POOLED FINANCE DEVELOPMENT FUND (PFDF) SCHEME

Central Government approved in 2006 Pooled Finance Development Fund (PFDF) Scheme 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.

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.

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.

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.

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.

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.

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.

The PFDF will be operationalised in accordance with the Guidelines for Pooled Finance Development Scheme .

To provide exemption in respect of interest on bonds issued by a State Pooled Finance Entity and specified by the Central Government by notification in the Official Gazette, Section 10(15)(vii) of the Income Tax Act has been suitably amended under Finance Act, 2007 enacted on 11.05.2007 and "State Pooled Finance Entity" has been defined therein to mean such entity which is set up in accordance with the Guidelines for the Pooled Finance Development Scheme notified by the Central Government in the Ministry of Urban Development. For operationalisation of the Scheme, Guidelines for Issue of Tax Free Pooled Finance Development Bonds have been issued on 7.6.2007. The matter has been pursued at the Chief Secretary and Chief Minister level on 23.1.2007 and 8.3.2007 respectively to expedite setting up of SPFEs in the States/UTs. However, so far, the States of Andhra Pradesh, Karnataka, Nagaland, Orissa, Rajasthan, Tamil Nadu, Kerala and Assam have set up their "State Pooled Finance Entity" for implementation of the scheme in their States in accordance with the Guidelines of the Scheme. The State of Goa has intimated that setting up of a SPFE in the State is not feasible. First proposal for issue of tax free Pooled Finance Development Bond worth Rs.45.00 crore received from Water and Sanitation Pooled Fund, the designated SPFE of Tamil Nadu, has been notified by the Department of Revenue in the Official Gazette on 14,1,2008.. The proposal involved release of Rs.4.50 crore towards contribution to CREF and Rs.1.16 crore for Project Development cost which were released on 15.2.2008 . During 2008-09, no expenditure incurred against a budget provision of Rs.20.00 crore as no proposal received during the year. . During 2009-10, a budget provision of Rs.0.01 crore was made for the Scheme and no expenditure incurred as one proposal has been received in November, 2009 was under consideration. During 2010-11, a budget provision of Rs.0.01 crore was made for the Scheme and an expenditure of ` 4.49 crore incurred. For issue of Tax-Free Bonds worth ` 83.19 crore as second tranche under Pooled Finance Development Fund (PFDF) Scheme by Water and Sanitation Pooled Fund, Tamil Nadu for six Under Ground Sewerage Schemes (UGSS) and one water supply project under implementation in seven Urban Local Bodies was notified by Department of Revenue on 14.7.2010 which was fully subscribed. During 2011-12, a budget provision of ` 0.01 crore has been made for the Scheme. However, no expenditure could be made as no proposal was received during 2011-12. During 2012-13, a budget provision of ` 0.01 crore was made and no expenditure incurred as no proposal received.

An outlay of ` 2500.00 crore has been proposed for Twelfth Plan.

Lukewarm response to the scheme is on account of market factors which are beyond the control of ULBs as well as demand and supply side constraints specific to ULBs. A Working Session on **Developing India's Municipal Bond Market: Constraints to overcome** was organised at New Delhi on 29th July, 2008 under Chairmanship of Secretary, Ministry of Urban Development. by the Ministry of Urban Development jointly with Ministry of Finance. Representatives of State Government, RBI, LIC, Private Sector/Institutional Investors and International Development Partners attended the Session. To address the constraints on development of India's Municipal Bond Market, the following issues have been taken up with authorities, such as IRDA, RBI and Ministry of Finance :

- Expanding the range of “approved investments” to include municipal bonds of investment grade or higher.
- Municipal bonds to be classified under ‘hold to maturity’ category rather than in ‘mark-to-market’ category.
- Specify municipal bonds under the ‘priority sector’ category for investment/lending purposes.
- To review the 8% cap on interest rate for tax-free municipal bonds and prescribe a benchmark market rate linked to SBI-PLR rather than an absolute percentage.