# Sub-national Instruments for Financing Basic Utilities

## Case Study from India –

## Tamil Nadu Urban Development Fund

TNUDF
TAMILNADU URBAN DEVELOPMENT FUND


Vikram Kapur
MD & CEO, TNUIFSL, Chennai



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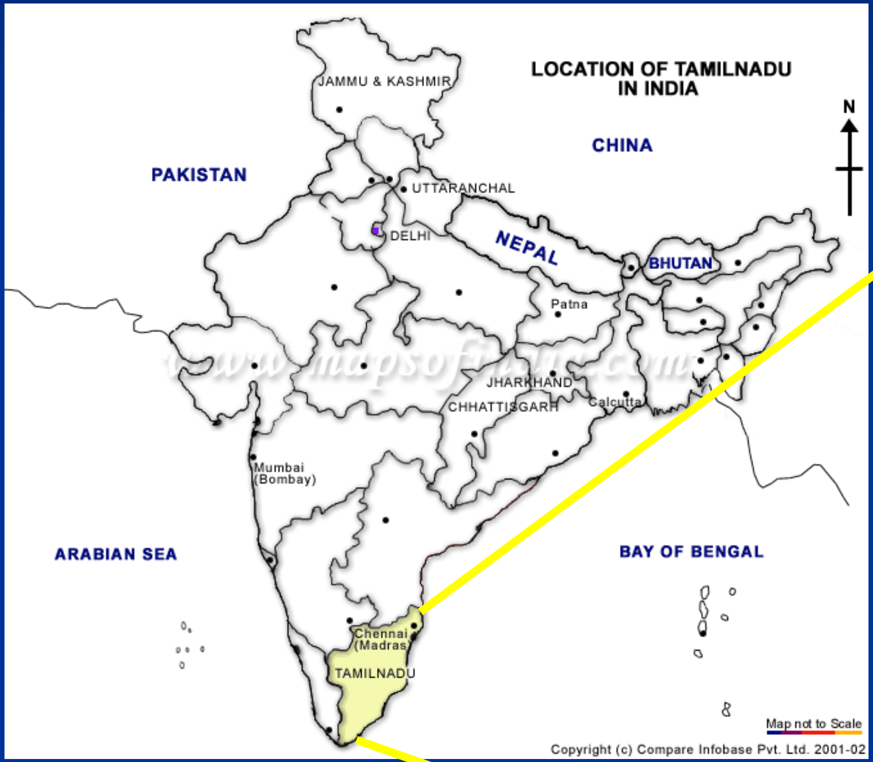
# Location of State of Tamil Nadu




