

Municipal Bonds in India: Growth Signals in a High-Potential Market



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Synopsis

This report is the third sequel to CareEdge Ratings' series on municipal bond issuances in India, following earlier editions published in February 2024 and February 2025. The previous reports underscored the importance of municipal corporations in funding urban infrastructure, the untapped potential of municipal bonds, and government efforts to meet rising capital expenditure requirements.

Consistent with CareEdge Ratings' expectations, FY26 witnessed increased activity in the municipal bond issuances. This opinion piece delves into the (i) status of issuances versus potential, (ii) outlines desired reforms, and (iii) highlights recent regulatory steps to deepen the market.

CareEdge Ratings expects the market to sustain this momentum in the near term, supported by continued policy interventions and rising investor interest in municipal bonds.

- The growing need for urban infrastructure, coupled with the untapped potential of municipal bonds for financing capital outlay, has triggered a series of reforms in the municipal bond market. SEBI's 2015 revision of the municipal bond framework and the RBI's October 2025 guideline allowing municipal bonds as collateral for repo transactions both aim to enable market development. Various measures by SEBI and the Government have led to a noticeable pickup in issuances during FY26, with municipal bond issuances totalling about Rs 1,000 crore during April–November 2025. As per CareEdge Ratings' estimates, full-year FY26 issuances are expected to reach around Rs 2,000 crore, which compares favourably with the cumulative issuances of approximately Rs 3,000 crore raised over the seven years from 2018 to 2025.
- CareEdge Ratings expects municipal corporations to raise additional debt of about Rs 30,000 crore, with annual bond issuances of Rs 2,500–Rs 3,000 crore for the period FY26–FY34.
- An assessment of around 32 key municipal corporations (covering metros, tier I and tier II cities) indicates outstanding debt of approximately Rs 13,500 crore as of March 31, 2025, with muni bonds constituting less than 20% of this debt. The municipal bond market in India remains small, accounting for only 0.06% of total outstanding corporate bond issuance as of September 30, 2025. In contrast, the U.S. municipal bond market accounts for about 14% of its GDP and 7% of its overall bond market.
- The Union Budget 2025–26 introduced an "Urban Challenge Fund" of Rs 1.0 lakh crore to finance incremental urban infrastructure, which is seen as a positive step for market development. However, the lack of clarity on the fund's operational mechanism has delayed its utilisation for urban capital expenditure. The likely finalisation of the mechanism in the upcoming Union Budget may accelerate on-the-ground implementation.
- Additional measures that could aid market development include granting greater autonomy to Urban Local Bodies (ULBs), strengthening institutional frameworks, and expanding projects under the Public Private Partnership (PPP) model. Other supportive initiatives include developing lighthouse cities, introducing innovative credit enhancement structures and establishing bankruptcy and debt management guidelines. These reforms are expected to improve ULBs' credit profiles, enhance market perception, and support informed investor decision-making.

India is experiencing an unprecedented increase in its urban population, growing from approximately 28% in 2004 to around 36% in 2024 and projected to reach 40% by 2036. Rapid urbanisation is straining existing infrastructure, and as the urban population grows, municipal corporations will require substantial capital investments to bridge the widening infrastructure gap.

A few prominent infrastructure development responsibilities of ULBs include public roads, drinking water supply, sewage disposal, solid waste management, street lighting, public health services, Government schools and hospitals, and other public amenities, which necessitate capex.

Municipal corporations rely on their own revenues and government grants to meet their capital outlay requirements.

- i. Municipal revenue sources recorded CAGR growth of ~13% over FY21-25 (Estimated). State-level policies and limited autonomy curb the ability to raise taxes and user charges. This results in inadequate cost recovery and impedes municipal revenue growth.
- ii. Fiscal transfers are the grants or devolution received from the Central or State, which may burden the state exchequer.
- iii. Public-Private Partnership (PPP) investments have not been encouraging for the ULBs due to revenue autonomy and growth limitations.
- iv. Bank borrowings come with several limitations—higher costs, shorter tenures, and restrictions under RBI guidelines, which allow funding only for revenue-generating projects. In this context, bond financing emerges as a viable alternative to meet the growing capital needs of urban infrastructure and plays a critical role in long-term capital planning.

