



# Urban Finances in Karnataka: How to Make them Sustainable?

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## Introduction

Karnataka is the 7<sup>th</sup> most urbanized state in India with its urban population accounting for 38.6% of the overall population, well above the national average of 31.16% (Census of India, 2011). There are a total of 277 urban local bodies (ULBs) in the state of Karnataka, including Municipal Corporations, Municipal Councils, Town panchayats and notified area committees. Property tax forms an important source of revenue for ULBs in Karnataka constituting about 53% of own revenues. ULBs in other states, such as Maharashtra and Gujarat, earn a significantly higher proportion of their total revenues from own sources, as compared to those in Karnataka, given that octroi has been abolished everywhere now with ULBs having to look for other buoyant sources of revenues to sustain themselves and reduce their fiscal dependence on the state and central governments.

In the context of deteriorating municipal finances, a study was undertaken to understand the current status of finances and to estimate the revenue capacities of selected ULBs of Karnataka - Hubli-Dharwad, Davanagere, Bidar, Sira, Yadgir, Chamarajnagar, Ullal, Bangarpet, K.R Nagar, Lingasugur, Haliyal and Sakleshpur. For purposes of analysis, the ULBs were divided into class I (with a population of greater than 1 lakh), class II (with a population of 50,000-1 lakh) and class III cities (with a population of 20,000-49,999), consistent with the Census definition. The class sizes of these cities are consistent with the classifications of municipal corporation, city municipal council (CMC) and town municipal (TMC) categories, except Bidar CMC, which qualifies as a class I city, as per the Census, but doesn't belong to the class of municipal corporations yet.

## Methodology

The study covered not only an examination of the ULBs' current major revenue sources, but also measures to improve their revenue capacity and generation, taking into

account their major revenue sources. A detailed analysis of audited income and expenditure statements of the 12 ULBs during the period 2010-11 to 2016-17 (subject to data availability) was carried out. For estimating revenue capacities, three scenarios were developed based on the existing and proposed property rates. Scenario 1 took into account only the existing property tax rates, including non-paying and un-assessed properties and excluding government properties. Scenario 2 took into account all the categories in scenario 1 plus government properties, as it might be the case that some government properties were being operated on a commercial basis. For the non-paying, unassessed and government properties that were not payers of the property tax until then, existing property tax rates were used for obtaining the per unit property tax revenue (i.e. by dividing the property tax revenue by the number of properties) and obtaining their average square footage. By applying per unit property tax revenue to the number of each of unassessed, non-paying and government properties, average revenue for each of the categories was arrived at. Scenario 3 took into account the non-paying, unassessed and government properties, similar to scenario 2, but made use of property values recommended by the Inspector General of Registration (IGR), Government of Karnataka, which are closer to market values, both for residential and commercial property. Besides, the additional revenue of the ULBs which could potentially be gained by metering their water connections, was estimated. In addition, in scenario 3, in the case of ULBs with unauthorized shops, the additional revenue potential from trade license fees, (possibly including penalties), was estimated. Based on the analyses, the study suggested policy recommendations for improving the existing revenue/financial status of ULBs in a sustainable manner.

## Key Findings

First, the current trends in the finances of ULBs are discussed, with respect to their total own-source revenues, property tax revenues, user charges and rental

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income from municipal properties as part of identifying the key factors that contribute to revenues across the selected ULBs representing various class sizes of cities. Further, we computed the trends in per capita revenues from each of the sources, to control for the size effect across ULBs. From the viewpoint of sustainability, fiscal transfers to ULBs from the central or state governments were not considered.

The trends in per capita own-source revenues from 2011-12 through 2017-18 with regard to the selected class I cities showed an increase for two ULBs (HDMC and Bidar), and a decline for Davanagere. Among the class II cities, the per capita own-source revenues showed a decline, while in the case of Chamarajanagar, showed an increasing trend; Sira, showed the highest per capita for all own-source revenues at Rs.473 per capita for 2016-17. With respect to class III cities, an optimistic trend was observed for K.R.Nagar with own-source revenues per capita increasing. Towns such as Sakleshpur with a peak of Rs.980 per capita revenues for 2015-16 also showed a promising trend. However, towns geographically close to Bengaluru such as Bangarpet and those in north Karnataka, such as Lingasugur, found themselves at the bottom with per capita own-source revenues at Rs.79 and Rs.219, respectively for 2016-17 and these cities remained all-time laggards, with lower per capita revenues. Overall, Sakleshpur, a class III city, matched up to the revenues of HDMC in terms of all own-source revenues per capita. Overall, in terms of per capita all own-source revenues, class I cities happened to be the best performers, followed by class III cities, not class II cities, as one would expect.

