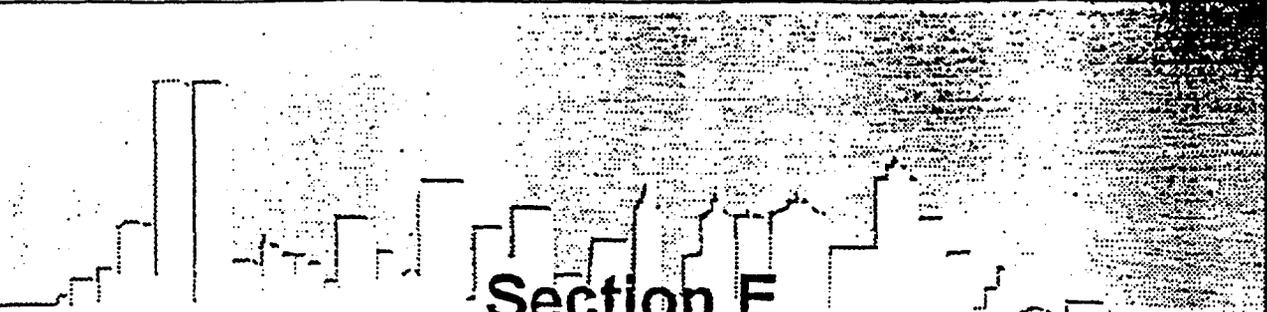
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■ The proposal of issuing a bond for the AMC on the basis of a credit rating is a unique exercise in India and maybe in the whole of Asia. This will be a forerunner for innovative financing mechanisms for Municipal entities

■ As a corollary, very few commercial institutions in India have any understanding of Municipalities. The credit rating would be a step towards creating a market for such instruments

■ The placement process would therefore have to be an interactive one involving Pedigreed institutions with relevant experience, Government, Multilateral and Bilateral agencies

■ AMC have sought the services of IL&FS who alongwith HUDCO would create the structure for resource raising. Assistance of the Housing Guarantee facility of USAID is also being sought



## Section E

# The Way Forward

## THE WAY FORWARD

- In the ultimate analysis, it is evident that municipal bodies would have to position themselves to raise resources from the capital market. The overall trend in the economy only serves to underscore this trend
- The fact that not all projects within the municipal area are commercially viable on a standalone basis requires Municipalities to ensure that their general revenue streams are efficiently captured
- Moreover municipalities would need to move to a higher level of transparency and accountability especially in the provision of civic services
- In other words Municipal operations have to become and must be seen to become more professionally oriented

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## THE WAY FORWARD

- To raise resources from the capital markets in the first instance, market confidence needs to be substantially enhanced of such entities. This could be achieved by obtaining a credit rating and providing suitable credit enhancements
- As an alternative, it will be possible to raise resources for municipal infrastructure through Special Purpose Entities (SPE) which are joint ventures between the government, reputed financial institutions and key local groups. The SPE would be in a position to raise resources through the issue of revenue bonds
- However, a number of other measures need to be taken to sustain the vibrancy of these bonds. These will deal primarily with improving the financial regime of municipalities and creating market friendly conditions

## CONCLUSION - I

- While, municipal bonds are not listed and traded by institutions, a vibrant and strong secondary market for municipals needs to be supported.
- As urban infrastructure is going to be financed via debt, Municipalities need to improve their financial position and their general image of having a poor credit reputation
- Over time a dealer network needs to be developed which can help attract country-wide investments for lucrative projects, whereas the smaller projects can be supported by local dealers

## **CONCLUSION - II**

- **As a corollary, the prime sources of financing need to be brought together. Once, the institutional funds dry up, individual investors represented by mutual funds will be the largest source of financing**
- **Encouraging such individual investors to participate in debt markets in general is necessary to have such investments trickle down to the municipal level**
- **To attract mass investments, tax incentives will form an integral part of the financing strategy**