REPORT

STUDY ON
**"SUSTAINABLE
FINANCING FOR
URBAN
KARNATAKA"**
VIABLE OPTIONS

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Janaagraha Centre for Citizenship and Democracy

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JANAAGRAHA
JANAAGRAHA CENTRE FOR CITIZENSHIP & DEMOCRACY

ACKNOWLEDGEMENT

ABOUT JANAAGRAHA
CENTRE FOR CITIZENSHIP & DEMOCRACY

Janaagraha Centre for Citizenship and Democracy (Janaagraha) is a Bengaluru based not-for-profit institution that is a part of the Jana group. Janaagraha's mission is to transform quality of life in India's cities and towns. It defines quality of life as comprising quality of infrastructure and services and quality of citizenship. To achieve its mission, Janaagraha works with citizens to catalyse active citizenship in city neighborhoods and with governments to institute reforms to City-Systems.

STUDY ON
"SUSTAINABLE FINANCING FOR URBAN KARNATAKA"
VIABLE OPTIONS

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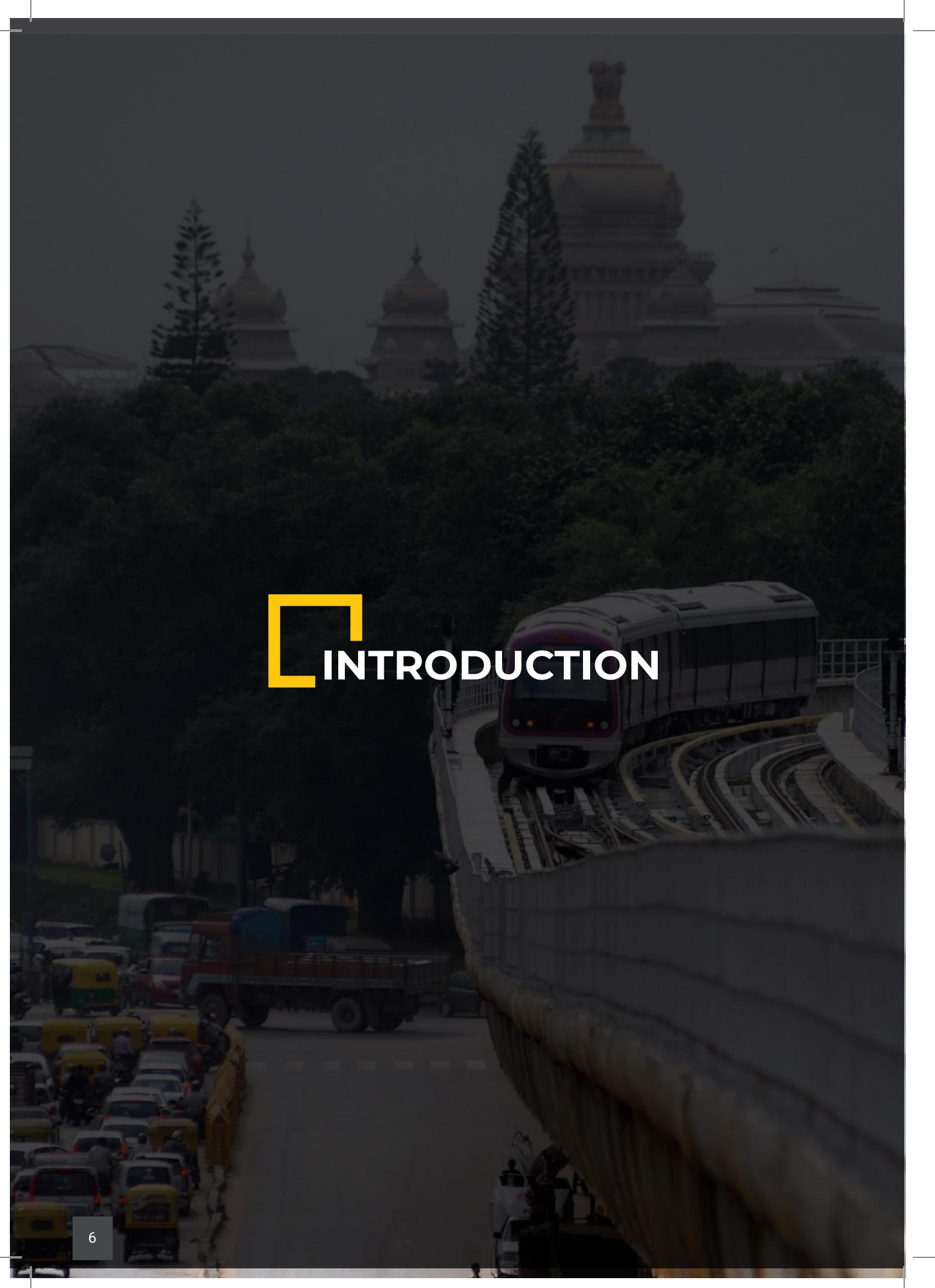
INTRODUCTION

Quality of infrastructure and services in cities is inter alia directly related to lack of availability of adequate financial resources (for both capital and operations and maintenance expenses) and accountability of spending such financial resources. This is particularly true in India's cities :

Municipal Finance Reforms therefore seek to achieve two goals with respect to our cities

1) financial self-sufficiency and 2) financial accountability. Both financial self-sufficiency and financial accountability are key enablers of transformation in quality of infrastructure and services.

Janaagraha has a Municipal Finance Blueprint which envisages the following six components as pathways to accomplishing these two goals: They are listed as below :

1. **Integrated Institutional Design** covering:
   a. Integrated view of cities finances
   b. Integrated treasury management

2. **Fiscal Decentralization** covering:
   a. **Widening of Municipal revenue base**
   b. **Rationalising transfers from state and making them more predictable**
   c. Control over tax rates and capital values, for revenue buoyancy
   d. Independence to Municipalities for budget setting and expenditure
   e. Greater powers to Municipalities to tap private capital

3. **Revenue Optimisation** covering:
   a. **Improved collection efficiencies, higher Return on Assets**

4. **Fiscal Responsibility and Budget Management** covering :
   a. Robust financial reporting
   b. Medium Term Fiscal Plans
   c. Better quality budgets
   d. Citizen participation in budgeting and civic works
   e. Robust internal controls and operational risk management

5. **Transparency and Accountability** covering:
   a. Laws that enable timely publication of financial and operational information in the public domain; redressal mechanisms for non-compliance

6. **Institutional Capacities** covering:
   a. **Availability of adequately skilled human resources particularly in revenue and finance functions**
   b. Information systems

This study is based on a MoU between DMA and Janaagraha to conduct a financial sustainability study of Urban Local Bodies ('ULBs') in Karnataka and to suggest best possible measures for improving own revenues in a sustainable manner. The report's primary focus is therefore on components 3a and 2a above while it addresses components 2b and 6a of the Municipal Finance Blueprint at a high level.

The report is structured in two parts -
- Part 1 which includes a brief overview of finances of ULBs of Karnataka based on six parameters namely, own revenue as a percentage of total revenue, own revenue as a percentage of revenue expenditure, grants as a percentage of revenue expenditure, average collection period, capital expenditure per capita and cash balances maintained as at year end.

- Part 2 which includes a detailed analysis of own source revenues of ULBs, namely property tax, water charges/tax, income from municipal properties with specific recommendation on enhancement of such revenues. Part 2 also touches up on alternative modes of municipal revenue generation.

