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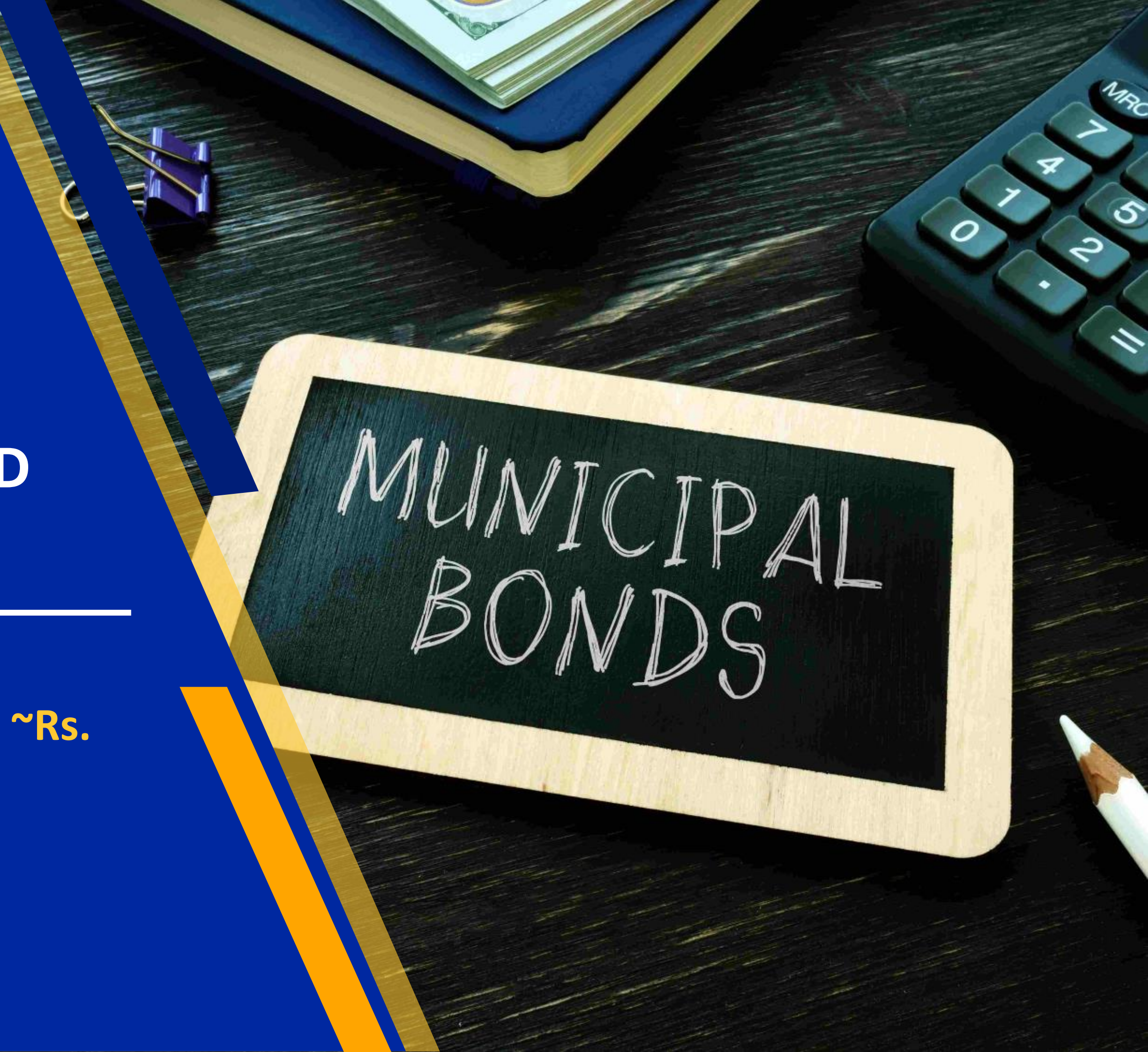
INDIAN MUNICIPAL BOND MARKET

Municipal bond issuances in FY2025/FY2026 expected to raise ~Rs. 1,500 crore

MARCH 2025



Municipal Bond market in India

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Municipal bond issuances are expected to raise more than Rs. 1,500 crore in FY2025-FY2026 driven by Government push; share of Green/pooled bonds likely to increase led by focus on ESG initiatives and enhancement in credit profile.

Overview: The municipal bond market in India has witnessed traction in recent years, especially since FY2018, driven primarily by fiscal incentives by the Government of India (GoI). While the total amount raised has been just over Rs. 2,600 crore since FY2018, it is significantly higher than the last such traction witnessed during FY1998-FY2005, when less than Rs. 1,000 crore was raised.

Enabling environment: The key enablers for the traction in the Indian municipal bond market can be attributed to measures taken by the Government and Regulators. In 2015, SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations were issued, which defined the status of bonds, thus garnering investor interest. Subsequently, in FY2018, the GoI initiated an incentive scheme (~Rs. 13 crore for every Rs. 100-crore bond issuance), providing impetus to Urban Local Bodies (ULBs) in using this mode of finance.

Key deterrents: The key deterrents observed have been high dependence on Govt grants by the ULBs, lack of adequate and timely financial disclosures, illiquidity and absence of a secondary market for bonds, high compliance requirements, and relatively weak credit quality of the ULBs to access capital markets.

Recent issuances: All the municipal bond issuances since FY2018 have been supported by a strong structured payment mechanism. This has been enhancing the credit rating of the bonds (all are rated in AA category), despite a diverse credit profile of the underlying issuer ULBs. Going forward as well, most of the bond issuances are likely to have a similar structure and terms.

Future outlook: Since FY2018, ~17 municipal bonds worth ~Rs. 2,600 crore have been issued with an average size of Rs. 150 crore. Going forward, ICRA estimates that more than 10 issuances combined in FY2025/FY2026 would raise funds in excess of ~Rs. 1,500 crore. However, this remains negligible relative to the size of Central/state Government issuance. In ICRA's view, persistent challenges such as improvement in the ULBs' own credit quality, lack of adequate disclosure and information systems would remain critical for a healthy municipal bond market in India.

