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GOVERNMENT OF INDIA
MINISTRY OF URBAN DEVELOPMENT
UD DIVISION
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New Delhi, 25th October, 2006

RESOLUTION

Majority of urban infrastructure projects currently being undertaken by the urban local bodies (ULBs) depend mostly on funds from Central Government, State Governments and some financial institutions like HUDCO. Considering, however, the number of cities and towns in the country, it may not be possible to adequately provide for investment needs of the cities. Moreover, ultimate objective of any initiative is to build sustainable cities that can meet their investment needs on their own without the need for continuous support from the Central and the State Governments.

2. Direct access to capital markets is one of the options exercised by some of the ULBs in the country through issuance of Tax free Municipal Bonds. This facility has been mainly availed by large municipal corporations. However, it is difficult for small and medium size cities to raise resources from market for infrastructure projects on stand alone basis due to lack of capabilities and credit worthiness. Besides, most of local bodies lack requisite capacities/expertise to prepare bankable urban infrastructure projects.

3. Keeping this in view, Central Government hereby constitutes a Pooled Finance Development Fund (PFDF) to provide credit enhancement to ULBs to access market borrowings based on their credit worthiness through State-Level-Pooled Finance Mechanism. The broad objectives of PFDF are:-

- Facilitate development of bankable urban infrastructure projects through appropriate capacity building measures and financial structuring of projects. Bankable projects within the context of PFDF are defined as those projects structured with appropriate credit enhancement measures in such a way that they demonstrate the capacity for servicing the market debt to the satisfaction of the rating agencies and potential investors.

- ❖ Facilitate Urban Local Bodies to access capital and financial markets for investment in critical municipal infrastructure by providing credit enhancement grants to State Pooled Finance Entities (SPFEs) for accessing capital markets through Pooled Financing Bonds on behalf of **one or more** identified ULBs for investment in identified urban infrastructure projects.
- ❖ Reduce the cost of borrowing to local bodies with appropriate credit enhancement measures and through restructuring of existing costly debts.
- ❖ Facilitate development of Municipal Bond Market.

4. For implementing Pooled Finance Mechanism, a State Pooled Finance Entity (SPFE) shall be required to be set up in each State. Each SPFE is to be primarily State designed and could either be a Trust or a Special Purpose Entity, provided that the entity is only a pass through vehicle. The basic advantage of setting up of SPFE would be that it would enable the ULBs to enter the bond market on a regular basis and take advantage of scaled up operations. Further, efficient SPFEs can generate fair degree of goodwill in the bond market and may be able to achieve much higher levels of efficiency in operations than individual ULBs. Most importantly, it shall be able to hedge risks against much larger spectrum of activities than individual ULBs.

5. The Central Government would support SPFEs through the PFDF. Of the funds made available with the Central Government for PFDF, 5% would be utilized for project development assistance. Balance 95% would be utilized for contribution to the Credit Rating Enhancement Fund (CREF) to improve the credit rating of the Municipal Bonds to investment grade.

6. Cost of project development for each municipality/ULB would be worked out. 75% of these costs would be reimbursed by the Central Government and 25% by the State Government/Union Territory Government/ULBs. Cost of transaction, including appointment of advisors, rating agencies and creation and operationalisation of SPFEs may also form part of this package. Contribution by the Central Government to the CREF will be 10% of the proposed amount of Bond issue or 50% of the CREF requirement as determined by a credit rating agency for investment grade rating,

whichever is less. Respective State Government/Union Territory Government will contribute the balance amount.

7. The contribution from Central Government to the CREF will be one time and upfront. In the event of default, there will be no further recourse to Central Government and the denouncement would be on the agency/institution guaranteeing the debt. At the end of tenure of bonds issued, the Central and State share in CREF would remain with the State entity for further leveraging of funds for infrastructure investment to municipalities/ULBs. CREF will be managed by the SPFEs and its accounts shall be kept separate from other functions of SPFE. Funds in CREF shall be invested in notes or bonds of Government of India or in accounts/notes/bonds of financial institutions rated by a recognized credit rating agency in the highest category (AAA). In this manner, corpus of CREF will grow with time and SPEF will be able to leverage further investment in urban infrastructure.

