# From Grants to Markets: The New Arithmetic of the Urban Challenge Fund

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**News context:** 26 November 2026
**Prelims:** Key scheme facts
**Mains:** GS Paper-II (urban governance and municipal capacity), GS Paper-III (infrastructure and investment models)




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## Why in the news

The Department of Urban Development (DoUD), Ministry of Housing and Urban Affairs (MoHUA), organised a National Workshop on "Unlocking Market-Based Financing for Urban Challenge Fund Projects" on 26 November 2026 at Vanijya Bhawan, New Delhi. The workshop was held to help cities prepare **bankable projects** (bankable = a financially viable project in which a lender or investor can reasonably expect repayment from its revenues) and move towards market-based financing of urban infrastructure.[1]

Municipal Commissioners and Chiefs of Development Authorities from 25 million-plus cities (cities with a population above 10 lakh) and State Mission Directors of the respective States took part, along with sectoral experts and senior officials of DoUD and MoHUA. Financial institutions including the Asian Development Bank (ADB), the Asian Infrastructure Investment Bank (AIIB) and HUDCO participated, while knowledge institutions such as CEPT University, IIT Kharagpur, ISEG, Janaagraha, NIT Calicut, NIUA and SPA supported the cities in the sessions.[1]

The Secretary, DoUD, MoHUA, emphasised the need to change the approach towards urban development and build capacities to conceptualise and ground transformative projects across the urban landscape; the workshop, he said, is a step towards equipping cities with the skills and ideas required to submit bankable projects under the UCF.[1]

## What is the Urban Challenge Fund

**Introduction:** The Urban Challenge Fund (UCF) is the Union Government's urban infrastructure scheme, announced in the Union Budget 2025-26 (1 February 2025); its operational guidelines were launched on 15 April 2026.[2][3][4]

**The core shift:** The UCF marks a move away from the grant-based approach to a **market-linked, reform-driven and outcome-oriented** framework for urban infrastructure. Central money no longer flows as a free grant; it acts as catalytic assistance that draws in far larger capital from the market.[1]

**Scale:** A Central Assistance of **Rs 1 lakh crore** is provisioned to catalyse nearly **Rs 4 lakh crore** of investment. The mission period runs from FY 2025-26 to FY 2030-31, extendable by three years.[1][3]

**Composition of Central Assistance (total Rs 1 lakh crore):**

- **Project Fund:** Rs 90,000 crore - for approved infrastructure projects
- **Project Preparation and Capacity Building Fund:** Rs 5,000 crore - at the national, State/UT and city levels
- **Credit Repayment Guarantee Sub-Scheme (CRGSS):** Rs 5,000 crore - a loan-repayment guarantee that lets even financially weaker bodies borrow

**Coverage:** All Urban Local Bodies (ULBs) are eligible, with a specific focus on Tier-II and Tier-III cities. It covers all cities with a projected 2025 population of 10 lakh or more, State/UT capital cities, major industrial cities with a population of 1 lakh or more, and all ULBs in hilly and northeastern States.[3]

## Financing architecture: the 25-50 formula

**The core condition:** The UCF finances up to **25 per cent** of the cost of a bankable project as Central Assistance, with a stipulation that at least **50 per cent** of the cost is funded from municipal bonds (debt instruments issued by a municipality, through which investors lend to it), bank loans or public-private partnerships (PPPs). The remaining share comes from the State or the urban local body.[2][3][4]

**How funds are released:** Central Assistance is not paid in one go; it comes in three instalments of **30:50:20**, tied to conditions -

- **First tranche (30%):** on approval of the project by the National Apex Committee (NAC) and the State High Powered Steering Committee (SHPSC)
- **Second tranche (50%):** on achievement of at least 40% physical progress, supported by geo-tagged evidence and third-party or independent verification, along with utilisation certificates for at least 75% of funds released earlier
- **Third tranche (20%):** on achievement of at least 75% physical progress with similar verification

**Financial discipline:** Every project must set up an **ESCROW mechanism** - project revenues flow into a separate account that is ring-fenced first for loan repayment and project expenditure. Funds cannot be diverted to purposes other than the approved project components.[3]

## Three verticals: where the fund goes

UCF projects are bucketed under three verticals:

- **Cities as Growth Hubs:** projects that develop cities as engines of economic growth. Approved examples: the Sarusajai area of Guwahati (Assam) and the Gangtok Gateway project (Sikkim).[1]
- **Creative Redevelopment of Cities:** renewal of old and congested urban areas. Approved examples: redevelopment projects in Patna, Lucknow and Varanasi.[1]
- **Water & Sanitation:** projects linked to water supply, sewerage and waste management. Approved examples: Lucknow's waste-to-energy project and Tamil Nadu's smart metering, water treatment and waste-to-energy projects; the comprehensive development of Warangal city also figures in this series.[1]