Agenda

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1. An Overview of the Indian Municipal Bond Market

2. A Comparison with US Municipal Bond Market

3. Details of Recent Issuances

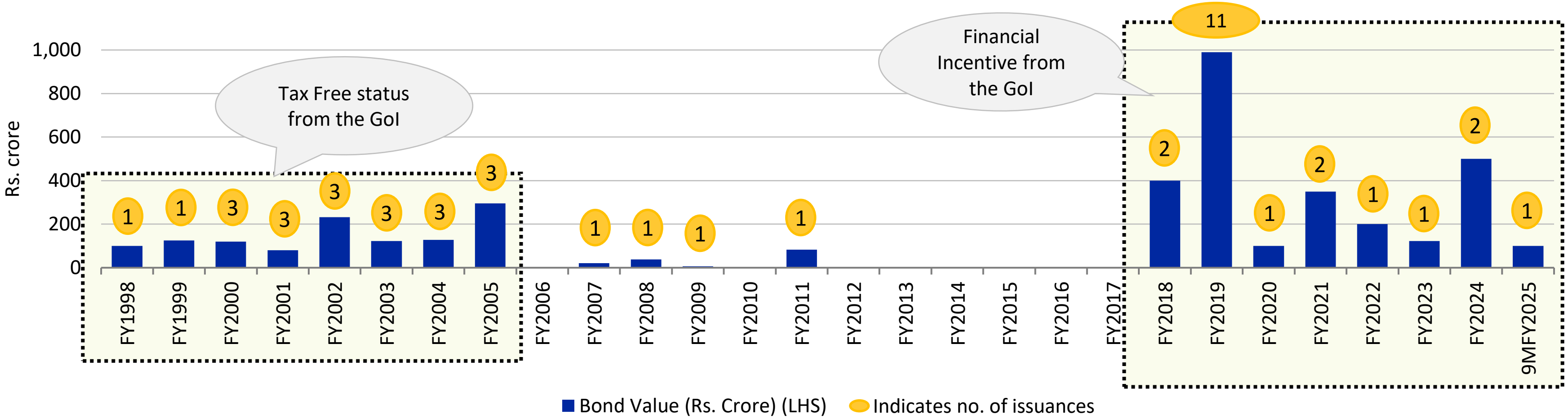
4. Future Outlook

5. Annexures

An Overview of the Indian Municipal Bond Market

Domestic municipal bond issuances showing signs of revival in recent years

EXHIBIT: Municipal bond issuances in India till date



- Over 1995-2005, 10 municipal corporations raised a total of ~Rs. 1,325 crore. These bonds were tax free in nature and primarily financed road construction, water and sewerage projects. Bond issuances were muted during 2006-2016, because large grants under the Central Government urban development missions have provided much needed funding support to municipal corporations.
- Supported by an attractive financial incentive from the GoI (~Rs. 13 crore for every Rs. 100-crore bond issuance), the municipal bond market has started showing some signs of revival in recent years. Additionally, with GoI's focus on ESG initiatives, recently ULBs are raising green bonds, which are used for funding environmentally sustainable projects. Nevertheless, sustenance of momentum, once the financial incentives from the GoI gets withdrawn remains to be seen.

Source: Ministry of Housing and Urban Affairs (Government of India); ICRA Research ;
ESG- Environmental, Social, Governance

The municipal bond market is primarily driven by fiscal incentives from the Central Government

Government incentives, such as reform linked grants and financial incentives for issuance of municipal bonds, encourage ULBs to opt for bond issuances, with special focus on green and pooled bonds.

2005

JNNURM: Substantial grant funding for urban infra in select 63 cities along with an incentive for implementing key reforms including credit rating

2015

AMRUT/Smart Cities Mission: Higher grant funding for urban infra in 500 cities/100 smart cities along with an incentive for implementing key reforms including credit rating

2019

Incentive for issuing municipal bonds: Rs. 13 crore for every Rs. 100 crore of bond issued up to a maximum of Rs. 26 crore. Extension of the incentive in subsequent years.

Major driver for recent bond issuances

2020

National Municipal Finance Portal: Centralised information database for ULBs – 'cityfinance.in' launched by the MoHUA, GoI

Structured payment mechanism: Reduced risk and improved yields of municipal bonds, leading to higher rating as well.

2023/2024

GoI's annual budgets/measures:

- Encourage fund raising via bonds
- Improve credit ratings and get a credit rating, if not rated.
- Urban Infrastructure Development Fund (UIDF) to provide funding to ULBs of tier-II and III cities.
- Continuation of incentives for issuing municipal bonds, with-special focus on green and pooled bonds.

Source: ICRA Research; JNNURM - Jawaharlal Nehru National Urban Renewal Mission*, AMRUT - Atal Mission for Rejuvenation and Urban Transformation*

SEBI has also taken various measures to facilitate municipal bonds

Increased focus of SEBI and RBI, such as SEBI listing regulations, inclusion of foreign portfolio investors to invest in municipal bonds and regulations to boost retail participation, would support the municipal bond market.

2015

SEBI (Issue and Listing of Debt Securities by Municipalities) **Regulations –** defined the regulatory status of bonds, garnering investor interest

2017

Continuous disclosures and compliances by the issuers

2019

RBI/SEBI permits **Foreign Portfolio Investors** (FPIs) to invest in municipal bonds

2019

Key SEBI amendments – Entities involved in municipal functions eligible for issuance of municipal bonds.

Mandatory provision of a **structured debt-servicing mechanism**

2022

Publication of first annual '**Report on Municipal Finances**' by RBI

2023

SEBI launches **Information Database and Repository on Municipal Bonds**

2024

SEBI **reduced the face value of bonds** to Rs. 10,000 from Rs. 1 lakh to boost retail participation.

