

Guidelines for Issue of Tax Free Pooled Finance Development Bonds

1. Eligible Issuers

The eligible issuers of Tax Free Pooled Finance Development Bonds shall be a State Pooled Finance Entity set up in terms of the Guidelines for the Pooled Finance Development Scheme notified vide Resolution No. K-14011/40/2001-UD-II (Vol.III) dated 25th October, 2006 and set up under the Indian Trusts Act, 1882.

2. Use of Funds Raised

The funds raised from Tax Free Pooled Finance Development Bonds shall be used only for capital investments in urban infrastructure for providing one or more of the following:

- i. Potable Water Supply;
- ii. Sewerage or Sanitation;
- iii. Drainage
- iv. Solid Waste Management;
- v. Roads, Bridges and Flyovers; and
- vi. Urban Transport (if this is a municipal function under respective state legislation)

The capital investments shall be for the following purposes:

- (a) setting up of new project(s);
- (b) expansion, augmentation or improvements of the existing system.

Water and sanitation projects will be given preference and participating Urban Local Bodies (ULBs) under the issuer choosing to undertake projects in sectors other than water and sanitation shall be required to demonstrate that water and sanitation services are reasonably provided for and only environment friendly infrastructure projects shall be financed by the proposed fund.

3. Essential Pre-conditions

A. Project Development

- a. The proceeds of the proposed issue shall be clearly earmarked for a defined project or a set of projects;
- b. Before the actual Issuance of Tax Free Bonds, the following tasks shall be completed :

- i. an investment plan for the project components indicating phasing and a financing plan approved by the Trust or the Board of the Agency as the case may be;
- ii. identification of the benchmarks for commencement and completion including the milestone dates for all the proposed components under the overall project(s);
- iii. Pre-qualification of the bidders for the proposed project should be completed and final tender documents should have been issued to all pre qualified bidders;
- iv. The land required for the project should be in possession of the issuer and/or the process for land acquisition and other statutory clearances, if any, should have been initiated.

B. Financial Viability

- a. The project(s) shall be financially viable;
- b. Financial viability here means that the project(s) should be able to generate a stream of revenue which should be sufficient to finance O&M cost.
- c. The issuer shall create an Escrow account for debt servicing of bond proceeds and for meeting O&M costs of the proposed project with earmarked revenue. Earmarking of revenue through Escrow mechanism will be monitored by an independent Trustee like the DFIs or the nationalised banks.
- d. 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 ULBs.

C. Reforms

- i. An Urban Local Body (ULB) under the issuers shall give an undertaking to undertake and implement the following reforms in a time-bound manner:-

- a. Adoption of modern, accrual-based double entry system of accounting in Urban Local Bodies;
 - b. Introduction of system of e-governance using IT applications like, GIS and MIS for various services provided by ULBs
 - c. Reform of property tax with GIS, so that it becomes major source of revenue for Urban Local Bodies (ULBs) and arrangements for its effective implementation so that collection efficiency reaches at least 85% within next five years.
 - d. Levy of reasonable user charges by ULBs with the objective that full cost of operation and maintenance is collected within next five years.
- ii. An entity, other than ULB, under the issuers shall give an undertaking to reform within its sphere of activity. The reforms could be (i) adoption of modern, accrual based double entry system, (ii) levy of user charges with the objective that full cost of operation and maintenance is collected in the next five years, and bringing efficiencies in the working of organization.

D. Other Conditions

- a. The issuers will be subject to rules regarding borrowings under respective municipal legislation (as specified 1(i)) in respective States or other laws relating to total borrowing;
- b.
 - i. The participating ULBs under the issuer shall further undertake to provide an additional debt covenant under which the Debt Service Coverage Ratio (DSCR) of at least 1.25 is maintained through out the tenor of the Tax Free Pooled Finance Development Bonds.
 - ii. DSCR is defined as a ratio of net income after meeting all the obligations and liabilities of the Issuer except the long term debt obligations (principal and interest) to long term debt servicing obligations.

- iii. For the purpose of estimating net income, the income and expenditure of the entire utility/ULB and grants from the State and grants from any other sources may be considered instead of project specific revenues and expenditures.
- iv. All State grants or transfers to the participating ULBs under the issuer should be deposited into the 'Escrow Account' and the Bond issue must clearly set forth the order of priority according to which the revenue generated by the issuer will be allocated for various purposes.
- v. Estimate of DSCR shall be based on realistic assumptions.