# Urban scenario in Tamil Nadu

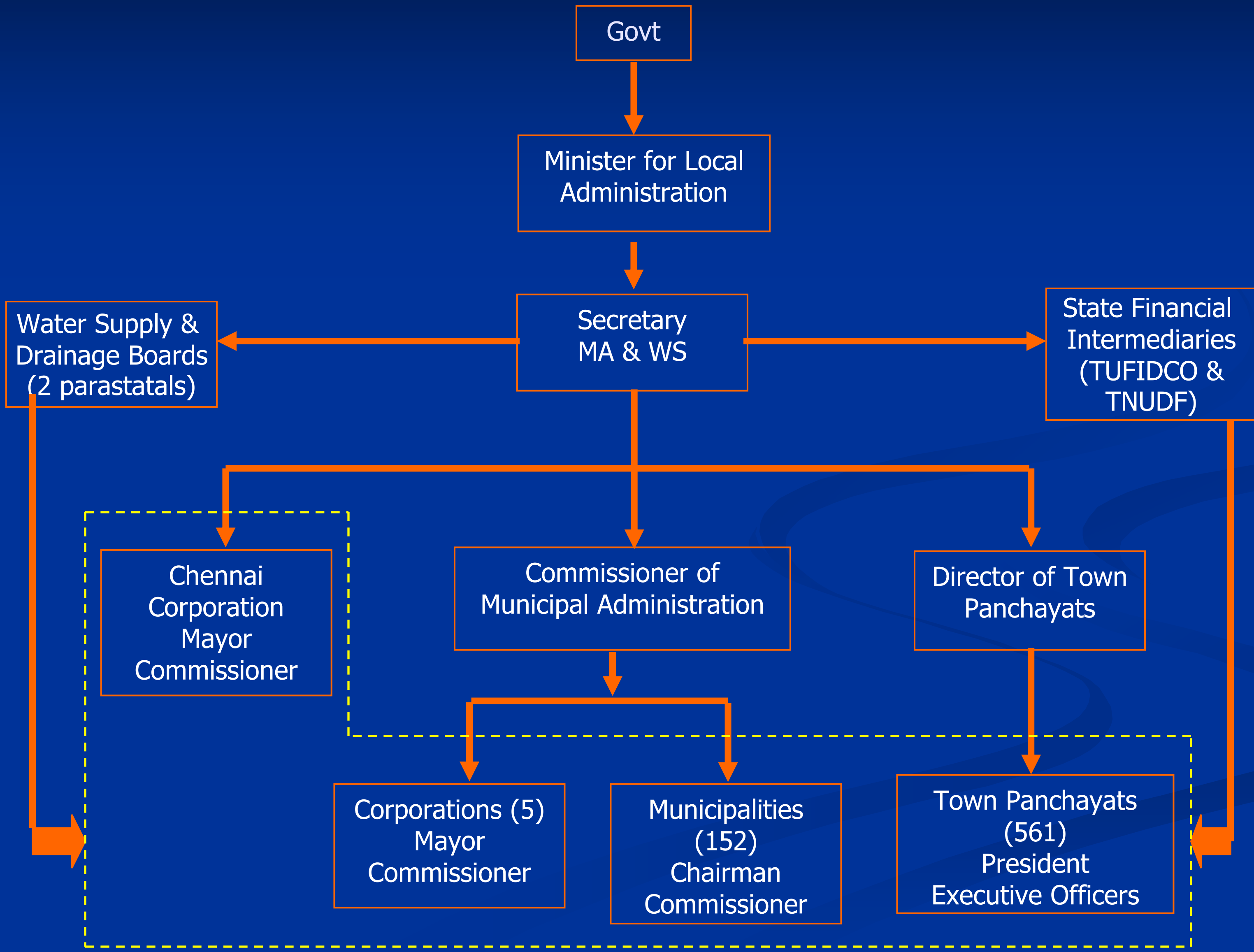
- Tamil Nadu – The most urbanised state in India
- 44% of its 65 million population resides in urban areas against national average of 28%
- Rate of Urban Growth is 44% in the decade 1991 – 2001 against national average of 31.2%
- 6 Municipal Corporations, 152 Municipalities and 561 Town Panchayats (Councils) in TN [719 ULBs]
- Urban areas contribute >70% of SGDP in TN
- Organic linkage between economic growth / human development and infrastructure development / service delivery

# Urban Sector Issues

However, reforms needed in financing and management of urban infrastructure

- Core issues
  - Capacity building at ULB level for efficient and responsive urban service delivery
  - 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 changes

# 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: INR 1.43 bn (71.5%)
  - ICICI Bank, HDFC, IL&FS: INR 0.57 bn (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 <u>no NPA</u>

# Tamil Nadu Urban Infrastructure Financial Services Ltd (TNUIFSL)

- Asset Manager under Indian Companies Act, 1956
- Public Private Partnership
  - GoTN – 49%
  - FIs – 51% (hence, not a public sector entity)
- 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 - Resources

- Unit Capital (INR 2 bn) by Govt of TN and Financial Institutions
- World Bank Line of Credit
- Market Borrowings
- Institutional Borrowings