The study was undertaken during the period December 1, 2017 to May 31, 2018. The DMA and Janaagraha have entered into a separate non-financial MoU to establish and run a Revenue Monitoring and Enhancement Cell (RMEC) during the period of May 2018 to May 2020. The responsibilities of the RMEC would include but not be limited to the following:

- Reviewing and reforming (where necessary) bases of assessments of revenue streams

- Maximising collections of revenues

- Reviewing and Optimising Return on Assets (RoA) of municipalities and improving balance sheet management

- Establishing a process of monthly dashboards and reviews specifically with respect to revenue assessment and collections and based on the same, conceiving and recommending performance-based grants for municipalities

- Conceiving and implementing Awards and Recognition programmes to incentivise Municipalities to achieve desired outcomes in respect of financial management.
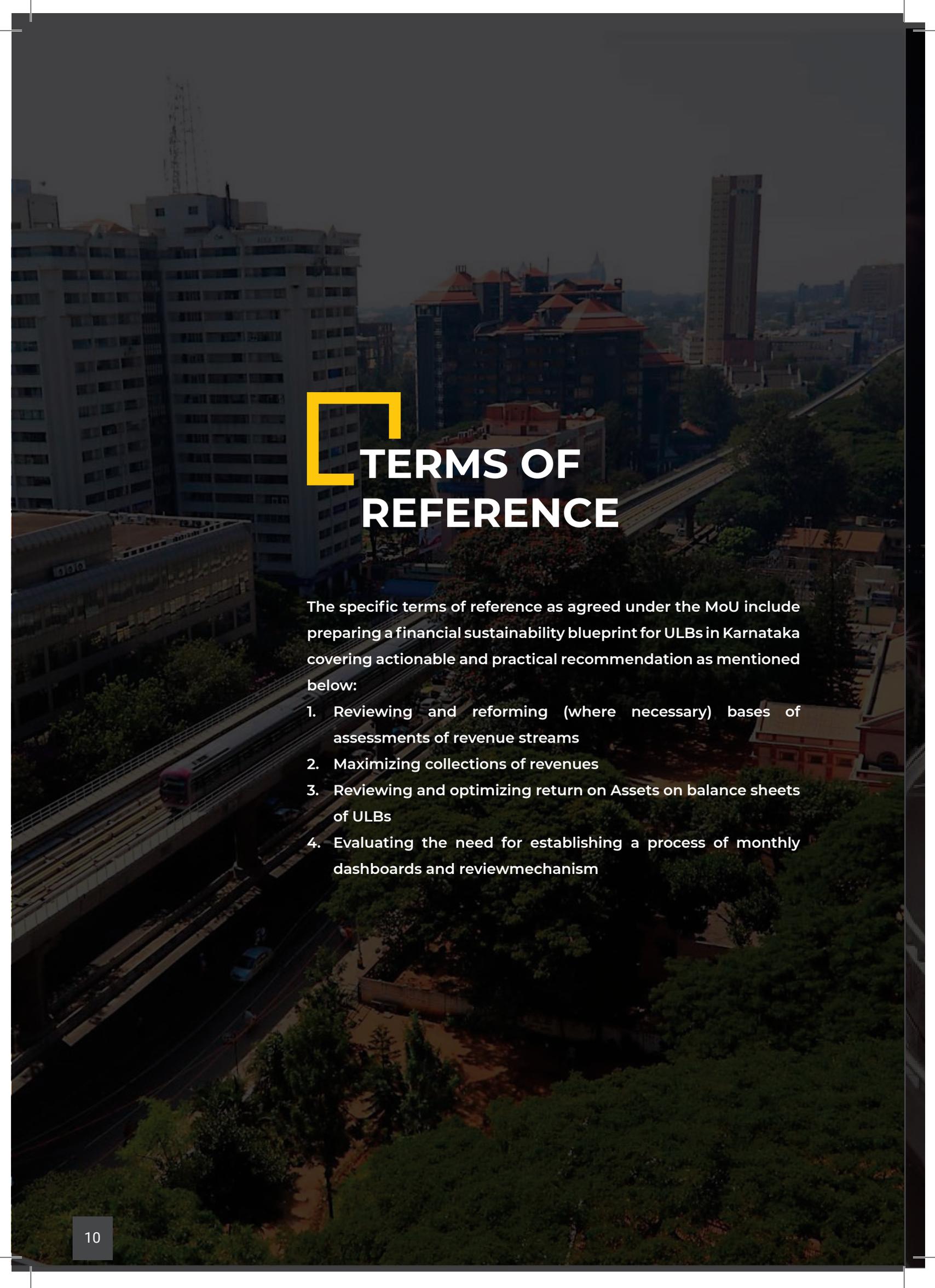
TERMS OF REFERENCE

The specific terms of reference as agreed under the MoU include preparing a financial sustainability blueprint for ULBs in Karnataka covering actionable and practical recommendation as mentioned below:

1. Reviewing and reforming (where necessary) bases of assessments of revenue streams
2. Maximizing collections of revenues
3. Reviewing and optimizing return on Assets on balance sheets of ULBs
4. Evaluating the need for establishing a process of monthly dashboards and reviewmechanism

PROJECT TIMELINE

Preliminary analysis of data and feasibility study

Final report and presentation of findings

| DEC 17 | → | JAN 18 | → | FEB 18 | → | MAR 18 | → | APR 18 | → | MAY 18 | → | JUN 18 ONWARDS |

Field Visits to 12 ULBs to collect data and conduct interviews with the ULB staff

Submission of the inception report and discussion for inputs from the DMA

Jointly implement actionable outcomes from the study, as part of the second MoU

A team from Janaagraha visited the following 12 ULBs for a field study

1. Hubbali-Dharwad City Corporation
2. Davangere City Corporation
3. Bidar CMC
4. Sira CMC
5. Yadgir CMC
6. Chamarajanagar CMC

7. Ullal TMC
8. Bangarpet TMC
9. K.R. Nagar TMC
10. Lingasagur TMC
11. Haliyal TMC
12. Sakleshpur TMC

SUMMARY OF RECOMMENDATIONS

1 Enumeration of Properties

Observations

- The last property enumeration process carried out across ULBs in Karnataka was between 2009 and 2011. The ULBs do not have a process of re-evaluating this number using alternative proxies.
- Therefore, the property tax demand estimated is not supported by updated property data.

Recommendations

- Since the enumeration was last performed in 2011 and continuous updation of records has not taken place since, a re-enumeration exercise is overdue and the property data could be updated using Geographic Information System ('GIS') applications. Given that the DMA has already initiated the process of re-enumeration, we are hopeful that the exercise will be conducted in a robust manner.
- Further, all properties enumerated or new properties subsequently registered must be assigned unique but universal PID number that can be used to track properties with ease, across various systems in the Government.
- The ULBs must also explore and identify appropriate proxies such as electrical connections, occupancy certifications, or property registration data to help update property details in case of new properties or modification of properties in the city.

2 Assessment of Property Tax

Observations

- As per the SAS rules, 2002, the taxable capital value to be considered was restricted to 50% of guidance value of 2005-2006 and therefore, the taxable capital value remains unchanged year on year. To offset this, there is a provision in the act to revise the property tax rates once every three years within a band of 15% to 30%.

Recommendations

- Since property tax is meant to be levied on the value the property, the current guidance value would be a more appropriate representative of the true value of the property.
- Therefore, it is recommended that the DMA commission a study to evaluate the impact on property tax revenue if the same is pegged against the current guidance value instead of the guidance value of 2005-2006. They could also re-evaluate the rate revisions required when the latest guidance value is then used.

3   Improving Collection Efficiencies

Observations

- Collection efficiencies of primary revenue sources such as property tax and water charges averaged at 62.7% and 55.3% during 2016-17, respectively.
- It was also observed that there was a large deficit in the number of required bill collectors in the revenue department that averaged at 36% across 268 ULBs.