E. Project Account and Monitoring

- a. The issuers as specified in paragraph (1) above shall maintain a separate account of the amount raised from the Tax Free Pooled Finance Development Bond, to be utilised only for the project related expenditure and will submit quarterly reports on progress, performance, accounts and audit to Sanctioning and Monitoring Committee and Ministry of Urban Development in prescribe format. ;
- b. The issuers shall establish a separate Project Implementation Cell and designate a Project Officer who shall monitor the progress of the project(s) and be responsible for ensuring that the funds raised through Tax Free Pooled Finance Development Bonds are utilised only for the project(s) for which the Bonds were issued.
- c. The issuer shall present time-table for utilization of bond proceeds i.e. at least 50% of proceeds may be invested in eligible projects in first twelve months and 85% in first 24 months to ensure speedy implementation of projects.

4. Instrument, Maturing and Buy-back

- a. The Tax Free Bonds should have a minimum maturity of 5 years. The issuers will have option to offer deep

discount bonds or other financial innovations especially to enhance the tenor of the bond.

- b. The issuers may have the option for buy-back arrangements of the face value of the bonds from any investor after a lock-in period of three years.

5. Nature of Issue and Tax Benefits

- a. The choice of raising the amount as a public issue or by private placement or a combination of both types will be left to the issuer;
- b. Only bonds carrying interest rate upto maximum 8% per annum shall be eligible for notification by the CBDT for the purposes of exemption under section 10(15)(vii) of the Income Tax Act, 1961.

6. Ceiling on Amount of Tax Free Pooled Finance Development Bonds for a Project

- a. The amount of issue of bonds for the purposes listed under item (2) above will be approved on a case by case basis by the Ministry of Urban Development, Government of India. The maximum amount of Tax Free Pooled Finance Development Bonds as a percentage of the total project costs (excluding interest during construction) will be 50% per cent or Rs. 300.00 crore whichever is lower;
- b. The debt equity ratio for the project shall not exceed 3:1. In case of municipal authorities, the issuers shall at least contribute 20 per cent of the project costs either from internal resources or other grants or a mix of the two.

7. Compulsory Credit Rating

It will be mandatory for the issuer to obtain an investment grade rating from an RBI approved and the reputed credit rating agency before the issuance of the Tax Free Pooled Finance Development Bonds. The credit rating agency will carry out a due diligence process at the time of award of the initial rating to ensure that all the conditions mentioned in the Guidelines are met and would also monitor the same as part

of its surveillance during the tenor of the Tax Free Pooled Finance Development Bonds.

8. Legal and Administrative Requirement

- a. The issuers shall adhere to all other applicable legal and administrative requirements which are in force from time to time;
- b. Where a public issue is made, the issuer shall abide by the guidelines issued by the Securities and Exchange Board of India (SEBI)

9. The Competent Authorities to Grant Tax Exemption and Approval

- a. The Ministry of Urban Development (MoUD), Government of India shall be the nodal agency for processing the proposal for tax free Pooled Finance Development Bonds. The MoUD will receive applications for issue of Pooled Finance Development Bonds and place the same after processing before a committee comprising representatives of Department of Economic Affairs (DEA) and the Central Board of Direct Taxes (CBDT). The Committee will forward its recommendations to the CBDT, for soliciting the approval of Finance Minister and for notification of specified bonds in the Official Gazette.
- b. The Pooled Finance Development Bonds notified by the Department of Revenue, CBDT, in the Official Gazette shall be eligible for tax exemption under section 10(15)(vii) of the Income Tax Act, 1961.

The approval for tax exemptions (notifying the specific bonds in the Official Gazette etc.) will be obtained from CBDT before approaching public etc. for subscription.

10. Monitoring

Ministry of Urban Development shall ensure that funds raised by the issuer are utilised in accordance with the timetable for utilization of bond proceeds and only for the project(s) for which permission has been granted by the

Central Government. The Ministry of Urban Development would also ensure that reforms are implemented by issuer as per the undertaking given by it at the time of application for issue of Tax Free Pooled Finance Development Bonds.

Within six months of the close of every financial year, the escrow account and the project account will be audited by a firm of Chartered Accountants appointed by the concerned State Urban Development Departments from a panel of Chartered Accountants approved by the C&AG and audit report submitted to the MoUD and CBDT.

11. Listing of Bonds

The Tax-Free bonds may be listed on the Stock Exchange.
