CSIR Policy Brief 3

SPATIAL TEMPORAL EVIDENCE FOR PLANNING SOUTH AFRICA   STEPSA.ORG

Capturing value from transport infrastructure investment – the need for a clearer policy context to support municipalities

Value capture is a public financing technique that 'captures' a part or all of the increases in private land values that result from new public investment, by imposing a tax on the property or requiring an in-kind contribution.

The additional revenue can be used to finance infrastructure for economic growth and urban development, or for poverty alleviation programmes. The infrastructure which is financed, in turn, leverages private investment in the area as it improves.

Context

Given the scale of public investment in transport and associated infrastructure in South African cities and towns over the last decade, a great deal of value is being created in the vicinity of such investments. In the current medium-term expenditure framework period, the public sector budgeted and approved projects totalling R844.5 billion[1].

At the moment Bus Rapid Transport systems are rolling out across many cities. Investment in the Gautrain network has been considerable (around R20 billion). For agencies and individuals who already own land, or buy up land close to new stations, road junctions and interchanges, and intermodal transport hubs, the public investment presents many opportunities. This applies also to investments such as parks, stadia, and any public environment improvement which enhances the value of land in a specific location.

A great deal of value is created via public investment, but not enough thought is given to how to capture some of that added value to fund the maintenance and further extension of that infrastructure. Much of the value is captured by the private sector, and this can have an exclusionary effect in that lower value land uses (such as middle and low income housing) cannot then be located close to such nodes of activity.

Some value is captured through property rates. As property values increase because of infrastructure investment, so rates increase, and additional funds are generated for the city coffers. Private sector agencies also make

[1] National Budget, 2012. http://www.treasury.gov.za/documents/national%20budget/2012/review/chapter7.pdf

considerable investments off the back of the increased value that is created via public investment, and so it has a positive stimulatory effect on urban development. Sometimes private sector project investments lead the value-creation cycle, and public investment follows behind (e.g. as with the early development of Sandton and the Gateway development in Umhlanga, eThekwini).

There are a range of useful instruments for creating and sustaining these positive cycles of value creation and capture. This policy brief describes some of them. Many are used in other countries and cannot be easily applied in South Africa, either because municipalities have not yet thought of using or applying them, but in many instances because the policy environment is not supportive of their development. An important element of value capture is the ability to create value within a precinct and then to re-invest that value within the area (as with Business Improvement Districts). But many policies prevent the ring fencing of funds for re-investment in geographic areas.

This policy brief focuses on some of the changes needed to stimulate the greater use of value capture strategies and instruments. If planned and regulated in the right way, they have the potential to stimulate inclusive urban development. The material in this policy brief is based directly on (and includes excerpts from) work by the Urban Land Markets Programme Southern Africa (Urban LandMark), the South African Cities Network, and National Treasury (Training for Township Renewal Initiative). The sources appear in the reference list.

Examples from International Best Practice[2]

What instruments exist for project managers, planners, municipal officials and others to capture value effectively? The various mechanisms from across the world that are described here have been used to capture value from mass transit and other transport interchanges. Not all are appropriate for use in South Africa, while others are already fairly commonly used. This section is highly summarised, and authorities wishing to employ such instruments would need to explore them further in much greater detail. They're included here to explain the idea of value capture, and to explore options for implementation.

Betterment Tax or Special Assessment

Betterment taxes are imposed by local governments to capture the increase in land value where public fund investment in infrastructure has allowed private development to benefit. In this way private owners and occupants contribute towards a public service. Betterment taxes are most effective in robust markets where there is a well established tax administration system.

Business Improvement Districts

A Business or City Improvement District (BID or CID) is a levy on property owners and/or businesses located within a specific area for services in addition to those normally provided within the city. These funds are often used to combat "crime and grime" issues through employing additional security and cleansing staff, as well as for infrastructure improvements, signage, landscaping, surveillance cameras, marketing, management, and other services that benefit the property owners, businesses, and residents of the designated area.

[2] This section is derived from a learning resource "Creating and capturing value around transport nodes" available at http://www.urbanlandmark.org/research/x18.php

Development Impact Fees or Direct Contributions

Impact fees or developer contributions are once-off fees levied by local governments on developers to help recover the cost of public infrastructure required for the developments, for example, bulk water systems, road works, and other public infrastructure. Developers can also be required to supply infrastructure beyond their own development site if their development causes impacts on regional infrastructure systems. This is an area of policy need in the South African context. Development fees are levied in many cities and towns but they are inconsistently applied, and local authority officials are sometimes in a weak position to negotiate reasonable charges. There is a great need for a national policy framework to regulate development charges in general.

