



India
Infrastructure
Finance
Company Limited

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Our Vision

"Provide innovative financing solutions to promote and develop world class infrastructure in India"

Our Mission

"To adopt best practices in financing infrastructure and develop core competencies in facilitating infrastructure development; Develop a team of highly engaged employees to deliver services in a professional manner and to the satisfaction of all stakeholders"

From the Chairman's Desk

*W*hat started as the sub-prime crisis in USA has now turned into global financial and economic crisis. Earlier, there was a view that India will not be affected by the crisis as it is largely "de-coupled" from the US economy and India's growth would remain insulated. The impact of the crisis was transmitted globally through three channels. First, it impacted the financial institutions all over the world, especially those institutions which had invested in the mortgage based securities and their derivatives which turned toxic with the bursting of the US housing bubble. Second, the crisis created a liquidity crunch all over the world, as US firms withdrew their investments in securities in other countries. The consequent fall in prices of securities, combined with the exit of the local investors from the market, led to tightening of credit. The "real sector" has been the third channel of transmission. The financial crisis coincided with an emerging recession in the US, which meant a cut back in US demand for imports from other countries.

India has largely come unscathed out of the impact of the first transmission channel. The exposure of Indian banks to Wall Street's toxic assets has been quite small. It has been estimated that the total losses of Indian banks due to their exposure to the Collateralised Debt Obligations and Credit Default Swaps at the end of July 2008 was around USD 450 million and the banks which have such exposure are well capitalized and can make the required provisions. The impact of the crisis on liquidity has been amplified. The liquidity constraints which started emerging from mid September became more pronounced, as evident from the steep rise in call money rates. To mitigate the situation, host of measures have been taken by the RBI. The Repo rate has been reduced from 9% to 5.5%, while the reverse repo rate has been cut from 5% to 4%. Cash Reserve Ratio (CRR) has been reduced to 5%. The cumulative amount of primary liquidity added to the system as a result of various measures by RBI is over Rs3,00,000 crore, with the result, the liquidity position turned into comfort zone.

At the same time, the indications of a slow down in economic activity emerged. Industrial production during the month of October 2008 turned negative at (-) 0.4%, while exports registered negative growth of (-) 9.9% in November 2008. With business confidence getting dampened, investment demand slackened.

Although, many banks cut their lending rates in response to the signals provided by RBI, the risk perception remained strong with the result, apprehension about a moderation in credit growth have emerged.

Concurrently, the Government of India came out with a fiscal stimulus package in December 2008 which included, inter-alia, additional plan expenditure of Rs20,000 crore mainly for critical rural, infrastructure and social security schemes, across-the-board cut of 4% in ad-valorem cenvat rate except for petroleum products, measures to support the exports, housing, micro and small enterprises and textile sectors and authorizing India Infrastructure Finance Co Ltd (IIFCL) to raise Rs10,000 crore by way of tax-free bonds to provide refinance to bank lending for infrastructure projects. Additional measures included liberalizing norms for External Commercial Borrowings (ECBs) under which NBFCs dealing exclusively with infrastructure financing were permitted to access such borrowings from multilateral and bilateral institutions under the "approval" route of RBI.

Following the approval of the government, IIFCL has issued the first tranche of tax-free bonds of Rs2,500 crore. The issue has been oversubscribed and the company will be moving ahead to raise the remaining part of Rs10,000 crore upto 31st March 2009. The funds raised are expected to enable refinancing mainly of highways and port projects of about Rs25,000 crore which have been competitively bid under the PPP route.

Despite the global crisis and its immediate impact on India, the long term growth story of India continues to remain intact. India will continue to grow on the strength of its domestic demand and as a result, the demand for infrastructure services will continue to remain strong. With the favourable policy push by way of increased liquidity with the banking system by RBI and focus on development of infrastructure by the government, the prospects for infrastructure sector remains bullish. As the risk aversion abates at the global level, investment flows will have to pick up and India will continue to remain as one of the favourable destinations for such flows.

S S Kohli

Chairman & Managing Director

Urban Infrastructure Development: Key to National Growth

With rapid economic growth, the process of urbanization in India has been gaining. In 1961, urban population constituted 18% of total population. In a span of 40 years, by 2001, the percentage of urban population swelled to 27.8% and this is expected to touch 40% by 2030. There are 35 cities with population of 1 million and above. The combined population of these cities form nearly 39% of total urban population. In terms of urban corporate entities, there are 109 municipal corporations, 1432 municipal councils, and over 2100 Nagar-panchayats. As per a study by Assocham, the contribution of urban population to national GDP is 60%, which is estimated to go upto 70% by 2011. This also reflects that strong economic growth leads to faster urbanisation and vice-versa. However, the degree of urbanisation in India is relatively lower compared to other countries. For instance, urban population constituted 32% in China, 37% in Indonesia, 78% in Japan and 83% in Korea.