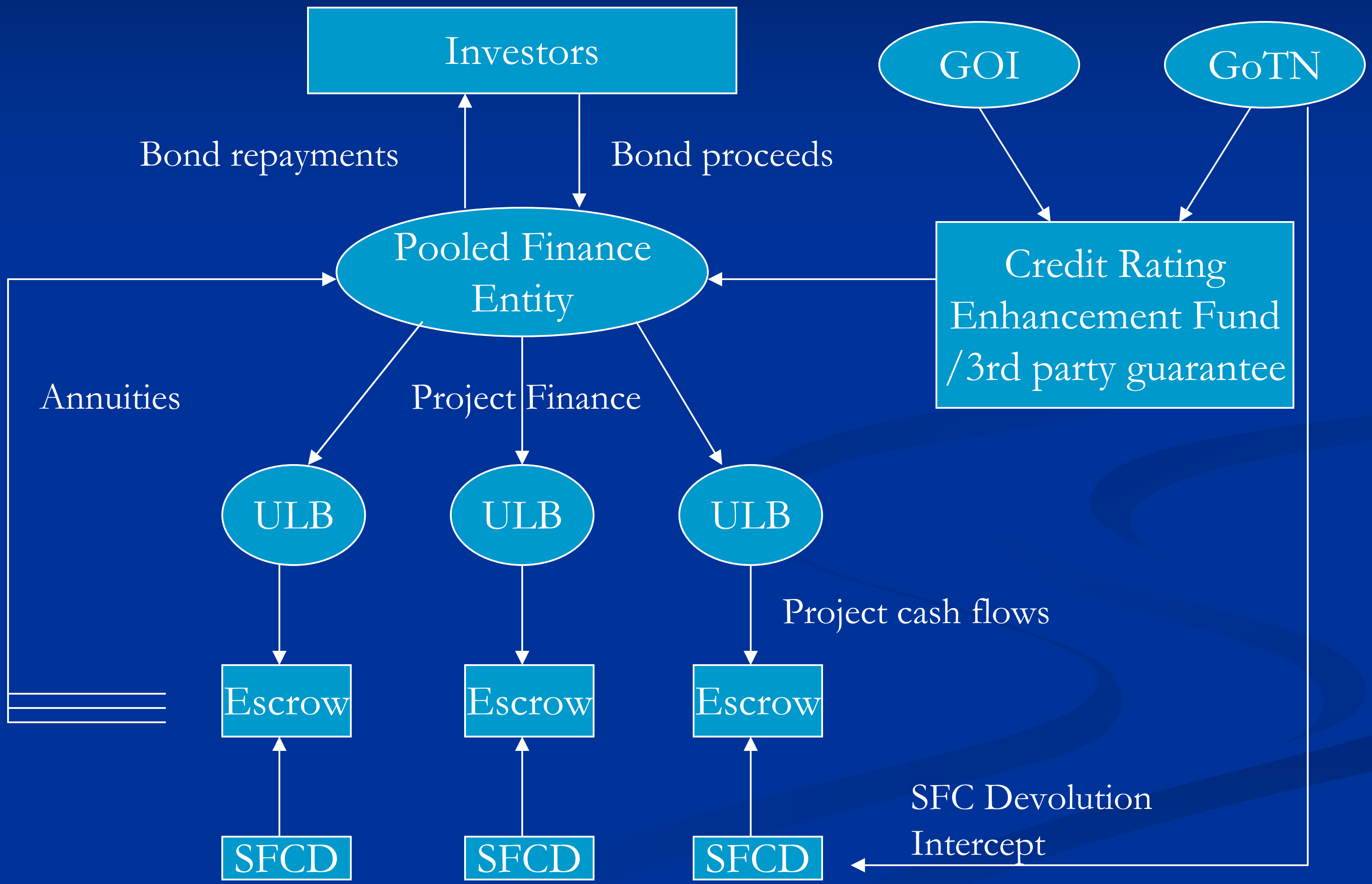
# Innovations

- Taxable / Tax free bonds – no government guarantee – INR 1.1 bn as bonds
- Pooled Bonds – INR 304 mn – USAID
- Arranged mobilization of bonds by Chennai Corporation, Madurai Corporation, Metro Water
- Project Structuring

# 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



# TNUDF - Innovative Financing

**Karur Bridge** –

- Facilitated first toll bridge contracted by a ULB in India – cost Rs.160 m under BOT
- Predictable cash flow
- TN State Toll Act amended to facilitate ULB to enter into BoT contract – stable regulatory framework

# KARUR TOLL BRIDGE

TNUDF
TAMILNADU URBAN DEVELOPMENT FUND

# TNUDF - Innovative Financing

- **Alandur Underground Drainage**

–

  - Project Cost INR.340 m
  - Initial tariff INR.150 per house per month
  - TNUDF organised people's participation @ INR 5000 per house and generated INR140 m
  - STP on BOT arrangement
  - With this, tariff reduced to INR 75 per house per month
  - *Project Champion in the form of the Chairman*

