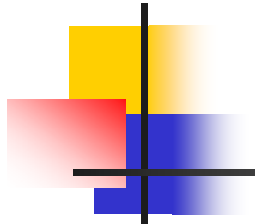


Investing in Asia's Urban Future



Financing Urban Development Infrastructure and Private Sector Involvement

February 6, 2007

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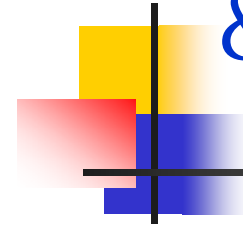
Terminology used may not necessarily be consistent with ADB official terms.

Presentation Structure



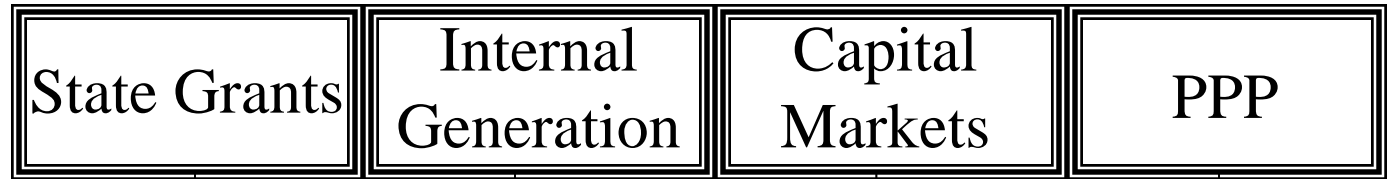
1. Status and opportunities under different modes of Urban Development Financing
 - I. Federal and state government funds
 - II. Internal generation of funds by urban local bodies
 - III. Access to capital markets
 - IV. Public private partnerships
2. Role of ADB

Urban Infrastructure Financing & Development Options



ASSETS & MAINTENANCE

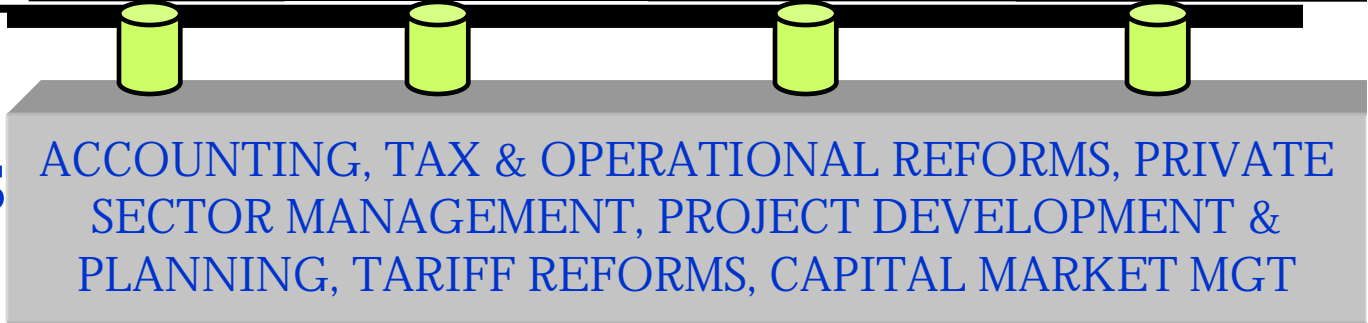
SOURCES OF FUNDS



INTERVENTIONS



CAPACITY REQUIREMENTS



Sources of Funding: Capital Markets



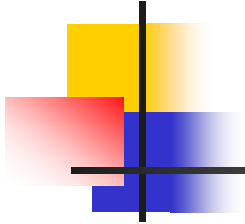
1. Leveraging: do more with less
 - ❖ Borrow today earn tomorrow
2. Commercial discipline & accountability
3. Instruments of Capital Market Access: Term Loans from Banks/Institutions, Municipal Bonds

Capital Markets: The City as a Market Player



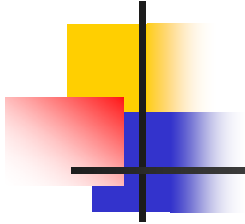
- ❖ Cities are emerging as the primary units of economic growth – the hierarchy of governance is shifting towards cities
- ❖ Sub-sovereign lending – its time has come!
 - ❖ Only the wearer knows where the shoe pinches
 - ❖ Banks, institutions, multilateral dfi's (E.G. ADB WB) to step in with sub-sovereign lending without govt guarantees
- ❖ Decentralization and delegation are key
- ❖ Sub-sovereign lending to be based on credit-worthiness of the ULB

'Term Loan' Vs 'Bond Issuance'



- ❖ Term loans: flexibility of draw down - in line with actual project implementation
- ❖ Bonds: can lead to idle funds and loss of interest
- ❖ Term loans: can have maturity in according to cash-flows with appropriate repayment schedules & moratorium periods > bonds are more standardized
- ❖ Bonds: wider reach including general public, lower interest rates, higher liquidity for the bond holder

