Presentation

At the

Vibrant Gujarat – Urban Summit

on

Funding Urban Infrastructure

Ahmedabad

February 15, 2007

December 26, 2006

Objective

- Define the Urban challenge
- Highlight the financing needs of the sector
- Identify instruments and policy frameworks to address urban needs

Structure of The Presentation

- Section A - Background - The Urban Challenge
- Section B - Current Financing Paradigm for Urban Infrastructure
- Section C - GoI Initiatives – JNNURM
- Section D - The Road Ahead – Creation of Urban Debt Funds
- Section E - Conclusion

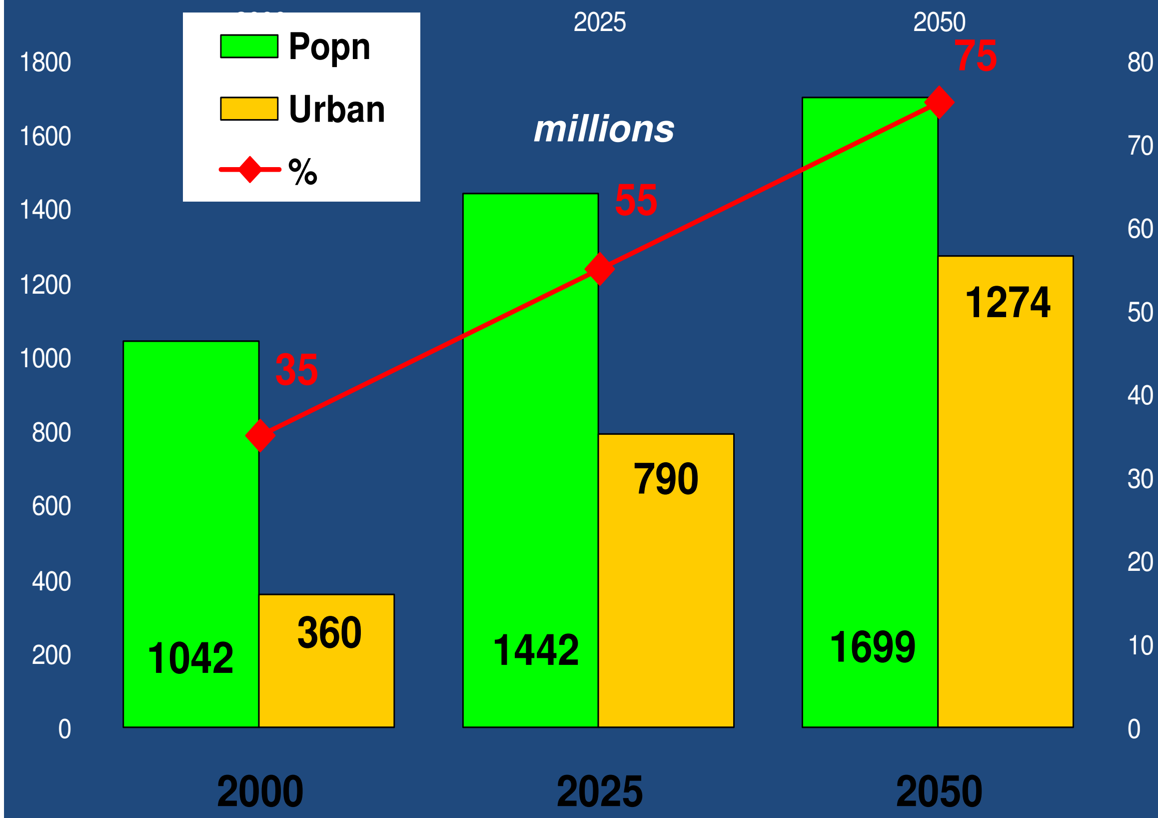
Section A

The Urban Challenge

Background

- Global and Indian experience indicates Increasing Dependence of National Economic Growth on the Efficiency of Cities
  - Urban population expected to become 41% of total population by 2021
  - Urban areas expected to contribute 65% of GDP by 2011
- The efficiency of cities is contingent upon the availability and quality of appropriate civic infrastructure
- Current levels of Civic Infrastructure are not commensurate with existing levels of demand, let alone the increasing influx/migration from rural areas
- A large hiatus between anticipated levels of demand and availability.

