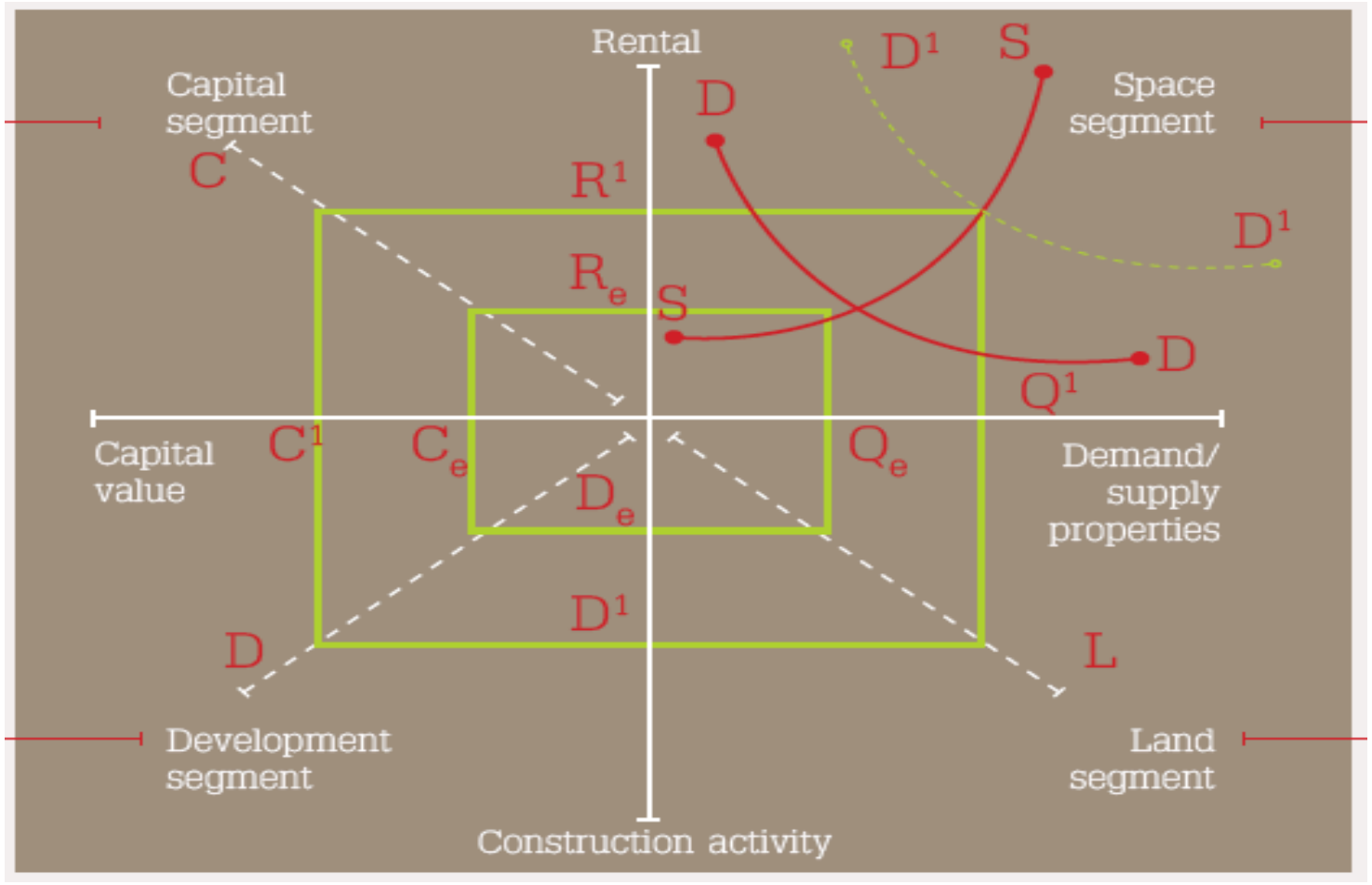
THE POTENTIAL OF VALUE CAPTURE IN SOUTH AFRICA

