

INNOVATIVE MUNICIPAL RESOURCE MOBILIZATION IN INDIA¹

Chetan Vaidya² and Hitesh Vaidya³

Background

Urbanization in India is accompanied by increasing incidence of urban poverty. The 2001 Census of India enumerated the total urban population in the country as 28.53 crore, which was 27.8 percent of the total population. In 2004-5, the percentage of poor in the urban population was estimated as 25.7 (based on Uniform Recall Period) and the number of the urban poor as 8.08 crore. Urban poor in India live in overcrowded housing conditions with very poor access to basic services. Such settlements of the urban poor communities are generally designated as slums. Multiple and weak local institutions involved in the management and governance of urban areas make the challenge of urban poverty difficult to meet. A huge investment is required for providing shelter and basic services for the poor. Since public funds for these services are inadequate, Urban Local Bodies (ULBs) have to look for innovative methods of resource mobilization and alternative sources for financing their infrastructure costs. City-level resource mobilization initiatives, management innovations, project specific efforts, and market-based financing have emerged as viable options for municipal resource mobilization. This paper describes these options and draws certain conclusions.

City-Level Resource Mobilization Initiatives

A number of ULBs have undertaken city-level initiatives to improve their revenue base. Such initiatives in Ahmedabad Municipal Corporation (AMC) and Indore Municipal Corporation (IMC) are described below.

Ahmedabad: Prior to 1993-94, AMC was a loss-making ULB resulting in accumulated cash losses of Rs. 35.0 crore. No new sources of income were apparent nor was it possible to continue to depend on government grants. In November 1994, AMC launched a major effort to improve revenue collection to fill this void. Octroi (entry tax) has traditionally been the AMC's major source of revenue, accounting for about 70-75 percent of total revenue. To increase octroi collection, the valuation manual for tax assessment was updated based on current market prices. Octroi collection was further improved through: (a) deployment of police personnel for controlling touts and catching defaulters; (b) linking all check posts with a wireless network to facilitate 24-hour communication; (c) formation of 13 vigilance squads to conduct spot checks of vehicles; and (d) installation of weighing machines at the check posts. A system of backtracking of the goods was also introduced. Strict action was taken against corrupt and negligent employees. As a result of these measures, annual Octroi collection increased by 60 percent.

Similarly, property tax accounts for about 30 percent of AMC's tax revenues. The tax assessment system is based on annual ratable value (ARV), which can be subjective and inequitable. In

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² Director National Institute of Urban Affairs (NIUA) email: cvoidya@niua.org

³ Sr. Project Development Specialist, Indo-US FIRE (D) Project email: hitesh@indo-usfired.com

1994, AMC introduced a series of measures to improve property tax collection. A computer database was created to identify defaulters, while attention was focused on recovering major outstanding tax amounts. These measures included issue of notices and warrants, disconnection of water supply and sewerage lines, publishing of the defaulters' names, attachment of property, and restructuring and strengthening of the property tax department. These steps helped to increase annual property tax collection by 55 percent.

Beginning in the mid-90s, AMC introduced a number of management improvements such as computerization of accounts and upgrading of the workforce. The above measures produced a turnaround in AMC's financial situation. AMC had a closing cash surplus of Rs. 2,14 crore in March 1999. AMC has been able to sustain improved performance for the last several years.

Indore: In 1999-00, the corporation embarked on a modernization plan, developed with extensive citizen participation, to improve urban services and increase revenues to do so. The IMC's own sources of revenue are primarily property taxes and water tariffs, with smaller amounts from business licenses, shop rents, and advertisement taxes.

To reform its property taxes, which average almost 50 percent of the city's own source income, the IMC shifted to a simpler, mass assessment method and introduced self-assessment of properties by taxpayers in 1997. Taxpayers provide information about their property, such as its location, size, age, and use, into a formula-based program that calculates what they owe. The IMC contracted with a private firm in 2001-02 to conduct a physical survey of properties in all wards to identify unregistered properties and add them to the property database. The surveyors also helped owners fill out their self-assessment forms. The number of properties registered nearly doubled in four years, from 135,000 before the survey to 236,000 in 2003. Revenues increased due to simplified and more equitable assessments, better administration, increased coverage and billing, and more efficient collections and enforcement (described below). Complementary measures, such as verifying tax records at registration when properties were sold, and requiring that payments be made by December 31, helped. In addition, assessment rates, especially of commercial properties, were revised after a considerable period.