Urban Challenge

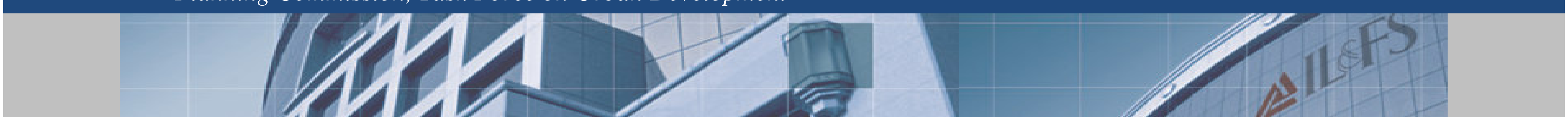


<u>India's Population</u>

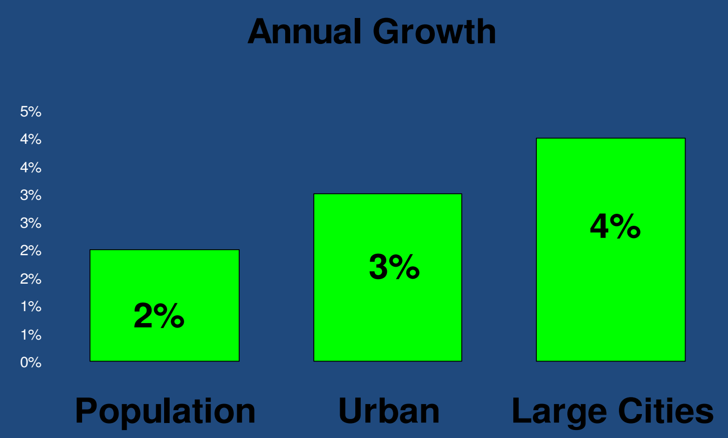
- Will grow to 1.7 billion by 2050
- Rapid urbanisation will add 914 million people to Indian cities
- City capacity will need to grow nearly 400 % in less than 50 years