Robert McGaffin

Value

Location: Amenities and services

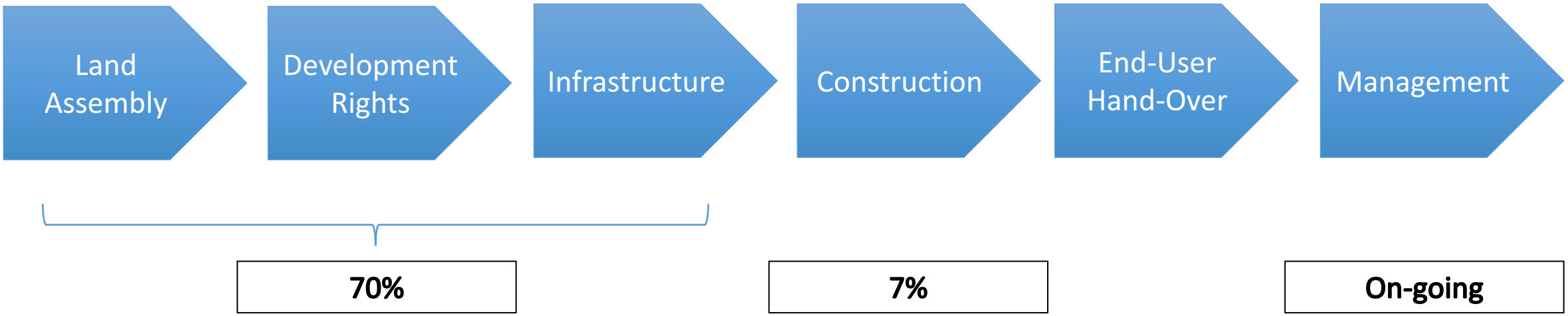


Infrastructure

(Developed from Dispaquela & Wheaton, 1992)

Funding the entire value chain – why it is important

Housing Delivery Process (Adapted from Financial and Fiscal Commission, 2013)



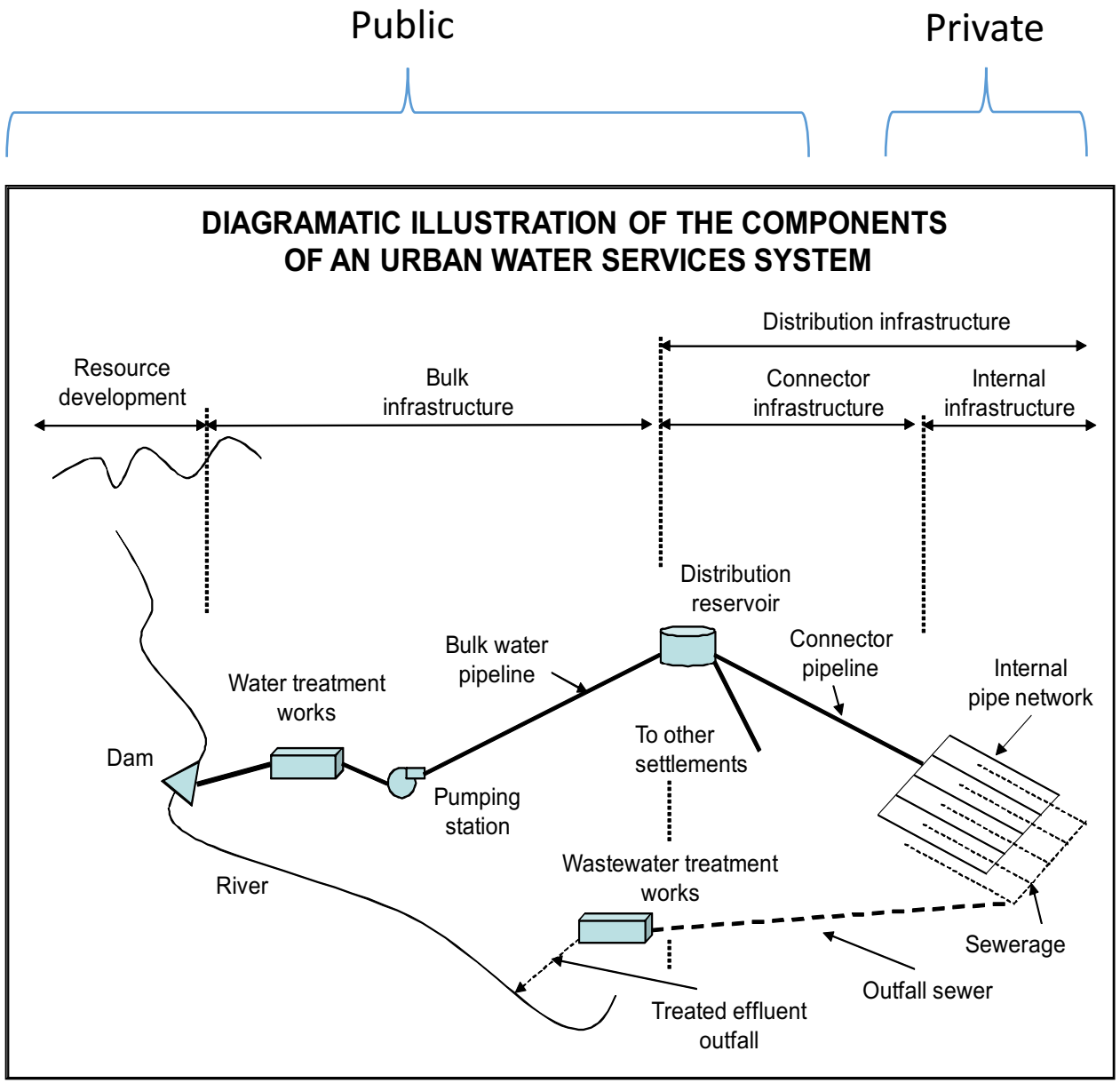
Infrastructure

- Multi-faceted
  - Each part funded differently
  - What are the parts?
  - Are they public or private goods?

