

# Pooled Development Funds for ULB's Mortgage

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Strengthening City Developmental Finances  
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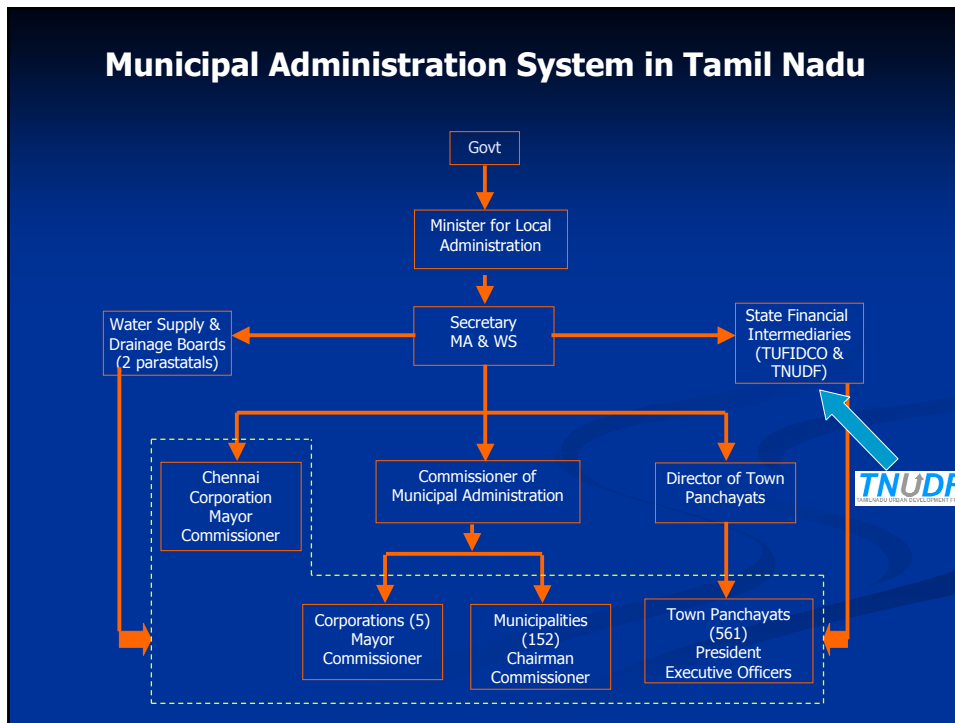


## Urban Sector Issues

- Infrastructure upgradation and reforms
- Capacity building at ULB level for efficient and responsive urban service delivery
- Sustainability of urban financing
- Need for accessing long tenor debt and eventually creating a market for municipal debt
- Political consensus and participatory project structuring to facilitate user charges / tariff



## Municipal Administration System in Tamil Nadu



## Tamil Nadu Urban Development Fund (TNUDF)

- Established in November 1996 as a Trust
- Public Private Partnership arrangement
  - Govt of TN: Rs 143 cr (71.5%)
  - ICICI Bank, HDFC, IL&FS: Rs 57 cr (28.5%)
- Vision: *Develop urban areas on sustainable basis*
- Trustee of TNUDF is a company (TNUITCL)
- Policies & procedures are prescribed by TNUITCL, not State Government (arm's length)
- Successfully managing Line of Credit
- Consistently profit making with no NPA

## Tamil Nadu Urban Infrastructure Financial Services Ltd (TNUIFSL)

- Asset Manager under Indian Companies Act, 1956
- Public Private Partnership
  - GoTN – 49%
  - FIs – 51%
- Manages under Management Contract
  - TNUDF
  - Grant Fund – I, II, III
  - WSPF
- Involved in project development, financial appraisal, structuring, fund sanctions / disbursement, project monitoring and project management



## TNUDF - Core Strengths

- Project Development
- Project Appraisal
- Financial structuring
- Access to capital market
- Flexibility in operation



## TNUDF Projects

- Water Supply
- Under Ground Sewerage
- Roads & Bridges
- Storm Water Drains
- Solid Waste Management
- Street lighting
- All other municipal infrastructure facilities including remunerative projects like bus stand, commercial complex etc.



