I. Introduction and Context

Country Context

1. India’s rapid economic growth is being accompanied by an unprecedented urban and spatial transformation. While the current level of urbanization in the country is around 31% (377 million persons) as 2011 census, it is projected to increase to 50% or more over the next 20 years. For the first time since independence, India has seen a greater absolute increase in urban population versus rural and the number of towns in India has increased from 5,161 in 2001 to 7,935 in 2011, with about 53 cities having over 1 million population. This massive urban transformation in many ways defines one of India’s fundamental development challenges going forward: to accommodate an additional 10 million urban dwellers per year, provide them with adequate housing and urban services such as water supply, sewerage, drainage, solid waste management and urban transportation networks and systems, addressing slums, create opportunities for economic growth
and at the same time, ensure that such urbanization is environmentally sustainable. This is in addition to the huge current backlog in urban services.

2. Therefore, accommodating the needs of its growing urban populations is now and will continue to be a strategic development challenge for many years to come that has to be faced primarily by the state governments, since urban development is entirely a ‘state’ subject under the Indian Constitution.

3. The scale of challenges summarized above also brings into context the urban capital investment needs in India as outlined by various Finance Commissions and expert bodies and the realization that such needs cannot be met by government budgetary sources alone. For example, a McKinsey study on Indian urbanization estimates an investment need of US$ 1.2 trillion over the next 20 year period. This is in addition to substantial resources required for sustainable operation and maintenance (O&M) of urban services. Policy makers at the national level too are now increasingly seized of the urbanization related challenges and hence the Jawaharlal Nehru National Urban Renewal Mission (JNNURM).

4. Among the larger Indian states, Tamil Nadu (TN) ranks 1st on urbanization rates and has the second largest state economy in India. From 2004-05 to 2011-12, its Gross State Domestic Product (GSDP) has grown at an average of 9.3% per annum, which was higher than the national average and also highest among the more developed states in India. During the same period, the state’s per capita income increased at a CAGR of 15.9% during 2004 – 2011, to reach $1,622 equivalent. Services contributed about 58% of the GSDP of TN, followed by industries / manufacturing that contributed about 30% and the rest accounted for by agriculture. Hence this underscores the importance of urban areas in TN, for many of the activities such as trade, hotels and restaurants; real estate, ownership of dwellings and business; transport storage and communication and construction.

Sectoral and Institutional Context

1. As per Census 2011, TN is about 48.5% urbanized with about 35 million people residing in urban areas and accounting for 9.6% of India’s urban population. In terms of absolute numbers of population living in urban areas, Tamil Nadu is in third position after Maharashtra (>50 million) and Uttar Pradesh (> 40 million). Further, the urban growth rates have outpaced rural growth rates - the urban population growth in the state was 27% during 2001 to 2011 as compared to rural growth of 6% during the same period. The urbanization in TN is widely dispersed and encompasses 12 municipal corporations, 124 municipalities and 528 town panchayats (not part of the scope of TNSUDP), besides about 374 ‘census towns’ identified as areas with urban characteristics, but not formally notified as urban. This urban growth combines net in-migration into urban areas, expansion of city boundaries to accommodate peri-urban growth as well as growth of existing urban populations.

2. Given the levels of urbanization, urban development is of critical importance to the Government of Tamil Nadu (GoTN) and this is clearly spelt out in their latest (12th) Plan Document and the TN Vision 2023 document. Though TN is a pioneer in many aspects of urban development, there remains a huge unfinished agenda and the key urban sector challenges for TN in this context include: (i) Meeting the demand supply gap in urban services in keeping with the fast paced urban growth – for instance coverage of sewerage and storm water drains is less than 30% in the state and less than 10% of the solid waste is scientifically treated and disposed; (ii) Deepening urban public finance reforms to enable city governments to generate the required financial resources by being
able to more effectively tap into the economic growth occurring in the cities. TN was the first state in India to set up structured system of state finance commissions in the late 1990s for formula based transfer of funds to ULBs that has greatly empowered the ULBs and such devolutions have grown at an average rate of 23% per annum over the last decade; (iii) Improving urban governance and capacity of cities to take on the challenges in keeping with the 74th Constitutional Amendment and ensuring accountability to city residents. TN already has a system of directly elected mayors, but with very limited powers and autonomy; (iv) Ensure cities continue to play an important role in fostering economic growth in the state.