8. The bonds issued under the Pooled Finance framework will be eligible for tax-free status under the Ministry's Guidelines on Tax Free Municipal Bonds, incorporating SPFEs being Trusts as Eligible Issuers for which necessary amendment to Income Tax Act is to be made by Ministry of Finance. However, interest and dividend income earned from investments made from the CREF corpus will not be exempted from the income tax.

9 There will be a State/Union Territory level "Sanctioning and Monitoring Committee" to approve proposals for accessing PFDF. Composition and function of the committee are as under:-

1. State Secretary of Urban Development (Chairperson)
2. Joint Secretary (Urban Development), Ministry of Urban Development, Government of India or his representative
3. Representative of the Planning Commission.
4. Representative of the Ministry of Finance, Deptt. of Economic Affairs
5. State Secretary of Finance or his representative
6. Director of Municipal Administration and/or Director of Town Panchayats
7. Managing Director of SPFE (Member Secretary of the Committee)

❖ Sanctioning and Monitoring Committee will examine the proposals, approve and communicate to the Ministry the items to be supported, quantum of assistance, phasing of support and any other recommendation which they find necessary for such purpose. It will also monitor the implementation of the scheme of concerned Municipality/ULB on a regular basis through reports and returns or any other means considered appropriate.

- ❖ Following approval of the application by the Sanctioning and Monitoring Committee, SPFE, through the State Government/Union Territory Government, would make an application to the Ministry of Urban Development for release of grant for any/group of municipalities/ULBs for which funds are to be raised from the market.

10. PFDF will ensure availability of resources to urban local bodies in order to improve urban infrastructure, service delivery and ultimately to achieve the goal of self-sustainability. Ongoing programmes of both the Central and State Governments may not be adequate enough to fill the resource gap given the extent of requirement. PFDF is one more effort to address this gap through which cities will be able to access market funds for their infrastructure projects.

11. The PFDF will be operationalised in accordance with the Guidelines for Pooled Finance Development Scheme appended below:-

<u>APPENDIX</u>

<u>GUIDELINES FOR POOLED FINANCE DEVELOPMENT SCHEME (PFDS)</u>

1. Background

1.1 In India, national growth rates and reduction in the national poverty levels are increasingly being determined by the efficiency of cities. Urban areas contribute much of this growth because there is limited potential of growth in agriculture and other rural sectors. It is expected that over the next two decades 40% population will be living in urban areas. The majority of urban infrastructure projects currently being undertaken by the urban local bodies (ULBs) depend mostly on funds from state governments and other agencies. Besides, most of local bodies lack requisite capacities/expertise to prepare bankable urban infrastructure projects. Therefore, local bodies are not able to raise resources from the market/financial institutions for investment in infrastructure. The capability of the cities needs to be enhanced to enable them to finance in a sustainable way the infrastructure requirement that exists at the municipal level. Direct access to capital markets is now an accepted option for the country's larger financially viable ULBs. In this context government has allowed issue of Tax Free Municipal Bonds. This facility has also been availed by large Municipal Corporations. However, it is difficult for small and medium sized cities to raise resources from market for infrastructure projects due to lack of capabilities and credit worthiness. There is, thus, need for concerted efforts to ensure availability of resources to urban local bodies in order to improve urban infrastructure, service delivery and ultimately to achieve the goal of self-sustainability. Ongoing programes of both the Central and State Governments may not be adequate enough to fill the resources gap given the extent of requirement. PFDS has been formulated to bridge this gap through which cities will be able to access market funds for their infrastructure projects.

1.2 The objectives of the PFDF include improving infrastructure facilities and help in the creation of durable public assets in cities, decentralizing economic growth and employment opportunities and promoting dispersed urbanization, integrating spatial and socio-economic planning as envisaged in the Constitution (74th Amendment) Act, 1992 and promoting resource generating schemes for ULBs to improve their overall financial position.

1.3 In order, therefore to enable the urban local bodies to look for alternative source of funding for their bankable projects/schemes, Pooled Finance Development Fund (PFDF) has been set up. The scheme is meant to provide credit enhancement grants to access market borrowings through Pooled Financing Bonds on behalf of identified ULBs for investment in urban infrastructure projects.