Recommendations

- Though we were unable to establish a direct correlation between the number of bill collectors and collection efficiency, in the current ecosystem, the bill collectors are the primary enablers of tax collection across Karnataka.
- Therefore, the gap of 36% in bill collector strength across the ULBs in Karnataka must be addressed. However, increasing the number of employees on the roles of the ULBs increases the liability in terms of pension costs for the ULB.
- Alternatively, ULBs could engage with an agency to facilitate collections through digital channels only, actively leveraging tele calling, instead of bill collectors going on a door to door campaign to give payment remainders. The agency hired is to be paid only a percentage of tax collected through the digital channels.

4   Monetising Municipal Properties

Observations

- None of the 12 ULBs visited, nor the Karnataka Municipal Data Society were able to provide a detailed listing of municipal properties owned/leased and therefore, the revenue potential from municipal properties owned is yet to be completely evaluated.

Recommendations

- As step one, the ULBs must update records of properties along with status of properties leased out. Secondly, in order to assess the revenue potential from properties owned by municipalities, the ULBs could opt to engage a Property Management Company (PMC) to conduct a study on such properties.

5 Information and Performance Review Systems

Observations

- The Karnataka Municipal Data Society (KMDS) maintains several online information systems that include - Fund Based Accounting System (FBAS), Monthly Information Booklet (MIS system), Property Tax Information System, Property Tax Calculator, SLB data, Official Vacancy position data, Asset Management System, to name only a few.
- Several issues in the systems maintained include :
  (i)   The FBAS system does not include a state level database.
  (ii) The performance MIS system is not updated or reviewed regularly.
  (iii) The Asset Management register has not been updated since 2006 for most ULBs in Karnataka.
  (iv) Multiple systems have been built to manage property tax data and none of the systems are interconnected.

Recommendations

- Currently, the DMA does not have a robust, centralised performance review system. Therefore, we recommend that the KMDS build a state level dashboard that is both linked to the FBAS and the MIB and the DMA must ensure a robust review system is put in place.
- Further, despite having first mover advantage on launching e-governance as early as in 2006, the IT systems in Urban Karnataka managed by KMDS have several platforms remaining unused and multiple platforms addressing the same issue. Therefore, we recommend that the KMDS conduct a technical due diligence study of all the systems built and make necessary amends, including building a robust performance tracking mechanism.

PART 1: BRIEF FINANCIAL OVERVIEW OF ULBS IN KARNATAKA

Karnataka has 10 City Corporations (CCs, excluding BBMP), 56 City Municipal Councils (CMCs), 115 Town Municipal Councils (TMCs) and 89 Town Panchayats (TPs) across 30 districts. The CCs are governed by the Karnataka Municipal Corporations Act, 1976 while the rest are covered under the Karnataka Municipalities Act, 1964.

Population by division and type of ULB

	CC		CMC		TMC		TP		Total	
Division	No. of ULBs	Population	No. of ULBs	Population	No. of ULBs	Population	No. of ULBs	Population	No. of ULBs	Population
Mysore Divison	2	18,09,454	11	9,48,869	24	6,90,747	19	2,66,344	56	37,15,414
Belagavi Division	3	15,17,740	13	10,27,430	40	12,21,295	40	6,42,971	96	44,09,435
Gulbarga Division	2	10,88,688	12	12,44,298	26	7,49,422	16	2,81,168	56	33,63,576
Bangalore Division	3	9,63,564	20	16,10,330	23	6,72,226	14	2,40,741	60	34,86,861
Total	10	53,79,446	56	48,30,927	113	33,33,690	89	14,31,223	268	1,49,75,286
	35.9%		32.3%		22.3%		9.6%		100%	

Source: DMA & JCCD analysis
Note: Note: ULB information updated to the extent of data available; Population figures above are from 2011 Census Population numbers adjusted for urban population growth rate up to 2017 as per report issued by Directorate of Economics and Statistics. All analysis in this report excludes BBMP.

The following parameters were analysed to provide a deeper understanding of the financial situation of ULBs in Karnataka:

1 Components Of Revenue

Revenues of ULBs in Karnataka primarily include:

i.   Property tax (13.8% of total revenue in 2016-17)
ii.   Other taxes include advertisement tax, toll taxes (0.7%)
iii. Fees & user charges (12.2%)
iv.   Other non-tax revenues include income from renting of municipal properties (3.4%)
v.   Other revenue receipts which primarily include income from investments, interest income etc (3.1%)
vi.   Transfers, Grants and Assigned revenues, which are funds received from the state/ centre in the form of tied/untied grants (66.7%)

For the purpose of our analysis, we have segregated the above mentioned revenue streams into two groups.

· Own revenues (revenue sources devolved to the ULBs as per the municipalities Act) including property tax, other taxes, fees & user changes, and other non-tax revenues
· Ancillary revenues (revenue sources that are either not operational in nature or are transferred from the Centre/State governments) including transfers, grants & assigned revenues and other revenue receipts

Components of Revenue
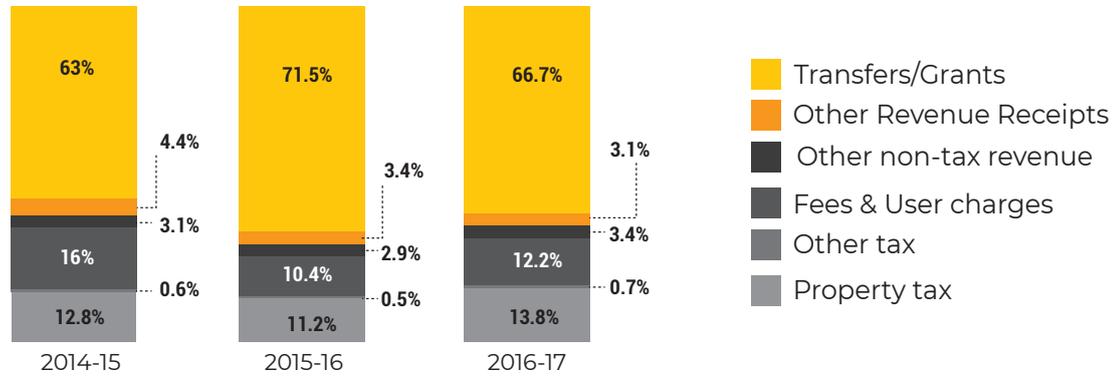
Source: Receipts and payments statement of ULBs

- On average, 67.1% of total revenues recorded in ULBs across Karnataka are assigned revenues, grants and aids received from the centre/state and only 29.3% of total revenues are own revenues of the ULB.

