

**Conference on Financing Strategies for Urban
Infrastructure**
Centre for Advanced Financial Research & Learning (CAFRAL)
Mumbai, India



**India Ratings
& Research**
A Fitch Group Company

Credit Rating of Urban Local Bodies: Impact on Financing

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Agenda

- **Need for rating for ULBs**
- **Rating Methodology for Subnationals**
- **Funding impact**
 - TNUDF – A case study
 - US experience in Development District Finance
- **JNNURM experience & learning**

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Need for rating for ULBs

- Rating increases a borrower's choice of lenders & debt instruments
 - Explore different debt products/structures
 - Bonds/Pooled finance/Securitisation/Loans
 - Diversify lenders and investors base
 - Rating an essential precondition for many investors
 - Banks/PFs/Multi lateral institutions/ Insurance Companies etc.
 - Best bargain hunting of terms of borrowing
- Allows matching of debt structure with the useful life of the assets
- Sophisticated move away from sovereign risk perception to interest in the actual mechanics of debt repayment
- Basel II reforms increase the importance of loan credit quality to bank capitalization requirements
- **Culminating in reduced dependence on center/state governments**

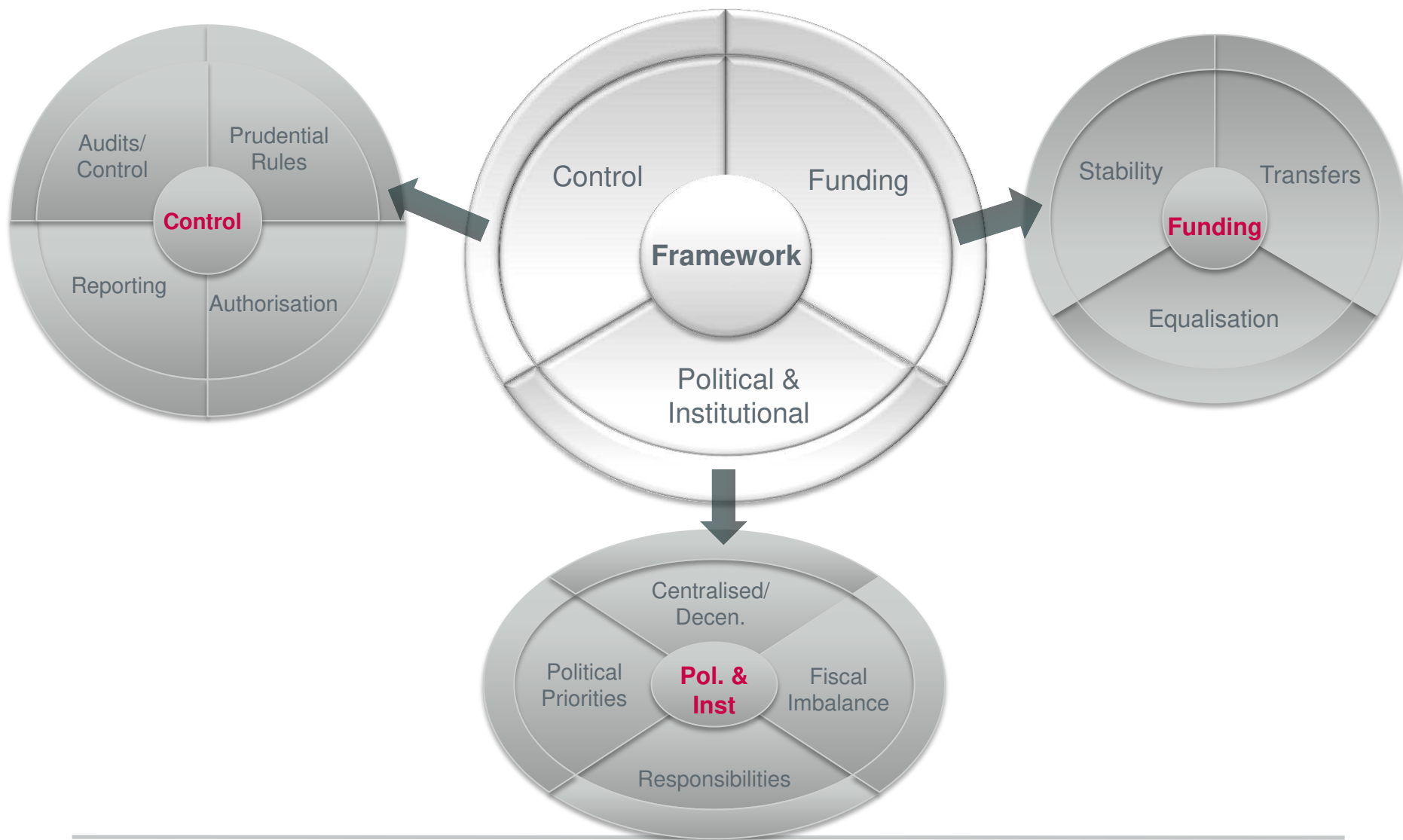
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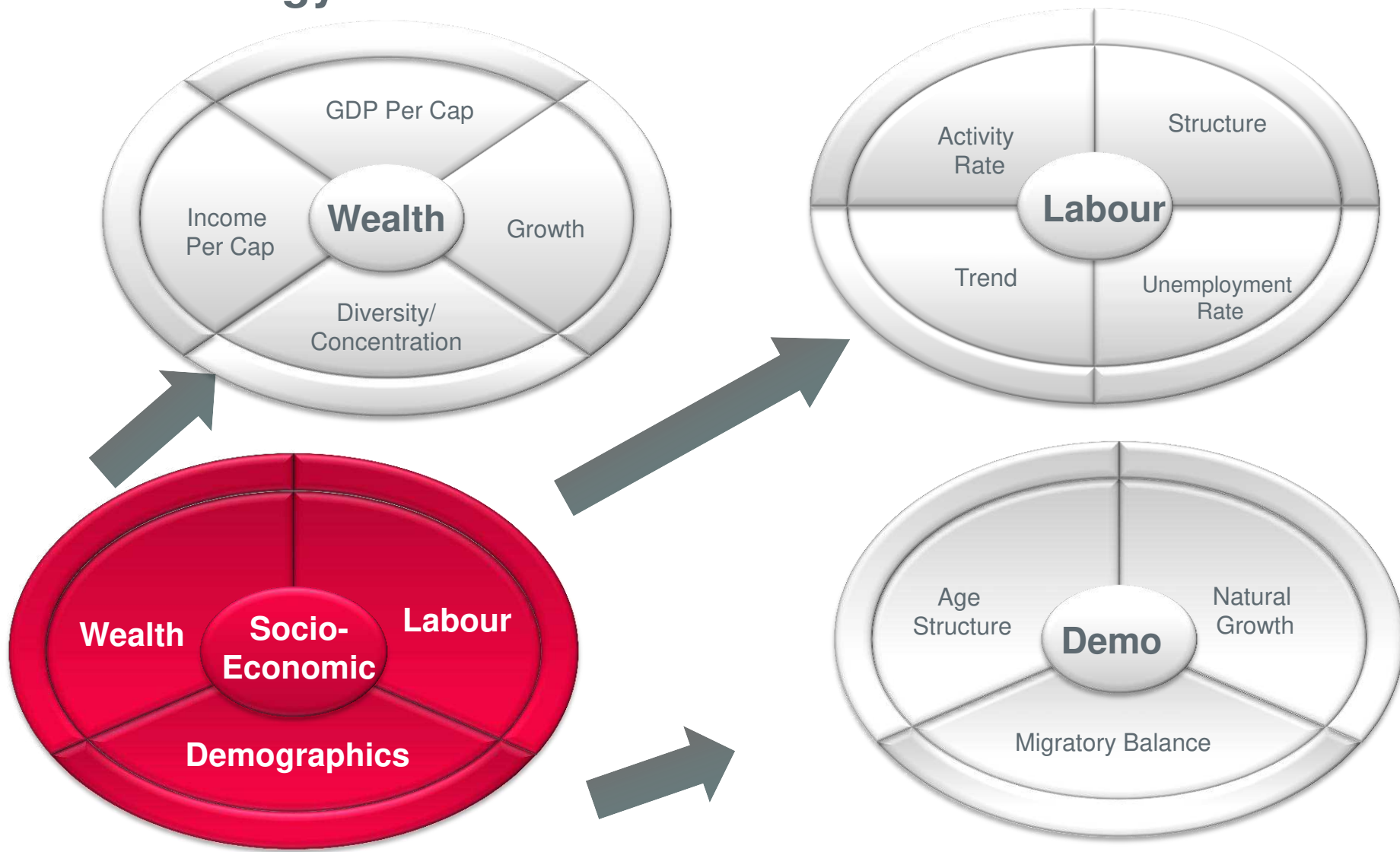
Rating Subnationals in India - Methodology

