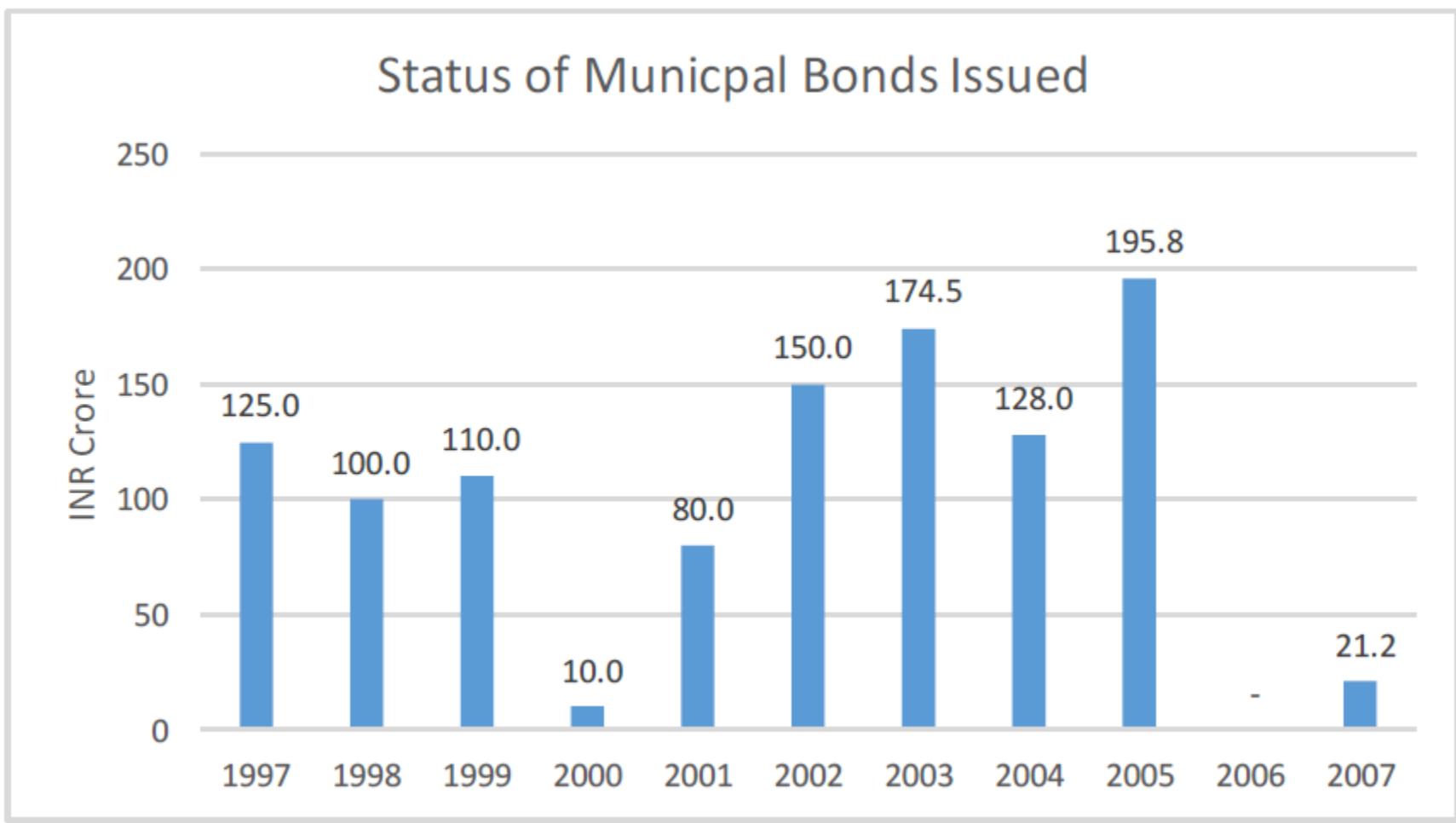


Municipal Bonds Market in India- Perspectives from investor viewpoint

August 2018

History of Muni Bond issuances in India- Low issuance base---



Source: Brookings Report, Building Smart Cities in India (Allahabad, Ajmer, and Visakhapatnam)

