

SEBI'S PUSH TO THE MUNICIPAL BOND MARKET



Pradeep Ramakrishnan

General Manager
Department of Debt & Hybrid Securities
SEBI, Mumbai
Pradeep@sebi.gov.in

Introduction

The first two tiers of the Government in India are the Central Government and State Government. Municipalities are the third tier of the Government (after Central and State Governments) and are so recognized in the Constitution of India as well. Municipalities play an important role in the development of a country as they plan for economic and social development, laying roads and bridges, create infrastructure for public health, sanitation, conservancy as well as solid waste management among other things. In the United States, Municipal bonds have been a huge success - the total amount of outstanding municipal bond in US market is approximately \$4.00 trillion and has helped fund creation and operation of urban infrastructure over a century or more.

Municipal bonds – what are they?

While Municipal corporations traditionally depend on the Central or State governments to fund them through grants, they can also levy taxes, duties and fees on the residents within the municipality. Subject to the laws governing the municipality, they can also borrow from commercial banks, developmental financial institutions and can also borrow through issuance of bonds or debentures. A municipal bond is a bond or a debenture or a debt security issued by a municipality or urban local body to an investor. The proceeds of issue are generally used to finance general administration as well as infrastructure projects such as roads and bridges, slum rehabilitation, parks, amenities like street lights, parking facilities, public health, sanitation & solid waste management, etc.

Revenue – municipalities

Municipalities derive revenue from property tax, toll tax, advertisements, parking contractors, and other miscellaneous receipts.

Evolution - Municipal bonds

Municipal bonds have been around for centuries. Massachusetts¹ seems to have issued the first such bond, in 1751 and New York in 1812² and such issuances have only grown over the years.

In Europe too, municipal bonds have flourished, particularly in Italy and Germany.³

In India the Bangalore (now Bengaluru) Municipal Corporation issued municipal bonds for the first time in 1997, for an amount of Rs.125 crore. Subsequently, other Municipal corporations like Ahmedabad, Nashik, Madurai, Hyderabad, Chennai etc. followed the suit.

Status of municipal corporations

In terms of SEBI regulations, municipal bonds can be issued by any municipality or any Statutory Body or Board or corporation, Authority, Trust or Agency established or notified by any Central or State Act or any Special Purpose Vehicle notified by the State Government or Central Government subject to the condition that it undertakes one or more functions that may be entrusted under Article 243W of the Constitution of India.

A municipality means an institution of self-government constituted under Article 243Q of the Constitution of India.

India and the municipal bond market – Government and SEBI initiatives

The government, as part of the Union Budget 2014-15, talked about initiatives for establishment of around 100 'Smart' cities in India⁴. Development of smart cities entails significant expenditure for creation of urban infrastructure such as water supply, sanitation, public health, roads transportation etc. At this juncture, in order to provide an alternative to bank and financial institution financing as well as an alternative to grants, it was thought appropriate by SEBI, to bring in a regulatory framework relating to

¹ This is a state in the US

² https://www.sechistorical.org/museum/galleries/mun/mun02a_share_growth.php

³ <https://www.tandfonline.com/doi/full/10.1080/00343404.2022.2047914>

⁴ A smart city is a technologically modern urban area. See <https://smartcities.gov.in/>

municipal bonds.

SEBI and the municipal bond framework

SEBI, in December 2014, issued a consultation paper inviting comments on a proposed regulatory framework for issuance of debt securities by Municipalities⁵. On July 15, 2015, SEBI issued the SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015 ('ILDM Regulations')⁶. These regulations, inter-alia, deal with:

- ⊙ the eligibility requirement for public issue,
- ⊙ listing requirements for both public issues and private placement,
- ⊙ conditions for continuous and trading of debt securities,
- ⊙ obligations of intermediaries and issuers etc.

The ILDM Regulations defined "*municipal debt securities*" to mean non-convertible debt securities which create or acknowledge indebtedness, and include debenture, bonds and such other securities of an issuer.

After receiving representations from municipalities, merchant bankers, Stock exchanges and other market participants to expand this market segment, SEBI, on August 21, 2019, revamped the then ILDM Regulations relaxing certain provisions in the framework to help smart cities and other registered entities working in areas of city planning and urban development work like municipalities to raise funds through issuance and listing of their debt securities. The major areas of relaxations were:

- ⊙ appointment of a monitoring agency,
- ⊙ filing of viability certificate or Detailed Project Appraisal Report,
- ⊙ setting up of a separate project implementation cell,
- ⊙ maintenance of 100% asset cover with specification of resources and mandatory backing of state or central government etc.

Why is India primed up for issue of Municipal bonds?

Presently, India's population is around 1.4 billion⁷ and is only expected to grow. This would result in requiring necessary infrastructure being enhanced in the cities. Consequently, the need for more and more funds to satiate the building and operating such urban infrastructure by municipal corporations around the country.