- Institutional Framework
- Socio-economic Profile
- Budgetary Performance
- Debt, Liquidity & Indirect Risk
- Management & Administration

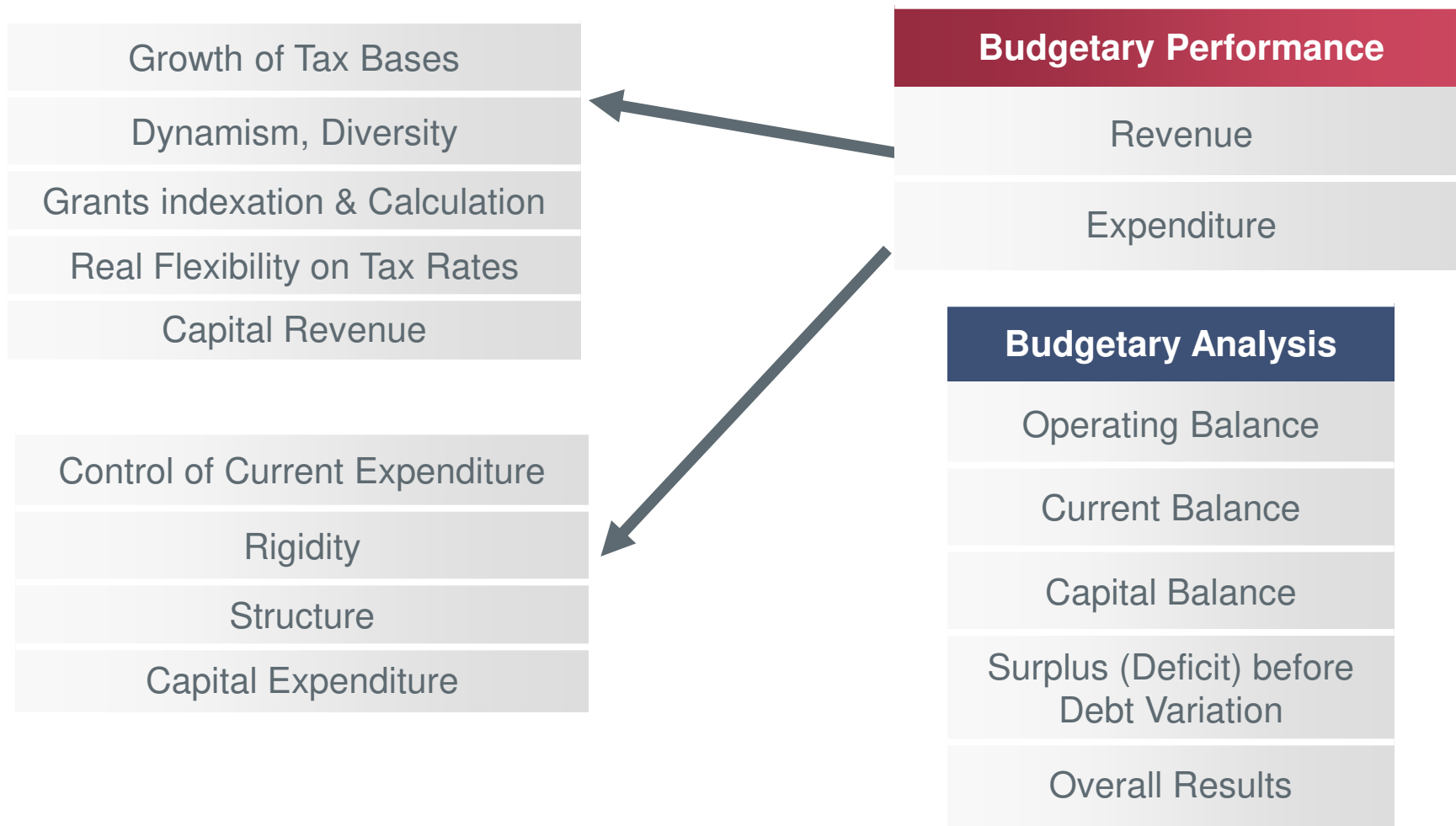
Methodology - Institutional Framework



Methodology - Socio-Economic Profile



Methodology - Budgetary Performance



Methodology - Budgetary Performance (Cont.)

Revenue / Receipts

- Average revenue receipt (INRm)
- Revenue receipt growth (%)
- Proportion of own revenue in total revenue
- Non-tax revenue to total revenue (%)

Revenue Performance — Indian Local Governments

Rating category	Average revenue receipt (INRm)	Revenue receipt growth (%)	Proportion of own revenue in total revenue (%)	Non-tax revenue to total revenue (%)
IND AA	6,000-116,000	5-28	54-98	12-18
IND A	1,800-6,500	11-16	92-94	10-18
IND BBB	350-2,900	10-16	8-39	5-13
IND BB and below	22-700	7-30	24-75	6-18

Source: India Ratings

Expenditure

- Revenue expenditure growth
- Proportion of establishment expenditure in revenue expenditure
- Proportion of O&M expenditure in revenue expenditure
- Capital expenditure growth

Fiscal Balances

- Revenue Balance to Revenue Income
- Capital Income to Capital Expenditure

Methodology - Debt & Liquidity

■ Debt Profile

- Debt / Revenue Income

Debt Profile — Indian Local Governments (%)

Rating category	Debt/revenue income
IND AA	14.4
IND A	17.8
IND BBB	25.8
IND BB and below	71.2

Source: India Ratings

■ Liquidity

■ Ways of Assessing Liquidity

- Cash balances and treasury, both year end and average for the year
- Bank deposits (type, nature of bank, period of notice)
- If there are any restrictions for accessing these
- Liquidity back-up facilities, particularly if there is a large debt repayment due
- Investment policies for excess liquidity

- Indian local bodies do not have any liquidity facilities available to them. In stressed liquidity conditions, local bodies generally either depend on state governments or borrow from banks

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Funding Impact – TNUDF A case study