3. In keeping with the aforesaid challenges and to leverage urbanization for economic growth, the TN Vision 2023 documents and GoTN's 12th Plan set out as its vision for the sector as seeking to "promote and facilitate the development of inclusive and sustainable cities". In keeping with this vision, some of the specific priorities / goals include: (i) Developing Ten "World Class" Cities; (ii) Improving Urban Environments through: (a) Achieving an “Open Defecation Free” State; (b) Achieving 100% access to safe sanitation; (c) Achieving a “Garbage Free” State; and (iii) Ensuring continuous water supply in urban areas. The aggregate investment requirements for achieving these and other related urban sector development goals are estimated to be in excess of US$ 37 billion over the next 20 years. For achieving these goals, it calls upon the state to take actions, with innovations as a cross-cutting theme, across four fronts: (i) Urban Governance; (ii) Planning; (iii) Funding; and (iv) Capacity Building.

4. The Bank has a long engagement with the Government of Tamil Nadu in the urban sector, starting from TNUDP-I project. The "Municipal Development Fund" (MDF) type urban projects in TN that began with the setting up of the Tamil Nadu Urban Development Fund (TNUDF) started under TNUDP-II in late 1990s which was followed by the recently closed TNUDP-III. TNUDF was setup as a municipal fund in Public-Private Partnership (PPP) format between Government of Tamil Nadu (GoTN) and private sector domestic financial institutions. TNUDF has played an important role in fostering greater access to financial markets by Urban Local Bodies (ULBs) in TN while maintaining an outstanding track record on loan repayments from ULBs - 100% over the last decade. It has also undertaken many pioneering transactions including first pooled finance municipal bond issuance, promoting capital contributions from beneficiaries of urban projects as a financing mechanism and PPPs at municipal level. TNUDF has grown as an institution as a result of this long standing partnership and supported over US$ 1.5 billion in urban investments in the state (leveraging an aggregate Bank support of about US$ 400 million over this period through TNUDF-II & III), combining public and private funds, as well as other donors (JICA, KfW). Under the recently closed TNUDF-III itself, over 3 million city residents have directly benefited through improved urban services. Further, these projects have tended to support secondary cities outside Chennai as well – for instance under TNUDP-III, only about 13% of the investment assistance went to Chennai city (excluding Chennai urban transport sub-component). TNUDF-II ICR had an IEG rating of ‘Satisfactory ’ and TNUDF-III is currently rated as ‘Satisfactory’.

Relationship to CAS

5. The proposed TNSUDP fully supports Bank's India Country Partnership Strategy (CPS) for FY2013-2017 aiming to reduce absolute poverty and boost shared prosperity. Specifically, TNSUDP would contribute to the development goals set out under Engagement Area Two on 'Spatial Transformation' under the CPS that seeks to leverage the rural-urban transformation as an opportunity to reduce poverty and increase competitiveness. In helping India and the state of Tamil Nadu manage such spatial transformation and improving the livability of cities, TNSUDP as
articulated through its PDO and components, aims to contribute to the following outcomes outlined under Engagement Area 2 of the CPS: (i) Strengthened institutional capacity of urban governments; (ii) Improved urban services; (iii) Improved environment protection.

6. In addition, the proposed TNSUDP is also fully consistent with the urban sector priorities as outlined in the 12th Plan of Government of India that includes: (i) Increasing investment in urban infrastructure; (ii) Strengthening urban governance, institutional capacity, improve long-term urban planning for sustainable and inclusive urban development; (ii) Raising environment sustainability; and (iii) Improving financial sustainability of ULBs. TNSUDP would contribute to these objectives as well as by strengthening the financial and administrative capacity of ULBs to plan, finance and deliver services in a financially sustainable manner.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)
To demonstrate improved urban management practices and improve urban services delivery in participating ULBs in a financially sustainable manner.

Key Results (From PCN)
Achievement of the PDO(s) will be measured by the following outcome indicators: (i) Increase in share (%) of own source revenue of pilot ULBs; (iii) Increase in share (%) of local expenditures over which pilot ULBs have full authority; (i) Number of direct project beneficiaries of improved urban services, of which female (%) (Core Sector Indicator); and (iv) Continued financial viability of Tamil Nadu Urban Development Fund (as measured by repayment rates on its loans to ULBs).

III. Preliminary Description

Concept Description
The proposed TNSUDP builds on the on-going Bank engagement with Tamil Nadu in the urban sector, in particular on TNUDP3. It will step-up the level of engagement by enhancing the local urban management and governance as well as further refining the line of credit support to ULBs. Innovations envisaged under the project include: piloting a Model Towns Concept; supporting credit enhancement; and supporting reforms in urban finance and in sector policies. In addition, there will be a greater focus on the sustainability of urban environment under the line of credit sub-loans/grants. The prospects for using the Disbursement Linked Indicator (DLI) mechanism to incentivize the Model Towns will also be explored.

The proposed project is expected to comprise two components: Urban Investment and Management; and Urban Sector Technical Assistance.