Urbanisation combined with low rate of investment in urban development has put heavy pressure on urban infrastructure. As per the 11th Five Year Plan document, 70% of the urban



households were served by tap water and 66% of such households had their principal source of water within their own premises. Sewerage connection in urban areas varied between 48% and 70%. Waste water generated in 300 Class I cities is about 15,800 million litres a day while treatment facilities are available hardly for 3750 million litres per day. 1,15,000 metric tonnes of municipal solid waste is generated daily in the country. Cities like Delhi and Mumbai generate about 5000-5500 metric tonnes of solid waste per day. Hardly 30% of such waste generated by the major cities is treated before disposal. As per Census 2001 estimates, nearly 62 million people lived in slums – every 7th person in urban India is a slum dweller. Housing shortage during the 11th Plan period is estimated at 24.7 million and 99% of the same are from economically weaker sections and low income groups.

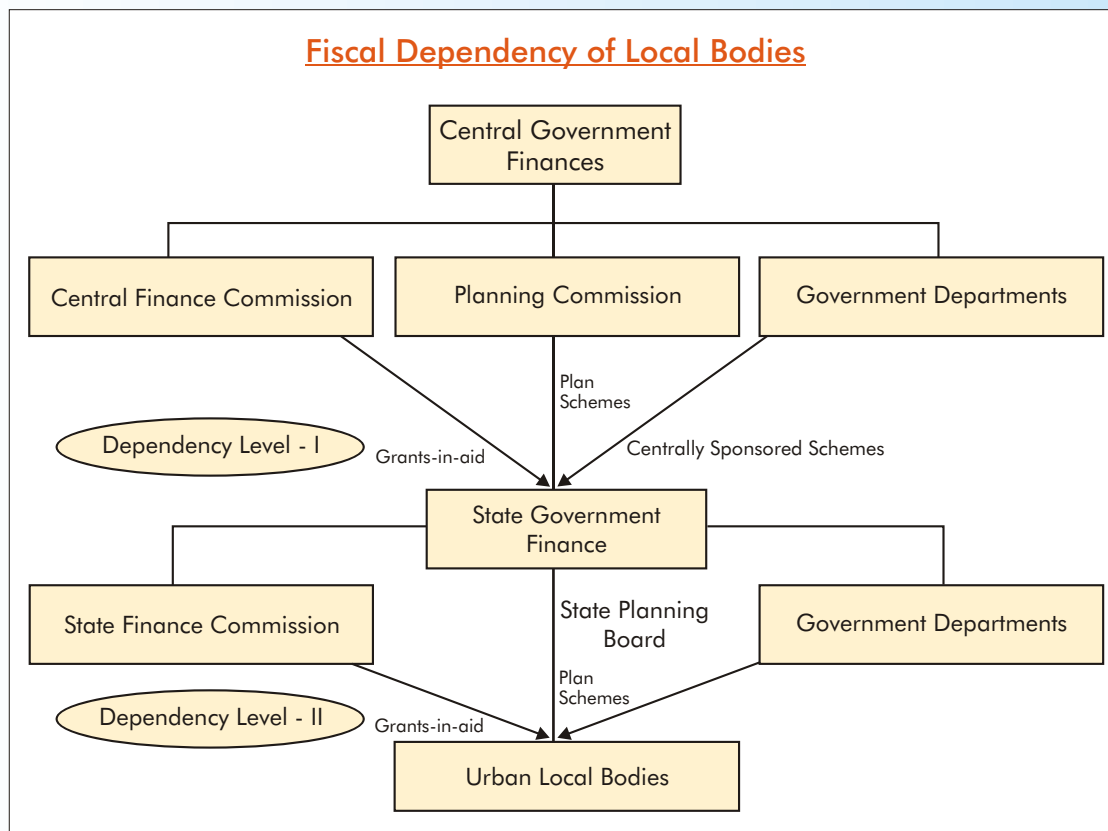
The strain on urban infrastructure is further added by migration. It is estimated that 22% of the increase in urban population is due to migration from rural areas. Mumbai has the highest number of migrants followed by Delhi, Kolkatta, Pune and Surat.

With high level of infrastructure deficit, the sustainability of cities has come under severe stress. Lack of safe drinking water and sanitation has posed problems of health from waterborne diseases. Inadequate solid waste management has contributed to blocked drains and consequent flooding and poor drainage in low lying areas. With increase in demand for urban transport, vehicular trips have spiralled leading to air pollution and traffic congestion. Waterways nearby cities have come to be highly polluted due to domestic and industrial effluents which mostly go untreated.

