

# Article

## Municipal Bonds: An understanding

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16<sup>th</sup> July, 2014

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## Article

Municipal bonds are debt securities issued by local governments or municipalities to finance its capital expenditures. These bonds are commonly recognised as *muni* bonds globally. The concept dates back to several centuries. The first recorded municipal bond was issued by the City of New York in 1812, which was general obligation bond<sup>1</sup> of the municipal body. Even now, the market in U.S. is very active and the same is evident from the figures mentioned in the Table 1 below. In India, the concept was discussed for first time in 1995; thereafter in 1997 Ahmedabad Municipal Corporation raised Rs. 100 crores, by issuing municipal bonds, which was used to finance water and sewerage projects<sup>2</sup>. Though the concept is not very new in India, but it is surely one such which has been explored very less.

Table showing U.S. Municipal Bonds Issuance (Figs in UDS Billions)

Year	Competitive		Negotiated		Private Placemen t	Total- Bond Type		Total –Bid Type		Total
	GO	Revenue	GO	Revenue	Total	GO	Revenue	GO	Revenue	
2010	49.0	24.2	97.9	259.3	2.8	146.9	283.4	73.1	357.2	433.2
2011	40.9	18.7	64.1	161.6	9.5	1.4/9	180.3	59.6	225.7	294.7
2012	47.7	26.4	87.6	207.8	9.3	135.3	234.2	74.2	295.4	378.9
2013	51.3	18.0	73.3	170.4	18.5	124.6	188.5	69.4	243.7	331.6
2014**	26.8	9.2	38.5	68.9	8.1	65.4	78.1	36.0	107.5	151.6

\*\* Figures upto June 2014

Table:1

Source: SIFMA

### Structure of the Bonds

Typically the municipal bonds are in the nature of debt obligations for the issuers. These are issued for a pre-determined period with a pre-determined coupon rate and require credit rating. The income generated from these instruments are either taxable or are exempted in the hands of the subscriber, subject to tax provisions specific to the country.

### Regulations in India

The Model Municipal Laws issued by the Ministry of Urban Developments and Poverty Alleviation, which was introduced in the year 2003 in order to guide the urban local bodies to structure their law properly, deals with municipal bonds in the paragraphs 122 to 127. The highlights drawn from the same have been discussed below:

<sup>1</sup> <http://www.citymayors.com/finance/bonds.html>

<sup>2</sup> [http://www.ilfsindia.com/downloads/bus\\_rep/ahmedabad\\_bonds\\_rep.pdf](http://www.ilfsindia.com/downloads/bus_rep/ahmedabad_bonds_rep.pdf)



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- The municipal bodies can issue bonds to raise funds for the development of the urban infrastructure.
- The bonds issued by municipal bodies are tax-free in nature, i.e. the income earned from such bonds will be exempt from income tax in the hands of the subscriber. The same has been discussed in detail below.
- Credit Rating – The municipal bodies will have to get the bonds rated by a recognised credit rating agency before offering the same for subscription.
- Security – The municipalities are required to pledge its movable and immovable assets including lands, buildings and tax revenues as a security for issuing bonds.
- End Use of the issue proceeds – The issue proceeds are to be for the purpose of capital investments to develop urban infrastructure like – water-supply, sewerage, drainage, solid waste management, markets, roads, bridges and urban transport. The same can be utilised for the purpose of repayment of loans raised through bonds or otherwise for development of the urban infrastructure.

### ***Tax applicability on the bonds***

In U.S. municipal bonds are either tax free or are subject to tax, but in India, the municipal bonds are tax-free bonds. Section 10(15)(vii) of the Income Tax Act, 1961, as read out below, says that interest on notified bonds issued by a local authority are exempt in the hands of the subscriber to the bond.

#### ***Provisions of law (relevant extracts) –***

Section 10 (15) (vii) of the Income Tax Act, 1961 –

*10. In computing the total income of a previous year of any person, any income falling within any of the following clauses should not be included –*

*XXX*

*(15)(vii) interest on bonds –*

*(a) issued by a local authority or by a State Pooled Finance Entity;  
and*

*(b) specified by the Central Government by notification in the  
official gazette*

*XXX*

Till date the central government has notified 15 issuances of municipal bonds as tax free, the same have been notified as tax free by the central government.



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<b>Issuer</b>	<b>Amount raised (Rs. in crores)</b>	<b>Year of issuance</b>
Municipal Corporation of Ahmedabad	100.00	2001-02
Municipal Corporation of Hyderabad	82.50	2001-02
Nasik Municipal Corporation	50.00	2002-03
Municipal Administration and Water Supply Department of Government of Tamil Nadu	15.19	2003-04
Visakhapatnam Municipal Corporation	50.00	2003-04
Hyderabad Metropolitan Water and Sewerage Board	50.00	2003-04
Ahmedabad Municipal Corporation	58.00	2003-04
Chennai Metropolitan Water Supply and Sewerage Board	42.00	2003-04
Karnataka Water and Sanitation Pooled Fund Trust	100.00	2004-05
Chennai Metropolitan Water Supply and Sewerage Board	50.00	2004-05
Ahmedabad Municipal Corporation	100.00	2004-05
Corporation of Chennai	44.80	2004-05
Ahmedabad Municipal Corporation	100.00	2004-05
Nagpur Municipal Corporation	128.00	2006-07
Ahmedabad Municipal Corporation	150.00	2006-07

### ***Why municipal bonds in India?***

In India, the need of public sector financing has increased sharply, the reason being rapid urbanisation and the fiscal decentralisation strategies that have increased the responsibilities of the local governments with respect to urban infrastructural developments. Over the years, on various occasions fiscal subsidies from the central government have been declined to the local bodies, this has made the situation even worse as the need for infrastructural finance have been increasing from time to time. One cannot depend on the private players for the provision of essential services and given the fixed and limited sources of revenue it is very likely that the infrastructure financing needs will always be a matter of concern for the local authorities. Therefore if the instrument and its proceeds are utilised properly, the municipal bond market has huge potential to flourish in India in time to come.