Cities are expected to undertake projects under at least two verticals to ensure integrated urban transformation, though phased implementation is permitted based on preparedness.[3]

## Challenge mode and reforms: the approval process

**Challenge mode:** The scheme runs on the 'challenge' principle - States and cities submit projects competitively, and evaluation is done across three pillars: (a) vision, mission and capacity; (b) transformative and impact outcomes; and (c) financial and operational sustainability.[3]

**Stages of the process:** project preparation by the ULB or implementing agency - shortlisting at the State level - in-principle approval from financial institutions - approval by the State High Powered Steering Committee (SHPSC) - evaluation and approval by the National Apex Committee (NAC) - and only then does the release of funds begin.[3]

**National Apex Committee (NAC):** the apex body chaired by the Secretary, MoHUA, with representatives of the Department of Expenditure, Department of Economic Affairs, NITI Aayog, TCPO, CPHEEO and NIUA. Its meetings are held in the first week of every month.[1][3]

**Reforms are integral:** reforms are foundational to the challenge mode - digital, financial, planning and governance measures, improving own-source revenue, the urban road reform initiative, city economic plans and carbon credit markets are all part of this chain. Every approved project must submit a reform roadmap within three months, and progress is reported on MoHUA's centralised reform portal.[1][3]

**Allocation rule:** inter-se allocation among States/UTs is broadly based on population; States are to take up projects equivalent to at least 25% of their allocated amount within six months of the issuance of guidelines; after two years the NAC may review progress and reallocate funds.[3]

## Progress so far and essential caveats

**Progress:** So far, projects worth more than **Rs 50,000 crore** from 16 States/UTs have been **approved** through National Apex Committee meetings across all three verticals. Against the minimum requirement of 50 per cent mobilisation through loans, municipal bonds or PPPs, around **61 per cent** has been **proposed** to be mobilised through these modes by the States.[1]

**Three caveats (important for the exam):**

- **Approval does not mean cash released:** the Rs 50,000 crore figure is the cost of approved projects - neither money already disbursed nor projects completed. The first tranche (30%) follows approval, and the remaining instalments are tied to physical progress.[1][3]
- **61% is proposed, not actually raised:** this ratio is the States' plan at the proposal stage; the test of actually raising market capital will come during implementation.[1]
- **Market-based finance does not mean privatisation of every asset:** municipal bonds and bank loans are the local body's own public borrowing - the asset stays with the body. PPP applies only to identified projects with a revenue stream (such as user charges); the guidelines advise keeping such projects on the PPP mode so that contingent liabilities on the ULB or State are minimised. Ownership and the regulatory role remain with the urban local body.[3]

## Municipal capacity: the real test

**Context:** the 74th Constitutional Amendment (1992) gave urban local bodies constitutional status, but financial autonomy remained limited - own-source revenue forms a small share of most municipal budgets, and without credit ratings the municipal bond market has reached only a limited set of cities.

**The UCF targets precisely this weakness:** a separate Rs 5,000 crore provision for capacity building, a credit guarantee in the form of the CRGSS, and handholding initiatives such as the 26 November workshop - in which cities were taught project structuring, risk allocation and building revenue streams - are aimed at this gap.[1][3]

**The challenge:** escrow discipline, the political decision to levy user charges, the technical capacity to prepare detailed project reports (DPRs) and PPP contract management are all difficult for bodies with limited trained staff and financial experience. That is why the foundation of success is not the fund alone, but the capacity of the local body.

## Relevance for Uttar Pradesh

Uttar Pradesh has a clear presence among the approved projects - the creative redevelopment projects in **Lucknow and Varanasi** and Lucknow's waste-to-energy project are among the notable projects approved by the NAC. Several UP cities fall in the million-plus coverage category of the UCF, making this topic relevant for UPPCS GS-I (urbanisation) and GS-II (urban development policies) alike.[1][3]

## Way forward

The real test of the UCF now lies in the implementation of approved projects: States will have to convert the proposed 61% market financing into actual mobilisation, urban local bodies will have to act on escrow discipline and reform roadmaps, and the Centre will have to ensure timely use of the capacity-building fund. If this model succeeds, the burden of Indian urban development can gradually shift from budgetary grants to sustainable, revenue-based financing - an important step towards the goal of Viksit Bharat 2047.