With respect to property tax, class I cities -- HDMC and Bidar were the leaders with continuous increases in per capita revenues over the years. Among class II cities, it was found that Sira accounted for the highest property tax revenues per capita, while among class III cities, K.R.Nagar recorded the highest for 2016-17 and Bangarpet the least. Hence, even with regard to property tax revenues, class I cities were found to be the leaders; as found with respect to all revenues, after the first tier of cities, it was not the class II cities (or the CMCs) that excelled, rather it was the class III cities that performed well in raising property tax revenues per capita.

User charges prevailing in the selected cities were studied and were found to be directly proportional to the size of ULBs. For instance HDMC,

a class I city, was found to be the leader for 2016-17, followed by a class III city, Haliyal. The trend in user charges was the same as that for all revenues and property tax revenues, with class I cities leading, and followed by class III rather than class II cities. It is interesting to observe that in the case of larger cities, it was the property tax revenues that led the total own-source revenues, whereas, in the case of smaller cities, it was the user charges that led increases in total own source revenues.

The rental income from civic amenities and municipal buildings accounted for a major part of the financial space of ULBs. Only the largest ULB, HDMC, a class I city, was able to capitalize on its land assets with a revenue of Rs.98 per capita, whereas, the other two class I cities were unable to tap into this source. Among class II cities, the coastal city of Ullal was found to be the most promising with a revenue of Rs.56 per capita whereas amongst class III cities, the leader happened to be K.R.Nagar, with a revenue of nearly Rs.343 per capita for 2016-17, more than three times that of HDMC, a class I city. While rental income accounted for 38% of the total own-source revenues in the case of smaller towns such as K.R.Nagar, the same accounted for less than 10% in the larger municipal corporations and CMCs. What is curious to note is that it is the class III cities, that held great promise with regard to the potential from land as a financing instrument.

It was found that trade license fee was an important source of non-tax revenue for ULBs, given its greater commercialisation potential. For instance, the per capita trade license revenue for class I cities showed a continuous increase over the years, while for class II cities, trade license revenue being higher than for class I cities in per capita terms, showed a steady decline for all cities except Sira. For Class III cities, trade license was promising with the smallest cities experiencing an increasing trend with the exception of Sakleshpur. Overall, class II cities accounted for the highest per capita revenues from trade license, but both class I and class III cities displayed a similar potential.

Summarizing from the analysis of the current trends across various class size cities, we found that class I cities, followed by class III cities, excelled in terms of raising own-source revenues, property tax revenues and user charges, while with respect to rental income, class III cities were promising and class II cities demonstrated the highest revenues from trade license.

### Additional Revenue Potential of ULBS

Scenario 1 took into account only the existing property tax rates, by including non-paying and un-assessed properties and excluding government properties. Under scenario 1, the additional revenue potential was found to be huge for class I cities - Rs.37.32 crore for HDMC (1.0 times its existing revenues from non-paying and 0.12 times its existing revenues from un-assessed properties); Rs.3.22 crore in respect of Davanagere (0.15 times its existing revenues from non-paying and 0.09 times its existing revenues from un-assessed properties); and Rs.1.09 crore for Bidar (one-ninth of the total own-source revenues and 0.17 times its existing revenues from the unassessed and 0.08 times its existing revenues from non-paying properties). As for class II cities, we found the revenue from taxing unassessed and non-paying properties for Yadgir would substantially increase to Rs.65 lakhs, of which unassessed properties alone would yield Rs 54.54 lakhs, an increase of 0.46 times



its current revenues. Our analysis indicated that the least revenue from non-paying properties would be generated in Ullal at Rs 1.92 lakhs. Among class III cities, we found the highest revenue from unassessed and non-paying properties could accrue to KR Nagar at Rs.1crore (0.73 times its existing revenues from un-assessed properties and 0.33 times its existing revenues from non-paying properties), followed by those in Bangarpet, with a substantial revenue (0.52 times its existing revenues from unassessed properties) (Table 1).

It may be recalled that scenario 2 considered all the categories included in scenario 1 plus government properties, since some government properties may well be operating on a commercial basis. Under scenario 2, wherein government properties were considered taxable, the additional property tax revenue potential amounted to Rs. 37.38 crore for HDMC, which was the highest, followed by Rs. 3.23 crore for Davanagere and Bidar, with an additional Rs.9.62 lakhs amounting to Rs. 1.18 crore. Among class II cities, we found Yadgir had an additional revenue potential of Rs.2.06 lakhs, followed by that in CR Nagar with a less than Rs 1 lakh in total. As far as class III cities were concerned, KR Nagar led the pack with an additional revenue potential of less than Rs.1 lakh, followed by those in Sakleshpur. Hence, given the number of government properties and their limited revenue potential, we found that there exists little room for taxing them even if one were to go by the existing property rates (Table 1).

