

Empowering Municipalities: Financial Self-Sufficiency Beyond Government Grants

By 2036, India will need to invest \$840 billion in infrastructure - an average of \$55 billion or 1.2 % of GDP per annum. However, estimates suggest that between 2011 and 2018, the country's total capital expenditure on urban infrastructure averaged only 0.6 % of GDP...



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Fueled by its consistent economic growth largely concentrated in its urban clusters, India is undergoing rapid urbanization. As per the World Bank, by 2036, its towns and cities will be home to 600 million people, or 40 % of the population, up from 31 % in 2011, with urban areas contributing almost 70 % to GDP.

To accommodate its rapidly growing urban population and provide consistent quality civic services, India will need to continuously make substantial investments in augmenting and creating new urban infrastructure. It is estimated that nearly 70 % of the urban infrastructure needed by 2047 is yet to be built. The World Bank estimates that by 2036, India will need to invest \$840 billion in infrastructure - an average of \$55 billion or 1.2 %

of GDP per annum. However, estimates suggest that between 2011 and 2018, the country's total capital expenditure on urban infrastructure averaged only 0.6 % of GDP, half the required quantum of investment.

As per the 74th Constitutional Amendment, the third tier of Government, viz. the Urban Local Bodies (ULBs) are responsible for providing requisite amenities to the urban population including development & maintenance of urban infrastructure and providing urban services. While the 12th schedule in the said amendment lists the functions that may be given to ULBs, it has been left to the respective State Governments to decide the functions that may be transferred. In most States, functions like building plan approvals, water supply, drainage,

solid waste and sewerage management, street and other urban area cleaning, maintenance of parks & markets, street lighting, etc have been transferred to ULBs. Hence, these also constitute potential sources for generating revenue.

However, such own source revenues from Property Tax, Building plan approval fees, Trade license fees, user charges for water supply & waste collection, etc. have typically accounted for only around 61% of total ULB revenues[1].

“ ... It is estimated that nearly 70 % of the urban infrastructure needed by 2047 is yet to be built... ”

ECONOMIC DEVELOPMENT

There exist significant opportunities for increasing these revenues by improving governance through which revenue leakages are arrested, coverage expanded and by exploring new avenues for increasing revenues. Revenue leakages can be addressed through better billing & collection mechanisms, inclusion of existing properties/ users who may be left out of the billing coverage, timely increase in rates of tax/ user charges in line with expenditure and valuation trends, etc. Contemporary technologies like drone survey & GIS mapping for increasing property tax coverage or installing SCADA for checking water supply leakages and wastage need to be standardized and leveraged across the country for this purpose.

A major source of funds for ULBs, estimated at around 39% of total revenues, is from grants and transfers from Central and State Government [1]. While under the 14th Finance Commission an amount exceeding Rs. 87,000 crores was allocated to be devolved to ULBs during 2015-20, the 15th Finance Commission covering the period 2021-26 proposed a significant increase of this amount to Rs. 1.2 lakh crores.

Establishment expense consisting of salaries, wages and pensions was the largest component of revenue expenditure, followed by operational and maintenance expenses, which are directed towards general services and maintenance of capital assets. Committed expenditure comprising establishment expenses and administrative expenses was estimated at around 40% of revenue receipts during 2017-20. Capital expenditure for urban infrastructure development has been around USD 85 billion over the past decade (2011-18), as compared to USD 450 billion required in the next 15 years till 2036 as estimated by the World Bank. There is therefore an immediate need for augmenting financial resources at the ULB level.

Key Considerations for Municipal Bonds & Municipal Pooled financing

<ul style="list-style-type: none"> • Bond issue for specific identified project/ set of projects <ul style="list-style-type: none"> – Water, Sewerage, Road projects • Smaller ULBs can pool projects together and issue bond through State Pooled Finance Entity • Escrow account for collecting revenue from financed projects to service debt and meet operations & maintenance costs • Can enjoy tax exempt status 	<ul style="list-style-type: none"> • ULB need to have strong balance sheet to access capital markets • Investment grade credit rating • Project to be financed to be financially viable <ul style="list-style-type: none"> – Willingness of citizens to pay market rates for services: user charges to recover capital cost in addition to O&M • Secondary market needs to be developed for trading • Organizational strengthening of ULB's required <ul style="list-style-type: none"> – Developed & IT enabled transaction recording & financial reporting systems & processes – Capacity building of ULB officials
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Source: Datavantage Advisory Analysis

Given experience in both developed and developing countries, in addition to augmenting own source revenue through improved governance and technology adoption, the following potential sources may be considered:

1. Leverage Municipal Bonds:

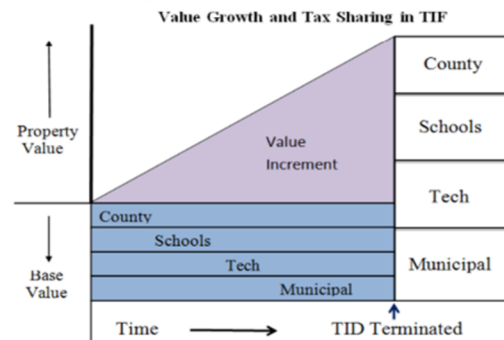
Municipal bonds offer an innovative pathway for ULBs to access capital markets. A key criterion for a ULB to consider issue of Municipal Bonds will be to identify a specific project in which the bond proceeds will be invested and revenues from that project will be used to service investors through an escrow mechanism. Most ULBs across India which have issued municipal bonds have invested in

water supply and sewerage projects where revenue is generated through user charges. Smaller ULBs may pool together for a common urban infrastructure project through a scheme of Pooled Financing. A good beginning has been made post issuing of SEBI's guidelines on listing with 11 municipal bond issues taking place during the period 2017-21 mobilizing Rs.3840 crores across 10 ULBs[2].

2. Explore Tax Increment Financing (TIF) and Public-Private Partnerships (PPP):

TIF is a powerful tool for financing urban redevelopment projects by using the incremental value generated from the development itself

Tax Increment Financing



- Usually used to finance roads, public transport infrastructure, city redevelopment in specified district/ ward in public private partnership mode
- Incremental tax collected kept in escrow account for financing project/ servicing debt
- Typical TIF tenure > 20 years

[2] DATAVANTAGE ADVISORY ANALYSIS BASED ON MINISTRY OF HOUSING & URBAN AFFAIRS, GOI DATA (CITYFINANCE.IN)

ECONOMIC DEVELOPMENT

with the tax component on the value addition being kept separately to be utilized in specified developmental activities. ULBs can employ TIF to finance large-scale projects such as road networks, transportation hubs, and commercial spaces, ensuring that the investments are self-funded and sustainable. A case in point is the city of La Verne, located in Los Angeles County, which financed USD 33 million in transit-oriented infrastructure in the vicinity of a future LA Metro light rail station through a TIF structure. In 2017, it designated a 142 acre area as the TIF district contributing 100% of the incremental tax collections to a fund. The Los Angeles County joined the scheme in 2020 allocating 50% of the county increment to the fund[3].

3. Using Business Improvement Districts (BID):

A BID is a designated area within a city where property owners collaborate through a public-private partnership to collectively fund the development and maintenance of their district or ward. In this arrangement, a designated agency or Urban Local Body (ULB) provides services that enhance the basic civic services already available.

Additionally, BID structures incorporate differential rates for various stakeholders, including business and commercial property owners, tenants, residences, government offices, public institutions, and non-profit organizations.

Cities such as New York, Toronto, Los Angeles, Vancouver, Philadelphia, and Cape Town have successfully adopted the BID model to improve urban environments and foster community engagement.

A case in point is South Africa which had over 40 designated Business Improvement Districts as of 2022. South Africa enacted enabling laws & regulations in 1997 for

Business Improvement District

- Public Private Partnership arrangement in which property owners commit to collectively contribute to development & maintenance of district/ ward
- ULB / designated agency to provide services which is incremental to the basic civic services being provided by the ULB
- Differential BID rates for business/ commercial property owners & tenants, residences, government offices & public institutions and not for profit organizations

- New York City's BID movement started in 1960s & 70s to address constraints from limited public resources and deteriorating commercial districts
- In mid 70s city made conditional offer for capital investments provided local property owners benefiting from it agreed to pay for maintenance
- Enabling legislation passed in 1981-82 with the 1st BID formed in 1984 around Union Square area
- Currently there are 75 BIDs within New York City
- Services provided include
 - Street cleaning and maintenance
 - Public safety and hospitality
 - Marketing and events
 - Capital improvements
 - Beautification
 - Advocacy
 - Business development

Source: New York city Department of Small Business Services

establishing BIDs comprising property owners in the designated area.

A separate levy is collected by the local authority to supplement civic services through not-for-profit companies engaged for this purpose. Services include cleaning, streetscaping, security, marketing / promotion, etc.

The time for ULBs to act is now. For the country to achieve its "Viksit Bharat" objective by 2047, it is imperative that requisite investments are made to improve the quality of life in our urban centers, which account for over 60 % of GDP (as per NITI Aayog) and are expected to contribute around 80% of GDP by 2047[4].

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