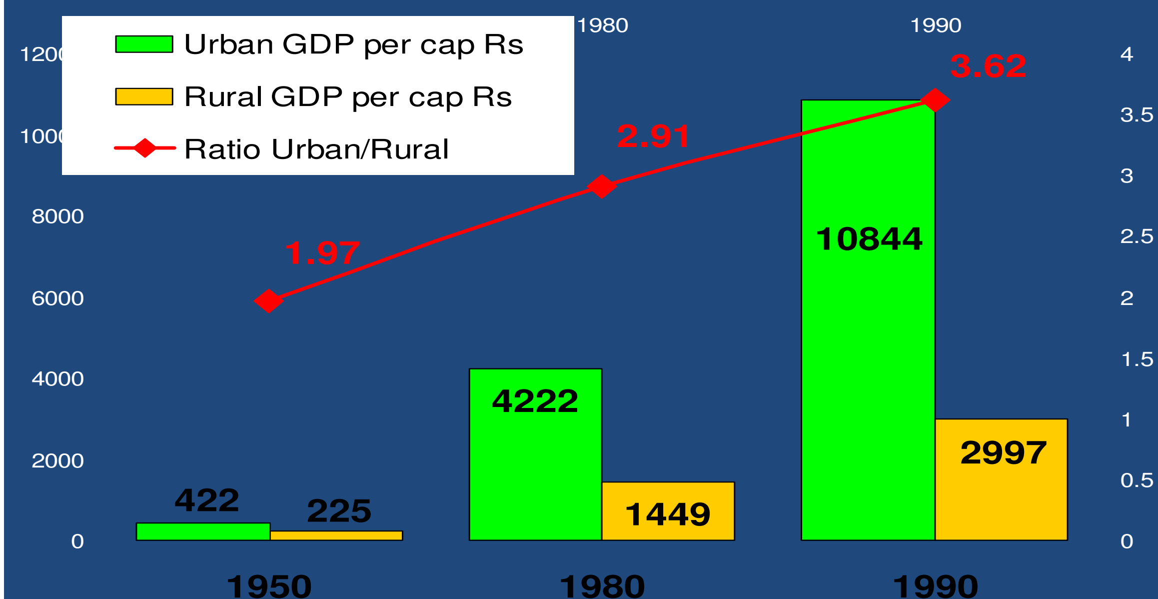
Sources – United Nations 1992

Planning Commission, Task Force on Urban Development



Urban Challenge…Contd.



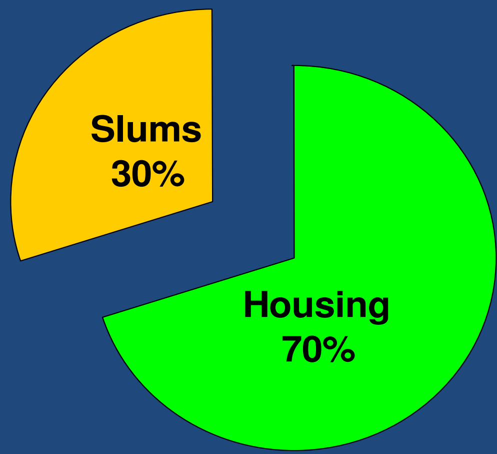


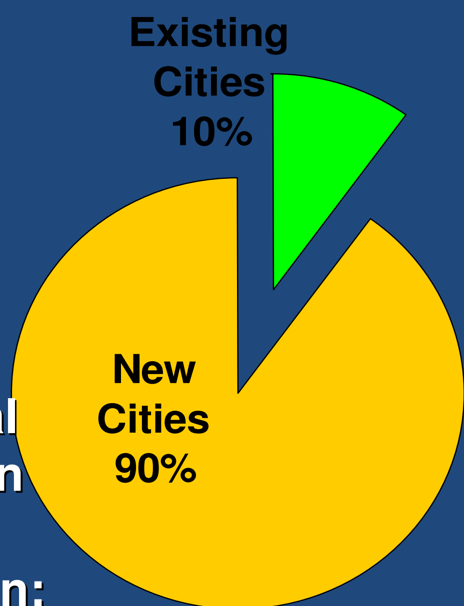
Basis & Rationale

- Growth of urban areas much faster than overall population
- Large cities growing at double the rate
- Urban / Rural economic divide is growing fast, leading to rapid urbanisation