2. Objective of State-Level Pooled Finance Mechanism

2.1 The main objective of State Level Pooled Finance Mechanism are as follows:

i) Facilitate Urban Local Bodies to access capital and financial market for investment in essential municipal infrastructure
ii) Facilitate development of bankable urban infrastructure projects[1]
iii) Reduce the cost of borrowing to local bodies with appropriate credit enhancement measures and through restructuring of existing costly debts
iv) Facilitate development of Municipal Bond market

3. State Pooled Finance Entity (SPFE) objectives and responsibilities

3.1 Each State/Union Territory is expected to designate either an existing state entity or create a new entity for execution of the Pooled Finance Development Scheme. Each SPFE is to be primarily state designed and operated, with minimum GOI requirements, which could either be a Trust or a Special Purpose Entity, provided that the entity is only a pass through vehicle**.** It is intended that SPFEs will issue debt securities on behalf of ULBs without state guarantees. State/Union Territories may provide credit enhancements to SPFEs but should be precluded from supporting SPFEs with direct state guarantees.

[1] Bankable projects within the context of PFDF are defined as "those projects structured with appropriate credit enhancements in such a way that they demonstrate the capacity for servicing the market debt to the satisfaction of the rating agencies and potential investors".

3.2 The SPFEs would:

i) Work with and support Municipality/ULBs in urban infrastructure project development
ii) Select projects for financing from the ones suggested by municipalities/ULBs based on viability and the priority
iii) Get the projects appraised by recognised credit rating agency which shall determine Credit Rating Enhancement Fund (CREF) requirement for investment grade rating for the project.
iv) Mobilise resources from local capital and financial markets by issue of bonds to fund viable/bankable local infrastructure projects
v) Provide sub-loans to ULBs or purchase bonds of ULBs
vi) Escrowing of resources for repayment of loan
vii) Sign agreement with the Central Government
viii) Sign appropriate grant and loan agreements with the Municipality/ULB
ix) Make application through the State Government/Union Territory Government for reimbursement of Central grant for project development and contribution to the Credit Rating Enhancement Fund (CREF).
x) Set up and manage Credit Rating Enhancement Fund (CREF).
xi) Prepare projects that meet acceptable technical, environmental and financial requirements

4. Existing State Institutions

4.1 In view of the fact that SPFEs will mobilize market funds, States/Union Territories may either modify the structure and operations of an existing institution or establish new entities. Since private investors will be involved, SPFE must therefore incorporate market-based lending practices and procedures in all aspects of their operations. This will require developing policies and procedures that balance the social goals of states and the needs of investors. It is encouraged that management of each SPFE may include participation of professional Trustees/Directors with a view to increasing the investor confidence.

4.2 SPFEs will also need to obtain credit ratings for the issuance of debt on behalf of ULBs. Judgments made about each of the aforementioned issues will reflect on the credit quality of SPFE bond issuance and should be considered in that light. Strong programme management of a SPFE can substantially upgrade a below average credit quality loan.

4.3 SPFEs are expected to be pass-through entities and cost neutral in development of pooled finance deals.

5. Pooled Finance Development Fund (PFDF)

5.1 Of the funds available with the Central Government for PFDF 5 percent would be utilized for project development assistance. The balance 95 percent would be utilized for contribution to the Credit Rating Enhancement Fund (CREF). This fund would serve as third tier of security in case first two tiers viz. escrowing of resources of ULB and any other internal arrangement between a state and the SPFE including state intercept, for some reason, fail to meet repayment obligations.

5.2 SPFEs should pursue market-based guarantees from bilateral and multi-lateral guarantees facilities and domestic financial institutions to further improve the credit quality of the pooled finance instruments.

5.3 The Grant funds will be provided for development of projects of essential municipal infrastructure. However, environmental infrastructure such as water and sanitation projects will be given preference. ULBs choosing to undertake projects in sectors other than water and sanitation must demonstrate to SPFE that they have adequate water and sanitation services in areas under their jurisdiction.

5.4 The bonds issued under the Pooled Finance framework will be eligible for tax-free status under the Ministry's Guidelines on Tax Free Municipal Bonds. However, interest and dividend income earned from investments made from the CREF corpus will not be exempted from the income tax.