SEBI plans to facilitate the **settlement and clearing of municipal bonds through AMC Repo Clearing (ARCL)** to encourage greater participation and increase volumes

Source: ICRA Research

Dependency on state governments for transfer/grant weighs on the credit profile of municipalities

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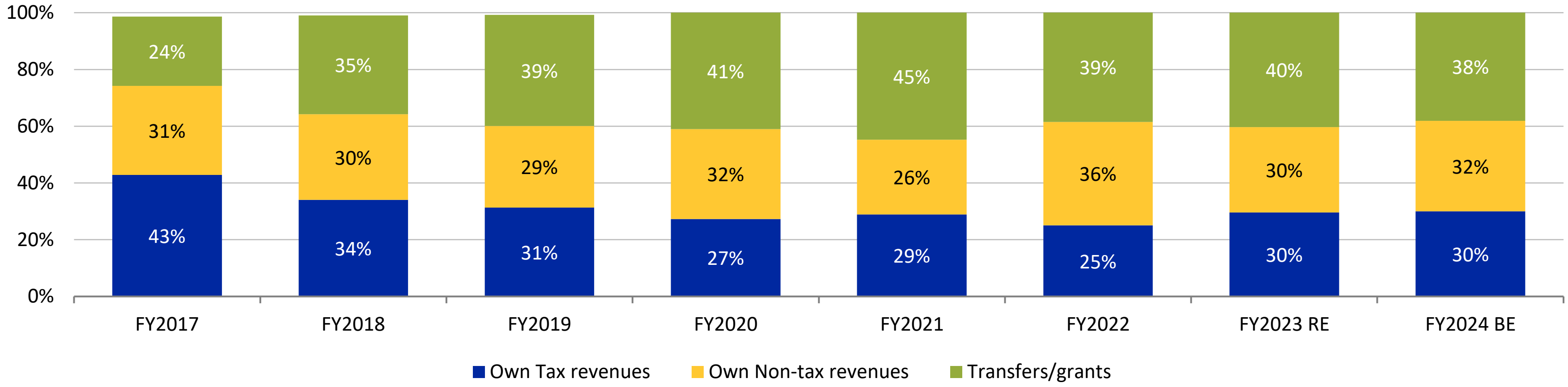
Exhibit: Trend in proportion of revenues



- Property tax is the major source of the ULBs' own revenues in India, constituting more than 16% of revenue receipts and more than 60% of its own tax revenue; while own non-tax revenue is dominated by fees and user charges, followed by income from investment and other income. Transfers/grants include assigned revenues, compensation, State Finance Commission (SFC) grants and other state government grants. Timely transfer of grants from state authorities remains crucial for the smooth functioning of municipal corporations.
- Own tax revenue as a percentage of total revenue has come down from ~43% in FY2017 to ~30% in FY2024 BE. On the other hand, the share of transfers has increased to ~38% in FY2024 BE from ~24% in FY2017 indicating the rise in dependence of ULBs on the state governments.

Source: RBI's Report on Municipal Finances, Nov-24; Note: FY2017-FY2019 data is based on 201 municipal corporations, and for 232 corporations from FY2020 onwards.

Overall low indebtedness of municipal corporation will restrict meaningful traction in municipal bond market

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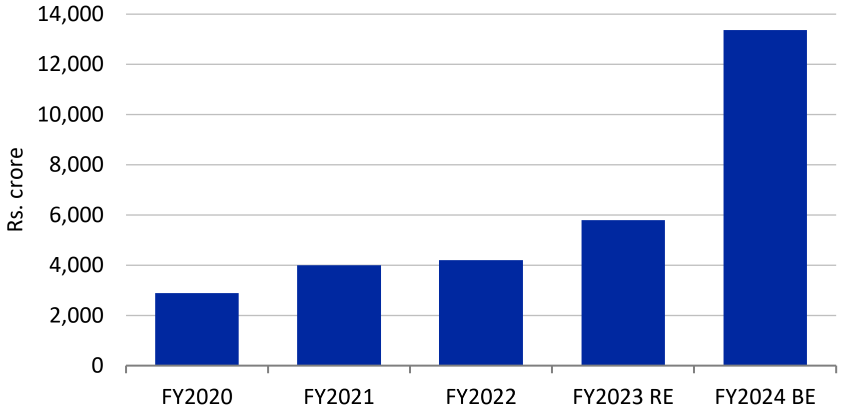
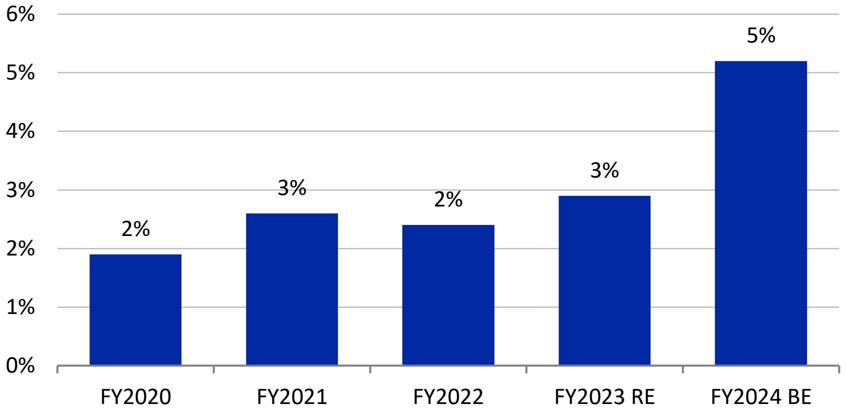
Exhibit: Trend in borrowings from FIs



Source: RBI's report on Municipal Finances, Nov-2024

Exhibit: Borrowings from FIs (% of total municipal receipts)



Source: RBI's report on Municipal Finances, Nov-2024

- Borrowings by the ULBs from financial institutions (FIs) (secured and unsecured) in India increased to Rs. 13,364 crore during FY2024 BE from Rs. 2,886 crore during FY2020, which accounts for ~5.2% of total municipal receipts in FY2024 BE compared to ~1.9% in FY2020.
- While the external borrowings by the ULBs have increased over the years, it remains negligible at less than 0.05% of India's GDP, as ULBs' dependence on the state government grants/transfers continues to be high. Overall indebtedness of municipal corporations remains low, which also limits their dependency on external borrowings and, hence, their need to access capital markets. Compliance burden and additional disclosure requirement also act as deterrents for municipal corporations to access capital markets for their borrowing requirement.