Zoning Tools

Zoning can be used as a powerful tool for creating value, by directing the location, type, and scale of development. Two types of zoning tools include incentive zoning (rewards for developers in exchange for including certain public amenities or meeting other public objectives), and inclusionary zoning (requiring housing developers to include a certain percentage of affordable units in their projects to create mixed-income communities).

Joint Development Agreements

Joint development refers to a type of public-private partnership where public and private entities contribute to the costs of infrastructure and share in potential revenues generated by it. Joint development projects are often location-specific and have a high degree of community involvement and complexity.

Land Value Increment Taxes

Land value increment tax can be applied to normal property tax by ring-fencing the revenue raised on the increase in value of land brought about by public interventions (such as the provision of transport infrastructure and other services).

The case of Fruitvale Transit Village

Oakland, California (part of the San Francisco Bay area) participated in the development of Fruitvale Transit Village, an example of a joint development project. The project was spearheaded by the Unity Council, a non-profit organisation which formed the Fruitvale Development Corporation together with the City of Oakland, Bay Area Rapid Transit (BART), Alameda County Transit, the Metropolitan Transportation Commission and various community based groups.

The primary objective of the project was to assist in the revitalisation of the East Oakland inner city which, like the Johannesburg city centre, suffered from disinvestment in the 1960s when factories and canneries that employed a large number of local residents relocated out of the area. In 1989, BART announced its intentions to build a 500-car parking garage at its Fruitvale Station, which the transit agency perceived as a commuter node. However, this plan was met with opposition from residents of the East Oakland community. The largely low income, Hispanic community felt that the parking garage would serve as a barrier and would spiral the community into further decline. The executive director of the non-profit Hispanic Unity Council put forward the concept of a transit village which would link the local economy of East Oakland to the mass transit station, largely based on a study completed by the nearby University of California at Berkeley.

Formation of a partnership between the Unity Council and BART was critical, as BART owned most of the land surrounding the station. Marketable properties that belonged to BART on the east side of the station were swapped with less marketable properties on the west side, which belonged to Unity Council.

Planning for development of the Fruitvale Transit Village began in 1992, and the site acquired in 2001. Construction of Phase 1 of the Fruitvale Transit Village was completed in February 2004. The total development covers an area of 1.62 hectares of mixed use development located next to the Fruitvale BART Station. It includes 37 market-rate housing lofts and 10 affordable housing units, a range of community-based facilities, and large commercial and retail components.

The non-profit Unity Council generates direct revenue from its participation in the project, which helps to fund activities to assist the organisation's low-income constituency.

Source: "Creating and capturing value around transport nodes" available at http://www.urbanlandmark.org/research/x18.php

Land Banking and Leaseholds

Land banks are used by local governments for a variety of public purposes. Most relevant is where local government acquires land located near or within Transport Oriented Development hubs. An increase in the value of land can then be captured by the public sector through income from leasing and sale. Leasing, as opposed to outright sale of land, gives the public authorities more autonomy and flexibility in directing development to public purpose over the long term. A disadvantage is the possibility that revenue can be redirected to general fund purposes unless policy is written to control use of funds.

Air Rights

Air rights allow for development above public infrastructure and facilities such as railway or mass transit stations, highways, and other facilities. They often come with requirements for the provision of public amenities, infrastructure, affordable housing, and other public benefits, for example Manhattan's Madison Square Garden arena, which was built above Pennsylvania Station, and the N1 Plaza, built above the N1 Highway in Midrand.

Tax Increment Financing (TIF)

Public infrastructure impacts on the value of property, thus increasing public tax revenues. The resultant increase in tax revenue can then be captured to repay municipal infrastructure financing within that precinct. TIF is usually targeted to encourage investment in under-developed or downgraded areas that otherwise generate little or no tax revenue for local government.

Use of Value Capture Instruments in SA Municipalities and Current Limitations[3]

At present, two forms of value capture are used in South Africa:

- City Improvement Districts (CIDS): CIDs are a form of self-imposed betterment tax used to improve local conditions within a specified district.
- Developer contributions: This is a form of impact fee that is applied specifically to funding of new infrastructure.

South African municipalities are generally *not allowed* to design other forms of value capture or financial incentives at the local level, unless they have approval from National Treasury. Opportunities such as ring-fencing the increase in property tax revenues, providing tax abatements, and funding through tax increment financing are restricted by national legislation, or by processes that require national government intervention or site-specific enabling actions.

Even where national government has offered incentives, the designation of districts can usually only be done by National Treasury. National Treasury has policies guiding development of several types of local economic development zones that offer certain (often limited) financial incentives:

- Industrial Development Zones (IDZs) offer only VAT benefits for corporations that locate investments in these designated zones (usually located at ports or major industrial sites);
- Urban Development Zones (UDZ) offer the Accelerated Depreciation Allowance incentive for development within the larger city centres.