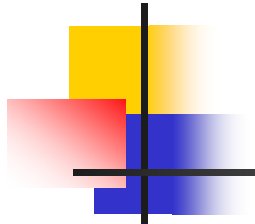
Term Loans: Constraints



Weak Tradition

- ❖ Government guaranteed loans from government corporations cannot usually be called “capital market operations”
- ❖ Weak tradition of true capital market operations by ulb’s
 - ❖ Lenders unfamiliar with ULB practices, are unwilling or unable to assess and price the risks
 - ❖ Inadequate ULB capacities to market their credit worthiness
 - ❖ Weak culture of credit ratings

Term Loans: Constraints CONTINUED



Short Tenor

- ❖ Absence of long tenor lending: most loans short term
 - ❖ *Just 11.50% of ULB loans in india have maturity profile > 3 years*
- ❖ Short tenors restrict ulbs. Rules out ambitious, long gestation, projects that transform quality of life and enhance future revenues

Municipal Bond Markets: Constraints



Challenges faced by Municipal Bonds

- ❖ Prudential norms of conservative banks limit exposure to municipal bonds
- ❖ Low liquidity – capital markets lack depth : not many buyers or sellers. Chicken and egg problem
- ❖ Markets used to asset backed lending. Security mechanisms poorly understood and perceived to be of low quality
 - ❖ Charge on future uncertain revenues
 - ❖ Escrow of future revenues
- ❖ Absence of a rating culture among ulb's
- ❖ Municipal borrowings perceived to carry huge political risks

Capital Markets: **You Can Do It**



You Can Do It : Asian City Mayors and Urban Officials Can Take Their Cities to the Capital Markets

A Vibrant Reform Agenda

- ❖ Accounting Reforms: Transparent Public Information
- ❖ Tax Reforms: Broader and Higher Property Tax Collections – Enormous Leveraging Possibilities
- ❖ Operational Efficiency Enhancement – Where Necessary With Private Sector Participation
- ❖ Tariff Reforms

Capital Markets: **You Can Do It**



Tariff Reforms and Full Cost Recovery

- ❖ Need to clear misunderstandings and mental cobwebs
- ❖ Absence of cost recovery does not result in **Inexpensive** Services but in **Poor** Services
- ❖ The poor suffer the most. They pay much more in coping costs than the benefit of low prices
- ❖ However, subsidy is not a dirty word
 - ❖ But subsidies must be goal directed and properly targeted
- ❖ **Good Economics Can Become Good Politics**

Capital Markets: **You Can Do It**



Credit Enhancement

- ❖ Ulb's are **Perceived** by capital markets as high risk borrowers
- ❖ Mitigating this perception can dramatically increase access to and reduce cost of borrowing from capital markets
- ❖ Measures to mitigate the risk perception may be called **Credit Enhancement**
- ❖ Credit enhancement works if the cost of getting it less than the reduction in cost of borrowing

Capital Markets: **You Can Do It**



Instruments of Credit Enhancement

- ❖ **Rating:** Mitigating Risk Through **Certification**
- ❖ **Guarantees** From Those Who Ought to Know Better: Mitigating Risk Through Superior **Knowledge**.
Appropriate Role for DFI's
- ❖ **Guarantee/Insurance Facilities:** Mitigating Risk Through **Diversification**
- ❖ **Debt Funds:** Mitigating Risk Through **Sharing**
- ❖ **First Lender:** Mitigating Risk Through **Leadership**.
ADB Can Play This Role With Great Effect.

Capital Markets: **You Can Do It**



Role of State and Federal Governments

- ❖ **Grants:** National or State Funds to Provide Grants to ULB's: E.G. JNNURM in India
 - ❖ Must aim to reduce themselves or be phased out as financial devolution takes roots
 - ❖ Must encourage rapid devolution not postpone it
 - ❖ Must be used to leverage reform – actual reform, not just the promise of it
 - ❖ Should be used to leverage debt and not used on a standalone basis
 - ❖ The distribution of grant should be subject to competition and economic returns and not be formula driven

Capital Markets: **You Can Do It**

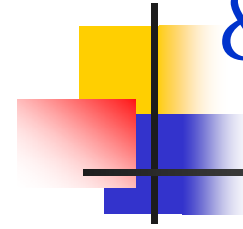


Role of State and Federal Governments

❖ **Loans:**

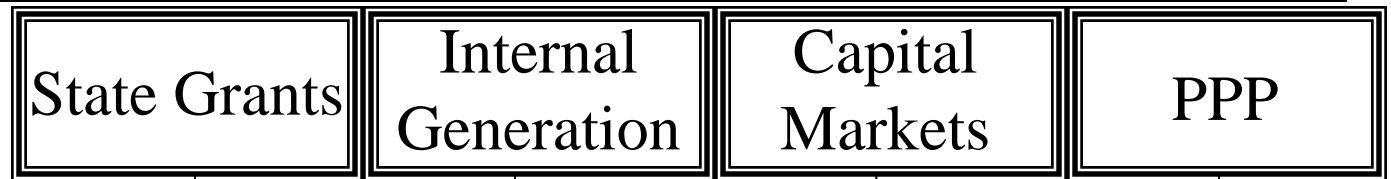
- ❖ Sovereign Guaranteed Loans From Public Agencies - Only As Interim Arrangement Making Way for Capital Markets
- ❖ Create Perverse Incentives for Lending to Poor Projects
- ❖ Susceptible to Political Capture