# ALANDUR UNDERGROUND DRAINAGE

# TNUDF - Innovative Financing

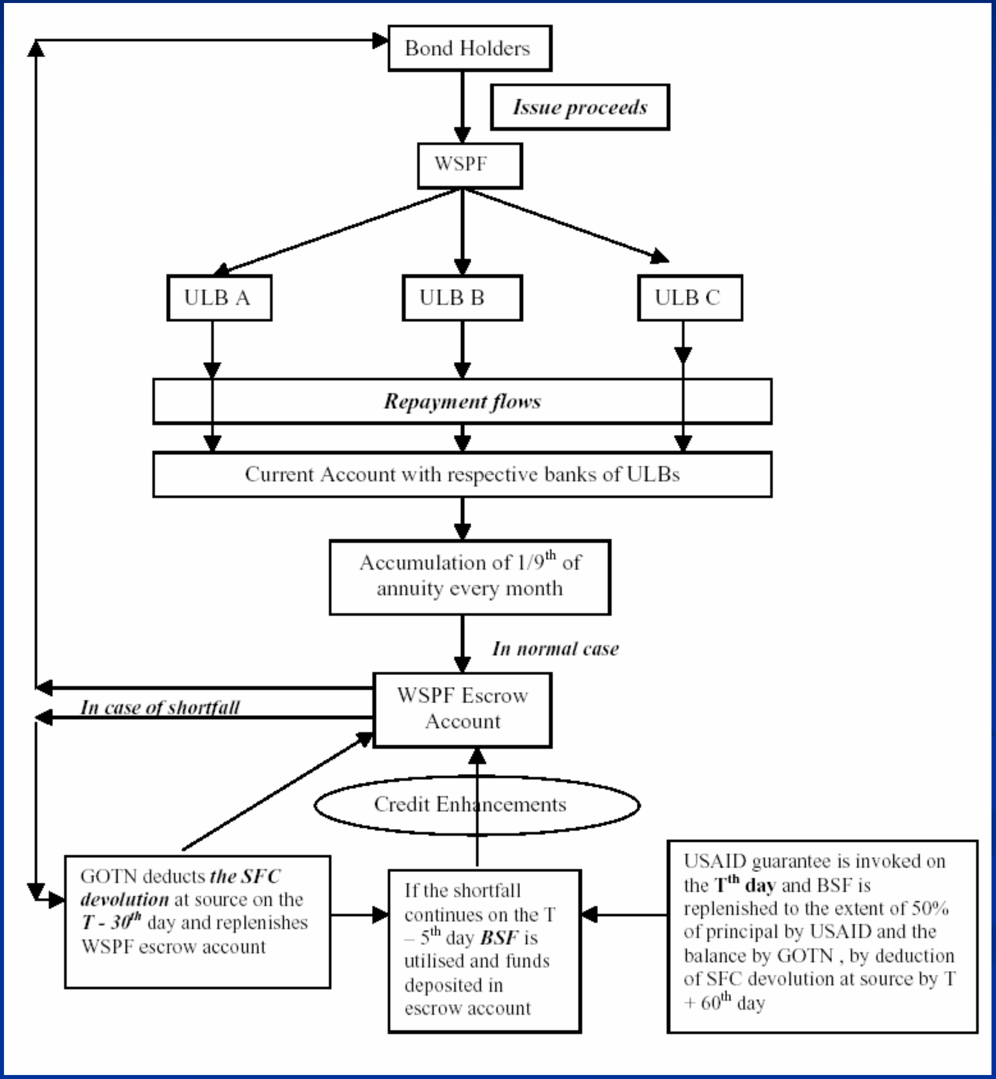
- **Madurai Bye-Pass**
  - Two-lane road of 27 km, 2 RoBs and 1 high level bridge.
  - Project cost of INR 460 m
  - Funded INR 334 m loan at 15.50%
  - The vehicles toll collection efficiency within 4 years found to be 54%
  - Based on toll tax collection efficiency, TNUDF facilitated first revenue bond in the country
  - Cost saving of 3% on interest rate to ULB

# Madurai Inner Ring Road

# Innovative Financing

- **Water and Sanitation Pooled Fund (WSPF) Bond**
  - First of its kind in country; refinancing of existing loan @16%
  - Fund requirement of 13 ULBs pooled and a pool bond of INR 304.1 m @ 9.20% p.a. for 15 years mobilized in 2002
  - Credit enhancement through
    - Escrow of property tax and other collections
    - Creation of Bond Service Fund
    - 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 Chart



