Financing of Smart Cities

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Responsibilities and finances of ULBs

Responsibilities

- Water and sewerage provision; Waste water treatment
- Primary education and health care
- Slum upgradation
- Local roads and public transport
- Solid waste management and sanitary landfills
- Maintenance of cremation and burial grounds
- Street lights
- Public parks and playgrounds
- Libraries

Sources of Finance

- Property tax
- Profession tax
- Entertainment tax
- Advertisement tax
- Octroi and entry taxes

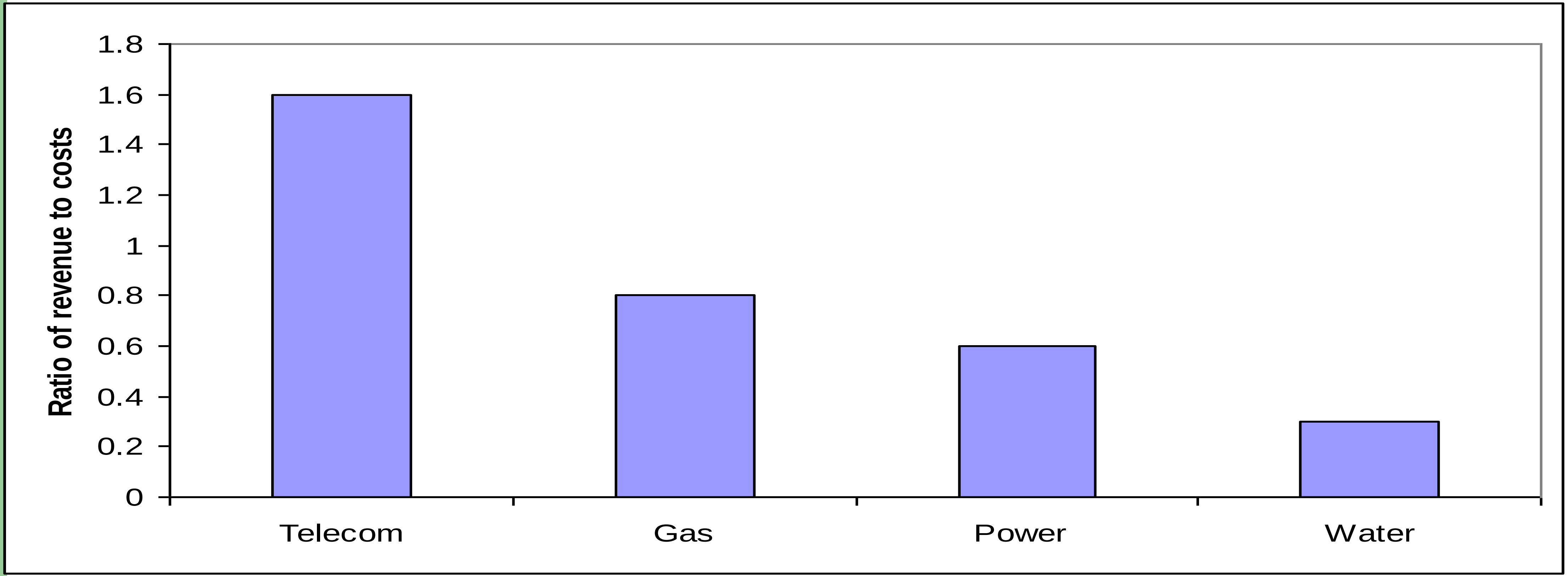
ADDITIONAL RESOURCES FOR FINANCING SMART CITIES

Additional Resources for financing Smart Cities

- GoI funds: ~ Rs.500 cr
- Matching contribution by States/ ULBs: ~ Rs.500 cr
- User Charges
- Public-Private Partnerships (PPPs)
- FFC recommendations (incl land based instruments)
- Municipal bonds
- Borrowings from bilaterals and multilaterals
- National Investment and Infrastructure Fund (NIIF)
- Convergence with other Government schemes