Urban Challenge

Large Cities



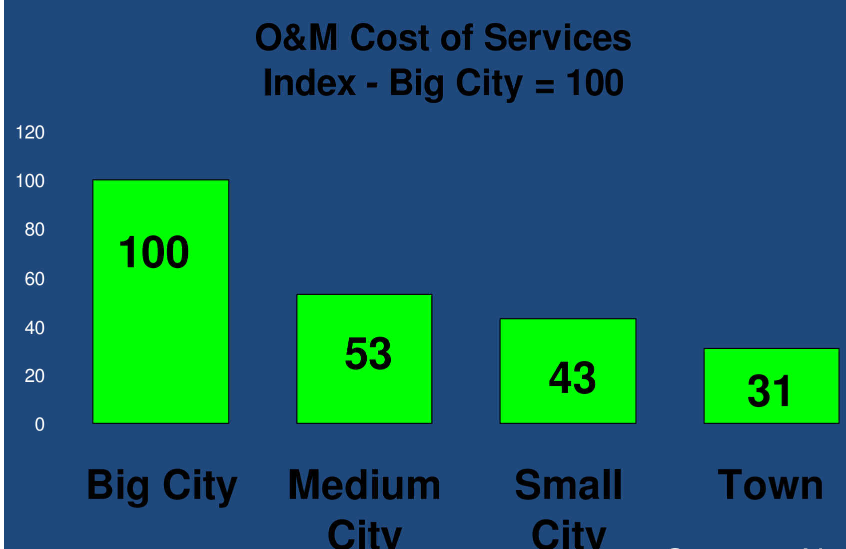


Additional population growth absorbed in:

<u>**Urban Housing needs**</u>

- **About 110 mn people live in city slums *(not enough housing)***
- **About 914 mn more people will need city housing in 2050**
- **Where will 1024 mn new urban people stay in 2050 ?**
- **Probably the existing cities will absorb 110 mn slum dwellers plus 100 mn more, I.e. grow by 45 %**
- **Still leaves over *<u>800 mn</u>* new urban dwellers without homes**

New Cities



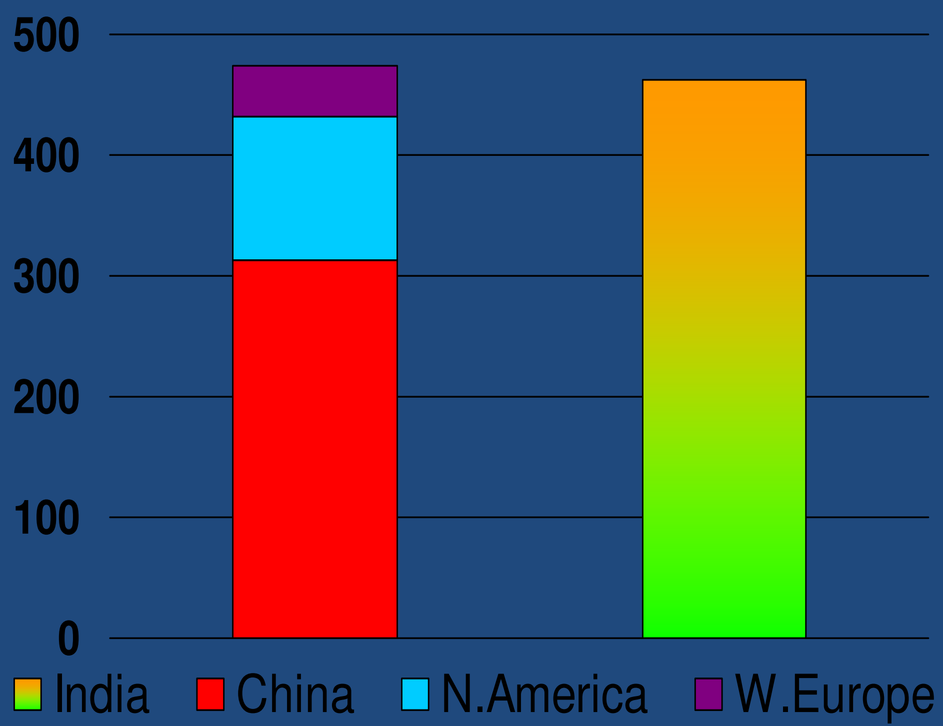
New vs Old, What size New ?

- **Far cheaper to build new cities than expand existing ones**
- **Since infrastructure & utilities in existing cities already stretched too far, it cannot support new housing without new investment**
- **Better to build smaller cities, ideally 200,000 population, but numbers too large. Hence new city size need to be around 750,000 population – Medium**
- ***Over 1,000 new cities needed !***

Source – National Institute of Urban Affairs

New Cities

Urban Population in new homes.
Increase from 2003 to 2030 (mn)



Source : Fairwood Research

But 2050 is far away. What are short term prospects ?