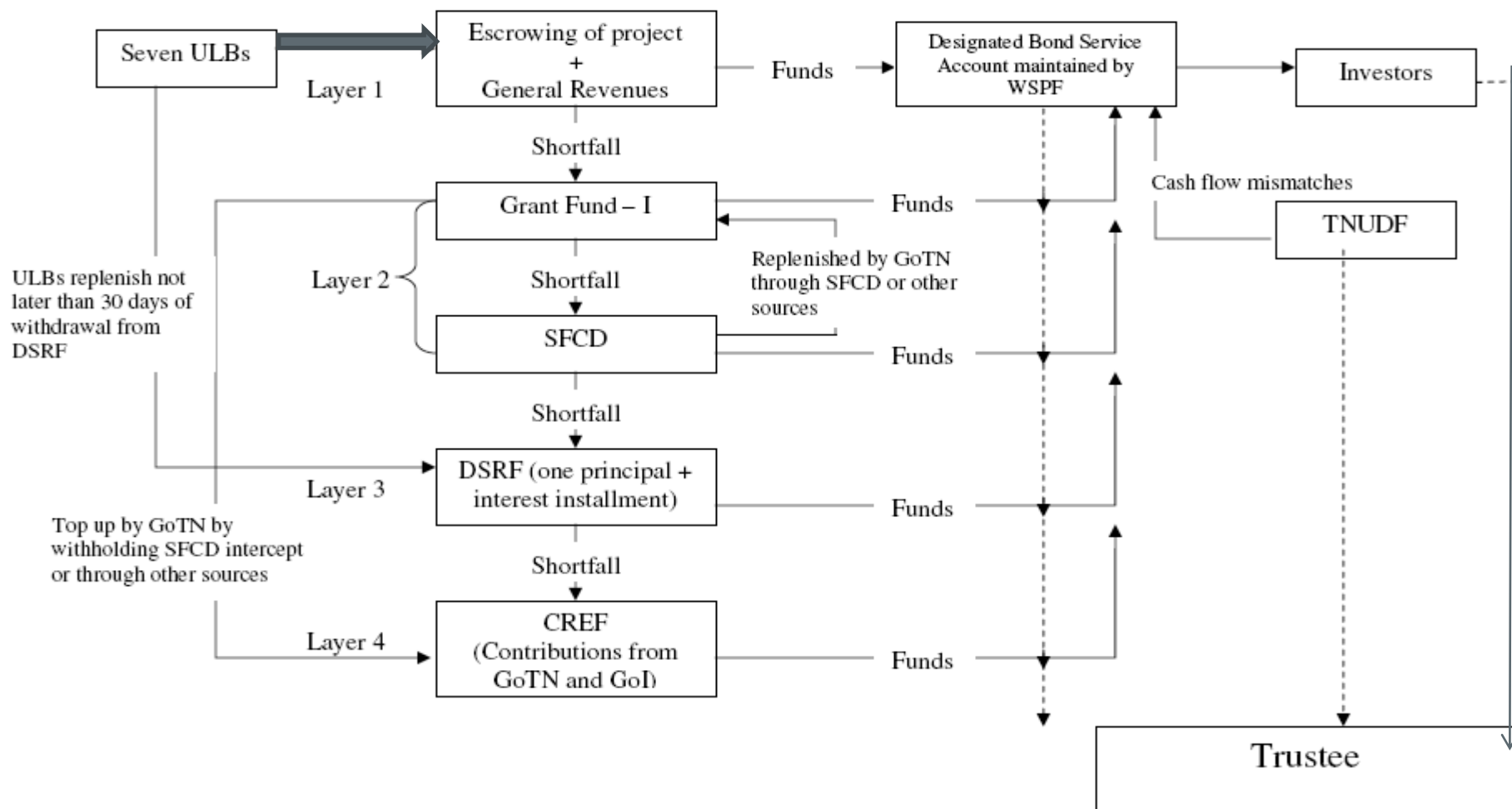
Features

- **Water & Sanitation Pooled Fund (WSPF), Tamil Nadu – Fitch AA(ind)(so)**
- INR 304mn Dec 2002; 15-year maturity, 9.20% coupon with put/call at 10 yr
- India's first pooled refinancing of the outstanding loans of 13
- Three issues floated subsequently in the last 10 years
- Credit enhancement provided by state aid intercept, cash collateral and a partial guarantee from USAID
- ULBs' interest costs were lowered by being able to refinance on a pooled basis with a longer maturity

Credit Rating Factors

- Rating based on pooled credit risk rather than individual credit risk of ULBs
- The number and composition of ULBs in the pool
- Type of projects and attendant risks
- Credit enhanced by:
 - Escrow of project revenues (user charges)
 - State devolutions' intercept
 - Credit Rating Enhancement Fund (CREF)
 - 10% of the issue or 50% of the CREF, whichever is lower, will be Gol's one time contribution; balance from state governments

Funding Impact – TNUDF A case study



Funding Impact - US Experience - Development District Finance

- The three major forms of government supported development districts are:
 - Tax Increment Districts
 - Special Assessment Districts
 - Municipal Utility Districts
- All three forms of development districts are created under state statutes, and utilize long-term bonds in order to finance their projects

US Experience - Tax Increment Districts

- TIF structures capture incremental tax revenues from increased property values within the district as a result of development
- Tax increments collected in-lieu of property taxes on district's growth
- Since the 1980s, TIF has been used in the US by cities for economic development and diversification
 - E.g. build affordable housing, office space, retail space, public infrastructure, to revitalize neighbourhoods, to redevelop contaminated sites and to try to overcome local fiscal stress
- TIF district bonds are issued without a government guarantee or voter approval
- TIF districts revenues pay debt service on district bonds over a twenty to thirty year period
- TIF bonds are sold in the municipal securities market on either a tax-exempt or taxable basis