---even as Funding requirements escalate

- † Huge scale of infrastructure development and upgradation required to meet the growth aims at various levels (State/ Centre)
- † Requirement of funding will increase given the pace of reforms being witnessed in the country and the objective of creating new smart cities
- † Large scale urban migration exerts pressure to create new urban infrastructure while also maintaining/upgrading the existing facilities
- † Current sources of revenues in the form of Tax & Non-tax and Grants from state/ central government proves to be insufficient

ULB market access hindered by challenges:

- **Financial challenges**
 - **Limited revenue base**
 - **Dependence on grants**
- **Institutional Challenges**
 - **Financial management systems/MIS**
 - **Project design and execution**
- **Governance related issues**
 - **Management stability**
 - **Multi level co ordination requirement**

Issues Faced by Investors

Availability of updated financial information

Limited credit enhancement for municipal bonds

Pricing. Lack of frequent and sizeable issuances that can build liquidity

Consistency of management-frequent changes

Disclosure and access

Conservative approach of insurance, pension and mutual funds to invest

Few municipals with high credit quality

less incentives for municipal bodies to tap debt market-low issuance-lower market appetite – low liquidity

Incentivizing investors:

- † Bonds issued by Municipals can be made tax-free, at least for retail investors
- † Banks could be mandated to lend to ULBs as a part of the 'priority sector'
- † Alternatively, Bank holdings of Municipal Bonds can also be given space in the SLR requirements provided they are of certain specified category
- † Long term investors such as Insurance and PF's can be asked to invest some minimum percentage of their investment book in muni bonds

Incentivizing Municipal Corporations:

- † Motivate municipal corporations to get a credit rating from a recognized CRAs and create an incentive structure based upon the credit rating by way of Additional Grants from the Centre/ State governments
- † The borrowings of the Municipal Corporations from Financial Institutions such as HUDCO etc. can be linked to the bond market

Safeguard Principles:

- † PFI's may look at providing guarantee/credit enhancement to the bonds issued by Municipal Corporations
- † Shortfall undertaking from state governments
- † Debenture Redemption Reserve

Alternative Fund Raising Options

ULB Direct borrowings:

- † Backed by escrow / Debenture Redemption Reserves/ DSRA accounts and strong covenants

Borrowing through Corporate Municipal Entity:

- † May be able to ringfence from ULB related governance issues
- † Independent Boards
- † Investors still need to have detailed credit comfort on underlying ULB

Borrowing through a state or central level specified entity:

- † Registered as NBFC under RBI
- † Specialised agency to on lend funds to ULB's
- † Agency can determine financial eligibility for ULB to access funds from it at a spread
- † Develop expertise in ULB funding, monitoring and develop best practices
- † Exemption / relaxation from SEBI for NBFC MF limits
- † State/central backing may reduce spreads

Borrowing through Pooled Bonds

- † Investors still need to take ULB credit view

Municipal Bond Market in U.S.- Take aways from a success story

MUNICIPAL MARKET BY THE NUMBERS

\$3.9 trillion
capital market

Approximately
1 million
outstanding
municipal securities

Around
39,000 daily trades
in municipal securities

Approximately
\$11 billion
in par traded
every day



Nearly 2/3 of municipal securities held by individual investors either directly or through mutual funds



Default rates for investment-grade municipal bonds were 0.18% compared to 1.74% for investment-grade corporate bonds¹

FINANCING STATE AND LOCAL INFRASTRUCTURE



2/3 of infrastructure projects in the United States are financed by municipal bonds



More than 50,000 different state and local governments and other issuing authorities