# Facilitating ULBs for Market Borrowing

| | Madurai Inner Ring Road | CMWSSB Issue I | CMWSSB Issue II |
|---|---|---|---|
| Issue Size | INR 290 mn | INR 420 mn | INR 500 mn |
| Tenor | 15 years | 7 years | 7 years |
| Redemption | 30 equated semi annual installments | Six semi annual installments in $5^{th}$ $6^{th}$ $7^{th}$ year | Six semi annual installments in $5^{th}$ $6^{th}$ $7^{th}$ year. |
| Coupon | 12.25 % | 5.20% | 5.45% |
| Tax Status | Taxable | Tax –Free | Tax-Free |

# TNUDF Resource Status

- Resources: INR 8.80 bn
  - Unit capital – INR 2.00 bn
  - Loan from GoTN – INR 2.10 bn
  - WB LoC – INR 4.70 bn


- Pipeline of projects as on date INR 5 bn (110 projects) and likely to grow to nearly INR 10 bn in next 5 years
- Additional resource mobilization from donor agencies (JBIC, KfW) and capital market (Pooled Finance Development Fund Scheme of Govt of India)

# Attempts at resource mobilization

## TNUDF Bond Issue

Issue Size : INR 1.1 bn

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)

# TNUDP-III

- A repeater project of TNUDP II (1999-2004)
- Project launched on19th October, 2005
- Project Size : US $ 434 Million
  - World Bank : US $ 300 Million
  - GoTN : US $ 84 Million
  - Market borrowings : US $ 40 Million
  - ULB Contribution : US $ 10 Million
- Project period : 5 years

# Objectives of TNUDP-III

- to develop TNUDF as a financial intermediary
- to provide finance for infrastructure in ULBs on a sustainable basis
- to strengthen urban reforms and consolidate the achievements under TNUDP-II
- to strengthen institutional and capacity building
- to provide grant for traffic and transportation in Chennai Metropolitan Area.

# TNUDP-III Financial Structure

(all figures in USD $ million)

| Component | Bank Finance | GoTN / Others | Total Cost |
|---|---|---|---|
| Institutional Development Component (IDC) | 15.00 | 10.00 | 25.00 |
| Urban Investment Component (UIC) | 283.50 | 114.00 | 407.50 |
| Front End Fee | 1.50 | 0.00 | 1.50 |
| **Total Project Cost** | **300.00** | **134.00** | **434.00** |

# TNUDP-III Flow of Funds

- World Bank to Govt of India (GOI) through Project's Special Account
- GoI to GoTN - pass through arrangement
- GoTN to TNUDF / Grant Fund I, II & III
- TNUDF / Grant Fund to ULBs

*Repayment of loan by ULBs to TNUDF, which repays World Bank through GoTN and GoI*

# Terms of GoTN loans to TNUDF

- 20 year loans, with 5 year grace period for principal repayment
- Fixed interest rate linked to 10 year GoI bond on the primary / secondary market
- Option to prepay if rate of interest exceeds 1.50%
- Grant up to 30% of the cost of sub-project subject to a maximum of INR 100 mn
- Viability Gap funding (with Capital Grant) shall not exceed INR 100 mn