- In just the next 25 years, nearly half a billion Indians will need new, urban homes
- This is equal to the needs of China, North America & Western Europe put together !

Section B

Current Financing Paradigm for Urban Infrastructure

Current Paradigm – Infrastructure

- The traditional paradigm financing sources are internal accruals of urban local bodies and loans & grants from state government

- Directed credit from institutions such as HUDCO and LIC linked to state government guarantees

- Small component of bilateral and multilateral assistance

Resource Gap for Urban Sector Development

Rs Crores

		2001-2006	Per Annum
A.	<u>**Funds Required**</u>		
	Backlog in Capital Investments	133,380	13,338
	Capital Investments[*] - normal	63,000	12,600
	Operation & Maintenance[$]	72,099	14,420
	Revenue Gap in Operation & Maintenance[**]	18,500	3,700
	Total Funds Required	**Including Backlog**	**44,058**
B.	<u>**Funds Available**</u>		
	Plan Sources & External Funding[***]	14,168	2,834
	Local Institutions	3,500	700
	Internal Sources- Revenues[#]	107,500	21,500
	Total Funds Available		**25,034**
C.	**Resource Gap**	**Including Backlog**	**19,024**

* NIUA

$ Eleventh Finance Commission

** Estimate by Ministry of Urban Development

*** As per Tenth Five Year Plan

Eleventh Finance Commission Report

Drawbacks of the Existing Institutional Framework

- Inadequacy of government budgetary support has led to a severe backlog in investments
- Implementation of projects within this framework has led to poor utilization of resources on account of lack of project development and management skills
- Lack of adequate financial management skills

Experience With Capital Markets

- Total Bond Market Size in India : Rs. 12,86,000 Crore

- The entire quantum of borrowings by ULBs from capital markets is less than Rs. 1000 crore in a period of 5 years i.e. Rs. 200 crore per annum vis-à-vis Rs. 75000 crores of other market borrowings in a year by other players

- This trend is indicative of a larger systemic problem of :
  - Poor credit quality of ULBs
  - Lack of bankable projects
  - Lack of investor appetite for low rated municipal debt
  - Absence of risk taking ability and appraisal skills of domestic financial institutions

Municipal Bond Issues

ULB	Year	Rating	Coupon
Bangalore Mahanagar Palika	1997-98	A (SO)	13.00%
Ahmedabad Municipal Corporation	1997-98	AA (SO)	14.00%
Ludhiana Municipal Corporation	1999-00	LAA (SO)	14.00%
Nashik Municipal Corporation	1999-00	AA (SO)	14.75%
Bangalore Water Supply & Sewerage Board	2000-01		12.90%
Madurai Municipal Corporation	2000-01	LA+ (SO)	12.25%
Kanpur Development Authority	2000-01	LA+ (SO)	13.50%
Ludhiana Municipal Corporation	2000-01	LAA- (SO)	13.50%
Nagpur Municipal Corporation	2000-01	LAA- (SO)	13.00%
Tamil Nadu Urban Development Fund	2000-01	LAA+ (SO)	11.85%
Municipal Corporation of Hyderabad	2001-02	AA+ (SO)	8.50%
Visakhapatnam Municipal Corporation	2003-04	AA-(SO)	7.50%

Need for Long Term Funding

- Typically projects in urban sector have construction periods ranging from 2-5 years
- Initial resistance towards paying user charges
- Accordingly paybacks vary from 15 to 30 years
- Hence financial structure for these projects necessitates a substantial component of long tenor financing
- Therefore a strong need to create layered ability structures to permit debt servicing requirements staggered over time and manageable within bounds set by project cash flows