## TNUDF Resource Status

- Resources: Rs 880 cr
  - Unit capital – Rs 200 cr
  - Loan from GoTN – Rs 210 cr
  - WB LoC – Rs 470 cr
- Pipeline of projects as on date Rs 500 cr (110 projects) and likely to grow to nearly Rs 1000 cr in next 5 years
- Additional resource mobilization from donor agencies (JBIC, KfW) and capital market (Pooled Finance Development Fund Scheme of Govt of India)



## Terms of TNUDF Loans to ULBs

- Period up to 20 years with a grace period of 5 years.
- Project should generate enough cash flow backed by B/S to cover O&M / debt servicing
- Recourse – Water supply, UGD Project
- Non-recourse – Roads, SWM
- Comply with ESF
- Security of project assets
- Security enhancement mechanism- Escrow and DSRF



## Criteria for Sanction of Loan

- Up to 60% of project cost
- Period upto 20 years with 5 years grace
- Interest up to 8.50%
- Total Expenditure / Total Revenue < 1
- Should have adequate debt repaying capacity (DSCR > 1.25)
- No default in the existing loans
- Cannot be used for land acquisition or for meeting working capital requirements



## Criteria for sanction of Grant

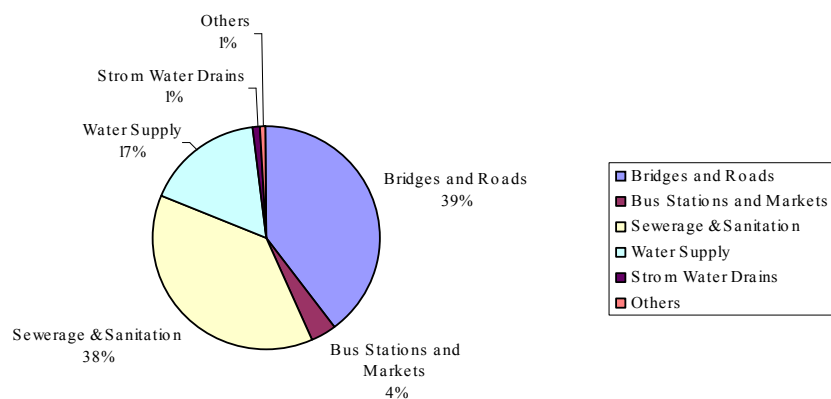
- Basic conditions:
  - BPL population minimum 20%
  - No default on existing loans
  - Maximum 30% of PC or Rs 10 cr
- Additional condition for remunerative projects
  - Collection efficiency (past 3 years) > 80%
  - Own revenue to the total revenue > 75%
  - Should follow IBRD procurement guidelines and Environment & Social Framework

*Grants can be used to structure projects to balance the need for recovery of user charges and affordability of services. However, if service quality is high, it is more a case of “reluctance to charge”*



## TNUDF's Portfolio in Urban Infrastructure

**TNUDF's Sector Wise Portfolio (Sanctions)**



## Learnings from TNUDF model

- State level commitment to urban reforms (accrual based accounting, collection efficiency, effective service delivery, tariff rationalization) crucial for enhancing fiscal, technical and management capacities of ULBs
- Level playing field for FIs in urban sector
- Transparent rules of engagement with ULBs and wider choice of products through marketing
- Going beyond being a pure lending agency – the TNUDF USP of project development, appraisal, management) – crucial to smaller ULBs



## Learnings from TNUDF model

- Risk management – including interest risk (preventing loss of loan asset portfolio) through resetting or floating rate, say based on rating of ULB; alternatively, pre-closure premium
- Up to date information on ULBs' financial position (debt monitoring cell)
- Ownership by state agencies and ULBs; close cooperation between TNUDF and such entities at concept, design, bidding, implementation stage
- Capacity building among ULBs, line agencies and contracting firms
- Ensure a project implementing agency and PMC to avoid time (hence cost) overruns and quality issues



## Innovations by TNUIFSL

- Taxable / Tax free bonds – no government guarantee – Rs 110 cr as bonds
- Arranged mobilization of bonds by Chennai Corporation, Madurai Corporation, Metro Water
- Pooled Bonds – Rs 30.4 cr – with USAID partial guarantee



