

Ahmedabad Municipal Bonds

Innovation Report

I. The Context

- (1) One of the key developments in the arena of infrastructure financing in the country has been the emergence of nascent municipal bond market in the country. The concept of municipal bonds as an additional mechanism for raising resources for urban infrastructure projects was first discussed in December 1995 at a national seminar. Later, the Rakesh Mohan Committee on the Commercialization of Infrastructure Projects in India also discussed the possibility of using municipal bonds as a tool for raising finances from markets
- (2) Internationally, municipal bonds have played a key role in the creation of urban infrastructure assets in United States and Canada. Therefore, it was envisaged that adapting this model to the Indian context would open new vistas for attracting private capital to the urban infrastructure sector
- (3) Taking a cue from the emerging discussions, the Ahmedabad Municipal Corporation (AMC) proposed to raise finances of Rs.1000 Million through municipal bonds. The AMC was at that time proposing to implement water supply & sewerage project and upgrade its existing networks for which it required substantial resources. It proposed to raise part of the resources required for this project through the bond issue
- (4) At that time, there was limited experience in the market of raising bonds in the market by a local body without any guarantee backed recourse structure. The AMC approached IL&FS in 1997 for structuring the transaction and for the issuance of the bonds. IL&FS thus became the financial advisor to AMC and the lead manager to the bond issue.
- (5) Innovative Features: The Ahmedabad Municipal Bond was an important innovation in the financial markets and in the field of financing infrastructure projects by a local body due to the following:
 - (a) it was the first issue by a local body to raise resources without a state government guarantee
 - (b) evolution of innovative credit enhancement measures that were used to structure the municipal cashflows for repayment to bondholders set the trend for evolving such recourse structures for municipal financing in India
 - (c) application of innovative cashflow structuring for credit enhancement facilitated enhancement of "A+" credit rating done by CRISIL to AA(SO), which facilitated a better position in the market

- (6) The entire process of establishing the framework for issue of municipal bonds and obtaining the necessary regulatory and state government approvals took about two years. With the structuring proposed by IL&FS, the credit rating of the bond issue was enhanced to AA(SO)
- (7) Ahmedabad Municipal Corporation finally accessed the capital markets in the last quarter of 1997 and privately placed Rs. 750 million of bonds with thirteen banks and institutional investors. The balance amount of Rs.250 million was earmarked for a public issue, which opened in January 1998
- (8) The success of the process of structuring the bond issue was realized when the issue opened for public. The public issue was opened on January 16, 1998 and closed on January 27, 1998. The issue was quite popular as it attracted considerable investor interest and was oversubscribed by 10%. The salient features of the bond issue are summarized below

Ahmedabad Municipal Corporate Bond Issue	
Issue Size	Rs 100 crore <ul style="list-style-type: none"> ▪ Rs 75 crore privately placed with 13 banks and institutional investors ▪ Rs 25 crore by way of public issue
Purpose	Part Finance water and Sewerage Projects
Interest	14% payable semi-annually
Redemption	At the end of 6,7 and 8 th year
Security Cover	<ul style="list-style-type: none"> ▪ First Mortgage and Charge on Corporations property subject to a minimum 1.25 times ▪ Structured Payment Mechanism by way of Escrow
Listing	National Stock Exchange
Credit Rating	AA(SO)

- (9) Needs and Objectives of the Innovation: The Ahmedabad Municipal Corporation (AMC) had proposed to implement a Rs. 4,890 million water supply and sewerage project. The scheme entailed development of new source of water and upgradation of the present water supply system through installation of additional tubewells in order to meet the future requirements of the city of Ahmedabad. The Project benefited over three million people.

To meet this financial requirement, it had to raise the resources for which AMC proposed the issuance of Rs.1000 million bonds to part finance this project

Credit Rating and Information Services of India, Ltd (CRISIL) assigned AMC an "A+" rating for a municipal bond issue of Rs.1000 million

Infrastructure Leasing and Financial Service (IL&FS) was appointed as the lead manager to the bond issue. Owing to the structuring of the issue by IL&FS, the rating of the instrument was enhanced to "AA(SO)" that indicates high safety for the timely payment of interest and principal. The rating reflected the strength of the credit enhancement mechanism that was put in place to meet the debt servicing obligations on the bonds. The bond was finally issued at a competitive coupon of 14.0%, just 65 basis points over the prevailing government security yield

The bond market issue saved the corporation an annual interest payout of about 3%, saving more than Rs.80 million.

II. Implementation of Innovation

- (1) The AMC had previously instituted fiscal and management reforms, including improved collection of property taxes and octroi, computerization of financial records, a modern accounting system, strengthened workforce and financial management, and development of a comprehensive capital improvement programme
- (2) Consequently, from a loss-making municipal corporation till 1992–1993, with accumulated cash losses of Rs.350 million, the AMC achieved a closing cash surplus of Rs.2142 million in March 1999. These reforms laid the groundwork for the AMC's bond issue and the successful implementation of the water supply and sewerage project

III. Impact Assessment

- (1) Achievements within the Organisation: Motivation and dedicated team efforts coupled with wide range of skill sets including financial and legal experts within the organization ensured successful closure of the bond issue
- (2) Achievements Outside the Organisation: The AMC issuance was the first of its kind, subsequent to which a number of Urban Local Bodies have accessed the market to finance urban development projects

(3) Specific Socio-Economic Impacts

- (a) The debt market for municipal securities in India has grown since the issuance of the AMC bonds. Following the AMC issue, Municipal Bonds are now available as an option for financing Urban Infrastructure outside the usual sources (grants and devolutions from the state governments and local taxes)
- (b) As more and more ULBs are taking the debt market route to fund their infrastructure initiatives, the central government has also undertaken policy initiatives to enable smaller and medium ULBs to access the capital markets and reduce the cost of borrowing
- (c) The ability of municipalities to take advantage of these opportunities depends on their presenting themselves as viable financial entities. This forces them to improve their revenue base by introducing reforms, including improved cost recovery and financial management, and better management of urban services
- (d) Reform and increased transparency by ULBs has resulted in improved efficiency in performance thereby further enhancing the overall socio economic impact to society.