Urban Local Bodies (ULBs) directly influence the economic welfare of urban population by providing various civic, social and economic infrastructure services. Although constitutionally

the functions of the ULBs is defined, there is no clear demarcation of municipal finance. The assignment of finance to the ULBs has been completely left to the discretion of the state governments. As a result, the ULBs are highly dependent upon the central and state governments for revenue, inter-governmental transfers etc. The dependency level of the ULB is shown in the diagram below.

- Property and professional taxes are the main source of revenue for the corporations, while Octroi is the most important source of revenue in some states
- The mix of municipal revenues viz., taxes, user charges, fees, transfers and loans is narrow compared to international benchmarks



Availability of urban finance is important to address the gaps in infrastructure and to ensure sustainability of the urban services. The primary impediment for raising urban finance is the weak financial base of ULBs and their inability to rationally price their services. The existing tariff for services in most cases is not sufficient to meet production and O & M costs. Subsidisation of services in the long run could only lead to worsening of the financial condition of the ULBs. Besides, there are large

Source: Municipal Finance In India: An Assessment, Reserve Bank of India

As per study by RBI, aggregate revenues of all ULBs has been estimated at 0.75% of GDP compared to 4.5% for Poland, 5% in Brazil and 6% in South Africa. A sample study of 35 Municipal Corporations by Reserve Bank of India has shown that

- Tax revenue accounted for 45% of total revenue
- Establishment and administration expenses accounted for 36% of total expenditure
- Analysis of revenue and expenditure of the municipal corporations shows that most of the corporations are generating revenue surplus and overall resource gaps are not large.
- Spending by the corporations is lower than required to provide minimum level of civic amenities.

leakages in revenue collection. For instance, leakage and unaccounted water in many cities is as high as 50%. Urban finance can develop only when the ULBs are financially sound and the investors and lenders are able to assess the risks more objectively.

Many measures for improving performance of ULBs have been taken by various state governments and central government. In 2001, the central government announced that bonds issued by local authorities will be exempt from income tax. Many state governments have reformed the system of property taxation, while some of the city municipal corporations have accessed the capital market by issue of municipal bonds. Further, many states have started improving municipal accounting system. However, Public-Private-Partnership (PPP) model which has gained in other infrastructure sectors like roads, ports, power, airports etc has so far played limited role in urban infrastructure. This could

be due to variety of reasons. Urban infrastructure comprises various sectors and one-size-fits all PPP model cannot be adopted as in the case of road sector. Most of the urban services have a large “public good” character and hence levy of user charges is a highly sensitive issue.

With private sector participation in urban infrastructure not forthcoming to the desired extent, recourse has been made to other ways of mobilizing resources. Some municipal corporations have raised resources through issue of municipal bonds. The pioneering effort in this regard was from the Ahmedabad Municipal Corporation in 1996. Subsequently, other ULBs have followed suit. Currently, municipal bond market is estimated at Rs733 crore which is expected to touch Rs1000 crore in the next two years.

An innovative finance raising mechanism has been Pooled Finance. The Tamil Nadu Water and Sanitation Pooled Fund (WSPF) was set up by the state government as a trust for channelling financial resources including private financing for urban infrastructure. In 2007-08, the fund issued tax-free bonds of Rs45 crore aimed at meeting the funding requirements of 7 municipal corporations in the state for building underground drainage and water supply. The bonds would be serviced through repayment mechanism involving an escrow of the



project revenue of the ULBs. Any shortfall in the payments into the bond servicings would be made up from the future accrued State Financial Commission Devolutions to the respective ULBs. The Pooled Finance approach has helped small and medium ULBs to access the capital market.

It may be mentioned in the Union Budget 2007-08, state Pooled Financial Entities formed for raising funds for a group of ULBs have been allowed to issue tax-free bonds.

The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) has been one of the important initiatives taken by the Government of India to improve urban infrastructure. The mission aims at linking infrastructure asset creation and management thereof with a focus on sustainability. Under the mission, 63 cities have been identified and the total support from the central government is Rs50,000 crore. The funding is provided to ULBs subject to their undertaking urban reforms in the area of accounting, property taxation, repeal of ULCRA, levy of user charges etc. As per data available, Rs 37,164.79 crore has been sanctioned in 371 urban infrastructure projects including water supply, sewerage, drainage, solid waste management and roads/flyovers. Among the states which have large number of such projects are Maharashtra, Andhra Pradesh, Karnataka, Tamil Nadu, Gujarat and West Bengal.