Components of Revenue in CCs
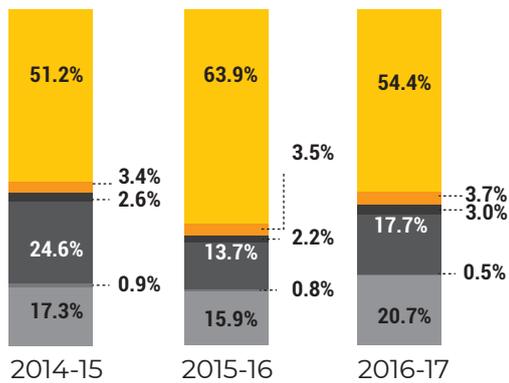
Components of Revenue in CMCs
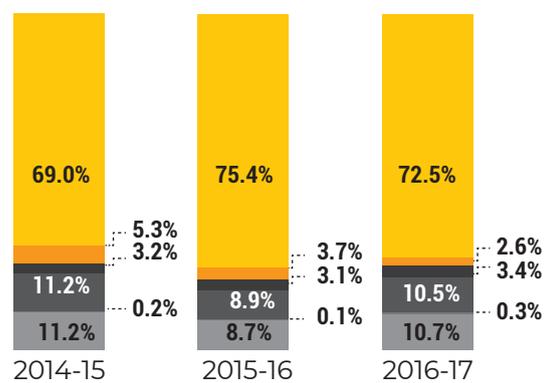
Components of Revenue in TMCs
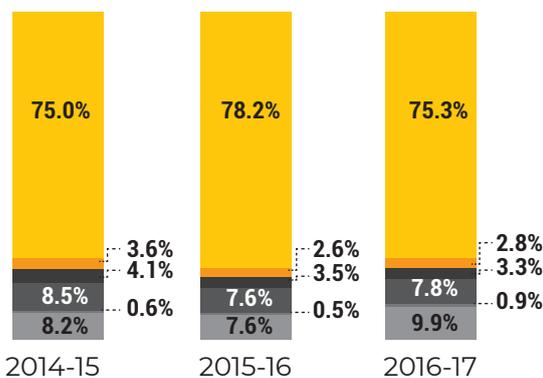
Components of Revenue in TPs
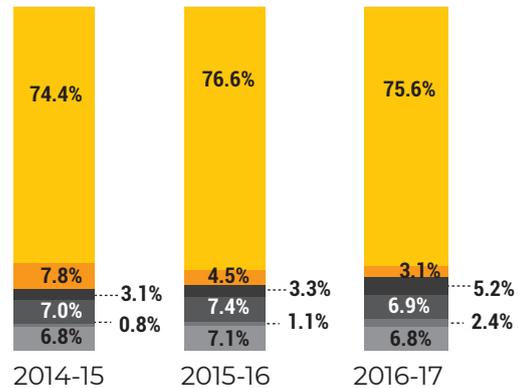
Source: Receipts and payments statement of ULBs

- Contribution of transfer, grant-in-aid and assigned revenue to total revenue is increasing with the decreasing size of the ULBs and the dependency on key revenue sources such a property taxes is as low as 6.9% in TPs as per the charts above.
- These trends indicate that ULBs across Karnataka are significantly dependent on grants from the Central and State governments as a primary source of revenue.

2   Own Revenues as a Percentage of Total Expenses

In order to evaluate the extent of self-sufficiency in ULBs across Karnataka, we have analysed own revenues as a percentage of total revenue expenses ('own revenue percentage'). Revenue expenses include salary expenses & other establishment related expenses (32.5% of total revenue expenses in 2016-17), O&M expenses (54.1%) and other incidental operational expenses like office electricity cost, postage costs etc (13.4%).

Own revenue % across ULB type

ULB Type	2014-15			2015-16			2016-17		
	Own Rev.	Rev. expenses	Own rev %	Own Rev.	Rev. expenses	Own rev %	Own Rev.	Rev. expenses	Own rev %
CC	60,813	79,057	76.9	54,328	98,429	55.2	64,203	105,537	60.8
CMC	23,206	49,539	46.8	28,006	64,560	43.4	31,247	65,326	47.8
TMC	13,522	35,877	37.7	16,792	42,498	39.5	0,814	44,150	47.1
TP	4,560	12,210	37.4	5,895	13,539	43.5	8,506	15,190	56.0
Total	102,101	176,682	57.8	105,022	219,026	47.9	124,770	230,203	54.2

Source: Receipts & Payments statement of ULBs

- Across 269 ULBs considered for the above analysis, on an average across three years, only 53.3% of day to day operations are funded by the ULB's own revenue sources, indicating significant dependency on state and central funds for not only infrastructure funding, but also for operational expenses.
- This trend is the lowest at the TMC and TP levels, where own revenues fund only 43.5% (average) of operational expenses of ULBs.
- The sharp decline in own revenue % of CCs in 2015-16 was driven by an abnormal increase in fees and user charges of Hubbali-Dharwad in 2014-15, which subsequently stabilised in 2015-16.

- Own revenue percentage has increased by 54.2% in 2016-17 from 2015-16 across ULB types, primarily driven by an increase in revenue from property taxes. However, we are unable to confirm if such increase is sustainable, as the ULBs were unable to provide specific reasons for the increase.
- This is a clear indication of an urgent need for a performance MIS mechanism couple with a robust review system at the DMA.

No. of ULBs in each own revenue% bucket   %

Bucketing	2014-15	2015-16	2016-17	2014-15	2015-16	2016-17
1 - 10%	9	4	4	3.6	1.5	1.5
10 - 25%	64	64	56	25.4	24.3	21.0
25 - 50%	117	123	110	46.4	46.8	41.2
50 - 75%	37	42	63	14.7	16.0	23.6
75 - 100%	12	9	16	4.8	3.4	6.0
> 100%	13	21	18	5.2	8.0	6.7
Total	252	263	267	100.0	100.0	100.0

Source: Receipts and Payments Statement of ULBs

- From the table above, on an average, 45% of the ULBs in Karnataka have own revenues ranging between 25% and 50%. Both the 1-10% and > 100% bucket primarily consists of TMCs and TPs, thus indicating the unpredictability of revenues across the smaller ULBs.
- In order to maximise the utilisation of existing buoyant sources of revenue, the ULBs must specifically focus of revenue enhancement of the 60 ULBs in the 1-10% and 10-25% bucket.

3   Grants, transfers and assigned revenues

To evaluate the extent of dependency on grants, transfers and assigned revenues (collectively known as 'revenue grants', 'grants') from Central and State Governments to fund operational expenses, we have compared the same with total revenue expenses of the ULBs as shown in the table below :

Revenue expenses vs Revenue grants by ULB type (Rs in lakhs)

ULB Type	2014-15			2015-16			2016-17		
	Rev exp.	Rev. grants	%	Rev exp.	Rev. grants	%	Rev exp.	Rev. grants	%
CC	79,057	68,669	86.9	98,429	1,06,550	108.3	1,05,537	83,336	79.0
CMC	49,539	62,274	125.7	64,560	1,01,190	156.7	65,326	91,305	139.8
TMC	35,877	47,356	132.0	42,498	68,353	160.8	44,150	71,422	161.8
TP	12,210	19,082	156.3	13,539	23,915	176.6	15,190	30,284	199.4
Total	1,76,682	1,97,381	111.7	2,19,026	3,00,009	137.0	2,30,203	2,76,347	120.0

Source: Receipts and payments statement of ULBs

- Except in CCs, all the other categories of ULBs receive revenue grants greater than the overall operating expense they incur on a yearly basis (without any adjustment towards expenses covered by own revenue sources). We were informed that, the excess untied revenue grants received are usually re-directed for capital projects. But there is no system currently that tracks such utilisation by the nature of the scheme, reiterating the need for a performance MIS with a robust review mechanism at the DMA.

4   Day sales outstanding

Analysis of day sales outstanding (DSO) is used to estimate the average collection period and aids in understanding the overall collection efficiencies of ULBs.

Average DSO across ULB types

ULB Type	31-Mar-15	31-Mar-16	31-Mar-17
CC	302	325	291
CMC	365	315	298
TMC	301	304	297
TP	371	368	343
Average	**335**	**328**	**307**

Source: Financial Statements from the FBAS systems of the ULBs

- The average collection period for all sources of revenue other than grants ranges at an average of 307 days to 335 days over three years. This indicates that, at every year end, ULBs have approximately 300 days of uncollected revenue accumulated as receivables.
- This brings to light the poor collection efficiencies of the ULBs across Karnataka which could be on account of incorrect assessment and billing, inefficient modes of collections or insufficient manpower to support the collection process.
- Refer subsequent sections of the report for a detailed discussion on collection efficiency.

5   Capital expense per capita

Analysis of capital expense per capita would help evaluate the infrastructure development across ULBs in Karnataka.

