Municipal Bonds

Why in News

Recently, **Rs. 200-crore worth Lucknow Municipal Corporation (LMC) bonds** have been listed on the **Bombay Stock Exchange (BSE).**

- **Lucknow** becomes **ninth city** to raise municipal bonds, incentivised by the **Ministry of Housing and Urban Affairs (Mohua)** under **Mission Amrut.**
- **BSE** is the oldest stock exchange in India as well as Asia.

Mission Amrut

- **Atal Mission for Rejuvenation and Urban Transformation** (Amrut) was **launched in 2015** to:
    - Ensure that every household has access to a tap with the **assured supply of water** and a **sewerage connection.**
        The Priority zone of the Mission is water supply followed by sewerage.
    - **Increase the amenity value of cities** by developing greenery and well maintained open spaces (e.g. parks).
    - **Reduce pollution by switching to public transport** or constructing facilities for non-motorized transport (e.g. walking and cycling).
- It is a **centrally sponsored scheme** with **80%** budgetary support from the Centre.

Key Points

- **Municipal Bonds :**
  - A **municipal bond (muni)** is a **debt security issued by a state, municipality or county** to **finance its capital expenditures,** including the construction of highways, bridges or schools.

    Through muni bonds, a municipal corporation raises money from individuals or institutions and promises to pay a **specified amount of interest** and returns the **principal amount** on a specific maturity date.
  - These are mostly **exempt from federal taxes and from most state and local taxes,** making them especially attractive to people in high income tax brackets.
- **History of Municipal Bonds Issuance in India:**
  - Municipal bonds were first issued in India in 1997, five years after the **74th Constitutional Amendment** decentralized urban local bodies and gave them autonomy; made them accountable to citizens, and reformed their finances enabling them to access capital markets and financial institutions.
  - Between 1997 and 2010, the city corporations of Bengaluru, Ahmedabad and Nashik **experimented with bond issues** but barely managed to raise Rs. 1,400 crore.
  - The **poor investor response** was due to the fact that **these bonds were not tradable** and **lacked regulatory clarity.**
  - **Securities and Exchange Board of India (SEBI)**'s detailed guidelines for the issue and listing of municipal bonds in March 2015, clarified their regulatory status and rendered them safer for investors.
  - In 2017, Pune Municipal Corporation had raised Rs. 200 crore through muni bonds at an interest of 7.59% to finance its 24x7 water supply project.

    The plan was to raise Rs. 2,264 crore in five years in what was then the biggest municipal bonds programme in the country.
- **Significance of Municipal Bonds Market:**
  - Municipal Bonds can help the **Urban Local Bodies (ULBs)** to garner revenue to complete budgetary projects as property tax is the only major source of municipal revenue.
  - Growth of the municipal bond market is critical for India's large cities and towns to **upgrade their creaking infrastructure.**
  - The ability of municipal bodies to be self-sustaining is also critical to the success of the Centre's pet projects **such as Smart Cities and Amrut.**

- **Benefits of Municipal Bonds for Investors:**
    - **Transparency:**
        Municipal bonds that are issued to the public are rated by renowned agencies such as **CRISIL**, which allows investors transparency regarding the credibility of the investment option.
    - **Tax benefits:**
        In India, municipal bonds are exempted from taxation if the investor conforms to certain stipulated rules. In addition to such conformation, interest rates generated on such investment tools are also exempt from taxation policy.
    - **Minimal risk:**
        Municipal bonds are issued by municipal authorities, implying involvement of minimal risk with these securities.
            Government bonds are usually viewed as low-risk investments, because the likelihood of a government defaulting on its loan payment tends to be low.
- **Challenges:**
    - **Reduced investor trust and confidence:** Weak financial position and poor governance and management of city agencies have limited their ability to issue bonds, and reduced investor trust and confidence.
    - **No authentic financial data available:** Investors have doubt over local bodies as there is no authentic financial data available.
    - **Other Issues:** Low accountability and autonomy of city agencies followed by lack of an enabling environment.

Way Forward

- With the plight of the **Covid-19**, revenue generation and state finances have come to a virtual standstill, **hampering the funding of ULBs.** However, under the **Atmanirbhar Bharat Abhiyan** package, states are **offered an increase in borrowing capacity, based on potential reform of the urban property tax regimen.**
- Still, most urban local bodies **do not have the institutional agency to raise funds,** systemise accounting, and put up bankable projects. In order to address this, the reforms enlisted in the **15th Finance Commission** **(which makes it mandatory for urban local bodies to submit audited accounts by linking them to grant disbursement)** must be implemented.
- **Transparency within ULBs will increase their credit worthiness,** thereby improving their prospects of **floating Muni bonds,** enabling them to contribute towards building resilient infrastructure under the **Atmanirbhar Bharat Abhiyan.**

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