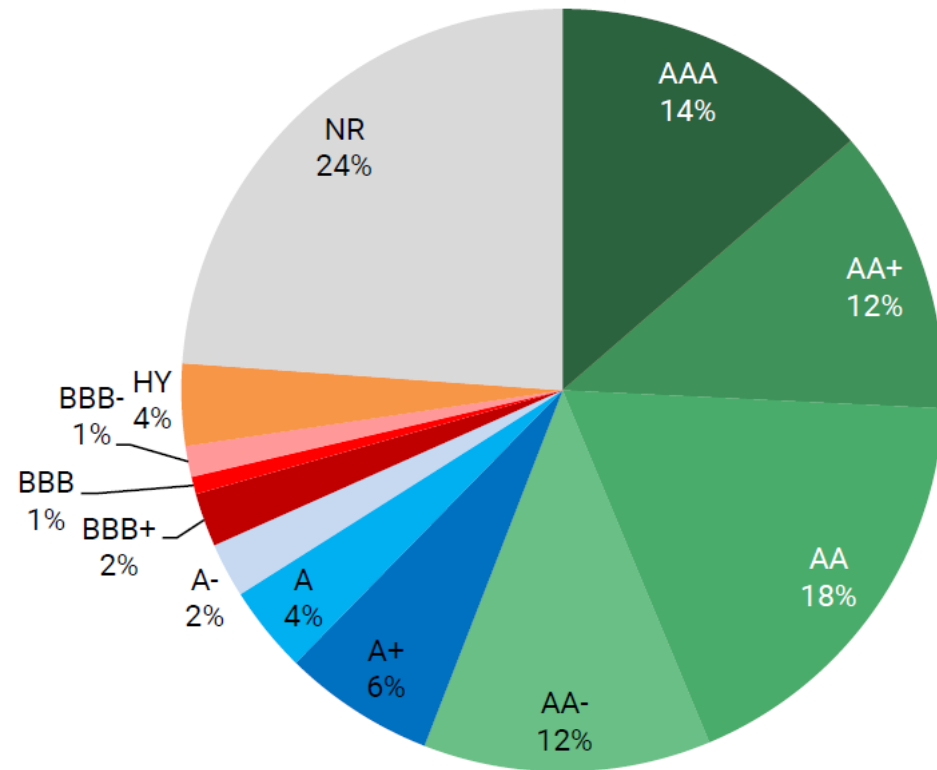


An average of nearly \$442 billion in new municipal securities were issued each year in the last decade

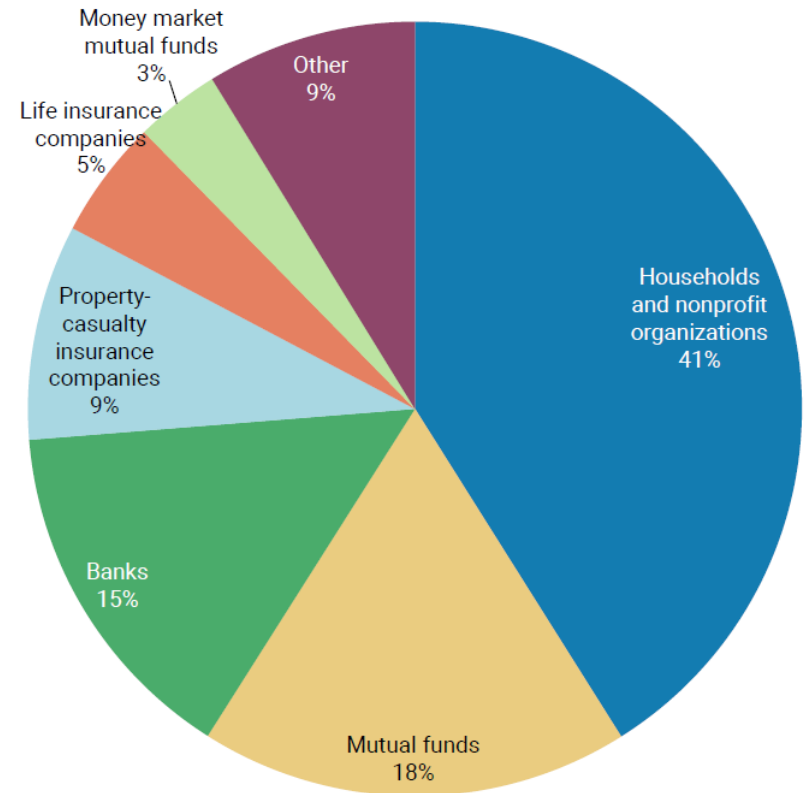
Source: Municipal Securities Rulemaking Board

Ownership Pattern & Credit Ratings

Total Muni Market (\$3.75T) by S&P Rating



Muni Market Ownership



Source: Morgan Stanley Research