Key challenges for raising municipal bonds

- Grant-based approach towards financing urban infrastructure with large dependence of ULBs on state government grants
- Absence of uniform/standard accounting norms across municipalities
- Illiquidity and lack of secondary market lowers investor interest
- Increased compliance burden to adhere to listing norms of bonds/NCDs
- Weak credit profile of most ULBs restricts their access to capital markets
- There is no specific statute governing the insolvency of ULBs, which adds to the uncertainty and risk for investors

Source: ICRA Research

A Comparison with US Municipal Bond Market

Fixed-income market in USA comprises ~40% of global fixed income market, of which municipal bonds constitutes ~5% of the total issuances

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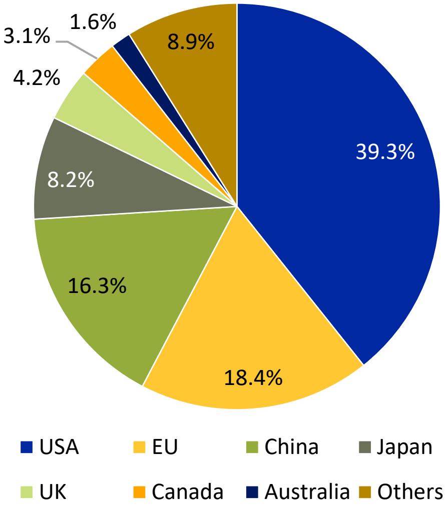
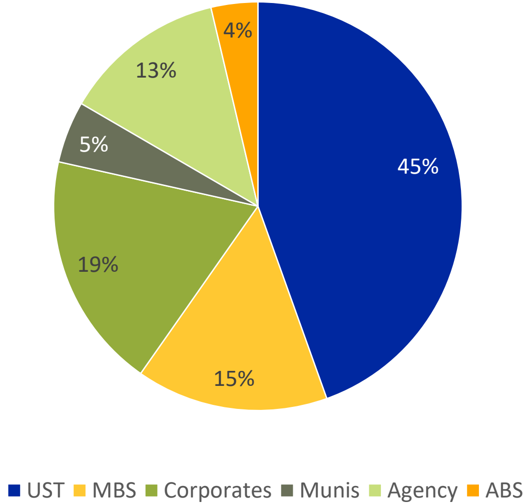
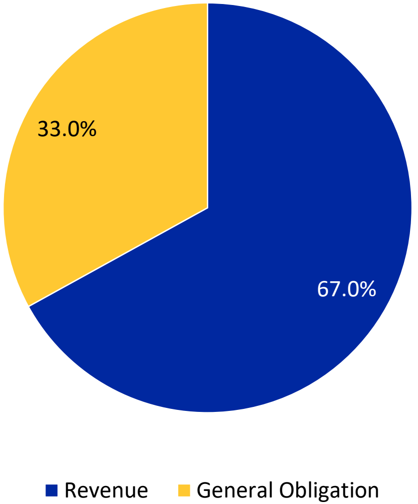
Global fixed income market share (country-wise) in CY2023 (total market size $140 trillion)



Fixed income market in USA (sector-wise) in CY2024 (total market size $10.5 trillion)



Types of municipal bonds issuances in USA CY2024 (total market size $0.5 trillion)

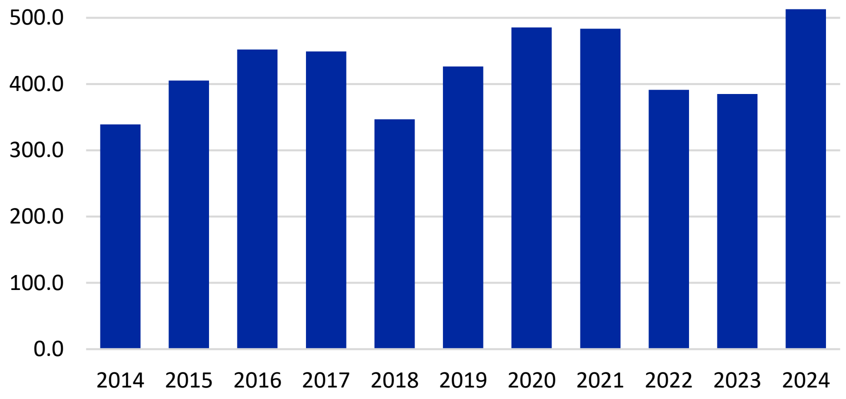


- The global fixed income market is estimated at $140 trillion as on CY2023, of which USA alone accounts for 40% share, and a similar pattern is expected for CY2024 as well. In the US bond market, municipal bonds accounted for ~5% of the total fixed income issuances in CY2024.
- More than 67% of the municipal bond issuances in the US were revenue bonds in CY2024. Revenue bonds are supported by project specific revenues, while general obligation bonds are backed by credit and taxing power of the municipality.

Source: ICRA Research; SIFMA Research (USA); UST – United States Treasury, MBS – Mortgage-Backed Securities, ABS - Asset-Backed Securities

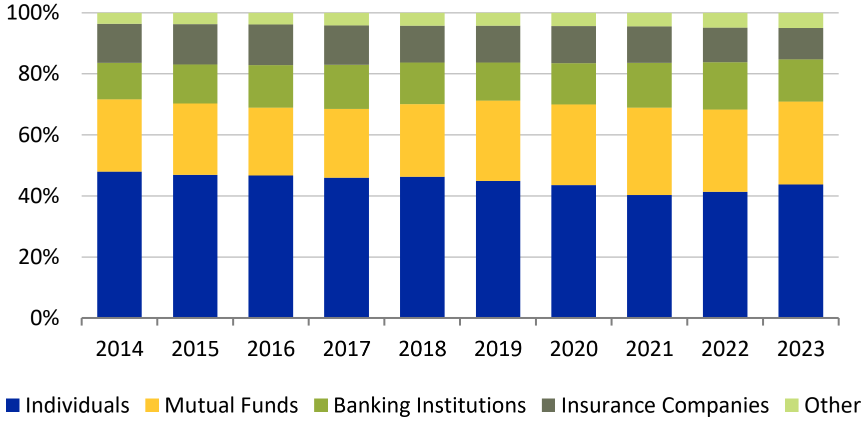
Municipal bond market in USA is vast with annual issuances exceeding $500 billion in CY2024 with ~40% retail participation