Section C

Recent GoI Initiatives

Jawahar Lal Nehru National Urban Renewal Mission

Recent GoI Initiatives…

- **Launch of the Jawaharlal Nehru National Urban Renewal Mission to provide capital grants to 63 mission cities to address commercial viability issues and use of reform linked assistance as a tool to enhance managerial efficiencies and credit quality of Urban Local Bodies**
- **Estimated investment requirements of these 63 cities during the Mission period (2005-2010 / 12) is Rs. 1,20,000 crore**
  - **Grant assistance to 63 cities to the tune of Rs 50,000 crores over 5 to 7 years.**
  - **This implies a debt requirement of Rs 30,000 to Rs 70,000 crores depending on the extent to which the gap can be bridged by State – ULB contributions**

City Size	No. of Cities	Central Govt Share (%)	State Govt Share (%)	ULB – incl. Loans from Banks/FIs
>4 mn	7	35	15	50
1-4 MN	28	50	20	30
Selected Cities <1 mn	25	80	10	10
			Rs 70,000 crs	

Recent GoI Initiatives

- Under the JNNURM :
  - Grant assistance to 63 cities to the tune of Rs 50,000 crores over 5 to 7 years.
  - The aggregate investment requirement for the 63 cities is Rs 120,000 crores over 7 years
  - This implies a debt requirement of Rs 50,000 to Rs 70,000 crores depending on the extent to which the gap can be bridged by State – ULB contributions
  - The JNNURM guidelines cover all core activities relating to urban renewal –
    - Roads
    - Solid Waste
    - Sewerage
    - Water
    - Special features for heritage cities

Terms for accessing JNNURM grants

- Mandatory reforms at ULB level e.g. double entry accounts, e-governance, user charges to recover O&M cost, property tax reforms with GIS to attain collection efficiency of 85% in 7 years.
- Mandatory state level reforms to be achieved in 5 years include repeal of urban land ceiling, stamp duty reduction, reform of rent control etc.
- Tripartitie MOA to be executed between Central Govt., State Govt. and the ULB

Opportunities in the Urban Sector…

- **Project Development, Project Implementation Supervision for projects amounting to over Rs. 1,20,000 crores over the next 5 to 7 years in the identified cities**
- **Bidding Opportunities for Construction contracts and O&M Contracts**
- **Reform assistance to ULBs in the context of JNNURM and UIDSSMT**
- **Debt requirement of Rs 70,000 crores over the next five years.**
- **Current financing flows to the Urban Sector are about Rs. 5000 crores per annum : LIC - Rs 1000 crores & HUDCO – Rs 4000 crores. Hiatus between Sector requirements and fund flow.**
- **The sector requires a variety of financial products ranging from long tenor debt, working capital, multi-layered debt with appropriate structuring, sub-ordinate debt and quasi equity to ULBs and other entities implementing urban infrastructure projects**
- **Need for market making and merchant banking in the Municipal Bond arena. Significant requirement for a financial guarantee intermediary to facilitate development of the Municipal Bond market.**
- **Lines of Credit to State Level Municipal Development Funds and equity participation in their AMCs.**

Section D

The Road Ahead – Creation of Urban Debt Funds

Debt Financing Options

- Currently, the PMDO facility sponsored by IL&FS, IDBI, SBI and IIFCL, with a corpus of Rs 3000 crores is possibly the only instrument available to meet ULBs own contribution /State Government component of JNNURM projects

Pooled Municipal Debt Obligation Facility: Salient Features

- **<u>Products:</u> Provide 'Term Loans' to urban bodies across**
- **<u>Corpus</u> : Rs 2750 crores**
- **<u>Tenor</u> : 3+10 years**
- **<u>Interest</u> : 9.5% + 1% with 3 year reset**
- **<u>Sectoral Coverage:</u> The Fund would deploy the corpus across projects from sub-sectors namely:**
  - **Water Supply & Sewerage**
  - **Solid Waste Management**
  - **Roads & Urban Transport**
  - **Area Development viz. infrastructure development for industrial parks, free trade zones, special economic zones etc**
  - **Environmental Projects**
  - **Healthcare and educational services**
  - **Governance improvement projects**
  - **Other remunerative urban infrastructure contributing to the improvement of the living standards of the population of an Urban Center**
  - **Funding of common infrastructure for small and medium enterprises**
  - **Any other approved by Credit Committee**