Cap. Exp. Per capita

ULB	No of ULBs	Population	Capital exp (Rs in lakhs)		Per capita (Rs)	
			FY17	FY16	FY17	FY16
CC	9	49,81,216	69,584	83,629	1,397	1,679
CMC	43	37,99,183	43,582	68,452	1,147	1,802
TMC	91	27,48,957	37,809	39,270	1,375	1,429
TP	41	6,65,815	13,278	16,808	1,994	2,524
Total	184	1,21,95,171	1,64,253	2,08,159	1,347	1,707

Source: Financial Statements from the FBAS systems of the ULBs; Population projected for 2017 as per the Directorate of Economics & Statistics

- The average per capita capital expense for the 184 ULBs analysed above amounted to Rs 1,707 during 2015-16 and Rs 1,347 during 2016-17, with the CCs averaging at Rs 1,679 and Rs 1,397 during 2015-16 and during 2016-17, respectively. This is significantly lower than the average per capita capital expense across the 23 cities surveyed as part of the Annual Survey of India's City Systems Report (2017 edition) of Rs 2,268.
- What is interesting however, is the per capita capital expense of TPs, which seems to be the highest among the ULB types, indicating that a significant amount of infrastructure work is happening in the TPs.

6   Cash and bank balances

As mentioned earlier, on an average, the revenue grants received by ULBs across Karnataka are higher than their operational expenses for the year. It is therefore, extremely relevant to analyse the cash balances maintained by ULBs in order to evaluate the extent of accumulation of grant money.

Cash & bank balances as % of revenue grants received (Rs in lakhs)

ULB Type	No of ULBs	Cash and bank balances			Revenue Grants			%		
		31-Mar 2015	31-Mar 2016	31-Mar 2017	31-Mar 2015	31-Mar 2016	31-Mar 2017	31-Mar 2015	31-Mar 2016	31-Mar 2017
CC	10	98,854	1,36,954	1,18,941	68,669	1,06,550	74,732	143.96	128.53	159.16
CMC	48	66,011	86,469	84,094	53,256	85,685	65,089	123.95	100.92	129.20
TMC	95	78,021	1,89,343	1,53,777	45,368	66,955	62,928	171.97	282.79	244.37
TP	31	16,421	18,910	20,369	10,001	12,988	14,853	164.19	145.59	137.14
Total	184	2,59,307	4,31,676	3,77,181	1,77,295	2,72,178	2,17,603	146.26	158.60	173.33

Source: Cash & Bank balance – FBAS; Revenue grants – Receipts and payments statements

- Out of the data provided for 184 ULBs, we observe that cash and bank balances maintained by ULBs across the state are higher than the grant amounts received in that year.
- The capital grants received by ULBs for infrastructure purposes could also contribute to such accumulation of balance. What is alarming is that as at 31st March, 2018, 184 ULBs in Karnataka have Rs 3,771 crores of un-utilised cash in the bank (assuming that none of them are on lien). Similar such balances were maintained in the previous years.
- Representatives from the DMA claim that due to delay in execution of projects, the grants have accumulated in the bank accounts. They believe that since most of such balances are deposited in PD accounts, the utilisation of these grants is monitored.
- However, this calls for a monthly review of the cash balance maintained by ULBs to first establish if such accumulation of cash exists throughout the year. Further, the review system, through a performance MIS, should also help to ensure optimal return on ideal cash balances that have been accumulated.

PART 2: A DETAILED REVIEW OF OWN SOURCE REVENUES

1   Property tax

Property tax continues to remain the primary own source revenue of ULBs all over the India. As for ULBs in Karnataka, property tax contributes to 48.6% of total own revenues. For the purpose of analysis, we have analysed property tax administration in three segments:

1. Enumeration
2. Assessment & Billing
3. Collections

1. Enumeration

Objective

To evaluate the accuracy of property base maintained by the ULBs.

Work done

- We have reviewed the respective sections of the Act and the taxation rules that define the method of enumerationand the nature of records to be maintained by ULBs.
- Interviewed Revenue Officers at the 12 ULBs during field visits to understand the nature of records maintained, and the process of enumeration and updation of property records.
- We have verified the manual property tax registers maintained by the ULBs.

Observations

- The last property enumeration process carried out across ULBs in Karnataka was between 2009 and 2011. The ULBs do not have a process of re-evaluating this number regularly using proxies such as occupancy certificates.
- Updated digitised record of properties by their Property Identification Number (PID numbers) was not maintained across the ULBs visited as part of the field study.
- The ULBs have multiple systems to keep track of properties namely, Property Tax Information System (an online property tax register), E-Aasthi (an online system to generate challans) and Property Tax Calculator (an alternative online portal to compute tax and generate challans). But none of these systems are linked to each other and parallelly store varied data.

Recommendations

- **Fresh enumeration exercise required -** A fresh enumeration exercise is overdue and the property data must be updated using Geographic Information System ('GIS') applications. Further, changes/updates in the property details must be periodically updated (e.g - once every three years) by identifying appropriate proxies that reflect the construction of new properties/modifications to existing properties in the city.

- **Property tax register to be updated –** The multiple online property tax systems maintained currently are not linked to each other and are also not updated regularly. Therefore, we recommend that the ULBs maintain a single online property tax register encompassing details of property (identified by its PID number or Katha number) along with measurements of the property, photos if any of the field survey, property wise demand, historical payments, and arrears. Further, the taxation rules prescribe formats (Form II and Form III) for property tax returns and property tax registers, but there is no requirement for the same to be maintained digitally. Therefore, the taxation rules must be appropriately amended to insist maintenance of records online.

2. Assessment & Billing

2.1 Assessment

Objective

- To evaluate the process of assessment by analyzing the method of computation of property taxes across ULBs to ensure its completeness and accuracy.

Work done

- Reviewed relevant sections of Karnataka Municipal Corporation Act, 1976 (KMCA, 1976), Karnataka Municipalities Act, 1964 (KMA, 1964), Karnataka Municipalities Taxation (Amendment) Rules, 2002
- Interviewed Revenue Officers Accountants and Bill Collectors during the field visit of 12 ULBs
- Interacted with officers of the KMDS who manage the Property Tax Calculator system.

Observations

- As per section 108 of the KMCA, 1976, and section 102 of the KMA, 1964, the taxable value of the building, together with the land occupied by it, shall be assessed having regard to the market value guidelines of properties published by the Government under section 45B of the Karnataka Stamp Act, 1957. The taxable capital value of the building shall be 50% of the market value guidelines prescribed, minus depreciation at the time of assessment as may be notified. Similar rules have been prescribed for arriving at the taxable capital value of vacant land.
- Further, as per Rule 5 of Karnataka Municipalities Taxation (Amendment) Rules, 2002, the taxable value must be determined as per the Karnataka Stamp Act and as prevailing immediately before the last date for filing return – on or before thirtieth day of June every year.
- However, as per the Self-assessment Scheme ("SAS"), introduced in 2002, the taxable capital value to be considered was restricted to 50% of the guidance value of 2005-06. Therefore, the taxable capital value remains unchanged year on year and that is then compensated by revision of rates once every three years within a band of 15% to 30% as per section 102A of the KMA, 1964. However, during the course of this study, we were not provided a copy of the SAS rules.
- Sections 108 of the KMCA, 1976 and 101 of the KMA, 1964, prescribe the property tax rates that shall be levied based on the nature of properties, in a municipal area. Further, these rates can be revised by council, once every three years within a band of 15% - 30%.