EXHIBIT: Municipal bond issuances in USA (value in $ billion)



Source: ICRA Research; SIFMA Research (USA)

EXHIBIT: Investor profile of municipal bond issuances in USA (in %)

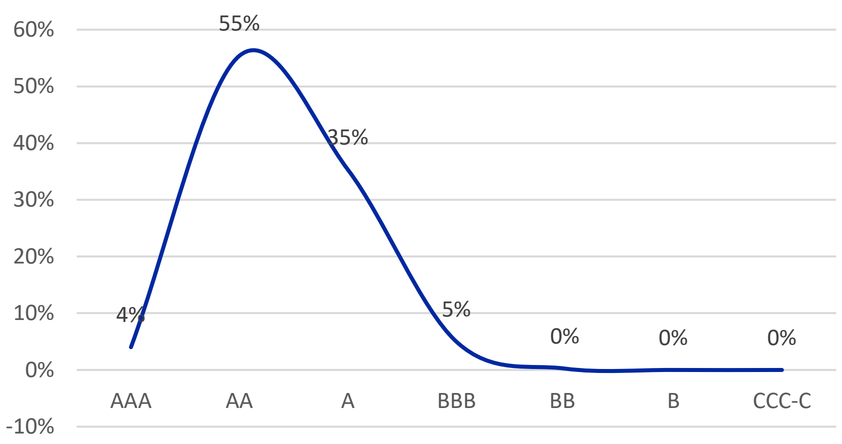


Source: ICRA Research; SIFMA Research (USA)

- The municipal bond market in USA is largely a mature market and has witnessed a consistent issuance by various municipal corporations.
- The primary investors in municipal bonds in India as well as USA mainly comprise banks, mutual funds, insurance companies as well as retail investors. While the secondary bond market in India is limited, USA has a large and vibrant secondary bond market.

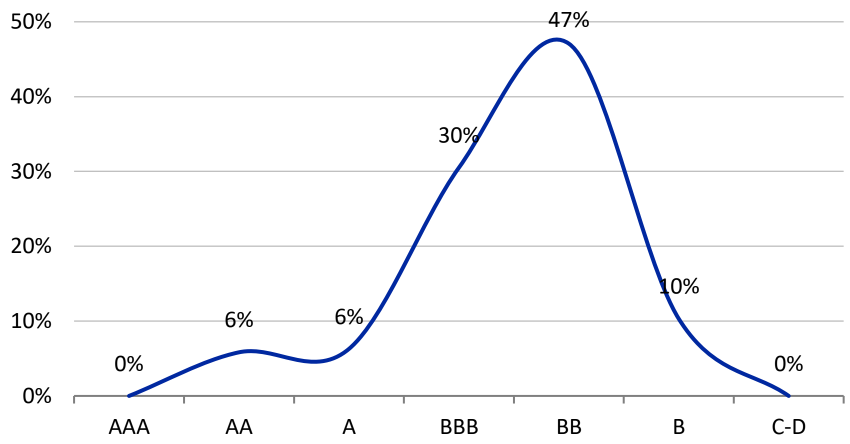
While most ULBs are highly rated in the US, most in India are rated as non-investment grade

EXHIBIT: Rating distribution of municipalities in USA



Source: Moody's US municipal bond default and recoveries 1971-2023, Oct 2024

EXHIBIT: Rating distribution of ULBs in India



Source: cityfinance.in/Press Information Bureau 2017;
As per ICRA's opinion, the rating distribution will not be materially different in the current context.

- ~99% of the municipalities in the US are rated in the investment-grade category compared to majority of municipalities in the non-investment grade in India.
- More than 90% of the municipalities are rated in the AA/A category compared to 12% in India. The municipalities in India primarily rely on state government grants and property/water tax collection to meet their funding requirement, and their dependency on bank borrowings/financial institutions is limited.

Key differences between municipal bond markets in USA and India

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Key features of municipal bond market in USA	Key features of municipal bond market in India
Long history of more than 200 years	Brief history of around 25 years
Frequent issuances; deep market	Irregular issuances with bunching in some years and no issuances in some; shallow market
High retail participation driven by large number of tax-free municipal bonds	Hardly any retail participation; tax-free municipal bonds issued in the past, however, no such issuances in recent years
Highly liquid secondary market	Non-existent secondary market
Ready availability of updated financials and proper disclosures	Low availability of updated financials and absence of proper disclosures

Source: ICRA Research

Details of Recent Issuances

Trend in municipal bond issuances for the last seven years

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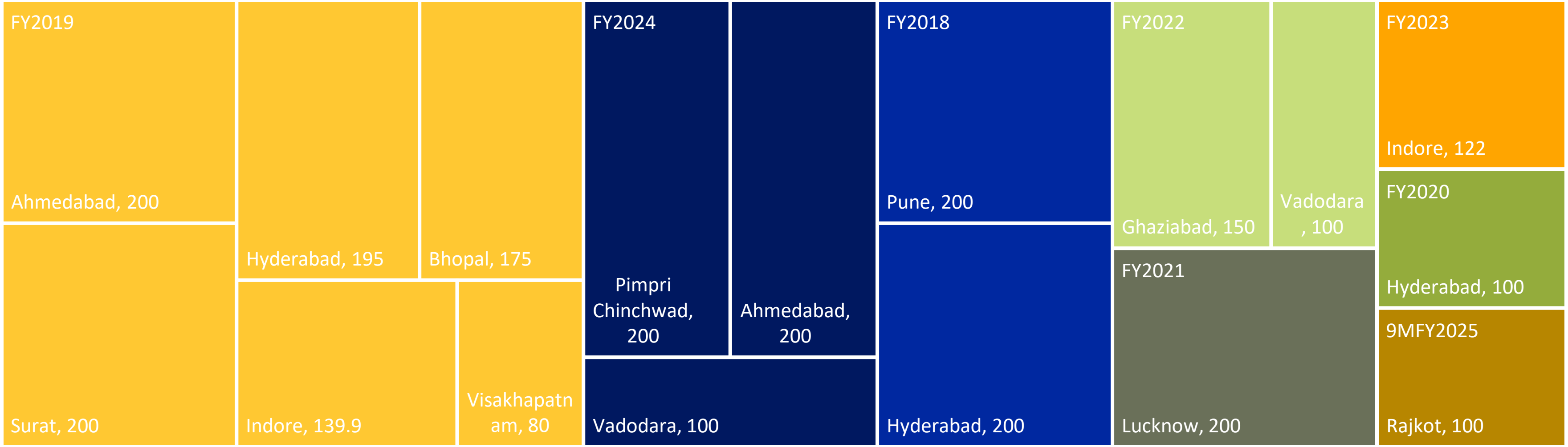
EXHIBIT: Trend in municipal bond issuances since last seven years (in Rs. crore) (in chronology of maximum to minimum issuances)