## Attempts at resource mobilization

### TNUDF Bond Issue

Issue Size : Rs 110 cr

Tenor : 5 years (2000-2005)

Redemption : in 5 equal annual instalments

Coupon rate : 11.85 % interest payable semi-annually

Rating : AA+(SO) upgraded to AAA(SO)



## Facilitating ULBs/Parastatals for Market Borrowing

	Madurai Inner Ring Road	CMWSSB Issue I	CMWSSB Issue II
Issue Size	Rs 29 cr	Rs 42 cr	Rs 50 cr
Tenor	15 years	7 years	7 years
Redemption	30 equated semi annual installments	Six semi annual installments in 5 <sup>th</sup> 6 <sup>th</sup> 7 <sup>th</sup> year	Six semi annual installments in 5 <sup>th</sup> 6 <sup>th</sup> 7 <sup>th</sup> year.
Coupon	12.25 %	5.20%	5.45%
Tax Status	Taxable	Tax -Free	Tax-Free

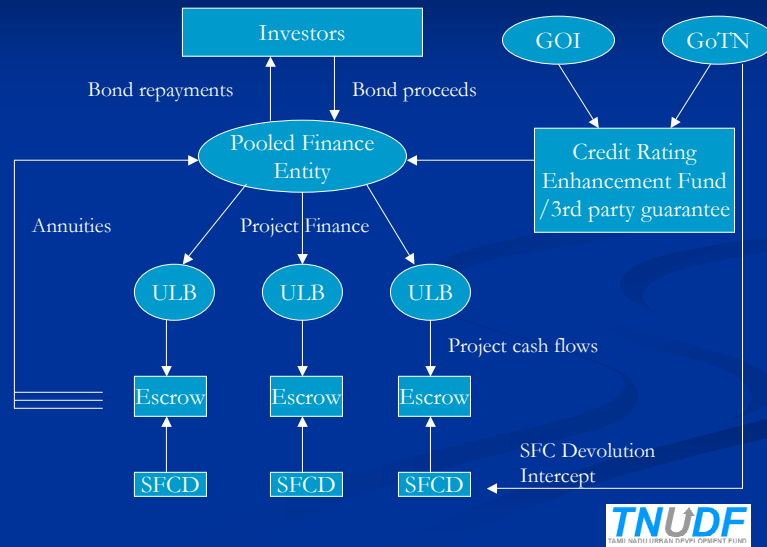


## Pooled Financing

- Pooling of individual project fund requirements of ULBs in a state
- State Pooled Finance Entity (SPFE) raises debt from capital market on behalf of the pool by issuing bonds
- Bond proceeds used to finance capital assets
- Asset revenues provide annuities to service debt
- SPFE responsible for repaying bond holders
- Credit enhancements and rating
- Guarantees and capitalization by State/Central Govt



## Pooled Finance Funds Flow



## Water and Sanitation Pooled Fund

### Formation

- Water and Sanitation Pooled Fund (WSPF) was set up in 2002
- Trust - fully owned by GoTN
- Recently designated as SPFE under PFDF scheme

### Objective

- Mobilize resources from the capital market
- Finance viable urban infrastructure projects
- Operate on no profit no loss basis

# WSPF Bond Issue - 2002

- First of its kind in country; refinancing of existing loan @16%
- Fund requirement of 13 ULBs pooled and a pool bond of Rs.30.41 cr @ 9.2% p.a. for 15 years mobilized in 2002
- Credit enhancement through
  - Escrow of property tax and other collections
  - Creation of Bond Service Fund – Rs.6.90 cr by GoTN
  - USAID guarantee for 50% of the principal amount
  - Interception of Sate transfers in the case of failure of ULBs to honor their commitment
- Credit rating AA(SO)
- Saving of 6.8% on interest rate