USER CHARGES

User charges way below cost recovery in urban infrastructure



Average Cost Recovery of Selected ULBs, (2007-08)

City	Revenue expenditure on urban services (Rs. crore)	Revenue receipts from urban services (Rs. crore)	Average cost recovery (%)
Metropolitan cities			
Hyderabad	347	139	40
Bhopal	49	20	41
Lucknow	16	3	18
Other cities			
Amravati	26	2	8
Palakkad	3	2	55

Parking fees

- Parking fee is an important instrument of revenue enhancement through user charges for local governments
- Dual impact - It also serves to influence commuting choices in favour of public transport

Comparison of Parking Fees in various cities, 2011

India	Parking Fees ($)
Bengaluru	1.54
Delhi	1.32
Mumbai	1.11
Chennai	0.99
Abroad	
Dubai	4.08
Beijing	7.05
Bangkok	13.2
Hong Kong	28.25
New York	41
London	65.97

Principles for levying user charges

- Where services can be measured and beneficiaries identified, user charges must apply rather than taxes → water and sewerage charges should be levied separately rather than built into the property tax
- User charges should be so structured as to meet at least the O&M cost
- Automatic partial indexation to inflation will ensure smooth increase over time
- User charges should also be linked to improved quality of service
- To enhance revenue streams and promote the use of public transport, ULBs should introduce parking fees

PUBLIC-PRIVATE PARTNERSHIPS

Public Private Partnerships

- Unmet infra needs in sectors like water supply, sewerage, solid waste management, urban transport are immense
- PPPs important for bringing in capital to urban infra and private sector efficiencies
- However, PPP success stories in urban infra are rare mainly because of inadequate cost recovery and associated political sensitivity

Essential elements of a PPP – also applicable to Smart Cities

- PPPs are commercial transactions between a public and a private party by which the private party:
  - performs a function traditionally performed by the public sector for an extended period of time;
  - assumes related construction, commercial, and operational risks; and
  - receives a benefit in exchange, either by way of public authority paying from its budget, or user fees, or a combination of these.

Level of risk borne by pvt partner depends on type of contract

- Management contract - private party shares minimal risks with the public sector
- Lease contract – in addition, private parties take on operating and collection risks
- BOT (and ROT) contract - private partners also take on investment and financing risks

Best practices in PPPs

- Competitive bidding is necessary to ensure ***competition for the market*** and thus value for money, besides ensuring transparency
- Two stage bidding process
- Single bidding parameter at the RfP stage
  - Lowest subsidy that the government must provide (Viability Gap Funding in India)
  - Lowest annuity payment (BOT – annuity projects)
  - Lowest initial tariff

GoI support to ULBs for entering into PPP arrangements

- Standardization of documents - Model documents are generic in nature and aim at lending ***transparency, consistency*** and ***predictability*** to the entire procurement process, allowing decisions to be made ***objectively*** and ***expeditiously***
- ***Model Concession Agreement in urban water supply*** is being developed covering:
  - Risk allocation between public and private sectors
  - Performance standards and Coverage targets
  - Tariff indexation to inflation to mitigate some risks
  - Would provide for ULB level flexibility

Rationale for PPP in Urban Water Supply – Improving services and coverage

- In a PPP, ownership of assets will remain with public agencies
- Regulation of tariffs would be by public agencies
- Aims at optimal/efficient utilization of water resources
  - 24 * 7 water supply
  - Improving quality of water supply
  - Covering uncovered areas (mainly the poor)
  - Reducing wastage and leakage – reducing Non-Revenue Water

14TH FINANCE COMMISSION RECOMMENDATIONS

14^{th} Finance Commission recommendations

	Recommendation	% ↑ over last FC
Tenth Finance Commission	Rs.1,000 crore grant	
Eleventh Finance Commission	Rs.2,000 crore grant	100%
Twelfth Finance Commission	Rs.5,000 crore grant	150%
Thirteenth Finance Commission	Rs.23,111 crore grant	362%
Fourteenth Finance Commission (2015-20)	Rs.87,144 crore grant	277%

- Grants should enhance resources available with municipalities to enable them to discharge their statutorily assigned functions.
- The division between basic and performance grant will be on a 80:20 basis.