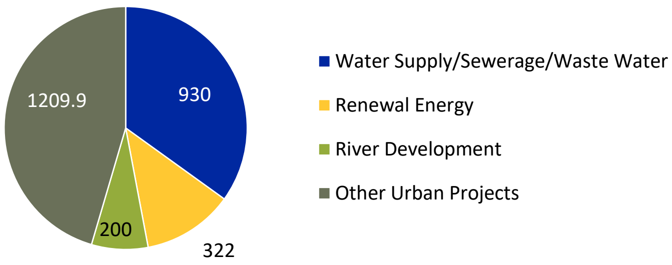


- Total of ~Rs. 2,660 crore from 17 municipal corporations has been mobilised through the bond market since FY2018. Of these 17 bonds, seven were rated at AA+ level and 10 were rated at AA by various rating agencies in India.
- With incentive of Rs. 13 crore per Rs. 100-crore bond, and with a capping of Rs. 26 crore incentive, overall issuances are limited to Rs. 200 crore from a municipal corporation – highlighting that recent issuances were driven largely by financial incentives provided by the GoI.

Source: BSE/NSE; ICRA Research

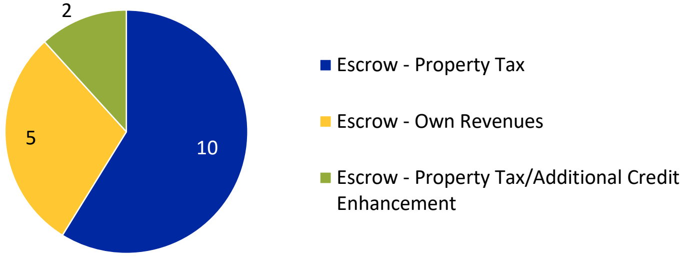
Key features of recently issued municipal bonds

EXHIBIT: Municipal bonds issued (in Rs. crore) for various project types (FY2018-9M FY2025)



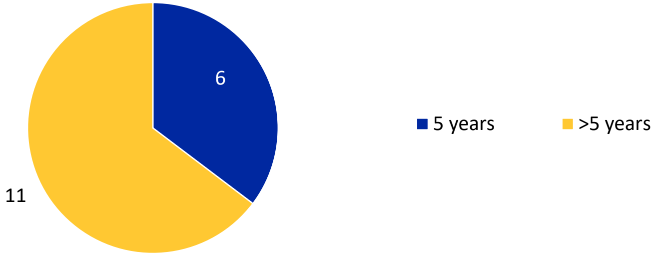
Source: ICRA Research, BSE/NSE

EXHIBIT: No. of bonds issued – by structure (FY2018-9M FY2025)



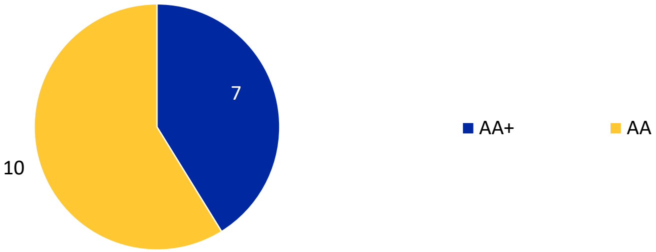
Source: ICRA Research, BSE/NSE

EXHIBIT: No. of bonds issued – by tenure (FY2018-9M FY2025))



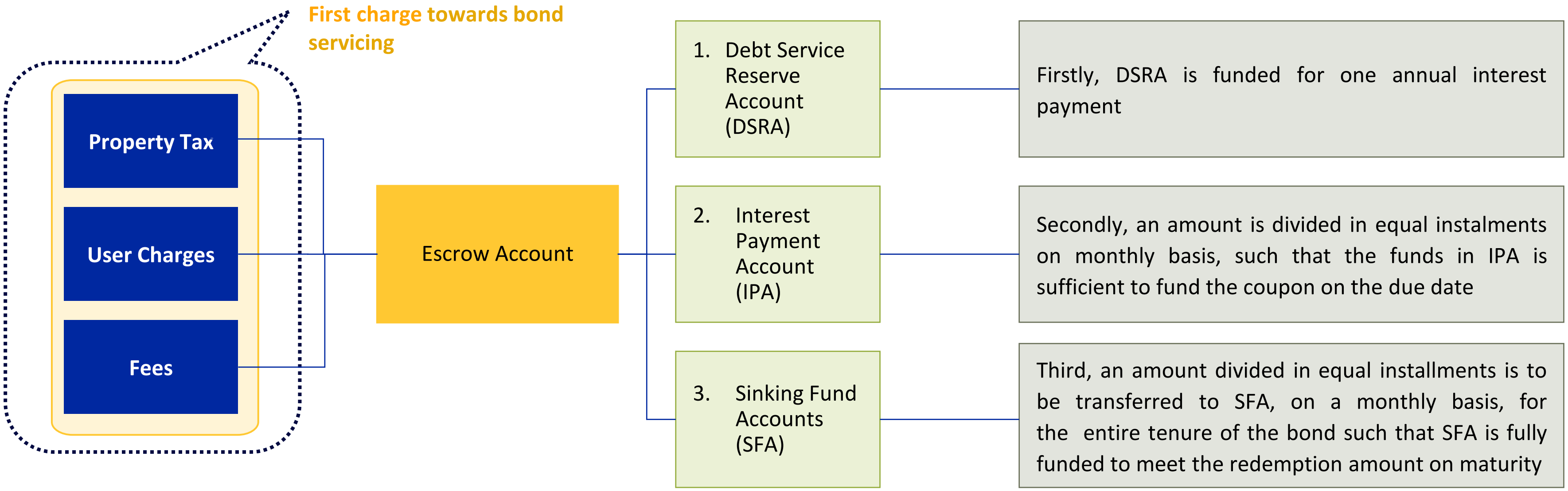
Source: ICRA Research, BSE/NSE

EXHIBIT: Credit rating distribution of municipal bonds (FY2018-9M FY2025)