Engineering Services:
- Water
- Sanitation
- Electricity
- Roads
- Public transport
- Solid waste – landfill
- Broadband?

…both “the pipe and the water”

Social Services:
- Schools
- Health
- Libraries
- Fire services
- Etc.



Source: PDG, 2015

Private & Public Goods

Is infrastructure a private and public good?

- Defined by:
  - Divisibility
    - Can it be divided into “units” – if not, market unlikely to provide – consumer must be able to demand more or less depending on need, preference and cost/price
    - P=MC (But MC = 0, therefore can’t price and get free riders)
  - Excludability – can “non payers” be excluded – if not, market unlikely to provide
  - User must place same value as society (i.e. not a merit good)

- If non divisible and non excludible generally serving the larger community, therefore provided at scale

Private & Public Goods

- **Community Good** (Street light, Police service):
  - Indivisible – must be complete supply or none at all
  - Non excludable – Can't prevent free-riders

  …therefore can't be charged a price based on use

- **Collective Good** (Dams, Highways):
  - Satisfy collective needs
  - By definition large and therefore entail high fixed capital
    - Results in production taking place under conditions of decreasing costs (economies of scale)
    - Results in long pay-back periods

  ....Therefore best placed for monopoly production

- **Merit Good** (Housing, Education)
  - Under-provision because individual places less value than society

“Conventional” Infrastructure model

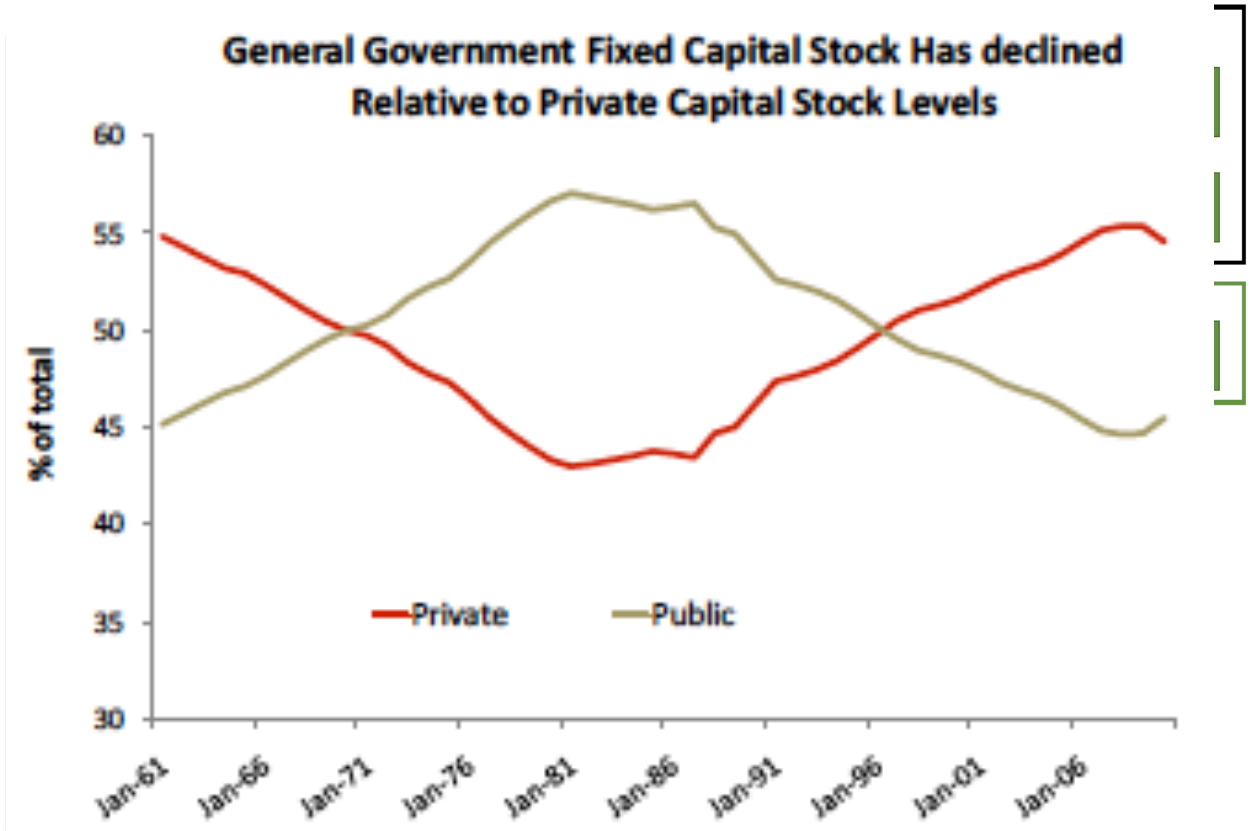
- Public Infrastructure is delivered at scale, is capital intensive and requires long payback periods
- Property development is smaller, incremental and has shorter repayment periods
- Therefore, state delivers and recoups through development contributions, general taxes and user charges over time