Urban Infrastructure Financing & Development Options



ASSETS & MAINTENANCE

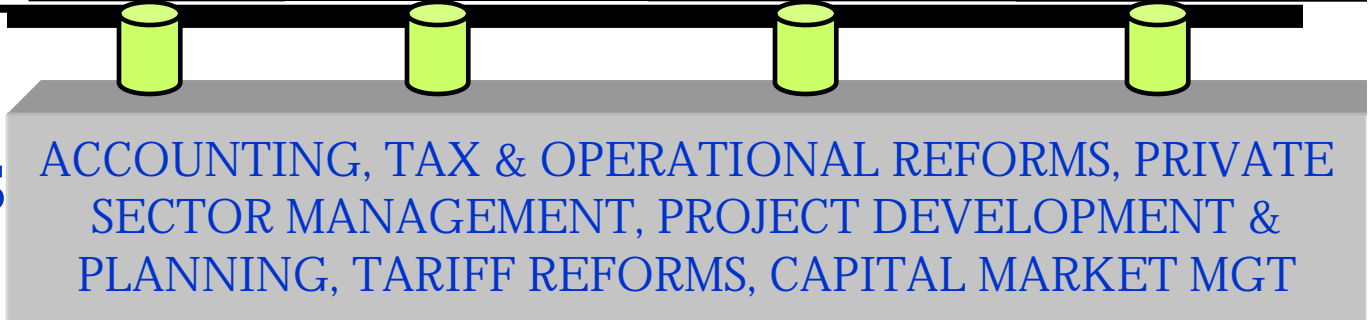
SOURCES OF FUNDS



INTERVENTIONS



CAPACITY REQUIREMENTS



Public Private Partnerships: Joining Hands



Drivers of Public Private Partnerships

- ❖ Source of private financing
- ❖ Beyond financing
 - ❖ Superior governance: greater accountability
 - ❖ Superior technology and management: efficiency gains
- ❖ Therefore, PPP can be appropriate even when little private financing is involved: management contracts/service contracts

Public Private Partnerships: Joining Hands



- ❖ Key Missing Link: Appropriate project structuring/development to make projects bankable
- ❖ Necessary Interventions
 - ❖ Project Development Funds
 - ❖ Project Development Process Management

Financing Urban Development – Summary



- ❖ **State Financial Support** to ulb's inadequate and declining
- ❖ Increasing need for enhancing **Internal Generation** of funds by ulb's through reforms, better taxation and operational efficiencies
- ❖ **Leveraging Resources** from capital markets imperative and highly doable

Financing Urban Development – Summary CONTINUED



- ❖ Rigorous accounting, taxation, and tariff reforms are at the heart of **Capital Market Access**
- ❖ **Credit Enhancement** instruments are necessary to reach out to a conservative capital market
- ❖ **Public Private Partnerships** offer promising access to private financing, superior performance and greater accountability
- ❖ Successful **Project Development** holds the key to make PPP projects bankable

Financing Urban Development – Role of ADB



❖ **Transformation in Capital Markets**

- ❖ Capital markets of the world have come a long way since ADB was founded
- ❖ Ample liquidity looking for good projects

❖ **Globalization**

- ❖ Money slides across porous borders easily

❖ **Changing Role of ADB**

- ❖ Adb's funds have less relevance and greater competition today as a source of pure financing

Financing Urban Development – Role of ADB.... CONTINUED



❖ **New Vistas for ADB**

- ❖ Rapid urbanization combined with democratization and decentralization of decision making creating a huge, underserved, and hungry brand new clientele

❖ **Capital Market Failure**

- ❖ But cities lack the experience, capacity and wherewithal to access the capital markets. There is market failure.

Financing Urban Development – Role of ADB.... CONTINUED

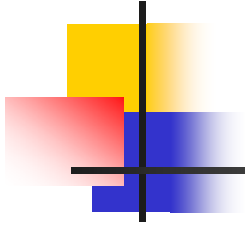
❖ **Market Maker: The Unique Positioning of ADB**

- ❖ ADB, a development institution with access to capital, credibility, and competence uniquely positioned to intermediate between the capital markets and asian cities

❖ **ADB As Leader**

- ❖ *In Addition to Its Loans*, ADB must provide leadership, knowledge, process management, credit enhancement, and risk capital

❖ **ADB Must Reach Out to the Growing Population of Urban Asia to Help Them Build Their Cities While Creating a Robust Business Pipeline for ADB**



Thank You !