Project Components

Component 1: The Urban Investment and Management component will comprise four sub-components:

a. Urban Governance and Management Enhancement of Model Towns (Bank loan: US$60 million):
   The main objective of this sub-component is to demonstrate new models on urban management with a focus on building strong governance and financial sustainability. This sub-component will target at least two medium sized ULBs, which will be empowered and incentivized to improve resource
planning and management, transparency and accountability, as well as enhanced municipal service delivery. These Model Towns are envisaged to become role models, and if implemented successfully, can potentially be scaled up to other ULBs across Tamil Nadu in the future. Conceptually, a likely Model Town would have the following outcomes: (i) improved decision making powers supported through the delegation of progressively increased administrative and financial powers; (ii) enhanced technical capacities in management systems; (iii) strategic urban and infrastructure planning linked to ULB resources; (iv) service delivery and operations management; (v) strengthened financial management, transparency and improved accountability mechanisms and processes; and (vi) open and active dialogue with its residents. The vision, objectives and definition of a Model Town including the selection criteria, would be identified and agreed upon by appraisal. The required regulatory and legal framework (in line with the 74th Constitutional Amendment and the related state level conformity legislation) that will underpin the systems improvement will be agreed with GoTN prior to appraisal.

Under this sub-component, the selected Model Towns will be provided an annual grant based on satisfactory performance in selected governance and management areas. The disbursement decision will be based on achievement of pre-specified results: annual targets that will need to be achieved for disbursements against a set of Disbursement Linked Indicators (DLIs). The achievement of annual targets for disbursements against the pre-set DLIs will be individually assessed for each city every year by the Gov TN, through independent assessment teams. The DLIs and corresponding annual targets will be identified with the Government over the course of preparation to reflect specific areas of improvement.

b. Credit Enhancement (Bank loan: US$10 million): Tamil Nadu is a pioneer in mobilizing resources from financial markets for urban infrastructure through the issue of municipal bonds. It has so far mobilized US$ 64 million for financing viable urban projects in the state through the issue of bonds. This sub-component will channel increased financial resources for investment in urban sector projects by leveraging Bank funds. Resources may be mobilized through the issue of municipal bonds / other debt instruments under pooled finance framework or on ULB based approach, borrowing from commercial banks, etc. Credit enhancement under this component includes any arrangement intended to decrease the likelihood of default on the debt instruments / borrowings including subordination, reserve fund, cash collateralization and / or other arrangements to improve the credit rating.

c. Line of Credit Urban Investments (US$300 million): The main objective of this sub-component is to help participating ULBs improve urban services with an emphasis on the urban environment. There will be an emphasis on 'sustainability' or improvement of urban environments (not less than 40% by value under this sub-component) through interventions in waste-water collection and treatment / water reuse, storm water drains and restoration of water bodies in urban areas. The selection of participating ULBs will be based on existing TNUDF criteria which assess financial sustainability of the interventions in ULBs. This sub-component will also include retroactive financing of some expenditures incurred in TNUDP-III.

d. Project Development Advisory Facility (PDAF) (Bank loan: US$10 million) to be managed by TNUDF, would provide technical assistance to ULBs for preparing and/or supervising sub-projects in ULBs, including environmental and social mitigation actions, contract supervision, Public Private Partnerships (PPPs), etc.
Component 2: Urban Sector Technical Assistance Component (Bank loan: US$20 million) is aimed at system-wide strengthening of the capacity of ULBs and urban sector officials in the state in specific areas, as well as supporting reforms in the area of urban finance and sector policies. It would comprise: (i) Support for the next generation of municipal e-governance system, covering all ULBs; (ii) Build on the financial management reforms initiatives carried out under TNUDP-III by moving to an integrated/centralized web-based financial management system, enhancement of capacity of newly created municipal accounts cadre; (iii) GIS Mapping for 119 ULBs; (iv) Training and Capacity Building; (v) Project development; and (vi) Urban sector studies focused on urban public finance issues (enhancing own source revenues, etc).

Environmental and Social Safeguards. Most of the investments proposed under the project will encounter environment and social impacts –both positive and adverse. Given the complex nature of urban sector, some of the proposed investments will be environment category A type sub-projects. The respective implementing agencies will be responsible for preparation and implementation of environment and social safeguard mitigation plans. TNUIFSL, who have demonstrated the capacity and willingness to implement the environmental and social safeguards practices in the previous TNUDP-III, will be playing the role of coordination and monitoring of safeguards implementation. The Environment and Social Safeguards Framework (ESF) that was applied in the previous project is being updated to take into account of changes in various regulatory measures and new land acquisition and R&R act provisions. The experiences and lessons learned as part of implementation of previous project will also be integrated in the updated framework. The ESF will describe the process, provisions and protocols for undertaking environment and social assessments for all investments and preparing mitigation plans to deal with adverse environment and social impacts.

IV. Safeguard Policies that might apply

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V. Financing (in USD Million)

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VI. Contact point

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