⁵ https://www.sebi.gov.in/sebi_data/attachdocs/1419931499189.pdf

⁶ https://www.sebi.gov.in/legal/regulations/sep-2019/securities-and-exchange-board-of-india-issue-and-listing-of-municipal-debt-securities-regulations-2015-last-amendment-on-august-03-2021-_34611.html

⁷ https://www.business-standard.com/article/economy-policy/the-global-economy-needs-a-new-powerhouse-india-is-stepping-up-123012800994_1.html

General conditions for an issuer under the ILMDS Regulations

An issuer desirous of issuing municipal bonds shall comply with the following conditions:

- ⊙ **Listing** is mandatory; The issuer should obtain an in principle approval from one or more recognised stock exchanges.
- ⊙ The issuer shall obtain **credit rating** from at least one credit rating agency registered with the Board, which shall in the offer document or placement memorandum.
- ⊙ The issuer shall enter into agreements with a **depository** for issue of securities in demat form.
- ⊙ Appointment of **merchant banker** is compulsory.
- ⊙ The issuer shall appoint a **debenture trustee**.
- ⊙ The issuer can come with a **public issue or private placement** of municipal debt securities.

Financials of a municipal bond issuer

An issuer of municipal bonds shall ensure that financials are prepared as per:

- i. National Municipal Accounts Manual or;
- ii. Municipal Accounts Manual as adopted by the respective State Governments; or
- iii. Accounting standards, applicable to issuers, as prescribed under the Companies Act or;
- iv. Accounting standards/ policies, applicable to issuers, as specified in their constitution document.

Disclosures to be made in the document

The draft offer document shall contain inter-alia, the following disclosures:

- ⊙ Details of the issuer
- ⊙ Risk factors in relation to the issue
- ⊙ Capital structure
- ⊙ Objects of the issue
- ⊙ Tax benefits, if any
- ⊙ Issuer specific information like credit enhancement mechanism, DRR, rationale for credit rating, coupon, terms of payment, escrow payment mechanism etc.
- ⊙ Financial information – for the past three years.
- ⊙ Government approvals
- ⊙ Material litigation

SEBI may issue observations, if any, within 21 days of such filing.

Use of issue proceeds

- ⊙ The funds raised from public issue of debt securities shall be used only for projects that are specified

under objects in the offer document.

- ⊙ The proceeds of the issue shall be clearly earmarked for a defined project or a set of projects for which requisite approvals have been obtained from concerned authorities.

Creation of Escrow Accounts

A specific condition for a municipal bond issuer is that the issuer shall create a structured payment mechanism and maintain specific escrow accounts for the purpose of debt servicing of the municipal debt securities.

Creation of these accounts facilitate better monitoring by Debenture Trustees of the debt servicing by municipalities.

Execution of Trust deed

- ⊙ A trust deed for securing the issue of debentures shall be executed by the issuer in favour of the debenture trustee.
- ⊙ In case of private placement by a corporate municipal entity, the trust deed shall, contain such clauses as prescribed under section 71 of the Companies Act, 2013 and Companies (Share Capital and Debentures) Rules 2014.

The issue proceeds shall not be utilised until the Trust deed is executed.

Continuous listing conditions for municipalities

- ⊙ All the issuers making public issues of debt securities or seeking listing of debt securities issued on private placement basis, shall comply with conditions of listing including continuous disclosure and other requirements specified by SEBI.
- ⊙ Where the issuer is corporate municipal entity, 1/3rd of its Board shall comprise of independent directors, as defined in section 149 of the Companies Act, 2013.
- ⊙ Every rating obtained by an issuer shall be periodically reviewed by the registered credit rating agency and any revision in the rating shall be promptly disclosed by the issuer to the stock exchange(s) where the debt securities are listed.
- ⊙ Any change in rating shall be promptly disseminated in such manner as the stock exchange where such securities are listed may determine from time to time.
- ⊙ The issuer, the respective debenture trustees, wherever appointed, and stock exchanges shall disseminate all information and reports regarding debt securities including compliance reports filed by the issuers and the debenture trustees, if appointed, to the investors and the general public by placing them on their websites.

