Funding Indian Cities of the Future

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India's urban population is growing at 2.4% CAGR and by 2030, it is expected to touch 590MM. While cities have been hubs of economic activities driving the country's progress, city services have struggled to keep pace with the surge in urban residents. This has resulted in a sharp decline in urban "ease of living".

Frequent environment related challenges have compounded the challenges of city living. In 2015, a heatwave hit India, particularly affecting cities like Ahmedabad and Delhi. Extreme temperatures led to heat-related deaths, increased electricity demand for cooling, and disrupted daily activities. Chennai, faced a severe water crisis in 2019 due to deficient monsoon rains and depletion of water reservoirs. The city had to implement strict water rationing measures, and residents faced acute water shortages for months. The devastating floods in Kerala in 2018 caused significant economic losses, particularly in cities like Kochi. Industries, businesses, and infrastructure were severely affected, leading to a slowdown in economic activities and a strain on local resources for recovery efforts. It was estimated to have caused economic losses of around USD 3.7B.

As we think of the cities of our future there is a need to reimagine city infrastructure to enable easy access of quality city services and to acknowledge that such investments should aim both to improve city resilience and long-term sustainability. This calls for an enormous increase in infrastructure investments - estimated to be as high as 7x of current levels. An improved ability to raise capital at the local city level is critical for this to happen.

There are 2 significant opportunities for ensuring that city planning is backed by sufficient funding:

- **Opportunity for cities to tap into a larger pool of bond funding**
  Municipal bonds are one avenue that cities in India can explore to fund infrastructure projects. These bonds are issued by municipal authorities and are backed by the future revenue streams of these projects. This could include construction, water supply systems, and waste management facilities.
- **Opportunity for cities to avail of climate finance that can help build greener cities**
  If cities design their infrastructure projects keeping in mind their climate impact, they can access the growing pool of climate finance. This includes investments in renewable energy, energy-efficient buildings, green transportation, circular economy, and climate adaptation measures such as nature-based solutions.

Municipal bonds

Municipal bonds are an important source of funds for infrastructure projects in cities. These bonds are issued by municipal authorities and are backed by the future revenue streams generated from the projects.

Between 2017-20, the bulk of city funding came from central grants (~USD 100B) and municipal borrowings were a mere ~USD 11B. Bond issuances were at a low of ~USD 400MM. The potential of municipal borrowings in India is largely untapped in comparison to other countries in the world, which leverage municipal bonds to finance urban infra projects.

The United States boasts one of the most robust municipal bond markets globally. Its ULB bond size is 20.4% of the GDP. The growth of the muni bond market can be attributed to clear regulations, availability of credit ratings, and a history of reliable debt servicing by municipalities.

In South Africa too, municipalities predominantly rely on self-generated revenue sources, minimizing their dependence on government grants. Significant budgetary requirements are fulfilled through service fees, and investments are strategically focused on providing essential amenities to historically marginalized sectors of society.

Even in India, the market opportunity is large. Estimates range from USD 20B - USD 100B. Sensing this, there have been increased efforts by critical stakeholders such as central government agencies, regulators, investment bankers & capital providers to tap this underutilized opportunity. A number of developments are driving an increased momentum in the space:

- **Role of XV Finance Commission - Increasing availability of audited financial statements**
  In the XV Finance Commission, the ULBs were mandated to upload their financial statements (audited / unaudited) onto the portal to avail central level grants. This has resulted in over 2,500 out of 4,500 ULBs using the City Finance Portal to upload their documents over the last 2 years. Further, over the last one year, the ULBs have also started uploading their budgets on this platform.

  The portal was further augmented by the implementation of the City Finance Rankings in 2022, where the ULBs

were evaluated over 15 different parameters across 3 indicators, resource mobilization, expenditure performance and fiscal governance. Going ahead, this data could be used to provide quality credit ratings for ULBs & to recognize the best performing ULBs.

- **Role of MOHUA - supporting credit ratings for ULBs / interest subsidy**
  In 2017, of the 500 cities covered under Smart Cities mission and AMRUT, 94 were assigned credit ratings through a study commissioned by MoHUA. Of these, 59% of the ULBs were estimated to be investment grade. By 2018, the effort was expanded to cover ~450 ULBs, and 160 ULBs have been found to be of investment grade. This effort has effectively led to 14 cities raising bonds worth USD 400MM from the market since 2017. In fact, to cover the tax costs on these bonds, MOHUA provided a 2% interest subsidy to ULBs raising capital through the bonds, allowing them to raise capital at cheaper rates.
  Going ahead it is expected that the credit ratings will be scaled to cover the rest of the ULBs – the City Finance Portal and comparative financials/rankings can also play a significant role in enabling this.

- **Role of regulator - SEBI interventions**
  In 2019, SEBI brought about a host of changes in its regulations that made it easier for ULBs to borrow from the public markets and for investor participation. Positive regulatory developments include easing restrictions on the types of agencies that can raise capital, relaxing norms round escrow accounts, doing away with the requirements of detailed project plans, a project implementation cell, and a monitoring agency. Reducing the subscription amount for private placements to widen the investor set is also being considered.