Under current government policies, there are few zones or districts in South Africa defined and controlled by municipalities that offer a mix of incentives appropriate to development and poverty reduction within a specific area,

[3] This section is an excerpt from "Managing Urban Land: a guide for municipal practitioners". Urban LandMark, 2011: 141. Available online at http://www.urbanlandmark.org/research/x60.php

except for CIDS. The result is that there is little opportunity for local municipalities to set up their own specific incentives or special taxing districts. This dependency on national intervention limits opportunities for local governments to experiment. It also means that it is hard for municipalities to take advantage of their tax base and encourage the types of development for which each municipality is particularly competitive.

Municipalities do have more control at present over regulatory mechanisms such as zoning. For example, there are opportunities for municipal governments to implement policies such as inclusionary zoning, which requires private developers to include affordable housing within their developments in order to create mixed income housing communities.

Urgent Need for Policy Reform[4]

Apart from encouraging good advance planning by municipalities, for example by acquiring or protecting land around future nodes of investment, there is an urgent need for a national policy framework to enable more value capture instruments to be developed and implemented.

Depending on how value capture mechanisms are defined – as surcharges, tariffs, taxes or property rates – their implementation would be governed by different legislation. When a municipality is considering the adoption of a value capture mechanism, as a first step it is important that the municipality is clear on what it wants to achieve – for example, revenue generation for infrastructure installation, or debt financing – and then design an instrument that effectively serves that specific purpose. The local authority then needs to make a decision on the appropriate category for the value capture mechanism. This argument must be based on the design features of the revenue instruments, not its label or name.

According to public finance theory, revenue instruments should be designed to adhere to the 'benefit principle', which states that the benefit of a service financed through fees or taxes should go directly to the taxpayer. Ideally, payment should be levied in exact proportion to usage or benefit. With the individual benefit principle, the individual paying benefits directly.

With the 'general benefit' principle, on the other hand, there is a still a link between the payer and the benefit, but the link is indirect and the benefit is not in direct proportion to the payment. The closer a revenue instrument adheres to the individual benefit principle, the greater its transparency and accountability.

The key distinction between taxes and user charges is that user charges adhere more closely to the individual benefit principle, compared to taxes that are typically used to generate general revenue for programmes or projects which provide benefits shared by a group of beneficiaries.

[4] Urban LandMark, 2012. Improving access to the city through value capture: An overview of capturing and allocating value created through the development of transport infrastructure in South Africa. Excerpts from pages 37 and 40-43. Available online at http://www.urbanlandmark.org/research/x58.php

National Treasury in 2011 produced an internal position paper[5] for the development of guidelines on the imposition, amendment and appropriate application of levies, user charges and administrative fees, which they use to establish a clear basis to distinguish taxes, duties and levies from user charges and administrative fees.

Often, revenue-raising instruments do not fall clearly into the category of a tax or a user charge, but instead have elements or characteristics of both.

While value capture revenue is most often used for urban regeneration or improvements, and for investment in low-income areas, municipalities may be tempted to apply it elsewhere, or to simply add it to general municipal revenue.

The viability and success of value capture mechanisms often depend on the ability to directly link the tax payment to the benefit received (the infrastructure or the service provided).

International practice has shown that capturing the value created from public infrastructure investment is best achieved by ring fencing revenues collected within the particular district or area where the infrastructure is located.

For example, tax revenue from the value capture instrument called tax increment financing is ring fenced for specific uses, while land value increment taxes ring fence the revenue raised on the incremental increase in the value of land brought about by public investment (such as transport infrastructure).

There are, however, a number of public policy arguments *against* the practice of ring fencing. They argue that:

- Ring fencing undermines democratic principles in that it detracts from the legislature or Council's authority and/or ability to set budget policy and priorities. As the body of elected citizen representatives, Parliament is meant to have the final say in how taxpayers' funds are spent.
- Earmarked funds may be exempt from the scrutiny and requirements for justification which are part of the annual budget process. In this manner, ring fenced funds can lose the transparency, accountability and efficiency gains that are created through the conventional budget process.
- Extra-budgetary funding (as per value capture mechanisms) can set up alternate structures and funds which may not be subject to the same accountability and reporting requirements as regular revenue. In this sense, earmarked funds and accounts may be said to 'operate in the dark'.
- When funds are earmarked for a specific purpose, over time a sense of entitlement may develop as the strength of the claim on the funds deepens, even if the original purpose for the revenue collection has expired.

