Credit Ratings & Issuance of Municipal Bonds

26th November, 2018

Sujatha Srikumar
Managing Director
Powertec Infrastructure
Fiscal Interdependence
Overview Of Municipal Finances

Factors Responsible for the Tiny Size of the Urban Sector

- A Property Tax Dominated Municipal System
- Low or Near Zero Productivity of Many Municipal Taxes
- State Policies Towards Property Taxation
- Inefficiencies in the Internal Management of Resources
- Large Scale Subsidies in Service Provision
- Irregular State Transfers
Commercial Sources of Borrowing

**Commercial Sources of Borrowing**

- **Government Institutions**
  - Housing & Urban Development Corporation (HUDCO)
  - The Life Insurance Company of India (LIC)

- **Scheduled Commercial Banks**
  - Private Sector Banks
  - Public Sector Banks

- **Sector Specific Municipal Development Funds/Facilities**
  - Pan India Pooled Municipal Debt Obligation Facility (PMDO)
  - State Specific Tamil Nadu Urban Development Fund (TNUDF)
  - State Level Financial Intermediaries

- **Capital Markets**
  - Municipal Bond
Municipal Bond Financing In India

• Urban Infrastructure financed through mix of:
  ➢ Budgetary allocations from Municipality’s own revenues
  ➢ Grants from state government
  ➢ Borrowing from insurance companies and specialized national level institutions like HUDCO and state level financial institutions
  ➢ Limited borrowings from banks/ Pvt. FIs and bond markets.

• Access to capital markets commenced in 1998 with Ahmedabad Municipal Corporation (AMC)

• Several ULBs explored credit ratings for accessing the debt capital market. Only a few manage to secure credit ratings acceptable to investors and even fewer issued municipal bonds
Municipal Bond Financing In India

• Between 1998-2010, 25 municipal bond issue were issued in India. These include taxable and tax-free bonds and pooled financing issues raising around US $ 300 Mn

• All Municipal Bonds issued by ULBs have been more in nature of general obligation bonds, financed by escrowing property tax or other internal ULB revenues

• Most Municipal Bonds in India have been raised to finance water supply and sewerage projects. This is because the Municipal Acts allow levy of user charges, it is technically easy to measure consumption, bill and collect user charges and penalise for non-payment. Further, the amount and frequency of expected revenues can be predicted with some certainty.
**Sample of Past Bond Issues (Till 2010)**