US Experience - Special Assessment Districts

- Assessment districts are created, financed and maintained by their parent municipality, and there is no independent board
- Financed by long-term bonds secured by special assessments collected from benefited properties
- Dedicated assessment taxes are on top of existing property taxes that flow to local government authorities (city, school district, county)
- Assessments often collected on property sales or turnover
- Assessments are used to pay debt service on district bonds
- Infrastructure improvements can include access roads and municipal utilities

US Experience - Municipal Utility Districts

- MUDs are managed by a board of directors and are responsible for the financing, operating and maintaining of the utility district's facilities
- Water, sewage and drainage utility improvements financed through long-term bonds and in some cases developer equity
- Used extensively in the 1980s in Texas to promote development of suburban and master planned communities
- Security for these bonds provided by district taxes although districts could also collect utility charges on developed properties for the payment of debt service

Fitch Rated Tax Increment District Bonds - examples

- Redevelopment Agency of the City of East Palo Alto, California
 - East Palo Alto Public Financing Authority Revenue Bonds 'BBB'

- Chico Redevelopment Agency, California
 - Chico Amended & Merged Redevelopment Project Tax Allocation Bonds 'A'

- City of Orlando, Florida (Community Redevelopment Agency – Downtown District)
 - Tax Increment Revenue Refunding Bonds 'A+'

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JNNURM – Experience

- A grant based programme aimed at improving urban infrastructure, and functioning of ULBs by greater transparency and disclosure
- Objective - prepare ULBs to access bond market to raise funds rather than traditional mode of finances
- 65 ULBs get rated by MoUD (all agencies)
 - 'AA (cat)': 10 'A (cat)': 10 'BBB (cat)': 16 = 36
 - 'BB (cat)': 18 'B (cat)': 10 'C (cat)': 1 = 29
- Ind-Ra rated 21 ULBs — eight in Maharashtra, four in MP, two in Delhi, two in Rajasthan, and five in North-east
 - 'AA (cat)': 7 'A (cat)': 2 'BBB (cat)': 4
 - 'BB (cat)': 5 'B (cat)': 3
 - Mumbai, Navi Mumbai, Thane, Pune, New Delhi, Delhi

JNNURM – Learnings

- Tardy Project Implementation: 21 Ind-Ra rated ULBs
 - 22 were completed out of 127 projects sanctioned -18.33% (Dec 2011)
- Lack of revenue diversity
 - Barring Maharashtra based ULBs other ULBs depend on state government for revenue (mainly octroi compensation grants)
- Sticky current expenditure - dominated by salaries and wages
- Unsatisfactory service delivery - service delivery levels remained below par even by Indian standard
- Governance issue - lack of manpower and absence of sound oversight systems

JNNURM – Lessons Learned

(Rs. Crs)

Municipality	Sanctioned Amount	Utilised Amount	% utilised
Mumbai	2,880 (8)	94 (2)	3.26%
Delhi	7,197 (28)	258 (4)	3.58%
Bhopal	1040 (7)	41 (3)	3.94%
Pune	3,193 (20)	110 (2)	3.45%
Thane	693 (8)	267 (3)	38.53%
Indore	815 (10)	708 (3)	86.87%
Navi Mumbai	634 (3)		

- Better rated Munis – flushed with liquidity - do not need funding
- Low rated Munis in need of money but no investor appetite at that rating level
- Lack of knowledge on structuring
- Absence of institutional framework for knowledge transfer on how to achieve urban funding at operating level
- Frequent transfers of officers

Muni Funding - Suggestions

- Create centralised institution that can help needy ULBs to prepare for capital market access
 - HUDCO? New institution?
- Better rated munis need to make bond issuance in different time buckets of 3 to 15 year to develop benchmark
 - Small amounts of Rs. 100 – 500 crs
- Institutionalise knowledge transfer and skill development at operating level
- Creating strong independence and commitment at ULB level

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