# 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

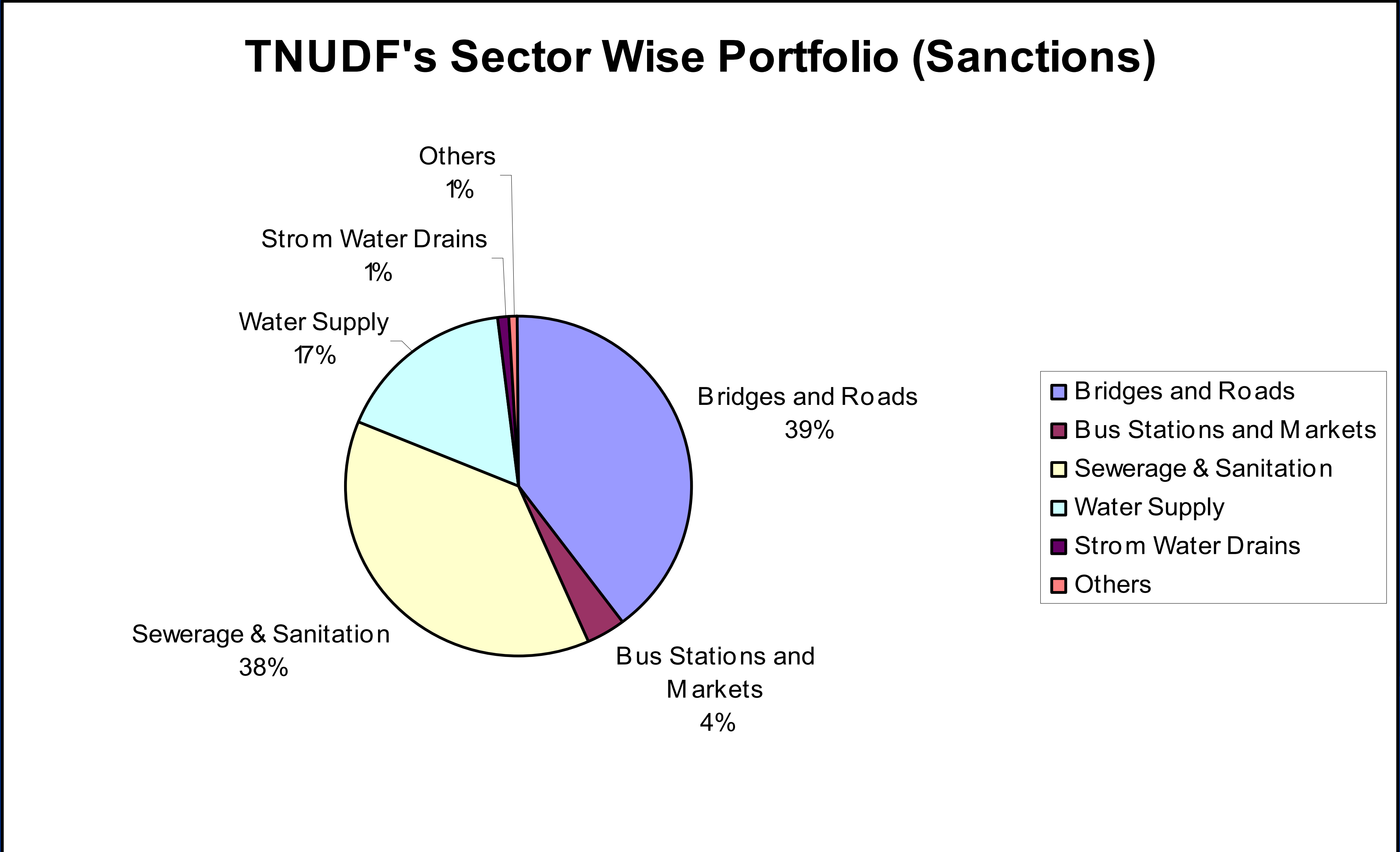
- Up to 60% of project cost
- Period upto 20 years with 5 years grace
- Interest up to 8.50%
- Total Expenditure / Total Revenue < 1
- Should have adequate debt repaying capacity (DSCR > 1.25)
- No default in the existing loans
- Cannot be used for land acquisition or for meeting working capital requirements

# Criteria for sanction of Grant

- Basic conditions:
  - BPL population minimum 20%
  - No default on existing loans
  - Maximum 30% of PC or INR 100 m
- 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



# 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 TNUIFSL 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

# Way Forward

- Clear strategy and policy initiatives by Governments to promote urban infrastructure (e.g. leveraging along with viability gap grants) and transparent reform agenda
- Prepare CCPs / CDPs for pipeline of projects
- Facilitate access of ULBs to capital markets through financial intermediaries / bond banks (possibly through tax-free pooled bonds) till they are able to stand on their own feet
- Promote development of municipal debt market through instruments like pooled bonds / master finance indenture (MFI) and statutory incentives

# In the context of SSA

- Key success factors
  - Municipal Reforms – Accounting, tax mobilization, e-governance, decentralization / autonomy
  - Capacity building of ULBs / parastatals
  - Policy direction (e.g. on leveraging of grants, user charges, private sector participation etc.)
- Financial intermediary (can build on Road Funds)
- Stable regulatory framework and political support

# THANK YOU

Visit us at www.tnudf.com or email at mdceo@tnudf.com

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