- **Role of exchanges - NSE's first municipal index**
  Earlier this year, NSE launched the first municipal bond index in the country, tracking 28 municipal bonds across 10 issuers. The bonds in the index have a credit rating of AA category. The index constituents are assigned weight in the index in accordance with their outstanding amount. This is expected to significantly improve informational access on municipal bonds for stakeholders exploring opportunities in the space.

- **Role of capital providers - availability of potential existing ecosystems**
  On the supply side, India's corporate bond market has an entire ecosystem (comprising merchant bankers, arrangers, rating agencies, lawyers, stock exchanges, investors, etc.) functioning under a robust regulatory framework, and has enabled several aspirant issuers to meet their funding needs. GoI is keen to build capacity among ULBs to tap this ecosystem to help shepherd the vibrant municipal bond market. To that extent, MoF released a guiding paper in 2019, titled 'Use of Municipal Bonds for Infrastructure Projects' to provide the necessary informational support for ULBs.

Cumulatively, the above factors have driven the increased momentum in ULBs accessing capital markets – municipal borrowings have increased 3x in 4 years between 2016/17 and 2019/20.

Climate Finance

Current estimates of available global climate finance flows for cities is around USD 384B (2017/18). There are two substantial disparities in the distribution of these funds. First, is the areas into which they flow. A large part of these funds (around USD 375B) is invested in urban climate change mitigation activities. This includes USD 202B for low-carbon transport (53% of total urban climate finance) and USD 167B for the urban buildings sector (44% of total urban climate finance). Only 9% of global flows (USD 7B) go towards urban adaptation and resilience measures annually and are primarily dedicated to water and wastewater projects.

The second pertinent disparity is that developing economies like South Asia and Sub-Saharan Africa only saw an annual average investment of USD 4B and USD 3B, respectively. Typically, the rationale cited behind this unequal flow of funds is the lack of financially viable projects and poor technical capacity leading to limited investment options.

India needs approximately USD 1.01T in climate finance by 2030 to meet its climate action targets. This translates to an average of USD 112B annually from 2022 to 2030. If cities design their infrastructure projects keeping climate impact at the forefront, they can access this growing pool of climate finance. This includes investments in renewable energy, energy-efficient buildings, green transportation, circular economy, and climate adaptation measures such as nature-based solutions. Creating and pitching infrastructure projects that align with the interests of capital partners can enable access to this large global pool of funds.

How can Indian Cities tap into Climate Finance?

Local governments can collaborate with national governments, development finance institutions, the private sector, and civil society to increase climate finance access using various strategies. Apart from strengthening the municipal finance systems as mentioned above, ULBs can take the following steps:

- **Develop enabling policies**
  Strengthen the capacity of various government bodies (especially local governments) to mobilize urban climate investment. This could include creating conditions for fiscal transfers, own-source revenues, and private market

investments. Eg: Ghaziabad issued a green bond for a water treatment facility.

- **Integrate Climate Change**
  City administrators can help align and mainstream climate change considerations at all levels through policies, planning, intergovernmental processes, and finance. CSOs like C40 work with a global network of cities to support ULBs in development and implementation of climate action plans. This helps to create pathways for cities to achieve their climate goals and helps to unlock financing for the same.

- **Coordinate project development**
  Cities can support the early project preparation phase of financing, supporting fundraising efforts, providing technical support in developing proposals and encouraging public-private partnerships with robust institutional. Calls for setting up national procurement facilities that can support state / local governments in sourcing, developing, and presenting projects are helpful to cities. UrbanShift is one such global platform that finances adaptation and resilience projects, albeit at a city level, through the support of Global Environment Facility (GEF). In India, Pune, Surat and Chennai have managed to raise USD 7MM through the platform.

- **Implement climate budget tagging**
  Cities could benefit from using climate budget tagging to measure progress and enable better coordination and mobilization of climate finance. This could extend beyond city budgets to track contributions made by all significant public and private actors.

- **Collaborate across sectors**
  Creating synergies with civil society, development finance institutions, and private corporations could help identify potential climate investment opportunities, promote best climate financing practices, and support the development of common definitions, taxonomies, and methods for tracking and reporting urban climate finance.

Oslo, Norway is a case study on incorporation of climate actions into budgets, resulting in increased capital inflows for the local government. Oslo's Climate and Energy Strategy outlines the city's ambitious climate goals, which includes a 95% reduction in emissions by 2030 compared to 2009 – in line with the 1.5°C target of the Paris Agreement. The climate budget was created to ensure that the city implements actions to match these ambitions, allocating carbon dioxide (CO_2) cuts to relevant sectors. The climate budget process is the responsibility of Oslo's finance department and is a fully integrated part of the regular financial budgeting process. It provides a strong signal that the city council can only approve spending plans that are consistent with Oslo's climate target. This has had impacts on 2 levels - the city's emissions are declining, despite being one of the fastest growing cities in Europe and its improved ability to signal stability against climate change, attracting investors and funders from across the globe.

In conclusion, there is a great opportunity to re-imagine the cities of our future. Cities that provide quality living and cities that are in harmony with environmental goals. This will mean significant capital investment and cities need to gear up to access funds through non-traditional means to build this infrastructure. The current momentum in both municipal bond markets and in climate finance is an opportunity for ULBs to raise capital and build out their ambitious vision for equitable, sustainable, and resilient cities.