“Conventional” Infrastructure model

Capital Investment:	Consumption:	Maintenance:
• General taxes and development charges	• User charges	• Property taxes

Model under pressure

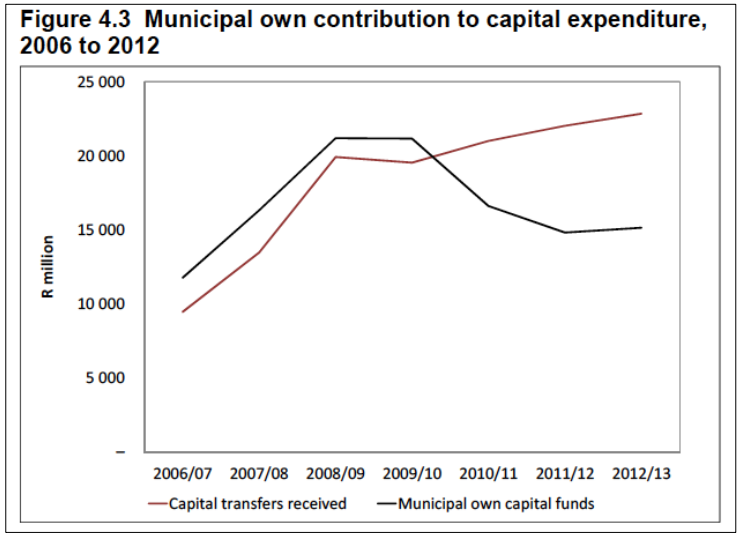
- Competing demands:
  - Service delivery
    - Increasing urbanisation
    - Backlogs
  - Spatial restructuring
  - Economic development
- Funding constraints