National Treasury's general position is therefore to avoid ring fencing of budget allocations or tax revenue, except where there is sufficient transparency and accountability to make the practice effective and equitable. Because of the

[5] National Treasury internal position paper for the development of guidelines on the imposition, amendment and appropriate application of levies, user charges and administrative fees. Received from Erwin Obermeyer (National Treasury: Tax Policy Unit), 10 July 2011.

strong direct link between payment and benefit, user charges meet this criteria and therefore lend themselves naturally to ring fenced expenditure. National Treasury's position has important implications for the design and application of value capture instruments by municipalities, and needs further discussion and development.

Similarly there is a need for a clear national framework for the levying of development charges at municipal level. Current practices are inconsistent and this leads to conflict, as local deals are struck with different units within municipalities on a case by case basis.

So there is a need for National Treasury and government in general to examine opportunities to expand the options and guidance available to local governments to experiment with fiscal (tax) and financial (direct investment, loans, or financing) incentives for economic development. A key for transport oriented development is to provide clear policy objectives, removing any contradictory policy objectives and to ensure cross-subsidisation is targeted to guard against the perpetuation of apartheid spatial development with district-based taxes.

Implementing at Municipal Level[6]

Despite the need for more supportive national policy frameworks, there are nevertheless many opportunities to implement creative value capture mechanisms at municipal level. The goal and form of each mechanism needs to be very clearly defined if it is to be successful.

Key issues to consider when choosing value capture mechanisms for a specific locality would include the following.

1. The type of transport interchange / node or public investment being contemplated.
2. The geographic setting: whether it is a city centre or on the periphery, within an already complex, multi-use built-up area or at the edge of the city on (mostly) vacant land.
3. The differential that can be achieved: what value can be extracted, based on the calculations outlined in this work?
4. The state of the local or broader economy at the time of the planned implementation: what surplus value can realistically be created or generated and then recovered?
5. The likely benefit that would accrue to poorer communities.
6. The strength of public, private and community institutions: the institutional ability and willingness to implement, both administratively and politically, are important, as some value capture mechanisms require greater capacity, experience and levels of agreement within and between partners than others.
7. Private sector appetite for infrastructure and other development.
8. Alignment with municipal, provincial and national legislation: what is the legal feasibility of being able to implement the mechanism?

[6] Urban LandMark, 2012. Improving access to the city through value capture: An overview of capturing and allocating value created through the development of transport infrastructure in South Africa. Excerpts from pages 44 - 45. Available online at http://www.urbanlandmark.org/research/x58.php

CSIR Policy Brief 3

Take Home Points[7]

- Transport interchanges are a form of incentive which stimulates development, spurring the private market and creating value that might not otherwise exist at a particular location.
- Where the public sector has created an asset or helped to stimulate and support a market (through the development of public infrastructure), there is opportunity for capturing value from such investment.
- Municipalities must recognise the power of public infrastructure itself as an incentive to development, and capture that value using existing regulatory processes and tax mechanisms.
- The value that is captured from the introduction of infrastructure (such as transport interchanges) can be used for poverty reduction and development.
- There are a number of value capture instruments – different tax and regulatory mechanisms – which can be used alone or in various combinations, depending on what is appropriate at a particular site. A municipality needs to choose the value capture instrument which makes the most sense in terms of the poverty reduction goals in a particular area, for example job creation, SMME development, affordable housing, etc.

Sources and Readings

ADEC (2010). Value capture from transit-oriented development and other transportation interchanges, prepared for Urban Landmark by African Development Economic Consultants (ADEC) with BKS Engineers, November 2010. Available online at http://www.urbanlandmark.org/research/x58.php

Tshangana, Alison (2011). Legislative and policy context for the application of value capture mechanisms by municipalities. Report commissioned by Urban LandMark. Available online at http://www.urbanlandmark.org/downloads/legislative_policy_context.pdf

Urban LandMark (2011). Managing Urban Land: a guide for municipal practitioners. Book developed by Isandla Institute for Urban LandMark. Available online at http://www.urbanlandmark.org/research/x60.php

Urban LandMark (2012). Improving access to the city through value capture: An overview of capturing and allocating value created through the development of transport infrastructure in South Africa. Booklet developed by Rob McGaffin and Lucille Gavera for urban LandMark. Available online at http://www.urbanlandmark.org/research/x58.php

Urban LandMark (2013). Creating and capturing value around transport nodes. Learning resource developed by Clacherty & Associates, based on a booklet published by the South African Cities Network in 2010 called 'Creating and capturing value around transport nodes' from research by African Development Economic Consultants commissioned by Urban LandMark. www.urbanlandmark.org.za/downloads/tm2013_05.pdf

For more information on this policy brief, please contact:

Mark Napier
CSIR Built Environment
mnapier@csir.co.za
Tel: 012 841 4908

[7] This section is an excerpt from "Managing Urban Land: a guide for municipal practitioners". Urban LandMark, 2011: 142. Available online at http://www.urbanlandmark.org/research/x60.php