Regulatory push for market development

Indian Government and regulatory bodies, including SEBI and RBI, are bringing in a series of reforms to support the muni bond market development, with some of the key regulatory initiatives highlighted below-

- ✓ Revised Municipal Bond Framework (2015)
- ✓ Expansion of Eligible bond issuers to include SPVs, Smart Cities, and pooled finance entities
- ✓ Subsidy on bond issuances under AMRUT, including green municipal bonds, thereby improving affordability for ULBs.
- ✓ Launch of Urban Challenge Fund to support viable urban development projects. This fund is designed to cover 25% of financing for viable projects, with the remaining 50% secured through bonds, bank loans, and public-private partnerships.
- ✓ Inclusion of Muni bonds in the eligible list of issuers for Partial Credit Enhancement (PCE) vide RBI's revised framework on PCE in August 2025.
- ✓ RBI's approval to consider muni bonds as collateral for repo transactions in October 2025– an attempt to expand the secondary market and augment liquidity for muni bond investors.

These measures are expected to enhance market depth, improve liquidity, and attract institutional investors, supporting annual issuances of Rs 2,500–Rs 3,000 crore over FY26-FY34

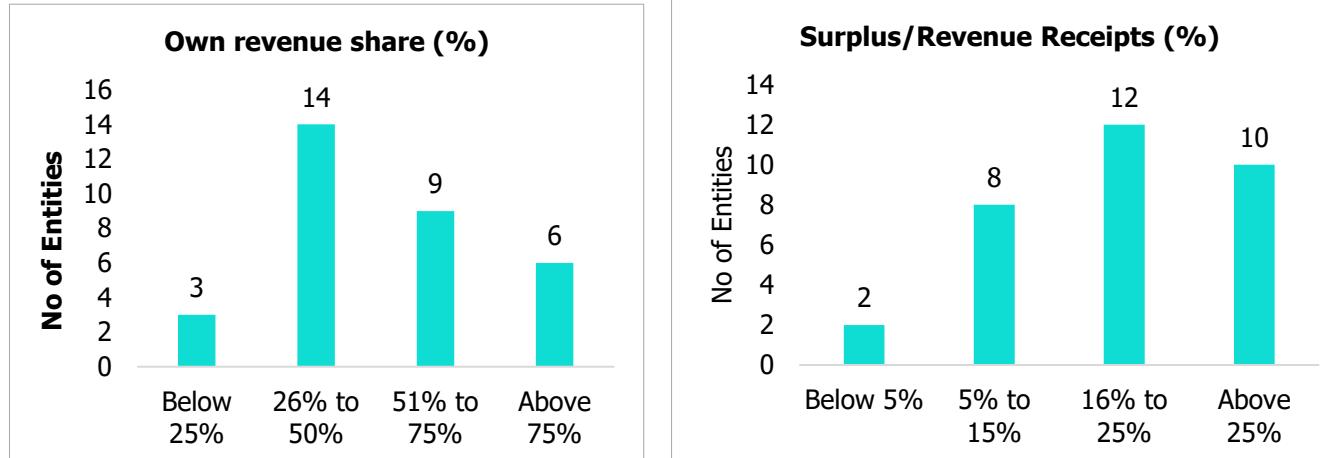
Financial scorecard

Particulars	FY22	FY23	FY24	FY25 (E)
Revenue growth (%)	14.65	12.09	19.87	5.46
Revenue Receipts/Revenue Surplus (%)	22.33	23.03	23.36	22.91
Debt/Revenue Surplus (x)	0.57	0.66	0.59	0.49

Source: CareEdge Ratings, E – Estimates

Sample size of 32 entities

Exhibit 2: Own revenue share and revenue surplus



Source: CareEdge Ratings

The table above represents the financial performance of 32 ULBs. The revenue of the stated sample of ULBs has grown at a CAGR of ~13% over the last four years (FY21-FY25E), with a consistent revenue surplus reported by all corporations.

