

**Proceedings of the Workshop on, “Alternative Sources of Financing Urban Development”
Ministry of Urban Development in association with NIUA, New Delhi on 26th March 2009
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Context

The Government of India has taken several initiatives to improve financing of urban infrastructure. The requirements of funds for the sector are so huge that there is need to integrate these initiatives with other alternate methods of financing. Several land based financing methods like higher Floor Space Index (FSI), Transferable Development Rights (TDR), Impact Fee, Area Linked Development Charge, External Development Charge, Betterment Levy and Private Sector Participation have been used as tools for financing urban development.

In this context, the Ministry of Urban Development in association with NIUA organized a Workshop on, “Alternate Sources of Financing Urban Development” at NIUA on March 26, 2009.

The workshop witnessed participation of Ministry of Urban Development. Over 60 participants representing the TCPO, NHB, ADB, AMDA, World Bank, Planning Commission, Urban Finance and Planning Organizations, a host of research and academic institutes, international organizations, NGOs, etc.

Introduction

Prof. Chetan Vaidya, Director, NIUA, welcomed the participants to the workshop. Mentioning the rapid urbanisation procedure in India, he talked about the needs to improve India’s urban infrastructure and governance to improve productivity and create jobs for the poor. To meet the challenges of growing urbanization and to enable Indian cities to develop to the level of global standards, a comprehensive programme, namely Jawaharlal Nehru National Urban Renewal Mission (JNNURM) was launched in December 2005. The Government of India has also taken several other initiatives to improve financing of urban infrastructure. These include tax-free municipal bonds, pooled finance, etc. However, the requirements of funds for the sector are so huge that there is need to integrate these initiatives with other alternate methods of financing. Therefore, he is of the view that alternate land based sources of financing should be a part of overall city development strategy.

Dr. M. Ramchandran, Secretary, Ministry of Urban Development (MOUD) inaugurated the workshop and guided the deliberations. He complimented NIUA to organize the workshop and said that it will be very useful to share experiences on initiatives using land as a resource for financing urban infrastructure. He also emphasized the need to look in details the following in terms of policy implications:

- Distribution of the taxes and development charges – proportion to be recovered from within the city and outside the city;
- Utilisation of the user charges and the funds raised by the ULBs;
- A detailed study should be made that would list out the practices being followed by different cities and states; and
- The distribution of administrative powers in terms of collection of taxes and charges between States and ULB's.

Mr. V. K. Phatak, Former Chief Town and Country Planner, Mumbai Metropolitan Region Development Authority (MMRDA) and presently Director, National Housing Bank made a presentation on the subject.

Alternative Methods of Infrastructure Financing – Land as a Resource

Mr. Phatak thanked for the opportunity provided for exploring alternative methods of financing urban infrastructure. Giving an introduction to the topic he mentioned about the currently available established sources of funding urban infrastructure and also mentioned about the major hindrances/limitations in the process – conventional methods of financing urban infrastructure and their limitations and need for exploring more alternative sources of finance like land and development rights, Impact fees, development fees, etc. The key points highlighted were:

- Currently available sources of finance are - Revenue surplus; Borrowings from financial institutions or from capital market through municipal bonds, Inter-governmental transfers, Private investment in PPP mode, Sale of land and real estate, etc.
- Each currently available source has its own limitations. Revenue surpluses are insignificant as property tax is not buoyant revenue, O & M expenses keep on increasing and user fees do not cover services other than water supply and sewerage. Commercial borrowings or bonds have not become popular for variety reasons. Intergovernmental transfers from state or center is the most favored source. PPPs in urban infrastructure are rare for eg. Metro 1 in Mumbai is an example but for Metro 2 there has been no response. Therefore, there is a major need to consider alternative sources of finance.
- Land as a resource had a very dominating role during 60's and 70's. The dominant view was - "Large-scale advance acquisition of land is by far the best and perhaps the only way to put an end to speculation in land and to capture subsequent increases in land values." (Examples DDA, Navi Mumbai by CIDCO and many development authorities on a smaller scale.) But this method of land value capture seems to be neither adequate nor feasible. Draft Land Acquisition Bill does not recognize town development as a public purpose.
- Infrastructure increases the land value and therefore there is a need to capture it. Increase in land value in turn will lead to an Increment Tax. Examples are Town Planning Schemes in Gujarat and Maharashtra. Though present in Andhra Pradesh and Punjab legislation they

are not in vogue. The other approach of introduction of extra FSI at market-linked rates under Transfer of Development Rights was also explained.