Historical property tax rate enhancement trends (%) by ULB Type

Year of change	Category	CC	CMC	TMC	TP	Average
2008-09 (% of propertyTax increased)	Residential	16.0	20.2	19.8	17.3	19.1
	Commerecial	22.9	21.7	20.3	18.8	20.3
2011-14 (% of propertyTax increased)	Residential	16.4	18.3	18.9	17.6	18.4
	Commerecial	20.8	19.8	20.2	19.4	20.0
2014-15 (% of propertyTax increased)	Residential	NA	NA	NA	NA	NA
	Commerecial	21.9	20.7	20.0	20.2	20.3
2017-18 (% of propertyTax increased)	Residential	15.0	18.9	19.2	19.1	18.2
	Commerecial	17.5	21.5	21.9	21.6	20.7
Average	Residential	15.8	19.1	19.3	18.0	18.6
	Commerecial	20.8	20.9	20.6	20.0	20.3

Source: KMDS data

- The average rate increase every three years for residential properties amounted to 18%, while that of commercial properties was higher at an average of 20% (subject to availability of rate enhancement data for 2014-15).

Recommendations

- **Alternative methods to compute property tax –** As discussed above, currently the guidance value of 2005-06 is considered with depreciation charged only up to 2005-06. Guidance value plays a major role in the determination of property tax. The objective with which the guidance value is used to arrive at property tax is that guidance value is expected to be representative of the current market value of the property. Based on the examples depicted in the table above, if the guidance value considered for the computation is linked to the latest value as per Kaveri online (an online database of latest sub-registrar values maintained by GoK), the ULBs might stand to benefit in the range of 20 – 35% (based on the scenario 1 below). The ULBs could also exercise the option of enhancing rates (probably at ranges lower than 15% - 30%), over and above basing the computation on the latest guidance value after evaluating its feasibility. Therefore, we recommend that the ULBs investigate the option of linking the property tax computation with the latest guidance and review the provisions of the SAS Rules that were introduced in 2002.

Alternative methods of computing property tax for 2018 - An Illustration

Year of con-struction	As per Property tax calculator		Scenario 1		Scenario 2	
	2000	2016	2000	2016	2000	2016
Area	Chowki Pete Road	Chowki Pete Road	Chowki Pete Road	Chowki Pete Road	Chowki Pete Road	Chowki Pete Road
Floor no	1	1	1	1	1	1
Built up Area	2000	2000	2000	2000	2000	2000
Use of property	Residential	Residential	Residential	Residential	Residential	Residential
Construction Type	RCC-Grnt-Tk	RCC-Grnt-Tk	RCC-Grnt-Tk	RCC-Grnt-Tk	RCC-Grnt-Tk	RCC-Grnt-Tk
Guidance value Rs/Sq Ft	500	500	1,270	1,270	1,270	1,270
Type	Tenanted	Tenanted	Tenanted	Tenanted	Tenanted	Tenanted
Depreciation factor	0.04901	0	0.176436	0.019604	0.176436	0.019604
Capital value of land	4,75,495	5,00,000	10,46,124	12,45,338	10,46,124	12,45,338
Base Rate	0.60%	0.60%	0.60%	0.60%	0.60%	0.60%
Enhancement						
2008-2009	1.1667	1.1667	1	1	1.1667	1.1667
2011-2012	1.2	1.2	1	1	1.2	1.2
2014-2015	1.15	1.15	1	1	1.15	1.15
2017-2018	1.15	1.15	1	1	1.15	1.15
Base property tax	5,282	5,555	6,277	7,472	11,622	13,835
Difference			994.3	1917.4	6339.3	8280.2
Difference %			19%	35%	120%	149%

Source: Property tax calculator and JCCD analysis

Definition of methods of computation

1. **Property tax calculator:** Guidance value of 2005-06 considered; Depreciation charged only up to 2005-06; Effect of all four rate enhancements considered
2. **Scenario 1:** Latest guidance value as per Kaveri Online considered; Depreciation charged up to 2018; Effect rate enhancements not considered
3. **Scenario 2:** Latest guidance value as per Kaveri Online considered; Depreciation charged up to 2018; Effect of all four rate enhancements considered

- Further, we have noted that the latest guidance value for ULBs across Karnataka is significantly lower than the prevailing market price. (Refer table below). Therefore, the DMA must further investigate the reasons for differences and accordingly advocate for the revision of the guidance value.

Latest Guidance Values vs Market Price

City	Area	Latest Guidance value	Market price as per 99acres.com (Rs)	Difference %	Average
Mysuru	Bogadi	1,858	3,600	93.76	19.1
Hubli	Shakti Colony	1,765	6,250	254.08	20.3
Mangaluru	Jeppinamogaru	790	4,074	415.91	18.4

Source: Guidance value – Kaveri Online

Note -The market value considered is an average of market value of 3 similar properties in the area. The nature of properties considered to arrive at the latest guidance value and the market value are similar.

- **Alternative basis to compute property tax –** Historically, property tax was introduced as a user charge for public services provided. Internationally as well as in India, property tax has proven to be a complex tax to administer on ground. Given that Karnataka has been on the forefront of municipal reforms, the DMA should consider commissioning a study to revisit the methodology of property tax fundamentally through alternative bases that are easier to administer and possibly more buoyant.

2.2 Billing

Objective

- To evaluate the billing process of property tax across ULBs to ensure accuracy and completeness.

Work done

- Interacted with Revenue Officers and Bill Collectors across the 12 ULBs to understand the process and controls in place.
- Reviewed the records maintained by the ULBs.
- Reviewed relevant sections of the KMA, 1964 and the KMCA, 1976 along with rules, if any as applicable.

Observations

- Under the self-assessment scheme, the tax payers (with or without PID numbers) file their property tax return and declare the basis of their assessment. The revenue officers claim that a random check of 10% of properties takes place every year. However, there is no documentation to support such a claim.

- Further, Hubbali-Dharward is one of the few ULBs that has more than one collection centre. For all the other ULBs, the Municipality office is the primary and only collection centre. Once the return is filed at the office, a challan is generated and a copy of the same must be submitted at the designated bank while making the payment. Once the payment is made, the receipt provided by the bank must be then submitted at the office by the tax payer. This process does not make payment of property tax easy for citizens and could potentially be one of the reasons why citizens are not forthright in payment of property tax.

Recommendations

- **Review of the self-assessment scheme –** Since the introduction of the self-assessment scheme in 2002, limited checks have been put in place to verify the declaration of tax payers. The ULBs claim that 10% of declarations made under the SAS each year are verified. However, thereis no documentation to support the same.

  Therefore, there is a need for a robust system to be put in place to verify the declaration of the tax payers in order to regulate any potential underassessment. ULBs must evaluate and adopt a scientific method of selecting the 10% sample that also takes into consideration the value of properties. Further, an appropriate audit trail of such a verification process must be maintained.

- **Increase in number of billing centres and support online bill creation–**Up to Mar18, all challans for property tax payment were raised at the ULB office or the collection centres (in case of CCs). Therefore, the citizen was required to come to the ULB office for the challan and subsequently make the payment at the bank. We believe that the billing and payment process must be simplified such that payment can be made at the same place where the challan is generated via debit/ credit card payments. We understand that the KMDS has launched a new online platform called 'e-sweekruthi' for a few CCs, where the challan is raised online and the payment can also be made online. This is a step in the right direction for ULBs and we urge that the 'e-sweekruthi' be open to all ULBs across the state.

3. Collections

<u>**Objective**</u>

- To analyse the collection patterns of ULBs and suggest ways to improve the same.

<u>**Work done**</u>

- We have analysed the demand - collection balance (DCB) of property tax collection across ULBs and also analysed staff vacancies of the corresponding ULBs.
- We have interviewed Revenue Officers and Bill Collectors of the 12 ULBs as part of the field visit to understand the operational difficulties in the collection process.