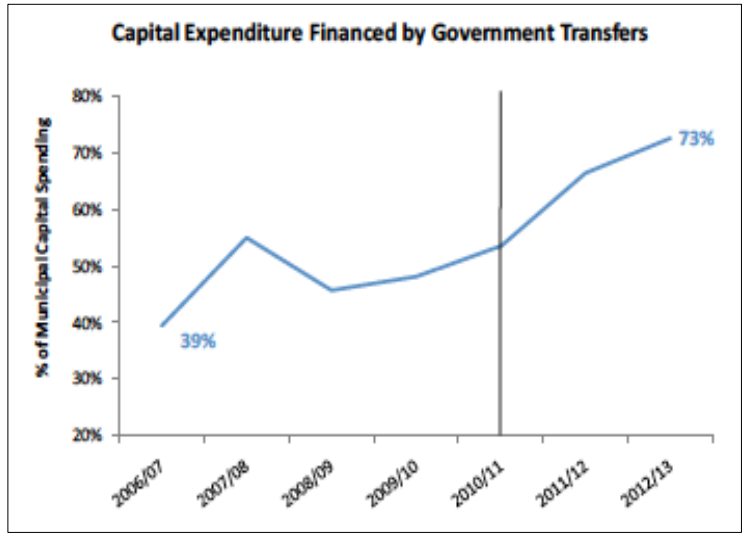


Source: South African Cities Network

Funding constraints

- Increasing reliance on national transfers to fund capital budgets

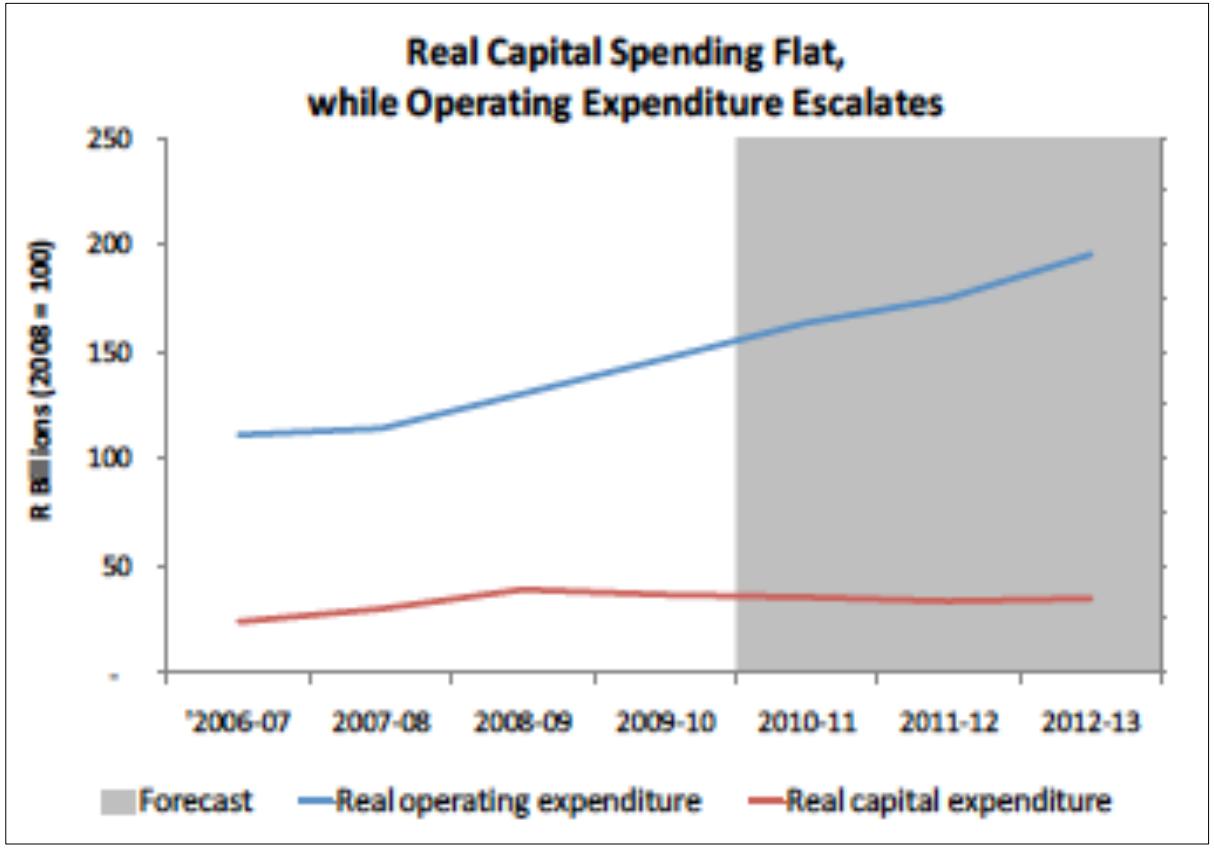




Source: Silberman and National Treasury

Funding constraints

- And increased operating expenses

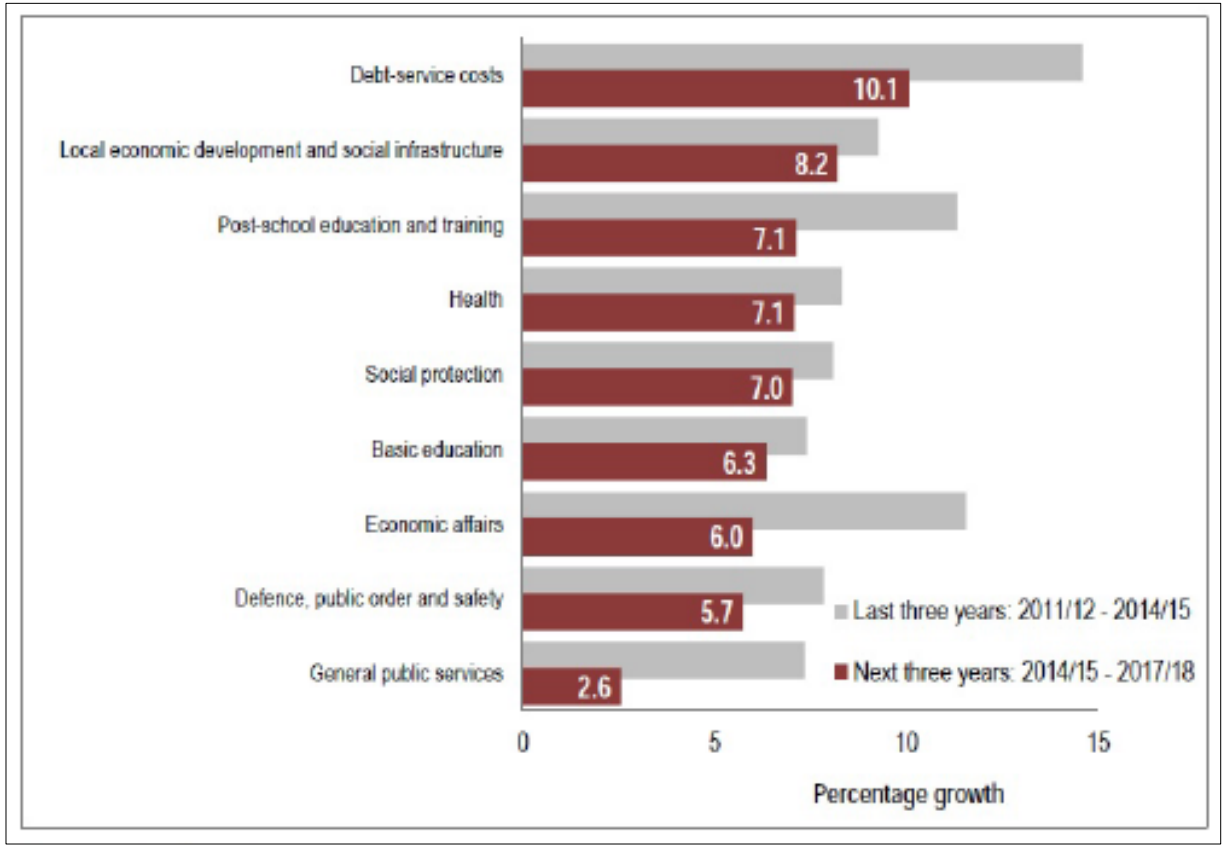


Source: Silberman

Funding constraints

- But declining national revenue and increased reliance on borrowing

Gross national tax revenue revised downwards by R35-billion between 2015/16 and 2017/18 due to steep decline in commodity prices and corporate income tax collection



Source: South African Cities Network

Funding constraints

- Therefore reduced national transfers:

