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Shaping the Urban Challenge Fund

INFRATALK

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India's cities are brimming with potential but hamstrung by outdated funding models and overburdened infrastructure. Capital expenditure on urban utilities infrastructure (excluding real estate) between 2011 and 2018 averaged just 0.6 per cent of gross domestic product (GDP) — barely a quarter of what is required.

The laudable objectives of the 74th amendment to the Indian Constitution, enacted in 1992 that enjoined cities to "take charge of their own destinies," have remained largely unfulfilled. Recognising this, the Union Budget in February announced a long-overdue shift. "The Union Government will set up an Urban Challenge Fund (UCF) of ₹1 lakh crore to implement the proposals for 'Cities as Growth Hubs', 'Creative Redevelopment of Cities' and 'Water and Sanitation'," declared Finance Minister Nirmala Sitharaman — marking a strategic departure from entitlement-based grants towards a competitive, performance-linked funding framework.

The Census of India classifies an area as urban if: (i) it is a statutory town with a notified urban local body, or (ii) it is a Census town that meets all three conditions — a minimum population of 5,000, a density of at least 400 persons per sq km, and 75 per cent of the male workforce in non-agricultural activities.

Applying these criteria in the 2027 Census is expected to show that in many parts of India, urban areas will account for over 60 per cent of the population — up sharply from 31 per cent in 2011. An extreme case is Kerala. Its urbanisation is expected to go up from 73.19 per cent in 2022 to 96 per cent by 2036. There are many other less extreme cases of "urban creep." To address this, the NITI Aayog is piloting a new framework based on economic activity and land use in four city-regions — the Mumbai Metropolitan Region, Varanasi, Surat, and Visakhapatnam. Clearly, the true scale of India's urban challenge is significantly underestimated.

The UCF, designed to reward ambition and innovation, offers 25 per cent central funding and mandates cities mobilise at least 50 per cent of project costs through bonds, loans, or public-private partnerships (PPP). By prioritising high-impact, revenue-generating projects, it aims to crowd in private investment and redefine how cities finance growth.

India's mixed record with urban funding highlights why a rethink was urgent. The 2015 Smart Cities Mission mobilised local innovation but saw limited private participation — only 6 per cent of projects used PPPs, and by 2023, just 12 per cent had achieved financial closure, far short of the 21 per cent target. The viability gap funding scheme, despite offering up to 80 per cent support for social infrastructure, saw only 71 projects approved over two decades — hindered by bureaucratic delays, opaque contracting, and poor lifecycle oversight. Municipal bonds remain underused as most urban local bodies (ULBs) lack creditworthiness.

To strengthen the design and delivery of the UCF, The Infravision Foundation, drawing on its extensive research and sectoral expertise, offers the following seven recommendations:

1. The UCF must embed lifecycle thinking into project planning. Operations and maintenance (O&M), service delivery, and citizen satisfaction should be treated as core components from the outset — not afterthoughts. Projects should be designed with structured O&M standards, service-linked payments, and citizen-centric monitoring to ensure long-term sustainability and quality of services. The ambition should not just be to fund infrastructure, but to reshape how cities think — transitioning from "infrastructure as product" to "infrastructure as service".

2. Private sector participation must be encouraged by de-risking urban infrastructure investment. The UCF should blend its grants with tools such as first-loss guarantees, credit enhancements, and revenue shortfall protection. The proposed partial credit guarantee fund by NaBFID, a development finance bank, can play a complementary role in boosting investor confidence in municipal debt.

3. Cities must become better at raising their own resources. Today, ULBs account for only 15 per cent of capital outlays, down from 30 per cent a decade ago. Property tax collection remains stuck at just 0.15 per cent of GDP. Instituting "user-pay" charges for a variety of municipal services continues to be a political hot-potato. Unless cities can raise and manage revenues transparently and efficiently, private investors will remain hesitant.

4. Capacity building is non-negotiable. Many Tier 2 and Tier 3 cities lack the planning bandwidth, technical teams, and financial acumen to conceptualise, tender, and manage complex urban infrastructure. Equipping cities with dedicated project preparation cells, technical mentorship, and streamlined approvals is essential to strengthen project preparation and execution.

5. The UCF should incentivise innovation by launching targeted challenge windows such as a water-secure cities challenge or a zero-waste challenge. These should be backed by performance-based funding and outcome-linked evaluation frameworks. Lessons from pilot initiatives show that cities, when given autonomy and support, can effectively innovate—UCF must institutionalise this innovation at scale.

6. The UCF must stay sharply focused on high-impact, innovative projects with clear revenue models, avoiding overlaps with existing schemes like PM Gati Shakti or Atal Mission for Rejuvenation. It should prioritise projects like transit-oriented development hubs, waste-to-energy plants that monetise waste, and smart water systems using IoT-based leak detection. To sharpen its focus, the UCF should exclude proposals covered under other schemes such as standalone metro or road projects or basic sewage treatment plants.

7. Institutional clarity is another pillar. The UCF must be governed by a lean, agile, and responsive body that can interface effectively with both public and private stakeholders. It must avoid becoming another top-down scheme, instead preserving its spirit of competition, autonomy, and innovation at every stage — from project selection to monitoring and evaluation.

If India is to truly become Viksit Bharat by 2047, our cities must first become bankable, liveable, and resilient. The Urban Challenge Fund may just be the catalytic spark we have been waiting for.

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