<u>**Observations**</u>

Collection as a percentage of demand by ULB type

ULB Type	2012-13	2013-14	2014-15	2015-16	2016-17
CC	43.6	41.1	41.8	42.1	45.2
CMC	73.2	72.1	76.1	77.0	81.5
TMC	78.5	79.2	78.4	76.4	82.1
TP	82.1	83.3	74.4	73.3	77.7
Total	59.0	55.7	57.3	58.2	62.7

Source: Data provided by ULBs from FBAS

Collection as a percentage of demand by division

ULB Type	2012-13	2013-14	2014-15	2015-16	2016-17
Bangalore Division	79.3	75.9	74.9	72.6	74.5
Belagavi Division	68.5	67.2	67.9	74.6	78.1
Gulbarga Division	71.4	76.1	80.2	80.6	93.0
Mysore Divison	39.0	35.3	37.0	36.6	40.6
Total	59.0	55.7	57.3	58.2	62.7

Source: Data provided by ULBs from FBAS

- On an average, collection efficiencies at CCs are the lowest at 42.8%, while the others averaged at 77% over the past five years.
- Further, on a region wise break down of collections, it is evident that ULBs in the Mysore Division have the lowest collection efficiency.
- However, it is important to note that the demand figure used to arrive the collection percentage has no scientific basis. The ULBs usually apply a flat growth % (of around 10%) from the previous year's demand.
- Due to the non-availability of updated property information, we are unable to comment on the extent of deviation of actual demand from the demand forecast by the ULB.

Bill collector vacancy position by ULB Type

ULB Type	Sanction Strength	Vacant Posts	%
CC	375	168	44.8
CMC	291	90	30.9
TMC	203	58	28.6
TP	49	11	22.4
Total	918	327	35.6

Source: Data provided by ULBs

- Bill collector vacancy percentage was highest in CCs, at 44.8%.
- Though we were unable to establish a direct correlation between bill collector vacancies and collection efficiencies in ULBs, bill collectors are a major part of the billing and collection process. Therefore, large vacancies as mentioned above are bound to have an impact on the collections of ULBs.

<u>**Recommendations**</u>

- **Increase the number of Bill Collectors -** Bill collectors play a major role in driving the collection efficiencies of ULBs. Therefore, the gap of ~36% in bill collector strength across the state must be addressed.

  Further, the DMA must also review the C&R rules against country wide best practices such as Greater Hyderabad Municipal Corporation, where for every 3000 households, 1 bill collector is recruited. Additionally, a report by ICF GHK in 2014 on the approach towards establishing municipal cadres in India suggests that for every 4000 to 5000 households, 1 bill collector must be recruited.

- **Collection through digital channels –** Alternatively, the ULBs could engage with an agency to facilitate collections through digital channels only, actively leveraging tele calling, instead of bill collectors going on a door to door campaign to give payment remainders. The agency hired is to be paid only a percentage of tax collected through the digital channels. This is a tried and tested method across the private sector such as in banks, insurance companies. The diagram below depicts the role of each stakeholder under this scheme -

Enumeration of all properties with contact numbers		Self Assessment Of properties		Verification of Self Assessed properties		Reminders / follow up through tele-calling, prioritising for digital channels		Payment through Mobile App / Online or cash (at ULB office only)		Payment to Agency on performance on tax collection = % of collection paid through digital channels
AGENCY	➡	**CITIZEN**	➡	**RO at ULB**	➡	**AGENCY**	➡	**CITIZEN**	➡	**ULB**

2 | Income from Municipal Properties

Income from Municipal Properties refers to the income received by Municipalities on renting out shops and other properties for commercial purposes.We have categorised the discussion of income from municipal properties into :

1. Enumeration
2. Assessment & Collections

1. Enumeration

Objective

- To evaluate the method by which the properties owned by Municipalities are enumerated in order to recognize revenue from the same.

Work done

- Interacted with Revenue Officers and Bill Collectors across the 12 ULBs to understand the process and controls in place.
- Reviewed the rules of the KMABR, 2006 related to recording of fixed assets including municipal properties.

Observations

- As per Rule 87 of the Karnataka Municipal Accounting and Budgeting rules, 2006, (KMABR) the municipalities must maintain fixed asset registers comprising of land, buildings and all other infrastructure, immovable and movable properties which belong to the municipality. These registers must be maintained category wise in respect of lands, buildings, etc., and fund wise.
- Following this rule, KMDS in 2006 built an Asset Management System, where in ULBs were to update and maintain the fixed asset register. Based on the test check performed on the 12 ULBs, we have noted that none of their fixed asset registers were up to date. Track of municipality properties leased out and details of such lease agreements were not maintained independently by the ULBs.

- **Recommendations**

   Update fixed asset register up to date – In order to first track the properties that the ULB owns and has leased out, the ULBs must update their assets register. The Asset Management System built and maintained by KMDS has provision to include information on whether the property is leased out, details of lease period etc. Therefore, we strongly recommend that ULBs be incentivised to update their fixed asset registers on the online system either by deploying internal teams to the task or employing chartered accountants in a one-time exercise to update the register. This will a have two fold effect of helping better assess the potential of revenue from lease of municipal properties and also keep track of all assets including the city infrastructure that is owned and maintained by the ULB.

2. Collections

Objective

To evaluate the method by which the properties owned by Municipalities are assessed to collect rental income and to ensure completeness and accuracy of such assessment.

Work done

- Interacted with Revenue Officers and Bill Collectors across the 12 ULBs to understand the process and controls in place.
- Analysed rental income and return on asset data across 2015 to 2017 for 182 ULBs in Karnataka.

Observations

- Municipal properties such as shops and other commercial establishments are rented out by the municipalities. These properties are leased out for a period of 3-5 years and in some cases for an extended period of 10 to 30 years at the discretion of the council. The maximum rental charges that the municipalities charge are derived from the guidance value. We already know that the guidance values prescribed are significantly lower than market value and therefore, the rental charges levied are not comparable with current market prices.

Return on assets by ULB type (Rs in lakhs)

ULB type	Rental income from Municipal Properties			Fixed asset - Land & Building - Gross Block			Average Return on asset (%)		
	31-Mar 2015	31-Mar 2016	31-Mar 2017	31-Mar 2015	31-Mar 2016	31-Mar 2017	31-Mar 2015	31-Mar 2016	31-Mar 2017
CC	2,410	4,073	1,724	70,354	64,420	56,301	3.4	5.4	4.9
CMC	2,165	1,857	1,901	98,419	93,528	86,677	3.3	3.3	4.4
TMC	2,676	2,577	2,211	63,329	69,076	52,976	4.7	5.3	5.0
TP	541	403	323	18,457	16,856	15,738	3.7	2.9	2.6
							4.1	4.4	4.4

Source: FBAS

- Since we have not been provided with the gross block details of properties on lease, we have calculated Return on Asset % (RoA) based on the rental income from municipal properties and total gross block of land and buildings capitalised in the books of accounts. The RoA has remained consistent across three years at approx. 4.3% of the gross block of land & building.
- Further, and more importantly, none of the 12 ULBs, nor the KMDS were able to provide a detailed listing of commercial properties owned by local bodies across Karnataka.

Recommendations

- Revision of guidance value –In order to increase the rental charges that a ULB can levy, the guidance value must be in line or close to the current market value. However, as discussed in the previous sections of the report, the guidance value is not regularly updated. Therefore, the ULBs must first take due steps in assessing the reasons for such lack of updation of guidance values.

- Engaging a Property Management Company– In order to assess the revenue potential from properties owned by municipalities, the ULBs must first update the records of all properties owned by the Municipalities with details of whether they have been leased or not. This exercise could be undertaken in house by the employees of the ULB or an external agent in case of manpower shortages. As the second step, the ULB could possibly engage a Property Management Company (PMC) to conduct a study on the commercial properties owned in order to evaluate the revenue potential from such properties. Through the study, the PMC could also help evaluate the right usage of the property and help explore options such as joint development in order to enhance the revenue potential of such properties.