5.5 The participating ULBs shall further undertake to provide debt covenant under which the Debt Service Coverage Ratio (DSCR) of at least 1.25 is maintained through out the tenure of the Pooled Finance Instrument. DSCR is defined as a ratio of net income after meeting all the obligations and liabilities (such as salaries and operation and maintenance expenditures of the participating ULBs) except the long-term debt obligations (principal and interest) to long term debt-servicing obligations. For the purpose of estimating net income, the income (including general revenues such as property tax and octroi) and expenditure of the entire utility/Corporation and grants from state and grants from any other source may be considered instead of only project specific revenues and expenditures.

6. Central Assistance to the State/Union Territory Entity

6.1 The Central Government would provide assistance for the following:

i) For Project Development

ii) Contribution to the Credit Rating Enhancement Fund.

6.2 The cost of project development for each Municipality/ULB would be worked out. 75 percent of these costs would be reimbursed by the Central Government and 25 percent by the State Government/Union Territory Government/ULBs. The cost of transaction including appointment of advisors, rating agencies and creation and operationalisation of SPFEs may also form part of this package. However, maximum amount that will be disbursed to individual cities are shown in the table below.

Table 1: Ceiling amounts for the funding project development grant

Category	Ceiling amount
Delhi, Mumbai, Chennai, Calcutta, Bangalore, Ahmedabad and Hyderabad	Rs 1 crore
Cities with population above ten lakhs	Rs 50 lakhs
Cities with population below ten lakhs	Rs 25 lakhs

6.3 Contribution by the Central Government to the Credit Rating Enhancement Fund (CREF) will be 10 percent of the proposed amount of Bond issue or 50 percent of the CREF requirement as determined by a credit rating agency for investment grade rating, whichever is less. Respective State Government/Union Territory Government will contribute the balance amount. These ceilings have been worked on the basis of current market conditions. The position is further clarified with illustrations, as below:-

Illustrations

	Item	Case-I	Case-II
1	Number of participating cities	14	8
2	Amount of Bond Issue in Rs. crores	32	100
3	Credit rating	AA(SO)	AA(SO)
4	Tenure of the instrument in years	15	15
5	Interest rate in percentage	9.2	7.0 (expected with tax free status)
6	Credit Rating Enhancement Fund Requirement in Rs. crores	6.1	25.5
7	10% of proposed Bond issue	Rs. 3.2 crores	Rs. 10 crores
8	50% of the CREF	Rs. 3.05 crores	Rs. 12.75 crores
9	Central Grant from PFDF (being lesser of (7) or (8))	Rs. 3.05 crores	Rs. 10 crores

6.4 The contribution from Central Government to the CREF will be one-time and upfront. In the event of default, there will be no further recourse to Central Government and the devolvement would be on the agency/institution guaranteeing the debt. At the end of the tenure of bonds issued, the central and state share in CREF would remain with the State entity for further leveraging funds for infrastructure investments of municipalities/ULBs. .

6.5 CREF will be managed by the SPFEs but CREF corpus and its account will be kept separate from the other functions of SPFE. Funds in CREF shall be invested in notes or bonds of the Government of India or in accounts/notes/bonds of financial institutions rated by a nationally recognized rating agency in the highest category (AAA).

6.6 Before considering access to PFDF, it must be demonstrated, by appropriate financial analysis, that the proposed Bond Issue is the most cost effective instrument for the proposed investment by the ULB.

6.7 The State entity through the State Government/Union Territory Government would make an application for release of grant for any/group of municipalities/ULBs for which funds are to be raised from the market. The application for the purpose should be received in the Ministry of Urban Development during anytime of the financial year. It would *inter alia* indicate:

a) SPFE needs to assist ULBs in analyzing various financing options by ULB and ensure, through appropriate analysis, that the pooled financing proposal is the most cost effective option.
b) Council resolutions from participating ULBs regarding approval for participation in Pooled Finance Structure.
c) Information on projects to be financed including

    i) Detailed project technical aspects and cost assessment/financial viability analysis;
    ii) Willingness-to-pay or demand assessment, if appropriate;
    iii) Status of project development; and
    iv) Nature of public consultations undertaken and their response.

d) Details of funds to be raised for each municipality/ULB;
e) Repayment schedule and escrow account;
f) Details of interception of State grant to the concerned municipality/ULB if funds in escrow account were not found sufficient to meet repayment obligations;
g) Details of reform package in each case indicating clearly the reforms proposed to be introduced in management and accounting practices, tariff, collection charges, etc.
h) Commitment of State/Union Territory Government to: provide matching contributions and approvals; participate in monitoring, certification and reporting process.