Analysis of the financial performance of Urban Local Bodies (ULBs) indicates that own revenue accounts for an average 63% of total income. This share, comprising tax and non-tax revenue, reflects ULBs' ability to generate income independently, which is critical for financial sustainability. Property tax accounts for nearly 60% of own revenue and has recorded a compound annual growth rate (CAGR) below 10% during FY21–FY25E.

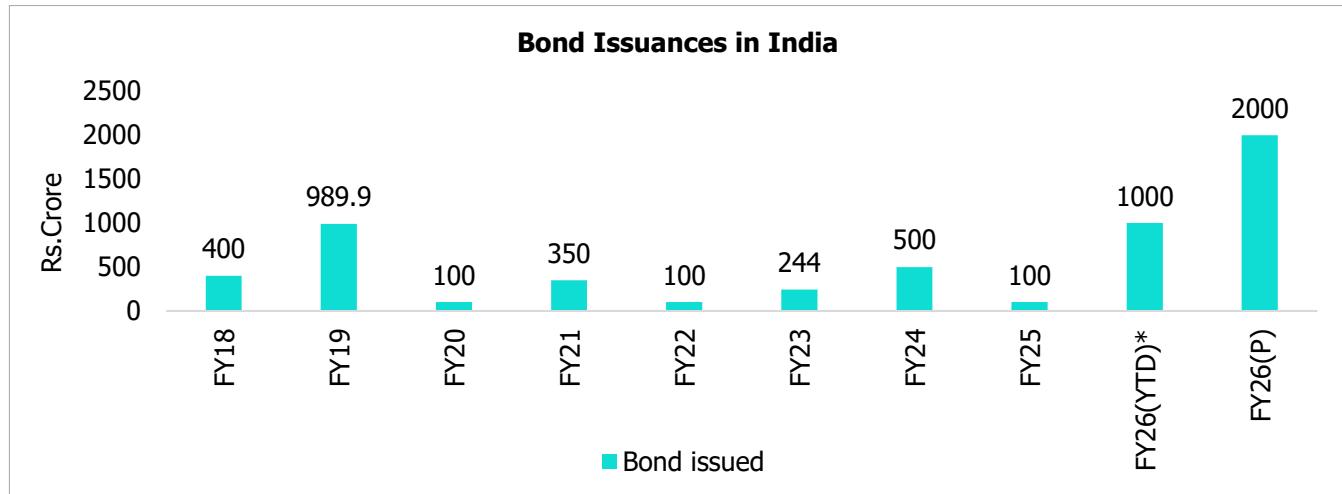
CareEdge Ratings has also observed that all municipal bond issuances typically require escrowing property taxes with 1.5-2x coverage, underscoring the importance of own revenues and strengthening the bond structure.

State government receipts (20–25%) and other income sources (10–15%) together form the remaining 35–40% of municipal revenue. This includes compensation for Octroi abolition, under which ULBs (except in most Southern States) receive GST compensation from states, which accounts for ~30–50% of their revenue receipts. Although not classified as own revenue, this remains a significant contributor. CareEdge Ratings observes a consistent track record of timely receipt of such compensation by ULBs.

Property tax collections are expected to grow at a moderate pace in the near term, supported by digitisation, which should help ULBs maintain their revenue share above 60% and strengthen their credit profile for future bond issuances.

Indian Municipal Bond Market: Growth Signals Amid High Potential

With concerted efforts by various market participants, the municipal bond market has shown signs of growth over the past two years, with more issuances in FY26.



*Year to Date till November.

Source: SEBI and CareEdge Ratings

The overall market size of muni bonds remains low; however, there are visible green shoots, particularly since 2023. According to a study by CareEdge Ratings, ULBs in India had total borrowings of approximately Rs 13,500 crore as of March 31, 2025 (Sample Size: 32), with bonds accounting for less than 20% of total borrowings.