Graduating the PMDO Facility to an Urban Infrastructure Fund

- The PMDO Facility provides 13 year Money to ULBs at a landed cost of around 10.5%.
- The 13 year door to door tenor incorporates 3 year moratorium and interest rate resets at the end of every 3 years.
- Urban Infrastructure Projects typically have long payback periods and low level of returns.
- Growth of the PMDO/Fund corpus to Rs 20,000 crores, is predicated on major systemic changes.

An Urban Infrastructure Fund

- The Urban Infrastructure Fund platform provides a suitable mechanism for blending multilateral resources with funds from the domestic financial sector and capital markets
- Based on the TNUDF model, the preferred approach is to set up a Trust Fund under the Indian Trust Act, 1882 with asset management function being carried out by separate company constituted for this purpose
- To facilitate participation of lenders in the proposed Urban Infrastructure Fund it will be necessary to secure SEBI approval for a fund structure with an AMC akin to a private equity fund.
- Equally critical, RBI regulations would need to be amended such that ***Bank/FI exposure to the Fund does not count as Capital Market exposure***

Priority Sector Label for Urban Infrastructure ??

- Typically, Bank exposure to the Urban Sector is limited to low cost urban housing and lending to urban artisans under Priority Sector lending.
- Currently incremental Prior Sector lending is Rs 120,000 crores p.a.
- Even if 5% of Priority Sector lending is directed at Urban Infrastructure, it would generate Rs 5000 crores p.a.
- At present Priority Sector lending includes investment in NABARD Bonds.

Pending issues in Urban Infrastructure Financing

Apart from SEBI and RBI regulatory issues which would allow Banks/FIS to participate in an Urban Fund, there are other critical issues :

1. Borrowing Costs:

Given precarious finances, most ULBs are not in a position to service debt at commercial terms **DESPITE** huge capital subsidies (80% to 50%) under JNNURM and UIDSSMT, ULBs

An interest subsidy on the analogy of the Textile Sector which provides 5% subsidy to SMEs on a phased manner can be mooted linked to reform milestones/asset creation

2. **Imperfect Security Structures**

Currently, the only security structure available is a contract on ULBs cash flows. Given the inherent limitations and fragile nature of ULB finances this is a major estoppels for fresh asset creation. A guarantee facility provided by the Insurance Companies has been successfully employed in the US.

A possible template could be the Credit Guarantee Insurance Corporation of India.

3.Leverage

Ideally, the State Govts could leverage the JNNURM grants on a 2:1 or 3:1 basis such that the incremental debt service is matched by fresh income streams for the ULBs.

Issues Impeding Development of Municipal Bond Markets

Differences between the US and Indian Municipal Bond Markets:

- Us Municipal Bond Market increased by 90% between 2000 & 2005, whereas Indian Bond Markets witnessed a negligible growth rate
- Fresh bond issuance of $459 Bn in 2005 Vs Rs. 300 Crore in India in the same year
- Market capitalization of $ 2.23 Tn as on December 31, 2005 Vs Rs. 1800 Crore of outstanding municipal bonds in India
- Investor base in the US comprises households (38%) and Mutual funds (37%) Vs mainly institutional investors (LIC) in India
- More than 50% of municipal bonds are AAA rated based on financial guarantees

Section E

Conclusion

Conclusion

- To meet the ULBs contribution/State Government component under JNNURM, will require debt mobilisation of Rs 70,000 crores over 5/7 years.
- Liquidity is not a constraint
- Debt mobilisation of this magnitude will require Banks/FIs participation which is not possible under current SEBI/RBI guidelines.
- The aggregate resource mobilisation to cater to an incremental urban Indian population of 700 million by 2050 is unprecedented in the history of mankind.

THANK YOU