<table>
<thead>
<tr>
<th>Municipality / Local Body</th>
<th>Year</th>
<th>Rating</th>
<th>Amount (Rs Crore)</th>
<th>Coupon (%)</th>
<th>10 year G-Sec</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahmedabad</td>
<td>Jan, 1998</td>
<td>AA (SO)</td>
<td>100.00</td>
<td>14.00</td>
<td>13.3</td>
</tr>
<tr>
<td>Bangalore</td>
<td>Nov, 1998</td>
<td>A (SO)</td>
<td>125.00</td>
<td>13.00</td>
<td>12.2</td>
</tr>
<tr>
<td>Ludhiana</td>
<td>Sep, 1999</td>
<td>LAA (SO)</td>
<td>17.80</td>
<td>14.00</td>
<td>11.6</td>
</tr>
<tr>
<td>Nasik</td>
<td>May, 1999</td>
<td>AA (SO)</td>
<td>100.00</td>
<td>14.75</td>
<td>11.7</td>
</tr>
<tr>
<td>Bangalore Water Supply Board</td>
<td>Aug, 2000</td>
<td>Not Available</td>
<td>10.00</td>
<td>12.90</td>
<td>11.4</td>
</tr>
<tr>
<td>Kanpur</td>
<td>Dec, 2000</td>
<td>LA+(SO)</td>
<td>50.00</td>
<td>13.50</td>
<td>10.9</td>
</tr>
<tr>
<td>Madurai</td>
<td>Mar, 2001</td>
<td>LA+(SO)</td>
<td>30.00</td>
<td>12.25</td>
<td>10.3</td>
</tr>
<tr>
<td>Ludhiana</td>
<td>Jun, 2001</td>
<td>LAA-(SO)</td>
<td>2.00</td>
<td>13.50</td>
<td>9.3</td>
</tr>
<tr>
<td>Tamil Nadu Urban Dev Fund</td>
<td>Aug, 2001</td>
<td>LAA+(SO)</td>
<td>106.10</td>
<td>11.85</td>
<td>8.9</td>
</tr>
<tr>
<td>Nagpur</td>
<td>Nov, 2001</td>
<td>LAA-(SO)</td>
<td>31.30</td>
<td>13.00</td>
<td>7.8</td>
</tr>
<tr>
<td>Ahmedabad</td>
<td>Mar, 2002</td>
<td>AA+(SO)</td>
<td>100.00</td>
<td>9.00</td>
<td>7.4</td>
</tr>
<tr>
<td>Hyderabad*</td>
<td>Mar, 2002</td>
<td>AA+(SO)</td>
<td>82.50</td>
<td>8.50</td>
<td>7.4</td>
</tr>
<tr>
<td>Chennai*</td>
<td>Mar, 2005</td>
<td>AA (SO)</td>
<td>30.15</td>
<td>5.38</td>
<td>6.6</td>
</tr>
<tr>
<td>Nagpur*</td>
<td>Mar, 2007</td>
<td>AA (SO)</td>
<td>21.70</td>
<td>7.75</td>
<td>8.0</td>
</tr>
<tr>
<td>Vishakhapatnam</td>
<td>Sep, 2010</td>
<td>AA-(SO)</td>
<td>30.00</td>
<td>9.50</td>
<td>7.9</td>
</tr>
</tbody>
</table>

* Tax Free Bonds

Source: SBI Capital Markets Ltd, 2013
## Details of Cities, Town and Credit Ratings

<table>
<thead>
<tr>
<th>Respective Credit Ratings</th>
<th>Cities/Towns</th>
</tr>
</thead>
<tbody>
<tr>
<td>AA +</td>
<td>New Delhi Municipal Council (NDMC), Navi Mumbai and Pune</td>
</tr>
<tr>
<td>AA</td>
<td>Ahmedabad, Visakhapatnam and Greater Hyderabad Municipal Corporation</td>
</tr>
<tr>
<td>AA -</td>
<td>Surat, Nashik, Thane and Pimpri - Chindwad</td>
</tr>
<tr>
<td>A+</td>
<td>Indore, Kishanganj (Rajasthan), Kolkatta, Vadodara (Gujarat) and Warangal (Telangana)</td>
</tr>
<tr>
<td>A</td>
<td>Jhunjhuna (Rajasthan)</td>
</tr>
<tr>
<td>A -</td>
<td>Alwar, Biwadi, Beawar, Jaipur (Raj), Bhopal, Jabalpur (M.P.), Lucknow, Ghaziabad, Mira Bhayandar (Maha) and New Town Rajarhat (W.Bengal)</td>
</tr>
<tr>
<td>BBB +</td>
<td>Ajmer, Kota and Udaipur (Rajasthan), Ludhiana (Punjab) and Jamnagar (Guj)</td>
</tr>
<tr>
<td>BBB</td>
<td>Kakinada, Anantapur, Kurnool and Tirupati (Andhra Pradesh), Davanagere and Hubballi-Dharwar (Karnataka), Kochi and Trivendrum (Kerela), Panaji (Goa), Kolhapur and Nagpur (Maharashtra), Jodhpur, Nagaur and Tonk (Rajasthan)</td>
</tr>
</tbody>
</table>
SEBI Regulations

On July 2015, SEBI notified a new regulatory framework for issuing municipal bonds in India.

