Financial Architecture for Smart Cities

(These are only suggestions for discussions and no final decision has been taken)

It is suggested that cities which desire to participate in the smart city programme develop a financing plan along with their smart city development plan and detailed project reports. The financing plan developed for a city/urban agglomeration could factor resources from multiple government agencies and departments not restricted to the ambit of urban development schemes alone such as the textile ministry's subventions for textile clusters, textile units in SEZs etc. Credit ratings could also be used by city managements as a dynamic managerial tool for assessing current level of borrowing capacity, along with other performance parameters including economic base, service levels and recovery of user charges and sustainability of proposed investments.

As part of the City Development Plan, the city may develop an investment and financing strategy and identify projects which are amenable to innovative financing such as accessing the bond market or structuring projects as PPP interventions for leveraging additional resources from the private sector. Other strategies for enhancing the resource pool available to cities include the following:

- User charges for utilities to reflect O&M and capital investment costs
- Land value based taxation:
    1. Sale or leveraging the land available with the ULBs
    2. Betterment levy/ Higher FSI or FAR to take advantage of the increase in property prices on land serviced by new infrastructure such as roads, water etc. by imposing a surcharge on stamp duty on sales transaction, FSI, FAR, property taxes etc.
- More accounting transparency (double entry, accrual based accounting, balance sheets) to capture unencumbered cash resources.

In addition to the budgetary resources available with various levels of government, resources would need to be leveraged for the sector from both domestic and overseas investors.

As a first step for leveraging such resources for the municipal sector, the Central government may establish a Fund consultation with other ministries, multilateral, bilateral developing agencies and banks. This fund may blend grant funds from:

- CSS (Central Government allocation),
- borrowings from multi-lateral and bi-lateral agencies and
- bonds subscribed by national and state level land development agencies (e.g. HUDA, PUDA, DDA etc.).

The pooling of monies from commercial and non-commercial sources would allow for reduction in borrowing cost and lengthening of tenor. The fund may provide VGF as well as provide credit guarantees to municipal bonds and term-loans in order to leverage debt resources from the financial markets.

Other financing sources could include:

- Pooled Municipal Debt Obligation (PMDO) facility: As er budget speech of the Finance Minister "This facility was set up in 2006 with the participation of several Banks to promote and finance infrastructure projects in Urban Area on shared risk basis. Present corpus of the facility is Rs 5,000 Crore. The Government has a major focus of providing good infrastructure, including public transport, solid waste disposal, sewerage treatment and drinking water in the urban areas, in keeping with the Hon'ble Prime Minister's vision for urban areas it is proposed to enlarge it to Rs 50,000 crore with extension of the facility by five years to March 31, 2019".
- Real Estate Investment Trusts (REITS): As er budget speech of the Finance Minister"REITS has been successfully used as instruments for pooling of investment in several countries. I intend to provide incentives for REITS which will have pass through for the purpose of taxation……. These structures would reduce the pressure on the banking system while also making available fresh equity. Iam confident these two instruments would attract long term finance from foreign and domestic sources including the NRIs"

- Infrastructure debt funds (IDFs) which could be directed to invest in highly rated municipal bonds/green bonds by defining these as eligible investments. As IDFs are required to invest in post construction assets they could be used as a means to re-finance debt taken during the construction phase as well as additional monies for financing operations

- Encourage issuance of tax-free municipal bonds by creditworthy local governments to bring down the cost of borrowing

- Use PPPs where feasible in smart city projects to leverage private sector financing. To encourage PPPs in the urban sector provision for incentives could be explred However, these need to be discussed with the relevant ministries of the Government of India and concerned departments in the Central/ State Governments.