Direct Transfers

- Equitable share & RCS Levy replacement grant
- National / Provincial operating grants
- National / Provincial infrastructure grants

Direct transfers to local government reduced by R3.8-billion over the 2014 Medium Term Expenditure Framework

→ Municipal operating budget

Source: South African Cities Network

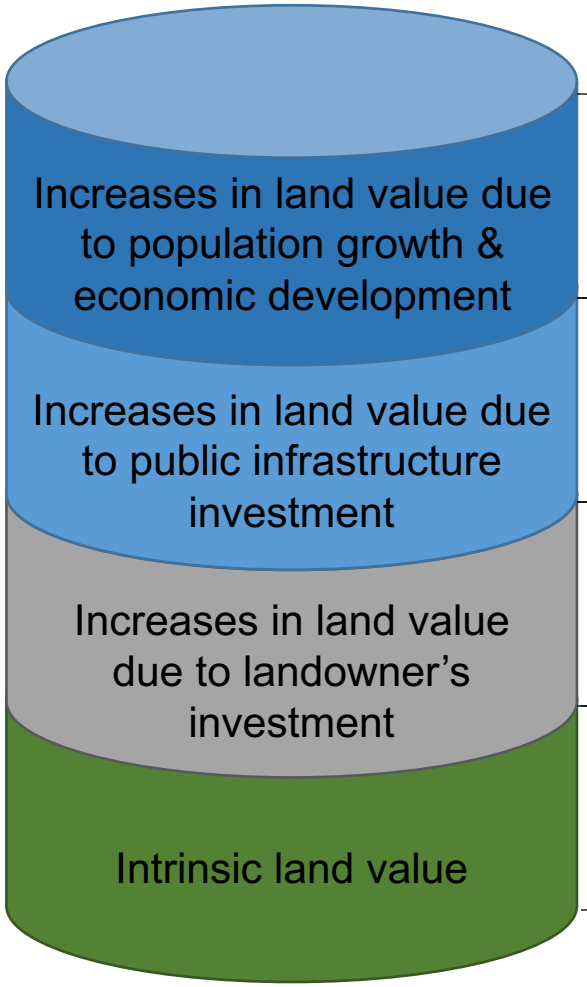
Value capture

Can value capture assist in addressing the above challenges?

What is it?

“The sharing between the state and private sector of the increased property value that results from public investment”

Sharing the value



The government, on behalf of the general public, should keep this portion of the land value