Main eligibility requirements include:

- Investment grade ratings for ULBs
- No default in last 365 days and positive net worth
- Compliance with the state’s municipal account standards or the National Municipal Accounts Manual to be eligible for the issue
Municipal Bonds – Major Constraints

Poor Credit Quality

- Multiplicity of overlapping jurisdictions / state government control – low accountability, lack of municipal control over development and infrastructure planning
- Political interference in day-to-day management
- Low user charges and poor collection efficiency
- Tax base limited and not buoyant enough.
- Lack of managerial capability to plan and implement projects as well as manage finances and treasury operations
- Municipal accounting practices are archaic and not in line with that of corporate debt market
- Legal framework governing municipal borrowings does not allow creation of charge on immovable assets in most states
- Enforcement of security, both movable and immovable, through civil courts and law not possible as ULBs are considered the 3rd tier of Govt. under law
Municipal Bonds – Major Constraints

- Most municipalities are unable to achieve high investment grade credit rating (A- & above) in absence of robust economic, legal, financial and project viability.

- For highly rated ULBs, reliance is placed on conservative assessment of cash flows and Escrow of certain cash flow streams to ensure debt servicing.

- Thus, the experience of structuring credit enhancements for the early issuers like Ahmedabad Municipal Corporation (AMC) assumes importance for the development of Municipal Bond Markets even today.

- Need to develop alternate credit enhancement structures for supporting Municipal Bond Issuances from entities with credit ratings in the lower investment grades (BBB- to BBB+).
Recent Bond issues by ULBs in India

- Pune MC: Issue Date: 20-06-17, Amount: 200.00
- Greater Hyd. MC: Issue Date: 16-02-18, Amount: 200.00
- Indore: Issue Date: 29-06-18, Amount: 139.90
- Greater Hyd. MC: Issue Date: 14-08-18, Amount: 195.00
- APCRDA: Issue Date: 16-08-18, Amount: 2000.00
- Bhopal MC: Issue Date: 26-09-18, Amount: 175.00
Prospects and Way Forward
Potential for Municipal Bonds in India

- Recent emphasis by GoI on financial incentives for issuance of municipal bonds having a major impact.

- Development of market would depend on –
  - Effective management of Municipal finances and adopting standard accounting practices
  - Improved institutional arrangement between of state government and Municipal corporations

- Addressing Municipal Bankruptcy
  - Create separate regulatory framework for dealing with Municipal Default
  - Create Municipal SPVs such as the Smart City SPV, which would enable lenders to enforce security in the event of default, through the courts and other civil law mechanism

Most of the investor concerns are related to framework of Municipal Corporations and need to be addressed to create vibrant Municipal Bond Market in India.
Prospects for City Credit Rating and Municipal Bond Issues in India

- Many cities in India have already obtained a corporate credit rating (not linked to a bond issue) from one of the rating agencies under AMRUT.

- At least 20 cities in India have high investment grade credit rating which can be upgraded to levels acceptable to the capital markets with suitable credit enhancements.

- Many cities like Pune, Hyderabad, Indore, APCRDA and Bhopal have already issued bonds and many more are trying to issue bonds to avail the recently announced incentive from Government of India.

- Subsequent efforts should be targeted at cities at the BBB level to assist them in improving their creditworthiness and putting in place suitable credit enhancements in order to facilitate their access the commercial debt market.
Way Forward

- Strengthening capacities of ULBs
- Adequate financial accountability
- Capacity building of Municipal Commissioners as to the importance of financial management, time bound preparation of financial statements for increase in efficiency
- Collapsing the silos and integration of water supply, sewage and sanitation, solid waste, traffic under the city corporation jurisdiction.
- Use credit rating as a dynamic managerial tool for assessing current level of borrowing capacity, along with other performance parameters including economic base, service levels, recovery of user charges, sustainability of proposed investments
- Credit rating process should not be a one time assessment but should provide feedback to city management on whether the reform implementation is leading to desired impact on credit quality.
- Infrastructure debt funds (IDFs) and mutual funds could be encouraged to invest in municipal bonds
- Improving transparency and disclosure norms to increase investor confidence
THANK YOU