Source: ICRA Research, BSE/NSE

Commonly used payment structure mechanism supports the credits profile

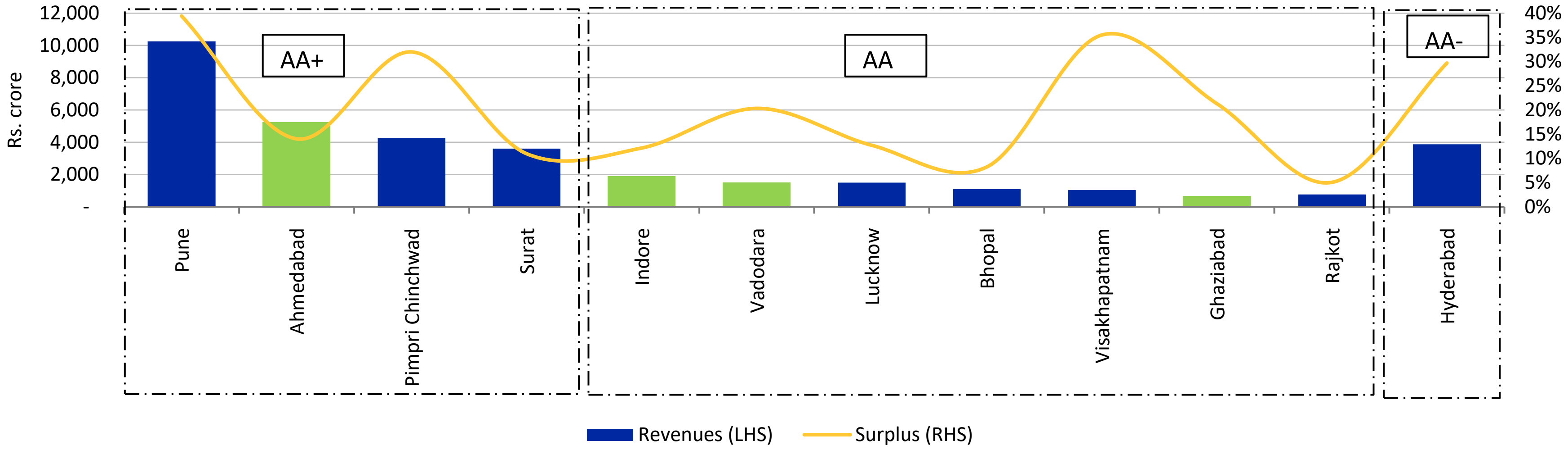


- All the municipal bonds issued since FY2018 have similar terms and structure related to debt servicing, as per which there is a first charge on the own revenue of the ULBs towards bond servicing. Effectively, bond servicing remains unaffected by expenditure commitment of the ULBs and, therefore, it enhances the credit quality of the bond, irrespective of the underlying credit quality of the ULBs. Further, various debt servicing accounts such as DSRA, IPA and SFA further strengthens the overall structure of repayment.
- The credit quality of the rated bonds also derives comfort from the fact that the ULBs are not covered under the Insolvency and Bankruptcy Code (IBC).

Source: ICRA Research

Despite a diverse financial profile of the ULBs, credit profile of recently raised NCDs are supported by structured payment mechanism

EXHIBIT: Revenue receipts and revenue surplus of various ULBs (FY2023)

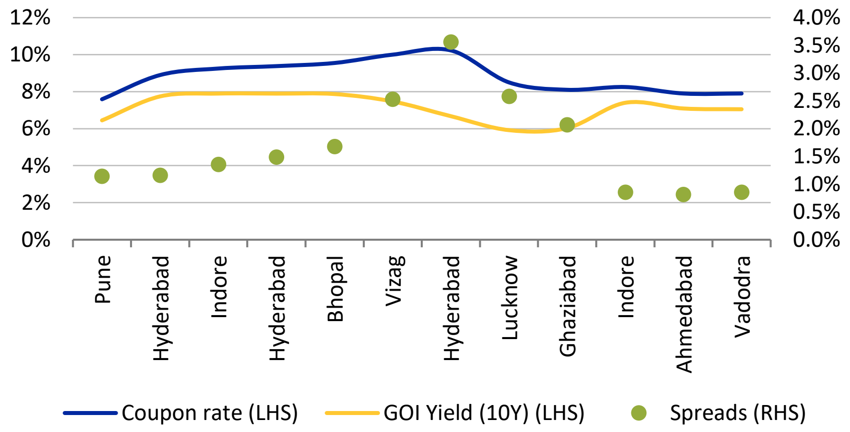


- The ULBs, which have issued municipal bonds, have a highly diverse financial profile as reflected by the gap between the property tax base and revenue surplus. Pune’s property tax base is ~7.7 times that of Ghaziabad.
- All the municipal bonds issued since FY2018 have similar term and structure related to debt servicing, which enhances the credit quality to AA category. These bonds have been credit enhanced based on structured payment mechanism supported by DSRA, IPA, SFA, and in some cases, shortfall undertaking by state governments.