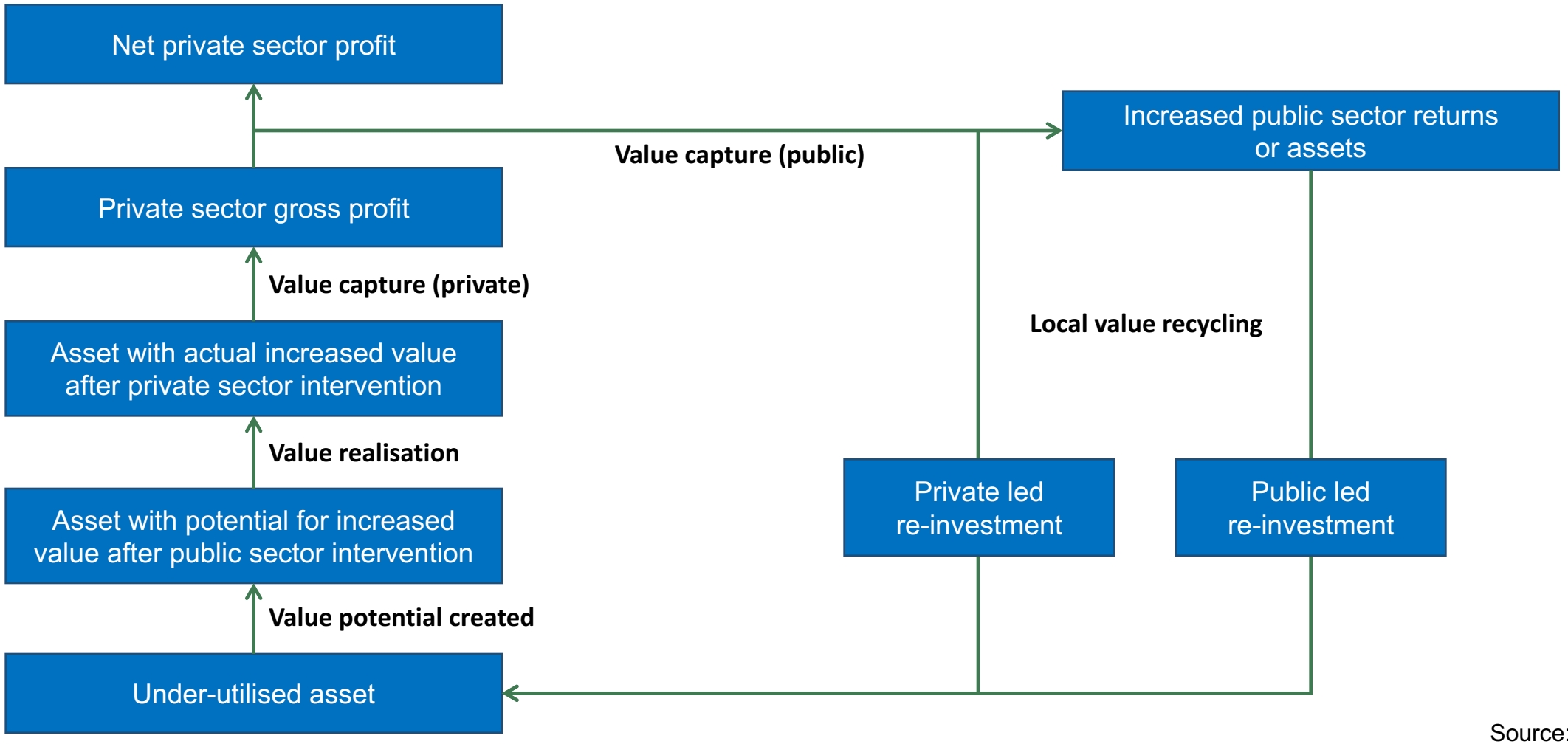
Public service providers should capture this portion of the increment to cover the costs of public infrastructure and local service provision

Private land owners should profit from this portion of the increment

Land buyers (or lessees) pay sellers (lessors) to obtain the property rights of land

Source: Suzuki *et al*, 2015

How it works



Source: Huxley, 2009

Use-related mechanisms

Value Capture Mechanism	Description
Density bonus	A zoning-based incentive aimed at encouraging developers to provide certain public amenities or to meet certain public objectives in exchange for allowing greater floor area and/or building height.
Air-rights	The granting of air rights above public infrastructure to the private sector could be aimed at encouraging the provision of public amenities, affordable housing, encouraging greater densities and increasing the City's tax base.
Tax abatement	A reduction or exemption from taxes for a specific period of time in a designated area, usually to stimulate investment in locations with lower demand – e.g. Urban Development Zone in South Africa
Lease or disposal of state-owned land	Instead of maximising the market value of the land sale or lease, the state may choose to prioritise other policy objectives, such as affordable housing in well located areas. Could also be an income-generating opportunity.
Land-adjustment	Landowners pool land together for reconfiguration and redevelopment, and contribute a portion of their land to raise funds to partially cover the public infrastructure development costs.

Income-generating mechanisms

Value Capture Mechanism	Description
Development charges	A levy imposed on developers to pay for infrastructure requirements resulting from additional and expanded land uses.
Business / City Improvement Districts	Delineated zones where an additional charge is levied on properties to finance top-up services to supplement the standard services provided by the state, often focused on security and cleansing. Often perform additional roles, such as area marketing, which together with the increased security and cleanliness, may resulted in increased property values.
Tax Increment Financing	TIF schemes enable municipalities to borrow against the future anticipated incremental tax revenue that would be generated within a specific geographic area as a result of the construction of large-scale infrastructure.
Special Assessment Districts	Similar to TIFs except that the income that is used to repay public funds or borrowings is in the form of a levy that has been agreed to upfront with the affected property owners within the SAD. This reduces the financial risk for the municipality, which instead is spread amongst the property owners.