6.8 SPFE will maintain separate accounts and audit reports for each pooled transaction. SPFE will submit regular reports on progress, performance, accounts and audits to Sanctioning and Monitoring Committee and MOUD.

7. Procedure for approval and review of request for PFDF assistance

7.1 **Sanctioning and Monitoring Committee:** There will be a State/Union Territory level "Sanctioning and Monitoring Committee" to approve proposals for accessing PFDF. It would also monitor the transaction. The Committee would include the following:

1. State Secretary of Urban Development (Chairperson)
2. Joint Secretary (Urban Development), Ministry of Urban Development, Government of India or his representative
3. A representative of the Planning Commission.
4. A representative of the Ministry of Finance, Deptt. of Economic Affairs
5. State Secretary of Finance or his representative
6. Director of Municipal Administration and/or Director of Town Panchayats
7. Managing Director of SPFE (Member Secretary of the Committee)

7.2 **Outcome of Assessment:** Sanctioning and Monitoring Committee will examine the proposals, approve and communicate to the Ministry the items to be supported, quantum of assistance, phasing of support and any other recommendation which they find necessary for such purpose.

7.3 **Grant Negotiation and Ratification by municipalities:** Following approval of the application by the Sanctioning and Monitoring Committee, SPFE, on behalf of the municipalities, will execute a Memorandum of Agreement (MoA) with Ministry of Urban Development, Government of India, which will indicate the terms, conditions, milestones, performance, benchmarks and disbursement of assistance. SPFEs will in turn incorporate the key points of this MOA, in SPFE loan/grant agreements with participating municipalities.

7.4 **Structure and content of Memorandum of Agreement (MoA)**: A common format will be developed for all MoAs. The common format for MoAs will also include detailed guidelines for preparation of Intended Use Plan, which will include detailed directions and guidance notes for ULBs to participate in the pooled finance deals. While the content of these agreements will vary between projects depending upon the agreed benchmarks for Reform Grant disbursement, all agreements will clearly specify:

a) Performance benchmarks for assistance disbursements;
b) Structure and the project institutional arrangements for design and delivery of the project;
c) Existing credit rating of projects/municipalities and the details about the proposed credit enhancement;
d) The anticipated timing and size of tranches to be disbursed;
e) The accounting and financial management procedures to be utilized in receiving and expending grant disbursements;
f) The SPFE/municipality's reporting requirements;
g) The obligations and rights of the SPFE/municipality and the Urban Development Department, MOUD, GOI to monitor implementation of the projects and utilization of the grant disbursements;
h) The general conditions leading to and the rights of the Ministry to suspend and/or terminate grant disbursements for a just cause;
i) Remedies of the Ministry and the SPFE/municipality in case of non-compliance with the terms of the grant agreement; and

j) Agreement by the SPFE/municipality regarding full public disclosure of any and all information relating to implementation of grant assistance.

8. Implementation and Monitoring

8.1 Sanctioning and Monitoring Committee will monitor the implementation of the scheme of concerned Municipality/ULB on a regular basis through reports and returns or any other means considered appropriate.

8.2 **Reporting requirements**: Appropriate reporting requirements will be agreed with each State level entity. These requirements will build on reports already being furnished by State level entities as required by law, to private creditors, and internal management reports. In all cases the State/Union Territory level entities will be required to submit regular reports, at agreed intervals.

8.3 **Progress assessment:** A Steering Committee will be constituted under the Chairmanship of Joint Secretary (UD) in the Department of Urban Development. A Project Review Committee will be constituted under the Chairmanship of Secretary (UD), Department of Urban Development. Besides these, State/Union Territory Level Sanctioning and Monitoring Committees may also appoint an independent expert(s) to monitor progress at agreed intervals. The frequency at which progress assessment will be carried out will reflect the complexity and risks involved in each project. MOUD&PA reserves the right to appoint independent assessors at any stage.