Source: Rating Rationale of various CRAs; ICRA Research, Municipal Corporation websites

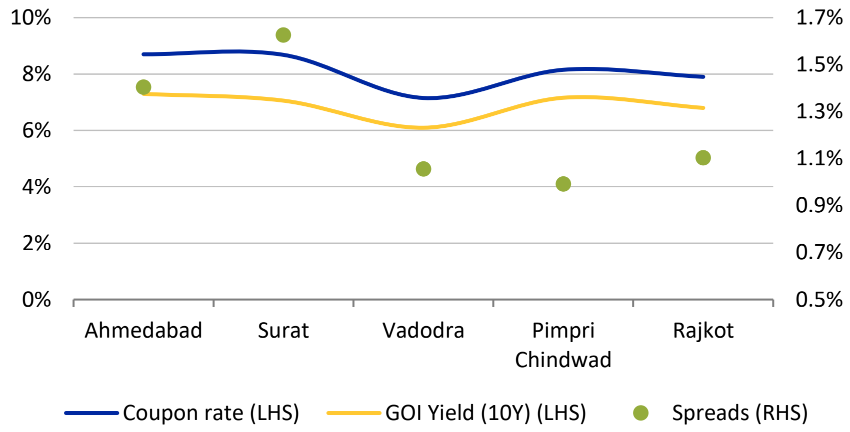
Coupon spread also underpins credit profile of respective state governments

EXHIBIT: Coupon rate of various municipal bonds (9/10 year) and GOI Bond Yields during bond issuance (FY2018-9M FY2025)



Source: NSE/BSE, ICRA Research

EXHIBIT: Coupon rate of various municipal bonds (5 year) and GOI Bond Yields during bond issuance (FY2018-9M FY2025)



Source: NSE/BSE, ICRA Research

- The coupon for all the municipal bonds is higher (up to 100-200 basis points) than the GoI security yields. The ULBs derive significant comfort from the financial incentive from the GoI for issuance of municipal bonds, which compensates for the high coupon rate to an extent.
- The coupon rates on municipal bonds increase with maturity, and the coupon spread will also underpin the credit profile of the state on which ULBs have high dependence to transfer grants.

Future Outlook

More than five issuances including pooled municipal bonds likely in the near term

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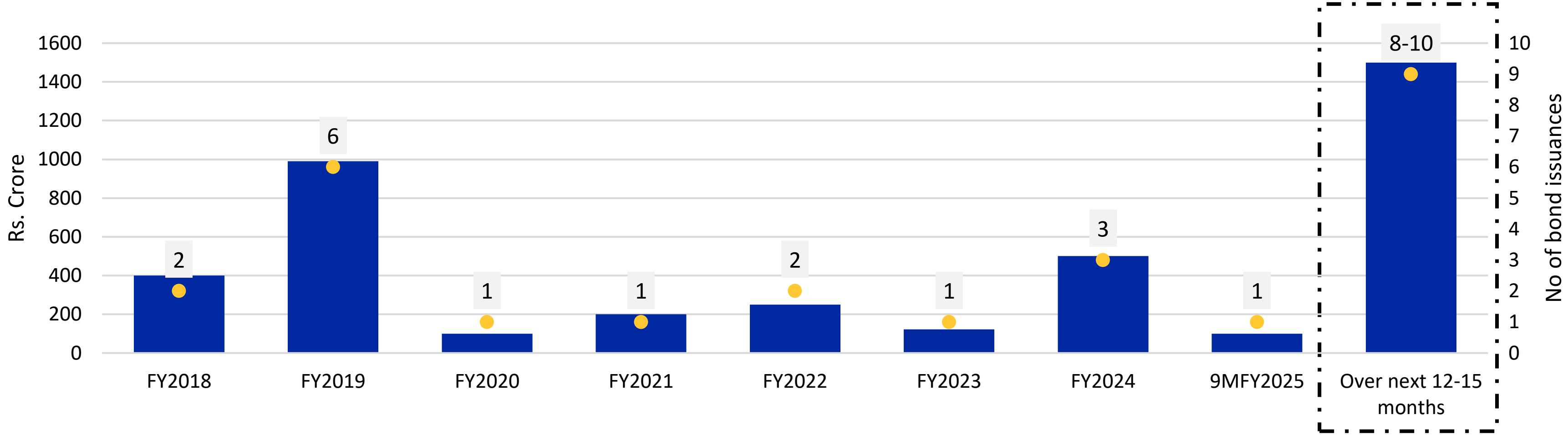
EXHIBIT: Trend in Bond Issuances



- More than five ULBs (Agra, Prayagraj and Varanasi are in advanced stages) are likely to issue municipal bonds in the near term, with five more in various stages of preparation amounting to more than ~Rs. 1,500 crore in FY2025/FY2026. Rajkot has already issued Rs. 100-crore bond in October 2024.
- Considering the focus of the Central Government on them, some of the issuances could be Green Bonds, which would be used to finance environmentally sustainable projects.
- For the ULBs with low credit quality, state governments are likely to issue pooled municipal bonds, wherein an Special Purpose Vehicle (SPV) is created to raise funds from capital markets by pooling the requirements of participating ULBs.

Source: BSE/NSE; ICRA Research

Persistent challenges will continue to limit municipal bond issuances in India

Extent of capex funding from the Central/state governments remains high; discourages external funding options	Own revenue base of ULBs remains low with a high dependence on transfers from state governments; constraints ULB’s credit quality	Information systems remain weak in most ULBs with instances of data inconsistency, absence of audited financial statements, low disclosures, etc.; reduces investor/lender confidence	Adequacy of municipal staff remains a concern; professional expertise required to manage fund raising and finances	Most ULBs lack track record and ability to design and execute large and complex projects in a timely manner within budgeted costs

- As per the ‘Report on Municipal Finances’ published by the RBI in November 2024, a majority of the ULBs continue to depend highly on the respective state governments by way of various grants and assigned revenues contributing ~38% of the total revenue receipts. Moreover, limited ULBs in the country enjoy a healthy financial profile with top 10 ULBs contributing over 58% of the total revenue receipts.
- Consequently, ICRA believes that apart from an improvement in ULBs’ capability and information systems, a significant increase in own revenue base would remain a key credit challenge in the future.

Source: ICRA Research

Annexures

Key requirements for municipal bonds

- Audited financial statements for last three years
- Details of projects to be funded
- Term sheet for proposed bonds
- Escrow of property tax and key revenues, and creation of debt servicing accounts
- Approval from the ULB Council and the respective state governments
- Key disclosures – debt servicing and provisional financials (6M/12M)

Source: ICRA Research

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Thank You!