Scenario 3 made use of property values which are closer to market values, both for residential and commercial properties, metering of water and trade license fees for unauthorized shops. It is no surprise that

the revenues from property taxes were found to be substantial for class I cities, ranging from Rs.247 crore for HDMC (4.4 times higher than its existing revenues) to Rs.23 crore for Davanagere (0.17 times higher than the existing revenues) to Rs.15 crore for Bidar (3.5 times higher than its existing revenues). Among the class II cities, for CR Nagar, the revenue potential was about Rs.4 crore (3.97 times higher than the existing), followed by that in Sira with a revenue potential of Rs.2.12 crore (which was 1.6 times higher than its current revenues). Amongst class III cities, we found Bangarpet had the maximum revenue potential of Rs.6.11 crore (6 times higher than its existing revenues), followed by that in KR Nagar at Rs.4.55 crore (4.6 times higher) (Table 1). The next in line we found was the revenue potential in Sakleshpur at Rs.3 crore (4.4 times higher than its existing revenues).

**Revenue from Water Metering** – In this scenario, we estimated the additional revenue potential accounting from metering water in ULBs. Considering that in HDMC and Haliyal, water was currently metered at Rs.13/KL and Rs.15/KL, respectively, we computed the revenue potential accruing to the cities from metering all their water connections. The surprising finding was that water, if metered, can yield almost the same additional revenue potential as that from property taxes. We found that the revenue potential accruing from metering water ranged from an additional Rs.38 crore (for HDMC), Rs.5.7 crores for Davanagere, and nearly Rs.2.4 crores for Bidar, which were nearly 25% of the city's own source revenues for 2016-17.

Among the class II cities, we found CR Nagar had the highest potential with a 4 fold increase over its existing revenues and Yadgir with a more

**Table 1: Additional Revenue Potential, Various Scenarios Considered, By Class Size of Towns**

Cities	Revenue Potential from Property tax (in Crore)			Revenue from Municipal buildings (in Cr)	Revenue potential from water supply (in Cr)	Revenue from Trade Licenses
	Scenario 1	Scenario 2	Scenario 3			
<b>Class I cities</b>						
HDMC	37.32 (0.67)	37.38 (0.7)	247.01 (4.4)	11.08 (2.7)	38.39 (3.2)	Nil
Davanagere	3.22 (0.24)	3.23 (0.24)	23.29 (1.7)	1.37 (1.4)	5.67 (0.5)	Nil
Bidar	1.09 (0.26)	1.18 (0.28)	15.03 (3.55)	0.91 (3.2)	2.36 (1.72)	Nil
<b>Class II Cities</b>						
Yadgir	0.65 (0.55)	0.67 (0.57)	-0.80	-0.08	3.13 (4.2)	Nil
Chamarajanagar	0.39 (0.39)	0.40 (0.40)	4.05 (3.97)	0.28 (2.79)	3.63 (3.9)	1.04
Sira	0.23 (0.18)	0.24 (0.19)	2.12 (1.63)	0.79 (1.9)	1.31 (1.5)	Nil
Ullal	0.019 (0.02)	0.02 (0.02)	0.03 (0.03)	0.02 (0.08)	1.11 (3.25)	Nil
<b>Class III Cities</b>						
Bangarpet	0.871 (0.87)	0.872 (0.87)	6.11 (6.11)	0.213 (3.68)	1.07 (2.5)	Nil
KR Nagar	1.038 (1.06)	1.048 (1.07)	4.55 (4.65)	0.20 (2.26)	1.04 (1.4)	0.09
Haliyal	0.092 (0.26)	0.094 (0.30)	1.54 (4.86)	1.268 (3.6)	1.31 (3.8)	Nil
Sakaleshpur	0.086 (0.12)	0.089 (0.13)	3.06 (4.4)	2.122 (3.9)	0.32 (1.1)	0.02
Lingasugur	0.24 (0.36)	0.241 (0.37)	1.89 (2.87)	0.616 (2.63)	1.11 (3.1)	6.20

Source: Budgets of selected ULBs and authors' analyses.