It was estimated that there were approximately 80,000 illegal water connections, compared to 120,000 legal connections. The IMC identified legal/illegal water connections during its physical survey of properties. It compared its water charges and property databases to identify residences that were not receiving or paying water bills. And it calculated arrears owed. The IMC improved collections and enforcement.

The measures described above increased revenue from its own sources from Rs. 34 crore in 1999-00 to Rs. 75 crore in 2003-2004. Total revenue increased correspondingly from Rs. 101 crore to Rs. 184 crore.

Other Cities: The Government of Andhra Pradesh issued an 18-point Revenue Improvement Action Plan (RIAP) in 2000-01 to improve the revenues from the internal sources of municipal bodies. The resulting revenue improvement drives focused on both tax and non-tax sources. The property tax assessment system was revised to detect un-assessed and under-assessed properties and buildings that were expanded or changed use. Some cities imposed a vacant land tax or

advertisement tax. Others exploited existing non-tax sources, such as fees and penalties. Detection of illegal water tap connections and improving water fee collections; increase in minimum water charges, with ULBs fixing their own rates over minimum tax rates. Other measures included: increasing registration charges on transfer of properties; using private sector participation in solid waste management; identifying open spaces with market potential; regularizing unauthorized construction; maintaining parks, public resorts, toilets, etc. on commercial lines; increasing fees for birth and death certificates, and marriage registration; and leasing ULB shops and buildings. The municipal resource mobilization measures helped the state's cities to increase their revenue by 10 to 17 percent.

Market-Based Financing System

Several ULBs and utility organizations have issued bonds that so far have mobilized over Rs.1,225 crore through taxable bonds, tax-free bonds and pooled financing (Table 1).

Table 1: Municipal Bonds in India

S. No.	Type of Bond	Amount (Rs. in Crore)
1.	Taxable bonds	4,45.0
2.	Tax-free bonds	6,49.5
3.	Pooled finance	1,30.4
	TOTAL	12,24.9

Credit Rating: Rating agencies provide investors with an independent third-party evaluation of the credit strength or weakness of a particular bond issue. Ratings of local governments establish a transparent credit record, and a reference framework for current and future performance of local finances and debt management. In ranking a local government's debt offering, rating agencies construct a general framework for evaluation that includes legal and administrative framework, economic base of service area, municipal finances, existing operations, management capacity, project viability, financial structuring, etc. In February 1996, Ahmedabad received a rating from CRISIL for a bond offering. This was the first rating received by a municipal bond offering in India. The municipal credit rating system has come to be regarded by India's private financial community as a solid indicator of a city's performance and competitiveness. In the last 12 years, rating agencies have provided ratings for municipal and municipal enterprise bond offerings. Under the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) about 47 ULBs have been rated and 27 of them are investment grade.

Taxable Municipal Bonds: The Ahmedabad Municipal Corporation was the first ULB to access the capital market in January 1998. It issued Rs.100 crore in bonds to partially finance an Rs.4,390 million water supply and sewerage project. This was a remarkable achievement since it was the first municipal bond issued in India without a state guarantee and represented the first step toward a fully market-based system of local government finance. The AMC had previously instituted significant fiscal and management reforms. Due to these measures, AMC was able to turn around its financial position from a cash deficit municipal corporation to achieve a closing cash surplus of Rs.2,140 million by March 1999. These reforms laid the necessary groundwork

for AMC's bond issue and the successful implementation of the water supply and sewerage project.

The debt market in India for municipal securities has grown considerably since the issuance of Ahmedabad bonds. Since 1998, other cities that have accessed the capital markets through municipal bonds without state government guarantee include Nashik, Nagpur, Ludhiana, and Madurai India's city governments have thus mobilized about Rs.4,45 crore from the domestic capital market through taxable municipal bonds.

Tax-Free Municipal Bonds: To boost the municipal bond market, in February 2001, the Government of India decided to provide tax-free status to municipal bonds. Ahmedabad was the first municipal corporation in India to issue tax-free municipal bonds for water and sewerage projects. In April 2002, AMC issued a tax-free 10-year bond with an annual interest rate of 9.00 percent. The bond issue amount was Rs.1,00 crore. The Municipal Corporation of Hyderabad also issued a tax-free municipal bond in May 2002 for Rs.82.5 Crore.

