

The Maturing of the Municipal Bond Market in India – A Boon for Urban Infrastructure



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Globally municipal bonds are a very popular instrument for government utilities to raise funding. These are fixed interest long term instruments ideally suited for projects with long gestation periods. Besides being a source of long term funding, these instruments also bring about fiscal discipline in the issuer. In order to attract subscribers to the bonds, the issuer must go through a vigorous due diligence and convince the subscribers that they have long term sustainable revenues to service the bonds.

There are two types of municipal bonds:

- **General Obligation (GO) Bonds:** which are backed by the “full faith and credit” of the issuing government. The municipality typically pays investors back either by general funds or by increasing taxes.
- **Revenue Bonds:** These are issued to fund specific infrastructure projects, like a toll road, bridge, or water treatment plant. The principal and interest are paid back *only* with the revenue generated by that specific project (e.g., tolls collected)

In the United States, for instance, the municipal bond market has evolved into a multi-trillion-dollar asset class that serves as a principal source of financing for public infrastructure, including roads, public transportation systems, water supply networks and schools. In India, although the framework for municipal bonds has been in place since 2016, there have only been 31 issues raising 4,540 crores. Compare this with the need for funding by these corporations in India, and you will realize that there has been almost no dent in the capital requirements for municipal organizations.

Municipal bonds have once again entered the spot light mainstream market discourse following a Consultation Paper issued in May 2026, which proposes a number of significant reforms aimed at deepening the municipal bond market and broadening access to capital. Among other measures, SEBI has proposed a framework for pooled financing structures that would enable smaller municipalities to collectively access the debt capital markets, enhanced disclosure requirements for refinancing transactions, safeguards governing the utilisation of issue proceeds towards working capital requirements, and alignment of several provisions of the municipal debt framework with the regulatory regime applicable to corporate bonds. The Consultation Paper also seeks to facilitate greater retail participation.

Additionally, for the first time, India’s largest corporation, the Brihanmumbai Municipal Corporation’s (“**BMC**”) decision to tap the bond market for up to ten thousand crores in one or more tranches for financing critical urban infrastructure projects. This proposed issuance has renewed investor interest in an asset class that has historically remained on the fringes of the Indian securities market.

Even smaller corporations are entering the fray. In February 2026, the Nashik Municipal Corporation issued a bond for multiple projects. The revenues of the corporation are appx 2070 crores which includes:

- o Own tax revenues (property tax, etc.)
- o Non-tax revenues (fees, user charges, rents, etc.)
- o Assigned revenues, particularly the state’s GST compensation
- o Revenue grants

The payment obligations have been secured by way of:

- o First Pari-passu charge by way of hypothecation over present and future receivables pertaining to entire own revenues/cash flows of the Corporation;
- o First Pari-passu charge over the Escrow Account and the account(s) where the entire own revenues/cash flows are collected and/ or pooled by Municipal Corporation (collection account(s)), in each case to the extent of the own revenues/cash flows gets collected and/ or pooled in each of such accounts;
- o First and exclusive charge over the Interest Payment Account-II (including the DSRA Amount), Upfront FD 2, Sinking Fund Account- II being opened for the issue, the funds lying in each such account and any investment(s) made from these account(s);
- o Exclusive charge over the Permitted investments made in terms of Structured Payment Mechanism

All these are interesting developments, but in order for the market to truly grow is that there must be availability of secure cash flow from the municipality to service these bonds on a long-term basis. What is needed is investable institutions. Regrettably, for multiple reasons like poor fiscal discipline, un-predictable revenues, reliance on uncertain state government grants and populist policies, municipal corporations have not given that type of confidence to investors over the years.

A key factor underpinning investor confidence in municipal bonds is the emphasis on credit quality and repayment security. Municipal bond issuances are typically supported by independent credit ratings, structured payment mechanisms, escrow arrangements, debt service reserve accounts and other safeguards designed to ensure timely

servicing of debt obligations. These features not only provide comfort to investors but also encourage municipalities to adopt greater financial discipline and governance standards, thereby strengthening the credibility of the municipal bond market as a whole.

Another encouraging factor is that even with the small amount of municipal bonds issued, repayment track record is unblemished. Despite being a relatively nascent asset class in India, municipal bond issuances have thus far demonstrated a commendable level of credit discipline, with no reported instances of default in servicing coupon or redemption obligations. This performance has helped strengthen investor confidence and underscores the effectiveness of the regulatory safeguards, disclosure standards and credit assessment mechanisms that govern municipal debt securities.

As India's urban infrastructure requirements continue to outpace traditional sources of funding, municipal bonds are poised to play an increasingly important role in bridging the financing gap. With a maturing regulatory framework, growing investor participation, financing of impactful infrastructure projects and a strong repayment track record, municipal bonds have the potential to evolve from a niche financing instrument into a cornerstone of India's urban development strategy.

What is particularly noteworthy is that as the market matures, SEBI has also demonstrated its willingness to adapt the regulatory framework to evolving market realities. The Consultation Paper proposes a number of significant reforms aimed at deepening the municipal bond market and broadening access to capital. Among other measures, SEBI has proposed a framework for pooled financing structures that would enable smaller municipalities to collectively access the debt capital markets, enhanced disclosure requirements for refinancing transactions, safeguards governing the utilisation of issue proceeds towards working capital requirements, and alignment of several provisions of the municipal debt framework with the regulatory regime applicable to corporate bonds. The Consultation Paper also seeks to facilitate greater retail participation through lower denomination issuances, permit investor incentives for specified categories of investors, and enable municipalities to issue ESG-linked debt securities. Collectively, these proposals reflect a clear regulatory intent to make municipal bond issuances more accessible, transparent and efficient while maintaining robust investor protection standards.

In countries with deep municipal bond markets, cities typically have:

- o stable and diversified revenue bases,
- o professional treasury functions,
- o long histories of audited accounts,
- o predictable fiscal rules,
- o significant local autonomy

Several developments are making municipal bonds more viable:

- o Implementation of the Smart Cities Mission improved project planning and financial management in some cities.
- o Larger municipalities are increasingly adopting accrual accounting and publishing audited financial statements.
- o Credit ratings for urban local bodies have become more common.
- o Institutional investors are showing greater interest in sustainable infrastructure, creating opportunities for green municipal bonds.
- o SEBI's recent consultation paper addresses practical barriers by proposing refinancing, pooled financing, ESG bonds, lower denominations, and limited working-capital funding.

After a long time on the books, the municipal bond market in India is about to live up to its promise. From global examples, we can directly establish a link between better civic amenities and a robust bond market. Indian cities need the capital and this time we must get it right.