3. Water charges

Water charge/tax (collectively known as 'water charges') is designed as a charge on consumption for both metered and unmetered water supply and is a significant source of revenue for ULBs.

Objective

- To analyse the process of revenue generation from supply of water across ULBs.

Work done

- Interacted with officers from the Revenue department of the 12 ULBs to understand the enumeration and assessment of water charges and the tariff structure levied.

Observation

- Due to lack of a complete consumer database or details of utilisation per household, the demand for revenue from water charges that is forecast by most ULBs is un-scientific and not supported by any workings. The 12 ULBs visited for the purpose of field work did not provide any working for the demand forecast in the budgets.
- Further, based on our interaction with 12 ULBs, we understand that only 2 out of these 12 ULBs have a certain number of metered connections. For the other 10 ULBs, consumption based rates are not levied and instead flat monthly tariffs are charged for both commercial and residential properties. The tariffs are rarely revised and are not indexed to power consumption or inflation and the process dis-incentivises efficient use of water. We further understand that this trend can be extrapolated to other cities across the state of Karnataka.

Water charges collection efficiency %

ULB Type	2012-13	2013-14	2014-15	2015-16	2016-17
CC	42.5	43.4	47.6	47.3	38.9
CMC	48.8	48.6	49.5	46.7	46.3
TMC	55.7	56.4	60.2	56.2	58.2
TP	49.3	53.8	54.4	59.3	59.0
Total	**51.7**	**53.3**	**55.5**	**54.9**	**55.3**

Source: Data provided by ULBs

- Apart from unscientific prediction of demand, we also note that collection efficiencies are significantly low at an average of 54.1% over the past five years. As per the revenue officers across the ULBs, the reason for poor collections can be attributed to incomplete customer databases, delivering bills to wrong addresses, long overdue unpaid bills by consumers and inaccurate water bills raised. Further, in water scarce areas, the ULBs refrain from collecting user charges on account of intermittent water supply.

Observation

- 100% metered connections– Currently, the water consumption across cities in Karnataka is hard to predict due to lack of 100% metered connections. Further, it makes consumption based levy of tariff rates impossible. Therefore, the ULBs must work with KUWSDB, supported by KUIDFC, to introduce metered connections across ULBs in the state.
- Improve collection efficiencies – As highlighted for property tax collection, the bill collectors play a significant role in collection of taxes. Therefore, their vacancies must be duly addressed. If the ULBs are unable to hire additional bill collectors, they could also engage an agency (via a transparent bid) to facilitate collections through digital channels, actively leveraging tele calling similar to how banks collect dues from credit card holders. We recommend the DMA conduct a feasibility study to evaluate the option of sourcing collections.

4. Innovative modes of municipal revenue generation

As the focus continues to remain on ways to enhance property tax, water charges and rental income, there has been very little discussion around identifying alternative ways to increase municipal revenues by evaluating fresh innovative modes of revenue generation. Globally, cities such as London and Singapore have successfully tapped revenue streams such as congestion charges and successfully leveraged technology to optimise collections. Smaller cities such as Kampala in Uganda have imposed charges on cab services, a potentially buoyant source of revenues in our cities where cab services are growing exponentially. Cities are transit centers, tourist attractions and major centers of consumption. There are several examples such as Time Square in New York, Bengaluru International Airport, and Delhi Metro where outdoor advertising space has been monetised for significant amounts. Some cities in Australia have successfully crowd funded neighborhood projects as well. Some of the innovative modes that ULBs across Karnataka can consider are as follows –

i. Surcharge on stamp duty: As per the KMCA, 1976 and KMA, 1964, the ULBs in Karnataka are entitled to receive a share of the stamp duty income collected by the state in that region. However, between 2014 and 2017, no such revenue is assigned to the ULBs from the State Government. Therefore, we urge that the DMA review reasons for the funds not being released and work with the State Government in receiving the due amount. We believe that surcharge on stamp duty in cities with higher economic activity would be a significant source of revenue. For example, the city of Lucknow earned Rs 90 crores from a surcharge on stamp duty during 2015-16.

ii. Grant of advertising rights: The Government of Karnataka recently passed an order abolishing the levy and collection of advertisement taxes. In 2016-17, advertisement tax contributed to approx. Rs 9.71 crores across 186 ULBs out of which CCs earned Rs 8.91 crores. With the passage of the government order, the CCs stand to lose a buoyant source of revenue.

We propose that instead of levying advertisement tax, the ULBs could grant advertisement rights for all hoardings, mobile bill boards, wallscapes, transit (bus stops, taxi), street furniture, electric poles, road dividers, to a single agency through a transparent bidding process. For example, the City of Chicago tied up with a large advertising agency for advertising throughout the city in 2,800 bus shelters resulting in a contribution of $18 million to the city's corporate fund budget for 2013. An example closer to home would be the hoardings at the Bangalore International Airport (BIAL). In a transparent competitive bid, a large advertising agency won the advertising concession earning BAIL approximately Rs 200 crores from this deal.

IT SYSTEMS FOR ULBS IN KARNATAKA

The IT infrastructure for ULBs in Karnataka is managed by the Karnataka Municipal Data Society (KMDS). The KMDS is a registered society in Karnataka and Karnataka was one of the first states to create a municipal data society for computerized reforms. It was created by the DMA during 2007-08 with a defined set of objectives towards strengthening ULBs through e-governance. A state level Municipal Data Center was established within the KMDS and a centralized database of all the ULBs are being maintained from it. The online applications that KMDS runs on ULB websites include – Fund Based Accounting System (FBAS), Monthly Information Booklet (MIS system), Street Vendor database, E-Aasthi, Property Tax Information System, Property Tax Calculator, SLB data, schemes data of ULBs, Official Vacancy position data, Asset Management System, to name only a few.

Despite the pioneering move by the GoK to take up e-governance way ahead of other states, the following are the issues and challenges noted with the current set up:

- **FBAS system –** No state level dashboard: A large portion of the data used for the purpose of this report has been sourced from the FBAS systems. However, despite the books of accounts of all ULBs being digital, KMDS currently is not equipped to provide a state level, consolidated dash board of the financial data. Therefore, in case of a need to view a consolidated financial status of ULBs in Karnataka, a back-end query must be raised to obtain all the financial statements and following which analysis is done.
- **MIB –** Not updated regularly and no review process in place: MIB was launched with an intention to collect monthly performance data of ULBs and to further build a robust, periodic review system. However, the ULBs have not updated the MIB on a regular basis and nor is there any review system in place where the data that is in fact uploaded is analysed.
- **Asset Management System –** Not updated by ULBs: Launched in 2006, the asset management system was introduced to replace the physical registers previously maintained. However, the online register has not been updated by the ULBs. The KMDS is still in the process of assisting ULBs collate the opening balance data (of year 2006) to be uploaded on the system. Therefore, there is a significant backlog in the asset registers maintained by ULBs across the state.
- **E-Aasthi, Property Tax Information System (PTIS), Property Tax Calculator –** Multiple systems for property tax that are not linked to each other: Updated digitised records of properties by their Property Identification Number (PID numbers) is not maintained across the ULBs. The property tax computation is performed online, on the Property Tax Calculator. However, the software does not have a provision to generate PID number wise reports. The ULBs have multiple systems to keep track of properties namely, Property Tax Information System, E-Aasthi and Property Tax Calculator. But none of these systems are linked to each other and parallelly store varied data.
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GLIMPSES OF THE FIELD VISITS

JANAAGRAHA Centre for Citizenship & Democracy