Pooled Financing: Only financially strong, large municipal corporations are in a position to directly access capital markets. Most small and medium ULBs are not able to directly access capital markets on the strength of their own balance sheets. Also, the cost of the transaction is another barrier. In the United States and elsewhere, small local bodies pool their resources and jointly access the capital market. Based on this model, the Governments of Tamil Nadu and Karnataka issued municipal bonds by pooling municipalities.

In 2003, the Tamil Nadu Urban Development Fund issued a bond by pooling 14 municipalities for commercially viable water and sewerage infrastructure projects. A special purpose vehicle, the Water and Sanitation Pooled Fund (WSPF), was set up to issue the municipal bonds. The WSPF structured a Rs.30.4 crore bond issue whose proceeds financed small water and sanitation projects in the 14 small ULBs. This was the first municipal pooled issue. It had a fifteen-year maturity and an annual interest rate of 9.20 percent. While the bonds were unsecured, a multi-layered credit enhancement mechanism was set up. The proceeds helped ULBs to refinance their loans at lower interest rates, connect periphery areas to new water supply schemes, and provide underground drainage and solid waste management schemes. Half of all the beneficiaries are estimated to be low income with monthly incomes of Rs. 2,500-5,500.

Subsequently, the Government of Karnataka used the concept of pooled financing to raise debt from investors for the Greater Bangalore Water Supply and Sewerage Project. This project covers eight municipal towns around Bangalore and has a total project cost of Rs.6,00 crore. A debt fund called the Karnataka Water and Sanitation Pooled Fund (KWSPF) was established under the Indian Trust Act to access the capital market by issuing a bond on behalf of the participating ULBs. During June 2005, the KWSPF successfully floated Rs.1,00 crore tax-free municipal bonds at an annual interest rate of 5.95 percent. The tax-free status of the bonds greatly enhanced the terms on which the ULBs were to repay the loans, which in turn elevated the confidence of the investors. USAID under its DCA program provided a guarantee of up to 50 percent of the principal amount of market borrowing.

It is felt that the tax-free status of the bonds and the DCA guarantee lowered the interest rate by about 1.5-2.0 percent per year compared to similar credit enhancement structures and helped to extend the bond's tenure to 15 years. The GBWASP will provide water supply to 1.5 million people residing in about 300,000 households, including some 60,000 urban poor households in 250 wards in the eight ULBs, which as of December 2006 have been merged with the Bangalore Municipal Corporation .

The success of the pooled finance model as demonstrated in the States of Tamil Nadu and Karnataka subsequently led the Government of India to create a Pooled Finance Development Fund (PFDF) that enables capital investments to be pooled under one state borrowing umbrella. The objective is to provide a cost-effective and efficient approach for smaller- and medium-sized ULBs and to reduce the cost of borrowing Ministry of Urban Development formulated the scheme. It is meant to provide credit enhancement grants to facilitate market borrowings through a pooled financing mechanism on behalf of identified ULBs for investment in urban infrastructure projects.

Project Specific Efforts in Sangli: The Sangli Miraj Kupwad Corporation (SMKMC) is a rapidly growing city in the state of Maharashtra. Approximately fifteen percent of the city's population lives in slum settlements with no/inadequate access to basic infrastructure services. In this context, United States Agency for International development (USAID), Cities Alliance (CA), Indo-US Financial Institutions Reform and Expansion – Debt (FIRE-D) Project, Shelter Associates (SA), a Pune based NGO and Baandhani, a Community Based Organization (CBO), are assisting SMKMC to implement a citywide community-led sanitation program which is aimed at ensuring access of the most vulnerable section of the city's population, that is, urban poor communities to adequate sanitation facilities at an individual/community level. The community driven slum up-gradation approach is propelled through community mobilization/federation building, public-private co-operation, and micro-credit savings. The program assisted twelve slums in Sangli to gain access to adequate sanitation facilities. In initial phase, for individual toilets the beneficiary contribution was twenty percent, while CA contributed remaining 80 percent. In later phase the local government and CA contributed forty percent each. Success of the program stemmed from a strong multi-stakeholder partnership between the local government, CBOs, and NGOs. The initiative has also been successful in leveraging resources from private individuals like Friends of Shelter Associates — formed by Professor Sunil Bhatia of Connecticut College, USA, which pledged Rs. 12 lacs to facilitate extension of the initiative.