Related reading: National Urban Conclave 2026

## Prelims Practice Question

**Question 1. With reference to the Urban Challenge Fund (UCF), consider the following statements:**

**Statement 1:** Under it, Central Assistance is limited to 25 per cent of the cost of a bankable project, provided at least 50 per cent of the cost is funded from bonds, bank loans or PPPs

**Statement 2:** Its three verticals are 'Cities as Growth Hubs', 'Creative Redevelopment of Cities' and 'Water & Sanitation'

**Statement 3:** The entire Central Assistance is released in one go along with the approval of the project

Which of the above statements are correct?

(a) 1 and 2 only

(b) 2 and 3 only

(c) 1 and 3 only

(d) 1, 2 and 3

▼ **Answer and Explanation**

**Correct answer: (a) 1 and 2 only**

**Statement 1 is correct:** the UCF finances up to 25 per cent of the cost of a bankable project as Central Assistance and stipulates that at least 50 per cent of the cost comes from bonds, bank loans or PPPs.

**Statement 2 is correct:** all projects under the scheme are bucketed under three verticals - Cities as Growth Hubs, Creative Redevelopment of Cities, and Water & Sanitation.

**Statement 3 is incorrect:** Central Assistance is not paid in one go; it is released in three instalments of 30:50:20, tied to physical progress (40% and 75%) and independent verification.

## Mains Practice Question

**Question 1. The Urban Challenge Fund marks a transition from a grant-based approach to a market-based, reform-driven model of urban infrastructure financing. Discuss the rationale behind this transition, and examine the challenges related to the capacity of urban local bodies in its successful implementation. (250 words, 15 marks)**

**Answer Outline**

**In the introduction:**

Briefly introduce the UCF - Central Assistance of Rs 1 lakh crore catalysing nearly Rs 4 lakh crore of investment; the shift from a grant-based model to a market-linked framework.

**In the main body:**

Discuss the rationale for the transition - the limits of budgetary resources against growing urban needs; the 25-50 formula that makes central money catalytic; outcome-linked instalments (30:50:20); the reform-driven challenge mode; the emphasis on bankable projects.
Examine the challenges - weak own-source revenue of municipalities; limited capacity for credit ratings and bond issuance; lack of experience in DPR preparation and PPP management; political resistance to user charges; escrow discipline.

**In the conclusion:**

Give a balanced conclusion - market finance is a supplement, not a substitute for public investment; capacity building (Rs 5,000 crore) and the CRGSS are steps in the right direction; the long-term solution lies in the financial self-reliance of urban local bodies.

## Frequently Asked Questions (FAQ)

**Short answer:** The Urban Challenge Fund is the Union Government's Rs 1 lakh crore scheme that provides catalytic assistance to draw market capital into urban infrastructure projects; it aims to catalyse nearly Rs 4 lakh crore of total investment.

**▼ Q1: On what conditions is Central Assistance given under the Urban Challenge Fund?**

Central Assistance is capped at 25 per cent of the cost of a bankable project, and at least 50 per cent of the cost must be raised from bonds, bank loans or PPPs. The money is released in three instalments of 30:50:20, tied to physical progress and independent verification.

**▼ Q2: Do approved projects worth Rs 50,000 crore mean this money has already reached the cities?**

No. That figure is the total cost of approved projects from 16 States/UTs. The first tranche (30%) comes after approval and the rest is tied to the physical progress of the project; it represents neither money released nor completed projects.

**▼ Q3: Does market-based financing mean the privatisation of urban services?**

No. Municipal bonds and bank loans are the local body's own borrowing - the asset remains with the body. PPP is adopted only in identified projects with a revenue stream, and even there ownership and the regulatory role remain with the local body.

## Sources

[1] Press Release, Press Information Bureau (PIB), 26 November 2026 - "National Workshop on Unlocking Market-Based Financing under the Urban Challenge Fund": https://www.pib.gov.in/PressReleseDetailm.aspx?PRID=2342087

[2] Press Release, PIB, 23 July 2026 - launch of UCF Operational Guidelines (15 April 2026): https://www.pib.gov.in/PressReleasePage.aspx?PRID=2288504

[3] Ministry of Housing and Urban Affairs (MoHUA) - Urban Challenge Fund Operational Guidelines (April 2026): mohua.gov.in (UCF Guidelines PDF)

[4] Union Budget 2025-26, Budget Speech of the Finance Minister (1 February 2025), paras 57-59: static.pib.gov.in (Budget Speech PDF)

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