Municipal Bonds

Why in news?

Vadodara Municipal Corporation is expected to issue municipal bonds to fund Atal Mission for Rejuvenation and Urban Transformation Scheme (AMRUT).

What are Municipal bonds?

- Municipal bonds are debt instrument issued by civic bodies where investors offer loans to local governments (ULB).
- They are given for specific projects & usually they have tenure of 10-years.
- ULB's pays the annual interest on the bonds to the investor at the decided rate.

What is the history of issuing Municipal bonds?

- Ahmedabad was the first city in south Asia to issue a municipal bond of Rs 100 crore in 1998.
- Surat Municipal Corporation was the second city in Gujarat to announce bonds of Rs 450 crore in 2018.
- Now Vadodara Municipal Corporation (VMC) will become the third Urban Local Body in Gujarat to use this method.
- It has proposed two bonds worth Rs 100 crore each & has favourable credit ratings from two reputed agencies.
- Other ULBs that have issued bonds are Lucknow, Ahmedabad, Pune and Indore.

How are Municipal bonds different from bank loans?

- Investor Base is higher in bond market when compared to getting loan from a single bank.
- Institution can issue Bonds only if they have favourable credit ratings.
- They are issued to institutional &high net worth individuals with minimum face value of Rs 10 lakhs.
- But it can be subscribed by a single investor or multiple investors.
- They help in raising funds from the stock market.

Why is the government pushing for municipal bonds?

- Municipal bonds are an integral part in the AMRUT scheme.
- They help in improving the credit profiles of ULB & increases the transparency & efficiency of revenue generation.
- ULB's can get direct transfer of funds from the Centre through this method.
- Also government pays ULBs Rs 13 crore for every Rs 100 crore raised via bonds subject to a ceiling of Rs 26 crore for each.
- This can help in repaying the lender if ULB has financial crunch.
- Moreover the Ministry of Housing and Urban Affairs incentivised eight ULBs which issued bonds issued in 2018-19.
- Further it now decided to incentivise up to 12 ULB based on 'first come, first serve' principle.

How does the bidding process take place?

- After the bond is listed on the exchange, bidding takes place on an electronic trading platform.
- It is open to all investors & ULB appointed transaction agent facilitates the investors.
- He gets a commission of 0.10% after the money is transferred to the account of the ULB.
- There can be one or many investors to take part in bidding.
- Once the bidding is closed, bidders must consent to the interest rate that has been decided after the last bid is made.

What is the credibility of ULB's in repaying the investors?

- Bonds cannot be easily floated on the platform.
- Detailed analyses are made on their repaying capacity, balance sheet of ULBs for the immediate preceding five years.
- Credit rating firms assess the financial health of the ULBs & AA++ is considered to be the best rating.
- ULBs also share an information memorandum which carries the details of the ULB and its financial performance.
- Moreover ULB's should mandatory open escrow account where Central government transfers all the annual incentives.
- This takes care of the payment to be made to the investor.
- Hence the notion that bonds are being issued because a corporation is in a crisis is wrong.

Source: The Indian Express

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