Amounts raised through recent issuances of Municipal bonds

Details of amounts raised through municipal bonds under the SEBI municipal bond framework are as follows:

Name of Municipality	Date of Issue	Amount of Issue (Rs. in cr.)	Coupon
Pune Municipal Corporation	June 20, 2017	200	7.59
Greater Hyderabad Municipal Corporation	Feb 16, 2018	200	8.9
Indore Municipal Corporation	June 28, 2018	139.9	9.25
Greater Hyderabad Municipal Corporation	Aug 14, 2018	195	9.38
Bhopal Municipal Corporation	Sept 25, 2018	175	9.55
Greater Vishakhapatnam Municipal Corporation	Dec 21, 2018	80	10
Ahmedabad Municipal Corporation	Jan 11, 2019	200	8.7
Surat Municipal Corporation	Feb 27, 2019	200	8.68
Greater Hyderabad Municipal Corporation	August 20, 2019	100	10.23
Lucknow Municipal Corporation	November 13, 2020	200	8.5
Ghaziabad Nagar Nigam	March 13, 2021	150	8.1
Vadodara Municipal Corporation	March 24, 2022	100	7.15
Total		1939.9	

Green municipal bonds

The urban infrastructure created by municipal corporations at times are for 'green' purposes. Accordingly, the bond issuance can also be considered being made as green bonds, which were developed as financing tools for sustainable investment.

In November 2022⁸, SEBI clarified that a municipal corporation under the ILDM Regulations may issue a ‘green debt security’ or Green Municipal Bonds, if it falls within the definition of “green debt security”, as per Regulation 2(1)(q) of the NCS Regulations, 2021.

SEBI is in the process of making changes to the sustainable bond finance framework to:

- ⊙ *amplify the definition of green debt securities on the lines of the green bond principles of the ICMA – by including soil remediation, waste to energy plants etc.*
- ⊙ *introduce the concept of blue bonds⁹;*
- ⊙ *reduce the compliance cost of green bond issuers with SEBI regulations for bond issuance while not creating any perverse incentives that may lead to ‘greenwashing’.*

Vide Gazette Notification dated February 02, 2023¹⁰, the definition of the green debt security was amended to this effect. Further, the revamped disclosure norms, to give effect to the above framework is expected to be issued shortly.

SEBI’s municipal bond outreach programme

SEBI recently organized an outreach programme on Municipal Bonds and Municipal Finance on January 20 and 21, 2023 at New Delhi to provide a common platform for stakeholders to discuss the concerns of the issuers of Municipal Debt Securities, the requirements of investors, the extant regulatory framework and to recommend measures to increase awareness of and improve traction in the market for Municipal Debt Securities.

The two-day event saw participants representing all stakeholders including the Ministry of Housing and Urban Affairs, Municipal Corporations, Stock Exchanges, Credit Rating Agencies, Merchant Bankers, Debenture Trustees, Lawyers, NGOs and Institutional investors.

Participants at the workshop had detailed discussions among various stakeholders on their concerns, suggestions and recommendations. The two-day event also brought focus to the use of existing revenue-generating assets managed by Municipal Corporations and the financing of green projects undertaken by Municipal Corporations.

⁸ https://www.sebi.gov.in/legal/circulars/nov-2022/issue-of-green-debt-securities-by-an-issuer-under-securities-and-exchange-board-of-india-issue-and-listing-of-municipal-debt-securities-regulations-2015_65404.html

⁹ *Blue bonds refer to the funds raised in the form of debt to finance sustainable projects towards ocean conservation, and related areas like offshore wind energy, fishing, coastal tourism, ocean waste disposal and so on.*

¹⁰ https://www.sebi.gov.in/legal/regulations/feb-2023/securities-and-exchange-board-of-india-issue-and-listing-of-non-convertible-securities-amendment-regulations-2023_67798.html

To assist municipal debt issuers and other stakeholders in the Municipal Debt market, SEBI launched an Information Database including a repository of information pertaining to Municipal Bonds on its website. The Information database can also be accessed by way of a Quick Response Code (QR Code):



The information database / repository¹¹ contains a wide range of information in the form of statistics and regulations, circulars, guidance note and Frequently Asked Questions issued by SEBI in respect of Municipal Debt Securities. Significantly, the repository contains various checklists for pre-listing requirements and sample letters and certificates from various intermediaries to be obtained by an Issuer who plans to tap the Municipal Bond Market. Templates for agreements between various stakeholders and an indicative Due Diligence Questionnaire for Merchant Bankers are also included. While this repository would serve as a guide, it is also hoped that it would result in more awareness.

Conclusion

While SEBI has introduced the framework for municipal bond issues in India, the same is waiting to be tapped. That, coupled with the new sustainable finance framework is expected to give a big fillip to the green municipal bonds in India. Municipal bonds have great potential, and can supplement bank financing and institutional financing. There are also possibilities of using InVIT/ REIT structures by municipalities for revenue generating assets owned by municipal corporations. Considering these options – issuance of municipal bonds or harnessing REITs/ InvITs, will go a long way in bridging the funding requirements of municipal corporations, furthering the cause of realisation of objectives, particularly infrastructure development and further the cause of the ‘Smart City’ mission in India, while also lending a hand in developing the market for such instruments. **MA**

¹¹ https://www.sebi.gov.in/mdr-repository/mdr_repository.html