Can value-capture address the identified infrastructure challenges?

Yes, it can…

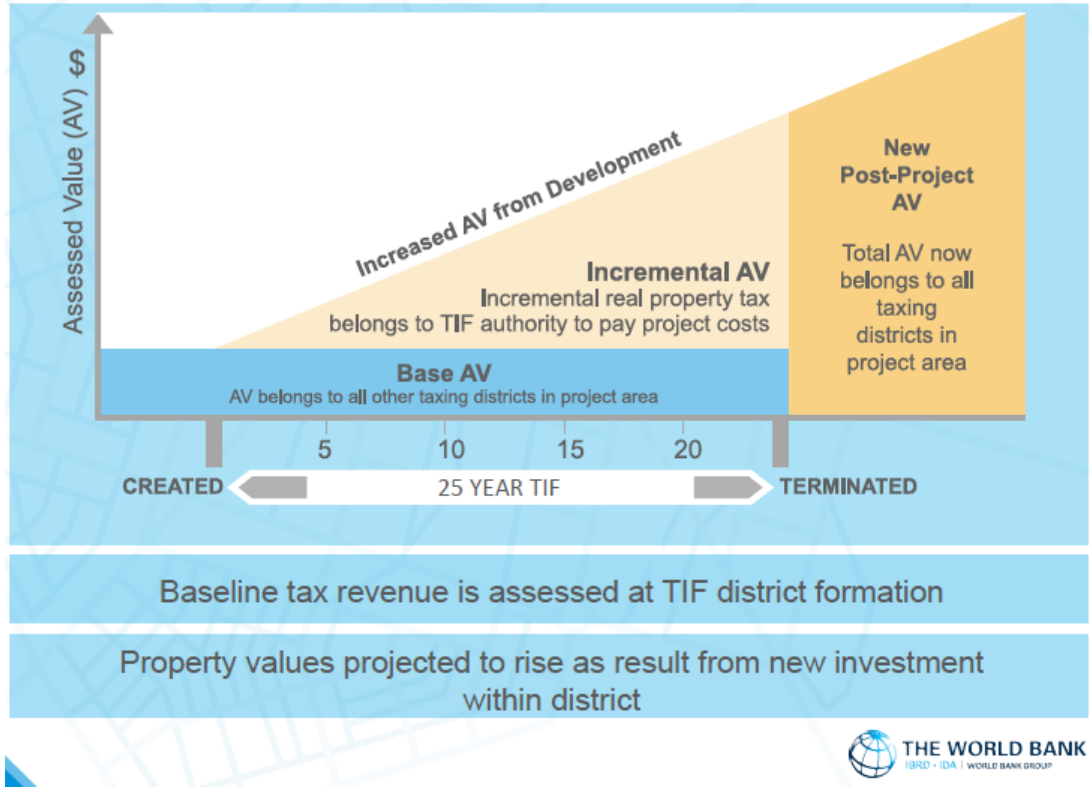
- Assist municipalities to raise local revenue
- Enable municipalities & private sector to respond to development opportunities
- Reduce need for municipalities to make trade-offs between infrastructure development for economic growth, spatial restructuring or service delivery
- Can increase borrowing capacity of municipalities without impacting gearing limits & credit rating
- Enable municipalities to share some of the financing risk with the private sector

However…

- Are market conditions conducive to value creation?
- Is there private sector appetite?
- Is there public sector capacity and skill?

How a TIF works

- Site / precinct identified based on (re)development potential
- Property taxes payable as per the site's **existing** use are determined
- Full development potential is calculated based on market conditions
- Infrastructure requirements are determined and priced.
- Property taxes that would be paid if the site were developed to its full potential are calculated
- The difference (the increment tax) between existing property taxes and potential property taxes is calculated
- Municipality raises public bond on the back of the expected increment income
- Size and phasing of the bond are determined based on the size of the increment tax generated
- The increment tax is ring-fenced to pay for a TIF bond
- The bond is issued and the proceeds used to fund the required infrastructure
- Once the bond has been repaid, the increment tax is "unfenced" and is added to the general property tax revenue pool.



Source: V. Santos, 2016

A closer look at TIF: What are the challenges?

- Scale of provision of bulk infrastructure – who pays for excess?
- Sites with multiple land-owners
- TIF not expressly provided for in existing legislation
- Administrative risk and burden for municipality
- May impact municipality's gearing limits and credit rating depending on whether TIF is treated as an on- or off-balance sheet item
- Currently off-balance sheet status only possible through a Special Purpose Vehicle

Is there appetite for value-capture?

Could we use it to get more affordable housing in the CBD of Cape Town?

UCT Nedbank Urban Real Estate Research Unit

www.ureru.uct.ac.za

Robert.McGaffin@uct.ac.za