Management Innovations

Faced with growing demand for urban services, urban local bodies (ULBs) opt for management innovations to improve efficiency and strengthen the municipal revenue base. These innovations include improved billing and collection, rationalization of service charges, simplification of the tax assessment system, computerization of records, and improved accounting and financial management systems.

Property Tax: Property taxes are the major source of revenue of ULBs in India. However, in most cities, not all properties are assessed, records are not updated regularly, and tax collection is

far from satisfactory. ULBs can increase revenue by improving property inventories, record management, public awareness and participation, and tax collection. Several ULBs introduced

Self-Assessment System (SAS) to make property tax assessments simpler and more transparent. This method helps taxpayers to understand the assessment process and removes the discretion of the assessors to assess the properties in an arbitrary manner. It increases taxpayers' involvement by allowing them to calculate their own assessment within pre-established guidelines. Another method to improve PT collection is introduction of a computerized information system that enables better linkages between property taxes and facilitates close monitoring of collections. Tax administration systems are labor intensive and sometimes the cost of collection exceeds the revenue collected. Some ULBs have begun to outsource sub-processes.

Municipal Asset Management: ULBs generally hold a significant amount of fixed assets in real estate. But very few local bodies have exploited the commercial potential of these properties to generate non-tax revenues. Most ULBs do not have a proper inventory of assets nor do they update them regularly. Often villages on the periphery are brought into municipal limits as the city expands. Panchayat land then comes under municipal ownership.

Management Information System: Traditionally, municipal records are handled manually and so searching them is time consuming and laborious. Lack of a computerized database also prevents ULBs from estimating their arrears and increasing their tax net revenue. By computerizing water/sewerage and residential property tax billing, payments and receipts, the municipal revenues can be increased.

User Charges: User fees can also increase municipal revenues. User charges levied by ULBs include fees for water, sewerage, solid waste management, parks, parking, birth and death certificates, business licenses, streetlights, ad space, and cable TV.

Lessons Learned

This overview highlights how ULBs of different sizes are introducing innovative measures successfully. The major lessons learned are:

Improved Management Information Systems: The first step to start the process of revenue mobilization in many ULBs was to improve the information base. Surveys of properties, computerization of records, identification of municipal properties, and cross checking of data from different sources helped strengthen billing and collection.

Simplification of Billing and Collection Processes: Provision of simple guidelines to citizens on tax assessment ensured that tax assessments are carried out in a transparent manner. People-friendly collection systems helped motivate citizens to pay their taxes. So did decentralization of collection centers, changes in hours, creation of a one-window system, and posting information on a website.

Public Communication: Intensive outreach to citizens through meetings with resident associations and using multiple communication channels such as cable television, local newspapers, billboards along major roads, websites, and e-mails are critical elements in revenue mobilization. These campaigns helped bring about attitudinal change and paved the way for the reform process. The media, in particular, was crucial in providing tax education and involving the people in these campaigns.

Local Leadership/ Champion: Strong and sustained commitment of both political and executive leaders was crucial for the reforms. In some cases, an outside consultant or private sector firm helped the ULBs initiate the innovations.

Project Specific Contribution: Project-specific contributions emerged as an effective way to raise resources for maintenance of new services. ULB leaders convinced citizens of the project benefits and this helped to generate additional municipal revenues.

Outsourcing Services: Some ULBs achieved significant financial savings and efficient collections by unbundling services and outsourcing labor-intensive components of the collection process.

Enforcement: Efficient administration and enforcement helped ULBs bridge the gap between revenue billing and collections.

State Government Guidelines: Policy directions from state governments encouraged many ULBs to initiate these reforms.

Conclusion

Increasing municipal revenue is a major challenge for ULBs. Various ULBs have implemented city-level resource mobilization initiative, management innovations, project specific efforts and market-based financing resulting in significantly increased revenues. Improved information systems simplified billing and collection, better enforcement, and public communication are key elements of success. The most important lesson learned is that the municipal resource mobilization process requires the strong commitment and unwavering support of elected leaders as well as of administrators.