During FY26 (through Nov 2025), aggregate bond issuances totalled Rs 1,000 crore, with several first-time issuers entering the market. Based on planned issuances underway, the likely issuance by the end of FY26 is ~Rs 2000 crore. Nevertheless, robust profitability, indicated by a 20-25% revenue surplus and a low leverage ratio (debt/revenue surplus below 1x), presents opportunities for additional borrowing. These corporations are expected to have financial flexibility by raising approximately Rs 30,000 crore in incremental debt. CareEdge Ratings projects that municipal corporations could raise bonds of ~Rs 2500-Rs 3,000 crore per year between FY26 and FY34.

What can be done

The lack of emphasis on capital budgeting policies, a socialistic mindset with an absence of willingness to borrow, a lack of autonomy in decision making, including steps required to augment the revenue base, information asymmetry with improper data management, etc., are some of the key challenges in approaching the capital market by the ULBs. The details have been captured in earlier reports published by CareEdge Ratings. In the opinion of CareEdge Ratings, along with insights gathered from various market participants, a few of the reforms/measures which shall support the municipal bond market are as follows-

A. Issuer-level reforms:

- Granting ULBs greater autonomy in asset management and revenue augmentation, expanding Public-Private Partnership (PPP) projects, and strengthening institutional capacity through dedicated functional teams.
- The functioning of ULBs is different from corporates and hence all of them may not be suitable for capital market issuances given the strong disclosure norms and adherence to regulatory frameworks. However,

to begin, lighthouse cities can be identified, which will provide guidance and precedent for others to access the municipal bond market. Such lighthouse cities may propose large issuances rather than small-ticket sizes, which restricts investor appetite and secondary-market development.

- Enhanced book-keeping practices and improved accounting disclosure and reporting, Formulation of Bankruptcy Framework and Debt Management Framework, etc to build creditworthiness, financial transparency and governance capacity of the ULBs.
- Innovative financing mechanisms, along with exploring credit enhancement measures, for uplifting the credit profile of the proposed instrument to gather a wider investor community. For small ULBs, for instance, the bond pooling mechanism presents an opportunity. Investors, particularly insurance and pension funds, are often constrained by investment guidelines that favour higher-rated bonds, which are in limited supply. Thus, various credit enhancement measures, including the recent PCE guideline for bond issuance, can provide a supportive framework for the development of the municipal bond market.

B. Investor & Regulatory considerations:

Several regulatory reforms have been implemented, and others are underway, to support the development of the municipal bond market. The introduction of a debt management framework and incentives for strengthening institutional capacity are expected to help Urban Local Bodies (ULBs) improve their creditworthiness and access to debt markets. Regulatory support is also anticipated in the form of

- i. Finalisation of the modalities of the Urban Challenge Fund
- ii. Continued investor and issuer education and awareness initiatives, and
- iii. A review of the subsidies extended under the AMRUT scheme.

CareEdge Ratings' view

FY26 could mark an inflection point for the muni-bond market, with several first-time issuers entering the market and aggregate issuance at levels not seen since 2018. CareEdge Ratings projects that municipal corporations could raise an additional debt of ~Rs 30,000 crore with new bond issuance of ~Rs 2500-Rs 3,000 crore per year over 8 years from FY26 to FY34.

As per Puja Jalan, Director "Municipal bond issuances are usually backed by escrowed property tax revenues, highlighting the importance of strong own-revenue base. Property tax collections are expected to grow at a moderate pace over the medium term, supported by ongoing digitisation efforts. This should help ULBs sustain a revenue share above 60% and strengthen their ability to tap the bond market".

Tej Kiran, Associate Director adds" Several government reforms, such as the launch of the Urban Challenge Fund, along with guidelines to include ULBs for Partial Credit Enhancement and to provide collateral for repo transactions, reinforce efforts to broaden the reach of India's municipal bond market".

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