# WSPF Funds Flow



## PFDF Scheme

- ❑ Pooled Finance Development Fund (PFDF) Scheme - by MoUD, GoI
- ❑ Each State / Union Territory expected to designate State Pooled Finance Entity (SPFE)
- ❑ Guidelines prescribed by GoI
- ❑ Projects to be approved Sanctioning and Monitoring Committee comprising GoI and State representatives
- ❑ Credit Rating Enhancement Fund (CREF) - 50% of CREF or 10% of the issue size contributed by GoI
- ❑ Project Development Grant (75% by GoI)



## Tax Free Pooled Bonds

- Rate of interest : Maximum 8%
- Tenor : Minimum 5 years
- Reforms : User charges and collection efficiency (85%)
- DSCR : At least 1.25 times
- Utilization : At least 50% within 12 months & 85% within 24 months



## Proposed Issue of WSPF

- Pooling of the requirements of 7 ULBs (already financed under TNUDP-III by TNUDF at 8.5%)
- Size : Rs.45 crs (about 50% of loan)
- Rating AA (SO) by Fitch Ratings
- CREF required: Rs.9.80 crs (about 22% of issue size)
- Tenor of bond: 10 years (as against repayment by ULB in 20 years)
- Credit Enhancements
  - Escrow
  - CREF
  - Interception of State grant



## Participating ULBs

Sl.No.	ULB	Rs. in cr.	
		Project Cost	Bond Amount
Underground Sewerage Scheme			
1	Ambattur	30.91	8.00
2	Pallavaram	47.21	12.00
3	Kancheepuram	12.48	2.00
4	Ramanathapuram	30.00	7.00
5	Namakkal	18.84	3.00
6	Virudhunagar	2325	5.00
Water Supply Project			
7	Salem	24.84	8.00
	<b>Total</b>	<b>187.53</b>	<b>45.00</b>

- All projects are under implementation



## Credit Rating Enhancement Fund (CREF) and other features

- CREF requirement is Rs.9.80 crs.
- 50% of the CREF or 10% of the project cost, which ever is lower - by GoI (Rs.4.50 crs)
- Balance by GoTN (Rs.5.30 crs)
- Financial tie up of WSPF with TNUDF for Asset-Liability Management
- Coupon rate of 8% or less would reduce cost of borrowing for ULBs, while repayment period (20 years) remains unchanged
- Interest earning on CREF can be used to further reduce interest burden on borrowing ULBs.



## Project Development Grant

- Maximum eligible : Rs.175 lakhs
- Proposed to be claimed: Rs.154 lakhs
- GoI Share : Rs.116 lakhs (75%)
- However, this works out as over 25% of CREF, which is way above the 5% allocation for such grants under the scheme
- The grant covers post reimbursement of project preparation costs (typically 2-4% of PC, which amounts to at least 6% of issue size, as against CREF of 10%)
- Rating fees, bond issue costs also to be met from grant



## Issues

- Marketability of the tax-free bonds
  - Long term players like PFs enjoy tax-free status; so do mutual funds; this limits the market
  - Banks affected by section 14 A of Income Tax Act
  - Retail investors – issue costs very high
  - Cap of 8% on interest rate a major hurdle
  - Tenors above 10 years, without put/call option have limited appeal; however, WS and UG projects need longer repayment periods
- Enhancement of CREF; tax on interest income



## Way Forward

- Clear policy by Governments to promote urban infrastructure through debt financing (i.e. leveraging), time-bound reforms and capacity building
- Redesign JNNURM/UIDSSMT so that their grants do not crowd out pooled development funds
- Convert these “one-size-fits-all” Central grants as
  - CREF upto 33% of issue size, with States contributing upto 17%
  - Viability grants only for weaker ULBs or unviable projects
  - Unavailable or available at reduced rates for remunerative projects
- Coalesce all nodal agencies into one entity (SPFE) at State level; pass State legislation to give it statutory status



## Way Forward

- Prepare DPRs for pipeline of projects through PFDF's project development grant window; need to provide such grants upfront to SPFE as a reimbursable corpus
- Simplify approval process (e.g. avoid need to go to CBDT/MoF after S&M committee's approval)
- Enable bridge financing by SPFE to remove construction risk from affecting bond issue, given the utilization stipulations for bond proceeds
- Remove impediments to development of municipal debt market by addressing marketability & other issues



# THANK YOU

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