FFC recommendations on Use of Land-based Financing Instruments

- Levy of ***vacant land tax*** be considered
- ***Conversion charges*** are collected at the time of land use conversion, e.g. from rural to urban use, and from residential to commercial use - part of this can be shared by State Governments with municipalities
- ***Betterment tax***: States should prepare a clear framework of rules for the levy of betterment tax

Other Land-based Financing Instruments (cont'd)

- ***Impact fees*** distinguish between differing impacts that buildings have on urban infrastructure and are charged at the time of giving building permission - separate rates for residential and commercial buildings.
- ***Floor Space Index*** (FSI) beyond a certain minimum which can be claimed as a right - such charges can be pegged higher because they get associated with land costs and the cost of developed property.
- ULBs can use these instruments, but they need approval from the state government

Other Land-based Financing Instruments (cont'd)

- ***Tax Increment Financing***: The cost of Smart City improvements is assessed to Property Taxes by local bodies:
  - Revenues from increases in property tax are escrowed for a defined period of time to finance new infra investments in the area
  - This would also enhance accountability by linking expenditure with outcomes relevant to local residents

Other FFC recommendations

- ***Advertisement tax***: two components - tax on hoardings and tax on advertisements on buses, cars, lamp posts and compound walls - States may consider steps to empower local bodies to impose this tax
- ***Entertainment tax***: States should take action to increase its scope to cover more and newer forms of entertainment
- ***Profession tax***: Ceiling should be raised from Rs. 2,500 to Rs. 12,000 per annum.

MUNICIPAL BONDS

Debt financing – Municipal bonds

- Financial status of ULBs is such that they lack credit worthiness for using this instrument
- Almost all Municipal Acts in India impose restrictions on the power of ULBs to borrow funds, in terms of balancing their budgets and seek permission of the state government before borrowing. These permissions are project-based and are granted on an adhoc basis

Municipal bonds

- In the short term, pooled financing can be an alternative option through which ULBs with poor financial health can access the market by sharing risks among number of participating ULBs - ***Pooled Finance Development Fund***
- ***Tax free municipal bonds*** can be a huge incentive
- Gujarat (Ahmedabad), Tamil Nadu (Chennai and Madurai) and Karnataka (Bangalore), Telengana (Hyderabad), AP (Vizag) and Maharashtra (Nagpur and Nashik) have tried this.

Latest development on municipal bonds

- Given the needs of Smart Cities, DEA has taken up a project for assessing some cities (Chennai, Indore, Bhubneshwar) for their credit worthiness and bond readiness and conducting one transaction

OTHER SOURCES OF FINANCE – MULTILATERALS, NIIF, CONVERGENCE

Assistance from the World Bank/ ADB

- $500 million from WB and $1 b from ADB over 5 years (2015-20) in the works
- Will be used to provide funds to Smart City SPVs – exact modalities are being worked out
- Loan should be available in 2016 for use by Round One Smart Cities

National Investment and Infrastructure Fund

- Objective: Maximize economic impact mainly through infra development in ***commercially viable projects***, both greenfield and brownfield.
- Initial authorized corpus of NIIF would be Rs.20,000 cr
- Functions include investing, which would entail considering and approving candidate companies/ institutions/ projects (incl state entities) for investments – both debt and equity
- Funds would also be available for equity support for NBFCs/ FIs that are engaged in infra financing.

Convergence with other Government schemes

- Strong convergence between AMRUT and Smart City Mission – Most Smart Cities (area based) would also be AMRUT Cities (project-based).
- At the planning stage itself, cities must seek convergence in the SCP with AMRUT, SBM, HRIDAY, Digital India, Skill development, Housing for All, etc.

Summing up, Additional Resources for financing Smart Cities

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Thank you