Notes: Figures in parentheses indicate the number of times by which the revenue is estimated to increase over its current revenues.

than 4 times increase over its current revenues. In the case of Ullal, we found that there was better scope for revenue potential from water supply as compared to that from the property tax, which was 3.25 times higher than its current revenues. Sira's potential with respect to revenue from water supply, we found was 1.5 times higher than its existing revenues, but the challenge in the water-scarce town seemed to be the supply of water to the extent of making user charges beneficial for the ULB. Among the class III cities, we found KR Nagar could expect an increase of 1.4 times the revenue generated and Haliyal could witness an increase of 3.8 times, whereas north Karnataka town of Lingasugur could realize an increase of 3.1 times its existing revenues and for Bangarpet, it could be 2.5 times the amount collected presently (Table 1). Overall, we found that the additional revenue potential from water was actually higher for smaller ULBs, as compared to that from the property tax, which is indeed consistent with their revenue profile summarized earlier.

**Revenue from Municipal shops** – With regard to the revenue potential of rent from municipal shops, we found that if market rates were to be applied, most of the smaller ULBs seemed to benefit. We found the application of IGR rates to rental income from municipal shops had an attractive revenue potential, ranging from Rs. 11.08 crore (for HDMC) to Rs. Rs.0.91 crore (for Bidar). In the case of Davanagere, we found that rent would increase approximately from the existing Rs.14,799 to Rs.20,000 per municipal shop. Amongst Class II cities, we found CR Nagar had the highest potential for rental income from municipal shops, (2.79 times higher than its current revenues) amounting to Rs 0.28 crore, followed by that in Sira, with Rs 0.79 crore (1.9 times higher). Ullal, we found, had the potential to increase by Rs 0.02 crore the rent on municipal buildings and shops (an increase of 0.08 times its existing revenues). As for Class III cities, the highest beneficiary happened to be Sakaleshpur (3.9 times) and K R Nagar the least (2.26 times) with a likely increase from the existing Rs.5,340 to nearly Rs.12,000 per municipal shop. (Table 1).

**Revenue from Trade license** – With respect to revenue from trade license fee, among the Class II cities, we found only CR Nagar had revenue potential (Rs.1.04 crore), as it had un-authorized shops. Among class III cities, we found the revenue potential from trade licenses to be huge for Lingasugur at 6.2 crore, with the vast majority of shops in that town being illegal. We found KR Nagar had the potential to generate Rs. 0.09 crore and Sakaleshpur could get an additional Rs. 0.02 crore by levying a fee on unauthorized shops (Table 1).

## Policy Recommendations

1. We recommend increasing revenue compliance from non-paying, unassessed residential/commercial properties, as part of increasing the property tax base of ULBs. Given that property tax is the most important revenue source of ULBs, this is highly desirable. Once the tax base is expanded, the next step is to increase the property guidance values for private properties, in accordance with values published by the state's IGR.

2. Across all the ULBs, we found GIS had been used to map properties. However, post GIS, besides unaccounted properties, many unauthorised constructions and commercial properties had cropped up, so a fresh GIS based assessment of properties should be undertaken immediately. In addition, violations should be brought under the tax net. Many unassessed properties do not have property identification (PID) numbers and those without PID numbers are subjected to rejection from provisions of the property tax. Therefore, we suggest the need for a GIS based re-assessment of properties to effectively bring new commercial and residential properties into the tax net. GIS also aides in documentation, immediate access to information, checking the authenticity of property specifications given by individuals.
3. We recommend the computerisation and further strengthening of the infrastructure across ULBs to leverage benefits such as speed, transparency and accountability in the process, timeliness, reduced manual work. Besides, it could aid in making paperless offices. Currently, maintenance of both the manual files and digital files is in practice. Better integration can be brought about to avoid repetition of information.
4. We propose metering of water connections, as water is a highly scarce resource. Hence, the user should understand its economic value and consumption should be based on a volumetric regime which helps to conserve this scarce resource and at the same time significantly improve revenues.
5. We urge ULBs to consider the issue of trade licenses for street vendors and hawkers, and increasing rents from municipal buildings, in line with market values of such properties.

## Conclusions

The policy recommendations suggested by this study can make the ULB finances sustainable, since the various measures we've suggested are intended to plug the loopholes in the administration of property tax revenues – the taxing of unassessed and non-paying properties is also the most legally tenable way of recovering revenues due to ULBs. Further, the IGR rates are published with a purpose and hence their application to property values (both owners and rental income) should be seriously the next step. Finally, water is a highly scarce resource and hence, the user should understand its economic value. Therefore, as part of raising revenues for ULBs, water connections should be metered with consumption based on a volumetric regime. Trade license fees should be enforced on unauthorized businesses in the towns. These components in tandem should lessen the ULBs' dependence on the state for transfers and make their financial position more self-reliant, lending credibility to their attempts to improve the delivery of basic urban services.

## References

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