- In US and Canada, cities found it difficult to fund incremental infrastructure to service additional growth through increased property tax to service the bonds. This led to Impact Fees in US and Development Charge in Canada. The US judiciary laid down “rational nexus between the investment required and the charge” as the basic criterion. Area linked development charges are prevalent in India as well. Maharashtra Town Planning Act allows for such a charge. Punjab charges External Development Charges (EDC) while granting permission for conversion for land. This usually suffers from lack of buoyancy.
- Instead of attempting to tax the land value increment on account of infrastructure, directly taxing the value of property at its inception would be a more effective way of obtaining capital receipts for financing urban infrastructure. This could be termed as an *Infrastructure Benefit Tax (IBT)*. It could be introduced through suitable amendment to the Town Planning Acts. The tax base would be value of the property at the time of construction. This would ensure buoyancy that is absent in area linked development charges. The use of tax revenues for capital infrastructure could be ensured by creating a ‘ring fenced fund’ in the ULB.
- IBT can avoid problems faced in existing methods. In this case, the development must contribute to Infrastructure Investment in proportion to its market price.
- Mr. Phatak said that IBT was evaluated with the other available sources of finance like LVIT/Betterment charges, sale of FSI, Impact Fee and Development Charges on the basis of legal feasibility, tax base, administration and Revenue potentiality. While others had some drawbacks, it has legal feasibility; had a tax base that is the market value of the property; administratively could be linked to Stamp Duty valuation and used for all infrastructures; and also is a general tax and a buoyant revenue. Last but not the least, the most opportune time for introducing this new tax would be when the real estate market is in an ascending mode. Mr. Phatak also suggested that any interventions in the land market should: (a) limit planning to essential; (b) pay attention to price of land and internalize price mechanism; (c) better land information systems and streamlined procedures.

Group Discussions and Way Forward

Mr. A.K.Mehta, Joint Secretary, MoUD highlighted the limitations of conventional methods of financing urban infrastructure through revenue surplus, inter governmental transfers stressed the need to examine various ways in which land linked capital contributions could be exacted. He said that in view of rapid urbanization and the demand for urban services, he emphasized the need to develop an action plan/model for alternative sources of finance that can be circulated and replicated wherever possible by different cities and states. The action plan could be prepared within a period of 6-7 months that would cover: (a) Impact of currently available sources of finance; (b) Need to identify the best model; (c) Legal framework.; and (d) Use of the

revenues. It added that there is need to develop a financial model for circulation among states and cities.

Dr. P.K. Mohanty, Joint Secretary, Ministry of Housing and Urban Poverty Alleviation presented his views on alternative sources of financing urban development. He highlighted:

- In many South Indian cities there is a tax on vacant lands;
- Land tax should follow the principles of payments by user, beneficiary, and polluter;
- Agricultural land is not taxable because of political reasons, but tax is levied when an agricultural land is converted for the purpose of some other uses. For instance, an agricultural land can be converted to commercial land, industrial land, residential land, green zone, etc. and every time it has an increased value with different rates and capital gain;
- Betterment levies, external development charges and US tax increment procedures can be other means of alternative sources of finance; and
- Provision of higher FSI could be linked to financing of housing for poor.

Mr. A. K. Jain, Advisor, DDA said that land acquisition (LA) is difficult and the Act does not provide for acquiring land for urban development. He said that instead of giving a cash compensation for LA, there is need to develop a hybrid model compensation that combines land reservation and higher FSI. Mr. Steeve Matzie of FIRE Project said that tax increment financing has to be a revenue generating project. Mr. M.L. Chotani of TCPO said that though town planning acts have enabling provisions betterment levies, most states do not use this method. There is a need to develop an Indian model. Prof. Dr. Sanjukta Bhaduri, SPA said that there is need to develop an approach that considers climate change issues as part of urban development. Prof. Vinod Tewari, TERI identified lack of good land information system as a major problem for generating revenues from the alternate model. Mr. Raj Pal, Advisor, NHB said that objective of generating revenues should be linked with affordability issues.

Prof. Gangadhar Jha, Mr. R.M.Kapoor and Mr. G. Dharmarajan said that potential of property tax should be explored.

Extensive discussions took place among the participants highlighting the following:

- The potential of existing method of property tax and other land taxes needs to be explored;
- Taxation should also be taken as a tool to disincentive the urban growth and protect the climate;
- Tax mapping through GIS should be done intensively;
- Tax payment and collecting procedures should be easy and flexible;
- A complete database should be developed with a complete city approach and a Five-Year Financial Operating Plan;
- Providing incentives to the public should encourage payment of taxes.

Mr. A. K. Mehta and Mr. Phatak said that overall potential to generate revenues from property tax is limited. Mr. Mehta summarized the discussions and stated that the workshop gave inputs to alternative sources to financing urban development as a whole He felt the need to develop detailed action plan and a model that could be circulated among all the states. For the purpose, he suggested to form a group of people who could contribute and develop this further.

The workshop ended with vote of thanks from Prof. V.K.Dhar, NIUA.