8.4 **Release of grants:** Taking into account the recommendation of the Sanctioning and Monitoring Committee, project development assistance and CREF grants would be sanctioned under intimation to the State Government/UT Administration by the Ministry of Urban Development to the SPFE. Reimbursement of funds for project development assistance will be released on receipt of formal request from the State entity through the State Government/Union Territory Administration.

8.5 **Power to relax:** In exceptional circumstances and for reasons to be recorded, the Government may consider reviewing/revising benchmarks in respect of a package agreed to in respect of SPFE/any municipality/ULB except the parameters stipulated in Para 6.2 and 6.3 of the Guidelines.

8.6 **Review of Guidelines:** The Project Review Committee is empowered to review and modify the guidelines, as appropriate based on the progress of the scheme, every two years, and with the approval of the Ministers of Finance and Urban Development.

9. Completion and Beyond

9.1 Reporting of the credit rating at the end of the completion of the project should be reflected in the report. Successful completion of all grant disbursements and the implementation of the scheme shall be signified by a Completion Report to be prepared by the SPFE, on behalf of municipality, for submission to the Ministry.

9.2 These reports will briefly summarize the municipalities' achievements in reforms and will provide projections of financial and fiscal performance for a three-year period beyond completion of the grant assistance programme.

9.3 **Downstream monitoring:** A State/Union Territory level entity that successfully completes the grant programme will be expected to provide performance data for a three year period after completion. The structure and content of these downstream monitoring reports will be agreed between State/Union Territory level entities and the Urban Development Department, MOUD&PA, GOI, but the reports will demonstrate that fiscal stability has been achieved and is sustained.

9.4 **Additional Areas for Assistance:** Completion reports may also highlight at the municipality's discretion, areas in which continuing non-financial assistance would be of benefit to it. Such areas might include achievement of creditworthiness, preparation of capital investment plans and instruments for submission to the private market, or other specific items.

9.5 **Issues Requiring Central Action:** The completion reports should also highlight the municipality's concerns, if any, with their fundamental fiscal viability and/or any other key issues that require the attention of Central or State Governments/Union Territory Governments.

9.6 **Further Information:** Any municipality/State Government/Union Territory Administration contact Joint Secretary (UD), Ministry of Urban Development, Government of India for any information related to Pooled Finance Development Fund, like, eligibility for assistance or procedure for submission of application, etc.

Sd/-
(M. RAJAMANI)
Joint Secretary to the Government of India

ORDER

ORDERED that a copy of the resolution be communicated to all States/UTs.
ORDERED also that the resolution be published in the Gazette of India for general information.

Sd/-
(M. RAJAMANI)
Joint Secretary to the Government of India

Manager,
Government of India Press,
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Copy to:

1. Cabinet Secretariat, Rashtrapati Bhawan, New Delhi.
2. Prime Minister's Office, South Block, New Delhi.
3. Finance Secretary, Ministry of Finance, North Block, New Delhi.
4. Secretary, Department of Expenditure, Ministry of Finance, North Block, New Delhi.
5. Secretary, Department of Economic Affairs, Ministry of Finance, North Block, New Delhi.
6. Secretary, Department of Revenue, Ministry of Finance, North Block, New Delhi.
7. Secretary, Ministry of Housing & Urban Poverty Alleviation, Nirman Bhawan, New Delhi.
8. Secretary, Ministry of Social Justice & Empowerment, Shastri Bhawan, New Delhi.
9. Secretary, Ministry of Environment & Forest, Paryavaran Bhawan, New Delhi.
10. Member-Secretary, Planning Commission, Yojana Bhawan, New Delhi.
11. Adviser (HUD), Planning Commission, Yojana Bhawan, New Delhi.
12. Chief Secretaries of all States/UTs
13. Principal Secretaries/ Secretaries of Finance Departments of all States/UTs
14. Principal Secretaries/ Secretaries of Urban Development Departments of all States/UTs.
15. Chief Planner, TCPO, I.P. Estate, New Delhi.
16. Adviser (PHEE), CPHEEO, Nirman Bhawan, New Delhi.
17. Director, NIUA, New Delhi.
18. PS to UDM/ PS to MoS (UD).
19. Sr. PPS to Secretary (UD)/PPS to AS (UD)/PS to JS (L&D)/JS & FA/ OSD, (MRTS)
20. Section File/Guard File.

Sd/-

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